

XVI. Uniform Commercial Code

GERALD L. BEPKO*

A. Introduction

There have been many developments of significance during the survey period on the subjects of commercial and consumer law. Because of the number and complexity of these developments, no effort has been made to discuss them all. Instead, this Survey Article includes a discussion of one significant recent development in each of the following categories: secured transactions, commercial paper, sales, and consumer law. The secured transactions development concerns the priority given to buyers of farm products. On the subject of commercial paper there is a discussion of a bank's right of charge-back under UCC section 4-212, and on the subject of sales there is a discussion of warranty disclaimers and an amendment to UCC section 2-316(3). Finally, in the area of consumer law, a new Indiana statute on health spa services is described.

B. Secured Transactions—Priority for Buyers of Farm Products

The Uniform Commercial Code (UCC) defines and gives a priority to a buyer of goods in the ordinary course of business in at least two situations. Under UCC section 2-403(2),¹ the ordinary course buyer has a priority over the owner of goods who has entrusted the goods to a merchant dealing in goods of that kind. Under UCC section 9-307(1),² the ordinary course buyer also has a priority over a security interest created by the seller even if that security interest is perfected. In this latter context the protection given to the ordinary course buyer does not extend to a person who buys farm products from a person engaged in farming operations unless the security interest was not perfected.³ This lack of protection will be referred to as the "farm products exception" to the basic priority accorded to ordinary course buyers.

The farm products exception is deeply rooted in commercial law history.⁴ In this century ordinary course buyers have been protected con-

*Dean and Professor of Law, Indiana University School of Law-Indianapolis. B.S., Northern Illinois University, 1962; J.D., IIT/Chicago-Kent College of Law, 1965; LL.M., Yale University, 1972. The author wishes to extend his appreciation to Timothy J. Bender for his assistance in the preparation of this article.

¹IND. CODE § 26-1-2-403(2) (1982). There is no farm products exception to the protection accorded by this section.

²*Id.* § 26-1-9-307(1) (Supp. 1983).

³*Id.* § 26-1-9-301(1)(c) (1982) (a buyer not in ordinary course takes priority over an unperfected security interest to the extent that he gives value and reserves delivery without knowledge of the security interest).

⁴See generally, 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY § 26.10 (1965).

sistently against claims of inventory financiers.⁵ Although there seems to be a formal similarity between the inventory buyer and a buyer of farm products, it is clear that, over the decades, the agricultural financier has been more successful in this type of dispute than the inventory financier. Thus, by engrafting the farm products exception on section 9-307(1), the Uniform Commercial Code drafters simply codified existing custom.⁶

It is less clear why the agricultural financier has been more successful. Perhaps it has been because, unlike the typical inventory purchaser, a buyer of farm products often purchases a substantial portion of the farmer's yield. In such a case the purchaser of farm products may be expected to investigate and discover prior liens because he has a sufficient stake in the purchase. Professor Gilmore, in his treatises on security interests in personal property, offered a sociological explanation for the farm products exception:

Perhaps a small country bank holding a small country mortgage makes a more appealing plaintiff than a national finance company doing a multi-million dollar business in inventory financing. . . . [I]t may be that a buyer who is a large cannery or agricultural cooperative—in any case a professional who knows the facts of life—makes a less appealing defendant than the untutored consumer who is the chief beneficiary of the inventory rule.⁷

Professor Gilmore was quick to note, however, that, even in 1965 when he published his books, many of the crop mortgagees were agencies of the United States Government and not small country banks.⁸

Perhaps because there has been no clearly understood basis for the farm products exception, it has come under increasing attack in recent years. Particularly at the insistence of grain dealers and cooperatives, it has been the subject of proposed legislation in many states,⁹ as well as the subject of an increased volume of litigation. Indiana, as a major agricultural state, has had activity on both fronts. Developments in both the Indiana General Assembly¹⁰ and the Indiana Court of Appeals¹¹ during the survey period should increase the protection given to buyers of farm products.

On March 29, 1983, the Indiana Court of Appeals handed down its

⁵*Id.* at § 26.1.

⁶*Id.* at § 26.11.

⁷*Id.* at § 26.10.

⁸*Id.*

⁹*See, e.g.*, ILL. REV. STAT. ch. 26, § 9-307(1) 1974; OHIO REV. CODE ANN. § 1309.26(B) (Page 1979).

¹⁰Act of Apr. 21, 1983, Pub. L. No. 255-1983, § 1, 1983 Ind. Acts 1651, 1651-53 (codified as amended at IND. CODE § 26-1-9-307 (Supp. 1983)).

¹¹*Anon, Inc. v. Farmers Prod. Credit Ass'n*, 446 N.E.2d 656 (Ind. Ct. App. 1983).

decision in *Anon, Inc. v. Farmers Production Credit Association*.¹² In this case the debtor, Flynn, a livestock processor, gave a security interest in hogs to Farmers Production Credit Association of Scottsburg (FPCA). The security agreement included the usual prohibition against sale of the hogs by the debtor without the prior written permission of FPCA. In disregard of this provision Flynn sold hogs to Anon on ten separate occasions between October, 1979, and October, 1980. No written permission for these sales was ever requested or provided. Flynn received ten checks as payment for the hogs, several of which he endorsed over to FPCA, but he kept payments totaling \$12,430.33. When Flynn defaulted, FPCA sued Anon for conversion claiming that its security interest continued in the hogs purchased by Anon. After a bench trial the court held for FPCA stating that FPCA did not consent to the sale, did not intend to waive its security interest, and did not impliedly waive the security interest by the manner in which it did business.¹³ Of course, Anon could not claim protection as a buyer in the ordinary course under UCC section 9-307(1) because of the farm products exception.

