

# Developments in Contract and Commercial Law

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## INTRODUCTION

This Article discusses some important recent Indiana decisions concerning contract law and the Uniform Commercial Code (UCC). The cases discussed include decisions from both Indiana courts and federal courts construing Indiana law.

### I. CONTRACTS—INDEMNITY PROVISIONS

The districts of Indiana's courts of appeals are split concerning the recovery of attorney's fees by an indemnitee suing to enforce an indemnity contract. One recent case, *Dale Bland Trucking, Inc. v. Kiger*,<sup>1</sup> discussed such a provision in a semi-truck lease and held that the fees were not available unless specifically provided for by contract.<sup>2</sup>

The owner of the semi-truck, Kiger, agreed to indemnify Dale Bland Trucking, the lessee, "from any and all claims, suits, losses, fines, or other expenses arising out of, based upon or incurred because of injury to any person or persons or damage to any property sustained by reason of negligence or recklessness on the part of [Kiger], its agents, servants, or employees."<sup>3</sup> An accident involving the truck occurred while being operated by one of Kiger's employees. Several lawsuits were filed against Dale Bland. Kiger and its insurer refused to defend the suits on Dale Bland's behalf. Dale Bland defended itself in the suits, incurred attorney's fees, and was ordered to pay damages to several of the plaintiffs.<sup>4</sup>

Following the suits, Dale Bland sued Kiger and its insurer for failure to indemnify and defend Dale Bland. The trial court awarded Dale Bland the amount it was required to pay to third-party plaintiffs, plus attorney's fees incurred in defending those suits. However, the court refused to award Dale Bland the attorney's fees incurred in bringing the action against Kiger and its insurer.<sup>5</sup>

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1. 598 N.E.2d 1103 (Ind. Ct. App. 1992).
2. *Id.* at 1106.
3. *Id.*
4. *Id.* at 1105.
5. *Id.*

The court of appeals affirmed the trial court's decision. The court of appeals noted that Indiana follows the American rule in awarding attorney's fees. "In Indiana, each party to litigation must pay for its own attorney's fees, absent a statute or agreement authorizing such an award."<sup>6</sup> The court then found that the indemnity clause in the lease, quoted above, did not specifically refer to the recovery of attorney's fees in any action to enforce the indemnity; therefore, attorney's fees could not be awarded to Dale Bland.<sup>7</sup>

Dale Bland argued to the court of appeals that the 1983 case of *Zebrowski and Associates, Inc. v. City of Indianapolis*<sup>8</sup> supported its argument that the indemnitee may recover attorney's fees incurred in prosecuting an indemnity claim. The contract at issue in *Zebrowski* covered attorney's fees, but did not specifically state that it covered attorney's fees incurred in prosecuting an action to enforce the indemnity. However, the plaintiff only sought and won attorney's fees incurred in defending underlying tort actions. The defendant appealed, arguing the amount of the award was not reasonable.<sup>9</sup> In dicta, the court stated that an "indemnitee may recover attorney fees from the indemnitor incurred through an original action which is settled, and also for the cost of prosecuting the indemnity clause."<sup>10</sup> However, the court in *Dale Bland* determined that *Zebrowski* did not support Dale Bland's contention.<sup>11</sup>

It seems reasonable that attorney's fees incurred in prosecuting an indemnity clause in a contract, when the indemnitor has refused to indemnify and defend an indemnitee in some underlying action, would come within the intent of a clause which indemnifies against "any and all costs and expenses incurred by the indemnitee as a result of the actions of the indemnitor." However, the *Dale Bland* decision unequivocally holds that unless a contract explicitly awards attorney's fees incurred while enforcing an indemnity, there can be no award of such fees.<sup>12</sup> Thus, attorney's fees are not treated like other costs an indemnitee faces when the indemnitor refuses to live up to its part of the bargain by not defending the indemnitee in the underlying action. Accordingly, practitioners drafting contracts governed by Indiana law that contain indemnity provisions should state explicitly that the indemnitee will recover attorney's fees incurred while enforcing the indemnity provisions.

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6. *Id.*

7. *Id.* at 1106.

8. 457 N.E.2d 259 (Ind. Ct. App. 1983).

9. *Id.* at 264.

10. *Id.* (citing *Price v. Amoco Oil Co.*, 524 F. Supp. 364 (S.D. Ind. 1981)).

11. 598 N.E.2d at 1105.

12. *Id.* at 1106.

A second case within the Survey period, *Essex Group, Inc. v. Nill*,<sup>13</sup> further illuminates the availability of attorney's fees in an indemnity action. In *Essex*, the court of appeals relied on *Zebrowski* in stating that an indemnitee may recover the cost of enforcing an indemnity clause. However, the contract provisions at issue in *Essex* provided only that the indemnitor "shall indemnify and hold harmless [the indemnitee] from all claims, demands, liabilities, loss or damage (including reasonable counsel fees and other reasonable out-of-pocket expenses) arising subsequent to the Closing out of any breach of any such representation, warranty, covenant or agreement by the [indemnitor]."<sup>14</sup>

Because this case arose from a trial court order dismissing the indemnitee's claim, the facts necessary to resolve the dispute had not been fully entertained by the trial court or the appellate court. However, the *Essex* decision seems to imply that if the lower court determines the indemnitee is entitled to indemnification, then it will also be entitled to recover reasonable attorney's fees both for defending any underlying litigation and for prosecuting the indemnity clause. Although this appears to be the law as stated in *dicta* in the *Zebrowski* case, the *Dale Bland* case clearly holds otherwise.

