Stop Payment Orders: What Hath the Uniform Commercial Code Wrought?

Leonard Lakin
City University of New York

Follow this and additional works at: https://uknowledge.uky.edu/klj
Part of the Banking and Finance Law Commons
Right click to open a feedback form in a new tab to let us know how this document benefits you.

Recommended Citation
Available at: https://uknowledge.uky.edu/klj/vol63/iss2/1

This Article is brought to you for free and open access by the Law Journals at UKnowledge. It has been accepted for inclusion in Kentucky Law Journal by an authorized editor of UKnowledge. For more information, please contact UKnowledge@lsv.uky.edu.
Stop Payment Orders: What Hath The Uniform Commercial Code Wrought?

By Leonard Lakin*

A salutary benefit of the Uniform Commercial Code was the adoption of a uniform rule of law permitting bank customers to stop payment on checks and other items. In so doing the Code replaced 29 separate and varied state statutes which regulated stop payment orders. The law governing the bank customer’s right to stop payment is found in U.C.C. Section 4-403. In its four sentences, divided into three subsections and comprising 118 words, the subject receives full coverage.

In arriving at a policy decision, it was necessary for the draftsmen to weigh the need of the banking customer to have the legal right to stop payment against the administrative burden, cost, and loss incurred by a bank in implementing its customer’s stop payment order. In adopting a policy which came down on the side of the bank customer, the Official Comment to this section explicitly made the Code’s rationale clear by stating:

The position taken by this section is that stopping payment is a service which depositors expect and are entitled to receive from banks notwithstanding its difficulty, inconvenience and expense. The inevitable occasional losses through failure to stop should be borne by the banks as a cost of the business of banking.

This article undertakes a detailed examination of Section

---

* Associate Professor of Law, Bernard M. Baruch College, City University of New York. B.B.A., City College of New York; J.D., New York University School of Law. Professor Lakin is the co-author of A Guide to Secured Transactions (with Howard J. Berger) and the author of other books and articles. He is a member of the New York and Hawaii bars.

1 Uniform Commercial Code § 4-403 [hereinafter cited as U.C.C.].
2 U.C.C. § 4-403, Comment 1.
3 U.C.C. § 4-403 also refers to § 4-303 discussed infra.
4 U.C.C. § 4-403, Comment 2.
4-403 and an analysis of how well the Code has accomplished its intended objective of balancing fairly the opposite interests of the bank customer and the bank with respect to stop payment orders.

**Customer's Right to Stop Payment**

The Code does not limit or qualify the customer's right to stop payment. Rather, it broadly states "A customer may by order to his bank stop payment of any item payable for his account ..." The Code therefore provides that the customer has an absolute right to order payment stopped on his check or any other item payable for his account prior to payment, certification, or acceptance, and the bank is obliged to honor the order and will be liable to the customer if it does not.

The Code's broadly stated rule merely codifies the common law which has long recognized the drawer's right to stop payment on his checks or other items prior to payment, certification, or acceptance by the drawee bank. In discussing the history of this rule, commentators frequently cite Lord Ellenborough's statement in an 1813 English case which recognized the validity of a stop payment order: "If I give a draft upon a condition, and I find the condition to be eluded, I may stop the payment," and his famous dictum in that case that after a stop

---

5 U.C.C. § 4-403.
6 U.C.C. § 4-403(1). The Code does not limit the customer's right to stop payment only to checks. The most common "item" payable by any bank for the customer's account, other than a check, would be a customer's note payable at his bank. A note payable at a bank is the equivalent of a check in those states which have adopted alternative A to U.C.C. § 3-121. In such states, principally in the North and East, the customer can stop payment on his note which is payable at his bank.
7 Note 101 infra. Prior to the adoption of the Uniform Negotiable Instruments Law, some states held that a check was an assignment of funds. In such cases the drawer was precluded from stopping payment of the check after the check had been taken by a bona fide purchaser for value. Gage Hotel Co. v. Union Nat'l Bank, 49 N.E. 420 (Ill. 1898); Moore, Sussman and Brand, Legal and Institutional Methods Applied to Orders to Stop Payment of Checks, 42 Yale L.J. 817 (1932). Section 189 of the N.I.L. rejected the equitable assignment concept and reinstated the common law rule permitting check stop payments.
8 Florence Mining Co. v. Brown, 124 U.S. 385 (1889); Taylor v. First Nat'l Bank, 138 N.W. 783 (Minn. 1921); 9 C.J.S. Banks and Banking § 344, at 692 (1938); 5 T. Michie, Banks and Banking § 193 (Perm. ed. 1932).
payment order is given a check becomes "a piece of waste paper."

In the United States the earliest reported decision recognizing the customer's right to stop payment on a check is *German National Bank v. Farmers' Deposit Bank*, in which the court said "I presume no one at this day questions the right of the drawer of a check to stop payment thereof . . . . If the bank pays after such notice, it does so at its peril." Although the court did not cite any authority in its opinion, the rule of the case is now well settled and is generally referred to as the common law rule. However, the impact of these statements should be considered along with the rule that a customer's effective stop payment order does not discharge his liability on the instrument or on the underlying transaction.