The court of appeals reversed. In its opinion the court emphasized the following testimony on cross examination of the managing officer of FPCA:

Q. O.K. So there was no doubt in your mind that Benny was going to sell hogs?

A. That's right.

* * * * *

Q. Now in your security agreement and financing statement there is a section, I believe it is section #6, that states that Benny is not supposed to sell any livestock that is pledged under that particular agreement without the prior written consent of PCA. Is that correct?

A. Yes.

* * * * *

Q. Did you ever require Benny Flynn to—during the course of this particular loan that we are talking about . . . did you require Benny Flynn to get your prior written consent to make a sale of hogs?

A. No.

Q. You never did?

A. No.

Q. Even in spite of what your agreement said you didn't feel that was necessary?

A. O.K. We normally trusted our members to do this and did not.

¹²446 N.E.2d 656 (Ind. Ct. App. 1983).

¹³*Id.* at 657.

Q. O.K. So you trusted Benny Flynn as you stated. He could go out and sell his hogs whenever he wanted but you expected him to bring the proceeds in to you.

A. That's correct.

* * * * *

Q. Once again to sum up your, what I understand your testimony to be, you were aware that Benny was selling hogs and you in fact wanted him to sell hogs. You just expected him and trusted him to come in and bring you the proceeds. Is that correct?

A. That's correct.¹⁴

On the basis of this testimony the court of appeals concluded that FPCA expected Flynn to sell the hogs and account for the proceeds and that the practice between the parties was *not* to enforce the requirement of written permission to sell the hogs.¹⁵ The court said that "[w]hen FPCA consented to the sales on the condition that Flynn remit, it knowingly and intentionally renounced a known right, that is, the right to require prior written consent for each sale."¹⁶ Once this barrier to sale had been eliminated, the disposition was authorized within the meaning of UCC section 9-306(2), which provides that "a security interest continues in collateral notwithstanding sale, exchange or other disposition . . . unless [the disposition] was authorized by the secured party in the security agreement or otherwise . . ."¹⁷ Because the sale was authorized, FPCA's security interest did not continue in the goods sold and the purchaser, even though not protected as an ordinary course buyer by section 9-307(a), took free of the security interest.¹⁸

This result is consistent with decisions in several cases in other states.¹⁹ In particular, the court adopted the result and rationale of *First National Bank & Trust Company v. Iowa Beef Processors*.²⁰ Although the reasoning of *First National Bank* and decisions in other states provide ample support for the court's decision in *Anon*, two noteworthy matters cut against the decision. One of these matters was not considered by the court and the other was considered but rejected. The court considered but rejected a line of cases which have refused to recognize conduct such as

¹⁴*Id.* at 658.

¹⁵*Id.* at 662.

¹⁶*Id.*

¹⁷IND. CODE § 26-1-9-306(2) (1982).

¹⁸446 N.E.2d at 662.

¹⁹See *First Nat'l Bank & Trust Co. v. Iowa Beef Processors*, 626 F.2d 764 (10th Cir. 1980); *Lisbon Bank & Trust Co. v. Murray*, 206 N.W.2d 96 (Iowa 1973); *Farmers State Bank v. Edison Non-Stock Coop. Ass'n*, 190 Neb. 789, 212 N.W.2d 625 (1973); *Baker Prod. Credit Ass'n v. Long Creek Meat Co.*, 226 Or. 643, 513 P.2d 1129 (1973).

²⁰626 F.2d 764 (10th Cir. 1980).

the acquiescence in the *Anon* case as a waiver or authorization to sell.²¹ These cases embrace the proposition that if an agreement is clear on its face, courts should be reluctant to infer a waiver from conduct, should infer a waiver only to prevent fraud, and should allow evidence of “course of dealing” only to interpret, not to contradict, a written term.²² Along this line of reasoning one state amended its commercial code to prevent a waiver by conduct and specifically overruled a decision similar to the one in *Anon*.²³

The *Anon* court did not even consider the Indiana Supreme Court’s recent decision in *Van Bibber v. Norris*.²⁴ One issue in *Van Bibber* was whether the debtor was in default at the time of repossession of the collateral. The debtor argued that the acceptance of late payments without comment operated as a waiver of the secured party’s right to insist on strict compliance with the terms of the agreement specifying time for payment, unless the debtor was notified that the secured party again intended to treat late payment as a default. The supreme court rejected this position on the basis of a provision in the security agreement which stated that “[n]o waiver . . . of any default shall be effective unless in writing, nor operate as a waiver of any other default nor of the same default on a future occasion.”²⁵ The enforcement of this anti-waiver clause, despite inconsistent conduct by the secured party, suggests that the supreme court might also enforce a “no sale without written permission” clause such as the one in the security agreement between *Anon* and FPCA, notwithstanding FPCA’s inconsistent conduct. Indeed the debtor’s specific reliance on the secured party’s conduct in *Van Bibber* seems at least as deserving of protection as the buyer’s position in *Anon*.

The *Anon* case probably will make lending against farm products more hazardous and increase the chances that a buyer will have a priority over the farm products financier. The hazards will not surface in the early stages of a financing relationship for it will take some time for any pattern of conduct which authorizes sale of the collateral to emerge. Nevertheless, at some stage the secured party will have to engage in some additional policing of the collateral and the debtor’s conduct in order to avoid the plight of FPCA. Perhaps some measure of protection against this hazard could be achieved through better documentation. For example, where the collateral is crops, a new security agreement must be executed each year.²⁶ The *Anon* hazards may be circumvented by incorporating into the security agreement a provision which states that the secured party acknowledges

²¹See 446 N.E.2d at 660-62.

²²*Id.* at 661.

²³N. M. STAT. ANN. § 55-1-205(3), (4) (1978) (overruling *Clovis Nat’l Bank v. Thomas*, 77 N.M. 554, 425 P.2d 726 (1967)).

²⁴419 N.E.2d 115 (Ind. 1981).

