

## EXCULPATORY PROVISIONS IN STOP-PAYMENT FORMS

THE COMPLEXITY of the modern banking system has led to a universal inclusion in banking forms of provisions which purport to relieve the banks from the more rigorous applications of the high standards of care and diligence imposed upon them by the common law.<sup>1</sup> Although such exculpatory provisions as relate to the collection of deposited items,<sup>2</sup> the correctness of statements of accounts,<sup>3</sup> and the payment of funds to holders of savings account passbooks,<sup>4</sup> have almost uniformly been held not to bar liability for negligence,<sup>5</sup> exculpatory

<sup>1</sup> For a general discussion see 1 MORSE, BANKS AND BANKING §§ 189-212A (6th ed. 1928); 5A MICHIE, BANKS AND BANKING § 167 (permanent ed. 1950).

<sup>2</sup> See generally 2 PATON'S DIGEST OF LEGAL OPINIONS 1247 *et seq.* (revised ed. 1942).

<sup>3</sup> See, *e.g.*, Los Angeles Investment Co. v. Home Savings Bank, 180 Cal. 601, 182 Pac. 293 (1919) (bank liable for payment of checks drawn on depositor to fictitious payees, despite depositor's failure to notify bank of irregularities within ten days as per provision in statement).

<sup>4</sup> See Note, 5 A.L.R. 1203 (1920).

<sup>5</sup> Although provisions in bank collection forms and deposit slips making the collecting bank the depositor's agent have been upheld, such provisions have generally not been allowed to cause a reduction in the standard of care required of the collecting agent. 6 MICHIE, *supra* note 1, §§ 13, 59; 2 PATON, *supra* note 2, at 1257, 1366. But commercial banks usually provide in their passbooks that the depositor must examine his statement and returned checks and notify the bank within a certain number of days of any error or mispayment in order to have a valid claim against the bank. 5B MICHIE, *supra* note 1, § 311. *But cf.* Los Angeles Investment Co. v. Home Savings Bank, 180 Cal. 601, 182 Pac. 293 (1919), where it was held that a depositor is not bound to know the indorsers of his checks; thus there may be a later questioning of the forged indorsement. The courts have also applied the general rule that even if a depositor does not examine his returned checks and balance sheet, if the bank was negligent in the payment of a forged check, the account may be questioned. *E.g.*, Wussaw v. Badger State Bank, 204 Wis. 467, 234 N.W. 720 (1931); Union Tool Co. v. Farmers' and Merchants' Nat'l Bank of Los Angeles, 192 Cal. 40, 218 Pac. 424 (1923); Notes, 103 A.L.R. 1147 (1936), 75 A.L.R. 1283 (1931), 67 A.L.R. 1121 (1930), 18 A.L.R. 887 (1922), 15 A.L.R. 159 (1921), 11 A.L.R. 586 (1921). The courts have almost uniformly held that there can be no contractual removal of the duty of ordinary care by the bank to prevent payment to an unauthorized person. See, *e.g.*, Kummel v. Germania Savings Bank, 127 N.Y. 488, 28 N.E. 398 (1891); Chase v. Waterbury Savings Bank, 77 Conn. 295, 59 Atl. 37 (1904). *But cf.* Appleby v. Erie County Savings Bank, 62 N.Y. 12 (1875); Dinini v. Mechanics' Savings Bank of Winsted, 85 Conn. 225, 82 Atl. 580 (1912). Generally, even though the depositor has himself been negligent in letting his passbook fall into the hands of an unauthorized person, if the bank by ordinary care could have determined that the person presenting the passbook was unauthorized, it is liable for payment. See Note, 5 A.L.R. 1203 (1920).

provisions in stop-payment order forms, somewhat inexplicably, have generally been accorded full force and effect.<sup>6</sup> A recent decision,<sup>7</sup> several dicta,<sup>8</sup> and the provisions of the new Uniform Commercial Code<sup>9</sup> have, however, cast some doubt upon the settled character of this latter proposition, and a re-examination of the problem, therefore, would seem to be not amiss.

