
Winter 1982

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Linda Teal

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Recommended Citation

Linda Teal, *Evra Corp. v. Swiss Bank Corp.: A Limitation on Recovery of Consequential Damages in an Electronic Fund Transfer*, 8 N.C. J. INT'L L. 103 (1982).

Available at: <https://scholarship.law.unc.edu/ncilj/vol8/iss1/6>

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Evra Corp. v. Swiss Bank Corp.: A Limitation on Recovery of Consequential Damages in an Electronic Fund Transfer

An electronic fund transfer is defined as the replacement of a paper order, promise of payment, or credit with an electronically-generated message.¹ The term encompasses an infinite variety of payment systems² that include either interbank transfers or transfers between banks and consumers.³ The increasing utilization of electronic fund transfers by financial institutions facilitates commercial transactions but also creates problems for courts and legislators who attempt to develop sound and consistent laws governing electronic fund transfers.⁴ In *Evra Corp. v. Swiss Bank Corp.*⁵, the Seventh Circuit Court of Appeals faced the question of whether a bank was liable for consequential damages resulting from its failure to transfer payment in accordance with a telex request. The Seventh Circuit relied on the common-law rule of *Hadley v. Baxendale*⁶ and held that the bank was not liable for consequential damages because the plaintiff failed to notify it of the special circumstances giving rise to the damage.

² Hyman-Michaels Company (Hyman-Michaels),⁷ an Illinois corporation, chartered a ship, *the Pandora*, to deliver scrap metal to a Brazilian corporation.⁸ The charter provided for a fixed daily rate payable semi-monthly in advance to the account of the *Pandora*'s owner at the Banque

¹ Brandel & Oliff, *The Electronic Fund Transfer Act: A Primer*, 40 OHIO ST. L.J. 531, 532 (1979).

² The well-known automated teller machine [ATM] is one type of electronic fund transfer. Another type is the processing of preauthorized payments and credits, which is generally accomplished through Automatic Clearinghouses [ACHs]. The oldest electronic fund transfer is the wire transfer that is utilized by financial institutions to transfer funds between bank accounts. *Id.* at 532-35.

³ See *id.* at 532 n.5.

⁴ Farley, "Dialing for Dollars"—Electronic Funds Transfer Systems, 37 U. PITT. L. REV. 613, 614-15 (1976).

⁵ 673 F.2d 951 (7th Cir. 1982), *cert. denied*, 103 S. Ct. 377 (1982).

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

⁷ Hyman-Michaels Company was engaged in buying and selling scrap metal. In 1976, it sold its business to Azcon Corporation and changed its name to Evra Corporation. 522 F. Supp. 820, 823 (N.D. Ill. 1981).

⁸ Hyman-Michaels entered into a two-year written contract with the Brazilian corporation. The contract provided that the purchaser could decline to purchase the scrap metal if the price exceeded a certain amount. *Id.*

de Paris et des Pays-Bas (Banque de Paris) in Geneva, Switzerland.⁹ The charter further provided that if Hyman-Michaels failed to pay in advance, the *Pandora*'s owner could cancel the charter.¹⁰

Hyman-Michaels generally made payment by requesting its bank, The Continental Illinois National Bank and Trust Company of Chicago (Continental), to make a wire transfer of the funds. Continental transferred the funds by sending a telex message to its London office for retransmission to its correspondent bank, the Swiss Bank Corporation (Swiss Bank).¹¹ Swiss Bank then deposited the funds in the ship owner's account at the Banque de Paris.

On the morning of April 25, 1973, Hyman-Michaels telephoned Continental and requested it to transfer payment to the Banque de Paris for the charter period from April 27 to May 11.¹² Continental's London office received the telex from the Chicago office and on April 26, attempted for an hour to retransmit the message to Swiss Bank's general telex number. The attempts were unsuccessful, and the London operator diverted the message to another machine in Swiss Bank's Foreign Exchange Department. Swiss Bank took no action on the request and on April 27, the *Pandora*'s owner cancelled the charter.¹³ Hyman-Michaels did not attempt to rewire the funds, but instructed Continental to keep trying to effect payment. Five days passed while the parties searched unsuccessfully for the missing telex.¹⁴ Finally, Continental retransmitted the telex message and on May 2, Swiss Bank attempted to deposit the funds at the Banque de Paris. The *Pandora*'s owner refused to accept payment.

After an arbitration panel concluded that the *Pandora*'s owner was entitled to cancel the contract,¹⁵ Hyman-Michaels brought a diversity

⁹ The charter was for one year, with two successive six-month options exercisable by Hyman-Michaels. *Id.*

¹⁰ *Id.* at 823. When the parties entered into the charter, market charter rates were low. Soon after the contract was signed, however, the market rates began to climb. *Id.* at 824. Thus, the *Pandora*'s owner was anxious to find a way out of the charter.

