

# SURVEY OF RECENT DEVELOPMENTS OF THE LAW CONCERNING THE UNIFORM COMMERCIAL CODE

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## INTRODUCTION

During the period covered by this survey, there were no reported Indiana Supreme Court cases addressing the Uniform Commercial Code (UCC). The Indiana Court of Appeals issued a limited number of decisions covering the areas of Sales, Negotiable Instruments, Bank Collections, and Investment Securities. These court of appeals decisions do not mark significant developments in Indiana law, but rather provide clarification of existing law and offer helpful points for those engaged in commerce. No federal court decisions offering any substantive discussion of the Indiana UCC were reported in the period covered by this survey.

Cases discussed herein, notably *Brandeis Machinery & Supply Co., LLC v. Capitol Crane Rental, Inc.*,<sup>1</sup> and *Roberts v. Agrifac Credit Acceptance Corp.*,<sup>2</sup> reflect fundamental principles of the UCC and Indiana law that parties are free to contract—even when the result is not as favorable as they might like. This means that parties to commercial contracts are entitled to the benefit of the bargain they make, but that the courts will not step in and convert a commercial transaction into a tort or impose fiduciary-like obligations on the parties.

### I. ARTICLE 2—SELLER'S REMEDIES

In *Brandeis Machinery & Supply Co., LLC v. Capitol Crane Rental, Inc.*, the court of appeals addressed the appropriate measure of damages when a buyer made an effective, but nonetheless wrongful, rejection of goods.<sup>3</sup> Brandeis and Capitol originally entered into an agreement whereby Brandeis leased a thirty-five ton crane to Capitol for a six-month period.<sup>4</sup> After first extending the lease agreement for a second six-month period, Capitol entered into an agreement dated June 16, 1999 to purchase the crane.<sup>5</sup> Capitol agreed to buy the crane for \$291,773.46 “as is-where is.”<sup>6</sup> Brandeis signed the contract on June 22, 1999,

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1. 765 N.E.2d 173 (Ind. Ct. App. 2002).

2. 764 N.E.2d 776 (Ind. Ct. App. 2002).

3. *Brandeis*, 765 N.E.2d at 173.

4. *Id.* at 175.

5. *Id.*

6. *Id.* The contract also provided that the payment terms were “Net 10 days from invoice date . . . . If not paid on due date, 2% per month service charge will be applied.” *Id.*

and sent an invoice for the crane to Capitol on June 29, 1999.<sup>7</sup>

In June 1999, a third party inquired about purchasing Capitol.<sup>8</sup> Capitol's owner decided to sell the business to the third party.<sup>9</sup> Capitol promptly made some repairs to the crane and returned it to Brandeis.<sup>10</sup> Brandeis refused to attempt to re-sell the crane, and maintained that Capitol was the owner of the Crane.<sup>11</sup> Eventually, Brandeis expended \$9,794.86 to inspect the repairs that Capitol had made to the crane.<sup>12</sup> At the trial, Brandeis' Indianapolis Branch Manager testified that the inspection was made because he was under the impression that the parties had come to some form of agreement and that Brandeis would attempt to sell the crane.<sup>13</sup> Brandeis' lead salesman also testified at trial that Brandeis had a practice of allowing customers to cancel contracts when money had not yet been exchanged and that Brandeis considered a transaction "final" only "when payment was made."<sup>14</sup>

Following the trial, both parties submitted post-trial briefs that included their calculation of the appropriate amount of Brandeis' damages. Brandeis contended it was entitled to the contract price (\$291,773.46) and interest upon the contract price that had reached \$159,302.38 as of May 31, 2001.<sup>15</sup> In addition, Brandeis also included the inspection costs it had incurred after Capitol returned the crane, for a total demand of \$460,870.70.<sup>16</sup> In reply, Capitol stated that if any damages were due then they should be limited to the difference between the fair market value of the crane and the contract price at the time of rejection.<sup>17</sup> This would result in an award of \$19,273.46. The court awarded Brandeis \$29,067.00, which apparently represented the trial court's acceptance of the measure of damages proposed by Capitol, together with its award of the amount expended by Brandeis in inspecting the crane repairs.<sup>18</sup>

Brandeis appealed the trial court's decision to reject Brandeis' contract price as the correct measure of damages and because the trial court did not award any late-payment charges to Brandeis. Brandeis first alleged that it was entitled to the full contract price under section 26-1-2-709 of the Indiana Code because Capitol had accepted the crane before returning it.<sup>19</sup> The court of appeals began its analysis by noting that the UCC did not provide much guidance as to the

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7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.* at 175-76.

