

Grading Guides for Past Examinations in
SECURED TRANSACTIONS AND COMMERCIAL PAPER

(Course No. 6181; 4 credits)

This document contains grading guides for the examinations in Secured Transactions and Commercial Paper that were given on the following dates:

Dec 7, 2017
May 4, 2017
Dec 15, 2015
Apr 30, 2015

In these examinations, problems I-III generally concern commercial paper under U.C.C. arts. 3 and 4; problems IV-VI generally concern secured transactions under U.C.C. art. 9; and problem VII generally concerns letters of credit under U.C.C. art. 5.

I did not teach this course on any other dates. But I have posted additional exams and grading guides for Commercial Paper (Course No. 6182) at <http://maggs.us/gwlaw/home.htm>.

No. Neither Pinero (the payee) nor USIF (the drawee) may recover from PCC for conversion. Under § 3-420(a)'s last sentence, "[a]n action for conversion of an instrument may not be brought by (i) the issuer [i.e., USIF] . . . or (ii) a payee [i.e., Pinero] . . . who did not receive delivery of the instrument"

C. What rights, if any, does Pinero have against USIF?

Pinero still has his right to the disability payment from USIF. USIF did not discharge or suspend that underlying obligation with the check because Pinero did not "take" the check in exchange for that obligation. § 3-310(b).

D. If USIF had not ordered Republic Bank to stop payment, and Republic Bank had paid the check, what rights, if any, would Republic Bank have against USIF, Pinero, the forger, and PCC?

Republic Bank v. USIF: Republic Bank (the payor bank) could not charge USIF's account because a check with a forged indorsement is not properly payable. § 4-401(a). The facts do not suggest any exception.

Republic Bank v. Pinero: Republic Bank would have no rights against Pinero. Pinero did not make any presentment warranties because Pinero did not transfer the check, § 4-208(a), and did not indorse the check because the forged indorsement was ineffective, § 3-403(a).

Republic Bank v. The forger and PCC: Republic Bank could recover from the forger and PCC for breach of the presentment warranty. Both warranted that they were entitled to enforce. § 4-208(a)(1). But neither was entitled to enforce because the check was payable to Pinero and the forged indorsement was ineffective to negotiate the instrument. § 3-403(a).

PROBLEM II.

[Max. points: 7 for A & B, 6 for C & D]

Wells Fargo
 PTO City \$X
 /x/ Wright
 Wright -----> The City -----> [The City's bank] -----> Wells Fargo -----> [The City's bank] -----> The City

A. Why is it unclear whether Wells Fargo met its deadline for returning the check?

Wells Fargo (the payor bank) had a duty to return the check by midnight on the day following the day on which it received the check. §4-302(a)(1). It is unclear whether Wells Fargo met this deadline because the facts do not indicate when the City's Bank (or an intermediary bank) presented the check to Wells Fargo or when Wells Fargo returned the check.

B. If Wells Fargo met its deadline for returning the check, what rights would Wright, the City, and Wells Fargo have?

Wright: Wright (the drawer) would have a claim against Wells Fargo (the drawee) for wrongful dishonor. §4-402(a). The facts indicate that the check was properly payable and therefore should not have been dishonored.

The City: The City (the payee) could enforce the check against Wright (the drawer). The drawer is liable on a check if it is dishonored. § 3-414(b). The City would have no rights against Wells Fargo (the drawee). The drawee of a check is not liable on the check to the payee unless the drawee

accepts (i.e. certifies) the check, which did not happen here. §§ 3-408; 3-409(d).

Wells Fargo: Wells Fargo (the drawee) would have the right to revoke any settlement that it made for the check. § 4-301(a).

C. If Wells Fargo did not meet its deadline for returning the check, what rights would Wright, the City, and Wells Fargo have?

Wright: Wright arguably would have a right to participate in the election because he would have paid the qualifying fee. When a check is taken for an underlying obligation, the obligation is suspended. § 3-310(b). The suspension ceases if the check is dishonored, but the check was not dishonored if Wells Fargo missed its midnight deadline for returning the check.

The City: The City would have a right to payment from its bank. A depository bank must credit a customer's account for a check when the depository bank receives a settlement which becomes final. § 4-215(e). All of the settlements in the check collection would become final if Wells Fargo missed its midnight deadline. § 4-302(a)(1); Blake v. Woodford Bank & Trust.

Wells Fargo: Wells Fargo would have a right to charge Wright's account. The payor bank may charge a customer's account after paying a check that is properly payable. § 4-401(a). The check in this case was properly payable to the City because there were no forgeries or stop payment orders.

D. If Wright had paid the qualifying fee with a cashier's check, how if at all would his rights be different?

Wright would have paid the qualifying fee to the City. When a cashier's check is taken for an underlying obligation, the obligation is discharged even if the cashier's check is later dishonored. § 3-310(a).

If the cashier's check was dishonored, Wright would be liable only if Wright had indorsed the cashier's check. § 3-415(a). Wright might have indorsed the cashier's check if the cashier's check was initially payable to him. Wright likely would not have indorsed the cashier's check if the check was initially payable to the City and Wright was merely a remitter.

PROBLEM III.

[Max. points: 7 for A & B, 6 for C & D]

Payor Banks				forgery				
PTO Timpson				↙				
/s/ Drawers				/s/ Timpson				
Drawers	----->	Timpson	---	Teri	----->	Bank	---->	Payor Banks

A. Might Timpson have had a right to payment from anyone other than the Bank?

Against Teri and the Payor Banks: If Timpson (the employer/payee) received the checks but did not entrust Teri (the employee/forgery) with responsibility with respect to the checks, § 3-405(b), then Timpson could recover from Teri and the Payor Banks for conversion. Teri would have converted the checks by taking them from Timpson without his consent. The law of conversion applies to negotiable instruments. § 3-420(a)'s 1st sent. The Payor Banks would have converted the checks by making a payment for Teri when Teri did not have a right to enforce. § 3-420(a)'s 2d sent.

Against the Drawers: If Teri stole the checks before Timpson received them, then Timpson would have a claim against the drawers of the checks for the underlying obligation for which the checks were written. The underlying obligations would not be discharged unless Timpson took (i.e., received) the checks. § 3-110(b).

B. Could there be any circumstances in which the Bank would not have had a duty to reimburse Timpson for the improperly indorsed checks?

If Timpson entrusted Teri with responsibility with respect to the checks, then Teri's signature would be effective, and the Bank would not have to reimburse Timpson. § 3-405(b).

Similarly, if Timpson's negligence substantially contributed to the making of the forged indorsements, Timpson would be precluded from asserting that the indorsements were unauthorized. § 3-406(a). For example, he might have been negligent if he left the checks in an insecure place where Teri could steal them. See id. cmt. 3, case #1.

Note: The reporting delay exceptions in § 4-406(c) do not apply in this case because Timpson is not the drawer of the checks.

C. What rights would John have against Teri if he pays the note, and what rights would Teri have against John if she pays the note?

The answer depends on whether John is an accommodation co-maker. If he is an accommodation co-maker, then he would have a right to reimbursement from Teri and she would have no right against him. § 3-419(f). If he is not an accommodation co-maker, then each of them would have a right of contribution against the other. § 3-116(b).

Whether John is an accommodation co-maker depends on whether he received a "direct benefit" from the consideration for the note. § 3-419(a). Arguably, he did not receive a direct benefit because the consideration for the note was the bank's paying off his wife's debt, not his own debt.

Note: The answer might be different in a community property state. See Problem (b), p. 740. But discussion of that possibility was not required for the purposes of this examination.

D. How would the parties' rights be different if John had indorsed the note instead of signing it as a co-maker?

If John had indorsed the note, the Bank could not enforce the note against John until Teri dishonored the note. § 3-415(a). And if John paid the note, John's remedy would be to enforce the note against Teri. § 3-414(b)'s last sentence.

PROBLEM IV.

[Max. points: 7 for A & B, 6 for C & D]

A. What would Fulton Bank have to show to establish that it had a right to repossess the camper without judicial process?

First, Fulton Bank would have to show that it had a security interest in the camper. Fulton Bank would have had a security interest if (1) the bank gave value (e.g., by lending money to Cooper); (2) Cooper had an interest in (i.e., owned) the camper; and (3) Cooper authenticated a security agreement creating the security interest. § 9-203(b).

Second, Fulton Bank would have to show that Cooper defaulted on the security interest. The security agreement itself would determine what is a breach. § 9-601 cmt. 3. Being delinquent on an account is likely a default.

Third, Fulton Bank would have to show that it took possession of the camper without a breach of the peace. § 9-609(a)(1), (b)(2). The facts that Cooper detained the repossession agents by using a gun and that the neighbors called the police suggests that there was a breach of the peace. See Williams v. Ford Motor Credit.

B. What rights might Cooper now assert against the Bank?

If Cooper can show that the Bank breached the peace, then taking possession was improper. Cooper would have a claim for non-compliance with the requirements of article 9 under § 9-625(b)&(c). The Williams case suggests that Cooper also might have a claim for conversion because the repossession agents took his property in an improper manner. Cooper also might have a breach of contract claim for breach of the security agreement.

C. Fulton Bank was considering three options: (1) selling the camper at a public sale; (2) selling the camper at a private sale; and (3) strict foreclosure. If Fulton Bank had properly repossessed the camper, what might have been the advantages and disadvantages of each option?

An advantage of a public or private sale over a strict foreclosure is that Fulton Bank would have the right to recover any deficiency from Cooper. § 9-615(d)(2). But if Cooper does not have any money, that is not much of an advantage.

An advantage of strict foreclosure over a public or private sale is that Cooper could not challenge the reasonableness of a sale. The disadvantage is that Fulton Bank would need Cooper's consent, see § 9-620(a)(1), and Fulton Bank could not accept the collateral in partial satisfaction (and then sue for the deficiency) because the camper is a consumer good, § 9-620(g).

An advantage of a public sale over a private sale is that Fulton Bank can participate in the bidding. § 9-610(c)(1). Fulton Bank therefore could buy the camper if it believes the going price is less than the value of the camper. Fulton Bank could pay the price by bidding in the amount of the debt.

An advantage of a private sale is that it may be easier and faster. Fulton Bank, for example, might call several dealers of used RVs and, after giving notice to Cooper, sell it to the one who bids the highest amount. See Prob. (2), p. 307. The disadvantage is that Fulton Bank could not participate in the bidding or buy the camper because used campers are not "customarily sold on a recognized market or the subject of widely distributed standard price quotations." § 9-610(c)(2).

D. If Cooper had declared bankruptcy in September, how might the bankruptcy have affected Fulton Bank's rights?

If Fulton Bank had perfected its security interest prior to Cooper's bankruptcy, the security interest would remain valid and have priority over the bankruptcy trustee in bankruptcy. Fulton Bank, however, would need leave of the bankruptcy court before foreclosing on the camper. If Fulton Bank had not perfected the security interest, the bankruptcy trustee could defeat the security interest. See 11 U.S.C. § 544(a). Perfection probably required making a notation on a certificate of title. See § 9-311(a)(a).

PROBLEM V.

[Max. points: 7 for A & B, 6 for C & D]

A. Under what circumstances would LEAF's financing statement have perfected LEAF's security interest in the TA400?

The financing statement would have perfected LEAF's security interest if searching for the name on Nay's driver's license would have found the financing statement under the standard search logic. Minor errors do not render a financing statement ineffective unless they are "seriously misleading." § 9-506(a). An error is not seriously misleading if a search of the records under the debtor's correct name, using the filing office's standard search logic, would disclose a financing statement. § 9-506(c).

