damages, and approve the plan without his consent.[32] It is apparent that this procedure would be justified only where the property is essential to the workings of the railroad or the success of the plan.[33]

Where new terms for the lease are neither required by nor permitted within the plan of reorganization, the court will have to exercise its discretion in determining full damages, and will be forced to apply some standard similar to the nebulous one suggested in the instant case, "evidence which satisfies the mind."[34] Because, however, the percentage of cases is so large where lessor will re-rent to the debtor[35] or the debtor will as of right continue to use the property, an omission of the arbitrary limitation in Section 77 is explainable. In allowing the landlord's claim for future damages, attention will be focused on his treatment in the plan. His treatment there will indicate the future revenues he will receive from the property, thus determining his damages.

Bills and Notes—Fictitious Payee—Protection of Innocent Holder—[Federal and Ohio].—An insurance company authorized its agent, a veteran claim adjuster, to settle certain claims for damages asserted against it. The agent, who was apparently the drawer, executed a draft in which the insurance company was drawee in favor of one of the claimants as payee. The agent had no general authority to execute drafts. The standard form of draft of the insurance company was in the nature of a contract of settlement reciting that proper indorsement was to be a full release of the described claim. The agent forged the indorsement of the payee, had one of his employees transfer the draft to the defendant bank, and pocketed the proceeds. At the time the draft was "issued," the agent intended that the payee should get no interest. The defendant bank collected from the insurance company as drawee, after which the insurance company, on discovering the fraud, settled with the real claimant. In a suit by the assignee of the insurance company to recover money had and received, *held*, the plaintiff may not recover. Since the instrument is payable to bearer under the fictitious payee doctrine, the rule as to forged indorsements is not applicable. *Hartford Accident and Indemnity Co. v. Fifth Third Union Trust Co.*[1]

In another case arising out of similar frauds of the same agent, the sequence of events was parallel except that in the drafts executed by the agent the insurance company appeared both as drawer and as drawee. Furthermore, the agent "at no time" intended that the named payees should get any interest in the instruments. In addition the agent transferred the drafts to the defendant bank personally. In a similar action, *held*, the plaintiff may recover because the instrument is not payable to bearer.

[32] The lease of the Old Colony R. Co. in the reorganization of the New York, N. H. & H. R. Co. is an excellent illustration of this problem. The court disaffirmed the lease but in its plan for reorganization the New Haven included plans for restoring the Old Colony to its system. The Old Colony also submitted a plan including the terms upon which the Old Colony would rejoin the New Haven. The reorganization plan could be more easily formulated if the court had power to deal with the lessor lines without the owners consent. See Palmer v. Palmer, 59 S. Ct. 647 (1939); reversing Old Colony R. Co. v. New York, N. H. & H. R. Co., 98 F. (2d) 670 (C.C.A. 2d 1938); Moody's, *op. cit. supra* note 26, at 645 (1938).

[33] Continental Illinois Nat'l Bank & Trust Co. v. Chicago, Rock Island & Pacific Ry. Co., 294 U.S. 648 (1935).

[34] P. 324.

[35] See note 26 *supra*.

[1] 23 F. Supp. 53 (Ohio 1938).

The negligence of the defendant bank in discounting the instruments prevented the application of the fictitious payee rule. *Hartford Accident and Indemnity Co. v. First Nat'l Bank.*[2]

