Delaware Journal of Corporate Law

VOLUME 10 1985 NUMBER 1

UNFAIR CREDIT REPORTING AND WRONGFUL DISHONOR—TWO WRONGS MADE FROM THE SAME RIGHT

BY FAIRFAX LEARY, JR.* AND RICHARD SETH HUDSON**

I.

Lawyers are too apt to engage in cause of action analysis, with each cause of action narrowly analyzed as to its essential elements. For many, this sort of analysis is what "thinking like a lawyer" means. However, this analytical approach needs to be accompanied by another sort of analysis; a broader "systems" approach. Precise analysis of issue conflicts neglects the larger scope of underlying similar social forces which may have evoked what today appear to be unrelated and disparate causes of action. As each developed through detailed separate analyses in the interest of litigants, and as each may have been subjected to separate statutory treatment at the urging of affected parties, the primordial force that originally evoked both may have been overlooked.

In this article, we propose to examine, in some detail, the separate paths taken by two situations that originally stemmed from the merchant's right to protection of an erroneous sullying of his credit reputation. We shall endeavor to show how changes in the mores and habits of the general population have caused quite different views to be adopted with respect to what we shall attempt to demonstrate are facets of the same wrong, namely an unjustified slur on one's credit reputation. This has happened as, over time, severe social changes

* Distinguished Senior Professor of Law, Delaware Law School. A.B. 1932, Princeton University; J.D. 1935, Harvard.

** B.A. 1982, Boston University; J.D. 1985, Delaware Law School.

The cases cited and some of the conclusions are from Professor Leary's work in 6 HAWKLAND, LEARY & ALDERMAN, U.C.C. Series 4-402:06 to :07 (1984).

have occurred. The rules we propose to discuss are the rules governing those who report for a fee or otherwise on the credit standing of others and the rules governing the liability of an account institution for wrongfully dishonoring an order to pay issued by its customer.

In the course of the discussion we shall find it necessary to refer to the changes, over time, of the economic system, the outlook of people generally on the use of credit, the growth of the commercial units that make up what we loosely call the business community, the effect of the onset and development of the consumer credit industry (including the use by consumers of checks and payment orders) and the development of Anglo-American legal systems addressing these changes.

Ours has largely become a credit economy and many businesses have become credit card oriented. It is extremely difficult to rent a car or stay in a hotel without possessing a nationally known credit card. The widespread distribution of capital goods is supported by purchases on the installment plan. This practice is not limited to consumer installment purchases with either seller- or lender-arranged financing. Purchases arranged by business entities with third party lender purchase money are essentially installment sales, whether secured by the article purchased, by other collateral, or by no security at all.[1]

The volume of credit outstanding in the United States is understandably staggering. Consumer credit, excluding home mortgages, has been estimated by the staff of the Federal Reserve Board to have been $396,448 million as of January 1984,[2] increasing by 6,800% from $5,665 million in 1945. To this must be added the $1,214,249 million of home mortgages outstanding.[3] To get some idea of the outstanding volume of business credit, we must include the outstanding volume of publicly held debt securities, bank and finance company loans to businesses and possibly preferred stocks, giving us a business total of $1,585 billion.[4] Thus the private use of credit amounts to v ell over three trillion dollars. For the purposes of the ensuing discussion we disregard public debts (federal, state and local), although such debts illustrate that public entities, as well as private ones, depend on credit.

1. Most sellers granting credit in turn obtain the deferred payments ahead of time by discounting their right to receive those payments. Many installment purchases of capital goods, from home appliances to production machinery, are but examples of turning payments for use into payments for ownership through the use of credit. Thus the need for good credit standing is pervasive.

2. 70 FED. RES. BULL. A3 (1984). *Cf. infra* note 17 and ENCYCLOPEDIA BRITANNICA, *Installment Selling* 457 (11th ed. 1960).

3. 70 FED. RES. BULL. at A37. This figure reflects outstanding mortgage debts owed on 1-4 member family residences as of the fourth quarter of 1983.

4. *Id.* at A15. (Figure for January 1984).

What controls whether a given entity has access to the sources of credit? Several controls exist in the economic sense. First is the supply of funds available for lending. Second is the cost of those funds to lenders. Third is the inflation factor, best described as the lenders' perception of the extent to which the purchasing power of the funds repaid will be less at the time of repayment than the purchasing power of the same amount at the time of lending. Finally, the lender must consider the risk of loss through lack of ability or willingness of the borrower to repay. While all of these factors interact to some extent, our focus in this article is on that factor last named: the risk of non-payment.

The risk of non-payment, or creditworthiness factor, is the one that most significantly varies with the particular borrower. The variation can be from credit availability at the lowest rate where several rates are used to a complete refusal of credit at any rate of interest. All of the foregoing depends on the availability of credit information from which those in charge of lending can make the necessary value judgments as to whether the credit should be granted at all, or, if granted, at what rate.

As we move from the larger and individualized credit transactions, such as the sale of securities through underwriters to the public, to privately placed loans from insurance companies and banks, to the mass marketing of typical loans to consumers, we find a narrowing of the negotiable areas. In the consumer credit market, in the home mortgage and automobile or major appliance purchasing situations, interest rates tend to be fixed and the credit is either granted or refused depending on whether the applicant for credit meets the lenders' minimum standards for granting credit.

The credit granting standards depend upon the credit grantor's perception of the ability and willingness of the applicant to repay. This perception is derived from an examination of information. It is important that the information be as nearly accurate as possible. To the extent that rules of law impose penalties for socially undesirable conduct, they also are thought to be instrumental in guiding human conduct into channels deemed socially desirable. The propriety and desirability of any given principle of law can be evaluated by considering the extent to which it deters undesirable conduct and appropriately allocates losses caused thereby, through criminal sanctions, or civil rules for transferring losses, or both.

Since information about the credit applicant is the basis for the grant or denial of credit, the importance attached to accurate credit information is tremendous. There is thus a strong social policy in favor

of having a free flow of credit information and in not unduly deterring those who have such information from sharing it with others.

Of necessity, much of a credit grantor's information must come from the applicant for credit. There is, therefore, a risk that information supplied by the applicant may be favorably colored. Statutes exist imposing criminal penalties for making various kinds of false statements for the purpose of obtaining credit.[5] Civil penalties also exist, ranging from the total denial of a discharge in bankruptcy, or just refusing to discharge a particular debt so obtained,[6] to rescission of contracts, and to the recovery of goods delivered on credit where there is a false representation of solvency or the making of a promise which the promisor had no intention of performing.[7]

Particular markets have been selected for special treatment to ensure the accuracy of credit information. Examples can be found in the various federal statutes designed to ensure and police the information available in the securities markets, not only in connection with the original public distribution of securities, but in connection with the continued trading thereof in the capital markets.[8]

Even with statutory and common law protection, criminal as well as civil, against the delivery of exaggerated information by credit applicants, large and small, the lender (particularly in the case of the

---

5. *See, e.g.*, ALA. CODE § 13A-9-13.1 (1975); ALASKA STAT. § 11.46.290 (1962); ARIZ. REV. STAT. ANN. § 13-2107 (1956); CAL. PENAL CODE § 476a (West 1970); COLO. REV. STAT. § 18-5-209 (1973); CONN. GEN. STAT § 53a-128b (1958)); DEL. CODE ANN. tit. 11, § 909 (1974); FLA. STAT. ANN. § 817.03 (West 1976); HAWAII REV. STAT. § 851-2 (1976); IOWA CODE ANN. § 533.65 (West 1983); KY. REV. STAT. § 434.570 (1984); LA. REV. STAT. ANN. § 6:668 (West 1984); MD. ANN. CODE art. 27, § 145(b) (1957); MASS. GEN. LAWS ANN. ch. 266, § 33 (West 1970); MINN. STAT. ANN. § 609.82 (West 1964); MONT. CODE ANN. § 45-6-317(1)(c) (1984); NEV. REV. STAT. § 205.680 (1983); N.J. STAT. ANN. § 2C:21-4 (West 1982); N.M. STAT. ANN. § 30-16-29 (1978); N.Y. PENAL LAW 175.45 (McKinney 1975); OHIO REV. CODE ANN. § 2921.13(A)(8) (Page 1953); OKLA. STAT. ANN. tit. 21, § 1501 (West 1983); PA. STAT. ANN. tit. 18, § 4107 (Purdon 1983); R.I. GEN. LAWS § 11-49-2 (1956); TENN. CODE ANN. § 39-3-503 (1982); TEX. PENAL CODE ANN. § 32.32 (Vernon 1974); VA. CODE § 18.2-186 (1950); WASH. REV. CODE ANN. § 9.38.010 (1977).

6. Bankruptcy Act, 11 U.S.C. §§ 727(a)(2)-(5) (1984).

7. The range is from outright fraud to the two implicit business frauds found in the 1978 version of the Uniform Commercial Code: the "credit sale" rule of U.C.C. § 2-702 and the "cash sale" rule of U.C.C. § 2.507.

All citations herein to the U.C.C. are to the Official Text and Comments Edition (1978) unless otherwise noted.

8. See, e.g., Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1933), and the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1934), governing the market for investment securities, supplemented by state Blue Sky Laws. *See also* Commodity Exchange Act, 7 U.S.C. §§ 1-27 (1936).

private lender and the small business or consumer lender) has an interest in a cost effective means of verifying the accuracy of applicant-supplied information. In earlier times, this could be done by direct inquiry of those with whom the applicant had dealt, and by inquiry of neighborhood sources for any omission of those with whom there had been dealings but who were not listed by the debtor.[9]

Transactional expense could be reduced if creditors could have access to previously gathered information. Hence, credit information exchanges and credit reporting agencies were developed.[10] These were founded to give creditors needed credit information. While creditors have an interest in obtaining accurate credit information from these sources, the damage to the creditor from erroneous derogatory information is slight; a deal was not made that perhaps could have been successfully made. More serious is the damage to a creditor if erroneous information, beneficial to the applicant in nature, is given by an applicant and is confirmed by the credit reporting agency. However, since the creditor and the reporting agency have contractual relations, their respective interests can be covered by their respective contracts.[11]

But erroneous information given to a potential creditor can have a very considerable impact on an applicant for credit where, by reason of the information, credit is denied.[12] This has been legislatively recognized in the case of consumers in the United States by the passage of the Fair Credit Reporting Act[13] in connection with the federal Consumer Credit Protection Act.[14] But the coverage of the Fair Credit

---

9. The "direct" method is used today by credit reporting agencies for more detailed investigations. It is also used by the F.B.I. in security clearance investigations. *See generally* Foer, *The Personal Information Market: An Examination of the Scope and Impact of the Fair Credit Reporting Act*, 2 LOY. L.A. CONSUMER J. 37, 41-43 (1974) [hereinafter cited as Foer].

10. *See id.* at 43-48.

11. These usually refer to the supplying of information felt to be accurate by the credit reporting agency.

12. Professor Leary is personally aware of one case where an erroneous report of a "history of drug abuse" in an investigation for an automobile insurance applicant caused a cancellation of the policy. This in turn caused the cancellation of the now uninsured soldier's privilege to live off base with wife and infant child. We ask how such damages can be quantified monetarily.

13. 15 U.S.C. § 1681 (1970). *See also* Denney, *Federal Fair Credit Reporting Act*, 88 BANKING L.J. 579 (1971); McNamara, *The Fair Credit Reporting Act: A Legislative Overview*, 22 J. PUB. L. 67 (1973); Note, *Judicial Construction of the Fair Credit Reporting Act: Scope and Civil Liability*, 76 COLUM. L. REV. 458 (1976); Note, *The Fair Credit Reporting Act*, 56 MINN. L. REV. 819 (1972); Comment, *The Impact of the Fair Credit Reporting Act*, 50 N.C.L. REV. 852 (1972).

14. 15 U.S.C. 1601 (1982). However, the Truth in Lending Act does not address problems of the granting or denial of credit.

Reporting Act is limited to defined agencies engaged in credit reporting.[15]

The purpose of this article is to examine the development of common law protections for those who are the subject of statements issued by persons not covered by the legislative rules heretofore discussed governing the substance of statements made. We propose to discuss how the interests of credit applicants were protected under the law of defamation and how courts came to consider the needs for limited protection of the credit reporters to ensure a free flow of credit information to credit grantors. We shall attempt to show that the original treatment of the wrongfully dishonored check, and the statutes secured originally by the banking industry and then embodied with abbreviated treatment in the Uniform Commercial Code (U.C.C.), have not been seen by some commentators in quite the same perspective as the origins of the rules might suggest. We believe, now, that the abbreviated expression given in the Uniform Commercial Code to wrongful dishonor may have led astray some courts and some commentators.

Examination of the problems from a slightly different stance may result in a different outlook. In conclusion, we shall suggest that any revisions of article 4 of the U.C.C. should use slightly different language in the hope that the change will have a clarifying effect.

