Commercial Law

Bank Collections

I. The Bank’s Right to Pay

a. 4 situations where check is not properly payable
   i. Forged Drawer’s Signature
   ii. Forged Endorsement
   iii. Proper post-date notice by the customer
   iv. Proper stop payment order

b. Bank has the right to pay overdrafted check
   i. Customer is not liable if customer neither signs the item nor benefits from
      the payment of the item
      1. If estranged wife overdrafts no clear answer to whether properly
         payable
   ii. Right to pay is function of holding the account

c. Bank can pay post dated check before post-date unless the customer gives proper
   notice and notice describes/identifies the check with reasonable certainty
   i. Standard: Customer must identify so that bank can recognize the check
      under the technology available at the time
   ii. Post dating notice
      1. Written notice effective for 6 months
      2. Oral notice effective for 14 days
   iii. Overall hostility to post-dating check, so often require check number
      amount, recipient, etc.

d. When bank pays a check that is not properly payable, the bank must credit the
   account unless it can exercise subrogation rights – defense to re-credit demand
   i. Defensive Subrogation Rights: Bank can assert the rights of the payee
      1. If payee held up her end of bargain bank does not need to re-credit
         because customer received what they paid for
      2. If goods are worthless – no good defense
      3. If goods worth some, but not all – partial defensive subrogation
   ii. Offensive Subrogation Rights: Bank can re-credit and assert rights of
      customer against the payee
      1. Once account re-credited, customer has no rights to goods
   iii. Right to reimbursement against customer
      1. Common law unjust enrichment OR under UCC

e. When check written, rights of payee on the underlying obligation are suspended.
   Suspension of rights on underlying obligation last until dishonor or payment
   i. Payment of check cancels underlying obligation
   ii. Dishonor of check – rights on underlying obligation spring to life

f. UCC rules are default rules and parties can vary provisions w/in limits
   i. Bank cannot disclaim its duty to act in good faith

g. Try to make UCC and Reg CC interact and give both weight, but supremacy
   clause says the federal law triumphs

II. When the Bank is Required to Pay and Funds Availability

a. Stale check: Bank not obliged to pay if more than 6 months old
Bank may pay so long as it acts in good faith
   1. Good faith requires honesty in fact
ii. No clear answer to whether bank may pay without consulting drawer
   1. Comments suggest that bank will not pay stale check without consulting drawer, but is this a breach of good faith?

b. Funds availability: Figure 22.1, p312
   i. Counting Days: only count business days after the banking day of deposit
      1. Saturday and Sunday are not business days
      2. Banking days: Subset of business days, Sat., Sun. and Federal Holidays are not banking days
   ii. Funds availability schedule: EFAA
      1. Non-local check, cash withdrawal: D1- $100, D5- $400, D6- Rest
      2. Non-local check, noncash withdrawal: D1 $100, D5 – Remainder
      3. Local check, cash withdrawal: D1-$100, D2 -$400, D3- Remainder
      4. Local check, noncash withdrawal: D1 - $100, D2 - Remainder
   iii. Special Rules
      1. **Over $5K deposited in single banking day:** Funds availability rules apply to first $5K, bank may hold rest until the depository bank knows that the check clears
      2. UCC requires bank to make funds available when it learns that final payment has been made
         a. Usually Reg CC has faster than bank knowledge
         b. If bank KNOWS check cleared- must make funds available even though the Reg CC deadlines have not yet occurred
      3. Low Risk Exception: See Figure 22.2, p314 – get answers from someone else
         a. In person deposit, own account – all low risk items available first business day after deposit
         b. ATM deposit, own account –
            i. On-us items and treasury checks – 1st bus. day after deposit
            ii. Cash, postal money orders, and Fed Reserve, local govt. or cashier’s checks – 2nd bus day after deposit
         c. Deposit by someone other than original payee
            i. On-us items – 1st bus day after deposit
            ii. Treasury checks, postal money orders – follow local check rules
            iii. Federal Reserve, local government, and cashier’s checks – local or non-local rules depending on location of drawee
      4. Funds do not need to be made available by EFAA guidelines if there is reasonable cause to doubt collectability
   c. Wrongful Dishonor (part of funds availability class)
      i. If bank fails to pay properly payable check that is not stale or overdraft then it has wrongfully dishonored
      ii. Damages: Serious Offense, fully compensable damages
1. Bank liable for any consequential damages for wrongful dishonor
2. No limit to the amount of item in case of wrongful dishonor
   iii. If overdraft created by improper honoring of post-date by bank, then not paying the overdraft check is wrongful dishonor
   iv. To determine whether or not to honor: Payor bank must simply choose a time between receipt and final deadline for deciding when to pay
      1. Dishonor valid even if funds deposited later
      2. Bank can dishonor check when funds not yet credited unless a subsequent determination of balance made to reevaluate dishonor

III. Mechanics of Check Collection (2 classes)
   a. Special Rules:
      i. Dating a check as received the following business day if received after 2pm is acceptable if bank notifies
      ii. Separate Branches of the same bank treated as separate banks for determination of midnight deadline
   b. Final Payment
      i. Final payment when give cash, settle w/o right to revoke, or settle by not revoking by midnight deadline
         1. Either properly dishonor or final payment made
      ii. At final payment, bank loses chargeback rights even if customer later puts money into the account
   c. Midnight Deadline for the Payor Bank under the UCC: To dishonor, must
      i. Return check by midnight of banking day following the banking day the check is presented and don’t make final payment
         1. Return simply means to put in the mail
         2. Payor bank must make provisional settlement w/ Dep bank on the day check is presented or accountable for check
      ii. Missing UCC midnight deadline means payor made final payment
         1. Bank accountable for item at final payment- can’t recover from anyone but there customer
      iii. Extend midnight deadline: See Reg CC 229.30(c)(1)
         1. If bank uses method that normally would get check back to Dep bank by the banking day following midnight deadline, the midnight deadline is extended to the time of delivery
         2. If bank uses highly expeditious means of transport the deadline is extended to time of sending even if would not normally arrive before banking day deadline above
         3. Meant to set bank system not save when deadline missed
   d. Returning and Notifying of Dishonored Check: Reg CC
      i. Rules do not affect the midnight deadline and right to dishonor
      ii. Dishonored item must be returned in expeditious manner
         1. 2day/4day test: Expeditious manner if will get to local place in 2 days or non-local in 4 days
         2. Forward Collection Test: Expeditious Manner if sent in the same way the check was sent
iii. Large Items ($2500 or more): Payor bank must give notice that is received by Dep bank by 4pm on banking day following day of presentment

iv. Missing the Reg CC deadline: Bank must pay damages actually incurred on the item – no harm, no foul
   1. Who is harmed by lack of expeditious return of check

e. Midnight Deadline for Depository Bank
   i. Dep bank must return item or send notification of dishonor to customer by midnight of the banking day following receipt or notice of dishonor
   ii. Missing Dep Bank midnight deadline does not mean depository bank loses chargeback rights, bank must pay damages actually incurred by failure to meet deadline. No harm, no foul

f. ON-US items: When dep bank is the same as payor bank
   i. If bank pays check over the counter, the bank makes final payment as payor bank and loses right to revoke or chargeback
   ii. If bank takes deposit and allows withdrawal later or through ATM rather than paying over the counter it still has right to recovery
      1. Early funds availability does not destroy chargeback rights


g. Chargeback Rights, Provisional Credits, and the EFAA
   i. Dep right to chargeback is function of payor’s right to dishonor
      1. If payor makes final payment Dep loses chargeback rights
         a. OK b/c payor bank is accountable for final payment
   ii. Obligation to make funds available simply a function of EFAA
   iii. If payor gives timely notice of dishonor under Reg CC but fails to meet midnight deadline of UCC
      1. Final Payment is made and Dep bank cannot chargeback
      2. If Dep bank charges bank and dishonors a check written on this amount, Dep bank liable for consequential damages, but can only recover up to amount of check
      3. On receipt of notice of dishonor Dep can choose to only make funds available to extent required by EFAA, don’t chargeback immediately, just don’t make funds available
         a. Exception to EFAA when reasonable cause to doubt collectability
         b. Seems like functional equivalent of chargeback, but really just timing issue for funds availability

h. Encoding warranty: Warrant that the information encoded correctly
   i. Both the encoder of a check and the Dep bank who allows its customer to encode makes warranty for encoding
   ii. Encoding bank liable for encoding error for amount of breach and result of the breach with no limit to amount of check.

