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WHEN MY NEGOTIABLE INSTRUMENTS CLASS is ready to consider Section 4-402 of the Uniform Commercial Code, I always like to start out by asking if anyone would have worded the language differently had they been drafting the section. Usually one of the first responses is to the effect that 4-402 is fine just the way it is because a bank should be made to answer to its customer if it fails to honor a properly payable item drawn upon it. My response to such an answer is twofold. First, I wholeheartedly agree that a bank should be held responsible for such a failure; and with regard to liability, 4-402 merely states a proposition that is at least more than two centuries old.[1]

But my second response is usually in the form of a question. Just what is the measure of damages recoverable under 4-402? Or perhaps there is an even more important question to ask: Have the drafters, in their wording of 4-402, given lawyers a basis for predicting with any degree of certainty just what the courts will allow customers to recover in the event of a wrongful dishonor? I submit that they have not, and usually after discussing a few of the cases that have been decided under the section my students either agree with me or are confused enough to at least agree that 4-402 is not an example of model draftsmanship.

Section 4-402 is captioned *Bank's Liability to Customer for Wrongful Dishonor.* It reads as follows:

> A payor bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. When the dishonor occurs through mistake liability is limited to actual damages proved. If so proximately caused and proved damages may include damages for an arrest or prosecution of the customer or other consequential damages. Whether any consequential damages are proximately caused by the wrongful dishonor is a question of fact to be determined in each case.[2]

Two questions come to mind upon reading the language. Does 4-402 provide for two different types of dishonor, "wrongful dishonor" and "dishonor by mistake," and do the drafters intend "actual damages" and "consequential damages" to be exclusive of one another? One solution to these questions could be arrived at with an analysis along the following lines: Section 1-109 and the comments to that section make it clear that

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[1] Marzetti v. Williams, 109 Eng. Rep. 842 (K.B. 1830).

[2] UNIFORM COMMERCIAL CODE § 4-402.

section captions are to be considered parts of the UCC and not mere surplusage. The caption to 4-402 predicates the customer's cause of action upon wrongful dishonor and wrongful dishonor only, thus there should be no distinction between wrongful dishonor and dishonor by mistake. In addition, actual damages, as that term is defined in *Black's Law Dictionary*, means "[r]eal, substantial and just damages, or the amount awarded to a complainant in compensation for his actual and real loss or injury, as opposed on the one hand to 'nominal' damages and on the other hand to 'exemplary' or 'punitive' damages."[3] Consequential damages, as defined by *Black's Law Dictionary*, means "[s]uch damage, loss, or injury as does not flow directly and immediately from the act of the party, but only from some of the consequences or results of such an act."[4] It is certainly reasonable and proper to assert that actual damages can include consequential damages, as these terms are generally defined, and thus just as there are not two different causes of action in 4-402, there also are not two different types of damages. Rather there is one cause of action, wrongful dishonor, and all damages proximately caused by such wrongful dishonor are recoverable. In my opinion this is exactly what the drafters intended.

However, it seems to me that a plausible rebuttal may be made to this analysis. Just as the section caption is not to be considered mere surplusage, neither should any part of the language of the statute be considered such. Thus, just the same as any other statute, the Uniform Commercial Code should be read so as to give effect to all of the language therein. The drafters have in fact used the terms "wrongful dishonor" and "dishonor by mistake," and "actual damages" and "consequential damages" and there is no requirement for lawyers or judges to equate these terms. In fact, because there is nothing in the comments to 4-402 to indicate that these terms are to be considered synonymous, are we not under a duty to give each an independent meaning? If so, then a distinction must be made between wrongful dishonor and dishonor by mistake, and, depending upon the facts of each case, the measure of damages owed by a bank when it fails to honor a properly payable item will be predicated upon the nature and degree of the bank's actions.

Regardless of which of the above analyses you want to accept, it is most important to consider what the courts have done with this section, and to see if any measure of predictability has sprung from the cases.

