

Payment Systems, Banking, and Documentary Transactions

*Carolina Academic Press
Law Casebook Series
Advisory Board*



Gary J. Simson, Chairman
Dean, Case Western Reserve University School of Law

Raj Bhala
University of Kansas School of Law

John C. Coffee, Jr.
Columbia University Law School

Randall Coyne
University of Oklahoma College of Law

John S. Dzienkowski
University of Texas School of Law

Paul Finkelman
Albany Law School

Robert M. Jarvis
*Shepard Broad Law Center
Nova Southeastern University*

Vincent R. Johnson
St. Mary's University School of Law

Michael A. Olivas
University of Houston Law Center

Kenneth Port
William Mitchell College of Law

Michael P. Scharf
Case Western Reserve University School of Law

Peter M. Shane
*Michael E. Moritz College of Law
The Ohio State University*

Emily L. Sherwin
Cornell Law School

John F. Sutton, Jr.
Emeritus, University of Texas School of Law

David B. Wexler
*John E. Rogers College of Law
University of Arizona*

Payment Systems, Banking, and Documentary Transactions

Problems, Cases, and Comments

SECOND EDITION

Edited by

Dellas W. Lee

EMERITUS PROFESSOR OF LAW
TEXAS TECH UNIVERSITY

and

Timothy R. Zinnecker

PROFESSOR OF LAW
SOUTH TEXAS COLLEGE OF LAW

CAROLINA ACADEMIC PRESS

Durham, North Carolina

Copyright © 2007
Dellas W. Lee and Timothy R. Zinnecker
All Rights Reserved

ISBN 10: 1-59460-429-0
ISBN 13: 978-1-59460-429-4
LCCN 2007928098

Carolina Academic Press
700 Kent Street
Durham, NC 27701
Telephone (919) 489-7486
Fax (919) 493-5668
www.cap-press.com

Printed in the United States of America

To my gracious wife, Mary
— D.L.W.

To Robert and Elaine, my extraordinary and beloved parents
— T.R.Z.

Contents

Preface	xv
Introduction	xvii
Part I · PROMISSORY NOTES	3
Chapter 1 · The Formal Requisites of Negotiability	5
EMERSON v. ZAGURSKI	8
A. Writing, Signed by the Maker or Drawer, and Words of Negotiability	11
1. Writing	11
2. Signature	11
3. Words of Negotiability: “Payable to Bearer or to Order”	12
Problem 1-1	12
4. Who Is Entitled to Indorse?	13
Problem 1-2	13
B. Unconditional Promise or Order to Pay	13
Problem 1-3	14
Notes	14
1. “Subject to” Language	14
TELERECOVERY OF LOUISIANA, INC. v. GAULON	15
Problem 1-4	17
Problem 1-5	18
Notes	18
2. The Effect on the Instrument of Unmentioned Side Agreements	19
Problem 1-6	20
Note	20
C. A Fixed Amount of Money	20
Problem 1-7	21
Notes	21
D. On Demand or At a Definite Time	22
KRAJCIR v. EGIDI	22
Note	25
1. On Demand	25
2. Definite Time	25
Problem 1-8	26
Note	26
Problem 1-9	27
Notes	27
E. A Negotiable Instrument Must Be a Courier without Luggage	28
Problem 1-10	28

Notes	29
F. Contracting Into, and Out of, § 3-104	30
Chapter 2 · The Liability of the Parties to Promissory Notes	31
A. The Nature of Primary and Secondary Liability	31
1. The Maker	31
a. Designating the Parties: Who Is the Maker?	32
i. Notes Made by Agents and Other Representatives	32
MUNDACA INVESTMENT CORP. v. FEBBA	33
Problem 2-1	35
Problem 2-2	36
Note	36
ii. Signatures in Ambiguous Circumstances	36
Problem 2-3	36
2. The Indorser's Liability	37
a. Liability on the Indorsement Contract	37
Problem 2-4	37
Note	38
b. Presentment, Dishonor, Notice, and Protest	38
i. Presentment	38
Problem 2-5	39
ii. Dishonor and Notice of Dishonor	39
Problem 2-6	39
Notes	40
Problem 2-7	41
iii. Waiver or Excused Presentment and Notice of Dishonor	41
Problem 2-8	41
B. Who Is a PETE?	42
Problem 2-9	42
C. Accommodation Parties	42
1. Suretyship Law	42
FLOOR v. MELVIN	43
Note	45
2. The Accommodation Contract	46
VENAGLIA v. KROPINAK	46
Problem 2-10	49
Note	49
Problem 2-11	50
3. The Accommodation Party's Affirmative Rights	50
Problem 2-12	50
Notes	51
Problem 2-13	51
Note	52
4. The Accommodation Party's Defenses	52
VENAGLIA v. KROPINAK	52
Note	59
Problem 2-14	59
D. Warranties	60
1. Who Gives Transfer Warranties and to Whom Do They Run?	61

