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The Impostor Rule

NOTES

NEGOTIABLE INSTRUMENTS

THE IMPOSTOR RULE

A drawer of checks issued payable to an impostor brought an action against the drawee bank to recover the amount paid on the checks by the bank and charged to the drawer's account. The drawer was the victim of two types of fraud operated by the same two persons. The checks were divided into two groups. The fraud as to the first group of checks was operated as follows: one person using the name of a prominent citizen known to the drawer only by reputation called the drawer by telephone and solicited funds for charitable purposes. Acting upon the speaker's instructions, the checks were drawn payable to the speaker's secretary. A second person called at the drawer's home, stated that he was the secretary, and received the checks from the drawer. The fraud as to the second group of checks was operated at the same time in a slightly different manner. The drawer was contacted by telephone by the same person using the name of a well known lawyer whom the drawer knew personally but had not seen for several years. These checks were also drawn payable to the supposed secretary of the speaker; however, the checks were then placed in an envelope and delivered by the drawer to a messenger sent by the impostor for that purpose.[1] The usual procedure in both groups of checks was for the speaker to indorse the payee's name upon the checks; the impostor secretary then indorsed his real name upon the checks and cashed them.[2] The Court of Errors and Appeals of New Jersey denied recovery to the drawer against the drawee upon those checks delivered by the drawer to the impostor payee in person. However, the court allowed the drawer to recover from the drawee the amount of those checks delivered by the drawer, not to the impostor payee,

1. The drawer inadvertently made one check payable in the name assumed by the speaker and delivered it to the messenger. The court properly treated this check as belonging in the second series. Instant case at 214.
2. The court held that the fact that the payee's name was indorsed on the checks not by the impostor, but by his accomplice in the fraud did not remove the case from the operation of the impostor rule. Instant case at 215-216.

but to a messenger sent by the unknown and unseen impostor. *Russell v. Second National Bank of Paterson,* 55 A.2d 211 (N.J. 1947).

In the impostor cases there are two parties who might possibly bear the loss. The first party is the drawer, maker, or indorser[3] from whom the impostor receives the instrument. The second party is the holder or drawee who takes the instrument from the impostor. Each of these parties has been defrauded by the misrepresentation of identity by the impostor. It thus becomes necessary to determine which of the parties to the instrument should bear the loss. The incidence of the loss must be determined by the rights which those who take the instrument by means of the impostor's indorsement have as against the party who transferred the instrument to the impostor.

The majority of the impostor cases have been decided upon the basis of the "impostor rule," which states that where the transferor of a negotiable instrument delivers it to an impostor supposing that the impostor is the person he has represented himself to be,[4] the indorsement of the impostor is treated as a genuine indorsement as between the transferor and a transferee who derives his title to the instrument from the impostor's indorsement. A few courts have applied §23 of the Uniform Negotiable Instruments Law to the impostor cases. By §23 no person can acquire any rights on a negotiable instrument by means of a forged indorsement as against prior parties to the instrument unless such prior parties are

3. Where the instrument is transferred to the impostor by an indorser the problem of the impostor cases arises only where the transfer is by special indorsement, for if the transfer is by blank indorsement the instrument becomes payable to bearer. Uniform Negotiable Instruments Law §9(5), Ind. Stat. Ann. (Burns 1933)' §19-109.

4. Uniform Negotiable Instruments Law §9(3), Ind. Stat. Ann. (Burns 1933) §19-109 which provides: "The instrument is payable to bearer: . . . . 3. When it is payable to the order of a fictitious or nonexisting person, and such fact was known to the person making it so payable;" does not apply to the impostor payee situation for the reason that a check drawn payable to an impostor is not so drawn with the knowledge of the drawer. Security-First Nat. Bank v. U.S., 103 F.2d 188, 189 (C.C.A. 9th 1939); Uriola v. Twin Falls Bank & T. Co., 37 Idaho 332, 345, 215 Pac. 1080, 1087 (1923); Montgomery Garage Co. v. Manufacturers' Liability Ins. Co., 94 N.J.L. 152, 154, 109 Atl. 296, 297 (1920). But cf. Kohn v. Watkins, 26 Kan. 691 (1881) (decided prior to the enactment of the N.I.L. but holding that a check payable to a fictitious person and delivered to an impostor as the supposed agent of the payee was payable to bearer).

