

STOPPING PAYMENT ON A CASHIER'S CHECK

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Since the Uniform Commercial Code (hereinafter Code) has no special provisions pertaining to cashier's checks, a bank's right to decline to pay its own cashier's check is decided by reference to the statutory sections which govern negotiable instruments in general. Although various courts have recognized that the cashier's check serves an important, if not unique, commercial purpose,¹ no consistent judicial analysis of a cashier's check as a legal obligation has emerged. Because of the important role which a cashier's check plays on the commercial stage, this article will examine the different ways in which courts have analyzed the rights and obligations arising from the issuance of a cashier's check.

The focus of this article will be on the right to stop payment of a cashier's check. The nature of a cashier's check as well as the procedures for stopping payment on ordinary checks will initially be considered. Against this general background, both a bank's right to stop payment when it asserts its own defense and the right to stop payment when a bank asserts the defense of its customer will be discussed.

I. NATURE OF A CASHIER'S CHECK

A simple definition suffices to denote the legal character of a cashier's check:

A cashier's check is simply a bill of exchange or draft drawn by a bank upon itself and is accepted by the act of issuance.²

Thus the drawer and the drawee are the same. The bank apparently has all the obligations of both drawer and drawee except insofar as the obligations of the one are owed to the other.

In considering the precise nature of a cashier's check, courts have noted that cashier's checks are the functional equivalents of cash. As stated by the New York Court of Appeals: "by reason of the peculiar character of cashier's checks and their general use in the commercial world they [are] to

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¹ Bank checks, i.e. checks drawn by one bank upon another, may or may not share in the specialized legal analysis that has been applied to cashier's checks. Compare *Fulton Nat'l Bank v. Delco Corp.*, 128 Ga. App. 16, 18, 195 S.E.2d 455, 457 (1973) (bank check is merely a check where the customer is another bank) with *Malphrus v. Home Sav. Bank*, 44 Misc. 2d 705, 707, 254 N.Y.S.2d 980, 982 (Albany County Ct. 1965) (bank or teller's check is taken as the equivalent of cash). Certified checks share most of the same characteristics as cashier's checks, but there are some differences. See J. BRADY, *BANK CHECKS*, § 7.6 at 156 (Bailey ed. 1969) (BRADY). This article addresses only cashier's checks and not any of the numerous other kinds of instruments which fall on various points in the spectrum between being primary obligations of the bank and purely private obligations of individuals. See generally Annot. *Right of Bank Certifying Check or Note by Mistake to Cancel, or Avoid Effect of, Certification*, 25 A.L.R.3d 1367 (1969); Benson, *Stop Payment of Cashier's Checks and Bank Drafts Under The Uniform Commercial Code*, 2 OHIO N.L. REV. 445 (1975); Note, *Personal Money Orders and Teller's Checks: Mavericks Under the U.C.C.*, 67 COLUM. L. REV. 524 (1967); Note, *Blocking Payment On A Certified, Cashier's or Bank Check*, 73 MICH. L. REV. 424 (1974).

² BRADY, *supra* note 1, § 1.6 at 10. See, e.g., *Walker v. Sellers*, 201 Ala. 189, 191, 77 So. 715, 717 (1918); *Pennsylvania v. Curtiss Nat'l Bank*, 427 F.2d 395, 398 (5th Cir. 1970); 6 A. MICHIE, *BANKS AND BANKING* 359 (1975) (MICHIE).

be regarded substantially as the money which they [represent]."³ Similarly, a New Jersey Court has explicated the rationale for treating cashier's checks as cash by observing that "people accept a cashier's check as a substitute for cash because the bank stands behind it, rather than an individual."⁴ Whether or not one characterizes the cashier's check as being "like cash," it cannot be doubted that cashier's checks are widely used, are readily taken by sellers, and thus serve a strong public policy.⁵ A cashier's check, unlike an ordinary check, stands on its own foundation as an independent, unconditional and primary obligation of the bank.⁶

Some courts, while not disputing the concept that cashier's checks serve an important function, have disagreed with the classical characterization that a cashier's check is a draft drawn by a bank upon itself and accepted at issuance.⁷ The courts which have taken issue with that definition have relied on section 3-118 (a) of the Code which provides that a draft drawn on the drawer is effective as a note.⁸ Since the maker of a note may assert certain defenses against the holder and thus resist payment,⁹ such a reference to the Code provisions pertaining to ordinary notes and checks might lead a court more readily to allow payment stoppage of a cashier's check upon the request of the bank's customer. Before looking closer at this question, it is necessary to distinguish between payment stoppage of ordinary checks and stoppage of cashier's checks.

II. ORDINARY CHECKS: THE RIGHT TO STOP PAYMENT

An ordinary check is an instruction to the bank by the depositor-customer to pay to the order of a named payee.¹⁰ Since the drawee bank is not liable until it accepts the check,¹¹ the check does not operate as an assignment of funds to the payee.¹² In the case of an ordinary check the customer has the right to countermand his payment order to the bank, prior to the bank's payment or acceptance.¹³ Although processing stop payment

³ *Hathaway v. County of Delaware*, 185 N.Y. 368, 374 (1906). Numerous cases have discussed or commented upon the similarity of cashier's checks to cash. See, e.g., *Munson v. American Nat'l Bank & Trust Co. of Chicago*, 484 F.2d 620, 624 (7th Cir. 1973); *Allison v. First Nat'l Bank in Albuquerque*, 85 N.M. 283, 286, 511 P.2d 769, 772 (1973); *First Nat'l Bank v. Noble*, 179 Ore. 26, 34, 168 P.2d 354, 366-67 (1946); *Angelo v. Chemical Bank & Trust Co.*, 529 S.W.2d 783, 786-87 (Tex. App. 1975).

⁴ *National Newark & Essex Bank v. Giordano*, 111 N.J. Super. 347, 351, 268 A.2d 327, 329 (1970). But see *TPO, Inc. v. FDIC*, 487 F.2d 131, 136 (3d Cir. 1973).

⁵ See *Kaufman v. Chase Manhattan Bank, N.A.*, 370 F. Supp. 276, 278-79 (S.D.N.Y. 1973).

