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FORMAL REQUIREMENTS OF NEGOTIABLE INSTRUMENTS

Writing any intentional reduction to tangible form is sufficient

Signed any symbol executed or adopted by a party with the present intention to authenticate/adopt or accept a writing

Promise or Order to Pay

- **Promise to Pay** an undertaking to pay, which must be more than a mere acknowledgment or recognition of an existing debt
- **Order to Pay** instruction to pay

Unconditional an absolute promise to pay that is not subject to any contingencies

- **Reference to Other Agreements** does not destroy negotiability unless the recital makes the instrument subject to or governed by the terms of another agreement
- **The Particular Fund Doctrine** an order or promise to pay only out of a particular fund no longer is conditional and does not destroy negotiability

Fixed Amount the holder must be assured of a determinable minimum principal payment although provisions in the instrument may increase the amount of recovery under certain circumstances

Money legal tender authorized or adopted by a sovereign government as part of its currency

No Other Undertaking or Instruction a promise or order to do an act in addition to the payment of money destroys negotiability

Payable on Demand or at a Definite Time an instrument is demand paper if it must be paid upon request; an instrument is time paper if it is payable at a definite time

Payable to Order or to Bearer a negotiable instrument must contain words indicating that the maker or drawer intends that it pass into the hands of someone other than the payee

- **Payable to Order** payable to the "order of" (or other words which mean the same) a named person or anyone designated by that person
- **Payable to Bearer** payable to the holder of the instrument; includes instruments (1) payable to bearer or the order of bearer, (2) that do not specify a payee, or (3) payable to "cash" or to order of "cash"

CASES

CASE

26-1

Formal Requirements of Negotiable Instruments HERITAGE BANK v. BRUHA

Supreme Court of Nebraska, 2012 283 Neb. 263, 812 N.W.2d 260

http://scholar.google.com/scholar_case?case=1681132292552202525&q=812+N.W.2d+260+&hl=en&as_sdt=2,39



Connolly, J.

[Jerome J. Bruha signed a promissory note on December 16, 2008, with Sherman County Bank. The note evidenced a promise to pay "the principal amount of Seventy-five Thousand & 00/100 (\$75,000.00) or so much as may be outstanding, together with interest on the unpaid outstanding principal balance of each advance." The note stated that it "evidence[d] a revolving line of credit." The note contained a variable interest rate. The rate was subject to change every

month and calculated on an index maintained by Sherman County Bank.

On this note, Bruha received advancements in the amount of \$10,000 on December 16, 2008, \$40,000 on December 17, and \$1,000 on January 30, 2009. This totaled \$51,000. Bruha then invested the money in accounts with a trading company, which allegedly shared management with Sherman County Bank.

There are a few typographical errors on the note. First, the maturity date on the note is February 1, 2008, which,

read literally, means that the note would have matured about 10 months before Bruha signed it. Other notes he had signed stated maturity dates of February 1, 2009. Second, in a section titled "COLLATERAL" the note reads: "Borrower acknowledges this Note is secured by an assignment of hedge account from Jerome Bruah [sic] to Sherman County Bank dated DATE [sic]." Thus, Bruha's name is misspelled and a line for a date is unfilled.

Sherman County Bank eventually failed, and the Federal Deposit Insurance Corporation (FDIC) was appointed as receiver. The FDIC then sold and assigned some of Sherman County Bank's assets to Heritage. These assets included the note signed by Bruha. Heritage sued Bruha to enforce the note.

In his answer, Bruha admitted that he signed the note but claims that he did not do it voluntarily. He claimed that Sherman County Bank had procured his signature "by fraud and/or misrepresentation." Bruha also claims that the typographical errors destroyed the negotiability of the promissory note. Moreover, Bruha claims that Sherman County Bank misled him into borrowing money that, in turn, he invested with a trading company that generated trade commissions through risky and speculative commodity trading. Bruha admitted that he had not paid the note but denied that he was obligated to do so.