precluded from setting up the forgery.[5] Therefore, if §23 is applicable,[6] the question becomes: is the indorsement of the impostor a forgery, and, if so, is the transferor precluded from setting up the forgery?[7]

The impostor rule is justified by the courts upon two theories. The first and most prevalent is the intent theory. It is said that the drawer of a check has two possible intents: (1) to make the check payable to the person before him (the impostor), (2) to make the check payable to the person he believes the impostor to be. The first is generally held to be the controlling intent.[8]

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5. Uniform Negotiable Instruments Law §23, Ind. Stat. Ann. (Burns 1933) §19-123: "When a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party against whom it is sought to enforce such right is precluded from setting up the forgery or want of authority."

6. It is not proposed to discuss the issue as to whether §23 is applicable to the impostor cases in this note. That issue has been widely debated by leading authorities with no definite result. See: "Ames, The Negotiable Instruments Law," 14 Harv. L. Rev. 241 (1900); "Brewster, A Defense of the Negotiable Instruments Law," 10 Yale L. J. 84 (1900); "Ames, The Negotiable Instruments Law: A Word More," 14 Harv. L. Rev. 442 (1901); Brewster, "The Negotiable Instruments Law—A Rejoinder to Dean Ames," 15 Harv. L. Rev. 26 (1901).

7. The application of §23 to the impostor cases does not appear to finally determine the problem. In Tolman v. American Nat. Bank, 22 R.I. 462, 48 Atl. 480 (1926), the court felt that §23 was applicable and dictated a holding for the drawer against the drawee. However, in Montgomery Garage Co. v. Manufacturers' Liability Ins. Co., 94 N.J.L. 152, 109 Atl. 296 (1920), the court felt that if the indorsement of the impostor was a forgery within the meaning of §23 the drawer was precluded from setting up the forgery; accord, Security-First Nat. Bank v. U.S., 103 F.2d 188, 191 (C.C.A. 9th 1939). It has also been said that §23 is merely declaratory of the common law. U.S. v. First Nat. Bank of Prague, 124 F.2d 484, 486 (C.C.A. 10th 1941).

8. Continental-American Bank & T. Co. v. U.S., 161 F.2d 935 (C.C.A. 5th 1947); U.S. v. First Nat. Bank, Albuquerque, 131 F.2d 985 (C.C.A. 10th 1942); Schweitzer v. Bank of America N.T. & S.A., 42 Cal.App. 2d 536, 109 P.2d 441 (1941); Meridian Nat. Bank of Indianapolis v. First Nat. Bank of Shelbyville, 7 Ind.App. 322, 33 N.E. 247, on rehearing, 34 N.E. 608 (1893); Meyer v. Ind. Nat. Bank, 27 Ind.App. 354, 61 N.E. 596 (1901); Robertson v. Coleman, 141 Mass. 231, 4 N.E. 619 (1886); First Nat. Bank of Fort Worth v. American Exch. Nat. Bank, 49 App.Div. 349, 63 N.Y.Supp. 58 (1900); Land Title & T. Co. v. Northwestern Nat. Bank, 196 Pa. 230, 46 Atl. 420 (1900); cf. Cohen v. Lincoln Savings Bank, 275 N.Y. 399, 10 N.E.2d 457 (1937) (purports to follow the intent theory, but requires some dealings between the tranferor and the impostor prior to the delivery of the check before it becomes the transferor's intent that the check be paid to the impostor;

The second theory of the impostor rule is the negligence or estoppel theory, or the maxim that as between two innocent persons the one whose act caused the loss must bear the consequences.[9] Proponents of the negligence theory say that the drawer has a duty to use diligence in determining the identity of persons with whom he deals.[10] However, the drawee has a corresponding duty to pay the proceeds of the check only upon the order of the payee designated by the drawer.[11] The negligence theory therefore not only raises a duty of diligence in the drawer but in effect declares that the failure of the drawer to fulfill this duty relieves the drawee from his corresponding duty to the drawer.[12]

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the requirement of prior dealings finds no support in the prior cases). Contra: Palm v. Watt, 7 Hun. 317 (N.Y. 1876); Tolman v. American Nat. Bank, 22 R.I. 462, 48 Atl. 480 (1901).