⁶ *Pennsylvania v. Curtiss Nat'l Bank of Miami Springs*, 427 F.2d 395, 400 (5th Cir. 1970).

⁷ *TPO, Inc. v. FDIC*, 487 F.2d 131, 135-36 (3d Cir. 1973); *Banco Ganadero y Agricola, S.A. v. Society Nat'l Bank of Cleveland*, 418 F. Supp. 520, 524 (N.D. Ohio 1976).

⁸ *TPO, Inc. v. FDIC*, 487 F.2d 131, 135-36 (3rd Cir. 1973); *Banco Ganadero y Agricola, S.A. v. Society Nat'l Bank of Cleveland*, 418 F. Supp. 520, 524 (N.D. Ohio 1976). See also *Laurel Bank and Trust Co. v. City Nat'l Bank of Conn.*, 33 Conn. Supp. 641, 365 A.2d 1222 (Conn. Super. Ct. 1976).

⁹ See U.C.C. §§ 3-306, 3-408.

¹⁰ *Kaufman v. Chase Manhattan Bank, N.A.*, 370 F. Supp. 276, 278 (S.D.N.Y. 1973); U.C.C. § 3-104.

¹¹ U.C.C. § 3-409.

¹² U.C.C. §§ 3-409, 3-410.

¹³ U.C.C. § 4-403. The countermanding order must be given in timely fashion. U.C.C. § 4-303.

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orders is burdensome, costly, and somewhat risky for the bank, according to the Code draftsmen "stopping payment is a service which depositors expect and are entitled to receive from banks . . ."¹⁴ To that end the Code expressly provides that a customer may stop payment on "any item payable for his account."¹⁵ Thus, stop payment orders on ordinary checks are sanctioned by commercial practice as well as by the Code.

III. STOPPING PAYMENT ON CASHIER'S CHECKS

A. General Analysis

Unlike the liberality with which payment orders on ordinary checks are countermanded, the general rule is that a cashier's check is not subject to countermand.¹⁶ Since "a cashier's check is a bill of exchange drawn by a bank on itself, accepted in advance by the act of issuance, [it] is not generally subject to countermand."¹⁷ Thus, under the general view, a cashier's check has the free transferability normally associated with cash. Indeed, because the inability to "stop payment" has been deemed basic to the nature of a cashier's check, some authorities have included this "characteristic" in the very definition of a cashier's check.

This reluctance to allow the stopping of payment of cashier's checks has been justified on the grounds that the rule serves the public policy favoring the ready acceptance of cashier's checks in the marketplace. Refusing to stop payment on cashier's checks is likewise consistent with the conventional analysis that a cashier's check is a draft "accepted" at the moment of issuance.

If the cashier's check is considered an accepted draft rather than a note, it is nevertheless a primary obligation of the drawee bank.¹⁸ Under this classification, a cashier's check is not an item "payable for" the account of the customer and thus the Code-defined right to stop payment of a personal check does not apply.¹⁹ Furthermore, any countermanding order from the customer must be received by the bank within a reasonable time prior to acceptance.²⁰ Clearly, if the draft — cashier's check — has been deemed accepted at the moment of issuance, a subsequent request from the "customer" to stop payment on the check is necessarily subsequent to the bank's acceptance of the check.²¹

The analysis would not be markedly different if one were to consider the cashier's check as a note, in accordance with U.C.C. § 3-118 (a), instead of as a draft accepted at issue. If a cashier's check is a "note" of the bank — a promise on the bank's part to pay — it is no more an item "payable for" the customer's account than is a draft of the customer accepted at

¹⁴ U.C.C. § 4-403, Comment 2.

¹⁵ U.C.C. § 4-403.

¹⁶ *Munson v. American National Bank & Trust Co. of Chicago*, 484 F.2d 620, 624 (7th Cir. 1973); *Pennsylvania v. Curtiss Nat'l Bank of Miami Springs Fla.*, 427 F.2d 395, 398 (5th Cir. 1970); *Ross v. Peck Iron & Metal Co.*, 264 F.2d 262, 269 (4th Cir. 1959).

¹⁷ *MICHE*, *supra* note 2, at 359; see *BRADY*, *supra* note 1, § 13.7.

¹⁸ See U.C.C. §§ 3-409, 3-410.

¹⁹ See U.C.C. § 4-403; *Wertz v. Richardson Heights Bank and Trust*, 495 S.W.2d 572, 574 (Tex. 1973); *Benson*, *supra* note 1, at 448.

²⁰ U.C.C. § 4-303.

²¹ *Kaufman v. Chase Manhattan Bank, N.A.*, 370 F. Supp. 276, 278 (S.D.N.Y. 1973).

the moment of issue by the bank.²² Indeed, regardless of whether the cashier's check is a note or a draft, it is a direct obligation of the bank, and the bank's customer, who holds the check, is not a party to the instrument and is therefore not liable for the check.²³ Since the cashier's check is the exclusive obligation of the bank, the holder of the check does not have the right to "stop" the payment which is owed by the bank—whether acceptor or maker—to the payee.²⁴

Hence, whether or not payment can be "stopped" on a cashier's check is not a function of the customer's untrammelled right to countermand his own order. The analogy to the ordinary draft or note is inappropriate and accordingly does not resolve the overriding issue of the circumstances under which a bank may properly decline to honor its own primary obligation. The resolution of this issue should not depend on whether the primary obligation is viewed as a note or a draft.

This article will now examine the courts' treatment of the issue of whether payment of cashier's checks may be stopped. The analysis will consider the issue in the context of the two most familiar fact patterns: first, the situation in which the bank has some defense of its own against the payee or holder, and, second, the situation wherein the bank has been requested by the person who originally procured the check not to pay it because of some claim or defense which that person has against the holder or payee.

