

Professor Matthews EXAM No. _____

Spring 1996 Graduating Senior? YES _____ NO _____

NEGOTIABLE INSTRUMENTS FINAL EXAMINATION

Instructions:

1. You have 3 hours (plus 15 minutes) to complete this exam. I will collect your answers in the room in which the exam is handed out at 11:45 a.m. Late bluebooks will be penalized.
2. All answers must be written in bluebooks (unless you are using a manual typewriter). Please write on only one side of a page, but you do not need to double space. Please number your answers to correspond to the question and sub-part you are answering, but you need not answer in any particular order.
3. Assume that the transaction takes place in Arkansas and that the UCC (current Arkansas version) applies to the transaction unless otherwise indicated.
4. You are permitted to use your copy of the UCC and relevant statutes which may have notations (such as those you have made during the semester), but may not be otherwise annotated. Any other notes or materials should be placed at the front of the room before the examination begins.
5. You are required to turn in your copy of the test along with your answers. Label both with your exam identification number. Please number your bluebooks.
6. If any ambiguity appears in any question, state the ambiguity, make your assumption, and proceed accordingly.
7. "HDC" means holder in due course. If a party is so labelled, you are entitled to assume that all the prerequisites of that status are met. If an instrument is labelled a "check" or a "note", you may assume that it meets the Article 3 requirements for that type of instrument unless one of the elements is put in issue by the facts of the particular problem.
8. This exam consists of eight fact patterns, labelled A-H. The points are apportioned as follows:

POINTS TIME

A-F 16-18 points each Approx. 30 minutes each

A. Washington was a local rancher who had a checking account with Second National Bank. Washington was the only authorized signatory. Adams was a local cattle dealer

who occasionally sold cattle for Washington on commission. On those past occasions, Washington had simply arranged for his wife to give an unsigned check form to Adams. Adams would fill in the amount of his commission, name himself as payee, and sign the check "Washington, by Adams, cattle agent." The checks had always been paid.

On February 1, 1996, Adams acquired a check form from Washington's wife by falsely representing that a commission was due. He completed the check for \$1000 in the manner used on prior occasions, indorsed and deposited it in his account at First National Bank that same day. The check was subsequently presented to Second National Bank and paid. Second National Bank had a policy of examining checks only over the amount of \$2500.

Second National Bank included the check in its monthly statement to Washington, which he received on March 15. Because Washington's wife became seriously ill, he did not examine his bank statement until May 15. On discovering the check to Adams, Washington immediately called Second National Bank and demanded that the account be recredited.

Second National Bank's investigation reveals that although Adams had plenty of assets in March, Adams has now become insolvent. Second National has also discovered that Adams withdrew \$500 from the First National Bank account, but the remaining \$500 is still held in that account. At this point, Second National Bank asks for your advice. Discuss Second National Bank's rights against, and any potential defenses of, the following parties: (16 points)

1. Washington
2. Adams
3. First National Bank

Explain your conclusions.

B. Nixon was a 17-year old high school drop-out who could not read or write. Ford agreed to provide Nixon the \$5000 cost of a full time literacy program, but on the condition that Nixon pay back the funds if Nixon failed to complete the program. Ford therefore drafted both a written agreement and a promissory note payable to the order of Ford for \$5000, which he explained to Nixon. The note was a simple form demand note, but the agreement stated that demand could be made on the note only if Nixon dropped out of the literacy program. Nixon executed both the note and the agreement by placing an "X" on the relevant signature line of each document. Ford indorsed the note "Gerald Ford", executed the agreement

himself, and placed both documents in his sock drawer.

Ford's son, in financial straits, removed the note from Ford's sock drawer and sold it to Bush. Bush agreed to pay \$4000, which he provided in cash to Ford's son. It took some persuasion on Ford's son's part to convince Bush that son was acting on Ford's behalf, and that the "X" on the note was actually made by Nixon. However, Ford's son had an excellent reputation and Bush believed that the transaction was legitimate.

Nixon is still in the literacy program. Bush made demand on Nixon for \$5000 on May 1, 1996, but Nixon refuses to pay. Nixon denies that he wrote the "X", and claims that he could not have understood the documents anyway. Bush immediately notified Ford. Assuming that this note does not fall within the FTC notice requirement, discuss the rights of Bush at this point against (and any defenses of) the following parties: (16 points)

1. Nixon

2. Ford

Explain your conclusions.

C. On December 20, 1995, Jackson drew a check payable to Van Buren for \$150 for the purchase of Christmas lights. (The lights proved defective, and Jackson subsequently spent \$50 having them repaired so they would function properly.) Van Buren indorsed the check "Pay to Harrison, Martin Van Buren," and delivered it to Harrison as a Christmas gift. Harrison put the check away, and did not find it until the following summer. On Monday, July 20, 1996, Harrison indorsed and deposited the check into his account at First State Bank. First State Bank presented the check that same day to Second State Bank, which was located in the same check processing region. Second State gave an immediate provisional credit for the check to First State.