The district court granted summary judgment to Heritage and awarded it \$61,384.67 (\$51,000 plus interest) on this note. The court disallowed Bruha's defenses because, under federal law, for certain defenses to be asserted against the FDIC or its assignees, the defenses must be evidenced in writing. The court found that there was no evidence in writing of a defense that would invalidate the note. The court also concluded that the FDIC had become a holder in due course and thus not subject to most defenses. Bruha appealed.]

The primary issues are whether either the holder-in-due-course rule of Nebraska's Uniform Commercial Code or federal banking law bars Bruha's defenses to the enforcement of the note.

* * *

Bruha argues that Heritage is not a holder in due course. Similarly, he argues that the FDIC was not a holder in due course when it held the note. A holder in due course is, with some exceptions, "immune to defenses, claims in recoupment, and claims of title that prior parties to commercial paper might assert. The holder in due course always enjoys certain pleading and proof advantages." So if Heritage were a holder in due course, it would enjoy an advantageous position in litigation with Bruha.

We conclude, however, that Heritage is not a holder in due course because the note was not "negotiable" and article 3 of the Uniform Commercial Code does not apply to this case.

Neb. U.C.C. § 3-104(a) provides: "Except as provided in subsections (c) and (d), 'negotiable instrument' means an

unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order..." (Emphasis supplied.) Here, the note fails to meet the definition of a "negotiable instrument" because it was not a promise "to pay a fixed amount of money."

Although the Uniform Commercial Code allows notes to have a variable interest rate, under § 3-104(a), the principal amount must be fixed. "A fixed amount is an absolute requisite to negotiability." This is because unless a purchaser can determine how much it will be paid under the instrument, it will be unable to determine a fair price to pay for it, which defeats the basic purpose for negotiable instruments.

We applied this principle in [citation], in which we stated that "[a] guaranty is not an agreement to pay a fixed amount and is therefore not a negotiable instrument subject to article 3 of the Nebraska Uniform Commercial Code." To meet the fixed amount requirement, the fixed amount generally must be determinable by reference to the instrument itself without any reference to any outside source. If reference to a separate instrument or extrinsic facts is needed to ascertain the principal due, the sum is not "certain" or fixed.

Here, the text of the note states that Bruha "promises to pay... the principal amount of Seventy-five Thousand & 00/100 Dollars (\$75,000.00) or so much as may be outstanding..." Further, the note states that it "evidences a revolving line of credit" and that Bruha could request advances under the obligation up to \$75,000. This fails the "fixed amount of money" requirement of § 3-104(a); one looking at the instrument itself cannot tell how much Bruha has been advanced at any given time. So, the note is not negotiable. Stated simply, "[a] note given to secure a line of credit under which the amount of the obligation varies, depending on the extent to which the line of credit is used, is not negotiable..."

For a person to be a holder in due course, the instrument must be negotiable. Because the note was not a negotiable instrument, neither the FDIC nor Heritage could ever become a holder in due course of it under Nebraska law. And further, because this note is not a negotiable instrument, article 3 does not apply.

* * *

[The Supreme Court of Nebraska reversed the district court's finding that the holder-in-due-course rule of Nebraska's Uniform Commercial Code bars Bruha's defenses. The Supreme Court, however, concluded that Federal law bars Bruha's defenses and thus affirmed the district court's summary judgment in part. The Supreme Court also held that Bruha had failed show how the typographical errors had invalidated the note. But because the Supreme Court found a minor error in the district court's calculation of interest, the Supreme Court remanded the case to the district court for correction.]

CASE

26-2

Demand

NATIONSBANK OF VIRGINIA, N.A. v. BARNES

Virginia Circuit Court, Twentieth Circuit, 1994 33 Va.Cir. 184, 24 U.C.C. Rep.Serv.2d 782

**Horne, J.**

This matter is before the court on Plaintiff's Motion for Partial Summary Judgment. Defendants have filed a Grounds of Defense, asserting certain affirmative defenses to liability. Plaintiff argues that it is entitled to partial summary judgment. As discussed more fully below, Plaintiff's motion will be granted in part and denied in part. The court will address Defendant's affirmative defenses as they relate to each note specifically, and to both Notes in general.

