1997 SURVEY OF THE UNIFORM COMMERCIAL CODE IN INDIANA

HAROLD GREENBERG*

INTRODUCTION

This Survey summarizes and comments upon developments during the survey period that are of special interest and that affect the Uniform Commercial Code (U.C.C.) in Indiana.[1] Decisions of the Seventh Circuit Court of Appeals that deal with U.C.C. issues from other states, but not yet clearly addressed by Indiana courts, have also been included. Until Indiana courts decide the issues in this group of cases, these decisions will be binding on Indiana's federal district courts, which frequently decide U.C.C. cases while sitting in diversity,[2] and may be persuasive authority in the state courts.

I. STATUTORY CHANGES

A. A New Article 6—Bulk Sales

During its 1997 session, the Indiana Legislature adopted a new Article 6—Bulk Sales to replace original Article 6 which had been adopted as part of the enactment of the Code in 1963.[3] This article of the Code relates primarily to protecting the creditors of a business that is selling more than half its inventory out of the ordinary course of business, whether voluntarily by negotiation, by auction, or by a liquidator on the seller's behalf.[4]

The drafting committee, which was chaired by Gerald L. Bepko,[5] had concluded that compliance with former Article 6 was unnecessarily burdensome, particularly when the seller had numerous creditors or was engaged in business at a number of locations. The statute applied strictly to all bulk transfers, even those clearly not intended to defraud creditors, and in some cases "may have

---

* Professor of Law, Indiana University School of Law—Indianapolis. A.B., Temple University; J.D., University of Pennsylvania.

1. IND. CODE §§ 26-1-1 to 26-1-9 (1993 & Supp. 1997). Unless the Indiana version of the Code differs from the Official Draft, the citation form used will be generic form of the Official Draft rather than that of the Indiana version of the Code, e.g., U.C.C. § 2-207 rather than section 26-1-2-207 of the Indiana Code. Citation to the Code in other states will also use the generic form.

2. *See, e.g.*, Community Bank v. Stevens Fin. Corp., 966 F. Supp. 775 (N.D. Ind. 1997); Kittle v. Newell Coach Corp., 830 F. Supp. 1209 (S.D. Ind. 1993); Dale R. Horning Co. v. Falconer Glass Indus., Inc., 730 F. Supp. 962 (S.D. Ind. 1990).

3. New Article 6 is designated IND. CODE § 26-1-6.1 (Supp. 1997); former Article 6 is IND. CODE § 26-1-6 (1993). These will be differentiated in text by references to Article 6.1 and Article 6, respectively.

4. *See* U.C.C. §§ 6-102, 6.1-102.

5. *See* U.C.C., 2C U.L.A. 5 (1991). Chancellor Bepko, of Indiana University-Purdue University at Indianapolis, is a former Dean of the Indiana University School of Law—Indianapolis.

[had] the unintended effect of injuring, rather than aiding, creditors."[6] Moreover, many states had enacted nonuniform amendments.[7] In the drafters' opinion, "[T]here is no evidence that, in today's economy, fraudulent bulk sales are frequent enough, or engender credit losses significant enough, to require regulation of all bulk sales, including the vast majority that are conducted in good faith."[8] Accordingly, the sponsors of the Code[9] encouraged all states that had adopted original Article 6 to repeal and not replace it.[10] In the alternative, for those states disinclined to repeal the Article, the sponsors substantially revised it.[11] The majority of states that have considered the matter have repealed Article 6.[12] Indiana, however, chose to join the minority and to enact the Revision.

The major changes brought about by Revised Article 6 are described by the drafters as follows: (1) it applies only when the buyer has notice or reason to know that the seller will not continue to remain in business; (2) it does not apply when the value of property sold is less than $10,000 or more than $25,000,000; (3) the law of only one state applies; (4) when there are a large number of creditors, the buyer may give notice by filing rather than by sending individual notices; (5) the notice period is increased from ten to forty-five days, and the statute of limitations from six months to one year; (6) the notice must include a "Schedule of Distribution" that describes how the proceeds are to be distributed; (7) a buyer who acts in good faith is not liable for noncompliance; (8) a non-complying buyer is liable only for damages and his title to the goods is not affected.[13] In particular, the Revision contains samples of the Notice of Sale Form for use in an ordinary bulk sale[14] and of the form for use in a bulk sale by auction or by a liquidator.[15] Needless to say, these forms should be followed scrupulously in order to avoid problems.