The classic textbook case regarding wrongful dishonor and the application of 4-402 is *Loucks v. Albuquerque National Bank*.[5] Plaintiff-Appellants Loucks and Martinez were partners in the L & M Paint and Body Shop. The partnership maintained a checking account in the defendant bank. Loucks was personally indebted to the bank in the sum of

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[3] BLACK'S LAW DICTIONARY 467 (4th ed. 1951).

[4] BLACK'S LAW DICTIONARY 467 (4th ed. 1951).

[5] 76 N.M. 735, 418 P.2d 191 (1966).

$402, and the bank charged that amount to the partnership account knowing full well that the debt was not a partnership obligation. Subsequently the bank dishonored a number of checks drawn by the partnership due to insufficient funds in the account. The insufficiency, of course, was due to the debit of the $402.

Plaintiffs, as partners, sued the bank for four separate items: (1) the $402 which was wrongfully charged; (2) $5,000 for damages done to the partnership reputation due to the stigma of issuing bad checks; (3) $1,800 for loss of income caused by the inability of Mr. Loucks to work because of illness, and (4) $14,000 in punitive damages. In addition, Mr. Loucks sued individually for $25,000 in damages incurred because of an ulcer caused by the wrongful acts of the defendant.

After proof was heard at the trial level, the trial court dismissed all of the above claims except the one for the $402. That claim was sent to the jury which promptly found for the plaintiffs. The trial court dismissed the claim for the punitive damages on the basis that there was no evidence to prove any wilful or wanton conduct on the part of the defendant in dishonoring the checks. It dismissed the $5,000 claim for damages to reputation for lack of evidence even though plaintiffs proved that after the dishonor the partnership was denied credit at various places and that other creditors and potential creditors who either knew of or had been victimized by the dishonors refused to accept anything but cash from the partnership. Mr. Loucks' claim for the ulcer damage and the partnership claim for damages caused to the business due to Loucks' inability to work were dismissed because the trial court ruled that Mr. Loucks had no standing under 4-402. It held that the partnership and not Loucks himself was the customer of the defendant bank.

The Supreme Court of New Mexico upheld the trial court's decision on the punitive damage claim, and its decision that the partnership was the defendant's customer and thus, in a wrongful dishonor claim, the individual partners had no right of recovery.[6] In addition it held that the partnership itself had no right in a wrongful dishonor action to recover $1,800 lost income because it had no right to recover for injuries to one of the partners, and because no substantial evidence had been presented to link Loucks' inability to work with the bank's actions.[7] There can be no quarrel with this part of the decision if there was in fact no evidence to sustain the $1,800 claim. But the court implied that even had

[6] The question of who should be able to qualify as a customer is not within the primary scope of this article, but it would seem that a person in Loucks' position should successfully be able to argue that a person who handles and directs the financial affairs of a business, signing the checks and vouching for the fiscal responsibility of the organization, puts his own reputation on the line and will be damaged by a wrongful dishonor. Thus if a bank has knowledge of such a situation (and such knowledge would be obvious in a two-man partnership), then the definition of "customer" should be expanded so as to encompass the partners.

[7] 76 N.M. at 746, 418 P.2d at 199.

there been evidence to support the claim, the partnership could not have recovered because it had no right to recover damages caused by personal injuries to one of the partners. This seems clearly inconsistent with the language of 4-402 because it is obvious that such injury to an individual partner would amount to an injury to the partnership and would be encompassed by the classical definition of consequential damages (assuming, of course, that the ulcer could be proximately related to the dishonor).

With regard to the $5,000 damage to reputation claim, the Supreme Court of New Mexico held that there was sufficient evidence to provide a jury issue and remanded the case to the trial court for a new trial on that matter. However, in remanding the case the court used language which seems to indicate that it was distinguishing dishonor by mistake and wrongful dishonor.

