Question 7 – July 2019 – Selected Answer 1

A. In order to be negotiable, an instrument must be negotiable when it is created. The test for negotiation is that the instrument must be an unconditional promise to pay an amount of money on demand or at a fixed or ascertainable time. There can be no unauthorized undertakings in the instrument and it must contain words of negotiation. The negotioability can be negated by writing that it is not a negotioable instrument on it, except that this is not possible for a check.

Generally, a check is a negotiable instrumnet and there are no facts to show that the checks given to Hannah deviate from a standard check. It is an unconditional promise to pay on sight. It has words of negotation (all checks written to the order of Hannah) and contains a fixed amount (Check 1 was for $75, Check 2 was $150, and Check 3 was for $100). There was no unauthorized undertaking, the facts show that Hannah wrote nothing else on the checks. Therefore, all three checks are negotiable instruments.

B. Hannah has no rights agaisnt Phone World for check 1, her only recourse is agaisnt Thief. A check payable to the order of a person must be indorsed by that person in order for the check to be enforceable. A blank indorsement, containing only the name of the person the check is payable to creates bearer paper. A person is a holder of bearer paper by taking possession. An entity becomes a holder in due course by becoming a holder of negotiable instrument for value, in good faith, and without notice of certain facts such as insolvency proceeds, forgery, and alteration. The test for good faith is that of the UCC, honesty in fact and observance of reasoable commercial standards. The tests for holder and an instrument being negotiable are discussed above (negotiation is discussed in question A). Holders in due course are only subject to certain real defenses: forgery, fraud in the execution, alteration, adjudicated incompetant, infancy, duress, and statute of limitations, among others.

Check 1 is bearer paper becuase it was a blank endorsement by Hannah. The blank indorsement by the Thief does not change that this is bearer paper becuase it was also a blank indorsement. This makes PhoneWorld a holder. The check is neogitable, see question A. PhoneWorld took for value, they recieved the check in exchange for a new phone. There are no facts to indicate that they did not take in good faith or with notice of facts that would not allow them to become holders in due course. Therefore, Phone World is a holder in due course. Becuase Phone World is a holder in due course, they are a holder and are entitled to possession becuase it is bearer paper. Hannah has no recourse against them.

B. Hannah can recover agaisnt Phone World for the value of check two becuase they are not holders with respect to the instrument. Hannah indorsed Check 2, but unlike Check 1, it was a special indorsement and was payable only to the order of Sara Smith. In order for a person to be a holder of order paper, they must have possession and be entitled to enforce. To be entitled to enforce, the person who the order was payable to must indorse the check over to them. Becuase Thief, and not Sara Smith, indorsed the check, Phone World is not a holder of the instrument. The indorsment is not effective and they are not entitled to enforce the check. Phone World should have checked the Thiefs ID in order to determine if she really was Sara Smith. Hannah can recover the value of check 2.

C. XYZ Bank will bear the loss of Check 3 becuase Theif cannot be found.

Customer and Hannah will not bear the loss for the check because the Bank wrongfully paid the check. Customer can bring an action for wrongful payment, and Hannah can bring an action for conversion. There can be no double recovery for these actions. In order for order paper to be properly paybable, it must have all proper indorsments. In this case, the check was not properly payable becuase the indorsement by Hannah was forged. The chain of title was broken by this forgery. ABC Bank will have recredit Customers account or pay Hannah the 100 dollars. If customer recovers, he must then pay Hannah for the books otherwise there would be unjust enrichment. If Hannah recovers, customers obligation is extinguished because Hannah recieved payment under the check.

ABC Bank will not bear the loss becuase it can recover agaisnt XYZ Bank for breach of presentment warranties. When a presenting bank presents a check to the bank paying the check, they make warranties: that there are no alterations, that all signitures are authentic and authorized, that they are entitled to enforce, and that the creation of the check was authorized if it is an electronic instrument. Here, XYZ Bank breached the warranty that they are entitled to enforce becuase they were not a holder of the instrument. The indorsment by Hannah was forged. No one is entitled to enforce the check without Hannah's indorsemnet on it becuase it was payable to her. It does not matter that XYZ was not aware of this. They still breached the warranty. Theoretically, XYZ would be able to collect agaisnt Thief for breach of transfer warranties, but his wherabouts are unknown so XYZ will bear the loss.