2. Disclaimer of Warranties	61
Problem 2-15	61
Note	62
3. Measure of Damages	63
Problem 2-16	63
E. The Underlying Contract	64
Problem 2-17	64
Chapter 3 · Defenses to Liability	67
A. Holder in Due Course	68
1. Negotiation: § 3-201	68
a. Holder: § 1-201(b)(21)	69
Problem 3-1	69
b. Holder in Due Course Defined: § 3-302	70
i. Value: § 3-303	71
Problem 3-2	71
Note	72
Problem 3-3	72
Problem 3-4	72
ii. Good Faith: § 1-201	73
MAINE FAMILY FEDERAL CREDIT UNION v.	
SUN LIFE ASSURANCE COMPANY OF CANADA	73
Notes	82
Problem 3-5	83
iii. Without Notice—Overdue, Dishonored, Default	84
Problem 3-6	84
iv. Without Notice of Claims or Defenses	85
Problem 3-7	85
B. Judicial and Legislative Qualifications to Negotiability in Consumer Transactions	85
DE LA FUENTE v. HOME SAVINGS ASS'N	86
FORD MOTOR CREDIT COMPANY v. MORGAN	88
Notes	92
C. Successors to Holders in Due Course—The Shelter Doctrine	93
Problem 3-8	93
D. Real and Personal Defenses	93
Problem 3-9	94
Problem 3-10	94
Problem 3-11	95
Problem 3-12	95
E. Claims of Ownership and Conversion	95
Problem 3-13	95
Notes	96
F. Claims in Recoupment	96
Problem 3-14	96
PART II · DRAFTS AND CHECKS	99
A. Formal Differences	99
B. Functional Differences	99

Chapter 4 · Rights and Duties under the Drawer-Drawee Relationship	101
A. Non-Bank Drawees	101
NORTON v. KNAPP	101
B. Banks as Drawees, the Federal Reserve System, and Check Collection	103
BLAKE v. WOODFORD BANK & TRUST CO.	106
C. The Contract of Deposit and Damages for Wrongful Dishonor	112
Problem 4-1	112
D. The Bank's Right to Charge the Drawer's Account:	
The Properly Payable Rule	112
1. Conditional Orders	113
Problem 4-2	113
2. Post-dated Checks, Stale Checks, and Overdrafts	113
Problem 4-3	113
Problem 4-4	114
Problem 4-5	114
3. Order in Which Items May Be Charged	115
Problem 4-6	115
Problem 4-7	115
Notes	116
4. Forgeries, Fictitious Payees, Impostors, and Alterations	117
VICTORY CLOTHING CO. v. WACHOVIA BANK, N.A.	117
Note	124
SCHRIER BROTHERS v. GOLUB	124
Problem 4-8	128
TITLE INSURANCE CO. OF MINNESOTA v.	
COMERICA BANK – CALIFORNIA	129
Problem 4-9	132
Problem 4-10	132
Problem 4-11	133
HSBC BANK USA v. F & M BANK NORTHERN VIRGINIA	134
Problem 4-12	137
Problem 4-13	138
GINA CHIN & ASSOCIATES, INC. v. FIRST UNION BANK	138
Note	140
5. Duty to Examine Cancelled Items	140
SPACEMAKERS OF AMERICA, INC. v. SUNTRUST BANK	140
Notes	145
Problem 4-14	146
6. Death or Incompetence of Drawer	148
Problem 4-15	148
Note	148
7. Stop Payment Orders and Orders to Close Account	148
ROVELL v. AMERICAN NATIONAL BANK	149
Problem 4-16	154
Problem 4-17	155
 Chapter 5 · The Holder's Rights Against the Drawer and Other Parties to Checks and Drafts	 157
TEPPER v. CITIZENS FEDERAL SAVINGS & LOAN	157

