

# BANKING, BUSINESS, AND CONTRACT LAW

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This Article surveys banking, business, and contract law decisions of the Indiana Supreme Court (“Court”) and Indiana Court of Appeals (“Court of Appeals”) between September 1, 2017, and August 31, 2018 (the “survey period”). This Article will not itemize every banking, business, and contract law case decided during the survey period. Instead, it will highlight cases illustrating some big-picture issues in these fields, as well as some practice pointers for both transactions lawyers and litigators.<sup>1</sup> This Article will also discuss the Indiana Supreme Court’s commercial courts initiative and pay tribute to the commercial law jurisprudence of Indiana Court of Appeals Judge Michael P. Barnes who retired during the survey period.

## I. COMMERCIAL COURTS UPDATE

Pursuant to Indiana Supreme Court rule, on June 1, 2016, six “commercial courts” throughout the state began accepting filings in business governance, intellectual property, contract, and other business and commercial disputes.<sup>2</sup> This was the launch of a three-year pilot project to assess the demand for and receptivity to specialized courts with the requisite judicial expertise to streamline business litigation.<sup>3</sup> Details on the commercial court pilot project were presented in previous surveys which the reader is invited to consult for further information.<sup>4</sup>

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1. This Article includes discussion of many so-called not-for-publication “memorandum” decisions of the Court of Appeals because such decisions often establish new law; clarify, modify, or criticize existing law; or involve legal or factual issues of unique interest or substantial public importance. Whatever the appellate rules are at the moment about the citation of memorandum decisions, they contain critical guidance on Indiana law and cannot be ignored. Indiana Rule of Appellate Procedure 65 provides decisions of the Indiana Court of Appeals that are not published in West’s Northeastern Reporter “shall not be regarded as precedent and shall not be cited to any court except by the parties to the case to establish *res judicata*, collateral estoppel, or law of the case.” IND. R. APP. P. 65.

2. Order Establishing the Indiana Commercial Court Pilot Project, No. 94S00-1601-MS-31, 2016 Ind. LEXIS 29 (Ind. Jan. 20, 2016).

3. *Id.*

4. See Frank Sullivan, Jr., *Banking, Business, and Contract Law*, 50 IND. L. REV. 1179, 1179

During the survey period, a challenge to the constitutionality of the project itself was summarily rejected by the Court of Appeals, and the Supreme Court's task force appointed by the Supreme Court to work on the commercial court project ("Commercial Court Working Group") worked to evaluate the pilot project in light of its forthcoming May 31, 2019, sunset.<sup>5</sup>

In *Ardagh Glass Inc. v. Vickery*,<sup>6</sup> the commercial court in Indianapolis entered a preliminary injunction against a man named Craig Vickery who had been sued by his former employer for allegedly breaching a covenant not to compete in his employment contract. In Vickery's appeal,<sup>7</sup> he made an argument that he had not made to the trial court: that the entire lawsuit should be dismissed for lack of constitutional jurisdiction.

Vickery maintained that the Indiana Supreme Court had exceeded its authority in establishing the commercial court; the Supreme Court lacked the authority to appoint the commercial courts' judges; the commercial courts bestow unconstitutional privileges on business entities; and commercial courts permit corporate plaintiffs to compel individual defendants to distant venues, creating extreme hardship.<sup>8</sup>

Now these claims were a little bit of a head-scratcher. Participation in the commercial court process is entirely voluntary; if Vickery didn't want his case tried in the commercial court, all he had to do was say, "I don't want my case tried in the commercial court," and the case would have been transferred to the plenary docket.

And that's exactly what the Court of Appeals told him:

Vickery acts as though litigating in the Commercial Court is compulsory if the plaintiff files a complaint there. That, however, is patently untrue. [Under the Supreme Court's rules for commercial courts,] if a party to litigation that was filed in a Commercial Court files a Refusal Notice within thirty days of being notified that the case was filed in Commercial Court, then the clerk "*shall* transfer and assign the case to a non-Commercial Court Docket . . . ." Indeed, the Commentary to Interim Rule 4 even emphasizes that "every other party has an absolute veto" of the placement of a case on the Commercial Court docket. . . . Only where, as here, no Refusal Notice is timely filed will the case be permanently assigned to a Commercial Court docket.<sup>9</sup>

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(2017) [hereinafter *2017 Survey*]; Frank Sullivan, Jr., *Banking, Business, and Contract Law*, 49 IND. L. REV. 981, 981 (2016).

5. Order Establishing the Indiana Commercial Court Pilot Project, No. 94S00-1601-MS-31, 2016 Ind. LEXIS 29 (Ind. Jan. 20, 2016).

6. Order Granting Plaintiff's Motion for Preliminary Injunction, No. 49D01-1606-PL-023465 (Ind. Comm. Ct. Jan. 13, 2017), *aff'd*, 85 N.E.3d 852.

7. *Vickery*, 85 N.E.3d at 856-57.

8. *Id.*

9. *Id.* at 857 (quoting Ind. Comm. Ct. Interim R. 4 & cmt. 1, Order Adopting Interim Commercial Court Rules for the Indiana Commercial Courts Pilot Project, No. 94S00-1601-MS-31,

All this was of intense interest to the author because, as a member of the Commercial Courts Working Group, I myself drafted this opt-out rule and the Commentary that the court quoted. It was the Working Group's deliberate recommendation that litigating before the commercial court be voluntary for all parties. (Even when a party is either joined or intervenes after the litigation is underway, those late-joining and late-intervening parties are entitled to opt out.)

The Working Group's giving litigants an automatic opt-out was not prompted by concerns over the Supreme Court's constitutional authority to establish commercial courts or appoint its judges or over any other constitutional concerns. It is certainly likely that those questions will be raised if participation is ever made mandatory. But the Court of Appeals was undoubtedly right that Vickery waived the right to challenge the commercial court's jurisdiction when he did not opt-out.

As noted above, the Indiana Supreme Court established the pilot project for a three-year time period to expire May 31, 2019.<sup>10</sup> During the survey period, the Working Group drafted a report to the Court containing its recommendations for the future of commercial courts in Indiana. The report was completed following the end of the survey period and transmitted to the Court on November 1, 2018.<sup>11</sup>

The report included metrics showing that filings in the six commercial courts increased from 124 in the pilot's first year to 165 in its second.<sup>12</sup> Based on the rate of filings in the first four months of the third year, the report projected even more filings in the third year.<sup>13</sup>

Sixty-one percent of the filings were made in the Commercial Court in Marion County (presided over by Judge Heather Welch) and 22% were in Allen County (Judge Craig Bobay).<sup>14</sup>

Civil plenary cases alleging breach of contract have been by far the most common type of case filed in commercial courts, comprising 80% of the statewide commercial court docket.<sup>15</sup>

Statewide, the commercial courts have issued orders on motions to dismiss an average of twenty-six days (median of twenty-seven days) after filing; on motions for temporary restraining orders and preliminary injunctions an average of fifteen days (median of seven days); and on motions for summary judgment an average of twenty-four days (median of twenty-three days).<sup>16</sup>

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2016 Ind. LEXIS 308 (Ind. Apr. 27, 2016)).

10. Order Establishing the Indiana Commercial Court Pilot Project, No. 94S00-1601-MS-31, 2016 Ind. LEXIS 29 (Ind. Jan. 20, 2016).

11. THE INDIANA COMMERCIAL COURT WORKING GROUP FINAL REPORT AND RECOMMENDATIONS (Nov. 1, 2018), <https://www.in.gov/judiciary/iocs/files/2018-commercial-courts-report-final.pdf> [<https://perma.cc/W2SE-6QD9>].

12. *Id.* at 7-8.

13. *Id.*

14. *Id.* at 9, 26.

15. *Id.* at 10.

16. *Id.* at 12.

The Working Group strongly recommended that the Supreme Court permanently establish Indiana commercial courts.<sup>17</sup> Other principal recommendations were that commercial courts not be expanded at this time beyond the six pilot sites;<sup>18</sup> the commercial court interim rules be made permanent rules of the Supreme Court with several modifications;<sup>19</sup> a searchable database of substantive commercial court decisions be made available on the Supreme Court's website;<sup>20</sup> and the commercial court law clerks become state employees.<sup>21</sup>

## II. LENDING AND BORROWING

The mandate of this Article includes “banking” and the author includes within that meaning litigation between lenders and borrowers.

### *A. Is Hughley's High Hurdle Too High?*

The lender-borrower dispute of *Scheffer v. Centier Bank*<sup>22</sup> is a sober saga of Indiana's non-movant-friendly summary judgment standard run amok. First enunciated by the Indiana Supreme Court in *Jarboe v. Landmark Community Newspapers of Indiana, Inc.*,<sup>23</sup> and then powerfully reasserted by the Court in its unanimous 2014 opinion, *Hughley v. State*,<sup>24</sup> Indiana's “heightened standard” allows summary judgment to be defeated with a self-serving affidavit because “summary judgment ‘is not a summary trial,’ and the Court of Appeals has often rightly observed that it ‘is not appropriate merely because the non-movant appears unlikely to prevail at trial.’”<sup>25</sup>

In *Scheffer*, a bank held some assignments of life insurance policies owned by the Scheffers as collateral.<sup>26</sup> The Scheffers sued to get the assignments released on grounds that the collateral had been posted as security for a residential mortgage loan that had been paid off.<sup>27</sup> The bank moved for summary judgment and designated evidence that showed that the collateral secured a business loan that that was still outstanding, not a residential loan at all.<sup>28</sup> The Scheffers offered

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17. *Id.* at 5.

18. *Id.* at 12.

19. *Id.* at 8.

20. *Id.* at 26.

21. *Id.* at 16.

22. 101 N.E.3d 815 (Ind. Ct. App. 2018) (“*Scheffer IP*”), appeal after remand from *Scheffer v. Centier Bank*, No. 45A03-1410-PL-367, 30 N.E.3d 788, 2015 WL 1142940 (Ind. Ct. App. Mar. 12, 2015) (unpublished disposition) (“*Scheffer P*”).

23. 644 N.E.2d 118, 123 (Ind. 1994) (“Indiana does not adhere to *Celotex* [*v. Catrett*, 477 U.S. 317 (1986)] and the federal [summary judgment] methodology.”).

24. 15 N.E.3d 1000 (Ind. 2014).

25. *Id.* at 1003-04 (citations omitted).

26. *Scheffer II*, 101 N.E.3d at 818.

27. *Id.*

28. *Id.*

an affidavit that asserted the contrary but designated no evidence to support their claim.<sup>29</sup> The trial court granted the bank's motion.

On appeal, the Court of Appeals reversed, finding its hands tied by *Hughley's* high hurdle:

The Scheffers have not designated any evidence to contravene Centier's claims beyond what appears to be a self-serving affidavit. They presented no documentation as to the alleged 1985 mortgage and no copies of the life insurance policies showing the owner of the policies. However, given the guidance in *Hughley*, we believe the razor thin affidavits are enough. Should they be? Our supreme court says, "Yes."<sup>30</sup>

Back the case went for trial. And lo and behold, it turned out that the Scheffers had been lying all along! The trial court found there was never a good faith basis to have proceeded with this lawsuit as no residential mortgage with the bank ever even *existed* and held "that the Scheffers brought the action in bad faith and continued to maintain the action when it became clearly apparent that it was frivolous, unreasonable, and groundless."<sup>31</sup>

When the Scheffers had the temerity to appeal again, the Court of Appeals put its stamp of approval on the trial court's holding by awarding the bank appellate attorney fees.<sup>32</sup>

#### *B. Who Owns the Debt? Some New Scenarios for a Familiar Problem*

In the wake of the Great Recession's mortgage foreclosure crisis, many defendant mortgagors challenged plaintiffs' documentation of their entitlement to recovery.<sup>33</sup> In fact, several mortgage loan servicers temporarily halted foreclosure proceedings in 2010 following allegations that the documents accompanying judicial foreclosures had been inappropriately signed or notarized.<sup>34</sup> Then in 2011, a major study of the issue by the United States Government Accountability Office reported "pervasive problems with [mortgage servicers'] document preparation."<sup>35</sup> The documentation problem results from the

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29. *Id.*

30. *Scheffer I*, 2015 WL 1142940, at \*5. In another case decided during the survey period and discussed elsewhere in this Article, the Court of Appeals used similar language to reverse summary judgment in favor of the defendant in a quiet title action. *Chmiel v. US Bank Nat'l Ass'n*, 109 N.E.3d 398, 412 (Ind. Ct. App. 2018) ("[T]he trial court incorrectly concluded that a self-serving affidavit is insufficient to present a genuine issue of fact. Our supreme court has held otherwise. *See Hughley*, 15 N.E.3d at 1004.").

31. *Scheffer II*, 101 N.E.3d at 826.

32. *Id.* at 827.

33. U.S. GOV'T ACCOUNTABILITY OFFICE, MORTGAGE FORECLOSURES: DOCUMENTATION PROBLEMS REVEAL NEED FOR ONGOING REGULATORY OVERSIGHT 1 (2011), <https://www.gao.gov/assets/320/317923.pdf> [http://perma.cc/9vxe-9zrj].

34. *Id.*

35. *Id.*

fact that the original mortgage lender usually sells its rights under the loan documents.

This author has been responsible for these annual surveys since September 1, 2013. In the first of those surveys, I discussed a number of cases during the survey period in which mortgagors were quick to demand evidence that parties bringing foreclosure actions against them were actually the successors in interest to their original mortgagees.<sup>36</sup> But mortgagors rarely prevailed, and by last year's survey, I reported my sense that real estate lenders had pretty much gotten their act together on this.<sup>37</sup> On the other hand, I also pointed out three cases in the prior two survey periods where credit card lenders were denied summary judgment because they did not have their paperwork in order<sup>38</sup> and called attention to a *New York Times* story, which predicted that lenders were in for a difficult time collecting on student loans for exactly the same reason—missing paperwork.<sup>39</sup>

Sure enough, this year's survey period produced a challenge to a student loan collection action: *Holmes v. National Collegiate Student Loan Trust*.<sup>40</sup> In fact, the plaintiff was the very student loan owner that was the focus of that *Times* story: National Collegiate Student Loan Trust (NCSLT).<sup>41</sup>

Alexander Holmes, who had co-signed for his son's student loan, was sued by NCSLT, claiming that it was the owner of the account and that Holmes owed approximately \$16,600 plus accrued interest.<sup>42</sup> Holmes had borrowed the money from Charter One Bank; NCSLT maintained that Charter One had sold a pool of student loans (including the Holmes loan) to National Collegiate Funding LLC,

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36. See Frank Sullivan, Jr., *Banking, Business, and Contract Law*, 48 IND. L. REV. 1195, 1198 (2015) [hereinafter *2015 Survey*].

37. See Frank Sullivan, Jr., *Banking, Business, and Contract Law*, 51 IND. L. REV. 945, 963 (2018) [hereinafter *2018 Survey*].

During this survey period, mortgagees prevailed in all reported residential mortgage foreclosure decisions. See *E1 v. Nationstar Mortg. LLC*, 108 N.E.3d 919 (Ind. Ct. App. 2018); *Clinard v. Visio Fin. Servs., Inc.*, No. 41A01-1707-MF-1552, 102 N.E.3d 352, 2018 WL 2325734 (Ind. Ct. App. May 23, 2018) (unpublished disposition); *Gray v. Wells Fargo Bank, NA*, No. 20A03-1612-MF-2885, 98 N.E.3d 141, 2018 WL 1976439 (Ind. Ct. App. Apr. 27, 2018) (unpublished disposition); *U.S. Bank Tr., N.A. v. Spurgeon*, 99 N.E.3d 671 (Ind. Ct. App. 2018); *Feehan v. CitiMortgage, Inc.*, 97 N.E.3d 639 (Ind. Ct. App. 2018); *Duty v. CIT Group/Consumer Finance, Inc.*, 86 N.E.3d 214 (Ind. Ct. App. 2017).

38. *2018 Survey*, *supra* note 37, at 963 (citing *Williams v. Unifund CCR, LLC*, 70 N.E.3d 375 (Ind. Ct. App. 2017); *Menendez v. CACH, LLC*, No. 29A02-1511-CC-2026, 61 N.E.3d 403, 2016 WL 4442487 (Ind. Ct. App. Aug. 23, 2016) (unpublished disposition); *Reef v. Asset Acceptance, LLC*, 43 N.E.3d 652 (Ind. Ct. App. 2015)).

39. *2018 Survey*, *supra* note 37, at 963 (citing Stacy Cowley & Jessica Silver-Greenberg, *As Paperwork Goes Missing, Private Student Loan Debts May Be Wiped Away*, N.Y. TIMES (July 17, 2017), <https://www.nytimes.com/2017/07/17/business/dealbook/student-loan-debt-collection.html> [https://perma.cc/Z2NH-HMGT]).

40. 94 N.E.3d 722 (Ind. Ct. App. 2018).

41. Cowley & Silver-Greenberg, *supra* note 39.

42. *Holmes*, 94 N.E.3d at 723.

which in turn sold the loans (again including the Holmes loan) to NCSLT.<sup>43</sup>

As in the real estate mortgage and credit card foreclosure cases mentioned above, NCSLT was required to show that (1) Holmes executed a contract for the student loan with Charter One, (2) NCSLT was the assignee and now the owner of that debt, and (3) Holmes owed the original lender, Charter One, the amount claimed.<sup>44</sup> To authenticate and lay the foundation for the admissibility of the loan contract between Holmes and Charter One and the schedule of pooled loans transferred from Charter One to National Collegiate Funding LLC, NCSLT relied on the affidavit of an employee of a company called Transworld Systems, Inc. (TSI), a subcontractor for another company that NCSLT had engaged to service its loan portfolio.<sup>45</sup> The Court of Appeals held that the affidavit provided by the loan servicer was not sufficient under the hearsay exception for business records to support admission of the attached loan contract or schedule of pooled loans.<sup>46</sup> Absent that evidence, summary judgment for the loan servicer was reversed.<sup>47</sup>

Of particular consequence to the Court of Appeals was that the affiant only testified as to her familiarity with TSI's business records,<sup>48</sup> not those of Charter One or even NCSLT.<sup>49</sup>

The analysis of the affidavit by the Court of Appeals provides a good checklist of what was missing and for that reason, I quote it in full:

[T]here was no testimony to indicate that [the affiant] was familiar with or had personal knowledge of the regular business practices or record keeping of Charter One Bank, the loan originator, or that of NCSLT regarding the transfer of pooled loans, such that she could testify as to the reliability and authenticity of those documents. Indeed, [the affiant] offered no evidence to indicate that those records were made at or near the time of the business activities in question by someone with knowledge, that the records were kept in the course of the regularly conducted activities of either Charter One or NCSLT, and that making the records was part of the regularly conducted business activities of those third-party businesses.<sup>50</sup>

One residential mortgage foreclosure case is worthy of particular note as it turned on a previously unanswered question of Indiana law. In *Duty v. CIT Group/Consumer Finance, Inc.*,<sup>51</sup> Bryant Duty had financed the purchase of a

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43. *Id.*

44. *Id.* at 724 (citing *Seth v. Midland Funding, LLC*, 997 N.E.2d 1139, 1140 (Ind. Ct. App. 2013)).

