VI. Contracts, Commercial Law, and Consumer Law

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A. Introduction

The following discussion reviews some of the most important developments during the past year in contracts, commercial, and related consumer law. Some of the developments which raise contract, commercial, or related consumer law problems may also raise questions concerning secured transactions or creditors' rights and may be discussed in the portion of the Survey devoted to those subjects. No effort will be made to duplicate the analysis of statutes and cases considered in that part of the Survey.

B. Scope of UCC Article 2

In Stephenson v. Frazier,2 the Indiana Court of Appeals examined the applicability of Article 2 of the Uniform Commercial Code3 (UCC) to an agreement by which there was a commitment to both deliver goods and provide services. The agreement involved the sale of a modular home along with a commitment by the seller to construct a septic system and a foundation on the rural property on which the modular home was to be assembled. The court's analysis began with the premise that UCC Article 2 applies to "transactions in goods"4 and that the word "goods" means "all things (including specially manufactured goods) which are moveable at the time of identification to the contract for sale."5 Of course, under this definition, the modular home constituted goods. However, the commitment to construct the foundation and septic system was a different matter. It did not constitute an agreement for the sale of goods but, instead, was an agreement to provide services. Generally, agreements to provide services are governed by common law contract principles.6

When faced with the question of whether to apply UCC Article 2, or principles of the common law of contracts, some courts have

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2U.C.C. §§ 2-101 to -725. All sections hereinafter cited to the U.C.C. are also found in IND. CODE §§ 26-1-1-101 to -3-7-36 (1976 & Supp. 1980).


4U.C.C. § 2-105(1); IND. CODE § 26-1-2-105(1) (1976).

concluded that the dominant feature of the contract should control;\textsuperscript{7} if the sale of goods is predominant, UCC Article 2 governs; if the commitment to provide service is predominant, common law contract principles govern. In the \textit{Stephenson} case the court took a different approach and concluded that agreements should be divided into components. Those components of the agreement which involved the sale of goods (goods components) were governed by UCC Article 2; those components of the agreement which involved the sale of services (service components) were governed by common law contract principles.\textsuperscript{8} The substantive issue raised in the \textit{Stephenson} case had to do with whether the buyer could call off the deal by virtue of the seller's breach. The court addressed the goods component under UCC Article 2 in terms of rejection,\textsuperscript{9} cure,\textsuperscript{10} revocation\textsuperscript{11} and cancellation.\textsuperscript{12} The court addressed the services component under principles of the common law of contracts in terms of rescission and substantial breach.\textsuperscript{13}

This analysis is logical, yet it may be difficult to apply in cases where the contract cannot be easily divided, such as a contract for laying an asphalt driveway.\textsuperscript{14} Also, this approach could lead to difficulties where the substantive issue is not related to performance, but is related to creation of the agreement, such as a question concerning the Statute of Frauds. For example, a court could find that the services component may be enforced, but the goods component could not be enforced because of a failure to satisfy the writing requirement of UCC 2-201(1).\textsuperscript{15} Partial enforcement of the contract could result in prejudice to the seller who may have offered services at a lower price because the goods were being sold as part of the same transaction.\textsuperscript{16}

\textsuperscript{7}See, e.g., Pittsburgh-Des Moines Steel Co. v. Brookhaven Manor Water Co., 532 F.2d 572 (7th Cir. 1976).
\textsuperscript{8}399 N.E.2d at 797.
\textsuperscript{9}IND. Code § 26-1-2-601 (1976).
\textsuperscript{10}Id. § 26-1-2-508.
\textsuperscript{11}Id. § 26-1-2-608.
\textsuperscript{12}Id. § 26-1-2-711.
\textsuperscript{13}399 N.E.2d at 798. The trial court had dismissed the buyer's suit for rescission. The court of appeals reversed; it held that with respect to the services component the buyer had made a prima facie case that the seller's failure to perform constituted a material breach of the entire contract.
\textsuperscript{15}IND. Code § 26-1-2-201(1) (1976).
\textsuperscript{16}This may be similar to the problem that arises in cases where part payment or part performance provides a basis for enforcement of the contract. See U.C.C. § 2-201(3)(a), (b); IND. Code § 26-1-2-201(3)(a), (b) (1976). In those instances the contract is enforceable only to the extent of payment or performance which may result in the
C. Are Farmers Merchants?

The question of whether a farmer is a merchant under UCC 2-201(2)\textsuperscript{17} has been litigated in a number of states with somewhat mixed results.\textsuperscript{18} These cases have usually involved an alleged oral contract for the sale of grain by a farmer to a grain dealer. The grain dealer usually has sent a written confirmation of the alleged oral contract to the farmer, and the farmer has failed to register an objection to the confirmation. When the grain dealer has sued on the alleged oral contract, the farmers have defended with the Statute of Frauds writing requirement of UCC 2-201(1).\textsuperscript{19} Grain dealers have countered with UCC 2-201(2) which provides that

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[b]etween merchants if within a reasonable amount of time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of subsection (1) against such party unless written notice of objection to its contents is given within 10 days after it is received.\textsuperscript{20}
\end{quote}

The farmer has generally claimed that he is not a merchant, and thus the transaction is not "between merchants." If the transaction is not between merchants, UCC 2-201(2) does not apply, and the Statute of Frauds defense could be successful since there is no writing signed by the farmer—the person against whom enforcement is being sought.

This year, the Indiana Court of Appeals addressed this question in \textit{Sebasty v. Perschke}\.\textsuperscript{21} In the \textit{Sebasty} case the defendant had

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\textit{same prejudice as described in the text. However, that is an unavoidable conclusion produced by a statute. The courts should be reluctant to reach that conclusion in the absence of a specific direction in a statute. For a discussion of the problem of the prejudice resulting from partial enforcement and a proposed solution see R. Nordstrom, Handbook on the Law of Sales § 27, at 71 (1970).}
\end{quote}

\textsuperscript{17}\textit{Ind. Code} § 26-1-2-201(2) (1976).
\textsuperscript{19}U.C.C. § 2-201(1) (1978 version) provides that
\textit{a contract for the sale of goods for the price of $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought . . . .}
\textsuperscript{20}\textit{Ind. Code} § 26-1-2-201(1) (1976).
\textsuperscript{21}\textit{Ind. Code} § 26-1-2-201(2) (1976).
\textsuperscript{22}404 N.E.2d 1200 (Ind. Ct. App. 1980).
been a farmer all his life and owned 1300 acres of land, of which 1000 were farmed. Three crops were grown on the land and sold by Sebasty as a means of earning his livelihood. Sebasty was familiar with the customs and practices involved in selling grain, was aware that the price of grain rises and falls daily, and had entered into four other oral agreements with the grain dealer for future sales which were followed by written confirmations. On the basis of these characteristics, the court of appeals affirmed the trial court decision that the farmer was a merchant.22 This conclusion was supported by two separate aspects of the definition of the word "merchant." UCC 2-104(1) provides that a merchant is "[a] person who deals in goods of the kind or otherwise by his occupation holds himself out as having knowledge or skill peculiar to the practices or goods involved in the transaction."23 First, the court emphasized that in this context the test for merchant status is whether the farmer has by his occupation represented or held himself out as having knowledge or skill peculiar to the practices in the transaction.24 The court said that "[a] person whose livelihood includes the selling of a commodity necessarily represents to those who purchase the commodity that he has the skill and knowledge involved in such a sale."25 Second, the court found that the farmer was a merchant for a separate and independent reason. If a person deals in goods of the kind involved then the dealer is a merchant for the transaction. The court held that a farmer who regularly sells his crops is a person who deals in

22Id. at 1203.
23IND. CODE § 26-1-3-104(1) (1976).
24"It is important to recognize that the definition of merchant has two different points of focus: The practices in the transaction or the goods involved in the transaction. For purposes of the problem in this case and other questions involving offer, acceptance, or modification, the practices focus of the definition is most important. Official Comment 2 of U.C.C. § 2-104 (1978 version) provides that for purposes of these formation questions

almost every person in business would . . . be deemed to be a "merchant"
under the language "who . . . by his occupation holds himself out as having knowledge or skill peculiar to the practices . . . involved in the transaction . . ." since the practices involved in the transaction are non-specialized business practices such as answering mail.

On the other hand, if the issue has to do with one of the UCC provisions dealing with quality, such as the warranty of merchantability, the emphasis shifts. In that case the warranty is created only "if the seller is a merchant with respect to goods of that kind." U.C.C. § 2-314(1); IND. CODE § 26-1-2-314(1) (1976). There is a third group of cases in which merchant status is to be measured either by the practices or the goods involved in the transaction. This group deals with such things as merchant buyer's responsibility for following seller's instruction (U.C.C. § 2-603 (1978 version)) or risk of loss (U.C.C. § 2-509 (1978 version)) or adequate assurances of performance (U.C.C. § 2-609 (1978 version)).
25404 N.E.2d at 1202-03.
goods of that kind and is a merchant in those transactions in which he sells his crops.\textsuperscript{26}

D. Recovery of Attorney’s Fees in Consumer Warranty Actions

Where defective consumer products cause personal injury or property damage, the stakes are usually high enough to justify a suit against the seller. The costs of the suit, particularly the fee for the plaintiff’s attorney, can usually be paid out of the recovery obtained in the personal injury action. The lawyer’s contingent fee agreement has provided a method for even poor consumers to prosecute complex litigation. This assumption is often not true in cases where defective consumer goods cause only disappointed expectations, not personal injury or property damage. Traditionally, courts have refused to award costs and attorney’s fees to the successful plaintiff-buyer and the stakes usually are not high enough to justify the cost of suit. Thus, consumer buyers have had limited practical recourse in cases where their only complaint is that products did not meet the agreed standard of quality.