An instrument is regarded as payable to bearer when it is "payable to the order of a fictitious or non-existing person and such fact was known to the person making it so payable."[3] In the early cases more frequently than in the modern cases it was the drawer of the instrument, rather than the agent, who supplied the name of the "fictitious payee" and falsely indorsed and negotiated the instrument. His purpose, as indicated in the early cases,[4] was to mislead the subsequent holder into believing that in the event of dishonor by the acceptor, he had recourse against not only the drawer but against an additional party as well. If the instrument were regarded as truly payable to the order of the named payee, the purported indorsement would have to be regarded as a forgery so that the subsequent holder would not have been protected in a suit upon the instrument. For, at the time of these cases, the general rule had already been developed that where a forged indorsement intervenes in the chain of indorsements, a holder taking subsequent to the forgery does not acquire good title.[5] In an effort to limit the application of the forged indorsement rule which protects the drawer, the courts have disregarded the intent expressed on the face of the instrument and treated it as if it were payable to bearer.[6] The basis of the rule is said to be that it gives effect to the "actual" intent of the drawer, the reasoning being that since he intended the payee to get no interest in the instrument thus rendering indorsement by the payee impossible, he must have intended that the instrument be negotiable by delivery.[7] In the early cases, the acceptor who was being sued had knowledge of the fictitious character of the instrument.[8] In the later cases lack of knowledge of the fiction by the acceptor was not considered essential because it was felt that other parties to the instrument should be bound by, though not aware of, what was called its "true nature" which is determined by reference to the subjective intent of the drawer.[9] Since all parties subsequent to the forged indorsement are protected and the acceptor or drawee who pays has recourse against the drawer, either by debiting the drawer's account or by becoming a creditor of the drawer, it would be more realistic to admit that this rule is an attempt to place ultimate liability on the drawer when he himself makes the instrument payable to a "fictitious payee."

Under this analysis it is clear that where the defrauding agent is the drawer of the instrument, as in the *Fifth Third Union Trust Co.* case, it should be regarded as payable to bearer assuming all the other facts to come within the fictitious payee rule. The

[2] 11 Ohio Op. 329 (1938).

[3] N.I.L. § 9 (3).

[4] Stone v. Freeland, 1 H. Bl. 316 footnote (1769); Gibson v. Minet, 1 H. Bl. 569 (1791).

[5] Mead v. Young, 4 T.R. 28 (1790); Kessler, Forged Indorsements, 47 Yale L.J. 863, 865 (1938).

[6] Gibson v. Minet, 1 H. Bl. 569 (1791); see also Stone v. Freeland, 1 H. Bl. 316 footnote (1769); Tatlock v. Harris, 3 T.R. 174 (1789).

[7] Gibson v. Minet, 1 H. Bl. 569 (1791); McKeehan, The Negotiable Instruments Law (A Review of the Ames-Brewster Controversy), 41 Am. L. Reg. 437, 446 (1902).

[8] Tatlock v. Harris, 3 T.R. 174 (1789); Gibson v. Minet, 1 H. Bl. 569 (1791).

[9] Phillips v. Im Thurn, L.R. 1 C.P. 463 (1866); Thayer, Fictitious Payees in Bills of Exchange, 25 Ky. L.J. 203 (1937).

drawee insurance company, though unaware of the fiction, may not recover from the subsequent holder the amount paid because payment was made to the rightful owner and the fact that the defendant did not derive its title through the payee intended by the insurance company is irrelevant. It was thus unnecessary for the court to determine whether or not the agent was acting within the scope of authority so far as application of the fictitious payee rule was concerned.[10]

A situation frequently appearing in recent litigation is where an employee to whom the drawer has delegated one or more of the functions which constitute preparation, execution, and delivery of the instrument, perpetrates the fraud. The motive of the agent is not to clothe the bill with an appearance of additional credit as where the drawer perpetrates the fraud, but to appropriate to his own use the proceeds of the instrument by falsely indorsing and negotiating it. The extension of the fictitious payee rule to many of these cases removes any foundation for the contention that the rule is based upon the "actual" intent of the drawer. It clearly illustrates that the fictitious payee rule is an inroad on the rule as to forged indorsements. The forged indorsement rule places the risk of an intervening forgery upon the purchaser who takes from the forger and protects from ultimate liability all parties prior to the forgery.[11] But by application of the fictitious payee rule the courts are able to protect the subsequent holder where the equities are considered to be in his favor. Conversely, where the subsequent holder knows of the fraud he will not be protected though the fictitious payee rule may be otherwise clearly applicable.[12] Furthermore, the assertion of the court in the *First Nat'l Bank* case that the negligence of the holder prevented the application of the fictitious payee rule seems to be a clear recognition of the problem as one of balancing the equities between the parties. Where the holder is regarded as innocent, however, the extent of the authority of the agent or employee seems to be the determining factor.