Although one might hope that the legislature would have joined the majority in repealing Article 6 entirely, the Revision at least, in the words of the drafters, "resolves the ambiguities that three decades of law practice, judicial construction, and scholarly inquiry has disclosed."[16]

---

6. *See* IND. CODE ANN. § 26-1-6.1-101, U.C.C. Cmt. (West Supp. 1997).

7. *Id.*

8. U.C.C., 2C U.L.A. 7 (1991).

9. The Conference of Commissioners on Uniform State Laws and the American Law Institute.

10. U.C.C., 2C U.L.A. 7 (1991).

11. *Id.*

12. As of September 11, 1997, 35 states had repealed former Article 6, six states (including Indiana) and the District of Columbia had enacted the Revision, legislation had been introduced in two states, and no action had been taken in the remainder. *UCC Scorecard*, COM. L. NEWSL. (A.B.A. Sec. of Bus. L.), Nov. 1997, at 22-23.

13. *See* IND. CODE ANN., § 26-1-6.1-101, U.C.C. Cmt. (West Supp. 1997).

14. U.C.C. § 6.1-105.

15. *Id.* § 6.1-108.

16. *See* IND. CODE ANN., § 26-1-6.1-101, U.C.C. Cmt. (West Supp. 1997).

II. Noteworthy Cases

A. Article 2—Sales

1. A Signed Writing under the Statute of Frauds: § 2-201.—In *Owen v. Kroger Co.*,[17] the narrow issue was whether notes written on memopads satisfied the requirement of section 2-201 that for the contract between the parties "to be enforceable, (1) there must be a writing sufficient to indicate the existence of a contract; and (2) that writing must be signed by an authorized agent or broker . . . ."[18] Plaintiff, a commercial flower grower and seller, sued defendant, a supermarket chain, for allegedly breaching contracts for 1992 and 1993 purchases of large quantities of flowers.[19] During meetings to discuss the buyer's needs for each coming season, in response to requests from the seller, representatives of the buyer wrote numbers on memopads that indicated quantities of flowers needed during specific weekly periods. The pre-printed memopads each contained the logo of the buyer's floral division and words "from the desk of" followed by the name of the person who wrote the numbers. In each of the years involved, the buyer purchased fewer flowers than indicated in the memos, thereby, according to the seller, breaching the contract between them. Both parties moved for summary judgment: buyer on the ground that even if there were contracts, they were unenforceable under section 2-201, and seller on the ground that the memos were evidence of the contracts which the buyer breached and which satisfied section 2-201.

Since the memos did not bear a traditional signature, the issue was whether the presence of the logo constituted a "'symbol executed or adopted by a party [the buyer] with present intention to authenticate a writing.'"[20] After examining many cases on the issue, the court correctly concluded that the pre-printed wording on the memos could satisfy the statute, but there remained the question whether they did, i.e., whether the buyer's representatives "intended to authenticate the memos by using the pre-printed memopad sheets."[21] The buyer

---

17. 936 F. Supp. 579 (S.D. Ind. 1996).

18. *Id*. at 583. Section 2-201(1) states:

> Except as otherwise provided in this section, a contract for the sale of goods for the price of five hundred dollars $500 or more is not enforceable by way of action or defense unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought or by his authorized agent or broker. A writing is not insufficient because it omits or incorrectly states a term agreed upon, but the contract is not enforceable under this paragraph beyond the quantity of goods shown in such writing.

U.C.C. § 2-201(1) (1995). The court noted that none of the statutory exceptions found in sections 2-201(2) or (3) applied. *Owen*, 936 F. Supp. at n.10.

19. *Owen*, 936 F. Supp. at 582. There was also a claim for breach of a 1994 contract, but it presented issues different from those disposed of in this opinion.

20. *Id.* at 584; *see also* U.C.C. § 1-201(39) (1995).