45. *Id.*

46. *Id.* at 725-26.

47. *Id.* at 726.

48. *Id.* at 724.

49. *Id.* at 725.

50. *Id.*

51. 86 N.E.3d 214 (Ind. Ct. App. 2017).

residence by giving a mortgage to Wilmington Finance.<sup>52</sup> Four years later, CIT Group foreclosed on the mortgage.<sup>53</sup>

Duty argued that a faulty assignment (or faulty assignments) of the note and mortgage (the “Loan Documents”) from Wilmington Finance to CIT Group at some point broke the “chain of assignments,” thereby denying CIT Group (and any of its successors in interest) the right to recover.<sup>54</sup> The Court of Appeals found the argument unavailing:

Even if we assume that each and every assignment of the Loan Documents has been faulty, it would not help Duty. Although our research does not reveal that the question has been previously addressed in Indiana, courts have routinely found that a debtor may not challenge an assignment between an assignor and assignee. . . .<sup>55</sup>

We find the . . . authority [of those courts] to be persuasive and explicitly adopt the general proposition that a debtor does not have the right to challenge an allegedly invalid assignment of the right to collect the debt. Regardless of any assignments of the Loan Documents, Duty’s rights and duties remained the same. Any conflict regarding who actually possessed the right to enforce the Loan Documents is between the various claimants (if any) to that right and does not involve Duty. . . . Duty does not have the right to challenge any allegedly invalid assignments of the Loan Documents. . . .<sup>56</sup>

Why was it that the assignee of the debt in *Holmes* had to prove it “was the assignee and is now the owner of that debt”<sup>57</sup> while the assignee in *Duty* did not have to prove the “valid[ity of the] assignment of the right to collect the debt”<sup>58</sup>? To collect a debt that has been assigned, a party must include in its complaint:

[1. A] chronological listing of the names of all prior owners of the debt and the date of each transfer of ownership of the debt, beginning with the name of the original creditor; and . . .

[2. A] certified or other properly authenticated copy of the bill of sale

52. *Id.* at 215.

53. *Id.*

54. In *Duty*, the appellant appeared pro se and the appellee declined to participate. My recitation of the facts are as they appeared to the Court of Appeals. *Duty*, 86 N.E.3d at 215 n.1, n.2.

55. The Court later supported its analysis with citations and quotations to four other jurisdictions and a respected treatise. *Duty*, 86 N.E.3d at 216 (quoting *Liu v. T & H Mack, Inc.*, 191 F.3d 790, 797 (7th Cir. 1999); *Livonia Prop. Holdings, L.L.C. v. 12840-12976 Farmington Rd. Holdings, L.L.C.*, 717 F.Supp.2d 724, 735 (E.D. Mich. 2010); *Ifert v. Miller*, 138 B.R. 159, 166 n.13 (E.D. Pa. 1992); *In re Holden*, 271 N.Y. 212, 2 N.E.2d 631, 633 (1936); RICHARD A. LORD, 29 WILLISTON ON CONTRACTS § 74:50 (4th ed.)).

56. *Duty*, 86 N.E.3d at 216-17 (footnote omitted).

57. *Holmes v. Nat’l Collegiate Student Loan Tr.*, 94 N.E.3d 722, 724 (Ind. Ct. App. 2018).

58. *Duty*, 86 N.E.3d at 217.



or other document that transferred ownership of the debt to the plaintiff.<sup>59</sup>

These were among the requirements that the assignee of the debt in *Holmes* failed to satisfy. In *Duty*, these requirements were met. What the debtor contended was not that the assignments did not exist but that the assignments were not valid. This, *Duty* holds, is beyond the right of the debtor.<sup>60</sup>

### III. BUSINESS LAW

#### A. *The Bedrock Principle of Limited Liability*

It is a bedrock principle of American corporate law that corporate shareholders sustain liability for corporate acts only to the extent of their investment and are not held personally liable for acts attributable to the corporation.<sup>61</sup> This principle of limited liability of corporate shareholders has been the common law of Indiana at least since 1897.<sup>62</sup> The General Assembly codified this principle in the course of enacting the Indiana Business Corporation Law in 1986, providing that “a shareholder of a corporation is not personally liable for the acts or debts of the corporation.”<sup>63</sup> Seven years later, the Legislature authorized the creation and operation of a new type of business entity, the limited liability company (“LLC”), the owners of which, called “members,” are provided the same limited liability as the corporation form.<sup>64</sup>

During the survey period, there were two decisions that implicated the bedrock principle of limited liability.

In the first case, *Pazmino v. 2444 Acquisitions, LLC*,<sup>65</sup> a company (“Acquisitions”) leased property to a corporation owned 51% by Ruben Pazmino for use as a restaurant.<sup>66</sup> The corporation operated the restaurant for about three years, and then Pazmino took over operating the restaurant himself.<sup>67</sup> In this lawsuit, Acquisitions alleged that both the corporation and Pazmino owed back

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59. IND. R. SMALL CL. 2(B)(4)(c)(2)-(3).

60. *Duty*, 86 N.E.3d at 216-17.

61. *Aronson v. Price*, 644 N.E.2d 864, 867 (Ind. 1994).

62. *Gainey v. Gilson*, 48 N.E. 633, 634 (Ind. 1897).

63. IND. CODE § 23-1-26-3(b) (1986). At the same time, the Legislature also codified the common law exception to this principle known as “piercing the corporate veil” by providing that “the shareholder may become personally liable by reason of the shareholder’s own acts or conduct.” *Aronson*, 644 N.E.2d at 876.

64. See Paul J. Galanti, 17 *Indiana Practice, Business Organizations* § 7A.1, at 59 (Supp. 2018) (discussing the “Indiana business flexibility act,” IND. CODE § 23-18-1 as enacted by Pub. L. No. 8-1993, § 301); *Troutwine Estates Dev. Co., v. Comsub Design & Eng’g, Inc.*, 854 N.E.2d 890, 899 (Ind. Ct. App. 2006).

65. No. 49A02-1701-PL-53, 94 N.E.3d 756, 2017 WL 5474239 (Ind. Ct. App. Nov. 15, 2017) (unpublished disposition).

66. *Id.* at \*1.

67. *Id.*

rent.<sup>68</sup>

Pazmino failed to appear and was defaulted.<sup>69</sup> He then sought relief under Trial Rule 60(B) provisions that required him to proffer a meritorious defense.<sup>70</sup> One of the counts on which he had been defaulted sought to hold Pazmino liable for rent owed to Acquisitions by the corporation.<sup>71</sup> Pazmino offered up the bedrock principle of limited liability as his “meritorious defense.”<sup>72</sup> Citing the bedrock principle as embodied in the statute, the Court acknowledged the possibility that a creditor could pierce the corporate veil but said that that would necessitate a highly fact-sensitive inquiry in which the creditor bears the burden of proof.<sup>73</sup> Because “Pazmino assert[ed] that his conduct [did] not rise to the level necessary for 2444 Acquisitions to pierce the corporate veil, he [had] adequately alleged a meritorious defense” and was entitled to have the default judgment set aside.<sup>74</sup>

I think the analysis and conclusion in *Pazmino* are correct. On the other hand, I am skeptical of the analysis in *Blacklidge v. Blacklidge*,<sup>75</sup> although the conclusion is likely correct.

*Blacklidge* is a dispute between father and son over real estate appraisal commissions.<sup>76</sup> The evidence seems to show that the two of them as individuals entered into an agreement to share commissions.<sup>77</sup> Later on, they began operating as a limited liability company although, again, the evidence suggests that they never really utilized the LLC as a business entity.<sup>78</sup>

Father subsequently sued son for allegedly unpaid commissions<sup>79</sup> and the trial court ruled in favor of the father, concluding that the two of them had a contract with each other; the LLC was out of the picture.<sup>80</sup>

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68. *Id.*

69. *Id.*

70. IND. R. TRIAL P. 60(B) provides in relevant part that:

the court may relieve a party or his legal representative from a judgment, including a judgment by default, for the following reasons: (1) mistake, surprise, or excusable neglect; . . . (4) entry of default or judgment by default was entered against such party who was served only by publication and who was without actual knowledge of the action and judgment, order or proceedings; . . . and (8) any reason justifying relief from the operation of the judgment, other than those reasons set forth in subparagraphs (1), (2), (3), and (4). . . . A movant filing a motion for reasons (1), (2), (3), (4), and (8) must allege a meritorious claim or defense.

71. *Pazmino*, 2017 WL 5474239, at \*3.

72. *Id.*

73. *Id.*

74. *Id.* at \*4.

75. 96 N.E.3d 108 (Ind. Ct. App. 2018).

76. *Id.* at 110.

77. *Id.*

78. *Id.* at 110-111.

79. *Id.* at 111.

80. *Id.* at 113.

On appeal, son offered up the bedrock principle of limited liability.<sup>81</sup> He argued that the trial court incorrectly disregarded the limited liability company form when it held him personally responsible for obligations of the LLC.<sup>82</sup> Father responded that the trial court correctly disregarded the existence of the LLC; that the contract here was between father and son as individuals.<sup>83</sup>

The Court of Appeals took the position that the commissions owed to the father were indeed debts of the LLC (remember, this was what the son was arguing) but then held that the son was personally liable for them.<sup>84</sup> It did so by invoking Indiana Code section 23-18-4-2(a) (“Sec. 4-2(a)”), a statute that reads as follows:

Unless otherwise provided in a written operating agreement, a member or manager is not liable for damages to the limited liability company or to the members of the limited liability company for any action taken or failure to act on behalf of the limited liability company, unless the act or omission constitutes willful misconduct or recklessness.<sup>85</sup>

The court has little trouble in characterizing the son’s conduct as willful misconduct and recklessness.<sup>86</sup> Here is the key language: “[Son] chose not to pay [father] the money he knew [father] was owed. . . . And [son] knew that . . . he was the only person in a position to make that payment. Nevertheless, [son] chose not to pay [father] the money he was owed, instead exhibiting indifference to the consequences of the non-payment.”<sup>87</sup>

Maybe so. But I suggest that there is not much to the bedrock principle of limited liability if merely not paying a known obligation of the entity results in personal liability to the owner.

The provision on which the *Blacklidge* court relies, Sec. 4-2(a), is part of a chapter of the statute authorizing the creation and operation of LLCs that primarily establishes rules for LLC governance and management. Reading Sec. 4-2(a) in that context, it doesn’t speak to the fact pattern in *Blacklidge*. Instead, it addresses the situation where a manager of an LLC takes or fails to take some act that subjects the LLC to damages; the manager is not personally liable for those damages unless the manager’s behavior constitutes willful misconduct or recklessness.

The Court of Appeals’ analysis relied *Purcell v. Southern Hills Investments, LLC*,<sup>88</sup> for its definition of “willful misconduct or recklessness.” In point of fact,

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81. *Id.* at 115.

82. Brief of Appellant at \*9, *Blacklidge*, 96 N.E.3d 108 (No. 34A02-1710-PL-02509), 2017 WL 10741556 (Nov. 29, 2017).

83. Brief of Appellee \*16, *Blacklidge*, 96 N.E.3d 108 (No. 34A02-1710-PL-02509), 2017 WL 10669219 (Dec. 22, 1987).

84. *Id.* at 115.

85. *Id.* at 115 (quoting IND. CODE § 23-18-4-2(a) (2018)).

86. *Id.* at 116.

87. *Id.*

88. 847 N.E.2d 991, 999 (Ind. Ct. App. 2006). *Purcell* is another case in which the Court of

the court's authority in *Purcell* on the meaning of "willful misconduct or recklessness" was *Miner v. Southwest School Corp.*,<sup>89</sup> and *Miner* wasn't a case about business owner liability at all; it was a personal injury tort case: the willful misconduct or recklessness at issue in *Miner* was causing a bad automobile accident.<sup>90</sup> That is, the prototypical situation to which Sec. 4-2(a) speaks is the situation where willful misconduct and recklessness usually arise: liability for torts caused by more than mere negligence (what *Miner* was about).

The rules for limited liability of members of LLCs are not provided in Sec. 4-2(a) (and the father in *Blacklidge* did not contend that they were). Rather, those the rules are provided in Indiana Code section 23-18-3-3(a) ("Sec. 3-3(a)") and they read as follows:

A member, a manager, an agent, or an employee of a limited liability company is not personally liable for the debts, obligations, or liabilities of the limited liability company, whether arising in contract, tort, or otherwise, or for the acts or omissions of any other member, manager, agent, or employee of the limited liability company.<sup>91</sup>

I agree with the Court of Appeals that father should win in *Blacklidge* but not on grounds that the son has personal liability for an LLC debt merely because the son knew that the money was owed and didn't pay it. Rather, I would have affirmed on the same basis that the trial court did: the amounts owed father were not owed by the LLC at all; they were owed under a contract that father and son made as individuals prior to the formation of the LLC.<sup>92</sup>

If the Court of Appeals read the evidence such that it couldn't reach the conclusion that this was not an LLC obligation, I think there are two different ways it could have ruled for father without saying that personal liability is triggered merely by not paying a known obligation.

First, the court could conclude that the limited liability provided by Sec. 3-3(a) should be disregarded in this circumstance using an analysis similar to that for determining the personal liability of a corporation's officers.<sup>93</sup> Indiana precedent dictates that this analysis proceeds by considering factors necessary to "pierce the corporate veil."<sup>94</sup> Piercing is available when "the corporate form [is] so ignored, controlled or manipulated that it [is] merely the instrumentality of another and that the misuse of the corporate form would constitute a fraud or

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Appeals found an LLC member personally liable for an LLC obligation based on "willful misconduct or recklessness." For the same reason set forth in the text, I believe the analysis in *Purcell* was incorrect.

89. 755 N.E.2d 1110 (Ind. Ct. App. 2001).

90. *Id.* at 1113 (citing *Witham v. Norfolk & W. Ry. Co.*, 561 N.E.2d 484, 486 (Ind. 1990)). *Witham*, too, was a personal injury tort case, not a case about business owner liability.

91. IND. CODE § 23-18-3-3(a) (2019).

92. *Blacklidge*, 96 N.E.3d at 113.

93. *See Troutwine Estates Dev. Co. v. Comsub Design & Eng'g, Inc.*, 854 N.E.2d 890, 899 (Ind. Ct. App. 2006).

94. *Aronson v. Price*, 644 N.E.2d 864, 868 (Ind.1994).

promote injustice.”<sup>95</sup> (The specific factors that a court considers in such an analysis are set forth in the margin.<sup>96</sup>)

Second, the court could conclude that to the extent that father himself was a co-owner, i.e., a member, of the LLC, son breached his fiduciary duty to a fellow owner by withholding the payments due. It is well established that members of LLCs are in a fiduciary relationship with each other and are required to deal fairly, honestly, and openly with the company and the other members.<sup>97</sup> *Purcell*—the case *Blacklidge* cited for the meaning of “willful misconduct” and “recklessness”—is a case in which an LLC’s manager was held liable for breach of fiduciary duty.<sup>98</sup>

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95. *Id.* at 867.

96. “In deciding whether a plaintiff has met this burden of proof, an Indiana court considers whether the plaintiff has presented evidence showing: (1) undercapitalization; (2) absence of corporate records; (3) fraudulent representation by corporation shareholders or directors; (4) use of the corporation to promote fraud, injustice or illegal activities; (5) payment by the corporation of individual obligations; (6) commingling of assets and affairs; (7) failure to observe required corporate formalities; or (8) other shareholder acts or conduct ignoring, controlling, or manipulating the corporate form.” *Aronson*, 644 N.E.2d at 867 (citing *Eden United, Inc. v. Short*, 573 N.E.2d 920, 933 (Ind. Ct. App. 1991); *Stacey-Rand, Inc. v. J.J. Holman, Inc.*, 527 N.E.2d 726, 728 (Ind. Ct. App. 1988); *State v. McKinney*, 508 N.E.2d 1319, 1321 (Ind. Ct. App. 1987)). For examples of courts applying these factors to LLCs, see *Burget v. R.A.M. Entm’t, LLC*, 2015 WL 4490938, at \*5 (N.D. Ind. July 23, 2015); *Lyons v. Durham*, 2012 WL 3915048, at \*18-19 (N.D. Ind. Sept. 7, 2012); *MFP Eagle Highlands, LLC v. Am. Health Network of Indiana, LLC*, 2009 WL 77679, at \*9 (S.D. Ind. Jan. 9, 2009); *Troutwine Estates Dev. Co., LLC v. Comsub Design & Eng’g, Inc.*, 854 N.E.2d 890, 899 (Ind. Ct. App. 2006), after remand, No. 45A04-0802-CV-111, 888 N.E.2d 1288, 2008 WL 2439916 (Ind. Ct. App. June 18, 2008) (unpublished disposition).

97. The lead cases are *Credentials Plus, LLC v. Calderone*, 230 F. Supp. 2d 890, 899 (N.D. Ind. 2002), and *Purcell v. S. Hills Investments, LLC*, 847 N.E.2d 991, 997 (Ind. Ct. App. 2006). See also *Aaron MacGregor & Assocs., LLC v. Zhejiang Jinfei Kaida Wheels Co.*, 328 F. Supp. 3d 906, 928 (N.D. Ind. 2018); *7E Fit Spa Licensing Grp. LLC v. Dier*, 2016 WL 4943824, at \*7 (S.D. Ind. Sept. 16, 2016); *In re Hood*, 2013 WL 5782918, at \*11 (Bankr. S.D. Ind. Oct. 25, 2013); *In re Kaufman*, 2013 WL 2403328, at \*3 (Bankr. S.D. Ind. June 3, 2013); *Grant v. Van Natta*, 2013 WL 466212, at \*9 (S.D. Ind. Feb. 7, 2013); *In re Nice*, 2012 WL 1029219, at \*12 (Bankr. S.D. Ind. Mar. 26, 2012); *BioConvergence, LLC v. Menefee*, 103 N.E.3d 1141, 1152 (Ind. Ct. App.), *trans. denied*, 113 N.E.3d 628 (Ind. 2018); *Joshi v. Apollo Med. Grp., LLC*, 94 N.E.3d 359, 2017 WL 4414302 (Ind. Ct. App. Oct. 5, 2017) (unpublished disposition); *Fiederlein v. Boutselis*, 952 N.E.2d 847, 860 (Ind. Ct. App. 2011); *Abdalla v. Qadorh-Zidan*, 913 N.E.2d 280, 285 (Ind. Ct. App. 2009); and *Techcom, Inc. v. Telematrix, LLC*, 903 N.E.2d 187, 2009 WL 485182, at \*7 (Ind. Ct. App. May 28, 2009) (unpublished disposition). To the effect that there is a “growing [national] consensus” on this point, see *Executive Center III, LLC v. Meieran*, 823 F. Supp. 2d 883, 891 (E.D. Wis. 2011).