While the Code explicitly recognizes the customer's right to stop payment, it does not provide an express solution for the vexing question whether a party to a joint checking account has a right to stop payment on a check drawn by the other party to the joint checking account without the latter's consent. It is suggested, however, that under the Code the result would be that either party in the joint account has a right to stop payment on any check drawn by the other party on that joint account without the latter's consent. This result is arrived at by implication, since the Code states that "A customer may by order to his bank stop payment . . . ." and elsewhere defines customer as "any person having an account with a bank . . . ."  

No reported Code decisions have been found which have applied this section to the joint checking account problem; moreover, the only reported pre-Code decision held that one

---

10 *Southern Bank & Trust Co. v. Whited*, 145 So. 832 ( Ala. 1933); *Hawitt v. First Nat'l Bank*, 252 S.W. 161 ( Tex. 1923); 9 C.J.S. *Banks and Banking* § 353, at 704 ( 1938); 7 Am. Jur. *Banks* § 607, at 441 ( 1937).
13 *U.C.C.* § 4-403(1).
joint tenant does not have the right to stop payment of a check
drawn by another joint tenant unless there is an express agree-
ment with the bank conferring this right. The court explained:

This asserted right by plaintiff (wife) is inconsistent with the
right of the husband to write checks on the account. We think
that since the husband was entitled to write this check on the
account, he was entitled to have it paid and that it was the
duty of the bank to pay the check when it was presented for
payment.17

In view of the Code’s silence as to the express right of
either party in the joint account to stop payment on any check
drawn by the other party on that joint account, three states
have eliminated any possible problem in this area by amending
Section 4-403 to provide that “[a] customer, or any customers
if there is more than one, or any person authorized to sign
checks or make withdrawals thereon may stop payment on any
item payable for or drawn against such customer’s or custom-
ers’ account . . . .”18 While the foregoing amendment ex-
pressly resolves the problem of the validity of a stop payment
order in joint accounts, the Permanent Editorial Board for the
Commercial Code has rejected this amendment stating:

This section (4-403) in its 1958 form was one of the most
extremely debated and carefully considered in the entire
Code. It represents final policy. It is considered sound by the
sponsoring organizations and the Editorial Board. The Board
is unwilling to revise the position.

In addition to the customer’s unqualified right to stop pay-
ment, the Code expressly recognizes that a “person claiming an
interest in the account” may also stop payment.19 The Official
Comment to that section states:

Any surviving relative, creditor or other person who claims an
interest in the account may give a direction to the bank not
to pay checks, or not to pay a particular check. Such notice
has the same effect as a direction to stop payment. The bank

17 Id. at 830.
19 U.C.C. § 4-405. No reported decisions have been found wherein a person’s rights
were adjudicated when the person was “claiming an interest in the account”. 
has no responsibility to determine the validity of the claim or even whether it is "colorable". But obviously anyone who has an interest in the estate, including the person named as executor in a will, even if the will has not yet been admitted to probate, is entitled to claim an interest in the account.20

Validity of Oral Stop Payment Order

The Code expressly recognizes the validity of an oral stop payment order but qualifies its effectiveness by providing that "an oral order is binding upon the bank only for fourteen calendar days unless confirmed in writing within that period."21 The Comments specifically contemplate such binding oral orders being given by telephone.22 The Code gives limited validity to oral stop orders to avoid the difficult fact questions presented by the pre-Code law regarding whether a bank had accepted an oral order and had waived the written requirement.23 Under the Code a "compromise" is effected, protecting "both parties by making the oral direction effective for only a short time during which the drawer must confirm it in writing and by eliminating thereafter any claim or waiver by acceptance of the oral direction."24

In validating the oral stop payment order the Code follows the well established common law rule that in the absence of a contrary statute or contract between a bank and its customer a stop payment order is valid although made orally, either directly or by telephone.25 Although oral stop orders seem permeated with problems of proof, identity, and authenticity, the drawer's need for immediate action is the Code's rationaliza-

---

20 U.C.C. § 4-405, Comment 4.
21 U.C.C. § 4-403(2).
22 U.C.C. § 4-403, Comment 6.
24 U.C.C. § 4-403, Comment 6.
25 Hiroshima v. Bank of Italy, 248 P. 947 (Cal. Dist. Ct. App. 1926); Ozburn v. Corn Exchange Nat'l Bank, 208 Ill. App. 155 (1917) (by telegraph); Second Nat'l Bank v. Meek Appliance Co., 244 S.W.2d 769 (Ky. 1952); Kentucky-Farmers Bank v. Staton, 235 S.W.2d 767 (Ky. 1951); (oral information not included in written notice held admissible and effective); Shude v. American State Bank, 248 N.W. 886 (Mich. 1933) (notice by telephone held effective); Deposit Guar. Bank & Trust Co. v. Silver Saver Stores, Inc., 148 So. 387 (Miss. 1933) (oral notice to teller within bank); Third Nat'l Bank v. Carver, 218 S.W.2d 66 (Tenn. 1948).
tion for continuing the practice of giving effect to oral stop orders. However, in recognizing the validity of an oral order, the Code protects the banks by placing the burden on the customer to prove that the order was given.