²⁵*Id.* at 120.

²⁶IND. CODE § 26-1-9-204(4)(a) (1982).

that the collateral under the previous year's agreement may have been sold without written permission, but insists on strict adherence to the requirement for this year's agreement.

Within a few days after the *Anon* decision was handed down, the Indiana General Assembly enacted an amendment to section 26-1-9-307(1) of the Indiana Code which may make the *Anon* case less significant. The amendment adds another measure of protection for farm products buyers and more hazards for farm products financiers. The story of this new legislation really begins in the 1982 Indiana General Assembly. In that session lobbyists who represented grain dealers and warehousemen pressed for more protection for buyers of farm products against farm products financiers. In what appeared to be a compromise, the General Assembly enacted Indiana Code section 26-1-9-307.5,²⁷ which required a secured party who filed a financing statement covering agricultural commodities to send written notice by certified mail to all warehousemen located within the county of the debtor's residence who were licensed under the Indiana Agricultural Commodities Warehousing Licensing and Bonding Statute.²⁸ This notice was to identify the debtor, the person filing the financing statement, and the commodity for which the financing statement was filed.²⁹ Failure by a secured party to give the required notice did not affect the validity or priority of the security interest, but constituted a Class C infraction.³⁰ Grain dealers and warehousemen found this compromise unsatisfactory for two reasons. First, it did not change the basic priority; grain dealers and cooperatives still bought agricultural commodities subject to the secured party's priority. Second, the amendment covered only agricultural commodities as defined in the Agricultural Commodities Warehouse Licensing and Bonding Statute and probably did not apply to cases such as *Anon* where the collateral, though a farm product, was not an agricultural commodity.

As a result of this dissatisfaction, the same forces were back at work in the 1983 General Assembly and Indiana Code section 26-1-9-307 was amended³¹ and Indiana Code section 26-1-9-307.5 was repealed.³² This time the General Assembly changed the basic priority and eliminated the language which created the farm products exception.³³ At the same time the 1983 amendment to Indiana Code section 26-1-9-307(1) created a scheme whereby secured parties may attempt to preserve their historical

²⁷Act of Feb. 25, 1982, Pub. L. No. 157, § 1, 1982 Ind. Acts 1206, 1206-07 (codified at IND. CODE § 26-1-9-307.5 (1982)) repealed by Act of Apr. 21, 1983, Pub. L. No. 255-1983, § 3, 1983 Ind. Acts 1651, 1656.

²⁸IND. CODE § 26-3-7-2 (1982).

²⁹*Id.* § 26-1-9-307.5(4) (repealed 1983).

³⁰*Id.* § 26-1-9-307.5(8), (9).

³¹Act of Apr. 21, 1983, Pub. L. No. 255-1983, § 1, 1983 Ind. Acts 1651, 1651-53 (codified as amended at IND. CODE § 26-1-9-307 (Supp. 1983)).

³²Act of Apr. 21, 1983, Pub. L. No. 255-1983, § 1, 1983 Ind. Acts 1651, 1656.

³³IND. CODE § 26-1-9-307(1) (Supp. 1983).

priority position.³⁴ The new statute provides that a person buying farm products from a person engaged in farming operations is not protected as a buyer in the ordinary course if he "has received prior written notice of the security interest."³⁵ Written notice is defined as "notice on a form prescribed by the Secretary of State" which contains specific information about the security agreement.³⁶ The secured party can employ this written notice through a procedure set forth in the statute. The secured party may request that the debtor provide a list of those persons who are potential buyers of the farm products.³⁷ Indiana Code section 26-1-9-307(1)(c) now provides that, if requested to do so by a secured party, "[a] debtor engaged in farming operations who has created a security interest in farm products must provide the secured party with a written list of potential buyers."³⁸ The secured party may then send the notice on the form provided by the Secretary of State to all of the persons on the list. The secured party thus triggers three provisions of new Indiana Code section 26-1-9-307(1). First, section 9-307(1)(c) provides that "[t]he debtor may not sell farm products to a buyer who does not appear on the list."³⁹ Second, a purchaser must issue a check for payment jointly to the debtor and the secured party from whom he received prior written notice.⁴⁰ Third, the notice prevents those receiving it from gaining a priority as buyers in the ordinary course.⁴¹

With respect to this third provision, in order to be considered "prior written notice" the notice must "be received before a buyer of farm products has made full payment . . . for the farm products."⁴² The notice "expires eighteen (18) months after the date the secured party signs the notice or at the time the debt that appears on the notice is satisfied, whichever occurs first."⁴³ This language may create two interpretation problems. The notice is "prior written notice" if it is received before the buyer has made "full payment." This suggests that the notice is effective, and a buyer will not gain buyer-in-the-ordinary-course protection, if only part payment, such as a down payment, has been made at the time notice is received. It seems harsh to tie buyer-in-the-ordinary-course protection to "full payment"—a requirement not imposed for other buyers in the ordinary course.⁴⁴ Perhaps the courts will prorate losses and give

³⁴*Id.* § 26-1-9-307(1)(a)—(c).

³⁵*Id.* § 26-1-9-307(1)(a).

³⁶*Id.*

³⁷*Id.* § 26-1-9-307(1)(c).

³⁸*Id.*

³⁹*Id.*

⁴⁰*Id.* § 26-1-9-307(1)(d). See *infra* notes 48-51 and accompanying text.

⁴¹IND. CODE § 26-1-9-307(1)(a) (Supp. 1983).

