Question 11 – July 2018 – Selected Answer 1

(A) Retailer is liable to Supplier on the dishonored check.

An agent may bind the principal when she acts with actual or apparent authority. Generally, the rule is that to avoid personal liability on a contract, an agent must (1) indicate that she is signing in her capacity as an agent and (2) indicate who the prinicpal is. However, in the contect of drafts , a principal is liable for a company check that an employee with authority signs, even if the employee does not indicate that she is acting in her capacity as an agent. Thus, an employee may sign a company check with her name and bind the principal while escaping personal liability.

Here, Employee had actual authority to bind Retailer in the transaction with Supplier because she has worked for Retailer for over ten years managing the business and this is a transaction in the ordinary course of business. Even though Employee signed the check with her name and did not indicate that she is acting as an agent, Retailer is solely liable for failure to pay the check because it was a company check. Employee's electronic signature is completely sufficient to satsify the signing requirement for a negotiable instrument - even a mark or an "X" would do.

(B) Employee is NOT liable to Supplier on the dishonored check.

[Please see discussion in (A) above]

(C) Employee is NOT liable to Tent Sales on Note 1.

To avoid personal liability, the maker of a note has to indicate that she is an agent acting on the principal's behalf.

Here, Employee signed Note 1 as "Kelly Smith, Agent" and did not indicate who the principal is in writing on the note. However, because of the nature of the transaction - Tent Sales is not a Holder in Due Course (to be defined in (D) below), Tent Sales is estopped from suing Employee on a transaction intended solely as a business transaction on behalf of Retailer. Employee went to Tent Sales on her employer's instruction and Tent Sales "knew Employee because she represented Retailer for the purchase of Retailer's larger tent." Employee will avoid personal liability as long as she proves that it was the intent of the contracting parties not to bind her, and instead only bind Retailer (a low bar).

Therefore, Employee will not be held liable on Note 1.

(D) Employee is liable to Beta Bank on Note 2 because Beta Bank is a Holder in Due Course.

A holder in due course ("HDC") is one in possession of a negotiable instrument who takes the instrument (1) for value, (2) without knowledge of any issues that would render the instrument defective; and (3) in good faith. A holder in due course may acquire rights better than those of the transferor because of its special status. One of the special rights a HDC enjoys is that it can enforce an instrument against parties who may not have been intended in the transaction in issue, but appear on the face of the instrument. While such parties have a defense against the other party on the original contract and simply need to prove that it was not the intention of the parties to bind the agent (please see (C) above, that defense does not work against a HDC.

Here, Beta Bank is a HDC because it paid value for the note and there was no reference to any obligation of Retailer on the Note, meaning Beta had no notice of deficiencies (such as existing real or personal defenses, bankruptcies, alterations or forgeries) and there is no indication in the fact pattern that Beta did not take the instrument in good faith. Because Beta is a Holder in Due Course, and Employee had not satisfied the two prongs of the rule to relieve herself of personal liability (1) sign as agent; (2) explicitly indicate principal), Beta may enforce the $5,000 note against Employee as maker.

Question 11 – July 2018 – Selected Answer 2

(A)

Retailer is liable on the check dishonored Check. At issue here is (1) when a principal is liable for the actions of an agent and (2) when a drawer is liable to a payee for a dishonored instrument. First, Texas agency law makes a prinicpal liable in contract based on the acts of an agent when an agent binds the principal when acting with actual or apparent authority. Here, the employee purchased 200 dresses from Supplier for the Retailer's business (which is to sell dresses). Employee had worked for Retailer for over ten years. She most likely had actual authority to bind Retailer on such a contract and there are not facts that indicate otherwise. She was also using company checks, so there is also probably an argument she had apparent authority.

The next step is to determine when a drawer is liable on a check when it is dishonored by its drawee. Here, the drawee, Alpha Bank, was proper in dishonoring the check because a drawee is not required to cash a check if the account drawn frmo has insufficient funds. Thus, Alpha Bank will not be liable. Retailer, however, will clearly be liable to Supplier because it (through Employee) gave Supplier a negotiable instrument that made it a proper holder who had the right to be paid on receipt. (With no indication otherwise, the check seems to be bearer paper because it was not payable to Supplier specifically. This would make Supplier a proper holder simply by possessing it.) Supplier can return to Retailer and attempt to recover through repayment or payment in a different form. It also has a cause of action in contract for the amount payable on the check if this doesn't work.