In an attempt to accomplish what we have set out to do, it will first be necessary to examine the origins of the protection of the interests of credit applicants or credit users under the tort law of defamation. We must go back to the earliest wrongful dishonor cases and discuss the development of that branch of the law of defamation later known as "trade libel." It is from the wellsprings of that doctrine that the law of wrongful dishonor developed and created its so-called "trader rule," which in reality was a credit user rule.

II.

The voluminous use of credit in today's world makes it difficult to appreciate a society in which the principal users of credit (where the parties did not intimately know each other) were the merchant traders. Yet such a society existed, perhaps as recently as the last quarter of the eighteenth century and perhaps even into the early years of the nineteenth century.[16] Indeed, the development of the use of credit

15. The Act applies only where Credit Reports and Investigative Reports, as defined, are involved. It does not apply where *A* tells *B* of *A*'s own dealings with *C*. *See* 15 U.S.C. §§ 1681a-1681t (1982).

16. For a background on this history of consumer credit, see M. BONER, THE

did not spawn the credit insurance industry until near the end of the nineteenth century.[17] The first legislation authorizing credit insurance in the United States was enacted in 1885 and 1886 in New York, New Jersey, and Louisiana.[18] However, it was not until 1892 and 1893 that credit insurance was written by companies that continued in the business until the present time.[19] Prior to the post World War II explosion in consumer credit,[20] there were only two such companies in the United States.[21] In England the use of credit insurance did not start until after World War I. Moreover, it was in response to different social pressures and took a different route, largely protecting the export trade.[22] The credit insurers also had need of credit information.

In quite another area, the law developed using a concept of credit evaluation that rapidly became outmoded, namely, that credit was extended as the result of a visual inspection of the tangible assets of the debtor. We can concede that the concept probably reflected the method in use at the time *Twyne's Case*[23] was decided in the reign of Elizabeth I. From that decision grew the doctrine of "ostensible ownership" as to personal property[24] which retarded the use of credit secured by

---

MERCHANT AND THE POOR: A SELECTED BIBLIOGRAPHY (1970); L. MCCAVLEY, CREDIT INSURANCE: ITS HISTORY AND FUNCTIONS (1955).

17. Credit insurance in the United States originated as a result of legislation enacted in 1885 and 1886 in New York, New Jersey and Louisiana which authorized the incorporation of companies to write this form of insurance. In 1887 the American Credit Indemnity Company of Louisiana was organized, and, in 1888, the U.S. Credit System company was established in Newark, New Jersey. Neither of these companies enjoyed success and they soon withdrew from the field. In 1892 the London Guarantee and Accident Co. of London, Eng., created a credit insurance department in the United States, and in 1893 the American Credit Indemnity Company of New York was founded. Both of these companies survived and wrote credit insurance uninterruptedly; in the latter 1950's they were the only two in the United States writing such insurance.

ENCYCLOPEDIA BRITANNICA, *Credit Insurance* 654-55 (11th ed. 1960) [hereinafter cited as *Credit Insurance*].

18. AMERICAN CREDIT INDEMNITY CO., CREDIT INSURANCE: ITS HISTORY AND FUNCTIONS 4 (1959).

19. *See supra* note 17.

20. See 50 FED. RES. BULL. 376 (1964) for chart indicating that installment credit holdings rose from a total of $4,503,000,000 in 1939 to a total of $53,745,000,000 in 1963. (These figures do not include real estate mortgage loans.)

21. *See Credit Insurance, supra* note 17, at 655.

22. *See supra* note 17. *See also* ENCYCLOPEDIA BRITANNICA, *Installment Selling* 457 (11th ed. 1960).

23. 3 Coke 806, 76 Eng. Rep. 809 (Star Chamber 1601).

24. Applying the doctrine to every transfer of an interest in chattels effectively prevented any common law non-possessory security interests in chattels. *See, e.g.*, Clow v. Woods, 5 Serg. & Rawle 275 (Pa. 1819); Martin v. Mathiot, 14 Serg. & Rawle 214 (Pa. 1826).

non-possessory security interests in personal property for a long, long time.[25] A series of recording statutes for chattel mortgages and conditional sales were then developed.[26] Thus, the source of necessary credit information shifted away from visual inspection to see whether goods were pledged and thus out of the possession of the applicant for credit. The new information source was again the credit reporting agency which more conveniently inspected the recording offices and reported on what was there to its subscribers.

At the same time, more and more businesses employed accountants who produced financial statements from which credit judgments could be made. The financial statements would be obtained by the credit reporting agencies and summarized in their credit reports.

The law of defamation grew to include liability for false statements as to a person's conduct of his trade or profession. Originally, it was not the merchant's need for credit that developed the law of "trade libel." It developed primarily to protect that person's relations with potential customers. But when the courts were faced with the earliest cases of wrongful dishonor the rules of "trade libel" produced a source of useful precedents.[27]

The law of defamation also recognized that there were two interests involved in most situations. There was the interest of the subject of the communication on the one hand. This was an interest in the accuracy of the information. On the other hand, the recipient of the information also had interests that deserved protection. But here the interests were conflicting. One was that information, especially derogatory information, be communicated. The other was that the information be accurate.

The cases involving information as to the character and ability of prospective servants or other employees highlight the tension be-

---

25. Leary, *Pennsylvania's Uncorrelated Chattel Security Law*, 19 PA. B.A.Q. (1948).

26. *See* A. FELDMAN, COMPILATION OF FEDERAL AND STATE LAWS REGULATING CONSUMER FINANCING SERVICES (1977).

27. For a discussion of such rules, see generally C. GATLEY, GATLEY ON LIBEL AND SLANDER 33-39 (1929).

> It is libellous to impeach the credit of a merchant or trader, or to impute to him fraud, dishonesty or any other conduct that would prejudice him in the way of his trade or business. Thus, it is libellous to write and publish of a trader or merchant that he is, or has been, bankrupt, insolvent, or in embarrassed circumstances, but not simply that he has made a chattel mortgage, without anything more as to the amount, subject of the mortgage, or the occasion of it.

Id. at 38 (citations omitted). Text contains numerous citations to caselaw dealing with the issue.

tween the several interests.[28] In an economy where labor was plentiful, the need to have the communication made was stronger than the need for accuracy. The recipient of the information would suffer little or no harm if derogatory information was not accurate, as there were plenty of potential servants seeking jobs. If derogatory information was not communicated, however, the harm that could be created by a thief or other criminal in the household could be large. Yet the passing on of information to those who had no need for it and the spiteful communication of groundless information could not be tolerated.

The reconciliation of these apparently conflicting policies was through the doctrine of qualified privilege. The need would be shown by a request for information by the recipient. Spiteful communications would be prevented or discouraged by the doctrine of malice which would destroy the privilege.[29] Should false information never-

---

28. The qualified privilege in this area required that there be first an inquiry indicating a legitimate interest in obtaining the information and a good faith belief in the accuracy of the answer. In Lewis v. Equitable Life Assurance Society of the United States, 361 N.W.2d 875 (Minn. App. 1985), a suit for defamation by wrongfully discharged employees, the court said, "To prevail in an action of defamation, respondents must show that a statement was 'false' and was communicated to someone other than the plaintiff. When made in good faith, an employer has the privilege to describe the discharge of an employee." *Id.* at 880 (citations omitted).

As to qualified privilege, the court approved the following instructions by the trial judge to the jury as to statements about an employee, by a former employer to a prospective employer: "To render such a statement qualifiedly privileged, . . . it must be made without actual malice, must be made in good faith and in an honest belief that it was true." *Id.* at 882. The instruction on what constituted actual malice was:

> Actual malice in a defamation action means that the defamatory statement was made from ill will and improper motives or causelessly and wantonly for the purpose of injuring the plaintiffs. You may find that the defendant, through its agents, was actuated by actual malice if it acted in bad faith toward the plaintiffs and with an intent to injure them in their reputations or if it acted in willful, wanton, and reckless disregard of the rights and interests of the plaintiffs.

Id. The appeals court stated in its opinion that an abuse of the qualified privilege is not shown by evidence that the communicator knew the statement was false, nor in the alternative by a reckless disregard as to the truth or falsity of the statement. *See id.* at 880-82.

29. For a discussion of this privilege and its background in the law of defamation, see W. KEETON, PROSSER AND KEETON ON TORTS §§ 114-15, at 815-36 (5th ed. 1984). Cases dealing with this privilege as it is accorded to credit agencies include: Putnal v. Inman, 76 Fla. 553, 80 So. 316 (1918); Woodhouse v. Powles, 43 Wash. 617, 86 P. 1063 (1906); Ideal Motor Co. v. Warfield, 211 Ky. 576, 277 S.W. 862 (1925); Pavlovsky v. Board of Trade of San Francisco, 171 Cal. App. 2d 110, 340 P.2d 63 (1959); Traynor v. Seilaff, 62 Minn. 420, 64 N.W. 915, (1895); Hartnett v. Goddard, 176 Mass. 326, 57 N.E. 677 (1900); Muetze v. Tuteur, 77 Wis. 236, 46 N.W. 123 (1890).

theless prove to have been believed, in good faith, to be true, then originally the privilege would protect the one giving the information.

When it came to the position of the mercantile agency, the need for credit information was not given the favorable treatment that was given to one responding to a request. In 1908, in *MacIntosh v. Dunn*,[30] the House of Lords denied a qualified privilege to a mercantile agency supplying information to customers as a business. The decision came in the opening years of the twentieth century. The Law Lords seemed to feel that a professional information supplier should not be given the same privilege as that given, for example, to a former employer responding to a request from a prospective employer, or to one merchant responding to a request from another merchant.

It would be tempting to treat the case as one based on the principle that a mercantile agency can more effectively spread the losses caused by incorrect credit information over a far wider populace, represented by its customers, than can either the subject or the originator of the information. But there is nothing in the opinion to indicate that any such thinking was present.[31] Given the background and upbringing of the judges of that period, the concepts of credit and the need to protect bona fide collectors of credit information was probably not well understood. Consequently, the opinion deals heavily with the idea that the mercantile agency made a contract to deliver accurate information and should not be protected in giving information that was not accurate.

On the other hand, in the United States, a split of authority developed over whether the doctrine of qualified privilege extended to mercantile agencies.[32] Those courts which denied the privilege could be said to be less influenced by the beginnings of the greater use of credit than the courts in the jurisdictions that granted the privilege. Perhaps it could be said that those jurisdictions which granted the privilege perceived that the interests of grantors of credit deserved more protection than the interests of credit users. Whatever the feeling of the courts, the division of authority (although a large majority grants the privilege) has not stopped the growth of credit reporting agencies. Nor, on a state-by-state basis, is there any discernible difference in the extent of their activities, between states which do grant the privilege,

---

30. 1908 A.C. 390.

31. The law lords' more simplified approach placed the responsibility for error on the party performing the service for profit. "It is only right that those who engage in such a business, touching so closely very dangerous ground, should take the consequences if they overstep the law." *Id.* at 400.

32. *See generally* Maurer, *Common Law Defamation and the Fair Credit Reporting Act*, 72 GEO. L.J. 95 (1983) [hereinafter cited as Maurer].

and states which do not have a qualified privilege rule for mercantile agencies.[33]

One point must be borne in mind. Applying a spread-loss principle to mercantile agencies requires that losses be paid by the subscribers to the agency, all of whom subscribe because they are credit grantors. But applying the same "spread-loss" principle to the "reason for return" stamped on the back of a returned check would reach a different result. We can see that the spread-loss effect would be to place the burden on all check issuers, many of whom would not be credit grantors needing information as to why a particular check was not paid. Hence, using banks to "spread the loss" is not a justifiable approach.

III.

Turning now to the issues arising in wrongful dishonor cases, the first question is whether a bank returning an item, not necessarily a check, must say anything. Neither the English Bills of Exchange[34] nor the Negotiable Instruments Law[35] required the party to pay to do anything but to pay. But the rules as to dishonor required that a proper presentment be made and that payment be either refused or not obtainable.[36] Article 3 of the U.C.C. also refers to a notice of dishonor to be given by the holder, particularly in U.C.C. section 3-508.[37] If a holder making a presentment in person were to ask "why" when payment was refused, the employee refusing payment would probably give the reason, especially if the reason were curable.

But the practice of direct sending by mail to a payor bank, and presentment "through" a clearing house with no one present to ask "why" when payment was refused, caused a practice to develop of placing reasons on the items returned unpaid. Thus, when article 3 came to be drafted, U.C.C. section 3-510 referred to the return item stamp or accompanying ticket, "stating that acceptance or payment has been refused for reasons consistent with dishonor."[38] Such a ticket

---

33. Retail Credit Co., one of the largest reporting companies, is headquartered in Atlanta, Georgia. Georgia is one of the states denying the privilege.

34. Bills of Exchange Act, § 59(1), 45 & 46 Vict. c. 61 (1882).

35. *See* F. BEUTEL, BEUTEL'S BRANNAN NEGOTIABLE INSTRUMENTS LAW § 88 (1943) ("Payment is made in due course when it is made at or after maturity of the instrument to the holder thereof in good faith and without notice that his title is defective.").