This problem was addressed in two ways in the Magnuson-Moss Warranty Act.\textsuperscript{27} First, the Act provides incentives for suppliers to create informal dispute settlement mechanisms.\textsuperscript{28} Where established, these mechanisms offer nonbinding resolution of disputes at no cost to the consumer. Second, the Act includes an effort to change the economics of litigation by providing for recovery of costs and attorney’s fees in suits brought under the Act.\textsuperscript{29} The Act provides that a consumer who is damaged by breach of an implied warranty may bring suit under the Act for damages and,

[i]f a consumer finally prevails in any action . . . he may be allowed by the court to recover as part of the judgment a sum equal to the aggregate amount of cost[s] and expenses (including attorneys’ fees based on actual time expended) determined by the court to have been reasonably incurred by the plaintiff for or in connection with the commencement and prosecution of such action, unless the court in its discretion shall determine that such an award of attorneys’ fees would be inappropriate.\textsuperscript{30}

\textsuperscript{26}Id. at 1203.
\textsuperscript{28}Id. § 2310(a)(1).
\textsuperscript{29}Id. § 2310(d)(2).
\textsuperscript{30}Id.
The only additional requirement for plaintiffs who seek to sue under the Act, and take advantage of this potential for recovery of fees, is that the person obligated under the warranty be "afforded a reasonable opportunity to cure such failure to comply" with the warranty obligation.\(^3\)

The appellate courts have not considered many cases under this provision of the Act. This may be due to the fact that many of these cases are resolved in trial court or by settlement. Indeed, the costs and attorney’s fees provision of the Act may provide an incentive for defendant-sellers to settle. However, this year the Indiana Court of Appeals dealt with a case in which there was an award of attorney’s fees under the Act. In *Jameson Chemical Co. v. Love*,\(^3\) a buyer purchased some roof coating which was applied on the buyer’s various construction projects. The roof coating was defective. The buyer sued and, although no evidence was presented on the number of hours actually worked by the buyer’s attorney, the buyer recovered a judgment including an award under Magnuson-Moss of $800 for attorney’s fees. In its appeal the seller argued that there was no evidence to support the award of attorney’s fees. In response the buyer argued that a trial judge has the power to make an award of attorney’s fees without evidence by relying on her knowledge of what a reasonable attorney’s fee should be. In resolving this conflict the court of appeals focused on the language of the Act.\(^3\) The Act authorizes an award of attorney’s fees “based on actual time expended.”\(^4\) The court said that, in the absence of evidence of the amount of time spent by the buyer’s lawyer on the case, the trial court was without authority to award attorney’s fees.\(^5\) Thus, in its first opinion, the court remanded the case for a hearing on the question of the number of hours worked by the buyer’s lawyer.\(^6\) Later, on its own motion, the court reversed its decision.\(^7\) Its first opinion had overlooked the fact that the buyer in question was not a consumer and the product was not a consumer product.\(^8\) Thus the

\(^3\)Id. § 2310(e).
\(^5\)Id. at 45.
\(^7\)401 N.E.2d at 45.
\(^8\)Id. at 48.

\(^3\)It said, “The Court of Appeals has inherent power to correct, on its own motion, an error in a decision and an opinion it has handed down... Accordingly, this court modifies its previous decision and opinion in this cause, which are reported at 410 N.E.2d 41.” Jameson Chem. Co. v. Love, 403 N.E.2d 928, 928 (Ind. Ct. App. 1980).

\(^4\)The right to sue under 15 U.S.C. § 2310(d) (1976) is available to consumers who claim defects against suppliers or warrantors of consumer products. Consumer is defined in 15 U.S.C. § 2301(3) (1976) as:
Magnuson-Moss Warranty Act did not apply and could not be the basis of an award of attorney’s fees.39

The importance of the Jameson Chemical case, other than to call attention to the potential for recovery of attorney’s fees, is in the commentary of the court on the proof required to support an award of fees. The court stated that some evidence of the number of hours actually expended in representing the plaintiff-buyer must be offered.40 This conclusion emphasizes the importance of good record keeping. It also suggests that the courts may review the proof of hours in a manner similar to the review of fees in other cases such as bankruptcy.41 Some of the insights on such things as the concept of billable hours could be borrowed from these other cases. Finally, the buyer should probably introduce some evidence of the reasonable fee per hour to which the plaintiff’s lawyer would be entitled.

E. Monetary Damages for Breach of Warranty

In Coyle Chevrolet Co. v. Carrier,42 a case which may have been

[A] buyer (other than for purposes of resale) of any consumer product, any person to whom such product is transferred during the duration of an implied or written warranty (or service contract) applicable to the product, and any other person who is entitled by the terms of such warranty (or service contract) or under applicable State law to enforce against the warrantor (or service contractor) the obligations of the warranty (or service contract).

Consumer product is defined in 15 U.S.C. § 2301(1) (1976) as:

[A]ny tangible personal property which is distributed in commerce and which is intended for personal, family, or household purposes (including any such property intended to be attached to or installed in any real property without regard to whether it is so attached or installed).


40Id. at 928-29.

41See In re First Colonial Corp. of America, 544 F.2d 1291 (5th Cir. 1977); Johnson v. Georgia Highway Express, Inc., 488 F.2d 714 (5th Cir. 1974). Both of these cases were remanded to the district courts due to insufficient documentation of the amount of time spent by the attorneys and the type of work involved. 544 F.2d at 1298; 488 F.2d at 717. The judges also failed to justify the awards with findings and reasons. 544 F.2d at 1298; 488 F.2d at 717. These cases listed several factors which should be utilized by judges when awarding the fees, including the time and labor required, the difficulty of the question, and the customary fee. 544 F.2d at 1298; 488 F.2d at 717-19. See also Rose Pass Mines, Inc. v. Howard, 615 F.2d 1088 (5th Cir. 1980), in which lawyers were required to distinguish between partner and associate time; In re City Planners & Developers, Inc., [1980] 6 BANKR. CT. DEC. (CRR) 707 (District of Puerto Rico 1980) requiring the same distinction; In re St. Pierre, [1980] 6 BANKR. CT. DEC. (CRR) 607 (District of Rhode Island 1980) prohibiting claims for study of the law which is in the nature of the continuing legal education exercise. Other courts have required lawyers to distinguish between travel time, clerical work, and lawyer work. All of these factors could be brought into play in a suit to recover fees under the Magnuson-Moss Warranty Act.

more appropriate for the award of attorney's fees under the Magnuson-Moss Warranty Act, but in which the issue was not raised, the court of appeals offered some insight on the meaning of the language of UCC 2-714(2) regarding the subject of the buyer's damages for breach of warranty. That section provides that "[t]he measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted, unless special circumstances show proximate damages of a different amount."

In Coyle, the plaintiff-buyer purchased an automobile which proved to be defective. After several efforts to have the dealer cure the defects, the buyer filed suit. A jury awarded $9,500, which amount was in excess of the purchase price of the car. On appeal the defendant argued that the damage award was excessive. In analyzing the trial judge's decision, the court of appeals concluded that the basic measure of recovery was to be computed under UCC 2-714. The defendant argued that the plaintiff had not proved the value of the automobile as accepted. The only evidence in the record was the testimony of the buyer that the car was worth about $500. On this issue, the court of appeals concluded that the owner of personal property is competent to testify as to its value and that the testimony of the buyer that the car was worth $500 could have been the basis for a decision by the jury that the automobile had a value of $500 at the time of acceptance. The lesson in this case for buyer's lawyers is that it may be advisable for plaintiff-buyers to testify on the issue of the value of the goods at the time of acceptance. The buyer apparently need not show any special knowledge or expertise, but will be competent to testify because he is the owner.