9. U.S. v. Nat. Exch. Bank, 45 Fed. 163 (C.C.E.D. Wis. 1891); Boatsman v. Stockmen's Nat. Bank, 56 Colo. 495, 138 Pac. 764 (1914); Peninsular State Bank of Michigan v. First Nat. Bank, 245 Mich. 179, 222 N.W. 157 (1928); Montgomery Garage Co. v. Manufacturers' Liability Ins. Co., 94 N.J.L. 152, 109 Atl. 296 (1920); Forbes v. Espy, 21 Ohio St. 474 (1871).

10. Central Nat. Bank v. Nat. Metropolitan Bank, 31 App. D.C. 391 (1908). But cf. U.S. v. Mercantile Nat. Bank, 67 F.Supp 759 (W.D. La. 1946), where the impostor adopted the identity of a veteran's widow and thereby secured five government checks which she indorsed by mark in the name of the payee. The United States was allowed to recover from the collecting bank upon the ground that the drawer is under no duty to exercise diligence in the issuance of a check such that no possible mistake may occur. However, the court apparently failed to realize it was dealing with an impostor case and decided the case upon the basis of Nat. Metropolitan Bank v. U.S., 323 U.S. 454 (1945) (federal employee fraudently procured the issuance of checks and indorsed them in the name of the payees) and Clearfield Trust Co. v. U.S., 318 U.S. 363 (1943) (U.S. check apparently stolen from the mails and the payee's name forged thereon). The Supreme Court cases relied upon have no application to the impostor situation.

11. Nat. Metropolitan Bank v. Realty Appraisal & Title Co., 60 App. D.C. 86, 47 F.2d 982 (1931).

12. One writer has carefully analyzed the cases prior to 1940 and has advanced the following conclusions as to the basis of the decisions. The issuer or transferor from whom the impostor takes is referred to as the first victim, and those taking from the impostor are referred to as the second victim. Where neither victim has exercised care, the loss has fallen upon the first victim; where both victims have exercised some care, the loss has fallen upon the first victim (decisions not unanimous); where the first victim has exercised no care and the second victim has exercised some care, the loss has fallen upon the first victim; where the first victim has exercised some care and the second victim has exercised no care, the loss has fallen upon the second victim (decisions not unanimous). Abel, "The Impostor Payee: or, Rhode Island Was Right," [1940] Wis. L. Rev. 161. It thus appears from this analysis that the loss falls upon the drawee only where the drawer exercises due care and the drawee fails to exercise due care.

The intent theory justifies placing the loss upon the drawer in those cases where the drawer and the impostor payee deal face to face whether the impostor assumes a wholly fictitious identity or assumes the identity of a real person. In either case, the controlling intent of the drawer is to make the check payable to the person with whom he is dealing.[13] Thus, in one phase of the instant case, the court held that where the drawer dealt face to face with an impostor who had adopted a fictitious name, the controlling intent of the drawer was to make the check payable to the person before her.[14]

The application of the negligence theory to those cases where the drawer and the impostor deal face to face raises the question: what amount of inquiry by the drawer discharges his duty to the drawee?[15] Where the impostor has assumed the identity of a real person and made representations consistent with the assumed identity, an inquiry as to the impostor's representations other than identity would normally fail to disclose the fraud.[16] However, it does not seem unreasonable in such cases to require the drawer to investigate the representations as to identity, for he has an adequate opportunity to make the investigation. By the negligence

13. In Meridian Nat. Bank of Indianapolis v. First Nat. Bank of Shelbyville, 7 Ind.App. 322, 33 N.E. 247, on rehearing, 34 N.E. 608 (1893), the impostor assumed a fictitious name, sold stolen cattle to the drawer, and received in return a check payable to W. C. Smith, the assumed name. This check was certified by the drawee bank and cashed by the plaintiff bank. As against the defendant drawee the indorsement of the impostor as payee was held sufficient to pass title. In Meyer v. Ind. Nat. Bank, 27 Ind.App. 354, 61 N.E. 596 (1901), the impostor assumed the name of an owner of real estate and by means of a forged mortgage upon the land secured two loans from the drawer. The loans were executed by checks payable to Volney J. Dawson, the name of the owner of the land. The defendant drawee paid the checks to the impostor upon his indorsement as payee. In affirming a judgment for the drawee, the court said that the check was paid to the individual designated by and named in it.