¹¹ *Id.* at 823-24. A correspondent bank is a bank which "regularly performs services for another [bank] in a place or market to which the other does not have a direct access." BLACK'S LAW DICTIONARY 311 (Rev. 5th ed. 1979).

¹² 522 F. Supp. 820, 824 (N.D. Ill. 1981).

¹³ No one knows what happened to the telex request. After diverting the message to the number in the Foreign Exchange Department, the London operator received an "answer-back" with a clear copy of the message, indicating that Swiss Bank received the telex. The Foreign Exchange Department received an average of three to four telexes per week which were actually destined for other departments. Swiss Bank had no procedure for insuring that these requests were promptly acted upon. It is possible that the machine continued to receive messages without recording them since the machine did not automatically shut off when it ran out of paper. It is also possible that the operator who received the message failed to act on it. *Id.* at 824-25.

¹⁴ *Id.* at 825-26. No action was taken by the parties on Saturday, April 28 or Sunday, April 29. *Id.* at 826.

¹⁵ The parties had already referred one disagreement to arbitration in October 1972. Instead of the usual wire transfer, Hyman-Michaels had mailed a check from Chicago the day before the funds were due at the Banque de Paris. When the check did not arrive in time, the *Pandora*'s owner cancelled the charter. The arbitration panel ruled in favor of Hyman-Michaels

suit against Swiss Bank in the District Court for the Northern District of Illinois.¹⁶ Hyman-Michaels based its claim against Swiss Bank on breach of contract, negligence, and breach of fiduciary duty.¹⁷ Hyman-Michaels sought damages for its expenses in the arbitration proceeding and its lost profits due to the cancellation of the charter.¹⁸

The district court first determined that Illinois law applied to the case.¹⁹ The court then dealt with plaintiff's breach of contract claim by analogizing Swiss Bank's role as a correspondent bank to the concept of a collecting bank under the Uniform Commercial Code.²⁰ Under U.C.C. § 4-201, a collecting bank's agency status with respect to the owner of an item is presumed prior to the final settlement of the item.²¹ Based on this analogy, the court concluded that Swiss Bank was plaintiff's agent and owed plaintiff the same duty of care as if there had been an express contract.²² Relying on the Illinois standard of negligence, the court determined that Swiss Bank owed a duty of care to plaintiff to maintain a reliable system of receiving telex messages, and that Swiss Bank had breached that duty.²³ The court rejected Swiss Bank's argument that three or four diverted messages per week was not sufficient notice of the potential risk involved to customers such as Hyman-Michaels. Concluding that the lost profits incurred by Hyman-Michaels were foreseeable by

because the *Pandora's* owner had given Hyman-Michaels no warning that it was cancelling the charter. The panel, however, put Hyman-Michaels on notice that the payment provision would be strictly enforced thereafter. *Id.* at 824. The second arbitration panel regarded Hyman-Michaels as blameless until April 27, when Hyman-Michaels learned that the *Pandora's* owner had cancelled the charter. The District Court for the Southern District of New York confirmed the arbitration decision. *Id.* at 826.

¹⁶ *Id.* at 822. Jurisdiction was based on 28 U.S.C. § 1332 (1980). *Id.* at 826.

¹⁷ *Id.* After Hyman-Michaels filed its original complaint against Swiss Bank, Swiss Bank joined Continental as a third-party defendant, pursuant to FED. R. CIV. P. 14(a). Continental and Hyman-Michaels then filed claims against each other, pursuant to FED. R. CIV. P. 13(a) and 14. *Id.* at 822-23. This note is limited to Hyman-Michaels' claim against Swiss Bank.

¹⁸ In March 1973, the price of the scrap metal rose and the Brazilian corporation elected not to buy from Hyman-Michaels. Hyman-Michaels immediately subchartered the vessel at the higher charter rates. The lost profits are based on the difference between the charter and subcharter rates. *Id.* at 824.

¹⁹ *Id.* at 827. This note does not address the controversial choice of law issue.

²⁰ The Code was adopted in Illinois at the 1961 Regular Session of the General Assembly. See ILL. ANN. STAT. ch. 26, §§ 1-101 to 1-108 (Smith-Hurd 1978). Under the U.C.C., the separate categories of banks are defined as follows: A "collecting bank" means "any bank handling the item for collection except the payor bank." A "payor bank" means "a bank by which an item is payable as drawn or accepted." An "intermediary bank" means "any bank to which an item is transferred in course of collection except the depository or payor bank." A "depository bank" means "the first bank to which an item is transferred for collection even though it is also the payor bank." ILL. ANN. STAT. ch. 26, § 4-105. Technically, the more correct analogy would have been to an intermediary bank since Swiss Bank could not be analogous either to a depository or payor bank. The analogy is not exactly on point since the methods of collection and payment under the U.C.C. and under the electronic fund transfers are different. See *infra* note 55 and accompanying text.