36. *See id.* §§ 89-118.

37. The contracts of drawers and indorsers, etc., to pay are conditional upon receipt of notice of dishonor. *See* U.C.C. §§ 3-501(2), 3-413(2), & 3-414(1).

38. *Id.* § 3-510(b).

was made admissible in evidence, created a presumption of dishonor and of the giving of any notice of dishonor shown on the ticket.[39]

It is understandable that a payor in possession of an item which it is not paying should state the reason for its return if the reason for the return is curable without reference to the drawer, as in the case of a return for lack of a proper indorsement or for a failure to comply with any of the payor's requirements under U.C.C. section 3-505. Yet the practice of giving reasons has resulted in far more potential statements being printed on the forms, or set up in the rubber stamps used by return item processors. Among such statements used are "Not Sufficient Funds," "Drawn Against Uncollected Funds," "Account Attached," "Account Closed," and, among others, "Refer to Drawer."[40]

Does stating the reasons for the return serve any other purpose than to indicate whether a cure in the presentment could be made? We feel that other significant purposes can be served and are being served. The recipient of a payment tendered by check has a legitimate reason for knowing why that item is not being paid. In today's credit oriented economy, the reason can affect future dealings between drawer and payee. For one example, a seller may have delivered goods on credit with the check covering a down payment. A return because drawn against insufficient funds can trigger the seller's U.C.C. section 2-702 right to reclaim the goods delivered on credit.[41] The Code requires the seller to discover that the buyer has received goods while insolvent. The Code's three pronged definition of "insolvent" in

---

39. *Id.*

40. These are found on the usual return item tickets used by banks.

41. U.C.C. § 2-702 (1978). The text of the code section follows:

Sec. 2-702. Seller's Remedies on Discovery of Buyer's Insolvency

(1) Where the seller discovers the buyer to be insolvent he may refuse delivery except for cash including payment for all goods therefore delivered under the contract, and stop delivery under this Article (Section 2-705).

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser [or lien creditor] under this Article (Section 2-403). Successful reclamation of goods excludes all other remedies with respect to them.

Id.

U.C.C. section 1-201(23) includes "ceased to pay his debts in the ordinary course of business." The Comment to the definition tells us to approach the phrase "from a commercial standpoint," and as a separate alternative to the other two tests.[42] From a commercial standpoint, drawing checks against insufficient funds is not paying in accordance with the ordinary course of business. U.C.C. section 2-507(2) also gives rise to rights in a seller to recover goods where a check given in payment for a cash sale is returned uncollected.[43]

In addition, many consumer contracts "on the installment plan" have acceleration clauses, often on a "deems itself insecure" basis. A good faith belief that the prospect of payment is impaired can arise from the return of a check for insufficient funds. Thus, a credit oriented society has many interests in knowing why a check or other payment item is returned unpaid.

As *Zatal v. First National City Bank*[44] shows, the reasons given for dishonor can have varying effects. In the case, a bank erroneously credited an $8,500 deposited check as $850. This could have resulted from a misencoded deposit slip. A check was returned marked "insufficient funds." Had the correct credit been made, the bank could have (and in the suit claimed it would have) returned the check anyhow. But in that case, it would have signalled "drawn against uncollected funds." In refusing to dismiss a complaint because the bank had the right to return anyway, the court impliedly held that the customer has a right to have the correct reason given for a return where that reason is less defamatory than the reason actually given.[45] The return "drawn against uncollected funds," has the same effect as if the bank were saying, "The midnight deadline rule requires this check to be returned, but really the presentment was a bit premature."

With the present "brouhaha" about "funds availability," and the generally asserted claims that banks are placing "holds" on uncollected checks for longer periods than are necessary for the vast

---

42. U.C.C. § 1-201 Official Comment 23.

43. This is done by a provision that in a sale where payment is due and demanded on delivery, the buyer's right to keep the goods "as against the seller is conditional" upon the buyer's making payment. U.C.C. § 2-507(2).

Under U.C.C. § 3-802, the obligation is suspended when a check is taken, but is fully viable if the check is dishonored. Payment not having been made, the buyer "as against the seller" has no right to the goods." *Id.*

44. 9 U.C.C. Rep. Serv. (Callaghan) 1098 (N.Y. Sup. Ct. 1971).

45. "If for no other reason, the complaint thus alleges a valid basis for relief founded upon Citibank's alleged failure to credit plaintiff's account properly and upon the purported consequences resulting therefrom." *Id.* at 1099.

majority of cases,[46] the credit effect of a return "drawn against uncollected funds" is just that the debtor may have mailed the check to the creditor a few days too soon.

But what is the effect of the return of a check marked "N.S.F." or "Account Attached"? Here today, we find the usual lag between the "lore" (i.e., the popular perception) as to the conduct and the present day "law" as to that conduct. When the use of checks was not as widespread as it now is, certain protections were felt in the business community to be desirable. Checks would be more convenient to handle and less subject to pilferage than money. Acceptability of checks, it was thought, would be enhanced by making it a crime to write a check without having and keeping funds on deposit from which it could be paid. Bad check laws were adopted with varying criminal sanctions.[47] Thus, returning a check N.S.F. when such was not the fact was the equivalent of a false accusation of the commission of a crime. This is recognized in U.C.C. section 4-402's provision permitting recovery of damages for arrest and prosecution if proximately caused by the wrongful dishonor.[48]

Bad check laws have, however, been changed from the earlier models supported by the American Bankers Association.[49] Some of the statutes have provided that no crime is committed if the check is made good within a statutorily specified period of time.[50] In others,

---

46. Deferred availability is discussed by Professor Emma Coleman Jordan in *Ending the Floating Check Game: The Policy Arguments for Delay Availability Reform*, 36 HASTINGS L.J. 515, 555 (1985). For a table showing the variations in the "hold" period of various California banks, see *id.*

47. For a representative sample of current bad check laws, see DEL. CODE ANN. tit. 11, § 900 (1984 Supp.); ILL. ANN. STAT. ch. 38, § 17-1(d) (Smith-Hurd 1984); MONT. CODE ANN. § 45-6-316 (1984); N.Y. PENAL LAW § 190.05 (McKinney 1975); PA. STAT. ANN. tit. 18, § 4105 (Purdon 1983).

48. *See* U.C.C. § 4-402 ("damages may include damages for an arrest or prosecution of the customer").

49. The 1937 version of the Check of Draft Without Funds Act recommended by the American Bankers Association included a provision presuming intent and provided that the making of a check draft or order, payment of which is refused for insufficiency of funds, shall be prima facie evidence of knowledge of insufficiency of funds and of intent to defraud. 1 T. PATON, PATON'S DIGEST OF LEGAL OPINIONS, *Checks*, § 22:20, at 1145 (4th ed. 1940) [hereinafter cited as T. PATON]. Paton expressed concern regarding the constitutionality of those bad check statutes not containing an intent provision in light of provisions within many state constitutions forbidding imprisonment for debt except in the case of fraud. *Id.* at 1124. Perhaps this is the one reason for the later weakening of the bad check laws.

50. Until 1983, Indiana had a statute of this nature, providing that "no crime [had] been committed" if the check was made good in 20 days. IND. CODE. § 35-43-5-5 (1978). This provision has been eliminated from the statute. *See* IND. CODE ANN. § 35-43-5-5 (Burns 1985). *See generally* 6 HAWKLAND, LEARY & ALDERMAN, U.C.C. SERIES § 4-402:07, at 244-45 (1984).

the return N.S.F. merely creates a presumption of intent to defraud which is rebutted by a prompt cover of the check.[51] Some still keep the old model.[52] Yet the average creditor still feels that there is something highly nefarious about being given a check that "bounces." Many still feel it is criminal for their customers to "play the float."[53]

We suspect that the reason for the weakening of many of the bad check laws is a perception by the prosecutors of criminal cases that it is not their true function to bring criminal cases, or to permit the criminal dockets to be clogged with actions, that are in essence debt collection actions where there was no real intention to obtain property without paying for it. The same perception may have caused the Supreme Court of the United States to go even further and rule, in *Williams v. United States*,[54] that giving a check did not imply a representation of the availability of funds available for its payment, thus effectively removing the prosecution of check kiting from any current federal statute. The Supreme Court certainly did not accept the current commercial view of the receipt of a bad check.[55]

Against this lengthy background, let us now examine the position of the drawer of a wrongfully dishonored check in the light of the following assumptions which we believe are correct. First, that no longer is it only the "trader" who uses credit and as to whom a credit standing is important. Second, that merchants and other credit grantors consider persons issuing checks presented against insufficient funds as poor credit risks, both in the mercantile market and in the consumer credit market. Third, that credit reporting agencies, when given a creditor's experience with a particular customer that includes the issue of a check returned N.S.F., will report that fact to those making inquiries about the same customer. Fourth, that the Uniform Commercial Code's equating of ceasing "to pay . . . debts in ordinary course" with insolvency or rapidly approaching insolvency is proper and conforms to commercial understanding.[56] Fifth and finally, that the return

---

51. Alabama, Delaware, New Jersey, and Pennsylvania have laws of this type. *See* ALA. CODE § 13A-9-13.1 (1975); DEL. CODE ANN. tit. 11, § 900 (amended in 1983 to increase penalty); N.J. STAT. ANN. 2C:21-5 (West 1982); 18 PA. STAT. ANN. tit. 18, § 4107 (Purdon 1983).

52. *See, e.g.*, CAL. PENAL CODE § 476a (West 1970); N.Y. PENAL LAW § 175.45 (McKinney 1975). *See also* HAWKLAND, LEARY & ALDERMAN, U.C.C. Series § 4-402:07, at 244-45 (1984).

53. "Playing the float" means issuing checks in anticipation of making and securing "clearance" of a deposit before the check is presented to the drawer for payment.

54. 458 U.S. 279 (1982).

55. *Id.* at 284-85.

56. *See* U.C.C. § 1-201(23).

of a check N.S.F., in commercial understanding, is a failure to pay in ordinary course.

While no statute so provides specifically, the account contract between a deposit institution and a checking account customer imposes an obligation on the deposit institution to pay properly presented, properly drawn and indorsed, and properly funded orders to pay, drawn by its customer, which are of the type customarily accepted by the deposit institution. So there is a contract obligation to pay which is breached by the failure to pay. We also believe that there is another obligation, founded in the law of defamation, not to return checks with reasons for return which are untrue and damaging to the depositor. This obligation is subject to a rule of mistake. We shall argue that this is analogous to a qualified privilege under the law of defamation that protects the deposit institution from defamatory type damages, including punitive damages, if the return is based on a good faith belief, reasonably founded, that the return is proper and the reason given is true.[57] But since the law of contract is felt to be a law of strict liability, absent excuse, even if the qualified privilege exists as to defamatory damages, contract type damages are still recoverable. In short, the privilege prevents the recovery of what, in the law of defamation, are called "general" damages, but does not prevent the recovery of properly alleged and proven "special" damages which meet the contract test of foreseeability whether denominated special or consequential.

It is the position of the authors that case law supports our theory of how the "trader rule" in wrongful dishonor cases developed, as we shall now proceed to discuss.

Briefly, the course of development of the law passed through four stages. First, the case law gave defamatory recovery to traders because a credit reputation was an important interest of one engaged in mercantile pursuits.[58] Here English and American law have parallels. In the second stage, there was American case law enlarging the populace allowed to recover defamatory type damages as it was realized that persons not engaged in trade and commerce needed credit reputations.[59] The third American stage was the attempt to protect the deposit institutions returning checks, "by mistake and without malice," from

57. *See* W. PROSSER, LAW OF TORTS, § 113, at 775 (4th ed. 1971).

58. *See* Marzetti v. Williams, 1 B. & Ad. 415, 109 Eng. Rep. 842 (K.B. 1830); Rolin v. Steward, 14 C.B. 595, 139 Eng. Rep. 245 (1854); Fleming v. Bank of New Zealand, [1900] A.C. 577, 69 L.J. (P.C.) 120, 20 W.R. 97.

59. 5A MICHIE, BANKS AND BANKING ch. 9, § 243(b), at 752 (1983).

an award of general defamatory damages.[60] The words "and without malice" indicate that a protection similar to a qualified privilege could result. But the use of "mistake," instead of "a reasonably grounded good faith belief in the right to return and in the truth of statements made in connection with the returned items" has caused some difficulty. Such decisions as there were under these statutes indicated that the "trader rule" was not to be completely abrogated. The so-called New York rule was also developed at common law during these three stages.[61] The last stage is under the verbal formulation of the Uniform Commercial Code, in which in all but very early drafts the words "and without malice" were omitted.[62] Three possible reasons for the omission exist. One is that if malice is present there is no mistake, as there would be more to the state of mind of the actor than a perception contrary to the facts. The second is that the general obligation of "good faith" found in U.C.C. section 1-203 could not be held to have been observed where malice was present, especially where an objective standard of "good-faith" was then being used in the drafts. The third is that the words were omitted to shorten the statute without a great deal of consideration of the reasons for the omission except a feeling that it would avoid difficult evidentiary problems as to malice and what constituted malice,[63] and thus would be more palatable to banks in the twenty-five states that had not yet adopted an American Bankers Association draft of a statute.

