

Question 2 – February 2018 – Selected Answer 1

1(a) Emily has no claim against Community Bank (CB) for paying the rebate check. To bring a claim for conversion against CB, Emily would have to show that she was a holder entitled to enforce the check. To become a holder, a person must receive a check through issuance or by negotiation. Issuance is when a drawer transfers a check to a person with the intent to give them the right to enforce it, and requires delivery. Here, the rebate check was mailed to Emily's previous address, and Emily never took delivery of the check. She thus did not become a holder entitled to enforce it and has no claim against CB for cashing it (though she would have conversion claims against the thief and a claim against ABC).

1(b) Emily has a claim against ABC for the underlying obligation to pay her \$500. When a party does not take delivery of a check because of the negligence of the issuer, she may still seek to enforce the underlying agreement once that check has been dishonored or discharged. Here, ABC had Emily's new address on file but still negligently sent the check to her old address, and the check was paid to the thief. ABC will bear the loss for its negligence and must send Emily a new rebate check.

2(a) Joe has a claim of conversion against CB because the check was not properly payable. To be negotiated, or for an order instrument to be enforceable by a holder, the payee must indorse the check. A forged instrument is not effective, and makes a check not properly payable so no one after the forgery can be a holder. Here, Emily gave Joe a check to pay for his services. Joe did not indorse the check. Thief forged the indorsement and presented it to CB. CB should not have paid it, because Joe knew the indorsement was forged and that he was entitled to enforce the check, breaching [sic] presentment warranties. CB should not have paid the thief as the check was not properly payable. CB may claim a defense that Joe was negligent. If a payee is negligent in not protecting checks or in not preventing forgery, he may not recover the check or be liable for some or all of the loss. Here, Joe was probably not negligent because he had it in a locked compartment in his truck, so Bank's defense will fail.

2(b) Joe has no claim against Emily. When an issuer gives a check in payment for an obligation, the underlying obligation is suspended until the check is either dishonored or paid. Here, Emily issued Joe a check to pay for his services, so her obligation to pay cash was suspended. When CB paid the check to thief, it debited her account, so her duties were discharged and she is no longer liable on the check. Joe will have to seek recourse against CB or find the thief!

Question 2 – February 2018 – Selected Answer 2

(1) (a) Emily does not have a claim against Bank for cashing the check. At issue is whether a payee who never receives possession of a check because it was mailed to the wrong address can maintain an action against the drawee bank for paying that check to an unauthorized person.

The UCC provides that a bank may be liable to a named payee of a check for conversion if the bank pays that check to an unauthorized person who forges the payee's indorsement. However, there is an exception to this rule where the named payee never receives possession of the check because it was mailed to the wrong address. In that instance, the named payee's recourse is to

demand payment from the drawer for the debt. The drawer may have claims against the drawee bank for wrongful payment, but the payee does not.

Here, Emily never received possession of the check because ABC mailed it to the wrong address. Because Ann never took possession of the check, she has no claim against the Bank for conversion based on wrongful payment of the check. As explained further below, Emily only has a claim against ABC for the underlying \$500 obligation.

(1) (b) Emily has a claim against ABC for the \$500 rebate. The issue is whether a debtor's obligation is suspended by mailing a check for payment of the debt to the wrong address.

Under the UCC, ordinarily, a debtor's drawing of a check to a creditor/payee suspends the debtor's obligation on the underlying debt. The creditor/payee's rights are limited to presenting the check for payment on the drawee bank, and only after a dishonor of the check can the creditor/payee demand payment directly from the creditor. However, where the debtor's check was sent to an incorrect address through the fault of the debtor, and the creditor/payee does not receive the check for that reason, the obligation is not suspended and the creditor/payee can demand payment directly from the debtor.

Here, ABC owed Emily a \$500 rebate. It mailed the check to the wrong address even though Emily had given them a new check. Because ABC has failed to submit the check to Emily, the underlying obligation on the rebate is not suspended and remains owing, and Emily can demand payment from ABC.

(2) (a) Joe has a claim for conversion against the Bank for \$350 for its unauthorized payment of the check to the thief. At issue is a payee's recourse against a drawee bank where the drawee bank pays a check to an unauthorized holder based on a forged indorsement.

As noted above, the UCC provides that a bank may be liable to a named payee of a check for conversion if the bank pays that check to an unauthorized person who forges the payee's indorsement. The bank may assert a defense based on the payee's negligence in allowing the thief to obtain the check and forge the indorsement.

Here, Joe received a \$350 check, which was stolen by a thief who forged Joe's indorsement and which the Bank paid to the thief. Therefore, the check was not properly payable to the thief, and Bank is liable to Joe for conversion in the amount of \$350. Bank could attempt to assert a defense based on Joe's negligence, but that defense would be unsuccessful based on the facts because the check was stolen from a locked glove compartment in a locked car, and nothing else suggests that Joe acted negligently.

(2)(b) Joe does not have a claim against Emily for the \$350. At issue is a payee's right to enforce an underlying obligation where a drawer has provided the payee a check for that obligation, and the check is subsequently stolen from the payee and wrongfully paid by the drawee bank.

As noted above, under the UCC, ordinarily a debtor's drawing of a check to a creditor/payee suspends the debtor's obligation on the underlying debt. Where that check is subsequently lost or stolen, the underlying debt remains suspended and the payee cannot enforce the debt against the drawer. To enforce a lost check, the payee would need to explain that the check is lost and provide the drawer adequate assurances against double liability in order to obtain payment a second time. But where the check has been stolen and cash, the payee's recourse is limited to the drawee bank based on wrongful payment of the check, and the payee cannot demand repayment from the drawer.

Here, Joe received possession of the check from Emily, which was subsequently stolen and wrongfully paid by Bank. The payment of the check to the thief discharged Emily's obligation to Joe, and Joe cannot recover the \$350 from Emily. Joe's recourse is limited to the thief and the Bank.