IV. Forgery and Liability (2 classes)
a. Loss lies with the wrongdoer or the first person who deals with wrongdoer
   i. Forged indorsement, check paid: Payor must re-credit b/c not properly payable. Payor recovers from Dep bank (or other who handled after forgery) on breach of presentment, Dep bank recovers from prior transferors all the way to the thief or person who took from thief
ii. Forged indorsement, check dishonored: Payor dishonors, Dep should chargeback (if misses midnight deadline then breach of transfer warranty), parties use transfer warranty to push back to forger or first to deal w forger

iii. Forged drawer (see p370), check paid: Payor must recredit b/c not properly payable, Payor bank can’t sue for breach of presentment on forged drawer – warranty not breached. Recover from forger or fraud/restitution or someone who knew of forgery b/c can recover from person to whose benefit payment made. Can’t recover from he who took in good faith.
   1. Payor bank stuck with loss under Price v. Neil

iv. Forged drawer (see p370), check dishonored: Payor dishonors, Dep should chargeback, parties push back to forger with breach of transfer, Payee of check can recover on fraud, drawer’s contract or rights on underlying instrument revive

b. Conversion liability
   i. Requires that the check was paid
   ii. Proper P is person entitled to enforce the instrument (payee)
      1. Must receive delivery of the check to be proper P in conversion
      2. Can have agent receive delivery
   iii. Proper D is the thief and anyone who purchase check from thief including payor bank who paid individual not entitled to enforce
      1. Once there is forgery, no other person is entitled to enforce; therefore, all parties are proper Ds
      2. Intermediary bank is not proper conversion D

c. Contract liability
   i. Contract liability does not arise until check is dishonored
   ii. Can disclaim endorser liability (cannot disclaim warranty liability)

d. Warranty Liability
   i. Presentment Warranty 4-208 – Payor Bank
      1. Does not work for forged drawer’s signature b/c forged drawer’s signature does not break chain of title
      2. Payor bank proper P b/c transferor warrants to transferee
      3. Proper D is anyone who made transfer after forged endorsement
         a. First movement is not transfer – therefore they make no warranty
         b. Individual from whom item is stolen is not a transferor b/c transfer indicates active movement
         c. If forged endorsement – everyone from thief on transfers the forged instrument
         d. Only responsible for presentment warranty for forgeries that exist on item at time of transfer
   ii. Breach of Transfer Warranty 4-207 -
      1. Proper P is transferee and any subsequent collecting bank
         a. Payor bank not a transferee b/c item presented
         b. First movement is not a transfer – its an issuance
      2. Proper D is anyone who transferred – see above
a. Can be better than chargeback rights b/c includes more possible Ds if funds already released

iii. Breach of Warranty damage calculation
   1. Amount paid by drawee – (amount drawee received OR is entitled to receive from drawer b/c of payment)

e. Chargeback rights – only a theory of recovery when payor bank dishonors
   i. By midnight deadline whenever there is dishonor b/c no suit required to recover funds
   ii. Properly used by Dep bank

f. Forgery of drawer’s signature does not present following receivers from being a person entitled to enforce, but forged indorsement does

g. Altered Instrument
   i. Payor bank that pays instrument altered after issue in good faith may enforce rights according to its original terms
      1. Payor bank recovers amount of alteration from Dep bank on breach of presentment
      2. Anyone who transfers after alteration breaches transfer or presentment warranty
   ii. Payor bank that pays instrument altered by unauthorized completion may enforce rights according to completed terms unless the bank knows the completion was improper
      1. Loss goes to party who left instrument incomplete
      2. Even if check was stolen from customer or payor bank can tell that the writing is different
   iii. Payor bank that pays unauthorized completion and re-credits its customer cannot recover from Dep on breach of presentment b/c of breach of warranty damage calculation

h. Remotely created checks
   i. Payor bank has rights against Dep b/c warranty for remote items
      1. A person who transfers remotely drawn item warrants that the drawer authorized issuance
   ii. Whether the draw was authorized will be hotly contested

V. Special Rules for Risk of Loss in Checking System (2 classes)
a. Negligence: If negligence substantially contributed to the unauthorized signature, negligent person precluded from asserting forgery against person who took in good faith
   i. If signature stamp is left with blank check – negligent
   ii. If employee steals check and forges to himself, employer can recover from payor bank b/c not properly payable
      1. Unless employer negligent – then can’t assert

b. When an instrument is lost, stolen, or destroyed the underlying obligation may not be enforced for the amount of the check
   i. Protects payor from double payment
   ii. You can still enforce lost instrument if you prove you had it and provide protection to the drawer
c. Impostor Rule: If impostor induces issue of instrument, the forged instrument is effective in favor of person who pays in good faith
   i. Presumptive negligence if drawer fooled by imposter

d. Impostor Rule 2: If person does not intend identified person as payee, possessor is holder of instrument and indorsement by anyone in name of stated payee is effective in favor of person who pays in good faith
   i. EE steals check and pays friend but writes a different payee. Friend forges indorsement and cashes.
      1. If employer is negligent he is stuck with loss
         a. Can’t get re-credit for not properly payable b/c of negligence in forgery
         b. Can’t get re-credit due to forged endorsement b/c anyone’s signature is effective as indorsement
      2. If employer not negligent payor bank stuck with loss
         a. Employer gets re-credit b/c not properly payable
         b. Payor bank can’t assert forgery for breach of presentment warranty b/c indorsement effective

e. Impostor Rule 3: If fictitious person identified as payee, any person in possession is holder and indorsement by any person in name of fictitious payee is effective in favor of person who pays in good faith
   i. Same result as Impostor Rule 2 question
   ii. Signature is effective means it is not a forgery with respect to anyone who pays in good faith

f. When drawer is precluded from asserting forgery, he can assert that preclusion is not absolute and recover contributory negligence

g. Employer-Employee situations
   i. Many Cases UCC puts loss on employer even when bank cashes fraudulent checks
   ii. Preventative Measures for Employer
      1. Have someone you trust look over bank statements soon
      2. Be mindful of location of blank checks, maybe at home
      3. When issuing check to unknown person or new supplier, make a phone call to person to confirm identity
      4. MOST IMPORTANT: Have at least 2, if not 3 employees in check writing process
         a. Greatly increases protection when you need 2 dishonest people to work together
   iii. Signature machine authorized by specific agreement with bank that allows recognition of machine signature
   iv. For bank paying in good faith, indorsement of employee who has responsibility for checks is effective as employers

h. Bank Statement Rules
   i. W/o regard to care or lack of care, a bank is off the hook for forged signature one year after issue of the statement that includes forged check
ii. When customer gets first statement of repeat forger, customer get 30 days to recognize forgery or they are out of luck for any forgery by the same person after that date

iii. Example of application: If checks forged over period of 18 months,
   1. Checks written more than 30 days after first statement with forgery from same person - loss to customer under rule 2
   2. For checks written before the 30 days rule, absolute one year statute of limitations – loss to customer under rule 1
   3. Customer recredit from loss for checks written 30-60 days (30 days after first statement with forgery), but even this re-credit is lost 1 year from issuance of statement with forged check

Bank Cards and Negotiability

I. Credit Card Payment Systems
   a. The basic relationships of an electronic payment system
      i. Issuing bank pays for charges, cardholder agrees to pay back over time.
      ii. Merchant has account with acquiring bank and sends slips to the acquiring bank to deposit funds into merchant’s account, provisional settlement.
      iii. Visa or MC is a network of banks that serve as clearinghouse for system. Network debits acquiring bank and charges issuing bank for transaction.
      iv. How money is made
         1. Issuing bank makes money by interest
         2. Acquiring bank and network take part of charge for their service
         3. Merchant only gets a percentage of the total price
   b. TILA cardholder rights
      i. Issuer subject to all claims and defenses from CC transaction, cardholder can withhold payment for disputed amount w/o adverse credit report if
         1. Cardholder makes good faith effort to resolve dispute w/ merchant
         2. Amount of transaction exceeds $50
         3. Transaction occurred in same state or w/in 100 miles of cardholder mailing address
      ii. Customer must give notice of dispute before paying disputed claim
         1. Once a person begins to make payments that would apply to the disputed transaction, cardholder loses right to withhold payment
            a. Payments first go against finance charges and penalties
            b. After finance charges and penalties: paid as first in, first out
         2. If notice comes at the same time as payment of disputed claim, notice is considered to come before payment
      iii. When cardholder disputes claim, issuing bank must credit account, then it can chargeback acquiring bank and acquiring bank charges back merchant
         1. Merchant has burden to contest charges against buyer
         2. If merchant and buyer don’t agree, then merchant must take buyer into arbitration that is run by network (Visa or MC)
            a. Arbitration tends to favor consumer
iv. TILA rights do not apply when money advanced for business purposes
   1. Payment w/holding unavailable to extent that bank knows purchases are for a business purpose
   2. If business is short on cash better to pay monthly payments so that issuer is stuck with loss when payments not made than to dispute charges and have the loss sent back to merchants

c. Credit exposure of the parties in credit card system
   i. Acquiring bank determines which merchants are allowed in system and takes risk that merchant will be insolvent and unable to pay chargeback
   ii. Issuing bank takes risk that cardholder won’t be able to pay account
      1. Credit card charges disposable in bankruptcy, high risk
      2. Risk is rightfully on issuing bank b/c they let cardholder in system
   iii. Issuing bank also risks that acquiring bank will be insolvent and the issuing bank is not able to chargeback disputed claim
   iv. Merchant is responsible for defects in the product it sent

d. Funds availability rules for credit card slips
   i. UCC and Reg CC funds availability rules do not apply – not “item”
   ii. Availability of funds for merchant with acquiring bank is decided by contract between merchant and acquiring bank
      1. Econ of situation allows merchant to demand funds availability
      2. Normally acquiring banks give funds w/in a few days
   iii. So long as customer has not paid down particular charge, customer maintains right to withhold payment - undisclosed lengthy period of time