B. If LEAF's security interest was perfected by LEAF's financing statement, who has priority in the TA400?

Although MainSource was the first to file, and would ordinarily have priority under the first-to-file rule, § 9-322(a), LEAF would have priority under the PMSI exception to the first-to-file rule, § 9-324(a). LEAF sold the TA400 to Nay on credit and perfected the security interest either before or within 20 days after Nay received possession of the collateral. Nay presumably did not receive possession before LEAF made the loan, and the facts say that LEAF made the loan on December 17 and perfected its interest on December 20.

C. If LEAF's security interest was not perfected, could LEAF (1) repossess the TA400, (2) sell the TA400, and (3) retain the proceeds from the sale?

Even if LEAF's security interest was not perfected, LEAF could repossess and sell the TA400. A secured party does not have to have a perfected security interest or priority to repossess, see § 9-609(a) & cmt 5, or to dispose of the collateral, see § 9-610(a) & cmt. 5. But the proceeds would first go to paying off MainSource's security interest. § 9-615(a). MainSource would have priority because it has a perfected security interest. § 9-322(a) (2)

D. If Mr. Nay sells the TA400 to another farmer, what rights would MainSource and LEAF have against Mr. Nay and the other farmer?

Unless they authorized the sale free of the security interest (or some other exception applies), MainSource and LEAF would continue to have a security interest in the TA400. § 9-315(a) (1). MainSource and LEAF also would have security interests in the proceeds from the sale. § 9-315(a) (2)

If MainSource and LEAF did not give Mr. Nay permission to sell the TA400, the sale also likely would be a default under the security agreement. MainSource and LEAF could recover from Mr. Nay for breach of contract, § 9-601(a), or could take possession of the TA400, § 9-609(b).

PROBLEM VI.

[Max. points: 7 for A, 6 for B, C & D]



↓
Murphy

A. What is the priority of any interests that FNBC, FMCC, Crossett Ford, and Murphy have in:

(1) the F-150?

FNBC no longer has any interest in the F-150. Although FNBC had a security interest in the F-150 when it was part of Crossett Ford's inventory, a security interest in inventory does not continue when the inventory is sold. §9-320(a).

FMCC has a security interest in the F-150 pursuant to the security agreement that Murphy made with Crossett Ford and that Crossett Ford sold and assigned to FMCC. This security interest has priority because it is the only security interest.

Crossett Ford does not have any interest in the F-150 because it sold the F-150 to Murphy and sold its security interest to FMCC.

Murphy owns the F-150 because Murphy bought the F-150 from Crossett Ford. But Murphy's ownership interest is subject to the security interest in the F-150 that he granted to Crossett, and that Crossett assigned to FMCC.

(2) the retail installment contract and its proceeds?

Note: The retail installment contract is the contract in which Murphy promised to pay the purchase price of the F-150 in installments. The proceeds of that contract are Murphy's installment payments.

FNBC has a security interest in the retail installment contract and its proceeds because the contract is proceeds of FNBC's former security interest in the F-150. § 9-315(a)(2). But FNBC's interest is subordinate to FMCC's interest because "[a] purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory." § 9-330(a).

FMCC owns the retail installment contract and the payments that Murphy makes (i.e., the proceeds) because FMCC purchased the retail installment Contract from Crossett Ford. As explained above, FMCC has priority under § 9-330(a).

Crossett Ford does not have an interest in the installment contract or its proceeds because Crossett Ford sold the installment contract to FMCC.

Murphy does not have an interest in the installment contract or its proceeds because he is the obligor under the contract.

(3) the funds Crossett Ford received for the F-150?

FNBC has a security interest in the funds because FNBC had a security interest in the F-150 when it was inventory and the funds are the proceeds of the sale of the F-150. § 9-315(a)(2).

FMCC has no interest in these funds. FMCC lent these funds to Murphy who used them to pay for the F-150.

Crossett Ford owns the funds subject to FNBC's security interest because Crossett Ford received the funds in exchange for the F-150.

Murphy has no interest in these funds. Murphy used the funds to pay for the F-150.

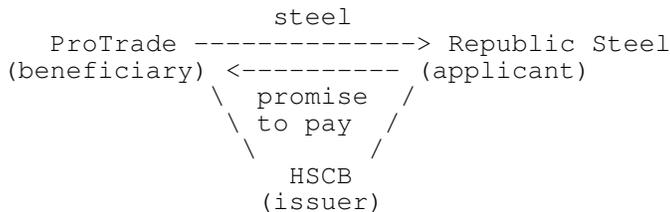
- B. Suppose another lender had a perfected security interest in all of Crossett Ford's inventory "now owned or hereafter acquired." Under what circumstances would this other lender have priority over FNBC or FMCC in the F-150 or its proceeds?**

The other lender would have priority over FNBC with respect to the F150 (before it was sold) and the proceeds (after it was sold) only if (1) the other lender was the first-to-file or perfect and FNBC could not claim an exception, such as PMSI inventory priority; or FNBC was the first to file or perfect and FNBC could claim an exception such as PMSI inventory priority. § 9-320(b).

The other lender would not have priority over FMCC for the same reasons that FNBC does not have priority over FMCC. Under § 9-330(a), "[a] purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory."

PROBLEM VII.

[Max. points: 7 for A, 6 for B, C & D]



- A. How would a good faith contract dispute between ProTrade and Republic Steel affect HSBC's duties?**

A good faith contract dispute would not affect HSBC's duties. Under the independence principle, the duty of the issuer [HSBC] is independent of any contract between the applicant [Republic Steel] and the beneficiary [ProTrade]. § 5-103(d).

- B. Does HSBC's payment to ProTrade affect ProTrade and Republic Steel's rights against each other?**

The payment discharges any claim that ProTrade had against Republic Steel to the extent of the payment. But Republic Steel retains whatever rights it had against ProTrade under the sales contracts. For example, Republic Steel might have a claim for breach of warranty if the steel was defective.

- C. Are there any circumstances under which a court could have enjoined HSBC from paying ProTrade?**

Yes. If ProTrade's presentation was materially fraudulent and other conditions for an injunction were met (e.g., showing of irreparable harm), then a court could enjoin payment. § 5-109(b).

- D. How could ProTrade have used a secured transaction to ensure recovery of the kind of claims ProTrade asserted against Republic Steel in this case?**

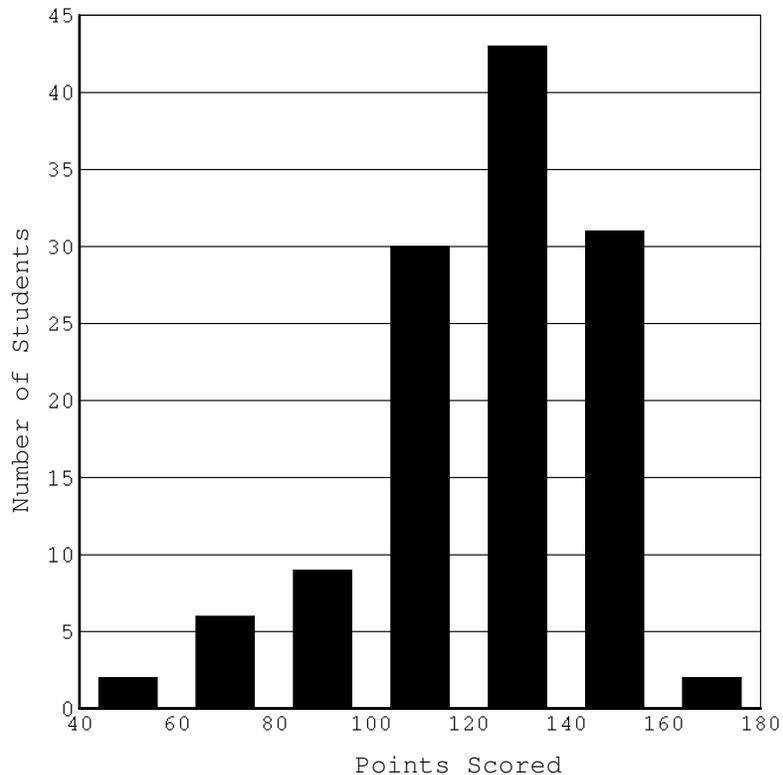
ProTrade and Republic Steel could have entered into a security agreement giving Protrade a security interest in accounts or other property owned by Republic Steel to secure ProTrade's claims against Republic Steel arising out of wrongfully canceled contracts. If Republic Steel defaulted, ProTrade could collect on the accounts or taken possession of the property.

Note: Some answers suggested that ProTrade could have retained a security interest in the steel that it was selling to Republic Steel. But it is not clear that this would help. When Republic Steel wrongfully cancels a sale, ProTrade presumably does not deliver the steel to Republic Steel.

Grading Guide for Final Examination In
SECURED TRANSACTIONS & COMMERCIAL PAPER
(Course No. 6281-10; 4 credits)
Professor Gregory E. Maggs

This grading guide provides suggested answers to the final examination questions. In many cases, the suggested answers contain more detail than could reasonably be expected of actual answers written under examination conditions. Accordingly, actual answers could receive full or partial credit even if they did not completely match the suggested answers. A few students lost points for exceeding the 4500-word length limitation.

The examination was worth a total of 180 points. Grades were awarded in accordance with the Law School's mandatory grading guidelines for large classes. The following histogram shows the distribution of scores:



The edited excerpts in the examination problems came from the following cases: I. Oupac, Inc. v. Sam, 89 So. 3d 402 (La. App. 2012); II. First Financial Bank v. Citibank, 2012 WL 3065546 (S.D. Ind. 2012); III. Silver v. Wells Fargo Bank, 2016 WL 6962862 (D. Md. 2016); IV. In re PTM Techs., Inc., 452 B.R. 165 (Bankr. M.D.N.C. 2011); V. 1st Source Bank v. Wilson Bank & Trust, 735 F.3d 500 (6th Cir. 2013); VI. In re Gannon, 461 B.R. 869 (Bankr. D. Kan. 2012); VII. Mago Int'l v. LHB AG, 833 F.3d 270 (2d Cir. 2016).

PROBLEM I.

[Max. points: 7 for A & B, 6 for C & D]

Sale

 promise to
 buy vehicle
The Sams -----> Creswell
 <-----
 Automotive
 promise to
 sell vehicle

Loan

 PTO Oupac \$x
 /s/ The Sams
The Sams -----> Oupac, Inc.
 <-----
 promise to lend \$14,309.54
 & deliver money to Creswell

A. Did the trial court err in finding there was no failure of consideration as to the promissory note?

No. The trial court did not err. "Failure of consideration" means that the consideration that was promised was not provided. In this case, the consideration for the note that the Sams issued to Oupac was Oupac's return promise to lend the purchase price of the car (i.e., \$14,309.54) and to pay the loan money to Creswell. There was no "failure of the consideration" because Oupac performed its side of the bargain. Cf. § 3-303(b) (recognizing the defense of failure of consideration by saying: "If an instrument is issued for a promise of performance, the issuer has a defense to the extent performance of the promise is due and the promise has not been performed."); Kaw Valley v. Riddle (Riddle raised the defense of "failure of consideration" because he never received the equipment for which he issued a note).

Note: "Lack of consideration" is different from "failure of consideration." Lack of consideration means that nothing was promised or given to the maker in exchange for the note. Lack of consideration is also a defense. See 3-303(b) ("The drawer or maker of an instrument has a defense if the instrument is issued without consideration.").

B. Why might Oupac's lack of affiliation with Creswell Automotive matter?

Because Oupac is not "affiliated" with Creswell, the Sams cannot assert against Oupac any claims or defenses that they may have against Creswell. If Oupac were "affiliated" with Creswell, and if the Sams are consumers, then the Federal Trade Commission's Holder in Due Course Regulation (FTC HIDC Regulation) would have made it an unfair trade practice for Creswell to accept the loan money unless the note contained the following legend:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED WITH THE PROCEEDS HEREOF.