Many early exculpatory provisions in stop-payment order forms did not unequivocally embrace negligent payment, and, accordingly, the courts, reluctant under any circumstances to honor releases from liability for negligence, generally construed them strictly against the banks. Thus, a release which stated that an endeavor would be made to execute all stop-payment orders was held not to absolve a negligent bank from liability, since the assent of the depositor was said to have been obtained by an invitation which implied an exercise of care on the part of the bank.<sup>10</sup>

Although more precise drafting obviated this particular judicial gambit, the courts had other strings to their bows. Lack of mutual assent was frequently sought, found, and asserted as the basis for denying operative effect to otherwise unconditional releases. Thus, where the depositor had neither read the exculpatory provision nor had it called to his attention, some courts facilely decided that he had not assented to it and that it was therefore nugatory.<sup>11</sup> This rationale, however, runs counter to the generally accepted contract doctrine that one is bound by the terms of his contract even though he has not read it;<sup>12</sup> and most courts, unwilling to upset so firm a doctrine, have held that the assent of the depositor must be implied from his act of signing the stop-payment order.<sup>13</sup>

Another more durable rationale which has also been widely employed by the courts to avoid releases in stop-payment orders is that of failure of consideration. Thus, in one case where no mention of the exculpatory provision had been made to the depositor when he opened

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<sup>6</sup> BRITTON, BILLS AND NOTES § 181 (1943); Notes, 1 A.L.R.2d 1155 (1948), 175 A.L.R. 8, 79-82 (1948), 9 A.L.R. 1069 (1920).

<sup>7</sup> Thomas v. First Nat'l Bank of Scranton, 376 Pa. 181, 101 A.2d 910 (1954), reversing, 173 Pa. Super. 205, 96 A.2d 196 (1953). See text at note 36 *et seq. infra*.

<sup>8</sup> Reinhardt v. Passaic Clifton Nat'l Bank & Trust Co., 16 N.J. Super. 430, 436, 84 A.2d 741, 744 (1951), *aff'd*, 9 N.J. 607, 89 A.2d 242 (1952).

<sup>9</sup> UNIFORM COMMERCIAL CODE §§ 4-103(1), 4-202.

<sup>10</sup> Elder v. Franklin Nat'l Bank of New York, 25 Misc. 716, 55 N.Y. Supp. 576 (Sup. Ct. 1899).

<sup>11</sup> See, *e.g.*, the Elder case *ibid*.

<sup>12</sup> 3 CORBIN, CONTRACTS § 607 (1950). *But cf.* Los Angeles Investment Co. v. Home Savings Bank, 180 Cal. 601, 182 Pac. 293 (1919).

<sup>13</sup> See, *e.g.*, Tremont Trust Co. v. Burack, 235 Mass. 398, 126 N.E. 782 (1920).

his account, but a subsequent stopping of payment was conditioned upon his assent to that provision, the court found only a *nudum pactum*, reasoning that the bank, upon accepting the account, had become obligated to stop payment on any countermanded check and to bear the loss of any payment made despite the depositor's order.<sup>14</sup> The judicial following of this rationale, however, has been curtailed by several factors. Where the account passbook issued to the depositor advises of the exculpatory provision, many courts have not been troubled by the consideration problem, since the release can be held a part of the depositor's contract with the bank<sup>15</sup>—for, unlike a common carrier,<sup>16</sup> a bank is not bound to accept an account and may impose conditions prerequisite to such acceptance. Further, in Pennsylvania, where the Model Written Obligations Act<sup>17</sup> has been adopted, the mere inclusion in the stop-payment order form of a recital that the depositor intends to be legally bound by the release will effectively substitute for consideration.<sup>18</sup> And the Connecticut court has indicated that there would be adequate consideration for an exculpatory provision if the bank would inform the depositor, when he seeks to stop payment, that he must either use the form with the release or lose his account.<sup>19</sup> This latter view has received no other sanction, however, and in any event would seem applicable only to future stop-payment orders.

Apart from their technical legal bases, the primary policy underlying the decisions holding these releases valid seems to be the preservation of freedom of contract. It was on this ground that the New York Court of Appeals in *Gaita v. Windsor Bank*,<sup>20</sup> rejected its historic position that a release from liability for negligence is void as contrary to public policy. This idea that the "clearly expressed intention" of the "freely contracting" parties must prevail has been reaffirmed in New York<sup>21</sup>

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<sup>14</sup> *Levine v. Bank of United States*, 132 Misc. 130, 229 N. Y. Supp. 108 (N.Y. Munic. Ct. 1928).