The following facts are undisputed with respect to the 1991 Note which is the subject of Count II of the Motion for Judgment. Defendants Ad Barnes, Trustee, Ad Barnes and Elaine Barnes executed a *** Note to Sovran Bank, N.A. on August 27, 1991, in the principal amount of \$200,000. Plaintiff NationsBank is the successor by merger to Sovran and is now the holder of this Note. *** By letter dated February 17, 1993, NationsBank made demand on the 1991 Note.

The factual question still in dispute concerning the 1991 Note is whether it is a demand note. Plaintiff argues that the language of the note is unambiguous and is clearly a demand note. Defendants argue that the detailed enumeration of events constituting default is inconsistent with a demand

note. Thus, a standard of good faith must be applied before a demand for accelerated repayment can be made.

[UCC] §1-203 establishes a general duty of good faith in every contract governed by the Commercial Code. Under any contract providing for accelerated payment at will, §1-208 states that the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired. However, the Official Comment to this section indicates that it is not applicable to a demand instrument.

[UCC] 3A-108(a) [UCC Revised §3-108(a)] states that a note is payable "on demand" if it says it is payable on demand or states no time for payment. In this case, the 1991 *** Note is a standard form with different forms of repayment set out on the first page. The box marked payable "on demand" has been checked in this instance. There is no time set for repayment, only a provision requiring monthly payments of interest.

It is the court's opinion that the 1991 Note is unambiguous and is clearly a demand note. Thus, Plaintiff is under no obligation to show good faith before requesting payment on the note. Since demand has been made by Plaintiff, Defendants are liable. Thus, Plaintiff is entitled to summary judgment on the issue of liability under the 1991 Note.

CASE

26-3

Payable to Order or to Bearer

COOPERATIEVE CENTRALE RAIFFEISEN-BOERENLEENBANK**B.A. v. BAILEY**

United States District Court, Central District California, 1989 710 F.Supp. 737

http://scholar.google.com/scholar_case?case=15799376056319723245&q=710+F.Supp.+737&hl=en&as_sdt=2,10**Rea, J.**

This matter comes before the court on the motion of both parties to this action for partial summary adjudication and on plaintiff's motion for summary judgment. ***

This is an action for collection on a promissory note brought by plaintiff, Cooperatieve Centrale Raiffeisen-Boerenleenbank, B.A. ("the Bank"), against the maker of the note, William Bailey, M.D. ("Bailey"). Bailey executed the note in December, 1982, in favor of "California Dreamstreet," a joint venture which solicited investments in a cattle-breeding operation. California Dreamstreet negotiated the note in 1986 to the Bank, which in turn filed this action on August 29, 1988.

The note states in relevant part:

DR. WILLIAM H. BAILEY *** hereby promises to pay to the order to CALIFORNIA DREAMSTREET *** the sum of Three Hundred Twenty Nine Thousand Eight Hundred (\$329,800.00) Dollars. ***

By this motion for partial summary adjudication, the parties seek to determine, as a threshold matter, whether the subject promissory note is a negotiable instrument. *** [The parties] agree that the sole issue is whether the unusual language in the note obliging Bailey to "pay to the order to California Dreamstreet" renders the note non-negotiable.

Whether an instrument is negotiable is a question of law to be determined solely from the face of the instrument, without reference to the intent of the parties. [Citation.] To be negotiable, an instrument must “be payable to order or bearer.” Code §3-104(1)(d) [Revised §3-104(a)(i)]. “Payable to order” is further defined by Code §3-110(1), as follows:

(1) An instrument is payable to order when by its terms it is payable to the order or assigns of any person therein specified with reasonable certainty, or to him or his order, or when it is conspicuously designated on its face as “exchange” or the like and names a payee.

[Compare Revised §3-109(b).]

