

# Recent Developments in Contract and Commercial Law

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During the last eighteen months, there have been numerous Indiana developments in contract and commercial law, the latter being defined as the subject matter of the Uniform Commercial Code (U.C.C.). This Article reports and comments on those developments that may be of particular interest to Indiana practitioners.

## I. LEGISLATION

### A. *The Indiana "Lemon Law"*

1. *Out of State Buyers.*—As reported in a prior issue of the Indiana Law Review, when the legislature enacted the Motor Vehicle Protection Act (the "Lemon Law") in 1988,<sup>1</sup> it joined many other states in giving a measure of added protection to consumers who purchase automobiles characterized as "lemons" because the manufacturer or dealer is either unable or unwilling to remedy problems.<sup>2</sup> Since its enactment, there have been several significant amendments.

Originally, the statute defined "motor vehicle," in part, as a vehicle "sold to a buyer in Indiana and registered in Indiana."<sup>3</sup> In 1990, this portion of the definition was amended to include a vehicle sold to "a

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1. IND. CODE §§ 24-5-13-1 to -24 (1988).

2. See Greenberg, *The Indiana Motor Vehicle Protection Act of 1988: The Real Thing for Sweetening the Lemon or Merely a Weak Artificial Sweetener?*, 22 IND. L. REV. 57 (1989).

3. Act of Feb. 29, 1988, Pub. L. No. 150-1988, § 5(2), 1988 Ind. Acts 1863-64. The full definition was:

As used in this chapter, "motor vehicle" or "vehicle" means any self-propelled vehicle that:

(1) has a declared gross vehicle weight of less than ten thousand (10,000) pounds;

(2) is sold to a buyer in Indiana and registered in Indiana;

(3) is intended primarily for use and operation on public highways; and

(4) is required to be registered or licensed before use or operation.

The term does not include conversion vans, motor homes, farm tractors, and other machines used in the actual production, harvesting, and care of farm products, road building equipment, truck tractors, road tractors, motorcycles, mopeds, snowmobiles, or vehicles designed primarily for offroad use.

buyer in Indiana who is not an Indiana resident."<sup>4</sup> The intended effect of the amendment appears to be to protect the business of Indiana border community automobile dealers whose customers may come from Kentucky, Ohio, Michigan, or Illinois. The Kentucky Lemon Law, in particular, applies only to in-state purchases.<sup>5</sup> Thus, a Kentucky resident who was aware that her state's lemon law applies only to locally purchased vehicles may well have been unwilling to buy in nearby Indiana if that protection would have been lost. With the Indiana Lemon Law extending protection to the Kentuckian who buys in Indiana, this problem for Indiana dealers is eliminated.

The original definition was also criticized because it gave no protection to the Indiana resident who bought an automobile outside the state but who lived in and registered the car in Indiana.<sup>6</sup> It was irrelevant whether the car owner was an out-of-state owner who already owned the automobile when she moved here, or an Indiana resident who purchased the car elsewhere because of convenience or price. Neither of these Indiana residents benefitted from the statute. This is a gap that the legislature should have filled promptly. Unfortunately, the 1990 amendment did nothing to address this particular problem. As laudable as the goal of protecting Indiana businesses might be, it would seem more appropriate in a consumer protection measure for the legislature to have extended protection to Indiana residents and taxpayers, regardless of where they purchase their automobiles, so long as those automobiles are registered pursuant to Indiana law.<sup>7</sup>

2. *Leases.*—In many instances, long-term automobile leases have replaced outright purchases for any number of reasons. Section one of the Lemon Law declares that it applies to leases as well as sales.<sup>8</sup> In order to clarify some problems with the application of the statute to

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4. Act of Mar. 20, 1990, Pub. L. No. 141-1990, § 1, 1990 Ind. Acts 2032.

5. KY. REV. STAT. ANN. § 367.841(1) (Michie 1987): "'Buyer' means any resident person who buys or contracts to buy a new motor vehicle in the Commonwealth of Kentucky."

The situation is less clear in the other states, although the likelihood is that out-of-state purchases are covered. See ILL. ANN. STAT. ch. 121-1/2, ¶ 1202 (Smith-Hurd Supp. 1990); MICH. COMP. LAWS ANN. § 257.1401(e) (West 1990); OHIO REV. CODE ANN. § 1345.71 (Anderson 1989).

6. See Greenberg, *supra* note 2, at 68-69.

7. It should be noted that manufacturers will be no more or less affected by such a provision. With the proliferation of lemon laws throughout the country, the care taken by manufacturers in designing and building cars should not vary based on the state in which the buyers reside. Manufacturers are held only to the promises that they expressly and impliedly make at the outset: to provide safe, eventually defect-free transportation in exchange for the purchase price.

8. IND. CODE § 24-5-13-1 (1988): "This chapter applies to all motor vehicles that are sold, leased, transferred, or replaced by a dealer or manufacturer in Indiana."

leases, the statute was amended in 1989 to define a lease as a contract in the form of a lease that is to last for a term of more than four months.<sup>9</sup> The amendments also set forth the manner in which any refund under the Lemon Law is to be divided between the lessee and the lessor. The lessee is entitled to recover all of her deposit and lease payments, less a reasonable allowance for use. The lessor is entitled to recover the purchase cost and other specifically enumerated costs, including insurance, sales tax, and five percent of the amount recovered by the lessee.<sup>10</sup> The reasonable allowance for use is determined by multiplying the total lease obligation by a fraction with a numerator equal to the number of miles traveled and a denominator of 100,000.<sup>11</sup>

### B. U.C.C. Article 3: Variable Interest Rates and Negotiability

The basic concept underlying negotiability is that a negotiable instrument must be a "courier without luggage,"<sup>12</sup> that is, all of the obligations on it must be ascertainable from the face of the instrument itself without reference to anything beyond its face.<sup>13</sup> This is particularly true with respect to the principal and interest due.<sup>14</sup> Thus, the U.C.C. requires that the instrument "contain an unconditional promise or order to pay a sum certain."<sup>15</sup> As originally adopted, the Code also stated that "the sum payable is a sum certain even though it is to be paid (a) with stated interest . . . ."<sup>16</sup>

In recent years, fluctuating interest rates have led to the use in promissory notes of variable rates of interest, that is, rates keyed to some fluctuating index such as a prevailing prime rate.<sup>17</sup> The use of

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9. IND. CODE § 24-5-13-3.7 (Supp. 1990).

10. *Id.* § 24-5-13-11.5(a).

11. *Id.* § 24-5-13-11.5(b). This is similar to the formula for an owned car. *See id.* § 24-5-13-11(b); Greenberg, *supra* note 2, at 92. Thus, if the total lease obligation is \$15,000, and the car has been driven 5,000 miles, the formula is  $15,000 \times 5,000/100,000 = 750$ .

12. *Overton v. Tyler*, 3 Pa. 346, 347 (1846) (classic case on this issue).

13. *See* U.C.C. § 3-105 comment 8 (1978). The official comments of the National Conference of Commissioners on Uniform State Laws and American Law Institute, sponsors of the U.C.C., were not adopted as part of, and do not appear in, Indiana's version of the U.C.C., which appears at Indiana Code § 26-1 (1988). Hereafter, reference to the U.C.C. will be to the numbering of the 1978 Official Draft, *e.g.*, § 3-105, rather than to the Indiana Code section numbers, *e.g.*, § 26-1-3-105, unless the two versions differ.

14. *See, e.g.*, J. WHITE & R. SUMMERS, *Uniform Commercial Code* § 14-4 (3d ed. 1988).

15. U.C.C. § 3-104(1)(b).

16. 1963 Ind. Acts, ch. 317, § 2-106. The Official Text of the Code still contains this definition.