See 16 C.F.R. § 433.2(b) (requirement of legend in non-seller financing sales); § 433.1(d)(2) (definition of "affiliated"); Casebook, p. 692. This legend would have subjected Oupac to any claims that the Sams have against Creswell based on the defective car. The Sams therefore might not have had to pay the note.

Note: Some answers suggested if Oupac and Creswell were closely connected, Oupac could not claim the status of a holder in due course.

See Unico v. Owen. But the holder in due course doctrine is inapplicable in this non-seller financing case. Creswell did not negotiate the note to Oupac; on the contrary, Oupac took the note directly from the Sams.

C. Does the merger doctrine preclude the Sams from bringing any claims against Creswell Automotive or Oupac?

No. The merger doctrine says that when a negotiable instrument is taken for an underlying obligation, the underlying obligation is merged into the instrument. As a result of the merger, only the holder of the instrument can enforce the instrument, and no one can enforce the underlying obligation. Casebook, p. 647. The Sams did not take a negotiable instrument from Creswell or Oupac; on the contrary. The merger doctrine therefore does not limit them from bringing claims against Creswell or Oupac.

D. Would the Sams have had more protection if they had borrowed the purchase price from Creswell and issued a note to Creswell promising to repay the amount borrowed?

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      PTO Creswell $x
      /s/ The Sams
The   -----> Creswell
Sams <----- Automotive
      vehicle
  
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Yes, the Sams would have more protection. Under the actual facts, because Oupac is not affiliated with Creswell, the Sams cannot assert any defense to payment of their note to Oupac. But if the Sams had issued their note to Creswell and Creswell had attempted to enforce the note, Creswell would be subject to their claim in recoupment for the defects in the car. § 3-305(a)(3). True, Creswell might have negotiated the note to a holder in due course. But if the Sams are consumers, then the FTC HIDC regulation would have required their note to contain a legend saying:

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS . . . WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS . . . OBTAINED PURSUANT HERETO.

See 16 C.F.R. § 433.2(a) (legend required in seller financing sale). With this legend, even if Creswell had negotiated the note to a holder in due course, the Sams could still assert their claims in recoupment against the holder in due course.

PROBLEM II.

[Max. points: 7 for A & B, 6 for C & D]

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      Citibank
      PTO McDonald unauthorized
      $298,750 ✓ signature
      /s/ Citibank
Forger --> AMPG --> McDonald -----> First -----> Chase --> Citibank --> FRB -> Chase -> First
      <--- <----- Financial Bank (Intermed. (Payor
      consideration? $298,750 (Depos. Bank) Bank)
      Bank)
  
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A. Does Citibank have any liability?

Citibank is not liable as the drawer of the cashier's check because the check was unauthorized. § 3-412 (obligation of drawer); § 3-403(1) (effect of unauthorized signatures).

Citibank is also not accountable for the check as the payor bank because Citibank returned the check before its midnight deadline. § 4-302(1)(a). Citibank received the check on July 8. Its midnight deadline was therefore July 9 at midnight. Citibank returned the check by sending it to the Federal Reserve Bank. Because the Federal Reserve Bank received the check on July 9, Citibank must have returned it on either July 8 or July 9.

Citibank is liable to First Financial for failing to provide timely notice of dishonor. Under regulation CC, if a paying bank determines not to pay a check in the amount of \$2,500 or more, it shall provide notice of nonpayment to the depository bank by 4:00 p.m. on the second business day following the banking day on which the check was presented. 12 C.F.R. § 229.33(a). The facts say that Citibank (the paying bank) sent the notice to Chase (the intermediary bank), not to First Financial (the depository bank). Nothing in the facts indicates that First Financial authorized Citibank to notify Chase instead of First Financial.

Citibank also may be liable to First Financial for failing to return the check to Chase in an expeditious manner as required by Regulation CC, 12 U.S.C. § 229.30(a). Under this regulation, a paying bank "may send a returned check to the depository bank, or to any other bank agreeing to handle the returned check expeditiously." The facts suggest that Citibank returned the check to Chase (via the Federal Reserve Bank) and not to First Financial. In addition the facts indicate that "Chase had no agreement with First Financial to handle returned checks expeditiously on First Financial's behalf."

For violations of Regulation CC, Citibank would be liable to First Financial for the amount of loss caused. § 229.38(a). This loss might include any amounts First Financial cannot recover from McDonald that it could have recovered if Citibank had complied with the regulation.

B. What rights does First Financial have against McDonald?

First Financial, as the depository bank, may revoke the settlement given by it to McDonald for the check, may charge back the amount of any credit to McDonald's account, and if there are insufficient funds in the account for a full recovery, may obtain a refund from McDonald. § 4-214(a). First Financial has this right because First Financial did not receive a final settlement for the check given that Citibank returned the check before its midnight deadline. First Financial also has a claim against McDonald for breach of the transfer warranty that all signatures are authentic and authorized. § 3-416(a)(2). McDonald violated this warranty because Citibank's purported signature as the drawer of the check was unauthorized. In addition, First Financial could enforce the check against McDonald if McDonald indorsed it. § 3-415(a).

C. What liability might Accurate Manufactured Products Group have?

Accurate Manufactured Products Group (AMPG) is identified as the remitter of the check. As the remitter, AMPG presumably negotiated the check to McDonald by transferring possession of it to him. § 3-201(a). If AMPG received consideration from McDonald, then AMPG would have made transfer warranties to McDonald. § 3-416(a). It would have breached the transfer warranty that all of the signatures on the check were authentic and authorized because Citibank's purported signature as the drawer of the check was unauthorized. § 3-416(a)(2). AMPG would be liable for any damage caused to McDonald, which would include whatever consideration he provided for the cashier's check.

AMPG probably did not make transfer warranties to anyone else, such as First Financial or Chase. As a remitter, AMPG was not required to indorse the check in order to negotiate it to McDonald, § 3-201(a), and it therefore

presumably did not indorse the check. Warranties extend to subsequent transferees only if the transferor indorses the check. § 3-416(a).

Note: If AMPG was also involved in the forgery, then AMPG could face additional liability. For example, if AMPG forged the check, it would be liable as the drawer because the unauthorized signature of Citibank would be effective as AMPG's signature. § 3-403(a). But the problem does not indicate that AMPG had any role in creating the unauthorized check.

D. When did First Financial have a duty to give McDonald credit for the check?

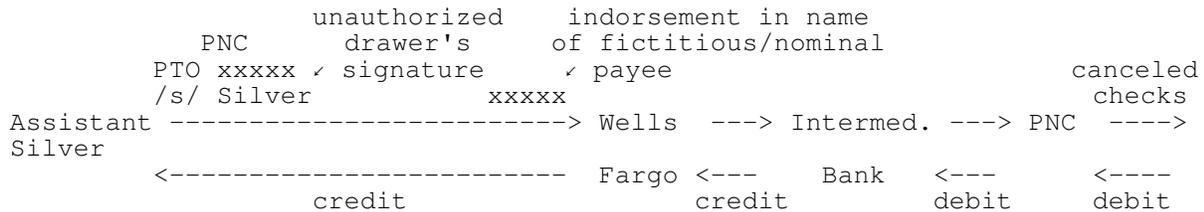
First Financial had to give McDonald \$200 by the start of the first business day after the check was deposited, see 12 C.F.R. § 229.10(c) (1) (vii) and Dodd-Frank Act; \$5000 credit by the start of the second business day, see id. § 229.12(b) (1) (second business day for local checks); id. § 229.13(b) (limit of credit to \$5000 for large checks); and had to give credit for the rest of the check (i.e., \$298,750 - \$5000) within a reasonable time, id. § 229.13(h) (1) (reasonable time for amount above \$5000). But the duty to give credit for the check would cease when the check was dishonored.

Note: This check was not an actual cashier's check because the signature on behalf of Citibank was unauthorized. As a result it was just a local check subject to the rules for checks for large amounts. If the check had been an actual cashier's check, First Financial would have had a duty to give McDonald credit for the first \$5000 by the start of the next business day after the check was deposited. 12 C.F.R. § 229.10(c) (1) (v).

PROBLEM III.

[Max. points: 7 for A & B, 6 for C & D]

Checks Deposited in the Assistant's Account at Wells Fargo



A. Did Wells Fargo breach any warranty to PNC?

Wells Fargo made the presentment warranties in § 4-208(a) to PNC, but did not breach any of them. The facts do not suggest that the checks were altered or that Wells Fargo had knowledge (as opposed to notice) that the purported signature of Silver was unauthorized. § 4-208(a) (2)&(3). Wells Fargo did not breach the presentment warranty that it was entitled to enforce the checks because Wells Fargo was entitled to enforce the checks against Silver's assistant. The assistant's signatures as the drawer were effective as her own signature, § 3-403(a), and her signatures as the indorsers were effective because she made the checks payable to herself or to fictitious payees. § 3-404(b). (Some of the checks that she made payable to her friends and creditors also may have been deposited in Wells Fargo by the payees. These checks would have authorized indorsements provided that her friends and creditors indorsed them.)

Wells Fargo did not make transfer warranties to PNC because transfer warranties are not made to a payor bank when a check is presented for payment. Silver has alleged that Wells Fargo breached a warranty by presenting "highly irregular checks" but there is no such warranty.

B. On what grounds might the PNC argue that it has a right to charge Silver's account for these checks?

The bank could charge Silver's account for a check if the check was properly payable; a check is properly payable if it is authorized. § 4-401(a). Although the assistant signed Silver's name, PNC might argue that Silver is precluded from asserting these checks were unauthorized (1) because Silver's negligence in failing to secure his checkbook substantially contributed to the making of the unauthorized signatures, § 3-406(a); (2) because Silver delayed in reporting unauthorized checks by the same wrongdoer, § 4-406(d)(2); and (3) because the one-year limitation period for reporting unauthorized checks has expired, § 4-406(f).

C. If PNC had dishonored one of the checks that the Assistant had made payable to a fictitious payee, could Wells Fargo enforce the check against Silver?

Yes. Wells Fargo could enforce the check against Silver if (1) Wells Fargo is a person entitled to enforce; (2) Silver is either the drawer of the check or precluded from denying that he is the drawer; and (3) Silver cannot assert a defense to payment against Wells Fargo, either (a) because he does not have a defense or (b) because Wells Fargo is a holder in due course.

Wells Fargo is a person entitled to enforce the check. As explained above, an indorsement in the name of a fictitious or nominal payee is effective to negotiate a check. § 3-404(b). Wells Fargo is therefore a holder of the check, § 1-201(b)(21)(A), and a holder is entitled to enforce. § 3-301(i).

Silver will argue that Wells Fargo cannot enforce the checks against him because he was not the drawer. But if Silver's negligence substantially contributed to the making of the unauthorized drawer's signature -- as discussed in Part B above -- then Silver would be precluded from asserting that his signature was unauthorized. § 3-406(a). (Silver could make Wells Fargo share the loss if Wells Fargo was also negligent in taking the checks given that they were so irregular. § 3-406(b).)

Silver may assert the defense that the check was not issued for consideration because he did not receive anything for it. Wells Fargo will first respond that this defense is invalid because his assistant received consideration. Wells Fargo also will contend that it is not subject to the defense because it is a holder in due course. It will assert that it took the check in good faith, for value, and without notice of any problems. But Silver may argue that Wells Fargo cannot be a holder in due course if the check was so irregular as to call in to question its authenticity. § 3-302(a)(1). (Silver also may assert that the depository bank did not act in good faith in giving credit for the check, see Maine Federal Credit Union, although this theory is controversial.)