It is well established that a promissory note is non-negotiable if it states only: “payable to (payee),” rather than “payable to the order of [payee].” [Citations.] Bailey claims that the instant note, which states “pay to the order to [payee],” falls between these two alternatives and should therefore be deemed non-negotiable.

The authorities are unhelpful. There is apparently no case on record in which a variance this small from the language of the Code has been called into question. Both parties direct the Court’s attention to Official UCC Comment 5 to Code §3-104, which states:

5. This Article omits the original Section 10, which provided that the instrument need not follow the language of the act if it ‘clearly indicates an intention to conform’ to it. The provision has served no useful purpose, and it has been an encouragement to bad drafting and to liberality in holding questionable paper to be negotiable. The omission is not intended to mean that the instrument must follow the language of this

section, or that one term may not be recognized as clearly the equivalent of another, as in the case of “I undertake” instead of “I promise,” or “Pay to holder” instead of “Pay to bearer.” It does mean that either the language of the section or a clear equivalent must be found, and that in doubtful cases the decision should be against negotiability.

In the court’s opinion, the Comment fails to persuasively support either party’s position. Rules of grammar belie the Bank’s argument that the preposition “to” is an apt substitute for “of” since the resulting sentence, read literally, is not just ambiguous but incomplete. On the other hand, the Comment expressly disavows Bailey’s argument that the Code drafters intended to set forth certain “magic words,” the absence of which precludes negotiability.

What does emerge from the Comment is the need for certainty in determining negotiability. Though sensitive to this goal and to the potentially harsh result of such a finding, the court does not find the instant facts to present the kind of “doubtful” case which should be resolved against negotiability. In this context, the phrase “pay to the order to” can plausibly be construed only to mean “pay to the order of.” While other explanations are possible, none are realistic. To hold otherwise would, in this court’s opinion, set an overly technical standard that could unexpectedly frustrate legitimate expectations of negotiability in commercial transactions.

For all the above reasons, IT IS HEREBY ADJUDGED that the promissory note which is the subject of this action is a negotiable instrument. It is further Ordered that plaintiff’s motion for summary judgment is denied without prejudice to its being renewed upon the completion of discovery.

QUESTIONS

1. State whether the following provisions impair or preclude negotiability, the instrument in each instance being otherwise in proper form. Answer each statement with either the word “Negotiable” or “Nonnegotiable” and explain why.
 - a. A note for \$2,000 payable in twenty monthly installments of \$100 each that provides the following: “In case of death of maker, all payments not due at date of death are canceled.”
 - b. A note stating “This note is secured by a mortgage on personal property located at 351 Maple Street, Smithton, Illinois.”
 - c. A certificate of deposit reciting “June 6, 2014, John Jones has deposited in the Citizens Bank of Emanon, Illinois, Two Thousand Dollars, to the credit of himself, payable

upon the return of this instrument properly indorsed, with interest at the rate of 6 percent per annum from date of issue upon ninety days’ written notice. (Signed) Jill Crystal, President, Citizens Bank of Emanon.”

- d. An instrument reciting “I.O.U., Mark Noble, \$1,000.00.”
- e. A note stating “In accordance with our contract of December 13, 2013, I promise to pay to the order of Sam Stone \$100 on March 13, 2014.”
- f. A draft drawn by Brown on the Acme Publishing Company for \$500, payable to the order of the Sixth National Bank of Erehwon, directing the bank to “Charge this draft to my royalty account.”
- g. A note executed by Pierre Janvier, a resident of Chicago, for \$2,000, payable in Swiss francs.

