

1995 SURVEY OF INDIANA COMMERCIAL CODE

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INTRODUCTION

In 1995 there were few decisions involving the Uniform Commercial Code as adopted in Indiana. This Article will survey those opinions. In addition, this Article includes a discussion of several decisions by the Seventh Circuit Court of Appeals examining the UCC adopted by other states. These cases address issues relating to the scope of a security interest, contract modification, the scope of setoff, indemnification for a breach of warranty claim, and an arbitration clause in a battle of the forms.

I. CHANGES AT HOME: CASES AFFECTING INDIANA'S UCC

A. *Kimco Leasing, Inc. v. State Board of Tax Commissioners:* *True Lease or Disguised Security Interest*

Whether a transaction is governed by Article 9 as a security interest is determined by the substance of the instrument, not its form. Section 26-1-9-102(1)(a) of the Indiana Code states that Article 9 applies "to any transaction (regardless of its form) which is intended to create a security interest in personal property"¹ In *Kimco Leasing, Inc. v. State Board of Tax Commissioners*, the tax court examined the issue of whether Kimco was the "owner" of leased equipment for the purpose of assessing taxes.² To make this determination, the court first considered the threshold issue of whether Kimco's leases were true leases or disguised security interests.³ Kimco purchased equipment from suppliers and leased the equipment to third parties under contracts titled "Equipment Lease Agreements."⁴ In 1991, the State Board of Tax Commissioners audited Kimco and assessed it taxes as the "owner" of unreported leased equipment.⁵ Kimco challenged the assessment arguing that it was not the "owner" of the leased equipment but rather the holder of a security interest.⁶

In deciding the threshold issue, the court looked to the definition of a security interest in the Indiana Code and to case law for guidance.⁷ The subject leases were written both before and after July 1, 1991, the effective date of the amended

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1. IND. CODE § 26-1-9-102(1)(a) (1993).

2. 656 N.E.2d 1208, 1211 (Ind. T.C. 1995) [hereinafter *Kimco II*].

3. *Id.* at 1214.

4. *Id.* at 1211. In *Kimco Leasing, Inc. v. State Bd. of Tax Comm'rs*, 622 N.E.2d 590, 592 (Ind. T.C. 1993) [hereinafter *Kimco I*], the Tax Court of Indiana had previously addressed the issue of whether Kimco's leases were true leases or disguised security interests.

5. *Kimco II*, 656 N.E.2d at 1211.

6. *Id.* at 1212.

7. *Id.* at 1214.

definition of security interest in the Indiana Code.⁸ Before it was amended, the definition provided that "[w]hether a lease is intended as a security interest is determined by the facts of each case."⁹ The tax court applied both the "nominal consideration" test and the "economic realities" test to Kimco's leases written before July 1, 1991.¹⁰

Under the nominal consideration test, if the purchase option price in the lease is nominal relative to the fair market value of the property at the time the option is exercised, the lease is a security interest as a matter of law.¹¹ Kimco argued that the purchase option price was ten percent of the price paid by Kimco to purchase the equipment.¹² Further, the purchase option was exercised at the beginning of the lease and the fair market value of the equipment was the purchase price paid by Kimco.¹³ Consequently, the purchase option price was nominal relative to the fair market value of the equipment when the option was exercised.¹⁴ The court did not accept Kimco's argument.¹⁵ It explained that Kimco's lease provides: "At the completion of this Lease the Equipment may be purchased for _____ (purchase option)."¹⁶ "The word 'completion' is defined as the 'act of becoming complete' and the word 'complete' is defined as 'to end after satisfying all demands or requirements.'"¹⁷ Consequently, the plain meaning of the words in Kimco's leases revealed that the purchase options arose at the end, not the beginning, of the leases.¹⁸ The court noted that Kimco did not provide evidence of the fair market value of the equipment at the end of the lease and as a result the court could not compare the anticipated fair market value of the equipment at the time the option was to be exercised and the purchase option price.¹⁹ This meant that the court could not determine whether the additional consideration was nominal, therefore, it concluded that Kimco did not satisfy the nominal consideration test.

The economic realities test evaluates the relationship between the purchase option price and the list price.²⁰ "A purchase option price of less than twenty-five

8. *Id.*

9. IND. CODE § 26-1-1-201(37) (repealed July 1, 1991).

10. *Kimco II*, 656 N.E.2d at 1214. In *Kimco I* the court found that the leases did not satisfy either test. *Kimco Leasing, Inc. v. State Bd. of Tax Comm'rs*, 622 N.E.2d 590, 593-94 (Ind. T.C. 1993).