17. *See* Hiller, *Negotiability and Variable Interest Rates*, 90 *COM. L.J.* 277 (1985)

such floating interest rates has resulted in a split in the courts on whether such promissory notes are for a sum certain, thereby affecting negotiability.<sup>18</sup> Some authorities agree with the decisions holding that such notes are non-negotiable and are excluded from Article 3; they suggest that Article 3 be amended to include variable interest rate notes.<sup>19</sup>

In 1990, the Indiana Legislature resolved the problem by amending Indiana's version of the U.C.C. to change the title of section 3-106 from "Sum certain" to "Stated rate of interest; sum certain," and to include variable interest rate instruments within the scope of Article 3.<sup>20</sup>

## II. JUDICIAL DECISIONS

### A. Sales: U.C.C. Article 2

1. *The Disclaimer of Implied Warranties and the Interpretation of Express Warranties: U.C.C. §§ 2-316, 2-313.*—Section 2-316(2) of the Uniform Commercial Code directs that a disclaimer of the implied warranty of merchantability "must mention merchantability" in order to be effective. In *Agrarian Grain Co. v. Meeker*, the court stated that because this section "is strictly interpreted for the protection of the buyer . . . , language such as 'there are no warranties expressed or implied' is ineffective because it does not mention merchantability" and, as a matter of law, does not exclude the implied warranty.<sup>21</sup> However, almost

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(According to Prof. Hiller, by 1984, 80% of new mortgage loans and 60% of all loans contained variable interest rate provisions.); Comment, *The Effect of Variable Interest Rates on Negotiability*, 48 LA. L. REV. 711 (1988); Annotation, *Negotiability of Instrument Providing for Variable Rate of Interest under UCC § 3-106*, 69 A.L.R. 4TH 1127 (1989).

18. See Annotation, *supra* note 17.

19. See, e.g., White & Summers, *supra* note 14, § 14-4. The new version of Article 3 proposed by the National Conference of Commissioners on Uniform State Laws agrees. It provides:

Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. . . .

U.C.C. § 3-112(2) (1989).

20. IND. CODE § 26-1-3-106 (Supp. 1990). The section now provides, in pertinent part:

(1) For the purposes of this section, "a stated rate of interest" includes a rate of interest that cannot be calculated by looking only to the instrument but is readily ascertainable by a reference in the instrument to:

- (a) a published rate or federal statute, regulation, or rule of court; or
- (b) a generally accepted or financial index; or
- (c) a compendium of rates; or
- (d) an announced rate of a named financial institution.

21. 526 N.E.2d 1189, 1192 (Ind. Ct. App. 1988).

identical language of disclaimer was effective in *Travel Craft, Inc. v. Wilhelm Mende GmbH & Co.*<sup>22</sup> because of the somewhat unusual factual situation of that case.

During negotiations for the purchase of an aluminum material called "Alu-Span" for use in the manufacture of mobile homes, Travel Craft, *the buyer*, drafted a letter containing the following warranty language, which the seller was requested to and did approve: "The seller agrees for a period of three years from the date of delivery that the product manufactured by it will be free under normal use from substantial defects in material or workmanship."<sup>23</sup> When the Alu-Span began to crack and separate because of structural stress, Travel Craft recalled more than 100 motor homes and sued the seller for breach of the express warranty and of the implied warranty of merchantability.

In response to the seller's defense that the implied warranty of merchantability had been disclaimed by the language of the letter, the buyer contended that the absence of the word "merchantability" rendered the disclaimer ineffective. The supreme court observed that the absence of the word "merchantability" ordinarily negates any attempted disclaimer of the implied warranty of merchantability because, as stated

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22. 552 N.E.2d 443 (Ind. 1990). The opinion of the court of appeals in this case, 534 N.E.2d 238 (Ind. Ct. App. 1989), was discussed in Greenberg, *Oral Warranties and Written Disclaimers in Consumer Transactions: Indiana's End Run Around the U.C.C. Parol Evidence Rule*, 23 IND. L. REV. 199, 203-04 (1990) [hereinafter *Oral Warranties*]. The article's focus was the tension between oral express warranties made pursuant to U.C.C. § 2-313 followed by written disclaimers or merger clauses which, according to § 2-316(1), should be given effect only if the parol evidence rule of § 2-202 is satisfied. The court of appeals affirmed the exclusion of evidence of oral express warranties because the complete agreement of the parties on the subject of warranties was in writing. The supreme court agreed that the writing was the final expression of the parties' agreement as to what warranties were given.

23. *Travel Craft*, 534 N.E.2d at 239. The full text of the warranty language was: The seller agrees for a period of three years from the date of delivery that the product manufactured by it will be free under normal use from substantial defects in material or workmanship. If any product fails within three years to be free from substantial defects in material or workmanship, seller agrees to repair or replace the product, F.O.B. buyer's receiving dock, Elkhart, Indiana. This warranty includes the cost of the product and the cost of repairs or replacement of the product and any other damage that is caused by the product defect. Seller agrees to maintain insurance covering [sic] personal injury in an amount of DM \$2,000,000.00,—for each occurrence (not to exceed DM \$1,000,000.00—per individual), and for property damage and repair and replacement of product in accordance with the warranty described in this paragraph of DM \$500,000.00—each occurrence. Seller agrees to furnish to buyer a letter, on an annual basis, from the insurance carrier detailing the terms and amounts of coverage.

*Id.* at 241.

in *Agrarian Grain* and in the official comment to section 2-316, the intention of the Code is to protect the buyer from the surprise of an unexpected disclaimer of that implied warranty.<sup>24</sup> However, in *Travel Craft*, the buyer who drafted the disclaimer did not need such protection. In essence, the buyer could not surprise itself.<sup>25</sup>

The court's position is sound. When the seller drafts the disclaimer, failure to use the term "merchantability" should rarely, if ever, be excused. Section 2-316(3) recites the rare instances when the term need not be used in the disclaimer, but the disclaimer is nevertheless effective.<sup>26</sup> However, the drafting buyer should fully understand the import of its own language and certainly needs no protection from itself.

The second issue in *Travel Craft* was whether the trial court was correct in granting summary judgment for the seller because the buyer had failed to show a specific defect. At issue was the interpretation of the express warranty that the goods "will be free under normal use from defects in materials or workmanship."<sup>27</sup> The supreme court disagreed with the trial court's interpretation of the two key terms in the warranty, "normal use" and "defect." The high court noted that the evidence conflicted as to what constituted normal use of Alu-Span and that a product may be defective either because of some imperfection or because it is not fit for the ordinary purpose for which it is sold.<sup>28</sup> The court added that the express warranty in the case "may be interpreted as tantamount to an express warranty of fitness for particular purpose."<sup>29</sup> Resolution of this issue of interpretation required the admission of the parol evidence excluded by the trial court.

2. *The Battle of the Forms: U.C.C. section 2-207.*—The so-called "battle of the forms," as dealt with in section 2-207 of the Uniform

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24. See U.C.C. § 2-316 comment 1; *Travel Craft*, 552 N.E.2d at 444-45.

25. See *Travel Craft*, 552 N.E.2d at 445.

26. U.C.C. § 2-316(3) states:

(3) Notwithstanding subsection (2)

(a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like "as is", "with all faults" or other *language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty . . . .*

(emphasis added.)

27. *Travel Craft*, 552 N.E.2d at 444, 446.

28. *Id.* at 446. Although the seller contended that normal use of its aluminum product did not include use in mobile homes because of the stresses involved, the affidavit of seller's president stated that he had solicited mobile home manufacturers throughout the United States to use the product. See *Travel Craft*, 534 N.E.2d at 240; Affidavit of John Koster, President and Owner of Wilhelm Mende GmbH & Co, in Support of Motion for Summary Judgment, Record at 193-94; Greenberg, *Oral Warranties*, *supra* note 22, at 203 n.27.

29. *Travel Craft*, 552 N.E.2d at 446.

Commercial Code, continues to be waged in the courts and in commentaries.<sup>30</sup> In *Dale R. Horning Co. v. Falconer Glass Industries, Inc.*,<sup>31</sup> the court characterized the issue as one of "form warfare."<sup>32</sup> In a telephone conversation, the seller agreed to sell to the buyer quantities of glass to be used in a construction project in which the buyer was a subcontractor. On the following day, the seller sent to the buyer a standard form which stated, "'confirms verbal 8/4/86,'" stated a quotation for the glass, and contained on the reverse side numerous terms and conditions that had not been discussed on the telephone. Of particular importance was paragraph seven which warranted that the glass would be "free from material defects in manufacture," specifically disclaimed the implied warranties of merchantability and of fitness for particular purpose, limited damages to replacement of defective material or a refund of the purchase price at the seller's option, and excluded liability for incidental or consequential damages.<sup>33</sup> The form also included a clause directing that any lawsuit arising from the contract must be brought in New York.