Therefore, the districts of the Indiana Court of Appeals<sup>15</sup> lack uniformity regarding the specificity required in indemnity contracts providing for attorney's fees to be recovered by indemnitees. Hopefully, the Indiana Supreme Court will entertain such a case in the near future. In the meantime, prudent practitioners should be specific in drafting indemnity provisions, explicitly stating that attorney's fees incurred in enforcing the indemnity provision are recoverable.

## II. CONTRACTS—CONSTRUCTION AGAINST DRAFTER

Several cases arose during the Survey period which reaffirm the well-known rule that an ambiguous contract is construed against the party who prepared the ambiguous document or language. The first case is *Woodbridge Place Apartments v. Washington Square Capital, Inc.*<sup>16</sup> The specific facts of this case are discussed later in this Article.<sup>17</sup> In this case, the United States Court of Appeals for the Seventh Circuit found that provisions in a loan application for refunding the borrower's deposit

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13. 594 N.E.2d 503 (Ind. Ct. App. 1992).

14. *Id.* at 506.

15. *Zebrowski* and *Dale Bland* were each decided by the first district, whereas *Essex* was decided by the third district.

16. 965 F.2d 1429 (7th Cir. 1992).

17. See text accompanying notes 26-28 *infra*.

were drafted by the lender. The court found the provisions were ambiguous and accepted the interpretation proposed by the borrower. The lender proposed several different interpretations of the contract provisions; however, the Seventh Circuit found that "Indiana courts invoke the cardinal rule of construction that 'ambiguities in a contract are to be strictly construed against the party who prepared the contract.'"<sup>18</sup>

The second case is *Boswell Grain & Elevator, Inc. v. Kentland Elevator & Supply, Inc.*<sup>19</sup> This case concerned the language of an option to purchase "grain facilities" contained within a lease. Kentland rented two grain elevators from Boswell Grain, the landlord. The lease contained an option to purchase "the grain facilities" on proper notice given by Kentland. Kentland gave such notice and tendered the purchase price, but Boswell Grain never tendered the executed deeds for the "grain facilities."<sup>20</sup> The ambiguity in the contract concerned the definition of the term "grain facilities." Kentland contended that the term included all of the machinery and equipment at the sites, while Boswell Grain contended that the term excluded certain items of machinery and equipment. Applying the general rule that ambiguous contracts are construed against the preparer, the court upheld the broader interpretation of the term "grain facilities" as proposed by Kentland.<sup>21</sup>

A third case using this rule of construction is *INB Banking Co. v. Opportunity Options, Inc.*<sup>22</sup> In this case, INB attempted to foreclose a mortgage granted to secure a debt. INB also tried to set off certain amounts against the debtor's accounts held at INB after the debtor defaulted. The note provided that:

If I do not pay the full amount of each monthly payment on time, the Note Holder may send me a written notice telling me that if I do not pay the overdue amount by a certain date I will be in default. That date must be at least 30 days after the date on which the notice is mailed to me.<sup>23</sup>

The debtor failed to make two installments. INB sent the debtor letters stating that if the installments were not paid by a certain date, INB would begin legal action. The installments were not paid by that date, and INB then set off certain amounts in excess of the amount of the two late installments against the debtor's checking accounts at INB. The

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18. 965 F.2d at 1439 (quoting *English Coal Co., Inc. v. Durcholz*, 422 N.E.2d 302, 309 (Ind. Ct. App. 1981)).

19. 593 N.E.2d 1224 (Ind. Ct. App. 1992).

20. *Id.* at 1225.

21. *Id.* at 1228.

22. 598 N.E.2d 580 (Ind. Ct. App. 1992).

23. *Id.* at 582-83.

debtor objected on the basis that INB did not give the thirty-day written notice and that the note required such notice before INB could accelerate the debt. INB countered that the language of the note—"may send me a written notice"—did not create a duty to send notice, but was simply permissive on INB's part. The court found that both interpretations were reasonable and that the note was therefore ambiguous. Because INB drafted the note, the court found the notice was required as the debtor contended.<sup>24</sup>

These cases underscore the potency of this rule of construction. Nearly every ambiguous contract can be resolved using this rule by accepting a reasonable interpretation of the contract language offered by the nondrafter. The only real issue to be decided in these cases is which party prepared the contract. In *Opportunity Options* and *Woodbridge*, it is clear the lenders in each case prepared the contracts in issue, because the contracts were the lenders' forms. However, the *Boswell* case presents a different situation. In that case, the landlord, Boswell Grain, argued this rule of construction should be "inapplicable where the contract was prepared with the aid and approval of and under the scrutiny of counsel for each of the parties thereto."<sup>25</sup> Boswell Grain could not cite Indiana precedent for this argument and the court of appeals noted that "this exception has not heretofore been recognized in Indiana."<sup>26</sup> The court of appeals indicated in *Boswell Grain* that there was some negotiation of the terms of the lease and option. However, Boswell Grain's attorneys prepared a draft of the contract following negotiations and submitted the draft to Kentland to sign. Thus, the court of appeals found that even if such an exception did exist in Indiana, the facts of *Boswell* would not fall within the exception.

These cases highlight the necessity for practitioners whose clients use form contracts and instruments to draft language which clearly expresses the clients' intent. Any ambiguity in these types of contracts and instruments could be fatal to the clients' ability to obtain the benefit of their bargains.

### III. CONTRACTS—IMPLIED DUTY OF GOOD FAITH

In *Woodbridge Place Apartments v. Washington Square Capital, Inc.*,<sup>27</sup> the United States Court of Appeals for the Seventh Circuit construed a contract under Indiana law. The case arose from a failed attempt by Woodbridge Place to refinance Woodbridge Place Apartments,

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24. *Id.* at 584.

