JUDICIAL DEVELOPMENTS IN CORPORATIONS, CONTRACTS, AND COMMERCIAL LAW

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INTRODUCTION

This Article surveys several interesting judicial developments in Indiana corporation law, commercial law and contract law from December 1, 1994 through December 1, 1995.

I. CORPORATION LAW—PIERCING THE CORPORATE VEIL

On December 20, 1994, the Indiana Supreme Court reversed a trial court's judgment, and in the process, clarified and simplified the concept of piercing the corporate veil.[1]

A. Factual Background

In April of 1990, Spencer Aronson went to Corbitt's Body Shop to get an estimate on restoring his 1957 automobile to show condition. The estimate did not reveal that Corbitt's Body Shop was owned by Corbitt's Body Shop, Inc., an Indiana Corporation. Kent E. Price and Sandra Price were the sole officers, directors and shareholders of Corbitt's Body Shop, Inc.[2]

A couple of months later, Aronson took his car to the shop to have the restoration work performed. While the car was in the shop, the business name of the shop was changed to Shadow's Body Shop and Aronson was given a business card reflecting the name change. At no time was Aronson told that the body shop was incorporated, nor did any of the shop's signs, business cards or business forms indicate that the shop was incorporated.[3]

In early October, Aronson had the car towed to an automobile paint shop because the car had been damaged while at Shadow's Body Shop.[4] Subsequently, Aronson brought suit against Kent E. Price d/b/a Corbitt's Body Shop, Corbitt's Body Shop, Inc. and Shadow's Body Shop. The trial court entered a joint and several judgment against Price and Corbitt's Body Shop, Inc.[5] In order to enter judgment against Price individually, the trial court pierced the corporate veil based on the following facts:

> (1) the sign on the front of the shop, the business cards, and the receipts did not indicate that the business was incorporated . . . ; (2) neither Price nor his employees informed Aronson that he was dealing with a

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1. Aronson v. Price, 644 N.E.2d 864 (Ind. 1994).
2. *Id.* at 866.
3. *Id.*
4. *Id.*
5. *Id.*

> corporation; and (3) a certificate of assumed name was not filed with the state until May 3, 1991 . . . .[6]

Price appealed the judgment against him personally, and the court of appeals reversed the trial court.[7] In doing so, the court of appeals held that: (1) Indiana Code section 23-1-23-1(a) simply establishes administrative procedures for indicating corporate status in the records of the secretary of state; (2) failure to inform Aronson that the body shop was incorporated does not justify piercing the corporate veil; and (3) failure to comply with Indiana Code section 23-15-1-1 is, by itself, insufficient to justify piercing the corporate veil.[8] Aronson then appealed to the Indiana Supreme Court.

B. The Majority Opinion

The supreme court explained that under certain circumstances, an Indiana court will impose personal liability on a shareholder to protect an innocent third party from fraud or injustice. However, the burden is on the party seeking to impose personal liability to prove that "the corporate form was so ignored, controlled or manipulated that it was merely the instrumentality of another and that the misuse of the corporate form would constitute a fraud or promote injustice."[9]

> In deciding whether a plaintiff has met this burden of proof, an Indiana court considers whether the plaintiff has presented evidence showing: (1) undercapitalization; (2) absence of corporate records; (3) fraudulent representation by corporation shareholders or directors; (4) use of the corporation to promote fraud, injustice or illegal activities; (5) payment by the corporation of individual obligations; (6) commingling of assets and affairs; (7) failure to observe required corporate formalities; or (8) other shareholder acts or conduct ignoring, controlling, or manipulating the corporate form.[10]

1. Failure to use Indicator of Corporate Status.—In *Aronson*, the trial court first concluded that the failure of the corporation to include an indicator of corporate status in its name as used on business cards and business forms in violation of Indiana Code section 23-1-23-1[11] exposed corporate shareholders to

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6. *Id.*

7. Price v. Aronson, 629 N.E.2d 268 (Ind. Ct. App. 1994).

8. *Id.* at 270-71.

