Bank Liability for Wrongful Dishonor: UCC Section 4-402 — Is Revision Needed?

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I. INTRODUCTION

The introduction of the Uniform Commercial Code (UCC) and its original subjection to legal scrutiny naturally were accompanied by some objection to and criticism of its provisions. Some critics contended that Articles 4 and 5 unduly favored banking interests and the commercial community. Despite this

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The author wishes to recognize the valuable assistance of Mr. Gary Kure, J.D., Illinois Institute of Technology, Chicago-Kent College of Law, 1975. The first state legislature to adopt the Uniform Commercial Code (UCC) was Pennsylvania. Pa. STAT. ANN. tit. 12A §§ 1.01 et seq. (1970) (effective July 1, 1954). All states except Louisiana now have adopted the UCC.


2See Beutel, The Proposed Uniform Commercial Code as a Problem on Codification, 16 LAW & CONTEMP. PROB. 141 (1951); Beutel, The Proposed Uniform [?] Commercial Code Should Not Be Adopted, 61 YALE L.J. 334 (1952); Braucher, The 1956 Revision of the Uniform Commercial Code, 2 VILL. L. REV. 3 (1956); Gilmore, On the Difficulties of Codifying Commercial Law, 57 YALE L.J. 1341 (1948); Vergari, Suggested Amendments to the Uniform Commercial Code, 72 BANKING L.J. 621 (1955). See also Symposium—Amending the Uniform Commercial Code: A Report on Valid Criticism and Suggested Change, 28 TEMPLE L.Q. 511 (1956). The following articles appeared in this Symposium: Braucher, In re Article 7, id. at 564; Hawkland, In re Articles 1, 2 and 6, id. at 512; Spivack, In re Article 9, id. at 529; Thomas, In re Article 8, id. at 582; Vergari, In re Articles 3, 4 and 5, id. at 529.

3See Beutel, The Proposed Uniform [?] Commercial Code Should Not Be Adopted, 61 YALE L.J. 334 (1952). Professor Beutel called Article 4 "an unfair piece of class legislation maneuvered through the American Law Institute and the Commission on Uniform Laws by pressure groups favoring the
alleged favoritism, however, the UCC has found general acceptance in the United States. The early criticism, which often demanded outright rejection of the Code, has yielded to constructive commentary suggesting judicious amendments. The trend is now toward improvement rather than complete rejection.\(^4\) Section 4-402, which concerns a payor bank's liability for wrongful dishonor of a customer's check,\(^5\) is one section that could benefit from judicious revision. While its subject matter was clearly appropriate for codification, the present version of section 4-402 does not appreciably improve the unsatisfactory and nonuniform results that arose under common law wrongful dishonor rules and previous codifications.

More than ever before, an individual's or an entity's credit rating is a key to viable commercial relations. Modern business practices rely heavily upon the use of credit to finance and to consummate purchases made by businesses and consumers. Highly computerized credit ratings generally dictate the amount of credit that can be extended to a potential purchaser. Congress, by enacting the Fair Credit Reporting Act,\(^4\) recognized the importance of credit ratings and the need for their meticulous accuracy. The Act is intended to maintain accuracy in credit reporting and to provide remedies for abusive reporting practices. As a result of the increased importance and sophistication of credit ratings, the need for more rational and balanced rules concerning a bank's liability for the wrongful dishonor of a check is even more acute than when section 4-402 was first enacted.

bankers over their customers.” \(\text{Id.}\) at 335. Furthermore, Professor Beutel explained this one-sidedness of Article 4 by stating: “This article is a deliberate sell-out of the American Law Institute and the Commission on Uniform Laws to the bank lobby in return for their support of the rest of the 'Code.'” \(\text{Id.}\) at 362. In a reply article, Professor Gilmore rebutted some of Professor Beutel's criticism but agreed, at least in principle, that Article 4 should not be adopted. He also conceded to Professor Beutel that Article 4 had been proposed by a group of bank counsel in 1950 and adopted by the Institute and Conference in September, 1951. See Gilmore, The Uniform Commercial Code: A Reply to Professor Beutel, 61 YALE L.J. 364 (1952).


\(^5\)Section 4-402 refers to "items." It is possible, therefore, for obligations other than checks to be dishonored, including instruments drawn against a savings account. Most wrongful dishonor cases, however, have involved the dishonor of a customer's check. See, e.g., Joler v. Depositors Trust Co., 309 A.2d 871 (Me. 1973).

A sound credit rating can be impaired or even destroyed by the negotiation of a check which is subsequently returned, stamped with the legend "not sufficient funds" or "insufficient funds." When the insufficiency is caused by the drawer's fault, he alone bears the negative consequences. When an incorrect notice of insufficiency is precipitated by the payor bank, however, the drawer is entitled to reimbursement for some part of the injury caused by the dishonor. The nature of the relationship between the bank and its customer, together with the permissible extent of the bank's liability for the wrongful dishonor,7 largely determines which of the drawer's injuries are compensable.

The problem of a bank's liability for wrongful dishonor has been confronted by common law doctrines, the American Banking Association's proposed statute regarding wrongful dishonor (ABA statute),8 and finally section 4-402 of the Uniform Commercial Code. The results have neither been consistent nor entirely logical. This Comment briefly traces common law principles governing a bank's liability for wrongful dishonor, the effect of the ABA statute, and the enactment of Uniform Commercial Code section 4-402. An amended section 4-402, which is intended to avoid some of the pitfalls of the present section, is then proposed.

II. COMMON LAW DOCTRINES

I think it cannot be denied, that, if one who is not a trader were to bring an action against a banker for dishonoring a check at a time when he had funds of the customer's in his hands sufficient to meet it, and special damages were alleged and proved, the plaintiff would be entitled to recover substantial damages.9

This statement sets forth the general common law rule of recovery in situations in which a bank has wrongfully dishonored

7Comment 2 to section 4-402 defines wrongful dishonor in the following manner:

"Wrongful dishonor" excludes any permitted or justified dishonor, as where the drawer has no credit extended by the drawee, or where the draft lacks a necessary indorsement or is not properly presented. The Comment actually fails to state the most common situation of wrongful dishonor—when the drawer has adequate funds to cover the item drawn upon the proper account. This is distinguishable from the situation in which the drawee has committed credit to the account and then dishonors the item.

81 T. Paton, Digest of Legal Opinions § 21B:1, at 1117 (1940) [hereinafter cited as Paton's Digest]. Eighteen states at one time had adopted this statute. They are Alabama, Arkansas, California, Idaho, Illinois, Maine, Michigan, Missouri, New Jersey, New Mexico, North Carolina, Ohio, Oregon, Pennsylvania, Tennessee, Virginia, West Virginia and Wyoming. Id. at 1118.

a customer's check. The majority of English and American courts followed this rule throughout most of the nineteenth and twentieth centuries. It remained in force in this country until the enactment of the Uniform Commercial Code by most states. Nevertheless, much of the common law is still viable today, and an understanding of its substance greatly facilitates an understanding of section 4-402. A bank's liability for wrongful dishonor may rest on two common law bases: tort and contract.

