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Negotiable Instruments - Fictitous Payees - Changes Effected by the Uniform Commercial Code

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seems to do a very workable job of compromise. Both seller and purchaser have their rights well defined, and such concepts as the inclusion of the auction sale in the field of bulk sales are clearly well conceived.[71] Certainly the former laxity on this point alone provided an excellent potential means for an unscrupulous creditor to escape his obligations. In summation it might be said that though ideally North Dakota might do better, it could also do a great deal worse as far as the adoption of this particular section of the UCC is concerned.

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NEGOTIABLE INSTRUMENTS — FICTITIOUS PAYEES — CHANGES EFFECTED BY THE UNIFORM COMMERCIAL CODE. — The common law as developed in England[1] and subsequently restated in early American cases,[2] declared that an instrument which was payable to the order of a designated payee should be given the effect of an instrument payable to bearer, if the instrument had been made payable to the order of a fictitious payee and such fact was known to the party sought to be charged thereon.[3] This was later revised by the British Bills of Exchange Act,[4] and the rule has subsequently evolved to its present form in the Uniform Negotiable Instruments Law,[5] which states: "The instrument is payable to bearer when it is payable to the order of a fictitious or nonexistent person and such fact was known to the person making it so payable."

A very anomalous situation occurs when courts are called upon to treat an instrument payable to the order of a designated person as if it were expressly payable to bearer. This is the fact however when fictitious payees are considered. Although this situation has not been adjudicated in North Dakota, it is by no means uncommon in other jurisdictions and has been decided in both South Dakota[6] and Minnesota[7] both of which have laws similar to our own.[8]

71. U.C.C. § 6-108 and Comment.

1. Minet v. Gibson, 1 H.Bl. 569, 100 Eng. Rep. 689 (1791).
2. *See* Shipman v. Bank of State of New York, 126 N.Y. 318, 27 N.E. 371 (1891).
3. Britton, Bills and Notes 691 (1943).
4. See Vagliano v. Bank of England, 22 Q.B. 103 (1888), *aff'd*, 23 Q.B. 243 (1889).
5. Negotiable Instruments Law § 9 (3); N.D. Rev. Code § 41-0209 (3) (1943).
6. See Janssen v. Tusha, 66 S.D. 604, 287 N.W. 501 (1939).
7. See Jorgensen Chevrolet Co. v. First Nat. Bank of Red Wing, 217 Minn. 413, 14 N.W.2d 618 (1944).
8. S.D. Code § 46.0114 (3) (1939); Minn. Stat. § 335.052 (3) (1945).

A typical case which might arise under §9 (3) would be: X, an employee of A corporation, prepares a check payable to P, a fictitious payee, and subsequently induces the treasurer of A to sign the check. X then cashes the check at B bank by indorsing the name of the fictitious payee, while B credits the account of A to the amount of the withdrawal. Under the present law A could maintain an action against B for conversion of funds, since the indorsement of X amounting to forgery would be ineffective and would not transfer title.[9] If, however, the treasurer of A or any other of its officers authorized to sign checks had made the check payable to a fictitious payee, it would have resulted in the instrument being treated as bearer paper. Thus no indorsement would have been necessary to transfer title and the corporation would have suffered the loss.[10]

This "bearer paper" concept has also been applied to a situation where two officers signed on behalf of a corporation, one of whom knew of the fictitious payee.[11] Where an insurance agent submitted false claims, thereby procuring the instruments payable to persons who were in fact real but not intended by the drawer to have any interest in the instruments, the drawee was held liable.[12] Where a clerk padded a payroll with the names of fictitious payees the drawee was likewise held liable.[13] One writer has said that indorsements by a real payee to a fictitious payee would also be covered by §9 (3).[14]

An interesting exception to the above rule was made in *National Bank of Commerce v. United States*,[15] where an instrument was held not to be bearer paper since federal regulations prohibited government clerks from issuing such instruments. Nor does the "bearer paper" concept apply to misnomer or abbreviation.[16]

Section 9 (3) of the NIL has now been amended in sixteen states[17] to read: "An instrument is payable to bearer when it is payable to the order of a fictitious or non-existent person, or living

9. United States Cold Storage Co. v. Central Mfg. Dist. Bank, 343 Ill. 503, 175 N.E. 825 (1931).
10. Snyder v. Corn Exch. Nat. Bank, 221 Pa. 599, 70 Atl. 876 (1908); *Cf.* Security-First Nat. Bank v. Bank of America, 129 P.2d 424 (Cal. App. 1942), *aff'd*, 137 P.2d 452 (1943).
11. See P.&G. Card and Paper Co. v. Fifth Nat. Bank, 172 N.Y.S. 688 (1918).
12. National Surety Co. v. Halsted Street State Bank, 246 Ill. App. 92 (1927).
13. American Sash & Door Co. v. Commerce Trust Co., 332 Mo. 98, 56 S.W.2d 1034 (1932).
14. Beutel, Brannan Negotiable Instruments Law 336 (7th ed. 1948).
15. 224 Fed. 679 (9th Cir. 1915).
16. Joseph Milling Co. v. First Bank, 109 Ore. 1, 216 Pac. 560 (1923).
17. Alabama, Arizona, California, Georgia, Idaho, Illinois, Iowa, Minnesota, Missouri, Montana, New Mexico, North Carolina, Oregon, West Virginia, Wyoming.

