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Bills and Notes: Fictitious Payees under the Amended N. I. L.

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NOTES

BILLS AND NOTES: FICTITIOUS PAYEES UNDER THE AMENDED N. I. L.—In a recent Missouri decision, *Prugh, Combest & Land, Inc.* v. *Linwood State Bank*,[1] a typical fictitious payee situation was litigated, but because Missouri has an amended version of section 9-3 of the Uniform Negotiable Instruments Law,[2] an exactly opposite result was reached than would have been reached under the unamended N. I. L. Since California[3] and nine other states besides Missouri have a similar amendment,[4] an analysis of the effect of this amendment is in order. The facts of the Prugh Co. case will be helpful in illustrating the law of fictitious payees as it stands both before and after the amendment.

It was part of the policy of the Prugh Co., a security investment firm, to arrange loans for its customers through the Linwood State Bank. When requested to arrange a loan, Prugh Co. would have its customer sign a promissory note payable to Linwood Bank and list thereon the stocks to be pledged as security for the loan. After the Linwood Bank had approved the loan, it would credit Prugh's account with the amount of the loan and Prugh would then issue its check drawn on Linwood Bank to the customer for the amount of the loan. It was this business arrangement which formed the basis for the fraudulent scheme which resulted in the litigation. One Ryan, an impecunious security salesman for Prugh Co., went to the office of the secretary-treasurer of Prugh Co. and falsely represented that one of their customers, with whom Ryan had had previous dealings, was desirous of negotiating a loan for $3,200 and that he wished to pledge his stocks, then on deposit with Prugh Co. for safekeeping, as security for the loan. Knowing that this customer had ample stock with which to secure such a loan, the secretary-treasurer gave Ryan an undated note made payable to the Linwood Bank. Ryan filled out the note, forged the customer's name as maker and took the note along with the stock certificates to the Linwood Bank where the loan was arranged. Ryan then returned to his office with the $3,200 credit to Prugh's account and presented it to the secretary-treasurer. The secretary-treasurer then made out a check drawn on Linwood Bank made payable to the customer, signed it in the name of Prugh Co. and handed it to Ryan who said he would mail it to the customer with a personal letter. Instead, Ryan indorsed the customer's name, took the check to his own bank, the South Side Bank, and deposited the check to his own account. The South Side Bank indorsed the check, "Prior Indorsements Guaranteed," and sent it on to the drawee Linwood Bank where it was paid and charged to the account of Prugh Co. Ryan repeated this whole process with the name and stocks of another customer for a loan of $1,750.

Under the original section of the N. I. L. the result would be that Linwood Bank would sustain the loss created by Ryan's fraud. The original section 9-3 provides: "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." That section is but a codification of the English common law position.[5] It has been a prolific source of litigation because the section does not

[1] 241 S. W. 2d 83 (Mo., 1951).

[2] Mo. Rev. Stat. Ann. 3025 (3), R. S. 1949, 401.009 (3).

[3] Cal. Civ. Code, sec. 3090 (3), as amended (1945).

[4] Louisiana: Dart's Gen. Stats. Supp. (1942), § 798; Massachusetts: G. L. Ter. Ed., c. 107, § 31; Georgia: Ga. Code Ann., § 14-209; New Mexico: 1941 Comp., § 53-109; North Carolina: 1949 G. S., § 25-15; Oregon: 1949 O. C. L. A., § 69-109; Montana: Rev. Codes Ann. (1947), 55-209 (3); Idaho: Idaho Code, 27-109; Illinois: Ill. Rev. Stats. (1949), c. 98, § 29 (3).

[5] The leading English case presenting the common law position is Minet v. Gibson, 3 T. R. 482, 100 Eng. Rep. 689 (1789).

mean literally what it says. For a payee to be fictitious within the meaning of the section, he does not have to be nonexistent. Conversely, a nonexistent payee is not necessarily fictitious within the meaning of the section. The key to the whole riddle is the intention of the party who gives life to the instrument by validating it with his signature. If the person who signs it intends that the named payee have no beneficial interest in the instrument, then the payee is fictitious and it is bearer paper (or a bearer is authorized to indorse the fictitious payee's name). On the other hand, if the party signing it intends that the named payee get the beneficial interest in the instrument, then that payee is nonfictitious and consequently it is order paper, and that is so whether that payee exists in the flesh or not. Thus it can be seen that the fictitiousness of the payee depends not on the existence or nonexistence of the payee in the lay sense, but rather on the intention of the person whose signature gives life to the instrument. The very simplest example of a fictitious payee is the common case of a check made out to "Cash."[6] Clearly that is a bearer instrument, not because there is no payee in existence by that name, but because the drawer of the check does not intend that anyone by the name of "Cash" get a beneficial interest in the check. The Prugh case represents the other extreme in complexity. In applying these principles to the Prugh case it is readily seen that it cannot be the intent of Ryan that controls because he did not sign the checks and had no authority to sign checks. So it is the intent of the secretary-treasurer that controls despite the fact that it was Ryan who instigated and carried out the entire deception. What then was the intent of the secretary-treasurer? Clearly he thought a valid loan was being made and so he intended that the named payee get the full beneficial interest in the checks. Therefore, the payee would not be fictitious and the checks would be order instruments under the unamended N. I. L. 9-3. It is important to determine whether the instruments are order or bearer paper because if they are bearer paper no indorsement is necessary to pass title in the checks. Then Ryan's forgeries, if they were forgeries, could be treated as surplusage so that Linwood Bank could rightfully debit Prugh's account. On the other hand, if the checks were order instruments an indorsement would be necessary to the passage of title, and so Ryan and South Side Bank were never holders and consequently were in unlawful possession of the checks. Therefore, the drawee Linwood Bank would have no right to debit Prugh's account when the checks were presented for collection. So under the unamended N. I. L. these checks would have been order instruments, Ryan's indorsements would have been forgeries, no title would ever have passed and Linwood Bank could not legally debit Prugh's account so that they would have to sustain the loss. There are many cases under the unamended N. I. L. where the drawee bank took the loss merely because the fraudulent employee had no authority to sign checks.[7] However, the drawee bank does have a recovery against the collecting bank, the South Side Bank in this case, either in quasi contract for money paid out by mistake,[8] or on the written guaranty of prior indorsements

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[6]Bascal v. Nat. City Bank, 262 N. Y. S. 839, 146 Misc. 732 (1933).

[7]Edgington v. Security First Nat. Bank, 78 Cal. App. 2d 849, 179 P. 2d 64 (1947); Security First Nat. Bank of Los Angeles v. Bank of America Nat. Trust & Savings Assn., 22 Cal. 2d 154, 137 P. 2d 452 (1943); Robertson Bank Co. v. Brasfield, 202 Ala. 167, 79 So. 651 (1918); Commonwealth v. Farmers' Deposit Bank of Frankfort, 264 Ky. 839, 95 S. W. 2d 793 (1936); Metropolitan Casualty Ind. Co. v. First Nat. Bank of Detroit, 261 Mich. 450, 246 N. W. 178 (1933); Republic Nat. Bank of Dallas v. Maryland Cas. Co., 184 S. W. 2d (1944).

[8]Wellington Nat. Bank v. Robbins, 71 Kan. 748, 81 Pac. 487 (1905); Corn Exchange Bank v. Nassau Bank, 91 N. Y. 74, 43 Am. Rep. 655 (1883); First Nat. Bank of Minneapolis v. City Nat. Bank of Holyoke, 182 Mass. 130, 65 N. E. 24 (1902).