25. *Boswell Grain & Elevator, Inc. v. Ken Hand Elevator & Supply, Inc.*, 593 N.E.2d 1224, 1228 (Ind. Ct. App. 1992) (citing *Beck v. F.W. Woolworth Co.*, 111 F. Supp. 824 (N.D. Iowa 1953)).

26. *Id.*

27. 965 F.2d 1429 (7th Cir. 1992).

a 192-unit apartment complex in Evansville, Indiana. Woodbridge Place applied for a loan from Washington Square. Woodbridge Place was required to make a standby deposit of three percent of the loan amount. The application provided the deposit would be returned to Woodbridge Place after the loan was made. If the loan was not made, Woodbridge Place was to have no right to a refund unless Washington Square wrongfully refused to make the loan.<sup>28</sup>

The loan was not made because conditions relating to the apartments were not satisfied. Woodbridge Place sought the return of the deposit. Woodbridge Place prevailed in the lower court, which held that the deposit penalized Woodbridge Place and was unenforceable as a liquidated damages provision. It ordered the refund of the deposit to Woodbridge Place. Washington Square appealed that order to the Seventh Circuit.<sup>29</sup>

The parties agreed the actual language of the loan application contemplated a refund of the deposit only if the lender wrongfully refused to make the loan. However, Woodbridge Place argued that despite the language of the application, the lender's retention of the deposit amounted to a penalty provision or an unenforceable attempt to provide for damages. The lender countered by arguing that the deposit constituted consideration. The problem with this loan application arose because the application itself did not characterize the deposit as either consideration for an option, consideration for a commitment, or a damages provision. Therefore, the court found that the agreement was ambiguous on this point.<sup>30</sup>

The most interesting aspect of this case arises in the court's discussion of whether the deposit constitutes consideration for an option contract. The lender made this argument in support of its retention of the deposit. The court had to decide whether, under Indiana law, the loan application constituted an option contract or a conditional bilateral contract. Again, the application itself did not contain any language specifically resolving this issue. The court found that in order for the loan application to constitute an option agreement, only the lender and not the borrower could be bound. "[I]f both the borrower and lenders are bound to carry through with the loan upon satisfaction of the specified conditions, then the loan commitment could only be a bilateral conditional agreement."<sup>31</sup> The court stated that when the language of an agreement fails to resolve the ambiguity as to whether a loan commitment is a bilateral conditional

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28. *Id.* at 1432-33.

29. *Id.* at 1433.

30. *Id.* at 1435-36.

31. *Id.* at 1437.

contract or an option, some jurisdictions, such as New York, presume that the loan commitment constitutes a bilateral agreement.<sup>32</sup> Other jurisdictions, such as California<sup>33</sup> and Texas,<sup>34</sup> presume it constitutes an option contract in which only the borrower is obligated. Still other jurisdictions, such as Illinois,<sup>35</sup> presume that neither side is bound.

The court stated that *Woodbridge Place* was a case of first impression in Indiana, as no Indiana cases regarding loan commitments were presumed to be actions on an option or bilateral contracts. The court then applied, by analogy, two Indiana Court of Appeals cases regarding conditional real estate contracts. The first case the court cited was *Keliher v. Cure*,<sup>36</sup> in which the Indiana Court of Appeals decided that a seller is entitled to retain an earnest money deposit after the buyer decided not to complete the sale. The second case cited by the court was *Billman v. Hensel*,<sup>37</sup> in which the court held that under a real estate contract which was "subject to financing" the buyer has "an implied obligation to make a reasonable and good faith effort to satisfy the condition."<sup>38</sup> The Seventh Circuit stated that both *Keliher* and *Billman* represented contracts similar to the loan application in *Woodbridge Place* because the contracts involved in *Keliher* and *Billman* did not specify whether the buyer was bound to the contract, and because both agreements required earnest money deposits similar to the stand-by deposit in *Woodbridge Place*.<sup>39</sup>

In *Keliher*, the court's reliance is plainly unwarranted. The *Keliher* contract provided that "[p]urchaser agrees to make application for any financing necessary to complete this transaction."<sup>40</sup> Clearly, the buyers in *Keliher* specifically obligated themselves to apply for the necessary financing. This is vastly different from a situation in which consummation of a transaction is merely subject to financing and the buyer is not specifically obligated to apply for financing, which was the case in *Billman*. *Keliher* involved a bilateral agreement in which the buyers obligated themselves to perform.

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32. See, e.g., *Murphy v. Empire of Am., FSA*, 746 F.2d 931 (2d Cir. 1984).

33. See, e.g., *Lowe v. Massachusetts Mut. Life Ins. Co.*, 127 Cal. Rptr. 23 (Cal. Ct. App. 1976).

34. See, e.g., *B.F. Saul Real Estate Inv. Trust v. McGovern*, 683 S.W.2d 531 (Tex. Ct. App. 1984).

35. See, e.g., *Runnemeede Owners, Inc. v. Crest Mortgage Corp.*, 861 F.2d 1053 (7th Cir. 1988).

36. 534 N.E.2d 1133 (Ind. Ct. App. 1989).

37. 391 N.E.2d 671 (Ind. Ct. App. 1979).

38. *Id.* at 673.

39. *Woodbridge Place Apartments v. Washington Square Capital, Inc.*, 965 F.2d 1429, 1438 (7th Cir. 1992).

40. 534 N.E.2d at 1135.

