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COMMENTS

BANK RESPONSIBILITY TO THIRD PARTY CLAIMANT AGAINST DEPOSITOR'S ACCOUNT

A bank may find itself in a very difficult situation upon receiving notice from a third party that he claims a deposit in the bank is his property and not the property of the person in whose name the deposit stands. Some states\(^1\) have adopted a statute which provides in substance that when a third party gives notice to a bank of an adverse claim to a deposit, the bank does not have to recognize such claim until it is directed to do so by proper court order or unless a proper indemnity bond is furnished the bank. The rules which obtain in the absence of such legislative enactment present a surprisingly varied expression of law. This comment treats of decisions handed down in courts where the common law prevails.

A leading authority has set forth what might be termed the common law rule governing the question in the following language:\(^2\)

"A bank is justified in paying to the depositor or his order until the fund is claimed by some other person; but, if notified that the funds belong to another, it will pay the depositor at its peril."

This statement of the rule tells the bank nothing concerning the nature or extent of notice required to remove the peril involved in not paying the depositor. The extensive liability to which a bank may be subject for wrongful dishonor of a depositor's checks makes it important for the bank to determine whether it has been "notified" by the third party claimant sufficiently, so that dishonor of the depositor's checks will be rightful. Thus, the problem is largely one of adequacy of notice, and it is here that disagreement is found in the cases.

Attention must first be directed to the nature and extent of the bank's liability for wrongful dishonor of the depositor's check. Some courts assign a breach of contract as the basis of such liability, while other courts base the bank's liability upon the tort of injury to the depositor's credit and reputation, which is similar to slander or libel.

In *Thomas v. American Trust Co.*,\(^3\) the depositor drew a check for $3.00 and delivered it to the payee, who presented the check to

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\(^1\) Paton's Digest of Legal Opinions (1940) Vol. II, lists the states which have adopted such a statute as being Arkansas, California, Idaho, Indiana, Kansas, Louisiana, Maine, Massachusetts, Michigan, Mississippi, Missouri, New Jersey, New Mexico, New York, Oklahoma, Oregon, Pennsylvania, South Dakota, Utah, and West Virginia.

\(^2\) Morse on Banks (3d Ed.), sec. 342.
the drawee bank, which refused to pay the check and marked it: “No account in this name.” The payee procured a criminal warrant for the arrest of the depositor for issuing a “bad check.” The depositor was found not guilty. The depositor then brought an action against the bank to recover damages caused by the wrongful and malicious refusal of the bank to pay a check. In its decision, the court said, Connor, J., speaking:

“There was evidence at the trial of this action from which the jury could find, as it did, that the refusal of the defendant to pay the check, which was drawn by the plaintiff and duly presented by the payee, was wrongful and unlawful. Such refusal was a breach of the contract between the plaintiff and the defendant with respect to plaintiff’s deposit with the defendant. For such breach, the plaintiff was entitled to nominal damages, at least.”

In Schaffner v. Ehrman a bookkeeper of the bank, by mistake, charged two checks of another depositor to the plaintiff’s (appellee’s) account. By this mistake the depositor’s balance was shown by the bank’s books to be $125 less than it was in fact. Some three weeks later, the depositor drew a check on the bank for $249. The payee presented this check, through the clearinghouse, and payment was refused for want of funds. The depositor brought action against the bank for refusing to pay checks drawn on it. Wilkin, J., in the opinion of the court, said:

“***To return a check marked “Refused for want of funds” to the holder, especially through a clearing-house, certainly tends to bring the drawer of that check into disrepute as a person engaged in mercantile business; and it needs no argument to show that a single refusal of that kind might often, and frequently, bring ruin upon a business man;***

“***So here the bank wrongfully refused to pay the checks of the appellee. That refusal was intentional, and without just excuse. There was, therefore, all the elements of legal malice, although there might have been no intention to injure the appellee***.”