²¹ Under U.C.C. § 4-104(g) an "item" is defined as "any instrument for the payment of money even though it is not negotiable but does not include money."

²² 522 F. Supp. at 828.

²³ *Id.* at 828-29.

Swiss Bank, the court awarded Hyman-Michaels damages exceeding \$2.1 million.²⁴

In reversing the award of damages, the Seventh Circuit Court of Appeals avoided the choice of law dilemma, stating that since Swiss Bank was not liable under Illinois law, the choice of law made no difference to the outcome of the case.²⁵ Relying on the principles of *Hadley v. Baxendale*²⁶ and the common-law doctrine of avoidable consequences, the court denied Hyman-Michaels' recovery of damages. The court also refused to apply the U.C.C. either directly or by analogy.²⁷ The court cited the Illinois case of *Siegal v. Western Union Telegraph Co.*²⁸ as an application of the *Hadley* rule. In *Siegal*, plaintiff sued Western Union for \$1,450 lost profits when Western Union negligently misdirected a \$200 money order that plaintiff intended to use to bet legally on a horse. The court held that under the rule of *Hadley v. Baxendale*, Western Union was not liable because it had no notice or knowledge of the purpose for which the money was to be used.²⁹

The court recognized that in *Siegal* and *Hadley* there was a contract between the parties, and that in *Evra* there was no express contract between Hyman-Michaels and Swiss Bank.³⁰ The court then addressed the issue of whether the absence of an express contract in *Evra* would make any difference in the application of the *Hadley* rule. The court recognized that since tort liability is generally broader than contract liability, Swiss Bank should be liable in tort for a broader set of consequences than if it had only broken a contract.³¹ Rejecting the distinction between contract and tort liability, however, the court concluded that *Siegal* was authority for holding Swiss Bank not liable for the consequences of

²⁴ *Id.* at 829, 833-35. The court also ruled that Swiss Bank was not entitled to indemnification from Continental. *Id.* at 831. The court held that Hyman-Michaels was not barred from recovery due to contributory negligence. *Id.* The court also ruled that Hyman-Michaels had no claim against Continental. *Id.* at 832.

²⁵ 673 F.2d at 955.

²⁶ 9 Ex. 341, 156 Eng. Rep. 145 (1854). The basic rule of *Hadley v. Baxendale* is that consequential damages are only recoverable if they arose naturally from the breach or if they were within the contemplation of the parties at the time the contract was made. For a discussion of the principles set out in *Hadley*, see *supra* text accompanying notes 70-75.

²⁷ 673 F.2d at 955. The *Evra* court cited the case of *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 609 F.2d 1047 (2d Cir. 1979), to support its refusal to apply the U.C.C. either directly or by analogy. 673 F.2d at 955. Actually, the *Delbrueck* court did not state that the U.C.C. did not apply to all electronic fund transfers; the court applied the U.C.C. by analogy. *Id.* at 1051. See *infra* text accompanying notes 64-69.

²⁸ 312 Ill. App. 86, 37 N.E.2d 868 (1941).

²⁹ *Id.* at 95-96, 37 N.E.2d at 871-72. The suit in *Siegal* was predicated on a tariff regulation that limited the recovery of damages for delay, nonpayment, or underpayment of a money order due to negligence to \$500. Plaintiff attempted to argue that the provision was a liquidated damages provision, but the court construed the regulation as a limitation on the liability of the company. The court, therefore, held that the tariff regulation did not override the common-law rule that special damages can only be recovered when the special damages were within the contemplation of the parties. *Id.*

³⁰ 673 F.2d at 956.

³¹ *Id.*

negligently failing to transfer the funds.³² The *Evra* court reasoned that in *Siegal*, Western Union had not only broken its contract to deliver the plaintiff's money order, but had negligently misdirected the money order as well. The court concluded that since the *Siegal* court did not hold Western Union liable for the broader tort set of consequences even though it was negligent, Swiss Bank likewise was not liable for the consequences of negligently failing to transfer the funds.³³

The court applied the common-law doctrine of avoidable consequences to further support the denial of recovery.³⁴ The doctrine provides that a plaintiff may not recover for harm which he might reasonably have avoided. The court stated that since a first arbitration panel had put Hyman-Michaels on notice that the payment provisions of the charter would be strictly enforced, Hyman-Michaels acted imprudently in waiting until the day before payment was due to instruct Continental to transfer the funds.³⁵ The court found that Hyman-Michaels also acted imprudently in not attempting to send payment to the Banque de Paris immediately after it realized the telex had been lost.³⁶ The court added that the result might have been different, and the charter not cancelled, had Hyman-Michaels not wasted five days while Continental and Swiss Bank searched for the missing telex.³⁷ Linking the concept of foreseeability of damages found in *Hadley v. Baxendale* to the same concept in tort, the court concluded that the circumstances leading to the injury suffered by Hyman-Michaels were too remote from Swiss Bank's practical range of knowledge.³⁸ Swiss Bank was not required to take elaborate precautions or insure against a harm that it could not measure or reasonably be expected to know about, but that was known with precision by Hyman-Michaels.³⁹