98. *Blacklidge v. Blacklidge*, 96 N.E.3d 108, 115 (Ind. Ct. App. 2018) (citing *Purcell*, 847 N.E.2d at 999). This case requires discussion. *Metro Xmit, LLC* (“Metro”) and *Southern Hills Investments, LLC* (“Southern Hills”), each owned a 50% interest in *Villagenet Services, LLC* (“Villagenet”). 847 N.E.2d at 994. *Purcell* was co-manager of *Villagenet* and also the owner of

In conclusion, *Blackledge* seems to open the door to allowing a creditor to come after an LLC member personally so long as the creditor can prove that the LLC member knew a debt was owed and didn't pay it. Overcoming the bedrock principle of limited liability demands more than that.

### B. Reminders of Some Important Agency Principles

Although they did not break any new ground, two pairs of cases during the survey period are worthy of mention because they restate important principles of agency law.

1. *Fiduciary Duties Under Powers of Attorney*.—Harding Revocable Trust by *Harding v. Wolfe*<sup>99</sup> and *Schwartz v. Wyatt*<sup>100</sup> are bookends of sorts in that the respective plaintiffs in both claim the defendants abused their powers of attorney, but the plaintiff prevailed in the former while losing in the latter. The principle at stake here is that a power of attorney creates an agency relationship which carries with it, *inter alia*, a fiduciary duty running from the agent to the principal.<sup>101</sup>

In *Harding Revocable Trust*, a woman executed a power of attorney appointing her sister-in-law as her attorney in fact; her husband died later that year. Fifteen years later, now in assisted living, the widow abruptly terminated this power of attorney and immediately thereafter executed a new power of attorney appointing her step-granddaughter as her attorney in fact.<sup>102</sup> In the next three months, the step-granddaughter used the power of attorney to transfer \$122,000 from the widow's accounts to herself.<sup>103</sup>

Because the law is clear and unequivocal that the step-granddaughter (as "agent" or "attorney in fact") was a fiduciary with respect to the widow (as her

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Metro. *Id.* at 993-94. Purcell used personal funds to pay some Metro expenses, then repaid himself using funds received by Metro that should have been forwarded to Villagenet. *Id.* at 995. The Court of Appeals affirmed the trial court's findings both that the repayment to Purcell constituted (1) a breach of Purcell's fiduciary duty VillageNet and Southern Hills, *Id.* at 997, 999, and (2) willful misconduct or recklessness under Sec. 4-2(a), *Id.* 999, 1000. For the reasons set forth in the text in my discussion of *Blackledge*, I agree with the analysis as to the first of these two points but disagree with the second.

99. No. 71A03-1702-PL-281, 94 N.E.3d 358, 2017 WL 4399298 (Ind. Ct. App. Oct. 4, 2017) (unpublished disposition).

100. No. 19A01-1610-PL-2355, 91 N.E.3d 1101, 2017 WL 4159978 (Ind. Ct. App. Sept. 20, 2017) (unpublished disposition).

101. "An attorney in fact shall exercise all powers granted under the power of attorney in a fiduciary capacity." IND. CODE § 30-5-6-3. "'Attorney in fact' means the person designated to act for the principal under a power of attorney." IND. CODE § 30-5-2-2. See RESTATEMENT (THIRD) OF AGENCY § 1.04 ("A power of attorney is an instrument that states an agent's authority."); see also RESTATEMENT (THIRD) OF AGENCY § 8.01 ("An agent has a fiduciary duty to act loyally for the principal's benefit in all matters connected with the agency relationship.").

102. *Schwartz*, 2017 WL 4159978, at \*2.

103. *Id.* at \*3.

“principal”) in exercising the power of attorney, these transfers were unlawful as violations of the agent’s fiduciary obligation to her principal.<sup>104</sup>

But that was not the end of this case. In addition to providing the step-granddaughter the widow’s power of attorney, the widow created a revocable trust, designating herself and the step-granddaughter as co-trustees.<sup>105</sup> The trust made a testamentary distribution that differed from that of the widow’s previously-executed will, including a testamentary distribution to the step-granddaughter among other persons.<sup>106</sup> When the widow died, the validity of the trust was challenged in probate proceedings.<sup>107</sup>

This raises the following important issue: whether the fact that the step-granddaughter was a fiduciary with respect to the widow in exercising the power of attorney also made her a fiduciary with respect to the trust. Stated more generally, whether the fiduciary relationship created by a power of attorney extends to acts by the agent in other than the exercise of the power of attorney.

At common law, the existence of such relationships would have created a “presumption of undue influence” on the part of the attorney-in-fact.<sup>108</sup> But the Legislature has modified the common law to provide that:

A gift, bequest, transfer, or transaction is not presumed to be valid or invalid if the gift, bequest, transfer, or transaction:

(1) is:

(A) made by the principal taking action; and

(B) not made by an attorney in fact acting for the principal under a power of attorney; and

(2) benefits the principal’s attorney in fact.<sup>109</sup>

”This statute frees the benefiting attorney-in-fact from a presumption of undue influence as long as the power of attorney is unused in the questioned transaction.”<sup>110</sup> In *Harding*, however, the trial court concluded that the step-granddaughter had (a) used the power of attorney in the questioned transaction such that the presumption of undue influence applied and (b) “exerted undue

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104. *Harding Revocable Tr.*, 2017 WL 4399298, at \*5. Indeed, the trial court entered summary judgment on this point which was not contested on appeal. *See Harding Revocable Tr. by Harding v. Wolfe*, No. 71A03-1702-PL-281 (Ind. Ct. App. 2017) (Br. of Appellant filed June 7, 2017).

105. *Schwartz*, 2017 WL 4159978, at \*2.

106. *Id.*

107. *Id.* at \*3.

108. *See In re Estate of Compton*, 919 N.E.2d 1181, 1186 (Ind. Ct. App. 2010) (citing *Nichols v. Estate of Tyler*, 910 N.E.2d 221, 229 (Ind. Ct. App. 2009)); *In re Estate of Wade*, 768 N.E.2d 957, 961-962 (Ind. Ct. App. 2002); *Villanella v. Godbey*, 632 N.E.2d 786, 790 (Ind. Ct. App. 1994).

109. IND. CODE § 30-5-9-2(b) (2019).

110. *See In re Estate of Compton*, 919 N.E.2d 1181, 1186-1187 (Ind. Ct. App. 2010) (quoting 4 DANIEL R. GORDON ET AL., HENRY’S INDIANA PROBATE LAW AND PRACTICE § 30.18, at 160.1-160.2 (2007)), for a thorough discussion of the effect of this statute on the presumption of undue influence.

influence upon [the widow] and thereby procured the execution of the [t]rust.”<sup>111</sup> The Court of Appeals affirmed.<sup>112</sup>

While *Harding* facts may well make the reader skeptical of the statutory exception to the common law presumption of undue influence, *Schwartz v. Wyatt*<sup>113</sup> may well illustrate what the Legislature was concerned about.

A man experiencing financial difficulties in his business asked a woman to provide him some financial and management assistance.<sup>114</sup> The man granted her a power of attorney, and she lent him money and began to put his financial affairs in order.<sup>115</sup> She later moved in with him and paid for renovations to his home.<sup>116</sup> The man executed promissory notes for the woman’s loans, as well as deeds that gave her an interest in his property as security for those loans.<sup>117</sup> The relationship subsequently soured and the woman filed suit for partition of the property and payment of the promissory notes.<sup>118</sup>

On appeal, the Court of Appeals assessed the effect of the power of attorney on the woman’s claims for partition and payment. The court, just like *Harding*, held the law was clear and unequivocal that the woman as “agent” or “attorney in fact” was a fiduciary with respect to the man as “principal”.<sup>119</sup> However, the court said, the trial court had found that all transactions between the parties were at arm’s length and primarily for the principal’s benefit and that the agent presented clear and convincing evidence that she did not exercise undue influence over the principal.<sup>120</sup> On this basis, the court held that there was no breach of fiduciary duty and the woman’s claims could proceed.<sup>121</sup>

Although the statutory exception to the presumption of undue influence was

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111. *Harding Revocable Tr. v. Wolfe*, No. 71A03-1702-PL-281 (Ind. Super. Ct. (St. Jos. Co.) 2017) (Amended Order filed Jan. 9, 2017).

112. *Harding Revocable Tr.*, 2017 WL 4159978, at \*6. The Court of Appeals used slightly different reasoning than the trial court. Rather than affirming the trial court’s finding that the step-granddaughter acted with undue influence, the Court of Appeals held that the step-granddaughter “that Rhonda used her power of attorney in the execution of the [t]rust, which was for her benefit.” *Id.* at \*5. This rendered the statutory exception to the common law presumption of undue influence unavailable, *id.*, and, finding the trust failed to rebut the presumption, held that the trial court did not err in finding that the trust was invalid and that the assets held in the trust should be treated as probate assets. *Id.* at \*6. The author submits that the consequence of the approach taken by the Court of Appeals is to narrow the availability of the statutory exception to the common law presumption by its interpretation of Indiana Code section 30-5-9-2(b)(1)(B).

113. No. 19A01-1610-PL-2355, 91 N.E.3d 1101, 2017 WL 4159978 (Ind. Ct. App. Sept. 20, 2017) (unpublished disposition).

114. *Id.* at \*1.

115. *Id.*

116. *Id.*

117. *Id.*

118. *Id.* at \*2.

119. *Id.* at \*4.

120. *Id.* at \*5.

121. *Id.*



not at issue in *Schwartz*, the woman becoming the man's attorney-in-fact in order to assist him illustrates a fact pattern unlike *Harding* in which a party agrees to serve as attorney-in-fact in a transaction while involved with the principal in other transactions entirely independent of and unrelated to the matters governed by the power of attorney. The Legislature likely concluded that imposing fiduciary obligations on an attorney in fact with respect to independent and unrelated matters would place an undue burden on the attorney-in-fact and might well discourage the undertaking of such responsibilities.<sup>122</sup> If the conditions required by the statute are met, not imposing the presumption of undue influence appears appropriate.<sup>123</sup>

2. *The Exceptions to Rule of Non-liability for the Torts of Independent Contractors.*—A principal is subject to vicarious liability to a third party harmed by an agent's conduct when the agent is an employee who commits a tort while acting within the scope of employment.<sup>124</sup> However, an entity employing a person is not liable for the torts of the person if the person employed is an "independent contractor."<sup>125</sup> *Franklin v. Bayview Loan Servicing, LLC*<sup>126</sup> and *Jacks by Jacks v.*

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122. Cf. GORDON ET AL., *supra* note 110, at 160.1-160.2 (2007) (footnotes omitted):

The current statute frees the benefiting attorney-in-fact from a presumption of undue influence as long as the power of attorney is unused in the questioned transaction. Presumably, the presumption may be raised through proof of a confidential or fiduciary relationship independent of the power of attorney but, standing alone, the principal/agent relationship under a power of attorney carries with it no presumption of validity or invalidity respecting a transaction benefiting the attorney-in-fact.

123. This is especially so if the restrictive interpretation given the statute by the Court of Appeals in *Harding* is imposed. See discussion of this point, *supra* notes 101-12 and accompanying text.

124. *Stropes ex rel. Taylor v. Heritage House Childrens Ctr. of Shelbyville, Inc.*, 547 N.E.2d 244, 247 (Ind. 1989); *Hurlow v. Managing Partners, Inc.*, 755 N.E.2d 1158, 1161 (Ind. Ct. App. 2001); RESTATEMENT (THIRD) OF AGENCY § 7.03 (AM. LAW INST. 2006).

125. *Bagley v. Insight Commc'ns Co.*, 658 N.E.2d 584, 586 (Ind. 1995) (citing *Prest-O-Lite Co. v. Skeel*, 106 N.E. 365, 367 (Ind. 1914); *City of Logansport v. Dick*, 70 Ind. 65, 78 (1880)); *Sword v. NKC Hosps., Inc.*, 714 N.E.2d 142, 148 (Ind. 1999) (citing *Burkett v. Crulo Trucking Co.*, 355 N.E.2d 253, 261-262 (Ind. Ct. App. 1976); RESTATEMENT (SECOND) OF TORTS § 409 (AM. LAW INST. 1965)). See also RESTATEMENT (SECOND) OF AGENCY § 2 cmt. b (AM. LAW INST. 1958).

The theory behind non-liability for independent contractors is that it would be unfair to hold a person employing another liable for the conduct of the other when the employing person has no control over that conduct. *Sword*, 714 N.E.2d at 148 (Ind. 1999) (citing RESTATEMENT (SECOND) OF TORTS § 409 (AM. LAW INST. 1979)). See also RESTATEMENT (THIRD) OF AGENCY § 7.07, cmt. b (AM. LAW INST. 2006) ("If an employee undertakes a course of work-related conduct for the sole purpose of furthering the employee's interests or those of a third party, the employee's conduct will often lie beyond the employer's effective control. When an agent is not an employee, the principal lacks the right to control the manner and means of the agent's physical conduct in how work is performed.")

*Sword* used the Restatement (Second) of Agency definition of independent contractor: "a person who contracts with another to do something for him but who is not controlled by the other

*Tipton Community School Corp.*<sup>127</sup> both examine the applicability of well-established exceptions to the rule of non-liability for the torts of independent contractors. The exceptions are several and are frequently formulated as follows:

- (1) where the contract requires the performance of intrinsically dangerous work; (2) where the principal is by law or contract charged with performing the specific duty; (3) where the act will create a nuisance; (4) where the act to be performed will probably cause injury to others unless due precaution is taken; and (5) where the act to be performed is illegal.”<sup>128</sup>

*Franklin* is a reminder of the common law rules applicable in such inquiries; *Jacks* has an important statutory overlay.

In *Franklin*,<sup>129</sup> the rights to collect the loan and associated mortgage on property owned by the plaintiff were assigned to a loan servicing company.<sup>130</sup> The loan servicing company had a contract with another company to inspect the property and protect the collateral.<sup>131</sup> And the inspection company subcontracted its obligations to a third “property preservation” company.<sup>132</sup> When the plaintiff failed to make required loan payments, the loan servicing company foreclosed.<sup>133</sup> Thereafter, the property preservation company entered the property, either securing and winterizing it (according to the loan servicing and inspection

nor subject to the other’s right to control with respect to his physical conduct in the performance of the undertaking.” 714 N.E.2d at 148 (Ind. 1999) (citing RESTATEMENT (SECOND) OF AGENCY § 2(3) (AM LAW INST. 1958).

The Restatement (Third) of Agency does not use the term “independent contractor,” except in discussing other material that uses the term. Instead, the newer Restatement sets forth criteria that classify a person as an employee, as opposed to a non-agent service provider, for purposes of an employer’s vicarious liability for torts committed within the scope of employment. RESTATEMENT (THIRD) OF AGENCY § 1.01, cmt. C (AM. LAW INST. 2006). This Article uses the older “independent contractor” nomenclature as being most consistent with Indiana practice although the Indiana Supreme Court has invoked the Restatement (Third) in related contexts. *See* *Knighen v. E. Chi. Hous. Auth.*, 45 N.E.3d 788, 792 (Ind. 2015); *Barnett v. Clark*, 889 N.E.2d 281, 284 (Ind. 2008).

126. No. 17A-PL-3058, 110 N.E.3d 1193, 2018 WL 4275430 (Ind. Ct. App. Aug. 30, 2018) (unpublished disposition).

127. *Jacks ex rel. Jacks v. Tipton Cmty. Sch. Corp.*, 94 N.E.3d 712 (Ind. Ct. App.), *trans. denied sub nom. Jacks v. Tipton Cmty. Sch. Corp.*, 102 N.E.3d 287 (Ind. 2018).

128. *Bagley*, 658 N.E.2d at 586 (citing *Perry v. N. Ind. Pub. Serv. Co.*, 433 N.E.2d 44, 47 (Ind. Ct. App. 1982)).

129. *Franklin*, 2018 WL 4275430.

130. *Id.* at \*1.

131. *Id.*

132. *Id.*

133. *Id.*

companies) or causing significant damage (according to the plaintiff).<sup>134</sup> Plaintiff sued the loan servicing and inspection companies based on the property preservation company's alleged vandalism of the property.<sup>135</sup>

The loan servicing and inspection companies defended on the basis that the property preservation company was an independent contractor as to both of them, thereby shielding both of them from liability.<sup>136</sup> The plaintiff responded with two arguments.

First, the plaintiff maintained that the property preservation company was not an independent contractor at all but rather the agent of both the loan servicing and inspection companies.<sup>137</sup> However, the Court of Appeals agreed with the trial court that unrebutted designated evidence<sup>138</sup> established that the property preservation company was, in fact, an independent contractor as to both of them.<sup>139</sup>

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134. *Id.*

135. *Id.*

136. *Id.* at \*4.

137. *Id.* at \*5.

138. *Id.* at \*2. The (unrebutted) designated evidence was as follows.

The loan servicing company designated an affidavit from its Vice President of Litigation to the effect that it authorized the inspection company to secure the property but exerted no control over its work and played no role in selecting, training, or supervising any of the persons the inspection company chose to engage. The loan servicing company also designated a "Service Agreement" which explicitly provided that the inspection company was to operate an independent contractor.

The inspection company designated an affidavit from its Vice President of Operations to the effect that it hired the property preservation company as an independent contractor to perform property inspections, preservation, and winterization, and that the inspection company did not exert control over the property preservation company's methods and played no role in selecting, training, supervising, inspecting, or otherwise managing the persons the property preservation company chose to engage for its work. The inspection company also designated an affidavit from the property preservation company's co-owner to the effect that the property preservation company was an independent contractor as to the inspection company and that the inspection company did not exert any control over the property preservation company's methods of performing its work. And the inspection company designated a "Vendor Contract," which explicitly provided that the property preservation company was to operate an independent contractor.

139. *Id.* The Court of Appeals did not enunciate an explicit legal standard for distinguishing between an agent and independent contractor. *Mortgage Consultants, Inc. v. Mahaney*, 655 N.E.2d 493, 495-96 (Ind. 1995), sets forth a ten-factor test for such determinations: (1) "the extent of control which, by the agreement, the master may exercise over the details of the work"; (2) "whether or not the one employed is engaged in a distinct occupation or business"; (3) "the kind of occupation, with reference to whether, in the locality, the work is usually done under the direction of the employer or by a specialist without supervision"; (4) "the skill required in the particular occupation"; (5) "whether the employer or the workman supplies the instrumentalities, tools, and the place of work for the person doing the work"; (6) "the length of time for which the person is employed"; (7) "the method of payment, whether by the time or by the job"; (8) whether

Second, the plaintiff argued that even if the property preservation company was an independent contractor, the loan servicing and inspection companies had liability because illegal acts allegedly performed by the property preservation company (the vandalism and a violation of the automatic stay provisions of bankruptcy law) qualified for one of the exceptions to the rule of non-liability torts of an independent contractor.<sup>140</sup> In rejecting this argument, the Court of Appeals explained that the “exception only applies where the principal is attempting to isolate itself from the consequences of illegality by engaging an independent contractor to carry out the illegal activity on its behalf.”<sup>141</sup> Even assuming that the property management company committed illegal acts, the court said, there was no designated evidence that either the loan servicing or inspection companies told the property management company to engage in any illegality. “[T]he five exceptions represent specific, limited situations in which the associated duties are considered non-delegable because public policy concerns militate against permitting an employer to absolve itself of all further responsibility by transferring its duties to an independent contractor.”<sup>142</sup>

Summary judgment in favor of the loan servicing and inspection companies was affirmed.<sup>143</sup>

Like *Franklin*, the exceptions to the general rule of non-liability of independent contractors were implicated in *Jacks by Jacks v. Tipton Community School Corp.*<sup>144</sup> But while *Franklin* was decided on common law principles, *Jacks* had an important statutory overlay.