<sup>15</sup> *Tremont Trust Co. v. Burack*, 235 Mass. 398, 126 N.E. 782 (1920).

<sup>16</sup> Common carriers, because they operate under government franchises and monopolies, have been held bound to accept the goods of a shipper and to charge a reasonable rate for their services. See, e.g., *Hart v. Pennsylvania R.R.*, 112 U.S. 331 (1884). See note 35 *infra*.

<sup>17</sup> 33 PA. STAT. ANN. §§ 6-8 (Purdon 1949).

<sup>18</sup> *Ibid.*

<sup>19</sup> *Calamita v. Tradesmen's Nat'l Bank*, 135 Conn. 326, 330, 64 A.2d 46, 49 (1949).

<sup>20</sup> 251 N.Y. 152, 167 N.E. 203 (1929), noted in 15 CORNELL L. Q. 256 (1930), 14 MINN. L. REV. 172 (1930), 29 COLUM. L. REV. 1150 (1929), 39 YALE L.J. 542 (1930).

<sup>21</sup> *Pyramid Musical Corp. v. Floral Park Bank*, 268 App. Div. 783, 48 N.Y.S.2d 866 (2d Dep't 1944) (bank held not liable for inadvertent payment of countermanded check because the stop order released it from such liability and evidence was insufficient to show a willful disregard of notice); *Edwards v. Nat'l City Bank of New York*,

and has been sanctioned by the courts of Indiana<sup>22</sup> and Pennsylvania.<sup>23</sup>

Not all courts, however, have followed this pattern. In *Hiroshima v. Bank of Italy*,<sup>24</sup> the California Court of Appeals declared such releases to be against public policy, relying largely upon two sections of the California Civil Code, one of which prohibits a person from contracting out of liability for his own fraud, willful or *negligent violation of law*, or willful injury to person or property;<sup>25</sup> and the other of which nullified all contracts which attempted to set the damages for a breach of an obligation in advance of the breach.<sup>26</sup> Writers seeking to distinguish the case have seized upon the questionable application of the statutes, pointing out that they are not directed against an attempted exculpation from mere negligence.<sup>27</sup> The *Hiroshima* case has also been distinguished by virtue of the fact that the depositor there could neither read nor write English, and its *ratio decidendi* has accordingly been held inapplicable by an Indiana court where a depositor has had an opportunity to examine the form and "assent" to the release.<sup>28</sup> The California courts have nevertheless consistently followed this case, specifically reiterating its policy basis.<sup>29</sup>

Nor does California stand alone in this regard. The Ohio court had repeatedly asserted that releases in stop-payment order forms would be given effect, but that there would be no relaxation of the standards of good faith and reasonable care not to pay a check after receiving a countermand.<sup>30</sup> Recently, however, in *Speroff v. First-Central Trust*

150 Misc. 80, 269 N.Y. Supp. 637 (N.Y. Munic. Ct. 1934) (where bank certified check after receiving a stop order which contained a release for inadvertent payment, a triable issue was held to exist as to whether the check was certified inadvertently or willfully).

<sup>22</sup> *Hodnick v. Fidelity Trust Co.*, 96 Ind.App. 342, 183 N.E. 488 (1932).

<sup>23</sup> *Cohen v. State Bank of Philadelphia*, 69 Pa. Super. 40 (1917). Here, the bank was held not liable to the depositor for a negligent payment of a countermanded check for the reason that the depositor asked to have payment stopped "as an act of courtesy only and in consideration therefor release[d] the [bank] from any liability. . . ." for negligent payment. The court felt that since the depositor was not required to use the stop-payment form, he could not complain of its terms.

<sup>24</sup> 78 Cal.App. 362, 248 Pac. 947 (1926).

<sup>25</sup> CAL. CIV. CODE § 1668 (Deering 1949).

<sup>26</sup> *Id.*, § 1670.

<sup>27</sup> See, e.g., Comment, 15 CALIF. L. REV. 46 (1926).

<sup>28</sup> *Hodnick v. Fidelity Trust Co.*, 96 Ind.App. 342, 183 N.E. 488 (1932).