II. Error and Fraud in Credit-Card Transactions
a. 3 ways for cardholder to contest charge: unauthorized, billing error, claim/defense
b. Cardholder liability for unauthorized charges
   i. Cardholder liable only up to $50 for unauthorized use
      1. 100 mile/same state limit doesn’t apply to unauthorized use claims
      2. No liability even if negligence contributes to loss
   ii. Miskoff holds that cardholder could be liable if unauthorized charges not known even after statement received, but TILA suggests that only statutory liability available – TILA grants liability only to $50
      1. Narrow holding is that courts willing to apply common law bank statement rule
      2. Broad holding is that courts are willing to apply common law negligence rule – this would override federal loss shifting CC rules
      3. Narrow holding hard to reconcile w/ statute, broad holding impossible to reconcile
   iii. Visa/MC rule: Can avoid $50 liability by reporting w/in first 2 bus days
   iv. Main incentive to report lost card is no one knows $50 rule
c. Authorization for use of credit card
   i. Signature not required for authorized use, TILA speaks in terms of authority to use
      1. Signature valuable to merchants for proof against claim or defense
d. Mail order merchants
   i. Disadvantage: Take on responsibility for fraud in order to be let in system
1. In face to face transaction issuing bank takes loss for unauth. use
   ii. Disadvantage: Merchant charged a higher discount rate by acquiring bank
   iii. Advantage: Increased chance that cardholder will not have right to withhold b/c likely outside of the 100 mile/same state limit

e. Billing error:
   i. Broadly defined to include goods or services not delivered as promised
   ii. Disadvantage: To claim billing error issuing bank must receive notice w/in 60 days after bank transmits statement w/ billing error (very strict)
   iii. Advantage: No loss of right to assert billing error for 100 miles/same state limit; no loss of rights due to already paying
   iv. If CC company overstates charge and individual doesn’t report w/in 60 day limit, cardholder may have restitution argument b/c someone is getting more money than they should.
      1. Restitution argument is at odds w/ clear language of CC agreement

f. Business Credit Cards and unauthorized use
   i. TILA does not protect business purchases
   ii. Unauthorized use provisions still apply to business related purchases
   iii. Business which provides credit cards to 10 or more people can contract to take on the liability for unauthorized use of the business credit card
   iv. In no case can business put the risk of unauthorized use on its employees for more than $50 TILA limit

III. Debit Cards (EFTA: Electronic Funds Transfer Act)
   a. Cardholder liability for Debit cards: 3 tiered system
      i. Even if customer reports theft immediately, liable for up to $50 charged before reporting of theft
      ii. Customer responsible for up to $500 that the bank can show would not have occurred if the consumer had reported theft w/in two days
         1. Bank must show losses caused by failure to report; thus, if thief charges $2K in first day the failure to report w/in 2 days does not cause loss unless failure to report stops bank from catching thief
      iii. Codified bank statement rule: Consumer responsible for all losses that bank can show would not have occurred if consumer had reported w/in 60 days of transmittal of bank statement showing unauthorized charges
         1. 60 days – greater time limit than bank statement rule for checks
         2. Consumer liability uncapped: Greater possible liability than CC

   b. PIN less debit:
      i. Visa/MC cap liability at $50 even if customer fails to notify of theft and fails to notice unauthorized charges w/in 60 days
         1. Even $50 loss avoidable if lost card reported in 1 day –MC, 2 -Visa
      ii. Visa/MC require banks to agree to 5 bus day re-credit deadline when customer reports unauthorized transaction

   c. Risk to merchants: final payment really final with debit card
      i. If forged card, stolen card, network rules stick loss w/ issuing bank
      ii. System malfunction: network rules stick loss w/ issuing bank
         1. Merchant only responsible for loss if knew it was getting paid when it shouldn’t be (knew of system malfunction, but used)
d. Comparison of CC, checkbook, and debit systems
   i. Stolen CC, checkbook or debit with PIN number
      1. Best off w/ stolen checkbook if not negligent b/c you cannot lose
      2. Better off with CC than debit w/ PIN b/c CC max liability is $50
         a. Only question is whether Minskoff puts greater liability on
            cardholder to report loses
   ii. Issuing bank preference
      1. Banks like debit card system better than checks b/c immediate
         income on per transaction fee
      2. Less processing costs, less time than checks
   iii. Consumer preference
      1. Consumer may prefer checks because of 2-7 day float time
      2. No claim or defense rule for debit card

e. Unauthorized funds transfer: Funds transfer initiated by person other than
   customer with authority to make such transfer (cardholder must get no benefit)
   i. If merchant charges as debit card when customer wanted credit card, this
      is not an unauthorized transfer with the debit card
      1. Mistake cost cardholder claim/defense privilege to w/hold payment
   ii. Bank must investigate unauthorized charge claim w/in 10 days, correct
      errors w/in 1 day of findings, and report results to customer w/in 3 days
      1. Provisional re-credit (with use of funds) must occur w/in 10 bus
         days of bank receiving notice of the error
         a. Different use of provisional re-credit than check system
      2. After re-recredit, bank has right to re-debit customers if bank later
         finds that the charge was correct
   iii. Unauthorized use of debit card vs. forgery of check
   iv. Debit card system assumes bank has the right to debit customer account
      1. Different that UCC assumption with forged check
      2. Check written on disputed funds properly dishonored if mistake on
         debit caused low funds, wrongful dishonor if forged check caused

IV. Negotiability – major problem with notes for class 13, chapter 39
   a. Negotiable vs. Non-negotiable instruments
      i. Negotiable instruments are subject to article 3 of UCC, non-negotiable is
         still valid and subject to common law contracts and article 4
         1. Negotiable instruments have presentment and transfer warranties
         2. Drafts (checks) have presentment and transfer warranties
            a. UCC 3-104(f) determines if it is draft
      ii. Later owners of non-negotiable instrument can’t get HIDC rights
         1. Shelter principle does apply
      iii. Negotiability may enhance liquidity, but negotiability is neither necessary
           nor sufficient for liquidity
         1. For bank liquidity more important than negotiability
      iv. Negotiability is not always clear cut; if there is doubt lawyer will not write
          opinion confirming negotiability – practical equivalent of non-negotiable
   b. 7 requirements for negotiability
      i. Must be written promise or order
II. Obligation must be unconditional

III. Obligation must require payment of money

IV. Amount of the obligation must be fixed

V. Obligation must be payable to the bearer or to order

VI. Must be payable on demand or at a definite time

VII. Obligation must not contain any extraneous undertakings by issuer

c. Things that do not destroy negotiability
   i. Late charges, variable interest rate - iv
   ii. Installment payments, prepayment rights, acceleration rights, extension at option of holder, or extension to further definite time at option of maker or on specific event – vi
   iii. If no time of payment (payable on demand) - vi
   iv. Promises by payee (payments applied in inverse order) - vii
   v. Promises by issuer having to do with paying money – vii
   vi. Reference to another record for statement of rights w/ respect to collateral, prepayment, or acceleration – ii
   vii. Traveler’s check requirement for countersignature – vii
   viii. Undertaking to give, maintain, or protect collateral – vii

ix. Usury Savings Clause

x. Standard mortgage ???

d. Things that destroy negotiability
   i. Promise by issuer to use money for business purpose (could argue that not an undertaking if no apparent penalty when undertaking not met) – vii
   ii. Requiring debtor to tell note holder for prepayment – vii

e. With respect to checks negotiability, bearer or order language requirement does not have to be met
   i. Check writer crosses out “to the order of” and substitutes “only to” – v
      1. Safe harbor for checks
   ii. Safe harbor does not protect condition/provision in memo line

f. Taxpayer using “shirt off back” to promise to pay taxes
   i. Shirt is draft which is a check
   ii. Can meet negotiability requirements
   iii. Bank doesn’t have to honor shirt b/c agreement w/ customer requires that checks be written on their chosen form
   iv. Govt. can sue on the instrument and recover just by showing shirt

V. Transfer and Enforcement of Negotiable Instruments (no notes for first of 2 classes)
a. Indorsement of instrument: manual, machine, or symbol OK for signature
   i. Signature is indorsement unless accompanying words unambiguously indicate otherwise
   ii. Indorsement is either blank or special
      1. When payee signs with blank endorsement, transforms order paper into bearer paper
         a. Holder (even if thief) entitled to enforce bearer paper
      2. Special endorsement creates order paper
         a. Forgery of endorsement breaks the chain of title
iii. Restricted indorsement “For deposit only” – proceeds must be deposited into the account of the named payee
   1. If not depository bank guilty of conversion

iv. Anomalous indorsement: indorsement made by person who is not holder
   1. Does not affect the manner in which instrument may be negotiated
   2. We presume anomalous endorsement is an accommodating party and that it is an indorsement with attaching indorser’s liability
      a. Accommodating party can recover from original indorser
      b. Accommodating party can recover from drawer if sued because drawer owes obligation to person entitled to enforce and indorser who paid the draft

b. Suing on the Instrument
   i. Liability on contract: Drawer’s liability 3-414
      1. Drawer liability conditioned on dishonor
      2. Drawer owes obligation to person entitled to enforce and endorser who paid the draft
      3. Once there is a forgery, any later party will not be able to sue on contract because they will not be a holder – must sue on warranty
   ii. Liability on instrument: endorser’s liability 3-415
      1. Must have dishonor for endorser’s liability
      2. Obligation owed to person entitled to enforce or person who paid instrument
      3. Forger takes on endorser’s liability
         a. Forging endorser obliged to pay person entitled to enforce or subsequent endorser who paid the instrument
   iii. When a check is dishonored, the payee can sue the drawer on the instrument or on the underlying obligation
      1. Suing on the instrument is easier evidence – just show 2 things

