<u>Negotiable Instruments Review Problems</u>

1. Borrower took a $10,000 loan from Lender to finance its current operations. The parties agreed that Borrower would repay the loan in one lump-sum payment of $10,450 in 90 days. In exchange for the loan proceeds, Borrower issued a negotiable promissory note to Lender reflecting their agreement. On the 90th day, Lender realized that it had lost the note, and it couldn't recall whether or not it had endorsed the note.

If Borrower pays Lender what it owes on the lost note, is it possible that someone else might find the note and enforce it later again?

2. Assume that John Doe is the payee of a negotiable instrument. Give one example of how John could give a blank endorsement to the instrument and one example of how he could give a special endorsement to the instrument. What is the effect of each type of endorsement on further negotiation.

3. John Jones owes Sam Smith $100, which John says he will pay Sam on September 15, 2009. Draft the one sentence body of a negotiable promissory note to evidence John's obligation.

4. Pawel Lutomski maintains a checking account with Polish Emigrant Savings & Trust (PEST). Pawel lives in Chicago, and his brother, Wladyslaw, has just been paroled from state prison after serving time for theft. Wladyslaw, having no place to live, is taken in by Pawel who is happy to have the company. Facing crippling discrimination in the job market due to his felony record, and desperate for money, Wladyslaw rummages through Pawel's desk, locates his check book, and begins forging Pawel's signature and cashing checks drawn on Pawel's account at PEST. From December 2007 through February 2008, Wladyslaw forged and cashed three $1000.00 checks each month in December, January and February, representing a total of 9 checks for $9000.00 over this three month period. The forged checks were all included in the respective monthly statements for January, February and March and provided to Pawel by PEST, but Pawel failed to review his statements during this period of time.

On April 16, 2008, Pawel received his next monthly bank statement from PEST and discovered three recently forged checks, each in the amount of $1000.00, which bore obvious forgeries of his signature and were cashed by Wladyslaw in March. Pawel contacted PEST that day and learned of the prior 9 checks that were also obviously forged by Wladyslaw during the prior months.

Pawel now demands that the bank remit payment to him for the $12,000.00 representing the money withdrawn from his account based upon his forged signature. PEST believes that it followed standard banking procedures and practices and paid the checks in good faith. As a result, PEST contacts you to determine what money, if any, should be returned to Pawel and asks you to answer the following questions:

(a) As a general rule, does the bank or the depositor suffer the loss for payment of an instrument bearing a forged signature? Explain fully.

(b) PEST feels that Pawel was negligent in failing to restrict access to his checkbook and asks you whether or not such negligence is relevant to any defense the bank could assert against Pawel. Explain fully whether this argument bears any legal merit and the likely findings of the court on this issue.

(c) Does PEST have any defenses, other than the one discussed in part (b) above, that it can assert to justify its decision to not reimburse Pawel for the 12 forged checks that were included in Pawel's monthly bank statement? Explain fully any available defenses or why such defenses are not available to PEST.

(d) If Pawel could prove that PEST failed to follow its own internal policy of reviewing and comparing signature cards for any checks in excess of $500.00, would this help his case? Why or why not?

5. Assuming that a promissory note is negotiable in *all* other respects, is it rendered nonnegotiable by any of the following elements? **Please respond "negotiable" or "nonnegotiable" and explain the reasons for your answer.**

a) The note is dated June 1, 2008, and is payable "three years from date" but also states that "payment shall immediately become due and payable upon demand if the maker should file bankruptcy before the due date."

b) The note is dated June 1, 2008, and states in part, "I promise to pay the sum of $500 Dollars to Jake Jones on July 1, 2009."

c) The note is dated June 1, 2008, and is payable "five years from date out of the accrued funds generated from the Blackacre timber sales."

d) The note is dated June 1, 2008, and states that it is payable to the order of Chip Donahue or Mona Douglas.

6. For the first time Peter McCallister is allowing his son, Kevin, to shop for school clothes on his own. Peter McCallister gives Kevin (who is 15) a signed personal check for $100 drawn on his account at Friendly Bank and made payable to the local department store, with instructions to use the money to buy only school clothes. Kevin agrees, but as soon as he leaves the house carefully changes the amount of the check to $1000. He then uses the check to purchase school clothes, an advanced video game system and several new games for the system. The department store deposits the check at Friendly Bank (where it maintains its own account), and in due course the check is honored. When Peter receives his next monthly bank statement, he finds the changed check and immediately demands that the bank recredit the $1000 to his account.

(a) What if any rights does Peter have against Friendly Bank?

(b) Suppose Peter had signed the check, but intentionally left the amount blank for Kevin to fill in because he did not know what the school clothes would cost. What if any rights would Peter then have against the bank?

7. Rhonda Price uses her final salary payment to purchase a $5,000 certificate of deposit from the Big & Greedy Bank, which the bank as a security measure stamped "Non-Negotiable" in a conspicuous place on its face. **Can a transferee of the certificate of deposit be a holder in due course? Why or why not?**

8. On May 1, 2007, Joe and Betty Stewart agree to lend $100,000 to their daughter, Silvia, and her business partner, Angie. In return, Silvia and Angie executed and delivered a promissory note to the Stewarts which read as follows:

> "For value received, we promise to pay the sum of $100,000 plus 10% annual interest to the order of Joe and Betty Stewart on or before June 1, 2008."

The note was properly dated and signed by both Silvia and Angie and the loan proceeds were used by Silvia and Angie to fund their start-up consulting services. However, Silvia and Angie's consulting venture soon failed and on November 1, 2007, Angie wrote the Stewarts saying:

> "Silvia and I discussed your loan to us and we have agreed that each of us will be responsible for one-half of the amount due. Enclosed is my check for $50,000 plus one half of the interest now due."

The Stewarts endorsed and deposited Angie's check.

On April 2, 2008, Bob Profit purchased the promissory note for value and in good faith from the Stewarts, who neglected to mention the prior payment by Angie. As part of this transaction, the Stewarts properly indorsed the note, without recourse, to Profit. About the same time, Silvia moved to Morocco and became a nun.

On June 1, 2008, Profit demanded payment from Angie in the amount of $110,000 and Angie refused to pay. In response, Angie raised the following defenses:

(i) Angie learns that the Stewarts actually only funded $50,000 of the agreed $100,000 loan proceeds;

(ii) When the note was signed, the Stewarts orally assured Angie that they would never transfer the note and, without that promise, she would not have signed the note; and

(iii) Angie has already paid $52,250 in satisfaction of the promissory note.

(a) How should a court rule on Angie's defenses (i), (ii) ,and (iii), above? Explain your answers thoroughly.

(b) If Angie had wanted to be sure that her defenses would survive any transfer of the note, how might she have accomplished this?

(c) Would it affect Angie's defenses if the promissory note also contains a clause requiring Angie and Silvia to additionally pay attorney's fees and court costs in the event suit is brought to enforce collection? Why or why not?

(d) Would it affect Angie's defenses if Profit had purchased the promissory note on July 27, 2008, instead of April 2, 2008, and demands payment on July 28, 2008? Why or why not?