Indiana Adds Articles 2A and 4A of Uniform Commercial Code

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During the past two decades, the Uniform Commercial Code (U.C.C.), which became part of Indiana law in 1963,1 has undergone major study and revision by its sponsors, the National Conference of Commissioners on Uniform State Laws and the American Law Institute. Twenty years ago, the sponsors made major revisions to Article 9—Secured Transactions and made corresponding changes in other Articles, all of which became part of Indiana’s version of the U.C.C. in 1986.2 More recently, the sponsors have drafted two completely new Articles, 2A—Leases and 4A—Fund Transfers (the subjects of this Article), have made major revisions in Articles 3—Negotiable Instruments and 4—Bank Collections,3 and have recently appointed a drafting committee to review and redraft Article 2—Sales.4

In 1991, the legislature added the two new Articles to the Indiana version of the U.C.C. as Chapters 2.1—Leases and 4.1—Funds Transfers and made corresponding changes in sections of the current Code which are affected by these additions.5 Chapter 2.1, which deals with leases of goods, is virtually identical to the 1990 Official Text of Article 2A.6

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5. 1991 Ind. Acts 2800-88. These new chapters appear at IND. CODE §§ 26-1-2.1 and 26-1-4.1 (Supp. 1991). As indicated supra note 1, reference to sections of these new chapters will be to the generic U.C.C. citation, 2A, rather than to the Indiana citation, § 1-26-2.1, unless the Indiana version differs significantly from the U.C.C. Official Draft.

As of fall 1991, Indiana was one of at least nineteen states to have adopted Article 2A.\textsuperscript{7} Chapter 4.1, which deals with major electronic funds transfers, is virtually identical to the 1989 Official Text of Article 4A.\textsuperscript{8} Indiana is one of at least twenty-eight states to have enacted that Article.\textsuperscript{9}

A complete analysis of the two new chapters would require a book-length work.\textsuperscript{10} This Article will principally highlight the manner in which Chapter 2.1 (Article 2A) affects or changes the law of Indiana with some additional comment about Chapter 4.1 (Article 4A).

\textsuperscript{7}Cf. supra note 2A-101.

\textsuperscript{8}Cf. supra note 26-1-4A-205.

\textsuperscript{9}Cf. supra note 39 ALA. L. REV. 559 (1988).

\textsuperscript{10}See infra notes 90-92 and accompanying text (indicating that Article 2A is essentially a modification and expansion of Article 2—Sales for application to lease transactions). Several books deal only with Article 2, and some are limited even further to specific topics within the article. See, e.g., BARKLEY CLARK & CHRISTOPHER SMITH, THE LAW OF PRODUCT WARRANTIES (1984); HAROLD GREENBERG, RIGHTS AND REMEDIES UNDER U.C.C. ARTICLE 2 (1987); ROBERT J. NORDSTROM, HANDBOOK OF THE LAW OF SALES (1970); GEORGE I. WALLACH, THE LAW OF SALES UNDER THE UNIFORM COMMERCIAL CODE (1981 Supps.); DOUGLAS J. WHALEY, WARRANTIES AND THE PRACTITIONER (1981).
I. Article 2A—Leases

A. Background

Since the promulgation of the first official text of the U.C.C. in 1951 and Indiana's adoption of the Code in 1963, equipment leasing has become a major part of the United States economy. The reasons for this growth are many, although the most prominent include the lessee's reduced cash outlay when equipment is leased rather than purchased, some favorable tax consequences for the lessee, and the lessor's apparently favorable position in the event of a lessee's bankruptcy. These are of particular importance in times of economic difficulties.

Despite this tremendous growth, the development of law specifically applicable to leasing was something of a patchwork that depended to a great extent on the common law of bailment and occasional analogy to the law of sales in the Code's Article 2. In the process of codifying the law of leases, the drafters perceived three basic issues to be resolved, none of which was clear under then existing law: (1) Is the transaction a lease or a security interest? (2) Has the lessor made any warranties to the lessee? and (3) What are the remedies available when the lessee (or the lessor) is in default? If the response to the first question is that the transaction creates a security interest rather than a lease, the "lessor" is required to comply with the secured transactions provisions of the Code's Article 9 in order to protect her interest in the goods with respect to both the "lessee" and third parties. If the transaction creates a lease, Article 9 does not apply. As to questions 2 and 3, the warranty and remedies provisions of Article 2 apply directly to sales, not to leases, and the Article 9 provisions on warranties and remedies apply only to secured transactions. If the transaction is a secured trans-

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12. See supra note 1.
13. See, e.g., Boss, supra note 6, at 576-77. Professor Boss, one of the leading scholars in this field, notes that by 1988, approximately one-third of all new equipment in the United States was leased and that leasing has become a multi-billion dollar industry. Id.
14. See id.
15. See U.C.C. § 2A-101 official cmt. The official comments, although not enacted by any legislature, including that of Indiana, are the product of the drafters of the Code and constitute the first line of interpretation of the meaning of the Code's language. This is particularly true of Article 2A. See Donald J. Rapson, Deficiencies and Ambiguities in Lessors' Remedies under Article 2A: Using Official Comments to Cure Problems in the Statute, 39 ALA. L. REV. 875 (1988). The official comments do not appear in the Indiana Code or the Burns Indiana Statutes Annotated, but are reproduced in West's Annotated Indiana Code.
action, the rights and duties of both "lessor" and "lessee" are governed by Article 9, and if a sale is involved, also by Article 2. If the transaction is a lease, the answers are uncertain.16

During the drafting process, the drafters borrowed extensively from Article 2 and in some instances carried over entire sections with changes made only to reflect the differences between sales and leases. Thus, decisions interpreting Article 2 may be helpful or even persuasive in applying similar provisions of Article 2A.17 As persons familiar with Article 2 well know, that Article is far from perfect. Problems with some of its provisions have arisen since its promulgation forty years ago, and the Article is, at the present time, itself the subject of study by the Code's sponsors.18 However, the drafters of Article 2A elected not to remedy the Article 2 problems when incorporating Article 2 provisions into Article 2A unless absolutely compelled to do so.19 This being so, if and when Article 2 is revised, it will be necessary to make corresponding modifications or amendments to Article 2A.

In addition to codifying the rules relating to the formation of leases and the rights, duties, and remedies of the parties, including some third parties, the drafters of Article 2A attempted to clarify the distinction between leases and other transactions by redefining the line between leases and secured transactions and by establishing a new definition of "finance lease,"20 which also helps in distinguishing a true lease from a secured transaction. The drafters' ultimate success in drawing these lines can be judged only over time.

B. The Definitions

1. Lease or Secured Transaction.—One of the most difficult and

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17. Id.
19. See U.C.C. Art. 2A foreword, 1B U.L.A. 649 (1991); Peter A. Alces, Surreptitious and Not-So-Surreptitious Adjustment of the UCC: An Introductory Essay, 39 Ala. L. Rev. 559, 566 (1988); Boss, supra note 6, at 601; Steven L. Harris, The Rights of Creditors Under Article 2A, 39 Ala. L. Rev. 803, 816-17 n.48 (1988) (The drafters generally adhered "to the 'gag rule': the provisions of Article 2 would be followed unless they were so bad that they caused one to gag.").
20. U.C.C. § 2A-103(1)(g). See the discussion of finance leases, infra notes 30-34 and accompanying text.
controversial problems prior to the promulgation of Article 2A was the actual task of distinguishing between leases and secured transactions. Consequently, an important part of the new Article 2A package is the substantial expansion of the Article 1 definition of "security interest" in section 1-201(37) from a single paragraph to a multi-paragraph, subsectioned provision roughly five times as long. The new definition is much more detailed and attempts to draw a clear distinction between a security interest or lease intended as security, which is governed by Article 9 (and Article 2 if a sale is also involved) and a true lease, which is governed by Article 2A. As noted by the drafters, if the transaction is a lease, the lessee's interest is possessory only. The residual interest belongs to the lessor who need not file a financing statement, but whose ownership of the goods is protected against the lessee's creditors and a trustee in bankruptcy. Thus, the determination of whether the transaction is a lease or security interest is the first step in any analysis.