c. Check cashing business (40.4)
   i. Cashing a check with forged indorsement makes guilty of conversion to the owner of check (payee)
      1. Breach of transfer and presentment warranties to later parties
      2. Not liable for contract remedies because only person entitled to enforce can obtain contract remedies – forgery breaks chain
   ii. Cashing a check written “pay to order of bearer” w/o indorsement from person who gives check
      1. Check casher can recover from drawer on contract b/c obligation owed to person entitled to enforce or endorser who paid draft
      2. Can’t recover from person who cashed b/c must transfer by endorsement for breach of transfer warranty
   iii. Cashing a check that is specially endorsed to check casher, but has another name below the endorsement to check casher
      1. Anomalous endorsement does not affect state of affairs before anomalous endorsement
   d. Issuer can note that tender is in “full satisfaction of claim in dispute”
      i. If payee cashes the instrument the claim is fully satisfied
1. Even if full satisfaction remark stricken, cashing is full satisfaction
2. Payee must choose either to cash in full satisfaction or reject and attempt to get more in the dispute

ii. In order for “full satisfaction” to work – 3 elements
   1. Must proceed in good faith
   2. Must be amount that is actually in dispute
   3. Language must be conspicuous (easy to see, obvious)

e. Special Rules
   i. When a person entitled to enforce releases the obligation of principal obligor (accommodated party), the secondary obligor (accommodating party) is discharged to the same extent as principal unless the terms of the release retain the right to enforce
      1. If the item is a check the secondary obligor is released w/o regard to retained rights in the release
   ii. Depository bank can collect on check for customer w/o payee indorsement
      1. Representative capacity
   iii. When taking a cashier’s check for an underlying obligation, the underlying obligation is discharged
      1. Taking a cashier’s check is taking chance on bank
         a. If you know bank is in trouble don’t accept
      2. No spring back of rights on underlying obligation

VI. Holder In Due Course (two days)
a. Requirements to be a HIDC
   i. Must be holder: obtain instrument through negotiation
      1. Possession of bearer paper or identified person of order paper
      2. Or can be depository bank as representative
         a. Dep bank doesn’t need signature from own customer
   ii. Must take instrument for value:
      1. Payment or release of liability is value
      2. Future performance not value until performance
   iii. Must take in good faith: honesty in fact and observance of reasonable commercial standards of fair dealing
   iv. Must take without notice of problem
      1. Actual knowledge or reason to know that instrument has problem
      2. Notice considered at the time value is given
      3. Four problems for which knowledge destroys HIDC
         a. Overdue, dishonored or in default
            i. Missing interest payments does not make overdue
            ii. If installment K overdue – no HIDC if installments include principal, but HIDC for interest only
         b. Has forgery or alteration
         c. One of the obligors has personal defense or claim that would limit or bar enforcement of the instrument
            i. Discharge of instrument is defense or claim
         d. Third party claims to own all or part of instrument (recoupment)
4. Payment to obtain note of less than the value of the note can indicate notice of the problem if large, but standard discount is OK.

b. Discharge of the instrument
   i. Current law in most states (old UCC): Payment of note must be to person entitled to enforce in order to discharge obligation
      1. If you pay former owner, then you have unjust enrichment, but the obligation has not been discharged
      2. New UCC (5 states): Obligor who pays person formerly entitled to enforce w/o notice of transfer is discharged
         a. Burden shifted to new transferee to tell of transfer

c. Defenses and the HIDC
   i. HIDC takes free of all personal defenses, only subject to real defenses
      1. If personal defense is against you, HDC status doesn’t protect
         a. Cashier’s check obtained w/ dishonored check (mistake)
            i. Individual who obtained can’t enforce b/c recoupment defense
            ii. 3d party HIDC can enforce, then issuer must obtain recoupment in separate action
         b. HDC status does not normally help payee b/c HDC doesn’t protect from your own fault personal defenses
      2. Maintain HIDC status if you cash traveler’s check with forged countersignature and do not know of forgery
         a. Countersignature is not indorsement
         b. Forged countersignature is personal defense
         c. Person who took forged countersignature must not know that it was forged or not HIDC b/c notice of alteration
   ii. 4 real defenses that stop HIDC from collection
      1. Infancy
      2. Duress, lack of legal capacity, illegality (interpreted narrowly)
      3. Fraud induced issuance w/ no knowledge or reasonable opportunity to learn of character or essential term items (interpreted narrowly)
      4. Discharge of obligor in insolvency proceedings

d. Shelter principle: You receive rights at least as good as transferor’s rights (possibly better because you can become HDC when transferor was not)
   i. If you cannot be HDC (charity received as gift – no value given), still able to enforce HDC rights if the person who transferred was HDC
      1. If transferor received notice of problem after giving value, then still HDC (notice determined when value given)
   ii. Cannot use shelter principle rights to assert HDC over personal defenses of the transferor b/c you obtain HDC rights from transferor and HDC rights are against personal defenses of the issuer

e. A collecting bank must make funds immediately available to be an HDC, they do not do this because they have chargeback rights
   i. Chargeback rights easier to enforce than HDC status against 3d party
   ii. If funds immediately available, HDC status - sue issuer after dishonor
Secured Creditor Remedies

I. Remedies of Unsecured Creditors Under State Law
   a. Collecting after default on unsecured credit
      i. Process to collect:
         1. Must institute collection action to get MONEY JUDGMENT
         2. Then take money judgment to sheriff who levies property for foreclosure sale
         3. Proceeds of foreclosure sale go to the creditor
      ii. Another Process: Get writ of garnishment and garnish wages
      iii. Process in total costs more than $1000
      iv. Fair debt collection practices prohibit debt collector from threatening action that debt collector is not going to take
   b. Unsecured creditor cannot use self help
      i. Actionable as civil conversion and in many states criminal conversion
   c. Unsecured loan to business powerless when business doomed, but not in default
      i. Can trigger default on signs of instability
         1. Allows unsecured creditor to get some money before gone
      ii. Lacks control of secured creditor
   d. The place of an unsecured creditor vs. secured creditor and stockholder
      i. Secured creditor has lowest risk and return, stockholder highest
      ii. On failure – secured creditor, unsecured creditor, stockholder
   e. What does secured creditor need to know to satisfy money judgment
      i. Need to know where money is to collect
         1. Look for unencumbered, nonexempt, liquid assets
         2. Can find in public records and with depositions (see g below)
      ii. Need to know what property owned by debtor
         1. If levy on 3rd party property, you are liable for damages
   f. Exemption statutes: Exemption statute grants protection to personal property so that individual can’t be left on street (Example p710)
      i. If property worth more than exception, sell property and split proceeds
      ii. For business equipment exemption, business must still be operating
      iii. Difficult to garnish accounts because debtor can move money
   g. Should ask debtor about all possible people that owe him and garnish
      i. Interest in bank account in own or any other name
      ii. Any interest in payment from debtors
      iii. Lent money, payment for performed services, owed commissions, injury claims, deposits with landlord or utility, prepaid services, insurance payments, sold property on installments

II. Security and Foreclosure
   a. Foreclosure: transfer of ownership, hopefully followed by transfer of possession
   b. Exemption statutes: Most do not allow exemption against secured interest
      i. Property that would be exempt from unsecured interest not protected from secured interest
      ii. Inexplicable dichotomy: Cannot contractually waive exemption for unsecured interest, but waiver is implicit for secured creditors
c. Disguised security interest: Article 9 applies to any transaction that creates a security interest, regardless of form
   i. Functional test: consider the reasonable likelihood at the inception of the lease that the lessor will eventually get goods back at a time when the goods still have meaningful residual value
      1. Lease if lessor likely to get back with meaningful residual value
         a. $10 purchase option at end of two year lease – likely still a lease b/c lessor could return in three months
      2. If no meaningful residual value then lease
         a. If lease overly frontloaded such that it would be stupid to walk away, then it is disguised sale
   ii. UCC 1-203 (Revised) lists cases where there is definite security interest
   iii. Advantages of being lessor rather than A9 security interest
      1. Lessor does not need to file an Article 9 financing statement to defeat other claimants to the property
      2. Easier to repossess if it is a true lease

d. Deed in lieu of foreclosure: mortgagee agrees to take deed in exchange for waiver of any deficiency claim
   i. For mortgagee – saves foreclosure costs, may gain equity from deed
   ii. Junior lien holders rights are not extinguished with a deed in lieu of foreclosure (unlike foreclosure) unless they join signing of the deed
   iii. If substantial equity is given away by the debtor a deed in lieu of foreclosure could be construed as a constructive fraudulent conveyance
      1. Constructive fraudulent conveyance will nullify the transfer
      2. Other interests will have remedies against you and property
   iv. Avoiding judicial foreclosure process:
      1. If transfer of ownership is not immediate, then the arrangement is just another mortgage (interest in property contingent on non-payment) that must be judicially foreclosed
      2. If state does not require judicial foreclosures an agreement to sign deed in lieu of foreclosure w/ a third party on default (deed of trust) avoids foreclosure sale if there is an enforceable power of sale (can also trick debtor)
      3. Business pledging stock along with property: Transaction allows foreclosure on stock, change of directors, and forced deed in lieu of foreclosure
         a. Will work to avoid property foreclosure process
         b. Still must foreclose on the stock, but this is easier under A9
         c. Works if no other creditors or significant assets beyond the property in which you have lien, otherwise problems w/ constructive fraudulent conveyance and junior liens