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 him with the name of such payee.*" The effect and purpose of the amendment is to protect drawee banks from losses which otherwise would be sustained as a result of the fraud perpetrated by agents of the bank's depositors.[18] It does this by making the paper payable in effect to bearer when the drawer does not intend that it should be payable to a fictitious payee, but is fraudulently induced to make it so payable by an employee or agent. Such being the case no indorsement is necessary, title to the instrument passes with delivery, and therefore it is not necessary to trace title through a forged indorsement. The amendment has also extended the old provision to include situations where the fictitious payee is a real person but one not intended to have any interest in the instrument.

Numerous attempts have been made by drawees and holders to evade liability on the ground that the drawer was negligent in allowing the checks or drafts to be issued. These attempts have met with little success, however. It is generally held that the negligence must relate to the forgery itself, not to the issuance of the check.[19] It is the duty of the bank to carry out the intent of its depositors, regardless of the liability it incurs.[20]

In regard to the present law, it is thought that the words "fictitious" or "non-existing" are unnecessary and to some extent misleading.[21] "Fictitiousness" or "non-existence" within the meaning of the rule is determined by the intention of the drawer, which must arise from his knowledge that the payee is in fact "fictitious."[22] Under §9 (3) actual signers of checks can have no intent as to a payee's identity where they sign in blank, merely complying with another's request, or where the signer is a mere automaton.[23] Fictitious payees have been construed to include: the estate of one who was yet alive,[24] one who was alive but not intended to have

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18. See Citizens Loan & Security Co. v. Trust Co., 79 Ga. App. 184, 53 S.E.2d 179 (1949); Houghton Mifflin Co. v. Continental Ill. Nat. B. & T. Co., 293 Ill. App. 423, 12 N.E.2d 714 (1938).
19. *E.g.*, New York Cas. Co. v. Sazenski, 60 N.W.2d 368 (Minn. 1953).
20. Shipman v. Bank of State of New York, 126 N.Y. 318, 27 N.E. 371 (1891).
21. See Britton, Bills and Notes 697 (1943).
22. See note 20 *supra*.
23. See Security-First Nat. Bank v. Bank of America, 129 P.2d 424 (Cal. App. 1942), *aff'd*, 137 P.2d 452 (1943).
24. Janssen v. Tusha, 66 S.D. 604, 287 N.W. 501 (1939).

any interest in the instrument,[25] a fictitious firm,[26] or a partnership or firm which has changed its name.[27]

It is thought that the present situation results oftentimes in unfair treatment of the bank, that rather it should be the drawer corporation which would always assume the loss involved, as a risk of business. It is the corporation which is in a position to prevent such occurences through care in selection and supervision of employees or through protection which may be purchased in the form of fidelity insurance. The bank on the other hand cannot often be certain of the validity of a payee's signature. This however, is not reason enough to hold the bank immune in the case where a legitimate order instrument is stolen and a bank pays on a forged indorsement. In such cases the loss properly falls on the bank. A different rule than this would destroy much of the usefulness of negotiable instruments as tools of trade, but fictitious payee and imposter cases are another matter.[28] Acknowledging that embezzlement is an evil of commerce to be avoided, there is under the present rule little incentive for the corporations to tighten their internal control as long as they know that it will be the drawee bank which will bear the loss, when it is the corporation's employee or agent which perpetrates the fraud.

> Section 3-405 of the proposed UCC states: "(1) An indorsement by any person in the name of the named payee is effective if: a. an imposter by use of 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 intends the payee to have no interest in the instrument; c. an agent or employee of the drawer has supplied him with the name of the payee intending the latter to have no such interest. (2) Nothing in this section shall effect the criminal or civil liability of the person so indorsing."