B. *The Bank Asserts Its Own Defense*

Although a cashier's check is most often issued by the bank at the request of its customer,²⁵ it quite often happens that the bank will, when it comes time for payment, assert its own claim or defense on the instrument. For example, the bank may have taken a check of its customer's and issued a cashier's check in exchange, only to learn later that the customer's account had insufficient funds. In this case, the bank may wish to stop payment on its own cashier's check. If the cashier's check was obtained by a worthless check or if the bank made a mistake in the issuance of the check, the issue becomes whether the bank may decline to pay the cashier's check and proceed to litigate the merits of its purported defense. If the oft repeated principle that cashier's checks are not subject to countermand is stringently applied, the bank will be forced to pay the cashier's check regardless of whether the bank has an otherwise recognizable defense.²⁶

²² See U.C.C. §§ 3-104, 4-403.

²³ See Benson, *supra* note 1, at 448-49.

²⁴ See U.C.C. § 3-413 for a discussion of the contractual engagements of primary obligors on drafts or notes.

²⁵ The word "customer" is used herein in a broad sense as referring to the person who has persuaded the bank to issue a cashier's check, regardless of whether or not that person has an account, or any type of long-term business relationship, with the bank. "Remitter" might be a more appropriate term, see W. BRITTON, *BILLS AND NOTES* 177-81 (2d ed. 1961), but the text of the U.C.C. does not use the word.

²⁶ It is beyond the scope of this article to explore the elements of every defense which may be claimed. For example, precisely what circumstances will suffice to enable an accepting or paying bank to escape payment or recover payment back by reason of mistake is a matter of considerable uncertainty. Compare *First Nat'l Bank of Portland v. Noble*, 179 Ore. 26, 34, 168 P.2d 354, 366-67 (1946) and *RESTATEMENT OF RESTITUTION* § 33 (1937) with *Wright v. Trust Co. of Georgia*, 108 Ga. App. 783, 788-89, 134 S.E. 2d 457, 462 (1963) and *Rockland*

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In the past, courts have almost always, by one means or another, allowed the bank to litigate the merits of its defense to payment of the cashier's check. If the bank is adjudged to have no valid defense on the merits, then the court will order the bank to pay the check.²⁷ Likewise, if the holder has the rights of a holder in due course²⁸ or if the holder has in good faith changed its position,²⁹ then the bank will be ordered to pay even though the bank might otherwise have had a defense. However, if the bank has a valid defense and the holder is neither a holder in due course, nor one having the rights of a holder in due course, nor one who has in good faith changed its position, the bank will prevail and will be allowed to refuse to pay its own cashier's check.³⁰

In general the defenses which have allowed banks to defeat holders of the bank's cashier's checks cluster around fraud, lack or failure of consideration, and mistake. For example, in *Mine & Smelter Supply Co. v. Stock Growers' Bank*,³¹ the bank issued a cashier's check with the expectation of being paid the next day.³² When payment was not received the following day, the bank was permitted to "stop payment" on the cashier's check even though the customer-payee introduced some evidence of change of position at trial.³³ In *Kinder v. Fishers National Bank*³⁴ the cashier's check was issued in exchange for a check which, subsequently, was not paid because of a stop order on the customer's personal check.³⁵ The court found that payment of the cashier's check, which had not found its way into the hands of a holder in due course, was properly refused by the bank.³⁶

These results appear contrary to the general principle that a cashier's check is accepted at the time of its issuance and therefore payment on the

Trust Co. v. South Shore Nat'l Bank, 366 Mass. 74, 81, 314 N.E.2d 438, 443 (1974). The question discussed herein is whether the courts will address the issue at all or rather will merely enter judgment against the bank because cashier's checks must be paid.

²⁷ *Pennsylvania v. Curtiss Nat'l Bank of Miami Springs*, 427 F.2d 395, 398 (5th Cir. 1970); *Citizens Bank of Booneville v. National Bank of Commerce*, 334 F.2d 257, 260-61 (10th Cir. 1964); *Banco Ganadero y Agricola, S.A. v. Society Nat'l Bank of Cleveland*, 418 F. Supp. 520, 524 (N.D. Ohio 1976); *Gillespie v. Riley Mgmt. Corp.*, 59 Ill. 2d 211, 215, 319 N.E.2d 753, 756-57 (1974); *First Nat'l Bank of Portland v. Noble*, 179 Ore. 26, 34, 168 P.2d 354, 366-67 (1946).

²⁸ *Citizens Bank of Booneville v. National Bank of Commerce*, 334 F.2d 257, 260-61 (10th Cir. 1964); *Wertz v. Richardson Heights Bank and Trust*, 495 S.W.2d 572, 574 (Tex. 1973).

²⁹ *Citizens Bank of Booneville v. National Bank of Commerce*, 334 F.2d 257, 261 (10th Cir. 1964). See *Mine & Smelter Supply Co. v. Stock Growers' Bank*, 200 F. 245, 247 (8th Cir. 1912); *National Bank of California v. Miner*, 167 Cal. 532, 534, 140 P. 27, 30 (1914).

³⁰ *TPO, Inc. v. FDIC*, 487 F.2d 131, 136 (3d Cir. 1973); *Mine & Smelter Supply Co. v. Stock Growers' Bank*, 200 F. 245, 247 (8th Cir. 1912); *Banco Ganadero v. Agricola, S.A. v. Society Nat'l Bank of Cleveland*, 418 F. Supp. 520, 524 (N.D. Ohio 1976); *Bank of Coffee Springs v. W.A. McGilvray & Co.*, 167 Ala. 408, 409, 52 So. 473, 474 (1910); *National Bank of California v. Miner*, 167 Cal. 532, 534, 140 P. 27, 30 (1914); *Wilmington Trust Co. v. Delaware Auto Sales*, 271 A.2d 41, 42 (Del. 1970); *Tropicana Pools, Inc. v. First Nat'l Bank of Titusville*, 206 So. 2d 48, 51 (Ct. App. Fla. 1968); *Wright v. Trust Co. of Georgia*, 108 Ga. App. 783, 788-89, 134 S.E.2d 457, 462 (1963); *Kinder v. Fishers Nat'l Bank*, 93 Ind. App. 213, 214, 177 N.E. 904, 906 (1931); *Dakota Transfer & Storage Co. v. Merchants Nat'l Bank & Trust Co.*, 86 N.W. 2d 639, 644 (N.D. 1957).

³¹ 200 F. 245 (8th Cir. 1912).

³² *Id.* at 247.

³³ *Id.* at 247-48.