III. Repossession of Collateral
   a. Secured party may use self-help repo so long as there is no breach of peace
      i. Policy: Allow self help b/c these rights are bargained for OR b/c secured creditors are more likely corporations –less risk of breach of peace
   b. Contours of Breach of Peace
i. Have rights to enter debtor’s property, but must make sure debtor is owner
ii. If there is confrontation with potential for violence repo is illegal
   1. Potential violence could be with anyone, not just debtor
   2. Polite or perfunctory objection does not cut it
   3. If repo people leave they can come back at time w/ no violence
   4. Repo at night often works better because of surprise
iii. Picking the lock has been allowed if there is provision in agreement
   1. Tresspass is not breach of peace unless chance of violence
   2. Liable for damages to other property protected by the lock
iv. Cases allow defrauding the guard, but lawyer cannot defraud or suggest using fraud

c. Provisions to include in security agreement to help repo
   i. Require debtor to assemble collateral and make available (legitimacy)
   ii. Require debtor to consent to creditors presence to effect repo even when debtor is not present (cannot give permission to go on 3d person’s land)
   iii. Require debtor to consent to cutting and picking locks, etc.
d. Advice for debtor facing repossession
   i. So long as there is resistance, repo person has no right to take - overreact
   ii. If sheriff, does he have writ of replevin or just to stop breach of peace
      1. If just to stop breach, debtor should still resist
      2. If has writ of replevin, some states allow sheriff to use force, others require sheriff to go back for more papers
   iii. Concealing property is criminal offense and risk to bankruptcy discharge
   iv. Debtor wins if well-advised against self-help repo

e. Notification to account holders to pay secured creditor directly (often best $)
   i. Account holder may request proof that the assignment has been made
   ii. Account holder payment to debtor will not discharge debt
   iii. Secured creditor takes accounts subject to any claims or defenses:
      1. Can only collect difference between amount account holder owes debtor and amount debtor owes account holder
f. Allocation of finite resources between creditors (consider leverage and time frame to exercise leverage)
   i. First: Utility company has great leverage and can exercise immediately
   ii. Second: If property needed article 9 creditors can get property in weeks
   iii. Third: Foreclosure on property could take months

g. Used car dealer can sell with switch because although article 9 only allows creditor to make “equipment” unusable, parties can vary A9 by agreement

IV. Judicial Sale and Deficiency

a. Bidding at a Foreclosure Sale
   i. If no deficiency available, creditor should credit bid entire amount of debt
   ii. If deficiency available, bid low but not so low to “shock the conscience”
      1. Cerillo: 40% won’t shock conscious if no procedural irregularities
      2. If procedural irregularities 2/3 FMV OK
      3. Stooge bidders can delay, some states stricter in second sale
   iii. If another bidder outbids credit bid, can either take payment or become a real estate speculator
b. Right of redemption
   i. Common law right of redemption exists in every state
      1. Must be exercised before the foreclosure sale
      2. Must pay full amount of debt
   ii. Statutory right of redemption is available in about half of the states
      1. Can be exercised after the foreclosure sale
      2. Only need to pay the price at the foreclosure sale

c. Advice to person who is facing foreclosure
   i. If house is worth less than amount of debt bargain for a deed in lieu of
      foreclosure or try to drum up interest to avoid possible deficiency
      1. Biggest worry is loss of property and deficiency settlement
      2. If relative is willing to buy the house bid upper end of value
   ii. If house is worth more than amount of debt try to sell the house and keep
      equity or get a new mortgage to pay off first mortgage
      1. If relative is willing to buy, buy from Sallie for amount of
         mortgage or from bank at lower price
      2. Buying from Sallie risks constructive fraudulent conveyance

d. Buying at a foreclosure sale
   i. Need to know about other liens on property and state of title (title search),
      condition of property, rights of redemption (statute), how much owing on
      mortgage (court records), FMV of house in area (zillow.com)
   ii. Debtor may have incentive to help w/ info if higher bid helps, bank has no
      incentive to help, sheriff will not give info b/c incorrect makes him liable

V. Article 9 Sale and Deficiency
   a. Unlike property foreclosure, many cases have repo’d, but don’t have title yet
   b. Deficiency award in article 9 sale: Commercially reasonable sales
      i. Non-consumer transactions: deficiency based on amount owed (with
         interest, cost of sale, and atty’s fees) less the amount received in
         commercially reasonable sale
         1. If commercially unreasonable sale then the deficiency is lesser of
            difference between amount owed and actual sale OR amount owed
            and what would be obtained at commercially reasonable sale
            a. Burden of proof is on secured creditor to show proceeds
               would have been less than debt
            b. Start with assumption that commercially reasonable sale
               would have yielded enough to cover debt
            c. Standard is liquidation value rather than FMV b/c we
               consider what we could get now not with time
      ii. Consumer transactions: Then article 9 provision does not apply and courts
          left to determine the amount of deficiency, if any
          1. Courts usually treat just as non-consumer transaction if
             commercially reasonable sale
          2. If commercially unreasonable then there is split in courts
             a. Some courts allow no deficiency in consumer context
             b. Some courts use the procedure for commercially
                unreasonable sales advocated by article 9 (see above)
iii. Commercially reasonable
   1. Secured creditor is not obligated to get the highest price for commercially reasonable sale
      a. Auto auction is commercially reasonable so creditor does not have to take offer that turns out to be more than auction
   2. Could include refurbishing collateral for profit (Helicopter hull)
      a. Statute doesn’t give credit for $ spent refurbing
      b. Argue for use of net proceeds to calculate deficiency
c. Right of Redemption under Article 9: To redeem debtor must pay full amount owed along with attorneys fees before the sale (No deficiency)
d. Proceeds from an article 9 sale are paid in the following order
   i. Reasonable expenses of repo, storage, and sale (Attorney’s fees if in K)
   ii. Satisfaction of Secured Debt
   iii. Satisfaction of obligations secured by subordinate interest on the same collateral IF secured party receives demand before distribution
   iv. Money left after these parties satisfied goes back to the debtor
      1. Unsecured creditors get nothing from this process
e. Notification of Disposition
   i. Reasonable notification to debtor, secondary obligor, and other lienholders
      1. If consumer goods no notice to other lienholder
      2. Consumer goods – used or bought primarily for personal, family or household use
   ii. Notification not required if goods perishable and in danger of losing value or customarily sold on a recognized market
      1. Stocks – customarily sold on recognized market, cars – NO
   iii. Reasonable notification prior to sale cannot be waived until default
      1. 10 days previous to non-consumer goods sale is reasonable
   iv. Parties can determine standards for sale unless manifestly unreasonable
      1. Could agree for 48 hours advance notice of sale
f. Secured party may lease or dispose of collateral, but deficiency limited to amount owed minus amount that would have been realized
   i. Court determines if disposition was commercially reasonable
   ii. Notice requirement applies even if disposing of collateral
   iii. Commercially reasonable includes refurbishing collateral for profit
      1. Deficiency calculated could be based on net proceeds of sale, but statute does not say to give credit for money spent
      a. Must argue that premise is “as is” sale
g. Secured creditor can accept collateral in full satisfaction of debt
   i. If accepted in full satisfaction, creditor can just send notice and lack of response means accepted in full satisfaction
      1. If debtor has paid 60% of debt then need signature
   ii. Collateral as partial satisfaction only w/ debtor consent (non-consumer)
      1. Consumer goods cannot be sold for partial satisfaction
      2. Debtor must sign and authenticate proposal for partial satisfaction
   iii. If creditor does not follow proper procedure for partial satisfaction, two possible results
1. Court can reduce deficiency to reflect amount that would have been obtained in commercially reasonable sale
2. OR Sale is completely invalid and ownership hasn’t transferred
   a. Debtor’s right to redemption lives indefinitely
   b. Cloud on title
   c. Debtor could argue for rent b/c creditor using his property

VI. Creditor’s Remedies in Bankruptcy
   a. Automatic stay: Any act to collect pre-petition debt violates stay
      i. Automatic stay enforced as soon as individual files for BR
      ii. Other parties may claim actual damages and court may impose punitives
      iii. Even state judgment must wait because of supremacy clause
         1. Cannot foreclose on property
         2. Exceptions to keep the peace, but not for a money judgment
      iv. Unsecured creditors must simply file proof of claim and wait
         1. Only leverage is vote needed to approve reorg plan
   b. Lift of stay: Secured creditors can lift stay and continue collection efforts
      i. Two situations for lift of stay
         1. Court must lift stay if property interest is declining in value and bankruptcy is providing “lack of adequate protection”
            a. Adequate protection determination left to BR court
               i. Failure to keep insurance
         2. Court must lift stay if there is no debtor equity in the property and the property is not “necessary to an effective reorganization”
      ii. Over-Secured Creditor
         1. If over-secured lift of stay will not meet either of two situations
         2. Over-secured creditor adds interest during BR, until reaches value of collateral
   c. Providing Adequate protection to avoid lift of stay
      i. Burden is on the debtor to find a way to protect your constitutional property interest
         a. Debtor can offer lien on other property to protect
      ii. Declines in value of the property and adequate protection
         1. Majority position forces debtor to give adequate protection based on value of collateral at time of filing
         2. Minority position forces debtor to give adequate protection based on value of collateral at time of petition to lift stay