In *Jacks*, the family of a thirteen-year-old student sued a school bus driver and a public school corporation on negligence and related theories after the bus driver drove over a dip in the road and the student was allegedly thrown into the seat in front of her causing her to sustain a lacerated pancreas.<sup>145</sup> Lawsuits against public school corporations are governed by the Indiana Tort Claims Act<sup>146</sup> which provides in part that a “governmental entity or an employee acting within the scope of the employee’s employment is not liable if a loss results from . . . [t]he act or omission of anyone other than the governmental entity or the governmental

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or not the work is a part of the regular business of the employer”; (9) “whether or not the parties believe they are creating the relation of master and servant”; and (10) “whether the principal is or is not in business.”

*Cf.* RESTATEMENT (THIRD) OF AGENCY § 7.07(3)(a) (AM. LAW INST. 2006) (“[A]n employee is an agent whose principal controls or has the right to control the manner and means of the agent’s performance of work.”).

140. *Franklin*, 2018 WL 4275430, at \*5.

141. *Id.*

142. *Id.* (quoting *Bagley v. Insight Commc’ns Co.*, 658 N.E.2d 584, 588 (Ind. 1995)).

143. *Id.* at \*6.

144. 94 N.E.3d 712 (Ind. Ct. App.), *trans. denied sub nom. Jacks v. Tipton Cmty. Sch. Corp.*, 102 N.E.3d 287 (Ind. 2018).

145. *Jacks*, 94 N.E.3d at 714.

146. IND. CODE § 34-13-3 (2019).

entity's employee."<sup>147</sup> For purposes of this statute, the term "employee" explicitly excludes "an independent contractor."<sup>148</sup>

The ability of the family to recover, therefore, turned first on whether the bus driver was an "independent contractor" for purposes of the statute. The Court of Appeals examined what it called the "comprehensive statutory scheme regarding school bus transportation"<sup>149</sup> that differentiates between "employment contracts"<sup>150</sup> and "transportation contracts"<sup>151</sup> and held that drivers under transportation contracts are not employees of the school corporation; rather, they are independent contractors.<sup>152</sup> Because the bus driver in this case had a transportation contract with the school corporation,<sup>153</sup> she was an independent contractor as a matter of law.<sup>154</sup>

Again like *Franklin*, the family argued that even if the bus driver was an independent contractor, the school corporation had liability because the school corporation's non-delegable duty to the students under its care qualified for one of the exceptions to the rule of non-liability torts of an independent contractor.<sup>155</sup> The family supported its position with two decisions of the Court of Appeals which held that, despite the ITCA's provisions, a governmental entity could be liable for an independent contractor's actions based on a non-delegable duty analysis.<sup>156</sup> The Court of Appeals rejected this argument. Disagreeing with the cases advanced by the family and relying on different authority, the court held that the immunity provision of the ITCA<sup>157</sup> would be "useless in situations involving an independent contractor if it did not apply to nondelegable duties, and we 'presume that the legislature did not enact a useless provision.'"<sup>158</sup>

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147. *Id.* § 34-13-3-3(10).

148. *Id.* § 34-6-2-38(b)(1).

149. *Jacks*, 94 N.E.3d at 718 (discussing IND. CODE § 20-27).

150. *Id.* at 717-18 ("An 'employment contract' is 'a contract: (1) between: (A) a school corporation that owns all necessary school bus equipment; and (B) a school bus driver; and (2) that provides that the school bus driver is employed in the same manner as other noninstructional personnel are employed by the school corporation.' I.C. § 20-27-2-4.").

151. *Id.* at 717 ("[A] 'transportation contract' is 'a contract between a school corporation and a school bus driver in which the school bus driver promises to provide, in addition to driving services, a school bus, school bus chassis, or school bus body.' I.C. § 20-27-2-12.").

152. *Id.* The court said that because of the clear statutory language on this point, it would not apply a common law test to differentiate between employees and independent contractors. *Id.* at 718.

153. *Id.* at 717.

154. *Id.* at 718-19.

155. *Id.* at 719-20 (quoting in *Bartholomew Cty. v. Johnson*, 995 N.E.2d 666 (Ind. Ct. App. 2013) (quoting, in turn, *Hinshaw v. Board of Commissioners*, 611 N.E.2d 637, 638 (Ind. 1993))).

156. *Id.* at 719. The cases relied on were *Shand Mining, Inc. v. Clay County Board of Commissioners*, 671 N.E.2d 477, 481 (Ind. Ct. App. 1996), *trans. denied*; and *City of Vincennes v. Reuhl*, 672 N.E.2d 495, 497-98 (Ind. Ct. App. 1996), *trans. denied*.

157. IND. CODE § 34-13-3-3(10) (2018).

158. *Jacks*, 94 N.E.3d at 719.

Concluding that where a governmental entity has immunity from the acts or omissions of an independent contractor, the nondelegable duty analysis is inapplicable, the Court of Appeals affirmed the trial court's grant of summary judgment in favor of the school corporation.

#### IV. CONTRACT LAW

##### *A. Relationship Between Contract and Tort Law; Economic Loss Rule*

Several things happened during the survey period that make the "Economic Loss Rule" worthy of consideration here. On May 21, 2018, the prestigious American Law Institute's membership gave final approval to a new restatement of the law in this regard called "Restatement of the Law Torts Third: Liability for Economic Harm."<sup>159</sup> On April 11, 2018, the Seventh Circuit handed down a most interesting opinion exploring whether the economic loss rule applies in the case of a massive consumer data breach!<sup>160</sup> And there were two Indiana Court of Appeals decisions in the survey period implicating the economic loss rule.<sup>161</sup>

The economic loss rule is formulated in Indiana to the effect that a person is not subject to liability for purely economic loss under negligence, strict liability, or products liability causes of action or theories of recovery.<sup>162</sup> For these purposes, purely economic loss is pecuniary harm not resulting from an injury to the plaintiff's person or property.<sup>163</sup>

There are several corollaries that flow from the economic loss rule. First, claimants cannot collect in tort when they buy products that merely disappoint their economic expectations.<sup>164</sup> Second, claimants cannot collect in tort for economic losses suffered as a result of injury to the person or property of another.<sup>165</sup> Third, if two parties have a contract, there is no liability in tort for

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159. AMERICAN LAW INST., ANNUAL REPORT 12 (2017-2018), <https://www.ali.org/news/?categories%5b%5d=Annual%20Report> [<https://perma.cc/D5VU-TXEN>]. The author was an Adviser to this Restatement project.

160. *Cnty. Bank of Trenton v. Schnuck Markets, Inc.*, 887 F.3d 803 (7th Cir. 2018).

161. *See* *Pearman v. Stewart Title Guar. Co.*, 108 N.E.3d 342 (Ind. Ct. App. 2018), reh'g denied (Sept. 11, 2018), *trans. denied*, 2019 WL 311111 (Ind. Jan. 17, 2019); *Carpenter Realtors v. Watkins*, No. 41A05-1706-PL-1286, 96 N.E.3d 127, 2018 WL 627203 (Ind. Ct. App. Jan. 31, 2018) (unpublished disposition).

162. *Indianapolis-Marion Cty. Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722, 726-727 (Ind. 2010). I was the author of this opinion.

163. *Id.* at 727.

164. *Martin Rispens & Son v. Hall Farms, Inc.*, 621 N.E.2d 1078, 1089-90 (Ind. 1993) (quoting *Seely v. White Motor Co.*, 45 Cal. Rptr. 17, 22, 403 P.2d 145, 151 (1965); other citations omitted).

165. This corollary is derived from admiralty law and the famous case of *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303, 309 (1927) ("a tort to the person or property of one man does not make the tortfeasor liable to another merely because the injured person was under a contract with that other unknown to the doer of the wrong. The law does not spread its protection so far.")

economic loss caused by negligence in the performance of the contract.<sup>166</sup> It is this third application of the economic loss rule—if two parties have a contract, there is no liability in tort for economic loss caused by negligence in the performance of the contract—that is the subject of the cases decided during the survey period.

The rationale for this third corollary is that the risks of economic loss tend to be especially well suited to allocation by contract.<sup>167</sup> The commentary to the new Restatement explains this point in some detail:

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(Holmes, J.) (citing *Nat'l Sav. Bank of District of Columbia v. Ward*, 100 U.S. 195 (1879); *Byrd v. English*, 43 S.E. 419 (Ga. 1903)).

This principle has particular implications in respect of disasters like a mass oil or chemical release. Even here, the starting point is that claims for pure economic losses are not recoverable in tort; the economic loss doctrine has been held fully applicable to oil spills and the like. *See, e.g., Louisiana ex rel. Guste v. M/V Testbank*, 752 F.2d 1019 (5th Cir. 1985). *But see Union Oil Co. v. Open*, 501 F.2d 558 (9th Cir. 1974) (providing an exception, limited to commercial fishermen, oystermen, crabbers, etc., to recover for loss fishing profits following a tortious diminution of aquatic life). As such, if there is to be a remedy for persons suffering purely economic loss in disasters like a mass oil or chemical release, it will not come from the common law.

One alternative to a common law remedy has proved to be by statute. Following a massive oil spill in 1989 that occurred when the supertanker Exxon Valdez ran aground on the Alaskan coast, Congress enacted the Oil Pollution Act of 1990, 33 U.S.C. §§ 2701-2719, which provides some remedies for some victims of purely economic loss due to oil spills. NAT'L COMM'N ON THE BP DEEPWATER HORIZON OIL SPILL, *DEEP WATER: THE GULF OIL DISASTER AND THE FUTURE OF OFFSHORE DRILLING—REPORT TO THE PRESIDENT* 231-232 (Jan. 2011). A sui generis approach followed another massive oil spill in 2010, when an exploratory oil well BP was drilling in the Gulf of Mexico blew out. *Id.* at vi. BP waived its statutory limit of liability under the Oil Pollution Act. *Id.* at 284. The company agreed to establish a \$20 billion trust to pay claims and later funded a claims process called the Gulf Coast Claims Facility. BDO CONSULTING, *INDEPENDENT EVALUATION OF THE GULF COAST CLAIMS FACILITY* 12 (2012). Eventually, BP negotiated a class settlement with the result that the claims before the Gulf Coast Claims Facility were transferred to a court-supervised program that the parties agreed to. *Id.* at 56.

166. *Indianapolis-Marion Cty. Pub. Library*, 929 N.E.2d at 728 (quoting *Gunkel v. Renovations, Inc.*, 822 N.E.2d 150, 153 (Ind. 2005)).

167. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 1, cmt. c(2) (AM. LAW INST., Tent. Draft No. 1, 2012). On May 21, 2018, the membership of the American Law Institute adopted Tentative Draft No. 3 of this Restatement, sub nom. RESTATEMENT OF THE LAW THIRD, TORTS: LIABILITY FOR ECONOMIC HARM. This action constituted final approval of the new Restatement. The Restatement Reporter, Ward Farnsworth, is now preparing the official text for publication. Until the official text is published, Tentative Drafts Nos. 1, 2, and 3 as approved by ALI's membership are the official position of American Law Institute, and may be cited as such. Press Release, American Law Institute, The American Law Institute Membership Approves Restatement of the Law Third, Torts: Liability for Economic Harm (May 21, 2018), <https://www.ali.org/news/articles/american-law-institute-membership-approves-restatement-law-third-torts-liability-economic-harm/> [<https://perma.cc/3GYJ-U7JH>]. The author was an adviser to this project.

First, economic injuries caused by negligence often result from a decision by the victim to rely on a defendant's words or acts when entering some sort of transaction—an investment in a company, the purchase of a house, and so forth. A potential plaintiff making such a decision has a full chance to consider how to manage the risks involved, whether by inspecting the item or investment, obtaining insurance against the risk of disappointment, or making a contract that assigns the risk of loss to someone else. Second, money is a complete remedy for an economic injury. Insurance benefits, indemnification by agreement, or other replacements of money payments are just as good as the money lost in a transaction that turns out badly. This fungibility makes those other ways of managing risk—insurance, indemnity, and the like—more attractive than they might be to a party facing a prospect of personal injury.

Those same points often will make it hard for a court to know what allocation of responsibility for economic loss would best serve the interests of the parties to a risky situation. A contract that settles responsibility for such a risk will therefore be preferable in most cases to a judicial assignment of liability after harm is done. The contract will better reflect the preferences of the parties and help prevent the need for speculation and litigation later. Contracts also are governed by a body of commercial law that has been developed to address economic loss, and thus will often be better suited for that task than the law of torts. In short, contracts to manage the risk of economic loss are more often possible, and more often desirable, than contracts to manage risks of other types of injury. As a result, courts generally do not recognize tort liability for economic losses caused by the breach of a contract between the parties (see § 3), and often restrict the role of tort law in other circumstances in which protection by contract is available.<sup>168</sup>

In *Pearman v. Stewart Title Guaranty Co.*,<sup>169</sup> Stewart Title issued a title insurance policy for which Pearman was a named insured.<sup>170</sup> It turned out that Stewart Title had made a mistake in the title search; Pearman incurred expense to obtain clean title.<sup>171</sup> Now, Pearman clearly suffered “pure economic loss” here—no physical damage was suffered from erroneous title search.

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168. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 1, cmt. c(2) (AM. LAW INST., Tent. Draft No. 1, 2012).

169. *Pearman v. Stewart Title Guar. Co.*, 108 N.E.3d 342 (Ind. Ct. App. 2018), *reh'g denied* (Sept. 11, 2018), *trans. denied*, 2019 WL 311111 (Ind. Jan. 17, 2019); *Carpenter Realtors v. Watkin*, No. 41A05-1706-PL-1286, 96 N.E.3d 127, 2018 WL 627203 (Ind. Ct. App. Jan. 31, 2018) (unpublished disposition).

170. *Pearman*, 108 N.E.3d at 345.

171. *Id.*



Pearman eventually recovered an award equal to the policy limits.<sup>172</sup> But Pearman contended that his damages exceeded that amount and continued to pursue Stewart Title under the tort theory of negligent misrepresentation.<sup>173</sup>

This seemed like a plausible approach in that the Indiana Supreme Court had recognized the tort of fraudulent misrepresentation against a title insurance company in 2010.<sup>174</sup> But there was a crucial difference then: the plaintiff in that case had not been a policyholder; there was no contract between the plaintiff and the defendant title insurer.<sup>175</sup>

Does the economic loss rule apply? It does—the title company is not subject to liability for pure economic loss under negligence.<sup>176</sup> The economic loss rule prohibited Pearman from pursuing the title insurance company in tort; his claim was limited to one for breach of contract.<sup>177</sup>

In *Carpenter Realtors v. Watkins*,<sup>178</sup> a realtor named Hodges agreed to represent the Watkinses in a search for a new home; the contract required Hodges to “advise” the Watkinses during closing.<sup>179</sup> Several months after closing, an undisclosed encroachment was discovered that cost the Watkinses \$25,000 to remedy.<sup>180</sup> Again, this was clearly “pure economic loss”—again no physical damage was suffered because of the undisclosed encroachment.

This is a bit of a bookend to *Pearman*. Here, it was the Watkinses who sought damages for breach of contract; the realtor argued that the claim was one for negligence, which if true would make tort defenses available to Hodges as well as subject the outcome to a comparative fault allocation.<sup>181</sup>

Does the economic loss rule apply? It does—the realtor is not subject to liability for pure economic loss under negligence.<sup>182</sup> What result under the economic loss rule? The Watkinses’ claim against the realtor must be treated as one for breach of contract.<sup>183</sup>

*Community Bank of Trenton v. Schnuck Markets, Inc.*,<sup>184</sup> written by Judge David Hamilton, involved a hack of the computer networks at Schnuck Markets (“Schnuck’s”), a large Midwestern grocery store chain based in Missouri.<sup>185</sup> The

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172. *Id.* at 346.

173. *Id.* at 347.

174. *U.S. Bank, N.A. v. Integrity Land Title Corp.*, 929 N.E.2d 742, 747 (Ind. 2010) (quoting RESTATEMENT (SECOND) OF TORTS § 552 (AM. LAW INST. 1977)). I was the author of this opinion.

175. *Pearman*, 108 N.E.3d at 347-48 (quoting *U.S. Bank, N.A.*, 929 N.E.2d at 749).

176. *Id.* at 348.

177. *Id.*

178. *Carpenter Realtors v. Watkins*, No. 41A05-1706-PL-1286, 96 N.E.3d 127, 2018 WL 627203 (Ind. Ct. App. Jan. 31, 2018) (unpublished disposition).

179. *Id.* at \*1.

180. *Id.*

181. *Id.* at \*2.

182. *Id.* at \*3.

183. *Id.*

184. 887 F.3d 803 (7th Cir. 2018).

185. *Id.* at 807.

hackers stole the data of about 2.4 million credit and debit cards.<sup>186</sup> By the time the data breach was detected and announced, the financial losses from unauthorized purchases and cash withdrawals had reached into the millions.<sup>187</sup>

Unlike most other data-breach cases, however, the plaintiffs in this case are not consumers but financial institutions.<sup>188</sup> Card-issuing banks and credit unions are required by federal law to indemnify their card-holding customers for losses from fraudulent activity.<sup>189</sup> In this case, those banks sued the hacked retail merchant, Schnuck Markets, for negligence in maintaining adequate security.<sup>190</sup> The issuing banks said their losses included the payments to indemnify customers for fraudulent charges, and also lost interest and transaction fees on account of changes in customer card usage and employee time to investigate and resolve fraud claims.<sup>191</sup>

The Seventh Circuit's decision is a thorough plowing of the field of applying the economic loss doctrine to hacking claims, but the bottom line was that this was a claim in tort for pure economic loss, for parties linked by contract.<sup>192</sup> Said Judge Hamilton:

For more than fifty years, state courts have generally refused to recognize tort liabilities for purely economic losses inflicted by one business on another where those businesses have already ordered their duties, rights, and remedies by contract. The reason for this rule is that “liability for purely economic loss . . . is more appropriately determined by commercial rather than tort law,” i.e., by the system of rights and remedies created by the parties themselves.<sup>193</sup>

The banks could not recover in tort for their pure economic loss. “In such cases, as the Indiana Supreme Court has explained, claims of purely economic loss are better treated under contract law, without supplementary remedies from

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186. *Id.*

187. *Id.*

188. *Id.*

189. *Id.* (citing 15 U.S.C. § 1643(a) (limiting credit-cardholder liability for unauthorized use) and 12 C.F.R. § 205.6 (limiting debit-card-holder liability for unauthorized use)).