The law in the first stage starts in England, and we must trace its development briefly as the decisions have strongly influenced

---

60. T. PATON, *supra* note 49, § 21B:1, at 1117.

61. The so-called New York Rule was different from the common law trader rule. It depended primarily on the character of the dishonor, willful or negligent, rather than on the character of the depositor, trader or nontrader. A merchant or trader customer had to show willful dishonor to obtain substantial damages; inadvertent damages warranted only nominal relief. Davenport, *Wrongful Dishonor, U.C.C. § 4-402 and the Trader Rule*, 56 N.Y.U. L. REV. 1117, 1126-29. (1981) [hereinafter cited as Davenport]. *See* Wildenberger v. Ridgewood Nat'l Bank, 230 N.Y. 425, 130 N.E. 600 (1921).

62. In an earlier proof of what became the April 15, 1948 proposed final draft No. 1 of Article 3, the words "and without malice" were included. These three words were subsequently omitted from that proposed final draft. *See* ALI-NCCUSL PROPOSED FINAL DRAFT No. 2, ARTICLE III (July 30, 1948).

63. Malice is defined as "the intentional doing of a wrongful act without just cause or excuse, with an intent to inflict an injury or under circumstances that the law will imply an evil intent. . . . A conscious violation of the law which operates to the prejudice of another person." BLACK'S LAW DICTIONARY 862 (rev. 5th ed. 1979). More recent definitions are more objective. *See infra* text accompanying note 109.

American courts. *Marzetti v. Williams*,[64] in 1830, seems to be the starting point. A check was dishonored at or about 3:00 p.m. in the afternoon, but the holder was orally told to put it through the clearing house and it probably would be paid the next day. It was. William Davenport has stated that the case was one involving a mistake.[65] In a very broad sense it was, as the clerk was not aware that a deposit of bank notes had been made in the forenoon. Yet, as tried and decided, the case, we suggest with respect, went to the jury to determine whether the bank had acted properly in not having the deposit posted sooner in the ledger book examined by tellers to determine whether or not funds were available. The jury verdict for the plaintiff indicates a determination, in modern words, that the bank had not followed reasonable commercial standards in posting deposits. Modern bank posting standards provide that a deposit of money, if not taken by a set-off, becomes available for withdrawal as of the opening of the next banking day following the day of receipt.[66] There would, therefore, have been no wrongful dishonor in *Marzetti* had it occurred today.

Marzetti included dicta as to the effect of a wrongful dishonor on a trader and its effect on the trader's credit,[67] with some indication that the smaller the amount of the check, the greater the presumed damage to the trader's credit.[68] The second case, *Rolin v. Steward*,[69] involved a failure to carry out an agreement to discount a note and place the amount thus realized in the account. Again, we suggest, this was not a case of mistake, but of a breach of agreement. The breach was caused by a failure of internal communication between supervisory employees. There was again discussion of the effect on the credit of a merchant, and a conclusion that both breach of contract and the tort of defamation were involved. Though the action was brought in libel, it did not prevent recovery of damages for breach of the customer-banker contract.

---

64. 1 B. & Ad. 415, 109 Eng. Rep. 842 (K.B. 1830).

65. *See* Davenport, *supra* note 61, at 1123-26.

66. See U.C.C. § 4-213(5) making deposits of money subject to withdrawal as of right at the opening of the next banking day after the deposit.

67. Lord Tenterden, C.J., stated:

> I cannot forbear to observe, that it is a discredit to a person, and therefore injurious in fact, to have a draft refused payment for so small a sum, for it shews that the banker had very little confidence in the customer. It is an act particularly calculated to be injurious for a person in trade.

Marzetti, 1 B. & Ad. at 424, 109 Eng. Rep. at 845.

68. The check involved in *Marzetti* was for £87, 7s. *Id.* at 417, 109 Eng. Rep. at 843.

69. 14 C.B. 595, 139 Eng. Rep. 245 (Exch. Ch. 1854).

In both *Marzetti* and *Rolin* there were no special damages alleged or proven. The *Marzetti* action was on a complaint in three counts, one for breach of a custom of trade in London requiring bankers to honor checks where funds on deposit were sufficient and that defendants had contrived "to injure the plaintiff and in his character credit as a trader" by refusing to pay.[70] A second count alleged malice and a third was in trover. The jury awarded one shilling.[71]

The rule *nisi* claimed by the bank was based on a claim that even nominal damages could not be awarded unless there was an express contract. The matter was argued before Lord Tenterdon, Chief Justice, and Justices Parke, Taunton and Patterson. All of the judges were of opinion that it was immaterial whether the declaration was in tort or contract, and it made no difference whether the contract was express or implied by custom. The damage issue was left to the jury. The award of one shilling was undoubtedly influenced by the fact that the rejection was oral, and was accompanied by the statement that, if put through the clearing house, the check would probably be paid the next day, as in fact it was. We suggest that, as early as *Marzetti*, wrongful dishonor produced a dual cause of action which was recognized by the judges.

In the *Rolin* case, a quarter of a century later, Chief Justice Campbell instructed the jury not to limit their verdict but to award the plaintiffs such "temperate damages as they should judge to be a reasonable compensation for the injury they must have sustained."[72] This instruction was given despite the lack of evidence to show that any special damage had been sustained. On this instruction the jury awarded £500 as damages.[73]

In the argument before Chief Justice Jervis and Justices Cresswell and Williams, Lord Campbell's instruction was affirmed. In his opinion, Justice Williams drew the distinction between a trader and a non-

---

70. *Marzetti*, 1 B. & Ad. at 417, 109 Eng. Rep. at 843.

71. The same award, if made in 1983 value dollars, would equal approximately $25. The rough equivalence of a mid-nineteenth century British shilling to 25 1983 U.S. dollars can be established by comparing the two shilling daily wage of an 1851 British farm worker, P. HOWARTH, THE YEAR IS 1851, at 81-84 (1951), *quoted in* Danzig, Hadley v. Baxendale: *A Study in the Industrialization of the Law*, 4 J. LEG. STUD. 249, 251-52 n.8 (1975) [hereinafter cited as Danzig]), with the 1983 $56 average wage for a U.S. factory worker, BUREAU OF THE CENSUS, U.S. DEPARTMENT OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1984 (104th ed. 1983).

72. *Rolin*, 14 C.B. at 599, 139 Eng. Rep. at 247.

73. *Id.*

trader that subsequently became the basis of the so-called "trader rule." He used contractual language, saying:

> [W]hen it is alleged and proved that the plaintiff was a trader, I think it equally clear that the jury in estimating the damages, may take into their consideration the natural and necessary consequences which must result from the defendant's breach of contract just as in an action for slander of a person in the way of his trade, or in the case of an imputation of insolvency on a trader, the action lies without proof of special damage.[74]

Yet all the judges felt that £500 was an excessive damage award and the rule *nisi* as to damages was left open with the suggestion that counsel might agree on a reduced amount. This counsel promptly did, agreeing upon £200.[75]

Considering even that amount in the light of what Professor Danzig found[76] as to current prices in his examination of the economic situation at the time of *Hadley v. Baxendale*,[77] the sum of £200 would today have to be a recovery of between $16,000 and $50,000 in U.S. dollars to give the same purchasing power.[78]

About a quarter of a century after *Rolin*, in *Larios v. Gurety*,[79] an English court allowed general damages for loss of credit, as determined by the jury, and also such special damages as had been properly alleged and proved. This is an early indication that both types of damage may be recovered simultaneously. As we shall show later, the U.C.C.'s limitation of recovery in certain cases has the effect of eliminating the general defamatory damages only, and will permit recovery, even in those certain cases, of contract damages subject to the usual rules as to contract damages.

Again, a half a century after *Rolin*, the Privy Council, in *Fleming v. Bank of New Zealand*,[80] advised a new trial after a verdict of £2,000

---

74. *Id.* at 607, 139 Eng. Rep. at 250.

75. *Id.* at 608, 139 Eng. Rep. at 250.

76. Danzig, *supra* note 71, at 252.

77. 9 Ex. 341, 156 Eng. Rep. 145 (1854).

78. Danzig, *supra* note 71, also points out that the £50 in Hadley v. Baxendale, 9 Ex. 341, 156 Eng. Rep. 145 (1854) (consisting of £25 paid into court and the £25 additional awarded by the jury), would pay the tuition of two boys at a private school. Professor Leary, through telephone calls to schools, learned that tuition at a local boys' day school amounted to $6,500, while boarding school charges were $9,500. The average is $8,000, and for two boys would amount to $16,000. Using the wage rate calculated in *supra* note 71 would give a figure of $50,000, but wages may have inflated to a greater amount than other costs.

79. 5 L.R.-P.C. 346 (1873).

unless plaintiff agreed to £500. The higher figure was said to be "exorbitant considering the plaintiff's checques were honoured by the bank the morning after the afternoon on which they were dishonored."[81] Yet the effect of the dishonor by the bank was shown by evidence of the refusal of some former customers to have continued dealings with the plaintiff.[82] Since no "special damages" had been alleged in the pleadings, the ruling was that it was error to have admitted such testimony.[83] The cause of the dishonor was the failure of the bank to live up to an agreement, found by the jury to have been made by the bank to pay the checks out of a deposit of £1,000 the plaintiff said would be made. A customer of the plaintiff appeared at the bank to make the deposit. He requested the bank to take the deposit in the form of his "store warrant," and to this the bank manager agreed, as the jury found.[84]

Yet the English law, as of the early years of the twentieth century, also was careful to examine the words used by banks as reasons of return to see if they were defamatory. Thus, in *Capital & Counties Bank Ltd. v. Henty*,[85] in 1882, the House of Lords held that a statement by a private banker that he would no longer accept for deposit checks drawn on a particular bank was not libelous. This holding was relied on by the Master of the Rolls in 1906 in *Frost v. London Joint Stock Bank (Ltd.)*,[86] where a depositary bank found a check deposited with it in a box where items returned by payor banks were placed, but no returned item slip was attached to it. In fact, the item had not been presented. The depositary bank attached a return slip but under the printed "Reason Assigned" the clerk wrote "Not Stated." The court ruled that the drawer was not libeled as no evidence was adduced to show that those to whom the publication was made understood it to indicate a want of assets on the part of the drawer.[87] A similar

---

80. 1900 A.C. 577, 69 L.J. (P.C.) 120, 20 W.R. 97.

81. *Id.* at 587, 69 L.J. (P.C.) at ____, 20 W.R. at ____.

82. *Id.*

83. "[T]he learned judge who tried the case was wrong in admitting evidence of the plaintiff's loss of custom and of credit from particular individuals." *Id.*

84. *Id.* at 583-84, 69 L.J. (P.C.) at ____, 20 W.R. at ____.

85. 7 App. Cas. 741, 47 L.T. 662 (1882).

86. 22 T.L.R. 760 (1906).

87. [Plaintiff's] counsel relied on the fact that Messrs. Bartlett's cashier interpreted the slip in an injurious sense, and on the evidence of expert witnesses that the absence of reasons for returning the cheque was equivalent to a statement that the reason was that the plaintiff had no assets. But this came short of what was requisite. There was no evidence that the cashier was a reasonable person; on the contrary, he seemed to have acted unreasonably and precipitately. And the absence of reasons for returning

requirement that the language of the return be defamatory is seen in the several cases on the meaning of the words "refer to drawer" used by English banks.[88]

In 1908, however, the House of Lords ruled, in *MacIntosh v. Dun*, that mercantile agencies which furnished credit information and operated for profit were not entitled, when false credit information was given, to defend on the ground of qualified privilege.[89] This decision and the tendency of the courts to reduce verdicts does, perhaps, indicate that, in the latter part of the nineteenth and very early part of the twentieth century, the English judiciary were not very conscious of either the need to protect the dissemination of credit information or of the damage false credit information could cause. The courts were nevertheless conscious that false credit information could cause some defamatory damage without specific proof thereof. Yet the courts were aware of juries' views as to the damage false statements as to assets could do to one in business. Illustrative of this is not only *Fleming v. Bank of New Zealand*,[90] which preceded *MacIntosh v. Dun*, but also the decision in *Wilson & Another v. United Counties Bank, Ltd.*,[91] which followed *MacIntosh* by a scant twelve years. In *Wilson*, a merchant went to war and arranged with his bank to conduct his business while he was away. He returned only to find that his business had been so badly managed that he was bankrupt. He sued for damages caused by the bank's breach of its contract due to its negligent handling of his business. This time the House of Lords *did* hold that an award in such a suit of £7,500 in damages for loss of credit standing was not excessive. In discussing wrongful dishonor precedent in his speech, Lord Atkinson did say: "It may be that this apparently indisputable presumption that the dishonor of a trader's checks under the circumstances mentioned is necessarily injurious to him as a trader is the special feature which distinguishes this class of cases from others and makes them exceptional."[92] Yet there was no articulation that

---

> the cheque could not rightly give rise to a presumption in favour of one interpretation of the slip more than another.