The focus of the definition is on the facts and economics of the transaction, rather than on the specific intent of the parties. As stated by the drafters:

Reference to the intent of the parties to create a lease or security interest has led to unfortunate results. In discovering intent,


22. Article 1 of the U.C.C., Ind. Code § 26-1-1 (1988), contains general provisions which are applicable to the entire Code.

23. Compare Ind. Code § 26-1-1-201(37) (1988) (old § 1-201(37)) with Ind. Code § 26-1-1-201(37) (Supp. 1991) (new § 1-201(37)). Until the 1991 revision, the section stated: (37) "Security interest" means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer . . . is limited in effect to a reservation of a security interest. . . . Unless a lease or consignment is intended as security, reservation of title thereunder is not a security interest but a consignment is in any event subject to the provisions on consignment sales . . . . Whether a lease is intended as a security interest is to be determined by the facts of each case. However:

(a) the inclusion of an option to purchase does not of itself make the lease one intended for security; and

(b) an agreement that upon compliance with the terms of the lease the lessee shall become or has the option to become the owner of the property for no additional consideration or for a nominal consideration does make the lease one intended for security.

The relevant portions of the definition in new § 1-201(37) are discussed in the text which follows this note.

24. U.C.C. § 1-201(37) official cmt. 37.
courts have relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, are as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor’s lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, amended Section 1-201(37) deletes all reference to the parties’ intent.25

The most important factor that distinguishes a true lease from a sale or loan is whether there is a meaningful residual interest in the goods at the conclusion of the lease term, followed by the determination of who is entitled to that interest. If a meaningful residual interest remains in the lessor at the end of the lease term, the transaction is a lease. If that residual interest is in someone other than the lessor because the lessee may acquire the goods at little or no additional cost or there is no residual interest at all because the goods have no remaining economic life, it is a secured transaction.26 Accordingly, the Code states a definition of “secured transaction” based upon where the residual interest in the goods will be at the end of the transaction as a matter of economic reality.

Pursuant to new section 1-201(37), a transaction in the form of a lease nevertheless creates a security interest as a matter of law if two requirements are met: (1) the lessee’s obligation to pay is not subject to termination by her during the term of the lease and (2) any one of the following is present: (a) the original term equals or exceeds the remaining economic life of the goods; (b) the lessee is required to renew for the remaining economic life of the goods or to become their owner; (c) the lessee has an option to renew for the remaining economic life of the goods either for no consideration or for nominal consideration; or (d) the lessee has an option to buy the goods either for no consideration or for nominal consideration.27 Underlying these requirements is the idea that if the nature of the transaction at its inception is such that the lessee, in the ordinary course of events and as a matter of practical economics, must become the owner of the goods at the end of the lease period, or that there will be no residual economic value to the lessor at the end of the lease, the transaction is a sale and secured transaction rather than a lease. Conversely, if the lessee may terminate the lease or the lease will expire at a time before practical economics clearly dictate that she become the owner of the goods, the transaction is a lease.

25. Id.
26. See Cooper, supra note 6, at 208, 234; Huddleson, supra note 18, at 626.
27. U.C.C. § 1-201(37).
The section also lists five provisions that do not create a secured transaction merely because they are present in the lease. These provisions are: (a) that the present value of the lessee’s total payments equals or exceeds the market value of the goods at the time of the lease; (b) that the lessee assumes the risk of loss or agrees to pay taxes, insurance, registration fees, or service or maintenance costs; (c) that the lessee has an option to renew or to buy the goods; (d) that the lessee has an option to renew for a rent that equals or exceeds the reasonably predictable fair market rent at the time the option is to be exercised; and (e) that the lessee has an option to buy at a price that equals or exceeds the reasonably predictable fair market value at the time the option is to be exercised. The drafters noted that although these factors are used by courts in determining the intent of the parties, these factors are as applicable to a true lease as they are to a secured transaction. As the discussion below indicates, courts have frequently relied on the presence of one or more of these factors in concluding that a secured transaction was created.

2. Leases and Finance Leases.—Article 2A defines “lease” as “a transfer of the right to possession and use of goods for a term in return for consideration, but a sale, including a sale on approval or a sale or return, or retention or creation of a security interest is not a lease.”

The Article also creates a new definition, “finance lease.” For a transaction to be a “finance lease,” it must first be a lease rather than a sale or secured transaction. It must then meet the following three specific requirements: (1) “the lessor does not select, manufacture or supply the goods”; (2) the lessor acquires the goods in connection with the lease; and (3) any of the following: (a) the lessee receives a copy of the contract by which the lessor obtained the goods; (b) the lessee’s approval of that contract is a condition to the lease; (c) before signing the lease, the lessee receives a complete statement of the promises, warranties, limitation of warranties, or damages, furnished to the lessor pursuant to the aforementioned supply contract; or (d) before the lessee signs the lease, if it is not a consumer lease, the lessor informs the lessee of the identity of the supplier (unless selected by the lessee), that

28. Id. § 1-201(37), second (a)-(e). For some reason, § 1-201(37) contains subsections (a)-(d) and a sentence fragment followed by (a)-(e), with no signal, letter, or number to distinguish between the first group of subsections and the second. Later in the section, there appear subsections (x)-(z), with nothing between (e) and (x).
29. See U.C.C. § 1-102(37) official cmt. (quoted in part in the text accompanying supra note 25).
30. See id. §§ 2-326, 2-327.
31. Id. § 2A-103(1)(j).
32. Id. § 2A-103(1)(g) & official cmt. (g).
the lessee is entitled to certain warranties, and that the lessee may communicate with the supplier and receive a statement of the supplier’s promises and warranties.33 The Official Comment describes a finance lease as

a three party transaction. The supplier manufactures or supplies the goods pursuant to the lessee’s specification, perhaps even pursuant to a purchase order, sales agreement or lease agreement between the supplier and the lessee. After the prospective finance lease is negotiated, a purchase order, sales agreement, or lease agreement is entered into by the lessor (as buyer or prime lessee) or an existing order, agreement or lease is assigned by the lessee to the lessor, and the lessor and the lessee then enter into a lease or sublease of the goods. Due to the limited function usually performed by the lessor, the lessee looks almost entirely to the supplier for representations, covenants and warranties.34

The Official Comment notes that many leases of goods back to their seller (sale-leasebacks) are in fact finance leases.35

3. The Cases.—The author has found six cases which directly involved the determination whether, pursuant to then current Indiana law, a transaction couched in lease terms was really a secured transaction under old section 1-201(37).36 To a large extent, the new legislation codifies the approach of one of these cases, In re Marhoefer Packing Co.,37 which is a leading case in the field.

In Marhoefer, if the equipment lease at issue was a true lease, the lessor could reclaim the equipment from the estate of the bankrupt lessee. If it was a lease intended as security for the purchase price, the lessor’s failure to file a financing statement to perfect its security interest under Article 9 rendered the lessor’s position subordinate to that of the bankruptcy trustee.38 The lease was for an initial term of four years,

33. Id. § 2A-103(1)(g).
34. Id. official cmt. (g).
35. Id. For a pre-Article 2A discussion and analysis of finance leasing, see Fairfax Leary, Jr., The Procrustean Bed of Finance Leasing, 56 N.Y.U. L. Rev. 1061 (1981).
37. 674 F.2d 1139 (7th Cir. 1982).
38. At the same time as the lease transaction, the lessee also purchased an identical piece of equipment pursuant to a conditional sale contract. The seller/lessor retained a security interest in this second machine and perfected that interest by an appropriate filing. Title to that equipment was not an issue in the case.
at the end of which the lessee could exercise one of two options: (1) purchase the equipment for $9,968 or (2) renew the lease at $2,990 per year for an additional four years, after which the lessee could purchase the equipment for one dollar. There was, however, no requirement that the lessee exercise either option, and the lessee could return the equipment to the lessor at the conclusion of the initial lease term with no further obligation. The bankruptcy occurred during the initial lease term.