If the depositor whose checks are dishonored is a merchant, trader, or businessman he can recover substantial damages from the bank, for wrongful refusal to honor his checks, without the necessity of proving actual damages. In ruling on the case of McFall et al. v. First National Bank of Forest City, the court said:

“***Under the law, the only burden imposed upon appellants was to show that they were merchants, that they had money on deposit in appellee’s bank in sufficient amount to cover checks

3 208 N.C. 653, 182 S.E. 136 (1935).
5 138 Ark. 370, 211 S.W. 919, 4 A.L.R. 940 (1919).
drawn by them, and that the bank refused payment of the checks. The instructions as written imposed the additional burden of requiring appellants to prove by competent evidence the amount of damages sustained by them, if any, in excess of nominal damages. The instructions practically eliminated the presumption of substantial damages arising from the law in favor of appellants on account of their being merchants at the time appellee turned down their checks."

Attention is now directed to those cases where the bank's reason for dishonor of a depositor's check is the known existence of a third party claim. In such cases it appears that nothing short of a judicial order obtained by the third party will constitute sufficient "notice" to protect the bank from liability to the depositor. In the case of Tassell v. Cooper, it was held that the bank had no right to dishonor the depositor's (plaintiff's) checks, where the money in the depositor's account had been paid to him by cheque under the mistaken belief that he was still an agent, and that agency had in fact been terminated and the depositor was no longer entitled to receive that money. The depositor's former principal had notified the bank in writing that he claimed the deposit and would hold the bank harmless in connection with his claim. Judge Maule said, in part, "The circumstances that the receipt of the cheque by the plaintiff might have been blameable, does not afford any answer to the action."

In Lund v. Seamen's Bank an assignee of the depositor sued the bank for funds on deposit in the bank to the credit of his assignor. The bank set up as a defense that the depositor had received the money on deposit by fraud. The court held that this was not a good defense, and said:

"No principle of law can however be found which permits a debtor for goods sold, or for money lent or deposited, to set up, as a defense against a claim of his creditor, that his title to the goods sold, or money lent or deposited, is defective or wrongful. That question is of no concern to the purchaser or borrower, unless the third party who claims to have been despoiled of his goods or money will proceed, by process of law, to enforce his rights."

Finally there are the cases wherein the bank has continued to honor the depositor's checks, after some notice of a third party claim, and has been sued by the third party claimant. These cases usually result in exoneration of the bank from liability because of insufficiency of the notice. This prompts the question as to whether anything short of an actual court order attaching the account will ever be adequate notice to justify the bank in dishonoring the de-

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69 Common Bench Reports 509 (England 1850).
772 Barb., N.Y., 129 (1862).
positor's checks. However, by way of dicta, these cases do indicate conflicting tests of notice which fall short of the court order requirement, and reference is sometimes made to a duty to hold up payment of the depositor's checks until the third party claimant has had a reasonable opportunity to institute legal proceedings to obtain a court order. For instance, in the case of *Drumm-Flato Commission Co. v. Gerlach Bank*, the court said:

"***Any one claiming money deposited in a bank to the credit of another ought to be required to exercise the same diligence in taking legal steps to assert his claim thereto that a reasonably prudent and diligent person would exercise in attaching the property of his debtor when satisfied that such debtor is about to make a fraudulent disposition of his property, or to remove the same from the state.***"

In *Huff v. Oklahoma State Bank*, the court cited the *Drumm-Flato Commission Co. v. Gerlach* case, supra, and said:

"The evidence in the case disclosed the bank held the money for nine days after receiving the notice of the plaintiff. Whether this was a reasonable time was a question for the jury, and there was no error in overruling the motion to instruct a verdict for plaintiff."

In *Gibraltar Realty Corporation v. Mount Vernon Trust Company*, the plaintiff, an assignee of the deposit of a depositor in the defendant trust company, sued to recover the amount of the deposit. The bank had been closed during the bank holiday and on March 24, 1933, it was opened on a restricted basis with the privilege of paying out 10 per cent of the deposits. On March 25, 1933, the depositor had on deposit in the bank $1,285.41. On that date she purchased some real estate from the plaintiff for $1,000, paying $128, the 10 per cent she was allowed to withdraw from the bank, and assigned to the plaintiff the balance of the deposit. On April 4, 1933, plaintiff wrote to the bank and stated that the depositor's account had been assigned to it. The bank did nothing about this letter until about nine months later, when it wrote and acknowledged the letter but said it would not recognize the assignment because of a prior charge against the account. This charge was dated October 9, 1933, was for the amount of $375, and had been authorized by the depositor as payment for thirty shares of stock in the defendant bank. By a reorganization arrangement of May 23, 1933, depositors had become entitled to 55 per cent in cash. The realty company contended that the bank, after it received the notice, should have held the money for it as assignee.