21. *Owen*, 936 F. Supp. at 585.

claimed that the figures were "'guesstimates'" and not written with the intention to authenticate anything.[22] The court ruled that since the intention to authenticate is a question of fact which is appropriately left to the jury, the motions of both parties for summary judgment should be denied.[23]

On a matter not specifically raised by the parties in the pending motions, the court observed that even if the authentication is established, there remained the issue whether the memos also satisfied the requirement of a writing sufficient to indicate the existence of a contract, an issue on which the court expressed doubt.[24]

2. A Party's Right to Inspection of the Goods: § 2-515.—In *J.R. Cousin Industries v. Menard, Inc.*,[25] a case dealing with section 2-515(a) of the Code,[26] the court was, in its words, writing "largely on a clean slate"[27] because there are few reported cases involving the section, and none dealing with the issues presented in *Cousin*.[28]

Cousin Industries, an importer of hardware, agreed to sell to Menard, a home-improvement product retailer, 20,000 sinks and toilets manufactured in Mexico, to be delivered by the manufacturer directly to Menard. A term of the agreement provided that Cousin would credit Menard for the price of any of the goods that were defective or that were returned by buyers to Menard. The agreement further provided that with respect to any such goods, Cousin could either have Menard ship the goods back to Cousin at Cousin's expense or have Menard destroy them. Cousin opted to have Menard destroy the goods because it would have been uneconomical to have them shipped back.[29] After shipments began and Menard subtracted what Cousin thought was an overly high amount for returns, Menard stated that many of the items were defective. Cousin requested that Menard allow it to inspect the defective goods at Menard's premises. Having already destroyed $15,000 worth of goods, Menard allowed

---

22. *Id.*

23. *Id.*

24. *Id.* at 585-86.

25. 127 F.3d 580 (7th Cir. 1997) (construing Wisconsin's Code).

26. Section 2-515(a) states:

> In furtherance of the adjustment of any claim or dispute
> (a) either party on reasonable notification to the other and for the purpose of ascertaining the facts and preserving evidence has the right to inspect, test and sample the goods including such of them as may be in the possession or control of the other; . . . .

U.C.C. § 2-515(a) (1995).

27. *J.R. Cousin Indus.*, 127 F.3d at 580.

28. *Id.* The U.C.C. Case Digest lists a total of six cases as involving section 2-515 since the adoption of the Code in the mid 1950s. U.C.C. CASE DIG. ¶ 2515 (1994 & Supp. 1997). The leading writers on the Code, White & Summers, do not even discuss the section in their treatise. *See* 4 JAMES J. WHITE & ROBERT R. SUMMERS, UNIFORM COMMERCIAL CODE, TABLE OF STATUTES 645 (4th ed. 1995 & Supp. 1997).

29. *J.R. Cousin Indus.*, 127 F.3d at 581.

the inspection of a small quantity of undestroyed goods, refused to allow further inspections, destroyed the rest, and subtracted $72,000 from Cousin's invoices. Cousin sued, and the jury awarded Cousin $70,000.[30]

At the outset, the court noted that Menard's destruction of the goods after Cousin's section 2-515 request to hold them for inspection had prevented Cousin from accurately estimating its damages and deprived Cousin of evidence it could have used in an action against its Mexican supplier.[31]

Menard argued that section 2-515 applied only in cases of rejection or revocation of acceptance of goods and that Cousin, in the contract, had waived its right to inspect. Referring to principal drafter Karl Llewellyn's unpublished notes and to the Official Comment, the court rejected Menard's argument.[32] Otherwise, the court noted, a buyer could avoid the requirements of section 2-515 by accepting the goods and complaining of their nonconformity in an action for breach of warranty.[33] The purpose of the section was to preserve evidence, to avoid gamesmanship, and to promote the possibilities of an agreement to resolve any dispute, a purpose that could be frustrated by Menard's restrictive interpretation.[34] The court concluded "that Cousin had a right of inspection under section 2-515 even though Menard was not attempting to reject the goods in dispute or to revoke its acceptance after acceptance of them . . . [and] that the jury was entitled to reject the argument that Cousin waived its right of inspection."[35]

The court's interpretation of section 2-515 and the result in the case are sound. According to Professor Hawkland, the section was intended to preserve the rights of both the buyer and the seller. Before the Code became effective, a rejecting buyer would be unable to preserve evidence of non-conformity by retaining a sample of the goods. His retention could well be construed as an acceptance that nullified rejection. Similarly, after a buyer accepted and gained control of the goods, the seller was deprived of a way to prove that the goods conformed to the contract.[36] Thus, it is reasonable to construe the statute as the court did: to permit inspection and preservation of evidence at any stage before suit is filed, after which the rules of discovery take over.

