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EXCULPATORY CLAUSES IN STOP-PAYMENT ORDERS

A problem common to all banks is the difficulty of handling stop-payment orders filled out by depositor-drawers. Courts have differed as to the liability of the parties involved when the bank, through the use of an "exculpatory clause,"¹ attempts to avoid liability for disregard of these orders.

A check is an order drawn on a bank, and it may be revoked by the drawer before payment or certification.² Such revocation is ordinarily effected by directing a stop-payment order to the bank. The drawer's right to stop payment arises out of the debtor-creditor relationship that exists between the bank and the depositor-drawer by virtue of the contract of deposit.³ Therefore, a bank paying a check contrary to a stop-payment order will ordinarily not be allowed to "charge the drawer's account."⁴

As a means of avoiding the loss that results from the inability to charge the drawer's account after paying his check, banks have adopted the practice of including an exculpatory clause in their stop-payment forms. The effect of such a clause was considered in *Commercial Bank v. Hall*.⁵ The bank had paid a check twelve days after receiving a stop-payment order filled out by the drawer. The printed form which the bank had supplied to the drawer to use in stopping payment contained the following clause: "[A]nd further agrees to hold said bank free of all liability should payment be made contrary to this request, if such payment occurs through inadvertence or accident

¹Writers in the field prefer the term exculpatory clause. Clarke and Bailey, *Bank Deposits and Collections* (under the Uniform Commercial Code) 121 (1955). But see *Speroff v. First Cent. Trust Co.*, 149 Ohio St. 415, 79 N.E.2d 119, 1 A.L.R.2d 1150 (1948), where the court used the term release.

²*Harlan Nat. Bank v. Carbon Glow Coal Co.*, 289 S.W.2d 200 (Ky. 1956); *Speroff v. First Cent. Trust Co.*, 149 Ohio St. 415, 79 N.E.2d 119 (1948); *Cincinnati H. & D. R. R. v. Metropolitan Nat. Bank*, 54 Ohio St. 60, 42 N.E. 700 (1896); Beutel's *Brannon, Negotiable Instruments Law* § 189 (7th ed. 1948); 5A Michie, *Banks and Banking* § 193 (1950).

³*Second Nat. Bank of Paintsville v. Meek Appliance Co.*, 244 S.W.2d 769 (Ky. 1951); *Reinhardt v. Passaic-Clifton Nat. Bank and Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd mem.*, 9 N.J. 607, 89 A.2d 242 (1952); *Carroll v. South Carolina Nat. Bank*, 211 S.C. 406, 45 S.E.2d 729 (1947).

⁴*Calamita v. Tradesmens Nat. Bank*, 135 Conn. 326, 64 A.2d 46 (1949); *Thomas v. First Nat. Bank of Scranton*, 376 Pa. 181, 101 A.2d 910 (1954); Beutel's *Brannon, Negotiable Instruments Law* § 189 at 1316 (7th ed. 1948); 5A Michie, *Banks and Banking* § 196 (1950). "Charge the drawer's account" is the correct legal terminology. However, since the cases usually arise after the bank has charged the drawer's account, courts and writers will ordinarily say "the bank is liable to the drawer."

⁵94 So. 2d 198 (Ala. 1957).

only..."⁶ The court held the clause void for lack of consideration,⁷ resulting in the bank's being "liable to the drawer for the amount of the check."⁸

In their wording of these clauses the banks have avoided the use of the word "negligence;" instead, they have used such expressions as "inadvertence" or "accident." Presumably their reason for doing so is to escape the general rule, applicable chiefly to quasi-public institutions, under which a party is forbidden to contract against liability for his own negligence.⁹ It has been suggested that this rule could appropriately be extended to banks.¹⁰ Despite any attempted subterfuge resulting from the language used, courts interpret the clause as though the word "negligence" had been included.¹¹

In support of this approach it may be stated that some cases have held that proof by the bank of the exercise of "reasonable care" will relieve it of liability for overlooking the stop-payment order.¹² However, the general rule imposes an absolute duty to stop payment upon the receipt of a stop-payment order.¹³ It is submitted that the pre-

⁶Id. at 199.

⁷Id. at 202.

⁸It would be considered better legal terminology to use the words "the bank must re-credit the drawer's account;" however, conflicts such as those found in the principal case usually result in a severance of relations between the bank and the drawer. Therefore, in the practical sense it is correct to say the bank is liable to the drawer.