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8 107 Mo. App. 426, 81 S.W. 503 (1904).
9 87 Okl. 7, 207 P. 963 (1922).
10 276 N.Y. 353, 12 N.E. (2d) 438 (1938).
The court, by a four to three decision, reversed the lower courts, and dismissed the complaint, saying:

"Under the peculiar relation existing between a bank and its customers, we think the bank was not called upon to honor the assignment in this case. When the depositor presented her check the bank was in no position to question her title to the funds. That title may be questioned by one holding a better title, but the bank cannot assert that party's right. It was bound to carry out its part of its contract to honor the depositor's checks up to the amount of the deposit, until it had notice sufficient to show that the depositor had put the title to the funds out of her hands. The notice here was merely a statement by the assignee that it held an assignment of the funds. The bank could not, by reason of such notice, be convinced that it was no longer liable to the original depositor. It could not, by the production of this letter, establish affirmatively that some one else had a better right. There was not placed in its hands the means of defense against the depositor. The case would be different if the assignment itself, bearing the signature of the depositor, had been filed with the bank. Anything less than that is not sufficient notice.

"***All that respondent had to do was to present the original assignment to the bank so that the bank could ascertain from the original signature that it was that of its depositor. That it failed to do, and because of such failure it should not be permitted to shift its loss onto the bank."

The latest of this line of cases is that of Gendler v. Sibley State Bank.1 Here, the depositor was engaged in the business of buying and selling wool. He bought wool from producers in Iowa and sold it to the plaintiff, who stored the wool in a warehouse in Faribault, Minnesota. The depositor made several shipments of wool amounting, in all, to some 31,600 pounds. He was not paid cash for this wool because, under regulations then in effect, it could not be sold until after it had been graded and appraised by Government apprais-
ers. He was, however, issued several warehouse receipts which, added together, accounted for all the wool he had shipped. In order to raise money with which to pay the producers, the depositor borrowed money from the defendant bank, using the warehouse receipts as collateral security therefor. The plaintiff was informed of this use of the warehouse receipts.

On July 6, 1943, the plaintiff caused a draft in the amount of $7,106 to be issued to the bank as payee, in partial payment of wool which had up to that time been graded and appraised. This draft was deposited in the checking account of the depositor, who used a major portion of the value of the draft in paying some of his notes held by the bank. On September 28, 1943, the plaintiff's attorney-in-fact sent a personal check in the amount of $12,775.88 payable jointly to the depositor and the bank. In a letter accompanying the check he stated that it was in settlement of the wool sold by the depositor. However, in calculating the amount due the depositor, he had neglected to take into account the draft for $7,106. When the check was received it was properly indorsed and deposited in the checking account of the depositor, who immediately drew a check in the amount of $2,044, payable to the bank, in full payment of his debt, with interest, to the bank.

On November 17, 1943, the plaintiff's attorney-in-fact discovered the overpayment and telephoned the bank to notify it of the overpayment and to inform the bank that the plaintiff expected the overpayment to be refunded. The bank immediately called the depositor, who, at the bank's request, drew a check in the amount of $1,100 (the balance of his account at that time was $1,155.04) payable to the bank, for which the bank issued a cashier's check in the amount of $1,100 payable to the depositor. The bank held this cashier's check pending developments.

The depositor, through his attorneys, made demand on the bank for the $1,100. The attorney for the bank advised the bank that it could not legally withhold the $1,100 from its depositor. The bank then turned the cashier's check over to the depositor, but the record is not clear as to just when this was done. The cashier of the bank testified that it was "quite a while afterwards", and also that it was "a few days after November 17, 1943." From entries in the bank's ledger sheets, concerning deposits and withdrawals on checks, it appeared that the cashier's check was handed to the depositor on November 23, 1943, or six days after the bank had received the telephone notice from the plaintiff of the overpayment to the depositor and the demand for refund.