Where the fraudulent agent was given general authority to prepare and execute negotiable instruments, the subsequent holder was protected and the fictitious payee rule applied.[13] A like conclusion has been reached where one or more parties ignorant of the fiction have co-signed the instrument with the dishonest agent.[14] The result should be the same where, as in the *First Nat'l Bank* case, only a special authority to execute negotiable instruments payable to particular persons was given the fraudulent agent. The drawer is putting him in as good a position to perpetrate the fraud as in the general authority case. The fact that the authority of the special agent is more limited than that of a general agent should make no difference since neither a general nor special agent has authority to execute negotiable paper payable to a "fictitious payee." Furthermore, an inquiry by the subsequent holder in the one case would no more disclose the fraud than in the other.

[10] But the problem becomes important in determining the rights of the insurance company against the agent.

[11] Kessler, *op. cit. supra* note 5, at 871.

[12] Hunter v. Jeffery, 2 Peake N.P. 146 (1797).

[13] Meuller & Martin v. Liberty Ins. Bank, 187 Ky. 44, 218 S.W. 465 (1920); Phillips v. Mercantile Nat'l Bank, 140 N.Y. 556, 35 N.E. 982 (1894); 118 A.L.R. 15 (1939).

[14] Goodyear Tire & Rubber Co. v. Wells Fargo Bank & Union Trust Co., 1 Cal. App. (2d) 694, 37 P. (2d) 483 (1934); Hackensack Trust Co. v. Hudson Trust Co., 119 Misc. 689, 197 N.Y. Supp. 158 (1921).

The fictitious payee rule likewise has been held applicable where the dishonest agent was entrusted with the filling in of the blank body of an instrument previously signed.[15] But where the agent is entrusted with preparing the bill for later signature[16] or is relied upon to supply the name of the payee by one who later prepares and executes the instrument,[17] a majority of the courts have denied the subsequent holder protection on the ground that the wording of the Uniform Negotiable Instruments Law does not authorize such a result, though there is contrary authority.[18] As evidence of the dissatisfaction with this ruling, an amendment to Section 9(3) of the Uniform Negotiable Instruments Law has been suggested by the American Bankers Association and adopted in three states[19] extending the rule to cases where the fiction is "known to his [the drawer's] employee or other agent who supplies the name of the payee." This amendment thus extends the rule to cover every case in which the fraudulent actor occupies an agency relationship to the drawer and is relied upon to supply the name of the payee.

Thus the rule endeavors to allocate equitably between the drawer and the innocent holder the risk of the intervening forgery of an agent of the drawer. The problem may be regarded as another phase of the doctrine of respondeat superior[20] it being felt that the loss resulting from this type of fraud by the agent should be borne by the principal as an ordinary risk of the business rather than thrown upon the innocent holder.

There seems, however, to be no reason for limiting the protection of the innocent holder to those cases in which the drawer has put the agent in a position to either execute or induce the execution of an instrument payable to a fictitious payee. Realistically the gist of the fraud is not the supplying of the name of a fictitious payee but rather the false indorsement and negotiation of an instrument by one placed in a position of trust by the drawer. In fact the term "fictitious payee" may be merely descriptive of the presence of an intent to falsely indorse and negotiate the instrument, as in the instant cases where the payees named were not only real persons but they had valid claims against the principal. A payee is said to be fictitious if the "maker" or, under the proposed amendment, "the agent who supplies the name of the payee," *intends* the payee to get no interest in the instrument, and the fact that the name used is that of a real person having an outstanding claim against the drawer in order to give the bill a bona fide appearance should not change the result.[21] Thus while the instruments in the instant cases may be considered payable to fictitious payees, it is clear

[15] Rancho San Carlos v. Bank of Italy Ass'n, 123 Cal. App. 291, 11 P. (2d) 424 (1932).