190. *Schnuck Markets*, 887 F.3d at 816.

191. *Id.* at 811.

192. *Id.* at 821. The court detailed the “web of contracts” that link the parties in this case. In brief, Schnuck's routed customer track data through a payment processor to its acquiring bank. The acquiring bank then routed customer track data through the card networks to the issuing banks (the plaintiffs in this case), who approved purchases, paid the merchant's acquiring bank the amount of the customer's purchase, which was credited to the merchant's account (minus processing fees), and later collected payments from their customers, the cardholders. Contracts governed all of these relationships, although typically no contracts directly link the merchant (e.g., Schnuck's) with the issuing banks (our four plaintiffs here). *Id.* at 807-808.

193. *Id.* at 812 (quoting *Indianapolis-Marion Cty. Pub. Library v. Charlier Clark & Linard, P.C.*, 929 N.E.2d 722, 729 (Ind. 2010)).

tort law.”<sup>194</sup>

*B. Some Exceptions to Basic Principles Freedom of Contract  
and Private Ordering*

In last year’s Article surveying banking, business, and contract law, I included an extended discussion of the way in which Indiana courts go about resolving disputes over contract interpretation.<sup>195</sup> The discussion began by emphasizing that “Indiana courts recognize the freedom of parties to enter into contracts and . . . presume that contracts represent the freely bargained agreement of the parties.”<sup>196</sup> “This reflects the principle that it is in the best interest of the public not to restrict unnecessarily persons’ freedom of contract.”<sup>197</sup>

Without question, Indiana contract law is built upon the foundation of freedom of contract and private ordering. But there are circumstances where an Indiana contract or contractual language will be deemed void as against public policy, notwithstanding our respect for freedom of contract. Such circumstances can include private agreements that contravene statute and common law. The following two subsections examine cases arising during the survey period that implicated statutory and common law limits on the enforceability of contracts.

*1. Contracts Subject to Statutory Requirements or Prohibitions.—*

*a. Lending contracts with “cognovit notes.”—EBF Partners, LLC v. Evolving Solutions Inc.*<sup>198</sup> and *EBF Partners, LLC v. Novabella, Inc.*,<sup>199</sup> two cases decided during the survey period, each grew out of a similar lending arrangement. At the outset of the transaction, an Indiana business borrower and a personal guarantor, signed a “Confession of Judgment” to the effect that the business and guarantor (1) acknowledged the existence of the debt (less any payments made but including attorneys’ fees and prejudgment interest; (2) confessed and authorized judgment to be entered on the debt; and (3) consented to the jurisdiction of any court in New York.<sup>200</sup> When the respective debts went into default, the creditors marched into New York court and reduced the debts to judgment.<sup>201</sup> The creditors then came to Indiana with their New York judgments and asked that the judgments be domesticated here.<sup>202</sup>

On their face, the “confessions of judgment” executed in these cases represent

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194. *Id.* at 815 (citing *Indianapolis-Marion Cty. Pub. Library*, 929 N.E.2d at 740). Judge Hamilton’s looking to Indiana law for guidance in helping resolve an undecided issue of Illinois and Missouri law is acknowledged with appreciation.

195. *2018 Survey*, *supra* note 37, at 945, 966-81.

196. *Id.* at 967 (quoting *Fresh Cut, Inc. v. Fazli*, 650 N.E.2d 1126, 1129 (Ind. 1995)).

197. *Id.* (quoting *Fresh Cut*, 650 N.E.2d at 1129; *Raymundo v. Hammond Clinic Ass’n*, 449 N.E.2d 276, 279 (Ind. 1983)).

198. 95 N.E.3d 145 (Ind. Ct. App. 2018).

199. 96 N.E.3d 87 (Ind. Ct. App. 2018).

200. *Id.* at 89-90; *Evolving Sols. Inc.*, 95 N.E.3d at 146.

201. *Novabella, Inc.*, 96 N.E.3d at 90; *Evolving Sols. Inc.*, 95 N.E.3d at 146.

202. *Novabella, Inc.*, 96 N.E.3d at 90; *Evolving Sols. Inc.*, 95 N.E.3d at 146.

the private ordering of the parties' affairs, eliminating the need for providing the Indiana debtors with any notice or opportunity to be heard. However, under Indiana law, such a confession of judgment constitutes a "cognovit note."<sup>203</sup> And several Indiana statutes demand that cognovit notes not be recognized. A first statute prohibits the execution of an agreement or stipulation that is "in connection with the execution of any negotiable instrument or other written contract to pay money" and is executed "before a cause of action on the instrument or contract has accrued."<sup>204</sup> Another provides that a contract, stipulation, or power of attorney "given or entered before a cause of action accrues on a promise to pay is void."<sup>205</sup> In fact, it can be a criminal offense to "procure another" to execute a cognovit note or to attempt to enforce within Indiana a foreign judgment based upon a cognovit note.<sup>206</sup>

Indiana has law on when a contract or contractual language will be deemed void as against public policy, notwithstanding our respect for freedom of contract.<sup>207</sup> In brief, courts have refused to enforce private agreements on public policy grounds that (i) contravene statute; (ii) clearly tend to injure the public in some way; or (iii) are otherwise contrary to the declared public policy of Indiana.<sup>208</sup> I am confident that an Indiana court would refuse to enter judgment on the basis of a cognovit note executed as part of a loan agreement governed by Indiana law, although I have found no appellate decision squarely testing that proposition.<sup>209</sup>

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203.

"Cognovit note", for purposes of IC 34-54-4, means a negotiable instrument or other written contract to pay money that contains a provision or stipulation: (1) giving to any person a power of attorney, or authority as attorney, for the maker, endorser, assignor, or other person liable on the negotiable instrument or contract, and in the name of the maker, endorser, assignor, or other obligor: (A) to appear in any court, whether of record or inferior; or (B) to waive personal service of process; in any action to enforce payment of money or any part of the money claimed to be due; (2) authorizing or purporting to authorize an attorney, agent, or other representative, however designated, to confess judgment on the instrument for a sum of money when the sum is to be ascertained, or the judgment is to be rendered or entered otherwise than by action of court upon a hearing after personal service upon the debtor, whether with or without attorney's fee; or (3) authorizing or purporting to authorize an attorney, agent, or representative to: (A) release errors or the right of appeal from any judgment; or (B) consent to the issuance of execution on the judgment.

IND. CODE § 34-6-2-22.

204. *Id.* § 34-54-3-2.

205. *Id.* § 34-54-3-3.

206. *Id.* § 34-54-4-1 (a person who knowingly commits such actions commits a Class B misdemeanor).

207. *Fresh Cut, Inc. v. Fazli*, 650 N.E.2d 1126, 1130 (Ind.1995).

208. *Cont'l Basketball Ass'n, Inc. v. Ellenstein Enters., Inc.*, 669 N.E.2d 134, 140 (Ind. 1996) (citing *Fresh Cut*, 650 N.E.2d at 1130).

209. There are cases in which a borrower has defended collection actions where the loan

But the question before the Indiana Court of Appeals in these two cases was not the enforceability of a cognovit note. The question before the Court of Appeals was whether two New York judgments were entitled to recognition in Indiana under the Full Faith and Credit Clause of the U.S. Constitution.<sup>210</sup>

Twenty years ago, in *Northern Indiana Commuter Transportation District v. Chicago SouthShore & South Bend Railroad* (“*NICTD v. South Shore*”),<sup>211</sup> the Indiana Supreme Court addressed the effect of the Full Faith and Credit Clause which mandates: “Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State.”<sup>212</sup> The Court said that the constitutional provision is implemented by an Indiana statute making explicit that “‘records and judicial proceedings’ from courts in other states ‘shall have full faith and credit given to them in any court within this state, as by law or usage they have in the courts whence taken.’”<sup>213</sup> Quoting long-standing United States Supreme Court authority, *NICTD v. South Shore* explained that “the judgment of a state court should have the same credit, validity, and effect, in every other court of the United States, which it had in the state where it was pronounced.”<sup>214</sup>

To repeat, the question before the Indiana Court of Appeals in these two cases was not the enforceability of a cognovit note. Rather, as Judge Rudolph Pyle succinctly and accurately stated, “that is a matter for the trial court in the State of New York.”<sup>215</sup> Reversing the trial court in both cases,<sup>216</sup> the Court of Appeals

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agreement has contained a cognovit note. However, in none of those actions has the lender relied upon the cognovit note to collect the debt; the debtors always had had the opportunity to appear and defend. In such cases, the courts have held that the presence of the cognovit note alone did not render the entire transaction void. *See Jaehnen v. Booker*, 806 N.E.2d 31, 34-35 (Ind. Ct. App. 2004) (citing *Barber v. Hughes*, 223 Ind. 570, 63 N.E.2d 417, 419 (1945); *Paulausky v. Polish Roman Catholic Union of America*, 219 Ind. 441, 39 N.E.2d 440, 445 (1942); *Peoples Nat’l Bank & Tr. Co. v. Pora*, 212 Ind. 468, 9 N.E.2d 83, 85 (1937)). This is all consistent with the general law of the unenforceability of private agreements on public policy grounds. *See generally Cont’l Basketball Ass’n, Inc.*, 669 N.E.2d 134.

210. *EBF Partners LLC v. Novabella, Inc.*, 96 N.E.3d 87, 92-95 (Ind. Ct. App. 2018); *EBF Partners, LLC v. Evolving Sols. Inc.*, 95 N.E.3d 145, 148 (Ind. Ct. App. 2018).

211. 685 N.E.2d 680, 685 (Ind. 1997). In *NICTD v. South Shore*, two railroads battled over the enforceability of an arbitration award simultaneously in Illinois and Indiana courts; a judgment had been rendered first in Illinois and the question was whether that judgment had preclusive effect in Indiana proceedings. *Id.* at 682.

212. U.S. CONST. art. IV, § 1.

213. *NICTD v. South Shore*, 685 N.E.2d at 685 (quoting IND. CODE § 34-1-18-7, recodified in 1998 as IND. CODE § 34-39-4-3).

214. *Id.* at 685 (quoting *Underwriters Nat’l Assurance Co. v. N.C. Life & Accident & Health Ins. Guar. Ass’n*, 455 U.S. 691, 704 (1982) (internal quotation marks omitted) (citing *Hampton v. McConnel*, 16 U.S. (3 Wheat.) 234, 235 (1818) (Marshall, C.J.)); *accord Durfee v. Duke*, 375 U.S. 106, 109 (1963).

215. *Evolving Sols. Inc.*, 95 N.E.3d at 149 (Pyle, J., concurring).

216. *Novabella, Inc.*, 96 N.E.3d at 95; *Evolving Sols. Inc.*, 95 N.E.3d at 148.

ordered the New York judgments enforced in reliance on the Full Faith and Credit Clause.<sup>217</sup>

*b. Home improvement contracts.*—The preceding subsection on cognovit notes discusses Indiana law that renders the enforceability of contracts subject to public policy considerations, including those embodied by statute. One such statute of consequence is the Home Improvement Contracts Act (“HICA”),<sup>218</sup> which was the subject of two decisions by the Court of Appeals during the survey period.

The purpose of HICA is “to protect consumers by placing specific minimum requirements on the contents of [real property] improvement contracts.”<sup>219</sup> The Act requires real property improvement suppliers performing “any alteration, repair, or modification of residential real property”<sup>220</sup> to provide the consumer, with a written home improvement contract containing specified information before it is signed by the consumer.<sup>221</sup>

In both *Seiwert v. Brown*<sup>222</sup> and *Tennant v. Peaks & Valleys, Inc.*,<sup>223</sup> homeowners refused to pay their respective contractors after a substantial amount of work had been performed on home improvement projects.<sup>224</sup> In subsequent litigation brought by the contractors to collect for their work, the homeowners sought to avoid their obligations by contending that the contracts were void because they did not comply with HICA.<sup>225</sup>

The court took the same approach in both cases. “We have previously concluded that ‘the General Assembly did not intend that every contract made in violation of HICA to automatically be void,’” it said.<sup>226</sup> Deploying a balancing

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217. *Novabella, Inc.*, 96 N.E.3d at 92-95; *Evolving Sols. Inc.*, 95 N.E.3d at 148.

218. IND. CODE § 24-5-11 (2019).

219. *Imperial Ins. Restoration & Remodeling, Inc. v. Costello*, 965 N.E.2d 723, 727 (Ind. Ct. App. 2012) (quoting *Benge v. Miller*, 855 N.E.2d 716, 720 (Ind. Ct. App. 2006)).

220. IND. CODE § 24-5-11-3(a) (2019).

221. The specified information includes the consumer’s name, the address of the real property that is the subject of the real property improvement, “a reasonably detailed description of the proposed real property improvements,” approximate starting and completion dates, “a statement of any contingencies that would materially change the approximate completion date,” and the contract price. IND. CODE § 24-5-11-10(a) (2019).

222. No. 15A01-1707-PL-1616, 107 N.E.3d 1113, 2018 WL 3355482 (Ind. Ct. App. July 10, 2018) (unpublished disposition).

223. *Tennant v. Peaks & Valleys, Inc.*, No. 92A04-1710-CC-2474, 107 N.E.3d 1112, 2018 WL 3321282 (Ind. Ct. App. July 6, 2018) (unpublished disposition), *aff’d on reh’g*, No.92C01-1505-CC-201, 110 N.E.3d 1192, 2018 WL 4272440 (Ind. Ct. App. Aug. 28, 2018) (unpublished disposition).

224. *Seiwert*, 2018 WL 3355482, at \*1; *Tennant*, 2018 WL 3321282, at \*1-2.

225. *Seiwert*, 2018 WL 3355482, at \*1; *Tennant*, 2018 WL 3321282, at \*1-2.

226. *Seiwert*, 2018 WL 3355482, at \*1 (citing *Imperial Ins. Restoration & Remodeling, Inc. v. Costello*, 965 N.E.2d 23, 729 (Ind. Ct. App. 2012)); *Tennant*, 2018 WL 3321282, at \*7 (citing *Imperial Ins. Restoration & Remodeling, Inc. v. Costello*, 965 N.E.2d 23, 729 (Ind. Ct. App. 2012)).

test,<sup>227</sup> the court found for the contractors in both cases.<sup>228</sup>

In both these cases, the Court of Appeals clearly took umbrage at homeowners who were attempting to use HICA as a sword rather than a shield. But the broader point remains that freely bargained agreements between homeowners and home improvement contractors are subject to the dictates of HICA.

*c. Employment contracts with cities.*—As with the contracts discussed in the previous two subsections, employment contracts with cities are also subject to various statutory mandates. For example, in *City of Lawrenceburg v. Hughes*,<sup>229</sup> a former city employee sued to collect compensation which he claimed was due under a written employment agreement following his termination as the city’s redevelopment director.<sup>230</sup> The city defended, arguing unsuccessfully that the contract was unenforceable because it violated as many as three statutes at least arguably limiting the terms of an employment contract between a city and a city department head:

- A statute prohibiting any city department, officer, or employee from obligating the city “to any extent beyond the amount of money appropriated for that department,” officer, or employee.<sup>231</sup>
- A statute that requires the city executive, subject to the approval of the city legislative body, to fix the compensation of each appointive officer, deputy, and other employee of the city, and to do so not later than November 1 of each year for the ensuing budget year.<sup>232</sup>
- A statute that provides that “the city executive shall appoint the head of each department . . . subject to the approval of any statutory board

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227. *Seiwert*, 2018 WL 3355482, at \*1; *Tennant*, 2018 WL 3321282, at \*7-8. The balancing test examine[s] the factors that courts use to determine whether or not a contract contravenes declared public policy. *Seiwert*, 2018 WL 3355482, at \*1; *Tennant*, 2018 WL 3321282, at \*7-8.

The considerations to be balanced are (1) the nature of the subject matter of the contract, (2) the strength of the public policy underlying the statute, (3) the likelihood that refusal to enforce the bargain or term wi[ll] further that policy, (4) how serious or deserved would be the forfeiture suffered by the party attempting to enforce the bargain, and (5) the parties’ relative bargaining power and freedom to contract.

*Seiwert*, 2018 WL 3355482, at \*1 (quoting *Costello*, 965 N.E.2d at 729).

228. *Seiwert*, 2018 WL 3355482, at \*1; *Tennant*, 2018 WL 3321282, at \*8.

229. 110 N.E.3d 365 (Ind. Ct. App. 2018).

230. *Id.* at 365.

231. *Id.* at 368 (quoting IND. CODE § 36-4-8-12(b)). There is an exception to this statute for specified interlocal agreements approved by the city fiscal body. IND. CODE § 36-4-8-12(c). The Court of Appeals held this statute “does not apply to employees but rather to other types of contracts entered into on behalf of a city” and, as such, did not render the contract at issue in this case unenforceable. *Hughes*, 110 N.E.3d at 365.

232. *Id.* (quoting IND. CODE § 36-4-7-3(b)). The Court of Appeals found these conditions had been met. *Id.* at 368-69.

or commission established in the department,”<sup>233</sup> which has been interpreted to prohibit “binding the new mayor to employment decisions made by the prior mayor.”<sup>234</sup>

2. *Contracts with Stipulated Damages Clauses.*—As a matter of separation of powers, an American court is likely obligated to subject agreements of private parties to the dictates of the legislature as illustrated by the preceding three subsections. Harder to understand are purely court-imposed restrictions on private parties’ use of stipulated damages clauses in their contracts.

“The term ‘liquidated damages’ applies to a specific sum of money that has been expressly stipulated by the parties to a contract as the amount of damages to be recovered by one party for a breach of the agreement by the other, whether it exceeds or falls short of actual damages.”<sup>235</sup> “A typical liquidated damages provision provides for the forfeiture of a stated sum of money upon breach without proof of damages.”<sup>236</sup>

In a 2004 decision, the Indiana Supreme Court gave some attention to liquidated damages clauses in *Time Warner Entertainment Co., v. Whiteman*.<sup>237</sup> There, the Court said that the

history of litigation of liquidated damage clauses suggests that their enforceability turned on whether the nature of the parties’ agreement was such that in the event of a breach, the damages resulting from the breach would have been difficult to ascertain. If actual damages could be readily calculated and the amount stipulated exceeded actual damages, then the contract provision was treated as a “penalty” and only actual damages awarded.<sup>238</sup>

The Court observed that this policy of skepticism toward the enforceability of liquidated damage clauses was grounded in equitable notions of equity and natural law: “It is the application, in a court of law, of that principle long recognized in courts of equity, which, disregarding the penalty of the bond, gives only the damages actually sustained.”<sup>239</sup>

233. IND. CODE § 36-4-9-2(a).

234. *Hughes*, 110 N.E.3d at 368 (citing IND. CODE § 36-4-9-2(a)). The Court of Appeals found no violation of this provision because the “[a]greement provided that the [c]ity could, at any time, decide to eliminate [the employee’s] position or terminate [the employee’s] employment without cause . . . . The designated evidence establishes that the [c]ity chose to exercise its right to eliminate [the employee’s] position but failed to compensate [the employee] according to these terms. *Id.*

235. 802 N.E.2d 886, 893 (Ind. 2004) (citing *Merrillville Conservancy Dist. v. Atlas Excavating*, 764 N.E.2d 718, 724 (Ind. Ct. App. 2002) (citing in turn *George B. Swift Co. v. Dolle*, 80 N.E. 678, 681 (1907)); *Liquidated Damages*, BLACK’S LAW DICTIONARY (7th ed. 1999)).