11. *Kimco II*, 656 N.E.2d at 1214. In *Kimco I*, there was no evidence of the fair market value of the equipment at the time the purchase option was to be exercised. Consequently, the court could not determine "whether the purchase option [was] nominal as a matter of law." *Kimco I*, 622 N.E.2d at 593.

12. *Kimco II*, 656 N.E.2d at 1214.

13. *Id.*

14. *Id.*

15. *Id.* at 1215.

16. *Id.* (quoting the Equipment Agreement).

17. *Id.* (quoting WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 465 (1981)).

18. *Id.*

19. *Id.*

20. *Id.* (citing *Kimco Leasing, Inc. v. State Bd. of Tax Comm'rs*, 622 N.E.2d 590, 593-94

percent (25%) of the . . . list price constitutes evidence of a security interest.”²¹ Kimco argued that although the list price was not stated on the lease it could be easily established.²² It explained that the line below the amount of the security deposit read, “10% Net Cost (Security Deposit).”²³ Therefore, the list price could be determined by multiplying the amount of the security deposit by ten.²⁴ Upon reviewing Kimco’s lease form, the court concluded that the list price could not be ascertained by using such a method and held that Kimco failed to satisfy the economic realities test.²⁵

The leases written by Kimco after July 1, 1991 were governed by the amended definition of “security interest” which reads as follows:

“Security interest” means an interest in personal property or fixtures which secures payment or performance of an obligation. . . . Whether a transaction creates a lease or security interest is determined by the facts of each case. However, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee and:

- (a) the original term of the lease is equal to or greater than the remaining economic life of the goods;
- (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods;
- (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement;
- or
- (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that:

- (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into;
- (b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods;
- (c) the lessee has an option to renew the lease or to become the owner

(Ind. T.C. 1993)).

21. *Id.*

22. *Id.* at 1215-16.

23. *Id.*

24. *Id.* at 1215.

25. *Id.* at 1216.

of the goods;

(d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market value rent for the use of the goods for the term of the renewal at the time the option is to be performed; or

(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.²⁶

The *Kimco* court identified two tests for determining whether a lease is a true lease or a security interest, which it characterized as the "bright line" test and the "meaningful residual test."²⁷ Under the bright line test "a lease creates a security interest as a matter of law if: 1) the lessee is obligated to perform for the full length of the lease without being able to voluntarily terminate it, and 2) one of [the] four enumerated terms are present."²⁸ The court found that Kimco's lessees were not able to terminate their leases before the end of the lease.²⁹ Hence, Kimco's leases satisfied the first part of the test.³⁰

The court then considered whether Kimco's leases met one of the four term requirements.³¹ The first requires that the "original term of the lease is equal to or greater than the remaining economic life of the goods."³² The court noted that Kimco's evidence indicated that typically the initial term of Kimco's leases was shorter than the remaining economic life of the leased equipment. Consequently, Kimco's leases did not satisfy the first term requirement.³³ The second requirement mandates that "the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods." The third requirement provides that "the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement."³⁴ The court found that Kimco's leases did not include an obligation or option to renew the lease or to become the owner of the leased equipment. Thus, it concluded that Kimco's leases did not satisfy the second or third term requirements.³⁵ The fourth requirement states that "the lessee must have an option to become the owner of the goods for no additional consideration or nominal

26. *Id.* at 1217 (quoting IND. CODE § 26-1-1-201(37) (1993)).

27. *Id.* at 1218-19.

28. *Id.* at 1217 (quoting IND. CODE § 26-1-1-201(37) (1993)).

29. *Id.*

30. *Id.*

31. *Id.*

32. IND. CODE § 26-1-1-207(37) (1993).

33. *Kimco II*, 656 N.E.2d at 1218.