<sup>29</sup> See, e.g., *Grisinger v. Golden State Bank of Long Beach*, 92 Cal. App. 443, 268 Pac. 425 (1928).

<sup>30</sup> *Hough Ave. Savings & Banking Co. v. Anderson*, 78 Ohio St. 341, 85 N.E. 498 (1908). *But cf.* *John H. Mahon Co. v. Huntington Nat'l Bank of Columbus*, 62 Ohio App. 261, 23 N.E.2d 638 (1938) (bank held not liable for payment of countermanded check because depositor gave it wrong check number).

*Co.*,<sup>31</sup> it made its position more explicit by unconditionally holding that any exculpatory provision purporting to relieve a bank from liability for its own negligence is against public policy and therefore void.<sup>32</sup> This maintenance of an absolute duty of care was further said to be dictated by the reciprocal rights and obligations inherent in the relationship between a bank and its depositors.<sup>33</sup> And in the recent case of *Reinhardt v. Passaic-Clifton National Bank and Trust Co.*,<sup>34</sup> the New Jersey court, after having declared an exculpatory clause invalid for want of consideration, examined the merits of the rule which denies validity to such releases. It observed that, while perhaps in legal contemplation the bank and depositor might stand upon equal footing, a recognition of modern day realities would suggest a contrary conclusion. It felt that banks have been entrusted with an important franchise to serve the public—a franchise analogous to that under which public carriers operate; and it finally concluded that it might not be inappropriate to apply to banks the same legal doctrines which had deprived carriers of the power to impose and invoke such exculpatory provisions.<sup>35</sup> The same policy considerations incited the Pennsylvania Supreme Court, in *Thomas v. First National Bank of Scranton*,<sup>36</sup> to overrule a long line of contrary decisions and to invalidate a release in a stop-payment order.

Of course, other factors must be weighed in determining the effect to be given these exculpatory provisions, one of the strongest of which is the difficulty faced by large modern banks in carefully examining a long list of stop-payment orders every time a check is presented for payment. It has been said that to discover every countermanded check is virtually impossible—but it would be a novel proposition indeed that a bank choosing to assume the proportions of a large business should

<sup>31</sup> 149 Ohio St. 415, 79 N.E.2d 119 (1948).

<sup>32</sup> *Id.* at 419, 79 N.E.2d 122 (1948).

<sup>33</sup> *Ibid.*

<sup>34</sup> 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd*, 9 N.J. 607, 89 A.2d 242 (1952).

<sup>35</sup> 16 N.J. Super. 430, 436, 84 A.2d 741, 744. The historic rule that a common carrier cannot contract out of liability as an insurer of the goods shipped is said to rest primarily on a policy dictated by the recognized inequality of bargaining power between carrier and shipper. See *Liverpool Steam Co. v. Phenix Ins. Co.*, 129 U.S. 397 (1889). Under present federal law, however, a carrier can minimize its burden by offering lower rates to shippers who wish to ship goods under a contract limiting the carrier's liability to a set minimum sum. 34 STAT. 593 (1906), 49 U.S.C. § 20 (11) (1946); See *Adams Express Co. v. Croninger*, 226 U.S. 491 (1913). Such a contract is enforceable because the arrangement meets both the consideration and the inequality of bargaining power arguments. It is suggested that a similar arrangement could be effected in the banking field. See text at note 46 *et seq. infra*.

<sup>36</sup> 376 Pa. 181, 101 A.2d 910 (1954), *reversing*, 173 Pa. Super. 205, 96 A.2d 196 (1953).

escape the usual principles of law applicable to like institutions.<sup>37</sup> It might also be argued, purely upon the policies which underlie the law of negotiable instruments, that a drawer should bear the risk of payment of a countermanded check as the party primarily responsible for putting it into circulation. This would accord with the askance with which the law has traditionally regarded that which impairs the ready circulability of instruments drawn in negotiable form.<sup>38</sup> But it would be erroneous to contend that the practice of stopping payment on checks can be discouraged only by allowing the banks to relieve themselves of liability for negligent payment. The drawer's liability to a holder in due course of any check upon which payment is even justifiably stopped<sup>39</sup> and his liability to the payee or a non-holder in due course of a check upon which payment is unjustifiably stopped,<sup>40</sup> are themselves formidable impediments to its reckless use. Furthermore, where payment might justifiably be stopped, without a fully effective stop-payment order right, an injured drawer, in order to recover from a fraudulent payee, might have to track him down and bear all of the burdens of litigation and execution. Effective stop-payment, on the other hand, would put the burden of litigation on a fraudulent payee and perhaps eliminate its necessity entirely, inasmuch as confidence men seldom resort to the courts to recover the benefits of their bargains. Nor is this possible reduction of litigation the only social benefit to be gained by control of renegade checks by effective stop-payment orders; a stopping of payment may afford a defrauded drawer his sole practicable means of relief.<sup>41</sup>