³⁴ 93 Ind. App. 213, 177 N.E. 904 (1931).

³⁵ *Id.* at 214-15, 177 N.E. at 905-06.

³⁶ *Id.* at 218-19, 177 N.E. at 906.

check cannot be stopped. Indeed, some courts while stating the general rule have actually applied a narrower one. For example, in *Wertz v. Richardson Heights Bank and Trust*,³⁷ the court broadly enunciated the principle that a cashier's check is accepted at issue and that payment on the check can not be countermanded. Despite its apparent adoption of this rule of law, the court nevertheless considered the status of plaintiff and concluded that plaintiff was a holder in due course.³⁸ If payment can not be stopped on a cashier's check, the court's consideration of the plaintiff-holder's status was unnecessary to the disposition of the case. Thus, *Wertz* demonstrates that although courts broadly declare that payment on cashier's checks may not be stopped, the specific holdings of such cases may indicate adherence to a much narrower rule.

Contrary to the cases which have permitted the banks to stop payment on their own cashier's checks, there are cases which have quite literally applied the broad prohibitory language against stoppage of payment as to cashier's checks when the bank attempted to assert its own defense. In *Kaufman v. Chase Manhattan Bank, N.A.*³⁹ the court, noting that "it is beyond the power of the bank to stop payment" on cashier's checks after delivery,⁴⁰ ruled that evidence proffered by the bank that it had not received consideration for the check was irrelevant.⁴¹ The court accordingly entered summary judgment for the payee, who was not shown to have been a holder in due course or to have changed her position in reliance upon the check.⁴²

The harshness created by strictly following the general principle has been ameliorated in some cases by invocation of the doctrine of offset. In *Munson v. American National Bank & Trust Co.*,⁴³ plaintiff was the holder of three cashier's checks issued by defendant bank.⁴⁴ These cashier's checks had been issued in exchange for a draft which had been endorsed by the payee to plaintiff and, in turn, endorsed by plaintiff.⁴⁵ When payment was stopped on the draft, thus depriving defendant-bank of its consideration for the issuance of its cashier's checks, the bank attempted to stop payment on its cashier's checks.⁴⁶ The court held that defendant could not "stop payment" on its own cashier's checks.⁴⁷ However, the court did permit the

³⁷ 495 S.W.2d 572, 574 (Tex. 1973).

³⁸ *Id.*

³⁹ 370 F. Supp. 276 (S.D.N.Y. 1973).

⁴⁰ *Id.* at 278.

⁴¹ *Id.* at 278-79.

⁴² *Id.* In *Kaufman*, the court applied New York law, which has been notably strict in its approach to the question whether a bank may avail itself of defenses of its customer when declining to honor a cashier's check. In *Moon Over The Mountain, Ltd. v. Marine Midland Bank*, 87 Misc. 2d 918, 924, 386 N.Y.S.2d 974, 978 (Civ. Ct. N.Y. 1976), however, the court entered summary judgment against a bank which was attempting to raise a defense claimed by its customer. The court specifically noted that the result would be different if the bank were asserting a defense of its own, 87 Misc. 2d at 921, 386 N.Y.S.2d at 976. In *Dziurak v. Chase Manhattan Bank, N.A.*, 396 N.Y.S.2d 414, 416 (App. Div. 1977), the court held that, faced with the adverse claim of its customer, the bank "could quite safely have stopped payment on its cashier's check" and resorted to interpleader. Thus New York law may be less stringent than the court in *Kaufman* assumed.

⁴³ 484 F. 2d 620 (7th Cir. 1973).

⁴⁴ *Id.* at 621.

⁴⁵ *Id.* at 621-22.

⁴⁶ *Id.* at 622.

⁴⁷ *Id.* at 624-25.

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defendant bank to offset its own claim against plaintiff on the dishonored draft which plaintiff had endorsed against the payment owed to plaintiff by virtue of the three cashier's checks.⁴⁸ The court ruled that the bank's offset created an affirmative defense to plaintiff's cause of action.⁴⁹ A similar result obtained in *Matter of Johnson*⁵⁰ where the court held that the issuing bank could not escape its obligation to pay its own cashier's check but could offset a debt owed to the bank by the payee.⁵¹

Neither the *Munson* nor the *Johnson* courts considered the question of plaintiffs' status as holders in due course as determinative of their rights to recover on the cashier's checks. Rather, the two cases stand for a very broad statement of the general rule that a bank may not stop payment on its own cashier's checks. Despite enunciation of this rule, in both cases the bank was allowed to litigate the merits of its contentions and in each case the bank prevailed to the extent of its offset.

Rather than adhering to the general rule, it would have been preferable if the *Munson* court had recognized that the issuing bank can assert defenses such as failure or want of consideration so long as the holder, suing on the cashier's check, does not have rights equivalent to those of a holder in due course.⁵² This is particularly true since the claim of the bank concerned the very transaction from which the cashier's check issued. In general, where the rights of innocent third persons are not involved, there is no overpowering reason to compel a bank to pay its own cashier's check without regard to possible defenses. If the bank, under familiar principles of law, has a valid defense against the plaintiff, it would seem that the interests of ready acceptability of cashier's checks are not sufficient to overcome the bank's defense. However, where innocent third persons have taken the instrument for value, perhaps relying upon the fact that cashier's checks are "like cash," then obviously the result must be different. These principles should be recognized forthrightly in the analysis of the holder's claim against the bank. Nothing is gained by resorting to concepts of offset and permissive and compulsory counterclaims to achieve an equitable result.⁵³

The *Johnson* case, however, illustrates a situation where it is appropriate to resort to the principle of offset. No defense to the cashier's check is asserted as such, but rather it happens that the payee itself owes the bank money. Therefore, the analysis of the *Johnson* court would appear correct.

In situations where a holder sues the issuing bank on a cashier's check and the bank asserts a defense of its own, the result of the litigation should not depend upon whether the instrument is treated as a note or an accepted draft. Either a note or a draft qualifies as an instrument,⁵⁴ and

⁴⁸ *Id.* Under U.C.C. §§ 3-414 and 4-207(2) plaintiff had undertaken to pay the draft upon dishonor.