- h. An undated note for \$1,000 payable "six months after date."
- i. A note for \$500 payable to the order of Ray Rodes six months after the death of Albert Olds.
- j. A note of \$500 payable to the assigns of Levi Lee.
- k. A check made payable "to Ketisha Johnson."
2. State whether the following provisions in a note impair or preclude negotiability, the instrument in each instance being otherwise in proper form. Answer each statement with either the word "Negotiable" or "Nonnegotiable" and explain why.
- a. A note signed by Henry Brown in the trade name of the Quality Store.
- b. A note for \$850, payable to the order of TV Products Company, "If, but only if, the television set for which this note is given proves entirely satisfactory to me."
- c. A note executed by Adams, Burton, and Cady Company, a partnership, for \$1,000, payable to the order of Davis, payable only out of the assets of the partnership.
- d. A note promising to pay \$500 to the order of Leigh and to deliver ten tons of coal to Leigh.
- e. A note for \$10,000 executed by Eaton payable to the order of the First National Bank of Emanon in which Eaton promises to give additional collateral if the bank deems itself insecure and demands additional security.
- f. A note reading, "I promise to pay to the order of Richard Roe \$2,000 on January 31, 2014, but it is agreed that if the crop of Blackacre falls below ten bushels per acre for the 2013 season, this note shall be extended indefinitely."
- g. A note payable to the order of Ray Rogers fifty years from date but providing that payment shall be accelerated by the death of Silas Hughes to a point of time four months after his death.
- h. A note for \$4,000 calling for payments of installments of \$250 each and stating "In the event any installment hereof is not paid when due this note shall immediately become due at the holder's option."
- i. An instrument dated September 17, 2014, in the handwriting of John Henry Brown, which reads in full: "Sixty days after date, I, John Henry Brown, promise to pay to the order of William Jones \$500."
- j. A note reciting "I promise to pay Ray Reed \$100 on December 24, 2014."
3. On March 10, Tolliver Tolles, also known as Thomas Towle, delivered to Alonzo Craig and Abigail Craig the following instrument, written by him in pencil:
- For value received, I, Thomas Towle, promise to pay to the order of Alonzo Craig or Abigail Craig One Thousand Seventy-Five (\$1,000.75) Dollars six months after my mother, Alma Tolles, dies with interest at the rate of 9 percent from date to maturity and after maturity at the rate of 9.75 percent. I hereby waive the benefit of all laws exempting real or personal property from levy or sale.
- Is this instrument negotiable? Explain.
4. Henry Hughes, who operates a department store, executed the following instrument:
- \$2,600 Chicago, March 5, 2014
- On July 1, 2014, I promise to pay Daniel Dalziel, or order, the sum of Twenty-Six Hundred Dollars for the privilege of one framed advertising sign, size 24 × 36 inches, at one end of each of two hundred sixty motor coaches of the New Omnibus Company for a term of three months from May 15, 2014.
- (Signed) Henry Hughes
- Is this instrument negotiable? Explain.
5. Paul agreed to lend Marsha \$500. Thereupon Marsha made and delivered her note for \$500 payable to Paul or order "ten days after my marriage." Shortly thereafter Marsha was married. Is the instrument negotiable? Explain.
6. For the balance due on the purchase of a tractor Henry Brown executed and delivered to Jane Jones his promissory note containing the following language:
- January 1, 2014, I promise to pay to the order of Jane Jones the sum of \$7,000 to be paid only out of my checking account at the XYZ National Bank in Pinckard, Illinois, in two installments of \$3,500 each, payable on May 1, 2014, and on July 1, 2014, provided that if I fail to pay the first installment on the due date, the entire sum shall become immediately due.
- (Signed) Henry Brown
- Is the note negotiable? Explain.
7. Sam Sharpe executed and delivered to Don Dole the following instrument:
- Knoxville, Tennessee May 29, 2014
- Thirty days after date I promise to pay Don Dole or order, Five Thousand Dollars. The holder of this instrument shall have the election to require the assignment and delivery to him of my 100 shares of Brookside Iron Works Corporation stock in lieu of the payment of Five Thousand Dollars in money.
- (Signed) Sam Sharpe
- Is this instrument negotiable? Explain.

8. Explain whether the following instrument is negotiable.

March 1, 2014

One month from date, I, James Jimson, hereby promise to pay Edmund Edwards: Six thousand,

Seven hundred Fifty (\$6,750.00) dollars, plus 8 3/4% interest. Payment for cutting machines to be delivered on March 15, 2014.