34. IND. CODE § 26-1-1-207(37) (1993).

35. *Kimco II*, 656 N.E.2d at 1218.

additional consideration upon compliance with the lease agreement.”³⁶ To determine whether the additional consideration is nominal, the definition of security interest instructs that “[a]dditional consideration is nominal if it is less than the lessee’s reasonably predictable cost of performing under the lease agreement if the option is not exercised.”³⁷ In *Kimco*, the court held that because Kimco did not meet this nominal consideration test, its leases were not security interests under the bright line test.³⁸

After the court concluded that Kimco’s leases did not satisfy the bright line test, it then considered the meaningful residual test. Under the meaningful residual test, a court must determine whether the lessor retains a meaningful residual interest at the end of the lease in the property.³⁹ If the lessor retains a meaningful residual interest, the lease is a true lease.⁴⁰ To make this determination, a court will consider whether the lease contains an option to purchase the property for nominal or no consideration and whether the lessee acquires equity in the property so that the only sensible decision for the lessee is to exercise the option to purchase.⁴¹ In *Kimco*, the court held that because Kimco did not provide evidence of the anticipated fair market value of the leased equipment at the time the option was to be exercised, it could not determine whether Kimco maintained a meaningful residual interest.⁴² The court concluded that Kimco’s leases were true leases and not security interests. Thus, Kimco was the owner of the equipment and was taxed accordingly.

*B. Wilson Fertilizer & Grain, Inc. v. ADM Milling Co.:
Additional Terms in a Battle of the Forms*

*Wilson Fertilizer & Grain, Inc. v. ADM Milling Co.*⁴³ involved a dispute arising out of a battle of the forms. Wilson Fertilizer & Grain, Inc. (“Wilson”) shipped grain to ADM Milling Co. (“ADM”) pursuant to a contract between the parties. A broker facilitated the transaction and sent each party a confirmation of trade. The confirmation did not include an arbitration provision. In addition, ADM sent a purchase confirmation to Wilson that contained a provision stating that the contract was subject to the Trade Rules of the National Grain and Feed Association. Wilson did not object or respond to ADM’s purchase confirmation.⁴⁴

A dispute under the contract arose between the parties and Wilson filed suit against ADM.⁴⁵ ADM filed a motion to dismiss the suit claiming that the Trade

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. 654 N.E.2d 848 (Ind. Ct. App. 1995).

44. *Id.* at 849.

45. *Id.*

Rules of the National Grain and Feed Association required the parties to arbitrate the dispute.⁴⁶ Wilson argued that the arbitration provisions were not part of its contract with ADM.⁴⁷ The trial court granted ADM's motion to dismiss and Wilson appealed.⁴⁸

The court instructed that a party seeking to compel arbitration must satisfy a two-prong test.⁴⁹ First, that party must prove there was an enforceable contract to arbitrate the dispute.⁵⁰ Second, that party must show that the disputed matter was the type of matter the parties would have agreed to arbitrate.⁵¹ In *Wilson Fertilizer*, the second prong was not in dispute. The issue before the court was whether the additional terms were part of the contract between Wilson and ADM.⁵²

Whether the additional terms were part of the contract was governed by Indiana Code section 26-1-2-207 which provides in relevant part that, between merchants, additional terms become part of the contract unless they "materially alter" the agreement of the parties.⁵³ The test for whether the additional terms materially altered the contract is whether "incorporation into the contract without express awareness by the other party would result in surprise or hardship."⁵⁴

Wilson argued that the arbitration provision materially altered the contract as a matter of law.⁵⁵ ADM contended that, as a matter of law, the additional provisions providing for arbitration did not materially alter the agreement.⁵⁶ The

46. *Id.*

47. *Id.*

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.* IND. CODE § 26-1-2-207 (1993) reads as follows:

(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.

The parties agreed that a contract had been formed, the disputed provisions were additional terms to the contract and they were merchants. The only question was whether the additional terms materially altered the contract. *Wilson Fertilizer*, 654 N.E.2d at 850.

54. *Wilson Fertilizer*, 654 N.E.2d at 850 (quoting *Maxon Corp. v. Tyler Pipe Indus., Inc.*, 497 N.E.2d 570, 576 (Ind. Ct. App. 1986)).

55. *Id.*

56. *Id.*

court rejected both parties' arguments and held that whether the arbitration clause materially altered the contract was a question of fact to be decided on a case by case basis.⁵⁷

Turning to the facts, Wilson argued that the arbitration provision caused Wilson hardship because the rules of arbitration provided that Wilson must file a complaint against ADM within one year which was significantly less than the six year statute of limitations under Indiana law.⁵⁸ Wilson argued that it suffered hardship because it was now time barred under the arbitration provision to file another complaint against ADM.⁵⁹ The court disagreed for two reasons. First, the court explained that the UCC permitted parties to contractually reduce the time in which to bring a claim. Second, the court noted that Wilson had filed its original complaint within the one year time limit after the contract was formed.⁶⁰ Because Wilson made a timely filing of its original complaint, the court was unable to see how a contract provision requiring Wilson to submit its claim for arbitration within one year imposed a hardship.⁶¹