However, when using *Billman*, the *Woodbridge Place* court's reliance is well placed. The contract at issue in that case merely provided that consummation of the contract was subject to the buyer's ability to secure financing. In *Billman*, the Indiana Court of Appeals relied on jurisdictions outside Indiana to find the buyers had an implied obligation to make a reasonable and good faith effort to obtain financing. There is no prior Indiana precedent for this position. The court in *Billman* even recognized that another Indiana Court of Appeals decision specifically refused to impose an implied obligation of good faith.<sup>41</sup>

The court in *Woodbridge Place* does not discuss the implications of the 1990 Indiana Supreme Court case of *First Federal Savings Bank of Indiana v. Key Markets, Inc.*<sup>42</sup> In *Key Markets*, the court reversed the Indiana Court of Appeals, which had imposed a duty of reasonableness upon a landlord who is asked to consent to an assignment of a lease. The lease simply provided that, with certain exceptions, the tenant could not assign the lease without the landlord's consent.<sup>43</sup> The supreme court held that the court of appeals used an improper standard to reach this conclusion because courts cannot "require a party acting pursuant to such a contract to be 'reasonable' 'fair' or show 'good faith' cooperation."<sup>44</sup> Therefore, it is rather clear that Indiana law, in cases not governed by the Uniform Commercial Code (UCC), will not impose general duties of good faith or reasonableness on a party to a contract.

The Seventh Circuit in *Woodbridge Place* created an implied covenant of good faith on the part of Woodbridge Place to see that all conditions to the loan application were satisfied. Based on this duty, the court found the contract was a bilateral conditional contract rather than an option contract and, therefore, the deposit was not consideration for an option agreement. Having found a bilateral contract, the court held the deposit retention provision was a liquidated damages provision that could only apply if Woodbridge Place were in default. Because the

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41. 391 N.E.2d at 673 (citing *Blakely v. Currence*, 361 N.E.2d 921 (Ind. Ct. App. 1977)).

42. 559 N.E.2d 600 (Ind. 1990).

43. *Id.* at 601.

44. *Id.* at 604. The Indiana Supreme Court further stated:

[the] proper posture for the court is to find and enforce the contract as it is written and leave the parties where it finds them. It is only where the intentions of the parties cannot be readily ascertained because of ambiguity or inconsistency in the terms of a contract or in relation to extrinsic evidence that a court may have to presume the parties were acting reasonably and in good faith *in entering into* the contract.

*Id.* (emphasis added). Therefore, the court should never imply an obligation of good faith but may presume the parties are acting in good faith in order to ascertain their intent in any given contract.

failure to close the loan was due to the failure of certain conditions, and not a breach by Woodbridge Place of its obligations, the damage provision could not be enforced and Woodbridge Place was entitled to a refund of the deposit.<sup>45</sup>

In so holding, the Seventh Circuit failed to recognize relevant Indiana precedent, including specifically *Key Markets*. Indiana courts would have difficulty obligating Woodbridge Place to an implied duty of good faith. The loan application should have been construed under Indiana law as an option contract, in which the prospective borrower is not bound to carry through with the loan. The deposit should have been deemed consideration for this option, which need not be returned by the lender.

#### IV. SECURED TRANSACTIONS—PRIORITY OF INTERESTS

The recent case of *Union Federal Savings Bank v. INB Banking Co. Southwest*<sup>46</sup> decides an issue of first impression in Indiana. The case involved a dispute between two parties with competing security interests in a boat. The first owner of the boat was Stephen K. Finney who bought the boat in 1986 with a loan from the Peoples Savings Bank of Evansville, Indiana, the predecessor in interest of INB Banking Company Southwest. Finney used the boat for personal purposes and kept it docked on the Ohio River in Henderson County, Kentucky. On February 26, 1986, Peoples filed a financing statement for the boat with the county clerk of Henderson County, Kentucky. The boat was registered with the Commonwealth of Kentucky.<sup>47</sup>

In late 1987, Finney decided to sell the boat and entered negotiations with Ronald D. Flick. Flick obtained a loan from Union Federal Savings Bank to purchase the boat. On January 18, 1988, Union Federal loaned Flick the money to buy the boat. Flick executed a financing statement giving Union Federal a security interest in the boat which was still in Kentucky. In order to save sales tax, Finney caused Whitewater Ford Lincoln Mercury, Inc., a corporation of which Flick was the president and chief operating officer, to purchase the boat. On January 27, 1988, Whitewater purchased the boat from Finney. Flick then moved the boat to Indiana and two days later, on January 30, 1988, Flick bought the boat from Whitewater.<sup>48</sup>

At this time, Indiana required certificates of title for boats. Therefore, on March 23, 1988, Flick obtained an Indiana certificate of title for

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45. *Woodbridge Place Apartments v. Washington Square Capital, Inc.*, 965 F.2d 1429, 1438-41 (7th Cir. 1992).

46. 582 N.E.2d 426 (Ind. Ct. App. 1991).

47. *Id.* at 427. The registration of the boat in Kentucky was, at the time, different from obtaining a certificate of title for the boat. *Id.* at 429, n.3.