The bankruptcy court found the transaction to be a true lease, but the district court reversed and based on the option to buy for one dollar at the end of the renewal term, concluded that as a matter of law pursuant to old section 1-201(37)(b), the lease was intended as security. The court of appeals agreed with the district court's interpretation of the statute as a general matter, but declared that old section 1-201(37)(b) "does not apply where the lessee has the right to terminate the lease before that option [to purchase for nominal consideration] arises with no further obligation to continue paying rent." Thus, because the lessee in Marhoefer had no obligation to pay rent beyond the first four years, the lease could be a true lease during its initial term. The court noted that had the lessee renewed for the second four year period, at the end of which it would have become the owner for only nominal consideration, the renewal lease would have been a security interest disguised as a lease pursuant to old section 1-201(37).

The court's approach is in close harmony with the intention of the drafters of new section 1-201(37). The elements that demonstrate that a lease is a security interest are the inability of the lessee to terminate and either the lessee's ultimate ownership of the goods for little or no consideration or the exhaustion of the economic life of the goods at the end of the lease term. "An essential characteristic of a true lease is that there be something of value to return to the lessor after the term." It follows that if the lessee may terminate the lease before it becomes economically unrealistic for him not to become the owner or before the economic life of the goods is exhausted, there is something of value to be returned to the lessor, and a true lease is created.

One issue not directly addressed by new section 1-201(37), but dealt with by the court, is the "chameleon" lease. At its creation, a chameleon

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39. See supra note 23.
40. Marhoefer, 674 F.2d at 1143-44.
41. There was also the question of whether the option price at the end of the initial term was nominal, thereby making it economically realistic for the lessee to buy the equipment, in which event the lease would be one intended for security.
42. Marhoefer, 674 F.2d at 1143.
43. Id. at 1145.
lease is a true lease with a substantial residual going back to the lessor at the end of the term but with an option to renew either to the end of the economic life of the goods or for a term ending with a purchase for nominal consideration. The better view, and the one indicated by the court, is that each term should be treated independently and that the treatment of the new term should be based on the economic realities as of the inception of that new term. Thus, the fact that the lessee might purchase for nominal consideration at the end of the second lease term did not change the nature of the initial transaction. Had there been a renewal, however, the lease would have become a secured transaction.

The court also considered the effect of the option to purchase for approximately $9,600 at the end of the first term. If that purchase price was nominal, the transaction might still be a secured transaction under old section 1-201(37). This issue had not been addressed in the lower courts. The court of appeals observed, "In determining whether an option price is nominal, the proper figure to compare it with is not the actual fair market value of the leased goods at the time the option arises, but their fair market value at that time as anticipated by the parties when the lease is signed." This, too, is in harmony with new section 1-201(37), which states that a lease does not create a security interest merely because the lessee has an option to buy "for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed" and that "an additional consideration is not nominal if . . . when the option to become the owner of the goods is granted to the lessee [usually, as in Marhoefer, when the lease is created] the price is stated to be the fair market value of the goods determined at the time the option is to be performed." In Marhoefer, the option purchase price was less than the fair market value at the time it was to be exercised. The Code drafters have observed that when a fixed price is less than fair market value but more than nominal, the determination of lease or security interest must be based on the facts of the transaction. The drafters also noted expressly that the rule of new section 1-201(37) did not deal with the specific facts of Marhoefer because "it would unnecessarily complicate the definition."

44. See Cooper, supra note 6, at 246-47.
45. See Marhoefer, 674 F.2d at 1143-44; Cooper, supra note 6, at 246-47.
46. Marhoefer, 674 F.2d at 1144-45.
47. U.C.C. § 1-201(37)(x). It would seem, however, that when the lease is for the economic life of the goods, the fair market value at the end would be nominal and there would be no residual interest in the lessor, thereby making the lease a secured transaction.
48. U.C.C. § 1-201(37) official cmt., para. 11.
The *Marhoefer* court declared, first, that a purchase price of almost $10,000, which was fifty percent of the fair market value, is not nominal, and second, that the proper price for comparison to the stated option price is not the fair market value at the time the option is to be exercised, as the trustee contended, but the fair market value at the time of exercise as previously predicted when the option was granted. The fair market value at the time of exercise actually may be more or less than that estimate, but that fact alone does not change the transaction from a true lease to one given for security. 49 Indeed, making the actual comparison at the time the option is to be exercised could make the lease-secured transaction distinction turn on the rise or fall of the market, rather than on the nature of the transaction when entered into and could make the rights and duties of the parties turn on fortuitous circumstances rather than on planned consequences.

Finally, the court noted that old section 1-201(37) was silent as to what facts, other than the nominal renewal or purchase price, are to be considered in determining the lease or secured transaction issue. 50 It looked at a list of factors that included the total rent, the lessee's possible acquisition of equity in the goods, the useful life of the goods, the lessor's business, and the payment of taxes and insurance, which are usually the burden of the owner, and ruled that none of these factors changed its conclusion that the lease was a true lease. 51 As observed earlier, in new section 1-201(37), the drafters intended to discourage the "laundry list" approach. 52 The court and drafters agree that the payment of taxes, insurance, and other expenses, is neutral because the rental will be adjusted according to which party is obligated to cover these expenses. The lessee pays them pursuant to a "net" lease. 53

The remaining analysis of the court, particularly with reference to the total rental, the non-acquisition of equity by the lessee, and the useful life of the goods, was also in harmony with new section 1-201(37). The court stated that because the lessee's total rent payment under the first term was less than the purchase price of the goods with interest, the lessee acquired no equity whatever, and because the term of the lease was less than the useful life of the equipment, the transaction was not the conditional sale urged by the bankruptcy trustee. 54 New section 2-201(37) states, as noted earlier, that without the right of the lessee to

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50. *Id.* at 1145.
51. *Id.*
52. *See supra* text accompanying note 25.
53. *See* U.C.C. § 1-201(37), second (b) & official cmt., para. 9; *Marhoefer*, 674 F.2d at 1146.
terminate, a lease for the full economic life of the goods is a secured transaction as a matter of law. The mere fact that the total payout may equal or exceed the fair market value of the goods, however, does not create a secured transaction as a matter of law. It is conceivable that the lessor may be fully compensated for the purchase price of the goods plus interest, yet there may be a significant residual value or economic life at the conclusion of the lease.

*Bolen v. Mid-Continent Refrigerator Co.*, involved a straightforward application of the old section 1-201(37)(b) rule that if the agreement permits the lessee to acquire the leased equipment at the end of the lease term for nominal consideration — in this case, one dollar plus sales tax — the lease was intended as security and the remedies for a lessee’s default are governed by Article 9. Because the lease did not grant the lessee a right to terminate before the conclusion of the lease term, the result would be the same under new section 1-201(37).