Section 4-403, however, does not bar a bank from making an agreement with its customers providing that only written stop orders shall be binding on the bank. Rather, the Code expressly provides that "[t]he effect of the provisions of this Article [Four] may be varied by agreement except that no agreement can disclaim a bank's responsibility for its own lack of good faith or failure to exercise ordinary care . . . ." Although banks could thus contractually eliminate the effectiveness of oral stop payment orders under the Code, the possibility of losing business to other banks has discouraged such a limitation on service. Instead, banks in some states have eliminated oral stop payment orders on a statewide basis by lobbying successfully for an amendment to section 4-403. Six states presently have amended their statutes to provide that only written stop payment orders are valid.

One other jurisdiction, the District of Columbia, has adopted a qualified oral stop payment order by amending section 4-403 to provide that a stop payment order transmitted by telephone by a customer to an officer of the bank, while such officer is on the premises thereof, shall be accepted by such bank, upon such identification that will insure the order has been transmitted by such customer, as an effective order for a period of twenty-four hours, after which it shall no longer be valid unless followed by a written order . . . .

However, even in the states which have adopted amendments

---

26 U.C.C. § 4-403(3). A Pennsylvania court construed this section as placing upon the customer the burden of proving that the customer stop payment order was given. See Dinger v. Market St. Trust Co., 7 Pa. D. & C.2d 674 (Dauphin County 1956), holding that a customer must identify the particular bank employee to whom he gave the order.

27 U.C.C. § 4-403(3).

28 U.C.C. § 4-103(1).


stating that the bank shall not be obligated unless the order is in writing, courts may find, as they did in pre-Code decisions,\footnote{Some pre-Code state statutes and depositor's contracts attempted to render oral stop orders ineffective against the bank. However, if the bank agreed to honor an oral stop order it could be held to have "waived" the benefit of the statute or contract. See Stamford State Bank v. Miles, 186 S.W.2d 749 (Tex. Civ. App. 1945) (state statute); Bohlig v. First Nat'l Bank, 48 N.W.2d 445 (Minn. 1951) (requirement of written notice to stop in deposit contract could be and was waived); Frost Nat'l Bank v. Dobbs, 423 S.W.2d 145 (Tex. Civ. App. 1967).} that a bank by its conduct has waived the protection of a written stop order.

**Validity of Written Stop Payment Order**

With respect to a written stop payment order, the Code provides that it "is effective for only six months unless renewed in writing."\footnote{U.C.C. § 4-403(2).} The Official Comment to Section 4-403 explains the rationale by noting that:

The purpose of the [six month limit] is, of course, to facilitate stopping payment by clearing the records of the drawee of accumulated unrevoked stop orders, as where the drawer has found a lost instrument or has settled his controversy with the payee, but has failed to notify the drawee.\footnote{U.C.C. § 4-403, Comment 7.}

The question arises then as to whether a bank has any liability to a drawer who has properly stopped payment on a check where the stop payment order has expired without renewal. In a leading pre-Code decision, *Goldberg v. Manufacturers Trust Co.*, a New York court held a bank liable to a drawer for payment on a 27 month old check even though a stop payment order had expired without renewal. The court predicated liability on the bank's payment of the stale check without inquiry into its own records, which the court said would have revealed the lapsed stop payment order and put the bank on notice as to the drawer's objection to payment.

However, the Code and the cases decided under Section 4-403 have explicitly rejected the reasoning of such pre-Code cases.
decisions. The sad consequence to a customer who fails to renew his stop payment order was illustrated in a 1971 New York decision. Therein, the question arose whether the bank had any liability to its depositor when it paid a stale check presented 13 months after its date and after expiration of the depositor's written stop payment order. The court rejected the depositor's reliance on Goldberg and, citing the Official Comment, said:

This Court believes that the Goldberg decision, without comment on its validity under the common law, is not now the law which prevails by virtue of the Uniform Commercial Code. Moreover, there was no proof at all as to whether the Bank even maintained the lapsed order in its files, particularly since it has no obligation to do so, and as reflected in the official commentary the purpose of U.C.C. [Section] 4-403 requiring renewal of stop payment orders is to facilitate stopping payment by clearing the records of the drawee of accumulated unrevoked stop orders . . . .

Granite cannot be permitted to predicate liability on the part of the bank on its failure to inquire about and find a stop payment order which has become terminated in default of renewal . . . .

When the depositor further asserted that the bank was liable to it because the bank paid on a stale check, the court rejected the claim stating:

Neither may Granite predicate a claim of liability upon the Bank's payment of a stale check. The legal principles applicable to this circumstance are codified in U.C.C. [Section] 4-404, which provides that:

[a] bank is under no obligation . . . to pay a check, other than a certified check, which is presented more than six months after its date, but it may charge its customer's account for a payment made thereafter in good faith.