VII. Treatment of Secured Creditors in Bankruptcy
   a. Unsecured Creditors Claims in Bankruptcy
      i. Calculating the amount of a claim
         1. Pre-petition interest builds at contract rate
         2. Post-petition interest, attorney’s fees and costs of claim are not allowed for unsecured creditor
         3. Pre-petition attorney’s fees included if part of original contract
      ii. Calculating the value received for a claim
         1. Divide assets available for unsecureds by amount of unsecured debt – this gives percent of claim received (cents on dollar)
2. Multiply percentage by the amount of the claim

iii. Unsecured creditors should collect at confirmation because there is risk of non-payment and time value of money decreases value later

1. Unsecureds generally not entitled to present value treatment

b. Best interests of creditors test:

i. If Chapter 11 reorg. promises to pay a return over time and the creditor can show that Chapter 7 liquidation would have paid this immediately, then the unsecured creditor can block the plan

ii. A reorganization plan must make creditors at least as well off as they would have been in liquidation

c. Secured creditor claims in bankruptcy

i. Pre-petition

1. Claim calculated to include principal and interest at petition

2. Claim bifurcated

   a. Amount covered by security is secured claim

   b. Amount above security value continues as unsecured claim

ii. Post-petition and preconfirmation

1. Secured claim accrues interest, attorney’s fees, and costs if

   a. Attorney’s fees and costs are reasonable

   b. Attorney’s fees and costs provided in K or state statute

   c. Interest, attorney’s fees, and costs accrue only to value of collateral

      i. Stops when meets value of collateral

2. Interest accrues at contract rate on the claim rather than just the principal compounding pre-petition interest

3. No-post petition interest for undersecured claims

   a. No adequate protection required for lost opportunity costs

iii. Post confirmation

1. Secured creditor entitled to present value of claim at confirmation for all of secured claim

2. Reorganization plan must meet total as discounted present value

d. Considerations for the trustee of an estate

i. Priority of claims against total proceeds

1. First, expenses of the sale

2. Second, secured creditor claims plus post-petition interest

3. Third, remainder to the estate to benefit unsecured

ii. Should trustee sell or abandon property

1. Sale is best until interest accrues so that there is no remainder value for the estate

2. Abandon properties that are worthless to estate - creditor foreclose
1. Value Given – presumably to the debtor (bad drafting)
2. Debtor must have rights in the collateral
3. Signed security agreement or possession of collateral (pawn shop):
   a. 3 reqs: Debtor signature, Granting Language, Collateral Description
   b. Security agreement should have all three requirements in one document, but Composite Document Rule
ii. Notice to the World: usually in the form of a financing statement
b. Signed Security Agreement (debtor signature, granting language, description)
   i. To be a signed security agreement all three requirements must be in the actual agreement
      1. Composite document rule favors equity
      2. Internal reference between documents helps bring application of composite document rule, cross references makes it even better
ii. Composite Document Rule: White and Summers 2 step test
   1. Does the language of the writings alone show that parties MAY have intended a security interest
      a. If yes, then consider step 2
      b. If no, then no signed security agreement
   2. Did the parties intend to create a security interest considering writings and parole evidence
iii. Courts generally do not let financing statement alone become signed security agreement (likely doesn’t have granting language)
   1. Many courts will allow financing statement to be part of composite document grouping

  c. Timing in creation of security agreement
   i. Security interest attaches when last of three requirements completed
      1. Typically none of these is binding until the closing is done because all acts at closing are contingent of one another
   ii. Timing is not usually the issue in security agreement
       1. In battle between creditor and debtor the question is whether the attachment happened
          a. Even in bankruptcy we look to whether attachment occurred
       2. In battle between creditor and third party, the important time is when the financing statement is filed

d. Collateral description
   i. Courts split as to whether collateral description must be in the security agreement when the debtor signs it
      1. Language of 9-203 suggests the description of the collateral must be in the document at the time of the signature
      2. Cases that allow collateral description to be added later do not mention timing, but extreme case could change the outcome (2yrs)
      3. Once bankruptcy filed, with no description the person becomes an unsecured creditor and cannot improve position
         a. Violation of Rules and automatic stay to fill in
ii. Description allowed to be in writing of the party with the secured interest when document in that party’s possession - sets up ethical problem

II. Proceeds, Products and Value Tracing
   a. What is included in a security interest
      i. Proceeds are automatically included in a security interest
         1. Proceeds means whatever is acquired on disposition of property, whatever is collected on account of collateral, rights arising from collateral, and claims or insurance arising from loss of collateral
            a. Young statute so not sure what limits are
            b. Early cases show expansive definition
         2. Proceeds may include types of property not specifically included
         3. Due to definition of proceeds there is risk that earlier secured creditor will have priority in objects not listed in agreement
         4. Horseracing purse probably proceeds under rights arising from
   ii. Presumption that after-acquired property is not covered in security
      1. With specific mention after-acquired property can be included
      2. Types of after acquired property
         a. Substitutions, additions, and replacements
   iii. Accounts: Monetary obligations owed to debtor from services done, property sold, or game of chance
      1. Bank accounts are only included if agreement refers to bank deposits, but Often money in bank will be proceeds from accounts
      2. Anything received paying these accounts will be proceeds
   iv. Equipment: Security interest in equipment only includes equipment that existed at time of agreement unless future equipment specifically added
   b. Comingled funds and collateral
      i. When collateral commingled security interest in identifiable proceeds
      ii. Lowest Intermediate Balance Rule
         1. Money taken out of a commingled account is taken from personal funds first, then from collateral
         2. When proceeds are taken from the account, they cannot be replaced so the security interest in the deposit account is decreased
            a. Whatever is purchased with funds is now collateral
         3. When funds used to purchase large item, this rule makes largest possible portion not proceeds
      iii. Transferees take money and $ proceeds in a bank account free of security interest absent collusion w/ debtor
         1. No security interest in amount paid to IRS in taxes
      iv. If cash proceeds combined w/ unsecured portions from commingled account to purchase property not otherwise in security agreement
         1. Fractional share of the copier could be used, but this requires leaving security interest until the copier sold
         2. Could argue for whole item as proceeds
         3. Not clear how A9 would come out

III. Prototypical Secured Transaction
   a. Modes of deception for collateral and ways to uncover it
i. Nonexistent collateral: must ensure that property is in possession  
   1. Floor checkers – oil, grain, and other swindle stories

ii. Double collateralization: getting security from two banks on same collateral (automobile example)  
   1. Creditor must check UCC filing system for borrower’s name against type of auto inventory  
   2. Get list of VIN’s from other bank and check against floor models

iii. Telling creditor that cars are on test drive or used as loan  
   1. Wait for car to come back from test drive  
   2. Require that debtor keep inventory in possession and not allow loan/test drive without written authorization  
      a. In this case demo ride is default

iv. Customer owned vehicles used for floor checks by calling them in for service and displaying as inventory  
   1. Lender could check the mileage  
   2. Demand MSO which must be surrendered to customer to gain title

v. Loans on fictitious sales  
   1. Attempt to verify that alleged consumer buyer existed  
   2. Require buyer to come to bank and show ID  
   3. Send customer satisfaction survey and see if it reaches customer  
   4. See if payments are coming from consumer address or PO box

b. Personal guarantees on secured interest in closely held businesses: 2 reasons  
   i. If borrower cannot pay the loan the owners might. Can get judgment against assets of the owner or sometimes secure against personal property  
   ii. Personal guarantee ensures that owners will cooperate even in default.  
      1. They have incentive to make corporation pay as much as possible to avoid personal liability  
         a. Owners decide who gets paid first  
      2. This could be preference in bankruptcy, but all you would have to do is give it back so you might as well take it

c. Out of trust: sale of collateral without paying lender; therefore short on collateral  
   i. Out of trust is default under many agreements (wholesale financing)  
      1. Default allows for immediate possession by creditor under UCC  
         a. Subject to breach of peace rules  
      ii. Being intentionally out of trust may be a criminal offense

d. Leverage of the debtor  
   i. Debtor can promise not to breach peace and not to file bankruptcy in return for promise to waive deficiency or drop criminal charges  
   ii. Argument for lack of consideration on an wholesale financing agreement only works before the first extension of credit

e. Secondary obligor can inherit rights against a third party from the primary obligor  
   i. Agreement to repossess at full amount owing on the collateral  
   ii. Dealer in this case could be subject to suit from manufacturer who is harmed by having to buy back inventory at full price (arguable)