The following three state court cases relied on, at least partially, the laundry list approach that new section 1-201(37) seeks to eliminate. In *United Leaseshares, Inc. v. Citizens Bank & Trust Co.*, the dispute was between a bank, which had initially financed a car dealer’s acquisition of four automobiles and ultimately perfected its security interest, and the successor to a lessor under a sale-leaseback transaction in which the dealer sold the cars to the lessor and leased them back. The Indiana Court of Appeals affirmed the trial court’s finding that the lease was a security lease, unperfected under Article 9, and that the bank’s security interest was superior. The court’s ruling was based on the facts that

55. U.C.C. § 1-201(37).
57. The lease agreement stated that it was for a term of four years at $62 per month with an option for a maximum of five additional one year terms at $62 per year. Exhibit A to Plaintiff’s Amended Complaint, Brief for Appellant at 16-19, Bolen v. Mid-Continent Refrigerator Co., 411 N.E.2d 1255 (Ind. Ct. App. 1980). The written shipping order, however, recited that the lessee had the option at the end of the lease term to purchase at one dollar plus sales tax. Exhibit B to Plaintiff’s Amended Complaint, Brief for Appellant at 20, Bolen v. Mid-Continent Refrigerator Co., 411 N.E.2d 1255 (Ind. Ct. App. 1980). The briefs of the parties are in the collection of the library at Indiana University School of Law—Indianapolis.
58. See supra text accompanying note 25.
60. Id. at 1390. Unfortunately, there was a gap of several months in the perfection of the financing bank’s security interest in the cars it financed for the dealer because its filed financing statement had expired, and the sale to the lessor took place during that period. See Appendix to Brief of Appellant, Findings of Facts, Conclusions of Law and Judgment of the Trial Court, Findings of Fact Nos. 42, 43, United Leaseshares, Inc. v. Citizens Bank & Trust Co., 470 N.E.2d 1383 (Ind. Ct. App. 1984) [hereafter F.F.]. Otherwise, the matter might have been resolved simply on the basis of the bank’s perfected
the lessee had assumed most of the obligations of ownership, including all operating expenses, insurance, title and other fees, taxes, and repairs, as listed in Marhoefer, and that the only economically feasible course for the lessee was to become the owner of the vehicles at the end of the lease term due to the low lease end value established by the lessor. 61

The lease-secured transaction analysis was actually unnecessary to the result because the lessor, who did not buy in the ordinary course of business, knew that the sale was in violation of an existing security interest in the automobiles. 62 Thus, the bank’s position was superior to that of the lessee. However, because the court explored the lease-secured transaction issue so extensively, it is necessary to do so here. An analysis of the case using new section 1-201(37) does not lead to the same conclusion concerning the nature of the transaction.

Both the trial court and the court of appeals observed that the “low lease-end value” made purchase of the automobiles the only “economically feasible course” for the dealer to follow. 63 In the sale-leaseback transaction, however, the dealer received $7,300 from the original lessor for each of the four automobiles 64 and, at the end of the two year lease term, had the option to buy each back at $3,796, described by the lease as the wholesale fair market value and by the trial court as being “very conservative (low).” 65 The trial court specifically found that the value “was not nominal or free” and that as of the date of the trial, approximately six months after the inception of the two year lease, the fair market value of the cars was $6,000 each. 66 Although it might make good economic sense for the lessee to take advantage of a good deal,
and the parties might have anticipated that he would do so, he was not obligated to do so. The price was far from nominal and was, based on any common understanding of automobile depreciation, probably fairly close to what would have been the wholesale value of the cars after two years. The residual value of the two-year-old cars to the lessor, based on remaining economic life, was considerable. Thus, under new section 1-201(37), the transaction appears to be a true lease.

One point not considered by the court was the fact that the lease provided that if the lessee did not purchase the vehicles, the lessor would sell them. If the sale price was less than the end price fixed in the lease, the lessee would make up the difference. If it was greater, the lessee would receive the excess.67 This type of provision is referred to as a "terminal rental adjustment clause" (TRAC), about which section 1-201(37) is completely silent.68 Whether or not a TRAC lease is a true lease has not been resolved in Indiana. Courts in other jurisdictions are divided on this issue.69

Once it is established that the transaction qualifies as a lease, the fact that it is a sale-leaseback used by the seller-lessee as a financing tool does not disqualify it or make it subject to Article 9. Article 2A expressly recognizes sale-leaseback transactions as valid leases.70 The drafters note that "[m]any leases that are leases back to the seller of goods (Section 2A-308(3)) will be finance leases."71

The court in McEntire v. Indiana National Bank72 stated that old section 1-201(37) established two ways for determining if a lease is really a conditional sale subject to Article 9: first, if the lessee has an option to purchase at the end of the lease for only nominal consideration, and second, if the transaction reflects certain court-established factors (the

68. See Huddleson, supra note 18, at 638-41.
69. Compare, e.g., In re Tulsa Port Warehouse Co., 690 F.2d 809 (10th Cir. 1982) and Bill Swad Leasing Co. v. Stikes, 571 F.2d 1361 (5th Cir. 1978) (not a lease because lessee takes all risk of appreciation or depreciation) with Budget Rent-A-Car v. Bergman, 175 Cal. Rptr. 286 (Cal. Ct. App. 1981) (a lease because lessor has substantial residual interest). See Huddleson, supra note 18, at 638-41.
70. Section 2A-308(3) states in part: "[R]etention of possession of the goods pursuant to a lease contract entered into by the seller as lessee and the buyer as lessor in connection with the sale or identification of the goods is not fraudulent if the buyer bought for value and in good faith."
71. U.C.C. § 2A-103(1)(g) official cmt. (g). See the initial discussion of finance leases, supra notes 32-35 and accompanying text.
72. 471 N.E.2d 1216 (Ind. Ct. App. 1984). If the lease in this case was in fact a secured transaction, the guarantor was entitled to raise the defense that the sale of the collateral was commercially unreasonable, an issue of fact which precluded summary judgment for the lessor of telephone equipment.
laundry list). The court could not, as a matter of law, declare that the option price of $710 was nominal because there was no evidence of the fair market value of the leased telephone system at the time the option to purchase would have been exercised. The following factors, however, led the court to conclude that the lease was a secured transaction as a matter of law: the lessee had an option to purchase; the lessor purchased the system from a supplier; third parties were required to sign a guaranty; the lessee was responsible for insurance, taxes, other expenses, and risk of loss; the total rent equaled the purchase price plus interest; the defaulting lessee could be held responsible for the total unpaid rent or the balance less proceeds of resale; and the option price was less than twenty-five percent of the list price. The court referred to the percentage of list price as an "economic realities" test.

Under new section 1-201(37), the only one of these factors which might justify finding a secured transaction rather than a lease is the option price, but not based upon that price being a particular percentage of the original list price, as the court's "economic realities" test mandated. The drafters rejected proposals that would rely on artificial formulae or specific percentages as determining factors. In particular, they rejected a proposal that an option price below a fixed percentage of original cost, such as ten percent, constituted nominal value and demonstrated conclusively that the lease was a secured transaction. In a particular situation, nine percent of original cost could be fair market value at the time of the exercise of the option and, therefore, not nominal.

The problem created by the McEntire fact pattern, and perhaps in Marhoefer and United Leaseshares as well, is that the option price fixed in the lease ultimately may be more or less than the actual fair market value at the time the option is to be exercised. If less, the provision may give rise to a "bargain option," which, nevertheless, should be construed as consistent with a true lease unless the consideration is indeed nominal. Only an extreme case should take a bargain option outside the range of the reasonably predictable fair market value. The test remains "whether, as a practical matter, at the outset of the transaction, the lessor had an economically meaningful interest in the residual."

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73. Id. at 1221-22.
74. Id. at 1222.
75. Id.
76. See Huddelson, supra note 18, at 628-33. The drafters also rejected a proposal that an option price of 75% of the estimated fair market value demonstrated a true lease. Id.
77. Id. at 636-38.
78. Id.
McEntire, although “economic realities,” to use the court’s term, might make the purchase a good deal for the lessee, the lease should be considered a secured transaction only if the purchase was compelled by a price of nominal consideration or if the economic life of the leased goods was exhausted.