> If we can say as a matter of law that the dishonor here occurred through mistake, then the damages would be limited to the "actual damages proved." Even if we are able to agree, as contended by defendants in their answer brief, that the defendants acted under a mistake of fact in ". . . that Mr. Kopp acting on behalf of the bank thought that the money was invested in the partnership and could be traced directly from Mr. Martinez to the L & M Paint and Body Shop," still the defendants cannot rely on such mistake after both Mr. Martinez and Mr. Loucks informed them on March 15th and 18th that this was a personal obligation of Mr. Martinez and that the partnership had outstanding checks. At least it then became a question for the jury to decide whether or not defendants had wrongfully dishonored the checks through mistake.[8]

This language clearly indicates the court's feeling that the bank's actions could have amounted to more than just a mistake, and if they did, that the partnership could recover more than "actual damages proved," which undoubtedly referred to the $402. Thus the court allowed the jury to consider the damage to reputation question. I do not believe that the drafters intended such a dichotomy when they drafted 4-402. I believe that regardless of the reasons for the dishonor the partnership should have been able to recover the $402 plus any damage to reputation or lost income attributable to the dishonor. Such a conclusion is not only good contract law, but the most equitable way to decide the matter and place the wronged party, the partnership, back into the position it would have been had the bank not dishonored the instruments.

Despite the fact that the best analysis of 4-402 envisions only one cause of action and one measure of damages, there is at least one recent case that has accepted *Loucks* for the proposition that "wrongful dishonor" and "dishonor by mistake" are two separate and distinct types of deeds and that the measure of damage for each is different. Not surprisingly, the case is another New Mexico case and it cites *Loucks* as

[8] 76 N.M. at 745, 418 P.2d at 198.

authority. In *Allison v. First National Bank*,[9] the New Mexico Court of Appeals defined wrongful dishonor as "a dishonor done in a wrong manner, unjustly, unfair, in a manner contrary to justice."[10] It defined mistaken dishonor as "a dishonor done erroneously, unintentionally, a state of mind that is not in accord with the facts."[11] It then went on to find that the defendant wrongfully dishonored the instrument and thus plaintiff was entitled to recover consequential damages.

Between the dates of the *Loucks* and *Allison* decisions, three other cases have been decided on this particular point. In *Skov v. Chase Manhattan Bank*,[12] Theodore Skov was the proprietor of a fish market and issued a check to one of his suppliers, which check was dishonored by the defendant bank. Because of this the supplier refused to deal further with Skov. Skov sued the bank, arguing for the right to recover the profits which would be lost to him because of the loss of this supplier. He projected the loss of profits over a period of years. Such damages seem clearly more analogous to the business reputation damages in *Loucks* than the $402 actual loss of the wrongly debited debt. Such damages seem clearly more "consequential" than "actual" as those two terms were applied in *Loucks* and *Allison*. Thus for the Third Circuit to have decided *Skov* consistently with *Loucks* it seems it would have had to find that the bank's actions constituted wrongful dishonor in order to allow Mr. Skov to recover. The trial court had not so found. It found that the dishonor was due to the bank's mistake, but nevertheless allowed Mr. Skov to recover his lost profits over the projected period. The Third Circuit affirmed and in doing so used the following language: "The trial judge properly relied on Section 4-402 of the Uniform Commercial Code... *which is not a model of clarity in its reference to 'damages proximately caused,' 'actual damages proved,' and 'consequential damages....'*" (emphasis added).[13] The court then went on to cite *Loucks* as authority for its decision allowing Skov the right to recover damages projected over a prolonged period. In this respect I agree that *Skov* is consistent with *Loucks* because both the projected loss of profits and the loss of business reputation are proper examples of consequential damages, if proved. However, the Third Circuit failed to wrestle with the question of whether there was a distinction between wrongful dishonor and dishonor by mistake. Perhaps it would be fair to say that, in light of the above quoted language from the opinion, the only problem the Third Circuit saw with regard to 4-402 was the measure of damages, and that it took for granted the fact that the drafters intended no distinction between wrongful dishonor and dishonor by mistake.

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[9] 85 N.M. 283, 511 P.2d 769 (1973), *rev'd on other grounds*, 85 N.M. 511, 514 P.2d 30 (1973).

[10] *Id.* at 287, 511 P.2d at 773.

[11] *Id.*

[12] 407 F.2d 1318 (3d Cir. 1969).

[13] *Id.* at 1319.