⁴²*Id.*

⁴³*Id.*

⁴⁴A buyer in the ordinary course may acquire goods on secured or unsecured credit. See IND. CODE § 26-1-1-201(9) (1982).

buyer-in-the-ordinary-course protection to the extent payment has been made, although this result is not suggested by the language of new Indiana Code section 26-1-9-307(1). Moreover, the notice may expire at the time "the debt that appears on the notice is satisfied"⁴⁵ although no potential buyers have been notified of satisfaction. This could create uncertainty as to the continuing efficacy of notice, especially in cases where the parties renew their entire documentation each year in order to take account of the limitations on after-acquired interests in crops under UCC section 9-204(4).⁴⁶

Another problem under the new statute concerns satisfaction of the debt. Indiana Code section 26-1-9-307(1)(b) provides that "[a] secured party must within fifteen (15) days of the satisfaction of the debt inform a buyer in writing whenever a debt has been satisfied and written notice . . . had been previously sent to that buyer."⁴⁷ The language of this provision leads to the conclusion that notice of satisfaction need be sent only to "buyers" and not to all persons to whom written notice of the security interest had been sent initially. If this interpretation is correct, this provision seems to have been written on the assumption that the secured party will know of every sale and the identity of any buyer. Undoubtedly this would be so in many cases. The buyer with "prior written notice" would purchase subject to the security interest and all parties would be aware of the purchase. When the debtor paid off the secured credit, the secured party would inform the buyer within fifteen days in accordance with this provision. Nevertheless, it is curious that such an assumption would be made in drafting a statute which addresses problems associated with unauthorized and often clandestine sales of farm products. In any case, this requirement may place a significant policing burden on the secured party or, as a practical matter, force the secured party to provide notice of satisfaction to all persons who received the "written notice" initially.

One of the three benefits triggered by "written notice" is found in new Indiana Code section 26-1-9-307(1)(d), which provides that a purchaser with prior written notice must issue a check for payment jointly to the debtor and the secured party.⁴⁸ A buyer with prior written notice cannot achieve buyer-in-the-ordinary-course protection and generally would take subject to the security interest. As a result, it is likely that the secured party would be protected by being able to recover the collateral and the need for the protection accorded by the jointly payable check requirement would be diminished. The secured party would not be able to claim the collateral, however, where the buyer claims that the sale is authorized under UCC section 9-306(2).⁴⁹ In this situation, the jointly payable check requirement could have its maximum impact. Unfortunately, there is no

⁴⁵IND. CODE § 26-1-9-307(1)(a) (Supp. 1983).

⁴⁶*Id.* § 26-1-9-204(4)(a) (1982).

⁴⁷*Id.* § 26-1-9-307(1)(b) (Supp. 1983).

⁴⁸*Id.* § 26-1-9-307(1)(d).

⁴⁹*Id.* § 26-1-9-306(2) (1982).

sanction imposed for failure to have the check for payment made payable jointly even though criminal sanctions are imposed for failure to meet other requirements of new Indiana Code section 26-1-9-307(1).⁵⁰ One may assume that the drafters would have wanted to insure that a buyer with prior written notice who failed to have the payment check made jointly payable would not achieve a priority under any circumstances, but this is not made explicit in the statute. Perhaps courts would reach this result by analyzing the buyer's conduct under the general obligations of good faith,⁵¹ or by concluding that Indiana Code section 26-1-9-307(1)(d) establishes a liability in favor of the secured party which cannot be discharged except by a jointly payable check.

There is one final curiosity in the new statute. Indiana Code section 26-1-9-307(1)(d) now provides that "[a] purchaser of farm products (on which there is a perfected security interest) . . . who withholds all or part of the proceeds of the sale from the seller, in order to satisfy a prior debt . . . owed by the seller to the buyer, commits a Class C infraction."⁵² For this purpose a prior debt does not include the cost of marketing the farm product or the cost of transporting the farm product to the market.⁵³ It is not clear what vice this provision was designed to address. It is clear, however, that the transfer of farm products to a person in total or partial satisfaction of a money debt does not constitute "buying" and the transferee is not a buyer in the ordinary course of business.⁵⁴ Therefore, under the old or new statute, the secured party could recover collateral sold without authority to such a buyer. Because this does not seem to be a transaction which could be troublesome for the secured party, it is surprising that the drafters prohibited this type of transaction and imposed criminal sanctions. In addition, the breadth of this language may preempt some perfectly innocent transactions. For example, suppose Farmer Jones owes Grain Dealer \$5,000. At the same time Jones owns \$10,000 worth of farm products subject to a perfected security interest in favor of Local Bank which secures a liquidated obligation of \$5,000. Jones wants to sell and Grain Dealer wants to buy the farm products for \$5,000 cash and discharge of the \$5,000 debt. Even if the \$5,000 check for payment was made payable to Jones and Local Bank, and even if the security of Local Bank would not be affected by the sale because Grain Dealer would not qualify as an ordinary course buyer, such an arrangement would seem to leave Grain Dealer exposed to criminal sanctions.

⁵⁰For example, criminal sanctions are imposed on a debtor for selling to a buyer not on a list furnished to a secured party. *Id.* § 26-1-9-307(1)(c).

⁵¹Indiana Code section 26-1-9-306(2) does not include an explicit good faith standard, but section 26-1-1-203 imposes a general obligation of good faith in all transactions. IND. CODE § 26-1-1-203 (1982).

⁵²*Id.* § 26-1-9-307(1)(d) (Supp. 1983).

⁵³*Id.*

⁵⁴*Id.* § 26-1-1-201(9) (1982).

The combined impact of the *Anon* case and the amendments to UCC section 9-307(1) will make it more difficult for a secured party to gain a priority over buyers of farm products. If a secured party takes steps to provide potential buyers with notice under new Indiana Code section 27-1-9-307(1)(a), the buyer of farm products may be prevented from qualifying as a buyer in the ordinary course of business. But even if the secured party has sent notice to all potential buyers on the list provided by the debtor, there still may be a buyer in the ordinary course to take a priority. A debtor who is inclined to sell in violation of the terms of the security agreement surely will pick someone who is not on the list; as to that purchaser, there will be no prior written notice. If it is difficult to find such a buyer in the community where the debtor resides, the debtor's mischief will only be made more complicated and difficult. Even if the purchaser does not qualify as an ordinary course buyer, the *Anon* case will give a purchaser an additional basis for priority. The result of all these developments may be a diminished willingness to accept farm products as collateral with some commensurate increase in price or reduction in the amount of credit available to farmers.