14. *Id.* at 176.

15. *Id.*

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.* at 177.

appropriate level of damages in the case before it.<sup>20</sup> The court of appeals observed that one of the principles animating the UCC's remedial provisions was that "the aggrieved party be put in as good a position as if the other party had fully performed, but not in a better position."<sup>21</sup> This principle is consistent with Indiana common law of contracts.<sup>22</sup>

The court went on to note correctly that, under section 26-1-2-709, an action for the price of goods may be maintained only if a buyer has accepted goods or the goods have been lost or damaged to the extent that they are not resalable.<sup>23</sup> The UCC, as adopted in Indiana, defines acceptance as the failure "to make an effective rejection."<sup>24</sup> If Capitol's rejection had been effective, i.e., if it had not accepted the goods, then the court concluded that the appropriate measure of damages was governed by section 26-1-2-708. Section 26-1-2-708 states that damages should be measured as the difference between the fair market value of the property at the date of rejection and the contract price plus any incidental damages and minus any expenses saved as a result of the buyer's breach.<sup>25</sup> The court, therefore, analyzed whether Capitol had made an ineffective rejection of the crane so as to justify Brandeis' proposed remedy.

The court carefully drew the distinction between the issue as to whether a rejection was "wrongful" and whether it was "effective." The court acknowledged that Capitol's rejection was "wrongful" in that it had rejected goods that conformed to the contract with Brandeis, but correctly identified the relevant inquiry for purposes of determining the correct amount of damages as whether the rejection was "effective."<sup>26</sup> This distinction between an effective, but "wrongful," rejection and an ineffective rejection is also consistent with the underlying policy of the UCC and Indiana contract law to permit parties to break contracts without imposing punitive sanctions.<sup>27</sup> The parties to a commercial sales contract are entitled to the benefit of their bargain—no less, but no more.

Under section 26-1-2-602(1) of the Indiana Code, a rejection of goods must be made "within a reasonable time after their delivery or tender. It is ineffective unless the buyer seasonably notifies the seller."<sup>28</sup> This determination, the court of appeals noted, was obviously dependent upon the "nature, purpose, and circumstances of the situation."<sup>29</sup> In the present case, the court of appeals concluded that the trial court was justified in finding that Capitol's rejection was effective because Capitol promptly returned the crane, the evidence demonstrated that Brandeis had a policy of canceling contracts after customers signed them but

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20. *Id.*

21. *Id.*

22. *See, e.g.,* Allstate Ins. Co. v. Hammond, 759 N.E.2d 1162, 1166-67 (Ind. Ct. App. 2001).

23. *Brandeis*, 765 N.E.2d at 177.

24. IND. CODE § 26-1-2-606 (2002).

25. *Brandeis*, 765 N.E.2d at 178.

26. *Id.* at 178-79.

27. *Miller Brewing Co. v. Best Beers of Bloomington, Inc.*, 608 N.E.2d 975, 981 (Ind. 1993).

28. *Brandeis*, 765 N.E.2d. at 177.

29. *Id.* at 179.

before any money was exchanged, Brandeis' salesman had testified that transactions were considered final only when payment was made, and Brandeis had inspected the crane after its return to prepare it for sale.<sup>30</sup> *Brandeis* demonstrates the critical distinction between, and consequences flowing from, a buyer's effective or ineffective rejection. In this case, the distinction accounted for a difference of several hundred thousand dollars.<sup>31</sup> Close attention should be paid to the guidance in the *Brandeis* decision as to what measure of damages is appropriate when a party rejects goods that conform to the parties' contract. *Brandeis* confirms that a party rejecting goods should always strive to notify the seller as soon as possible as to its intent to reject.