(Signed) James Jimson

CASE PROBLEMS

9. Broadway Management Corporation obtained a judgment against Briggs. The note on which the judgment was based reads in part: "Ninety Days after date, I, we, or either of us, promise to pay to the order of Three Thousand Four Hundred Ninety Eight and 45/100 --- Dollars." (The underlined words and symbols were typed in; the remainder was printed.) There are no blanks on the face of the instrument, any unused space having been filled in with hyphens. The note contains clauses permitting acceleration in the event the holder deems itself insecure and authorizes judgment "if this note is not paid at any stated or accelerated maturity." Explain whether the note is negotiable order paper.
10. Sandra and Thomas McGuire entered into a purchase and sale agreement for "Becca's Boutique" with Pascal and Rebecca Tursi. The agreement provided that the McGuires would buy the store for \$75,000, with a down payment of \$10,000 and the balance of \$65,000 to be paid at closing on October 5, 2014. The settlement clause stated that the sale was contingent upon the McGuires' obtaining a Small Business Administration loan of \$65,000. On September 4, 2014, Mrs. McGuire signed a promissory note in which the McGuires promised to pay to the order of the Tursis and the Green Mountain Inn the sum of \$65,000. The note specified that interest payments of \$541.66 would become due and payable on the fifth days of October, November, and December 2014. The entire balance of the note, with interest, would become due and payable at the option of the holder if any installment of interest was not paid according to that schedule.
- The Tursis had for several months been negotiating with Parker Perry for the purchase of the Green Mountain Inn in Stowe, Vermont. On September 7, 2014, the Tursis delivered to Perry a \$65,000 promissory note payable to the order of Green Mountain Inn, Inc. This note was secured by transfer to the Green Mountain Inn of the McGuires' note to the Tursis. Subsequently, Mrs. McGuire learned that her Small Business Administration loan had been disapproved. On December 5, 2014, the Tursis defaulted on their promissory note to the Green Mountain Inn. On June 11, 2014, PP, Inc., formerly Green Mountain Inn, Inc., brought an action against the McGuires to recover on the note held as security for the Tursis' promissory note. Discuss whether the instrument is negotiable.
11. On September 2, 2008, Levine executed a mortgage bond under which she promised to pay the Mykoffs a preexisting obligation of \$54,000. On October 14, 2014, the Mykoffs transferred the mortgage to Bankers Trust Co., indorsing the instrument with the words "Pay to the Order of Bankers Trust Company Without Recourse." The Lincoln First Bank, N.A., brought this action asserting that the Mykoffs' mortgage is a nonnegotiable instrument because it is not payable to order or bearer; thus it is subject to Lincoln's defense that the mortgage was not supported by consideration as an antecedent debt is not consideration. Is the instrument payable to order of bearer? Discuss.
12. Horne executed a \$100,000 note in favor of R. C. Clark. On the back of the instrument was a restriction stating that the note could not be transferred, pledged, or otherwise assigned without Horne's written consent. As part of the same transaction between Horne and Clark, Horne gave Clark a separate letter authorizing Clark to pledge the note as collateral for a loan of \$50,000 that Clark intended to secure from First State Bank. Clark did secure the loan and pledged the note, which was accompanied by Horne's letter authorizing Clark to use the note as collateral. First State contacted Horne and verified the agreement between Horne and Clark as to using the note as collateral. Clark defaulted on the loan. When First State later attempted to collect on the note, Horne refused to pay, arguing that the note was not negotiable as it could not be transferred without obtaining Horne's written consent. Is the instrument negotiable? Explain.
13. The Society National Bank (Society) agreed in a promissory note to lend U.S.A. Diversified Products, Inc. (USAD) up to \$2 million in the form of an operating line of credit upon which USAD could make draws of varying amounts. The outstanding balance was to be paid on April 30 of the following year. USAD defaulted on the line of credit, and Society filed a complaint against USAD. Is the promissory note negotiable? Explain.



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