When the glass proved to be defective, the seller agreed to replace it and also to pay any consequential damages. By the time the problem was fully corrected, the buyer had incurred consequential damages of \$19,000 which the seller refused to pay. In response to the buyer's suit for breach of warranty and fraud, the seller moved to dismiss on the grounds that the forum selection clause precluded suit in Indiana and the limitation of remedies and exclusion of consequential damages precluded the buyer's recovery of consequential damages as a matter of law.

The court characterized the case as involving "a straightforward application of § 2-207 of the U.C.C."<sup>34</sup> and noted that the section deals with two situations: (1) where an offer is followed by an acceptance on a standard form, and (2) "where the parties have reached an agreement and the standard form is merely a 'confirmation' of that agreement."<sup>35</sup> The court continued that where there is an already existing agreement, albeit oral, the issue is not whether a contract exists but what the terms of that contract are under section 2-207(2).<sup>36</sup>

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30. See, e.g., Thatcher, *Sales Contract Formation and Content —An Annotated Apology for a Proposed Revision of Uniform Commercial Code Section 2-207*, 32 S.D.L. REV. 181 (1987); Murray, *A Proposed Revision of Section 2-207 of the Uniform Commercial Code*, 6 J.L. & COM. 337 (1986).

31. 730 F. Supp. 962 (S.D. Ind. 1990) (order on bench trial); 710 F. Supp. 693 (S.D. Ind. 1989) (motion for summary judgment).

32. 730 F. Supp. at 970.

33. *Falconer Glass*, 710 F. Supp. at 695.

34. *Id.* at 697.

35. *Id.*; see U.C.C. § 2-207 comment 1.

36. *Falconer Glass*, 710 F. Supp. at 697. This approach is apparently directed by

Applying section 2-207(2)(b), the court concluded first that the forum selection clause would materially alter the contract between the parties and therefore was not part of the contract. With respect to the exclusion of consequential damages, the court stated that whether the exclusion was a material alteration so as to cause surprise or hardship to the buyer was a question of fact to be determined at trial. The grant of a motion to dismiss or for summary judgment was improper.<sup>37</sup>

At the conclusion of a bench trial, the court found that the shifting of responsibility for consequential damages from the seller to the buyer by virtue of the exclusion of such damages would indeed work a hardship on the buyer who, as a subcontractor, must necessarily incur liability for delay in a construction project caused by the failure of the products it contracts to incorporate into the project.<sup>38</sup> In a candid admonition to the lawyers involved, and to all lawyers, the court stated:

The lesson to be learned from this case is that merely inserting boilerplate provisions into standard forms is not the end-all way to deal with the U.C.C. . . . . Despite the Code's rejection of the mirror image rule, it is apparent that the best, and, in some instances, the only way to get a preferable term into a contract *is to actually propose the term and reach a meeting of the minds* on the issue. The Code did not completely abolish the concept of mutual assent.<sup>39</sup>

3. *Acceptance by Shipping Promptly: U.C.C. section 2-206.*—At common law, if a buyer offered to buy goods for immediate shipment and the seller responded by immediately sending nonconforming goods, the seller was deemed to have made a counter-offer and the buyer who

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§ 2-207. See U.C.C. § 2-207 comment 3; H. GREENBERG, RIGHTS AND REMEDIES UNDER U.C.C. ARTICLE 2, 76-77 (1987) [hereinafter RIGHTS AND REMEDIES]; WHITE & SUMMERS, *supra* note 14, § 1-3, at 43-46. However, it is at odds with the approach taken by the Indiana Court of Appeals in *Continental Grain Co. v. Followell*, 475 N.E.2d 318 (Ind. Ct. App. 1985), in which the court stated in the opening sentence of its "Statement of the Facts" that a telephone call "resulted in an oral agreement" between the buyer and seller. *Id.* at 319. Nevertheless, rather than determining the terms of that oral agreement, the court ignored its existence, analyzed the case as one involving offer and acceptance, and concluded that no contract existed because there had been no acceptance. The author believes that the court's approach was inconsistent with the language and intention of the statute and, therefore, was misdirected. It is also interesting to note that in the *Followell* opinion, the court quoted extensively from the White & Summers (2d ed. 1980) discussion of § 2-207 but omitted (with stars indicating the omission) the authors' discussion of "Prior Oral Agreement." Compare *Followell*, 475 N.E.2d at 322 with WHITE & SUMMERS, *supra* note 14, § 1-2.

37. *Falconer Glass*, 710 F. Supp. at 700-701.

38. *Falconer Glass*, 730 F. Supp. at 967.

39. *Id.* at 970 (emphasis in original).

used the goods was deemed to have accepted that counter-offer, thereby losing his right to complain about the nonconformity. This was sometimes called the seller's "unilateral contract trick."<sup>40</sup> In a provision consistent with the Code concept that an offer may be accepted in any manner reasonable under the circumstances,<sup>41</sup> and with the abolition of the "mirror image rule" that an acceptance exactly match the offer before a contract exists,<sup>42</sup> the U.C.C. provides that the seller's prompt or immediate shipment constitutes an acceptance of the buyer's offer.<sup>43</sup> If the goods are nonconforming, there is a breach of contract. The seller who promptly but knowingly ships nonconforming goods may avoid accepting the buyer's offer and the concurrent breach of contract by informing the buyer that the shipment of nonconforming goods is an accommodation to the buyer, thereby making the shipment a true counter-offer.<sup>44</sup>

In *Corinthian Pharmaceutical Systems, Inc. v. Lederle Laboratories*,<sup>45</sup> the buyer unsuccessfully tried to take advantage of the acceptance-by-prompt-shipment rule of section 2-206(1)(b) in an attempt to avoid a dramatic increase in a vaccine's price. Seller's standard price list stated that orders were subject to acceptance at the home office and would be invoiced at the price in effect at the time of shipment. On the day before the increase was to become effective, the buyer, with knowledge of the impending increase, ordered 1000 vials of vaccine. Two weeks later, the seller sent to the buyer fifty vials invoiced at close to the old price. The seller also sent a letter stating that the shipment was only a partial shipment, that standard practice was to charge the price in effect at the time of shipment, that in light of the magnitude of the increase this partial shipment was an exception to the practice, and that the remainder of the order would be invoiced at the new price unless the buyer objected and cancelled. The buyer sued for specific performance

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40. See 3 R. DUESENBERG & L. KING, SALES & BULK TRANSFERS UNDER THE U.C.C., BENDER'S UNIFORM COMMERCIAL CODE SERVICE § 402[1] (1990); H. GREENBERG, RIGHTS & REMEDIES, *supra* note 36, § 5.5; 2 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-206:03 (1984); WHITE & SUMMERS, *supra* note 14, § 1-5.

41. U.C.C. § 2-206(1)(a).

42. See *id.* § 2-207(1).

43. *Id.* § 2-206(1)(b):

[A]n order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods, but such a shipment of non-conforming goods does not constitute an acceptance if the seller seasonably notifies the buyer that the shipment is offered only as an accommodation to the buyer.

44. See *id.*

45. 724 F. Supp. 605 (S.D. Ind. 1989).

to compel the seller to deliver the remaining 950 vials at the lower price.

In ruling in favor of the seller's motion for summary judgment, the court initially observed that the offer was the buyer's order for the serum. Neither the seller's price list nor the confidential memorandum in which the price increase was announced (and which the buyer had somehow obtained) constituted offers. Turning to the application of section 2-206, on which the buyer relied to show that the seller had accepted the purchase offer at the lower price, the court noted that the shipment of 1/20 of the amount ordered clearly was nonconforming. However, the letter that the seller sent to the buyer demonstrated that the nonconforming shipment was sent to the buyer not as an acceptance but as an accommodation, as "an arrangement or engagement made as a favor."<sup>46</sup> Consequently, the shipment plus the accommodation letter constituted a counter-offer that the buyer could accept or reject.