14. Instant case at 214-216.

15. Upon the basis of Professor Abel's analysis of the cases, n.7 supra, no amount of inquiry by the drawer will shift the loss to the drawee unless the drawee fails to exercise some care.

16. In Commerical Bank & T. Co. v. Southern Industrial Banking Corp., 16 Tenn.App. 141, 66 S.W.2d 209 (1932), the impostor adopted the name of a real person and negotiated a loan from the drawer. The drawer made no inquiry as to the impostor's identity; an investigation as to his financial standing revealed that a person of the name assumed by the impostor had a satisfactory credit rating. The holder required no identification of the impostor; however, the court held that the drawer intended that the check be paid to the impostor.

theory, if the drawer fails to detect the fraud, he is estopped to deny the impostor's indorsement.

In the instant case, the court recognized that the intent theory does not justify placing the loss upon the drawer where delivery was to an agent of the impostor payee.[17] This was true because the drawer had in mind only a name as payee of the check; there was no person connected with that name in the mind of the drawer.[18] The court dismissed without discussion the negligence theory as a means of throwing the loss upon the drawer.[19] In this connection it should be noted that the slightest inquiry by the drawer of the person whose name was used to accomplish the fraud would have revealed the fraud.[20] Therefore, if the result is justifiable, it must be so in spite of the negligence theory of the impostor rule or upon the basis that no inquiry is expected of a drawer in these circumstances.

A more difficult case for decision arises when the drawer and the impostor payee do not deal face to face but deal with each other by means of mail or telegrams. Again the majority of the decisions place the loss upon the drawer,[21] but the result is difficult to justify under either theory of the

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17. This phase of the instant case should not be confused with the well recognized exception to the impostor rule where the check is delivered to the impostor, not as payee, but as the agent of the payee. In such cases the loss falls upon the drawee who pays the check upon the indorsement of the payee's name by the impostor. Russell v. First Nat. Bank of Hartselle, 2 Ala.App. 242, 56 So. 868 (1911); McCornack v. Central State Bank, 203 Iowa 838, 211 N.W. 542 (1926); Armstrong v. Pomeroy Nat. Bank, 46 Ohio St. 512, 22 N.E. 866 (1889). Contra: Ryan v. Bank of Italy Nat. T. & S. A., 106 Cal.App. 690, 289 Pac. 863 (1930); Kohn v. Watkins, 26 Kan. 691 (1881).

18. "Here not only was the name of the payee fictitious, but there was no one representing himself as, or represented by another to be, the person of that name. The name had no embodiment and presented no objectivity." Instant case at 216.

19. Instant case at 216.

20. The fraud in the instant case was discovered when the drawer received simultaneous requests for donations to both charities. She became understandably confused and placed each check in an envelope addressed to the supposed solicitor of the other check. When she subsequently met one of the persons whose name was being used to accomplish the fraud she apologized for her error; whereupon the fraud was disclosed.

21. Uriola v. Twin Falls Bank & T. Co., 37 Idaho 332, 215 Pac. 1080 (1923); Maloney v. Clark, 6 Kan. 82 (1870); Emporia Nat. Bank v. Shotwell, 35 Kan. 360, 11 Pac. 141 (1886); Hoffman v. Amer. Exch. Nat. Bank, 2 Neb. (Unoff.) 217, 96 N.W. 112 (1902); cf. Forbes v. Espy, 21 Ohio St. 474 (1871). Contra: Moore v. Moultrie Banking Co., 39 Ga.App. 687, 148 S.E. 311 (1929); Palm v. Watt, 7 Hun 317 (N.Y. 1876).