⁴⁹ 484 F.2d at 625.

⁵⁰ 552 F.2d 1072 (4th Cir. 1977).

⁵¹ *Id.* at 1077-78.

⁵² See cases and text at note 32 *supra*.

⁵³ Followed literally, the *Munson* court's analysis would require the bank to pay if the present plaintiff had endorsed the cashier's checks to a third person who had given no consideration. The bank's claim against Mr. Munson could not, of course, be asserted as a "counterclaim" against the third person who could thus force the bank to pay, despite its valid defense and despite the fact that the holder gave no consideration.

⁵⁴ See U.C.C. § 3-104.

holders, other than holders in due course, take instruments subject to numerous possible defenses.⁵⁵ Thus, the characterization of the cashier's check as a note or a draft is somewhat pointless. Instead, in analyzing situations in which a bank wishes to stop payment on a cashier's check, courts should permit the bank to litigate its defense so long as the rights of third parties have not been jeopardized by the bank's refusal to pay its check.

C. *The Bank Asserts The Defense of its Customer*

Perhaps more typical than the case in which a bank asserts its own defenses to a cashier's check are those situations in which the bank is requested by its customer to decline to pay the payee or endorsee on the grounds that the customer has a claim or defense against the payee or holder. The question is thus raised whether the bank may honor the customer's request and then litigate the merits of the customer's contentions when the payee or holder sues the bank for failure to honor its own cashier's check.

The facts of a typical consumer transaction highlight the bank's dilemma. The bank's customer wishes to buy a car and the seller, reluctant to accept a personal check which may be returned for insufficient funds or because of a stop payment order, readily takes a cashier's check, either payable directly to the seller or payable to the buyer—the bank's customer—and endorsed over to the seller. Following the purchase the buyer discovers some problem with the car which causes him to ask the bank to stop payment on the check while the buyer seeks to rescind the sale. Thus, the bank's customer has requested the bank to refuse to honor its own cashier's check.

As a starting point, it is clear that the customer has no absolute right to require the bank to stop payment. This is so because the check constitutes a primary obligation of the bank. It is not "payable for" the customer's account, and furthermore, under the conventional analysis, the request for a stop payment comes after issuance and thus after "acceptance," whereas under the Code a stop payment order must be received a reasonable time before acceptance.⁵⁶ In reference to the lack of any duty on the part of the bank to honor a stop payment request made after the bank has certified acceptance of a check, the Code suggests that the drawee-bank "is not required to impair his credit by refusing payment for the convenience of the drawer."⁵⁷ If the bank does not have to honor a stop payment request after it has accepted an ordinary check, the same principle a fortiori applies with regard to cashier's checks since the bank's customer is not even a party to such a check.⁵⁸

⁵⁵ See U.C.C. §§ 3-305, 3-306, 3-408. The act of acceptance, while creating a primary obligation on the part of the acceptor, U.C.C. § 3-410, does not forever preclude the acceptor from any possible defense on the instrument. For example, the person obtaining acceptance makes certain warranties to the acceptor, U.C.C. § 3-417, which presumably may be utilized by the acceptor in appropriate circumstances. The finality of acceptance will often depend upon whether or not the holder is a holder in due course. U.C.C. § 3-418.

⁵⁶ U.C.C. §§ 4-303, 4-403.

⁵⁷ U.C.C. § 4-403, Comment 5.

⁵⁸ Three pre-Code cases have held that, under the circumstances of those cases, the bank was under a duty to stop payment on its cashier's check at the request of its customer. *Drinkall v. Movius State Bank*, 11 N.D. 10, 13, 88 N.W. 724, 726 (1901); *Nielsen v. Planters*

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The options available to the bank faced with a request or demand by its customer that payment of a cashier's check be stopped and a corresponding demand by the holder that the bank's obligation be honored entail an analysis of sections 3-603 and 3-306 of the Code. Section 3-603(1) provides in part:

The liability [for payment] of any party is discharged to the extent of his payment or satisfaction to the holder even though it is made with knowledge of a claim of another person to the instrument unless prior to such payment or satisfaction the person making the claim either supplies indemnity deemed adequate by the party seeking the discharge or enjoins payment or satisfaction by order of a court of competent jurisdiction in an action in which the adverse claimant and the holder are parties.

Under section 3-603(1), then, mere notice that the bank's customer thinks that it was cheated by the seller does not impose a duty upon the bank to decline to honor the cashier's check when presented by the seller. The bank is not placed in the position of having to determine the merits of a dispute between its customer and a third person. As Comment 2 to section 3-603 points out, "[W]hen the party to pay is notified of an adverse claim to the instrument he has normally no means of knowing whether the assertion is true." Thus section 3-603 relieves the bank of any responsibility for arbitrating the dispute.

If, however, the customer either supplies indemnity deemed adequate by the bank, or obtains injunctive relief in a case in which both the customer and the holder are parties, then under section 3-603 the bank is freed of its immediate obligation to pay.⁵⁹ In either case, the claim of the customer against the seller must be litigated by the customer itself. Moreover, under section 3-306(d) the bank may not, on its own, defend the holder's suit by resorting to claims of the bank's customer. Yet if the customer actually assumes the defense after indemnifying the bank fully,⁶⁰ the bank is entitled to the benefit of whatever claims the customer has and can successfully assert against the holder.⁶¹

The above resolution under section 3-603 and 3-306 demonstrates the Code's handling of the complex common law concept of *jus tertii* or rights of third parties. At common law an obligor could set up a claim of a third person by way of defense to the action of the holder if the third person

Trust & Sav. Bank, 183 La. 645, 647, 164 So. 613, 615-16 (1935); *Wolf v. Title Guarantee & Trust Co.*, 251 App. Div. 354, 356, 296 N.Y.S. 800, 802-03 (1937). *aff'd*, 277 N.Y. 626, 14 N.E.2d 193 (1938).

⁵⁹ U.C.C. § 3-603(1). See U.C.C. § 3-603, Comments 2 and 3. The bank may ultimately be required to pay, of course, if the holder prevails on the merits. Presumably the customer's indemnity will have held the bank harmless and the customer will have litigated its claim in its own name and at its own expense. U.C.C. § 3-306(d).