Even if the buyer's estimate of value was admissible and served as the basis for the jury's verdict, the total $9,500 award was still not justified. This award raised the further issue of the scope of consequential and incidental damages which may be recovered under UCC 2-715 in addition to the value of the goods which may be recovered under UCC 2-714. The court stated that sales tax of forty dollars could be recovered as incidental damages resulting from expenses "reasonably incurred in . . . receipt" of the car. Also, the

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43 IND. CODE § 26-1-2-714(2) (1976).
44 Id.
45 397 N.E.2d at 1284.
47 397 N.E.2d at 1287.
48 Id. at 1287-88.
49 Id. at 1286-87.
court stated that the finance charge of $1,581.38, which was paid to finance the purchase of the automobile, could be recovered as consequential damages.\textsuperscript{50} These conclusions may be inconsistent with UCC 1-106(1) which provides that the UCC is to “be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed . . . .”\textsuperscript{51} The court based its decision on the assumption that the buyer had retained the automobile and was entitled to damages under UCC 2-714. If the goods are accepted and revocation of acceptance is unavailable, the complete measure of recovery is usually provided by the formulation found in UCC 2-714(2)—the difference between the value of the goods as warranted and as accepted. Sales tax is not something which must be recovered over and above the amount produced by that formula in order to achieve the full performance position. Instead, sales tax seems to be the sort of expense which the buyer was willing to contribute in order to bring about the full performance position. This criticism also applies to the amount recovered to compensate the buyer for the finance charge. This, too, was an amount which the buyer had agreed to contribute in order to bring about the full performance position.

To support its conclusion that the buyer should recover the finance charge, the court relied on the recent decision of the Indiana Court of Appeals in \textit{Hudson v. Dave McIntire Chevrolet, Inc.}\textsuperscript{52} In that case the court of appeals volunteered in a concluding footnote that interest could be recovered as a form of consequential damages where the seller had reason to know that the buyer needed to borrow money in order to complete the purchase.\textsuperscript{53} However, in the \textit{Hudson} case the buyer had revoked acceptance with respect to the auto. Where there has been a rightful revocation of acceptance, the contract is cancelled and the computation of damages begins with the assumption that the buyer has returned the goods, has no obligation to pay the purchase price, and should receive a refund of any amount paid. In this type of case, the finance charge actually paid may be a cost which should be attributed to the breaching seller.\textsuperscript{54} However, this reasoning should not be transferred to a case, such as the \textit{Coyle} case, where the buyer kept possession of the

\textsuperscript{50}Id.
\textsuperscript{51}Ind. Code § 26-1-1-106 (1976).
\textsuperscript{52}390 N.E.2d 179 (Ind. Ct. App. 1979).
\textsuperscript{53}Id. at 184 n.4.
\textsuperscript{54}Even if the seller returned the purchase price and the buyer paid off the auto loan, the buyer would still have incurred a portion of the prepaid finance charge. The amount of the finance charge would be computed on the basis of the rule of 78’s. Ind. Code § 24-4.5-2-210 (1976).
goods and recovered the full performance position by receiving the value of the goods as promised.

F. Warranty of Habitability—Notice Requirement

Several years ago, in *Theis v. Heuer*, the Indiana Supreme Court held that a seller of a new home makes a warranty of habitability to the buyer. The buyer may sue for breach of warranty of habitability if there are defects in the home which substantially interfere with enjoyment. A few years later, in 1976, the Indiana Supreme Court decided *Barnes v. Mac Brown and Co.*, which extended the warranty protection beyond the first buyer of the home. Under the reasoning of the *Barnes* case a person who bought the home from the original buyer could sue the builder, even though there was no privity of contract. The second buyer could sue the builder as long as the defect was latent, was not discoverable by reasonable inspection, and had manifested itself after the second purchase.

This past year, in *Wagner Construction Co. v. Noonan*, the court of appeals again had occasion to deal with the warranty of habitability, and imposed an important new condition on the buyer's right to sue for breach. In that case, Wagner constructed a house and sold it to Hill in 1973. Five years later Hill sold the house to Noonan who took occupancy on June 26, 1978. On July 4, 1978, a problem arose concerning the septic system which caused raw sewage to back up into the basement. Noonan employed a plumbing contractor who made corrections which temporarily alleviated the problem. In November 1978, Noonan called Wagner and asked about changing some drainage pipes inside the house, but he apparently made no mention of the exact nature of the problem. On January 13, 1979, the same problem arose and the sewage again backed up into the basement. The plumbing contractor was called back to repeat the procedure which had been successful in July 1978. A week later sewage backed up for a third time and again the plumbing contractor was called to repeat the procedure. At this point the plumbing

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57264 Ind. at 12, 280 N.E.2d at 306.
58Id. at 10, 280 N.E.2d at 305 (quoting Bethlahmy v. Bechtel, 91 Idaho 55, 415 P.2d 698 (1966), wherein the Supreme Court of Idaho stated that "major defects which render the house unfit for habitation, and which are not readily remediable, entitle the buyer to rescission and restitution." Id. at 68, 415 P.2d at 711).
60Id. at 229, 342 N.E.2d at 620.
61Id. at 229, 342 N.E.2d at 621.
contractor recommended digging into the septic tank as soon as the ground thawed to determine the root of the problem. Again, in April, the problem occurred. At that time, the recommended excavation was performed, the septic tank was opened, and it was discovered that the lead-in pipe extended some three feet into the septic tank. At the trial, Wagner admitted that this condition constituted a defect in the construction and that this was the cause of Noonan’s problems. After discovery of the lead-in pipe problem, Noonan did not call Wagner to report the defect or give Wagner an opportunity to repair it. Instead, Noonan sued Wagner on June 8, 1979. The first knowledge Wagner had of the problem was when he received the complaint in June 1979. The small claims court held for Noonan and awarded $632.66 damages.

On appeal, the court first disposed of some general questions concerning the scope of the warranty of habitability. Wagner argued that the warranty should not extend indefinitely and that five years was beyond its period of protection. The court of appeals held that the implied warranty of habitability extends for a reasonable period, and that the small claims court decision extending the warranty to a defect discovered five years after completion of the house was not unreasonable. Also, Wagner argued that the defect did not make the premises “uninhabitable” since Noonan was not forced to vacate the premises. The court of appeals held that the warranty of habitability protects not only against conditions which make the premises uninhabitable but also protects against conditions which substantially impair the owner’s use. The presence of the sewage was a sufficient impairment of use to support the trial court’s decision.

Finally, and most importantly, Wagner argued that Noonan was obligated to give notice of the defect within a reasonable period of time or his right to recovery would be barred. To advance this argument, Wagner relied on a California Supreme Court case, Pollard v. Saxe & Yolles Development Co., which held that failure to give notice constituted a bar to recovery for breach of warranty of habitability. In the Pollard case, the plaintiff purchased an apartment building and took possession on April 1, 1963. The plaintiffs discovered defects at the time they took possession, but did not notify the defendants until January 1967. In concluding that this delay

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61Id. at 1148.
62Id.
63Id.
64Id.
65Id.
67Id. at 380, 525 P.2d at 92, 115 Cal. Rptr. at 652.
operated as a bar to recovery, the California Supreme Court took note of the purposes for requiring notice. The court said that notice afforded the defendant an opportunity to repair the defective item, to reduce damages, to avoid defective products in the future, to negotiate settlements, and to protect against stale claims. These are the same concerns which serve as underpinning for the notice requirement of UCC 2-607(3)(a), applicable in sales of goods. Under that section, the buyer must give notice to the seller within a reasonable period of time after discovery of a defect in goods, or recovery is barred. Both the California and Indiana courts referred to UCC 2-607(3)(a) in support of imposing a notice requirement in a warranty of habitability case and, in this discussion, it is assumed that these notice requirements are parallel.

In the Wagner Construction case, the Indiana Court of Appeals adopted the notice requirement created by the California Supreme Court. The Indiana court focused on the fact that no notice was given until the time of suit. The contact which Noonan made in November 1978, concerning some possible, but unspecified change in interior piping, when no difficulty with the septic system was being encountered, did not constitute notice which would preserve the right to sue. The court stated that "[n]o particular form of notice is required, but the purchaser must at least inform the builder-vendor of the problem and give him a reasonable opportunity to cure or repair." Because Noonan did not meet the notice requirement he was not entitled to sue, and the trial court’s decision in his favor was reversed.

There may be some basis for criticism of the court’s reasoning in the Wagner Construction case. First, the court said that notice was necessary to give the seller a right to "cure" or repair. If the court was thinking of an analogue to the concept of "cure," defined in UCC 2-508, this emphasis was improper. There is no right to cure defects in goods that have been accepted. "Cure" under UCC 2-508 can be initiated only to block a rejection under UCC 2-601 and cancellation under UCC 2-711. In the Wagner Construction case, the buyer had accepted and was keeping the seller's performance (the house). Therefore, the principle of cure found in UCC 2-508 would

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"Id.
"Id.
"403 N.E.2d at 1150.
"Id.
"Id.
"Id.
"Id.
"Id.
not be applicable. Second, under UCC 2-607, the reasonable period during which notice must be given begins when the buyer "discovers or should have discovered any breach." The notice period does not run from the date of original sale. In the Wagner case, it seems that the buyer did not realize there was any defect for which the builder could be held responsible until after an investigation of the septic tank in April 1979. It was on this date that the buyer discovered a breach. Therefore, the trial court may have been justified in concluding that the period for notice began in April 1979. Because Wagner received a copy of the complaint in June 1979, the trial court may have concluded that notice was given within a reasonable time.