The other factors recited by the court to support its position would not, under new section 1-201(37), justify finding a secured transaction rather than a lease. That the lessee had an option to purchase and was required to pay insurance, taxes, and other expenses does not demonstrate that the lease was for security. 79 That the lessor purchased the equipment from a supplier and required guarantors of payment resembles the “finance lease” of Article 2A, which is a valid lease, not a secured transaction. 80

In Morris v. Lyons Capitol Resources, 81 the lessees agreed to lease agricultural equipment for a total rent which exceeded the cost of the equipment plus interest, agreed to pay for insurance, taxes, license fees, and repairs, and had an option at the end of the lease term to renew for another year at the fair rental value or to purchase the equipment for its fair market value. Citing United Leaseshares and McEntire, and referring to the factors listed in both cases, the court concluded that a sufficient number of those factors were present to indicate that the lease was intended as security. 82 As already noted, under new section 1-201(37), none of these factors support a finding of a secured transaction rather than a lease.

Also, because the option price was fair market value, the court said it could not conclude that the price was nominal. 83 Neither could the court conclude that the option price would have been less than twenty-five percent of the original cost, one of the factors in McEntire, although it noted that the challenged repossession and resale during the third year of the five year term yielded $44,000 in a declining market for such equipment. 84 As with McEntire, the inquiry under the new provision should be whether there is any meaningful residual economic life at the end of the lease term, not the application of a particular formula based on a percentage of cost.

Finally, because the original party with whom the lessees agreed immediately assigned the agreement to a leasing company, the court

79. See U.C.C. § 1-201(37)(b), (c).
80. See the discussion of finance leases at supra notes 32-35.
81. 510 N.E.2d 221 (Ind. Ct. App. 1987). As in McEntire, the issue was the commercial reasonableness of the repossession and sale of the “leased” equipment and the appropriateness of summary deficiency judgment for the lessor.
82. Id. at 223.
83. Id.
84. Id. at 223 n.3.
concluded that the leasing company purchased the equipment from that original party "in order to provide financing while retaining a security interest." As with McEntire, this more closely resembles the "finance lease" of Article 2A than a secured transaction under Article 9.

TKO Equipment Co. v. C & G Coal Co., adds an interesting twist because the lessor argued that the transaction created a security interest, not a lease, which is the reverse of the usual argument. The printed lease for two earthmovers provided for a monthly rent of $15,000, a minimum term of one month, and an option to purchase the equipment for $90,000 at any time during the term of the lease with full credit for rental payments previously made. The lease also expressly declared that because the lessee was under no obligation to purchase the equipment, the lease was not to be construed as creating a security interest. Despite this disclaimer, the lessor immediately filed a financing statement asserting that it had a security interest in the equipment.

It was necessary for the lessee to have substantial repairs performed on the earthmovers, but the lessee was unable to pay the repair company. After the lessee had made its sixth monthly payment, thereby becoming entitled to ownership of the earthmovers, the repair company filed its own financing statement. However, because the lessee was behind on other payments to the lessor and (the parties assumed) the lessee had previously signed a future advances clause, the right of the repair company turned on whether the agreement was a lease or a secured transaction.

The district court characterized the transaction as a disguised sale-secured transaction and held in favor of the lessor who had a prior perfected security interest. The court of appeals concluded otherwise, ruled that the transaction was a lease, and held in favor of the repair company. The latter court observed that this case was the reverse of the usual situation in which the "lessor" claims the transaction is a lease in order to recover the goods from a trustee in bankruptcy. In TKO, the "lessor" wanted the transaction to be secured, so that its alleged prior perfected security interest would be superior to the security interest of the repairer. If it was a lease, at the end of which the lessee virtually automatically became the owner of the goods, the lessor's attempt to perfect a prior security interest by filing would be ineffective and irrelevant, and the repairer would prevail as having a prior perfected interest in the equipment.

Of major importance to the court of appeals was the fact that the language of the lease agreement emphatically denied that the transaction

85. Id. at 223 n.2.
86. 863 F.2d 541 (7th Cir. 1988).
87. Id. at 546.
88. Id. at 544.
created a security interest, but the lessor, nevertheless, filed a financing statement. The court refused to allow the lessor to have it both ways and ruled, in effect, that the language used by the lessor estopped it from claiming that a secured transaction was created.\textsuperscript{89}

Applying new section 1-201(37) and Article 2A to the transaction, the agreement takes on the characteristics of a chameleon lease, discussed earlier in connection with \textit{Marhoefer}. At its inception, the transaction fulfilled the definitional requirements of new section 1-201(37) that it be terminable by the lessee with no further obligation and have a substantial residual value to the lessor. By the time the sixth payment of $15,000 was made, however, the lessee had the right to ownership, and there was no residual value for the lessor. At some time during the six month lease term, the lease changed into a secured transaction. The questions a court should explore under the new statutory provisions are whether the financing statement filed at the inception of the lease term protected the lessor at the time of the change, whether the previously perfected security interests of the lessor included this after acquired equipment, or whether the lessor had an unperfected security interest, subordinate to the security interest of the repairer who had filed. The estoppel question might still be pertinent to whether the repairer was induced by the security disclaiming language of the lease agreement (a) to release its repairer’s possessory lien, which would have been superior to any other security interest, perfected or not, by returning the repaired equipment to the lessee and (b) to gamble on the ability to perfect by filing once the lessee acquired ownership rights in the equipment at the end of the lease term.

\textbf{C. The Substantive Provisions}

In the view of the drafters of Article 2A, “[t]he lease is closer in spirit and form to the sale of goods than to the creation of a security interest.”\textsuperscript{90} Consequently, the drafters relied heavily on Article 2—Sales for both format, including some numbering, and substantive provisions,

\textsuperscript{89} \textit{Id.} at 544-46. Pursuant to U.C.C. § 9-408, a true lessor may file a financing statement, “but its filing shall not of itself be a factor in determining whether or not the . . . lease is intended as security (Section 1-201(37)). However, if it is determined for other reasons that the . . . lease is so intended, a security interest of the . . . lessor which attaches to the . . . leased goods is perfected by such filing.” \textit{Id}. The Official Comment notes that a true lessor may “file for safety even while contending that the lease is a true lease for which no filing is required.” \textit{Id}. § 9-408 official cmt. 2. Thus, the filing is neutral, and other factors will determine the ultimate classification.

\textsuperscript{90} \textit{Id}. § 2A-101 official cmt. statutory analogue.
many of which were incorporated into Article 2A bodily, with only some language changes to reflect the nature of the transaction as a lease rather than a sale. As with the Sales Article, the first digit of the three number section designation following the article (or Indiana chapter) number is an indicator of the general subject matter of that group of sections. Thus, section 2.1-102 “Applicability” is in a group of general provisions, and section 2.1-201 “Statute of Frauds” is in a group of sections dealing with contract formation.

1. Part 1 — The General Provisions.—Of particular note in the general provisions of Article 2A, in addition to the definition of “finance lease” discussed earlier, is the definition of “consumer lease,” a lease between a merchant lessor and an individual “who takes under the lease primarily for a personal, family or household purpose, if the total payments” excluding options do not exceed $25,000. Unlike Article 2, which does not contain any provisions directed specifically to consumer issues, Article 2A contains a number of provisions directed only to consumer leases. One of these provisions makes unenforceable a choice of law other than that of the residence of the consumer lessee.

Also of note is the inclusion of a provision expressly authorizing a court to take appropriate action in the event the lease contract or any clause in it was unconscionable when the contract was made. More specifically, if the court finds that a consumer lease was induced by unconscionable conduct or that unconscionable conduct occurred during collection under a consumer lease, “the court may grant appropriate relief.”