Notes	159
A. Holder's Rights Against the Drawer	159
1. Presentment and Dishonor	159
2. Time for Presentment and Dishonor	160
Problem 5-1	160
3. Presentment for Acceptance and Notice of Dishonor	161
Problem 5-2	161
Problem 5-3	162
Problem 5-4	162
B. Holder's Rights Against the Payor Bank and Collecting Banks	163
1. Acceptance and Certification	163
MESSING v. BANK OF AMERICA, N.A.	163
Problem 5-5	174
2. Conversion	175
GERBER & GERBER, P.C. v. REGIONS BANK	175
Problem 5-6	178
Note	179
3. Restrictive Indorsements and Other Instructions	181
Problem 5-7	181
Note	182
Problem 5-8	182
Problem 5-9	183
4. Funds Availability Under Regulation CC	184
Problem 5-10	184
C. Payor Bank's Recovery of Money After Final Payment or Settlement	184
1. Forgery and Payor Bank's Right to Recover After Final Payment	185
Problem 5-11	185
Problem 5-12	185
Problem 5-13	186
2. Alteration Before and After Final Payment and Final Settlement	186
Problem 5-14	186
3. Mistake	187
Problem 5-15	187
Problem 5-16	188
D. Cashier's Checks and Teller's Checks	188
Problem 5-17	188
PART III · DOCUMENTARY TRANSACTIONS	191
Chapter 6 · Documents of Title—Article 7	193
A. Some Comparisons of Documents of Title with Negotiable Instruments	194
B. The Parties in a Typical Documentary Transaction	195
BRANCH BANKING & TRUST CO. v. GILL	196
C. The Storage and Carriage Contract: §§7-201, 7-302, 7-204, 7-403, 7-309	199
1. Scope of Issuer's Responsibility	199
a. Failure to Deliver	199
Problem 6-1	199
Note	200
b. Nonreceipt and Misdescription	200

Problem 6-2	200
Notes	201
D. Impact of Due Negotiation on Equities of Ownership—Cut-Off Power	201
Problem 6-3	201
Problem 6-4	202
Problem 6-5	202
E. Shipments Under Reservation: §§ 2-310, 2-505	203
1. Buyer Defaults—Seller’s Rights Against the Bailee	204
Problem 6-6	204
2. Buyer Defaults—Seller’s Rights Against the Buyer	205
Problem 6-7	205
3. Buyer Defaults—Seller’s Rights Against Collecting Bank	206
Problem 6-8	206
4. Seller Defaults—Buyer’s Rights Against Collecting Bank	207
Problem 6-9	207
5. Seller Defaults—Buyer’s Rights Against Depository Bank	208
Problem 6-10	208
6. Buyer’s Right of Inspection in Domestic and International Transactions	208
Problem 6-11	208
Problem 6-12	209
Chapter 7 · Letters of Credit	211
Problem 7-1	213
A. Issuer’s Duty and Privilege to Honor Letter of Credit	214
SZTEJN v. J. HENRY SCHRODER BANKING CORP.	214
Note	217
SRS PRODUCTS CO. v. LG ENGINEERING CO., LTD.	217
Problem 7-2	222
COLORADO NATIONAL BANK OF DENVER v. BOARD OF COUNTY COMMISSIONERS OF ROUTT COUNTY, COLORADO	223
MELLON BANK, N.A. v. GENERAL ELECTRIC CREDIT CORP.	229
B. Issuer’s Obligation to the Applicant and the Beneficiary:	
The Strict Compliance Doctrine	233
NEW BRAUNFELS NATIONAL BANK v. ODIORNE	233
IN RE CORAL PETROLEUM, INC.	236
SAMUEL RAPPAPORT FAMILY PARTNERSHIP v. MERIDIAN BANK	240
KERR-MCGEE CHEMICAL CORP. v. FDIC	242
Note	244
Problem 7-3	245
PART IV · ELECTRONIC FUND TRANSFERS AND CREDIT CARD PAYMENTS	247
Chapter 8 · Consumer Electronic Fund Transfers	249
A. The Electronic Fund Transfers Act—Scope of Coverage	249
KASHANCHI v. TEXAS COMMERCE MEDICAL BANK, N.A.	249
Notes	254
B. Consumer Electronic Fund Transfer Conventions	254