236. *Id.* at 893 (citing *Gershin v. Demming*, 685 N.E.2d 1125, 1127 (Ind. Ct. App. 1997)).

237. *See id.* I was the author of this decision.

238. *Id.*

239. *Id.* at 894 (quoting *Sterne v. Fletcher Am. Co.*, 204 Ind. 35, 50, 181 N.E. 37, 43 (Ind.1932) (quoting in turn *Jaquith v. Hudson*, 5 Mich. 123, 133 (1858))).



During the survey period, the Court of Appeals confronted challenges to the enforceability of liquidated damages clauses in two cases.

In *Carriage Courts Homeowners Association, Inc. v. Rocklane*,<sup>240</sup> a homeowners' association ("HOA") entered into a contract with a roofing company following a hail storm that damaged some homes in the community.<sup>241</sup> Specifically, the contractor was authorized to perform inspections with the HOA's insurer and to "complete all storm damage repairs authorized in the final insurance settlement."<sup>242</sup> The contract provided further that failure by the HOA to complete the contract would result in a 20% cancellation fee plus collection and attorney fees. When an insurance settlement was reached, the HOA hired

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Two of the Indiana Supreme Court's best known cases, albeit dating to the 1970s and 1980s, were decided consistent with the principles just described: *Skendzel v. Marshall*, 301 N.E.2d 641, 644-646 (Ind. 1973), which held invalid as a penalty a land contract vendees' forfeiture of \$ 21,000, "well over one-half the original contract price"; and *Raymundo v. Hammond Clinic Assn.*, 449 N.E.2d 276, 284 (Ind. 1983), which held valid as liquidated damages payment of \$25,000 for violation of a restrictive covenant not to compete, largely because of the uncertainty in determining the amount of actual damages. *Id.*

Likewise, the Court of Appeals has largely maintained this attitude in analyzing disputes over the enforceability of stipulated damage clauses. In 2012, for example, the Court of Appeals held a stipulated damages provision in a contract to be an unenforceable penalty. *See Dean V. Kruse Found., Inc. v. Gates*, 973 N.E.2d 583, 593-95 (Ind. Ct. App. 2012). For another decision of the Court of Appeals of recent vintage holding a stipulated damages provision in a contract to be an unenforceable penalty, see *Olcott Int'l & Co. v. Micro Data Base Sys.*, 793 N.E.2d 1063 (Ind. Ct. App. 2003), *trans. denied*. Olcott's explication of the relevant law reflects much of current jurisprudence:

"In determining whether a stipulated sum payable on a breach of contract constitutes liquidated damages or a penalty, the facts, the intention of the parties and the reasonableness of the stipulation under the circumstances of the case are all to be considered." [Gershin v. Demming, 685 N.E.2d 1125, 1127 (Ind. Ct. App. 1997).] If the sum sought by a liquidated damages clause is grossly disproportionate to the loss that may result from a breach of contract, we should treat the sum as a penalty rather than liquidated damages. *Rogers v. Lockard*, 767 N.E.2d 982, 991 (Ind. Ct. App. 2002). "Liquidated damages provisions are generally enforceable where the nature of the agreement is such that when a breach occurs the resulting damages would be uncertain and difficult to ascertain." Gershin, 685 N.E.2d at 1127. However, to be enforceable the stipulated sum must fairly be allowed as compensation for the breach. *Id.* at 1127-28. Additionally, we construe any contract ambiguity against the party who drafted it. *Rogers*, 767 N.E.2d at 990. If there is uncertainty as to the meaning of a liquidated damages clause, classification as a penalty is favored. *Id.* at 992.

*Id.* at 1077.

240. No. 49A04-1705-PL-968, 2017 WL 5986010 (Ind. Ct. App. Dec. 4, 2017) (unpublished disposition).

241. *Id.* at \*1.

242. *Id.*

another company to do the repairs;<sup>243</sup> the contractor sued and, pursuant to the cancellation fee clause, was awarded approximately \$125,000, 20% of the total insurance settlement, plus attorney fees and court costs.<sup>244</sup>

The arguments on appeal followed the traditional lines: the HOA arguing that the cancellation fee clause was a prohibited penalty; and the contractor contending it was a permitted liquidated damages clause.<sup>245</sup>

First, the court observed that “liquidated damages provisions . . . are generally enforceable where the nature of the agreement is such that the damages resulting from a breach would be uncertain and difficult to ascertain.”<sup>246</sup> The court found for the contractor on this point, saying that the loss suffered was not readily ascertainable because “net profits realized from construction projects, particularly large projects like the one at issue here, are variable and may be affected by numerous factors, including fluctuating material costs and availability, labor stoppages, accidents, weather, and other delays.”<sup>247</sup>

Second, as to the contractor’s initial burden of proving that the liquidated damages were not grossly disproportionate to its actual damages, the court held the affidavit of one of the owners was insufficient to satisfy this burden.<sup>248</sup> And because the HOA did not come forward with any contrary evidence to establish a genuine issue of material fact as to the proportionality of the liquidated damages

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243. *Id.*

244. *Id.*

245. *Id.* at \*3. The court first rejected the HOA’s contention that no contract had been formed under the doctrine of “mutual mistake of fact.” *Id.* at \*2.

246. *Id.* at \*3 (citing *Gershin v. Demming*, 685 N.E.2d 1125, 1127 (Ind. Ct. App. 1997)).

247. *Id.*

248. *Id.* at \*4. The court explained that:

[T]here is “some contradiction” in the rules relating to distinguishing liquidated damages and penalties. *Harbours Condominium Ass’n v. Hudson*, 852 N.E.2d 985, 993 (Ind. Ct. App. 2006). Specifically, in order to show that the sum stipulated in an agreement as liquidated damages is not ‘grossly disproportionate’ to the loss, the party seeking to enforce the liquidated damages provision must demonstrate some proportionality between the loss and the sum established as liquidated damages. [Gershin, 685 N.E.2d at 1128.] Yet a “typical liquidated damages provision provides for the forfeiture of a stated sum of money without proof of damages.” *Gaddis v. Stardust Hills Owners Ass’n, Inc.*, 804 N.E.2d 231, 236 (Ind. Ct. App. 2004).” We resolve this apparent conundrum by looking to the purpose of liquidated damages, which . . . is to compensate for damages that would be uncertain and difficult to ascertain. See *Gershin*, 685 N.E.2d at 1127; *Harris v. Primus*, 450 N.E.2d 80, 84 (Ind. Ct. App. 1983). Thus, a party who seeks to enforce a liquidated damages clause need not prove actual damages but may be required to show a correlation between the liquidated damages and actual damages in order to assure that a sum charged may fairly be attributed to the breach. See *Gershin*, 685 N.E.2d at 1127.

*Id.* at \*3.

amount, the court found for the contractor on this point as well.<sup>249</sup>

Third and last, while the court acknowledged authority to the effect that payment of a stipulated sum will not be enforced in the event of a partial or inconsequential breach,<sup>250</sup> it held that this was not a situation in which the contract provided for the payment of a stipulated sum in event of any breach, regardless of its materiality.<sup>251</sup>

The Court of Appeals affirmed the trial court's determination that the cancellation fee was a valid and enforceable liquidated damages clause.<sup>252</sup>

The second stipulated damages case decided during the survey period is probably the more interesting. *American Consulting, Inc. v. Hannum Wagle & Cline Engineering, Inc.*<sup>253</sup> reflected an epic contest between two competitors, American Consulting, Inc. ("ACI") and Hannum Wagle & Cline Engineering, Inc. ("HWC"), architectural and engineering firms that perform substantial amounts of work for various agencies of state and local government.<sup>254</sup> This litigation that had already produced one appellate decision.<sup>255</sup>

For purposes of our discussion here, it is sufficient to say that Marlin A. Knowles, Jr., David Lancet, and Jonathan A. Day left ACI to work for HWC in 2014-15. These employees had employment contracts with ACI that included the following provisions:

- Knowles' employment agreement required him to pay "liquidated damages" upon breach of the agreement's (1) non-competition covenant an amount equal to 45% of all fees and other amounts that ACI had billed to former customers lost to Knowles' new company during the twelve-month period immediately preceding the breach and (2) employee non-recruitment covenant an amount equal to 50% of each employee's total compensation from ACI for the twelve months immediately preceding such employee's termination of employment with ACI.<sup>256</sup>
- Lancet's and Day's employment agreements required each of them to pay upon breach of the agreement's employee non-recruitment covenant as "liquidated damages" an amount equal 100% of each improperly recruited employee's annual salary for the preceding

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249. *Id.* at \*4.

250. *Id.* (citations omitted).

251. *Id.* at \*4-5.

252. *Id.* at \*5.

253. 104 N.E.3d 573 (Ind. Ct. App. 2018), *trans. granted*, 110 N.E.3d 1146 (Aug. 30, 2018).

254. *Id.* at 576.

255. *See Hannum Wagle & Cline Eng'g, Inc. v. Am. Consulting, Inc.*, 64 N.E.3d 863, 868 (Ind. Ct. App. 2016) (affirming, over defendants' objections, trial court's entry of preliminary injunction, and, over plaintiff's objection, trial court's subsequent dissolution of preliminary injunction as to one defendant).

256. *Am. Consulting, Inc.*, 104 N.E.3d at 584-85.

calendar year.”<sup>257</sup>

In this case (and in contrast with the trial court’s finding in *Carriage Courts Homeowners Association*), the trial court determined that the liquidated damages clauses in each of the employment contracts are unenforceable as a matter of law because they constituted penalties.<sup>258</sup> As to Knowles’ employment agreement, the trial found in part that

the liquidated damages provisions . . . are punitive and thus unenforceable. . . . This figure may not adequately account for injuries suffered by the aggrieved party; or it could exceed them if the aggrieved party is able to quickly move on following such a breach of contract. . . . The clause allows damages to balloon out of control in the event of multiple employee exits, as has been the case here, regardless of the level of Knowles’ involvement or the amount of actual damages suffered by ASI. . . . [T]he valuation of the damages far exceeds what ASI could have reasonably expected to suffer. . . .<sup>259</sup>

Similarly, the trial court found the liquidated damages provisions of the Day and Lancet employment agreements unenforceable. It said that the amounts stipulated in the Day agreement were “not reasonably related to any actual damages incurred” as a result of the alleged breaches and “grossly disproportionate to damages designated by ACI and instead serves only to be a penalty,” and reached the same conclusion for the same reasons as to the Lancet agreement.<sup>260</sup>

The Court of Appeals began its analysis in much the same tone as in *Carriage Courts Homeowners Association*. “Where the liquidated damages are ‘grossly disproportionate to the loss which may result from the breach or are unconscionably in excess of the loss sought to be asserted, we will treat the sum as an unenforceable penalty rather than as liquidated damages.’”<sup>261</sup> But then the court took a most interesting turn, quoting from the Indiana Supreme Court as follows:

[D]espite the longstanding principles represented by these cases of ours and the Court of Appeals, we are left with some unease over any decision

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257. *Id.* at 585-87.

258. *Id.* at 586-87. The trial court judge entering these findings was the Honorable Heather Welch, Presiding Judge of the Marion County Commercial Court, although this case was filed before the inauguration of the Commercial Court Pilot Project and, as such, not subject to its jurisdiction. See discussion of the Indiana Commercial Court Pilot Project accompanying *supra* Section I.

The enforceability of the non-compete clauses outside of their liquidated damages provisions were not otherwise at issue in this interlocutory appeal.

259. *Am. Consulting Inc.*, 104 N.E.3d at 587.

260. *Id.*

261. *Id.* at 588 (internal brackets omitted).

where what appears to be the freely bargained agreements of the parties are set aside. Fixing the respective rights and expectations of the parties as to damages makes economic and commercial sense. Enforcing such provisions would seem to conform to this Court's longstanding recognition of the freedom of parties to enter into contracts and our presumption that contracts represent the freely bargained agreement of the parties.<sup>262</sup>

Proceeding on this basis, the court emphasized that these were individually negotiated agreements and recognized the "very strong presumption that freely negotiated contracts are enforceable, based on the policy that it is in the best interest of the public for courts not to unnecessarily restrict the freedom to contract."<sup>263</sup>

But while the Court of Appeals certainly viewed the contract through the lens of freedom of contract-private ordering principles, it did not ignore the traditional method of examining stipulated damages clauses. In particular, the court gave detailed attention to the question of whether the damages covered by the liquidated damages provisions were difficult to ascertain.<sup>264</sup> As to the non-competition provision of Knowles' contract, the court said that

[T]he nature of the process of bidding for and being awarded civil engineering contracts shows why damages are difficult to quantify on this front . . . It is impossible to know how the contracts would have been awarded had HWC not had numerous contacts with ASI's clients in violation of the non-compete agreement.<sup>265</sup>

As to the non-recruitment provisions of all three contracts, the court said that "the nature of the business ACI is in is highly dependent on cultivating and maintaining client relationships . . . . The fact that ACI is unable to quantify its costs in losing existing employees and recruiting and training new employees shows why a liquidated damages provision is appropriate."<sup>266</sup>

The Court of Appeals reversed the trial court, holding the liquidated damages clauses to be enforceable.<sup>267</sup>

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262. *Id.* (quoting *Time Warner Entm't Co. v. Whiteman*, 802 N.E.2d 886, 894-95 (Ind. 2004)).

263. *Id.* at 588-89 (citing *Zollman v. Geneva Leasing Assocs., Inc.*, 780 N.E.2d 387, 391-92 (Ind. Ct. App. 2002)).

264. *Id.* at 590.

265. *Id.* (citation omitted).

266. *Id.*

267. *Id.* at 592. The Court gave a nice summary of its analysis:

In sum, liquidated damages in this case serve exactly the purpose for which they were designed because:

- These were negotiated agreements, in which the parties agreed in clear and explicit terms that liquidated damages were appropriate.
- The relative bargaining power of the parties was reflected in the agreements, in that the agreements had different provisions and different damages calculations

### C. Interpreting Particular Types of Contracts

1. *Purchase and Sale Contracts.*—The prototypical contract for the purchase and sale of real property or a business consists of an agreement by the parties to “close” the deal and specifies the parties’ respective rights and obligations both before and after the closing. The Indiana Court of Appeals faced several disputes during the survey period rising under purchase and sales contracts that turned on such specified rights and obligations.

In *Wolanin v. Balanow*,<sup>268</sup> buyer and seller signed the purchase agreement on February 18, 2017, with closing scheduled for April 18.<sup>269</sup> On April 17, seller notified buyer that seller terminated the agreement.<sup>270</sup> Buyer sued for specific performance; seller sought judgment on the pleadings, arguing that seller’s termination had been permitted by the contract.<sup>271</sup>

The Court of Appeals affirmed the trial court’s denial of seller’s motion.<sup>272</sup> While there were contingencies in the contract that permitted either party to terminate, seller had no unilateral right to terminate.<sup>273</sup> Neither court found any evidence that any of the contingencies that would have permitted seller to terminate had materialized; as such, buyer’s specific performance action could proceed.<sup>274</sup>

depending on the employee’s tenure and position.

- The actual damages are difficult to calculate because of the widespread and ongoing nature of the contacts between the HWC Parties and ASI employees and clients.
- The actual damages are difficult to calculate because ASI was required to seek and train *multiple* new people due to the HWC Parties’ targeted recruitment efforts.
- The actual damages are difficult to calculate because the nature of the business means ASI could have lost only some or all of any one client’s business due to HWC’s interference.

*Id.* at 591-92. The court’s decision was not unanimous. Judge Patricia Riley dissented, arguing that Judge Welch had been correct in holding the stipulated damages provisions to be unenforceable penalties. *Id.* at 596 (Riley, J., dissenting). As to both the non-competition and non-recruitment provisions, Judge Riley made forceful arguments as to why any loss that ACI may have suffered due to a breach of the employment contracts was in her view clearly grossly disproportionate to the amount sought in liquidated damages. *Id.* at 596-97 (Riley, J., dissenting).

It is likely that the Indiana Supreme Court will have the last word on this matter. The Court granted transfer on August 30, 2018, and held oral argument on October 4, 2018.

268. No. 18A-PL-93, 110 N.E.3d 1193, 2018 WL 4275468 (Ind. Ct. App. Aug. 30, 2018) (unpublished disposition).

269. *Id.* at \*1.

270. *Id.*

271. *Id.*

272. *Id.* at \*3.

273. *Id.*

274. *Id.*

In *Hometown Station, Inc. v. Jessey*,<sup>275</sup> buyer agreed to purchase a gas station business in suburban Indianapolis for \$1.6 million, contingent on buyer using “due diligence” to secure financing for the purchase.<sup>276</sup> Buyer was unable to secure financing and the deal did not close.<sup>277</sup> Seller later sold the business for \$1.3 million to a third party and then sued buyer for breach of contract damages amounting to \$300,000.<sup>278</sup>

The litigation turned on whether buyer had exercised “due diligence” such that the financing contingency justified his failure to close.<sup>279</sup> The trial court found that the buyer had, and the Court of Appeals affirmed.<sup>280</sup>

Lastly, in *McCutcheon v. Pavco Trucking Co.*,<sup>281</sup> buyer agreed to purchase certain of seller’s trucking company assets for “\$40,000, an additional amount of cash equal to two weeks of Pavco’s payroll, and a covenant-not-to-compete.”<sup>282</sup> Shortly before the closing of the transaction, seller fired two truckers employed

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275. No. 32A01-1707-PL-1548, 96 N.E.3d 127, 2018 WL 669205 (Ind. Ct. App. Feb. 2, 2018) (unpublished disposition).

276. *Id.* at \*1. The Court observed that “due diligence” was not defined in the contract and turned to a legal dictionary to determine that “due diligence” means “[t]he diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation.” *Id.* at \*3 (quoting *Due Diligence*, BLACK’S LAW DICTIONARY (10th ed. 2014)). “Diligence,” the court continued, “is more specifically defined as ‘[c]onstant application to one’s business or duty; persevering effort to accomplish something undertaken. . . . The attention and care required from a person in a given situation; care; heedfulness.’” *Id.* (quoting *Diligence*, BLACK’S LAW DICTIONARY (10th ed. 2014)).

277. *Id.* at \*2. Materially adversely affecting buyer’s ability to close was the fact that, prior to the execution of the agreement and without buyer’s knowledge, the seller’s lender had commenced foreclosure proceedings against the gas station and property. “The [seller] had entered into a forbearance arrangement with its lender and was anticipating that the proceeds of the sale would cover its debt and cancel out the foreclosure action.” *Id.* at \*1.