The new Uniform Commercial Code<sup>42</sup> propounds one solution to the problems arising from stop-payment orders by flatly declaring that banks may not by contract relieve themselves of their liability for a failure to exercise due care in stopping payment on checks.<sup>43</sup> The

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<sup>37</sup> See *Calamita v. Tradesmen's Nat'l Bank*, 135 Conn. 326, 329, 64 A.2d 46, 48 (1949). An entirely different approach was taken in *Carroll v. South Carolina Nat'l Bank*, 211 S.C. 406, 45 S.E.2d 729 (1947), where the court found for the depositor without passing on the validity of the exculpatory provision in the stop-payment request form. This was accomplished by holding that the bank had not met its burden of proof as to whether the failure to stop payment was "mere inadvertence or oversight."

<sup>38</sup> BRITTON, *op. cit. supra* note 6, §§ 2, 5.

<sup>39</sup> If payment is stopped when the check is in the hands of a holder in due course and the bank pays the check, in an action by the drawer against the bank, the bank is subrogated to the rights of the holder in due course. BRITTON, *op. cit. supra* note 6, § 181, at 839-40.

<sup>40</sup> BRITTON, *op. cit. supra* note 6, § 199.

<sup>41</sup> See Comment, 20 U. CHI. L. REV. 667 (1953).

<sup>42</sup> UNIFORM COMMERCIAL CODE §§ 4-103, 4-202.

<sup>43</sup> *Id.* § 4-103.

draftsmen comment that stopping payment is a service that depositors not only expect, but are entitled to, despite the concomitant difficulty, inconvenience, and expense to the banks. Accordingly, they observe that the inevitable occasional losses incurred because of a failure properly to stop payment should be borne by the banks as a normal expense of doing business. To the extent that such expenses are not covered by the charge for the stopping of payment allowed by the Code, they should be covered by bankers' insurance, the cost of which may be spread among all depositors by the charges made for the accounts.<sup>44</sup> This method of handling the problem represents something of a compromise. On the one hand, the injustice of allowing the bank to relieve itself of a liability inherent in its business is avoided; on the other, the burden of such liability is recognized and methods of mitigating its impact are indicated.

Another possible solution is suggested by the courts' treatment of common carriers<sup>45</sup> to which analogy is frequently drawn in cases involving stop-payment orders.<sup>46</sup> Banks might be allowed to offer a depositor a choice of three types of checking accounts—each with a different service charge scaled to the liability to which it exposes the bank. One type could relieve the bank from any liability for negligent payment of countermanded checks; another limit the liability of the bank to a set minimum number of checks; and a third leave intact the bank's common law liability. The depositor would be free to choose the type of account he desired and the bank would be adequately compensated for the degree of liability which it might assume.

The availability of these possible compromises, together with a few recent judicial statements, indicate that a trend denying validity to exculpatory provisions in stop-payment order forms has begun. It is submitted that the trend is in the right direction. Suggestions such as that presented by the draftsmen of the Code and the limited liability formula furnish adequate protection for the banks as well as depositors, and represent a more socially satisfactory approach to the problem.

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<sup>44</sup> *Id.*, § 4-202, comment 2.

<sup>45</sup> See note 35 *supra*.

<sup>46</sup> See, e.g., *Reinhardt v. Passaic-Clifton Nat'l Bank & Trust Co.*, 16 N.J. Super. 430, 84 A.2d 741 (1951), *aff'd*, 9 N.J. 607, 89 A.2d 242 (1952); *Thomas v. First Nat'l Bank of Scranton*, 376 Pa. 181, 101 A.2d 910 (1954), *reversing*, 173 Pa. Super. 205, 96 A.2d 196 (1953).