91. See supra note 10 and accompanying text. With respect to the similarity in numbering, for example, the Statutes of Frauds in the Sales and Leases articles are found in §§ 2-201 and 2A-201, respectively, and the Parol Evidence Rules are found in §§ 2-202 and 2A-202, respectively.

92. See 1B U.L.A. 44 (Supp. 1991), which contains the heading, “Part 1 General Provisions,” preceding the § 2A-1 series of sections. The other headings are: “Part 2 Formation and Construction of Lease Contract,” id. at 57; “Part 3 Effect of Lease Contract,” id. at 64; “Part 4 Performance of Lease Contract: Repudiated, Substituted and Excused,” id. at 84; and “Part 5 Default,” id. at 87. Although the Indiana Code utilizes individual section headings similar to those of the 1990 Official Draft, it does not utilize the Part headings. Neither does the West annotation, although West is the publisher of U.L.A. For an example of the difference in sections headings, compare § 2A-102 (Scope) with § 26-1-2.1-102 (Applicability).

93. See the discussion supra notes 32-35 and accompanying text.

94. See U.C.C. § 26-1-2.1-103(e). The 1987 Official Draft set the figure at $25,000; the 1990 Official Draft leaves the amount blank for a determination by the enacting state’s legislature.

95. See id. § 2A-103 official cmt. (e) (citing a number of such sections).

96. Id. § 2A-106.

97. Id. § 2A-108(2).
2. Part 2 — Formation and Construction.—The statute of frauds, parol evidence rule, general formation, firm offer, manner of acceptance, course of performance, and modification provisions of Article 2A are similar to those in Article 2.98 The monetary floor above which a lease must be evidenced by some writing, with enumerated exceptions, is $1,000.99

The drafters deemed it unnecessary to include a section similar to section 2-207 on the “battle of the forms,” apparently because they thought that such battles are unusual in leasing transactions.100 In Rockwood Manufacturing Corp. v. AMP, Inc.,101 however, the court was confronted with precisely such a battle. Following discussions about the leasing of a machine, the lessor sent a quotation to the lessee which stated that it was not an offer and that all orders were subject to acceptance by the lessor in accordance with its standard acknowledgement form. The lessee sent a purchase order which incorporated the quotation by reference and included a $14,000 check as requested therein. The lessor returned its standard acknowledgement form which disclaimed warranties and limited remedies. It also cashed the check.

The court of appeals affirmed the trial court’s conclusion that the U.C.C. did not apply, that the cashing of the $14,000 check did not constitute an acceptance, and that because the acknowledgement form contained terms additional to those in the purchase order, it constituted a counter-offer which was accepted by the lessee when it took delivery of the machine and did not object to the terms in the acknowledgement.102 The court specifically declared that the “mirror image” rule applies in Indiana and controlled the case.103

Section 2-207 was specifically designed to do away with the mirror image rule and the “last shot doctrine” which it perpetuates.104 Unfortunately, without a parallel provision in Article 2A, both will continue to apply unless the courts, as a matter of common-law development, are willing to deal with a battle of the forms in the manner suggested by section 2-207 and the Restatement (Second) of Contracts.105

98. Compare id. §§ 2A-201 to -208 with id. §§ 2-201 to -209.
99. Id. § 2A-201.
100. See Huddleston, supra note 18, at 620.
101. 806 F.2d 142 (7th Cir. 1986).
102. Id. at 144.
103. Id.
105. Restatement (Second) Contracts § 59 (1981), states “A reply to an offer which
Article 2A includes all of the warranties created in Article 2, whether express or implied.  However, if the lease is a finance lease, in which the lessor is actually only a financing party and the lessee looks to the supplier of the goods for performance of warranties, the finance lessor does not make a warranty against infringement, nor does the lessor make either an implied warranty of merchantability or of fitness for particular purpose. Instead, the lessee under a finance lease is expressly made the beneficiary of all promises and warranties by the supplier of the goods to the finance lessor under the supply contract by which the finance lessor obtains the goods in the first place.

Disclaimer or modification of warranties is the same as in Article 2, except that, unlike Article 2, Article 2A requires the disclaimer of the implied warranty of merchantability to be conspicuous and in writing. The strict horizontal privity requirements of Indiana’s Article 2 have been continued by the adoption of Alternative A to section 2A-216.

The Article 2A provisions concerning risk of loss, that is, which party bears the loss in the event of damage or destruction of the goods through no fault of either of them, have made little change in the prevailing common law. The statute states that except in the case of a finance lease, or unless the parties agree otherwise, risk of loss does not pass to the lessee, but remains on the lessor. However, if the lease is a finance lease, risk of loss passes to the lessee.

Prior to the enactment of Article 2A, leases of goods were governed by the common law of bailment. If the goods were in good condition when received by the bailee and in damaged condition when returned or not returned at all, there was an inference that the loss was caused by the negligence of the bailee. The bailee had the burden of producing

purports to accept it but is conditional on the offeror’s assent to terms additional to or different from those offered is not an acceptance but is a counter-offer.” The comment adds, “[b]ut a definite and reasonable expression of acceptance is operative despite the statement of additional or different terms if the acceptance is not made to depend on assent to the additional or different terms,” followed by a citation to § 2-207(1).

106. See U.C.C. § 2A-210 (express warranties); id. § 2A-211 (warranties against interference and infringement); id. § 2A-212 (implied warranty of merchantability); id. § 2A-213 (implied warranty of fitness for particular purpose); id. § 2A-210, official cmt. (purposes).

107. See id. § 2A-211(2).
108. See id. §§ 2A-212, -213.
109. See id. § 2A-209.
110. Compare id. § 2-316(2) with id. § 2A-214(2).
112. Id. § 2A-219(1).
evidence, but not the burden of proof, that he was without fault. Once the bailee produced evidence of lack of fault, the burden of proof was on the bailor. If, indeed, the bailee was without fault, he was not liable for the loss.\textsuperscript{114} The obligations of the bailee, however, could be expanded by agreement to impose liability for loss regardless of fault, as where the lease agreement requires the bailee to return the goods in as good condition as received, reasonable wear and tear excepted.\textsuperscript{115} It is highly likely that most leases under Article 2A will contain a similar provision and that courts will continue to interpret such provisions as a contractual modification of the statutory allocation of risk of loss. Automobile lessors, for example, typically inform lessees that the lessees will be responsible for any damage and try to persuade the lessees to purchase additional insurance. Once it is determined that risk of loss will pass from the lessor to the lessee, the provisions on when risk passes are similar to those in Article 2.\textsuperscript{116}

3. Part 3 — Effect of the Lease Contract.—The 300 series in Article 2A deals primarily with the relationship between the lessor, lessee, and third parties, and is derived from both Article 2 and Article 9.\textsuperscript{117} Both voluntary and involuntary transfers of either party’s interest will be effective, regardless of a lease term prohibiting any transfer. However, a prohibited transfer may be a default under the lease, thereby entitling the nontransferring party to various remedies. Even if not prohibited, the transfer may adversely affect the rights or duties of the nontransferring party, thus entitling her to damages and/or cancellation of the lease.\textsuperscript{118}

In a fashion similar to the ability of a holder of voidable title to transfer good title under section 2-403, a subsequent lessee from a lessor who had already leased the goods can obtain a good leasehold, subject to the existing lease.\textsuperscript{119} Similarly, a buyer or sublessee from a lessee takes what the lessee had the power to transfer, subject to the lease agreement.\textsuperscript{120}

In McDonald’s Chevrolet, Inc. v. Johnson,\textsuperscript{121} the lessee of a motor home for a thirteen day term traded the home to a dealer as partial

\textsuperscript{114} See id.
\textsuperscript{116} Compare U.C.C. §§ 2-509 to -510 with id. §§ 2A-219 to -220.
\textsuperscript{117} See id. §§ 2A-301 to -311 official cmts. uniform statutory source.
\textsuperscript{118} See id. § 2A-303 & official cmts.
\textsuperscript{119} See id. § 2A-304 & official cmts.
\textsuperscript{120} See id. § 2A-305(1) & official cmts.
\textsuperscript{121} 376 N.E.2d 106 (Ind. Ct. App. 1978).
payment for a truck. That dealer sold it to a second dealer who intended to resell it. After the police seized the motor home from dealer two, dealer two sued his seller (dealer one) for breach of the warranty of title. In applying section 2-403, the court determined that the trade-in was a sale and that the sale by dealer one to dealer two could stand only if dealer one had voidable title. The court stated that the lessee had only a possessory interest limited to the lease term of thirteen days and that this possessory interest was all that he could transfer. Accordingly, dealer one had void title and had breached the warranty. The result would be the same under section 2A-305 because any subsequent buyer from a lessee takes subject to the lease. Upon the expiration of the lease term, the lessee has no title whatever.