(B)

Employee is not liable to Retailer on the check because the check was a company check from Retailer. The issue is when is an agent liable in contract for obligations of the principal. Typically, if the agent executes an instrument, she can be personally liable unless the instrument both states who the principle is and that the agent is in fact an agent working on behalf of that principle. However, there is a specific exception for checks; checks do not have to specifically state that the agent is an agent of the principal. Checks simply need to have the principal's name clearly displayed on them somewhere, such as with a company check. Here, the check was a company check, so, assuming it had Retailer's name on it, Employee would not be liable on this contract.

(C)

Tent Sales will not be able to hold the Employee liable on the note because Tent Sales had actual notice that Employee was an agent of Retailer. The issue here is when is an agent liable on a negotiable instrument that's not a check. As stated above an agent can be liable in contract on a negotiable instrument if instrument (1) did not have the principal's name on it and (2) did not state that the agent was acting as an agent on behalf of that principle. Here, Note 1 did not reference Retailer anywhere on it. Addittionaly, Employee only signed it "Kelly Smith, Agent," which is not a clearly unambiguous statement that she is acting on behalf of a principal. However, the first issue is dispostive and without the principle's name, the agent can be held liable depending on whether the holder of the instrument is a holder in due course (HDC) or not. If the holder is an HDC, the agent will be liable in contract on the instrument unless the HDC has actual notice that there was in fact a principal to the transaction. If the holder is a nonHDC, they merely need to be notified of the agency relationship.

Here, regardless of whether or not Tent Sales is an HDC, they will not be able to hold Employee liable. This is because even if they were an HDC, they will not be able to claim they had no notice that Employee was acting as an agent. The facts state that Employee was instructed and acting pursuant to Retailer's business in making these notes. Further, Tent Sales actually knew Employee because she had purchased another tent from Tent Sales previoulsy in her capacity as an agent of Retailer. Thus, Tent Sales knew Employee was acting as an agent of Retailer and thus cannot hold her personally liable.

(D)

Employee will be liable to Beta Bank. The issue is the same as above, however, we must determine if Beta Bank is a holder in due course. In order to be an HDC, one must (1) hold, (2) a negotiable instrument, (3) which they obtained for value, (4) without notice of any other claim, right, or defect in the instrument, and (5) have obtained the instrument in both subjective and commercially objective good faith. Here, Beta Bank will be considered an HDC. They bought Note 2 from Tent Sales for value. They had not notice that Retailer would not pay on this note or that it was past due. The note is a properly negotiated instrument, with no facts to indicate otherwise.

Because Beta Bank is an HDC and because, as discussed above, the Employee can be held liable on the note because the Prinicipal was not referenced and because she probably did not effectively state she was acting as an agent for the principal, Beta Bank can recover against Employee personally if they did not have actual notice of the principal retailer. Here, there is no indiciation in the facts that they had such notice. Thus, Employee will be liable on Note 2.

Question 11 – July 2018 – Selected Answer 3

A. Retailer is liable to Supplier on the dishonored check.

A prinicipal is liable for negotiable insutrments issued by its agents when: (a) the agent had authority to do so, such as actual, express authority; actual, implied authoirty; or apparent authority, (b) the principal ratifies the instrument, or (c) the principal is estopped from denying the instrument. As a general rule with drawers of drafts, such as checks, liability is secondary, and only attaches when the check is dishonored.

An agent has actual, implied authority when the agent had a reasonable belief based on business custom or interactions with the principal that the agent's actions were reasonably necessary to carry out the principal's business.

Here, Employee is Retailer's agent. Retailer is an entity which is engaged as a traveling dress shop. The check in question was drawn by employee when she went to Supplier and bought 200 dresses. This seems to be reasonably necessary to carry out Retailer's business of dress selling, and if it was not, Employee was justified in believing so. Thus, Employee had actual, implied authority to draw the check and buy the dresses. Alpha Bank properly dishonored the check when presented for payment, because it is under no obligation to honor a check drawn on an account with insufficient funds. On dishonor a check's drawer becomes liable on the instrument. Thus, because the check was dishonored, and Employee had authority to issue the check and make the purchases, Retailer is liable for the check.