#### B. *Negotiable Instruments: U.C.C. Articles 3 & 4*

A bank that fails to dishonor a check by its midnight deadline is liable for the amount of the check even if there is not enough money in the drawer's account to pay it.<sup>47</sup> "Midnight deadline" means "midnight on [the bank's] next banking day following the banking day on which it receives the relevant item."<sup>48</sup> And "'banking day' means that part of any day on which a bank is open to the public for carrying on substantially all of its banking functions."<sup>49</sup>

The sole issue in *United Bank of Crete-Steger v. Gainer Bank*,<sup>50</sup> was whether Saturday was a banking day for the drawee/payor bank that received the subject check on a Friday but did not process and dishonor it until the following Monday. If it was a banking day, the dishonor on Monday came too late, and the drawee bank was liable on the check. If it was not, the dishonor occurred in time. This issue reduced itself, in turn, to whether the drawee was open for "substantially all of its banking functions" on Saturday. The facts showed that the main office and branches were open only for limited services on Saturday mornings, such as the cashing of checks, making deposits and withdrawals, opening new accounts, and applying for loans. Many other functions, such as bookkeeping, access to safety deposit boxes, and commercial banking were not available. The court concluded that the availability of limited banking services did not satisfy the definitional requirements, and that

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46. *Id.* at 610-11 (citing BLACK'S LAW DICTIONARY (5th ed. 1979)).

47. *See* U.C.C. § 4-302.

48. *Id.* § 4-104(1)(h).

49. *Id.* § 4-104(1)(c).

50. 874 F.2d 475 (7th Cir. 1989).

the plaintiff-bank's position improperly confused "banking day" with "business day," two distinctly different terms.<sup>51</sup>

The check involved in this case was written in 1984, thereby making unnecessary the consideration of 1987 amendments to Indiana's U.C.C. In 1987, the legislature amended the Code, apparently to deal with this very type of problem. A new definition, "partial banking day," was added to the definitions in Article 4, and "means any day on which a bank is open to the public for fewer than its regular banking hours, or any day on which a bank does not carry on substantially all of its banking functions."<sup>52</sup> Furthermore, the Code was amended to provide that "with respect to a partial banking day, a bank may . . . treat any item or deposit of money received on the partial banking day as being received at the opening of business on the following full banking day."<sup>53</sup> Unfortunately, the amendments would not resolve the *Gainer Bank* problem. The court is still required to determine whether the bank conducts "substantially all" of its business on the day in question, the very issue confronted by the court in that case.

### C. Secured Transactions: U.C.C. Article 9

1. *Sale of Collateral and Deficiency Judgments.*—A secured party who intends to sell the collateral of a defaulting debtor must notify the debtor of the time and place of any public sale or the date after which there will be a private sale, and every aspect of the sale must be commercially reasonable.<sup>54</sup> There apparently is a split among the jurisdictions as to what happens when the reselling secured party fails to comply with the requirements of the Code. The majority favors a rebuttable presumption that the reasonable value of the collateral was equal to the balance of the debt, thereby precluding recovery of a deficiency judgment. The secured party may rebut the presumption by proving both that the sale was commercially reasonable and that the value of the collateral sold was less than the balance of the debt. A minority of jurisdictions favors an absolute bar against recovery of a

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51. *Id.* at 479 (quoting U.C.C. § 4-104 official comment 1).

Under [the definition of 'banking day'] that part of a *business day* when a bank is open to the public for *limited functions*, e.g., on Saturday evenings to receive deposits and cash checks, but with loan, bookkeeping and other departments closed, is not part of a *banking day*.

*Id.* at n.7 (emphasis in opinion).

52. IND. CODE § 26-1-4-104(1)(i) (1988).

53. *Id.* § 26-1-4-107(1)(b).

54. See U.C.C. § 9-504(3).

deficiency judgment when the creditor fails to comply with the Code's requirements.<sup>55</sup> Indiana follows the majority rule.<sup>56</sup>

In *Vanek v. Indiana National Bank*,<sup>57</sup> without ever notifying the debtor of its intention to sell after it repossessed, the secured party sold restaurant equipment collateral for more than its appraised value but less than the balance of the debt.<sup>58</sup> When the bank sought to recover the deficiency, the debtor asserted that the bank had failed to prove the commercial reasonableness of the sale. The court of appeals ruled that the trial court's finding of commercial reasonableness was supported by the fact that the collateral actually sold for more than its appraised value. Therefore, the deficiency judgment was properly entered.<sup>59</sup>

2. *Good Faith and Buying in the Ordinary Course.*—In *Foy v. First National Bank*,<sup>60</sup> the key issue was whether a dealer-buyer of conversion vans from a van converter-seller was a buyer in the ordinary course of business so as to take free of perfected security interests in those vans held by a bank that had financed the seller.<sup>61</sup> Determining factors were whether the buyer was acting in good faith and whether his method of purchase was in the ordinary course.<sup>62</sup> Resolution of the issue raised the question of whether the definition of good faith stated in Article 2 as being applicable to merchants ("honesty in fact and observance of reasonable commercial standards of fair dealing in the trade"<sup>63</sup>), also applied to Article 9.

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55. See WHITE & SUMMERS, *supra* note 14, § 25-19.

56. See *Vanek v. Indiana Nat'l Bank*, 540 N.E.2d 81, 83 (Ind. Ct. App. 1989); *Hall v. Owen County State Bank*, 175 Ind. App. 150, 370 N.E.2d 918 (1977).

57. 540 N.E.2d 81 (Ind. Ct. App. 1989).

58. The debtor in this instance was the guarantor of a corporate debt. Upon default, the guarantor has the same rights as the debtor under the U.C.C. See *Vanek*, 540 N.E.2d at 82; *McEntire v. Indiana Nat'l Bank*, 471 N.E.2d 1216 (Ind. Ct. App. 1984); WHITE & SUMMERS, *supra* note 14, § 25-12.

59. *Vanek*, 540 N.E.2d at 83.

60. 868 F.2d 251 (7th Cir. 1989).

61. U.C.C. § 9-307(1) states that a buyer in the ordinary course of business "takes free of a security interest created by his seller even though the security interest is perfected and even though the buyer knows of its existence."

62. U.C.C. § 1-201(9) defines "buyer in the ordinary course" as:

a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker.

U.C.C. § 1-201(19) defines "good faith" as "honesty in fact in the conduct or transaction concerned," whereas § 2-103(1)(b) defines it in the case of a merchant as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

63. U.C.C. § 2-102(1)(b).

Under the financing agreement between the seller and his bank, the bank would retain certificates of origin of financed vans and would release them only as the vans were sold. The seller would either pay the bank in advance or would issue a trust receipt in exchange for each certificate and would pay as soon as his buyer paid him.<sup>64</sup> In fact, he was selling the vans without immediately delivering the certificates of origin to his buyer and was retaining the proceeds for his own use. The explanation he gave his buyer for the delay in forwarding the certificates was that the blanket agreement between the buyer and seller provided that the seller might repurchase the vans from the buyer. The seller did not tell the buyer that the bank had the certificates, but instead said that he had them in his desk. The buyer's own financier did not require that he turn over the certificates as security. Ultimately, the seller's scheme collapsed, and the bank demanded that in order for the buyer to obtain the certificates of title to ten vans in his possession (and for which he had paid the seller), the buyer had to pay off the seller's loans from the bank on those vans. He refused and brought this suit to recover the certificates free and clear of the bank's claim.

Writing for the court, Judge Posner first stated that whether the buyer was acting in the ordinary course was a question of fact on which the district court, which had found for the buyer, could be reversed only if its finding was clearly erroneous under rule 52(a) of the Federal Rules of Civil Procedure.<sup>65</sup> He continued that there were no facts on the record that raised suspicion about the buyer's failure to insist on the prompt delivery of the certificates. Furthermore, although other courts are divided on whether the definition of good faith found in Article 2 should be applied to Article 9, Indiana courts have not yet decided the issue.<sup>66</sup> The court was reluctant to import the definition in Article 2 into Article 9 when there already was an Article 1 definition applicable to the entire Code.<sup>67</sup> However, the court stated that if "there are grounds for suspicion that a security interest is being imperiled," the ordinary course of business requirement of section 9-307(1) requires the buyer to act reasonably, thus imparting some of the elements of the Article 2 definition into this part of Article 9 in any event.<sup>68</sup>

On the record before it, the court found no basis for concluding that the buyer acted unreasonably. If anyone acted unreasonably, it was the bank, which both conducted its periodic audits of the seller only after announcing them, thereby enabling him to cover up his misconduct,

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64. *Foy*, 868 F.2d at 253.