A. Contract Liability

Courts were quick to clothe bank-customer transactions with the trappings of contract law. Banks often promised to pay all checks that were drawn by their customers so long as the customer's account contained sufficient funds. If there were sufficient funds to pay only several of a number of checks presented, banks were obligated to honor as many as they could. Under the basic rules of contracts set forth in Hadley v. Baxendale, damages for breach are to be apportioned. Some damages flow naturally from the breach, while other damages are considered to be reasonably within the contemplation of the parties at the time of the contract. For example, in Wahrman v. Bronx County Trust Co., the plaintiff sought special damages for a cancelled insurance policy caused by a wrongfully dishonored check. The court stated that to recover for special damages the plaintiff was required to plead and prove "that the defendant had actual or constructive knowledge of the consequences reasonably to be expected from the nonpayment of the check." This knowledge, the court held, could not be inferred solely from the fact that an insurance company was the payee. Under this theory, bank customers were limited to recovery of damages that would place them in substantially the same position as they would have occupied had the contract been performed. On the other hand, damages for loss of expected credit and mental suffering were not recoverable since they generally were not within the contemplation of the parties at the creation of the contract.

B. Tort Liability

A tort action similar to slander represented another method

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of recovery at common law. A bank’s wrongful dishonor was considered a false statement that placed a drawer in disrepute in the business community.\textsuperscript{15} Indeed, a wrongful dishonor, when applied to a customer engaged in a profession or trade, was considered slanderous per se. In an action for slander the plaintiff was not required to plead or prove special damages, since special damages were presumed to flow from the fact of publication.\textsuperscript{16} Consequently, in actions for wrongful dishonor based on tort, it was within the province of the jury to consider actual monetary damages as well as such “other damages as necessarily arise out of the act; and . . . if the effect of such damage is to produce mental suffering and anxiety, they are at liberty to award damages on that head, also.”\textsuperscript{17}

In circumstances involving wrongful dishonor, the advantages of a tort action rather than a contract action are obvious. Tort damages are compensatory and provide relief for all injuries proximately caused by a wrongful dishonor.\textsuperscript{18} Nevertheless, reliance upon a tort theory did not necessarily mean that a customer could have recovered for all his injuries. For example, damage to a person’s credit standing often arises from wrongful dishonor, but credit is an elusive concept and loss is difficult to prove. Moreover, any claim for injury to a person’s credit rating could be defeated by the argument that the dishonor did not proximately cause the diminution. An individual’s credit standing is a composite of various intangible criteria, any of which could affect his total financial status.

C. The Trader Rule

The use of checks traditionally has been limited to a commercial context, and the trader rule modification of the two common law theories of damages was formulated to accommodate the business community. Accordingly, if a plaintiff were a trader, damages normally associated with tort actions were available as conclusively presumed contract damages.\textsuperscript{19} Notably, a plaintiff did not need to show that the injury was within the contempla-


\textsuperscript{17}Davis v. Standard Nat’l Bank, 50 App. Div. 210, 214, 63 N.Y.S. 764, 767 (1900).

\textsuperscript{18}Those courts allowing a tort recovery have identified specific torts in certain cases of wrongful dishonor. Cf., e.g., Macrum v. Security Trust & Sav. Co., 221 Ala. 419, 129 So. 74 (1930) (defamation); Schaffner v. Ehrman, 139 Ill. 109, 28 N.E. 917 (1891) (slander); Nealis v. Industrial Bank of Commerce, 200 Misc. 406, 107 N.Y.S.2d 264 (Sup. Ct. 1951) (libel).

\textsuperscript{19}In this context the word “trader” or “merchant” meant any bank customers engaged in business. In Peabody v. Citizens’ State Bank, 98 Minn. 302,
tion of the parties. Moreover, proof that a plaintiff was not, in fact, injured by the dishonor did not defeat his action but merely mitigated his damages.\textsuperscript{20}

While some courts were liberal in applying the trader rule to nontraders,\textsuperscript{21} most maintained the distinction between traders and nontraders.\textsuperscript{22} Special damages suffered by a nontrader, therefore, still were required to be pleaded and proved, and failure to do so limited recovery to only nominal damages for a technical breach of contract.\textsuperscript{23} Apparently, courts accepted the idea that the dishonor of a check did substantially less damage to the reputation of a person not engaged in mercantile activities than it did to a "trader."

The generally accepted trader rule essentially involved a two-step method of proof: first, proving wrongful dishonor, and secondly, proving the plaintiff's status as a trader.\textsuperscript{24} New York courts

\textsuperscript{20}First Nat'l Bank v. N.R. McFall & Co., 144 Ark. 149, 222 S.W. 40 (1920). For example, in Rolin v. Steward, 139 Eng. Rep. 245 (C.P. 1854), the trader rule was described in the following manner: 

[\textit{W}]hen it is alleged and proved that the plaintiff is a trader, I think it is equally clear that the jury, in estimating the damages, may take into their consideration the natural and necessary consequences which must result to the plaintiff from the defendant's breach of contract: just as in the case of an action for a slander of a person in the way of his trade, . . . the action lies without proof of special damage. 

\textit{Id.} at 250 (Williams, J.).

Forty years later, in Shaffner v. Ehrman, 139 Ill. 109, 28 N.E. 917 (1891), the court expressed the same sentiment:

It is well understood that in an action of slander by a person for the speaking of slanderous words of him in the way of his trade the fact he is a trader takes the place of special damages. To return a check marked "Refused for want of funds" to the holder, especially through a clearing-house, certainly tends to bring the drawer of that check into disrepute as a person engaged in mercantile business; and it needs no argument to show that a single refusal of that kind might often, and frequently does, bring ruin upon a businessman; and yet it is no more possible in either case to prove special or actual damages than it is for one charged with the commission of a crime to show specifically in what manner he has been injured.

\textit{Id.} at 113, 28 N.E. at 919.

\textsuperscript{21}See Patterson v. Marine Nat'l Bank, 130 Pa. 419, 18 A. 632 (1889); Lorick v. Palmetto Bank & Trust Co., 74 S.C. 185, 54 S.E. 206 (1906).

\textsuperscript{22}See, e.g., First Nat'l Bank v. Stewart, 294 Ala. 199, 55 So. 529 (1920).


\textsuperscript{24} See generally J. White & R. Summers, \textit{Handbook of the Law Under
accepted the trader rule but included a three-step modification which necessitated proving a wrongful dishonor, proving that the dishonor was the result of "malice," and proving the plaintiff's trader status.\textsuperscript{25} The "malice" element required a showing of intentional action and could be inferred from a bank's dishonor of checks after notice of the bank's error was given or from the bank's wrongful application of funds in the plaintiff's account to purposes other than the payment of checks.\textsuperscript{26} Failure to show malice in a dishonor resulted in the recovery of only nominal damages. The requirement of malice did not mean that the dishonor must have been the product of hatred or malevolence. The necessity of proving malice was intended, however, to limit a bank's liability to nominal damages for the consequences of accident or mistake.\textsuperscript{27}

Judicial confusion inevitably resulted from the availability of two separate causes of action for wrongful dishonor and the application of the trader rule to the awarding of damages. Some courts, having piously announced that an action for wrongful dishonor sounded in contract, proceeded to award damages based on tort.\textsuperscript{28} Other courts attempted to explain the trader rule as either a simple tort or a simple contract action.\textsuperscript{29}

Some courts, however, did make lucid attempts to explain the trader rule. In \textit{Patterson v. Marine National Bank},\textsuperscript{30} for example, the court justified its recognition of the trader rule as a tort doctrine on public policy grounds. The court reasoned that banks are in the nature of quasi-public institutions and should be held responsible for the disorder created within the community when they wrongfully dishonor checks. The court postulated that

the business of the community would be at the mercy of

\textsuperscript{25}Id.