IV. Personal Property Filing Systems  
   a. Priority: General rule is first in time wins priority to collateral
i. Judgment lien creditor finishes when sheriff levies
ii. A9 consensual creditor crosses the line when they perfect secured interest
iii. For collateral subject to cert. of title act perfection defined by statute

b. Filing A9 financing statement is not necessary or sufficient to perfect security interest subject to statute like a certificate of title statute
   i. Uniform Motor Vehicle Certificate of Title Act
      1. Lien perfected at time of creation if delivery w/in 10 days
      2. Lien perfected on delivery if not delivered w/in 10 days
   ii. If filed in wrong system secured creditor turns into unsecured

c. Debtor’s rights in collateral may be transferred
   i. Document that says that transfer is default, does not prohibit alienability
   ii. Property is still debtor’s to sell or pledge

d. Security interest continues in property despite sale, lease, etc.
   i. Large exception for buyer in the ordinary course of business
   ii. Purchaser who is not in ordinary course of business takes subject to security interest even though he didn’t know it existed
   iii. In order to remove security interest, must show that secured creditor was a party to the fraud
      1. Courts only protect equity if egregious misconduct
      2. Peerless packing said conduct not enough even though secured creditor sat by, allowed collateral delivery to fatten their take

e. Filing systems: Article 9 does not apply if preempted by federal law
   i. Filing categories with state UCC filing system (through Sec. of state)
      1. Equipment: goods other than inventory, farm, or consumer goods
      2. Inventory: Goods held by person for sale or lease, furnished by person under service contract, leased by a person as lessor, or raw materials, work in progress, or materials consumed in business
      3. Accounts: accounts receivable
      4. General intangibles: Trademarks, etc.
   ii. Patents: file in state and USPTO
      1. 9th Circuit holds patent act doesn’t preempt A9
      2. Some states hold that patent act does preempt
   iii. Copyrights: must be filed with copyright office: file in both
      1. Proceeds of copyrights are questionable
         a. Peregrine – must file in copyright office
         b. In re auxiliary power: copyrights not federally registered could be perfected in UCC system alone
         c. Broadcast Music – (9th Cir): assignment of royalties from copyright does not need to be filed in copyright office
      2. Copyright filing very expensive because must search for each work
         a. Federal systems do not have file by author, etc.

iv. Right to Trademark
   1. Peregrine: state filing OK
   2. Probably file with both to be safe
   3. Federal search to see if trademark is registered, state search for rights to trademark other than registration
v. Automobile ownership: file with DMV
   1. Car dealership files cars for sale in UCC filing office b/c inventory
   2. If car not for sale then filing should be with DMV
      a. Could be equipment
f. Collateral could be subject to cert. of title act for one and inventory for another
g. Generally file first to hold place in line, then search after a week or so to see that
   you are first in time

V. Concept of Priority: State Law
a. Article 9 and real property foreclosure sale discharges security interest of
   foreclosure sale and subordinate liens, but senior liens transfer with property
   i. If senior liens are worth more than property highest bid should be $0
   ii. Senior liens stay with the property, but they do not become the personal
       liability of the purchaser
       1. Could buy for $10 and hold off repo for cheap rental
   iii. Credit bid is only available to the person who will receive proceeds
       1. Senior liens cannot credit bid they are not entitled to proceeds
       2. Secured creditors subordinate to the foreclosing creditor can cash
          bid to amount satisfying foreclosing creditor and add your own
          credit bid to the amount of your lien
b. Expenses of foreclosure sale paid before money goes to foreclosing creditor
   i. If expenses take from foreclosing creditors total, then foreclosing creditor
      can ask for deficiency including that amount if expenses part of K
c. Foreclosure initiated by junior lien
   i. First lien holder entitled to notice of foreclosure by junior lien holder
      1. No notice requirement for consumer goods
      2. Entitled to damages for noncompliance with notice requirement
   ii. Reason for first creditor to be concerned when second lien is forcing
       foreclosure sale and property will bring in enough value to cover lien
      1. Lien holder is subject to the mercy of the possessor
         a. Thieves could buy and either disappear or destroy collateral
         b. Could misuse, abuse, or fail to insure
      2. First creditor might need to pursue improper procedure
   iii. First lienholder protection of interests
      1. Could try to protect interest by purchasing for maximum of total
         value minus debt owed on first lien – likely not a helpful strategy
      2. Better if original security interest prohibits junior liens
d. Prohibiting junior liens from foreclosing
   i. Grocer’s Supply: if debtor in default, senior lien can prohibit sale and get
      the collateral back at expense of junior lien holder
      1. Allows senior to give property back to debtor
   ii. Frierson: Does not allow senior creditor to use the right to possession to
       stop junior creditor from foreclosing
      1. Senior creditor can only have possession in order to foreclose
e. Junior lien holder strategy
   i. If you have junior lien and property is worth more than senior liens and
      your lien combined, foreclose and take property subject to mortgage
1. If senior lien forecloses, you must make sure bid is enough to cover your lien
   ii. Junior lien may want to include right to make payments on the first mortgage and make payments become part of the junior lien loan

VI. Concept of Priority: Bankruptcy Law
a. Trustee may sell property free and clear of liens if price at sale is greater than value of liens on property
   i. Oneida: value of lien is lesser of value of collateral or amount of debt
      1. Under this understanding property must just be sold for greater than its “value”
   ii. Correct reading: must sell for greater than aggregate amount of liens
      1. BR Code allows sale free and clear with consent of lien holders suggesting that we are protecting property interest of lien holder
         a. Thus, property only sold if lien holders get paid in full or they consent to selling of property b/c best they can get
      2. If we follow Oneida, this section of code and other ways to sell free and clear are superfluous
b. If debtor tries to sell free and clear under Oneida secured creditor can object to the sale free and clear under BR code
   i. Creditor can appeal to delay until price comes up, but appeal will not affect the validity of the sale unless court stayed the sale for the appeal
   ii. To stay the sale during an appeal, creditor must post insurance bond
b. Debtor in Possession in reorganization can borrow new money and have the lender prime the liens (jump to the front of priority)
   i. Must show that estate is unable to get loan otherwise
   ii. Must show that lien holders are adequately protected
      1. Lien holders would be OK if they believed court’s valuation

Priorities: Make sure to consider if parties is A9 secured creditor, state law lien creditor, trustee in bankruptcy, or buyer who would be in ordinary course (consumer and business buyer)
I. Lien Creditors Against Secured Creditors
a. Security interest is subordinate if person becomes lien creditor before the earlier of 1) perfection or 2) signed security agreement and financing statement
   i. Even if value not given; thus, no attachment, security interest takes priority when financing statement filed and security agreement filed
   ii. A9 system has speed advantage over state law judgment lien system
      1. If one unsecured creditor gets a judgment, the other may get security agreement to trump the judgment before levy
         a. Useful if it is too late to win judgment lien race
         b. Debtor may cooperate if creditor agrees not to foreclose or to pay some consideration
   b. Inchoate priority: if financing filed and security agreement signed, secured creditor holds place in priority line, but place in line only secured on perfection
      i. Must become choate before foreclosure sale or bankruptcy is filed
      ii. Article 9 creditor does not need to be perfected to defeat judgment lien
c. Beating the lien creditor
i. In jurisdiction that creates lien creditor at levy, airtight procedure is to file financing statement and get security agreement, search to ensure no one filed ahead, make sure property is in debtor’s possession, then loan money
   1. If jurisdiction where judgment liens shown in filing system you do not even have to check for possession of property

ii. In jurisdiction where judgment lien priority is based on time when writ delivered to officer, potential secured creditor must search both UCC filing system and check sheriff records
   1. Law specifically only gives priority against other judgment creditors, but would seem that writ is also time vs. A9 interest
   2. Law does not specify whether writ delivery must be in the county where property located
      a. If limited in this way only need to check in one county
      b. Otherwise, must check every county in jurisdiction

   d. Purchase Money Security Interest: Loan that enables debtor to purchase the collateral which will become the security of the loan
      i. For consumer goods (personal, family, household purpose) PMSI automatically perfects on attachment
      ii. For non-consumer goods PMSI perfection dates back to attachment so long as financing stmnt filed w/in 20 days after debtor receives delivery
         1. 20 day clock starts once debtor receives delivery of collateral, but if filed within 20 day period relation back to time of attachment
      iii. Examples of PMSI
         1. Seller gives credit to a buyer
         2. Buyer purchases machine w/ money from third party lender
      iv. Examples that are not PMSI
         1. Loan money for security interest in property already owned
      v. PMSI in inventory only valid if proper steps are taken – see IV f below