65. *Id.* at 254.

66. See *supra* notes 60-63 and accompanying text.

67. *Foy*, 868 F.2d at 256.

68. *Id.*

and failed to call dealers to whom the seller said he had entrusted (not sold) vans.

Almost as a postscript, the court imposed sanctions on the buyer for his frivolous request and argument that the bank itself should be sanctioned for filing the appeal. Although the bank lost the appeal, its appeal was not frivolous, and "a frivolous request for sanctions is itself sanctionable."<sup>69</sup>

3. *Priority of Mechanics' (Artisans') Liens over Perfected Security Interests.*—Confronting the issue for the first time, the Indiana Court of Appeals, in *Church Bros. Body Service v. Merchants National Bank and Trust Co.*,<sup>70</sup> held that the statutory, non-possessory lien of a mechanic who had repaired an automobile has priority over a bank's prior perfected Article 9 security interest. The court therefore reversed the entry of summary judgment for the bank and directed the entry of summary judgment for the mechanic.

The security agreement between the car owner-debtor and the bank not only prohibited the owner from creating any adverse lien or security interest in the car without the bank's written consent, but also required him to keep the car in good order and to repair any damage within thirty days or be in violation of the agreement.<sup>71</sup> Following an accident, Church Brothers, a mechanic-body shop, performed repairs costing approximately \$5,400 and released the car to the owner without receiving payment. When the owner failed to pay on later demand, the body shop filed a Notice of Intention to File Mechanic's Lien, a lien created by statute in favor of mechanics who repair motor vehicles.<sup>72</sup> When the owner later failed to make payments on his automotive loan, the bank notified him of its intent to repossess and sell the car. The mechanic sought a declaratory judgment in its favor and an injunction against the sale. Ultimately, the car was sold and the amount of the repair bill put in escrow. The trial court granted the bank's motion for summary judgment and awarded it the escrow amount.

The bank contended that the priority rules of Article 9 applied, and gave its perfected security interest priority over the mechanic's lien. The court disagreed. Section 9-104(c) expressly excludes from the scope of Article 9 liens "given by statute or other rule of law for services or materials except as provided in [Section 9-310] on priority of such liens." Section 9-310 speaks only of possessory mechanics' liens and gives them

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69. *Id.* at 258. The buyer was required to pay the part of the bank's attorney's fees incurred in defending the buyer's request for sanctions.

70. 559 N.E.2d 328 (Ind. Ct. App. 1990).

71. *Id.* at 329.

72. See IND. CODE §§ 32-8-31-1 to -6 (1988).

priority over perfected security interests.<sup>73</sup> It does not address the priority of non-possessory, statutory liens. The court concluded that the priority issue on these facts would be determined by the common law, not the Code.

Under ordinary circumstances, in the absence of a statutory resolution of priority disputes, common law gave priority to a prior recorded mortgage or conditional sales contract.<sup>74</sup> However, when the repairs benefit the mortgagee by preserving the chattel, the repairs were necessary to continued use of the chattel in the mortgagee's interest, or the mortgagee knew or should have known of the repairs, the mechanics' lien took priority, and the priority did not depend on possession.<sup>75</sup>

In this case, the security agreement required the owner to repair the car in the event of damage. In essence, he was authorized by and acting on behalf of the bank when he did so. The repairs preserved the collateral and benefitted the bank. The lien asserted by the mechanic therefore was an exception to the usual common law rule of priority in favor of recorded liens and took priority over the bank's security interest.

#### D. Contracts

##### 1. Guaranty and Suretyship.—

###### a. The statute of frauds

The statute of frauds, which requires a written, signed memorandum in order to enforce the promise of one person to answer for the debt of another,<sup>76</sup> is alive and well. In *National By-Products, Inc. v. Ladd*,<sup>77</sup>

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73. U.C.C. § 9-310:

When a person in the ordinary course of his business furnishes services or materials with respect to goods subject to a security interest, a lien upon goods in the possession of such person given by statute or rule of law for such materials or services takes priority over a perfected security interest unless the lien is statutory and the statute expressly provides otherwise.

74. *Church Bros.*, 559 N.E.2d at 331 (citing, *inter alia*, *Champa v. Consolidated Fin. Corp.*, 231 Ind. 580, 588, 110 N.E.2d 289, 292 (1953); *Personal Fin. Co. v. Flecknoe*, 216 Ind. 330, 334, 24 N.E.2d 694, 696 (1940)).

75. *Church Bros.*, 559 N.E.2d at 331 (citing *Flecknoe*, 216 Ind. at 338-39, 24 N.E.2d at 697-98).

76. IND. CODE § 32-2-1-1 (1988) states:

No action shall be brought . . . to charge any person, upon any special promise, to answer for the debt, default or miscarriage of another . . . unless the promise, contract or agreement upon which such action shall be brought, or some memorandum or note thereof, shall be in writing, and signed by the party to be charged therewith, or by some person thereunto by him lawfully authorized . . .

77. 555 N.E.2d 518 (Ind. Ct. App. 1990).

the wife of one of the officers of the corporate debtor promised orally to pay a creditor's claim in installments of \$500 per month from her own funds in order to avoid having her husband appear in court. After she sent the first check, the creditor sent a letter acknowledging receipt, stating the amount of its judgment, and reciting that the amount would be paid off in monthly installments of \$500 each. The wife later sent a second check with a letter stating that the check should be credited to the debtor's account. Subsequently, the debtor decided to go out of business and to liquidate its assets. The creditor filed suit after the wife (and her husband) failed to make any further monthly payments.

The trial court granted summary judgment for the defendants based upon the statute of frauds. The only writings signed by the wife were the two checks and the letter directing that the second check be credited to the debtor corporation's account. The court first stated the general rule:

A memorandum, to be sufficient within the meaning of the Statute of Frauds, must set out the contract with such reasonable certainty that its terms may be understood from the writing itself, without recourse to parol proof. . . . A written contract which leaves some essential terms thereof to be shown by parol, is only a "parol contract" not enforceable under the Statute of Frauds.<sup>78</sup>

The court concluded that the writings in this case did not evidence a promise to pay the balance of the debtor's account. Rather, they constituted nothing more than a volunteer's promise to pay \$500 toward that account.

A similar result was reached in *Strutz v. Robinson*,<sup>79</sup> except that there was not any writing that even arguably satisfied the statute. In *Strutz*, the attorney for a trust engaged an accountant to render services in connection with trust litigation, the expenses for which were apparently borne by the beneficiary. When the accountant sued the beneficiary for his fee, the trial court found in the accountant's favor because the beneficiary had engaged the attorney, orally authorized employment of the accountant, and promised to pay his fee. Although the court of appeals expressed sympathy for the plight of the accountant who had rendered valuable services to the trust, it reversed the trial court because the statute of frauds requires a writing to support enforcement of a guaranty, and there was none here. The dissenting judge expressed that he would agree if the trust had hired the accountant. However, he read

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78. *Id.* at 520 (citations omitted).

79. 558 N.E.2d 896 (Ind. Ct. App. 1990).

the trial court's determination as a finding that the actual employer of both the attorney and the accountant was the beneficiary.

*b. Modification of guaranty and discharge*

Ordinarily, any material change in an underlying obligation will discharge a guarantor who has not consented to the change. In *United States v. Stump Home Specialties Manufacturing, Inc.*,<sup>80</sup> the court upheld a modification from a fixed interest rate to a variable interest rate as having been agreed to in the guaranty agreement and as being supported by consideration. When the guarantors signed the guaranty agreement, the loan agreement provided for interest at a fixed 9.5%. The guaranty agreement also authorized the lending bank, without notice to the guarantors, to modify any terms or the rate of interest, but not to increase the principal. The loan itself was to be guaranteed by the Small Business Administration (SBA), which had previously approved a fixed interest rate. The bank's loan committee, however, preferred a variable rate. Therefore, the principal debtor signed two notes, one at 9.5% and another at 1.5% over the lending bank's prime rate. The SBA ultimately approved the variable rate but insisted that it be set at 1.5% over New York prime. The loan agreement was amended to reflect the change and was approved by two of the debtor's officers, who were also guarantors. The remaining five guarantors were never notified of the change. By the time of the principal debtor's default, New York prime had reached 16%, thereby making the interest rate under the amended agreement 17.5%.