---

37 Id. at 882.
Here too, the Goldberg case reasoning is discarded in the official commentary. There is no obligation under the statute of the Bank to search its records to discover old lapsed stop payment orders. The Bank does not have to pay a stale check, but it may pay one in "good faith."\(^{38}\)

While stop payment orders are usually given after the drawer has issued his check, the Code does not state whether a stop payment order is valid if it is given before the drawer issues his check. The question of whether such a stop payment order is valid was answered in an unusual case\(^{39}\) where the drawer issued a stop payment order five days before the issuance of his check. The trial court agreed with the payee who claimed that the drawee bank knowingly participated in the drawer's acts in stopping payment of checks before the date of such checks. The payee then argued:

(1) that the stop-payment order issued by [the drawer] five days before the issuance of his check was not valid and was "a badge of fraud," and (2) that the repeated connivance of the Richardson Bank in honoring [the drawer’s] stop payment orders given before the issuance of the checks constitutes legal malice requiring imposition of exemplary damages in order to make [the payee] as a faultless party whole.\(^{40}\)

On appeal, the court rejected the payee's claim and held that the stop payment was valid though given five days before the check was issued. It based its holding on the drawer's absolute right to order payment stopped on his check.\(^{41}\)

Regarding the equally interesting claim that the bank was liable in exemplary damages to the payee because the bank was aware of the drawer's "penchant" for stopping payment on checks before he even drew them and that by honoring the stop payment order in question the bank and the drawer had "connived" in this practice, the court denied the payee's claim simply stating: "We know of no authority which would support

\(^{38}\) Id. at 883. Emphasis added by the court.

\(^{39}\) Richardson Heights Bank & Trust v. Wertz, 482 S.W.2d 692 (Tex. Civ. App. 1972). One should note, however, that this case was subsequently reversed and the bank was held liable because the check involved was a cashier's check. 495 S.W.2d 572 (Tex. 1973).

\(^{40}\) Id. at 695.

\(^{41}\) Id. at 694.
this position." However, the court affirmed the trial court’s judgment awarding exemplary damages of $1,000 against the drawer for stopping payment before he issued his check.

Where Must Stop Orders be Given?

The Code does not state where the stop payment order must be given. It only requires that the stop payment order be received “in such manner as to afford the bank a reasonable opportunity to act on it . . . .” Moreover, as plaintiff, the customer will have the burden of establishing the fact of the binding stop payment order.

The status of the pre-Code common law as to where the stop payment order could be given was set forth in a leading case where the customer orally stopped payment by telephoning the bank cashier at his home on Sunday. The cashier replied that he would make a written memorandum of the matter and attend to it when he returned to the bank the next day. When the cashier arrived on Monday at 8:40 a.m. the check had already been presented and paid. In a suit by the customer against the bank, the bank argued that the stop payment order was not effective because it was not served in the bank and during banking hours. The court rejected the bank’s argument stating:

We do not think it can be seriously contended, in view of the authorities, that notice to stop payment of a check, when served upon a bank cashier, is ineffectual simply because not served in the banking house during banking hours . . . . [I]f any person wishes to impart information so as to warn the bank or to affect it with notice, it would be absurd to say that he could do so effectually only if he should make his communication to the cashier actually within the walls of the banking house, and before it was closed to the public for the day. There would be no reason in such restrictions, and there is no law in their support.

---

42 Id. at 696.
43 Id.
44 U.C.C. § 4-403(1).
45 Compare § 4-403(3) which places the burden of establishing the fact and amount of loss on the customer.
47 Id. at 163.
This common law rule has been widely followed. Cases under the Code have followed it scrupulously by allowing stop payment orders although communicated by telephone or telegraph to bank officials outside the bank's premises.

Two jurisdictions to date have sought to avoid the impact of the common law rule by amending Section 4-403 to prohibit off-premises stop payment orders. In the District of Columbia the stop payment order must be transmitted "to an officer of a bank while such officer is on the premises thereof," and in Florida a binding stop order must be "served upon and received by an officer of the bank at the banking house during regular banking hours . . . ." Moreover, it would appear that under U.C.C. Section 4-103 a bank may contract with its customers that such stop payment orders will be effective only if received at the bank during banking hours. Interestingly, a random sampling of the practice of ten large commercial banks in New York City disclosed no such contract provision between bank and customer.

To Whom Must Stop Payment Orders be Given?

The Code does not specify to whom the stop payment order must be given. It provides only that "the order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it . . . ." Here again it is likely that courts will apply the common law rules which held that stop payment orders were valid where delivered to a teller, cashier, or clerk. Thus, common law agency principles will probably be followed by the courts in judicial interpretations of Section 4-403(1) and any bank employee who agrees to accept a stop payment order will bind the bank. In this

5A T. Mch, Banks and Banking § 194 (Perm. ed. 1932).


FLA. STAT. § 674.4-403 (1971).

U.C.C. § 4-403(1).