48. *Id.* at 428.

the boat. The certificate did not list either Peoples or Union Federal as a secured party. However, on August 29, 1989, a new Indiana certificate of title was issued which showed, for the first time, Union Federal as the first lien holder. Peoples was never noted as a secured party on the Indiana certificate of title.<sup>49</sup>

On March 31, 1988, approximately two months after the sale to Flick and removal of the boat to Indiana, Peoples learned that the boat had been sold by Finney. However, Peoples made no inquiry about the identity of the new owner or the boat's whereabouts. It was not until July 24, 1989, that Peoples advised Flick that it claimed a security interest in the boat. However, Peoples never filed any financing statement in Indiana or otherwise tried to perfect its security interest in the boat in Indiana.<sup>50</sup>

In September 1989, Peoples filed a complaint against both Flick and Finney, seeking to foreclose its security interest in the boat. However, the complaint was dismissed against Finney because he had filed a bankruptcy petition. Peoples later amended its complaint to add Union Federal as a competing secured party. The trial court entered judgment in favor of Peoples against both Flick and Union Federal.<sup>51</sup>

The court of appeals misread Indiana's version of Article 9 of the UCC,<sup>52</sup> and incorrectly affirmed the trial court. The court of appeals began its analysis by noting that "Peoples properly perfected its security interest in the boat in Kentucky on February 26, 1987."<sup>53</sup> The court then correctly discussed section 103 of Article 9 of Indiana's UCC,<sup>54</sup> which provides as follows:

(d) When collateral is brought into and kept in this state while subject to a security interest perfected under the law of the jurisdiction from which the collateral was removed, the security interest remains perfected, but if action is required by [Indiana Code section] 26-1-9-301 through [section] 26-1-9-318 to perfect the security interest:

(i) If the action is not taken before the expiration of the period of perfection in the other jurisdiction or the end of four (4) months after the collateral is brought into this state, whichever period first expires, the security interest becomes unperfected at

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49. *Id.*

50. *Id.* at 428.

51. *Id.*

52. IND. CODE §§ 26-1-9-101 to -507 (1992). For all relevant purposes, Indiana's version of Article 9 of the UCC is identical to the official text of Article 9 of the Uniform Commercial Code.

53. *Union Federal*, 582 N.E.2d. at 429.

54. IND. CODE § 26-1-9-103 (1988).

the end of that period and is thereafter deemed to have been unperfected as against a person who became a purchaser after removal.<sup>55</sup>

The court relied on the last clause of section 103(1)(d)(i) to find the real issue in this case “is whether the boat was purchased before or after it was moved to Indiana.”<sup>56</sup> The court then proceeded through an excellent discussion of whether Union Federal was a “purchaser” under the UCC and at what time it became a “purchaser.”<sup>57</sup> The court correctly found that Union Federal became a purchaser of the boat on January 27, 1988, the date that its security interest in the boat attached.<sup>58</sup> After finding that Union Federal was a “purchaser” of the boat prior to its removal to Indiana, the court held that section 103(1)(d) of Article 9 of the UCC “did not apply, and Peoples’s [sic] security interest was not unperfected against Union Federal even though Peoples did not reperfect its interest in Indiana.”<sup>59</sup>

This is where the court of appeals misreads the UCC. Section 103(1)(d) of Article 9 of the UCC provides that the prior secured party’s security interest is “deemed to have been unperfected as against a person who became a purchaser after removal.”<sup>60</sup> Because Union Federal is not “a person who became a purchaser after removal,” this clause of section 103 does not apply to this case. However, the remaining portions of section 103(d) do apply. This means that if the prior secured party does not take action before the expiration of the four-month period after the collateral is removed from the state in which the party’s security interest

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55. *Id.* § 26-1-9-103(1)(d). Section 103(d) of Article 9 of the UCC is applicable in this situation through § 103(2)(c) of Article 9 of the UCC, which provides that, with a certain exception not relevant here, a security interest which is perfected in another jurisdiction (other than by notation on a certificate of title and goods removed to Indiana and thereafter covered by a certificate of title in Indiana) is subject to the rules stated in sub-section 1(d) of section 103. IND. CODE § 26-1-9-103(2)(c).

56. *Union Federal*, 582 N.E.2d at 430.

57. *Id.* The term “purchase” is defined in the UCC as including “taking by sale, discount, negotiation, mortgage, pledge, lien, issue or reissue, gift, or any other voluntary transaction creating an interest in property.” IND. CODE § 26-1-1-201(32) (1988 & Supp. 1992). Consequently, the term “purchaser” means a person who takes by purchase. *Id.* § 26-1-1-201(33) (Supp. 1992). Therefore, a secured party is clearly a “purchaser” under the UCC.

58. A security interest attaches to the collateral once the following three conditions exist: (1) the debtor has signed a security agreement which contains a description of the collateral, (2) value has been given, and (3) the debtor has rights in the collateral. IND. CODE § 26-1-9-203 (1988). In this case, Flick signed the security agreement on January 18, 1988, and Union Federal, at that time, gave Flick the proceeds of the loan. Flick acquired rights to the boat when, pursuant to an oral agreement with Whitewater, he obtained possession of the boat on Jan. 27, 1988. *Union Federal*, 582 N.E.2d at 430.

59. *Union Federal*, 582 N.E.2d at 431.

60. IND. CODE § 26-1-9-103(1)(d)(i) (1988).

is perfected, that security interest becomes unperfected at the end of that four-month period. Therefore, Peoples' security interest in the boat became unperfected four months after the boat was moved by Flick to Indiana.