The court rejected plaintiff's argument that two earlier Illinois cases, *Postal Telegraph Cable Co. v. Lathrop*⁴⁰ and *Providence-Washington Insurance Co. v. Western Union Telegraph Co.*⁴¹ compelled recovery of consequential damages. In *Lathrop*, a coffee dealer engaged in buying and selling futures contracts sent a telegram directing his broker to buy 1000 bags of

³² *Id.* at 956-57.

³³ *Id.* at 957.

³⁴ *Id.*

³⁵ *Id.* See also *supra* note 15 and accompanying text.

³⁶ 673 F.2d at 957.

³⁷ *Id.*

³⁸ *Id.* at 957-58. "To estimate the extent of its probable liability in order to know how many and how elaborate [sic] fail-safe features to install in its telex rooms or how much insurance to buy against the inevitable failures, Swiss Bank would have to collect reams of information about firms that are not even its regular customers." *Id.* at 958.

³⁹ "The sender can protect himself by insurance in one form or another if the risk of nondelivery or error appears to be great The [telegraph] company, if it takes out insurance for itself, can do no more than guess at the loss to be avoided. 673 F.2d at 958-59 (quoting *Kerr S.S. Co. v. Radio Corp. of Am.*, 245 N.Y. 284, 291-92, 157 N.E. 140, 142 (1927)).

⁴⁰ 131 Ill. 575, 23 N.E. 583 (1890).

⁴¹ 247 Ill. 84, 93 N.E. 134 (1910).

coffee, but the telegraph company changed the message to 2000 bags. The price of coffee fell, and the dealer sued the telegraph company for the loss. In *Providence-Washington*, a telegram from an insurance company cancelling a policy was misdirected, and the insurance company was liable on the policy due to a fire. In both cases, the court held that the companies had sufficient notice to be liable for consequential damages under *Hadley v. Baxendale*. The *Evra* court distinguished the two cases by stating that in the prior cases the defendants had more information and the plaintiffs could not take their own precaution against the mistakes.⁴² Reasoning that Hyman-Michaels was a sophisticated business enterprise that should take its own precaution against risk of loss, the court held that, as a matter of law, plaintiff was not entitled to recovery.⁴³

To understand the court's reliance on the common-law rule in *Hadley* and the significance of the court's decision, it is necessary to examine the development of the law governing electronic fund transfers. There has been a significant amount of legislation concerning electronic fund transfers, but none of the legislation is applicable to the facts of *Evra*. In 1981 Congress enacted the Electronics Fund Transfer Act,⁴⁴ which governs the rights and liabilities of both consumers and providers of transfer services. The act, however, excludes interbank transactions and transactions that service large corporate customers.⁴⁵ Several states, including Illinois, have enacted laws governing electronic fund transfers, but these also exclude interbank transactions.⁴⁶ Federal regulations that govern interbank transfers are limited to the use of the Federal Reserve Communications System.⁴⁷

A few commentators have suggested that Articles 3 and 4 of the U.C.C. may be applied directly to electronic fund transfers to determine the rights and liabilities of the parties.⁴⁸ Article 3, entitled "Commercial Paper" and Article 4, entitled "Bank Deposits and Collections," govern the rights and liabilities of parties to check payment transactions. The argument for applying these provisions of the U.C.C. is based on the assumption that an "item" as defined in § 4-104(1)(g) of the Code includes not only paper transactions but electronic fund transfers as well.⁴⁹ According to U.C.C. § 4-104(1)(g) an "item" is "any instrument for the payment of money even though it is not negotiable but does not include

⁴² 673 F.2d at 959.

⁴³ *Id.* The judgment in favor of Continental on Hyman-Michael's counterclaim was affirmed. *Id.* at 960.

⁴⁴ Electronic Fund Transfer Act, Pub. L. No. 95-630, § 2001, 92 Stat. 3641, 3728-41 (1978) (codified at 15 U.S.C. §§ 1693-93r (Supp. V 1981)).

⁴⁵ *See id.* § 1693a.

⁴⁶ *See, e.g.*, Electronic Fund Transfer Transmission Facility Act, §§ 1-100 to 14-100, ILL. REV. STAT. ch. 17, §§ 1301-1360 (Smith-Hurd 1981 & Supp. 1982).