Even if the buyer had discovered the breach when the backup problem first arose, in July 1978, the trial court's decision could still be defended. Some compassion in measuring the reasonable time period must be shown for consumers who could not be expected to know about notice requirements. Official Comment 4 to UCC 2-607 states that "'[a] reasonable time' for notification from a retail consumer is to be judged by different standards so that in his case it will be extended, for the rule of requiring notification is designed to defeat commercial bad faith, not to deprive a good faith consumer of his remedy.'" Furthermore, the buyer's delay was not in any way comparable to the delay in the Pollard case where the buyer knew of the defects when he took possession, but did not give notice until nearly four years later.

The court of appeals may have based it decision on the assumption that the suit could not serve as notice. Such an assumption suggests that there must be some form of notice prior to filing suit. The purpose of such a notice requirement may be to give the seller an opportunity to settle the claim. This presumes that it is more difficult to settle after suit is filed. However, this is a rather formalistic approach. It would require all consumers to give notice prior to filing suit to permit the seller to explore settlement. Furthermore, its application would be especially attenuated where suit was filed, as in the Wagner Construction case, in a small claims court with rather informal procedures and lower costs for initiating suit. These lower costs and informal procedures may form less of an obstacle to settlement than a suit in a court of general jurisdiction.

Finally, the court of appeals concluded that Noonan's call to Wagner in November 1978, did not constitute notice because it did not specifically identify defects." This suggests a more rigorous re-

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\(^{39}\)U.C.C. § 2-607, Official Comment 4.

\(^{70}\)403 N.E.2d at 1150.
requirement than is imposed by UCC 2-607. The notice required by UCC 2-607 need not specify the exact nature of a defect. Official Comment 4 to UCC 2-607 states that "[t]he content of the notification need merely be sufficient to let the seller know that the transaction is still troublesome and must be watched." The trial court could have found that the call of November 1978, informed the seller that the transaction was troublesome.

G. Liability of Agents on Checks

Shareholders and officers of closely held corporations and representatives in other small businesses sometimes execute negotiable instruments without making clear in what capacity they are signing. They may intend to create only corporate liability; they may intend only personal liability; or they may intend corporate liability with personal liability as a surety or accomodation party. The resulting uncertainty as to the liability of the signer is of special concern where the contracts are made on negotiable instruments. To address this problem, UCC 3-403 provides some strict operating rules on the subject. To begin, there are obvious extreme cases resolved as a matter of law under UCC 3-403(2)(a). If the signer neither names the person represented nor shows the representative capacity, the signer is personally obligated. On the other hand, if the signer both names the person represented and indicates a representative capacity, UCC 3-403(3) provides that the signer is not liable and has made a contract on the instrument only on behalf of the principal. In between these extreme cases there are some signatures which may create ambiguities. If the instrument names the person represented, but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented, but does show the representative signed in a representative capacity, UCC 3-403(2)(b) causes the analysis to be governed by the identity of the parties in the litigation. It provides that an authorized representative who signs his own name to an instrument,

[e]xcept as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representa-

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38Ind. Code § 26-1-3-403 (1976).
39Id. § 26-1-3-403(2)(a). Courts have been generous in finding some indication of representative capacity to avoid assessing personal liability as a matter of law. See, Weather-Rite Inc. v. Southdale Pro-Bowl Inc., 301 Minn. 346, 222 N.W.2d 789 (1974).
40Id. § 26-1-3-403(3).
41Id. § 26-1-3-403(2)(b).
tive signed in a representative capacity, or if the instrument
does not name the person represented but does show that
the representative signed in a representative capacity.\textsuperscript{82}

Thus, if the suit is between the immediate parties to the instrument,
such as the maker and payee of a note, the dispute can be resolved
in the same manner as it would be in the context of a simple con-
tract.\textsuperscript{83} The agent may show, by any relevant evidence, that her sig-
nature was made in a representative capacity and that the parties
did not intend her to have personal responsibility. However, if the
suit is not between the immediate parties, but is between a subse-
quently holder and the agent, the special needs of negotiable paper
are brought into focus and the ambiguity is resolved against the
agent.

With regard to corporate checks, UCC 3-403(2)(b) may present
special dangers of accidental liability for agents of closely held cor-
porations. If a check bears the printed name of the corporation, but
does not have an indication under the drawer’s signature line that
the drawer is signing in a representative capacity, the liability of
the agent on the check may be governed by UCC 3-403(2)(b). This
check would be an instrument which named the principal but did not
indicate a representative capacity. If the person suing on the check
is the payee, then, of course, even under UCC 3-403(2)(b), the agent
would be able to show that the parties intended her signature to be
in a representative capacity. However, if the suit on the check is
brought by someone other than the payee, that is, someone other
than one of the immediate parties to the instrument, the agent may
not be able to show by other evidence that the signature was made
in a representative capacity. Under UCC 3-403(2)(b) she may be per-
sonally liable as a matter of law.

A case involving just this type of check was presented to the
court of appeals last year in \textit{Highfield v. Lang}.\textsuperscript{84} Fortunately for the
agent, the suit was brought by the payee and was thus between the
immediate parties. The court permitted the representative of the
closely held corporation to introduce evidence of his representative
capacity. The representative showed that the payee was an
employee of the corporation who knew that the representative was
Vice-President and was signing in a representative capacity.\textsuperscript{85} The
trial court held for the agent and the court of appeals affirmed.\textsuperscript{86}

\textsuperscript{82}Id.
\textsuperscript{83}Id.
\textsuperscript{84}394 N.E.2d 204 (Ind. Ct. App. 1979).
\textsuperscript{85}Id. at 206.
\textsuperscript{86}Id.
However, the important lesson of the Highfield case is not in the holding, it is in the attention it calls to the risk that someone other than the payee could bring suit against the agent on the check. For example, the suit could have been brought by a collecting bank. In that case, the agent may not have been able to prove his representative capacity and may have been personally liable as a matter of law. The lesson for lawyers is to make certain that company checks have some indication of representative capacity near the line for the drawer’s signature.

H. Customer’s Duty to Examine Bank Statements

UCC 4-406(1) provides a standard of care for bank customers with respect to bank statements. When a bank sends “a statement of account accompanied by items paid in good faith . . . the customer must exercise reasonable care and promptness [in examining] the statement and items to discover . . . unauthorized signature[s] or alteration[s].”87 Furthermore, the customer must notify the bank promptly after a forgery or alteration is discovered. A customer’s failure to comply with these duties with respect to any item may preclude the customer from asserting that the item was not properly payable in the following circumstances.88 If a customer was the victim of forgery or alteration by the same wrongdoer on a series of items which the bank paid and forwarded to the customer at periodic intervals, the customer may be precluded from asserting the forgeries or alterations that took place after the customer had the statement for a reasonable period not exceeding fourteen calendar days and before the bank received notice from the customer of this forgery or alteration.89 However, if the bank was negligent in paying the item the customer’s negligence would be cancelled out; the customer would be able to claim that the checks bearing forgeries or alterations were not properly payable and could still insist on recredit to her account.90

In Indiana National Corp. v. Faco, Inc.91 the Indiana Court of Appeals had occasion to deal with UCC 4-406 in a situation which presented a very common fact pattern. In that case, there was a dishonest employee of a closely held family corporation (Faco) who was responsible for its books. The employee repeatedly forged the signature of a corporate officer as drawer on Faco checks, made the

87IND. CODE § 26-1-4-406(1) (1976).
88U.C.C. § 4-406(2); IND. CODE § 26-1-4-406(2) (1976).
89U.C.C. § 4-406(2); IND. CODE § 26-1-4-406(2) (1976).
90U.C.C. § 4-406(3); IND. CODE § 26-1-4-406(3) (1976).
checks payable to himself or to his daughter and thus embezzled $51,809.09 from Faco. The checks were all paid by the payor bank and were forwarded to Faco along with monthly statements. Of course, since the forger was the bookkeeper, the forgeries and fraud did not come to the attention of the officers of Faco and were not discovered until the scheme had operated for two years. At that time, the corporation sued the payor bank alleging that these forged checks were not properly payable. The trial court entered a judgment in favor of Faco for the entire amount.\textsuperscript{92}

On appeal, the bank raised some interesting questions with respect to the customer's negligence under section 4-406. First, the bank urged that the failure of the officers of Faco to discover the fraud committed by their employee was a failure to exercise reasonable care and promptness in examining statements under UCC 4-406(1). The court of appeals agreed.\textsuperscript{93} The court noted that no audit was performed and none of Faco's officers took the time to inspect the items or the statements provided by the bank. Thus, Faco had been negligent, presumably as a matter of law. This approach differs from the approach taken by other courts. One court held that the test of negligence is whether the entity was negligent in selecting the employee on the basis of the facts known to it at the time.\textsuperscript{94} Other courts have held the customer is chargeable with knowledge of such facts as an honest agent would acquire from a prudent examination of the statement.\textsuperscript{95} The formulation used by the Indiana Court of Appeals is close to this latter approach and seems to be the better reasoned position.