Question 7 – July 2019 – Selected Answer 2

(A) Yes, the checks written by customer were negotiable instruments. Article 3 governs negotiable instrument. A negotiable instrument is an unconditional promise or order to pay a certain amount to the order or bearer of an individual on demand or at a definite time that has no unathorized undertaking. It must be in writing and signed by the promisor or drawer. A check is considered a negotiable instrument because it is an order to pay; it is for a certain amount, the express number written on the check; it is "to the order of" a person or entity (negotiability language); it is payable on demand, when the check is deposited; it has no unauthorized undertaking included on; and it is unconditional.

Check 1: Check 1 was a negotiable instrument. It was an unconditional order to pay Hannah, the definite amount of $75, there were no conditions attached, payment could be made on demand (when Hannah deposited the check), and there was no unauthorized undertaking in the check. Check 1 became bearer paper when Hannah indorsed the back, thus it would be properly negotiated by any subsequent holder since the indorsee signed the check, giving the right to enforce it to anyone who had possession of the check.

Check 2: Check 2 was a negotiable instrument. It was an unconditional order to pay Hannah, the definite amount of $150, there were no conditions attached, payment could be made on demand (when Hannah deposited the check), and there was no unauthorized undertaking in the check. Check 2 became order paper when Hannah wrote on the back "Pay to the Order of Sarah Smith" and indorsed it. This was properly negotiated.

Check 3: Check 3 was a negotiable instrument. It was an unconditional order to pay Hannah, the definite amount of $100, there were no conditions attached, payment could be made on demand (when Hannah deposited the check), and there was no unauthorized undertaking in the check. Hannah never indorsed this check, so a forgery would be required (an indorsement) and it would not be properly negotiated if transferred because the person is not entitled to enforce it.

(B) Hannah has no rights against PhoneWorld for the value of Check 1.

Because Hannah turned Check 1 into bearer paper when she indorsed the back of the check (a blank indorsement) anyone in possession of the check would be entitled to enforce it. Thus, when the thief gave it to PhoneWorld, it was properly negotiated, and PhoneWorld was a "holder." A holder is one who has possession of a negotiable instrument and is entitled to enforce it. Further, PhoneWorld is a holder in due course. A holder in due course is one who takes a negotiable instrument for value, in good faith, without notice of certain things such as claims or defenses, overdue principal amount, among others. Here, PhoneWorld is a holder in due course because it took the check for value, it gave Theif a new phone. Second, it was in good faith, meaning honesty in fact and observance of reasonable commercial standards. There is no indication that this amount was not high enough, combined with the other check to be close to the value of the phone or give notice of anything fraudulent. Finally, it had no notice of any claims or defenses because the check was bearer paper and in fact signed by the original payee. Thus, it would only be subject to real defenses, such as unauthorized signature or infancy, but no real defenses would apply here.

However, Hannah would have a claim against Theif for common law fraud and conversion.

(C) Hannah has rights against PhoneWorld based on the theft.

Check 2 was payable to the Order of Sarah Smith. Theif then forged "Sarah Smith" as an indorsement. This forgery was the forgery of a "special indorsee." Thus any prior holder will not be qualified as a holder in due course because the unauthorized signature of a speical indorsee or payee breaks that chain. As a result, PhoneWorld is not a holder in due course and will be subject to personal defenses. Thus, Hannah has rights against PhoneWorld based on personal defenses and real defenses including an unauthorized signature making the check not properly payable. PhoneWorld is not entitled to enforce the check because a special indorsement was forged, breaking the chain.

PhoneWorld has a common law claim for fraud against Thief.

(D) XYZ Bank will ultimately bear the loss. ABC Bank will be held liable, but can in turn hold XYZ Bank liable and make it bear the loss.

In this case, the payee's name, Hannah Jones', name was forged. ABC Bank will bear the loss. This is because the check was not properly payable. There are two potential claims that could happen first.

First, the payee, Hannah Smith, could sue ABC bank for conversion. This is because it essentially converted her money by taking her property and giving it to someone else, Thief. The Bank may try to raise the defense of negligence because Hannah left three checks sitting in open view on the front seat of her parked car, unattended while she went inside to eat dinner. If the Bank succeeds on this defense, then the court will apportion fault as it finds, and the Bank may not be liable for the full amount of the check due to Hannah's negligence.