## II. ARTICLE 2A—FRAUDULENT INDUCEMENT OF LEASE CONTRACT

In *Lighting Litho, Inc. v. Danka Industry, Inc.*,<sup>32</sup> the court of appeals confirmed that Indiana is among those jurisdictions that measure damages in fraudulent inducement and fraudulent misrepresentation cases using the "benefit of the bargain" rule. Litho was a small printer that typically produced 5000 to 20,000 copies per month.<sup>33</sup> Danka's salesman continually pressured Litho to lease a high-capacity copier that could produce 500,00 to 1,000,000 copies per month.<sup>34</sup> Danka's salesman and a company manager represented to Litho's owner that they would provide to Litho an existing business account that would more than off-set the cost of the lease and, in fact, allow Litho to make a profit, if Litho leased the high-capacity machine.<sup>35</sup> Litho's owner ultimately agreed to enter into a lease for a sixty-month period at a cost of \$755 per month. Litho also signed a service and supply contract.<sup>36</sup> After signing the lease, Litho quickly found out that the supposed contract did not exist, and it sued to rescind the lease contract.<sup>37</sup> During the trial, Litho changed its strategy and amended its complaint to ask for tort and breach of contract damages.<sup>38</sup> At the close of the trial, the trial court granted Danka's motion for judgment on the evidence on the grounds that Litho had failed to present any evidence to support its request for damages.<sup>39</sup> The trial court based its ruling on the fact that Litho had asked the court to award it a sum representing the total lease payments due under the contract, which the court characterized as "rescission" damages that were not available after Litho

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30. *Id.*

31. The difference may have been more obvious in this case because the seller admitted that it had a business practice of allowing customers to cancel executed contracts.

32. 776 N.E.2d 1238 (Ind. Ct. App. 2002).

33. *Id.* at 1240.

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.*

38. *Id.*

39. *Id.* at 1241-42.

affirmed the contract.<sup>40</sup>

On appeal, Litho alleged that it had provided sufficient evidence to support its claim for fraudulent inducement. The court first noted that a party bringing an action for fraud in the inducement must elect between two remedies: either to rescind the contract and return to the *status quo ante* or to affirm the contract and keep the benefits and seek damages.<sup>41</sup> Further, “[w]here a party elects to affirm a contract induced by fraudulent misrepresentations, the party may only seek tort damages.”<sup>42</sup> These damages are measured using the “benefit of the bargain” rule that requires the fraudulent party to place the other party in as good a position as it would have been in if the fraudulent representations had not been made or the fraudulent promises had actually been performed.<sup>43</sup> The court of appeals reversed the trial court because it found that Litho had presented sufficient evidence as to its expected “benefit of the bargain” when it submitted its evidence as to Danka’s representation that Litho could expect \$50,000 of profits as a result of entering into the lease.<sup>44</sup>

### III. ARTICLE 3.1—DEFENSES TO NEGOTIABLE INSTRUMENTS

*Roberts v. Agricredit Acceptance Corp.*<sup>45</sup> construes the provisions of Article 3.1 of the UCC dealing with the defenses available to an obligor under a negotiable instrument and reinforces the basic proposition that a party should read a contract before signing it. Section 26-1-3.1-305(1)(c) of the Indiana Code provides that an obligor may state a defense against enforcement of its obligations under an instrument due to “fraud that induced the obligor to sign the instrument with neither knowledge nor reasonable opportunity to learn of its character or its essential terms.”<sup>46</sup> In this case, Roberts executed a lease agreement with its equipment supplier, Sulphur Implement Corporation. Sulphur subsequently assigned the lease to Agricredit Acceptance Corporation.<sup>47</sup> Upon Roberts’ default under the lease agreement, Agricredit asserted that it was a holder in due course of the lease agreement and moved for summary judgment.<sup>48</sup> In reply, Roberts raised the defense of fraud under section 26-1-3.1-305.<sup>49</sup>

Roberts did not allege that it did not sign the lease agreement or that Agricredit was not a holder in due course of the lease agreement. Rather, Roberts contended that it had signed the lease agreement in blank upon the express condition that it would apply only to new farm and construction

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40. *Id.* at 1243.

41. *Id.* at 1241.

42. *Id.*

43. *Id.* at 1242.

44. *Id.* at 1243.

45. 764 N.E.2d 776 (Ind. Ct. App. 2002).

46. *Id.* at 779.

47. *Id.* at 777-78.

48. *Id.* at 778.

49. *Id.*

equipment. Roberts further claimed that it would not have signed the lease agreement if it had known that it would be applied to the equipment actually listed, which Roberts claimed was of "poor quality and age."<sup>50</sup> Roberts contended that, by including this substandard equipment instead of the new equipment, Sulphur had committed fraud in inducing Roberts' execution of the lease agreement, and that Sulphur's fraud constituted a complete defense to Agricredit's action against Roberts.<sup>51</sup>