See notes 53-55 supra.
respect, contrary to the general rule of agency that the party who asserts the authority of an agent must prove it by evidence of the principal's conduct, the authority of a person answering the telephone of a business firm will probably be presumed.\(^5\)

Nevertheless, the extreme importance of the customer being able to state the date when the oral or written stop payment order was given to the bank and the identity of the bank employee to whom the stop payment order was given was illustrated in a Pennsylvania case styled *Dinger v. Market St. Trust Co.*\(^5\) The court there dismissed the complaint because the plaintiff's allegation that he gave a stop payment order "sometime during the Spring of 1954 and before July 21, 1954 (the exact date being unknown to Plaintiff)" was not specific enough "especially where the defendant [bank] denies receiving any such stop payment orders." Moreover, the complaint did not "identify the person to whom his oral notice was given, and it is only reasonable for the defendant bank to require the identity of this person with particularity in order that it can answer and properly prepare its defense . . . ." The court stated that the customer also was required to name and identify the bank employee to whom he gave a *written* stop order. While the court gave the plaintiff leave to amend his complaint it added: "If the complaint is not so amended and the specific information given to which the defendant is entitled, that will be the end of the case."\(^5\)

**What Information Must the Stop Payment Order Contain?**

The Code does not specify what information the stop payment order must contain. Rather, it states only that "the order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it . . . ."\(^6\) The relevant information which banks usually require includes the names of the drawer and payee, the check number, the date of check, the amount of check, the check account number, any special notations on the check, and any known endorsements.

---

\(^5\) Restatement (Second) of Agency § 8 (1958).
\(^6\) 7 Pa. D. & C.2d 674 (Dauphin County 1956).
The pre-Code law did not require absolute accuracy in the stop payment notice given by the customer for it to be binding on the bank. Rather, reasonable accuracy was the litmus test and each case was decided on its own facts when the stop payment order did not contain absolutely accurate information. What constitutes reasonably accurate information has produced interesting litigation and judicial results which can be reconciled only on the basis that each case is decided on its own merits. Thus, in one New York case the drawer notified the bank not to pay a check for the sum of $196.76 dated December 21 and payable to the order of a designated firm. The bank subsequently paid a check for $196.75 dated December 23 which was payable to the order of bearer. In an action against the bank, the drawer contended that the check paid by the bank was the one on which he stopped payment. The court held that the notice to the bank did not describe the check with sufficient accuracy to render the bank liable.

The same result was reached in another New York case where the plaintiff accepted a trade acceptance for $17,000 drawn by a coal company and payable at the defendant bank on October 5, 1921. On October 3, the plaintiff wrote to the bank requesting that payment be stopped on a $15,000 trade acceptance. The notice did not give the date of the trade acceptance and the amount stated was $2,000 less than the actual amount of the instrument. On October 5, the day on which the draft was payable, the plaintiff orally notified the bank that the correct amount of the draft, referred to in the October 3 letter, was $17,000. The bank paid the acceptance on presentation. It did not appear that the oral notice was given to the bank before the time of payment or in sufficient time prior thereto to have enabled the bank, in the exercise of reasonable diligence, to stop payment. The court held, under these circumstances, that the bank was not liable to the plaintiff for having honored the acceptance. In so holding, it explained:

The defendant was under no obligation to suspend the payment of the draft and to communicate with the plaintiff to

---

ascertain whether or not it was the draft plaintiff wished it to dishonor, for the due transaction of its business entitled it to receive accurate information, with respect to a negotiable instrument on which it was called upon to stop payment, to enable its paying teller to act at once when the draft should be presented; and it was warranted in assuming that the draft it paid was not the draft which the plaintiff desired it to dishonor. 3

A more difficult question was presented in an Ohio case 4 in which the drawer, in the stop payment order, described the check accurately in all particulars except the number of the check which he incorrectly stated was 1484 instead of the correct number, 1485. The bank paid the check when its bookkeeper concluded that the check numbered 1485 was a substitute or duplicate for the check of the same amount and date and payable to the same payee but bearing the number 1484, and paid the same, writing on the folder a symbol indicating that check 1485 was a duplicate of check number 1484. The court held in these circumstances that the bank was not liable in making payment of the check because the stop payment order did not describe the check with reasonable accuracy and the bank acted in good faith and exercised reasonable care to avoid payment to the wrong party or contrary to the order of the drawer.

In other pre-Code cases, however, courts have held for the drawer even though the stop payment order did not contain accurate information. For example, in a Kentucky case, Kentucky-Farmers Bank v. Staton, 5 the stop payment order accurately stated the date of the check, the number of the check and the name of the payee. However, the amount was stated to be $1,634.94 instead of the actual amount of the check which was $1,805. Although this error occurred because the drawer erroneously entered the wrong amount in his checkbook stub, the drawer prevailed in his claim against the drawee bank based on evidence, not contained in the written stop payment order.

---

5 235 S.W.2d 767 (Ky. 1951).
order, that the bank was told why the drawer wanted payment stopped and that the check under consideration was the only one the drawer had issued to the named payee. Other courts have held that a stop payment order was effective although, in one case, the date of the check was incorrect and in another the payee’s name was incorrectly described as “Harold Orkland” instead of “H. Orkland.”