If this matter is the subject of continuing study, one aspect of these transactions should merit special focus. Earlier in this analysis it was suggested that one reason for the farm products exception was that buyers of the farm products are not like purchasers from inventory because their purchases may involve such a substantial part of the seller's product. To the extent that this type of purchaser may deserve different or less protection than an ordinary course buyer, the differences could be reflected in the definition of a buyer in the ordinary course. It may be that some purchasers of farm products, such as consumers purchasing at a roadside stand, should be entitled to protection as buyers in the ordinary course of business, but a purchaser of the entire year's yield of a farmer should not.

C. *Commercial Paper—Collecting Bank Liability for Delay*

For purposes of bank collection, Article 4 of the Uniform Commercial Code distinguishes between payor banks and collecting banks. A payor bank is the bank on which an item such as a check is drawn and by which an item is payable.⁵⁵ A collecting bank is any other bank which handles the item for collection.⁵⁶ For example, assume that Customer has funds on deposit in a checking account at First Bank and Payee has a checking account at Second Bank. Assume further that Customer is indebted to Payee and draws a check on her account at First Bank payable to Payee. Payee then makes a deposit in his account at Second Bank

⁵⁵IND. CODE § 26-1-4-105(b) (1982).

⁵⁶*Id.* § 26-1-4-105(d). The expression "collecting bank" includes depository banks and intermediary banks as defined in Indiana Code section 26-1-4-105(a) and (c).

which includes the check drawn by Customer. In handling this check for Payee, Second Bank is a collecting bank which, through regular banking channels, would bring about a presentment of the item to First Bank, the payor bank.

Article 4 of the Uniform Commercial Code is drafted on the assumption that the payor bank plays a pivotal role in the check collection process. The payor bank should have in its records the authentic signature of persons authorized to draw on an account, the account balance, and stop orders or legal process affecting an account. Also, its actions are often the foundation for firming up numerous provisional transactions in the collection process. Because of this important role, UCC section 4-302(a)⁵⁷ provides that a payor bank must take certain actions promptly, generally before what is called its midnight deadline.⁵⁸ If a payor bank fails to meet these time requirements it is accountable for the item.⁵⁹ This means that the payor bank is liable for the face amount of the item even though the item may have been drawn on an account without funds and recourse by the bank against its customer is unlikely.

In contrast, collecting banks simply serve as agents for collection of items under Article 4.⁶⁰ As such, collecting banks usually possess much less information concerning the items they handle and play a less pivotal role than payor banks. As might be expected, in light of this different role, collecting banks generally are not subject to the same rigid requirements and sanctions as payor banks. UCC section 4-202(1)⁶¹ provides a general standard of ordinary care for collecting banks. In what seems to be a refinement of the ordinary care standard, UCC section 4-202(2) provides that a collecting bank acts seasonably if it takes action, such as giving notice of dishonor, before its midnight deadline.⁶² A reasonably longer time may be seasonable, but UCC section 4-202(2) provides that “the [collecting] bank has the burden of so establishing.”⁶³ UCC section 4-202 does *not* provide any sanctions such as “accountability” for failure of a collecting bank to use ordinary care or to act seasonably.

⁵⁷*Id.* § 26-1-4-302(a).

⁵⁸Indiana Code section 26-1-4-302 is drafted to accommodate a deferred posting practice. The payor bank must act before midnight of the banking day following the day of receipt by settling for it. Normally this is a provisional settlement which may be revoked if the payor bank ultimately decides not to honor the check for reasons such as insufficient funds in the account. In any case, the payor bank must pay or return the item, or send notice of dishonor before its midnight deadline. The midnight deadline for a bank is defined in Indiana Code section 26-1-4-104(1)(h) as “midnight on its next banking day following the banking day on which it receives the relevant item or notice or from which the time for taking action commences to run, whichever is later.”

⁵⁹*Id.* § 26-1-4-302(a).

⁶⁰*Id.* § 26-1-4-201(1).

⁶¹*Id.* § 26-1-4-202(1).

⁶²*Id.* § 26-1-4-202(2).

⁶³*Id.*

The only specific sanction for failure to use ordinary care is found in UCC section 4-103(5), which provides that "[t]he measure of damages for failure to exercise ordinary care in handling an item is the amount of the item reduced by an amount which could not have been realized by the use of ordinary care."⁶⁴

This language makes it clear that, at a minimum, a negligent collecting bank is responsible to its customer for the amount which could have been collected if the bank had exercised ordinary care. In addition, there has been speculation of further potential liability if the collecting bank's negligence consists of failure to give notice of dishonor before the midnight deadline. Most often the collecting bank will give a provisional credit for the item. UCC section 4-212(1) provides that the collecting bank may "charge-back the amount of any credit given for the item to its customer's account . . . if by its midnight deadline or within a longer reasonable time after it learns the facts it returns the item or sends notification of the facts."⁶⁵ This language suggests that there is no right to charge-back or recover the credit if the collecting bank fails to act before its midnight deadline.