Section 103 of Article 9 requires a secured party holding a perfected security interest in one state to take action in another state to maintain its perfected security interest. If the secured party fails to reperfect its interest, the disputes over priority with other interested parties must be governed by the other sections of Article 9. Section 301 of Article 9 states that "an unperfected security interest is subordinate to the rights of: (a) persons entitled to priority under [Indiana Code §] 26-1-9-312."<sup>61</sup> Section 312(5)(a) of Article 9 provides:

Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made covering the collateral or the time the security interest is first perfected, whichever is earlier, provided that there is no period thereafter when there is neither filing nor perfection.<sup>62</sup>

Thus, if the secured party with a perfected interest in the original jurisdiction fails to reperfect its interest in the new jurisdiction within the four-month period, any junior secured creditor can obtain priority if the junior secured party perfects its security interest in the new jurisdiction before the senior secured party does. If the junior secured party does not perfect its interest, then the senior secured party will prevail because its interest attached first.<sup>63</sup> However, in *Union Federal*, Union Federal perfected its security interest in Indiana by having it noted on the certificate of title. Accordingly, Union Federal's security interest should have been given priority over Peoples' prior security interest.

The official comment to Section 103 of Article 9 of the UCC states the rationale behind the provisions of Section 103:

The four-month period is long enough for a secured party to discover in most cases that the collateral has been removed and refile in this state; thereafter, if he has not done so, his interest, although originally perfected in the jurisdiction from which the collateral was removed, is subject to defeat here by purchasers of the collateral. . . . The rights of a purchaser with a security interest against an unperfected security interest are governed by Section 9-312. In case of delay beyond the four-

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61. *Id.* § 26-1-9-301(1)(a).

62. *Id.* § 26-1-9-312(5)(a).

63. *Id.* § 26-1-9-312(5)(b).

month, there is no "relation back;" and this is also true where the security interest is perfected for the first time in this state.<sup>64</sup>

Noted commentators James White and Robert Summers explain a hypothetical situation quite similar to *Union Federal*. They assume a senior party and a junior party who have perfected security interests in state one. The collateral is moved to state two. The junior party quickly reperfects its security interest in state two while the senior party does nothing. White and Summers conclude:

One might argue [that the junior secured party], having notice of the original security claim, has no greater equities than those of a lien creditor whose claim arises within the four month period in the new state. On the other hand [§ 103(1)](d)(i) states that the security interest is unperfected at the end of four months and the last clause of (d)(i) that otherwise would subordinate the lien creditor does not explicitly apply here. We are not confident about what the proper outcome should be in such a case. We tend to favor the diligent junior creditor; on the other hand we can certainly see situations in which the senior secured creditor should win because, for example, the junior might have encouraged the debtor to move the goods to enable him to achieve priority.<sup>65</sup>

The *Union Federal* case is not quite identical to the hypothetical raised by White and Summers. The court of appeals in *Union Federal* stated that *Union Federal* had no actual knowledge of Peoples' security interest. On the other hand, Peoples knew of the sale of the boat within the four-month period but made no attempt whatsoever to determine who the new owner was or where the boat was. *Union Federal* is a case in which two competing secured creditors, ignorant of the existence of each others' interests, attempt to perfect their own interests. The court favors the senior party because it was the first to file. In order to favor the senior party, the court must bend the UCC in a way it cannot be bent. Both parties are at fault in this case—*Union Federal* for failing to discover Peoples' original financing statement, and Peoples for failing to reperfect in Indiana. It is a difficult case, but the UCC and its comment, as well as noted commentators such as White and Summers, clearly reward the more diligent secured creditor.

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64. U.C.C. § 9-103 cmt. 7 (1992), 3 U.L.A. 151 (1992); see also 2 JAMES WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 395 (3d ed. 1988).

65. WHITE & SUMMERS, *supra* note 64, § 397.

V. SECURED TRANSACTIONS—PRIORITY OF SECURITY INTEREST AS AGAINST CORPORATE EMPLOYEE LIEN

A second case was decided within the Survey period concerning the priority of a security interest perfected under Article 9 of the UCC. *Ameritrust National Bank, Michiana v. Domore Corp.*<sup>66</sup> does not concern competing priorities of two perfected security interests, but rather the priority of a perfected security interest vis-a-vis a corporate employees' lien.<sup>67</sup> Indiana has been blessed with the corporate employee lien statute since 1877 in substantially the same form as it exists today.<sup>68</sup> The lien statute gives all employees of any corporation doing business in Indiana a first and prior lien upon the property of the corporation and its earnings. The lien amount is for all work performed by the employees from the date of their employment. For the employees to acquire the lien, they must file notice with the recorder's office of the county where the corporation is located or doing business. The notice of intent to hold the lien may be filed regardless of whether the employee's claim is then due. The lien relates back to the date of employment of the employee by the corporation, or to any subsequent date, at the employee's election.

The corporate employee's lien has priority over all liens created later, except for other employee liens, over which there is no such priority. One exception to the priority of the lien exists:

Where any person, other than an employee, shall acquire a lien upon the corporate property of any corporation located or doing business in this state, and such lien remain a matter of record for a period of sixty (60) days, in any county in this state where such corporation is located or doing business, and no lien shall have been acquired by any employee of such corporation during that period, then and in that case such lien so created shall have priority over the lien of such employee in the county where such corporation is located or doing business, and not otherwise.<sup>69</sup>

*Ameritrust* arises in connection with the bankruptcy proceedings against The Domore Corp.<sup>70</sup> In this case, Ameritrust acquired an interest in Domore's personal property as security for a \$4,000,000 loan. Ameritrust perfected its interest by filing a UCC-1 financing statement with

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66. 147 B.R. 473 (Bankr. N.D. Ind. 1992).

67. The corporate employee's lien is provided by statute set forth in IND. CODE §§ 32-8-24-1 through -6 (1992).

68. 1877 Ind. Acts, ch. 8, § 1.

