Wrongful Dishonor

James J. White
University of Michigan Law School, jjwhite@umich.edu

Available at: https://repository.law.umich.edu/other/104

Follow this and additional works at: https://repository.law.umich.edu/other
Part of the Banking and Finance Law Commons, Commercial Law Commons, and the Torts Commons

Recommended Citation

This Conference Proceeding is brought to you for free and open access by the Faculty Scholarship at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Other Publications by an authorized administrator of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.
Wrongful Dishonor

By

James J. White
Professor of Law
University of Michigan School of Law
Ann Arbor, Michigan
WRONGFUL DISHONOR
By Professor James J. White

I. Basic Liability

Section 4-402 renders the payor bank liable for wrongful dishonor in the following words:

§ 4-402. Bank's Liability to Customer for Wrongful Dishonor

A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. When the dishonor occurs through mistake liability is limited to actual damages proved. If so proximately caused and proved damages may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.

Typically claims arise under 4-402 when the bank dishonors a check of its customer because it (1) has improperly set off money in the account; (2) failed properly to credit a deposit; (3) has made some other error and has so either reduced the apparent amount in the account or has mistakenly concluded that there are insufficient funds in the account to meet the check. Note below that the dishonor of a customer's check is not the only way that a bank can violate section 4-402.

Under the statute and the cases the bank need not be guilty of negligence to commit a "wrongful" dishonor. Indeed, some courts have found a knowing refusal to pay a check (because an account had been reduced in a good faith response to a garnishment, for example) more reprehensible than mistaken refusal to honor. In short there is prima facie liability under 4-402 anytime a bank dishonors a check under circumstances in which there were sufficient funds in the account or would have been sufficient funds in the account if the bank had made all the correct debits, credits and computations. The fact that the bank's action in reducing the account or not crediting it proves only by hindsight to be "not correct," is no defense for the bank. Put another way, the presence of the adjective "wrongful" has not enabled payors to escape liability by showing good faith and use of reasonable commercial practices.
II. Damages

A. "Actual and Consequential" Damages

The second sentence of 4-402 limits recovery to "actual damages proved" when dishonor occurs "through mistake." The inference in that sentence is that there are some damages that may be recovered which are not "actual" damages. The next sentence authorizes the recovery of "consequential damages." Presumably actual damages include consequential damages and the only difference between consequential and other forms of actual damages would be the length of the chain of causation between the dishonor and the damage.

Courts interpreting the section have granted recovery for lost profits, Skov v. Chase Manhattan Bank, 407 F.2d 1318 (3d Cir. 1969), for mental anguish and for a variety of other somewhat intangible injuries. One case, Bank of Louisville Royal v. Sims, 435 S.W.2d 57 (Ky. App. 1968) denied recovery for mental anguish ("nerve" the court called it) on the following grounds: "From the proximate cause standpoint, these nebulous items of damage bore no reasonable relationship to the dishonor of her two checks and consequently they cannot be classified as 'actual damages proved.'"

Whether one labels the question as one concerning the definition of "actual damage," of "proximate cause" or of the word "consequential," it is clear that there is a dispute in the courts about the extent to which a plaintiff may recover for intangible nonmonetary injuries; of course there is always a question about the form of evidence necessary to prove proximate causation even for monetary injuries. Consider Allison v. First National Bank In Albuquerque, 12 UCC Rep. Serv. 885 (N.M. App. 1973, reversed on other grounds 13 UCC Rep. Serv. 291). In that case the plaintiff had deposited in a Mexican bank cashier's checks drawn by the defendant bank. The drawer-drawee dishonored the checks when they were presented and was found to have violated 4-402. In its remand to the trial court the court of appeals addressed the consequential damage question as follows:

As a consequence of the dishonor (1) An attachment lien was filed against 54 items of personalty of the plaintiff in Mexico seizing all his personal assets for purposes of satisfying his debts owed to the Mexican bank. (2) Plaintiff was personally threatened with imprisonment if the checks were invalid. (3) His credit standing was ruined. (4) He was placed under a cloud of suspicion in
his Mexican community. Plaintiff had an excellent professional reputation.

"Plaintiff is entitled to reasonable and temperate damages determined by the sound discretion and dispassionate judgment of the trial court." 12 UCC Rep. Serv. at 891.

It is apparent that the appellate court was willing to let the lower court or the jury place some monetary value on the personal threats that the plaintiff received on the loss of his credit standing and on the consequences of the "cloud of suspicion."

B. The Trader Rule

Under the pre-Code law of many states a businessman whose checks were dishonored was presumed to have suffered loss because of injury to his reputation. He could recover for such loss even though he could prove no actual monetary loss as a consequence of the injury to his reputation. Whether 4-402 has completely rejected the trader rule is not clear; even if the rule has been rejected, the consequence of such a rejection is not clear.

Comment 3 to 4-402 specifically states that the trader rule is rejected. Despite that statement in the comments, one can argue 4-402 continues the trader rule. One can draw an inference from the second sentence in 4-402 that when the dishonor occurs not "through mistake" but through some intentional act of the bank (as for example preferring itself in an improper set off over the customer), the liability is not limited to "actual damages" as it is in cases in which the dishonor occurs only by mistake. Indeed this distinction between mistaken and intentional dishonor was followed in the pre-Code New York law and the law of some other states prior to the Code. At least one case, American Fletcher Nat'l Bank & Trust Co. v. Flick, 146 Ind. App. 122, 252 N.E.2d 839 (Ind. App. 1969), has found that the trader rule continues notwithstanding the enactment of 4-402. Nevertheless that court awarded only nominal damages to the plaintiff.

