COMMENTS

THE FICTITIOUS PAYEE AND THE UCC—THE DEMISE OF A GHOST

The career of that shadowy gentleman, the fictitious payee, “affords a good illustration of the uncertainty of law, and of the kaleidoscopic nature of the judicial mind.” Today, most courts follow rigid rules when dealing with negotiable instruments payable to nonexistent payees, fictitious payees, or impostors. In following these rules, though, the essential problem of all litigation, the determination of liability, is often badly solved. Sensing this, judges still expend masses of highly questionable legal logic in attempts to justify unsatisfactory distribution of loss. The imminent adoption of a final draft of the new Commercial Code brings the hope that the ancient ghost may at last be laid. This comment covers the history and present state of the law and discusses at somewhat greater length the merits of Section 3-405 of the proposed code.

I

When a group of English commercial houses failed late in the eighteenth century English courts first encountered negotiable instruments bearing the names of imaginary payees. In order to give greater credit to their bills, and to avoid unsettling the bill market by their huge speculations, these houses had made ingenious arrangements with those willing to lend them credit. The lenders of credit had appeared either as drawers of bills payable to imaginary but realistically named firms, or as acceptors of similar bills. After the crash, these signers found themselves defendants in a series of suits on the instru-

2 Chalmers, Vagliano’s Case, 7 L.Q. Rev. 216 (1891).

3 In common usage, “nonexistent” means just what the word implies: an absolutely imaginary, unreal, person or firm, a name which signifies nothing. A “fictitious payee” usually indicates the name attaching to a real person or firm where the drawer or the one causing the instrument to issue does not intend the payee ever to see the instrument. English usage is more specific; the whole controversy under the English statute depends on just when a payee is “fictitious.”

A payee may be fictitious by accident, as when a name chosen at random as nonexistent turns out to belong to a real person.

Proposed Uniform Commercial Code (May draft, 1949), referred to hereafter as UCC.

4 An earlier case, Stone v. Freeland (1769), is mentioned in a footnote, 1 H.B. 316 (C.P., 1790); Lord Mansfield is supposed to have held liable an acceptor who had knowledge that the drawer had indorsed the payee’s name.

ments.\(^6\) Humanly, they resisted payment although they had known well that the payees did not exist and that the defunct houses had indorsed the non-existent payees' names. They claimed that the plaintiff-holders could not prove the payees' indorsements. When plaintiffs pointed to defendants' knowledge, the defendants replied that title could not be made through a forgery. The "conscience of the case" was clear: defendants had to pay. Pay they did, generally on the ground that they were estopped to take advantage of their own fraud.\(^7\) The judges felt that the defendants must have intended something by their actions in putting the bills into circulation, and, since the bills could not be payable to order, they must be treated as bearer instruments, as far as defendants were concerned.\(^8\) Two justices\(^9\) foreshadowed two centuries of judicial confusion by objecting to an action since in their view the bills were mere nullities, order instruments which could not be indorsed.

In the hundred years that elapsed between the early English cases and the great codifications of negotiable instruments law, the rule was generally accepted to be that "a bill payable to a fictitious person or his order is in effect a bill payable to bearer, and may be declared on as such, in favor of a bona fide holder . . . against all the parties knowing that the payee was a fictitious person."\(^10\) During this period the modern practice of drawing order checks appeared,\(^11\) and as the codifications were enacted a new type of case began to be litigated.

A typical case would arise as follows: A trusted clerk, charged with preparing checks, would make out a few payable to nonexistent payees, or to real customers who had no present claims. The unsuspecting employer, signing many checks daily, would sign these too. The clerk then stole the checks, indorsed them, and the drawee bank, recognizing the drawer's signature, paid without question. When the fraud was discovered the indignant employer demanded the recrediting of his account. The bank resisted.

In England, the Bills of Exchange Act\(^12\) provided only: "Where the payee is


\(^{7}\) Other grounds of recovery were considered acceptable by many judges: treating the indorsements as making new bills, the indorser assuming the payee's name; treating the lenders of credit as having appropriated money to pay the bills, etc.

\(^{8}\) Already, order bills to inanimate objects were treated as bearer bills: Grant v. Vaughan, 3 Burr. 1516 (K.B., 1764); argument of counsel in Tatlock v. Harris, 3 T.R. 174 (K.B., 1789).

\(^{9}\) Eyre, C. B., and Heath, J., in Gibson v. Minet, 1 H.Bl. 569 (1791).


\(^{11}\) See opinion of Burton, J., in Agricultural Savings Ass'n v. Federal Bank, 6 Ont. App. R. 192, 197 (1881).