impostor rule. The similarity of the mail cases to that phase of the instant case in which the drawer delivered the checks to an agent of the impostor is so great that any attempt to distinguish the cases is not only difficult but there is no apparent basis to justify the distinction. In each case there is an absence of face to face dealings and consequently the drawer has no physical being in mind as the payee. If any distinction is possible, it is that in the instant case the messenger was the agent of the impostor, while in the mail cases the post office is the agent of the sender.[22]

The intent theory breaks down completely in the mail cases. It cannot be said that the drawer has any person in mind as the payee of the check for in fact the drawer has only a name in mind as the payee.[23] In the usual case of this type the impostor assumes the name of a real person; therefore, the negligence theory is no more successful in justifying placing the loss upon the drawer. As a practical matter, the drawer cannot go to the expense and trouble of making a complete inquiry and the normal inquiry would disclose that a person of the name which the impostor has adopted is everything which the impostor has represented himself to be.[24]

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22. United States Post Office Regulations (1940) §§729, 730 provide for the withdrawal and recall of mail by the sender thereof upon written application to the postmaster at the office of mailing, stating the reasons for such request. Such mail must be returned to the sender if it has not been delivered to the addressee. This regulation is the basis for holding that the post office is the agent of the sender. Guardian Nat. Bank v. Huntington County State Bank, 206 Ind. 185, 192-196, 187 N.E. 388, 390-391 (1933). Compare Maloney v. Clark, 6 Kan. 82 (1870), where the impostor assumed the name of the drawer's brother and hired an attorney to secure money from the drawer. The drawer sent the drafts to the attorney payable to his brother. The court held that the attorney was the drawer's agent for the delivery of the checks; therefore, the loss fell upon the drawer.

23. "The criminal fraud of R. (the impostor) induced the defendants to send their check, not to him, but to John M. Gillespie (drawer's son), to whom it was made payable. There was no delivery nor intention to deliver the check to R., and no authority conferred upon him to take the letter inclosing it from the postoffice, or to make any disposition of the check." Palm v. Watt, 7 Hun. 317, 318 (N.Y. 1876).

24. In Emporia Nat. Bank v. Shotwell, 35 Kan. 360, 11 Pac. 141 (1886), the impostor assumed the name of the owner of certain land and secured a loan by mail by means of forged mortgages upon this land. A search of the public records showed the land to be owned by one having the name assumed by the impostor. It would appear that the drawer could not have intended his check to be paid to any person other than the owner of the land; however, the court held that it was the lender's intent that the check be paid to the impostor.

Any rule which determines which of the parties to the instrument should bear the loss resulting from the impostor's fraud should take into account two factors: (1) preserving the free circulation of commercial paper, and (2) the opportunity of the parties to protect themselves against loss. One means of furthering negotiability is to cut down the defenses available to prior parties to the instrument. Thus, in the impostor cases it has been argued that it would aid negotiability to place the loss upon the one who transferred the paper to an impostor.[25]

However, is it desirable to encourage negotiability at the expense of those persons who of necessity must make use of negotiable paper? The transferee of the instrument is under no duty to take the paper and need not do so unless the holder can clearly establish his right to the paper. As a practical matter, the transferee and the impostor usually deal face to face and the transferee thus has an opportunity to protect himself against loss.[26] Does the transferor have an equal opportunity? Where the transferor and the impostor deal face to face it is obvious that the former's opportunity to protect himself is equal to that of the transferee. However, where the transferor and the impostor do not deal face to face but deal by means of mail, telegraph, or other agency of communication, including a personal messenger of the impostor as in the instant case, the transferor's opportunity to protect himself is not equal to that of the transferee. As has been previously stated, the normal inquiry made by the transferor reveals only that a person of the name assumed by the impostor is everything the impostor has represented himself to be. A complete inquiry which would disclose the fraud is normally too burdensome to be practical. It thus becomes

25. Notes, 38 Col. L. Rev. 171, 173 (1938); 32 Ill. L. Rev. 731, 732 (1938); 24 Va. L. Rev. 192, 193-194 (1938).

26. The opportunity of the transferee to protect himself from loss was recognized in Rosin v. Lawrence Byars Used Car Post, 30 Ala.App. 576, 10 So.2d 48 (1942), an action by the holder against the drawer upon a check on which the drawer had stopped payment after learning of the fraud. The court recognized the impostor rule but held that when the drawer informed the holder upon inquiry, "it's all right to cash the check if you know that the man presenting it is Sergeant J. M. Phillips (the named payee)," the burden of ascertaining the impostor's identity was transferred to the holder who took the check from the impostor. Why should it be necessary that these words be spoken? Should not every check carry with it the representation, "it is all right to cash the check if you know that the man presenting it is" the person he represents himself to be?

necessary for the transferor to rely upon the banking system to pay the paper to the proper person. This necessity and the transferee's ever present opportunity to protect himself should relieve the transferor from loss in such cases.