D. What steps should Silver take to prevent, detect, and reduce losses from this type of fraud?

Silver should take greater care to secure his checkbook. Silver should review his bank statement every month, either by himself or by hiring a trustworthy person who does not have access to the checks. § 4-406(b). Relying on a person who has access to his checks to review the bank statements is not safe. See, e.g., Espresso Roma v. Bank of America. If Silver notices

that PNC has paid an unauthorized check, he should notify PNC promptly. § 4-406(c). Silver also might ask PNC if it offers a "positive pay" service through which he could independently inform PNC which checks are authorized. See Casebook, p. 899.

In addition to these steps, Silver should be more careful in hiring and monitoring his assistants. Silver also might buy a fidelity bond or fidelity insurance to cover his assistants. See Casebook, p. 928; § 3-405 cmt. 1.

PROBLEM IV.

[Max. points: 7 for A & B, 6 for C & D]

	security		security
	interest		interest
PTM	----->	Maxus	----->
Technologies			GE Capital
Inc.			

A. Why might a missing "h" render the financing statement seriously misleading?

A financing statement is seriously misleading if it "fails sufficiently to provide the name of the debtor in accordance with Section 9-503(a)." § 9-506(b). Under § 9-503(a)(1), the name of a corporation is the name registered with the state. In this case, the registered name was "PTM Technologies, Inc.," not "PTM Tecnologies, Inc."

An exception is that a financing statement is not seriously misleading if a search of the records of the filing office under the debtor's correct name, using the filing office's standard search logic, would disclose the financing statement. § 9-506(b). In this case, if someone entered the correct name "PTM Technologies, Inc.," the search might not disclose a financing statement under the name "PTM Tecnologies, Inc."

B. Does a seriously misleading financing statement necessarily prevent perfection of a security interest?

No. The security interest might be perfected by a method other than filing. Some security interests are perfected automatically. § 9-309. Others are perfected by possession or control. §§ 9-313 & 9-314. Still others are perfected by notation on a certificate of title. § 9-310. In addition, a secured party can file an amended financing statement that is not seriously misleading by providing the correct name of the debtor. § 9-512(d).

C. If PTM had defaulted under the security agreement before declaring bankruptcy, how would filing for bankruptcy affect Maxus and PTM's rights?

If PTM had defaulted before bankruptcy, Maxus and PTM could enforce their security interests even if they were not perfected. They would have all of the rights in part 6 of UCC art. 9. For example, they could have repossessed and sold the collateral to cover their claims. After bankruptcy, any unperfected security interests are subordinated to the rights of the trustee as a hypothetical lien creditor. See 11 U.S.C. § 544(a) (the "strong arm" clause). The secured creditors then effectively lose their rights to the collateral. They must share equally with unsecured creditors.

D. What advice would you have given Maxus and GE Capital in this transaction?

Advice to both Maxus and GE Capital: To verify that Maxus's security interests were perfected by filing, Maxus and GE Capital should have taken the very simple step of searching the UCC filing system for "PTM Technologies, Inc.," the correct name of the debtor. In most jurisdictions, searching is free and takes just seconds on the internet. If the search did not discover a financing statement, they could have filed a new, correct financing statement.

But searching the UCC filing statement is not enough. Maxus and GE Capital also should have checked to make sure that PTM actually had possession of the collateral. If PTM did not have possession of the collateral, the collateral might not actually exist or the person in possession of the collateral might have priority, having perfected by possession.

Advice to GE Capital: GE Capital should amend the financing statement to indicate its status as the new secured party. GE Capital also should review the security agreements that Maxus assigned to it so that it would understand the agreements, including what constitutes a default by PTM.

PROBLEM V.

[Max. points: 7 for A & B, 6 for C & D]

1st Source Bank

Security agreement: tractors and trailers, accounts, and proceeds from the agreed-upon collateral

Financing statement: specified tractors/and or trailers, and "all proceeds thereof"

Wilson Bank & Trust, Pinnacle Bank, and TransCapital & Leasing, Inc.

Security agreement: "all accounts receivable now outstanding or hereafter arising."

Financing statement: "all accounts receivable now outstanding or hereafter arising"

A. Who has priority in Debtors' accounts receivable?

If 1st Source Bank had a perfected security interest in the tractors and trailers, 1st Source Bank would have priority over Wilson Bank & Trust, Pinnacle Bank, and TransCapital & Leasing ("Wilson et al.") in the accounts arising from the lease of the tractors and trailers based on the following reasoning:

1. The accounts arising from leases of the tractors and trailers are proceeds because proceeds include "whatever is acquired upon the . . . lease . . . of collateral." § 9-102(a) (64) (A).
2. 1st Source Bank has a security interest in these accounts because "a security interest attaches to any identifiable proceeds of collateral." § 9-315(a) (2).
3. 1st Source Bank's security interest in these accounts was automatically perfected because "[a] security interest in proceeds is a perfected security interest if the security interest in the original collateral was perfected." § 9-315(c). (Even without the automatic perfection, the financing statement covering "all proceeds" arguably would cover the accounts arising from leasing the equipment, but some courts disagree with this analysis.)

4. 1st Source Bank's security interest did not become unperfected after 20 days because all of the elements for the exception in § 9-315(d)(1) are satisfied: (A) a filed financing statement covers the original collateral (i.e., the tractors and trailers); (B) the proceeds (i.e., the accounts) are collateral in which a security interest may be perfected by filing in the office in which the financing statement has been filed; and (C) the proceeds are not acquired with cash proceeds (i.e., they were acquired from leasing the original collateral).
5. Although Wilson et al. also have a perfected security interest in the accounts, 1st Source has priority under the first-to-file-or-perfect rule in § 9-322(a)(1), because 1st Source filed its financing statement covering the tractors and trailers before Wilson et al. filed their financing statements covering accounts.

Wilson Bank et al. have priority over 1st Source Bank in any accounts receivable that are not proceeds from leasing the tractors and trailers. Although Wilson Bank has a security interest in these accounts under its security agreement with Debtors, this security interest was not perfected because 1st Source Bank's financing statement did not indicate accounts.

B. Suppose Debtors had sold the tractors and trailers to raise funds to pay off their loans. Would 1st Source's security interest, perfection, and priority continue:

1. in the tractors and trailers after their sale?

1st Source's security interest, perfection, and priority would continue in the tractors and trailers, see § 9-315(a)(1), unless 1st Source authorized Debtors to sell free of the security interest, see id., or unless the sales were in the ordinary course of business, see § 9-320(a). 1st Source might have authorized the sale free of the security interest if the purpose was to repay 1st Source's loans. It is not clear whether the sale would be in the ordinary course of business unless Debtors were in the "business of selling goods of that kind." § 1-209(b)(9). The facts suggest that they were in the business of leasing tractors and trailers, but not necessarily selling them.

2. in accounts arising from the sale?

Yes. Accounts arising from the sale of the tractors and trailers would be proceeds, § 9-102(a)(64)(A), and the same rules regarding continuation of the security interest, perfection, and priority that were discussed in the answer to question A above would apply.

3. in chattel paper arising from the sale if Debtors sold the chattel paper to a third party?

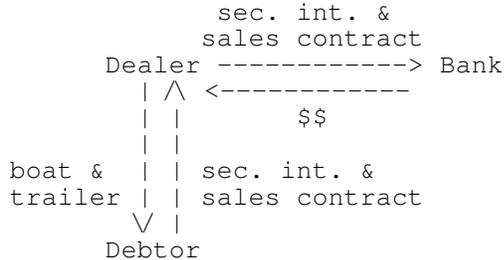
No, assuming that 1st Source Bank authorized the sale of the chattel paper. Chattel paper arising from the sale of the tractors and trailers would be proceeds, § 9-102(a)(64)(A), and the same rules regarding continuation of the security interest, perfection, and priority discussed in the answer to question A above generally would apply. But 1st Source most likely would authorize the sale of the chattel paper free of its security interest, § 9-315(a)(1), so that Debtors would have funds to repay 1st Source. (And even if 1st Source did not authorize Debtors to sell the chattel paper, a buyer "in good faith, in the ordinary course of the purchaser's business, and without knowledge that the purchase violates the rights of the secured party" would have priority over 1st Source's security interest. § 9-330(b).)

Note: The inventory exception for chattel paper in § 9-330(a) might apply if the tractors and trailers are inventory. But it appears that

Debtors were in the business of leasing the equipment rather than selling it.

PROBLEM VI.

[Max. points: 7 for A, 6 for B, C, & D]



A. Did the bank ever have a perfected security interest in the boat?

The answer depends on whether Kansas has a statute (outside the UCC) that requires the kind of boat that The Debtor bought to be indicated on a certificate of title. § 9-311(a)(2). All states require some kinds of boats to have a certificate of title (e.g., large motor boats), but some states exempt certain classes of boats (e.g., canoes). The problem does not indicate what the Kansas statute says or what kind of boat The Debtor bought.

If The Debtor bought a boat that could only be perfected by a notation on a certificate of title, then the bank would not have a perfected security interest because the facts indicate that the bank's security interest was noted on the certificate of title to the trailer but not the boat.

Note: The automatic perfection of a purchase-money security interest in consumer goods does not apply to consumer goods that must be perfected by notation on a certificate of title. § 9-309(a) (automatic perfection except for consumer goods subject to a statute in § 9-311(a)).

B. Would noting the lien on the Oklahoma certificate of title have perfected the security interest in the boat if the boat should have had a certificate of title issued by Kansas?

Yes. The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection. § 9-303(c). It does not matter which state issues the certificate of title. Section 9-303(c) "applies to goods covered by a certificate of title, even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor." § 9-303(a). See also id. cmt. 1; Meeks v. Mercedes-Benz Corp.

C. If the Debtor had not declared bankruptcy, and the government had imposed a federal tax lien on the boat, would the federal tax lien have priority over the bank's security interest?

The text of revised article 9 indicates that the answer is no. A UCC security interest defeats a federal tax lien only if, at the time the tax lien arises, three requirements are met. See 16 U.S.C. § 6323(a), (h); Casebook, p. 248. First, the security interest must be in existing collateral (i.e., not after acquired property). This requirement is met because the bank has a security interest in the boat. Second, the security interest must secure funds already advanced (i.e., not future advances). This requirement is met because the Dealer extended the credit for buying the boat. Third, the security interest must be protected against a judgment lien. A security

interest can be protected against a judgment lien in two circumstances. One circumstance is that the security interest is perfected. § 9-317(a)(2)(A). In this case, the security interest was not perfected because it was not recorded on a certificate of title. § 9-311(a)(2). The other circumstance is that "one of the conditions specified in Section 9-203(b)(3) is met and a financing statement covering the collateral is filed." § 9-317(a)(2)(B). One of the requirements in § 9-203(b)(3) is that the parties have signed a security interest. In this case, the parties have signed a security agreement giving Bank a security interest in the boat and the Bank filed a financing statement identifying the boat as collateral.

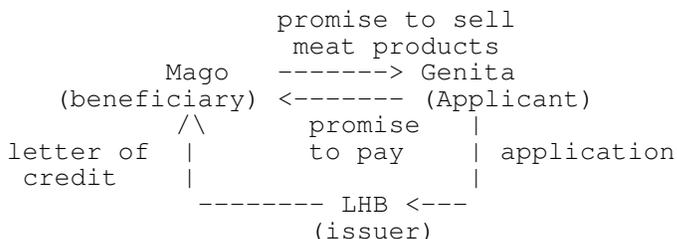
Note: Full credit was given to anyone who addressed the language of § 9-317(a)(2)(B), regardless of the conclusion reached about its application. The answer above is controversial because Pre-revision U.C.C. art. 9 cases say that a judgment lien takes priority over a security interest which has not been noted on a certificate of title even though a financing statement has been filed. See, e.g., Westenhoefer v. Navistar Fin. Corp., 155 B.R. 7, 8 (Bankr. E.D.Ky. 1993) ("Where a creditor has properly filed a financing statement but the clerk has failed to note the lien on the certificate of title, the lien is unperfected and the trustee in bankruptcy, as a judgment lien creditor, prevails over the unperfected lien creditor.").