Shortly before *Skov* was decided, the Kentucky Court of Appeals rendered an opinion on this subject in *Bank of Louisville Royal v. Sims.*[14] In that case the bank failed to honor two small checks drawn on it by Sims. She sued under 4-402 and recovered $631.50, which sum included the following items: $1.50 for a telephone call (presumably to try to get the check situation straightened out); $500 for "illness, harassment, embarrassment and inconvenience"; and $130 for two weeks' lost wages. The Court of Appeals reversed and directed the trial court to enter judgment for the plaintiff-customer in the amount of $1.50, the charge for the telephone call. In the course of its short opinion the court noted that the trial court found that the dishonor was due to a mistake and was not malicious. If the Kentucky court was going to construe 4-402 the same way as the New Mexico court, it could have stopped right there and concluded that as this was merely a mistake, the $1.50 phone call was the only actual damage done and in the absence of any intentional act on the part of the bank, "consequential damages" would not be in order. However, the Kentucky court, to its credit, did not attempt that line of reasoning. Rather, it based its decision on the concept of foreseeability saying: "This statute [4-402] does not define 'consequential' damages but it is clear they must be proximately caused by the wrongful dishonor."[15] It then said that the nervousness, sickness and lost wages suffered by Sims as a result of the dishonor were not reasonably foreseeable and thus not a properly recoverable item given the fact situation. Regardless of whether one agrees or disagrees with the court's decision as to the foreseeability of these damages, it seems clear that the Kentucky court was not interested in making a distinction between "wrongful dishonor" and "dishonor by mistake," nor did it quarrel with the argument that "actual" damages could include "consequential" damages.

The last case pertinent to this discussion is *American Fletcher Bank & Trust Co. v. Flick.*[16] As in *Loucks,* the customer sued not only for the amount of money wrongly debited to his account, but also for the damage to his business and credit reputation. Judgment for over $18,000 was entered for Flick but the Indiana Appellate Court reversed because, in its opinion, Flick did not present sufficient evidence to substantiate the verdict. As to its analysis of 4-402 and *Loucks,* the Indiana Court considered the matter much the same as the Third Circuit did in *Skov.*

> Additionally, the second sentence of the statute [4-402] creates confusion as to whether "actual damages" include or are separate and distinct from "consequential damages," as the latter term is contained in said statute. . . . [W]e construe it [4-402] to permit recovery of monetary compensation for *any* [court's emphasis] actual or consequential harm, loss or injury proximately caused by a wrongful

[14] 435 S.W.2d 57 (Ky. 1968).
[15] *Id.*
[16] 146 Ind. App. 122, 252 N.E.2d 839 (1969).

> dishonor [citing *Loucks*]. We believe in this respect that labels such as "actual" or "consequential" are less than meaningful in the sense of the compensability of harm, injury or loss proximately caused by wrongful dishonor.[17]

The Indiana court, as the Third Circuit, either did not consider or want to consider the possibility that the New Mexico court believed that there was a distinction between "wrongful dishonor" and "dishonor by mistake."

Let's return to the question posed near the beginning of this article. Has any measure of predictability sprung from the cases that have wrestled with 4-402? I suppose one could argue that if you practice in New Mexico you will surely be confronted with the question of whether the dishonor was wrongful or because of a mistake and damages will be awarded accordingly. On the other hand, if you practice in Kentucky, Indiana or any Third Circuit state you will probably be able to tell your client that a customer will be able to recover all damages proximately caused no matter what the nature of the dishonor. However, this is small comfort for a lawyer practicing in one of the many states that have not been confronted by this problem. It is unfortunate that the drafters did not try to remedy the problems caused by the present language of 4-402 when the 1972 Amendments to the Uniform Commercial Code were written. It cannot be doubted that the drafters had some measure of damage in mind when 4-402 was originally drawn. It is probable that, even in the face of a strong bank lobby, they intended the courts to interpret this section in favor of the customer whenever possible and to allow the customer to recover all damages caused by the dishonor. It is obvious that they did not intend for lawyers and courts to spend such a large amount of time and effort arguing the meaning of all of the terms incorporated into this short section. That they have failed in this latter goal is clear from our study of the cited cases. Section 4-402 still remains a maze that will be stumbled through and misinterpreted until the language is clarified.

[17] *Id.* at 132, 252 N.E.2d at 845.