Wilson also argued that the additional provision caused surprise. The arbitration provision was not expressly stated in the confirmation. Instead, it was incorporated by reference to the trade rules which included arbitration provisions.⁶² The trade rules were not provided with the confirmation, and Wilson was not familiar with them. Consequently, Wilson argued that the addition of the arbitration provision resulted in surprise.⁶³ ADM counterargued that because Wilson was not familiar with the rules it should have objected to the additional provision or at least inquired about the rules.⁶⁴ The court was unpersuaded by Wilson's argument and held that the additional provisions in the purchase confirmation did not materially alter the agreement between the parties.⁶⁵

II. DECISIONS BY THE SEVENTH CIRCUIT COURT OF APPEALS

A. *American Suzuki Motor Corp. v. Bill Kummer, Inc.:* *When an Attempted Modification is a Waiver*

In *American Suzuki Motor Corp. v. Bill Kummer, Inc.*,⁶⁶ Bill Kummer, Inc. ("Kummer") entered into an Authorized Suzuki Motorcycle Dealer Agreement ("Dealer Agreement") with American Suzuki Motor Corp. ("Suzuki") in 1986. The Dealer Agreement authorized Kummer to purchase motorcycles, parts, and

57. *Id.* at 850-51.

58. *Id.* at 852.

59. *Id.*

60. *Id.* at 853.

61. *Id.*

62. *Id.*

63. *Id.* at 854-55.

64. *Id.* at 855.

65. *Id.*

66. 65 F.3d 1381, 1383-84 (7th Cir. 1995).

accessories for resale. In turn, Kummer agreed to use its best efforts to sell Suzuki products. The agreement further provided that any modification must have been in writing. In late 1988, Suzuki notified Kummer that it would terminate the Dealer Agreement in sixty days. Kummer filed a complaint with the Office of the Commissioner of Transportation of Wisconsin ("OCT") under the Motor Vehicle Dealer Law challenging the proposed termination. By filing the complaint, Kummer triggered the automatic stay provision that required the Dealer Agreement to remain in effect until the OCT issued a final decision.

The OCT did not issue its final decision until January 1993 finding that Suzuki had wrongfully terminated the Dealer Agreement with Kummer. After OCT issued its decision, Suzuki gave notice of the termination of Kummer as a distributor, this time for not stocking and selling Suzuki products while Kummer's complaint with the OCT was pending. (During the automatic stay period, Kummer did not order any motorcycles and sold the last one in stock by August 1990. Suzuki also failed to visit Kummer's store.) In addition, Suzuki filed a complaint in federal court alleging that Kummer breached the Dealer Agreement. Kummer filed another complaint with the OCT and counterclaimed alleging in part that Suzuki breached the Dealer Agreement.⁶⁷

After a trial before a magistrate, the court found that neither party had breached the Dealer Agreement because "the parties had mutually abandoned or modified their agreement, allowing a cessation from an active dealership agreement."⁶⁸ Both parties appealed.⁶⁹

Suzuki asserted that the magistrate erred in finding that the parties had modified the Dealer Agreement.⁷⁰ It argued that the Dealer Agreement provided that any modification was to be in writing and section 2-209(2) of the Code adopted by Wisconsin provided that "[a] signed agreement which excluded modification or rescission except by a signed writing cannot be otherwise modified or rescinded"⁷¹ Because there was no written modification, the Dealer Agreement was not modified.⁷² The court pointed out an exception to this rule in section 2-209(4).⁷³ This section states that an attempt to modify a contract which does not meet the contractual requirement can operate as a waiver.⁷⁴ For an attempted modification to act as a waiver, the party seeking to enforce it must have reasonably relied on the modification.⁷⁵ The waiver may occur by conduct or words, although the conduct must be unequivocal in character under Wisconsin law.⁷⁶ Kummer argued that the parties' conduct constituted an attempted

67. *Id.* at 1384.

68. *Id.* at 1385.

69. *Id.* at 1384.

70. *Id.* at 1385.

71. *Id.* (quoting WIS. STAT. § 402.209(2)).

72. *Id.* at 1386.

73. *Id.*

74. *Id.*

75. *Id.* at 1384.