Upon the debtor's default, the bank assigned the loan to the SBA, which brought suit against the guarantors. The guarantors raised two basic defenses: that the modification without notice and consent discharged them from liability, and that there was no consideration for the modification. On the first issue, the court ruled that two officer-guarantors had notice and did consent when they signed the amending agreement. In response to the bank's argument that they had waived notice of changes in their guaranty, the remaining guarantors contended that the waiver expressly excluded changes in the principal amount of the loan and that a doubling of the interest rate was the equivalent of increasing the principal. The court, speaking through Judge Posner, rejected this argument and explained the policy differences underlying changes in principal and changes in interest. An increase in principal benefits both the lender and the borrower, thereby creating an incentive for those two parties to conspire against the guarantors and to increase

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80. 905 F.2d 1117 (7th Cir. 1990).

the guarantors' risk. However, an increase in the interest rate is a cost to the borrower, thereby reducing the incentive on the part of the borrower to conspire with the lender against the guarantors.<sup>81</sup>

Judge Posner apparently would abolish the requirement of consideration for contract modifications and would substitute a determination of whether the modification was coerced.<sup>82</sup> It was not necessary to do so, however, because the court found consideration. The issue reduced itself to whether there was consideration for the borrower's agreement to substitute the variable rate for the fixed rate. The court concluded that what the guarantors actually agreed to guarantee was a contingent loan agreement, subject to approval by the bank's loan committee and the SBA. In order to eliminate the contingency and to firm up the agreement, the borrower had to agree to the variable rate. This firming up was consideration for the change in interest rate.<sup>83</sup> Moreover, by the time the New York prime rate entered into the agreement, the borrower already had agreed to a variable rate, and, according to the court, there was no difference ascertainable from the record between measuring the rate against the bank's own prime rate and the New York prime rate.<sup>84</sup>

2. *Promissory Estoppel*.—Two recent cases demonstrate that the doctrine of promissory estoppel is a viable basis for the enforcement of promises even when there is no apparent contract in the traditional sense of offer and acceptance.

The plaintiff in *Hoo Siong Chow v. TransWorld Airlines*,<sup>85</sup> had made arrangements through a travel agent to fly to Singapore via TransWorld Airlines (TWA) through St. Louis to San Francisco, where he was to change to a flight on Singapore Airlines (SA). Because of apparent mechanical and scheduling problems, the flight was delayed in St. Louis for several hours, but TWA personnel assured him that if he missed his scheduled flight to Singapore, TWA would make new arrangements. He missed his Singapore flight by several minutes, and TWA agents said the he would be housed overnight and would be booked on a priority list for the next SA flight. When he called SA the next morning to check his flight, SA told him that no arrangements had been made.

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81. *Id.* at 1121.

82. *See Stump Home Specialties*, 905 F.2d at 1121-22. As Judge Posner points out, this is consistent with § 2-209(1) of the U.C.C., which eliminates the requirement of consideration when the parties agree to modify their contract. The Code does not apply to this loan transaction, however.

83. *See Stump Home Specialties*, 905 F.2d at 1123.

84. *See id.* at 1123-24. In fact, there was nothing in the record to show that there was a difference between the two prime rates. *Id.* at 1120.

85. 544 N.E.2d 548 (Ind. Ct. App. 1989).

TWA then reassured him that arrangements would be made. After several more hours, TWA had not made any arrangements and told him that he was "on his own." Because SA had no seats remaining in economy class, plaintiff was required to purchase a business class seat for an additional \$928, for which plaintiff brought suit against TWA.

The trial court found that the facts "fit squarely" within the doctrine of promissory estoppel but denied relief because plaintiff failed to prove that if TWA had fulfilled its promises, he would have had a seat in economy class.

The court of appeals observed that promissory estoppel, as embodied in section 90 of the Restatement (Second) of Contracts, has been applied in Indiana both to charitable subscriptions, for which it was originally developed, and to commercial settings.<sup>86</sup> However, the court was unable to find a decision involving "this fairly commonplace set of facts."<sup>87</sup> Nevertheless, the court held that the facts fit squarely within the doctrine: TWA personnel made promises that they should have realized would induce plaintiff not to call SA himself and such reliance was reasonable.<sup>88</sup>

The court also held that the trial court's limitation on the applicability of promissory estoppel was in error. "The purpose of Section 90 is to make a promise binding even though consideration is lacking 'in the sense of something that is bargained for and given in exchange.'"<sup>89</sup> There is no causation element engrafted on the rule.

A similar result was reached in *Medtech Corp. v. Indiana Insurance Co.*,<sup>90</sup> in which the plaintiff corporations purchased through an agent an insurance policy covering inventory, equipment, and supplies. While the roof of the corporate premises was being repaired, the plaintiffs sustained rain damage. The agent prepared and forwarded to the insurance company a property loss notice and assured the plaintiffs that the notice would preserve their claims under the policy and would protect them if the roofer failed to compensate them for their loss, that the insurance company would contact them if any additional information was needed, and that he would take any steps necessary to process the

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86. *Id.* at 549. Section 90, as quoted by the court, states: "A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by the enforcement of the promise." RESTATEMENT (SECOND) OF CONTRACTS § 90 (1984). The actual language is "forbearance on the part of the promisee or a third person . . . ." *Id.*

87. *Hoo Siong Chow*, 544 N.E.2d at 549.

88. *Id.*

89. *Id.* at 550 (quoting *Pepsi-Cola General Bottlers, Inc. v. Woods*, 440 N.E.2d 696 (Ind. Ct. App. 1982) (quoting *Drennan v. Star Paving Co.*, 51 Cal. 2d 409, 333 P.2d 757 (1958))).

90. 555 N.E.2d 844 (Ind. Ct. App. 1990).

claims. When the roofer's insurance company ultimately refused to pay, plaintiffs sought to recover under their own policy. Defendant insurance company denied the claims because plaintiffs had missed the time deadlines specified in the policy for filing proofs of loss and for bringing suit.

Plaintiffs filed suit against the insurance company, the agent, and his agency based on promissory estoppel and fraud. The trial court granted summary judgment in favor of all defendants. The appeal related only to the agent and his agency-employer.

At the outset of its analysis, the court stated that if promissory estoppel applied to the facts of the case, the grant of summary judgment in favor of the agent and the agency for which he worked was improper. The court rejected the defendants' arguments that the agent's assurances were merely opinions and held that they constituted promises on which plaintiffs could have relied in not pursuing their claims against the insurance company and which could support plaintiffs' claim for relief against the agent and agency based on promissory estoppel.<sup>91</sup>

In examining the opinions in both of these cases, it is important that the courts do not speak of promissory estoppel as a substitute for consideration in the formation of an enforceable contract, breach of which is the basis of plaintiffs' cause of action. Rather, the courts create a separate cause of action based exclusively on promissory estoppel, that is, the enforceability of a promise that causes reliance to the detriment of the promisee, a cause of action far removed from the traditional, early common law idea of contractual obligation supported by consideration or bargain.

3. *Third-Party Beneficiaries.*—The rights of third-party beneficiaries under contracts to which they are not parties continue to be major issues before the courts. Two recent cases, *Barth Electric Co. v. Traylor Bros.*<sup>92</sup> and *Tonn & Blank, Inc. v. Board of Commissioners of LaPorte County*,<sup>93</sup> involved suits by construction contractors for damages arising from breaches between other contractors and the owner-builder of a facility. Both cases involved terms found in the standard contract of the American Institute of Architects (AIA), interpretation of which previously had not been before the court.

In *Barth*, each of the contractors, such as general, electrical, and mechanical, executed the same AIA Standard Form of Agreement. Several of the standardized provisions required cooperation between the signing contractor and other contractors on the job.<sup>94</sup>

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91. *Id.* at 847. The court reached a similar conclusion on the issue of fraud.

