

## Chapter 12 Negotiable Instruments and Secured Transactions

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Source: Bohlman/Dundas, The Legal, Ethical,  
& International Environment of Business

### Four Requirements for Negotiable Instruments

- Written and signed by maker or drawer
- Are unconditional promises or orders to pay a fixed amount of money
- Are payable to bearer
- Are payable on demand or at a definite time

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Source: Bohlman/Dundas, The Legal, Ethical,  
& International Environment of Business

### Negotiable Instruments

- Negotiable instruments serve two functions
  - Substitute for money
  - Credit device

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Source: Bohlman/Dundas, The Legal, Ethical,  
& International Environment of Business

### Types of Negotiable Instruments

- Two party
  - Promises to pay
    - Notes
    - CDs
- Three party
  - Order to pay
    - Drafts
    - Checks

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Source: Bohlman/Dundas, The Legal, Ethical,  
& International Environment of Business

#### What is negotiable?

*Negotiable* means transferable.

The negotiation that goes on refers to the transfer of the instrument between two people, or from one bank to another, or even from one country to another.

#### What is an instrument?

In the broadest sense, almost any agreed-upon medium of exchange could be considered a negotiable instrument. In day-to-day banking, a negotiable instrument usually refers to checks, drafts, bills of exchange, and some types of promissory notes.

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Source: Bohlman/Dundas, The Legal, Ethical,  
& International Environment of Business

### CHECKS

- Most common form of negotiable instrument
- Preferred method of payment for many debts
- Offer convenience, safety, and a record of transactions

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Source: Bohlman/Dundas, The Legal, Ethical,  
& International Environment of Business

## STANDARD FEATURES OF PERSONAL CHECKS

Maria Mills  
12 River Street  
Pettisville, OH 43553-0177

Check Number 801  
Date Date 5-25-42

Pay to the order of Payee \$ Amount Dollars

Amount  
Pettisville Bank  
Pettisville, Ohio

For Memo Signature

⑆000601⑆ ⑉41200257⑆ 103⑆ 7943⑆

Identification Numbers Account Number

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## PROMISSORY NOTES

- A promissory note is a written promise to pay at a fixed or determinable future time a sum of money to a specified individual.
- These two-party instruments are legally binding documents with many specified terms that vary widely.
- *Commercial paper*, a short-term (270 days or fewer) note or draft issued by a corporation or government, is a common investment instrument.

Slide Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## DRAFTS

- A draft is a three-party instrument similar to a check.
- A draft is an order signed by one party (the *drawer*, or *drafter*) that is addressed to another party (the *drawee*) directing the drawee to pay to someone (the *payee*) the amount indicated on the draft.
- The payment may be at sight or at some defined time.
- Most drafts are used for the purchase of goods and services when the transaction goes beyond the bounds of U.S. banking law.

Slide Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## ELEMENTS OF NEGOTIABILITY

- Written
- Signature
- Unconditional promise or order
- Sum certain
- Payable on demand or at a defined time
- Words of negotiation

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## BILLS OF EXCHANGE

- A bill of exchange is a negotiable and unconditional written order, such as a check, draft, or trade agreement, addressed by one party to another.
- The receiver of the bill must pay the specified sum or deliver specified goods on demand or at a specified time.
- Bills of exchange are a common form of internationally negotiable instruments.

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## Signature Liability

- This relates to signatures on the instrument
- Signers of negotiable instruments are potentially liable for the amount of the instrument
- Primary liability
  - Acceptors or makers
- Secondary liability
  - Drawers or indorsers

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## Four Categories of Indorsements

- Unqualified
  - Blank
    - Secondary liability
  - Special
    - Secondary liability
  - Restrictive
    - Conditional indorsements
    - Prohibiting indorsements
    - Trust indorsements
- Qualified

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## Assignment

- An assignee of a negotiable instrument obtains the assignor's contract rights
- A holder in due course generally has greater rights than the assignor

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Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## Holder in Due Course