Id. at 762.

88. *E.g.*, Pyke v. Hernian Bank, 1950 I.R. 195, where the Supreme Court of Ireland was evenly divided on the libelous character of these words, thus affirming by necessity the trial court's ruling that the words were libellous and upholding the trial court's jury verdict for £400 for the plaintiff. *See also* Jayson v. Midland Bank, Ltd., [1968] 1 Lloyd's List L.R. 409 (court of appeal ruled that the term "Refer to the Drawer" meant insufficient funds).

89. *MacIntosh*, 1908 A.C. 390.

90. 1900 A.C. 577, 69 L.J. (P.C.) 120, 20 W.R. 97.

91. 1920 A.C. 102.

92. *Id.* at 134.

it was the use and need of credit that was the reason for this presumption.

Some years later, Justice Lawrence at King's Bench ruled in *Gibbons v. Westminster Bank Ltd.*,[93] that a non-trader was not entitled to the £50 damages awarded by the jury, but only to nominal damages in the absence of pleading and proof of special damages. We point out that consumer credit was not widely found in Great Britain until after World War II, so that a court's pre-World War II failure to recognize that the trader rule was a credit user's rule is understandable.

We have mentioned that the English courts required plaintiffs to show that the words and actions involved in returning a check were defamatory, both by proving funds existed for the payment, and by showing that the words in their normal meaning or by the understanding of the recipients, meant the contrary. Implicit here is recognition of the defense of truth as to defamatory damages.

What of the defense of qualified privilege? There is an indication in the argument of counsel in the *Frost* case that a question of qualified privilege was raised but the opinion of the court does not refer to that issue.[94] In January 1940, Justice Lawrence squarely faced the claim of qualified privilege in *Davidson v. Barclays Bank, Ltd.*[95] The case involved the dishonor of a bookmaker's check for £2, 15s, 8d, giving as a reason that funds on deposit were not sufficient. The case involved a bookkeeper's failure to inquire why the provisional debit of a check subject to a stop order had not been reversed when the "red stop label" was still attached to the ledger sheet. Two "mistakes" were thus involved, one due to the failure of the clerk posting the provisional debit to reverse it, and the second due to the failure of the clerk handling the next check to notice the debit and the continued presence of the red stop label.

Consistently with the ruling in *MacIntosh*, the judge in *Davidson* felt that no common interest between the bank and the payee existed unless the "true" state of the account warranted a communication. He ruled that the bank should not be heard to urge its own mistake as creating the occasion for a qualified privilege, at least where the mistake, in the judge's opinion was "a mistake which one would think that a very indifferently qualified bookkeeper who used reasonable care would not have made, but which nevertheless, . . . was made in this branch of the bank."[96] We shall revert to this type of limitation on

93. [1939] 1 K.B. 882.
94. Frost v. London Joint Stock Bank (Ltd.), 22 T.L.R. 760 (1906).
95. [1940] 2 All E.R. 316.
96. *Id.* at 318.

the nature of the mistake later when we suggest the approach that should be taken in cases of wrongful dishonor.

Thus, while the English cases had not progressed beyond stage one by 1940, the case and statutory law in the United States had.

Initially, the American courts accepted the doctrines of *Marzetti, Rolin*, and *Fleming*. The "trader" rule of granting defamation type damages also achieved a considerable following in pre-Code common law, being extended by some courts to non-traders as well as traders.[97]

However, unlike the courts in the British Commonwealth, American courts were more alert to the need for the dissemination of credit information concerning individuals. Whether this was due to the greater distances between buyer and seller, or to a greater realization of the growing use of credit, we can only speculate. Far from preceding or following *MacIntosh v. Dun*, American courts as early as 1868 applied the doctrine of qualified privilege to actions based on false credit reports.[98] The great Jeremiah Smith wrote on the privilege for mercantile agencies as early as 1914.[99] In 1983 Professor Virginia G. Maurer summarized the state of the law of defamation in the credit reporting context before the enactment of the Fair Credit Reporting Act (FCRA) as follows:

> Prior to the FCRA, the principal legal theory available to the victim of a false credit report was the common law action for defamation. Two major obstacles made recovery on that theory difficult. First because credit reporting agencies

---

97. *E.g.*, Columbia Nat'l Bank v. MacKnight, 29 App. D.C. 580, 587-88 (1907) (physician); Woody v. National Bank, 194 N.C. 549, 554, 140 S.E. 150, 153 (1927) (private individual). *See also* Davenport, *supra* note 61, at 1127 n.62 (noting that more recently the extension of the trader rule to all depositors has been justified on the ground that modern banking practice has rendered unrealistic any distinction between trader and non trader, and that because both traders and non traders have come to increasingly rely on credit, the dishonor of checks of either will ruin their credit or seriously affect their ability to structure their financial affairs).

98. *See, e.g.*, Erber & Strickler v. Dun, 12 F. 526, 533 (E.D. Ark. 1882) (requiring a finding of malice in libelous publication); Ormsby v. Douglass, 37 N.Y. 477, 478 (1868) (applying privileged communication theory to credit reporting); Trussell v. Scarlett, 18 F. 214, 216 (C.D. Md. 1882) (doctrine of privileged communications between merchants); King v. Patterson, 49 N.J.L. 417, 431, 9 A. 705, 712 (1887) (immunity of privileged communications extends to those who have a special interest in the information). *See generally* Comment, *The Time of Discovery Rule and the Qualified Privilege Defense for Credit Reporting Agencies in Illinois After* World of Fashion v. Dun & Bradstreet, Inc., 10 J. MAR. J. PRAC. & PROC. 359, 377-80 (1977) (discussing the historical background of qualified privilege).

99. Smith, *Conditional Privilege for Mercantile Agencies*, 14 COLUM. L. REV. 187 (1914).

> operated in almost complete secrecy, a victim was unlikely to discover the existence of the erroneous information at the root of his credit problems until the statute of limitations precluded relief. Second, beginning in the last quarter of the nineteenth century, all but two American jurisdictions, Georgia and Idaho, adopted the theory of qualified privilege for credit reporting agencies in defamation suits.[100]

Professor Maurer correctly notes that recent cases in a Florida intermediate court,[101] the Illinois Supreme Court,[102] and the Fifth Circuit applying Georgia law,[103] have weakened the total support for the qualified privilege. She also sees further weakening in a parallel willingness by some courts, notably in California,[104] the Seventh Circuit,[105] and New Jersey[106] in recent cases, to seek objective standards for the "malice" that defeats the privilege. Two quotations from these opinions set the stage for our later suggestion that what is needed is a reference to "reasonable commercial standards," a phrase not unknown to students of the U.C.C.[107] In *Dun & Bradstreet, Inc. v. Robinson*,[108] the court said:

---

100. Mauer, *supra* note 32, at 99. For an additional case denying the privilege see Greenmoss Builders, Inc. v. Dun & Bradstreet, Inc., 143 Vt. 66, 461 A.2d 414 (1983).

101. Vinson v. Ford Motor Credit Co., 259 So.2d 768 (Fla. Dist. Ct. App. 1972); Maurer, *supra* note 32, at 101.

102. Tom Olesker's Exciting World of Fashion, Inc. v. Dun & Bradstreet, Inc., 61 Ill. 2d 129, 334 N.E. 2d 160 (1975); Maurer, *supra* note 32, at 103 & n.44.

103. Hood v. Dun & Bradstreet, Inc., 486 F.2d 25 (5th Cir. 1973), *cert. denied*, 415 U.S. 985 (1974); Maurer, *supra* note 32, at 102.

104. Roemer v. Retail Credit Co., 44 Cal. App. 3d 926, 119 Cal. Rptr. 82 (1975); Maurer, *supra* note 32, at 104.

105. Oberman v. Dun & Bradstreet, Inc., 460 F.2d 1381 (7th Cir. 1972); Maurer, *supra* note 32, at 104.

106. Krumholz v. TRW, Inc., 142 N.J. Super. 80, 360 A.2d 413 (1976); Maurer, *supra* note 32, at 104. For a discussion of *Krumholz*, see *infra* text accompanying notes 110-12.

107. U.C.C. § 2-103(1)(b) states: " 'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." "Reasonable commercial standards" are referred to throughout the Code. *See, e.g., id.;* § 3-406 (negligence contributing to the alteration or unauthorized signature of an instrument); § 3-419 (conversion of an instrument and liability of an innocent representative); § 7-404 (exempting a bailee who observes reasonable commercial standards from liability for the acceptance or delivery of goods); § 8-318 (exempting an agent or bailee of securities from liability if he observed reasonable commercial standards); and § 9-318 (allowing modification of an assigned contract to be made as long a reasonable commercial standards were observed).

108. 233 Ark. 168, 345 S.W.2d 34 (1961).

> Malice is defined as the doing of a wrongful act, either in a personal sense, as the doing of an act intentionally that is wrong, or the doing of an act actuated by spite, grudge, hatred, ill will or evil intent, or in the impersonal sense, as the doing of an act without just cause or excuse with such a conscious indifference or reckless disregard as to its results or effects upon the rights or feelings of others as to constitute ill will.[109]

And in *Krumholz v. TRW, Inc.*,[110] a New Jersey Superior Court required a showing of reasonable grounds or probable cause for belief in the truth of the statements. The opinion also stated that an honest belief could not be found "if that belief was unreasonable in the circumstances."[111] The court concluded that its

> opinion should serve as notice to those involved in credit reporting that, in order to be protected by the qualified privilege, their honest good faith belief in the truth of the report must be predicated on reasonable grounds, and in making that determination consideration will be given to whether the information reported has been obtained from reliable sources and the investigation and evaluation of information were reasonable under the circumstances.[112]

In the case of wrongful dishonor, the pre-Code New York law, heavily urged on the 1956 revisors of the Code, may have been searching towards concepts strikingly similar to those of the qualified privilege in defamation as applied recently to credit reporting cases. A memorandum filed by Milbank, Tweed, Hope & Hadley, a Wall Street firm representing banks, stated: "Under the present law of New York (which was still common law based), the bank's liability for wrongful dishonor is limited to actual damages unless the dishonor is a result of a 'conscious wrongdoing, a recklessness or gross carelessness on the part of the bank."[113] Strangely, there was no reference in the memorandum to the 1921 opinion of Chief Justice Cardozo of the New York Court of

---

109. *Id.* at 175, 345 S.W.2d at 38 (quoting lower court's jury charge).

110. 142 N.J. Super. 80, 86, 360 A.2d 413, 416 (1976).

111. *Id.*

112. *Id.* at 88, 360 A.2d at 417.

113. 1 New York Law Revision Commission Report, Hearings on the Uniform Commercial Code, 1954, at 318-19 (reprint ed. 1980); Study of Uniform Commercial Code, Memoranda Presented to the Commission and Stenographic Report of Public Hearings on Articles 3 and 4 of the Code, 130-31.

Appeals in *Wildenberger v. Ridgewood National Bank*,[114] summarizing New York law as follows:

> The wrong, if wilful, charged the bank with liability for the consequences. In many jurisdictions the liability is the same whether the wrong is wilful or merely heedless. In this state the liability is for nominal damages and no more if the dishonor is the result of an innocent mistake. That was the situation in T.B. Clark Co. v. Mt. Morris Bank, where dishonor was due to the blunder of a bookkeeper who misread the plaintiff's balance. Sometimes we are told that to permit recovery of substantial damages the wrong must be malicious. This does not mean, however, that it must be the product of hatred or malevolence. It is the exclusion of liability for the consequences of mistake.[115]

The decision was that an award of only nominal damages was not sustainable on the facts of the case as the dishonor was not by mistake, and since the plaintiff was a trader, i.e. a person needing a good credit reputation, the opinion states, "Some injury to credit may, therefore, be inferred." Thus, the pre-Code New York law applied the defamation damages rule to "traders" in the absence of mistake. Where special damages were also alleged and proven, in the absence of mistake dual recovery was allowed. In the *Davis* case in 1900,[116] the court allowed damages for emotional distress caused by wrongful dishonor. Also, as in the English cases, it made no difference whether the complaint sounded in tort or in contract.

Stage three in America saw the advent of special interest legislation drafted by Thomas Paton, the learned counsel for the American Bankers Association in the light of several statutes theretofore adopted.[117]

---

114. 230 N.Y. 425, 130 N.E. 600 (1921).

115. *Id.* at 427, 130 N.E. at 600 (citations omitted).