\(^{12}\) 45 & 46 Vict., c. 61, § 7(3) (1882), cited as "BEA."
In the historic case of *Vagliano v. Bank of England* the House of Lords decided that the statute changed the prior law. An English bill is payable to bearer if the payee is nonexistent, regardless of what the drawer thought he was doing when he drew it. If the payee is real and known to the drawer, who intended to pay him, then the bill is not payable to bearer where a clerk fraudulently caused the bill to be drawn. In the vague middle ground between these situations it seems to be possible for a payee to be real, and yet “fictitious” within the meaning of the act, on the authority of the *Vagliano* case.

In the United States, Section 9(3) of the Uniform Negotiable Instruments Law adds a clause to the British section: “The instrument is payable to bearer . . . when it is payable to the order of a fictitious or non-existent person,” and such fact was known to the person making it so payable. . . . A leading New York case which has been almost universally followed, *Shipman v. Bank of the State of New York*, held that it was impossible for an order check to be treated as payable to bearer, under a New York statute similar to the NIL, unless the drawer—the actual signer—intended the payee to have no interest; the NIL did not change the common law in this respect. But, where the earliest English cases had rested mainly on a simple estoppel of the drawer with knowledge to claim his formal rights, that is, to have the holder prove the payee’s indorsement, the American courts have resorted to numerous

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12 22 Q.B.D. 103 (1888), aff’d 23 Q.B.D. 243 (1889), rev’d [1891] A.C. 107. Noted, Chalmers, op. cit. supra note 7; Butterworth, The *Vagliano* case in Australia, 20 L.Q. Rev. 40 (1894); Adams, The *Vagliano* Case, 7 L.Q. Rev. 295 (1892). Adams suggests that the real culprit was the clerk’s stockbroker, who should have been put on inquiry when he saw a poor clerk speculating with huge sums (£71,000).


16 For some light, see Falconbridge, op. cit. supra note 15, and Butterworth, op. cit. supra note 15. A good guess would seem to be that English bills will fall within BEA § 7(3) unless the drawer had actual knowledge that the payee was in existence. Note, though, that no English bank is liable if it pays in good faith on a forged indorsement. BEA § 60.

17 Cited as NIL. The following clause was not in Crawford’s first draft of the NIL: Beutel’s Brannan, NIL 270 n. (b) (7th ed., 1948).


20 1 Rev. Stat. 768, § 5 (Bank’s ed., 1889), provided for validity against the maker and others with knowledge as if the instrument were payable to bearer. See discussion infra of the Illinois amendment to NIL § 9(3).
fanciful arguments to justify the results of their (undoubtedly correct) construction of Section 9 (3).

The fact complexes, as usual, have not adjusted themselves to any easily-stated rule. The problem of who is the "person making it so payable" has caused some litigation, but the present law is fairly definite. If an officer of a company who has check-issuing powers decides to defraud the company by issuing checks payable to fictitious payees and then abstracts, indorses and cashes the checks, the checks are payable to bearer.22 But if a clerk, no matter how trusted, makes out checks to fictitious payees which are signed, no matter how mechanically,23 by an authorized officer without knowledge of the fraud, the checks are not payable to bearer.24 Similarly, if the clerk pads a payroll,25 or if an insurance agent submits false claims,26


Courts trying to operate under NIL § 9(3) are faced with a curious problem when two officers are required to sign checks and only one knows the payee is fictitious. Some have decided that one is enough to make the check payable to bearer. Goodyear Tire & Rubber Co. v. Wells Fargo Bank, 1 Cal. App. 2d 694, 57 P. 2d 483 (1934); Penn. Co. v. Federal Reserve Bank, 30 F. Supp. 982 (Pa., 1939); Globe Indemnity Co. v. First Nat'l Bank, 135 S.S. 2d 706 (Mo. App., 1939). Contra: Portland Postal Employees' Credit Union v. United States Nat'l Bank, 171 Ore. 40, 135 P. 2d 467 (1943). See Bourne v. Md. Casualty Co., 185 S.C. 1, 194 S.E. 605 (1937); Union Bank & Trust Co. v. Security-First Nat'l Bank, 57 P. 2d 1332 (Cal. App., 1936), aff'd 8 Cal. 2d 503, 65 P. 2d 355 (1937). To be consistent with the strict drawer-equals-signer equation the opposite decision is indicated, for the check is not valid until both sign.

21 If the authorized signature were actually affixed by a machine, presumably the operator of the machine would be the person making the check payable. But a "signing officer" who writes his name 800-1500 times a day has enough free will left to be a "person." Security-First Nat'l Bank v. Bank of America, 129 P. 2d 424 (Cal. App., 1942), rev'd 137 P. 2d 452, 22 Cal. 2d 134 (1943). See note 24 infra.