B. Employee is not liable on the dishonored check.

An agent is liable on a negotiable instrument, when she fails to adequately disclose her agency and identity of the principal. However, when an agent signes only her name by machine signature on the prinicpal's check drawn on the principal's bank account, the agent does not incur personal liability.

Here, Employee issued a company check drawn on the Retailer's bank account, and she signed by machine signature. Therefore, even though she only signed her name, Employee will not be personally liable because this was a company check.

C. Employee is likely not liable on Note 1.

A note is a two party instrument by which the maker promises to pay the payee. Notes can be negotiable instruments and governed by article 3 of the Texas UCC when: (1) they are signed writings, (2) making an unconditional promise to pay, (3) a fixed sum of money, (4) to the order or bearer, (5) on demand or at a definite time, (6) at no additional undertaking.

An agent is generally liable on a note she makes on behalf of a principal, unless she clearly indicates her agency and indentifies her principal. A person seeking to enforce an instrument may be immune from certain defenses if the party is a holder in due course. To attain this status, the person must be a holder (i.e., take by issuance or negotiation), for value, in good faith, and without notice of certain infirmities. A holder in due course is immune from certain personal defenses, such as issuance or contract defenses, but not real defenses, such as duress or illegality.

Here, Note 1 is a negotiable instrument, because it is (1) a writing signed by Employee, (2) which made an unconditional promise to pay (3) $10,000 (4) to the order of Tent Sales (5) at a definite time - on November 1 (6) at no additional undertaking. Thus, Note 1 is governed by article 3 of the Texas UCC. Here, Employee indicated her agency by signing her name and "agent" but she did not disclose the identity of the principal.

However, she may assert a defense that she was never intended to become a party to the instrument. While Tent Sales may be the holder of Note 1, as it took Note 1 by issuance, Tent Sales is not a holder in due course vis-a-vis Employee. This is because Employee signed the instrument, indicating her agency, and Tent Sales knew both Retailer and Employee and knew that Employee represented Retailer in tent sales. Thus, Tent Sales had notice of "infirmities" i.e., Tent sales knew that Employee was signing on behalf of Retailer. Because of that Employee can argue that she was not intended to be a party ot the instrument. Therefore Employee is not likely to be held liable on Note 1.

D. Employee is liable on Note 2.

A described above, a note is subject to article 3 of the Texas UCC as a negotiable instrument when: (1) it is a signed writing, (2) making an unconditional promise to pay, (3) a fixed sum of money, (4) to the order or bearer, (5) at a definite time or on demand, (6) at no additional undertaking. A negotiable isntrument is intended to be a convenient cash substitute and can be transfered. They are transferred by negotiation. To negotiate bearer paper, one need only transfer possession. To transfer order paper, one must transfer possession and indorse the instrument. When a transferee takes for value, he is entitled to specific performance to obtain the transferor's indorsement.

When a person seeks to enforce an instrument they must show: (a) that they are entitled to enforce the instrument, and(b) that the signatures are valid. The validity of the signatures is generally presumed. A holder may enforce the instrument, and may even be immune from personal defenses if he is a holder in due course. To be a holder in due course, one must be a holder who took for value, in good faith, and without notice of infirmities.

Here, Note 2 is a negotiable instrument subject to article 3 of the Texas UCC becuase it is (1) a writing signed by Employee, (2) makes an unconditional promise to pay, (3) $5000 (4) to the order of Tent Sales (5) on December 1 (6) at no additional undertaking. Tent Sales sold Note 2 to Beta Bank on October 15. The facts do not indicate whether Tent Sales indorsed the Note, but because Tent Sales "sold" it, Beta Bank likely took for value, and is therefore entitled to specific performance to get Tent Sales's indorsement of the Note. Thus, Beta Bank is a holder and entitled to enforce the instrument. Moreover, Beta Bank took for value, in a manner that seems to show honesty in fact and a commercially reasonable manner (i.e., in good fatih), and had no notice of infirmities. Critically here, Beta Bank had no notice of Retailer and nothing indicates that Beta Bank had notice as to Employee's agency and principal.

Therefore, Beta Bank is a holder in due course and can enforce the instrument against employee, even though she could defend on Note 1, because Beta Bank took with no notice of her principal and no notice that she was not intended to be a party to the instrument. Thus, Employee is liable.