\textsuperscript{26}See Wildenberger v. Ridgewood Nat'l Bank, 230 N.Y. 425, 130 N.E. 600 (1921).

\textsuperscript{27}Id. at 428, 130 N.E. at 600.


\textsuperscript{29}See First Nat'l Bank \textit{v.} Stewart, 204 Ala. 199, 85 So. 529 (1920); Weaver \textit{v.} Grenada Bank, 179 Miss. 564, 178 So. 105, suggestion of error overruled, 180 Miss. 876, 179 So. 564 (1938) (tort).

\textsuperscript{30}130 Pa. 419, 18 A. 632 (1889). \textit{Patterson} also has been advanced to support the application of the trader rule to nontraders. This extension of the court's public policy explanation recognizes that banks occupy a vital and influential position in the nonbusiness as well as the business community. \textit{See}, e.g., Schaffner \textit{v.} Ehrman, 139 Ill. 109, 28 N.E. 917 (1891).
banks if they could at their pleasure refuse to honor their depositors' checks and then claim that such action was the mere breach of an ordinary contract for which only nominal damages could be recovered unless special damages were proved.\(^3\)

Another approach was utilized by courts which recognized the trader rule as a contract doctrine. To meet the test of *Hadley v. Baxendale,*\(^4\) courts would infer a bank's knowledge of a trader's special circumstances.\(^5\) A bank would then be considered to have had constructive knowledge of the effect of a dishonor on a trader customer. The inference was made even if the bank, in fact, was completely unaware of a customer's trader status at the time of contract.\(^6\) Under this interpretation, the customer still was required to allege and prove special damages.\(^7\)

The advent of the twentieth century brought changes in the law concerning wrongful dishonor. At that time, most American courts looked to the status of the plaintiff for the purpose of applying the trader rule.\(^8\) Nontraders generally did not have the advantage of the conclusive presumption of special damages conferred to traders. The distinction between traders and nontraders, however, was rapidly becoming irrelevant. In the southern and western states, courts, seemingly in response to the newly rekindled Jeffersonianism of the "Agrarian Revolt" and its concomitant social equality,\(^9\) were recognizing the unfairness of the trader rule. Some jurisdictions, cognizant of the effect of a wrongful dishonor upon an individual's standing within his community, extended the presumption of damages to nontraders.\(^10\)

For example, in *Valley National Bank v. Witter,*\(^11\) the court extended the presumption of special damages to nontraders because changing financial conditions had eliminated, to a large extent, the degree to which traders and nontraders relied upon credit in their financial transactions. The court noted that at the inception of judicial recognition of the trader rule "practically

\(^{31}\)130 Pa. at 433, 18 A. at 633.
\(^{32}\)156 Eng. Rep. 145 (Ex. 1854).
\(^{34}\)See, e.g., id.; Spiegel v. Public Nat'l Bank, 184 N.Y.S. 1 (Sup. Ct. 1920).
\(^{35}\)See generally First Nat'l Bank v. N.R. McFall & Co., 144 Ark. 149, 222 S.W. 40 (1920).
\(^{36}\)Cf. WHITE & SUMMERS § 17-4, at 568.
\(^{37}\)For a thorough study of this period and movement, see R. HOFSTADER, THE AGE OF REFORM (1955).
\(^{38}\)Atlanta Nat'l Bank v. Davis, 96 Ga. 334, 23 S.E. 190 (1895); Grenada Bank v. Lester, 126 Miss. 442, 89 So. 2 (1921); Lorick v. Palmetto Bank & Trust Co., 74 S.C. 185, 54 S.E. 206 (1906).
\(^{39}\)58 Ariz. 491, 121 P.2d 414 (1942).
all of the business of a merchant or trader was based upon credit rather than cash.”

It was logical to presume, therefore, that any attack upon the trader’s financial status would diminish his ability to obtain credit. Nontraders, on the other hand, “seldom had a bank account, conducted most of [their] dealings for cash, and only required credit in isolated and special circumstances.”

This de minimus reliance upon credit made it unlikely that nontraders would suffer serious financial repercussions from a wrongful dishonor. The court noted, however, that modern financial conditions had rendered these premises invalid, since “[t]he vast majority of all modern financial transactions, whether carried on by traders or nontraders, are based upon credit.” For this reason, the court held that the presumption of special damages applied in favor of traders also should be applied to nontraders. The court’s reasoning in Witter is particularly relevant today in light of the pervasive extent to which potential creditors rely upon credit reporting services.

The extension of the trader rule to nontraders can be contrasted with the response to that extension by the commercial and industrial communities which attempted to restrict recoveries from banks for wrongful dishonor. Eighteen states resurrected and enacted a dormant statute, the ABA statute, to govern bank liability for wrongful dishonor. The ABA statute eliminated the trader rule and reinstated the fundamental common law rule of contracts that special damages must be pleaded and proved.

III. THE AMERICAN BANKING ASSOCIATION STATUTE

The wrongful dishonor statute drafted by the American Banking Association in 1914 generally did not contribute lasting stability or predictability to the law of banking transactions. It applied only to a narrow set of circumstances and existed simultaneously with the state’s common law. The ABA statute set forth the following rule of wrongful dishonor:

No bank or trust company doing business in this State shall be liable to a depositor because of the non-payment through mistake or error and without malice of a check which should have been paid unless the depositor shall allege and prove actual damage by reason of such non-payment and in such event the liability shall not exceed the amount of damage so proved.

40Id. at 500, 121 P.2d at 418.
41Id.
42Id. See also Johnson v. National Bank, 213 S.C. 458, 50 S.E.2d 177 (1948).
43See note 8 supra.
44Paton’s Digest, supra note 8, § 21:B1, at 1117.
Consequently, the ABA statute negated the trader rule by requiring a depositor to prove actual damages arising from a wrongful dishonor. This rule was a direct response to the contention of bank officials that the trader rule took unfair advantage of their position and resulted in liability disproportionate “to the imaginary injury inflicted.”