However useful the pre-Code law was in affording protection to an occasional drawer who made a mistake in his stop payment order, it is unlikely that the same result will be reached today in the era of the computer. When a bank uses a computer system which is programmed to stop all payments of checks of a given amount drawn on a particular account, absolute accuracy in the stop payment order will be required. No court decisions have been found under the Code in which a stop payment order was declared ineffective because of erroneous information where a bank put the stop payment order on its computer. However, courts may hold that before a stop payment order will be declared ineffective, the bank will be required to inform the customer on the stop payment order form in conspicuous bold type that absolute accuracy is required to implement the stop payment order.

When Does the Stop Payment Order Become Effective?

The Code provides that the stop payment “order must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it prior to any action by the bank with respect to the item described in Section 4-303.”

Section 4-303 provides that:

any . . . stop-order received by . . . a payor bank . . . comes too late . . . if the . . . stop-order . . . is received or served and a reasonable time for the bank to act thereon expires . . . after the bank has done any of the following:

(a) accepted or certified the item;
(b) paid the item in cash;
(c) settled for the item without reserving a right to re-

---

U.C.C. § 4-303(1).
voke the settlement and without having such right under the 
statute, clearing house rule or agreement;
(d) completed the process of posting the item to the 
indicated account of the drawer, maker or other person to be 
charged therewith or otherwise has evidence by examination 
of such indicated account and by action its decision to pay 
the item;
(e) become accountable for the amount of the item 
under subsection (1)(d) of Section 4-213 and Section 4-302 
dealing with the payor bank's responsibility for late return of 
items.

Thus, not only must the stop payment order be received 
by the bank before any of the enumerated events occur, but the 
order also "must be received at such time and in such manner 
as to afford the bank a reasonable opportunity to act on it" 
prior to the occurrence of any of the enumerated events. Since 
the Code does not define how much time a "reasonable oppor-
tunity" to act upon a stop payment order is, the cases on that 
subject decided under pre-Code law would continue to be au-
thoritative.69

The courts have said that what constitutes sufficient time 
for a bank to act after it has received the stop payment order 
must depend on the facts and circumstances of each case. In 
one pre-Code case, the court held that the vice-president 
should have been able to forward a stop payment order notice 
to the bookkeeper at the depositor's branch office in twenty-
five minutes and the bank was liable when he did not do so.70 
In another leading pre-Code case an Illinois court71 held that 
the bank had a reasonable opportunity to act upon a stop pay-
ment order (by telegraph) when it received it at 2:49 p.m. on 
one day and wrongfully paid the check between 10 and 11 
o'clock the next day. The court said:

It does not seem reasonable . . . to give much weight to the 
argument that as the appellant [bank] had about 7,000 de-
positors, 16 bookkeepers and 275 employees taking care of the 
receipts and payments of checks, and handled between

69 Spanogle, The Bank-Depositor Relationship—A Comparison of the Present 
40,000 and 50,000 checks or items each day, the appellant was therefore entitled, in order to be affected by the notice of countermand, to more time than elapsed between 2:49 p.m. of one day and 10 o'clock a.m. of the next.\(^7\)

The court reached that conclusion upon testimony of the paying teller that stop payment notices would be sent to him until 4:00 p.m., that such matters were attended to very expeditiously and only took at most five minutes, and that to telephone or send a messenger from the head bookkeeper’s department to the paying teller would take very little time under any circumstances.

Since there may be a factual question whether the bank has a reasonable opportunity to act on the stop payment order after its receipt, it would seem desirable for the customer to obtain a receipt from the bank acknowledging the date and hour that the stop payment order is received. This evidence will help the customer satisfy his burden to prove that he has given the bank a stop payment order. It will also eliminate any issue as to when the bank received the stop payment order, which might otherwise be a crucial factual question upon which the entire case could be decided.

In a state which permits branch banking the question arises whether the customer’s stop payment order is effective when given to a branch other than that where the customer maintains his account. The Code provides that “[a] branch or separate office of a bank is a separate bank... for the purpose of computing the time within which... a notice or order shall be given...”\(^7\) Thus, the stop payment order will not be effective under the Code unless it is given to the branch where the customer has his account.\(^7\) While another branch will usually accept a stop payment order and forward it to the branch where the customer has his account, the time to process the stop payment order will probably be longer and this fact will adversely affect the customer since the Code provides that

---

\(^7\) Id. at 159.

\(^7\) U.C.C. § 4-106.

the stop payment order "must be received at such time and in such manner as to afford the bank a reasonable opportunity to act on it . . . ." Here again the benefit of due diligence in giving the stop payment order to the branch where the customer maintains his account, rather than to another branch, is self-evident.