During the survey period, in *Appliance Buyers Credit Corp. v. Prospect National Bank*,⁶⁶ the United States Court of Appeals for the Seventh Circuit addressed this question of collecting bank liability under UCC section 4-212(1). In that case, Appliance Buyers Credit Corporation (Appliance) deposited two checks for collection at the Prospect National Bank on October 18, 1979. At that time Prospect National Bank gave a provisional credit to Appliance's account. Prospect National Bank then forwarded the checks through the Chicago Federal Reserve Bank which in turn forwarded the checks to the payor bank, the Corn Belt Bank of Bloomington. On October 22, 1979, the Corn Belt Bank dishonored the checks because there were no funds in the account on which the checks were drawn and notified the Federal Reserve Bank of the dishonor by telephone. On the following day, October 23, 1979, the Federal Reserve Bank notified Prospect National Bank of the dishonor by telephone. The Federal Reserve Bank then mailed the dishonored checks to Prospect National Bank and the checks arrived on October 29th. When Prospect National Bank received the dishonored checks it immediately revoked the provisional credit given to Appliance and notified Appliance of the dishonor. Unfortunately, this was well beyond the midnight deadline for Prospect National Bank since Prospect had been notified of the dishonor on October 23rd. On October 31st the drawer of the check became the subject of a bankruptcy proceeding.

Appliance filed suit against Prospect National Bank claiming that Pros-

⁶⁴*Id.* § 26-1-4-103(5).

⁶⁵*Id.* § 26-1-4-212(1).

⁶⁶708 F.2d 290 (7th Cir. 1983). This was an appeal from a decision of the District Court for the Central District of Illinois.

pect National Bank was liable for the amount of the check because of its delay in giving Appliance notice of dishonor. The district court dismissed the claim. Although the district court acknowledged that Prospect National Bank's failure to give timely notice constituted a failure to exercise ordinary care, the court found that Appliance failed to establish its damages. The court stated that

[b]ecause the plaintiff has not demonstrated that it had a reasonable chance to collect all or part of the amount of the checks, the amount plaintiff was actually damaged, if any, as a result of the bank's failure to exercise ordinary care in notification is pure speculation. . . . Because the court is unable to determine what an appropriate award of damages would be in this case, if any, none can be awarded.⁶⁷

The district court also rejected Appliance's argument that UCC section 4-212(1) made Prospect Bank responsible for the face amount of the check.⁶⁸

Appliance appealed and placed the question of extended liability for a collecting bank under UCC section 4-212(1) squarely before the court of appeals. Two of the three judges sitting for the case agreed with the district judge and the dismissal was affirmed. In their opinion for the court, Judges Coffey and Timbers acknowledged that the Prospect National Bank had failed to give the required notice and that UCC section 4-212(1) conditioned charge-back on giving proper notice. Nevertheless, they concluded that UCC section 4-212(1) "is silent on the measure of damages a depositor can recover, if any, when the bank breaches its duty of giving a timely notice of dishonor and still charges back the provisionally credited check."⁶⁹ They emphasized that the drafters of the Code knew how to establish liability for the face amount of an instrument by use of the word "accountable." The fact that the drafters did not use the word "accountable" in UCC section 4-212(1) suggests that it was not their intention to make a collecting bank automatically responsible for the face amount of the item. Instead they looked to the measure of damages provided by UCC section 4-103(5)—the face amount reduced by the amount which could not have been realized by the use of ordinary care. There was substantial evidence that the check in this case could not have been collected even if notice of dishonor had been given in a seasonable fashion. Judges Coffey and Timbers concluded that the plaintiff had the burden of proving the amount which could have been collected and that, because the plaintiff failed to offer proof on this subject, the district judge was correct in dismissing the case.⁷⁰

⁶⁷*Id.* at 292 (quoting district court order).

⁶⁸*See id.*

⁶⁹*Id.* at 293.

⁷⁰*Id.* at 293-94.

Judges Coffey and Timbers did not base their decision on UCC section 4-212(4), which provides that "[t]he right to charge-back is not affected by . . . failure by any bank to exercise ordinary care with respect to the item but any bank so failing remains liable."⁷¹ This language seems applicable and seems to support their decision. There is some reason to believe, however, that this language is a closed reference to UCC section 4-212(3) and applies only to cases where the collecting bank is also the payor bank. Because Judges Coffey and Timbers did not cite this language in support of their decision, it appears that they concluded that the language was limited in this way.

In his dissent, Judge Cudahy did not adopt Appliance's argument on UCC section 4-212(1), but created an intriguing middle ground position. His thesis was that once it has been established that the collecting bank failed to notify its customer in the time prescribed, UCC section 4-212(1) raises a presumption of injury to the customer. This presumption is combined with the formula for damages found in UCC section 4-103(5) in the following manner. The recovery specified by UCC section 4-103(5) is the face amount of the item reduced by the amount which could not have been realized with ordinary care. Judge Cudahy would have presumed that the injury caused by failure to give timely notice was equal to the face value of the check. The bank could have rebutted this presumption by proving that the item could not have been collected even if timely notice had been given.⁷² This is consistent with the formulation of UCC section 4-103(5) which starts with a base liability to be *reduced* if there has been no injury.

D. Sales—Warranty Disclaimers

While several sections of Indiana's version of the Uniform Commercial Code have been the subject of special interest amendments,⁷³ only one, UCC section 2-316,⁷⁴ dealing with disclaimers of warranty, has been amended more than once.

The first special interest amendment to this section was enacted in 1980, apparently at the instance of livestock producers.⁷⁵ This amendment had the effect of limiting the warranty of merchantability. As amended Indiana Code section 26-1-2-316(3)(d) provides that "with respect to the sale of cattle, hogs, or sheep, there is no implied warranty that the cattle, hogs, or sheep are free from disease, if the seller shows that all state and federal regulations concerning animal health have been complied with."⁷⁶

⁷¹U.C.C. § 4-212(4).

⁷²708 F.2d at 296-97 (Cudahy, J., dissenting).

⁷³See, e.g., IND. CODE §§ 26-1-2-721, -7-403, -9-307 (1982 & Supp. 1983).

⁷⁴IND. CODE § 26-1-2-316 (1982 & Supp. 1983).