⁶⁰ Requiring the customer to obtain injunctive relief or post indemnification is consistent with the Code rule that a holder, other than a holder in due course, takes an instrument subject to "all valid claims to it on the part of any person." U.C.C. § 3-306(a).

⁶¹ It appears, according to the terms of § 3-306(d) itself, that claims that the instrument was stolen or that payment would be inconsistent with a restrictive endorsement may be raised by the bank in defense to the holder's suit even if the third person asserting these allegations does not make that defense for the bank. Other claims require the active participation by the third person.

had legal title to the instrument.⁶² However, the obligor-bank could not assert a third party's rights if the third party had merely an equitable claim to the instrument.⁶³ The Code appears to expand the obligor-bank's alternatives in the situation where the cashier's check is presented by someone other than a person having the rights of a holder in due course. If the holder of the check is not a holder in due course and the bank's customer requests that the bank not pay, the bank may ignore the request and decline to assert defenses against the holder unless properly indemnified by the customer, who must take over the burden of asserting the claim. The bank will prevail if the customer succeeds in establishing any "valid claim" to the instrument. Thus, the bank, under the Code, does not have to resolve the issue of title to the cashier's check and may choose not to become embroiled in the dispute between its customer and the check's holder.

Given the broad Code definition of claims against instruments allowing the bank to disengage itself from the controversy is a commercially sound policy. Specifically, Comment 2 to section 3-306 states:

"All valid claims to [the contested instrument] on the part of any person" includes not only claims of legal title, but all liens, equities, or other claims of right against the instrument or its proceeds. It includes claims to rescind a prior negotiation and to recover the instrument or its proceeds.⁶⁴

Thus while the Code uses the word "claim" instead of "claim or defense," if the customer's complaint against the seller-payee is serious enough to give rise to the right of rescission of the underlying transaction, the customer may assert this defense and if the defense is valid the customer may claim the proceeds of the cashier's check by way of rescission or restitution.⁶⁵ However, it should be noted that the customers' claims must be related to the issuance or transfer of the cashier's check and unrelated claims which the customer might have against the seller will not be considered.⁶⁶

Pre-Code cases sometimes allowed, or even occasionally required, a bank to refuse to pay its own cashier's check if the customer asserted some claim against the holder-seller. The decisions did not always purport to consider whether the holder had "legal" title to the cashier's check. Thus, courts did not consistently adhere to the common law principles referred to in the literature.⁶⁷ For instance, if the cashier's check was transferred to the

⁶² Note, *Blocking Payment On A Certified, Cashier's or Bank Check*, 73 MICH. L. REV. 424, 428-33 (1974). See also 5 C. ZOLLMAN, *BANKS AND BANKING* § 3198 (1936); 2 T. PATON, *DIGEST OF LEGAL OPINIONS* 1656 (1918); Chafee, *Rights in Overdue Paper*, 31 HARV. L. REV. 1104, 1108 (1918).

⁶³ Note, *supra* note 62, at 428-33.

⁶⁴ See also U.C.C. § 3-306, Comment 5.

⁶⁵ See generally Comment, *Adverse Claims and the Consumer: Is Stop Payment Protection Available?*, 67 NW. U. L. REV. 915 (1973). See, e.g., U.C.C. §§ 2-608, 2-711. See also *Jacobs v. Metro Chrysler-Plymouth, Inc.*, 125 Ga. App. 462, 465, 188 S.E.2d 250, 254 (1972) (car purchaser able to recover the purchase for a breach by the seller of its warranty to repair).

⁶⁶ Under the fairly liberal permissive counterclaim procedures now available in many jurisdictions, the customer as a practical matter might be able to force litigation of even such unrelated matters before a final judgment enters. See, e.g., FED. R. CIV. P. 13(b). Whether this could be accomplished in a particular case would depend upon such factors as the court's willingness or ability to sever or to order separate trials, see *id.* 13(i) and 42(b), or enter partial summary judgment, see *id.* 56(d) and 54(b). Such questions are beyond the scope of this article.

⁶⁷ See authorities cited in note 49 *supra*.

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holder by the customer in payment of an illegal gambling debt, the bank could properly refuse to pay the holder.⁶⁸ One case even went so far as to rule that where the cashier's check was endorsed over to pay an illegal gambling debt, payment could be subsequently refused a holder in due course since gambling debts are absolutely void.⁶⁹ Similarly, if the customer alleged fraud on the part of the seller and the customer persuaded the bank to decline to pay, the bank was entitled to litigate the merits of the fraud allegations.⁷⁰ Failure or want of consideration was also a sufficient excuse to allow a bank, at the request of its customer, to decline to pay.⁷¹ In these situations, the bank could, rather than pay the holder, resort to interpleader where there were competing claims to the check.⁷²

There have been comparatively few cases decided under the Code considering the issue of whether the bank can raise the claims or defenses of its customer when faced with the demand of the holder that a cashier's check be paid. In one such case, *National Newark & Essex Bank v. Giordano*,⁷³ the court asserted that cashier's checks must be honored. There, a customer, sued by the bank on a loan balance, defended on the ground that the bank should have honored its request to stop payment on a cashier's check issued to a truck seller who allegedly had sold the customer a defective truck.⁷⁴ The New Jersey Court ruled against the customer, asserting in broad terms that cashier's checks cannot be countermanded.⁷⁵ Despite its broad language, however, given the facts and allegations, the case merely stands for the proposition that a bank may not be compelled to honor its customer's request to stop payment. It remains to be seen whether the New Jersey Court would hold, following the broad language in *Giordano*, that a bank which did honor its customer's request, obtained appropriate indemnity and had the customer defend, was acting improperly without regard to the merits of the customer's case.⁷⁶

Unlike the bank in *Giordano*, the bank in *Moon Over The Mountain, Ltd. v. Marine Midland Bank*,⁷⁷ honored its customer's request to stop payment. In *Moon Over The Mountain, Ltd.*, the customer filed an affidavit with the bank asserting that the check had been lost and requested the bank not to honor the check.⁷⁸ Nonetheless, the court entered summary judgment for

⁶⁸ *Nielsen v. Planters Trust & Sav. Bank*, 183 La. 645, 647, 164 So. 613, 614 (1935); *Drinkall v. Movius State Bank*, 11 N.D. 10, 11-13, 88 N.W. 724, 725-27 (1901). See *Winecoff Operating Co. v. Pioneer Bank*, 179 Tenn. 306, 309, 165 S.W.2d 585, 588-89 (1942) ("cashier's negotiable certificate," holder prevails on the merits only because he was holder in due course).