Even when a bank's cashier issues a cashier's check at a customer's request, the cashier is held to be the person making the check payable, and his "intent" governs. Seaboard Nat'l Bank v. Bank of America, 193 N.Y. 26, 85 N.E. 829 (1908); Payne v. Continental & Commercial Nat'l Bank, 259 Ill. App. 526 (1931). But cf. Union Bank & Trust Co. v. Security-First Nat'l Bank, 57 P. 2d 1332 (Cal. App., 1936), aff'd 8 Cal. 2d 303, 65 P. 2d 355 (1937). In American Express Co. v. People's Sav. Bank, 192 Iowa 366, 187 N.W. 701 (1921), where the company exchanged checks on itself to fictitious payees for a worthless personal check, the checks were held not payable to bearer, since the company's "intent" was not fulfilled.

22 American Sash & Door Co. v. Commerce Trust Co., 332 Mo. 98, 56 S.W. 2d 1034 (1932).

24 Checks to existing policyholders on fake claims (by an agent) were held not payable to bearer in Nat'l Surety Co. v. Halsted Street State Bank, 246 Ill. App. 92 (1927); Nat'l Union Fire Ins. Co. v. Mellon Nat'l Bank, 276 Pa. 212, 119 Atl. 910 (1923). There was a similar holding as to checks to nonexistent "policyholders" in Caledonian Ins. Co. v. Nat'l City Bank, 208 N.Y. App. Div. 83, 203 N.Y. Supp. 32 (1924).

26 Checks to existing policyholders on fake claims (by an agent) were held not payable to bearer in Nat'l Surety Co. v. Halsted Street State Bank, 246 Ill. App. 92 (1927); Nat'l Union Fire Ins. Co. v. Mellon Nat'l Bank, 276 Pa. 212, 119 Atl. 910 (1923). There was a similar holding as to checks to nonexistent "policyholders" in Caledonian Ins. Co. v. Nat'l City Bank, 208 N.Y. App. Div. 83, 203 N.Y. Supp. 32 (1924).
Equally fine distinctions are drawn when the payee named is a firm on the edge of legal existence. If a company is defrauded into issuing checks to a firm which the signing officer thinks is real, but which is not, the checks are said to remain undindorsable nullities. But if the clerk or his confederate has set up a dummy firm and filed a certificate of doing business, then the indorsement of one “authorized” to sign for the dummy firm is quite valid. Hence the clerk’s choice of a convenient device to cash checks results, fortuitously, in determining whether the drawer carries the loss.

There is at least one well-recognized exception to the rigorous application of Section 9(3): the impostor rule. If a defrauder represents himself to be someone else in a face-to-face encounter with the drawer of a check, and the drawer issues the check to the defrauder under the assumed name, the check is usually treated as properly indorsable by the impostor. It is said that the intent to pay the visible man outweighs the intent to pay to the assumed name. But, when the imposture is by mail, the drawer may avoid loss. Where an impostor falsely represents himself to be the agent of a nonexistent principal and the check is drawn to his “principal,” the impostor rule does not apply, and the check cannot be indorsed by the impostor so as to pass title.

In an attempt to circle around the prevailing Section 9(3) interpretation, drawees and holders have often claimed that drawers were negligent in allowing instruments to issue. Rarely have these attempts succeeded. Usually, it is

30 Banks in which such paper may be deposited require such a certificate or other authorization before they will allow withdrawals of funds under a firm’s (or corporation’s) name. Thus some slight protection is still offered to the drawer.

Any attempt to cite cases following “the” impostor rule is fairly futile in the light of Professor Abel’s learned, convincing, and exhaustively annotated article, “The Impostor Payee: Or, Rhode Island Was Right” [1940] Wis. L. Rev. 161 and 363. Taking Tolman v. American Nat’l Bank, 22 R.I. 462, 48 Atl. 480 (1901), usually cited as a refusal to follow the impostor rule, Professor Abel demonstrates that in a considerable number of cases the impostor rule as actually applied carries a qualification: the loss falls on the drawer unless he has exercised care and the holder or payor has exercised none.

For discussions of imposture by mail see Abel, supra at 172, 173, and The Impostor Rule, 23 Ind. L.J. 484 (1948). Cohen v. Lincoln Sav. Bank of Brooklyn, 275 N.Y. 399, 10 N.E. 2d 457 (1937), should be noted as tacking a special requirement onto the impostor rule: there must be an antecedent fraud by which the drawer was induced to enter into the transaction.