116. Davis v. Standard Nat'l Bank, 50 A.D. 210, 63 N.Y.S. 764 (1900).

117. Mr. Paton's proposed legislation was as follows:

Be it enacted, etc.—

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.

T. PATON, *supra* note 49, § 21B:1, at 1117.

This statute was approved and recommended to the state Associations by the American Bankers Association in October 1914 as desirable for enactment in their respective states. Mr. Paton wrote that the statute was

The statutes all provided, in effect, that where a dishonor occurred "through mistake or error and without malice," the customer must allege and prove actual damages. It is unfortunate that the draftsman did not stay with the law of defamation and refer to "special damages" as distinguished from the "temperate" general damages awardable in the usual case of a per se defamation. However, such language would have spoiled the pejorative effect of the explanatory statement accompanying the draft.[118] The explanation starts by characterizing the trader rule as an "unjust rule" where the "fact is often contrary" to the presumption of damage. Then "probably in the majority of the cases" no damage is suffered, and the result is that the bank "is often mulcted in damages" disproportionate to what is now called "the imaginary injury inflicted," and this "not infrequently" by a customer habitually having overdrafts but now fortuitously having "a small balance to his credit." There is no supporting statistical analysis of the cases.

Mr. Paton concluded his Opinion on the effect of the statute with:

> It should be noted, however, that the statutes have no application where the wrongful non-payment was the result of a wilful or malicious act of the bank and not merely due to an inadvertent error. If it is shown that the bank wilfully intended to dishonor the check, the well established rules on liability discussed" [in other Opinions] are applicable.[119]

In the July 30, 1948 draft[120] of what later became U.C.C. section 4-402, the language read: "Section 510. *Liability of Drawee for Dishonor.*

> designed to correct the unjust rule established by the courts in many states to the effect that a bank, which refuses to pay the check of a customer who is a merchant or trader and who has sufficient funds on deposit, is liable to such drawer in an action for substantial damages, without proof of actual damage or any malice on the part of the bank. . . .[I]n the majority of instances where a customer's check is refused payment through error, the mistake is promptly corrected, an explanatory letter is written by the banker and no actual damage results to the customer. The application of the rule, therefore, works an injustice to the bank which is often mulcted in damages out of all proportion to the imaginary injury inflicted, not infrequently at the suit of a customer who has been in the habit of making overdrafts, but who in the particular instance has a small balance to his credit.

Id.

118. *Id.*

119. *Id.* (citations omitted).

120. The draft was submitted to the National Conference of Commissioners on Uniform State Laws at their annual meeting on Aug. 30-Sept. 4, 1948. Wrongful

Where a drawee wrongfully dishonors a bill through mistake or inadvertence the drawer's recovery for defamation or loss of credit is limited to actual damages proved, including any arrest or prosecution of the drawer." For some period of time in the drafting, the concept of "good faith" included an objective test of observance of the reasonable commercial standards of fair dealing of the actor's trade or business.[121] It is tempting to think that when the good faith concept was changed to the purely subjective "honesty in fact,"[122] the revisors inadvertently failed to consider the effect of the removal of the objective test of good faith on the wrongful dishonor rules. There is no evidence available to the authors one way or another as to this.

We suggest, however, that it is appropriate, now that revisions of articles 3 and 4 of the Code are under consideration, to consider whether the concept of "mistake" is really the correct and proper approach for a credit oriented society, or whether language more closely allied to the doctrine of a qualified privilege is not more appropriate.

Unlike qualified privilege, however, which defeats all liability, the privilege should only defeat liability for defamation. Since wrongful dishonor is also a breach of the contract between bank and customer, properly alleged and proven contractual damages should be recoverable.

Mr. Davenport, in his article,[123] would eliminate all defamatory damages and resort to the law of punitive damages as the penalty for egregious conduct on the part of the bank. With respect, we suggest that he unduly emphasizes an early draft when Comment No. 3's last sentence read, "[T]he merchant or trader is placed upon the same footing as any other drawer, and in all cases the damages recoverable are limited to those actually proved."[124]

As a result of the 1956 Revisions, however, this comment was changed to read "and in all cases of dishonor *by mistake* damages

---

dishonor was covered as a part of what was then called "Commercial Code—Proposed Final Draft No. 2—Article III." ALI—NCCUSL PROPOSED FINAL DRAFT No. 2, ARTICLE III (July 30, 1948).

121. Section 1-102(16) of the May, 1949 draft, reads: " 'Good Faith' means honesty in fact in the conduct or transactions concerned. Good faith includes good faith toward all prior parties and observance by a person of the reasonable commercial standards of any business or trade in which he is engaged." ALI-NCCUSL PROPOSED FINAL DRAFT No. 2, at 19 (May 1949).

122. The change was made in the Proposed Final Draft Number Two, Spring 1951. In that draft, Section 1-201(19) read: " 'Good faith' means honesty in fact in the conduct or transaction concerned." ALI-NCCUSL PROPOSED FINAL DRAFT No. 2, at 11 (Spring 1951).

123. Davenport, *supra* note 61, at 1139-40.

124. ALI-NCCUSL PROPOSED FINAL DRAFT No. 2, ARTICLE III, § 3-417 Comment 3, at 362 (1949).

recoverable are limited to those actually proved."[125] The placing of trader and non-trader "on the same footing," however, can also be interpreted as meaning that anyone with a need for credit could also recover for special damages to credit if, in cases of mistake, such damages could be proved, and on a *per se* basis where dishonor was not by mistake. In 1956 when the final language of text and comment were fixed, the explosion in consumer credit was well under way. Consumer credit exploded from $5.7 billion in 1945 to $38.8 billion by 1955,[126] a situation undoubtedly known to the 1956 revisors and the bodies subsequently approving the Official Comments.

Since the Code carefully avoids fixing a theory under U.C.C. section 4-402 for the action of wrongful dishonor, the strongest position that can be taken, in view of the pre-Code split on the position of a non-trader but a credit user, is that courts are free to develop the law in relation to modern commercial practices. We, therefore, disagree with Mr. Davenport and join with Professors White and Summers in their sympathy for their run of the mill consumer, Mr. Templeton Zigafuse.[127] But we fail to see why, if his credit rating falls off as a result of the non-mistaken wrongful dishonor of his checks, he is not entitled to compensatory solace in such temperate amount as a jury of his peers may fix and the judicial system permits to stand as not excessive.

The doctrine of mistake may not be the most appropriate means of encouraging the flow of information and, at the same time, protecting credit users from loss of credit standing due to erroneous credit information given a credit grantor. It is clear that the mistake need not be mutual.[128] There is no need for the drawer of the dishonored

---

125. After the 1956 revisions were submitted and approved, Professor Robert Braucher of Harvard Law School rewrote the comments to be consistent with the revisions. The revised comment appeared in the 1958 and in all subsequent official texts.

126. *See* BUREAU OF THE CENSUS, U.S. DEPARTMENT OF COMMERCE, HISTORICAL STATISTICS OF U.S. COLONIAL TIMES TO 1970, at 973 (pt. 2) (1975). *See also supra* notes 2-4 and accompanying text.

127. Professors White and Summers state that "Templeton Zigafuse," the run of the mill consumer, is entitled to recover, if he is arrested for wrongful dishonor, any additional loss he suffers because his credit rating falls off, and for mental distress in those states that permit it. They add, however, that:

> [W]e suspect that Templeton Zigafuse will have difficulty showing any damages at all in the usual case, and that courts will not sympathetically receive his arguments that he suffered compensible loss because he had to look at black and white TV rather than the color TV he might have bought with his untarnished credit rating.

J. WHITE & R. SUMMERS, HORNBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 676-77 (2d ed. 1980) [hereinafter cited as WHITE & SUMMERS].

128. The mistake must be that of the bank, as a mistake by the customer as to the state of the balance could result in a rightful dishonor. The *Restatement* defines

item to have a state of mind that is contrary to the facts. As to the available balance in the account, the drawer's state of mind should be in accord with the correct facts. Has the rule in some contract cases, that relief is not obtainable where a negligent unilateral mistake has been made, been carried over into wrongful dishonor? It would seem not, as the misreading of the account balance has been held to qualify as a mistake in the United States.[129] The concept of an improper set-off as creating a non-mistaken dishonor because the set-off was a wilful act[130] indicates that some courts may be influenced by the doctrine that mistake of law does not furnish ground for relief. But should it be the rule that all negligent mistakes, or mistakes of law should constitute wilful dishonors? Some negligence, perhaps, is present in every mistake.

In view of the result desired, namely, that the "general" or "temperate" damages to credit standing should be eliminated, but recovery should be allowed for "actual" damages, including, in breach of contract language, consequential damages as well, would not the desired result be more soundly achieved by a different approach?

One such approach could be a limited concept of qualified privilege. The rule could be, in the case of wrongful dishonor, that where the conduct of the bank is within the scope of the privilege, there can be no recovery of "general" defamatory damages. In such cases the action should be one for tortious breach of contract. What would be meant by this theory? Half a century ago Professor George K. Gardner attempted to classify breaches of contract so that differences in the conduct of the breaching party could lead to differences in the

---

mistake as "a belief that is not in accord with the facts," RESTATEMENT (SECOND) OF CONTRACTS § 151 (1979), which is not very helpful where the issue should be the reasonableness of the grounds for the belief, as in the qualified privilege under the law of defamation.

129. *See, e.g.*, T.B. Clark Co. v. Mount Morris Bank, 85 A.D. 362, 63 N.Y. Supp. 764 (1st Dept. 1903). Justice Cardozo reaffirmed this principle in Wildenberger v. Ridgewood Nat'l Bank, 230 N.Y. 425, 130 N.E. 600 (1921).

130. In Wildenberger v. Ridgewood Nat'l Bank, 230 N.Y. 425, 130 N.E. 600 (1921), the bank first dishonored its customer's checks when his wife filed an adverse claim to the account. After notice of the first wrongful dishonor, the bank dishonored the checks a second time. Justice Cardozo ruled for the court that this was a willful dishonor by the bank because it dishonored them with full knowledge of the state of the account after weighing the risks of the adverse claims against the risk of wrongful dishonor. *Id.* at 427-28, 130 N.E. at 600. Professors White and Summers would adopt Justice Cardozo's test and find the bank guilty of willful dishonor any time it dishonored its customer's checks because it had previously reduced his account through its own improper setoff, garnishment, or the like even where the bank acted in a good faith but mistaken belief that garnishment or setoff was valid. WHITE & SUMMERS, *supra* note 127, at 673.

available modes of recovery.[131] We believe that wrongful dishonor of payment orders is a situation where breaches of the duty to pay should result in different measures of recovery depending on the conduct of the breaching party.[132] We suggest that three levels of conduct by the breaching party should be considered. The most common could be called the "breach with privilege," the second the "breach without privilege" and the third, perhaps, the "breach without privilege accompanied by egregious conduct." Breaches of the implied deposit contract would, at each level, be classed as "tortious" or "non-tortious" depending on whether the words accompanying the return of the item, or the surrounding circumstances, constitute defamation or are non-defamatory.

Given a tortious breach with privilege, what results should follow? We suggest that such a breach should be treated as would a straight breach of contract case. The plaintiff, as in any breach of contract case, should prove damages subject to general contract damages rules, including a foreseeability test for consequential damages. The general contract damage rules eliminating punitive damages and damages for emotional distress, if still not recoverable in contract actions, should apply.[133] But, as in *Skov v. Chase Manhattan Bank*,[134] recovery should be had for proven loss of customers and loss of profits.[135] The deposit

---

131. Professor Gardner proposed a moral approach to the law of contract breaches. *See* Gardner, *An Inquiry Into the Principles of the Law of Contracts*, 46 HARV. L. REV. 1, 1932. In this scheme, the quality of breaches would be classified into four categories:

(1) promise "*not fulfilled* whenever performance fails to follow an attempted exercise of the predicted power";

(2) promise "*dishonored* whenever performance fails to follow an attempted exercise of the asserted power";

(3) promise "*violated* whenever an attempted exercise of the asserted power fails to produce even so much performance as is then within the promisor's actual control"; and

(4) promise "*appropriated* whenever the promisor exercises for his own benefit the same or substantially the same power which the promise attributes to the promisee." *Id.* at 13-15. See also Professor Gardner's discussion of the Trust principle. *Id.* at 35-36.

132. Starting with the lowest recovery these would be (1) special but foreseeable damages, (2) general defamatory damages and such special damages as are proved, and (3) the same as (2) plus punitive damages.

133. Under the *Restatement* view, "Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result." RESTATEMENT (SECOND) OF CONTRACTS § 353 (1979).

134. 407 F.2d 1318 (3d Cir. 1969).

135. In the case the court awarded the annual profits on the lost "hotel business" for three years.

contract has been breached, and, as in the cases of defamation where the privilege exists, all defamatory damages are eliminated.

