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Bills and Notes - Ficticious Indorsee - Immaterial Alteration

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RECENT DECISIONS

BILLS AND NOTES—FICTITIOUS INDORSEE—IMMATERIAL ALTERATION—Thomas and Betty Gallegos asked defendant bank for a loan to purchase an automobile from Schneider Motors. Defendant gave them a cashier's check for $1,000 payable "To the order of Betty J. and Thomas Gallegos." To assure itself that the check would be used to purchase the car, the bank, before delivering the check to the payees, had them indorse it "to the order of Schneider Motors," signed "Betty J. and Thomas Gallegos." The Gallegoses then went to Schneider Motors, but a partner of that firm refused to accept the check and returned it to Thomas Gallegos. Having taken it upon themselves to indorse the check in the name of Schneider Motors, the Gallegoses cashed the check at plaintiff's store, plaintiff being unaware that the indorsement was made without the authorization of Schneider Motors. When defendant bank refused to honor the check, plaintiff brought an action and recovered. On appeal, *held*, affirmed. Since Schneider Motors was a fictitious indorsee under the Negotiable Instruments Law,[1] the check was payable to bearer. *Hall v. Bank of Blasdell*, (N.Y. 1954) 118 N.E. (2d) 464.

The doctrine of the "fictitious" payee is a common one in negotiable instruments law. It has been dealt with extensively in other writings.[2] Thus, when a drawer draws a check to the order of a person to whom he does not intend to give an interest in the instrument, and this intention exists as an affirmative fact when the check is delivered,[3] it is changed to a bearer instrument, transferable by mere delivery. The indorsement of the payee's name, by whomever made, may be regarded as being superfluous, and any holder may sue thereon as bearer.[4] However, in a situation where the named payee indorses the instrument to a "fictitious" person, the applicability of the above principle is not clear. Several writers have summarily dealt with the subject and reached the conclusion that the rules applicable to a fictitious payee should apply to a fictitious indorsee as well.[5] When one knowingly specially indorses a negotiable instrument to a fictitious person, the instrument may be treated as if no

[1] Sec. 9(3). "The instrument is 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."

[2] Bourne v. Maryland Casualty Co., 185 S.C. 1, 192 S.E. 605 (1937); Phillips v. Mercantile Nat. Bank, 140 N.Y. 556, 35 N.E. 982 (1894); 22 BOST. UNIV. L. REV. 336 (1942); 17 So. CAL. L. REV. 70 (1943); 2 ST. LOUIS UNIV. L.J. 193 (1952); 57 DICK. L. REV. 168 (1953); 30 NOTRE DAME LAWYER 149 (1954).

[3] Seaboard Nat. Bank v. Bank of America, 193 N.Y. 26 at 33, 85 N.E. 829 (1908); American Express Co. v. Peoples Sav. Bank, 192 Iowa 366 at 369, 181 N.W. 701 (1921); Jorgensen Chev. Co. v. First Nat. Bank of Red Wing, 217 Minn. 413, 14 N.W. (2d) 618 (1944).

[4] Smith v. Clapp, 15 Pet. (40 U.S.) 125 (1841); 118 A.L.R. 15 at 18 (1939).

[5] BRITTON, BILLS AND NOTES 696 (1943). "Although §9(3) applies only to fictitious payees, it seems probable that by analogy an instrument would be payable to bearer if the indorsee were a fictitious person and this fact were known to the indorser making it so payable." BRANNAN, NEGOTIABLE INSTRUMENTS LAW, 7th ed., 336 (1948).