Almost all the cases cited in notes 20, 24 supra, involve such claims.
said that the drawer's negligence must relate to the forgery itself and not to
the issuance of the check, if he is to be charged with the loss.33

This, in brief, is the present state of the law.34 Drawee and collecting banks
or those buying checks from defrauders bear most losses on checks drawn to
fictitious payees. The current draft of the UCC makes some bold changes. Be-
fore final adoption, however, it is proper to reassess the old arguments which
have so long supported the prevailing rules.

II

In commercial law, perhaps more than in any other field, Justice Brandeis' 
famous dictum holds true: "[I]t is more important that the applicable rule of
law be settled than that it be settled right."35 To the banker and the business-
man litigation is a positive evil. If under a new commercial statute claims can-
not be quickly and surely adjusted without lawsuits, the drafting lawyers have
failed. The rules of the commercial game should of course distribute burdens
equitably, placing losses where justice and sound economic policy require them
to be placed; but above all the rules should allow the game to be played fast
and without hesitation.

The essential problem posed by the fictitious payee cases is well recognized:
"The issue, as a large scale matter, is one between collecting bankers on the
one hand ... and corporate business on the other."36 As between the two, jus-
tice appears to be more on the side of the banks. A bank cannot often be sure
of the validity of a payee's signature. This is not always a good excuse: When
a legitimate order instrument is stolen, and a bank pays on the forged indorse-
ment, the loss properly falls on the bank.37 A different rule would destroy much
of the usefulness of negotiable instruments as tools of trade. But the fictitious
payee and impostor cases are another matter.

Many justifications are offered in support of the majority rules in the various
fictitious payee situations. Most decisions speak of the bank's obligation, at its
peril, to carry out the drawer's intent.'8 Such statements are meaningless. The

33 This is the old common-law rule. Agricultural Sav. & Loan Ass'n v. Fed. Bank, 6 Ont.
App. R. 192 (1881).

34 Ignoring many problems such as business names, estates and officers for the time being
as possible fictitious payees. Most of these problems are simple and are usually handled cor-
Kulp, op. cit. supra note 24, covers all these side issues thoroughly. Compare UCC § 3-110.

supra note 30, at 389 ff., rejects the certainty criterion on grounds which may have been ap-
propriate in discussing case law in 1940 but which should not concern the drafters of a new
code.


37 4 Univ. Chi. L. Rev. 670, 672 (1937), noting Union Bank & Trust Co. v. Security First
Nat'l Bank, 8 Cal. 2d 303, 65 P. 2d 355 (1937), does not even admit this.

38 The Shipman case is the prototype. Under NIL § 9(3), the drawer's intent is crucial,
but this lends no cogency to the statements about "the bank's duty." NIL § 9(3) specifically
drawer's intent was frustrated ab initio by his dishonest employee. Though any discussion of intent is sterile, yet, as between an "intent" to issue a scrap of paper, misleadingly in form like a check, and the drawer's belief that he is issuing a valid order instrument to pay out money, the latter does appear as his natural, true, intent.

Again, according to the Section 9(3) it is necessary for the drawer to know that the payee is fictitious if he is to bear the loss. The guilty clerk's knowledge, it is said, cannot be attributed to the corporation-drawer, because of an immutable principle of agency law. While any discussion of agency law is beyond the scope of this comment, it is well to point out that this application is highly rarefied. To anyone but a lawyer, there is no real distinction between an employee who fills out and signs checks and one who fills out checks and submits them by the score to be mechanically signed by an authorized officer. A corporation too easily escapes liability by selecting an honest but insulated assistant treasurer. Honesty is easy to find in rubber stamps.

The usually unsuccessful attempts of banks to claim that drawers have been negligent arouse a certain sympathy. Yet, the courts rejecting the claims of negligence are acting wisely, though the arguments supporting their decisions are palpably weak. Commercial matters should not often go to an expensive jury trial with the result depending in part on the whims and antipathies of untutored jurymen.

While there is satisfaction in "economic" analyses of risk which assign losses makes it the bank's duty to bear losses when the drawer did not know what he was doing. When the drawer knows what he was doing, as drawing to a certain John Smith, and the bank cashes the check on another John Smith's signature, then indeed the bank has failed in its duty to carry out the drawer's intent. Mead v. Young, 4 T.R. 28 (K.B., 1790). But this last example is really a standard forgery, unless, of course, there has been an imposture. Compare Abel, op. cit. supra note 30, at 205 ff., on the minimal usefulness of the dominant intent (of the drawer) explanation in the impostor cases.