⁹Restatement, Contracts § 575 (1932); 6 Corbin, Contracts § 1472 (1951); 6 Williston, Contracts § 1751(c) (rev. ed. 1938).

¹⁰Reinhardt v. Passaic-Clifton Nat. Bank and Trust Co., 16 N.J. Super. 430, 84 A.2d 741, 744 (1951), aff'd mem., 9 N.J. 607, 89 A.2d 242 (1952). Contra, 6 Corbin, Contracts § 1472 at 871 (1951) and 6 Williston, Contracts § 1751(c) at 4971 (rev. ed. 1938), where the point under discussion is treated as an exception to the general rule.

¹¹Thomas v. First Nat. Bank of Scranton, 376 Pa. 181, 101 A.2d 910 (1954).

¹²Speroff v. First Cent. Trust Co., 149 Ohio St. 415, 79 N.E.2d 119 (1948); Carroll v. South Carolina Nat. Bank, 211 S.C. 406, 45 S.E.2d 729 (1947). While these cases differed as to the validity of exculpatory clauses, they agreed in not considering the effect of the exculpatory clause to be the complete answer to the question of the bank's liability and therefore held reasonable care a defense for the bank. Cf. Calamita v. Tradesmens Nat. Bank, 135 Conn. 326, 64 A.2d 46, 47 (1949), and Thomas v. First Nat. Bank of Scranton, 376 Pa. 181, 101 A.2d 910, 911 (1954).

¹³Reinhardt v. Passaic-Clifton Nat. Bank and Trust Co., 16 N.J. Super. 430, 84 A.2d 741 (1951), aff'd mem., 9 N.J. 607, 89 A.2d 242 (1952); Chase National Bank v. Battat, 297 N.Y. 185, 78 N.E.2d 465, 467 (1948); Beutel's Brannon, Negotiable Instruments Law § 189 at 1316 (7th ed. 1948); 5A Michie, Banks and Banking § 196 (1950); Clarke and Bailey, Bank Deposits and Collections (under the Uniform Commercial Code) 121 (1955). The rule of absolute liability is often stated to this effect: the bank is under an absolute duty to obey a seasonable stop-payment order. It appears inconsistent for any court so stating the rule to fail to consider reasonable care a defense.

ferable view is that proof of reasonable care will be a defense¹⁴ with the question of the exercise of care left to the finders of fact.

Exculpatory clauses in stop-payment orders have been upheld in several jurisdictions.¹⁵ However, under the majority rule and in the more recent cases such clauses have been invalidated.¹⁶ These courts base invalidation on lack of consideration and on grounds of public policy.¹⁷

Though a few cases have held that there is consideration for the exculpatory clause,¹⁸ the majority find that consideration is lacking.¹⁹ The best-reasoned approach to the question points out that the only thing the bank can claim as consideration is the pre-existing duty owed to the depositor-drawer.²⁰ The general rule is that the per-

¹⁴"(1) A customer may by order to his bank stop payment of any item payable for his account but the order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in Section 4-303." Uniform Commercial Code § 4-403(1). It is not difficult to imagine fact situations where it would be inequitable to impose an absolute liability upon the bank. But see Note, 18 Cin. L. Rev. 105 (1949).

¹⁵*Martinez v. Nat. City Bank*, 80 F. Supp. 545 (D. P.R. 1948); *Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N.E. 488 (1932); *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N.E. 782, 9 A.L.R. 1067 (1920); *Gaita v. Windsor Bank*, 251 N.Y. 152, 167 N.E. 203 (1929).

¹⁶*Commercial Bank v. Hall*, 94 So. 2d 198 (Ala. 1957); *Hiroshima v. Bank of Italy*, 78 Cal. App. 362, 248 Pac. 947 (1926); *Calamita v. Tradesmens Nat. Bank*, 135 Conn. 326, 64 A.2d 46 (1949); *Reinhardt v. Passaic-Clifton Nat. Bank and Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd mem.*, 9 N.J. 607, 89 A.2d 242 (1952); *Speroff v. First Cent. Trust Co.*, 149 Ohio St. 415, 79 N.E.2d 119 (1948); *Thomas v. First Nat. Bank of Scranton*, 376 Pa. 181, 101 A.2d 910 (1954). Invalidation is also supported by the Uniform Commercial Code § 4-103(1). "It is clear from the comment to Section 4-403 (as well as from Section 4-103) that a bank may not, by agreement, excuse itself from liability for negligently paying an item contrary to a stop-payment order. The section thus follows what is probably the majority rule, as well as the rule of the more recent cases." *Clarke and Bailey, Bank Deposits and Collections* (under the Uniform Commercial Code) 123 (1955). Accord: 5A *Michie, Banks and Banking* § 196 at 477 (1950).