⁶⁹ *Manufacturers' & Mechanics Bank of Kansas City v. Twelfth St. Bank*, 223 Mo. App. 191, 194, 16 S.W.2d 104, 106 (1929).

⁷⁰ *Leo Syntax Auto Sales, Inc. v. Peoples Bank & Sav. Co.*, 215 N.E.2d 68, 70-71 (Ct. Com. Pleas Ohio 1965). See 6 A. MICHIE, BANKS AND BANKING 372-73 (1975).

⁷¹ *First Nat'l Bank of Mishawaka v. Associates Inv. Co.*, 221 N.E.2d 684, 688 (Ind. App. 1966). This case concerned a variation of the cashier's check equivalent of the eternal triangle: bank, car purchaser, and auto dealer. *Id.* at 684-85.

⁷² *State v. District Ct. of First Jud. Dist.*, 94 Mont. 551, 25 P.2d 396, 399 (1933).

⁷³ 111 N.J. Super. 347, 268 A.2d 327 (1970).

⁷⁴ *Id.* at 348, 268 A.2d at 328.

⁷⁵ *Id.* at 350, 268 A.2d at 329.

⁷⁶ The customer in *Giordano* did offer to post a bond in favor of the bank if it would stop payment. *Id.* at 350, 268 A.2d at 329. The court in ruling that this fact was irrelevant did not refer to § 3-603(1). *Id.*

⁷⁷ 87 Misc. 2d 918, 386 N.Y.S.2d 974 (Civ. Ct. N.Y. 1976).

⁷⁸ *Id.* at 919, 386 N.Y.S.2d at 975.

the holder against the bank, noting that under section 3-802 the payee's rights on the underlying transaction were lost once a cashier's check was taken in payment.⁷⁹ Section 3-802 provides that if an instrument is taken for an underlying obligation, the obligation is automatically discharged if a bank is the drawer, maker, or acceptor of the instrument. Thus, with the payee's, or holder's, rights in the underlying transaction gone, the court found that it would be inappropriate to permit the bank, now the primary and sole obligor, to escape its liability on the instrument.⁸⁰

In analysing *Moon Over The Mountain, Ltd.*, several points should be recognized. First, the court specifically stated that a bank may stop payment if it has a defense of its own, rather than an attempted defense of a third party.⁸¹ Second, the court pointed out that the customer's affidavit, upon which the bank relied, was cursory.⁸² Finally, the holding on the facts is correct: the bank attempted to avoid its own obligation by raising a claim or defense of a third person who was not a party to the case and who was not defending on behalf of the bank. Thus, the third person's claims were irrelevant under section 3-306(d) and the bank should have paid the holder of the check.

Another case addressing the general issue of a bank's right to refuse to honor a cashier's check is *Dziurak v. Chase Manhattan Bank, N.A.*⁸³ There, the court delineated procedures which a customer must follow to authorize a bank to stop payment. In *Dziurak*, the bank's customer had obtained a cashier's check payable to himself and had endorsed it over to one Staveris, who had sold the customer an interest in a restaurant.⁸⁴ Claiming fraud in the sale of the restaurant, the customer asked the bank to stop payment but Staveris demanded and received payment from the bank.⁸⁵ In the customer's suit against the bank, the New York lower court ruled that the bank should have acceded to the customer's request and entered judgment in favor of the customer.⁸⁶ The Appellate Division reversed the lower court's judgment but stated that "the Bank, as a practical matter, could quite safely have stopped payment" and resorted to interpleader.⁸⁷ The

⁷⁹ *Id.* at 920-21, 386 N.Y.S.2d at 976-77. U.C.C. § 3-802(1) states, in part:

(1) Unless otherwise agreed where an instrument is taken for an underlying obligation

(a) the obligation is pro tanto discharged if a bank is drawer, maker or acceptor of the instrument and there is no recourse on the instrument against the underlying obligor

Analytically, this section should not affect whatever right a bank may have to decline to pay a cashier's check at the request of its customer. Section 3-802 merely determines that the seller takes the cashier's check as payment, as he would with cash. This obviously has no effect on the buyer's right to rescind in a proper case. Rescission can be obtained even where cash payment has been made. The assertion of a right to rescission by the buyer-customer would give rise to a "claim" to the check, *see* U.C.C. § 3-306(a) and Comments 2 and 5. Such a claim could be raised as a defense by the bank against the holder if the customer defends the action for the bank. U.C.C. § 3-306(d).

⁸⁰ *Moon Over The Mountain, Ltd.*, 87 Misc. 2d at 923-24, 386 N.Y.S.2d at 977-78.

⁸¹ *Id.* at 920 n.*, 386 N.Y.S.2d at 976 n.*.

⁸² *Id.* at 923-24, 386 N.Y.S.2d at 977-78.

⁸³ 58 App. Div. 2d 103, 396 N.Y.S.2d 414 (1977).

⁸⁴ *Id.* at 105, 396 N.Y.S.2d at 415.

⁸⁵ *Id.*

⁸⁶ *Id.* at 108, 396 N.Y.S.2d at 417.

⁸⁷ *Id.* at 107, 396 N.Y.S.2d at 416.

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court noted, however, that the bank was under no duty to do so since the customer had not offered an indemnity bond nor sought an injunction.⁸⁸ The court ruled that since the customer did not pursue either of the two remedies available under section 3-603(1), the bank was entitled to honor the check.⁸⁹

Dziurak stands for the proposition that section 3-603 applies to cashier's checks and that payment can be stopped if the customer either resorts to the injunctive power of the court or posts indemnity for the bank. If the customer does neither, the bank may, nonetheless, pay the money into court and let the competing claimants litigate their claims. If the customer does not comply with section 3-603(1), however, the bank acts properly in paying the holder and is discharged from liability.