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39 "Hamlet: Do you see yonder cloud that's almost in shape of a camel?
   Polonius: By the mass, and 'tis like a camel indeed.
   Hamlet: Methinks it is like a weasel.
   Polonius: It is backed like a weasel.
   Hamlet: Or like a whale?
   Polonius: Very like a whale."

—Hamlet, Act III, Scene 2.

40 United States Cold Storage Co. v. Central Mfg. District Bank, 343 Ill. 503, 175 N.E. 825 (1932), contains a typical discussion, as does the Shipman case.

41 For example, the citing of Cave v. Cave, L.R. 15 Ch. Div. 639 (1880), in the Shipman case.

42 See note 32 supra. The author of a case note, 97 U. of Pa. L. Rev. 122 (1948), objects to language in a recent New York case, Int'l Aircraft Trading Co. v. Manufacturers Trust Co., 297 N.Y. 285, 79 N.E. 2d 249 (1948), which seems to imply that no conceivable negligence of the drawer will result in his bearing the loss. Even in the worst cases, though, a gross negligence exception seems undesirable. Better to change the rule.
to the proper enterprise unit, these speculations are not too helpful here. No "entrepreneur rule" will fulfill certainty requirements. One such argument is forceful, however: embezzlement, like sin, is undesirable. Good internal organization in a corporation makes it difficult for employees to carry out frauds. If banks, and not employers bear fraud losses, there is no pressure on companies to organize their affairs to minimize these losses.

It can be said in support of Section 9(3) that under it, in theory, banks can avoid most losses. If the collecting banks look to their depositors, making sure of their responsibility, the bank will have an action back should the payee's signature be forged. The depositors can sue up the line on the indorsements, and thus eventually the one who originally cashed the check for the thief will suffer the loss, which is delightful, and in accordance with principle. Practically, the scheme may break down. Some checks are cashed directly with the drawee bank by the wrongdoer. Small businesses cash a great many checks. Such concerns may not be good for any large amount, and recoveries in small cases often will scarcely pay the expenses of suit. The number of suits multiplies.

On the other hand, if drawers were forced to take all these risks, they would not only be less negligent, but much litigation would be avoided. A drawer's

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43 Even a Daniel would have difficulty in deciding between bank and companies in these terms. Banks, after all, make a business of dealing with checks, and receive the use of the deposited money. Yet the accidental placing of fictitious payee losses on banks, as opposed to other embezzlement losses, has no great appeal. It is the company which has the opportunity of preventing the loss, as has been said. And why should not these losses be treated as a risk of business, rather than of banking? Compare comment (4) to UCC § 3-405. At any rate, bank charges reflect bank costs, and companies pay for what they get. The situation of a holder caught with a check to a fictitious payee is too often a sad one under the NIL: he may not be insured (or self-insured). As to forgery losses in general, see 14 Univ. Chi. L. Rev. 705 (1947), noting R. H. Kimball, Inc. v. R.I. Hospital Nat'l Bank, 72 R.I. 144, 48 A. 2d 420 (1946).

44 This argument should be distinguished from the one which would place losses on employers of agents since they can select honest men. Compare comment (4) to UCC § 3-404. Until the science of psychology is perfected, it will be impossible to hire only honest men. No Diogenes, only a good accountant, is required to set up procedures to avoid payroll padding. Compare Defiance Lumber Co. v. Bank of Cal., 180 Wash. 533, 41 P. 2d 135 (1935).

45 In 14 Univ. Chi. L. Rev. 705, 709 n. 19 (1947), noting R. H. Kimball, Inc. v. R.I. Hospital Nat'l Bank, 72 R.I. 144, 48 A. 2d 420 (1946), it is estimated that total U.S. forgery losses (including fictitious payee losses?) run to only $800,000 a year. This would seem to make the whole problem relatively minor. The estimate is wrong, in the opinion of counsel for a large Chicago bank. After all, several illustrious swindlers have put themselves into what Franklin P. Adams called "the six-figure, or non-hay bracket": Glyka (Vagliano's Case) lifted £ 71,000, Bedell (Shipman case) took almost $200,000, and Nickel (Bank of N.Y. case, note 28 supra) achieved a score of more than $300,000. One regrets that a certain Swindels, name notwithstanding, contented himself with a few thousands (Welsh case, note 20 supra).

46 UCC § 3-417 gives the bank an immediate action against all indorsers on their warranties, whereas NIL § 66 gives such an action only to holders, not payors.


48 This is an important and frequent vexation, according to a lawyer for a large Chicago bank.
failure in his suit to have his account recredited would be final. This would be bad for lawyers, perhaps, but good for the interests they serve.