⁴⁷ *See* Federal Reserve Board Regulation J, 12 C.F.R. § 210.1 (1982) (limiting application of interbank transfer regulations to collection by Federal Reserve Banks).

⁴⁸ *See, e.g.*, Clarke, *An Item is an Item is an Item: Article 4 of the U.C.C. and the Electronic Age*, 25 BUS. LAW. 109 (1969).

⁴⁹ *Id.* at 111-12.

money."⁵⁰

The majority of commentators have argued against the direct application of the U.C.C. to situations involving electronic fund transfers.⁵¹ Professor Hal S. Scott of Harvard Law School has noted that "[i]t is not the rather prosaic technical question as to whether an 'item is an item,' within the meaning of § 4-104(g) If that were indeed a problem it could be corrected with a simple stroke of a pen."⁵² The underlying problem, as he points out, is that the heart of the U.C.C. is the paper item, and there are many issues raised by electronic fund transfers that are not addressed by Articles 3 and 4. For instance, under Article 3, a party's rights and liabilities often depend on whether the party falls within ascriptive definitions such as "transferee", "holder", or "holder-in-due-course".⁵³ Under Article 4, a customer has the right to stop payment on a check before final payment is complete, but with many electronic fund transfer systems, the payment is complete at the time of the transaction.⁵⁴ If Article 4 is applied strictly, the customer would have no opportunity to stop payment.⁵⁵

A third problem encountered in attempting to apply the U.C.C. directly to electronic fund transfers is that the U.C.C. does not provide specifically for the rights and liabilities of those who are not parties to the transaction but who are engaged solely in providing transfer or data processing services.⁵⁶ The two communications systems that process the bulk of international interbank transactions today are the Clearing House Interbank Payments System (CHIPS) and the Society for Worldwide Interbank Financial Telecommunication (SWIFT).⁵⁷ Each of these systems has developed its own methods for allocating rights and liabilities among parties for such losses that are caused by failure or delay in transmission, faulty information or equipment, and fraud.⁵⁸

Although it is difficult to apply specific provisions of the U.C.C. di-

⁵⁰ U.C.C. § 4-104(1)(g) (1977).

⁵¹ See, e.g., H. SCOTT, NEW PAYMENT SYSTEMS: A REPORT TO THE 3-4-8 COMMITTEE OF THE PERMANENT EDITORIAL BOARD FOR THE UNIFORM COMMERCIAL CODE 47 (1978).

⁵² *Id.*

⁵³ See U.C.C. §§ 3-201, 3-202, 3-301, 3-305, 3-306 (1977).

⁵⁴ See *id.* § 4-303.

⁵⁵ See H. SCOTT, *supra* note 51, at 88. For a recent case holding that payments made via the Clearing House Interbank Payments System (CHIPS) were irrevocable, see *infra* text accompanying notes 64-69. The process of effecting payment under the U.C.C. and the process under the electronic fund transfer systems are different. Situations governed by the U.C.C. involve the transfer of paper items that are used to produce or substantiate debits and credits throughout the collection process. One can now send a check to a distant payee on the 25th of the month and wait until the end of the month to replenish the account since the payee will not present the item for payment until then. In an electronic fund transfer the accounts are debited and credited instantaneously as the funds are sent through the system. See J. WHITE, TEACHING MATERIALS ON BANKING LAW 700 (1976).

⁵⁶ R. ZIMMER & T. EINHORN, THE LAW OF ELECTRONIC FUNDS TRANSFER 46 (1980).

⁵⁷ Comment, *Risk Allocation in International Interbank Electronic Fund Transfers: CHIPS & SWIFT*, 22 HARV. INT'L L.J. 621, 621-22 (1981).

⁵⁸ *Id.* at 630-31.

rectly to electronic fund transfers, it has been suggested that the underlying principles of the U.C.C. can be applied by analogy.⁵⁹ One commentator suggests that if the U.C.C. were applied by analogy, almost all of the risk allocations as set out by the rules of the CHIPS and SWIFT systems would be upheld.⁶⁰ Article 4 provisions "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."⁶¹ U.C.C. § 4-103(2) gives effect to "Federal Reserve regulations and operating letters, clearing house rules and the like . . . whether or not specifically assented to by all parties interested in items handled."⁶² Professor Scott has stated that the U.C.C. principle that the risk of mistake should lie with the party making the mistake, or that the risk of fraud should lie with the party best able to insure against it could be applied to any payment system.⁶³

The case of *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*⁶⁴ illustrates the application of U.C.C. provisions and principles in a situation involving an electronic fund transfer. Delbrueck and Co. (Delbrueck) was a German banking house that maintained an account with Manufacturers Hanover Trust Co. (Manufacturers), a New York banking corporation. Delbrueck had entered into three foreign exchange contracts with Bankhaus I.D. Herstatt (Herstatt), one for \$2.5 million and one for \$10 million, both due on June 26, 1974, and one for \$10 million due on June 27, 1974. In accordance with standard procedure, Delbrueck telexed Manufacturers on June 25 ordering the transfer of the \$12.5 million to Chase Manhattan Bank (Chase) for the account of Herstatt. On June 26, Delbrueck authorized the payment of the \$10 million due on June 27.