92. 553 N.E.2d 504 (Ind. Ct. App. 1990).

93. 554 N.E.2d 827 (Ind. Ct. App. 1990).

94. The court placed particular emphasis on the following provisions:

Barth, the electrical contractor, claimed it was a third-party beneficiary of each of the standard contracts and sued the general contractor and the mechanical contractor for damages caused by their schedule delays and deviations. The trial court granted defendants' motions to dismiss.

The court of appeals recognized that the sole issue in the case was whether the plaintiff was a third-party beneficiary of the other contracts. The court stated that a party claiming third-party beneficiary status must show: (1) a clear intent of the parties to the contract to benefit the third party; (2) a duty on one of the parties to confer that benefit; and (3) that performance of the contract is necessary to confer the benefit.<sup>95</sup> Defendants relied on *Reed v. Adams Steel & Wire Works*,<sup>96</sup> in which the court denied third-party beneficiary status. The *Barth* court noted that *Reed* interpreted the provision in that case as intending to assure the owner that the job would be completed on time rather than to give third-party beneficiary status. Moreover, the *Reed* contract contained nothing like the mutual responsibility clause in the *Barth* contracts.<sup>97</sup>

Although courts in other jurisdictions are divided on whether the standard AIA contract grants third-party beneficiary rights, the trend is

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## 6.2 MUTUAL RESPONSIBILITY

6.2.1 The Contractor shall afford the Owner and separate contractors reasonable opportunity for the introduction and storage of their materials and equipment and the execution of their Work, and shall connect and coordinate his work with theirs as required by the Contract Documents.

6.2.2 If any part of the Contractor's Work depends for proper execution or results upon the work of the Owner or any separate contractor, the Contractor shall, prior to proceeding with the Work, promptly report to the Architect any apparent discrepancies or defects in such other work that render it unsuitable for such proper execution and results . . . .

6.2.3 Any costs caused by defective or ill-timed work shall be borne by the party responsible therefor.

*Barth*, 553 N.E.2d at 505. The remaining two sections quoted by the court related to wrongful damage by the contractor to work or property of the owner or other contractors, and an indemnification of the owner against claims by other contractors arising from defalcations by the contractor.

95. *Barth*, 553 N.E.2d at 506.

96. 57 Ind. App. 259, 106 N.E. 882 (1914). In *Reed*, the provision in question stated:

All the materials and labor to be furnished by the second party [contractor], not governed by the foregoing schedule, shall be furnished at such time as may be for the best interest of all contractors concerned, to the end that the combined work of all may be fully completed on contract time.

*Id.* at 263, 106 N.E. at 883-84.

97. *Barth*, 553 N.E.2d at 506. It should also be noted that *Reed* was decided in 1914, fairly early in the historical development of the concept of third-party beneficiary rights. See E. FARNSWORTH, *CONTRACTS* § 10.2 (2d ed. 1990); J. MURRAY, *MURRAY ON CONTRACTS* § 129 (3d ed. 1990).

in favor of such rights.<sup>98</sup> Referring to one of those cases, the court quoted six factors that support the trend:

- (1) the construction contracts contain substantially the same language;
- (2) all contracts provide that time is of the essence;
- (3) all contracts provide for prompt performance and completion;
- (4) each contract recognizes other contractors' rights to performance;
- (5) each contract contains a non-interference provision;
- and (6) each contract obligates the prime contractor to pay for the damage it may cause to the work, materials, or equipment of other contractors working on the project.<sup>99</sup>

Based on these factors, the court ruled that the provisions of the AIA contract did indeed support third-party beneficiary rights.

Three weeks after the decision in *Barth*, the court decided *Tonn & Blank*,<sup>100</sup> in which the identical mutual responsibility clause as in *Barth* was at issue in determining third-party beneficiary rights of a contractor whose work had been delayed by another contractor.<sup>101</sup> Again the trial court had granted defendants' motions to dismiss, and again defendants relied on the 1914 *Reed* case. Without referring to *Barth*,<sup>102</sup> the court distinguished *Reed* in the same way; namely, that the clause there intended only to assure completion on time, but that the contracts signed in *Tonn & Blank* did intend to confer third-party beneficiary rights.<sup>103</sup>

In *Hermann v. Frey*,<sup>104</sup> a case of particular interest to practitioners, the court held that an attorney may be sued for malpractice by someone who is not his client if the plaintiff is a known third-party beneficiary of the agreement with his client. In this case, a widow retained an attorney to bring a medical malpractice action on behalf of her late husband. The attorney opened an estate and the widow was named administratrix.

In the administrative proceeding, the medical panel determined that one of the doctors had not been negligent, and the attorney did not name him as a defendant in the later medical malpractice lawsuit. After a verdict for the named defendants, the widow, in her own name, sued the attorney for malpractice because he had failed to join the exonerated

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98. *Barth*, 533 N.E.2d at 507 (citing *Moore Constr. Co. v. Clarksville Dep't of Elec.*, 707 S.W.2d 1, 10 (Tenn. Ct. App. 1986), and cases cited therein).

99. *Id.*

100. 554 N.E.2d 827 (Ind. Ct. App. 1990).

101. The court cites only 6.2.1, quoted *supra* note 94, but it is reasonable to assume that the parties had signed the standard AIA form. *Tonn & Blank*, 554 N.E.2d at 829.

102. The author of the *Barth* opinion served on the panel in *Tonn & Blank*.

103. *Tonn & Blank*, 4 N.E.2d at 829.

104. 537 N.E.2d 529 (Ind. Ct. App. 1989).

doctor. The trial court granted the attorney's motion for summary judgment because he had been engaged to act on behalf of the estate and its administratrix, not on behalf of the widow as an individual.<sup>105</sup>

The court of appeals reversed and remanded. Acknowledging that the well-established majority rule is that an attorney is not liable to third parties for professional negligence in the absence of privity of contract, fraud, or collusion, the court recognized that the trend is against the strict privity requirement either on a third-party beneficiary theory or a balancing of factors test.<sup>106</sup>

In Indiana, the requirement of privity in similar cases is eroding, and the negligent drafter of a will may be liable to a known third-party beneficiary.<sup>107</sup> In this case, the widow met the requirements for being a third-party beneficiary because she was her husband's only surviving heir, she had retained the attorney to represent the estate, and she was entitled to his professional advice. Thus, she stated a cause of action.<sup>108</sup> The court expressly did not decide whether the defendant attorney had in fact committed malpractice by failing to join the exonerated doctor.

4. *Mistake*.—Lest lawyers and law students think that the old classics are of no current importance, *Rose of Aberlone*, the barren cow,<sup>109</sup> once again demonstrates her importance in the law of mistake. In *Wilkin v. 1st Source Bank*,<sup>110</sup> the bank, as executor of a decedent's estate, agreed to sell decedent's house. At the time of her death, decedent was the owner of many works of art by her late, internationally famous husband, all of which were to be sold and the proceeds distributed to her family.<sup>111</sup> "A large number of these works of art were located in her home at the time of her death."<sup>112</sup> When the buyers of the house took possession, they complained that the premises were cluttered and would require substantial cleaning. The bank proposed that either it would arrange for a trash hauler to clean the premises or the buyers could clean out the premises and keep any items they wished. According

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105. *Id.* at 530.

106. *Id.* at 531.

107. *Id.* (citing *Walker v. Lawson*, 526 N.E.2d 968 (Ind. 1988))

108. *Id.* at 531.

109. *Sherwood v. Walker*, 66 Mich. 568, 33 N.W. 919 (1887).

110. 548 N.E.2d 170 (Ind. Ct. App. 1990).

111. Decedent was the widow of Ivan Mestrovic, artist and sculptor, whose works are at the Art Institute of Chicago, Brooklyn Museum, Syracuse Museum of Fine Arts, London's Victoria & Albert Museum and Tate Gallery, among others. See *Wilkin*, 548 N.E.2d at 171 n.1; Brief for Appellee at 7, *Wilkin*, 548 N.E.2d 170 (No. 71A03-8908-CV-334); see also *The Mestrovic Gallery of the Snite Museum at the University of Notre Dame*.