Article 2A is consistent with Article 9 in that a statutory possessory lienholder (such as a repairman) has priority over the rights of the lessor or lessee, but other creditors of the lessee take subject to the lease contract, as do creditors of the lessor under ordinary circumstances. The remaining sections of Article 2A’s 300 series contain detailed rules regarding leased goods which become fixtures or accessions and permit the parties to agree to subordinate a priority. Of special importance with respect to goods which become fixtures is the provision permitting the lessor to perfect his interest in the goods and obtain priority over creditors of the lessee by filing a financing statement as a fixture filing pursuant to the rules of Article 9 even though the lease agreement is a true lease and not a security agreement.

4. Part 4 — Performance: Repudiated, Substituted, or Excused.—The provisions on insecurity and adequate assurances of performance, anticipatory repudiation and retraction thereof, substituted performance, and excused performance (impracticability) are essentially the same under Article 2A as under Article 2.

The promises of the lessee under a finance lease that is not a consumer lease become irrevocable and independent of the lessee’s acceptance of the goods. This provision is a codification of the “classic ‘hell or

122. U.C.C. § 2-312(1).
123. McDonald’s Chevrolet, 376 N.E.2d at 109.
124. Id.
125. Id.
128. See id. §§ 2A-309, -310.
129. Id. § 2A-311.
130. See id. § 2A-309(9).
132. Id. § 2A-407(1).
high water' clause'' by which the lessee must continue to pay the rent regardless of any defect in the goods, failure of the goods, or failure in the lessor's performance. As noted earlier, the finance lessee has the benefit of all promises made to the lessor by the supplier of the goods, including any warranties of quality.

5. Part 5 — Default.—In its provisions on default and remedies, Article 2A resembles both Articles 2 and 9. As provided in Article 2, there may be a breach of the lease agreement by either party, thereby entitling the nonbreaching party to a variety of remedies, including damages. As in Article 9, the lessor may be entitled to repossess the goods in the event of a breach or default in the same manner as a secured party. Whether the lessee is in default and what remedies will be available to the other party will be determined by provisions of both Article 2A and the lease agreement itself. These provisions are quite detailed and will be discussed here only in summary fashion.

As in Article 2, a remedy may be limited or made exclusive by agreement, but if any limitation of remedy fails of its essential purpose or is unconscionable, the lessee may resort to all available remedies. The parties may also liquidate damages either by a set amount or by a formula based on anticipated harm. Subject to any offset for actual damages, a breaching nonconsumer lessee who has made some payments but has not yet received the goods may recover, by way of restitution, twenty percent of the present value of the total rent due under the lease; a consumer lessee may recover the lesser of that figure or $500.

The statute of limitations in Article 2A, like that in Article 2, is four years from the accrual of the cause of action. However, unlike Article 2, the cause of action under Article 2A accrues when the default or breach of warranty is or should have been discovered by the nonbreaching party. Under Article 2, the cause of action accrues at the time of delivery in the case of a breach of implied warranty or an express warranty that does not extend to future performance.

133. See id. official cmts.
134. See id. § 2A-407 official cmt. 2. See also supra notes 106-09 and accompanying text.
136. Id.
137. Id.
139. Id. § 2A-504(1).
140. See id. § 2A-501(3), (4).
141. Compare id. § 2A-506 with id. § 2-725.
142. Id. § 2A-506.
143. Id. § 2-725.
The rules concerning the lessee's right to reject the goods, duties with respect to rejected goods, cure by the lessor, acceptance of the goods and the effect thereof, and rejection of the goods are substantially similar to those set forth in Article 2, but have been rewritten to reflect the fact that a lease is involved.\textsuperscript{144} There are also some important changes. For example, if the lessor fails to give instructions following rejection, a merchant lessee must arrange to dispose of goods which threaten to decline in value speedily,\textsuperscript{145} whereas a buyer is expressly required to do so only if the goods are perishable.\textsuperscript{146}

In the case of a finance lease, if the lessee has accepted the goods with knowledge of a nonconformity, the lessee may not thereafter revoke acceptance because of that nonconformity,\textsuperscript{147} but the lessee will still have his warranty claim against the supplier.\textsuperscript{148} In any other case, or if a finance lessee accepts the leased goods without knowledge of the nonconformity, revocation is the same as under Article 2.\textsuperscript{149} A lessee must give notice of breach and, except for a consumer lessee, of possible third party liability to the lessor. In the case of a finance lease, notice must also be given to the supplier. Any remedy against the party not notified will be barred.\textsuperscript{150} Because, unlike a seller, a lessor may have continuing duties under the lease, the lessee may be able to revoke acceptance for breach of those duties.\textsuperscript{151}

Section 2A-508, in a manner similar to section 2-711, is an index of the lessee's remedies in the event of rejection, revocation, lessor's repudiation, or nondelivery. The remedies include cancellation of the contract, recovery of any rent already paid, cover, damages for non-delivery, recovery of identified goods, or specific performance. Each of these is dealt with in more detail in a specific section.\textsuperscript{152} The section also lists a right to recover damages for breach of warranty, gives the lessee a security interest in the goods for any rent, security, or expenses incurred, and allows the lessee to deduct her damages from any rent still owing.\textsuperscript{153} Although based on the similar Article 2 remedies, each

\textsuperscript{144} Compare id. §§ 2A-509 to -517 & official cmts. with id. §§ 2-508, -601 to -608, & 2-612.
\textsuperscript{145} Id. § 2A-511(1).
\textsuperscript{146} Id. § 2-603.
\textsuperscript{147} Id. § 2A-516(2).
\textsuperscript{148} Id. official cmt. 1. See supra note 133 and accompanying text (discussion of "hell or high water clause").
\textsuperscript{149} Compare id. § 2A-516(2), -517 with id. § 2-607, -608.
\textsuperscript{150} See id. § 2A-516(4), (5) & official cmt. This is similar to § 2-607(3) and to § 2-607(5) on vouching in.
\textsuperscript{151} Id. § 2A-517.
\textsuperscript{152} See id. §§ 2A-509 to -522.
\textsuperscript{153} Id. § 2A-508(4)-(6).
of these remedies is revised to reflect the terminology and circumstances of leases rather than sales as in the use of the term "market rent" rather than "market price."  

The remedies of a lessor who still has control of the goods, i.e., when the lessee wrongfully rejects or revokes acceptance, fails to make a payment when due, or repudiates, are similarly indexed in section 2A-523.\(^\text{155}\) Included in the lessor's remedies are the rights to cancel the lease, to withhold delivery, to stop delivery, to dispose of the goods and recover damages, to retain the goods and recover damages, or to resort to any other remedies provided in the lease.\(^\text{156}\) If the lessee's default substantially impairs the value of the lease contract, the lessor may resort to any of the remedies listed; otherwise, he may recover only the loss resulting in the ordinary course of events.\(^\text{157}\) Each of the specific remedies is similar to those set forth in Article 2 but is redrafted to reflect the fact that a lease, rather than a sale, is involved.