D. If a lender had a perfected security interest in the Dealer's inventory, who would have priority in the contract that the Dealer assigned to the Bank?

The Bank would have priority over the lender. The contract would be for chattel paper. § 9-102(a)(11). Although the contract would be proceeds of the inventory, § 9-102(a)(64)(A), and the lender therefore would have a security interest in the contract, § 9-315(a)(2), the Bank would have priority in the contract under the special rule concerning the assignment of chattel paper. § 9-330(a) ("A purchaser of chattel paper has priority over a security interest in the chattel paper which is claimed merely as proceeds of inventory").

PROBLEM VII.

[Max. points: 7 for A, 6 for B, C, & D]



A. If the letter of credit did not expressly specify that the bills of lading must be signed, how might LHB justify its actions?

LHB might argue that its decision to honor or dishonor presentations must comply with the "standard practice" of issuers. § 5-108(a),(e). If the standard practice requires bills of lading to be signed, even if the letter of credit does not expressly specify that they must be signed, then LHB was required to dishonor the presentations.

B. If LHB wrongfully dishonored Mago's presentations, what rights would Mago and Genita have?

Mago (the beneficiary) and Genita (the applicant) both would have claims against LHB (the issuer) for wrongful dishonor. § 5-111(a) (claim of beneficiary for wrongful dishonor); § 5-111(b) (claim of applicant for wrongful dishonor). Mago could recover the amount of the letter of credit, plus incidental damages (like communication costs), and attorney's fees, less any damages actually avoided (which appear to be none because Genita has not paid). It is difficult to see how Genita would be injured by LHB's dishonor of the letter of credit, but perhaps it suffered some incidental damages also. In addition, under the independence principle, Mago would have a claim against Genita for breach of contract because Genita did not pay the invoices. § 5-103(d).

C. What steps could LHB have taken to avoid a dispute?

LHB actually did take one important step to avoid a dispute: LHB informed Mago of exactly why it was dishonoring the presentation and what Mago needed to present. LHB complied with § 5-108(b)(3) in this regard. Mago should have made a conforming presentation before the letter of credit expired.

LHB could have taken two additional steps to avoid a dispute. First, LHB could have refused to issue the letter of credit until the application expressed the documents to be presented in a clearer manner (i.e., specified whether the bills of lading needed to be signed). Second, once Mago presented the unsigned bills of lading, LHB could have asked Genita to waive any discrepancy. § 5-108 & cmt. 2, ¶4.

D. What advice would you have given Mago when Mago, Genita, and LHB were setting up and executing the transaction?

When setting up the transaction, Mago should have understood what documents Mago would have to present in order to obtain payment under the letter of credit. If it was unclear whether the bills of lading had to be signed, Mago should have asked.

Mago also should have insisted that the letter of credit require presentation only of documents that Mago could easily produce. In this case, it was not wise for Mago to agree to produce signed bills of lading if Mago would have difficulty obtaining them. Given that the parties agreed to use a standby letter of credit, Mago should have pushed for only requiring an affidavit attesting that Mago had shipped conforming goods, that Mago had sent Genita invoices, and that Genita had not paid the invoices when they were due. Mago would have had no difficulty producing such an affidavit.

Mago should have immediately addressed the discrepancy that was identified by LHB. Rather than re-presenting the unsigned bills of lading or presenting telexes, Mago should have done what was necessary to obtain and present the signed bills of lading before the letter of credit expired.

Mago also should have contacted Genita and asked Genita to waive the discrepancy.

If Mago was worried about whether Genita would pay for the goods, or LHB would not pay the letter of credit, Mago might have structured the transaction so that it did not ship and invoice all four installments before receiving any payment. Mago also might have decided to sell to Genita only for cash, thus avoiding the risk of non-payment by both Genita and LHB.

Grading Guide for Final Examination In
SECURED TRANSACTIONS & COMMERCIAL PAPER
(Course No. 6281-10; 4 credits)

Professor Gregory E. Maggs

In Problems I-V, questions A and B were worth 7 points, and questions C and D were worth 6 points. In Problems VI-VII, question A was worth 7 points, and questions B, C, and D were worth 6 points.

PROBLEM I.

	PTO McKee				returned			
	HGE	McKee			unpaid			
Houston	----->	McKee	----->	RR Maloan	----->	Houston	----->	RR Maloan
Gold	<-----					Gold	<-----	
Exchange	watch					Exchange's		Bank

A. What arguments should RR Maloan make in its lawsuit against Houston Gold Exchange?

RR Maloan should make three arguments. First, Houston Gold Exchange, as the drawer of the check, is liable on the check because the check was dishonored by the drawee, Houston Gold Exchange's bank. § 3-414(b). Second, RR Maloan is entitled to enforce the check under § 3-301(i) as a holder. RR Maloan is a holder because the check was issued to McKee, and McKee negotiated the check to RR Maloan. § 3-201(a); § 1-201(21)(b). Third, although Houston Gold Exchange may have a claim in recoupment for breach of warranty against McKee because the Rolex watch was not genuine, RR Maloan is not subject to this claim in recoupment because RR Maloan is a holder in due course. § 3-305(a)(3), (b). From the facts, it appears that RR Maloan is a holder in due course because it took the check in good faith, for value, and without notice of the claim in recoupment (or other problems). § 3-302(a)(2).

B. Does RR Maloan have any rights against McKee or Houston Gold Exchange's bank?

RR Maloan would have a claim against McKee based on McKee's indorsement of the check (unless McKee indorsed the check without recourse) because an indorser is liable on a check if it is dishonored. § 3-415(a).

RR Maloan also may have a claim against McKee for breach of the transfer warranty that no one could assert a claim in recoupment against McKee. § 3-416(a)(4). As noted above, Houston Gold Exchange may have a claim in recoupment against McKee for breach of the warranty that the watch was a Rolex. But if RR Maloan is a holder in due course, and is not subject to Houston Gold Exchange's defense, then RR Maloan likely will not have suffered any damages from this breach of transfer warranty. § 3-416(b).

RR Maloan has no rights against Houston Gold Exchange's bank. As the drawee, the bank had no duty to the holder to pay the check. § 3-408.

C. What rights, if any, would Houston Gold Exchange's bank have if it had paid the check?

Houston Gold Exchange's bank could revoke the payment if it returned the check by its midnight deadline. § 4-215(a)(2).

If Houston Gold Exchange's bank did not return the check by its midnight deadline, the bank would not have a right to charge Houston Gold Exchange's account because the check was not properly payable given the stop payment order (assuming the stop payment order was received in time for the bank to act). § 4-401(a); § 4-403(a). But upon payment, the bank would be subrogated to RR Maloan's rights against the drawer, and therefore could enforce the check against Houston Gold Exchange. See § 4-403 cmt. 7. And if RR Maloan is a holder in due course, then the bank would be subrogated to the rights of a holder in due course against the drawer, § 4-407(1), and Houston Gold Exchange could not assert its apparent claim in recoupment against RR Maloan, § 3-305(b).

Houston Gold Exchange's bank could recover from RR Maloan or McKee under a theory of restitution for mistaken payment under § 3-418(a)(i), unless the Price v. Neal exception in 3-418(c) applies. The Price v. Neal exception probably applies to RR Maloan, which appears to have taken the check in good faith and for value. But the Price v. Neal exception would not apply to McKee if McKee did not act in good faith in selling the watch.

D. Houston Gold Exchange attempted to protect itself by issuing a post-dated check and then a stop payment order. How effective were these measures? Were there better options?

Stopping payment on a check may have protected Houston Gold Exchange in a typical transaction in which all of these conditions are met: (1) the payee does not negotiate the check to a holder in due course but instead deposits the check directly into his or her bank; (2) Houston Gold Exchange stops payment before the check is presented to the payor bank; and (3) the payor bank dishonors and returns the check before the payee withdraws any credit given by the depository bank. In such cases, although the payee (in this case McKee) would have a right to enforce the returned check against Houston Gold Exchange, § 3-414(b), Houston Gold Exchange could assert any defense or claim in recoupment that it might have, § 3-305(b). (Note: Under § 4-401(c), a bank may pay a post-dated check before the date on the check unless the customer notified the bank of the postdating.)

But stopping payment was not effective in this case because it could not prevent a holder in due course such as RR Maloan from enforcing the check. A better method would be for Houston Gold Exchange not to issue a check until it knows that there will be no defenses. For example, perhaps Houston Gold Exchange could have inspected the purported Rolex watch carefully before paying for it. Paying with a negotiable instrument is like paying with cash if the negotiable instrument is negotiated to a holder in due course.

PROBLEM II.

PTO Merchants Banks
\$400,000
/s/ David
/s/ Elizabeth

A. If David had answered the complaint, but did not deny the authenticity of his signature or raise any defense, what evidence would Merchants Bank need to present at trial to prevail against him on the note?

The only evidence that Merchant's Bank would need to present would be the note itself. Under § 3-308(a), the validity of the signatures on the note would be admitted because they were not specifically denied. Under § 3-

308(b), because the validity of the signatures is admitted and there is no defense, Merchants Bank would only have to show that it was entitled to enforce the note. Producing the note would prove that Merchant's Bank was a holder because it would show that Merchant's Bank is in possession of the note and that the note is payable to it. § 1-201(b)(21). As a holder, Merchant's Bank would be entitled to enforce the note. § 3-301(i). (Note: This question is very similar to Prob. (1), pp. 649-650.)

B. How should Merchants Bank respond to Elizabeth's arguments?

In response to Elizabeth's argument that she signed the note only "to give a security interest in her and David's residence" but not to incur liability for paying the note, Merchants Bank should argue that Elizabeth signed the note in the same capacity as Michael, that she is therefore a co-maker of the note, and that as a co-maker she is jointly and severally liable on the note. § 3-412(a), § 3-116(a).

In response to Elizabeth's argument that she did not receive consideration, Merchants Bank should make alternative arguments depending on whether Elizabeth is an accommodation co-maker or an ordinary co-maker (see next question). If Elizabeth is an accommodation co-maker because she did not receive a direct benefit from the loan, then lack of consideration is not a defense. Although an ordinary maker of an instrument has a defense if the instrument is issued without consideration, § 3-303(b), an accommodation party cannot raise this defense, § 3-419(b). On the other hand, if Elizabeth is not an accommodation maker then by the definition of accommodation maker in § 3-419(a), she received a direct benefit from the loan, which would be consideration for promising to pay. (Note: The holder in due course doctrine would not strip away a defense of lack of consideration because (a) Merchants Bank would have notice of this defense and (b) the doctrine in any event only strips away defenses "against a person other than the holder," § 3-305(b).)

C. If Elizabeth pays Merchants Bank, what rights will she have?

Elizabeth's rights depend on whether she is an accommodation co-maker or an ordinary co-maker. A co-maker who does not receive a direct benefit from the loan is an accommodation co-maker. § 3-419(a). The facts suggest that Elizabeth did not receive a direct benefit from the loan because it was a business loan to David and Merchants Bank reviewed David's financial information in making the loan. But more information would be necessary to say for sure whether she received a direct benefit. If Elizabeth is an accommodation co-maker because she did not receive a direct benefit from the loan, she will have a right to reimbursement from Michael. § 3-419(f). In addition, she will be subrogated to Merchants Bank's rights to the collateral. § 3-419 cmt. 5. If she is an ordinary co-maker and not an accommodation co-maker, then she will have only a right to contribution from David. § 3-116(b).