III

The UCC provides:

§3-405. Impostors; Signature in Name of Payee.

(1) With respect to a holder in due course or a person paying the instrument in good faith an indorsement is effective when made in the name of the specified payee by any of the following persons, or their agents or confederates:

(a) an impostor who through the mails or otherwise has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee;

(b) a person signing as or on behalf of a drawer who intends the payee to have no interest in the instrument;

(c) an agent or employee of the drawer who has supplied him with the name of the payee intending the latter to have no such interest.49

The intent of this provision, as has been indicated, is laudable;50 but there are difficulties. One grave imperfection is suggested in a report to a subcommittee of the Chicago Bar Association.51 Section 3-405 is open to the construction that the burden is on the holder of proving that the defrauder (or confederate) was the actual indorser.52 The writers of the report object to this. The

49 There is some loose drafting here. First, to say, "With respect to a holder in due course" begs the whole question. What must be meant is, "With respect to one otherwise a holder in due course..." In any event, the words are unnecessary. Even if the indorsement is good, the rights of a holder will turn on other sections, and will depend on just whether or not he is a holder in due course. Compare UCC § 3-305. In fact, the limitation to holders in due course is positively undesirable. Suppose the case where drawer D intentionally makes a note payable to a nonexistent payee, indorses the payee's name, and passes the note to A in the course of a transaction in which there is a partial failure of consideration. A indorses to B after maturity. Now B cannot be a holder in due course and hence, under the section, he is not even a holder by indorsement. But there is no reason to make B take a total loss. He is at least entitled, as against D, to whatever A could get; but even A's position is doubtful under the section.

Second, while subsection (a) applies to a "maker or drawer," the maker has mysteriously disappeared from (b) and (c). Surely these omissions are not purposeful.

Third, there is no mention at all of indorsers or indorsees. Yet a case where an indorser through an employee's fraud indorses to a fictitious or nonexistent payee is indistinguishable from a case where a maker or drawer signs an instrument to a similar payee.

Fourth, as subsection (b) reads, no indorsement would be good except that of the "person signing" or of his "agents or confederates." This excludes the quite normal case where the agent who signs has nothing to do with the subsequent indorsement and delivery, say by the company's president, who in no real sense is the agent or confederate of the signer.

50 Palmer, Negotiable Instruments Under the U.C.C., 48 Mich. L. Rev. 255, 284 (1950), calls § 3-405 "a first-rate achievement."


52 Under NIL § 9(3), the impostor exception is not applied if the impostor himself does not indorse, on the grounds that the drawer intended the impostor, no one else, as payee. J. C.
situation is posed where a thief steals a check which the signer has intended not to be payable to the named payee. Under present law this is the classical bearer-payable situation. Under the proposed law, the thief's transfer is bad. The authors say that "this is not good sense."52

The report suggests two possible solutions. Either the payee's signature should be conclusively presumed to be regular, or, as they prefer, such paper should be made payable to bearer, at least as against the drawer. The latter solution, without the qualification, has been adopted in Illinois and seven other states54 by amending NIL Section 9(3) to read:

The instrument is payable to bearer: . . . (3) When it is payable to the order of a fictitious or non-existent or living person not intended to have any interest in it, and such fact was known to the person making it so payable, or known to his employee or other agent who supplies the name of such payee. . . .55

The Illinois provision has its own defects. The early English cases show that the device of calling an order instrument to a fictitious payee payable to bearer was adopted as a simplification in pleading because of the rigid rule that one suing on order paper had to prove the payee's indorsement. Most of the pre-NIL cases recognize that it is as against the drawer or acceptor with knowledge that the instrument is to be treated as payable to bearer: only another way of saying that as against them the payee's signature need not be proved. But the Illinois provision makes the instrument simply payable to bearer. Anomalies result.56

Suppose the situation where a drawer intentionally draws a check to a non-existent payee, indorses it, and passes it to X. The check is stolen from X, and the thief passes it to Y, forging X's indorsement. Under the Illinois amendment, while the drawer must see that the check is paid, X, who thought he had a perfectly valid order instrument, takes a loss, and Y, who thought he was buying an order instrument, with all the attendant risks, receives a windfall. Such a result is foolish.57 The UCC definitely disposes of this possibility by