The court's (and Menard's) characterization of Menard's conduct as not constituting a rejection or revocation of acceptance, however, is questionable. The court could have characterized Menard's conduct as rejection or revocation with little difficulty. Neither term is defined in the Code,[37] although the duties of the revoking buyer with respect to the goods are the same as if he were

---

30. *Id.*
31. *Id.*
32. *Id.* at 582.
33. *Id.*
34. *Id.*
35. *Id.*
36. 2 WILLIAM D. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES § 2-515:01 (1982).
37. *See* U.C.C. §§ 2-601, 2-608 (1995).

rejecting.[38] When rejecting or revoking acceptance, the buyer must make clear that he wants nothing further to do with the goods and that he is throwing all responsibility for them back on the seller.[39] Thereafter, "when the seller has no agent or place of business at the market of rejection, a merchant buyer is under a duty . . . to follow any reasonable instructions received from the seller with respect to the goods . . . ."[40] The rejecting or revoking buyer may also recover "so much of the price as has been paid."[41] In other words, the buyer either gets his money back or does not have to pay for the subject goods.

In *Cousin*, the buyer, Menard, by demanding a full credit for the price of defective goods against the amounts due, was indicating that it did not intend to keep those goods, a rejection. With respect to goods returned to it by its customers, Menard was revoking its acceptance in the same manner. By contract, the parties had agreed on how rejection or revocation was to be manifested: by deducting the price of the defective or returned goods. The contract also contained instructions to Menard as to what to do with the goods after rejection or revocation: either ship them back or destroy them, as instructed by Cousin. Cousin chose destruction. Thus, even if Menard were correct in its contention that section 2-515 applies only in cases of rejection or revocation, it still would have lost. Notwithstanding the court's hesitation at calling Menard's conduct rejection or revocation of acceptance, the interpretation of the section and the result in the case are correct.

3. Limitation of Liability Under Section 2-719 and Strict Products Liability.—The Indiana Supreme Court, voting 3-2 in *McGraw-Edison Co. v. Northeastern Rural Electric Membership Corp.*,[42] ruled that a limitation of liability provision in a contract for the sale of electrical power equipment was unenforceable as a defense in the buyer's action brought under Indiana's Product Liability Act.[43] McGraw-Edison sold electrical power station equipment to Northeastern pursuant to a contract that included a limitation of liability provision, as permitted under section 2-719.[44] The provision specifically limited

---

38. *Id.* § 2-608(3).

39. *See* HAROLD GREENBERG, RIGHTS AND REMEDIES UNDER U.C.C. ARTICLE 2 § 21.5 (1987); 1 WHITE & SUMMERS, *supra* note 28, § 8-1.

40. U.C.C. § 2-603(1) (1995).

41. *Id.* § 2-711(1).

42. 678 N.E.2d 1120 (Ind. 1997).

43. IND. CODE § 33-1-1.5-1 to -10 (1993 & Supp. 1997).

44. Section 2-719 provides, in pertinent part:

> (1) Subject to the provisions of subsection (2) and (3) of this section and of IC 26-1-2-718 on liquidation and limitation of damages,
>
> (a) the agreement may provide for remedies in addition to or in substitution for those provided in this Article and may limit or alter the measure of damages recoverable under this Article, as by limiting the buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods or parts; and
>
> (b) resort to a remedy as provided is optional unless the remedy is expressly

the seller's liability to the purchase price, whether the claim was for "breach of contract, breach of warranty or negligence."[45] Some years later, a fire, allegedly caused by a defect in the equipment, caused property damage in excess of ten times the purchase price. The buyer sued for damages pursuant to the Product Liability Act,[46] following which the seller moved for partial summary judgment in its favor based on the contractual limitation of liability. The trial court denied the motion, and the court of appeals affirmed and held that the limitation of liability provision was unenforceable. The Indiana Supreme Court affirmed.[47]

After discussing both the Code and the Product Liability Act, which post-dated the Code, a majority of the court concluded the intention of the legislature to be that the Product Liability Act negates the ability of a seller to limit liability for defective goods except where the total circumstances demonstrate the agreement of the parties to the limitation.[48] The circumstances in this case did not support enforcement of the limitation.[49]

One of the dissenting opinions agreed with the majority that, notwithstanding the Products Liability Act, private agreements that allocate risks between sophisticated parties will be enforceable, but it disagreed with what appears to be the majority's test for enforceability.[50] The dissenting opinion distills that test to require the following findings before the limitation of liability will be enforced. The finding needed is that

> (i) the underlying transaction was between "truly large and 'sophisticated' organizations," (ii) "the amount of money involved . . . was very large," and (iii) "the parties did not simply trade printed forms, but rather entered into true negotiations over all the terms and conditions, including the allocation of risks from product defects and the

---

> agreed to be exclusive, in which case it is the sole remedy.
>
> . . . .
>
> (3) Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable. Limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable, but limitation of damages where the loss is commercial is not.