¹⁷Cases that base invalidation on a lack of consideration: *Commercial Bank v. Hall*, 94 So. 2d 198 (Ala. 1957); *Reinhardt v. Passaic-Clifton Nat. Bank and Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd mem.*, 9 N.J. 607, 89 A.2d 242 (1952); *Calamita v. Tradesmens Nat. Bank*, 135 Conn. 326, 64 A.2d 46 (1949). Cases that base invalidation on public policy: *Thomas v. First Nat. Bank of Scranton*, 376 Pa. 181, 101 A.2d 910 (1954). Another case invalidated the clause on both grounds: *Speroff v. First Cent. Trust Co.*, 149 Ohio St. 415, 79 N.E.2d 119 (1948).

¹⁸*Hodnick v. Fidelity Trust Co.*, 96 Ind. App. 342, 183 N.E. 488 (1932); *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N.E. 782, 9 A.L.R. 1067 (1920).

¹⁹*Commercial Bank v. Hall*, 94 So. 2d 198 (Ala. 1957); *Calamita v. Tradesmens Nat. Bank*, 135 Conn. 326, 64 A.2d 46 (1949); *Reinhardt v. Passaic-Clifton Nat. Bank and Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd mem.*, 9 N.J. 607, 89 A.2d 242 (1952); *Speroff v. First Cent. Trust Co.*, 149 Ohio St. 415, 79 N.E.2d 119 (1948).

²⁰*Reinhardt v. Passaic-Clifton Nat. Bank and Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd mem.*, 9 N.J. 607, 89 A.2d 242 (1952).

formance of pre-existing duties does not constitute consideration.²¹

Banks could avoid this problem of consideration by putting the clause under seal, or by incorporating into the stop-payment form the words "I intend this to be legally binding," as permitted by the *Uniform Written Obligations Act*.²² Another method which would probably meet with the approval of the courts of a larger number of jurisdictions would be to put the exculpatory clause in the original deposit contract, thereby making it part of the entire agreement between the parties.²³

Another reason given for invalidating exculpatory clauses is that they are contrary to public policy. While several cases have invalidated exculpatory clauses on this theory without benefit of statute,²⁴ courts are generally hesitant to hold any agreement contrary to public policy unless the decision can be based on a statutory provision or the operation of the clause is clearly shown to be injurious to the public welfare.²⁵ Section 4-103 (1) of the *Uniform Commercial Code* states that: "The effect of the provisions of this Article may be varied by agreement except that no agreement can disclaim a bank's responsibility or limit the measure of damages for its own lack of good faith or failure to exercise ordinary care." In view of this stand taken by the American Law Institute and considering that the majority of cases and writers in the banking field are in accord, it is submitted that the courts have a valid basis for holding these clauses contrary to public policy.

Since the bank is not allowed to charge the drawer's account under the facts of the principal case, the question arises whether the bank has any alternative remedy against either the drawer himself or the payee to protect itself from loss.

Section 4-403 (3) of the *Uniform Commercial Code* provides that: "The burden of establishing the fact and amount of loss resulting from the payment of an item contrary to a binding stop-payment order is on the customer." Logically, it appears that this section will eliminate the complex situation whereby the bank can recover from the drawer after being denied the right to charge his account.²⁶

²¹Id. at 744; Restatement, Contracts § 76(a) (1932); 1 Williston, Contracts § 130 (rev. ed. 1936).

²²Thomas v. First Nat. Bank of Scranton, 376 Pa. 181, 101 A.2d 910 (1954).

²³Note, 39 Yale L.J. 542, 547 (1930).

²⁴Speroff v. First Cent. Trust Co., 149 Ohio St. 415, 79 N.E.2d 119 (1948); Thomas v. First Nat. Bank of Scranton, 376 Pa. 181, 101 A.2d 910 (1954).

²⁵Hodnick v. Fidelity Trust Co., 96 Ind. App. 342, 183 N.E. 488 (1932).

²⁶Section 4-407(b) of the Uniform Commercial Code states that the bank may be subrogated to the payee's rights against the drawer. If the drawer of the check