Second, Customer could sue ABC bank for paying a not properly payable check. A check is properly payable when it is authorized being enforceable and within the agreement of the customer and the bank. Here, the check had a forged payee signature, so the bank was not entitled to enforce it. Thus, ABC Bank will have to re-credit Customer's account for paying a not properly payable check.

However, only one of these two courses of action - (1) Hannah's claim for conversion, or (2) Customer's right to have ABC recredit her account because it was not a properly payable check - will work. This is because if the payee (Hannah) succeeds and recovers the amount of the check on conversion grounds against ABC, the money got where it was supposed to go. The Customer essentially paid Hannah. The Bank would not then credit Customer's account because she owed the money to Hannah. However, if Customer's account is recredited because the check was not properly payable, then she could issue a new check to Hannah as payee, and Hannah would not be permitted to recover for conversion as this would permit a "double recovery."

Thus, in either case ABC Bank will be liable. However, it will have a claim against XYZ Bank for breaching a presentment warranty. XYZ made three presentment warranties when it presented Check 3 to ABC Bank: (1) it was entitled to enforce the check, (2) there was no alteration, and (3) it had no knowledge of any unauthorized signature. Here, because the payee, Hannah's, signature was forged, XYZ Bank was not entited to enforce the check. Thus, ABC Bank can hold XYZ Bank liable for a breach of a presentment warranty.

Question 7 – July 2019 – Selected Answer 3

(A) Checks 1, 2, and 3 are all negotiable instruments under the UCC.

Checks 1,2, and 3 all appear to be negotiable instruments. First off, under the UCC, there are two types of instruments: a draft and a note. In this case, a check is always considered a draft. Therefore, it would be covered by the UCC.

To determine whether the checks are negotiable there are eight elements for each check: (1) written, (2) signed by maker or drawer, (3) unconditional promise to pay, (4) a fixed amount, (5) of money, (6) with no additional undertakings or limitations, (7) payable at a definite time, and (8) with words of negotiability (order or bearer language).

In this case, all three of the checks would be considered drafts. Furthermore, all three of the checks appear to be written and signed. Each check specified a fixed amount of money ($75, $150, and $100 respectively), and the checks were written to the "order of Hannah Jones." There are no facts of any conditions placed in the checks or additional undertakings or limitations. As such, all three checks would be classified as negotiable instruments.

(B) Hannah has no rights against PhoneWorld for Check 1 because PhoneWorld is a Holder in Due Course.

In this case, we are dealing with the fact that a thief broke into Hannah's care and used Check 1 at Phoneworld. The facts indicate that after Hannah received Check 1, she put a blank indorsement on the back of the check. A blank indorsement is simply the signing of the payee's name on the back of the check. The effect of a blank indorsement is that it turns Order paper into Bearer Paper.

In this case, Check 1 was order paper because it had the words "Pay to the order of Hannah Jones" written on it. When a blank indorsement was placed on the back, it became bearer paper. The rule regarding bearer paper is that the person who "bears" the paper is entitled to cash or utilize the check. Therefore, Check 1 became a bearer paper.

In this case, when the thief gave the check to PhoneWorld, PhoneWorld became a holder. A person becomes a holder when they: (1) have possession of the instrument and (2) have good title. In order to have good title to order paper, you need possession plus the necessary indorsements. In order to have good title to bearer paper, you simply need to possess it. In this case, PhoneWorld has possession of Check 1. Furthermore, they have good title because it is order paper with the necessary blank indorsement.

There is an issue in the fact that the thief indorsed the name "Sarah Smith" on the back of Check 1. Ultiamtely, this has no effect on Phoneworld. Under the UCC, there is a presumption if a name not in the chain of title appears on the back of the instrument, the party is a surety or accomdation party. In this case, PhoneWorld may have rightfully assumed that Sarah Smith was a surety on the check.

Therefore, the next step in a UCC issue is to determine if PhoneWorld was a holder in due course. In order to become a Holder in Due Coure, the instrument must be (1) negotiable, (2) properly negotiated, (3) obtained in good faith, (4) free from any signs of alteration or forgery, (5) given value for the instrument, and (6) taken without notice of seven things.