⁷⁵Act of Feb. 22, 1980, Pub. L. No. 167, § 1, 1980 Ind. Acts 1523, 1523-24 (codified at IND. CODE § 26-1-2-316 (1982)).

⁷⁶IND. CODE § 26-1-2-316(3)(d) (1982).

Generally, under the UCC, this limitation of warranty could be achieved by use of a warranty disclaimer incorporated in the agreement between a buyer and a seller.⁷⁷ As a result, it is not entirely clear why it was necessary for sellers to press for this amendment. Moreover, since warranties are now limited by statute in Indiana, some buyers, who may believe that they are protected by the warranty of merchantability, will be surprised to find that they are not, even though these buyers have not agreed to any limitation or exclusion of the warranty of merchantability. This could have negative effects on small farmers who purchase livestock. Finally, since other states may not have this limitation on warranty, unnecessary questions concerning choice of law could be raised in sales involving more than one state.

The second amendment to UCC section 2-316 was enacted by the 1983 Indiana General Assembly as House Enrolled Act 1381.⁷⁸ This amendment was a part of a larger effort to address repair and express warranty service on audio or visual home entertainment products such as radios, televisions, and audio or video playback or recording devices.⁷⁹ In addition to these matters of express warranty and service, however, House Enrolled Act 1381 purported to add to UCC section 2-316 another method for limiting or excluding implied warranties. Indiana Code section 26-1-2-316(3)(e) now provides that:

with respect to a sale of audio or visual entertainment products . . . made as a result of a solicitation through a mail order catalog, it is sufficient to exclude all implied warranties in connection with the sale of any product in the catalog, if the contract is in writing and the language in the contract conspicuously states that: (i) the product is sold "as is" or "with all faults"; and (ii) the entire risk as to the quality and performance of the product is with the buyer.⁸⁰

It is not completely clear why this amendment to the UCC was sought. Indiana Code section 26-1-2-316(3)(a) already provided that "unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like 'as is', 'with all faults' or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty."⁸¹ This language

⁷⁷All implied warranties may be disclaimed as long as certain formalities are observed to insure that the buyer willfully and knowingly gave up the protection of the warranties. See generally *Id.* § 26-1-2-316(2), (3) (Supp. 1983).

⁷⁸Act of Apr. 7, 1983, Pub. L. No. 254-1983, § 1, 1983 Ind. Acts 1647, 1647-48 (codified as amended at IND. CODE § 26-1-2-316 (Supp. 1983)).

⁷⁹This Act also created a new chapter on service for audio or visual entertainment products. IND. CODE §§ 26-2-6-1 to -7 (Supp. 1983).

⁸⁰*Id.* § 26-2-316(3)(e).

⁸¹Some courts have held that this language must be conspicuous if found in a writing. See, e.g., *Woodruff v. Clark County Farm Bureau Coop. Ass'n*, 153 Ind. 31, 286 N.E.2d 188

seems to cover all the cases addressed in this new provision and, therefore, this special interest amendment does not appear to create any problems of nonuniformity under the UCC.

E. Consumer Law—Health Spa Services Act

Contracts between consumers and organizations providing health, weight loss, and exercise facilities and services have generated an increasing volume of disputes in recent years. In an effort to address these disputes, regulate these contracts, and reduce consumer dissatisfaction, the 1983 Indiana General Assembly enacted the Health Spa Services Act.⁸²

1. *Coverage of the New Law.*—The coverage of the new law is tied to the expression “health spa services,”⁸³ defined broadly to include

instruction, training, or assistance in physical culture, bodybuilding, exercising, reducing, figure development, or any other health spa service, for the use of the facilities of a health spa, figure salon, weight loss clinic, gymnasium, or other facility used for the delivery of health spa services, or for membership in any group, club, association, or organization formed to deliver health spa services.⁸⁴

This definition appears to cover services provided by a wide range of organizations including some hospitals, athletic clubs, social clubs, and the YWCAs and YMCAs.

Non-profit social or athletic organizations do not seem to have been responsible for the type of activities and problems which are addressed in this new statute; and the drafters may have intended to exclude these organizations from coverage. The new statute defines “health spa” to include only those business entities which offer health spa services and to exclude those entities which are tax exempt under section 501 of the Internal Revenue Code.⁸⁵ Unfortunately, the definition of “health spa services” is not so limited and many provisions of the statute apply to anyone who delivers “health spa services” whether it is a “health spa” or another type of organization. Therefore, it may be that some non-profit organizations will have to examine the new law carefully to determine whether their activities involve health spa services and, if so, what steps they must take to comply with the new law.

2. *Formality Requirements and Documentation.*—Section 2 of the new statute provides that every contract for health spa services must be

(1972). Since the language added by this amendment to UCC section 2-316(3) requires a writing and conspicuousness, no additional protection is provided by the new amendment.

⁸²Act of Apr. 14, 1983, Pub. L. No. 249-1983, § 1, 1983 Ind. Acts 1632, 1632-37 (codified at IND. CODE §§ 24-5-7-1 to -18 (Supp. 1983)).

⁸³IND. CODE § 24-5-7-1 (Supp. 1983).