76. *Id.* at 1386.

modification of the Dealer Agreement to allow nonperformance during the automatic stay and the attempted modification operated as a waiver of the requirement in the Dealer Agreement that modifications be in writing.⁷⁷

The magistrate's decision was based on Suzuki's express desire to terminate the Dealer Agreement, the failure of Suzuki representatives to visit Kummer's store, and the parties' failure to agree on a minimum volume of sales.⁷⁸ In its de novo review, the court of appeals found clear error stating that "none of the conduct relied on by the court indicate[d] that Suzuki and Kummer had agreed [on] . . . Kummer's nonperformance" while the complaint to OCT was pending.⁷⁹ Thus, the parties conduct did not operate as a waiver to effectively modifying the contract, and the court of appeals concluded that Kummer had breached the Dealer Agreement

B. ECHO, Inc. v. The Whitson Company, Inc.: The Right of Setoff

In *Echo, Inc. v. The Whitson Company, Inc.*,⁸⁰ The Whitson Company, Inc. ("PTC") entered into a distributorship agreement with ECHO which provided that PTC would promote sales of ECHO products in Tennessee. PTC purchased products using purchase orders and accepted the goods. Subsequently, ECHO notified PTC of its intent to terminate the distributorship agreement. PTC was unsuccessful in challenging the termination of the agreement. Following the termination, PTC admitted owing ECHO \$93,417.21.⁸¹

ECHO brought suit to collect the principal due. PTC filed an answer, setoff, and counterclaim alleging wrongful termination of the distributorship agreement. PTC refused to pay its admitted debt claiming a right of setoff under ILCS 5/2-717 for damages arising out of ECHO's wrongful termination of the distributorship agreement.⁸² The trial court granted ECHO's motion for summary judgment and entered final judgment ordering PTC to pay the principal due with interest. PTC appealed.⁸³

Section ILCS 5/2-717 provides that upon notice to the seller, the buyer "may deduct all or any part of the damages resulting from any breach of the contract from any part of the price still due under the *same contract*."⁸⁴ On appeal, PTC argued that each party's claim arose out of the same contract. Therefore, it should not be required to pay the judgment until the court decided PTC's counterclaim. This would allow PTC to setoff its debt to ECHO against any damages awarded for the counterclaim.⁸⁵

77. *Id.*

78. *Id.* at 1387.

79. *Id.* at 1386.

80. 52 F.3d 702 (7th Cir. 1995).

81. *Id.* at 703-04.

82. *Id.* at 703.

83. *Id.* at 704.

84. *Id.* at 705.

85. *Id.* at 704.

The issue before the court was whether the contract PTC allegedly breached, the distributorship agreement, and the contract under which PTC owed money to ECHO, a purchase order pursuant to the distributorship agreement, were the same agreement.⁸⁶ The court noted that as a general rule under Illinois law applying section 2-717 of the Code, a distributorship agreement and the purchase orders arising under that agreement were different contracts.⁸⁷ However, the parties to a contract were allowed to expand their rights of setoff.⁸⁸ PTC argued that two provisions in the distributorship agreement expanded the parties rights to setoff to include violations of the agreement.⁸⁹

The Seventh Circuit rejected PTC's argument. It interpreted paragraph 5.1 of the agreement very narrowly, explaining:

Only in instances where the parties use conflicting forms, or where a purchase order conflicts with the distributorship agreement does paragraph 5.1 apply. And when paragraph 5.1 does apply, it impacts the purchase order only to the extent that it designates what language controls. Paragraph 5.1 unambiguously does not provide PTC with greater rights to set-off because it does not make the distributorship agreement part of every purchase order.⁹⁰

The court also found that paragraph 9.4 did not expand PTC's right of setoff

86. *Id.* at 705.

87. *Id.* at 705-06.

88. *Id.* at 706.

89. *Id.* The clauses read as follows (ECHO is the Company and PTC is the Distributor):

5.1 Purchase Orders. Concurrently with the execution of this agreement, Distributor shall submit to Company its purchase orders for the first shipment of Products. All purchase orders of Distributor shall, unless otherwise agreed by Company from time to time, set forth the quantity of the Products desired, the specification therefor, the desired delivery date, the price of each Product, and all other relevant information necessary to effectuate shipment of the Products by Company. It is contemplated that from time to time purchase orders, in forms prepared by Distributor or other purchasers, may be used in ordering products and that there may be included in such forms certain stipulations, conditions or agreements not otherwise contained herein. **It is expressly understood and agreed that the provisions of this Agreement shall be deemed a part of each purchase order which shall be inconsistent or contrary to the provisions of the Agreement shall be deemed amended or deleted as the case may be [sic].** Specifically, all provisions on the backside of said purchase order shall be deemed deleted or superseded by the provisions of this Agreement.

