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# PROBLEMS AND MATERIALS ON NEGOTIABLE INSTRUMENTS

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This book explores the law of payment primarily through focus on a series of problems designed to encourage the student to concentrate on the exact statutory language in the Uniform Commercial Code and the Electronic Fund Transfer Act. While I have included illustrative cases to demonstrate the reactions of the courts to these issues, I have used as few as I felt necessary; most UCC court decisions are too imposing, either factually or legally, to make good pedagogical tools.

Unfortunately, students reared on the case method sometimes have trouble concentrating on problem after problem. Such an attitude here can be academically fatal. As a guide to the degree of concentration required, I have used a hierarchy of signals. When the problem states "Read §3-406," I mean "Put down this book, pick up the Uniform Commercial Code, and study §3-406 carefully." When the instruction is "See §3-406," the reader need look at the cited section only if unsure of the answer. "Cf. §3-406" or simply "§3-406" are lesser references, included as a guide for the curious.

I have heard it said that law students cannot follow legal problems having more than two characters. If true, negotiable

instruments law would be unteachable, as its issues almost always involve three or more parties. To help the reader keep them straight I have given the characters in my Problems distinctive names and, I hope, have created interesting factual patterns, all designed to keep the mind alive.

I have edited the footnotes out of most cases; the ones that remain have been stripped of their original numbering and have been consecutively numbered with my own footnotes. Unless clearly indicated otherwise, all footnotes in the cases are the court's own. I have also taken the liberty to change all statutory citations in cases to their simple Uniform Commercial Code form.

I wish to acknowledge the debt I owe to Professor R. Bruce Townsend of Indiana University, Indianapolis Law School, one of the drafters of the Uniform Commercial Code, and my mentor in my early days of teaching this subject. Professor John J. Slain, New York University School of Law, also deserves my thanks for helping me organize my initial exploration of the world of investment securities, as does Professor Albert L. Clovis, my colleague on The Ohio State University law faculty, with whom I have had many fruitful commercial law discussions. The same is true of my good friend, Professor Gerald L. Bepko, also of the Indiana-Indianapolis faculty. I hasten to add the usual disclaimer of any responsibility by these worthy people for any errors that I may have committed. I also want to thank my many student researchers over the years, particularly James D. Gradel, '79, Gerry W. Beyer, '80, and William E. Fister, '80, all graduates of The Ohio State University College of Law. I express my deep appreciation to the army of typists who have struggled with this material, particularly Connie S. Johnson, Carol Stull, Darlene Johns, and Barbara Ottavi. Finally, I thank my students, who, due to their eagle-eyed reading of the Code and this book in its many forms, corrected my early errors and suggested many ideas that never would have occurred to me in a lifetime of solo study.

*Douglas J. Whaley*  
Columbus, Ohio

March 1, 1980

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**PART I** 

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**COMMERCIAL  
PAPER**

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# CHAPTER 1

## NEGOTIABILITY

### A. INTRODUCTION

There is not, of course, enough money to go around, and what money is available is frequently too physically awkward to be moved easily. Man, an inventive creature, has been able to create additional sources of money in the form of transferable contractual debt. Thus, one can borrow money and give the lender a written promise to repay it (a *promissory note*), and, in this way, realize early expected future prosperity. Man solved the problem of the awkwardness of the physical transfer of money, and the concomitant possibility of its theft while in transit, by putting the money in the hands of a guarded depositary (typically a bank) and then issuing written orders (*drafts*) for the money's transfer to various people.

In time, complicated things began to happen to these pieces of paper. For one thing, they were transferred (negotiated) through many hands before being presented for payment. If payment was then refused for some reason (the goods proved defective, the maker was financially embarrassed, the bank failed to open its doors one morning), rules had to be invented to straighten out who owed what to whom, and to establish which defenses would be good against the person demanding payment and which would not. Similarly, if the instrument were stolen or forged, rules had to be established to put the risk of loss on



somebody. Article 3 (Commercial Paper) and Article 4 (Bank Deposits and Collections) of the Uniform Commercial Code are designed to supply these rules. Article 3 replaces its widely-adopted predecessor, the Negotiable Instruments Law (hereinafter, the NIL), and Article 4 replaces the not-so-widely-adopted Bank Collection Code. Article 8 (Investment Securities), discussed in Part II of this book, deals with similar problems raised by the transfer of stocks and bonds.

## **B. TYPES OF NEGOTIABLE INSTRUMENTS**

There are many types of negotiable instruments in the world. To begin with, money itself is technically a negotiable instrument. Aside from the notes and drafts covered by Article 3, the Code deals with investment securities (stocks and bonds) in Article 8, documents of title (warehouse receipts and bills of lading) in Article 7, and letters of credit in Article 5. These types of negotiable instruments are specifically excluded from the coverage of Article 3 by §3-103.

The types of negotiable instruments Article 3 does cover can be divided into two basic categories: notes and drafts.

A note is a written promise to pay money. If the note is created by a bank, it is called a certificate of deposit (or CD for short); see *Southview Corp. v. Kleberg First Natl. Bank*, 512 S.W.2d 817, 15 U.C.C. Rep. Serv. 408 (Tex. Civ. App. 1974). Investors buy CDs because they pay a higher rate of interest than a normal savings account, but CDs have the disadvantage that the investor is not able to reclaim the money until the CD matures (comes due). The typical note is not made by a bank, but is the promissory note signed by those who borrow money or make credit purchases.

A draft is a written order by one person (the drawer) to another (the drawee) directing the latter to pay money to a third person (the payee). The most common situation involving drafts arises when someone deposits money in a checking account with a bank and then writes checks addressed to the bank ordering it to pay out the account money to those nominated. In this situation the bank's customer is the drawer, the bank is the drawee, and the nominee (the electric company, the book club, the IRS, etc.) is the