The ABA statute was not comprehensive. While it negated the trader rule by requiring strict proof of actual damages for wrongful dishonor, it failed to consider situations in which wrongful dishonor arose from a bank’s “mistake or error.” This enabled courts to apply common law principles when presented with a situation not specifically covered by the ABA statute. The resultant judicial freedom produced various approaches in those areas beyond the ambit of the statute’s coverage. For example, in wrongful dishonor situations not covered by the statute, it is arguable that plaintiff could state a claim for defamation against the defendant bank. It has been suggested, however, that this approach is unacceptable in states that have adopted the ABA statute. One commentator has contended that the theories behind an action for defamation and the wrongful dishonor provision of the ABA statute make these remedies mutually exclusive. The rationale behind this position is that many defamation claims are actionable per se, while the statute always requires proof of actual damages.

It seems, however, that the ABA statute was generally considered to apply to dishonors caused by bank error alone, rather than to all dishonor situations. Moreover, the adoption of this narrow interpretation precipitated a resort to the common law in situations not expressly governed by the statute. Thus, the adoption of this narrow approach, combined with the difficulty of determining when the statute applied, resulted in an inability to predict the outcome of dishonor cases.

*Woody v. National Bank* is exemplary of these difficulties. In *Woody* the drawee bank returned a check with the notation “no account.” In fact, the plaintiff had maintained an account which contained sufficient funds to cover the check. In his suit against the bank based upon wrongful dishonor, the plaintiff requested $5,000 in compensatory damages and an additional $5,000 of punitive damages despite the fact that the check was for only $6.00. The court sustained the bank’s demurrer for failure to

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45 Id. at 1118.
47 See *Paton’s Digest, supra* note 8, § 21:B1, at 1117.
48 194 N.C. 549, 140 S.E. 150 (1927).
state a cause of action and relied upon the ABA statute, which North Carolina had adopted. The supreme court reversed and chose not to apply the statute. The court held that the dishonor had not occurred through a mistake and decided that a bank statement of "no account" was an intentional act rather than a mistaken act.\(^4\) The ABA statute, therefore, did not apply. The court, indicating that the plaintiff's actual damages provided an additional ground for reversal, stated:

A complaint is subject to demurrer only when it appears from the facts alleged therein that the nonpayment of the check was through error without malice, and that no actual damages resulted to the depositor from such nonpayment, for in such case the statute is applicable. If the statute is not applicable, the bank may upon well-settled principles be liable to its depositor not only for nominal or actual damages, but also for punitive damages.\(^5\)

Clearly, the ABA statute did not provide a uniform rule applicable to all or most wrongful dishonor situations. It would only prevail in situations of mistaken dishonor, and even then recovery was limited to actual damages. Moreover, the statute provided minimal or no stimulus to establish careful bank operations.

In sum, the ABA statute failed to improve the law and probably added to an already confused jurisprudence.\(^6\) It failed to meet the typical statutory goals of clarity, fairness, unambiguity, and predictability. This same failure foreshadowed yet another attempt to legislate in the area of wrongful dishonor.

IV. LIABILITY FOR WRONGFUL DISHONOR UNDER THE UNIFORM COMMERCIAL CODE

In describing a bank's liability to its customer for wrongful dishonor, the present version of section 4-402 provides:

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 consequent damages. Whether any consequential damages

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\(^4\)Id. at 556, 140 S.E. at 154.
\(^5\)Id. at 557, 140 S.E. at 155.
are proximately caused by the wrongful dishonor is a question of fact to be determined in each case. 52

Like the ABA statute, section 4-402 was drafted with the intent to abolish the trader rule by rejecting the conclusive presumption of damages when a businessman suffers from wrongful dishonor. 53 This section, however, is more comprehensive than the ABA statute since it controls all situations of wrongful dishonor, not only those caused by mistake or inadvertrice. Section 4-402, unlike the ABA statute, refers to "wrongful" dishonor and impliedly distinguishes between "mistaken" dishonor and "intentional" but still unjustified dishonor. This distinction, although not clearly defined, may be inferred from the section's second sentence which limits recovery in instances of mistaken dishonor to actual damages.

The last two sentences of section 4-402 definitely add something new to possible recoveries for wrongful dishonor. These demonstrate that a bank customer has the right to collect damages caused by his arrest and possible prosecution for passing a "bad" check. 54 Comments to earlier drafts had justified this addition by recognizing that almost all jurisdictions had adopted criminal "bad checks" statutes. 55 Even more significantly, section 4-402, unlike the ABA statute, allows a customer to recover proven consequential damages if proximately caused by a bank's dishonor. 56 The section is in distinct contrast to the common law rule that consequential damages were recoverable if they were reasonably foreseeable at the time a contract was formed. 57

A plaintiff suing his payor bank under section 4-402 has the burden of proving the bank's knowledge of all consequences actually caused by the dishonor. Meeting this burden may be difficult, since the bank-customer relationship usually is highly im-

52Uniform Commercial Code § 4-402.
53Id., Comment 3.
54Various earlier versions of section 4-402 contained a similar provision. Uniform Commercial Code § 4-402 (1950 version) provided:
   The bank is liable to its customers for any wrongful dishonor of an item, but where the damages occur through mistake the liability is limited to the actual damages proved including damages for any arrest and prosecution.
Uniform Commercial Code § 4-402 (1952 version) provided:
   A payor bank is liable to its customer for the wrongful dishonor of an item but where the dishonor occurs through mistake its liability is limited to the actual damages proved including damages for any arrest and prosecution of the customer.
56See text accompanying notes 10-14 supra.
personal. For example, a bank normally has minimal, if any, knowledge of the significance of its dishonor upon its customer’s credit rating or ability to obtain credit. Except when a bank officer has unique knowledge of a customer’s activities, therefore, it could be extremely difficult to impute to a bank anything more than general knowledge of foreseeable injury to its customer.58

The difficulties inherent in section 4-402 do not end with plaintiff’s burden of proving the foreseeability of consequential damages. Doubt also exists concerning the extent of recovery allowable under the statute. This problem arises from the second sentence of section 4-402 which states that, in the case of mistaken dishonor, “liability is limited to actual damages proved.”59 This statement is not as clear as it seems on its face. Significantly, a negative implication from the sentence could be inferred so that more than actual damages would be recoverable when a dishonor is not due to mistake or inadvertence. Despite the main thrust of the second sentence to restrict damages, the negative implication could extend them.60

It is questionable, however, whether this negative implication has been adequately established. The next sentence of the section states that “if so proximately caused and proved, damages may include damages for an arrest or prosecution of customer or other consequential damages.”61 Regardless of the nature of the dishonor, therefore, it is arguable that a causal relation must exist between a dishonor and an injury before a customer will be entitled to consequential damages. A further inference also can be drawn from these two sentences. They may be construed to permit actual damages any time there is a dishonor, and, if the requisite causal connection between dishonor and injury exists, the customer has an additional remedy for legitimate consequential damages arising from the dishonor. This interpretation, however, goes beyond that suggested by Professors White and Summers.62 Moreover, it also reveals a possible inconsistency within section 4-402.

The present language in sentences two and three apparently was a product of concern that prior unenacted drafts of section 4-402, which were silent on the subject of proximate cause, would be interpreted as not requiring a showing of causal connection.63

The results have been mixed, both in decisions prior to and subsequent to the UCC’s enactment. Compare Bank of Louisville Royal v. Sims, 435 S.W.2d 57 (Ky. Ct. App. 1968), with Skov v. Chase Manhattan Bank, 407 F.2d 1318 (3d Cir. 1969).