The Validity of Exculpatory Clauses in Stop Payment Orders Under the Uniform Commercial Code

The draftsmen of Section 4-403 were well aware of the widespread use by banks of exculpatory clauses, in stop payment order forms or depositor's contracts. Banks attempted, by such clauses, to limit their strict common law liability which made a bank liable to its depositor when it paid a check or other item over a stop payment order. These exculpatory clauses generally provide that the bank shall not be liable to its depositor in the event the check is paid through what is typically called "oversight" or "inadvertence."

The pre-Code decisions reflected a split of judicial authority on whether such exculpatory clauses were valid. In New York, Indiana, Massachusetts and South Dakota such clauses were held valid. In the leading New York case, Gaita v. Windsor Bank, the court recognized the common law standard imposing absolute liability upon a bank that did not obey an effective stop payment order. However, the stop payment order containing an exculpatory clause was held valid on "freedom of contract" principles:

75 U.C.C. § 4-403(1).
76 Hewitt v. First Nat'l Bank, 252 S.W. 161 (Tex. 1923).
79 Tremont Trust Co. v. Burack, 126 N.E. 782 (Mass. 1920), where the court said in the absence of fraud the defendant is assumed to have assented to all the provisions of the contract and is bound by its terms.
81 167 N.E. 203 (N.Y. 1929).
He [the depositor] had a legal right to serve such a notice qualifying the bank's common law liability, and, when the bank paid the check, after receipt of such notice, it did not become legally liable to the drawer in the absence of evidence of willful disregard of the notice.

If a drawer desires to hold the bank to its common law liability and impose upon it the absolute duty of stopping payment of a check, the notice served should be positive and unqualified . . . . [I]f the drawer serves a qualified or limited notice like the one in question, the obligation of the bank is thereby limited, and it will not be liable to the drawer if the check is inadvertently paid.\[62\]

The Indiana,\[83\] Massachusetts\[84\] and South Dakota\[85\] courts agreed with this principle. On the other hand, in California,\[86\] Pennsylvania,\[87\] and Ohio,\[88\] exculpatory clauses were held invalid on the ground that they violated public policy, whether the exculpatory clause appeared in the original passbook or depositor contract or in stop order forms. Furthermore, in New Jersey\[89\] and Connecticut,\[90\] the exculpatory clause was also declared invalid because the bank failed to give consideration in return for the depositor's agreement. Finally, a South Carolina court,\[91\] although not specifically invalidating such an exculpa-

\[62\] Id. at 204.
\[84\] Tremont Trust Co. v. Burack, 126 N.E. 782 (Mass. 1920).
tory clause, held that the bank still had the burden of proving that it had not been negligent. The court held that the bank had not met that burden by a statement that, for some unaccountable reason, the bookkeeper overlooked the stop payment order and the check was paid by mistake.

In the context of these conflicting pre-Code decisions on the validity of exculpatory clauses, the Code has elected to declare exculpatory clauses invalid if they would excuse the bank from liability for negligently paying a check or other item contrary to a stop payment order. This conclusion is arrived at from the Code’s provision that a customer has a right to stop payment,92 coupled with the Code prohibition of an agreement disclaiming a bank’s responsibility for failure to exercise ordinary care.93 Comment 8 to Section 4-403 states:

A payment in violation of an effective direction to stop payment is an improper payment, even though it is made by mistake or inadvertence. Any agreement to the contrary is invalid under Section 4-103(1) if in paying the item over the stop payment order the bank has failed to exercise ordinary care.

Notwithstanding the clear pronouncement of the Code, it is common bank practice today to include exculpatory clauses in the stop payment order forms used by banks. Undoubtedly, banks know that such clauses are void. They persist in using them because their experience has been that the average customer, in ignorance of his rights, will abide by the terms of such exculpatory clauses if the bank fails to honor a stop payment order due to “oversight” or “inadvertence”. At least one well known authority on the subject has come forward and stated forcefully:

Perhaps the time has come for the banking authorities (e.g. Federal Reserve; FDIC, etc.) to promulgate regulations prohibiting the use of the exculpatory clause. The banks have gained much through the enactment of Sections 4-403 and 4-407, and present-day stop order law seems fair to all con-

---

92 U.C.C. § 4-403(1).
93 U.C.C. § 4-103.
cerned and is flexible enough to enter the age of the com-
puter. This delicate balancing of interests should not be 
thrown out of proportion by the use of clauses that clearly are 
proscribed.41

**Liability of Bank When it Does Not Stop Payment and Its 
Right of Subrogation**

The common law rule was that a bank which paid a check 
or other item over a valid stop payment order could neither 
charge the amount of the item against the customer's account 
nor recover the amount from the party to whom payment was 
made45 in the absence of fraud or deceit.46 In a few pre-Code 
cases the drawee bank asserted its right of equitable subroga-
tion against the drawer. The bank claimed that if it was liable 
to the drawer for failing to obey an effective stop payment order 
it should be entitled to be subrogated to the holder's rights 
against the drawer. The bank claimed that if it was not given 
the right of subrogation against the drawer, the drawee would 
be unjustly enriched. Some courts permitted the bank to have 
the right of subrogation against the drawer47 while others did 
not.48