9. *Aronson*, 644 N.E.2d at 867 (citing Winkler v. V.G. Reed & Sons, Inc., 638 N.E.2d 1228, 1232 (Ind. 1994)).

10. *Id.* (citing Eden United, Inc. v. Short, 573 N.E.2d 920, 933 (Ind. Ct. App. 1991), *trans. denied*; Stacey-Rand, Inc. v. J.J. Holman, Inc., 527 N.E.2d 726, 728 (Ind. Ct. App. 1988); State v. McKinney, 508 N.E.2d 1319, 1321 (Ind. Ct. App. 1987)).

11. IND. CODE § 23-1-23-1 (1993). The statute provides in the relevant part that a corporate name:

> (1) must contain the word "corporation", "incorporated", "company", or "limited", or the abbreviation "corp", "inc.", "co.", or "ltd.", or words or abbreviations of like import

personal liability.[12] In reversing the trial court, the supreme court explained that:

> Indiana Code § 23-1-23-1 does not require an Indiana corporation to use words designating its corporate form in its signage, business forms, invoices, or business cards. The requirements of this section of the Indiana Code go only to legal requirements of a corporate name for purposes of issuance of a corporate charter by the Indiana Secretary of State.[13]

In fact, the corporation's official name included a corporate designation, but the name used by the corporation on a daily basis included no such designation. "There is no requirement in the corporate code that a corporation must do business under the name by which it was chartered, and we refuse to read any such requirement into the statute."[14]

2. *Failure to File Assumed Business Name Certificate.*—The *Aronson* trial court based its decision to pierce the corporate veil on the failure of the corporation to file an assumed business name certificate with the county recorder. Although the supreme court concluded that the corporation was indeed in violation of Indiana Code section 23-15-1-1,[15] the court also concluded that such a violation is insufficient to justify imposing personal liability on corporate shareholders.[16] The court explained that "the legislature intended the assumed business name filing requirement to provide information to litigants and others as to the true party in interest when contracts are made or business is done in an assumed name."[17] The court found "no basis in law for imposing personal liability on a shareholder for acts of the corporation solely because the failure of a corporation to file an assumed business name certificate under Indiana Code § 23-15-1-1."[18]

Although it is true that adherence to corporate formalities is a proper consideration when determining whether the corporate veil should be pierced, "[c]orporate formalities for this purpose include proper corporate filings, the

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in another language; and

(2) except as provided in subsection (e), may not contain language stating or implying that the corporation is organized for a purpose other than permitted by IC 23-1-22-1 and its articles of incorporation.

12. *Aronson*, 644 N.E.2d at 868.

13. *Id.*

14. *Id.*

15. IND. CODE § 23-15-1-1 (1993). The statute provides in relevant part that:

a person conducting or transacting business in Indiana under a name, designation, or title other than the real name of the person conducting or transacting such business . . . shall file for record, in the office of the recorder of each county in which a place of business or an office of the . . . corporation . . . is situated, a certificate stating the assumed name to be used and, . . . the address of the corporation's . . . principal office in Indiana.

16. *Aronson*, 644 N.E.2d at 868.

17. *Id.* (citing Humphrey v. City Nat'l Bank, 130 N.E. 273, 277 (Ind. 1921)).

18. *Id.*

issuance of stock, election of directors and officers, shareholders and directors meetings, resolutions authorizing payments and corporate minutes."[19] Because corporate designation on business signs and stationary is not a corporate formality that must be adhered to, failure to designate corporate status on signs and stationary cannot be the basis for piercing the corporate veil. "Thus, the only evidence to support piercing the corporate veil present in this case is the failure to observe the corporate formality of filing an assumed business name certificate . . . . [S]uch evidence alone is insufficient to impose personal liability on a shareholder."[20] Accordingly, the supreme court reversed the trial court's judgment against Price and affirmed the court of appeals.