69. IND. CODE § 32-8-24-2 (1992).

70. 147 B.R. 473 (Bankr. N.D. Ind. 1992).

the Indiana Secretary of State in 1988. In early 1991, at approximately the same time that Domore filed its bankruptcy petition, several employees of Domore filed notices of corporate employees' liens with the Elkhart County Recorder. A dispute quickly arose in the bankruptcy court as to whether Domore's corporate employees' liens took priority over Ameritrust's perfected security interest. The bankruptcy court found in favor of the employees and held that their liens had priority over Ameritrust's perfected security interest.<sup>71</sup> Ameritrust appealed to the district court, arguing that the bankruptcy court misconstrued the phrase in the corporate employees' lien statute requiring prior security interests to be recorded in the county in which the corporation does business. Ameritrust argued that its filing with the Secretary of State made its lien a matter of record in the county, despite the fact that Ameritrust did not file its financing statement in the county recorder's office.<sup>72</sup>

Ameritrust's argument has a great deal of merit. The corporate employees' lien statute was adopted at a time when there was no central filing with the Secretary of State for the perfection of security interest. At that time, all security interests had to be perfected by filing with county recorders. When the Indiana General Assembly adopted the UCC in 1963, it did not revise the exception to include security interests perfected by filing with the Secretary of State within the exception to the corporate employees' lien priority status.

Very few cases exist regarding the corporate employees' lien statute. One case, *Watson v. Strohl*,<sup>73</sup> did discuss the priority of the mechanics' lien over the corporate employees' lien. Both statutes provided that liens created under them would be prior to any other lien. The statutes made no reference to each other and therefore were in direct conflict with one another. In *Watson*, the court found the mechanics' lien law, which was enacted after the corporate employees' lien law, took precedence over the corporate employees' lien statute because the subsequent statute impliedly amended the prior statute.<sup>74</sup>

In *Ameritrust*, however, there is no direct conflict between the corporate employees' lien statute and Article 9. The corporate employees' lien statute specifically provides that in order for a security interest to meet the exception to the priority of the corporate employees' lien, the security interest must be filed with the county recorder. Article 9, on the other hand, does not discuss the priority of the security interest perfected under its rules against security interests or liens given by some

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71. *Id.* at 474.

72. *Id.* at 476.

73. 46 N.E.2d 204 (Ind. 1943).

74. *Id.* at 207.

other statute. Therefore, there is no conflict between these two statutes, and there is no occasion to find that one of the statutes impliedly amends the other.

For these reasons, the district court affirmed the decision of the bankruptcy court and held that the corporate employees' liens were entitled to priority over the perfected security interest of Ameritrust. That result is absurd under the policy and rationale of Article 9 of the UCC, and under present-day financing practices. But the courts are not in the position to rewrite the corporate employees' lien statute. This should be done by the Indiana General Assembly.<sup>75</sup>

#### VI. UNIFORM COMMERCIAL CODE—SALES OR SERVICES

*Insul-Mark Midwest, Inc. v. Modern Materials, Inc.*<sup>76</sup> highlights a conflict among the districts of the Indiana Court of Appeals regarding the application of the UCC to a "mixed" transaction involving both goods and services. This conflict arose when the Second District Court of Appeals decided *Baker v. Compton*.<sup>77</sup> The court in *Baker* refused to follow the approach of the Fourth District Court of Appeals in *Stephenson v. Frazier*.<sup>78</sup>

The *Stephenson* case involved a contract in which the Stephensons agreed to purchase a modular home from Frazier. The contract included the installation of a septic system and construction of a foundation. Problems arose with both the construction of the foundation and the condition of the modular home, and the Stephensons desired to rescind the contract.<sup>79</sup> The fourth district found the modular home came within the definition of a "good" under the UCC,<sup>80</sup> and thus the sale was covered by the UCC. The court then held that

the part of the contract related to the construction of the foundation and installation of the septic system, however, does not

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75. An attempt was made during the 1993 Indiana General Assembly to amend the corporate employees' lien statute. On January 5, 1993, Sen. Mrvan Worman introduced Senate Bill 136, which would have had the effect of subordinating corporate employees' liens to security interests filed with the county recorder's office. S.B. 136, 108th Gen. Assembly, 1st Reg. Sess. (1993).

The bill unanimously passed the Senate on February 16, 1993, and was sent to the House of Representatives. On April 5, 1993, the House approved an amended version of Senate Bill 136, but it completely excluded Sen. Worman's proposed changes to the employees' lien statute. As of publication time, no bills had been passed that amend the lien statute.

76. 594 N.E.2d 459 (Ind. Ct. App. 1992).

77. 455 N.E.2d 382 (Ind. Ct. App. 1983).

78. 399 N.E.2d 794 (Ind. Ct. App. 1980), *trans. denied*, 425 N.E.2d 73 (Ind. 1981).

79. *Stephenson*, 399 N.E.2d at 796.

80. IND. CODE § 26-1-2-105 (1992).

fall within the definition of "goods." These contractual provisions were for the performance of services and thus the issues pertaining to them must be determined by common law and contract principles.<sup>81</sup>

In so holding, the fourth district adopted the minority position that in mixed transactions the UCC applies to that portion of the contract involving the sale of goods, and general contract principles apply to that portion of the contract which relates to services.