The court of appeals began its analysis by noting that consideration of any claim of fraud requires evaluation of both the fact of reliance and the right of reliance.<sup>52</sup> Although the court of appeals was prepared to accept that Roberts in fact relied upon Sulphur's statements as to the quality of the equipment that the lease agreement would cover, it held that Roberts was not, however, entitled to rely upon those statements and had failed to contest Sulphur's provision of the equipment pursuant to the lease agreement.<sup>53</sup> The court summarized the right of reliance as follows, "A man who can read and does not read an instrument which he signs is, as a general rule, guilty of negligence."<sup>54</sup> This rule is based upon a party's duty to be diligent in protecting its own interests. Roberts was aware that he was signing a lease agreement and did not allege that he was not given the opportunity to discover the transaction's essential features and terms before doing so. The law will not protect Roberts from his own failure to read the lease agreement before signing it.<sup>55</sup>

#### IV. ARTICLE 4—IMMUNITY OF BANK PURSUANT TO GARNISHMENT ORDER

Although *Title Search Co., Inc. v. 1<sup>st</sup> Source Bank*<sup>56</sup> does not directly address Article 4 of the UCC, it does confirm that a bank does not have a duty under Article 4 to challenge a garnishment order on behalf of its depositor. On November 20, 1996, the United States District Court for the Northern District of Indiana entered judgment against Title Search.<sup>57</sup> Following the judgment, the district court sent 1<sup>st</sup> Source a notice of garnishment proceedings as a result of which the court eventually ordered 1<sup>st</sup> Source to disburse funds from Title Search's accounts to the plaintiff.<sup>58</sup> Title Search subsequently filed suit against 1<sup>st</sup> Source in state court claiming that 1<sup>st</sup> Source had disbursed funds from its escrow account without its authorization and was therefore liable for breach of fiduciary duty, breach of contract, conversion, and a violation of Indiana's UCC

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50. *Id.*

51. *Id.* at 778-79.

52. *Id.* at 779.

53. *Id.* at 779-80.

54. *Id.* (quoting *Robinson v. Glass*, 94 Ind. 211, 212 (1883)).

55. *Id.* at 780.

56. 765 N.E.2d 167 (Ind. Ct. App. 2002).

57. *Id.* at 169.

58. *Id.*

provisions.<sup>59</sup> The court summarily disposed of Title Search's claims. First, the court upheld the trial court's determination that section 34-25-3-15 of the Indiana Code provides immunity to banks that comply with an apparent garnishment order even if the garnishment order is later determined to be procedurally defective.<sup>60</sup> The court then turned to Title Search's argument that even if the garnishment order was valid that 1<sup>st</sup> Source breached its statutory duty to it by failing to take "any lawful and legal steps to have the [garnishment] order delayed, reconsidered, or set aside."<sup>61</sup> In rejecting this claim, the court noted that Title Search's position would require 1<sup>st</sup> Source to disobey a court order, which 1<sup>st</sup> Source could not do. Further, the court noted that even if 1<sup>st</sup> Source had expressly contracted to take the action that Title Search wanted it to take, then this contract provision would be contrary to established public policy and unenforceable.<sup>62</sup>

#### V. ARTICLE 8.1—INVESTMENT SECURITIES

*Watson v. Sears*<sup>63</sup> involved the validity of a transfer of assets between investment accounts where the signature of one of the registered owners was forged. The case provides some interesting guidance as to when a securities intermediary,<sup>64</sup> such as Edward D. Jones & Co., L.P., will be liable to an entitlement holder<sup>65</sup> for an improper transfer. William Watson, Sears' father, opened an account consisting entirely of bonds at Edward Jones that was registered to his daughter and himself as joint tenants with rights of survivorship.<sup>66</sup> Watson subsequently transferred the account assets to a new account that was registered to his wife Allene, Sears, and him as joint tenants with rights of survivorship.<sup>67</sup> The document that Watson and Edward Jones executed in order to make the transfer required the signature of all registered owners of the delivering account. Watson signed his own name but forged Sears' signature.<sup>68</sup> Sears became aware of the transfer of assets after her father's death in September 1999, whereupon she withdrew half of the assets from the account and sued Allene for control of the remaining assets. On August 16, 2001, the trial court entered judgment in favor of Sears and awarded her the remaining assets.<sup>69</sup>

Allene appealed, contending that under section 32-4-1.5-15 of the Indiana

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59. *Id.*

60. *Id.* at 171-72.

61. *Id.* at 172 (alteration in original).

62. *Id.* at 173.

63. 766 N.E.2d 784 (Ind. Ct. App. 2002)

64. IND. CODE § 26-1-8.1-102(a)(14) (2002).

65. *Id.* § 26-1-8.1-102(a)(7).

66. 766 N.E.2d. at 785.

67. *Id.*

68. *Id.*

69. *Id.* at 785-86.