U.C.C. § 2-719 (1995).

45. *McGraw-Edison*, 678 N.E.2d at 1121.

46. An action solely under the Act might have been seen as a way of avoiding the limitation of liability that apparently satisfied section 2-719. However, there may also have been a problem with the Code's statute of limitations which bars any action brought more than four years after the date of delivery, absent a definite extension of time. *See* U.C.C. § 2-725 (1995). The equipment had been purchased in 1978, the fire occurred in 1982, and suit was filed in 1984. *McGraw-Edison*, 678 N.E.2d at 1124-25. The limitation under the Product Liability Act is two years from the date of the injury. IND. CODE § 33-1-1.5-5 (1993).

47. *McGraw-Edison*, 678 N.E.2d at 1125.

48. *Id.* at 1124-25.

49. *Id.* at 1125.

50. *Id.*

> contract explicitly waives strict liability claims."[51]

This, in the dissenters' opinion, "sets the bar for enforceability too high" and changes the "'total circumstances' test into a 'knowing waiver' test."[52] This author disagrees. On the evidence before the court, as described in the majority opinion, "there is nothing in the record to support the sophistication of Northeastern,"[53] and the provision was "a boilerplate limitation of liability in the invoice."[54] Furthermore, there was no evidence of "a true negotiation over risk allocation," "a knowing assumption of the risk," or "even a conspicuous and explicit provision barring strict liability claims."[55] These facts support the conclusions of the three courts involved that the totality of circumstances in this case did not demonstrate an allocation of risk to the buyer. Perhaps in some future case, the dissenters may prove to be correct that the test as stated by the majority requires too much, but not in this case on these facts.

B. Article 4A—Fund Transfers

In 1991, the legislature added new Article 4A—Fund Transfers to Indiana's U.C.C. as section 26-1-4.1 of the Indiana Code.[56] *Community Bank v. Stevens Financial Corp.*[57] is the first case to arise in Indiana under this Article and, in the words of the court, presents circumstances "unlike any case that has been reported under Article 4A of the U.C.C."[58] The ultimate issue in the case was whether a bank that had wired a payment order by mistake to the wrong receiving bank could recover the entire amount from the receiving bank, notwithstanding the receiving bank's credit of the amount to the beneficiary's account and subsequent set-off of a debt owed by the beneficiary to the receiving bank.[59]

Pursuant to an ongoing agreement between them, HomeSide Lending Company agreed to purchase a mortgage from Stevens Financial Corporation for $500,000.[60] Under the terms of the ongoing agreement and in payment for mortgages it purchased, HomeSide was to transfer funds to Stevens' designated lender, Community Bank. Some time thereafter, Stevens gave HomeSide amended instructions to wire the purchase money to Chase Manhattan Bank. Eight days later, in order to finalize the purchase, HomeSide wired $500,000, by

---

51. *Id.* (Sullivan, J., dissenting).

52. *Id.*

53. *Id.* at 1122.

54. *Id.* at 1123.

55. *Id.* at 1124.

56. *See* 1991 Ind. Acts 2800-88. The enactment was part of a "2A-4A" package and was virtually identical to the 1989 Official Draft of Article 4A. *See* Harold Greenberg, *Indiana Adds Articles 2A and 4A of Uniform Commercial Code*, 25 IND. L. REV. 1029, 1030 (1992).

57. 966 F. Supp. 775 (N.D. Ind. 1997). The action was originally filed in the Circuit Court of LaPorte County but was removed to the federal district court. *Id.* at 778.

58. *Id.*

59. *Id.* at 780.