At 10:30 A.M. on June 26, the German banking authorities closed Herstatt. Delbrueck immediately sent a telex to Manufacturers to stop payment on the last \$10 million. Manufacturers stopped payment on the \$10 million, but transferred to Chase via the CHIPS system the two earlier payments of \$12.5 million. After Manufacturers had made the payment, Delbrueck called and attempted to stop payment of the \$12.5 million as well. The attempts were unsuccessful, and Chase formally credited Herstatt's account with the \$12.5 million.

Delbrueck sued Manufacturers alleging negligence and breach of

⁵⁹ See, e.g., *Delbrueck & Co. v. Manufacturers Hanover Trust Co.*, 609 F.2d 1047, 1051 (2d Cir. 1979).

⁶⁰ See Comment, *supra* note 57, at 654.

⁶¹ U.C.C. § 4-103(1) (1977).

⁶² *Id.* § 4-103(2). "Other agencies or associations may be established in the future whose rules and regulations could be appropriately looked on as constituting a means of avoiding absolute statutory rigidity. The phrase 'and the like' leaves open such possibilities for future development." *Id.* Comment 3.

⁶³ H. SCOTT, *supra* note 51, at 89.

⁶⁴ 609 F.2d 1047 (2d Cir. 1979).

contract for failing to revoke the two payments.⁶⁵ The Second Circuit Court of Appeals held that the payments of \$12.5 million were irrevocable.⁶⁶ Although the CHIPS system had no specific rule concerning the finality of transfers, the court reasoned that member banks viewed the transaction as irrevocable due to the nature and speed of the system itself.⁶⁷ The court analogized the situation to the U.C.C. concept of the finality of accepted checks to support the decision.⁶⁸ The court also deemed the deposits choses in action under the common law, and held that as such they were validly assignable.⁶⁹

The court in *Evra* did not analogize, as did the *Delbrueck* court, to banking principles found under the U.C.C. Instead, the court refused to allow the recovery of lost profits based on the common-law rule of *Hadley v. Baxendale*,⁷⁰ the well-known case that limits the recovery of special damages in a breach of contract action. In *Hadley*, a mill owner sued a carrier for lost profits after the carrier delayed the return of a mill shaft which the owner had sent out to be repaired. The court held that the mill owner was not entitled to recover the lost profits because he did not inform the carrier of the special circumstances giving rise to the damage.⁷¹ The court set out two principles governing the recovery of special damages in a breach of contract action. First, special damages are recoverable if they arise naturally from the breach of contract.⁷² Second, special damages are recoverable if they were within the contemplation of the parties at the time the contract was made, that is, if they were foreseeable.⁷³ The principles set out in *Hadley v. Baxendale* are followed widely by the courts in the United States, their major focus being on the concept of foreseeability.⁷⁴ The courts have applied the requirement of foreseeability strictly and have often refused recovery when the damages seemed likely.⁷⁵

The well-known tort concept of foreseeability also seeks to limit the recovery of special damages to those which are a foreseeable consequence of a defendant's carelessness. The tort concept of foreseeability is set out in the famous case of *Palsgraf v. Long Island R. Co.*⁷⁶ In *Palsgraf*, a passenger was running to catch one of the defendant's trains. The defendant's employee, while assisting the boarding passenger, dislodged a package containing fireworks. The package fell onto the rails and exploded. The

⁶⁵ *Id.* at 1049.

⁶⁶ *Id.* at 1052.

⁶⁷ *Id.* at 1051. See *supra* text accompanying notes 54-55.

⁶⁸ *Id.*

⁶⁹ *Id.*

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

⁷¹ *Id.* at 355, 156 Eng. Rep. at 151.

⁷² *Id.* at 354, 156 Eng. Rep. at 151.

⁷³ *Id.*

⁷⁴ D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 805 (1973).