It is submitted, therefore, that the true basis of decision in the impostor cases should be the practical opportunity of the parties to protect themselves from loss and the use to which each party has put this opportunity. Stated otherwise, each party to a negotiable instrument should have the duty of conforming to sound business practice and failing to so act, he should bear the loss due to his neglect.[27]

But what effect would this rationale have upon the case law of the impostor cases? The possible cases must be examined to answer this question:

1. The transferor and an impostor assuming either the identity of a real person or a wholly fictitious identity deal face to face. The transferor and the transferee have equal opportunities to protect themselves against loss; therefore, the loss should fall upon the transferor, for his failure to detect the fraud makes the later fraud upon the transferee possible. This reasoning accords with the estoppel theory; the result is in accord with both the estoppel and intent theories.

2. The transferor and an impostor assuming the identity of a real person deal by means of mail, telegraph, or other agency of communication, and the imposter makes representations consistent with the assumed identity. The transferee

27. Thus, in U.S. v. First Nat. Bank of Prague, 124 F.2d 484 (C.C.A. 10th 1941), the impostor negotiated a loan by mail from the Veterans' Administration upon a stolen adjusted-service certificate. The loan was handled through the defendant bank which also cashed the check representing the proceeds of the loan. The certificate establishing the impostor's identity was witnessed by the president of the bank in his capacity as a notary public. The court allowed the United States to recover the amount of the check from the bank, stating at page 488, "Thus the issuance and mailing of the check to the imposter was not the first act which made possible the loss. On the contrary, by first reposing confidence in him and by cooperating with him as indicated, the bank unwittingly contributed to the deception of the Administration in respect to the vital matter of identity; and such cooperation constituted the initial act which resulted in the imposter fraudently obtaining money to which he was not entitled. The act and conduct of the bank, without being so intended, facilitated the fraud and primarily made possible the loss. Stated otherwise, the bank unwittingly cooperated with the imposter in setting in motion the train of events which culminated in the loss." Or, the person having the best opportunity to detect the fraud and failing to do so should bear the loss.

has the only practical opportunity to detect a fraud as to the identity of the impostor and should bear the loss. This reasoning does not accord with either theory of the impostor rule, and the result is contra to the majority view.

3. The transferor and an impostor assuming the identity of a real person deal by means of mail, telegraph, or other agency of communication, and the impostor makes representations inconsistent with the assumed identity. The normal inquiry of the transferor would reveal the inconsistent representations; therefore, it is reasonable to require the transferor to make a further investigation which would reveal the fraud. While this inquiry is more difficult for the transferor than for a transferee who is dealing face to face with the impostor, it would be unreasonable to allow the transferor to proceed with the transaction in spite of the inconsistency of representations. If he elects to do so, he should bear the resulting loss. This reasoning accords with the estoppel theory; the result is in accord with both the estoppel and intent theories.

4. The transferor and an impostor assuming a wholly fictitious identity deal by means of mail, telegraph, or other agency of communication. The normal inquiry of the transferor would detect the fraud as to the identity of the impostor; therefore, the transferor should bear the loss. This reasoning accords with the estoppel theory; the result is in accord with the majority view under both theories.

This analysis of the possible impostor situations shows that the above rationale of the impostor cases would change the majority view only at what is, on principle, its weakest link—the mail cases in which the impostor has assumed the identity of a real person and made representations consistent with that identity. With regard to free circulation of commercial paper, this rationale should have a negligible deterrent effect upon negotiability. In fact, if the above rationale compels those persons who do not wish to conform to sound business practice to cease using negotiable paper, it should prove to further the free circulation of negotiable instruments.