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52 Nor is it.
54 Ga., Ida., La., Mo., Mont., N.M., Wis.
56 All of the following discussion is also true of NIL § 9(3).
57 Even under the Illinois amendment [and NIL § 9(3)] a court might reach the correct result in the situation posed by drawing an analogy with NIL § 40. For, while Y might be permitted to recover of the drawer as a holder of bearer paper, he could not recover of X upon the forged indorsement, and it would seem that as between X and Y the prior right of X to the paper or its proceeds would be protected. It must be admitted that no such case seems to have been reported yet. But surely code drafters should anticipate everything.
abolishing the bearer device. There should be, though, an unmistakable command that the payee's indorsement is to be conclusively presumed regular.5

Part (a) of UCC Section 3-405 attempts to clarify and codify the impostor rule. Apparently, however, when the impostor pretends to be an agent of a nonexistent principal, the present rule is to remain in force, and the drawer is to be protected.59 This is a distinction without a difference. It places, rightly, the responsibility for ascertaining bona fides on the drawer if the impostor pretends to be a principal, but allows a reckless disregard for the safety of the commercial community if the impostor claims to be an agent of such a principal. Again, it is reliance on arguments about the drawer's "intent" which leads to such anomalies. The real reasons for placing losses on drawers in all impostor situations are exactly those which make it fair for drawers to bear fictitious payee losses.

Subsection (c) of UCC Section 3-405 wisely makes no distinctions between nonexistent payees and real payees who are or are not known to the drawer, thus avoiding the tangle into which the BEA led the English courts. Yet provisions (b) and (c) are still not satisfactory. That legal fact, but practical uncertainty, "intent" remains as the touchstone of liability.60 Some more concrete test seems advisable. Subjectively, the satisfying test for liability seems to depend on whether the payee, if real, has any right to the instrument. All bills drawn to nonexistent payees should result in losses to drawers, if to anyone, regardless of intent.

To suggest a provision such as this, which places the loss on the drawer whenever the named payee has no interest in the instrument, would be to make one

58 Such a presumption would eliminate the need for the "agents or confederates" language in UCC § 3-405.

Section 61 of the NIL already states that the drawer admits the existence of the payee and his then capacity to indorse. Usually courts completely ignore the section. The opinion of MacLaren, J., in London Life Ins. Co. v. Molsons Bank, 8 Ont. L. R. 238 (1904), is an exception, applying BEA § 55(1)(b) (equivalent to NIL § 61) to place the loss on the drawer. In Robertson Banking Co. v. Brasfield, 202 Ala. 167, 79 So. 542 (1918), and McCormack v. Central State Bank, 203 Iowa 833, 211 N.W. 542 (1926), the courts wrestled with NIL § 61, but did not apply it, over dissents. Compare UCC § 3-413, and Drawee Liability, 29 Neb. L. Rev. 96 (1949).

NIL § 61 is absolutely inconsistent with NIL § 9(3). For NIL § 9(3) requires the drawer or maker to know that the payee is nonexistent if an instrument payable to a nonexistent payee is to be treated as payable to bearer. If the drawer does not know, the instrument is indorsable order paper: a nullity. And, a drawer refusing to pay such paper is denying the existence of the payee, not to mention the payee's capacity to indorse.

However, BEA § 7(3), as interpreted, is consistent with BEA § 55(1)(b). For British paper is payable to bearer whenever the payee is nonexistent. Clutton v. Attenborough, 19 A.C. 69; London Life v. Molsons Bank, supra. Thus, NIL § 61 may be explained as an anomalous carryover from a consistent BEA. The trouble with this explanation is, it assumes that the drafters of BEA § 7(3) knew what they were doing, which may not be true. Chalmers, Vagliano's Case, 7 L.Q. Rev. 216 (1891).

59 In the past, drawers have been protected from what certainly looks like their own folly. Cohen v. Lincoln Savings Bank of Brooklyn, 275 N.Y. 399, 10 N.E. 2d 457 (1937).

60 That is, a definition of "fictitious" has been substituted for the word.
more change in present law. For, in addition to covering the padded payroll cases, for example, it would include all situations where a check is made out by mistake to a real payee to whom no money is owing. In these instances, though, the loss should fall on the drawer. The man who draws and issues such a check shoots his arrow into the air. If when it falls someone is wounded financially, in all justice the archer should see to the wound. Banks already bear many another loss.

IV

In summary, the drafters of UCC Section 3-405 have made some progress, but not enough. A different version could unite the treatment of impostors, nonexistent payees, real payees with no interest, and real payees intended by the drawer to have no interest, all on a subjectively satisfying basis. For example:

§3-405. Where Indorsement Is Conclusively Presumed Effective; “Fictitious” or Non-existent Payees; Impostors.