⁷⁵ *Id.*

⁷⁶ 248 N.Y. 339, 162 N.E. 99 (1928).

plaintiff, who was some distance away, was injured by some scales that overturned as a result of the explosion. The jury found that the defendant's employees had been negligent,⁷⁷ but the court held that there was no liability because there was no negligence directed toward the plaintiff.⁷⁸ Courts have utilized the principle of foreseeability as set out in *Palsgraf* to limit the recovery of special damages in tort actions, but the foreseeability rule in tort imposes a much wider liability than the foreseeability rule in contract. The disparity can be attributed to the fact that in contract, a party has the opportunity to protect himself from an unusual risk by communicating the risk to the other party. In tort, an injured plaintiff does not have the same opportunity to protect himself.⁷⁹

The *Evra* court relied on common-law principles to limit plaintiff's recovery of consequential damages in an interbank electronic fund transfer because there was no specific statutory authority to govern this particular electronic fund transfer situation. The case is consistent with many courts' strict application of the *Hadley* rule and their general reluctance to award special damages for breach of contract in a commercial situation.⁸⁰ Although the *Evra* court refused to apply the U.C.C. either directly or by analogy, the result is also consistent with U.C.C. § 4-103(5), which precludes the recovery of consequential damages unless a bank is acting in bad faith.⁸¹ The result in *Evra* is sound since the risk of loss is efficiently allocated to the party best able to insure against it.⁸²

The major obstacle that the court faced in *Evra* was in attempting to apply the strict rule of *Hadley v. Baxendale* to a factual situation where it could find no express contract. In order to solve the problem and bring the case under the rule of *Hadley*, the court found it necessary to make a series of inferences that are tenuous at best. The court relied on *Siegal* and noted that in that case, the defendant had been guilty of both negligence and breach of contract but that the court did not extend the defendant's liability to the broader set of consequences in tort. Based on this fact, the court concluded that the defendant's liability in *Evra* should also be limited.⁸³ The court's analysis simply begs the question, however, since the distinction to be made is that there was a contract in *Siegal* by which to limit damages. In contrast, the court in *Evra* did not find an express contract.

⁷⁷ *Id.*

⁷⁸ *Id.* at 346, 162 N.E. at 101.

⁷⁹ See D. DOBBS, *supra* note 74, at 804 n.24. "[I]t is clear that what is 'foreseeable' in a tort case may not be 'foreseeable' in a contract case, and a defendant may find himself liable for a given item of damage on the ground that it is foreseeable where he is sued for tort, but not liable for the same item of damage where he is sued in contract." *Id.*

⁸⁰ See *id.* "*Hadley* is important—and revealing—in the way the principle is applied . . . [M]any courts happily followed its niggardly refusal to award special damages, even where such damages seemed clearly normal and expectable." *Id.* at 804-05.

⁸¹ U.C.C. § 4-103(5) (1977).

⁸² See Comment, *supra* note 57, at 650 (discussing the district court opinion in *Evra*).

⁸³ 673 F.2d at 957.

After a strained analysis that brought the case within the rule of *Hadley*, the court continued to apply both tort and contract principles to deny the recovery of consequential damages. For instance, in order to deny recovery by Hyman-Michaels, the *Eura* court relied on the contract rule as applied in *Siegal* that general foreseeability is not enough for the recovery of special damages.⁸⁴ The court then turned to the tort concept of foreseeability to determine that the circumstances surrounding Hyman-Michael's contract were too remote from Swiss Bank's practical range of knowledge. More than likely the court was simply using the rules of both tort and contract to limit the recovery of special damages and bring about the desired result of a denial of recovery. As Professor Dobbs states:

The test of foreseeability [in *Hadley*] has little or no meaning. The idea is so readily subject to expansion or contraction that it becomes in fact merely a technical way in which the judges can state their conclusion. . . . Everyone else might disagree, but no one could prove the judges wrong, since the question is not one that can be resolved by a scientific test.⁸⁵

The application of common-law principles, therefore, may give rise to a wide variety of results.

The decision in *Eura* is consistent with modern banking principles governing the recovery of special damages. The court, however, is taking the risk that future decisions will not be consistent with modern banking principles since the application of common-law principles may give rise to a wide variety of results. The better approach by the court in *Eura* would have been to follow the example in *Delbrueck*. In *Delbrueck*, the court looked to the nature of the transaction itself and applied by analogy the U.C.C. concept of the finality of checks once accepted to find that payments made by wire transfer were irrevocable.⁸⁶ The court then turned to the common law to support its decision.⁸⁷

Rather than relying exclusively on common-law principles to deny recovery, the *Eura* court could have applied U.C.C. § 4-103(5) by analogy. Section 4-103(5) precludes the recovery of consequential damages in the absence of bad faith.⁸⁸ The court then could have turned to *Hadley v. Baxendale* to support the decision. Although there was no express contract between Hyman-Michaels and Swiss Bank, it was unnecessary for the court to resort to the strained analysis under *Siegal* to bring the case within the contract rule of *Hadley*. The court could have concluded

⁸⁴ *Id.*

⁸⁵ D. DOBBS, *supra* note 74, at 814.

⁸⁶ 609 F.2d at 1051. Professor Scott has suggested, however, that a strict application of Article 4 making the time to stop payment turn fortuitously on the speed of the collection is outdated. H. SCOTT, *supra* note 51, at 88-89.