Once the customer's negligence is established the bank can avoid liability for these forgeries unless the bank was negligent. In the Faco case the court of appeals concluded that there was evidence that could support a decision that the bank was negligent and could therefore support the trial court's judgment for the customer.\textsuperscript{96} First, Faco had presented evidence that three unsigned checks drawn on the Faco account had been paid. Further, an employee of the bank, who was to examine the checks for unauthorized signatures, testified that these three checks should not have been paid. Finally, Faco presented evidence of the extremely heavy workload

\textsuperscript{92}Id. at 203.
\textsuperscript{93}Id. at 204-05.
\textsuperscript{96}400 N.E.2d at 205.
of bank employees responsible for examining checks and that the bank was unable to produce copies of thirty of the forged checks which had been sent to Faco.\textsuperscript{97} This negligence cancelled out the customer's negligence and caused the bank to be responsible for the checks because they were not properly payable.

However, despite the bank's negligence, there was one final step in the analysis of this problem under UCC 4-406. UCC 4-406(4)\textsuperscript{98} creates a condition precedent to recovery by the customer. It provides that

\begin{quote}
[w]ithout regard to care or lack of care of either the customer or the bank a customer who does not within one (1) year from the time the statement and items are made available to the customer (subsection (1)) discover and report his unauthorized signature or any alteration . . . is precluded from asserting against the bank such unauthorized signature . . . .\textsuperscript{99}
\end{quote}

The purpose of this provision is to encourage promptness and good business practices on the part of bank customers and to relieve banks of any liability to their customers who fail to follow those practices. The court noted that Faco had reported the forgeries to the bank in August 1975.\textsuperscript{100} Under UCC 4-406(4), the bank was responsible only for those forged checks which had been received by Faco within one year prior to the date of notice. In other words, those checks which were sent to the customer before August 1974, were the responsibility of the customer, not the bank. Applying this provision, the court affirmed the trial court's judgment for Faco, but instructed the trial court to deduct the sum of the forged checks which were sent to the customer prior to August 1974.\textsuperscript{101}

\section{I. Check Forgery}

The court of appeals last year decided two cases on the subject of check forgery. One case, Insurance Co. of North America v. Purdue National Bank,\textsuperscript{102} dealt with a forgery of an endorsement; the other case, Payroll Check Cashing v. New Palestine Bank,\textsuperscript{103} dealt with a forgery of the drawer's signature. In both cases, the court of appeals addressed interesting and important forgery issues.

\begin{footnotes}
\item[97]Id.
\item[98]IND. Code § 26-1-4-406(4) (1976).
\item[99]Id.
\item[100]400 N.E.2d at 205.
\item[101]Id. at 206.
\item[102]401 N.E.2d 708 (Ind. Ct. App. 1980).
\item[103]401 N.E.2d 752 (Ind. Ct. App. 1980).
\end{footnotes}
1. Drawer Forgery.—In the Payroll Check Cashing case, checks on which the drawer’s signature was forged were cashed at the Payroll Check Cashing Service (Payroll). Payroll forwarded them through regular banking channels and they were paid by the drawee, New Palestine Bank (payor bank). After the cancelled checks and monthly statement were sent to the drawer named on the checks, the drawer notified the payor bank of the forgeries. The payor bank reccredited the drawer’s account and sued Payroll. The trial court entered a judgment in favor of the payor bank for the amount of the checks.

Any analysis of the payor bank’s right to sue for payment made on checks bearing drawer forgeries must take account of the finality principle codified in UCC 3-418. That section provides in part that “payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.” This principle is built on the assumption that once an instrument is finally paid, the payment should not be recovered unless there are special circumstances. This follows because there are usually numerous transactions firmed up by the payment of an instrument and there may be decisions in various subordinate transactions made in reliance on payment. To reopen those transactions could cause considerable dislocation.

Among other things, this finality principle operates to prevent a payor bank from suing to recover money paid out on a check bearing a forged drawer’s signature. However, this result should not engender excessive sympathy for payor banks. A payor bank should discover the forgery of the drawer’s signature when the check is presented for payment. It should have the drawer’s signature on file and should be able to verify the signature on the check. If it does not discover the forgery, there is little to commend permitting the payor bank to shift the loss to parties who have handled the check in the collection process.

104 Id.
105 Id. at 754.
107 Id.
108 Official Comment 1 to U.C.C. § 3-418 provides that “it is highly desirable to end the transaction on an instrument when it is paid rather than reopen and upset a series of commercial transactions at a later date when the forgery is discovered.”
109 Official Comment 1 to U.C.C. § 3-418 provides that the text of § 3-418 “follows the rule of Price v. Neal, 3 Burr. 1354 (1762), under which a drawee who accepts or pays an instrument on which the signature of the drawer is forged is bound on his acceptance and cannot recover back his payments.”
110 Official Comment 1 to U.C.C. § 3-418 provides that “[t]he traditional justification for the result is that the drawee is in a superior position to detect a forgery because he has the maker’s signature and is expected to know and compare it . . . .”
Despite the finality principle, the payor bank may still be able to recover its payment if it can show that there are special circumstances which constitute breach of a presentment warranty.111 Presentment warranties liability constitute an exception to the finality principle.112 These presentment warranties include a warranty that: (1) The presenting party has good title to the item, (2) the presenting party has no knowledge that the signature of the maker or drawer is unauthorized, and (3) the item has not been materially altered.113 Unfortunately for payor banks, in drawer forgery cases there is usually no breach of presentment warranty. The warranty of good title is not breached simply by virtue of the forgery of the drawer's signature.114 Since the forgery operates as the signature of the forger, the check is simply the forger's check bearing the forger's order and drawer's contract. Thus, the presenting party has good title.115 The most likely way for payor banks to establish a presentment warranty breach is to show that the person presenting the check had knowledge of the drawer's forgery.116

In the Payroll Check Cashing case, the trial court's decision in favor of the payor bank had to be affirmed by the appellate court if there was any basis for the trial court's decision. The court of appeals noted that there was no evidence that Payroll had breached a presentment warranty.117 Therefore, the only basis for the trial court's decision was the assumption that Payroll was not entitled to the benefit of the finality principle. UCC 3-418 states that the finality principle operates only in favor of two groups: (1) Persons who have changed position in reliance on payment, and (2) holders in due course. There was no evidence that Payroll had changed position in reliance on payment. Thus, Payroll had to establish that it was a holder in due course. In general, the burden of proof is on the person claiming the rights of a holder in due course. UCC 3-307(3) pro-

111U.C.C. § 3-417(1); IND. CODE § 26-1-3-417(1) (1976). There is a special set of warranty provisions that apply to transfer and presentment in the context of bank collection. These warranties are found in U.C.C. § 4-207(1); IND. CODE § 26-1-4-207(1) (1976).
112U.C.C. § 3-418 states that “except for liability for breach of warranty of presentment . . . payment or acceptance . . . is final . . .”.
113IND. CODE § 26-1-3-417(1) (1976).
115U.C.C. § 3-404 provides that an unauthorized signature “operates as the signature of the unauthorized signer in favor of any person who in good faith pays the instrument or takes it for value.” IND. CODE § 26-1-3-404(1) (1976). The instrument is simply the forger’s check and there are no title questions.
116U.C.C. § 3-417(1)(b) provides that the party making the presentment warrants “he has no knowledge that the signature of the maker or drawer is unauthorized.” IND. CODE § 26-1-3-417(1)(b) (1976).
117401 N.E.2d at 756-57.
vides that "[a]fter it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course." The court of appeals concluded that neither the general principle with regard to the burden of proof, nor this language was applicable to this case. The court concluded that this language applied to cases where a holder in due course was attempting to sue on an instrument with respect to which there were defenses. In the Payroll Check Cashing case, the payor bank brought suit against an intermediate holder who needed the protection of the finality principle. The court held that on this issue the burden of proof was on the payor bank in its effort to establish that Payroll was not a holder in due course. Since there was no evidence in the trial record to show that Payroll was not a holder in due course, Payroll was entitled to the benefit of the finality principle. As a result, the trial court's decision in favor of the payor bank was erroneous and it was reversed with instructions to enter judgment for Payroll.

Some courts and authors have argued that it is not necessary to examine UCC 3-418 where the payment has been made by a bank on a check bearing a drawer forgery. The argument begins with UCC 4-102(1) which provides that "[i]n the event of conflict the provisions of this Article govern those of Article 3 . . . ." UCC 4-213(1) provides that "[u]pon a final payment . . . the payor bank shall be accountable for the amount of the item." This language suggests a broader final payment principle imposed by UCC Article 4 on banks which make payment on instruments. It is broader in the sense that it operates in favor of all parties who act in good faith, not only in favor of holders in due course and persons who change position in reliance on payment. The fact that the Indiana Court of Appeals analyzed the Payroll Check Cashing case under UCC 3-418 suggests that it has rejected this argument and has concluded that the only finality principle is found in UCC 3-418.