58UNIFORM COMMERCIAL CODE § 4-402.
59WHITE & SUMMERS § 17-4, at 569-70.
60UNIFORM COMMERCIAL CODE § 4-402 (emphasis added).
61WHITE & SUMMERS § 17-4, at 569-70.
for recovery of damages for arrest or prosecution. In curing this defect, however, other possible interpretive problems have arisen. For example, it is tenable to infer that there is no requirement of proximate cause when actual damages are sought. The New York Law Revision Comments to section 4-402 suggest this problem:

[The] revision creates further difficulty in the section, since by inserting a specific requirement of proximate cause as to damages for arrest or prosecution it creates a negative inference that the main provision for recovery of "actual damages proved" is not so limited. It was also suggested that a reference to consequential damages generally is needed to overcome the effect of Section 1-106(1), which provides that consequential damages shall not be had except as specifically provided "in this Act or by other rule of law." While simultaneously approving section 4-402 in principle, the New York Law Revision Commission proposed a revision to overcome this defect. Its revision, however, was not accepted, and the UCC drafters adopted the present version instead. Notably, nothing in the current comments to section 4-402 prohibits recovery of actual damages without proof of proximate cause. Comment 3 only entrenches the statement that actual damages must be proved.

64NEW YORK STATE LAW REVISION COMM’N, 1956 REPORT 430 (1956).
65Id. The suggested revision stated:
A payor bank is liable to its customer for consequential damages proximately caused by wrongful dishonor of an item, including damages for any arrest or prosecution of the customer so caused, but when dishonor occurs through mistake its liability for consequential damages is limited to the actual damages proved. Whether an arrest or prosecution was proximately caused by wrongful dishonor is a question to be determined upon the facts of each case.
67UNIFORM COMMERCIAL CODE § 4-402, Comment 3, states:
This section rejects decisions which have held that where the dishonored item has been drawn by a merchant, trader or fiduciary he is defamed in his business, trade or profession by a reflection on his credit and hence that substantial damages may be awarded on the basis of defamation “per se” without proof that damage has occurred. The merchant, trader and fiduciary are placed on the same footing as any other drawer and in all cases of dishonor by mistake damages recoverable are limited to those actually proved.

The present formulation of section 4-402 may also create confusion in distinguishing between actual damages and consequential damages. The drafters' concern for the need to show proximate cause in arrest-prosecution situations
The difficulties in applying and interpreting section 4-402 are compounded by the cases which have construed it. Courts infrequently have confronted controversies under section 4-402, but the variety of results indicates their confusion and uncertainty regarding its proper interpretation. In particular, the concurrent use of phrases such as "actual damages proved," "consequential," and "proximate cause" have contributed to this confusion, since each of these terms is capable of differing construction.

In Bank of Louisville Royal v. Sims, the Kentucky Court of Appeals demonstrated an example of this judicial confusion and found that section 4-402 merely codified prior Kentucky law. In Sims, the plaintiff's check was dishonored when the bank placed a ten-day hold on a deposit instead of the normal two-day hold. The plaintiff sought damages of $1.50 for a phone call to the bank, $130 for lost wages, and $500 for injury to his reputation. The court of appeals ultimately reversed the trial court and allowed only $1.50 for the phone call. Significantly, it relied upon American National Bank v. Morey, but this reliance was misplaced since the court in Morey relied upon decisions that stood for propositions of law bearing little or no relationship to the facts in Sims.

In Sims, a curious paragraph stands out:
On authority of Morey, the plaintiff was not entitled to recover for her hurt feelings or for her "nerves". It follows, therefore, that she was likewise not entitled to recover for her two weeks' lost time from work even if her mental state actually contributed to this loss. From the proximate cause standpoint, these nebulous items of damage bore no reasonable relationship to the dishonor of her two checks and consequently they could not be classified as "actual damages proved". (Had the action of the bank been willful or malicious, justifying a punitive award, damages of this kind might have been recoverable.

may have produced the result that the nature of available damages is partly determined by the existence or nonexistence of a clearly definable causal relation rather than by the nature of the dishonor. This possible result ignores prior law but is not an appreciable improvement over it. The problem is partly due to the drafters' ambivalence in stating whether recovery for wrongful dishonor is based upon tort or contract theories.

435 S.W.2d 57 (Ky. Ct. App. 1968).

113 Ky. 857, 69 S.W. 759 (1902).

In Morey the court failed to distinguish between decisions giving a narrow construction to the trader rule and those extending its presumption to nontraders. See id. at 863, 69 S.W. at 759-60. Compare Schaffner v. Ehrman, 139 Ill. 109, 28 N.E. 917 (1891), and Rolin v. Steward, 139 Eng. Rep. 245 (C.P. 1854), with Patterson v. Marine Nat'l Bank, 130 Pa. 419, 18 A. 632 (1889).
as naturally flowing from this type of tortious misconduct, but we do not have that question here."

This statement could mean that consequential damages are allowable only for the type of conduct resulting in recovery of punitive damages. That construction, however, would ignore the express language of section 4-402, which states that it is only necessary to show that consequential damages were proximately caused by a bank's dishonor.\textsuperscript{72} \textit{Sims} is obviously a mistaken interpretation of section 4-402, therefore, if it is construed to require a punitive damage basis for the recovery of consequential damages. Any other conclusion would simply ignore the plain directions of section 4-402.

\textit{Sims} may also demonstrate some uncertainty whether recovery should be determined upon the basis of breach of contract or commission of a tort. The court of appeals refused any damages except a $1.50 telephone bill because the plaintiff's voluntary leave of absence from her job and "nerves" reasonably could not have been anticipated from the dishonor. Thus, the court essentially seemed to rely upon a contract theory. The court also stated, however, that if the dishonor had been willful or malicious, damages might have been recoverable as "naturally flowing from this type of tortious misconduct."\textsuperscript{73} Recovery seemingly was placed, therefore, upon a threshold level somewhat beyond the actions of the bank in \textit{Sims}.

The difficulty with this approach results from its duality. Sometimes recovery would be justified by breach of contract. In other instances, under slightly different circumstances, a customer would be entitled to recover under a tort theory. Without a consistent standard to apply to bank action in different situations, predictability of results is lost. Obviously, this problem could be avoided by a single theory of recovery.