[16] Nat'l Surety Co. v. Nat'l City Bank, 184 App. Div. 771, 172 N.Y. Supp. 413 (1918).

[17] Jordan Marsh Co. v. Nat'l Shawmut Bank, 201 Mass. 397, 87 N.E. 740 (1909).

[18] Equitable Life Assurance Society v. Nat'l Bank of Commerce, 181 S.W. 1176 (Mo. App. 1916); Jones v. Peoples Bank Co., 95 Ohio St. 253, 116 N.E. 34 (1917); see also Union Bank & Trust Co. v. Security-First Nat'l Bank, 8 Cal. (2d) 303, 65 P. (2d) 355 (1937); Defiance Lumber Co. v. Bank of Cal., 180 Wash. 553, 41 P. (2d) 135 (1935).

[19] Ill. Rev. Stat. 1937, c. 98, § 29 (3); Iowa Code 1932, § 26–109 (3); Anderson & McFarland Mont. Rev. Code 1935, § 8416 (3).

[20] Steffen, The Independent Contractor and the Good Life, 2 Univ. Chi. L. Rev. 501 (1935).

[21] Bourne v. Maryland Casualty Co., 185 S.C. 1, 192 S.E. 605 (1937).

that nothing irregular was done until the agent forged the indorsements of the payees and then transferred the instruments to defendants. Even where the payee has no valid claim against the principal there has been no fraudulent act until the paper is falsely indorsed and negotiated, though the agent may have possessed the fraudulent intent from the first. In the final analysis it is the entrusting of the agent with the possession of a completed instrument that directly enables him to accomplish those acts which result in the loss. Thus the functions of executing the instrument, preparing the instrument, or supplying the name of the payee are mere steps leading up to the fraudulent acts and while they may be helpful to the dishonest agent in setting the stage for a successful execution of the fraud, they in themselves do not enable the agent to effectuate his fraudulent purposes. Therefore the possibility of protecting the innocent holder in every case in which the drawer has placed the fraudulent actor in a position of trust which aids in the forgery of an indorsement should be considered. The use by the court in the *Fifth Third Union Trust Co.* case of the "two innocent party rule" as an alternative ground for the holding illustrates a willingness to protect the innocent purchaser irrespective of the application of the fictitious payee rule. Such a result in the cases cannot, however, be immediately expected since the protection of the subsequent holder in forged indorsement situations has been customarily thrown into the fictitious payee category.

Though it appears from the testimony in the *Fifth Third Union Trust Co.* case that the agent intended the payee to get no interest at the time of "issuing" the bill, this does not necessarily indicate that such an intent existed at the time of the execution of the bill, though the court so treated it. This raises the problem of whether or not the fictitious payee rule will be applied when the fraudulent intent is formed subsequent to execution. Under a formalistic view of the act, it may be argued that if the bill was intended to be payable to the order of a specific person at the time of execution, it cannot be converted into a bearer instrument by a subsequent change of mind. Furthermore, where an agent is the party who perpetrates the fraud, it may be said that once the bill is drawn up, the task of the agent is completed and when he later perpetrates the fraud he is acting in a different capacity. But as a practical matter, however, there should be no distinction between a formation of the intent that the payee should get no interest before execution of the instrument and a formation of such intent after execution of the instrument. Whenever the drawer perpetrates the fraud or so long as the agent is still in a position of trust when he perpetrates the fraudulent acts, the instrument should be regarded as payable to bearer.

The fictitious payee rule thus seems to be applicable in both the instant cases and it is doubtful whether the court in the *First Nat'l Bank* case was justified in its view that the recital of release in the drafts should have caused the defendant to take unusual precautions in discounting the drafts. The purpose of such a recital is ostensibly to protect the insurance company from further liability on the claims and not to protect it against forged indorsements. Thus the addition of a stipulation that indorsement by the payee will also serve as a release should not put the purchaser on guard any more than usual. Furthermore, since every order bill to which the fictitious payee rule is applied expresses on its face an intent that only the designated payee may indorse, the stipulations in the drafts do not necessarily make a proper indorsement a condition precedent to the validity of the instrument.