The *Baker* case involved a contract in which Baker agreed to purchase a number of furnaces, air conditioners and water heaters from Compton to be installed by Compton in a building Baker was renovating. Before any of the equipment was installed, a dispute arose as to whether the proposed configuration of the equipment would properly regulate the temperature of the space. Baker refused to pay the initial installment of the purchase price due upon delivery of the equipment, and eventually sued for rescission of the contract.<sup>82</sup> The second district in *Baker* recognized that the contract represented a "mixed" transaction involving both goods and services. This second district decision expressly declined to follow the *Stephenson* case. It held that

[t]he test for inclusion or exclusion is not whether they are mixed, but, granting that they are mixed, whether their predominant factor, their thrust, their purpose, reasonably stated, is the rendition of service, with goods incidentally involved (e.g., contract with artists for painting) or as a transaction of sale, with labor incidentally involved (e.g., installation of a water heater in a bathroom).<sup>83</sup>

In so holding, the second district adopted the majority position, providing that the UCC applies to the entire contract if its "predominant thrust" is the sale of goods rather than the rendition of services.<sup>84</sup> If not, general contract law applies to the whole transaction. The *Baker* court felt that "the uniformity and clarity sought to be promoted by the UCC are better served by determining the predominant thrust of a mixed goods and services contract."<sup>85</sup>

The fourth district used the case of *Data Processing Services, Inc. v. L.H. Smith Oil Corp.*<sup>86</sup> to express its view of the *Baker* decision. In this case, Data Processing Services (DPS) and L.H. Smith Oil Corp.

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81. *Stephenson*, 399 N.E.2d at 797.

82. *Baker v. Compton*, 455 N.E.2d 382, 384-85 (Ind. Ct. App. 1983).

83. *Id.* at 386 (citing *Bonebreak v. Cox*, 499 F.2d 951, 960 (8th Cir. 1974) (footnotes omitted)).

84. *Id.* at 387. *See also* *Insul-Mark Midwest, Inc. v. Modern Materials, Inc.*, 594 N.E.2d 459, 463 (Ind. Ct. App. 1992), and authorities cited therein.

85. *Baker*, 455 N.E.2d at 387.

86. 492 N.E.2d 314 (Ind. Ct. App. 1986).

had entered into an agreement providing that DPS would develop a computer software program for Smith's accounting needs. The trial court held that the program to be developed by DPS was a "good" under the UCC. The fourth district disagreed and found that the program was not a "good" governed by the UCC and, therefore, no part of the contract would be governed by the provisions of the UCC.<sup>87</sup> The fourth district reiterated its "bifurcation" approach. The UCC applies to the goods portion of a contract and common law applies to the services portion of a contract. The court rather tersely rejected the "predominant thrust" approach by citing the legal maxim "*inclusio unius est exclusio alterius*."<sup>88</sup> Thus, as a matter of statutory construction, the fourth district holds that because the UCC applies to a sale of goods and only a sale of goods, it can never be applied to a portion of a contract which does not involve the sale of goods. Likewise, if part of a contract involves a sale of goods, the court must apply the UCC to that portion of the contract which relates to the sale of goods.

The third district of the court of appeals has joined the fray in *Insul-Mark Midwest*. In this case, Insul-Mark contracted with Modern Materials to have Modern Materials coat Insul-Mark's roofing screws with a supposedly rust-retardant coating. Modern Materials applied the coating to Insul-Mark's roofing screws and Insul-Mark began selling the coated screws. Unfortunately, the coating process did not work and the screws began to rust immediately. Insul-Mark sued Modern Materials seeking damages.<sup>89</sup> The third district had to decide whether the UCC applied to this contract in order to determine what warranties would be available to Insul-Mark. The court reviewed the different approaches adopted by *Stephenson* and *Baker* and decided the better view was set forth in *Baker*. The court determined the predominant thrust of the contract was providing a service, and not selling goods.<sup>90</sup>

Although *Stephenson* has been criticized,<sup>91</sup> it is not without merit. The bifurcation approach clearly attempts to construe the UCC strictly by limiting it to transactions specifically within its stated scope. If a "mixed" transaction can be easily separated into its goods component and its services component, then there should be little difficulty in applying the bifurcation approach.<sup>92</sup>

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87. *Id.* at 318.

88. *Id.*

89. *Insol-Mark Midwest, Inc. v. Modern Materials, Inc.*, 594 N.E.2d 459, 461-62 (Ind. Ct. App. 1992).

90. *Id.* at 463.

91. See, e.g., Gerald L. Bepko, *Contracts, Commercial Law, and Consumer Law*, 14 IND. L. REV. 223, 224 (1981).

92. One noted commentator has stated that when a case does not involve difficulties

The two approaches can be reconciled. In cases where the contract can easily be separated into goods and services components, the bifurcation approach should be used. For instance, the *Stephenson* case can easily be divided into the sale of the modular home and the installation of the foundation. If the dispute arose concerning the modular home (a sale of goods), then the UCC would be applied by the courts to resolve the dispute. On the other hand, if the dispute arose concerning the installation of the foundation (the provision of services), then the common law would be applied by the courts to resolve the dispute. In cases like *Insul-Mark*, however, it is impossible to separate the goods from the services. Because of this inability to segregate the component parts of the contract, the "predominant thrust" approach would apply. The courts should strive to construe statutes strictly. The bifurcation approach clearly attempts to do so. Only where a contract cannot easily be bifurcated, or where bifurcation presents difficult problems of proof or remedies, should the predominant thrust approach be used.

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such as separating a contract into its goods component and its services component, or: insurmountable problems of proof in segregating assets and determining their respective values at the time of the original contract and at the time of resale, in order to apply two different measures of damages", [there is] no reason not to apply two bodies of law to the same transaction: the Article Two law to the sale of goods and the non-Article Two law to the rest.

1 WHITE & SOMMERS, *supra* note 64, at 26 (quoting *Hudson v. Town & Country True Value Hardware, Inc.*, 666 S.W.2d 51 (Tenn. 1984)).