Three other decisions, \textit{Loucks v. Albuquerque National Bank,}\textsuperscript{74} \textit{Skov v. Chase Manhattan Bank,}\textsuperscript{75} and \textit{American Fletcher National Bank & Trust Co. v. Flick,}\textsuperscript{76} present, at least in some aspects, a more reasoned and appropriate interpretation of section 4-402. \textit{Loucks} represents one of the first cases to interpret section 4-402, and the decisions in \textit{Skov} and \textit{Flick} partially relied upon it. The plaintiffs in \textit{Loucks} consisted of a partnership and its individual partners, Loucks and Martinez. Their bank, in an attempt to

\textsuperscript{71}435 S.W.2d at 58.
\textsuperscript{72}"A payor bank is liable to its customer for damages proximately caused by wrongful dishonor." \textsc{Uniform Commercial Code} § 4-402.
\textsuperscript{73}435 S.W.2d at 58.
\textsuperscript{74}N.M. 735, 418 P.2d 191 (1966).
\textsuperscript{75}407 F.2d 1318 (3d Cir. 1969).
\textsuperscript{76}146 Ind. App. 122, 252 N.E.2d 839 (1969).
collect a prior individual debt of Martinez, charged the partnership account. Its action was protested by both partners without success, and they closed the account by withdrawing the balance of $3.66 remaining after the set-off. Subsequently, the bank dishonored ten checks drawn against the partnership account.

As a result, Loucks and Martinez were limited to cash transactions by some of their suppliers, and certain credit previously granted to the partnership was denied. Loucks also stated that the wrongful dishonor gave him an ulcer which caused further injury to the partnership by the loss of his services. In sum, the plaintiffs sued the bank on behalf of their partnership for damages that included $402 for the wrongful set-off against the partnership account, $5,000 for injury to the partnership's credit, good reputation, and business standing in the community, $1,800 for loss of profits because of Louck's absence caused by his ulcer, and $14,404 as punitive damages. Each partner in an individual capacity sought damages of $5,000 for injury to his personal credit, good reputation, and business standing. In addition, Loucks sought $60,000 for punitive damages and $25,000 for the ulcer allegedly caused him by the dishonor, and Martinez sought $10,000 punitive damages.77

The trial court granted $402, the amount of the set-off, but it denied recovery for the other claims. On appeal, the New Mexico Supreme Court held that Loucks was not entitled to damages because he did not come within the UCC definition of "customer."78 However, the court decided that the trial judge committed error when he removed the question from the jury, since evidence of the partnership's loss of credit had been presented and the injury fell within section 4-402. In respect to the loss of individual credit and the loss of service counts, the court affirmed the dismissal for insufficiency of the evidence since "the partnership had no legally enforceable right to recover for the personal injuries inflicted upon a partner."79 Moveover, the court upheld dismissal on the issue of punitive damages and reasoned that evidence of intemperate remarks by the bank's vice-president when the plaintiffs closed the account was insufficient to require submitting that issue to the jury.80

77 76 N.M. at 741, 418 P.2d at 195.
78 Id. at 746, 418 P.2d at 198. The meaning of "customer" was also discussed in Steinbrecher v. Fairfield County Trust Co., 5 Conn. Cir. 393, 255 A.2d 138 (1968), in which it was held that the drafters of the Code did not intend a payee to be a "customer." The question that may follow is "why not?" Certainly a payee might be "any person having an account with a bank." UNIFORM COMMERCIAL CODE § 4-104(e).
79 76 N.M. at 746, 418 P.2d at 199.
80 This may be interpreted to permit punitive damages when evidence of
In holding as it did on the right of Loucks to join in the action, the court misapplied both the Uniform Partnership Act (UPA) and the Uniform Commercial Code. The UPA generally accepts that the "aggregate" theory of partnership is merely the sum of the partners. Situations in which an "entity" theory may be used are specifically delineated in the UPA.81 The UCC, on the other hand, makes no attempt to choose one characterization over another as the form of partnership to be followed. The court erred in assuming that the entity theory was intended to be the only form acceptable under the UCC.

Skov v. Chase Manhattan Bank 82 presented a broader interpretation of consequential damages recoverable under section 4-402. The plaintiff operated a fish shop and sold various types of fish to hotel customers. When a bank erroneously dishonored the plaintiff's check to one of its suppliers, the supplier terminated its relationship with the plaintiff. This made it impossible for the plaintiff to continue to supply his customers with whom he had been doing business for approximately two years. The Court of Appeals for the Third Circuit affirmed an award of damages for three years of anticipated lost profits. The court reasoned that section 4-402's reference to consequential damages "authorized the trial judge . . . to award damages by determining the annual loss of profits to plaintiff from the termination of his relationship with his supplier and to project this loss for a three-year period."83 After initially determining that section 4-402 is unclear, the court broadly interpreted "consequential damages" to include the possible value of the plaintiff's business had there been no dishonor. Furthermore, the court relied upon Loucks v. Albuquerque National Bank84 and two decisions which spoke to damages in the con-

"malice" or "willfulness" is sufficiently presented. Under common law doctrines, some jurisdictions did permit punitive damages for wrongful dishonor. See, e.g., First Nat'l Bank v. Stewart, 204 Ala. 199, 85 So. 529 (1920); Clark v. McClurg, 215 Cal. 279, 9 P.2d 505 (1932); Hurst v. Southern Ry., 184 Ky. 684, 212 S.W. 461 (1919). In these jurisdictions as well as others allowing punitive damages, the jury is given the discretion to award punitive damages. E.g., McCurdy v. Hughes, 63 N.D. 435, 248 N.W. 512 (1933) (jury refused to award punitive damages when malice was shown). Though at present most courts operating under section 4-402 would, as a matter of law, deny punitive damages, arguments can be made that allowance of them is permissible under section 4-402. See Note, Punitive Damages for Wrongful Dishonor of a Check, 28 WASH. & LEE L. REV. 357 (1971).

81 For a more complete discussion of the partnership issue in Loucks, see Note, Right of Partners to Damages for Wrongfully Dishonored Partnership Checks, 8 NATURAL RESOURCES J. 169 (1968).
82 407 F.2d 1318 (3d Cir. 1969).
83 Id. at 1319.
84 76 N.M. 735, 418 P.2d 191 (1966).
text of antitrust and unfair trade practices litigation.

American Fletcher National Bank & Trust Co. v. Flick developed an even more expansive construction of section 4-402. In Flick, a bank's erroneous set-off of an outstanding loan against a business checking account caused three of the plaintiff's checks to be dishonored. The plaintiff, the operator of a used car business, alleged that his credit and business standing were damaged as a result of the dishonors. He also contended that a resultant loss of income ultimately forced him to close his business. The trial court awarded $18,000 in damages in addition to allowing an improper set-off. The Indiana Court of Appeals reversed the $18,000 damage award only because the plaintiff had failed to prove that a causal connection existed between the dishonors and his alleged business losses.

Rather than narrow the possible scope of recovery under section 4-402, the court of appeals went beyond any prior interpretation:

Suffice it to say, that insofar as the facts before us require construction of . . . [section] 4-402, we construe it to permit recovery of monetary compensation for any actual or consequential harm, loss or injury proximately caused by a wrongful dishonor. . . . We believe in this respect that labels such as "actual" or "consequential" are less than meaningful in the sense of the compensability of harm, injury or loss proximately caused by wrongful dishonor.

Despite Comment 3 to section 4-402, the court also resurrected the trader rule, which specified that credit and business standing are presumptively harmed by a wrongful dishonor. Notably, this presumption was considered to allow recovery of only nominal damages. Further evidence was required to support substantial damages. In sum, Flick reflects a favored interpretation of section 4-402. As the Indiana Court of Appeals indicated, the purpose of section 4-402 is to compensate adequately for loss caused by a wrongful dishonor. It is not intended to deprive banks of all protection, but rather to place legal responsibility on the party causing the injury.