Assuming that section 3-603(1) does apply to cashier's checks and that a bank *may* properly decline to pay its check if the customer posts indemnity and agrees to defend the bank itself, the question then becomes whether the bank *must* refuse to pay the holder of the cashier's check in those circumstances. While the question is not free from doubt, the language of section 3-603, together with the Comments thereto,⁹⁰ indicates that if the customer adheres to the procedures set forth in section 3-603(1), the bank must decline to pay the instrument. The rationale for this result is that the bank presumably has adequately protected itself by virtue of the indemnity posted by the customer.⁹¹ While there certainly are strong policies to be served in favoring unimpeded processing and paying of these unique instruments, those interests would not appear logically served by leaving the question to the uncontrolled discretion of the paying party. If the bank is fully protected, the Code seems to contemplate that the two protagonists, the bank's customer and the ultimate holder of the check, should be allowed to litigate their contentions. Since the indemnity provided by the customer is a serious and expensive step, the customer is unlikely to proceed under section 3-603(1) unless the customer is convinced that he has a substantial claim against the holder.⁹² Moreover, since the litigation of legal rights between customer and seller, once payment has been fully accomplished, will often be a hollow exercise,⁹³ a customer who fol-

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ See Comment 3, which states, in part: "The paying party *may* pay despite notification of the adverse claim unless the adverse claimant supplies indemnity . . ." (emphasis added).

⁹¹ Section 3-603(1) provides that the indemnity must "be deemed adequate" by the bank. Comment 2 points out that there is no good reason to put the paying party to inconvenience because of a dispute between two other parties. Presumably, as the *Dziurak* court seems to have implied, indemnity would entail a bond and not merely a hold harmless agreement. "[T]he plaintiff was aware that . . . he could file an indemnity bond to protect the bank . . ." 58 App. Div. 2d at 107, 396 N.Y.S.2d at 416. Although if payment is not made the face amount of the check will be available when the litigation is concluded, there may well be attorneys' fees, incidental expenses, and possibly even consequential damages to take into account. See *Allison v. First Nat'l in Albuquerque*, 85 N.M. 283, 286, 511 P.2d 769, 772 (1973). Payment into court, where available, would be a desirable alternative. See the discussion on this point in Note, *supra* note 62, at 433-43.

⁹² See note 69 *supra*.

⁹³ In *Dziurak*, the seller was paid by the bank, the customer obtained a judgment against the seller, but no part of it was collected. 58 App. Div. at 104, 396 N.Y.S.2d at 415. Obviously, a dispute over whether a cashier's check is to be paid will often, as a practical matter, entail more than a question of the mere *timing* of payment.

lows the Code procedure should be able to force a bank to refuse payment on a cashier's check. The Code, by requiring indemnification of the bank or judicial intervention by way of injunction, has assured that the bank need not, at its peril, adjudge the merits of the bank customer's claim against the holder. Since the Code provides protection for the bank, there is no reason for allowing the bank to disregard its customer's stop payment request.

In sum, *Dziurak's* application of section 3-603 to cashier's checks is commercially sound. The alternatives available to both the bank and its customer when a stop payment on a cashier's check is demanded are clearly delineated thus fostering commercial predictability. Unlike the common law result, *Dziurak* permits the merits of the stop payment contest to be litigated by the interested parties—the bank customer and the holder. Thus, *Dziurak* advances a desirable and practical result to the issue of payment stoppages of cashier's checks.

CONCLUSION

Although much of the case law contains broad language indicating that cashier's checks must be paid and are not subject to countermand, the holdings of the cases indicate a much narrower rule of law. Where the bank asserts defenses of its own to payment of the cashier's check, the widespread tendency among the courts is to allow the bank to litigate the merits of its defense as well as the status of the holder as a holder in due course. If the bank prevails on both of these points, its refusal to pay will be upheld. While this result theoretically may detract from the immediate recognition which the business community affords to cashier's checks, the proposition that a bank must pay even though it may have a valid defense to payment and even though the rights of innocent third persons are not involved is not one which commends itself as appropriately invoked merely to serve such a goal.

Where the bank has issued the check at the request of its customer and subsequently is requested to stop payment by the customer, the case law is unclear. Despite the uncertainty in the case law, however, it is apparent that sections 3-306(d) and 3-603 apply to the situation.⁹⁴ Adherence to these Code provisions would produce a just and practical solution favoring immediate payment to the holder. The bank need not run an unsecured risk of being second-guessed as to which of competing claimants has the best entitlement to the proceeds. Moreover, under section 3-603 the person asserting that the bank should depart from the ordinary and desirable practice of paying its obligees must either persuade a court to order this be done or else post adequate and substantial security before the bank must refuse to pay the check. This latter is not a course lightly to be taken by the customer, and accordingly frivolous or weak claims will not likely be pursued.

⁹⁴ It is suggested by one commentator that the Code should be amended to add a specific provision allowing payment to be stopped only by resort to the injunctive power of the courts. Note, *supra* note 62, at 441-43.

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No substantial difference is discernible in the Code as being dependent upon the conceptual characterization of a cashier's check — draft or note — or the bank's status thereon — acceptor or maker. The bank is the party liable on the instrument. Where the bank asserts its own defense the outcome will depend upon the merits of its contentions and the status of the holder. Where the bank attempts to raise the claims of its customer, the customer should proceed under sections 3-603 and 3-306(d) and either indemnify the bank or obtain an injunction. These sections provide protection to a "party liable" on an instrument who makes "payment" or seeks "discharge." The protection is not aimed only at a particular category of "party liable" such as acceptor, maker, or drawer.

Finally, it would be well for the courts to eschew the phraseology of "stopping payment" when considering the question of a bank's right to decline to pay.⁹⁵ The phrase, rooted in the concept that a customer has an absolute right to order his bank not to pay, serves mainly to confuse the issue. The obligation on the instrument is that of the bank, and the law, not the "customer's" whim, should dictate when a bank may avoid this obligation.

⁹⁵ The writer acknowledges that he has not himself completely avoided the phrase herein.

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