Second State had adopted a cut-off hour of 2:00 p.m. for purposes of check priority disputes under Article 4 of the UCC. On Tuesday, July 21, at 9:00 a.m., Second State Bank was served with a garnishment of Jackson's entire account balance for past due child support payments. At 10:00 a.m. on Tuesday, July 21, therefore, Second State reversed its provisional credit, marked the check "Not sufficient funds" and deposited it in the mail for `return` to First State.

First State Bank received the returned check on Tuesday, July 28. Unfortunately, First State had permitted Harrison to withdraw \$150 against the check on Monday, July 27. Harrison has now departed for parts unknown. First State notified both Van Buren and Jackson of the dishonor within its midnight deadline.

Discuss the rights of First State Bank against, and any potential defenses of, the following parties: (18 points)

1. Second State Bank

2. Jackson

3. Van Buren

4. After First State notified Van Buren, Van Buren has been spreading the word that Jackson's checks bounce. Does Jackson have a claim against Second State for the damage to his reputation? (17 points)

Explain your conclusions.

D. Tyler wanted to purchase \$5000 worth of business equipment on credit from Polk, but Polk would not agree unless Tyler provided a co-maker on a one-year promissory note. Tyler therefore persuaded his friend Fillmore to sign as co-maker, but in doing so Tyler misrepresented to Fillmore Tyler's financial situation. Tyler and Fillmore signed the note payable to Polk, and the equipment was delivered and used by Tyler in his business. The note was stored in the file room at Polk's office.

Pierce, a clerk employed by Polk who had access to negotiable instruments for filing purposes, discovered the note in the file drawer. Pierce took the note, indorsed it "James K. Polk," and delivered it to Buchanan. Buchanan took the note as payment for a used pickup truck, in good faith, and without notice of any claim or defense.

Buchanan presented the note to Tyler on its due date, and Tyler paid the \$5000. Polk has just discovered the theft. Discuss the rights of Polk against, and any potential defenses of, the following parties: (16 points)

1. Tyler

2. Fillmore

3. Buchanan

In addition, discuss the rights of:

4. Tyler against Buchanan

5. Buchanan against Pierce

Explain your conclusions.

E. On Monday morning, Cleveland drew a check on McIlroy Bank payable to McKinley for \$1000 for certain goods. McKinley raised the amount of the check to \$2000, indorsed it "Pay to Roosevelt, William McKinley", and delivered it to Roosevelt in payment for four lawn care treatments. Roosevelt applied the first treatment to Roosevelt's lawn on

Tuesday morning, then indorsed the check and took it down to Taft's place of business to apply against an overdue account that Roosevelt owed to Taft. Taft knew of McKinley's shady business practices, and told Roosevelt that he suspected that there would be some problem with the check. However, Taft agreed to apply the \$2000 against Roosevelt's indebtedness and just see what would happen. Taft therefore presented the check for payment to a teller at McIlroy Bank Tuesday afternoon.

Cleveland had become suspicious about McKinley, and had telephoned McIlroy Bank to stop payment of the check on Monday afternoon. Because the order was oral, it was forgotten by the bank's employee and the tellers were not notified. McIlroy's teller therefore paid \$2000 in cash to Taft.

Cleveland has demanded that McIlroy Bank recredit his account, and McIlroy contacts you. Advise McIlroy as to its rights against, and potential defenses of, the following parties: (17 points)

1. Cleveland
2. Taft
3. McKinley

Explain your conclusions.

F. Truman instructed his comptroller, Eisenhower, to execute a note to Kennedy to purchase commercial computer equipment and software on behalf of Truman's business. Kennedy understood that Eisenhower was acting on Truman's behalf. Eisenhower therefore executed the following document in this form:

The undersigned hereby undertakes to pay to Kennedy or bearer the sum of \$20,000, with interest payable annually at the rate of 6% over the Federal Reserve Discount Rate in effect in this federal reserve district. Said sum shall be due 60 days after demand is made therefore. This undertaking arises out of the sale of computer equipment and software listed in Attachment A. The undersigned hereby grants a security interest in such equipment and software to secure the payment of this obligation, and the right to proceed against that collateral shall be governed by the Security Agreement set out as Attachment B hereto. Payment of this obligation shall be made only out of earnings generated by Truman Enterprises.

Harry S Truman

Dwight Eisenhower

Kennedy delivered the equipment and software, and Kennedy and Truman subsequently developed a close working relationship. As a personal relations tactic, Kennedy delivered

to Truman a letter forgiving the entire obligation.

Some time later, finding himself in financial embarrassment, Kennedy delivered the Truman note without indorsement to Johnson as collateral for a \$50,000 loan from Johnson to Kennedy. Johnson was another personal friend, but was financially unsophisticated. Kennedy did tell Johnson that the interest payment had never been made, but Johnson was unaware of any other problem with the note. When Kennedy defaulted on his obligation to Johnson, Johnson arranged for the Truman note to be sold at judicial auction.

Reagan purchased the note at the sheriff's sale for \$5000, and has made demand on both Truman and Eisenhower to pay. Discuss Reagan's rights against, and any potential defenses of: (17 points)

1. Truman
2. Eisenhower

Explain your conclusions.