II. Lien Creditors Against Secured Creditors: Future Advances
   a. Advances made after judgment lien (Different for A9 v. A9 –see IV below)
      i. In real estate
         1. Majority: Advances pursuant to optional future advance clause take priority over known intervening judgment lien creditor
            a. Here, attorneys fees clearly take priority to judgment lien
         2. Minority: Only advances which are committed before the judgment have priority over judgment lien. Optional vs. Obligatory (similar to Article 9, without 45 day rules)
            a. Priority of attorney’s fees relates to priority of associated $
            b. Priority to attorneys fees for proportion associated with original loan, no priority to fees associated with advance
      ii. Under Article 9
         1. Advance subordinate to lien creditor if made more than 45 days after person becomes lien creditor UNLESS
            a. Advance made w/o knowledge of lien
            b. Advance made pursuant to commitment entered into w/o knowledge of the lien
2. Attorney’s fees and interest (non-advances)
   a. Majority: non-advances mimic the priority of the underlying debt to which they attach
   b. Minority: ?
3. 3 circumstances where advances take priority over judgment lien creditor under the article 9 regime
   a. Future advance made no later than 45 days after judgment lien creditor becomes judgment creditor
   b. More than 45 days after levy, A9 creditor still takes priority if no knowledge of judgment lien at time of advance
   c. If more than 45 days and A9 creditor knows of judgment lien, A9 still takes priority for advance made pursuant to commitment made before knowledge of judgment lien
b. Effects of advance priority on bidding at foreclosure
   i. Buyer of property subject to senior A9 lien must be careful that A9 creditor cannot make advance w/in 45 days because this will add to the lien which has priority over judgment lien
c. Advances: Article 9 secured creditor vs. the buyer
   i. Buyer takes free of secured interest advance if secured party advances
      1. Either After secured party knew of the purchase
      2. OR After 45 days after the purchase
      3. Unless advance made pursuant to a commitment made w/in the 45 day period AND the secured party did not know of purchase
   ii. In order to have advance run with property the secured creditor must
      1. Have no knowledge of purchase AND advance w/in 45 days of purchase
      2. OR Make commitment w/in 45 days w/o knowledge
      3. A buyer at a foreclosure sale is not in the ordinary course of business
d. Right to know of secured interest
   i. Jr creditor has right to discovery in aid of executing foreclosure
      1. Prospective buyer does not have formal right, but judgment creditor may have incentive to give information
   ii. Junior creditor foreclosing on property can freeze priority by giving Sr creditor knowledge of the foreclosure sale
   e. If search shows multiple security interests at a time when no one would rightly lend money it likely means unsecured creditors made deals to secure priority on preexisting debts
III. Trustees in Bankruptcy Against Secured Creditors: The Strong Arm Clause
a. Strong Arm Statute:
   i. At time of BR filing trustee can step into shoes of
      1. Judicial lien creditor who became creditor at BR filing against competing interests in personal property
         a. If A9 attaches, but fails to perfect before BR filing generally loses to trustee
b. Most claims that are unperfected at BR avoided, becoming unsecured claims
c. If perfected just before BR, trustee preference powers would probably avoid

2. The Bona Fide Purchaser who purchased on the date of BR filing with respect to Real Property (slightly more powerful than JLC)
   a. With this power trustee prevails over A9 secured creditor who was supposed to do something but did not
   ii. If trustee in the shoes of hypothetical person takes priority over a secured creditor, the trustee can avoid security which makes creditor unsecured
      1. Corporation in BR does not have to avoid security interest
         a. Unsecureds can come forward and compel avoidance
      2. DIP makes decision as to whether to avoid
         a. DIP is usually managers who are shareholders
      3. Because of this situation it is common for plan to give some money to SHs. This is payoff to managers that allows the unsecureds to avoid litigation costs of compelling avoidance
b. If financing statement not filed at commencement of BR, secured creditor becomes unsecured
   i. Commencement date does not change if BR converted from reorganization to liquidation of vice versa
   ii. Exception to BR law if there is another law granting more time to file financing statement
      1. Exception to the automatic stay in order to file when bankruptcy law allowing exception for another law applies
      2. PMSI may be able to perfect post-petition and relate back due to 20 day rule
c. If financing statement defective, the lien is subordinate to A9 secured creditors and bona fide purchasers who gave value in reasonable reliance on priority
   i. In Real Estate situation, bona fide purchaser strong arm allows trustee to take priority
      ii. In Article 9 situation, strong arm power does not grant priority
      iii. Financing Statement defective if 9-516 not met
d. Financing statement effective for 5 years (unless otherwise noted); effectiveness lapses unless continuation statement filed w/in 6 months prior to lapse
   i. If security interest had not lapsed at time of BR filing, then it will not lapse as against trustee when the effective period runs during BR
   ii. Bona Fide purchaser would defeat lapsed security agreement, but judicial lien creditor would not
e. If become judicial lien creditor at filing of writ and writ filed before bankruptcy then judicial lien creditor will have priority over hypothetical lien creditor
   i. This does not allow levy, levy would be violation of automatic stay
f. In BR, unless there is a way to pay unsecured creditors 100 cents on the dollar, the Shareholders get nothing
g. Professor White’s proposal to repeal UCC §9-317(a)(2) w/ no changes to BR
   i. Give priority to unperfected security interest over judicial lien creditor
1. Providers of security interests would still have to file to beat other creditors who file and PMSIs
2. Contracts with bars against secondary liens would be enforceable, but impractical because you would not know of liens
3. Judicial lien holder would have to levy and expect bad surprises about security interests

ii. Effectively proposal would shift wealth from general unsecured creditors to unperfected secured creditors
   1. Secured creditors mainly interested in defeating trustee would save money of filing fees and attorney’s fees in BR
   2. Secured creditors mainly concerned with defeating other secured creditors more inclined to file if they believe less will file
   3. If unsecured creditors include involuntary creditors such as judgment creditors the shift in wealth will be negative overall

IV. Secured Creditors against Secured Creditors
   a. Priority among secured creditors ranks according to first to file or perfect
   b. Circular Priority Problem
      i. A files but does not get security agreement (not perfected), then B files and perfects, then C gets judgment lien levied
      1. A beats B, B beats C, C beats A
   ii. To break circular priority
      1. First, look to any subordination agreement that might break circle
      2. Second, courts look to policy favorites like secured creditors over judgment lien creditors
      3. Third, court can split pro rata between the three
   c. Double Debtor Problem
      i. C1 perfects against D2, C2 perfects against D1, then C1 perfects against D1 on the same collateral. Collateral in hands of D1, C2 wins. But if D1 transfers to D2 C1 should win under normal rules
      ii. UCC subordinates C1’s interest in collateral in D2’s hands so long as C2 was perfected at the time D1 transfers the collateral to D2
      1. Do not allow C1’s earlier filed financing statement upset priority to collateral when the first debtor had possession.
      2. Requires that C2 has already perfected against D1 and at no time is unperfected when D2 gains possession
         a. If no perfection then go back to first to file or perfect rule
   d. Pre-filing of financing statement is acceptable (and advisable)
      i. If a filing statement from prior loan already describes collateral for new loan properly, any security agreement should take priority over another secured creditor because priority dates to original financing statement
   e. Advances and New Loans on same collateral
      i. Priority of any advance dates back to the earliest filing or perfection
      ii. Unlike the case of an advance vs. a judgment lien, a future loan on the same collateral takes priority at time of original financing statement
      1. Advances and new loans against same collateral will always defeat later filed security interests
2. Even just a financing statement would do the trick so long as value given and security agreement signed before bankruptcy or foreclosure

iii. Second security interest can avoid being primed by advances from prior filed security interest by gaining subordination agreement
   1. Must get debtor to obtain subordination agreement, but little reason for primary lender to sign this
   2. Secured creditors who have filed, but will not loan may be willing to subordinate
   3. If no subordination agreement do not loan on secured collateral

f. Purchase Money Security Interests: proper PMSI beats secured creditor even if secured creditor filed first
   i. PMSI gets to jump in front of secured creditors
      1. Exception to first to File or Perfect Rule
      2. Allows person to loan for property and not get stuck behind secured interest that transfers with the property
   ii. PMSI in inventory
      1. Special rules to prevent double collateralization by gaining a PMSI on inventory that would otherwise be secured by a prior interest
         a. Must run an A9 search to find existing creditors
         b. Must send notice to each of the previous creditors
         c. Must repeat notice every 5 years
         d. Must perfect interest in each shipment before debtor has possession
            i. Get financing statement and signed security agreement
            ii. Never let debtor have possession before acquiring ownership rights
   iii. Foreseeable problems
      1. Existing inventory lenders will not be happy with PMSI
      2. Arrangement suggests that debtor is using one of the two loans for something other than inventory – double collateralization
         a. Primary lender will know and not count PMSI inventory as part of collateral

V. Buyers Against A9 Secured Creditors
   a. Exceptions to the rule that buyers of property take subject to security interest
      i. Authorized Disposition
      ii. Buyer in the Ordinary Course
      iii. Buyer without knowledge before filing financing statement
          1. If security interest has not been perfected, then buyer wins
      iv. Consumer to consumer sale (Garage Sale)
   b. Buyer in ordinary course Exception: Must have right buyer and seller
      i. The right type of Buyer in ordinary course
         1. May purchase with credit
         2. May NOT take goods in satisfaction of debt
      ii. The right type of seller
1. Must purchase from a person in bus of selling this type of good
   iii. Even if right seller and buyer, buyer in ordinary course only takes free of
        security interests created by the seller
       1. Security interests of prior parties remain on the collateral
       2. Risk in purchasing used goods from dealer of goods
          a. To be safe purchaser must inquire about former owners and
             search under former owner’s names
          b. Odds of having this problem are remote
          c. Not necessarily unique to used goods b/c dealer may
             purchase from middle man who had security interest
       3. If you purchased with prior security interest, article 2 seems to give
          buyers rights over secured creditor when goods are identified upon
          contract for sale, shipped, or marked as goods for that customer
          c. Purchaser who leaves car w/ a dealer and inventory lender also has rights to goods
             i. Buyer in ordinary course definition requires that purchaser either take
                possession or the right to recover goods from the seller
                1. If you have prepaid you have right to recover goods from seller
                   once the goods have been identified by contract
                   a. If you can show this you defeat inventory lender
             ii. If you are commercial buyer and you pay in advance this is probably not
                 commercially reasonable which makes you not in good faith
                1. If not in good faith you cannot be buyer in ordinary course and you
                   lose to inventory lender or BR trustee
                2. Good faith requires not only honesty in fact, but commercially
                   reasonable practices