Sub-section 1 enlarges the original subsection 9 (3) to include additional situations which it has not been held to cover. The instrument is not made payable to bearer and indorsements are still necessary to negotiation. It recognizes however, as effective indorsement of the types of paper covered no matter by whom made. This solution is thought preferable to making such instruments bearer paper. On the face of things they are payable to order

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25. Home Indemnity Co. v. State Bank of Ft. Dodge, 233 Ia. 103, 8 N.W.2d 757 (1943).
26. Jorgensen Chevrolet Co. v. First Nat. Bank of Red Wing, 217 Minn. 413, 14 N.W.2d 618 (1944).
27. First Wisconsin Nat. Bank v. Peoples Nat. Bank, 136 Va. 276, 118 S.E. 82 (1923).
28. See 18 U. of Chi. L. Rev. 281, 288 (1951).

and should require what purports to be a regular chain of indorsements.[29]

Sub-section 1 (a) would reverse those decisions which distinguish between face-to-face imposture and imposture by mail, on the theory that the loss, regardless of the type of fraud which the particular imposter has committed, should fall upon the drawer.[30]

Sub-section 1 (b) restates the substance of the original subsection 9 (3) but limits it to drafts with which most of the decisions have been concerned. The following situations illustrate its application: (a) The drawer of a check, for his own reasons, makes it payable to P knowing that P does not exist. (b) The drawer makes the check payable in the name of P. A person named P exists, but the drawer does not know it. (c) The drawer makes the check payable to P, an existing person whom he knows, intending to receive the money himself and that P shall have no interest in the check. (d) The treasurer of a corporation draws its check payable to P. P exists but the treasurer has fraudulently added his name to the payroll intending that he shall not receive the check. (e) The treasurer of a corporation draws its check payable to P, who to the knowledge of the treasurer does not exist. (f) The president and the treasurer of a corporation both sign its check payable to P. P exists, the treasurer knows it but intends that P shall have no interest in the check. In all of the foregoing examples an indorsement by any person in the name of P is effective.[31]

Sub-section 1 (c) extends the rule of §9 (3) to include padded payroll cases and fraudulent insurance claim cases. It applies only to those situations where the agent or employee has supplied names of payees intending that they should have no interest in the instrument. This section may be applied in the following situations (a) an employee of a corporation prepares a padded payroll for its treasurer, which includes the name of P. P does not exist, and the employee knows it, but the treasurer does not. The treasurer draws the corporation's check payable to P. (b) The facts are the same as in (a), except that P exists and the employee knows it but intends him to have no interest in the check. In both cases an indorsement by any person in the name of P is effective and the loss falls on the corporation.[32]

Section (2) of UCC §3-405 is to be read with the section under

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29. U.C.C. § 3-405 (comment 1).
30. U.C.C. § 3-405 (comment 2).
31. U.C.C. § 3-405 (comment 3).
32. U.C.C. § 3-405 (comment 4).

which an unauthorized signer is personally liable on his signature to any person who takes the instrument in good faith. As stated it is not intended to effect criminal liability for forgery or any other crime or civil liability to the drawer or to any other person.[33]

With reference to the recent amendment to the Minnesota NIL, it is stated in the annotation that the extension of the bearer paper concept promotes expediting and safety in circulation of negotiable instruments.[34] The proposed changes of the UCC do not further extend this theory but effect even more desirable results by abrogating the theory completely. Section 3-405 does this by requiring indorsement no matter by whom made.

Applying §3-405 to the hypothetical case presented earlier, the result would seem to place the loss on the corporation on whom it rightfully belongs. If adopted, this same section would in all likelihood prevent much litigation, not benefiting the lawyer directly but the community as a whole.[35] Ezekiel would be happy to see his prophecy come true, if only in this one small phase of the law.[36]

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TRIAL — INSTRUCTIONS TO JURY — INSTRUCTIONS BEFORE ARGUMENT. — Although the purpose of the instruction by the court to the jury has been defined in a multitude of ways, it may be said, in general, that its purpose is to inform the jury as to the law of the case as it applies to the facts in such a manner that the jury is not misled.[1] In order that this might best be accomplished the practice was adopted at common law of giving the instructions after the argument of counsel and immediately preceding the retiring of the jury.[2] The reasoning assigned as afixing this time for giving the instructions was that after argument of counsel had pulled the jurors hiteher and yon the judge had the final word to see that they retired with a clear, unbiased and unemotional statement of the facts and the applicable law fresh in their minds. A further reason was that

33. U.C.C. § 3-405 (comment 5).
34. See Minn. Stat. § 335.052 (3) (1945).
35. See 18 U. of Chi. L. Rev. 281, 289 (1951).
36. See Prophecy of Ezekiel c. 18, v. 20: "The soul that sins the same shall die. The son shall not bear the sins of the father, the father shall not bear the sins of the son. The justice of the just shall be upon him. The wickedness of the wicked shall be upon him."

1. See Order of United Commercial Travelers of America v. Nicholson, 9 F.2d 7 (1925).
2. Busch, Law and Tactics in Jury Trials § 443 (1950).