112. Brief for Appellee, Statement of the Case at 2, *Wilkin*, 548 N.E.2d 170 (No. 71A03-8908-CV-334).

to the bank, the clutter, characterized as "junk" or "stuff," consisted of "papers, books, underwear, purses, hats, clothing, a walker, an old bed, two air conditioning units, one of which did not operate, boxes of books and an old television."<sup>113</sup> Neither party realized that included in this "junk" were eight drawings and a piece of sculpture, all by decedent's husband and all apparently quite valuable. The drawings were found in a bedroom closet, in a tube wrapped with a dry cleaner's plastic bag. The sculpture, found a year later, was in a crate in the garage.

The probate court ruled that because neither party knew of the existence of these items, there was no meeting of the minds and, consequently, no contract of sale of the items, which remained part of the estate. The court of appeals agreed and restated the rule: "Where both parties share a common assumption about a vital fact upon which they based their bargain, and that assumption is false, the transaction may be avoided if because of the mistake a quite different exchange of values occurs from the exchange of values contemplated by the parties."<sup>114</sup> The court observed that, as in *Sherwood v. Walker*,<sup>115</sup> the parties presupposed certain facts that were false, namely, that the premises were cluttered with trash. Neither suspected that there were any works of art amidst the clutter. Thus, quoting *Sherwood*, the court stated that "[t]he mistake was not of the mere quality of the animal, but went to the very nature of the thing."<sup>116</sup> The resulting gain to the buyers and loss to the bank were not contemplated when the parties agreed that the buyers would clean the premises.<sup>117</sup>

This reasoning and the application of a "difference in kind" test has been criticized as "specious and artificial,"<sup>118</sup> and as "overly metaphysical."<sup>119</sup> The more accurate statement of the applicable rule is set forth in the Restatement (Second) of Contracts:

Where a mistake of both parties at the time a contract was made as to a basic assumption on which the contract was made has a material effect on the agreed exchange of performances, the contract is voidable by the adversely affected party *unless*

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113. *Id.* Statement of Facts at 6.

114. *Wilkin*, 548 N.E.2d at 172 (citing J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* § 9-26 (3d ed. 1987))

115. 66 Mich. 568, 33 N.W. 919 (1887).

116. *Wilkin*, 548 N.E.2d at 172 (quoting 66 Mich. at 577, 33 N.W. at 923)

117. *Id.*

118. See E. FARNSWORTH, *supra* note 97, § 9.3, at 689-90.

119. See J. CALAMARI & J. PERILLO, *THE LAW OF CONTRACTS* § 9-26, at 383 (3d ed. 1987).

*he bears the risk of the mistake* under the rule stated in section 154.<sup>120</sup>

Thus, the issue is not only whether the parties were mistaken as to the existence of the artwork, but also whether the bank bore the risk that something of value might be found in the "junk."<sup>121</sup> The resolution of this issue in turn requires a determination whether the parties were laboring under a "conscious ignorance" of the facts, as in one of the other classic cases, *Wood v. Boynton*.<sup>122</sup>

In *Wood*, the buyer and seller both thought, but did not really know, that the gem stone being sold might be a topaz and valued it as such. In fact the stone was a diamond. The court refused to compel the buyer to return the stone to the seller because there was conscious uncertainty about the stone. The risk that it was worth more than the price paid was on the seller; the risk that it was worth less was on the buyer. In a more recent case, a Washington court refused to compel the return of money found in the locked drawer of a safe sold at auction because the auctioneer manifested the intention of selling the safe and its contents despite conscious ignorance of the safe's contents.<sup>123</sup> A similar case in Illinois ruled that the buyer of a locked filing cabinet was required to return a certificate of deposit found therein because the seller and buyer understood the sale to be only of used office furniture, not of its contents as well.<sup>124</sup>

As stated by Professor Corbin with respect to *Sherwood* and *Wood*:

In these cases, the decision involves a judgment as to the materiality of the alleged factor, and as to whether the parties made a definite assumption that it existed and made their agreement in the belief that there was no risk with respect to it. Opinions are almost sure to differ on both of these matters, so that decisions must be, or appear to be, conflicting. The court's judgment on each of them is a judgment on a matter of fact, not a judgment as to law. No rule of thumb should be constructed for cases of this kind.<sup>125</sup>

Consequently, the result in *Wilkin* may well be the same after a factfinder considers questions in addition to whether both parties knew of the

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120. RESTATEMENT (SECOND) OF CONTRACTS § 152(a) (1981).

121. See E. FARNSWORTH, *supra* note 97, § 9.3, at 690-91; J. MURRAY, *supra* note 97, § 91.D.

122. 64 Wis. 265, 25 N.W. 42 (1885); see E. FARNSWORTH, *supra* note 97, § 9.3, at 690; J. MURRAY, *supra* note 97, § 91.D.

123. See *City of Everett v. Sumstad's Estate*, 95 Wash. 2d 853, 631 P.2d 366 (1981).

124. See *Michael v. First Chicago Corp.*, 139 Ill. App. 3d 374, 487 N.E.2d 403 (1985).

125. A. CORBIN, CORBIN ON CONTRACTS § 605 (one vol. ed. 1952).

existence of the artwork. For example, is it not reasonable to assume that in the home of the widow of a famous artist, clutter might include some of his works? Is it not reasonable that a crate in the garage might contain something of value? Why did the bank, which was under a duty to deliver clean premises, offer to let the buyers keep whatever they found if the bank assumed that there was nothing of value and saved expense by so offering? Was the bank not taking the risk that something of value might be found? Why did the buyers agree to clean out the clutter themselves rather than have the bank pay to have it done if the buyers assumed that there was nothing of value in the clutter that they might want to keep? Were they assuming that they might indeed find something of value? Was the bank's offer of all the clutter actually like the offer of a surprise package: the buyer takes a chance on winning a prize or getting nothing? All of these questions relate to what risks, if any, either party was assuming.

5. *Accord and satisfaction.*—In reviewing the historical rule that the agreement of a creditor to take less than the amount due on a liquidated debt is unenforceable for lack of consideration (the old pre-existing duty rule), the court of appeals indicated that a substantial relaxation of the rule is appropriate. In *Chesak v. Northern Indiana Bank & Trust Co.*,<sup>126</sup> the bank agreed to accept two payments of \$500 each in payment of a long overdue debt of approximately \$6,100. When the debtors failed to make the second payment, the bank sued for the full amount of the debt.

In their appeal from the trial court's grant of summary judgment in favor of the bank, the debtors argued that the bank's agreement to take \$1,000 and acceptance of the first \$500 constituted an accord and satisfaction which precluded suit on the original debt. The ultimate conclusion of the court was that the offer of an accord and satisfaction is the offer of a unilateral contract that may be accepted only by full performance (the satisfaction).<sup>127</sup> Since the debtors never fully performed by paying \$1,000 within the time allowed, there was no accord and satisfaction to bar suit for the original amount due.

This analysis should have resolved the matter. Nevertheless, the court apparently concluded it was important to clarify the applicable rules of accord and satisfaction and the effect of the pre-existing duty rule. In doing so, it first observed that the pre-existing duty rule is based on an historically restrictive definition of consideration that has fallen into disfavor. The court continued:

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126. 551 N.E.2d 873 (Ind. Ct. App. 1990).

127. *Id.* at 876.

In cases such as this where the accord allows the creditor to recover in cash promptly and without collection proceedings a portion of a long overdue liquidated debt and thereby clear its books of the account, we cannot say that the creditor has received no consideration. That is, the creditor has determined that the benefits of such an arrangement outweigh the costs, both direct and indirect, of pursuing the claim to judgment and attempting to collect thereon. Those benefits are sufficient consideration to support an accord and, indeed, would have been sufficient here to bar [the bank] from suing on the note had this accord been satisfied.<sup>128</sup>

Although dictum, these observations indicate that the court is willing to move toward a more realistic approach to the issue of consideration. However, each case must be determined on its own facts. Courts should avoid overly liberal application of this approach to past due obligations lest sharp business people adopt the regular practice of not paying their debts on time in order to negotiate and pay lesser amounts to their creditors.

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128. *Id.*

