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Commercial Law I

with answers of a sort

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May 1969

NEGOTIABLE INSTRUMENTS

I - 10 points

Fred Farmer, living near Pocomoke City, Md., agrees to sell and deliver a truckload of potatoes to Henry Merchant, in Newport News, for a cash price of \$450.00. He will not accept a personal check and wants cash; finally it is agreed that, as he and the potatoes will arrive in Newport News after banking hours, Merchant will have at hand a cashier's check of a Newport News bank, payable to the order of Fred Farmer for \$450.00. The deal takes place just as agreed, at 6 p.m. on Saturday. On Monday, Farmer indorses the check and deposits it in his account in the bank at Pocomoke City, which sends it through the proper routine of collection, and it is presented to the Newport News Bank Wednesday morning. Unfortunately the bank was declared insolvent by State authorities and closed on Tuesday. It also appears that Henry Merchant committed a fraud in obtaining the check, by representing to the bank that he was buying \$1100 worth of potatoes, on which the bank would have a lien for its loan of \$450.00 and that he was himself putting up the balance of \$650.00.

Fred Farmer now seeks for your advice as to:

- 3-302(2) 1. Payee as HDC
2. Whether obligation is discharged by cash check.
3. Whether obligation is generally
- ✓ 1. What recourse, if any, he has against Henry Merchant ~~discharged~~
 - ✓ 2. Whether Merchant's fraud on the bank will bar Farmer's claim against it.

II - 15 points

X Corporation, in order to raise working capital for its business, signed 20 notes for \$5000 each, payable to Bearer, dated April 20, 1963, due in 5 years, with interest at 6%, and containing the following recital:

"This note is secured by a loan agreement dated April 20, 1963, with Y as trustee, for the benefit of noteholders."

The loan agreement was in possession of Y. It contained various covenants and restrictions as to the conduct of the business of X Corp., and also a provision that with the consent of the holders of 2/3 of the outstanding notes, the principal of all of the outstanding notes could be extended for another 5 years.

All of the notes were sold for cash. Subsequently Attorney A was retained by the corporation; he sent a bill in the sum of \$5000.00 for services he had rendered over a period of time which bill the corporation thought excessive but in any event was currently unable to pay; finally the president, who owned several of the notes, persuaded A to take one of the existing notes from him, in exchange for an assignment of the attorney's claim for services against the corporation. There is no question of bad faith.

Later it became apparent that the notes could not be paid at maturity; over 2/3 of the noteholders voted for a five year extension; A refused, and the original maturity date having gone by without payment, he sued the corporation for the \$5000.00. He stated that until the request for extension was made he had no idea that the notes were subject to an extension of maturity and had relied on the face of the note. In defense,

the corporation made the following contentions:

- ✓ (1) A is not a holder in due course because he did not give value *3-303(a)*
- ✓ (2) The instrument is non-negotiable by reason of the reference therein to the loan agreement *3-105(2)*
- ✓ (3) By reason of the reference to the loan agreement, A's rights are subject to all its provisions, including the right of 2/3 to make an extension binding upon all *3-119*

Discuss the merits of those contentions

III - 5 points

- (a) What is the difference between a "defense" and a "claim"?
- (b) Explain, by illustration or otherwise, the difference between "real" and "personal" defenses.

IV - 10 points

E, clerk in the office of X Company whose duty it is to make up the payroll, prepares a check for \$125, inserting as payee the name "John Dough". Dough is a friend of E who lives in Alaska. E, however, intends to indorse and cash the check himself. The check is properly signed by a company official along with the rest of the payroll, and E slips it out and cashes it at Toby's Bar & Grill, although the bartender overlooked obtaining an indorsement. After closing, T, a burglar, steals the check, endorses it "John Dough" and cashes it at the Way-Out Clothing Mart. The check is presented to the drawee bank showing the endorsements below, is paid, and X Company's account is debited \$125:

John Dough
Way-Out Clothing Mart

- (1) Can the drawee bank or the Clothing Mart be held liable at the suit of X Company? Discuss.
- (2) Why does or does not the real John Dough have any rights here?

V - 10 points

A makes a note for \$1000 payable to B, the place of payment being X Bank. B negotiates it to C. C forgets to present the note at maturity, or to take any other action. Two months have passed, and X Bank is now insolvent. At maturity and since, A has \$200 on deposit in X Bank, under standing instructions to apply moneys in his account to meet any notes presented.