⁸⁷ 609 F.2d at 1051.

⁸⁸ For a more recent case analogizing to the U.C.C., see *infra* note 89 and accompanying text.

either that Swiss Bank was Hyman-Michaels' agent,⁸⁹ or that Hyman-Michaels was a third-party beneficiary under a contract between Continental and Swiss Bank.⁹⁰ This approach would have been less complicated because it would have been unnecessary for the court to utilize common-law tort principles. It would also insure that future cases similar to those in *Evra* would be decided under consistent banking principles as governed by the U.C.C.⁹¹

The issue that the *Evra* court addressed was difficult because there was no law governing electronic fund transfers that applied directly to the factual situation. The *Delbrueck* court faced the same problem. Since courts are just beginning to address the issue of rights and liabilities under electronic fund transfers, the problem will continue to arise. The drafters of the U.C.C. are currently considering a model draft which addresses the issue of the rights and liabilities of participants in electronic fund transfer systems.⁹² Also, it has been suggested that there should be

⁸⁹ Under Illinois law, an agency relationship may be implied from the facts of the particular case and need not be express. The existence of an agency relationship may be shown by reference to the situation of the parties, the property, and the acts of the parties. *Kalman v. Bertacchi*, 57 Ill. App. 3d 542, 548, 373 N.E.2d 550, 556 (1978).

⁹⁰ Under Illinois law the test for determining whether a contract is for the benefit of a third party is whether the benefit is direct or incidental. If the benefit is direct, he may sue under contract; if it is incidental, he may not sue. *Midwest Concrete Prod. Co. v. LaSalle Nat'l Bank*, 94 Ill. App. 3d 394, 396, 418 N.E.2d 988, 990 (1981).

⁹¹ For a more recent application of agency and third-party beneficiary theories in an electronic fund transfer, see *Security Fund Servs. v. American Nat'l Bank & Trust Co.*, 542 F. Supp. 323 (N.D. Ill. 1982). Security Fund Services (SFS) processed and recorded the purchases and redemptions of the shares of Templeton Growth Fund Ltd. (Templeton). One of Templeton's shareholders was John Bushman who was trustee for approximately 260,000 shares valued at \$2 million. On October 14, 1980, SFS received instructions bearing John Bushman's signature, requesting that his shares be redeemed and the proceeds wired to his account at American National Bank and Trust Company of Chicago (ANB). Bushman's signature had been forged, and ANB did not have an account in the name of John Bushman. ANB credited the funds to another account, however, and when the forgery was discovered, SFS paid for and reissued the redeemed shares to the trustee. SFS brought suit against ANB for the price of the shares alleging nine causes of action. One count alleged that ANB was an agent of Templeton's custodian, the New England Merchants National Bank of Boston (NEMB); the other alleged that SFS was a third-party beneficiary under the contract between NEMB and ANB. On ANB's motion to dismiss, the district court held that an agency relationship existed and that SFS adequately pleaded its status as a third-party beneficiary. In determining that an agency relationship existed, the court did not follow the court of appeals' refusal in *Evra* to apply the U.C.C. by analogy. Instead the court cited the district court decision in *Evra* to analogize the U.C.C. concept of a collecting bank to Swiss Bank's role as a correspondent bank. The court in *Securities Fund Services* then drew an analogy between SFS and the concept of a customer under § 4-103(e) of the U.C.C. and held that ANB owed a duty of care to SFS in handling the wire transfer. The court noted that the Seventh Circuit in *Evra* had reversed the award of damages because general foreseeability was insufficient to support an award of consequential damages. The court concluded that the case in *Securities Fund Services* was different, however, because direct damages, rather than consequential damages, were being sought. *Id.* at 327.

⁹² See ZIMMER & EINHORN, *supra* note 56, at 49-50. The Permanent Editorial Board for the U.C.C. approved recommendations from the 3-4-8 Committee that the Committee should begin drafting a Comprehensive Payments Code that would include all other methods of payment other than cash and would replace, amend or supplement Articles 3 and 4 of the Code. The Board recommended that the new Code not be limited to banks and their customers and that rules governing transactions that did not affect the rights of customers (bank-to-bank or

an international codification of rules regarding electronic fund transfers.⁹³ Until such time as there are applicable standards to govern situations similar to *Eura*, courts should attempt to develop sound and consistent laws that are in keeping with established banking principles.

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bank-to-merchant transactions) should be subject to variation by private agreements. Although the 3-4-8 Committee has officially resolved to create a new Comprehensive Payments Code, much work remains to be done before any new legislation can be expected. *Id.* The 3-4-8 Committee has now completed and circulated a preliminary draft of the Comprehensive Payment Code. Telephone interview with Paul Wolfkin, American Law Institute (April 6, 1983).

⁹³ See Comment *supra* note 57 at 655.