An indorsement by any person in the name of the named payee or indorsee is to be conclusively presumed effective to transfer the instrument where the named payee or indorsee:

(a) does not exist; or
(b) exists, but has no interest in the instrument; or
(c) exists and has an interest in the instrument, but the instrument is issued to an impostor (either face-to-face or at a distance) of the named payee or indorsee.6

Even under present law, if the intended payee does indorse, the indorsement is good, though the payee has no claim to the money. See Bank of N.Y. v. Public Nat'l Bank & Trust Co., 195 N.Y. Misc. 812, 82 N.Y.S. 2d 694 (1948). The proposal below would make any indorsement effective in such case. Certainly, if the payee had no claim and the paper had never been received, who indorsed it would be a matter of indifference to the named payee. On the other hand, if the payee has any claim, even overstated or mistaken, his actual indorsement should be required.

All the rather soggy figure is intended to convey is that the same arguments apply here for placing the loss on the drawer as apply in the fictitious payee cases. Or to put it another way, all payees who have no interest in the instruments in question should be treated as fictitious.

It should be noted that Subsection (b) of the proposal reads “no interest in the instrument.” The proposal does not include the cases where a payee has another claim against the drawer, perhaps an inchoate claim in process of litigation, or more likely a sum due on an unconnected transaction. The proposed section might read, “If the named payee or indorsee has no connection with the transaction giving rise to the instrument.” But this is clumsy. Of course, either way some part of the drawer’s intent is dragged in the back door.

One application: suppose an impostor pretends to be the agent for a well-known charity and obtains donations in the form of checks payable to the charity. The impostor-agent cannot validly indorse under the proposed section, for the payee has an interest in the check. This result is fair, for the situation is equivalent to one where a check made out to a creditor is given to someone claiming to be the creditor’s messenger.

Finally, it may be noted that both the present suggestion and UCC § 3-405 shift losses from collecting banks to paying banks on some cashier’s checks. Thus, under neither can a bank escape liability, when it does not know a man demanding payment, by issuing a cashier’s check to him under the name he gives. However, it may be that paying banks could still avoid loss in this situation by certifying the tendered check. See Steffen and Starr, A Blue Print for the Certified Check, 13 N.C.L. Rev. 450 (1935).
Such a provision states an equitable, simple, legally elegant test for liability. It finds a rightful place in a code that is truly Commercial: one designed to serve commerce.

THE NEW YORK AND CALIFORNIA EXPERIMENTS WITH ACADEMIC CONTROL

Since in a democracy all men are rulers, all men must have the education that rulers ought to have.

—ROBERT M. HUTCHINS

The anti-radical feeling following the first world war reached the schools through such measures as the Lusk Law\(^2\) and then quickly subsided. In the long period from the early twenties to the present time the central issues of academic freedom seemed to center around causes célèbres involving individuals. Now, with such measures as the Feinberg Law in New York and the loyalty oath requirement at the University of California, the problem is broadening again. The re-evaluation of government personnel in terms of loyalty\(^3\) has spread to the personnel of state schools. Corruption of the youth joins sedition and espionage as an immediate threat to the American way of life. The private school has been dealt with by informal pressure\(^4\) partly because the loyalty of government personnel is the primary concern of the day and partly because the freedom the state has in choosing its employees\(^5\) avoids, legally at least, the problems of free speech involved in preventing private institutions from teaching disapproved doctrines or hiring disapproved personnel.\(^6\) As international tension mounts, the problem of balancing the traditional American freedoms

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2 The Lusk Law, N.Y. Laws (1921) c. 667, required the licensing of private educational institutions and forbade the licensing of institutions teaching the violent overthrow of the government. It was primarily aimed at the Rand School, a socialist school. The law was repealed after a year. N.Y. Laws (1923) c. 799. Consult Chafee, Free Speech in the United States, c. 8 (The Rand School Case) (1941), for a complete discussion of the case.

3 Consult Emerson and Helfeld, Loyalty among Government Employees, 58 Yale L.J. i (1948).

4 Some legislatures have rattled the investigative sword at private schools, as did a committee of the Illinois legislature which conducted an investigation of the University of Chicago. The committee sent an investigator and later held hearings. It made no definite assertions about the University of Chicago although it did undertake to show that some of the faculty members were members of “communist fronts.” Consult Special Report of Seditious Activities Investigation, State of Illinois (1949); Report of the Seditious Activities Commission, State of Illinois (1949). The Testimony of Chancellor Hutchins, at 17 et seq. of the Special Report, is particularly noteworthy.

5 Consult note 49 infra.

6 Thus even the Internal Security Act, popularly known as the McCarren Act, requires only registration of private communist organizations and the labeling of communist propaganda. H.R. 9490, 81 Cong. 2d Sess. (Pub. L. No. 831, 1950).