C now consults you: What is the liability of A? What is the liability of B?

3-502(b) A remains liable - no payment necessary
didn't have funds to cover the instrument

VI - 20 points

A mailed a check to P, payable to the order of P, in payment for a valuable picture P had sold him. X stole the check from the mailbox in the apartment building where P lived, forged P's name and cashed the check at B Bank. B Bank indorsed in the usual manner and presented to the drawee, D Bank and was paid.

Six months later P asks A for payment, and the facts come out. P looks at the cancelled check in A's file and is satisfied that the indorsement is forged. D Bank and B Bank are notified immediately. D is not satisfied as to the existence of forgery and refuses to credit A's account; A is sympathetic to P's plight but says he can't take care of the obligation at this time.

Discuss the following:

- (a) Is D Bank liable to P for conversion? *yes - property of P - D converted 3-419-1(c)*
- (b) If so, on what theory or theories can D Bank hold B Bank? *warranty 2-417(d) (a) 4-207(1)(c)*
- (c) Is the 6 months delay a defense to B Bank? *no - not an unreasonable delay - the notified promptly after learning of breach 4-207(d)*
- Suppose P decides against suing D for conversion. Discuss the following:

- (d) On what theory or theories can he
- 3 i. Recover from A *no - not in possession of check - present a sum of it*
- 2 ii. Recover from B or D (apart from conversion) *no. In warranty, or contractual obligation to P*
- 4 If P succeeds against A, can A require D to credit the amount of the check to A's bank account? *yes - if D cannot justify the charge to A's account. A should perhaps inquire D to save circuitry.*

VII - 30 points

It is 9:45 Saturday morning June 3 and just as you are about to leave for the golf course you receive an urgent phone call from Mr. Goodheart, president of the Community State Bank. His agitation is soon matched by your own because you happen to know that the bank's relationship with its regular attorney, Mr. Bumble, has cooled and this may be the opportunity you have been waiting for. Mr. Goodheart wants to come right to your home, and you say good-bye to your golfing companions.

It seems that there will mature on Monday, June 5, a note held by the bank in the sum of \$50,000, and there is doubt whether it will be paid. Mr. Goodheart does not have all the facts because the matter has been handled entirely by Mr. Friendly, a vice-president of the bank, who is hunting wildebeest in Africa and cannot be reached for at least two weeks. What Mr. Goodheart does tell you, based on the bank's files and what he knows, is the following:

The note is in proper negotiable form, dated June 5, 1967 and due two years after date, payable to Kenneth Kook, and signed by George Gottrox III and George Gottrox (son and Father, respectively). No place of payment is named. The bank bought the note from Milton Miser for \$50,000 cash six months ago. It bears the following indorsements on the reverse side:

Pay to the order of Sam Scalper
Kenneth Kook
Sam Scalper
Pay to the order of Community State Bank
Milton Miser without recourse

All of the parties are deemed solvent except George Gottrox III who, since signing the note, was declared bankrupt and all his debts discharged. His father and co-maker, George Gottrox saw Mr. Goodheart at the Lions Club last week and told him that he (Geo. Gottrox) had signed for accommodation to enable his son to get a loan from Kook, and that he did not consider himself liable. There is nothing in the bank's file about this. Mr. Gottrox mentioned that he and Sam Scalper were leaving on Sunday the 4th for a footloose tour of Europe.

A memo in the file from one of the bank's tellers adds further uncertainty. This man was waiting at a bus stop near the Gottrox mansion one evening, and heard parts of a family altercation, the highlight of which was a tirade from George Gottrox ending with - "If I have to tell the truth in court it will send that son of mine to jail for signing my name as well as his own."

Kenneth Kook was an infant when he indorsed, but has recently come of age. The bank had no notice of his infancy. The general law of the state is that contracts or conveyances are not binding on an infant.

While Mr. Goodheart listens patiently (wishing he had taken up some other line of business) you expound at length upon:

- (a) The exact nature and timing of steps to be taken by the bank in the near future to protect its interests.
- (b) The bank's rights against, and the defenses of, the several parties possibly liable, taken one by one. Reference should be made, of course, to the alternatives existing because of factual uncertainties in Mr. Goodheart's statement.

Please expound.

Kook
Yes III
Yes

Pay to the order of
Samuel Seelye
Community Bank
Frostburg, Md.
without recourse