D. How, if at all, would the rights of the parties be different if Elizabeth had written the words "for accommodation" or "without recourse" next to her signature?

If Elizabeth had written the words "for accommodation" next to her signature, the words would create a presumption that she is an accommodation party. § 3-419(c). But as explained above, the facts already suggest that she is an accommodation party, with or without those words, because she did not receive a direct benefit from the loan. § 3-419(a).

If Elizabeth had written the words "without recourse" next to her signature, then she would not have personal liability on the note. § 3-415(b). Merchants Bank could still exercise its rights against the collateral--the residence that she co-owned with David--but it could not

RBS Citizens Bank did not lose any rights by destroying the original checks because a substitute check can be used for all purposes. Check 21 Act § 5003(b).

D. What advice would you give Goodson about potential risks in these two transactions and how to avoid them?

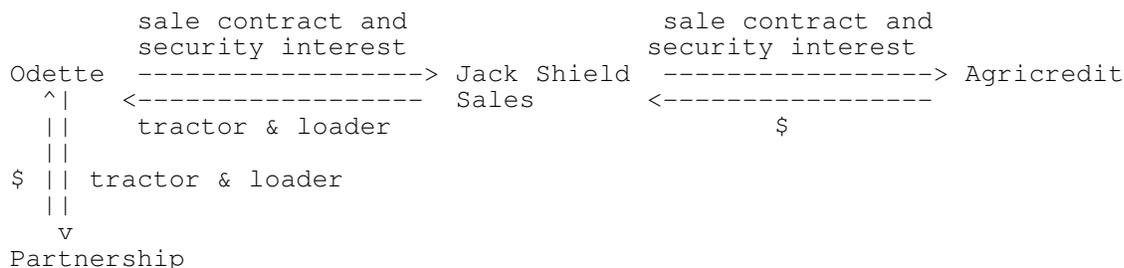
Goodson may not have incurred a loss in this case because the loss for forged checks usually falls on the payor bank. But Goodson faced a risk that First America Bank would dishonor and return the checks and that RBS Citizens Bank would revoke any credit to his account under § 4-214(a). Revoking the credit could cause Goodson to suffer a loss if he had already sent the money to Anderson and could not get it back.

Goodson could avoid the risk that First American Bank would dishonor the checks by determining whether the checks were properly payable and whether First Aid Corp. had enough money in its account to pay the check. To determine whether the checks were properly payable, Goodson should have called First American Bank to ask whether it actually had issued the checks to Anderson and by requiring Anderson to prove he was in fact the intended payee. He could also ask First American Bank whether First Aid Corp. had a sufficient balance to clear the checks.

Goodson could avoid a loss if RBS Citizens Bank revoked the credit from his account by not forwarding the money to Anderson until the checks had been finally paid. (Note: Writing "without recourse" on the checks would not prevent RBS Citizens Bank from revoking credit.)

Anderson's story sounds a lot like other fraudulent scams involving complex stories by foreigners for why they need assistance with checks and bank accounts. It might be better to avoid all risks and all hassles if something goes wrong by just not getting involved.

PROBLEM IV.



A. How did the transfer of the tractor and loader to the Partnership affect Agricredit's rights?

The transfer of the tractor most likely did not diminish Agricredit's security interest in the tractor. Unless an exception applies, the buyer of goods takes the goods subject to any security interest in the goods. § 9-315(a)(1). It seems unlikely that any exception would apply in this case. The Partnership would have notice of the security interest if the security interest was indicated on a certificate of title, which the state probably requires for tractors and loaders, § 9-311(a)(2). In addition, the Partnership presumably did not buy the tractor and loader in the ordinary course unless Odette is in the business of selling such equipment.

Transfer of the tractor and loader to the Partnership was a default under the security agreement. Under § 9-601(a), this default gave Agricredit

whatever rights were provided in the security agreement and all the rights identified in part 6 of UCC art. 9, including the rights to proceed judicially or to take possession of the property.

B. Why might Agricredit have decided to seek a writ of execution and have the sheriff seize the tractor and the loader instead of privately taking possession of them?

Agricredit may have been worried that it could not take possession of the tractor and loader without a breach of the peace, § 9-609(b), and would have faced liability if it caused a breach of the peace, see Williams v. Ford Motor Credit. In addition, if the sheriff damaged the Partnership's property when repossessing the goods, then Agricredit would not be liable. See Major's Furniture v. Castle Credit.

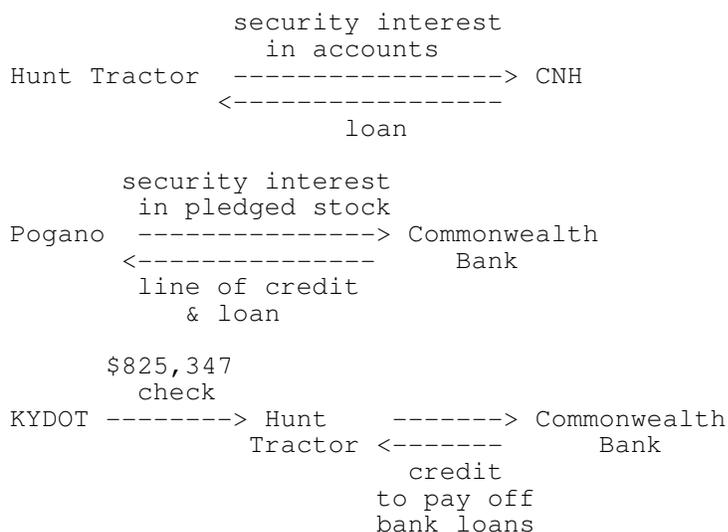
C. For what business purpose might Jack Shields Sales and Service have assigned the sales contract to Agricredit?

Jack Shields Sales might have preferred to have the immediate cash from selling the sales contract to Agricredit than to have periodic payments from Odette. Jack Shield Sales may have needed the immediate cash to buy additional inventory and to pay its operating expenses. Agricredit might have purchased the sales contract at a discount (i.e., for less than what Odette promised to pay) and therefore would make a profit in the transaction. See, e.g., Co-Mac v. Riddle.

D. What advice would you have given the Partnership when it was contemplating acquiring the tractor and loader?

The Partnership should have determined whether the tractor and loader were subject to a security interest. In most states, tractors and farm vehicles are subject to certificate of title statutes. § 9-311(a)(2). In those states, any security interests would be identified on the certificate. If the Partnership still wanted to purchase the items, it should have contacted Agricredit to obtain permission. If the tractor and the loader were not covered by a certificate of title, the Partnership should have checked financing statements in the state in which Odette lives, § 9-301(1), and previously lived within the past four months, § 9-316(f)(2).

PROBLEM V.



A. Why would Pagano pledge his own property as collateral for a loan to Hunt Tractor?

If a lender believes that a small business is not sufficiently creditworthy for a loan, the lender may ask the owner of the small business to guarantee the loan or provide collateral for a loan. One example is Madison Capital v. S & S Salvage. In this case, Commonwealth Bank may have thought that Hunt Tractor was not creditworthy because Hunt Tractor had already given a security interest in most of its assets to CNH.

Pagano might be willing to pledge his own property as collateral for a loan to Hunt Tractor because he is the co-owner of the business. If the loan will benefit Hunt Tractor, then it indirectly will benefit him as well. He may have information which causes him to believe that the business is more creditworthy than Commonwealth Bank thinks that it is.

B. Assume Hunt Tractor gave Commonwealth Bank a security interest in its checking account when it obtained the Bank Loans. What would determine who had priority in the \$825,347.00 deposited into the account?

The first-to-file-or-perfect rule in § 9-322(b)(1) would determine who had priority in the deposit. If CNH had filed a financing statement covering either the inventory or the proceeds of the inventory before the check was deposited, then CNH would have a perfected security interest in the check. § 9-315(c). This perfection would continue into the bank account because the bank account would be cash proceeds. § 9-315(d)(2); § 9-102(a)(9).

On the other hand, if CNH had not filed a financing statement, Commonwealth Bank would have priority when the check was deposited. Commonwealth's security interest would be perfected by its control over the deposit account. § 9-314(a); § 9-104(a)(1).

C. What interest, if any, does CNH have in the backhoes that were sold to KYDOT?

Absent an agreement to the contrary CNH would not have any interest in the backhoes after they were sold to KYDOT. Under § 9-320(a), a buyer in ordinary course of business--as KYDOT apparently was in this case--takes free of a security interest created by the buyer's seller (i.e., Hunt Tractor), even if the security interest is perfected and the buyer knows of its existence. Otherwise, no one would buy goods from a merchant if the merchant had financed its inventory.

D. What advice would you have given CNH in drafting the security agreement with Hunt Tractor?

The problem here is that Hunt Tractor misused the proceeds from the sale of inventory to pay back a loan to Commonwealth Bank rather than to repay CNH's loan. Pagano may have caused Hunt Tractor to take this action because Commonwealth Bank could have foreclosed on the stock that Pagano had pledged as collateral and Pogano did not want that to happen. CNH may be protected, as described above, because of its security interest in the proceeds from the sale of the backhoes. But CNH could have given itself even more protection by specifying in the security agreement that it would be a default for Hunt Tractor (1) to incur any other indebtedness without permission; (2) to pay off any other indebtedness without permission; or (3) to use the proceeds from the sale of inventory other than in specified ways. These clauses or similar ones might have dissuaded Hunt Tractor and Pagano from acting as they did.

PROBLEM VI.

Inventory Financing/Floor planning

security interest in
accounts, chattel paper,
equipment, inventory
Integrity -----> Eclipse
<----- (inventory/floor-planning lender)
loan to buy inventory

Sale of chattel paper

chattel paper
(sales contracts granting
security interests)
Snowbear -----> Integrity
<-----
trailers
chattel paper
-----> Action
<-----
\$\$

Additional Financing

security interest in
accounts and contract rights
Integrity -----> Action
<-----
loans

A. What arguments might Eclipse and Action make in support of their respective claims of priority in this case?

Eclipse (the inventory lender) and Action (the chattel paper purchaser) each claim priority in the 1700 trailers that were sold to Snowbear but that were still in Integrity's possession at the time of default.

Eclipse's arguments: If the trailers were still inventory (i.e., if title to them had not passed to Snowbear), then Eclipse will argue that it had priority over them because the security agreement did not give Action a security interest in inventory. Alternatively, if title to the trailers had passed to Snowbear, Eclipse will argue that it has priority because its original security interest in the trailers persisted notwithstanding the sale. Although a buyer in the ordinary course generally takes goods free of any security interest, § 9-320(a), this rule does not apply when the seller retains possession, § 9-320(e).

Action's argument: If Snowbear granted a security interest in the trailers to Integrity when it bought them on credit, and Integrity sold the chattel paper to Action, then Action will argue that it has priority under the rule that the purchaser of chattel paper (i.e., Action) has priority over the inventory financier (i.e., Eclipse) who claims a security interest only as proceeds. § 9-330(a).

B. Why might a subordination agreement have been necessary to make Eclipse's interest in Integrity's accounts subordinate to Action's interest in those accounts?