- The holder (possessor of order or bearer paper)
  - Gives value
  - Takes in good faith
  - Has no notice that the instrument is overdue
  - Has no notice of defects
  - Has no notice of unauthorized signatures
  - Has no notice of a claim to the instrument
  - Has no notice of any party's real defense

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Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## Defenses

- Real
  - Forgery
  - Fraud in the execution
  - Instrument discharged in bankruptcy
  - Illegal conduct
  - Material alteration
- Personal
  - Breach of contract
  - Breach of warranty
  - Misrepresentation
  - Mistake
  - Undue influence
  - Economic duress

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Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## Shelter Principle

- Person is not a holder in due course, but derives his/her title through a holder in due course

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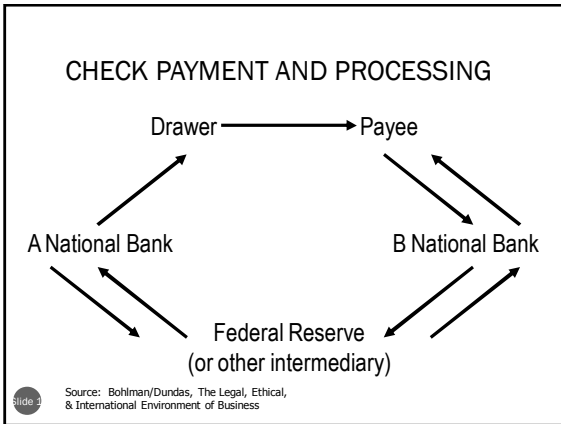
Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## Checks and the Banking System—Duties

- Customer's duties
  - Examine monthly bank statements
- Bank's duties
  - Honor customer's checks
  - Accept deposits in currency and collect checks
  - Honor stop-payment orders
  - Authenticating signatures on checks

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Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business



- ### Electronic Funds Transfer Systems
- Components
    - Automatic teller machines
    - Point-of-sale systems
    - Automatic payments and direct deposits
    - Telecommunications systems
    - Automatic clearinghouses
  - Federal statutes
    - Electronic Funds Transfer Act
    - Debt Collection Improvement Act
- Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

- ### BANK PAYMENTS
- Electronic funds transfer (EFT)
    - Direct deposit
    - Automatic payments
  - Automated clearing houses (ACHs)
  - Online transfers
    - Fedwire
    - Clearing House Interbank Payment System (CHIPS)
- Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

- ### Secured Transactions—Definition
- Creditor must have a written security agreement
  - Creditor must have given something of value to the debtor
  - Debtor must have ownership rights in the collateral
  - If the above are present, creditor's rights are said to "attach" to the collateral, i.e., the creditor has an enforceable security interest against the debtor
- Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

- ### Maker/Drawer Is Liable
- Imposter rule
  - Fictitious payee rule
  - Dishonest employee rule
- Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

- ### Secured Transactions—Perfection
- Occurs automatically upon attachment if there is a purchase-money security interest agreement in consumer goods
  - Occurs if the creditor is in possession of the collateral
  - Occurs upon the proper filing of a financial statement
  - First party to perfect its security agreement has the first priority over the collateral
- Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## Secured Transactions—Default

- Secured party's remedies
  - Forgo its security interest and proceed directly to a court judgment on the debt
  - Take peaceful, legal possession of the collateral, or repossess it
  - Retain the collateral or resell the collateral to satisfy the debt
- Termination statement
  - Shows that the debt has been paid and that the creditor must file it in the same office where she/he filed the financing statement

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Source: Bohlman/Dundas, The Legal, Ethical, & International Environment of Business

## International Considerations

- Convention on International Bills of Exchange and Promissory Notes
- Uniform Customs and Practices for Documentary Credits

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## Summary

- Negotiable Instruments
- Four Requirements for Negotiable Instruments
- Types of Negotiable Instruments
- Signature Liability
- Four Categories of Indorsements
- Holder in Due Course
- Shelter Principle
- Assignment
- Defenses
- Checks and the Banking System—Duties
- Maker/Drawer Is Liable
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