If the trader rule no longer exists, what are the consequences? If one accepts the proposition that intangible injury such as "mental distress" is part of "actual damages" as that term is used in the Code and if he further rejects the proposition that 4-402 is fundamentally a contract action
governed by Hadley v. Baxendale, it is difficult to see that the abolition of the trader rule has had any effect. Presumably even under the trader rule the jury would have to guess about the amount of damages it wished to award to plaintiff. Under the generous interpretation of 4-402 illustrated by the New Mexican court, the jury's job will simply be to guess about the "actual damages" that attended the mental distress. I fail to see the practical significance of the difference between that jury guess and the guess it would make under the trader rule.

C. Punitive Damages

A recent Texas case, Northshore Bank v. Palmer, 17 UCC Rep. Serv. 488 (Tex. Civ. App. 1975) will send shivers down the spines of bank lawyers. In that case the court affirmed an award of $2,000 actual damages and $3,500 of punitive damages. In part the court found that the bank had not made timely objections to jury instructions of the court below. Nevertheless the court found that there was sufficient evidence in the record to support a finding of $2,000 actual damages; it did so despite the fact that the out-of-pocket loss was apparently only $290. The court held that 4-402 did not bar the punitive damage recovery and apparently concluded punitive damages could be recovered outside of 4-402 since the dishonor was "intentional." The court describes the facts of the case as follows:

"A forger had secured a number of printed checks of one Marvel Fikes and proceeded to include Palmer as one of his victims. A person showed up at the Bank seeking to cash the $275 check payable to Palmer. The teller ascertained that Palmer had an account with the Bank and paid out the money. She could not testify as to whether this person was or was not Palmer. Some four or five days later, the check was returned by the bank on which it was drawn because the signature was not like the signature of Fikes which it had on file. The checks written by Palmer, which are in question here, had already been paid by the Bank, when the situation with respect to the forgery became known to it. The officer in charge immediately charged Palmer's account with the forged check despite his protestations that his endorsement was a forgery. When he went to see the Bank officer to deny endorsement and receipt of the proceeds of the forged check, the officer called over a uniformed
guard. Even though the checks had been cleared for payment and were covered by sufficient funds when presented, the Bank recalled them and returned them marked "paid in error" or "account closed." Palmer immediately reported the forgery to the police, contacted the bank on which the forged Fikes check was drawn, and contacted Mr. and Mrs. Fikes. He then underwent the embarrassment of calling on each of the payees of the dishonored checks. The Bank never relented. They charged appellee $5 for each check they considered drawn on "insufficient funds". Additionally, after all of the claims of Palmer were known to the Bank officer having charge of the matter, the Bank placed the claimed balance due in the hands of a collection agency, where it rests today. The Bank never has paid Palmer the $275 which under the jury's findings is wrongfully charged to his account. Under the Bank's own evidence, each step it took was deliberate and intentional and done with a knowledge of Palmer's claim of right. The exemplary damages found by the jury are reasonably related to the amount of actual damages found and are fully justified under the evidence. We overrule appellant's points attacking special issue number five and the answer of the jury thereto." 17 UCC Rep. Serv. at 491.

E. Damage Summary

The foregoing cases make at least the following facts clear. (1) Some, perhaps most, courts will grant recoveries in proper cases for nonmonetary damages related to mental anguish, humiliation and the like. (2) Although the Code does not speak to the question, it appears under the rules of civil procedure in most jurisdictions these issues will be for the jury. (3) No reported case under 4-402 has applied the Hadley v. Baxendale foreseeability test to the plaintiff's request for consequential damages. (4) The trader rule is probably insignificant but it may have survived 4-402's enactment.

III. Miscellaneous Asides

A. Types of checks to which 4-402 applies.

In the Albuquerque case the court allowed a recovery for wrongful dishonor when the bank refused to pay its own cashier's check. Ordinarily one would characterize the
plaintiff's cause of action in such a case as for breach of the drawer's contract under 3-413. However the court analyzed it as a 4-402 case and granted a recovery on that basis. Note that the use of 4-402 brings in all of the damage claims discussed above that would not be heard on a traditional contract claim. In a similar case the Maine supreme court allowed a recovery in Joler v. Depositors Trust Co., 13 UCC Rep. Serv. 515 (Maine 1973). The later case seems sound; the former is more questionable.

B. Zatal v. First National City Bank, 9 UCC Rep. Serv. 1098 (N.Y. Sup. Ct. 1971) is not strictly a 4-402 case, but it is analogous. The court sustained plaintiff's complaint against the bank's motion to dismiss for failure to state a cause of action. In that case the plaintiff had deposited an $8,500 check. The bank erroneously credited its account with only $850 and consequently bounced a check on the grounds of "insufficient funds." Had the check been presented and the credit been correctly made, the bank still would have bounced the check but on the basis that it was "drawn against uncollected funds." By rejecting the bank's motion, that court has implicitly found a cause of action not for wrongful dishonor but for making an incorrect and perhaps defamatory statement of the reason for dishonor.