Code the signature of only one party to a joint account was necessary to change the form of an account and therefore the fact that Sears' signature was forged was irrelevant.<sup>70</sup> The court rejected the suggestion that section 32-4-1.5-1 to -15 (the "Indiana Nonprobate Transfers Chapter") applied, based upon its conclusion that the Indiana Nonprobate Transfers Chapter did not apply to bonds.<sup>71</sup> Rather, the applicable governing authority was Article 8.1 of the UCC regarding investment securities. Under Article 8.1, an endorsement, instruction, or entitlement order is effective if it is made by an appropriate person.<sup>72</sup> The court then looked at how other courts have decided who is an "appropriate person," and found that "when the intermediary has agreed [with the entitlement holders] that the 'appropriate person' to make an order is both owners of a joint account, both owners must make the order."<sup>73</sup> As a result, if Edward Jones agreed that both Watson's and Sears' signatures were necessary to effect a transfer of the account, then any transfer lacking both signatures was ineffective.<sup>74</sup> The court proceeded to find, based upon the evidence, that Sears' signature was necessary for any effective transfer.

Because Sears had only sued Allene, and not Edward Jones, the court was then faced with the question as to whether Sears had a cause of action against Allene. The court found that Article 8.1 did not provide any guidance on this issue so it instead turned to section 26-1-1-103 of the Indiana Code. Section 26-1-1-103 is the provision of the UCC that provides that, unless otherwise displaced by the UCC, the principles of law and equity supplement the provisions of the UCC.<sup>75</sup> Article 1 of the UCC, and thus section 1-103, is applicable to all Articles of the UCC, including Article 8.1. Sears would be able to reach the funds held by Allene, therefore, by maintaining an action for money had and received. Again, this case demonstrates that parties will be held to their bargain. If Edward Jones contracted with Sears and her father that both their signatures were necessary to make a transfer, then the court will hold them to that agreement, even if it turns out that one of those signatures was forged.

## VI. ARTICLE 9—SECURED TRANSACTIONS

In *Leasing One Corp. v. Caterpillar Financial Services Corp.*,<sup>76</sup> the court reiterated that a buyer in the ordinary course of business only takes free of a security interest created by the buyer's seller and that a lessor of goods could create a security interest under Article 9 (now Article 9.1 in Indiana). Caterpillar originally leased a backhoe loader to Boston Equipment Corporation.<sup>77</sup> Boston

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70. *Id.* at 786.

71. *Id.*

72. IND. CODE § 26-1-8.1-107(b)(1) (2002).

73. *Watson*, 766 N.E.2d at 789 (internal citations omitted).

74. *Id.*

75. *Id.* at 790.

76. 776 N.E.2d 408 (Ind. Ct. App. 2002).

77. *Id.* at 409.

subsequently sold the loader to R & D Homes & Supply, Inc., which purchased it under a commercial lease that was assigned to Leasing One.<sup>78</sup> Upon Boston's default under the original lease, Caterpillar filed suit against R & D to recover the loader. Although the case was decided under Kentucky law because that is where Caterpillar filed its original financing statement, the same result would have been obtained under Indiana's version of the UCC. Leasing One's first defense was that it was "buyer in the ordinary course of business" and therefore took the loader free of Caterpillar's security interest.<sup>79</sup> The court rejected this argument, however, by noting that a "holder in the ordinary course" only takes free of security interests created by its seller. Leasing One purchased its interest in the loader from Boston, and thus it did not erase the security interest created by Caterpillar.<sup>80</sup> Leasing One then attempted to create a material issue of fact as to "whether Caterpillar was a seller with a security interest or a lessor of the backhoe."<sup>81</sup> The court responded that this did not create a material issue of fact because a seller or a lessor of goods could acquire a security interest under the Kentucky statute.<sup>82</sup> The same outcome would have resulted under Indiana law.<sup>83</sup>

#### CONCLUSION

The cases decided during this survey period did not produce any drastic changes in Indiana law. Rather, the cases confirmed Indiana's traditional approach that courts will not step in to rewrite contracts where one party has failed to take appropriate steps to protect its interests barring some recognized fiduciary or other duty. Parties in Indiana are free to contract as they see fit, but even if they make what turns out to be an unwise bargain, they are left with the contract they made, and cannot expect the courts to rewrite the contract or change the bargain.

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78. *Id.* at 409-10.

79. *Id.* at 411-12.

80. *Id.* at 412.

81. *Id.*

82. *Id.* at 412-13.

83. IND. CODE § 26-1-1-201(37) (2002) ("a seller or lessor may also acquire a 'security interest' by complying with IC 26-1-9-1.").