1. The Automated Teller Machine (ATM)	254
KRUSER v. BANK OF AMERICA NT & SA	255
Note	259
OGNIBENE v. CITIBANK, N. A.	259
Note	262
Problem 8-1	262
Notes	263
2. Point of Sale (POS)	264
3. ACH Transfers	264
Problem 8-2	265
Problem 8-3	266
Chapter 9 · Commercial Electronic Fund Transfers	267
A. Wholesale Wire Transfers and Article 4A	267
B. Fedwire	268
C. CHIPS	269
D. Terminology and Basic Concepts	269
BANQUE WORMS v. BANKAMERICA INTERNATIONAL	270
Notes	275
Problem 9-1	277
Note	278
E. Erroneous Submission or Execution	279
Problem 9-2	279
F. Unauthorized Transfers	280
REGATOS v. NORTH FORK BANK	280
Problem 9-3	286
Chapter 10 · Credit Cards	289
A. The Nature and Operation of the Credit Card Payment System	289
B. Unauthorized Use	291
TELCO COMMUNICATIONS GROUP, INC. v.	
RACE ROCK OF ORLANDO, L.L.C.	291
MARTIN v. AMERICAN EXPRESS, INC.	295
MINSKOFF v. AMERICAN EXPRESS TRAVEL RELATED	
SERVICES CO.	297
DBI ARCHITECTS, P.C. v. AMERICAN EXPRESS	
TRAVEL-RELATED SERVICES CO.	302
C. Billing Errors	308
GRAY v. AMERICAN EXPRESS COMPANY	308
STRANGE v. MONOGRAM CREDIT CARD BANK	
OF GEORGIA	314
Note	318
Problem 10-1	319
D. Asserting Claims and Defenses Against the Issuer	319
IZRAELEWITZ v. MANUFACTURERS HANOVER TRUST COMPANY	320
PLUTCHOK v. EUROPEAN AMERICAN BANK	321
Notes	323
Problem 10-2	325

Table of Cases	327
Table of Statutes	329
Index	335

Preface

Dellas Lee, my co-author and principal draftsman of the first edition, has retired as a professor of law at Texas Tech University. He gave me unfettered discretion in creating this second edition. The fruits of his labor remain throughout this work, which rightfully continues to bear his name.

Like the first edition, this second edition continues to rely heavily on problems as the primary learning tool. Most of the problems found in the first edition remain, with some tweaking here and there. Some new problems have been added. A few cases from the first edition have been deleted, and a handful of new cases have been added. Textual material has been updated where appropriate.

As noted in the first edition, the classroom has served as a working laboratory during the writing of this book. On behalf of Dellas Lee, I extend gratitude to the many students who have offered insightful comments and helpful suggestions, and express appreciation to Carolina Academic Press for being our publisher.

Timothy R. Zinnecker

Introduction

Negotiable instruments have been important to the world of commerce for more than a thousand years, a period during which the right to the payment of money has been conveyed from one person to another by the transfer of a piece of paper. The early development and long importance of negotiable instruments is suggested by the fact that even before the ninth century on the continent of Europe (and probably in England) a right to the payment of money could be merged with and into a piece of paper. That is, the right to the payment of money could be made to depend upon the production of the paper on which the obligation to pay was written.

Negotiable instruments – the most common of which are promissory notes and checks – are still indispensable to the consumer and commercial world, and their end is nowhere in sight. A study conducted for the Federal Reserve System in 2004 revealed that 36.7 billion checks were paid in 2003, having an average value of \$1,070 and an aggregate value of \$39.3 trillion.¹ But the advent of sophisticated communications technology now permits the majority of noncash payments to be initiated electronically with a debit or credit card, or through an automated clearinghouse (e.g., direct deposits or automatic withdrawals). The same study revealed that 44.5 billion electronic payments originated in the United States in 2003, with an aggregate value of \$27.4 trillion and an average value of \$617. That trend – more electronic payments and fewer paper-based payments – is expected to continue.

The materials in this textbook cover paper-based and electronic payments and are divided into four parts. In Part I (chapters 1, 2, and 3) our primary focus is on promissory notes, with emphasis on selected provisions of U.C.C. Article 3.² In Part II (chapters 4 and 5) we shift our primary focus to drafts and checks, including some banking law and procedure, again focusing attention on selected provisions of U.C.C. Article 3, and adding selected provisions of U.C.C. Article 4. In Part III (chapters 6 and 7), we place the use of notes, drafts, and checks into their commercial context through a study of documents of title under U.C.C. Article 7 and letters of credit under U.C.C. Article 5. Finally, in Part IV (chapters 8, 9, and 10), we explore electronic payment systems, with emphasis on consumer electronic fund transfers under federal law, commercial wire transfers governed by U.C.C. Article 4A, and credit card transactions under federal law.

1. See “The 2004 Federal Reserve Payments Study,” available at <http://www.frbservices.org/Retail/pdf/2004PaymentResearchReport.pdf>.

2. Unless otherwise indicated, all U.C.C. citations are to the various Articles as revised through 2006. Citations to former versions of an Article are prefaced with an “F” (e.g., F§ 3-104). A former version of selected Articles can be found in your statutes book.