In this case, the instrument is negotiable. Moreover, it was properly negotiated because PhoneWorld is a holder. Nextly, Phoneworld needed to obtain it in good faith. This means they obtained it in actualy good faith and observed commercially reasonable standards. There are no facts to suggest they obtained it in bad faith or commercially unreasonable standards. Nextly, the instrument is free from signs of alteration or forgery. PhoneWorld gave value for the instrument (i.e., the phone). Finally, PhoneWorld obtained the instrument without notice of the seven statutorily enumerated things (i.e., a fraud, a claim against the thief, alteration, etc.).

As such, PhoneWorld would be a holder in due course for Check 1. Hannah would have limited rights against PhoneWorld. Hannah would only be able to assert "real defenses" against PhoneWorld. Ultimately, amongst the real defenses, Hannah would nto be able to win any claims against PhoneWorld. Hannah, by blankly indorsing the instrument, placed herself at risk of a situation like this. Therefore, she will have to pay PhoneWorld and won't be able to resist their status as HDC.

(C) Hannah could assert rights against PhoneWorld for Check 2 because Phoneworld was not a holder or holder in due course.

As previously mentioned, there are eight elements to negotiability, 2 essential elements to being a holder, and 6 elements to being a holder in due course. When it comes to Check 2, there are some minor differences that change the analysis regarding PhoneWorld.

The first issue is the way Hannah handled Check 2. When Hannah received Check 2, she put a specific indorsement on the back of the instrument. This indorsement stated "Pay to the Order of Sarah Smitth." As such, the instrument was order paper when created by Customer and continues to be order paper.

Therefore, for PhoneWorld to be a holder in due course they must be a proper holder. in order to be a holder, PhoneWorld must have good title plus physical possession. PhoneWorld has physical possession. However, PhoneWorld will not be deemed to have good title. In this case, sicne the instrument was order paper, PhoneWorld would need possession plus the necessary indorsements to have good title. PhoneWorld would need Sarah Smith's indorsement on the back of the instrument.

In this case, we are told that the Thief indorsed the back of Check 2 with "Sarah Smith." This is a forgery, and the rule is that a forgery cuts off proper chain of title for the instrument. As such, when PhoneWorld received the instrument, they never became a proper holder.

Furthermore, because PhoneWorld did not become a holder (i.e., the instrument was not properly negoatied), they can't be a holder in due course. WIthout Holder in

Due Course protection, Hannah can assert personal and real defenses against PhoneWorld. As such, Hannah would be able to assert her claim of forgery and theft of the isntrument against PhoneWorld. She could reobtain the check from PhoneWorld.

(D) XYZ Bank would bear ultimately loss on Check 3.

In this case, the thief once against engaged in the act of forgery. Hannah did not place any indorsements on the back of Check 3. In this case, the thief put a blank indorsement of Hannah's name on the back of Check 3 and presented the Check to XYZ Bank. As previously mentioned, this act of forgery cuts off good title and any subsequent party can't be a holder or holder in due course. Furthermore, when the thief presented the check to XYZ, the thief violated a presentment warranty. Under the UCC, a presenment warranty on a check entiles 4 warranties that a party makes when they present a check to be cashed. These four warranties are: (1) that they are entitled to enforce, (2) that the instrument is free of alterations, (3) the instrument is free of forgeries, and (4) if it is a remotedly created instrument it was created with appropriate authority. In this case, the thief violated warranties (1) and (3) when he presented it to XYZ Bank.

When XYZ Bank took Check 3, there is an equitable rule that the bank takes on the same role as the previous party that presented it. In this case, XYZ would not be a proper holder or holder in due course because the forgery broke proper chain of title. After XYZ received the check, XYZ presented Check 3 to ABC Bank to be paid out of Cusomter's account. XYZ violated the same two presentment warranties when they presented the isntrument to ABC Bank. XYZ was not entitled to enforce the check and the check had a forgery on it. This in effect will lead to XYZ to be ultimately liable on this instrument for reasons discussed below.

When ABC Bank paid out on the check, they did so inappropriately. The check had a forgery. As such, Hannah could file suit against ABC Bank for conversion to get the $100. Alternatively, the customer could sue ABC Bank under an NPP (not properly payable) suit. Therefore, Hannah and the Customer would not have ultimately responsibility on the check.

After the bank repays either Hannah or Customer, ABC Bank would turn around and pursue a claim against XYZ for violation of the present warranty. XYZ would be liable since they breached 2 of the 4 presentment warranties. Therefore, XYZ would bear ultimate loss on Check 3.