⁸⁴*Id.*

⁸⁵*Id.*

in writing.⁸⁶ The most important sanction for failure to observe this formality is found in section 10 which provides that “[a] contract for health spa services that does not comply with this chapter is voidable at the option of the buyer.”⁸⁷ Although this formality requirement operates in a slightly different manner than the Statute of Frauds,⁸⁸ it seems to have the same purpose and effect. Section 2 of the new law also requires the entity providing health spa services to furnish the buyer with two forms of documentation: (1) a copy of the written contract and (2) an explanation of the buyer’s cancellation rights.⁸⁹

3. *Cancellation Rights.*—The buyer of health spa services has two cancellation rights under the new statute. First, section 5 provides that every contract for health spa services must give the buyer the right to cancel any time before midnight of the third full business day after the buyer signs the contract.⁹⁰ This is similar to the three-day cooling-off right found in other statutes.⁹¹ The buyer may exercise this cancellation right by “written notice, in any form, delivered in person or mailed by certified or registered mail to the seller at the address specified in the contract.”⁹² This notice must be accompanied by the membership cards which were furnished to the buyer under the contract.⁹³ In the event of cancellation pursuant to this three-day cooling-off right all money paid pursuant to the contract is to be refunded within thirty days of receipt of the cancellation notice.⁹⁴

Section 6 of the new law provides that every health spa services contract must state, in at least ten point boldface type, that the buyer or the buyer’s estate may cancel in four circumstances:

- (1) The buyer dies.
- (2) The buyer becomes totally physically disabled for the duration of the contract.
- (3) The health spa facility operated by the seller is moved to a location that is more than five (5) miles from the original facility.
- (4) The services are no longer available as provided in the contract because of the seller’s permanent discontinuance of operation.⁹⁵

⁸⁶*Id.* § 24-5-7-2.

⁸⁷*Id.* § 24-5-7-10(a).

⁸⁸For example, UCC § 2-201 prevents suits on contracts for sale of goods priced at more than \$500 unless there is either a writing or some other evidence of the existence of the contract. If it is admitted by the person against whom enforcement is sought that there is a contract, the Statute of Frauds barrier of UCC § 2-201 is eliminated. In contrast, the Health Spa Services Act makes any contract which is not in writing, even if admitted, voidable at the option of the buyer. IND. CODE § 24-5-7-10(a) (Supp. 1983).

⁸⁹IND. CODE § 24-5-7-2 (Supp. 1983).

⁹⁰*Id.* § 24-5-7-5(a).

⁹¹See, e.g., UNIF. CONSUMER CREDIT CODE § 2.502(1), 7 U.L.A. 676 (Master ed. 1978).

⁹²IND. CODE § 24-5-7-5(b) (Supp. 1983).

⁹³*Id.*

⁹⁴*Id.* § 24-5-7-5(c).

⁹⁵*Id.* § 24-5-7-6(a).

Section 7 of the statute sets forth procedures for determining the buyer's total physical disability.⁹⁶

In the event of cancellation in one of these four circumstances, the buyer of health spa services is not entitled to a full refund; "[t]he seller may retain the portion of the total price representing the services used or completed plus reimbursement for the expenses incurred in an amount not to exceed twenty-five percent (25%) of the total contract price."⁹⁷ Apparently this means that if the buyer has used six months of a one-year contract, the provider of health spa services may retain one-half of the total price and, in addition, an amount as reimbursement for expenses incurred. It is not clear what items of expense are to be reimbursed under this formula. In any case, the claim for reimbursement may not exceed twenty-five percent of the total purchase price and the total amount due to the seller in the event of cancellation may not exceed the full contract price.⁹⁸

4. *Terms to Protect Customers.*—The new law mandates various contract terms designed to protect customers. For example, no health spa services contract may require payments or financing by the buyer over a period in excess of thirty-six months from the date of the contract.⁹⁹ Moreover, the term of a health spa services contract "may not be measured by or be for the life of the buyer,"¹⁰⁰ and the term of the contract may not exceed three years from the date the contract was entered into, although the buyer may renew the contract for additional periods.¹⁰¹ The new law also provides that "[a] contract for health spa services to be rendered at an existing health spa facility must provide that the performance of the agreed upon services is to begin within forty-five (45) days from the date that the contract was entered into."¹⁰²

Where the services are to be provided at a planned spa facility or a spa facility under construction, the contract for health spa services is voidable at the option of the buyer if the health spa facility and the services are not available within twelve months from the date of execution of the contract.¹⁰³ In addition, where the services are to be provided at a facility to be completed in the future, the new law provides that a bond must be filed with the Secretary of State, issued by a surety company admitted to do business in Indiana, in an amount of \$25,000 or such greater amount as the Secretary of State may specify by rule.¹⁰⁴ Although

⁹⁶*Id.* § 24-5-7-7.

⁹⁷*Id.* § 24-5-7-8(a).

⁹⁸*Id.*

⁹⁹*Id.* § 24-5-7-3(a).

¹⁰⁰*Id.*

¹⁰¹*Id.* § 24-5-7-3(b).

¹⁰²*Id.* § 24-5-7-4(a).

¹⁰³*Id.* § 24-5-7-4(b).

¹⁰⁴*Id.* § 24-5-7-13.

the State of Indiana is the obligee of the bond,¹⁰⁵ section 15 of the new law provides a procedure by which the Secretary of State may make awards from the bond to buyers who have sustained financial losses as a result of a breach of the health spa services contract.¹⁰⁶

5. *Remedies.*—Under section 12 non of the statute's provisions may be waived; any effort to provide for waiver by agreement is void as contrary to public policy.¹⁰⁷ Subject to some cure opportunities which the service provider may invoke, any contract for health spa services that does not comply with the new law is voidable at the option of the buyer.¹⁰⁸ Finally, a seller who violates any provision of the new law commits a deceptive act that is actionable by the Attorney General or a buyer under the Indiana Deceptive Sales Practices Act,¹⁰⁹ and the seller may be subject to the penalties under that Act.¹¹⁰

¹⁰⁵*Id.* § 24-5-7-14(a).

¹⁰⁶*Id.* § 24-5-7-15.

¹⁰⁷*Id.* § 24-5-7-12.

¹⁰⁸*Id.* § 24-5-7-10.

¹⁰⁹IND. CODE §§ 24-5-0.5-1 to -9 (1982).

¹¹⁰*Id.* § 24-5-7-17 (Supp. 1983).