278. *Id.* at \*2.

279. *Id.* at \*3.

280. *Id.* The Court of Appeals agreed with the trial court’s conclusion that

“[the buyer] exercised due diligence in [the pursuit of] obtaining a financial commitment.” . . . [The buyer] contacted Tulshan, a financial broker whom [the buyer] had utilized since 2011, and “forwarded to [Tulshan] the [APA] and title commitment in an attempt to obtain financing for the property.” During the bench trial, [buyer] testified that Tulshan maintains a file with all of [buyer]’s updated financial information and that Tulshan applied for financing on [buyer]’s behalf with “about nine different banks.” [Buyer] stated that financing was denied because of the pending foreclosure. Furthermore, the trial court accorded special credit to [buyer]’s testimony based on [buyer]’s substantial experience in buying and selling convenience stores.

*Id.* (Internal citations to the trial court record omitted).

281. No. 10A05-1711-PL-2713, 110 N.E.3d 1186, 2018 WL 4003125 (Ind. Ct. App. 2018) (unpublished disposition).

282. *Id.* at \*1.

by seller.<sup>283</sup> These truckers ultimately obtained an approximately \$180,000 default judgment against the seller for retaliatory discharge and wrongful termination.<sup>284</sup> The truckers then sought proceedings supplemental against buyer on the theory that buyer had assumed the liabilities of seller.<sup>285</sup>

The trial court granted summary judgment to the buyer, and the Court of Appeals affirmed for the following three reasons.<sup>286</sup> First, the purchase agreement was explicit that seller was “responsible for all debts, obligations, leases and expenses of the business prior to [the date and time of closing].”<sup>287</sup> Second, there was no evidence that the truckers had ever worked for the buyer.<sup>288</sup> Third, there was evidence that both seller and buyer had maintained separate corporate structures with no overlapping ownership and no stock transferred in the deal.<sup>289</sup>

2. *Employment Contracts (Including Non-competition Covenants)*.—Several cases involving employment and consulting contracts, some of which included non-competition covenants, were decided during the survey period are worthy of mention.<sup>290</sup>

In each of the last two years, I have commented in this annual survey article that, unlike some of our sister states, Indiana courts readily enforce non-competition clauses in employment agreements.<sup>291</sup> A robust example of that was *Vickery v. Ardagh Glass Inc.*<sup>292</sup>

Craig Vickery signed an employment agreement with Saint–Gobain Containers, Inc. (SGCI), a glass manufacturer, in 2004.<sup>293</sup> An engineer, Vickery

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283. *Id.*

284. *Id.*

285. *Id.*

286. *Id.* at \*4.

287. *Id.* at \*1, \*3. Seller had also indemnified and held buyer harmless for any liability before February 28, 2014, at midnight. *Id.* at \*1. Seller was required to indemnify and hold buyer harmless from any liability for “all debts, obligations, leases and expenses of the business prior to the date and time of closing,” and warranted that there were no “judgments, liens, claims, actions or proceeding [sic] against the assets being conveyed” except as described the agreement. *Id.*

288. *Id.* at \*1, \*2.

289. *Id.* at \*1.

290. *See, e.g., Am. Consulting, Inc. v. Hannum Wagle & Cline Engineering, Inc.*, 104 N.E.3d 573, 2018 WL 2325436 (Ind. Ct. App. 2018) (unpublished disposition), *trans. granted*, 110 N.E.3d 1146 (Aug. 30, 2018) (discussed at length, *supra* text accompanying notes 253-67, for its consideration of liquidated damage clauses, also involved non-competition clauses in the contracts of ACI employees who left to work for HWC, an ACI competitor). However, that case was an interlocutory appeal in which the question of the enforceability of the non-competition clauses themselves (in contrast to their purported liquidated damage remedies) had not yet been addressed by the trial court. *Id.* at 583.

291. 2018 Survey, *supra* note 37, at 990-91; 2017 Survey, *supra* note 4, at 1208-09.

292. 85 N.E.3d 852 (Ind. Ct. App. 2017). This case was discussed previously, *see supra* note 6 and accompanying text, regarding the plaintiff’s attack upon the constitutionality of the Indiana Commercial Court Pilot Project.

293. *Id.* at 855.



agreed that he would not compete with SGCI for a period of one year after leaving its employ and to protect SGCI's trade secrets and confidential information.<sup>294</sup> In 2014, SGCI was merged into Ardagh Glass Inc. ("Ardagh"), pursuant to the terms of a transaction in which Ardagh acquired all of the shares of SGCI.<sup>295</sup> Two years later, Vickery resigned to go to work for a competitor; Ardagh filed this lawsuit to enforce the non-competition clause.<sup>296</sup>

Vickery set up a long list of objections to the enforceability of the non-compete, but the Court of Appeals knocked them down like duck pins.<sup>297</sup>

First, Vickery contended that Ardagh could not enforce the non-compete because his employment agreement was with SGCI, not Ardagh, and under governing law, a non-compete could not be assigned without the employee's consent.<sup>298</sup> The Court of Appeals found no assignment in the first place.<sup>299</sup> Because SGCI had merged into Ardagh, Ardagh acquired all of SGCI's contractual rights following the merger by operation of law; there had been no assignment.<sup>300</sup> "Ardagh stepped into the shoes of SGCI and acquired all of its rights, including those related to the [non-]compete."<sup>301</sup>

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294. *Id.*

295. *Id.*

296. *Id.* at 855-56

297. *Id.* at 856-57, 860-63. Under the non-compete's choice of law provision, Pennsylvania law, not Indiana, applied. *Id.* at 860. But Pennsylvania law appears to me to be sufficiently similar to Indiana law that the court's analysis and disposition of this case would have been the same if Indiana law controlled. *Compare* Pulse Techs., Inc. v. Notaro, 620 A.3d 778, 784 (Pa. 2013) (explaining that "[r]estrictive covenants are not favored in Pennsylvania, but have long been held to be enforceable if (1) they are incident to an employment relationship between the parties; (2) they are supported by adequate consideration; (3) the restrictions imposed by the covenant are reasonably necessary for the protection of legitimate interests of the employer; and (4) the restrictions imposed are reasonably limited in duration and geographic extent." (citations omitted)), *with* Cent. Ind. Podiatry, P.C. v. Krueger, 882 N.E.2d 723, 728-29 (Ind. 2008) (explaining that "[t]his Court has long held that noncompetition covenants in employment contracts are in restraint of trade and disfavored by the law. . . . To be enforceable, a noncompetition agreement must be reasonable. . . . In arguing the reasonableness of a non-competition agreement, the employer must first show that it has a legitimate interest to be protected by the agreement. The employer also bears the burden of establishing that the agreement is reasonable in scope as to the time, activity, and geographic area restricted." (citations omitted)).

298. Under the non-compete's choice of law provision, Pennsylvania law applied. The Pennsylvania Supreme Court had held that when, as here, there is no assignability provision in a non-compete, the covenant was not assignable. *Vickery*, 85 N.E.3d at 860 (citing *Hess v. Gebhard & Co.*, 808 A.2d 912, 922 (2002)).

299. *Id.* at 861 (stating that the non-compete was not assigned, but that Ardagh "acquired all of SGCI's rights associated with the stock, including contractual rights held by SGCI before the stock purchase. . . . In other words Ardagh stepped into the shoes of SGCI and acquired all of its rights, including those related to the Noncompete.").

300. *Id.*

301. *Id.*

Second, Vickery contended that the non-compete was unenforceable because it was imposed by SGCI after his employment had already begun, violating the requirement of applicable law that non-competes must be supported by adequate consideration.<sup>302</sup> But the court observed that when begin working for SGCI, he began as a temporary employee; it was only on the day he signed the non-compete that he became a full-time, permanent employee.<sup>303</sup>

Third, Vickery contended that the non-compete was unenforceable because Ardagh had not identified any protectable interest to justify keeping him employed<sup>304</sup> as required by applicable law.<sup>305</sup> The court rejected this contention, characterizing it as a request for appellate reweighing of the evidence.<sup>306</sup> It found the trial court's findings concerning Ardagh's trade secrets and confidential information sufficient to establish that Ardagh had protectable interests at stake.<sup>307</sup>

Fourth, Vickery contended that the non-compete was unenforceable because it did not contain any geographic restriction on its scope<sup>308</sup> as required applicable law.<sup>309</sup> Crediting the trial court's finding that the non-compete was limited to the United States, the court found that limitation reasonable under applicable law.<sup>310</sup> The court said that Ardagh had manufacturing plants and customers—and competed directly with Vickery's new employer—throughout the United States.<sup>311</sup> As such, the court said, “the nationwide scope of the [non-compete was] reasonable.”<sup>312</sup>

Vickery stands testament to the continued vitality of covenants not to compete under Indiana law.

One other employment contract case decided during the survey period raises the recurring issue of whether employee handbooks are incorporated into employment contracts. *Board of Trustees of Purdue University v. Eisenstein*<sup>313</sup> involved a set of claims and counter-claims among Purdue University, a Purdue professor, and other members of the Purdue community emanating from the professor's frequent pro-Jewish and anti-Muslim statements.<sup>314</sup> Most of the claims and counter-claims are beyond the scope of this Article, but the professor

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302. *Id.* (citing *Pulse Techs., Inc. v. Notaro*, 67 A.3d 778, 784-85 (Penn. 2013)).

303. *Id.*

304. *Id.* at 861-62.

305. *Id.* at 861 (citing *Pulse Techs.*, 67 A.3d at 784-85).

306. *Id.* at 862.

307. *Id.*

308. *Id.*

309. *Id.* at 861 (citing *Pulse Techs.*, 67 A.3d at 784-85).

310. *Id.* at 863 (“Courts applying Pennsylvania law have readily enforced nationwide—and even global—restrictive covenants where, as here, the former employer's business was itself nationwide or global.”).

311. *Id.*

312. *Id.*

313. 87 N.E.3d 481 (Ind. Ct. App. 2017).

314. *Id.* at 490-91.

did allege that Purdue “breached his employment contract by failing to follow Purdue’s policy and procedures in many ways.”<sup>315</sup>

The court held that the Purdue Faculty and Staff Handbook was not part of the professor’s employment contract.<sup>316</sup> Rather, the contract read only that the faculty member should become “acquainted with” the Handbook.<sup>317</sup>

The court buttressed its argument with the holding of a recent federal case involving similar facts in a contract dispute involving a faculty member at Indiana University.<sup>318</sup> The court went on to say that “Indiana courts have long held that employee handbooks that contain such disclaimers do not create a contract for employment.”<sup>319</sup> So too here: the court found that the Handbook was not part of the professor’s employment contract and he could not rely on it to support a breach of contract claim.<sup>320</sup>

3. *Guaranties*.—A contract that constitutes a guaranty carries with it some special rules of interpretation, illustrated during the survey period by *Fish v. 2444 Acquisitions, LLC*.<sup>321</sup>

In August, 2007, Michael Fish loaned \$220,000 to 2444 Acquisitions, LLC, the principal to be repaid in a lump sum by mid-September.<sup>322</sup> James E. Chalfant personally guaranteed repayment of this loan.<sup>323</sup> In November, 2008, Fish made a second loan to the LLC in approximately the same amount, the principal to be repaid in monthly installments with a final payment due in December, 2011.<sup>324</sup> When the LLC defaulted on the second of these loans, Fish commenced this litigation to enforce the guaranty provided by Chalfant in 2007.<sup>325</sup>

The trial court ruled in favor of Chalfant, and the Court of Appeals agreed.<sup>326</sup> In a thorough examination of Indiana guaranty law, the appellate court distinguished between “restricted” and “continuing” guaranties, the former being “limited to a single transaction” while the latter “contemplates a future course of dealing encompassing a series of transactions.”<sup>327</sup> “The determination whether a guaranty is continuing or restricted centers on the parties’ intention, as revealed by the language of the guaranty,” the court said.<sup>328</sup>

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315. *Id.* at 501-02.

316. *Id.* at 502.

317. *Id.*

318. *Id.* at 502-03 (citing *Packer v. Trs. of Ind. Univ. Sch. of Med.*, 73 F. Supp. 3d 1030 (S.D. Ind. 2014), *aff’d*, 800 F.3d 843 (7th Cir. 2015)).

319. *Id.* at 503 (citing *Orr v. Westminster Vill. N., Inc.*, 689 N.E.2d 712, 721 (Ind. 1997)).

320. *Id.*

321. No. 49A02-1702-MF-213, 91 N.E.3d 1103, 2017 WL 4509828 (Ind. Ct. App. 2017) (unpublished disposition).

322. *Id.* at \*1.

323. *Id.*

324. *Id.*

325. *Id.* at \*2.

326. *Id.* at \*1.

327. *Id.* at \*3 (quoting 38 AM. JUR. 2D *Guaranty* § 17 (2017)).

328. *Id.* (quoting 38 AM. JUR. 2D *Guaranty* § 17 (2017)).

The court analyzes the case in accordance with longstanding Indiana contract construction principles.<sup>329</sup> It begins by announcing that it would examine whether the parties meant for the guaranty to cover the 2008 loan as well as the 2007 loan when Chalfant signed it. If so, it would be a “continuing guaranty” and enforceable; if not, a “restricted guaranty” and not enforceable.

The court proceeds with its examination and finds nothing in the language of the guaranty suggesting that Chalfant agreed, much less contemplated, that it would apply to any future transactions.<sup>330</sup> From this, it concludes that the guaranty should not be read as a continuing guaranty.<sup>331</sup>

But in between announcing that it would be looking to determine the intent of the parties and actually doing so, the court took a diversion common in the interpretation of guaranties in Indiana, demonstrating once again that a guarantor “is a favorite of the law.”<sup>332</sup> In particular, a guarantor can be relieved of liability in the event of “material alteration” of its obligation.<sup>333</sup> The court held that there had been no material alteration of the corporation’s liability here.<sup>334</sup>

The court gives the “material alteration” a thorough going-over here and concludes that the November 2008 loan indeed constituted a material alteration of the terms of the August 2007 loan: the principal amount of the second loan was higher; the first was interest-free, the second carried an interest rate in excess of 12.2%; and the first loan was payable in a lump sum, the second in installments.<sup>335</sup>

The bottom line is that in interpreting guaranties, an Indiana court will go beyond the standard tenets of contract contraction to protect a guarantor from the adverse effect of any material alteration in the guaranteed obligation to which the guarantor has not agreed.

#### *D. Calculation of Damages, Including Mitigation of Damages*

In *Thompson v. Wells Fargo Bank, N.A.*,<sup>336</sup> the Court of Appeals deployed a recent decision of the Supreme Court, *Fischer v. Heymann*.<sup>337</sup> Both are instructive

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329. *2018 Survey*, *supra* note 37, at 967 (“Because the problem of contract interpretation arises with so much frequency, Indiana courts have developed a disciplined approach to addressing it” of which “[t]he ultimate goal . . . is to determine the intent of the parties at the time that they made the agreement.”) (quoting *Citimortgage, Inc. v. Barabas*, 975 N.E.2d 805, 813 (Ind. 2012)).

330. *Fish*, 2017 WL 4509828, at \*4.

331. *Id.*

332. *See 2018 Survey*, *supra* note 37, at 984.

333. *Id.* (quoting *Keesling v. T.E.K. Partners, LLC*, 861 N.E.2d 1246, 1254 (Ind. Ct. App. 2007)); *see also 2015 Survey*, *supra* note 36, at 1201 (discussing *Finley v. First Fed. Sav. Bank*, No. 02A03-1302-PL-48, 2013 WL 6629207 (Ind. Ct. App. Dec. 16, 2013)).

334. *Fish*, 2017 WL 4509282, at \*4.

335. *Id.* at \*3-\*4.

336. No. 41A04-1704-CC-884, 94 N.E.3d 756, 2017 WL 5474502 (Ind. Ct. App. 2017) (unpublished disposition).

337. 12 N.E.3d 867 (Ind. 2014).

on the principles of mitigation of damages for breach of contract.

Thompson Quality Foods, Inc., borrowed approximately \$340,000 from Wells Fargo Bank, secured by a first mortgage on real estate owned by the borrower and guaranteed by some people named Thompson.<sup>338</sup> The guaranty contained a very explicit set of waivers of the guarantors' rights against the bank, including any right to require the bank to proceed against any collateral before proceeding against the guarantors and "all rights and protections of any kind" that would limit the amount of the bank's recovery following a sale or foreclosure of any collateral.<sup>339</sup>

The loan subsequently went into default with the borrower and guarantors owing the bank approximately \$367,000 on the note.<sup>340</sup> Thereafter, the real estate was sold at sheriff's sale to a man named Cleveland for failure to pay taxes.<sup>341</sup> During the redemption period, the borrower and guarantors entered into a purchase agreement with Cleveland to sell the real estate to Cleveland for \$175,000, conditioned on the bank waiving its right to collect approximately \$190,000 from the guarantors, i.e., the balance due the bank after applying the sale proceeds to the amount of the debt.<sup>342</sup> After review, the bank declined to agree and the deal with Cleveland was not consummated.<sup>343</sup>

In the bank's collection action on the approximately \$367,000 judgment, the guarantors argued that the bank's refusal to ratify their purchase agreement with the tax-sale purchaser Cleveland constituted an "unreasonable failure to mitigate its damages."<sup>344</sup>

For guidance, the court looked to *Fischer*, a case involving the seller's mitigation of damages where the buyers breached a contract to purchase a condominium.<sup>345</sup> *Fischer* contains a useful concordance of mitigation principles:

[Seller] had a right to damages for "the loss actually suffered as a result of the breach" once the [buyers] breached the [Purchase] Agreement, but not "to be placed in a better position than [seller] would have been if the contract had not been broken." [Seller] also had a duty to mitigate [seller's] damages. "The duty to mitigate damages is a common law duty independent of the contract terms" that requires "a non-breaching party [to] make a reasonable effort to act in such a manner as to decrease the damages caused by the breach." Still, "the burden of proving that the non-breaching party has failed to use reasonable diligence to mitigate damages" lies with the party in breach—here, the [buyers]. And since assessing [seller's] diligence is a question of fact, we defer to the trial

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338. *Thompson*, 2017 WL 5474502, at \*1.

339. *Id.* at \*3.

340. *Id.* at \*1. This amount was reduced to judgment. *Id.*

341. *Id.*

342. *Id.* at \*1, \*3.

343. *Id.* at \*1.

344. *Id.* at \*3.