C. The Dissenting Opinion

Justice Dickson viewed the dispute from a different perspective altogether. In his dissent, Justice Dickson construed the issue as "whether the defendant dealt with the plaintiff on behalf of an undisclosed principal."[21] He noted that "neither the plaintiff's complaint nor the initial trial court judgment makes any mention of 'piercing the corporate veil.'"[22] From this perspective, Justice Dickson concluded that the shareholder, Price, who failed "to disclose from the outset the existence of the corporation," should not be entitled to escape personal liability where the plaintiff, Aronson, was unaware that he was dealing with a corporation.[23]

D. Conclusion

In *Aronson*, the Indiana Supreme Court established a clear and unambiguous approach to determining whether to pierce a corporate veil.[24] Whether piercing the corporate veil should have been an issue on appeal is not nearly so clear.

II. COMMERCIAL LAW—IMPAIRMENT OF COLLATERAL

On June 25, 1995, the Indiana Supreme Court made clear the applicability of the impairment of collateral defense specifically set forth in Indiana's version of the Uniform Commercial Code (UCC), Indiana Code section 26-1-3-606.[25]

A. Factual Background

Robert and Anne Letsinger (the "Letsingers") were shareholders of T-C Crop

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19. *Id.*
20. *Id.* at 869.
21. *Id.* (Dickson, J., dissenting).
22. *Id.*
23. *Id.* at 870 (quoting Record at 38).
24. *Id.* at 864.
25. Farmers Loan & Trust Co. v. Letsinger, 652 N.E.2d 63, 64 (Ind. 1995). Indiana Code section 26-1-3-606 (1993) is a part of Indiana common law that defines situations where the UCC does not apply.

Care, Inc. ("T-C").[26] On November 21, 1982, Farmers Loan & Trust Co. (the "Bank") loaned T-C $32,998.39 in exchange for a promissory note signed by the Letsingers in both their individual capacity and in their business capacity as officers of T-C. The promissory note gave the Bank a security interest in all of T-C's plant, buildings, fixtures and equipment, as well as all additions, accessions, accessories and replacements thereto. The note further gave the Bank a first lien and security interest on any product and proceeds from T-C's present and future accounts receivable and inventory. The Letsingers subsequently signed a separate guaranty on the loan on December 31, 1982.[27]

Two years later, "T-C granted a second lien and security interest in the same corporate property and assets to [another corporation], . . . which lien was duly perfected."[28] Initially, this second lien was subordinate to the lien held by the Bank, but it gained priority when the Bank failed to re-file a financing statement or a continuation statement.[29]

In February 1989, the Letsingers executed renewal notes and a new guaranty for T-C's debt to the Bank. The renewal notes contained a waiver of defenses provision designed to prevent the Letsingers from claiming that the Bank had impaired the security for the loan.[30] Soon thereafter, T-C filed for bankruptcy and the bankruptcy court ordered T-C to liquidate its assets to pay creditors. The majority of the proceeds went to pay the first priority security interest, resulting in a deficiency of $115,554.41 owed to the Bank.[31] The Bank brought suit against the Letsingers to recover the deficiency.

At trial, the court found that the Letsingers had endorsed the promissory notes as accommodation parties.[32] The Letsingers, as accommodating parties to a negotiable instrument, were entitled to the defense of unauthorized impairment of collateral.[33] The trial court found that the Letsingers had not consented to the impairment of collateral that occurred when the Bank allowed its priority interest to lapse and permitted the Letsingers to assert the unauthorized impairment of collateral defense.[34]

In its Petition to Transfer, the Bank did not dispute the trial court's findings with respect to the Letsinger's liability as accommodation parties. Instead, it challenged whether the Letsingers were entitled to the use of an impairment of

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26. *Farmers*, 652 N.E.2d at 64 (quoting Farmers Loan & Trust Co. v. Letsinger, 635 N.E.2d 194, 195-96 (Ind. Ct. App. 1994)).

27. *Id.*

28. *Id.*

29. *Id.* at 64-65.

30. *Id.* at 65.

31. *Id.*

32. *See* IND. CODE § 26-1-3.1-419(c) (Supp. 1995).

33. The relevant part in 1994 was IND. CODE § 26-1-3-606 (1993). Effective July 1, 1994, sections 26-1-3-101 to -805 were repealed. Subsequently, chapter 3.1 contains similar provisions and now the relevant section is IND. CODE § 26-1-3.1-605 (Supp. 1995).