The plaintiff did nothing further in the matter until October 14, 1944, nearly eleven months after discovering the overpayment, when
he brought action against the bank and the depositor for the over-payment of $7,106. The depositor defaulted in the action.

The court had no difficulty in finding no liability of the bank before it had notice of the overpayment since, to be chargeable with liability for receiving a deposit of money belonging to another person, a bank must be in conspiracy with the depositor or actually know of wrongdoing, and mere means of knowledge is not sufficient.

In ruling on the liability of the bank for its acts after it received notice from the plaintiff that an overpayment had been made and that plaintiff was claiming the $1,100 in the account of the depositor, the court said:

"The liability of a bank to an adverse claimant to a deposit standing in the name of another is clearly not based upon contract for the bank's contractual relations are with its depositor and not with such third party. Therefore, it seems clear that the liability of a bank to such third party must be based on tort.***

"***the burden would be upon the plaintiff as to the $1,100 deposit to establish that the Sibley Bank was under a duty to the plaintiff in regard thereto, and that the Bank breached that duty, and that the breach of that duty was the proximate cause of the loss to the plaintiff of the $1,100. The plaintiff proved notice to the Bank of its adverse claim. Such notice gave rise to the duty on the part of the Bank to withhold payment from Sanders for such length of time that the plaintiff by proceeding diligently and promptly in its institution of a suit could have tied up the deposit by court order or process. The burden is upon the plaintiff to prove that it was diligently and promptly so proceeding with the institution of legal proceedings to tie up the deposit by court order or process when the Bank made an unreasonably early release of the deposit, and that as a proximate cause of such early release that the plaintiff was unable to tie up the deposit by legal proceedings and thereby lost the deposit."

Judgment was entered against the depositor, and in favor of the bank as to the claim of the plaintiff against it.

A very general review of the cases indicates one truth threading itself through each of them, discernible with varying degrees of clarity, to the effect that a bank's primary duty is to its depositor, and this is true whether the relationship between the two is considered as based on contract, as debtor and creditor, as that peculiar relationship which exists between a bank and its depositor, or as one individual and another as viewed by the tort law. The courts of the various states differ in their decisions as to just what a third party claimant must do to establish his claim to a deposit in the bank as superior to the claim of him in whose name the deposit stands. In Huff v. Oklahoma State Bank, supra, failure of the third party claimant to institute
court proceedings within nine days prevented his establishing that superiority as a matter of law. The case of *Drumm-Flato Commission Co. v. Gerlach Bank*, *supra*, required the third party claimant to exercise the same diligence in taking legal steps to assert his claim that a reasonably prudent and diligent person would exercise in attaching the property of his debtor when satisfied that such debtor is about to make a fraudulent disposition of his property. The *Gibraltar Realty Corp. v. Mount Vernon Trust Co.* case, *supra*, required the third party claimant to do nothing more than place the depositor's assignment, bearing the depositor's signature, into the hands of the bank. The third party claimant failed to establish the superiority of his claim in *Gendler v. Sibley State Bank*, *supra*, through failing to bring the necessary suit within six days.

It appears that the "notice" under which a bank makes payment to the depositor "at its peril" must be sufficient to furnish the bank with a legal defense against the depositor's suit for wrongful dishonor. Certainly a restraining order or injunction furnishes such a defense, and, so far as the actual holdings in the cases are concerned, the bank may continue to pay the depositor's checks until this defense is furnished.

However, in the absence of such an order, the dicta in the cases place the bank in a real position of peril. A written assignment filed with the bank gives it a legal defense according to the dictum in one jurisdiction. The precarious position of the bank is further complicated by the duty, imposed by dicta in other jurisdictions, to hold up payment of depositor's checks until the third party claimant has had reasonable time in which to institute court proceedings. Since the reasonableness of this time will be a jury question in a suit either by the depositor or the third party claimant, the receipt by a bank of "notice" of a third party claim other than by an appropriate judicial process will require the bank to make a very difficult decision.

*Joseph A. Bethel*