345. *Fischer v. Heymann*, 12 N.E.3d 867, 869 (Ind. 2014).

court's discretion and reverse only if there are no facts to support its conclusion either directly or by inference.<sup>346</sup>

The contract in *Fischer* had authorized the buyers to terminate their agreement to purchase the seller's condo if the seller refused to fix any "major defect" discovered during inspection, but did not allow them to terminate if the seller refused to perform "routine maintenance" or make "minor repairs."<sup>347</sup> After the inspection, the buyers sent a demand to the seller to fix an electrical problem or void the contract.<sup>348</sup> The seller did not act by the contract deadline and the buyer repudiated.<sup>349</sup> A court determined that the electrical problem was not a "major defect" and held buyer's repudiation wrongful.<sup>350</sup> In seller's subsequent damages action against buyer, buyer maintained that the seller's duty to mitigate damages required that she surrender to their demand to fix the problem or release them from the contract.<sup>351</sup> The *Fischer* court disagreed, emphasizing that the seller's duty to mitigate did not require seller to "surrender to the very demand that generated the [buyers'] breach."<sup>352</sup> The Supreme Court explained:

Just as breaching parties may not take advantage of their breach to relieve them of their contractual duties, neither may they take advantage of their breach to require non-breaching parties to perform beyond their contractual duties. And just as nonbreaching parties may not place themselves in a better position because of the breach, neither may breaching parties.

Holding otherwise would require sellers . . . to choose between surrendering to the terms of a breach or forfeiting damages whenever a buyer breaches an agreement by conditioning purchase on strict compliance with an unreasonable demand.<sup>353</sup>

Drawing on *Fischer*, the Court of Appeals in *Thompson v. Wells Fargo* rejected the borrower's and guarantors' contention that the bank's duty to mitigate required it to approve the purchase agreement between themselves and Cleveland.<sup>354</sup>

Notwithstanding the fact that the duty to mitigate damages is an independent common-law duty, the [borrower's and guarantors'] assertion is similar to the buyers' assertion in *Fischer*, where the

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346. *Id.* at 871 (internal citations omitted).

347. *Id.* at 869.

348. *Id.*

349. *Id.*

350. *Fischer v. Heymann*, 943 N.E.2d 896, 902-03 (Ind. Ct. App. 2011), *trans. denied*.

351. *Fischer*, 12 N.E.3d at 871.

352. *Id.* at 872 (quoting *Fischer v. Heymann*, 994 N.E.2d 1151, 1164 (Ind. Ct. App. 2013)).

353. *Fischer*, 12 N.E.3d at 872-73 (citations omitted).

354. *Thompson v. Wells Fargo Bank, Nat'l Ass'n*, No. 41A04-1704-CC-884, 2017 WL 5474502, at \*4.

breaching parties, under the banner of mitigation, demanded release from the contract. Per the [terms of the guaranty], the [guarantors] waived any rights/protections they might otherwise have to limit [the bank's] recovery for any deficiency following a sale of the property. Conversely, the [condition waiving the bank's right to a deficiency] in the Purchase Agreement [with] Cleveland would essentially operate as a waiver/release provision preventing [the bank] from collecting any deficiency.<sup>355</sup>

Much as the Supreme Court had done in *Fischer*, the Court of Appeals in *Thompson* concluded that the contract breacher had improperly tried to gain an advantage from their own breach by equating the bank's rejection of their Purchase Agreement with a third-party buyer to the failure of a nonbreaching party to mitigate damages.<sup>356</sup> Just as the seller in *Fischer* had not been obligated to repair a non-major defect, the bank was not obligated to ratify the Purchase Agreement—and thereby forfeit its right to a significant deficiency—as a means of mitigating its damages.<sup>357</sup>

In addition to the buyer's appeal in *Fischer* just discussed, seller also appealed, challenging the amount of damages awarded by the trial court as insufficient.<sup>358</sup> The purchase price for the condo in the repudiated contract with closing scheduled in May, 2016, had been \$315,000; seller sought damages of the difference between that amount and the eventual sale price in 2011 of \$180,000 (plus carrying costs, other expenses, and attorney fees).<sup>359</sup> Buyer argued, and the trial court agreed, that seller fell short of exercising reasonable diligence in mitigating her damages when seller listed the condo at an “unreasonably high [price] from at least the beginning of 2007 to early 2011,” and rejected a third-party offer to purchase the condo for \$240,000 in February 2007 by making an “unreasonably high” counter-offer of \$286,000.<sup>360</sup>

Emphasizing that a party's reasonableness in mitigating damages is a question of fact, the Supreme Court held that the trial has discretion to determine whether parties have reasonably mitigated their damages in calculating a final damage award, so long as the trial court applies the correct legal standard and the evidence supports its calculation.<sup>361</sup> The court said that while the parties disputed the evidence, the trial court acted within its discretion in finding that seller failed to mitigate damages because seller could have accepted an offer to sell the condo in 2007 for \$240,000, instead of waiting to sell it in 2011 for only \$180,000.<sup>362</sup> As a result, the court affirmed the trial court's holding that seller was only entitled

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355. *Id.*

356. *Id.*

357. *Id.* at \*4.

358. *Fischer*, 12 N.E.3d at 870.

359. *Id.* at 869-70.

360. *Id.* at 873.

361. *Id.*

362. *Id.*

to the difference between the original \$315,000 selling price and the \$240,000 offer, plus all carrying costs, expenses, and attorney fees that accrued from the moment of breach until seller rejected the \$240,000 offer.<sup>363</sup>

Taken together, *Fischer* and *Thompson* put some nice flesh on the bones of both the procedural and substantive law of mitigation of damages for breach of contract.

#### V. CONCLUSION: A TRIBUTE TO JUDGE MICHAEL P. BARNES

During the survey period, Judge Michael P. Barnes retired after 18 years on the Indiana Court of Appeals.<sup>364</sup> Judge Barnes had a very distinguished career as a prosecutor before being appointed to the Court of Appeals and so had particular expertise in criminal law.<sup>365</sup> In addition, Judge Barnes made a major contribution to business and commercial law. To conclude this year's survey of banking, business, and contract law, I will discuss two commercial law opinions authored by Judge Barnes that are so good and so important that they appear in a number of casebooks and treatises.

*Belden, Inc. v. American Electronic Components, Inc.*,<sup>366</sup> is a UCC Article 2 opinion and it sorts out with astonishing dexterity and clarity the mysteries of the “battle of the forms.”

Belden, Inc. (“Belden”), sold insulated wire to American Electronic Components, Inc. (“AEC”).<sup>367</sup> AEC used the Belden supplied wire in components that it manufactured and sold to Chrysler.<sup>368</sup> As a consequence of the poor insulation, the components failed, and Chrysler was subjected to a recall.<sup>369</sup> When Chrysler sought damages from AEC, AEC brought this lawsuit to recover from Belden.<sup>370</sup>

In its forms accepting AEC's orders, Belden disclaimed liability for consequential damages and said that Belden's acceptance of AEC's order “is expressly made conditional upon Buyer's assent” to any additional term.<sup>371</sup> The form goes on to say that AEC will be “deemed” to consent to such any additional term if it accepts any of the products delivered. In other words, Belden contended that its acceptance of AEC's order was conditioned on AEC's agreement to the limitation on consequential damages clause and that AEC gave its agreement when it accepted the goods.

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363. *Fischer*, 12 N.E.3d at 874.

364. Olivia Covington, *Friends, Colleagues Laugh and Cry During Barnes' Retirement Ceremony*, IND. LAW., May 31, 2018.

365. Judge Michael P. Barnes, *Judges of the Court of Appeals*, <https://www.in.gov/judiciary/appeals/2455.htm> [<https://perma.cc/P5N5-5A6N>].

366. 885 N.E.2d 751, 754 (Ind. Ct. App. 2008).

367. *Id.*

368. *Id.*

369. *Id.*

370. *Id.*

371. *Id.* at 755.



Judge Barnes starts with the common law of contracts:

For an offer and an acceptance to constitute a contract, the acceptance was required to meet and correspond with the offer in every respect, neither falling within nor going beyond the terms proposed, but exactly meeting [those terms] at all points and closing with them just as they stand. An acceptance which varied the terms of the offer was considered a rejection and operated as a counter-offer, which could be accepted by the original offeror by performing without objection under the terms contained in the counter-offer.<sup>372</sup>

But, Judge Barnes continues, Uniform Commercial Code (“UCC”) § 2-207<sup>373</sup> was specifically designed to alter this common-law “mirror image” rule.<sup>374</sup>

The drafters recognized that in commercial practice, especially with the advent of printed forms, the terms of the ‘offer’ and ‘acceptance’ were seldom the same. They further recognized that the parties to a commercial transaction seldom were aware of the conflicting terms and conditions contained in the printed forms they exchanged. [UCC] § 2-207 was therefore designed to allow enforcement of an agreement despite discrepancies between offer and acceptance, if enforcement could be required without either party being bound to a material term to which it had not agreed.<sup>375</sup>

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372. *Id.* at 756 (quoting *Uniroyal, Inc., v. Chambers Gasket & Mfg. Co.*, 380 N.E.2d 571, 575 (Ind. Ct. App. 1978) (quotations and citations omitted)).

373. Uniform Commercial Code (“UCC”) § 2-207, codified in Indiana at Indiana Code section 26-1-207, provides:

(1) A definite and seasonable expression of acceptance or a written confirmation which is sent within a reasonable time operates as an acceptance even though it states terms additional to or different from those offered or agreed upon, unless acceptance is expressly made conditional on assent to the additional or different terms.

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: (a) the offer expressly limits acceptance to the terms of the offer; (b) they materially alter it; or (c) notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

(3) Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular contract consist of those terms on which the writings of the parties agree, together with any supplementary terms incorporated under any other provisions of this Act.

374. *Belden*, 885 N.E.2d at 756 (quoting *Uniroyal*, 380 N.E.2d at 575 (quotations and citations omitted)).

375. *Id.*

Where a seller responds to a buyer's offer with an acceptance that contains additional terms, UCC section 2-207 operates as follows.<sup>376</sup> First, if the response is not expressly conditioned on the offeror's assent to the additional terms in the acceptance, a contract is formed subject to the provisions of section 2-207(2).<sup>377</sup> On the other hand, if an acceptance is expressly conditioned on the offeror's assent to the new terms and no assent is forthcoming, then no contract is formed at that point.<sup>378</sup> However, notwithstanding "expressly conditional" language, if the parties' conduct recognizes the existence of a contract by performance, then a contract for sale is formed after all subject to the provisions of section § 2-207(3).<sup>379</sup>

As noted above, Belden's acceptance was expressly conditioned on AEC's assent to the new terms limiting consequential damages and no assent was forthcoming.<sup>380</sup> Judge Barnes says that Belden could not unilaterally include terms that were expressly conditional on AEC's assent.<sup>381</sup> Thus, the parties' writings did not create a contract.<sup>382</sup>

Although the parties' writings did not create a contract, the parties' actions established the performance necessary to establish a contract for the sale of the wire subject to the provisions of section 2-207(3).<sup>383</sup> This subsection specifies that "[t]he terms of the contract are the written terms on which the parties agree" and the "supplementary terms incorporated under any other provisions of the UCC."<sup>384</sup>

Now AEC did not agree in any of the written terms to any limitation on seeking consequential damages from Belden.<sup>385</sup> So if Belden was to establish that is not liable for any consequential damages suffered by AEC, it would need to show that the "supplementary terms incorporated under any other provisions of the UCC" established a limitation on AEC seeking consequential damages.<sup>386</sup>

Belden has several arguments that its proposed limitation on damages was incorporated into the parties' agreement due to provisions of the UCC.<sup>387</sup> Judge Barnes does a very careful job of disposing of each of them.<sup>388</sup>

In summary, the *Belden* opinion holds:

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376. *Id.*

377. *Id.*

378. *Id.*

379. *Id.* at 757.

380. *Id.* at 755.

381. *Id.* at 757.

382. *Id.*

383. *Id.*

384. *Id.* (quoting UCC § 2-207(3)).

385. *Id.* at 759.

386. *Id.* at 757.

387. *Id.* at 757-58, 758-60.

388. *Id.*

- The parties' writings did not form a contract because Belden made its acceptance of AEC's offer conditional upon AEC's acceptance of certain additional terms.<sup>389</sup>
- But the parties' subsequent performance of the purchase and sale of the wire did establish the existence of a contract.<sup>390</sup>
- The terms of that contract consisted of the written terms on which the parties agreed and the "supplementary terms incorporated under any other provisions of the UCC."<sup>391</sup>
- Belden's proposed limitation on consequential damages was not a provision in the written terms on which the parties agreed and it was not incorporated into their contract by any supplementary terms of the UCC.<sup>392</sup>

*Belden* is a very good piece of work indeed, studied by commercial law students throughout the land.

The other commercial law opinion written by Judge Barnes that I will discuss in this conclusion is *Indianapolis Car Exchange, Inc. v. Alderson*,<sup>393</sup> which arises under UCC Article 9.<sup>394</sup>

*Alderson* is a case about priorities and a quick refresher is probably in order. The general rule is that a security interest continues in collateral notwithstanding its sale, *i.e.*, if I, Debtor, sell property in which my Lender has a security interest to Buyer, Buyer takes subject to Lender's security interest.<sup>395</sup> But there are exceptions. Relevant here, Buyer would take free of Lender's security interest if Buyer is a "buyer in the ordinary course of business" under UCC section 9-320(a).<sup>396</sup> For this to be so, the sale must be of inventory<sup>397</sup> and the security interest must have been created by Buyer's seller, Debtor in this hypothetical.<sup>398</sup> The policy justification for this result is that a creditor who has financed inventory invariably *wants* its debtor to sell inventory; that's where the proceeds to pay the debt will come from.<sup>399</sup>

This is a powerful exception because it applies even if the security interest

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389. *Id.* at 757.

390. *Id.*

391. *Id.*

392. *Id.* at 764.

393. 910 N.E.2d 802 (Ind. Ct. App. 2009).

394. Judge Barnes' August 2009 opinion in *Indianapolis Car Exchange v. Alderson* may have been the basis for Question #5 on the July 2010 Indiana bar exam. See <https://myble.courts.in.gov/july-2010> [<https://perma.cc/9VDC-2NG3>]. I thought it was a very hard question; one requiring a much more sophisticated understanding of secured transactions that I would expect from a lawyer meeting even average standards of competency.

395. UCC § 9-315(a).

396. *Indianapolis Car Exchange, Inc.*, 910 N.E.2d at 805 (quoting UCC § 9-320(a)).

397. *Id.* at 808 (quoting UCC § 403, cmt. 2).

398. *Id.* at 805 (citing UCC § 9-320(a)).

399. *Id.* at 808 (quoting UCC § 403, cmt. 2).

was perfected and even if the Buyer knew of the existence of the security interest.<sup>400</sup>

In Judge Barnes' case, Indianapolis Car Exchange, Inc. ("ICX") provided financing to an auto dealership called Top Quality Auto Sales ("Top-Quality"), run by Michael L. Thurman.<sup>401</sup> Top-Quality's obligations to ICX were secured by perfected security interest in Top-Quality's inventory.<sup>402</sup> Top-Quality had serious credit worthiness problems of which ICX was well aware.<sup>403</sup>

Top-Quality used some of the money it borrowed from ICX to buy a truck.<sup>404</sup> Top-Quality then sold that truck to another dealer named Lightly Used Trucks ("Lightly-Used") run by Bonnie Chrisman.<sup>405</sup> Chrisman paid Thurman for the truck, but Thurman did not pay ICX.<sup>406</sup>

Then Chrisman sold the truck to Randall and Christina Aldersons.<sup>407</sup>

Now ICX had possession of and its lien noted on the title to the truck and took the position that it needed to be paid the money that it had advanced Thurman to buy the truck before it would release the title to the Aldersons.<sup>408</sup> The Aldersons took the position that they had bought the truck free and clear of any security interest that ICX might've had in it, and they sued to get their title.<sup>409</sup>

ICX made three arguments as to why summary judgment in favor of the Aldersons was incorrect.

First, ICX maintained that there was a genuine issue of material fact as to whether either Chrisman or the Aldersons were buyers in the ordinary course of business because either or both knew of ICX's security interest in truck.<sup>410</sup> But Judge Barnes rejects this argument, pointing out that UCC section 9-320(a) recognizes that a buyer in the ordinary course might well know of the existence of a perfected security interest.<sup>411</sup> This is consistent with the policy justification set forth above; it is only if the buyer knows that the sale violates the rights of another person that UCC section 9-320(a) is not effective, and there was no evidence that either Chrisman or the Alderson's new the sale violated ICX's rights.<sup>412</sup>

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400. *Id.* at 805 (citing UCC § 9-320(a)). Buyer takes free of Lender's security interest if Buyer is a "buyer in the ordinary course of business" in situations that constitute what's called "entrustment" under UCC Article 2. More about that in a minute—it's a relatively obscure point but does raise its head in *Alderson*.

401. *Id.* at 803.

402. *Id.* at 803-04.

403. *Id.* at 804.

404. *Id.*

405. *Id.*

406. *Id.*

407. *Id.*

408. *Id.*

409. *Id.*

410. *Id.* at 805.

411. *Id.*

412. *Id.* at 805-06.

Second, ICX contended that under UCC section 9-320(a), a buyer in the ordinary course of business only takes free and clear where the security interest was created by the buyer's seller.<sup>413</sup> Here the Aldersons bought the truck from Chrisman, and Chrisman didn't create the security interest; Top-Quality did.<sup>414</sup> Judge Barnes makes an important point here. He says that the "created by [buyer's] seller" limitation only applies where the original buyer (Top-Quality here) is not a buyer in the ordinary course.<sup>415</sup> Top-Quality was an auto dealer.<sup>416</sup> This made Chrisman a buyer in the ordinary course of business, and, when the Aldersons bought the truck from Chrisman (also used car dealer), they too were buyers in the ordinary course of business.<sup>417</sup> Again, recognizing the tacking of ordinary course status is consistent with the policy justification set forth above.

Third, ICX points to some language in the official commentary to the UCC that it asserted that its acquiescence was required for the sale of the truck to be made free of its security interest.<sup>418</sup> Judge Barnes says this language does not stand for the point asserted. He says that it refers to language in UCC section 2-403(2) dealing with a concept called "entrustment."<sup>419</sup> Entrustment gives a merchant the power to transfer all of a secured party's rights to a buyer, even if the sale is wrongful against the secured party. In fact, Judge Barnes says, ICX did entrust the truck to Top-Quality by delivering the truck to Thurman and acquiescing in his retention of possession of the truck with the expectation that Thurman would sell the truck to someone else.<sup>420</sup> This is exactly the situation described in and protected by section 2-403(2).<sup>421</sup>

The trial court's judgment that the Aldersons were buyers in the ordinary course as a matter of law was affirmed.<sup>422</sup>

Once again, Judge Barnes does an excellent job of providing a roadmap for resolving future questions of when buyers—and buyers' buyers—acquire goods free of security interest, including perfected security interest.

I know I speak for all Indiana judges and lawyers who work in the commercial law space in expressing appreciation to Judge Barnes for these and many other excellent opinions.

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413. *Id.* at 806.

414. *Id.* at 804.

415. *Id.* at 806-07 (quoting *Gary Aircraft Corp. v. Gen. Dynamics Corp.*, 681 F.2d 365 (5th Cir. 1982)).

416. *Id.* at 806.

417. *Id.*

418. *Id.* at 807.

419. *Id.* at 807-08 (quoting UCC § 2-403(2) & (3)).

420. *Id.* at 808.

421. *Id.*

422. *Id.* at 809.