In the case of the tortious breach without privilege, the recovery for all persons would include general defamatory damages to credit, and all other damages such as emotional distress, loss of time at work, loss of customers and loss of profits. No punitive damages, however, would be allowed. The recoverable damages would be subject to the "tort" rules limiting damages and not to the contract foreseeability tests of the jurisdiction.[136] Where the breach was both non-tortious and non-privileged the "pure" contract rules should apply.

Where the breach is tortious, without privilege, and accompanied by egregious conduct, the rules just suggested should apply with the added element that punitive damages, in appropriate cases, as under present law, would be recoverable.

In our second and third types of breach, the damage difficulty is the same as that encountered by senior Circuit Judge Aldrich in *Morse v. Mutual Savings & Loan Association*.[137] The difficulty lies in separating general defamatory damages from damages for emotional distress, and where special damages to credit are alleged and proven, in determining the extent to which general damages otherwise awardable should be reduced. The difficulty can be reduced by directing the jury to award a series of separate verdicts on the various elements, with each verdict subject to the control of the court through remittitur.

What conduct would render a breach non-privileged? Several loss allocations under the Uniform Commercial Code require the party seeking to avoid bearing the loss to have acted in good faith and in accordance with the reasonable commercial standards of the party's trade or business.[138] A similar rule should also apply to wrongful dishonor, requiring a good faith belief in the accuracy of the statements made in connection with the return. The rule should also require the observance of reasonable commercial standards, such as reasonably reliable procedures used to determine the customer's balance account when the determination is made to return the check or other item.[139]

---

136. Where the breach is both tortious and non-privileged, the plaintiff will be able to recover damages subject only to the general proximate cause limitation applicable to tort claims. Where the breach is both non-tortious and non-privileged, contract rules will also impose their more stringent constraints on recovery of damages through the requirement that the plaintiff demonstrate that the damages were foreseeable.

137. 536 F. Supp. 1271, 34 U.C.C. Rep. Serv. (Callaghan) 230 (D.C. Mass 1983).

138. *See supra* note 107.

139. One recent example of a situation where reasonable procedures were not

This formulation parallels the objective rule as to qualified privilege in the recent cases of erroneous credit reports previously discussed.[140] The two prongs for the rule are necessary to avoid an application of the good faith belief test solely to the individuals ordering the return,[141] when there has been an improper debit to the account made by others, whose belief and standards for ensuring accuracy are the real issue.

Finally, we discuss two effects of the revised formulation we suggest. One is what would have been the effect on the case law under the Code had it been the law. The second is what effect would the rule have on bank conduct in cases that do not reach the litigation stage.

As to the reported cases heretofore decided, we are of the opinion that in many instances there would be no significant change, except that it would be clear that the *raison d'être* of the "trader rule" of pre-Code law was, in reality, a "credit users" rule. The Code would protect the interest of all credit users instead of just the mercantile class. Its rules would be in accord with the policy of protecting credit reputations of consumers evidenced by the Fair Credit Reporting Act.[142]

Indeed, *Marzetti v. Williams*,[143] in 1830 was, in fact, a decision in accordance with our suggestion. The judge's instruction to the jury left to that body the determination of whether the delay in posting the deposit of bank notes was reasonable. The verdict of 1 shilling reflected a determination that it was not. The usual award of nominal damages in England was one farthing, or roughly 2% of a shilling. Looked at in terms of purchasing power in today's world, the *Marzetti* verdict was about $25.[144] The *Rolin* case[145] was one of a clear failure

---

followed by the bank is found in Yacht Club Sales & Serv. v. First Nat'l Bank of N. Idaho, 101 Idaho 852, 623 P. 2d 464, 31 U.C.C. Rep. Serv. 1677 (1980). In that case the bank was served with legal process directed against a corporation named "Yacht Club, Inc." Because the bank neither consulted its attorney nor communicated with its client before placing a "hold" on the account of Yacht Club Sales & Service, Inc., the court sustained the lower court's ruling that the dishonor occasioned by the "hold" was not to be taken as a dishonor by mistake. *See infra* text accompanying note 160. In fact, as early as Marzetti v. Williams, 1 B. & Ad. 415, 109 Eng. Rep. 842 (1830), liability has been imposed because the bank failed to establish what the trier of fact found to be adequate procedures.

140. *See supra* notes 101-06.

141. This might happen through an erroneous application of the U.C.C.'s rule of notice to an organization (U.C.C. § 1-201(27)) which concentrates on "the individual conducting the transaction." But here "the transaction" to be considered is to the return of the check but the prior actions that reduced the balance. The issue is thus, was the prior action "in good faith and in accordance with proper banking standards."

142. 15 U.S.C. § 1681. See *supra* text accompanying notes 12 and 13 for a discussion of the Fair Credit Reporting Act.

143. 1 B. & Ad. 415, 109 Eng. Rep. 842 (1830).

144. *See supra* note 71.

145. 14 C.B. 595, 139 Eng. Rep. 245 (Ex. 1854).

to take steps to ensure the accuracy of the balance even after notice of the failure was timely given by the depositor. Several items were dishonored. The verdict of £200, as reduced, expressed in terms of today's purchasing power, was for between $16,000 and $50,000.[146] *Fleming*, a 1900 case, after remittitur allowed £500 in general damages, and *Wilson*, in 1920, allowed £7,500 for a destruction of a business.[147] In both of these cases, there were other factors. In *Fleming*, there was proof of actual refusals to deal not properly pleaded. The business in *Wilson* was substantial and in addition, there was the stigma of bankruptcy. Then, in 1940 in *Davidson*, the judge awarded £250 in general damages, or about $3,000 in present day purchasing power due to inflation.[148]

The case of *Raymer v. Bay State National Bank*,[149] it has been urged,[150] impliedly stands for the proposition that the defamatory rule has been completely abolished. The case was before the Massachusetts Supreme Judicial Court on appeal from a non-jury decision by Judge Mitchell below. The appellate court was acting under the clearly erroneous rule.[151] The trial judge had ruled that the bank had returned as dishonored checks that, under the completion of the process of posting rule as he found it, had been paid.[152] He awarded as damages the face amount of the dishonored checks. This, on appeal, the plaintiff argued, could be justified since the corporation had, due to the bank's set-off, lost the use of the funds which would have paid the dishonored checks. Plaintiff's second point was that the return of the checks to the trade creditors had caused the bankruptcy and loss of projected profits. The trial court rejected such a damage claim as "the Plain-

---

146. *See supra* notes 71, 78.

147. *See* Fleming v. Bank of New Zealand, 1900 A.C. 577, 69 L.J. (P.C.) 120, 20 W.R. 97; and Wilson & Another v. United Counties Bank, Ltd., 1920 A.C. 102.

148. *See* Davidson v. Barclays Bank, Ltd. [1940] 2 All E.R. 316.

149. 384 Mass. 310, 424 N.E. 2d 515, 31 U.C.C. Rep. Serv. (Callaghan) 1537 (1981).

150. *See* Davenport, *supra* note 62, at 1144. Mr. Davenport reads *Raymer* as supporting his construction that U.C.C. § 4-402 rejects the trader rule "in *all* actions for wrongful dishonor, whether the dishonor is negligent or intentional." *Id.* at 1137. The customer must always allege and prove actual damages; punitive damages may be awarded where malice accompanied the dishonor. *Id.* at 1138.

151. *Raymer*, 384 Mass. at 316, 424 N.E. 2d at 519. Under the clearly erroneous standard, a reviewing court will not set aside a lower court's findings absent a showing that they are clearly erroneous.

152. *Id.* "The judge ruled that the set-off came too late . . . because . . . the bank had 'completed the process of posting' the items to the indicated account . . . and had evidenced by examination of such indicated account and by action its decision to pay the item."' *Id.*

tiff's evidence and offer of proof did not show the requisite causal connection necessary under § 4-402."[153] The judge concluded his ruling, stating, "since Plaintiff has already been awarded damages under Count 1 for amounts wrongfully withheld and has shown no additional actual damages which this court considers recoverable as a result of Defendant Bank's conduct, his recovery is limited accordingly."[154]

Justice Braucher wrote the opinion for the Supreme Judicial Court reversing the lower court and ordering a judgment for nominal damages, stating merely that the trader rule "was said to be abolished, and in cases of mistaken dishonor liability was limited to actual damages proved. . . ."[155] He did not say by whom it was said, but cited Professor Holland's article.[156] He then continued, saying that this dishonor was not by mistake, and "we think it proper, in accordance with the Wiley case" (a trader rule case), "to order entry of judgment for nominal damages."[157]

Why was a judgment for nominal damages proper? Plaintiff had urged damages under two heads. The trial court found no proximate cause for damages for causing the bankruptcy. The bank had a good set-off except as it may have lulled plaintiff into believing it would not be exercised. The appellate court ruled that no quantifiable damage ensued because the bank had merely reduced its own debt instead of the debt due trade creditors, thus the plaintiff's net equity (loss) position was not changed. A reading of all briefs filed shows no urging of the court to grant general defamatory damages apart from the two heads discussed.[158] Hence, we conclude that the *Raymer* case does not constitute a holding that the U.C.C. has abolished the right to recover general defamatory damages in all cases, but only in those cases where

---

153. Trial Judge's Memorandum in Record on Appeal; Mass. Superior Court, No. 8896 (Jan. 18, 1980) (opinion of Mitchell, J.).

154. *Id.*

155. *Raymer*, 384 Mass. at 318, 424 N.E.2d at 520.

156. *Id.* (citing Holland, *An Analysis of the Legal Problems Resulting From Wrongful Dishonors*, 42 Mo. L. REV. 507, 517-26 (1977) [hereinafter cited as Holland]). Professor Holland notes that while the drafters of section 4-402 "sought to eliminate the presumption of substantial damages, they also failed to distinguish between proof of injury and proof of amount of damages." *Id.* at 524. Surveying the confusion arising from this omission, he concludes that the provision should be interpreted to preclude a presumption of injury to credit. *Id.* at 524-26.

157. *Raymer*, 384 Mass. at 318, 424 N.E.2d at 520.

158. The senior author has had access to the briefs of counsel and parts of the record on appeal in *Raymer* and the brief of Boston Clearing House Association as *amicus curiae*.

a plaintiff, suing as an assignee of the wrongful dishonor claim of a corporation which was bankrupt at the time of the dishonor, does not seek general defamatory damages. *Raymer* could also stand for the proposition that where a corporation is in fact insolvent, saying so by returning a check is not defamatory, or if it is, the defense of truth is a complete defense to the defamatory aspects, and in *Raymer* no other compensatory damages were shown.

American Fletcher National Bank & Trust Co. v. Flick[159] also involved no proof of causation by the wrongful dishonor. True, the business did decline, but there was affirmative evidence indicating that reasons other than the wrongful dishonor caused the downfall of the business. Hence, only nominal damages were awarded.

An Idaho case, *Yacht Club Sales & Service v. First National Bank of North Idaho*,[160] did contain a flat statement that the U.C.C. had abolished the trader rule. It reversed awards of $20,000 in general damages and $30,000 in punitive damages. The Idaho court agreed with the lower court that returning the checks of the subsidiary where the garnishment order referred only to the parent was not a case of mistaken dishonor. The trial court had referred to the fact that in "holding" the account, the bank had not taken what it felt were the customary steps of consulting counsel, consulting its customer, or requiring that the procedures of the adverse claim to bank deposit statute be followed. Under our theory of qualified privilege, this would render the breach non-privileged. The court then ruled that a plaintiff was required to prove that the wrongful dishonor was of some harm to plaintiff but need not prove the dollar value of the damages with any specific testimony. It is not clear just how this was to be done. The court may have been unconsciously applying Professor Holland's theory[161] of a dual conclusive presumption in a credit users case; one that the wrongful dishonor caused damages and the other that such damages were substantial. A third suggestion is that the court felt that the first sentence of U.C.C. section 4-402 limited damages to those "proximately caused" and that this had the effect of requiring some

---

159. 146 Ind. App. 122, 252 N.E.2d 839, 7 U.C.C. Rep. Serv. (Callaghan) 224 (1969).

160. 101 Idaho 852, 623 P.2d 464, 31 U.C.C. Rep. Serv. (Callaghan) 1677 (1980).

161. "[O]nce an injury has been established, [section 4-402] should not be strictly interpreted as to the degree of proof necessary to establish the amount of damages." Holland, *supra* note 156, at 526.

evidence that the effect of the dishonor was defamatory before general damages could be recovered.

Elizarraras v. Bank of El Paso[162] was a Fifth Circuit case which started with the proposition that U.C.C. section 4-402 does not demolish the right to recover defamatory damages in the case of a non-privileged (non-mistaken) dishonor. A payment of a check as to which plaintiff felt he had properly stopped payment caused the dishonor of a $64,000 check which the bank had "assured" plaintiff would be paid if an additional $746.68 was deposited. Despite the deposit and the stop order, the bank paid the $12,000 check. Not without significance was the fact that the payee of the $12,000 check had indorsed it to the bank in payment of the payee's debt to the bank. The jury awarded $75,000. The bank's defenses of set-off, of an interpleader and deposit of the balance in court without notice to the customer and that the stop order of the check was not timely were all ruled against the bank. The claim that the stop order came too late was raised for the first time on appeal, the set-off was not ripe when claimed and the interpleader was made without notice to the customer.