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56American Motor Sales Corp. v. Semke, 384 F.2d 192 (10th Cir. 1967).
57Id. at 132, 252 N.E.2d 839 (1969).
58Id. at 132-33, 252 N.E.2d at 845.
59See note 67 supra.
60Id. at 134, 252 N.E.2d at 846.
A proper interpretation of section 4-402 probably may be derived from Loucks, Skov, and Flick. In each decision, however, possibilities for misinterpretation and uncertainty still remain. In each, damages were awarded only upon proof that a causal connection existed between the dishonor and the alleged injury. In Loucks, for example, the court detailed the various financial difficulties that the plaintiffs encountered after the wrongful dishonor of nine or ten checks. The court then held that the evidence of these financial difficulties "was sufficient to raise a question of fact to be determined by the jury as to whether or not the partnership credit had been damaged as a proximate result of the dishonors." The trial court, therefore, should have submitted the question of proximate cause to the jury. This holding was quoted approvingly in Skov. In Skov, however, the court recognized potential uncertainty regarding the proper interpretation of section 4-402 and relied upon two decisions awarding damages for anticipated business profits. One of these decisions, Bigelow v. RKO Radio Pictures, Inc., involved a civil action under the Sherman Anti-Trust Act for conspiracy in the maintenance of a system that prevented proper distribution of motion pictures to independent motion picture exhibitors. The Supreme Court affirmed an award of damages which represented a loss of anticipated admission receipts caused by the unlawful conspiracy. American Motor Sales Corp. v. Semke, also relied upon in Skov, permitted damages for anticipated profits. Semke arose out of a breach of franchise agreements between a manufacturer and an automobile dealer. In fact, the liability of the defendant was based upon the Automobile Dealer's Day in Court Act. The Tenth Circuit Court of Appeals refused the contention that the damages recoverable were limited to damages for breach of contract. The court reasoned that "it is clearly established that the

9376 N.M. at 746, 418 P.2d at 198.
94Id. A more recent New Mexico decision concerning the proper damages for wrongful dishonor came to the following conclusion, but only after reviewing all relevant case law: "Plaintiff is entitled to reasonable and temperate damages determined by the sound discretion and dispassionate judgment of the trial court." Allison v. First Nat'l Bank, 85 N.M. 283, 288, 511 P.2d 769, 774 (1973). The case was remanded for a determination of consequential damages, and it seems that such a determination should be based upon the reasons for the dishonor. The court seemed to be following Sims by basing the amount of recovery on the type of bank misconduct involved; willful conduct would give rise to a broader recovery than would dishonor by mistake.
95327 U.S. 251 (1946).
97884 F.2d 192 (10th Cir. 1987).
statute creates a new cause of action and is not merely a new remedy for breach of contract."

Similar recovery in these three cases is not entirely consistent. Some uncertainty remains because the court in Skov relied upon decisions which were factually distinguishable when it justified a recovery for lost profits. Moreover, Skov failed to indicate why it relied upon antitrust and related doctrines to formulate a basis for recovery under section 4-402. This reliance was not necessarily unwarranted, but the court’s failure to justify it further confuses the grounds for recovery under section 4-402.

The court in Flick seems correct in having denied more than nominal damages when the plaintiff failed to prove that the wrongful dishonor caused the demise of his business. On the other hand, the court, citing Loucks, did construe section 4-402 "to permit recovery of monetary compensation for any actual or consequential harm, loss or injury proximately caused by a wrongful dishonor." The court further noted "that labels such as 'actual' or 'consequential' are less than meaningful in the sense of the compensability of harm, injury or loss proximately caused by wrongful dishonor." This interpretation of section 4-402 may have gone too far in two respects. First, in its effort to provide the plaintiff with all possible compensation for damages caused by the dishonor, the court overlooked the distinction between recovery of only "actual damages" and "consequential damages." This oversight can be attributed to the confusion regarding the different meanings to be given these terms as used in section 4-402. Although the court’s decision allowing all damages caused by the dishonor is preferable, a more explicit version of section 4-402 would dispel any doubts about the validity of the decision.

Secondly, the Flick court might be criticized for resurrecting the old and disavowed trader rule. Although plaintiff Flick showed a causal relation between the dishonor and the collapse of his business, the court still held that damage to credit and business standing would be presumed. It then added that the "primary reason for the recognition of this presumption is that a wrongful dishonor renders the existence of some harm to the customer's credit and business standing so probable that it makes legal sense as well as common sense to assume the existence of such harm unless and until the adversary comes forward with some evidence to the contrary." As previously emphasized, the

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99384 F.2d at 199-200.
100146 Ind. App. at 132, 252 N.E.2d at 845.
101Id.
102Id.
103Id. at 133, 252 N.E.2d at 846.
plaintiff in *Flick* failed to show lost income and was permitted to recover only the amount of the check wrongfully dishonored. Reference to the trader rule, therefore, was superfluous. The court was stating that it would have allowed greater monetary damages if the requisite proximate cause had been shown, irrespective of the trader rule. It can only be surmised that the court adopted this reasoning because of its dissatisfaction with the confusing language of section 4-402.

V. THE NECESSITY FOR A REVISED SECTION 4-402

The overriding confusion attending past and present theories underlying recovery for wrongful dishonor should be apparent. An unambiguous and fresh approach, which is free from unjustified distinctions and misplaced priorities, is essential. Consequently, a revised version of section 4-402 should be adopted with simplicity, economy of language, and internal consistency as its basic guidelines.

Moreover, the new section should implement one single theory of recovery. The Code's present neutrality has allowed courts to apply common law theories with little other guidance. The result has been lack of clarity and specificity regarding the proper amount of damages allowable for wrongful dishonor. Legislation enacted by the states also has failed to establish definite standards for the recovery of damages after a wrongful dishonor.\(^{104}\)

The new theory of recovery should be a sui generis recovery based primarily upon tort principles. In particular, the new section should establish an independent tort which creates bank liability for all proximate injuries of wrongful dishonor. Damages, therefore, would constitute compensation for injury rather than the benefit of the bargain.\(^{105}\)

A revised section 4-402 should more explicitly recognize that damage to credit and related injuries are recoverable. This would be consistent with the intent of the Fair Credit Reporting Act\(^{106}\) to give greater protection to the consumer and would eliminate


\(^{105}\)Contract recoveries are unsatisfactory since bank-customer negotiations rarely give the parties notice of any unusual circumstances that might later give rise to special damages. The injuries caused by the bank's wrongful dishonor are those that lie in the subsequent turn of events and, therefore, should not be rejected upon the ground that the parties did not contemplate their occurrence. See note 11 & accompanying text *supra*.