Ordinarily, the first-to-file-or-perfect rule would determine which of the two secured parties had priority. § 9-322(a)(1). If the parties wanted Action to have priority, a subordination agreement might have been necessary because Eclipse may have been the first to file a financing statement covering the accounts or any proceeds of other collateral in which Eclipse had priority that would be deposited into the accounts.

below), after WTC honored it by paying Sussex County, WTC acquired a right to reimbursement from Reserves. § 5-108(i). In addition, WTC became subrogated to Sussex County Council's rights against Korotki. § 5-117(a). WTC could recover from Korotki based on Korotki's guarantee. See Ochoco Lumber v. Fibrex.

B. Could WTC pay the \$2,216,233.00 only if this amount was in fact reasonable and necessary to complete construction?

The facts do not provide enough of the text of the letter of credit to answer this question definitively.

If the letter of credit (1) made payment dependent on a documentary presentation asserting that "satisfactory performance has not occurred," and (2) said the bank would honor the letter of credit by paying drafts up to \$2,216,233, then the actual amount that was reasonable and necessary to complete construction would not matter. The independence principle would make the underlying obligation independent from the letter of credit. § 5-103(d).

But the facts seem to say that WTC is undertaking (1) to pay only if performance is in fact not satisfactory, and (2) to pay only the amount that is actually reasonable and necessary. If this is true, then the "letter of credit" would not meet the definition of a letter of credit in § 5-102(a)(8) because payment would not depend on a documentary presentation. A court might construe the document as an ordinary guaranty. Wichita Eagle v. Pacific Nat'l Bank. Accordingly, only the actual money owed would be due.

C. How might WTC respond to the contention that its request for attorney's fees is unconscionable?

Section 5-111(e) says that "[r]easonable attorney's fees . . . must be awarded to the prevailing party in an action in which a remedy is sought under this article [i.e., article 5, which governs letters of credit]." Under this provision, WTC could recover attorney's fees from Reserve if (1) WTC prevails in an action to obtain reimbursement under § 5-108(i), and (2) the attorney fees are reasonable. But WTC could not recover an unreasonable or unconscionable amount of attorney fees.

Section 5-111(e) would not apply to an action by WTC to enforce Korotki's guarantee because that is not an action under article 5. Likewise, § 5-111(e) would not apply at all if the document in question is not a letter of credit. But it seems unlikely that a contract term providing for attorney's fees in a business transaction is per se unconscionable. Of course, the amount of the fees requested in a particular case could be unconscionable if the amount was too high.

D. Given the letter of credit securing Reserves' obligations, was it reasonable to ask Korotki for a personal guarantee?

Although the guaranty and the letter of credit are redundant in that they both back up Reserve's obligation to pay Sussex County, both Sussex County and WTC have grounds for arguing that asking for the personal guarantee was not unreasonable. WTC may have wanted Korotki to make the guaranty because it was worried that Reserves would lack the funds to reimburse WTC after WTC paid the letter of credit under § 5-108(i), which may have happened here. Sussex County may have wanted Korotki to guaranty Reserve's obligation because Sussex County may have been worried that Reserve would challenge WTC's payment of the letter of credit, which also happened here.

Grading Guide for Final Examination In
SECURED TRANSACTIONS & COMMERCIAL PAPER
(Course No. 6281-10; 4 credits)
Professor Gregory E. Maggs

PROBLEM I.

(26 points)

PTO PNB
/s/ Griscom Street
/s/ Smith, guarantor
Griscom -----> GreenPoint -----> PNC ----> FDIC ----> Bank
Street Mortgage

A. Must the Bank prove its ownership of the Promissory Note in order to enforce it?

No. The Bank does not have to prove its ownership of the note. The Bank can prove that it is entitled to enforce the note by showing that it is the holder of the note or a non-holder in possession with the rights of a holder. § 3-301(I) & (ii). Neither of these statuses would require the Bank to be the owner of the check. The Bank would be a holder if it was in possession of the instrument and the instrument was payable to the Bank or bearer. § 1-201(a)(21). The Bank would be a non-holder in possession with the rights of a holder if the instrument was transferred directly or indirectly to the Bank by a holder. § 3-203(b). For example, the Bank would be a non-holder in possession with the rights of a holder if PNC was a holder of the note but did not indorse the note when its assets were taken over by the FDIC (which is likely if the assets were transferred in bulk).

B. Under what circumstances, if any, would the Bank take the note free of Smith's asserted defense of unconscionability?

The Bank would take the note free of Smith's asserted defense of unconscionability if (1) unconscionability is an ordinary contract defense and (2) the Bank either (a) is a holder in due course or (b) has the rights of a holder in due course.

Under § 3-305(b), a holder in due course (or person having the rights of a holder in due course) takes an instrument subject to the "real" contract defenses listed in § 3-305(a)(1) but free of the "ordinary" contract defenses listed in § 3-305(a)(2). Unconscionability is not one of the defenses listed in § 3-305(a)(1), and it therefore appears to be an ordinary defense. Our textbook briefly discusses the argument that a holder in due course would take free of the defense of unconscionability on p. 690.

The Bank would be a holder in due course only if it met all of the requirements in § 3-302(a) or took the instrument from someone who met all of those requirements, see § 3-203(b). One of these requirements is that the person must take the instrument without notice of defenses. § 3-302(a)(2)(vi). Smith will argue that the Bank and everyone else who took the note had notice of the "extremely one-sided clauses" that in his view make the note unconscionable because these clauses appear in the note itself. The problem does not provide enough information to determine whether the terms of the note actually are unconscionable or whether the other requirements for holder in due course status are met.

Note: Although there are exceptions to the holder in due course doctrine for consumer transactions, this is not a consumer transaction because a corporation, Griscom Street LLC, made the note.

C. What rights would Smith have if he pays the Note?

The problem says that Smith "guaranteed" the note. A person who signs a note as a "guarantor" is presumed to be an accommodation party. § 3-419(b). As an accommodation party, Smith would have the right to reimbursement from Griscom Street, the accommodated party. § 3-419(e). Smith also would be subrogated to the Bank's right to enforce the mortgage. § 3-419 cmt. 5; Plein v. Lackey. The payment would also discharge Smith's liability on the note. § 3-602(a).

D. If the Bank cannot recover from Smith, who else might be liable to the Bank?

The Bank could recover from Griscom Street as the maker of the note. § 3-412. The Bank could also recover from GreenPoint, PNB, or the FDIC if they indorsed the note. The indorser of a note is liable if the note is dishonored, unless the indorser has signed without recourse (which would be uncommon in the transfer of mortgage notes). § 3-415(a). GreenPoint likely indorsed the note when GreenPoint sold the note to PNB. If the FDIC acquired and sold PNB's assets in bulk, it is possible that neither PNB nor the FDIC indorsed the note.

The FDIC made transfer warranties to the Bank if it transferred the note for consideration and did not disclaim the warranties. § 3-416(a). GreenPoint and PNB also would have made transfer warranties that would extend to the Bank if they had indorsed the note, transferred it for consideration, and did not disclaim the warranties. § 3-416(a). One transfer warranty is that the maker cannot assert any defenses against the transferor. § 3-416(a)(4). The FDIC and the other transferors may have breached this warranty if Griscom Street had a valid defense of unconscionability and the transferors are not holders in due course and do not have the rights of a holder in due course.

PROBLEM II.

(26 points)

Troy Bank										
PTO Cile			check							
\$100,000			misencoded							
/s/ Gilley			as \$1000							
Gilley	----->	Cile	---->	Citizens	---->	Federal	---->	Troy	---->	Gilley
			<----	Bank	<----	Reserve	<----	Bank	<----	
			\$1K/\$99K			\$1K/\$99K		\$1K/\$99K		\$1K/\$563.57

A. Why might Troy Bank have believed that it had a duty to make a final payment of \$99,000 even if there were insufficient funds in Gilley's account when the payment was made?

Troy Bank may have believed that it had a duty to make a final payment of \$99,000 because a payor bank that does not return a check by its midnight deadline is accountable for the amount of the check. § 4-302(a)(1). Troy Bank missed its midnight deadline for returning the check to Citizens Bank because it never returned the check. The amount of the check was \$100,000 because Gilley drew the check for that amount; the error in encoding did not affect the amount of the check. § 4-209 cmt. 2. Because Troy Bank had only paid \$1000, it would still owe \$99,000.

Note: A separate but closely related question is whether Troy Bank may

have believed that it had a duty to pay the check when it was initially presented. A payor bank is not liable on a check, § 3-408, and is free to revoke a settlement prior to its midnight deadline, § 4-301(a)(1). But Troy Bank might have worried that it would be liable to Gilley for wrongful dishonor if it did not pay the check because the check was properly payable and Gilley had sufficient funds to pay the check. § 4-402(a).

B. What amount may Troy Bank charge against Gilley's account?

Troy Bank may charge \$100,000 against Gilley's account. The payor bank may charge its customer for the full amount of a properly payable check, even if this causes an overdraft. § 4-401(a). The full amount is the amount which the drawer authorized -- \$100,000 -- not the encoded amount. § 4-209 cmt. 2.

C. On what legal theory might Troy Bank support its claim against Citizens Bank?

Troy Bank would have a claim against Citizens Bank for breach of encoding warranty under § 4-209(a) because Citizens Bank did not properly encode the check. Troy Bank can assert that \$98,436.43 is the amount that it lost as a result of the breach, § 4-209(c), because it would have debited Gilley's account while he still had \$100,000 if the check had been properly encoded.

D. If Citizens Bank pays the amount claimed by Troy Bank, what rights, if any, will it have against Gilley and Cile?

Citizens Bank will have no rights against Cile. A depository bank can revoke credit given for a check only if it fails to receive final payment. § 4-214(a). In this case Citizens Bank did receive final payment when Troy Bank paid the full \$100,000 for the check. Although Citizens Bank may be liable to Troy Bank for breach of an encoding warranty, nothing in the UCC allows Citizens Bank to pass this liability for its error on to Cile.

If Citizens Bank pays Troy Bank the amount of money that Troy Bank is unable to recover from Gilley, Citizens Bank arguably should be subrogated to Troy Bank's claim against Gilley for the amount of the check under § 4-401(a). But no provision in § 4-209 expressly affords this right.

PROBLEM III.

(26 points)

PTO Martha <-- *nominal payee*
 \$188,473
 /s/ Jay's estate,
 by Cochonour, "Pay Jones & Co.
 Executor Martha" <-- *signed by Cochonour*
 Cochonour -----> Cochonour -----> Jones ----> Dep. ----> Payor ----> Jay's
 <----- & Co. <--- Bank <--- Bank <--- Estate

A. What claims might Martha assert?

Martha might assert a claim against Jay's estate for \$400,000, which is the amount of her inheritance. The check issued by Cochonour did not suspend this underlying obligation, in whole or in part, because Martha never "took" the check in payment. § 3-310(b).

Martha does not have a claim for conversion against Jay's estate (or against Cochonour) because she never received delivery of the check. § 3-420(a)'s last sentence.

B. What claims might Jay's estate assert?

Jay's estate might assert a claim against Cochonour, outside of the UCC, for misappropriation of the estate funds.

Jay's estate does not appear to have a claim against the payor bank for paying a check that was not properly payable. § 4-401(a). The bank will assert that the check was properly payable for two reasons. First, Cochonour had authority, as the executor of Jay's estate, to issue checks on behalf of the estate. § 3-402(a). Second, the check was made payable to a "nominal payee" because Cochonor evidently did not intend the person identified as the payee -- Martha -- to have any interest in the check. § 3-404(b). As a result, Cochonour's indorsement in the name of Mary was effective in favor of the bank. § 3-404(b)(2).

C. In subsequent litigation, the parties disagreed about whether Jones and Company had a duty "to ask Martha--the payee and purported endorser of the check--about the validity of that instrument." Did Jones and Company have this duty?