34. *Farmers*, 652 N.E.2d at 65.

collateral defense on the Bank's claim against them as guarantors.[35] The Bank alleged that because the guaranty was a non-negotiable instrument the UCC was therefore inapplicable.[36]

B. Applicability Of The Uniform Commercial Code

"The guaranty executed by the Letsingers was not a negotiable instrument because, *inter alia*, it was an unlimited guarantee, and so not a promise to pay a sum certain."[37] As such, the UCC does not apply and instead, Indiana common law and the law of equity apply.[38]

C. Indiana Common Law and Equity

Because the UCC was inapplicable, the supreme court relied on Indiana common law.[39] The Court found that Indiana has recognized the impairment of collateral defense well before adoption of the UCC noting that:

> In *Stewart v. Davis' Executor* (1862), 18 Ind. 74, we said: It is a well settled principle of equity, that a creditor, who has the personal contract of his debtor, with a surety, and has also, or afterwards takes property from the principal, as a pledge or security for the debt, is to hold the property fairly and impartially, for the benefit of the surety as well as himself, and if he parts with it, without the knowledge or against the will of the surety, he shall lose his claim against the surety to the amount of the property so surrendered.[40]

Furthermore, in *Weed Sewing Machine Co. v. Winchel*,[41] the court said that "[g]uarantors and sureties are exonerated if the creditor by any act, done without their consent, alters the obligation of the principal in any respect, or impairs or suspends the remedy for its enforcement."[42]

The court explained the rationale for allowing a guarantor to assert the impairment of collateral defense. The court stated that:

> [T]he guarantor at the time of making a guaranty may make the judgment that the collateral for the loan to the guarantor's principal will be sufficient to cover the debt. If the creditor impairs the collateral, and the guarantor has not consented to release or other impairment of the

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35. *Id.*

36. *Id.*

37. *Id.* (citation omitted). The relevant section can be found at IND. CODE § 26-1-3.1-104 (a) (Supp. 1995).

38. *Farmers*, 652 N.E.2d at 65.

39. *Id.*

40. *Id.* at 66 (quoting Stewart v. Davis' Executor, 18 Ind. 74, 75-76 (1862)).

41. 7 N.E. 881 (Ind. 1886).

42. *Id.* at 884.

> collateral, the guarantor may become exposed to liability beyond the guarantor's expectation at the time the parties entered into the contract.[43]

In fact, if the priority security interest in corporate property had not been permitted to lapse, the collateral would have covered T-C's debt to the Bank and the Letsingers would not have incurred personal liability.[44]

Additionally, the court explained that "a guarantor who satisfies the principal debtor's obligation to the creditor generally steps into the shoes of the creditor, becoming subrogated to the creditor's claim and assuming both the creditor's rights and duties."[45] As a result, a creditor who impairs its recourse against a debtor cannot pass the consequence of that impairment on to a guarantor. Instead, the creditor must suffer the consequences of its own mistake.

D. Conclusion

In *Farmers Loan & Trust Co. v. Letsinger*, the Indiana Supreme Court found that Indiana law has long provided that when a creditor unjustifiably impairs collateral securing a debt, guarantors of that debt should be discharged to the extent that the creditor has impaired the collateral, regardless of whether the UCC or common law principles apply.

III. CONTRACTS—INDEMNIFICATION CLAUSES

In *Morris v. McDonald's Corp.*,[46] the Indiana Court of Appeals explained the effects of exculpatory and indemnity clauses. The court of appeals reversed the trial court's decision to grant McDonald's Corp.'s ("McDonalds") motion for summary judgment based on exculpatory and indemnity clauses contained in the agreement with McDonalds' franchisee.

A. Factual Background

In February 1993, Morris tripped and suffered personal injuries inside a McDonalds' restaurant operated by a McDonalds' franchisee, GBS Restaurants, Inc. (GBS).[47] The Morrises later filed suit against GBS and McDonalds under claims of negligence, nuisance, and loss of service. McDonalds moved for partial summary judgment asserting the indemnity and exculpation clauses in the lease shielded McDonalds from liability.[48] The trial court granted McDonalds' motion and Morris appealed the judgment.