9.4 Entire Agreement. This Agreement, together with all attachments hereto and all purchase orders issued hereunder constitutes the entire agreement between the parties and supersedes any and all previous agreements, memoranda, or other understandings of the parties. This agreement may be amended only in writing.

Id.

90. *Id.* at 706-07.

reasoning that the language was not fairly interpreted to unify the purchase orders with the distributorship agreement.⁹¹ Consequently, PTC was not able to setoff its admitted debt to ECHO.

*C. Hydrite Chemical Co. v. Calumet Lubricants Co.:
Indemnification in a Breach of Warranty Action*

In *Hydrite Chemical Co. v. Calumet Lubricants Co.*,⁹² Hydrite Chemical Co. ("Hydrite") purchased white mineral oil from Calumet Lubricants Co. ("Calumet") and then resold it to George A. Hormel Company ("Hormel"). The oil was applied to the machinery used to make Spam. Hormel claimed that the oil made the Spam stink. As a result, Hormel removed millions of pounds of Spam from the market, and sued Hydrite on a breach of warranty theory. Hydrite settled with Hormel for \$2.25 million dollars. After it had settled the case with Hormel, Hydrite sued Calumet on its own behalf and as Hormel's assignee.

The judge bifurcated the liability and damages phases of the trial. In the liability phase, the jury found that Calumet had breached its warranty that the oil was suitable for use involving incidental contact with food products, and that the breach caused damage to Hydrite but not to Hormel.⁹³ In the damages phase, the judge ruled that Hydrite could not mention its settlement with Hormel in the opening statement. After the trial began, the judge reversed himself. When Hydrite attempted to introduce evidence relating to its settlement with Hormel, the judge ruled the evidence was inadmissible as hearsay as well as confusing and redundant.⁹⁴ The jury awarded Hydrite \$30,000 for increased cost and management time, \$43,000 for lost profits and \$128,000 for settlement and related expenses. The judge set aside the \$128,000 reasoning that because the jury did not award Hydrite any of the settlement, it was precluded from an award for expenses incidental to the settlement.⁹⁵

Hydrite sought a new trial for damages on the grounds that the judge did not ameliorate the negative consequence of refusing to permit Hydrite to mention its settlement with Hormel in the opening statement and for not admitting evidence offered on the amount and rationale of Hormel's settlement demands.⁹⁶ Calumet cross-appealed arguing that Hydrite did not have an actionable breach of warranty claim because it should have inspected the oil upon delivery, discovered the bad smell, and rejected the oil. Had that been done, Hormel would not have incurred the loss for which Hydrite sought indemnification.⁹⁷

The court of appeals noted that the proceeding was marred by a number of procedural errors including Hydrite's failure to bring Calumet into the law suit as

91. *Id.* at 707.

92. 47 F.3d 887 (7th Cir. 1995).

93. *Id.* at 889.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.* at 890.

a third party defendant. The court pointed out that this procedure was authorized by Rule 14(a) of the Federal Rules of Civil Procedure as well as section 2-607(5)(a) of the UCC. The court also noted that had Calumet been a party to the suit, the question of whether the settlement was reasonable would not have been an issue. Hormel would, therefore, not have assigned its claim to Hydrite which resulted in the confusing situation in which the jury was required to decide both Hydrite's own claims as well as those assigned from Hormel.⁹⁸ The court discussed the other procedural problems and held that any errors by the trial court were not reversible error.⁹⁹

Turning to Calumet's cross appeal, the court instructed that under section 2-607(3)(a) of the Code a buyer who accepts goods which do not conform to the specifications in the contract forfeits his remedies against the seller unless the buyer notifies the seller of the breach within a reasonable time "after he discovers or should have discovered" the nonconformity.¹⁰⁰ Whether Hydrite should have discovered the defect in the oil depended on the language of the parties' contract and usage of trade incorporated by implication.¹⁰¹ This was a question of fact that the jury resolved against Calumet. Further, the court noted that the contract was oral and the duty of inspection was unclear. For these reasons, the court refused to disturb the jury verdict.¹⁰²

98. *Id.*

99. *Id.* at 890-93.

100. *Id.* at 893 (quoting UCC §2-607(3)(a)).

101. *Id.*

102. *Id.*