2. Forged Indorsements.—In Insurance Co. of North America v. Purdue National Bank, the court of appeals addressed the ques-

120401 N.E.2d at 758.
121Id.
122Id.
123See J. White & R. Summers supra note 95, § 16-2, at 613-17.
125Id. § 26-1-4-213(1).
tion of whether the drawer could sue a depositary bank\textsuperscript{126} which presented a check bearing a forged endorsement. In that case Freyman forged a power of attorney for Helen Creech who had a savings account at the Lafayette Savings Bank (Savings Bank). Using this forged power of attorney, Freyman made a withdrawal of $8,000 from Helen Creech’s savings account. The funds withdrawn were paid out by way of a check drawn by Savings Bank on the Lafayette National Bank (National) payable to Helen Creech. Although Savings Bank had a signature card bearing Helen Creech’s signature, the forgery of the power of attorney was not discovered. There was no evidence that the signatures were compared. Freyman forged Helen Creech’s endorsement on the back of the check and deposited it in his account at the Purdue National Bank of Lafayette (Purdue). It was presented through regular banking channels and paid. In a very similar transaction, Freyman went to Savings Bank with a notice of administration for the estate of James Paul Davis, another depositor at Savings Bank. On the basis of his representation that he was attorney for the estate, Freyman withdrew $1,000 from Davis’ savings account and a check in the amount of $1,000 was drawn by Savings Bank on National, payable to Ruth A. Braun, the executrix of the Davis estate. Freyman forged Braun’s endorsement on the check and deposited it in his account at Purdue. It was presented for payment through regular banking channels and paid by National. Thereafter, Savings Bank discovered the forgeries on the two checks and the fraud which had been perpetrated against the accounts of its two customers. It recredited the accounts of Creech and Davis in the amount of the respective withdrawals and demanded reimbursement from the depositary bank, Purdue, which refused. The Insurance Company of North America paid Savings Bank under a policy of insurance against loss from forgery and filed suit as subrogee of the claim against Purdue. The case was tried on this stipulation of facts and the trial court entered a judgment for Purdue.\textsuperscript{127}

In deciding the insurance company’s appeal the court of appeals first considered whether it was appropriate to permit a suit by the drawer of a check bearing a forged endorsement against the depositary bank. It is clear that, absent negligence, the drawer has a claim against the payor bank,\textsuperscript{128} which in turn could sue the collec-

\textsuperscript{126}A depositary bank is “the first bank to which an item is transferred for collection . . . ” \textit{Ind. Code} § 26-1-4-105(a) (1976). The question raised in the case also applies to all collecting banks which are any banks handling items for collection. \textit{Id.} § 26-1-4-105(d).

\textsuperscript{127}401 N.E.2d at 710.

\textsuperscript{128}A check which does not bear the endorsement of the payee is not properly payable. The payor bank may charge the customer’s account only in the case of a properly
ting bank, but it is a direct suit by the drawer with which we are concerned. Several theories have been advanced for this type of direct suit: (1) The collecting bank may be liable to the drawer for conversion; (2) the drawer may be a third party beneficiary of the presentment warranty of good title made by collecting banks; (3) the drawer is an assignee of the drawee’s right to sue on the presentment warranty of good title; or (4) the drawer is an “other payor” within the meaning of UCC 4-207(1), is thus a person to whom presentment warranties are made, and can sue collecting banks on the presentment warranty of good title. These theories have produced mixed results in the courts. At the center of the controversy seems to be a problem of deciding which parties should litigate questions concerning the drawer’s negligence. To demonstrate this proposition, assume that the drawer had just discovered the forgeries and was contemplating how to recoup its losses. The most likely defendant would be the payor bank which had paid the forged checks improperly. The drawer could demand that payor bank recredit her account, but in response to this demand the payor bank could raise various issues of negligence. The drawer may have been guilty of negligence which substantially contributed to the forgery and may thus be precluded from asserting it. Similarly, the drawer may have failed to exercise reasonable care in examining her statement and may be precluded from asserting later forgeries by the same wrongdoer. Finally, the drawer may have failed to give notice within three years from the time the forgery was discovered and thus would be precluded from asserting the forgery against the payor bank. The proof of these various types of negligence would be more readily available to the payor

payable item. See U.C.C. § 4-401(1); Ind. Code § 26-1-4-401(1) (1976). The customer has a claim for any improper charge to an account.

129. The payor bank can sue the collecting bank for breach of the presentment warranty of good title. 401 N.E.2d at 711-14. A check as to which there has been a forgery of the payee’s signature is still owned by the payee, and persons handling the check do not have good title. For a discussion of the effect of a forgery on the rights of the payee and subsequent holders, see J. White & R. Summers supra note 95, § 15-2.

130. This theory has been rejected because the drawer does not have a property interest in the check which can be the subject of a conversion. The property in the check is owned by the payee. See Allied Concord Fin. Corp. v. Bank of America Nat’l Trust & Sav. Ass’n, 275 Cal. App. 2d 1, 80 Cal. Rptr. 622 (1969).

131. Id.


bank. It would probably be the only bank which would have knowledge of the drawer's negligence or sloppy practices or the customer's failure to exercise reasonable care in examining statements. Because these defenses can be best raised by the payor bank, the drawer should be required to proceed against the payor bank and not be entitled to sue directly against the collecting bank which would not be as well prepared to raise negligence defenses. UCC 4-406(5) seems to support this argument. It provides that, "[i]f . . . a payor bank has a valid defense against a claim of a customer . . . and . . . fails upon request to assert the defense the bank may not assert against any collecting bank . . . a claim based upon the unauthorized signature . . . giving rise to the customer's claim." This is the position advanced by White and Summers, the authors of the most popular treatise on the subject.

The Indiana Court of Appeals, however, was less impressed with these concerns than with a recent decision of the California Supreme Court, Sun' N Sand, Inc. v. United California Bank. In that case the court focused on the language of UCC 4-207(1) in permitting the drawer's suit against the collecting bank. That section provides that a presentment warranty extends to "the payor bank or other payor who in good faith pays or accepts the item." The court in Sun' N Sand, concluded that the drawer of a check qualifies as an "other payor who . . . pays." This interpretation is supported by the internal logic of UCC 4-207(1). Some presentment warranties are specifically not made to a drawer. For example, the presenting party warrants that she has no knowledge that the signature of the drawer is unauthorized. However, this warranty is not made by a collecting bank which is a holder in due course acting in good faith, "to a drawer with respect to the drawer's own signature." By specifically excluding drawers from this warranty protection, the drafters created a negative implication that other warranties are made for the benefit of the drawer. The Indiana Court of Appeals adopted this reasoning in Insurance Co. of North America. In addition, the court concluded that some weight had to be given to avoiding the circuitry of action created by requiring the drawer to look first to the payor bank.

138J. WHITE & R. SUMMERS supra note 95, § 15-5, at 602.
140Id. at 682, 582 P.2d at 928, 148 Cal. Rptr. at 337 (emphasis added).
141U.C.C. § 4-207(1); IND. CODE § 26-1-4-207(1) (1976) (emphasis added).
142U.C.C. § 4-207(1)(b)(ii); IND. CODE § 26-1-4-207(1)(b)(ii) (1976).
143401 N.E.2d at 714.
144Id.
Even though the drawer may bring a direct action against a collecting bank on the presentment warranty of good title, the collecting bank may raise any defense which could be raised by the payor bank against its customer. Thus, if the drawer were guilty of some negligence which substantially contributed to the forgery or if there were some other basis for the payor bank to refuse to recredit the drawer's account, the collecting bank would be able to raise the defense. In Insurance Co. of North America, there was evidence that Savings Bank's negligence substantially contributed to the forgeries. Savings Bank had allowed withdrawals from the savings accounts of its customers on the fraudulent assertions of the forger that he had authority to make the withdrawals. With respect to the first check, the forger used a Power of Attorney bearing a forged signature which Savings Bank did not discover even though the genuine signature was in its files. Instead, Savings Bank simply issued a check payable to its customer, Helen Creech, and gave it directly to the forger. As for the other check, there was no written authorization for withdrawal from the savings account. The forger presented a Notice of Administration which identified him as attorney for the estate. Savings Bank made no attempt to verify his authority. On the basis of these facts the trial court could have found that the drawer failed to use ordinary care in dealing with the accounts of its customers and in delivering these checks to the forger. Further, the negligence was a substantial factor contributing to the unauthorized indorsements. Thus, the trial court was correct in holding that the collecting bank was not liable to the drawer, and its judgment was affirmed.