The Code's treatment of a bank's liability for disobeying 
effective stop payment orders and the bank's rights in such an 
event are to be found by reading Sections 4-403 and 4-407 to-
gether. Section 4-403(3) provides that if a bank disobeys a valid 
stop payment order it is liable to its customer only for the 
"amount of loss resulting from the payment of an item contrary 
to a binding stop payment order" and not for the face amount

---

41 Huffman v. Farmers Nat'l Bank, 10 S.W.2d 753 (Tex. Civ. App. 1923), noted 
in 13 MINN. L. REV. 373 (1929); National Bank v. Berrall, 58 A. 189 (N.J. 1904); Miller 
v. Chatham & Phoenix Nat'l Bank; 214 N.Y.S. 76 (App. T. 1926); RESTATEMENT OF 
RESTITUTION § 33. Contra, Foster v. Federal Reserve Bank, 113 F.2d 326 (3d Cir. 1940); 

42 Bank of Moulton v. Rankin, 131 So. 450 ( Ala. 1930); Smith & McCrorken, Inc. 

43 American Nat'l Bank v. Reed, 134 S.W.2d 782 (Tex. Civ. App. 1939); Texas 
v. A.S. Tucker Co., 105 N.E. 369 (Mass. 1914), the teller paying a check in disregard 
of a stop payment order was held personally liable to the bank-employer. He received 
an assignment of the bank's rights and was successful in his suit to recover the amount 
of the check against the drawer.

of the check. Moreover, under the Code the customer has the burden of establishing the fact and extent of loss.99

The drawer’s loss, if any, resulting from the payment of the check, depends on his rights against the payee or other holder. If the drawer would not be liable on the check to the holder, then the drawer has suffered a loss when the bank wrongfully pays a check over a stop payment order. In such a case the bank must credit the customer’s account. Since the holder would not have been able to collect on the check if payment had been stopped because of the drawer’s rights, unjust enrichment to the holder would result if he could retain the payment the bank made to him. To prevent unjust enrichment, and thereby protect the bank from loss, the Code provides that where the bank is liable to its customer the bank is subrogated to the rights of the drawer against the holder of the check.100 The bank typically will assert its right of subrogation when it is sued by the drawer by impleading the holder of the check and will claim that if the bank is liable it should be allowed to recover from the holder.101

Conversely, if the drawer would have been liable on the check if payment had been stopped because his defense was not valid against the holder of his check, then the drawer has suffered no loss if the bank wrongfully paid the holder. Therefore, in such cases, the bank is not liable to the drawer under the Code.102

The Code gives effect to these broad principles by expressly providing that the bank shall have the right of subrogation. Section 4-407 provides:

If a payor bank has paid an item over the stop payment order of the drawer or maker or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent

---

99 U.C.C. § 4-403(3).
100 U.C.C. § 4-407(c).
unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank shall be subrogated to the rights

(a) of any holder in due course on the item against the drawer or maker; and

(b) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and

(c) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

In giving the drawee bank the right of subrogation, when the bank has wrongfully disobeyed an effective stop payment order, the Code achieves equitable results since unjust enrichment of the drawer and the holder is thereby prevented.

The courts, in giving effect to this important section, have stated that the principle of subrogation is highly favored in the law and is to be liberally construed. Indeed, in a June 1974 New York Court of Appeals decision, the court extended the parameters of Section 4-407 with respect to the bank's right of subrogation against the payee. In that case the bank disregarded an effective stop payment order and paid $10,000 to the payee who also maintained her account at the drawee bank. Two or three banking days afterward, the drawee bank debited the payee's account and returned the money to the drawer's account. The payee sued to recover the $10,000 charged back, and the bank impleaded the drawer. The drawer successfully moved for summary judgment, and the bank then specifically claimed the right to be subrogated to the drawer's claims against the payee.

The payee acknowledged that a drawee bank normally would be subrogated to the drawer's rights against a payee, but claimed that since the bank never debited the drawer's account, the drawer suffered no loss to which the bank could be

---

103 South Shore Nat'l Bank v. Donner, 249 A.2d 25 (N.J. Super. Ct. 1969). The court held that where the drawer has a claim against the payee or the payee and other persons for fraudulently causing the drawer to issue the check to the payee, the bank, upon improperly paying such check over the drawer's stop payment order, is subrogated to the rights of the drawer against the payee and such other persons. Sunshine v. Bankers Trust Co., 314 N.E.2d 860, 358 N.Y.S.2d 113 (N.Y. 1974).

subrogated. The court rejected this claim, saying that it interpreted Section 4-407 as conferring substantive rights of subrogation on the bank, even if the technical mechanical requirements of common law subrogation have not been met. Thus, the court held that it is not necessary for a bank to show that the drawer has lost any money before the bank can assert its rights of subrogation against a payee or other holder of a check.

Conclusion

Sections 4-403 and 4-407 have together achieved a fair balancing of the respective interests of the bank and its customers. The Code decisions have largely interpreted the particular sections to achieve the results intended by the draftsmen. In this respect, the Code has become an effective handmaiden to the banking community and its customers.