Constitutional Law—Taxation—Immunity of Federal Employees from State Income Taxation—[Federal].—The State of New York sued to collect an income tax levied by it upon the salary of an employee of the Home Owners Loan Corporation. *Held*, judgment for the State. Without deciding whether the HOLC is an essential activity of the federal government, the Court found that a tax on the income of employees is not a substantial burden upon a governmental activity. *Graves v. O'Keefe.*[1]

The instant case[2] is a significant step in the current reconsideration and restatement[3] of the tax immunity doctrine by means of which essential activities of the state governments are exempted from taxation by the national government, and activities of the national government are exempted from taxation by the states.[4] This implied limitation on the taxing power of both the state and national governments was originated by the Supreme Court in *McCulloch* v. *Maryland*[5] as an incident to the supremacy of federal legislation, and was extended some fifty years later in *Collector v. Day*[6] to preserve the sovereignty of the states at a time when it was threatened by a strengthened nationalism.[7] As the doctrine developed, the Court has distinguished between proprietary (non-essential) activity and governmental (essential) activity,[8] denying immunity to the former and exempting the latter from

[1] 59 S. Ct. 595 (1939).

[2] Expressly overruled by this decision is the line of cases including Dobbins v. Comm'n of Erie County, 41 U.S. 434 (1842); Collector v. Day, 11 Wall. (U.S.) 113 (1870); New York *ex rel.* Rogers v. Graves, 299 U.S. 401 (1936); and Brush v. Commissioner, 300 U.S. 352 (1936).

[3] This decision is a corollary to Helvering v. Gerhardt, 304 U.S. 405 (1938), which held that salaries of employees of the Port of New York Authority were taxable by the federal government since the burden of the tax upon the government of New York was merely speculative. See also James v. Dravo Contracting Co., 302 U.S. 134 (1937), and Helvering v. Mountain Producers Corp., 303 U.S. 376 (1938), overruling Gillespie v. Oklahoma, 257 U.S. 501 (1922) and Burnet v. Coronado Oil Co., 285 U.S. 393 (1932). See 5 Univ. Chi. L. Rev. 679 (1938).

[4] McCulloch v. Maryland, 4 Wheat. (U.S.) 316 (1819); Collector v. Day, 11 Wall. (U.S.) 113 (1871); Indian Motorcycle Co. v. United States, 283 U.S. 570 (1930).

[5] 4 Wheat. (U.S.) 315 (1819) (prohibiting the state of Maryland from levying a tax on notes of the Bank of the United States). The national government was deemed supreme in the sense that the part must not be allowed to govern the whole. A tax levied on the activities of the national government by a state is truly "taxation without representation." Mr. Justice Stone in Helvering v. Gerhardt, 304 U.S. 405, 412 (1938).

[6] 11 Wall. (U.S.) 113 (1871) (federal tax on income of a state judge held invalid).

[7] Collector v. Day has been much criticized. See, *e.g.*, the dissenting opinion in that case by Mr. Justice Bradley: "In my judgment, the limitation on the power of taxation in the general government which the present decision establishes, will be found very difficult of control. . . . . I cannot but regard it as founded on a fallacy, and that it will lead to mischievous consequences . . . . no concession of any of the just powers of the general government can easily be recalled." 11 Wall. (U.S.) 113, 129 (1871).

[8] The measure of an "essential" governmental activity is not a simple one. The confusion of the cases may be due to a conflict on the basic premise. One view holds that the concept is one of changing content, as expressed by Mr. Justice Black, concurring in the Gerhardt case, "There is not, and there cannot be, any unchanging line of demarcation between essential and nonessential governmental functions." Our form of government provides that the people have