J. Truth in Lending

1. Truth in Lending Simplification.—On March 31, 1980, President Carter signed into law the Depositary Institutions Deregulation and Monetary Control Act of 1980. A major part of this Act is Title VI, devoted to Truth in Lending Simplification—a subject which has been under discussion in Congress for the past several years. Title VI on Truth in Lending Simplification (TILLS) is quite

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143 U.C.C. § 4-406(5); IND. CODE § 26-1-4-406(5) (1976).
144 401 N.E.2d at 715.
complex, and an exhaustive discussion of its provisions is beyond the scope of this survey. However, in the few paragraphs that follow, an attempt is made to review some of its highlights.

a. Definitions.—Some key definitions were modified by TILS. First, the term "creditor" was redefined to eliminate some persons from its scope. To understand this modification it may be useful to consider two illustrations. First, assume that Acme Health Spa sold memberships for $500 payable in twenty-four monthly installments. On the date each membership contract was created, Acme assigned the contract to the Universal Finance Company at a substantial discount. Second, assume that Sally Broker was a real estate agent who worked with consumer house buyers. After finding houses, Sally helped buyers obtain financing by participating in the preparation of documents required in connection with mortgage loans. Under Truth in Lending (TIL),¹⁵⁰ the possibility exists that both Universal and Sally could be creditors and incur liability for failure to make proper disclosures because they either extend or arrange for credit.¹⁵¹ This potential has been eliminated by TILS. The new definition of creditor refers only to a person who "is the person to whom the debt arising from the consumer credit transaction is initially payable on the face of the evidence on indebtedness."¹⁵² Under the new law assignees and arrangers will not be creditors unless they are named on the face of the evidence of indebtedness.

TILS also modified the definition of "open-end credit." Under TIL some credit sellers were avoiding disclosure requirements by casting their transactions in the form of open-end credit extensions. Creditors did not actually contemplate that the consumer would engage in a series of transactions, and, for the most part, these arrangements amounted to a sham designed to avoid making the more significant disclosures required in closed-end transactions.¹⁵³ Open-end credit is now defined to mean "a plan under which the creditor reasonably contemplates repeated transactions."¹⁵⁴ Under this language a creditor will be able to treat an extension as open-end only if she contemplates repeated transactions.

b. Scope of TIL.—TILS brings about a fundamental change in the scope of TIL. With reference to credit transactions, TIL defines

¹⁵¹ See, e.g., Claire v. LaLanne Paris Health Spa, Inc., 528 P.2d 357 (Cal. 1974); Regulation Z, 12 C.F.R. § 226.2(s) and (L) (1980).
the adjective "consumer" to include extensions for personal, family, household, or agricultural purposes.\(^{155}\) As a result, agricultural credit extended to a natural person is consumer credit under TIL and, among other things, disclosures are required. TILS changes the definition of the word "consumer" in TIL to cover only extensions for personal, family or household purposes. Now exempt from TIL are "[c]redit transactions involving extensions of credit primarily for business, commercial, or agricultural purposes."\(^{156}\) This new definition and exclusion are in furtherance of the premise that agricultural credit is essentially commercial in nature and that TIL protections are unnecessary.\(^{157}\) Although in some states this change in scope of TIL will eliminate complexity, it may cause significant headaches for Indiana creditors who extend credit for agricultural purposes because the disclosure requirements of the Indiana Uniform Consumer Credit Code may continue to apply.\(^{158}\)

The scope of TIL has been expanded to include one increasingly important transaction—extension of credit secured by an interest in a mobile home. Again, this change can be understood best by way of an illustration. Assume that a consumer borrows more than $25,000. Currently this extension is not covered by TIL. The assumption is that customers who have the capacity to borrow large amounts are not in need of disclosures. However, where the consumer credit is secured by an interest in real property, this assumption may not operate. The most important credit transaction for many consumers is the purchase of a home through a loan secured by a mortgage. Borrowers in this context are assumed to need TIL protection. As a result, TIL applies to all extensions of consumer credit, regardless of the amount, in connection with which a security interest in real property is or will be retained or acquired.\(^{159}\) However, credit extended for the purpose of acquiring a mobile home is not subject to this exception because no security interest in real property is acquired. An extension of credit in excess of $25,000 secured by a mobile home is not covered by TIL because it falls within the gen-

\(^{157}\) See note 153 supra.
\(^{158}\) IND. CODE § 24-4.5-2-301(3) (1976) provides that "information which would otherwise be required pursuant to the Federal Consumer Credit Protection Act is sufficient even though the transaction is one of a class of credit transactions exempted from that Act pursuant to regulation of the Board of Governors of the Federal Reserve System." Generally, it is believed that this language will not exempt agricultural credit from state UCCC requirements for disclosure. See Miller, Living with Both the UCCC and Regulation Z, 26 Okla. L. Rev. 1 (1973).
eral exclusion of large credit extensions. TILS changes this result and gives parallel treatment to transactions secured by mobile homes or real property. Under TILS, credit transactions in which the amount financed exceeds $25,000 are excluded "other than those in which a security interest is or will be acquired in real property, or in personal property used or expected to be used as the principal dwelling of the consumer." 160

c. Model Forms.—TILS provides that "[t]he board [of Governors of the Federal Reserve System] shall publish model disclosure forms and clauses for common transactions to facilitate compliance with the disclosure requirements." 161 Other than numerical disclosures, if creditors use forms published by the Board, they shall be deemed to be in compliance with TIL disclosure requirements. 162 This should aid small creditors who have had difficulty in drafting or adapting their own forms. The model forms will be of less significance to major creditors who, because of the complexity of their transactions, may not be able to adapt the model disclosure forms as readily. Also, large creditors may have a sufficient volume of transactions to justify the expense of drafting complying forms suited to specialized transactions.

d. Effective dates for regulations.—TILS also provides that new regulations, amendments, or interpretations which require any disclosure differing from the disclosure previously required "shall have an effective date of that October 1 which follows by at least six months the date of promulgation." 163 The likely effect of this provision will be to cause most changes to take effect on October first of any given year with at least six months warning to give creditors time to prepare. This will aid creditors in changing their forms and gearing the purchase of forms to these effective dates. However, TILS provides that a creditor may comply with a new regulation prior to the October first effective date. 164

e. Disclosures.—TILS brings about major changes in the matters which must be disclosed. First, under TILS the key disclosures in other than open-end transactions must "be conspicuously segregated from all other terms, data, or information provided in connection with the transaction including any computations or itemization." 165

162Id.
163Id.
164Id.
Second, some disclosures have been simplified. For example, TIL requires disclosure of "[a] description of any security interest held or to be retained or acquired by the creditor in connection with the extension of credit." Under TILS, a creditor need only disclose a statement that a security interest has been taken in property purchased as part of the transaction or other property identified by item or type. Similarly, under TIL the creditor must disclose "[t]he amount or method of computing any default, delinquency, or similar charges payable in the event of late payments." TILS provides that the creditor must disclose "[a] statement that the consumer should refer to the appropriate contract document for any information such document provides about nonpayment, default, the right to accelerate the maturity of the debt, and prepayment rebates and penalties." This should reduce litigation over whether such things as acceleration clauses constitute default charges which must be disclosed. Third, TIL requires an itemization of disclosures such as the amount financed and the finance charge. TILS eliminates this requirement of itemization and provides, for example, that "[i]n conjunction with the disclosure of the amount financed, a creditor shall provide a statement of the consumer’s right to obtain, upon a written request, a written itemization of the amount financed." Fourth, there are some interesting new disclosures required in the context of consumer real property mortgaged transactions. Under TIL the creditor is required to disclose the finance charge and the total of payments, except in cases where the credit is extended in a sale of a dwelling or a loan secured by a first lien on a dwelling. This exception to the disclosure requirement was built on the assumption that, in these transactions, the total of payments and finance charge could be so forbidding that consumers would be frightened and would withdraw from home purchase transactions. This concern seemed doubtful and had been refuted by experience in some states where

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166See generally, S. Rep. No. 73, 96th Cong., 1st Sess. 3.
171See notes 176-80 infra and accompanying text.
172Regulation Z, 12 C.F.R. § 226.8(c)(4) (1980) (amount financed); id. § 226.8(c)(8) (finance charge); id. § 226.8(d)(1) (amount financed); id. § 226.8(d)(3) (finance charge).
174Regulation Z, 12 C.F.R. § 226.8(c)(8) (1980); id. § 226.8(d)(3).
disclosures were required by state law.\footnote{S. Rep. No. 73, 96th Cong., 2d Sess. 17, reprinted in [1980] U.S. CODE CONG. & AD. NEWS 834, 892.} TILS requires disclosure of the total finance charge and the total of payments in all transactions. Finally, TILS requires disclosure "[i]n any residential mortgage transaction, [of] a statement indicating whether a subsequent purchaser or assignee of the consumer may assume the debt obligation on its original terms and conditions."\footnote{Pub. L. No. 96-221, § 614(a), 94 Stat. 178 (1980) (amending 15 U.S.C. § 1638(a)(13) (1976)).}

f. Remedies.—TILS makes a number of changes in the remedy provisions of TIL. First, an award of civil penalties and attorneys' fees to consumers in private litigation for TIL violations will be available only in the event the creditor fails to comply with one of the important disclosure requirements.\footnote{15 U.S.C. § 1640(a)(3) (1976).} This may reduce some of the litigation over technical disclosure defects. Second, TILS provides that the agencies which have responsibility for enforcing TIL are now authorized to seek restitution from creditors who have violated the truth in lending laws. The new law provides:

In carrying out its enforcement activities under this section, each agency . . . in cases where an annual percentage rate or finance charge was inaccurately disclosed, shall notify the creditor of such disclosure error and is authorized . . . to require the creditor to make an adjustment to the account of the person to whom credit was extended, to assure that such person will not be required to pay a finance charge in excess of the finance charge actually disclosed or the dollar equivalent of the annual percentage rate actually disclosed, whichever is lower.\footnote{Pub. L. No. 96-221, § 608(a), 94 Stat. 171 (1980) (amending 15 U.S.C. § 1607 (1976)).}

The agency must require an adjustment when it determines that the disclosure error resulted from a clear and consistent pattern or practice of violations, gross negligence, or a willful violation intended to mislead the persons to whom the credit was extended.\footnote{Id.} However, there are some mitigating factors. For example, no adjustment should be ordered if the adjustment would have a significantly adverse impact upon the safety or soundness of the creditor.\footnote{Id.} This potential for a broad restitution remedy poses a significant new exposure for creditors.
Finally, there are some miscellaneous changes in remedies. For example, multiple obligors may only recover one civil penalty.\textsuperscript{181} This reverses the position taken by the United States Court of Appeals for the Seventh Circuit.\textsuperscript{182} Also, the period of time during which a creditor may discover and correct an error without being exposed to liability for civil penalties has been extended from fifteen to sixty days.\textsuperscript{183}

2. Acceleration Clauses and Deference to Federal Reserve Opinion.—As Section J.1.e. of this Survey suggests, TILS has eliminated the requirement for disclosure of the amount or method of computing default, delinquency, or charges payable in the event of late payments. Instead, the creditor must state that the customer should refer to the contract document for information on late payment charges or, in particular, acceleration rights. However, this past year, before TILS, the United States Supreme Court decided an issue involving this disclosure requirement which had been resolved in different ways by various courts and by the Federal Reserve Board staff.\textsuperscript{184} The issue is whether an acceleration clause is a term which must be disclosed as a charge payable in the event of late payment. In the course of deciding that acceleration clauses, in and of themselves, were not late payment charges,\textsuperscript{185} the Supreme Court made some interesting observations concerning the deference which should be given to Federal Reserve Board staff opinions construing TIL. The court said that “[u]nless demonstrably irrational, Federal Reserve Board staff opinions construing the Act or Regulation should be dispositive.”\textsuperscript{186} This is because of the general proposition that respect is due interpretations offered by agencies charged with administration of a law, especially with respect to interpretations of regulations which were created by the agency offering the interpretation. Also, Congress has recognized the influence of the Federal Reserve Board’s staff opinions by giving creditors a defense based on good faith compliance with official staff opinions. Finally, the sheer complexity of TIL calls for deference to the agency. In the context of this complexity the correct answer to a problem is often a result of compromise. “[S]triking the appropriate balance is an em-

\textsuperscript{182}Mirabal v. General Motors Acceptance Corp., 537 F.2d 871 (7th Cir. 1976).
\textsuperscript{184}Ford Motor Credit Co. v. Milhollin, 444 U.S. 555 (1980). The various views expressed in the courts and by the Federal Reserve are set forth in the opinion.
\textsuperscript{185}Id. at 561.
\textsuperscript{186}Id. at 565.
pirical process that entails investigation into consumer psychology and that presupposes broad experience with credit practices."^{187}

The Federal Reserve Board staff had repeated the opinion that if a "creditor rebates unearned finance charges in connection with prepayment upon acceleration using the same method as for voluntary prepayment and that method has been properly disclosed . . . there is no default charge."^{188} The Supreme Court embraced this reasoning and reversed the court of appeals decision which rejected it.^{189}

3. Informal Workout Agreements.—In *Bright v. Ball Memorial Hospital Association*,^{190} the court of appeals for the seventh circuit had occasion to decide whether a hospital collection procedure amounted to a credit transaction within the meaning of TIL and whether TIL disclosures were required. This case involved Ball Memorial Hospital which operates a general public hospital admitting all persons without regard to ability to pay. Patients who do not pay bills upon discharge from the hospital are sent an initial bill on the fourth day after discharge which delineates the specific charges assessed to their accounts. On the reverse side of this initial bill is a schedule of information headed "FINANCE CHARGE" which informs the patient that a finance charge of three-fourths of one per cent per month or a fifty cent handling charge, whichever is greater, will be added to any balance unpaid for thirty days or more. No such charge is imposed if the bill is paid in full within the thirty days. If the patient has not made payment on the eighteenth day after discharge, the patient is mailed the first billing statement which indicates a total amount due. This bill states that "[y]our account is now due and payable. Please remit today." On the reverse side of this statement there is again a schedule of information headed "FINANCE CHARGE" which is the same as the schedule sent on the initial bill except that there is some additional information concerning the amounts that will have to be paid monthly in order to complete payment of the amount due. Where no payment arrangements have been made on the forty-eighth day after discharge, the patient is sent a second billing statement identical to the first billing statement, except that the face of the second statement contains a warning in the following language: "No doubt you have overlooked payment of your account, please make your remittance now." At this point the Ball Memorial Hospital considers the account to be

^{187}Id. at 568-69.
^{188}Id. at 563-65 n.8 (quoting Federal Reserve Board information letter number 1324).
^{189}444 U.S. at 570.
^{190}616 F.2d 328 (7th Cir. 1980).
delinquent. If no payment arrangements are made, the hospital sends a third statement on the sixty-second day after discharge. The statement is identical to the first two, except that it contains stronger language. Along with this statement, in-patients automatically receive a coupon payment book which offers the patient various monthly plans for repayment. On the seventy-sixth day after discharge a patient who has not arranged to pay or begun paying her bill is sent a fourth statement identical to the first three except that it bears an even stronger statement on the delinquency. The fifth and final statement is mailed on the ninetieth day. It is stamped "Final Notice" in red ink and warns that the account will soon be turned over to a collection agency. At the same time these written statements are being sent, the hospital attempts to make contact with the patient by telephone. The decision to turn the account over to a collection agency is made on a case by case basis after the fifth and final statement, but no accounts are turned over to a collection agency if the patient is making some form of payment.\footnote{Two patients who received these statements from the hospital filed a class action alleging TIL violations. The United States district court dismissed the action, apparently holding that as to its billing practices, the hospital was not a creditor within the meaning of TIL.\footnote{Id. at 330-32.} The court of appeals concluded that as to some of its patients, the hospital was a creditor;\footnote{Id. at 333.} however, it affirmed the district court's dismissal of the case on the grounds that the hospital did not consummate a credit transaction with either of the named plaintiffs.\footnote{Id. at 336.} One of the plaintiffs, nearly four months after discharge, entered into an oral agreement with the hospital to pay her bill at fifteen dollars per month. Several days later the oral agreement was modified to require payments of twenty dollars per month. No payments were made pursuant to any of these agreements, but several months later the plaintiff paid thirty dollars to the hospital, which amount was credited to her account. Thereafter, another oral agreement was made providing that the entire obligation of about $930 would be satisfied if the plaintiff paid fifteen dollars per month for twenty-four months.\footnote{Id. at 338-39.} The court of appeals concluded that these oral agreements did not constitute "consummation of a credit transaction."\footnote{Id. at 332.} Instead, they were informal workout arrangements. The billing procedures are set forth in a portion of the opinion entitled "Background." Id. at 330-32.}
terms of these oral agreements were not consistent with any of the payment plans set forth in the statements sent by the hospital and they were not memorialized by any writing. They were thus not credit transactions within the meaning of the TIL laws and did not require disclosures despite the fact that they called for payment in more than four installments and may have entailed a monthly charge of three quarters of one per cent on any outstanding balance. The fact that the plaintiff actually paid thirty dollars did not satisfy either of the earlier workout agreements or the terms of the coupon book or statements. It amounted to a one-time partial payment of the account. The hospital's acceptance of this payment did not constitute an agreement to a credit transaction.

4. Finance Charges v. Late Payment Charges.—In the Bright case, the plaintiffs further argued that a credit agreement had been consummated because the hospital had imposed a finance charge in connection with their billing procedure. The plaintiffs pointed out that the hospital actually assessed a monthly charge of three quarter per cent of any outstanding balance or fifty cents, whichever was greater, and attempted to collect these charges. The court of appeals concluded that these charges were not finance charges, but, instead, were late payment charges. A late payment charge is distinguished from a finance charge by Regulation Z, section 226.4(c) which provides that "[a] late payment . . . charge is not a finance charge if imposed for actual unanticipated late payment, delinquency, default, or other such occurrence." The plaintiffs argued that the hospital anticipated a substantial volume of these charges and budgeted income of $78,000 a year from this type of charge. However, the court noted that this income was not anticipated in individual cases, but was anticipated as a result of a year's business. It concluded that charges do not become finance charges simply because a business may expect to have delinquent accounts and anticipate revenue from these charges. Rather, the word "unanticipated" in Regulation Z section 226.4(c) refers to the failure of any particular customer to pay her bill on time. Because the charge was not a finance charge its imposition did not constitute a credit transaction and the district court's dismissal was affirmed.

197Id.

198Id. at 338.

199Id. at 338.


201616 F.2d at 337.

201Id.

202Id.

203Id. at 338-39.