In a sale transaction, once the buyer has accepted conforming goods, the seller has no interest in those goods and is entitled to recover their price.\(^\text{158}\) Only if the sale is part of a secured transaction does the seller (or other financing party) have any interest in the goods. In the true lease situation, however, the lessor has a residual interest in the goods which, in the event of a default by the lessee, the lessor will seek to protect. It is at this point that the drafters of Article 2A turned from Article 2 to Article 9 as a model.

The lessor's remedies, upon a default by the lessee which substantially impairs the value of the lease to the lessor are quite detailed. In summary, the lessor may retake possession of the goods or, without removal, "render unusable any goods employed in trade or business."\(^\text{159}\) The lessor need not resort to the courts if either of these courses may be achieved without a breach of the peace.\(^\text{160}\) The subsequent remedies available to the lessor are similar to those in Article 2, pursuant to which the aggrieved seller may either resell and recover the difference between the resale and the contract prices\(^\text{161}\) or retain the goods and recover the difference between the market and contract prices.\(^\text{162}\)

The aggrieved lessor who has control of the goods may dispose of the goods either by lease or sale and recover accrued and unpaid rent,

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154. Compare id. § 2A-519 with id. §§ 2-513, 2-514.
155. Compare id. § 2A-523 with id. § 2-703.
156. Id. § 2A-523(1).
157. Id. § 2A-523(2), (3).
158. Id. §§ 2-607(1), 2-709(1).
159. See id. § 2A-525(2) & official cmt. Cf. id. § 9-503.
160. Id. § 2A-525(3).
161. Id. § 2-706.
162. Id. § 2-708.
the present value of the rent for the remaining lease term less the present value of the new lease, and incidental damages.\textsuperscript{163} Alternatively, he may keep the goods and recover any accrued and unpaid rent, the present value of the rent for the remaining lease term less the present value of the market rent for the same lease term, and incidental damages.\textsuperscript{164} This latter measure of damages is also appropriate if the lessor’s disposition of the goods does not qualify for the release or resale measure of damages.\textsuperscript{165}

Finally, just as the Article 2 seller may recover the price of the goods under limited circumstances,\textsuperscript{166} the aggrieved lessor may recover accrued and unpaid rent, the present value of the rent remaining under the lease, and incidental damages for goods accepted by the lessee and not repossessed by the lessor or for goods identified to the contract if, after reasonable efforts to dispose of them, the lessor is unable to or highly unlikely to dispose of them at a reasonable price.\textsuperscript{167} The lessor must hold the goods for the lessee for the remaining term of the lease, although the lessor may dispose of the goods before the end of the term, in which event damages will be measured by the provisions discussed in the preceding paragraph.\textsuperscript{168}

\section{II. Article 4A—Funds Transfers}

The primary focus of Article 4A is on wholesale electronic transfers of funds which typically involve large sums of money and are principally between sophisticated business or financial institutions.\textsuperscript{169} It is new law based on technology which did not exist when the U.C.C. was drafted and for which there had previously been no single body of law to define the rights and obligations of the parties to these transfers.\textsuperscript{160}

A typical funds transfer is described by the drafters as follows:

X, a debtor, wants to pay an obligation owed to Y. Instead of delivering to Y a negotiable instrument such as a check or some other writing such as a credit card slip that enables Y to obtain

\begin{itemize}
  \item \textsuperscript{163} \textit{Id.} § 2A-527.
  \item \textsuperscript{164} \textit{Id.} § 2A-528.
  \item \textsuperscript{165} \textit{Id.}
  \item \textsuperscript{166} \textit{Id.} § 2-709(1).
  \item \textsuperscript{167} \textit{Id.} § 2A-529(1).
  \item \textsuperscript{168} \textit{Id.} § 2A-529(3).
  \item \textsuperscript{169} See U.C.C. Art. 4A prefatory note, 2B U.L.A. 457-59 (1991). More than one trillion dollars per day is transferred over the wire payment systems of the Federal Reserve wire transfer network and the New York Clearing House Interbank Payments Systems. \textit{Id.}
  \item \textsuperscript{170} \textit{Id.} at 458.
\end{itemize}
payment from a bank, X transmits an instruction to X's bank to credit a sum of money to the bank account of Y. In most cases X's bank and Y's bank are different banks. X's bank may carry out X's instruction by instructing Y's bank to credit Y's account in the amount that X requested. . . . The instruction that X issues to its bank is a "payment order." X is the "sender" of the payment order and X's bank is the "receiving bank" with respect to X's order. Y is the "beneficiary" of X's order. When X's bank issues an instruction to Y's bank to carry out X's payment order, X's bank "executes" X's order. . . . The entire series of transactions by which X pays Y is known as the "funds transfer." . . . With respect to the funds transfer, X is the "originator," X's bank is the "originator's bank," Y is the "beneficiary" and Y's bank is the "beneficiary's bank." 171

Although this transaction may, in some ways, resemble payments made by check, covered by Articles 3 and 4, or by consumer electronic transfers (bank-by-phone or automated teller machines), covered by the Federal Electronic Fund Transfer Act, 172 which are excluded from Article 4A, 173 Article 4A treats the funds transfer "as a unique method of payment that is governed by unique principles of law that address the operational and policy issues presented by this kind of payment." 174

Among the problems facing the drafters of Article 4A were the liability of the receiving bank (X's bank) for consequential damages in the event of failure properly to transmit the payment order, allocation of risk of loss in the event of unauthorized or fraudulent payment orders, misdescription of the beneficiary, errors made in the course of the wire transfer (such as duplicate transmissions), payment to an unintended beneficiary, and transfer of an incorrect amount. 175 Each of these problems is dealt with by a set of "precise and detailed rules" rather than broad, general principles and were drafted to enable the parties to a

171. Id. at 457. For these and additional definitions, see U.C.C. §§ 4A-104, -105.
funds transfer "to predict risk with certainty, to insure against risk, to adjust operational and security procedures, and to price funds transfer services appropriately." 176

Of prime importance is the establishment by the parties of a "security procedure" of some kind, whether by way of codes, callbacks, or other devices, to assure that the payment order or other communication is that of the customer and is correct. 177 The remaining rights and obligations of the various parties, particularly with reference to allocation of their respective risks, are quite detailed. To attempt to summarize would require essentially a repetition of the language of both the statutory sections and the Official Comments, many of which contain comprehensive examples and descriptions of the type of transaction or problem involved. The reader is urged to consult both in dealing with funds transfers problems.

III. CONCLUSION

As we move toward the twenty-first century, the sponsors of the U.C.C. have continued their review and updating to keep the law of commercial transactions as modern, effective, and efficient as possible. By enacting Articles 2A and 4A in 1991, the Indiana Legislature has followed the sponsors' lead. It is hoped that the legislature will continue to do so as new or revised Articles of the U.C.C. are promulgated. Next will likely come the adoption of newly revised Articles 3 and 4, and ultimately, a revised Article 2. 178 And in another forty or fifty years, the process will begin again.

177. See id. § 4A-201 & official cmt.
178. Gerald R. Bepko, Chancellor of Indiana University's Indianapolis campus and former Dean of I.U. School of Law—Indianapolis, is a member of the N.C.C.U.S.L. Article 2 Drafting Committee, whose work is well under way. He predicts that the new versions of Articles 3 and 4 will be introduced in the Indiana Legislature during the 1993 session. The introduction of a new Article 2 will take a bit longer.