The jury had awarded $75,000 in damages, but the circuit court remanded on the ground that some evidence of harm to credit and reputation must be shown before general defamatory damages could apply.[163]

Under our analysis, both *Yacht Club* and *Elizarraras* would reach the same result; a tortious dishonor without privilege. However, the items' return must be shown to have had a defamatory meaning to the recipient creditor in order to permit recovery of general defamatory damages.

Farmers & Merchants State Bank of Krum v. Ferguson[164] involved a wrongful dishonor caused by a "hold" placed on an account due to a wrongful conception of what constituted a default under the customer's loan agreement. No notice of the freeze was given the customer so that deposits would continue to be made. To further maintain the customer's ignorance of the freeze on the account, the bank paid certain checks whose payees would find out quickly and notify the customer, but dishonored others. We would classify this breach as a tortious breach without privilege. The *Morse, Elizarraras*, and *Ferguson* cases all illustrate

---

162. 631 F.2d 366, 30 U.C.C. Rep. Serv. (Callaghan) 627 (5th Cir. 1980).
163. *Id.* at 377, 30 U.C.C. Rep. Serv. (Callaghan) at 642.
164. 617 S.W.2d 918, 31 U.C.C. Rep. Serv. (Callaghan) 198 (Tex. 1981).

another type of conduct that must be taken as unprivileged, namely improper action by the bank to feather its own nest at the expense of the customer.

The Texas intermediate court in *Ferguson* felt that the bank's conduct deserved something extra. It applied the Texas Deceptive Trade Practices Act and trebled the damages, adding insult to injury by also awarding attorneys' fees to the plaintiff, for a total award of $110,000.[165] Two-thirds of the untrebled award were for damages for emotional distress.

The Texas Supreme Court ruled that the Deceptive Trade Practices Act did not apply to an account not used exclusively for business purposes, but the untrebled verdict stood. The Texas legislature promptly amended the statute to apply to non-consumer situations. In *Raymer*, incidentally, the Massachusetts court also applied its Deceptive Trade Practices Act to award attorneys' fees, but that act did not provide for treble damages.[166]

We agree with Professors White and Summers[167] that *Bank of Louisville Royal v. Sims*[168] was wrongly decided when damages for mental distress and lost work time were denied. Our reasoning, however, differs somewhat. If the case were that of a non-tortious dishonor with privilege, it could be considered decided under a blanket concept of the privilege, rather than the reasonable banking standards approach that we urge. It would then be a holding that the U.C.C. had not changed Kentucky's pre-Code rules of recoverable contract damages. Under our suggested analysis, the inquiry in *Bank of Louisville Royal* would be whether the bank had followed the procedures customary in the industry to avoid mistakes so that its belief in the insufficiency of funds rested on a reasonable foundation and did not involve the

---

165. Farmers & Merchants State Bank of Krum v. Ferguson, 605 S.W.2d 320, 327, 30 U.C.C. Rep. Serv. (Callaghan) 300, 307 (Tex. Civ. App. 1980).

166. *Raymer*, 384 Mass. at 319-20, 424 N.E. 2d at 521. Neither the Massachusetts nor Texas deceptive trade practices acts are modeled after the Uniform Deceptive Trade Practices Act. The Uniform Act lists eleven general deceptive trade practices and provides a catchall category for other conduct which creates a "likelihood of confusion." UNIFORM DECEPTIVE TRADE PRACTICES ACT § 2, 7A U.L.A. 72 (1966). The Massachusetts legislature did not specify any deceptive practices, preferring instead to authorize the attorney general to make rules and regulations interpreting the act. MASS. GEN. LAWS ANN. ch. 93A, § 2 (West 1970). By contrast, the Texas act lists twenty three separate deceptive practices and limits relief to conduct enumerated in the act. TEXAS BUS. & COM. CODE ANN. § 17.46 (Vernon Supp. 1985).

167. WHITE & SUMMERS, *supra* note 127, at 675.

168. 435 S.W.2d 57, 7 U.C.C. Rep. Serv. (Callaghan) 234 (Ky. 1968).

bank in acting for its own benefit at the customer's expense.[169]

As indicated by Professor Holland,[170] it is difficult to show general harm to credit. We suggest that the recent cases just discussed are seeking a rule requiring that a plaintiff demonstrate the potential for harm from the return in the plaintiff's particular situation. As in the *McFall* case[171] (a pre-Code Arkansas case), this could be done by showing that plaintiff, whether a trader or not, frequently used credit and had a continuing need for a good credit standing.

What effect would the rule we advocate have on bank conduct? To the extent that a rule of law channels conduct by those subject to it, our suggestion would add an incentive to use reasonable procedures to assure the accuracy of statements made on returned items. The qualified privilege concept could avoid the creation of hard lines between intentional acts and returns due to mistake by requiring consideration of the bank's motives and processing standards applied in performing the so-called intentional act that reduced the balance. Usual bank actions to minimize damage[172] would be somewhat encouraged as indicating the good faith necessary to preserve the privilege. Analyzing in terms of privilege would emphasize defamation, defenses such as showing credit was not damaged, i.e., the prior credit reputation was poor[173] and prompt payment on representment as indicating a bank's error so that the dishonor did not indicate "want of assets."[174]

Non-cooperation by the customer in straightening out the account could reduce damages[175] as would wilful issuance of additional items to increase damage recovery when the customer knows of the

---

169. Acting for the bank's own benefit (*see* Farmers & Merchants State Bank of Krum v. Ferguson, 605 S.W.2d 320, 30 U.C.C. Rep. Serv. (Callaghan) 300 (1980), where the bank made selective dishonor of checks, paying local and dishonoring those deposited at a distance) definitely negates any "mistake."

170. Holland, *supra* note 156, at 526.

171. McFall v. First Nat'l Bank, 138 Ark. 370, 211 S.W. 919 (1919), *after retrial* 144 Ark. 149, 222 S.W. 40 (1920).

172. Writing a letter of apology for a mistake to the payee, prompt payment on representment, and payment of "bad check" fees charged to payee are some affirmative steps to mitigate damages. *See, e.g.*, Spearing v. Whitney Cent. Nat'l Bank, 129 La. 607, 56 So. 548 (1911); Weaver v. Grenada Bank, 180 Miss. 876, 179 So. 564 (1938); Crites v. Security State Bank, 52 Mont. 121, 155 P. 970 (1916).

173. *See, e.g.*, Donmoyer v. Columbus Bank & Trust Co., 151 Ga. App. 38, 258 S.E.2d 725 (1979); Berea Bank & Trust Co. v. Mokwa, 194 Ky. 556, 239 S.W. 1044 (1922) (dictum).

174. *Cf.* Marzetti v. Williams, 1 B. & Ad. 415, 109 Eng. Rep. 842 (K.B. 1830).

175. *See* Berea Bank & Trust Co. v. Mokwa, 194 Ky. 556, 239 S.W. 1044 (1922).

dishonor.[176] This is because such damages would be caused by conduct of the customer. But this rule, as in *Rolin v. Steward*,[177] should not defeat recovery for items dishonored after the customer has notified the institution of the true facts, if the institution continues to dishonor.

IV. CONCLUSION

The courts appear to be groping for a formulation of the rules governing wrongful dishonor that will be clearer and address more problems than does the present U.C.C. section 4-402. While this Article does not address all of the problem aspects,[178] the one discussed, the defamatory aspects of wrongful dishonor, suffers from a lack of a clear statement of the underlying theories. It was perhaps unwise to state in Comment 2, "This section does not attempt to specify a theory" without more.[179] It should have been indicated that any or all of the theories enumerated above were usable by the courts if needed to obtain just results in particular cases. A clearer formulation would recognize the dual nature of the cause of action and the necessity to distinguish between tortious and non-tortious breaches of the obligation to pay, as well as three tiers of conduct rendering breaches privileged, without privilege, and without privilege accompanied by egregious conduct. The essentially defamatory element in all wrongful dishonor cases is emphasized in the Comment to the definition of value, U.C.C. section 1-201(44): "Checking credit is 'immediately available' within the meaning of this section if the bank would be subject to *an action for slander of credit* in case checks drawn against the credit were dishonored. . . ."[180]

The draftsmen of the proposed New Payments Code in section 101(2), (3), and (4) of P.E.B. Draft No. 3 propose some revisions

---

176. *Id.*

177. 14 C.B. 595, 139 Eng. Rep. 245 (Exch. Ch. 1854).

178. The limitation of recovery to a "customer" where the criminal laws provide for the arrest of the individual signing checks for an organization is one problem. The late lamented New Payments Code would exacerbate the problem by referring to liability for the customer "but not to other parties." UNIFORM NEW PAYMENTS CODE, P.E.B. DRAFT No. 3, § 301. Another is whether there should be guidelines for assessing punitive damages. Consideration might also be given to a short statute of limitations, even where the action sounds only in contract. Finally, the Code might take a position on the extent of defamatory damages allowable in non-privileged breaches. There is some case law on all of these points.

179. U.C.C. § 4-402 Comment 2.

180. U.C.C. § 1-201(44) Comment 44 (1984).

in the rules for wrongful dishonor.[181] But they continue to use the words "actual" damages and the dichotomy between "damages" and "consequential damages." They do provide for the recovery of consequential damages in certain specified cases as included in the term "actual" damages. The concept of dishonor by mistake as limiting recovery to "actual damages" is no longer used. Apparently, all damages that are not "actual" damages may no longer be recovered. If by "actual" damages all general defamatory damages are eliminated and only what are called in the law of defamation "special damages" are to be recoverable, what are such damages in the ordinary cases? Will they be limited to extra interest or late charges assessed for delay in payment?[182] Will they include only such charges and reimbursement to the creditor of bank fees incurred by it in connection with a "returned" item?[183] This is going further to accomplish bank protection than is needed. As for recovery of "consequential damages," if proximately caused, the draft includes damages for arrest and prosecution, consequentials for any consumer (although all consumer provisions are to be removed).[184] Then, based on the unneeded distinction between "draw orders" and "pay orders", the draft provides for consequentials where "the dishonor" (of a draw order) results from the failure of the bank to observe "the reasonable commercial standards of its business."[185] But for "pay orders" consequentials result only "from an intentional act on the part of the account institution."[186]

As worded, the draft places the burden of proof on the customer to justify recovery of consequentials. Our suggestion of wording the rules in terms of privilege goes the other way.[187] Where the plaintiff

---

181. *See* UNIFORM NEW PAYMENTS CODE, P.E.B. DRAFT NO. 3.

182. *See, e.g.*, Bank of Louisville Royal v. Sims, 435 S.W.2d 57, 7 U.C.C. Rep. Serv. (Callaghan) 234 (Ky. 1968) (no recovery for hurt feelings, "nerves" or time lost from work, even if loss of work shown to be proximately caused by the mental state, although recovery allowed for phone call).

183. Banks now charge fees to both drawer and depositor of checks returned dishonored.

184. *See* UNIFORM NEW PAYMENTS CODE, P.E.B. DRAFT NO. 3, § 101(2)(a)-(d).

185. *See* Leary & Pitcairn, *New Payments Code: The Essential Identity of "Pay Orders" and "Draw Orders,"* 12 HOFSTRA L. REV. 813 (1984).

186. *See* UNIFORM NEW PAYMENTS CODE, P.E.B. DRAFT NO. 3, § 101(2)(d). Will "intentional act" if used result in liability where the dishonor is the result of an improperly taken set-off?

187. There is a hint of this in Bank of Louisville Royal v. Sims, 435 S.W.2d 57, 7 U.C.C. Rep. Serv. (Callaghan) 234 (Ky. 1968), where the court indicated that the elements not constituting "actual damages proved" could be considered if the dishonor had been "malicious" in any award of punitive damages. It is an unusual idea for punitive damages to have compensatory elements.

shows that the reason given for the return is defamatory and that some harm has resulted, the law of defamation places the burden of proof of a qualified privilege on the party asserting the privilege.[188]

Thus, under our proposal, once plaintiff has made out a prima facie case, defendant will carry the burden of proving its qualified privilege so as to avoid liability for general defamatory damages.

We close by asking these questions. When a bank, or other account institution states, in effect, that a person is drawing checks, or similar instruments, when there are no funds in the account to pay them, why do the rules of liability vary when the statement is in a credit report as compared to being written on a check? Why, when the law of credit reports protects the credit standing and reputation of all credit users, including non-traders, should the law adopt different rules if the same damage can be shown to occur by reason of the wrongful dishonor of checks and like items containing an untrue statement of the reasons for the dishonor?

188. *See* W. KEETON, PROSSER AND KEETON ON TORTS § 115, at 835 (5th ed. 1984).