Under § 3-404(d), Jones & Company had a duty to exercise ordinary care when taking the check payable to Martha as a nominal payee and would be required to share the loss from the check if it did not exercise ordinary care. Ordinary care requires observance of reasonable commercial standards of fair dealing. § 3-103(a)(9). The parties are likely to dispute whether such standards would require inquiry into the validity of the signature. The estate might argue that the check was for a very large amount, that Jones & Company likely could tell from the signatures on the check that Cochonour was the trustee of the estate, and that it would be highly irregular for the payee of such a large check to sign it back over to the executor. It will assert that in these circumstances, good faith required inquiry. The decision in Maine Family Federal Credit Union v. Sun Life, although not directly on point, supports this argument by suggesting a higher standard for someone taking a check from a fiduciary. Jones & Company might respond that the entire premise of negotiable instrument law is that person taking an instrument has no duty to inquire into the validity of signatures or the nature of the underlying transaction that gave rise to the instrument. As Grant Gilmore wrote: "The stranger who purchased the [negotiable instrument] in the market was entitled to do so without inquiry into the facts of the underlying transaction or of previous transfers of the bill and without being affected by them." Textbook, p. 645. In further support of its position that a person taking an instrument need not conduct an investigation, Jones & Company will also cite the existence of transfer warranties which put the duty on the transferor rather than the transferee, § 3-416(a); the ability of a person to become a holder in due course so long as the person has no notice of irregularities (without an explicit duty to inquire), § 3-302(a); and the general presumption of the validity of signatures, § 3-308(a).

D. Under what circumstances, if any, might the holder in due course doctrine shield any of the parties from the claims of others?

If Jay's estate makes a claim for the check or its proceeds under § 3-306, Jones and Company and the depository bank may assert that they are holders in due course and took the instrument free of such claims. They are holders, even though Martha did not indorse the check, because Martha was merely a nominal payee. § 3-404(b). In addition, they would be holders in due course if they took the check in good faith, for value, and without notice of claims and defenses. The problem does not provide sufficient facts with respect to these elements.

Note: It probably does not matter that the check was indorsed "pay Jones & Co." An instrument must be payable to order only at the time it is issued, § 3-104(a)(1), and even this requirement is loosened for checks, § 3-104(c).

PROBLEM IV.

(26 points)

A. Is Barretts's argument under § 9-203(b) (2) correct?

No. Section 9-203(b) says that a security interest in collateral cannot attach until "the debtor has rights in the collateral or the power to transfer rights in the collateral to a secured party." Barretts's argument is that Lucky Moon did not have rights in the cattle because it had not yet paid for the cattle. This argument is wrong for three reasons. First, Lucky Moon has paid for some of the cattle, and therefore presumably owned at least them. Second, whether a buyer has paid for goods does not determine whether a buyer has rights to the collateral or the power to transfer rights. In most cases in which a buyer buys goods on credit, the buyer obtains title to the goods before paying the full price. Third, in this case, we know that Lucky Moon had at least a possessory right to the collateral that it had not paid for.

B. Could Barretts prevail by arguing that it had a perfected security interest in the cattle under § 9-309(2)?

No. Section 9-309(2) says that "[t]he following security interests are perfected when they attach: . . . (2) an assignment of accounts or payment intangibles which does not by itself or in conjunction with other assignments to the same assignee transfer a significant part of the assignor's outstanding accounts or payment intangibles." This argument would fail because the transaction does not involve an assignment of accounts or payment intangibles; it involves a security interest in cattle. Cf. In re Tri-County Materials (assignment of accounts).

C. Would you have advised Barretts not to sell the cattle on credit to Lucky Moon given the apparent security agreement between Bank and Lucky Moon?

The apparent security agreement between the Bank and Lucky Moon is not, by itself, a sufficient reason to refrain from selling cattle on credit to Lucky Moon. Barretts could structure a transaction in which it sold the cattle on credit and had priority over the Bank's security interests by taking a purchase money security interest in the cattle. See 9-324(d). [Note: 9-324(a) is the general rule for PMSIs, while 9-324(d) concerns PMSIs in livestock.]

Other factors, however, might dissuade Barretts from selling the cattle on credit to Lucky Moon. For example, Barretts might worry that there is something wrong with Lucky Moon's business model if Lucky Moon has an outstanding debt of \$2 million to the Bank which is secured by a dragnet clause and that it cannot pay. While taking a security interest in the cattle might lessen the risks in lending to Lucky Moon, the risks still might be too great.

D. If Lucky Moon sells some of its cattle, what rights will Bank have with respect to the cattle sold and to the proceeds?

The Bank will have a security interest in any identifiable proceeds of the cattle because a security interest in collateral automatically continues into the proceeds of the collateral. § 9-315(a)(2).

As for the a security interest in the cattle, a buyer of collateral takes the collateral subject to a security interest unless the secured party consents or an exception to this general rule applies. § 9-315(a)(1). In the security agreement, the Bank most likely authorized Lucky Moon to sell the

cattle free of the bank's security interest for two reasons. First, the Bank would want Lucky Moon to sell the collateral so that Lucky Moon has enough money to repay the Bank, and buyers would not want to purchase the collateral if it came subject to a security interest. Second, the Bank would be protected by its security interest in the proceeds (as discussed above). If the security agreement does not expressly authorize Lucky Moon to sell the collateral, then the issue is whether an exception applies. Article 9 contains an exception for buyers in the ordinary course, but this exception does not apply to buyers of "farm products," § 9-320(a), a term which includes livestock, § 9-102(a)(34)(b). [Note: Other law outside may provide an exception for the cattle, see 9-320 cmt. 4, but this was not something covered in class.]

PROBLEM V.

(26 points)

Americredit loan
 ----> Debtors
 <----
 promise to
 repay & lien

American Honda Finance

A. Why might the timing of the perfection of AmeriCredit's lien matter?

If AmeriCredit's lien was not perfected prior to the Debtors' filing of a bankruptcy petition, AmeriCredit would effectively have only an unsecured claim in bankruptcy. Bankruptcy Code § 544(a) gives the bankruptcy trustee the status of a hypothetical lien creditor. Section 9-317(a)(2) makes an unperfected security interest subordinate to the rights of a lien creditor. See Casebook, p. 49. In addition, if the Debtors have any actual lien creditors, the timing of the perfection of AmeriCredit's lien could determine whether AmeriCredit has priority over them.

B. If the state statute requiring a security interest in automobiles to be indicated on a certificate of title does not specifically address AmeriCredit's arguments, what UCC provisions might AmeriCredit cite by way of analogy?

There were several possible answers. What was key was to identify a UCC provisions and make good arguments by analogy. Most answers said that AmeriCredit should cite § 9-506(a), which says that minor errors or omissions do not make a filing statement ineffective unless they are seriously misleading and that the name of a debtor is not seriously misleading if it could be found using standard search logic. These answers argued that AmeriCredit could argue, by analogy, that even if the certificate of title listed the wrong name of the lien holder, anyone looking at the certificate of title would know that there was a lien on the vehicle, which is really what potential creditors would be interested in knowing. Other answers analogized what happened here to the failure of the filing office to index a record correctly, which does not affect the perfection of a security interest under § 9-517.

Note: Some answers missed the point of the question by simply citing § 9-311(a)(2), which says that state statutes outside the UCC govern the perfection of security interests in automobiles by indication on a certificate of title. The question was what arguments could be made if such state statutes were silent on the particular issue presented in the case.

C. If Dealer used secured credit from a lender to buy its inventory of cars, what rights, if any, would this lender have against the Debtors?

None. The lender's security interest would not continue in the car because the Debtors bought the car in the ordinary course. § 9-320(a). In addition, the security agreement presumably would give the dealer the right to sell the cars free of the security interest because otherwise no one would buy the cars and the dealer then could not repay the lender.

Note: Many answers went into elaborate detail about the rights that the lender would have against the Dealer, but that was not part of the question.

D. If AmeriCredit does not prevail in its dispute with the Trustee, what rights would AmeriCredit likely have?

As described above, AmeriCredit would have only the rights of an unsecured creditor against the debtors. AmeriCredit would share in whatever non-exempt assets were left in the estate, if any, after the secured creditors satisfied their interests.

AmeriCredit would have a claim, presumably for breach of contract or negligence, against the Dealer for its error in applying for the certificate of title.

PROBLEM VI.

(25 points)

s.i. in
restaurant
equipment
Linn -----> March
<-----
equipment

A. What would be an example of how a secured party could dispose of collateral other than by selling it?

Section 9-610(a) describes how a secured party may dispose of collateral. One example is that a secured party might dispose of collateral by leasing it. § 9-610(a). For instance, in this case, March might have leased the restaurant equipment to another restaurant, if that would have been commercially reasonable. March would apply the rental payments to the debt and presumably would stop leasing the collateral and return it after the debt was fully paid.

B. Under what circumstances, if any, could a secured party repossess the collateral and not dispose of it?

The secured party could repossess the collateral and then hold onto it while it seeks a judicial remedy, so long as that would be commercially reasonable in the circumstances. Okefenokee Aircraft v. PrimeSouth Bank.

In addition, the secured party could repossess the collateral and not dispose of it in a case of strict foreclosure. § 9-620(a). The debtor, however, would have to agree to the strict foreclosure. § 9-620(a)(1).

Note: Some answers said that the secured party could disable the property. But the secured party does not usually do that if it repossesses the property. Compare § 9-609(a)(1) with § 9-609(a)(2).

C. If Linn had sold some of the equipment covered by the security agreement, what rights would March have?

March would have a security interest in the equipment unless he consented to the sale free of the security interest. A buyer of collateral

the documents required by the letter of credit and HSBC could have and likely would have paid Benetton. This was possible because the documents were not required to say that Markowitz owed any money.

On the other hand, several factors likely would have "prevented" Benetton, as a practical matter, from making a baseless demand for payment. First, Benetton would worry about the harm to its business reputation. Second, Benetton would worry about criminal liability for fraud. Third, Benetton would worry about civil liability for breach of contract, breach of warranty, and the tort of deceit (or some other tort).

Note: This purely hypothetical question did not ask whether (or assert that) Benetton USA had made a baseless demand for money. It also did not ask how the parties could have restructured the transaction to provide more protection against baseless demands for money.

C. Assuming the letter of credit was valid, what rights do the parties have against each other now?

HSBC has no rights against any party. Upon paying the letter of credit, HSBC had a right to reimbursement from Weiss, which it realized by debiting his account in the full amount of the payment. § 5-108(a)(1).

Weiss might have a contract claim against Markowitz based on whatever they agreed when they entered into this arrangement. This agreement would be independent of the letter of credit. § 5-103(d).

Although Benetton Trading has received payment of \$500,000, it would still have a claim against Markowitz under their underlying contract for any deficit remaining of the original debt of approximately \$1 million. Under the independence principle, this claim would not be extinguished by issuance of the letter of credit. § 5-103(d).

D. Why might the parties have decided to use a standby letter of credit instead of a commercial letter of credit?

The parties could not use a commercial letter of credit because Markowitz was buying the goods on credit provided by the seller.

In a typical letter of credit transaction, the seller would present documents to the issuing bank upon shipping the goods, the issuer would pay the seller, and then immediately seek reimbursement from the buyer. That would not have worked here because Markowitz needed to sell the goods in order to have money to repay the seller. As a result, the seller agreed to sell the goods on credit to Markowitz and to use a standby letter of credit, not as a means of obtaining payment immediately, but to provide security for repayment of the credit extended.

Note: Some answers described the difference between commercial and standby letters of credit but never explained that Markowitz could not have used a commercial letter of credit because the seller was selling the goods on credit to Markowitz.