indorsee had been named and hence payable to bearer.[6] The cases are of little help since this writer has been able to uncover only two American decisions which deal with the fictitious indorsee question.[7] In both cases a check was specially indorsed by the payee to a nonexistent person whom the payee believed to be real. The Tennessee court held that the rule with reference to fictitious persons did not apply because, when the payee indorsed the check, he believed in the indorsee's existence.[8] The Illinois court, however, held that the rule applies whether or not the payee knew his indorsee was fictitious.[9] Despite the inconsistency between the two holdings, both seem to recognize the analogy between the situations involving fictitious payees and indorsees.[10] Another analysis of the principal case can be built on the following legal rule: "Whatever writing the payee of a note may have put upon it, he may, while it remains in his hands . . . render inoperative."[11] Thus, when the Gallegoses indorsed Schneider Motors' name on the check before delivery, "such means of recalling a proposed transaction or of changing the use to be made of a draft is sustained upon the right that a person has to do as he pleases with his own and . . . until the rights of others in the draft have become vested, the acts of the owner therewith are innocent and colorless."[12] Therefore, the immaterial alteration by the Gallegoses can be discounted and a good title passed to the plaintiff.[13] The principal decision seems sound in its legal analysis but its effect will be appreciable in the business world. The type of loan transaction entered into by the bank and the Gallegoses is a common one by which the bank attempts to guard against any unauthorized use of the money by the payee. According to the court's holding, such a device no longer protects the bank if

[6] BIGELOW, LAW OF BILLS, NOTES AND CHECKS, 3d ed., §150 (1928).

[7] In Forbes v. Espy, 21 Ohio St. 474 at 483 (1871), the court stated in dicta, "A bill knowingly made, or indorsed to a fictitious person, is to be regarded as made or indorsed to bearer. . . ."

[8] Chism v. First Nat. Bank of New York, 96 Tenn. 641, 36 S.W. 387 (1896).

[9] Keenan v. Blue, 240 Ill. 177, 88 N.E. 553 (1909).

[10] An interesting change is made in §9(3), note 1 supra, by the new Uniform Commercial Code adopted in Pa. Gen. Laws, 1953 sess., vol. 1. It is stated in the UNIFORM COMMERCIAL CODE OF PENNSYLVANIA, OFFICIAL 1952 DRAFT, TEXT AND COMMENTS, §3-405b: "An indorsement by any person in the name of a named payee is effective if: A person signing as or on behalf of a drawer intends the payee to have no interest in the instrument." The drafter's comment declares, "The words 'fictitious or non-existing persons' have been eliminated as misleading. The instrument is not made payable to bearer. Instead, the instrument becomes good 'order' paper and an indorsement by anyone is effective." This section leaves open to interpretation the status of the fictitious indorsee since by its terms the rule applies only to a "person signing as . . . *drawer*" whereas §9(3) does not so limit its application.

[11] Pardee v. Lindley, 31 Ill. 174 at 185 (1863). *Accord,* In re Tranor's Estate, 318 Pa. 206, 177 A. 820 (1935). A note may be specially indorsed by a payee, yet if not delivered to someone as indorsee, title remains in the payee, and no contract whatever is created from such indorsement. May v. Cassiday, 7 Ark. 376 (1847).

[12] Seaboard Nat. Bank v. Bank of America, note 3 supra, at 32.

[13] Cf. NIL, §16: "Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto." Also cf. NIL, §48: "The holder may at any time strike out any indorsement which is not necessary to his title."

the payee does not intend the indorsee to have any interest in the check.[14] To achieve the same result, the bank could mail the check directly to the indorsee instead of delivering it to the payee after requiring the special indorsement. Further, the bank could draw the check directly to Schneider Motors, for example, and in order to show the loan transaction to the Gallegoses, have them sign some type of printed form acknowledging receipt of the money. Although the decision, if followed elsewhere, will force the banks to change the standard commercial practice for this type of transaction, they can, without inconvenience, adapt their policies to conform to the law.

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[14] The delivery of the instrument which is important in this respect is the one from the indorser to the person who takes the check as indorsee. As the court said in the principal case at 341, "If he [the indorser] then regards the check as a bearer instrument, his earlier intention, formed when he had no reason to believe that the named indorsee would refuse to accept it, is of no moment."