\(^{106}\)15 U.S.C.A. §§ 1681 et seq. (1974). Congress established the Fair Credit Reporting Act to prevent possible abuses in credit reporting. This protection is incomplete. Under section 1681h(e) of the Act, recovery is limited to instances in which "false information [is] furnished with malice or willful intent to injure such consumer." Also, section 1681i sets forth procedures
the distinction between mistaken and intentional dishonor. In short, section 4-402 should emphasize the extent of the injury caused by a dishonor.

Both the ABA statute and section 4-402 were drafted by bank counsel to prevent excessive recoveries against banks.\textsuperscript{107} While that objective is not necessarily unjustified, the present form of section 4-402 has the potential to stifle recovery against banks even when actual injury can be shown. Banks seek the efficiency of high speed check processing, while simultaneously insulating themselves from the possible injuries that it may cause. Banks cannot have it both ways. The equities should rest with the party who has been injured, rather than with the party who has proximately caused the injury.

VI. A Proposed Revision of Section 4-402

In view of the compelling reasons for liberalizing a bank customer's right to recover damages upon a wrongful dishonor, the following revision of section 4-402 is proposed:

\textit{Section 4-402 Bank's Liability to Customer for Wrongful Dishonor}

A payor bank shall be liable to a customer or person treated in the same manner as a customer by the payor bank for damages proximately caused by the wrongful dishonor of an item. If so proximately caused and proved the payor bank's liability may include, but is not limited to, damage to credit and damages for arrest and prosecution. In all situations where a wrongful dishonor has been proved, recrediting of the account shall be allowed, without any further proof of proximate cause. The determination of what damages have been proximately caused by the wrongful dishonor shall be determined by the trier of fact in each case.

\textit{Comments to Proposed Section 4-402}

1. This section has been changed. Unlike the previous version, the section now adopts a tort remedy. How-

\textsuperscript{107}Apparently both statutes have achieved their goal of precluding large and possibly unjustified recoveries against banks. It is questionable, however, whether such a policy arose from a real need or only from imaginary fears.
ever, it is a new tort with its own elements of recovery. This avoids any confusion with prior tort theories which were sometimes used by courts to fashion a recovery for the customer. The emphasis in the new section is on a causal connection between the dishonor and the injury.

2. Recovery is allowed for loss to credit and loss due to arrest and prosecution. Damages otherwise are those allowable under traditional tort concepts and may include, if appropriate, punitive damages. The common law concept of wrongful dishonor whereby such dishonor is slanderous per se if the check is of one engaged in a business or trade is no longer of any effect.

3. The section allows recovery by a person whose item has not been dishonored but who, by nature of his relation to the bank and to the dishonored item, is nevertheless injured by such wrongful dishonor. For example, where a partnership account is charged in order to satisfy an indebtedness of one partner in his individual capacity, the other partner shall be allowed standing in his individual capacity for any damages proximately caused by the wrongful dishonor.

4. "Wrongful dishonor" excludes any permitted or justified dishonor, as where the drawer has no credit extended by the drawee, or where the draft lacks necessary endorsement or is not properly presented.108

5. Wrongful dishonor is different from "failure to exercise ordinary care in handling an item," and the measure of damages is that stated in this section, not that stated in section 4-103 (5).109

The advantages of the revised section can be seen by its application to some of the decisions previously discussed in this Comment. For example, if the proposed section had been utilized in Loucks v. Albuquerque National Bank,110 the plaintiff would have been a "customer" and therefore a proper plaintiff. If the bank had charged the checking account of the partnership because of the outstanding debt of a single partner, it is clear that the bank considered both as a single entity. It would seem fair, therefore, to permit a suit by one or both partners for the wrongful dishonor of checks drawn against the partnership account. The re-

108 Proposed Comment 4 is verbatim from the second sentence of Uniform Commercial Code § 4-402, Comment 2.
109 Proposed Comment 5 is identical to Uniform Commercial Code § 4-402, Comment 4.
vised section 4-402 would dictate this result by broadening the definition of "customer" to include anyone "understood by the payor bank to be a customer."

The result in Bank of Louisville Royal v. Sims\(^{111}\) would have been reversed under the proposed section 4-402. The court relied upon contract theories of recovery to justify the denial of damages, and the injuries suffered from the dishonor were not deemed to bear a reasonable relation to the dishonor.\(^{112}\) While it is questionable whether the court's interpretation is consistent with the present language of section 4-402, the proposed revision explicitly refuses to follow contract theories of recovery. If the proposed revision were applied, therefore, the customer in Sims would have been permitted to present evidence to establish the causal connection between the alleged injury and the wrongful dishonor.

The decisions in Skov v. Chase Manhattan Bank\(^{113}\) and American Fletcher National Bank & Trust Co. v. Flick\(^{114}\) are consistent with the proposed revision. Both courts gave a sufficiently broad interpretation to "consequential damages" to permit recovery for injuries when a causal connection between the harm and the wrongful dishonor was shown. Flick and Skov permitted damages for loss of profits and injury to business reputation only if the actual damages were proved. Notably, in both cases the courts expressed their dissatisfaction with the terminology of section 4-402, especially when called upon to construe the phrase "consequential damages."\(^{115}\)

VII. CONCLUSION

The creation of an independent tort to govern a bank's liability for wrongful dishonor is the best solution to a problem that has defied traditional legal classifications. Recovery based upon contract principles, with its requisite foreseeability of damages, is peculiarly unsuited to the area because it leads to either limited recovery or no recovery at all.\(^{116}\) The use of existing tort remedies, especially slander, also has been unsatisfactory.\(^{117}\)

\(^{111}\)435 S.W.2d 57 (Ky. Ct. App. 1968).
\(^{112}\)See note 67 supra.
\(^{113}\)407 F.2d 1318 (3d Cir. 1969).
\(^{115}\)See, e.g., Skov v. Chase Manhattan Bank, 407 F.2d 1318, 1319 (3d Cir. 1969), in which the court stated, "The trial judge properly relied on § 4-402 of the Uniform Commercial Code . . . which is not a model of clarity in its reference to "damages proximately caused", 'actual damages proved', and 'consequential damages'.'
\(^{116}\)See note 12 & accompanying text supra.
\(^{117}\)See note 15 & accompanying text supra.
While the adoption of a presumption of damages after proof of a wrongful dishonor would serve to discipline banks, it would do so unfairly. Such a rule conceivably could permit damage awards beyond the harm actually caused. The more balanced proposed rule would allow a party to recover for all damages which result from a bank's wrongful conduct.

The proposed section 4-402's adoption of an independent tort theory proceeds from the argument that banks have a legal and public duty to avoid the wrongful dishonor of checks. Banks have always encouraged the use of checks, and the public has now come to rely heavily upon them as the virtual equivalent of cash. The present commercial system requires rapid honoring of checks. Since banks have encouraged this system and have profited from checking accounts, equity demands an extension of their liability for all wrongful dishonors. Moreover, because bankers do profit from checking arrangements, they are in a much better position to insure against occasional errors than are their customers.

The adoption of the proposed section 4-402 ultimately could result in greater self-discipline by banks so as to prevent wrongful dishonors. If so, the effect would be fewer recoveries against banks rather than more. The end result could be even greater reliance upon checks and a concomitant benefit to both banks and their customers."