**Imposters and Fictitious Payees**

Welcome to this podcast on Imposters and Fictitious Payees brought to you by CALI. I am Professor Jennifer S. Martin. The topic of this podcast is who has responsibility for losses involving imposters and fictitious payees. I find that students often get confused about these rules a lot, so it’s worth the time to sort this out. Oh and yes, again, this deals with instruments, typically paper checks and promissory notes. I know that most of you don’t use paper checks very often, but checks and promissory notes are still used in many transactions, particularly larger ones. Moreover, financial fraud remains a problem. Not only is this a practice issue, but imposters and fictitious payees are covered in Article 3 of the Uniform Commercial Code, which is tested by a number of states on the bar examination. These loss shifting rules are favorites on bar exams. The primary rule at play here is 3-404. It is important to try and use the correct terminology so in this podcast be on the lookout for the following: imposter, issuer, indorsement, payee, fictitious persons, person whose intent determines to whom an instrument is payable, holder, indorsement, and person entitled to enforce (or sometimes called a PETE).

Let’s begin with the imposter rule, as it is the easiest to learn. Remember that issuers of promissory notes and checks are ultimately responsible in most cases for instruments that they issue themselves. So, what happens if an imposter induces an issuer to issue an instrument? The basic answer is the issuer will take the loss. Time for a hypo. So, let’s imagine John comes to my door dressed as a police officer and claims to be from the police auxiliary and is collecting monetary donations for injured officers. Wanting to support the local police officers, I write a check to him for $100 and he leaves. As it turns out, John had no relationship with the police auxiliary. John indorses the back of the check. Under the imposter rule, John, the imposter, induced me to issue the instrument, a check. John’s indorsement is effective as the indorsement of the police auxiliary when he cashes the check at the bank. I take the loss and cannot pass it back to my bank. I will have to recover from John, if at all, which is not likely.

Ok, let’s turn to the trickier problem of fictitious payees. This rule usually applies when an employer has given an employee responsibility to issue checks for them or to order the issuance of checks. Students often get this one wrong, so pay close attention here. The rule applies when a person whose intent determines to whom an instrument is payable does not intend the person to have any interest in the instrument (or makes the instrument out to a payee that doesn’t even exist because it is a fictitious person). Notice that this involves the issuance of an instrument. It is a fraud initially perpetrated on the front side of the instrument. If the rule applies THEN a person in possession of the instrument is its holder AND an indorsement in the name of the payee stated on the instrument is effective in favor of a person (usually a bank) who in good faith pays the instrument. In these cases, the account holder, most often an employer, takes the loss.

Let’s look at an example that comes from a bar exam question. Dan was an employee of Insure, a life insurance company. Starting in June, Dan caused Insure to issue three checks per month to the order of Insure policyholders by telling Insure that the policyholders had requested policy dividend withdrawals, when in fact no such requests had been made. All the checks were drawn on First Bank. It was the practice of Insure to deliver such checks to Dan upon his request, and Dan was then responsible for sending the checks to the policyholders. Insure did not require any verification that the dividend withdrawals were requested by the policyholders or that Dan sent the checks to them. After Insure delivers the checks to Dan, Dan signs the payees’ names on the checks beneath an endorsement that read “pay to the order of Dan.” Dan then cashes the checks at various branches of First Bank. When Dan is discovered, can Insure, the employer, recover from First Bank for its losses?

The answer is no. Insure will take the loss under the fictitious payee rule. First, Dan is a person whose intent determines to whom an instrument is payable. Even though he doesn’t write the checks himself, Insure has given him authority to order checks. Second, even though the policyholders are real, Dan does not intend them to have any interest in the checks. The fictitious payee rule applies to make any person in possession of the instrument its holder. Meaning, Dan was the holder of the instrument and he becomes a person entitled to enforce, a PETE. Also, the indorsement of Dan is effective as the indorsement of the policyholder in favor of First Bank who in good faith paid on the checks. Dan was a holder and the indorsements are effective, so Insure takes the loss.

Ok, this seems straightforward, so where might this go wrong? It always seems to go wrong in a fact pattern on an examination. Well, sometimes students choose the wrong rule. Insure might be negligent here, so students might think about the rules on negligence. But, the fictitious payee rule fits cleanly and clearly allocating liability making it the best rule here. The other rule that students sometimes wrongly choose is the employer responsibility rule of 3-405. Notice that with Dan his first fraud is getting the checks issued. While there is a later indorsement, his first fraud was in the issuance of the checks. The employer responsibility rule has no application here because that rule deals with forged indorsements. The fictitious payee rule validates the indorsement here, so there is no forged indorsement and the employer responsibility rule does not apply. If there is fraud in the issuance of the instrument like with Dan, apply the fictitious payee rule to validate the indorsement and place liability on the employer.

So, can you get this last one correct? Let’s look at it. Big Company gives their bookkeeper, Samantha, general authority to issue company checks. Samantha can pay employees wages and other corporate bills. Samantha, being short of cash herself, decides to issue a check for $10,000 payable to Geraldine Gone, an old acquaintance who she hasn’t seen in years. Neither Big Company nor Samantha intends Geraldine to receive any of the funds and Geraldine is not an employee or creditor of Big Company. Samantha indorses the check in Geraldine’s name. She then cashes the check at National Bank. National Bank charges the Big Company’s account for $10,000. Big Company discovers the fraud and demands that the account be re-credited. Will it be successful? The answer is no, the fictitious payee rule makes Samantha’s indorsement in the name of Geraldine effective. Big Company takes the loss. Notice the employer responsibility rule has no application here because the original fraud related to the issuance of the check.

At this point, you should be able to identify when the imposter and fictitious payee rules apply to leave responsibility of losses on issuers and account holders.

I hope you’ve enjoyed this podcast on Imposters and Fictitious Payees.

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