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43. *Farmers*, 652 N.E.2d at 66.
44. *Id.* at 66-67.
45. *Id.* at 67 (citing Ertel v. Radio Corp. of Am., 307 N.E.2d 471, 474 (Ind. 1974)).
46. 650 N.E.2d 1219 (Ind. Ct. App. 1995).
47. *Id.* at 1221.
48. *Id.*

B. The Effect Of Exculpatory and Indemnity Clauses

McDonalds argued that under the franchise operator's lease, GBS assumed all further liability for occurrences on the premises and therefore, McDonalds was shielded from suit by the Morrises.[49] Even though, McDonalds' argument was faulty, the trial court accepted it and granted partial summary judgment. In its opinion, the court of appeals asserted that "McDonalds' argument demonstrates some confusion between the definition of an exculpatory clause and the definition of an indemnity clause."[50] In fact, neither an exculpatory clause nor an indemnity clause can produce the effect desired and advocated by McDonalds.

"An exculpatory clause covers the risk of harm sustained by the exculpator [here, GBS] that might be caused by the exculpatee [here, McDonalds]. By releasing the exculpatee from liability for such harm, an exculpatory clause deprives the exculpator of its right to recover damages for the exculpatee's negligence."[51] Thus, by agreeing to the exculpatory provision, "GBS relinquished its right to hold McDonalds liable for McDonalds' acts of negligence toward GBS."[52] "On the other hand, an indemnity clause covers the risk of harm sustained by third persons that might be caused by either the indemnitor or the indemnitee. It shifts the financial burden for the ultimate payment of damages from the indemnitee to the indemnitor."[53] Thus, in this case, if the Morrises ultimately prevail against McDonalds, GBS will suffer the consequences.

Therefore, the court concluded that:

> neither an exculpatory nor an indemnity clause [can] shield McDonalds from suit by a third party injured as a result of McDonalds' and/or GBS's negligence. While a party can ordinarily contract out his duty to exercise reasonable care with respect to another contracting party via a simple exculpatory provision, a party cannot contract out his duty to exercise reasonable care with respect to third parties.[54]

Thus, because the Morrises were not parties to the lease between McDonalds and GBS, the provisions of the lease cannot bind them and the exculpatory and indemnity clauses are not determinative of their rights against McDonalds.

C. Conclusion

Although *Morris v. McDonald's Corp.* added little to Indiana's existing law, the opinion highlights the differences between exculpatory clauses and indemnity clauses and clarifies the effects (or lack thereof) that such provisions have on third parties.

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49. *Id.* at 1222.
50. *Id.*
51. *Id.*
52. *Id.*
53. *Id.* (citation omitted).
54. *Id.* at 1222-23.

IV. CONTRACTS—EXCULPATORY CLAUSES

A split of authority developed early in the survey period when the Indiana Court of Appeals apparently disagreed with a previous panel's review of similar facts. In *Pinnacle Computer Services, Inc. v. Ameritech Publishing, Inc.*,[55] the court of appeals re-examined whether an exculpatory provision limiting a party's liability to the contract price or the amount actually paid is unconscionable. The court decided that such an exculpatory provision is not unconscionable.

A. Factual Background

On August 30, 1992, the president of Pinnacle Computer Services, Inc. ("Pinnacle") met with an Ameritech Publishing, Inc. ("Ameritech") representative to place an order for an advertising listing in the Ameritech Pages Plus directories ("Yellow Pages").[56] When the Yellow Pages were published, the listing was mistakenly printed under the wrong heading. Pinnacle filed suit to recover its damages and Ameritech moved for summary judgment based upon an exculpatory provision on its order form.[57] The exculpatory clause read as follows:

> PUBLISHER'S LIABILITY: . . . IF PUBLISHER SHOULD BE FOUND LIABLE FOR LOSS OR DAMAGE DUE TO A FAILURE ON THE PART OF THE PUBLISHER OR IT DIRECTLY, IN ANY RESPECT, REGARDLESS OF WHETHER CUSTOMER'S CLAIM IS BASED ON CONTRACT, TORT, STRICT LIABILITY OR OTHERWISE, THE LIABILITY SHALL BE LIMITED TO AN AMOUNT EQUAL TO THE CONTRACT PRICE FOR THE DISPUTED ADVERTISEMENTS, OR THAT SUM OF MONEY ACTUALLY PAID BY THE CUSTOMER TOWARD THE DISPUTED ADVERTISEMENTS, WHICHEVER SUM SHALL BE LESS, AS LIQUIDATED DAMAGES AND NOT AS A PENALTY, AND THIS LIABILITY SHALL BE EXCLUSIVE . . . .[58]

The trial court granted Ameritech's motion and Pinnacle appealed.[59]

B. Enforceability of Exculpatory Clauses

On appeal, Pinnacle argued that the exculpatory clause relied upon by Ameritech was unconscionable and unenforceable as against public policy.[60] As an introductory matter, the court explained that:

> As a general rule, the law allows persons of full age and competent understanding the utmost liberty of contracting and their contracts, when

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55. 642 N.E.2d 1011 (Ind. Ct. App. 1994).
56. *Id.* at 1012.
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.* at 1013.

> entered into freely and voluntarily, are enforced by the courts. . . . Accordingly, the parties to a contract are free to include in the agreement any provisions they desire so long as such provisions do not offend the public policy of this state.[61]

Thus, it is possible to "contract out of" the duty to exercise reasonable care.[62] "Although no public policy exists to prevent contracts containing exculpatory clauses, some exceptions do exist where the parties have unequal bargaining power, the contract is unconscionable, or the transaction affects the public interest . . . ."[63]

C. Pigman v. Ameritech Publishing, Inc.

Pinnacle Computer Services, Inc. is interesting because the Indiana Court of Appeals had previously decided a similar case concerning the same disputed exculpatory clause. In *Pigman v. Ameritech Publishing, Inc.*,[64] the court sided with a minority of jurisdictions and held that the provision in question was unconscionable and void as against public policy.[65]

In declining to follow *Pigman*, the court in *Pinnacle* explained that "a standardized contract is not unenforceable merely because of the unequal bargaining power of the parties. There must also be a showing that the contract is unconscionable."[66] "A contract will be held void as against public policy only where one party is at such a disadvantage in bargaining power that the effect of the contract is to put him at the mercy of the other's negligence."[67] "In addition, the contract must be one that no sensible person not under delusion, duress or in distress would make, and one that no honest and fair person would accept."[68]

In *Pinnacle*, although Ameritech's publication was the only Yellow Pages directory in the Evansville area, other means of advertising were available. Also, Pinnacle had dealt with Ameritech for several years and was not an uninformed customer.[69] In brief, the court concluded that the circumstances were not such that Pinnacle should be permitted to escape the effect of the exculpatory clause contained in the order form.

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61. *Id.* at 1013-14 (citing Fresh Cut, Inc. v. Fazli, 630 N.E.2d 575, 577 (Ind. Ct. App. 1994)).

62. *Id.* (citing *Fresh Cut, Inc.*, 630 N.E.2d at 578).

63. *Id.* at 1014.

64. 641 N.E.2d 1026 (Ind. Ct. App. 1994).

65. *Id.* at 1035.

66. *Pinnacle*, 642 N.E.2d at 1016 (citing Rumple v. Bloomington Hosp., 422 N.E.2d 1309, 1313 (Ind. Ct. App. 1981), *trans. denied*).

67. *Id.* (citing LaFrenz v. Lake City Fair Bd., 360 N.E.2d 605, 608 (Ind. Ct. App. 1977)).

68. *Id.* at 1017 (citing Weaver v. American Oil, 276 N.E.2d 144, 146 (Ind. 1971)).

69. *Id.* at 1016.

D. Conclusion

While *Pinnacle* compiles and explains Indiana law on unconscionability, it adds little to Indiana's existing law. However, the split of authority on whether the particular exculpatory clause used in Ameritech Publishing's order forms is unconscionable and unenforceable may make for an interesting case in the future.