60. All sums have been rounded off. The actual purchase price was $489,466.84. *Id.* at 777.

mistake, to Community and directed Community to credit Stevens' account. On the following day, Community accepted the payment order and credited the funds to Stevens. As of that date, Stevens was in default on a prior obligation it owed to Community. Accordingly, Community exercised its right of set-off and deducted $125,000 from the transferred amount to satisfy Stevens' debt. Two days after the set-off by Community, HomeSide notified Stevens that it had mistakenly transferred the $500,000 to Community. At the same time, HomeSide also sent $500,000 to Chase on Stevens' account in accord with the amended instructions. The next day, HomeSide informed Community that the earlier wire transfer was sent in error and requested Community to cancel the transfer and to wire the amount of the transfer to HomeSide's own bank in New York. Community wired $375,000 to HomeSide's bank but refused to return the $125,000 it had set-off earlier.[61]

The case was originally filed as an action by Community against Stevens Financial. HomeSide intervened and sought to recover from Community and Stevens Financial on a theory of unjust enrichment. Stevens Financial failed to answer, and a default judgment was entered against it in HomeSide's favor. This opinion dealt with Community's motion for summary judgment that its set-off was proper and that it need not return the $125,000 to HomeSide.[62]

The court first noted that the wire transfer was sent via Fedwire, the transfer network of the Federal Reserve Bank, and that, pursuant to Federal Reserve regulations, Article 4A applied to the transaction.[63] Moreover, although the court could resort to principles of law or equity outside Article 4A, it could do so only if those principles were not inconsistent with Article 4A.[64] The court divided the matter into four distinct questions, each of which will be discussed in order.

First, was the wire transfer by HomeSide a payment order?[65] The court correctly answered in the affirmative.[66] "'Payment order' means an instruction of a sender to a receiving bank . . . to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:" the instruction is unconditional, the receiving bank is to be reimbursed by the sender, and the instruction is transmitted directly or indirectly to the receiving bank.[67] In a wire transfer transaction, the party who owes the money (the "originator") instructs its bank (the "originating bank") to pay its creditor (the "beneficiary") by giving the bank a payment order instructing it to pay the appropriate amount into the account of the beneficiary at his designated bank (the "beneficiary's bank").[68] In this case, HomeSide was both the originator, because it owed the money to

61. *Id.* at 778.

62. *Id.*

63. *Id.* at 780.

64. *Id.* (quoting U.C.C. § 4A-102, Official Cmt. (incorrectly cited as § 4A-101 in the opinion)).

65. *Id.* at 781.

66. *Id.* at 782.

67. U.C.C. § 4A-103 (1995).

68. *Community Bank*, 966 F. Supp. at 782; *see also* U.C.C. § 4A-104, Official Cmt (1995).

Stevens as payment for the mortgage it was purchasing from Stevens, and the originating bank. It sent the payment order to Community, which was both a receiving bank and the beneficiary's bank.[69] Clearly, the transaction was a payment order, and the court so found.[70]

Second, was HomeSide's payment order authorized?[71] HomeSide contended that the payment order was unauthorized because Stevens had changed its instructions and had designated a different bank to which HomeSide was to wire the funds. Section 4A-202(a) states that "a payment order received by the receiving bank [Community] is the authorized order of the person identified as the sender if that person authorized the order or is otherwise bound by it under the law of agency."[72] The premise of HomeSide's position was that Stevens, not HomeSide, was the originator or sender of the payment order, a premise with which the court disagreed. The court was correct in concluding that the sender or originator of the payment order was HomeSide itself, acting as both originator and originator's bank in order to pay Stevens for the mortgage.[73] The money being sent was HomeSide's money and did not belong to Stevens until payment for the mortgage was complete. If Stevens were the originator with power to authorize the payment order, it would have simply been transferring funds it already owned from one of its accounts to another, a situation totally different from the facts of this case.[74] In simple terms, the transaction was a purchase by buyer HomeSide from seller Stevens. HomeSide could have paid either by "pulling" the payment from its own account in the form of a check drawn on itself as drawee bank and given to Stevens or by "pushing" the payment from its own account in the form of a payment order to Stevens' bank for credit to Stevens' account. HomeSide did the latter procedure.

Third, notwithstanding Community's acceptance of the payment order, did HomeSide effectively cancel the order an erroneous payment order, thereby continuing HomeSide's ownership of the funds?[75] A beneficiary's bank accepts a payment order, inter alia, when that bank notifies the beneficiary that the beneficiary's account has been credited with the amount of the transfer or when the bank receives payment.[76] Community received the entire amount and credited Stevens' account five days before HomeSide informed Community and Stevens of its mistake.[77] The issue reduced itself to: under what circumstances may an accepted payment order be canceled, a matter dealt with expressly in

---

69. In actual fact, HomeSide sent the payment order to Priority Bank, an intermediary receiving bank, which, in turn, sent the payment order to Community. *Community Bank*, 966 F. Supp. at 782.

70. *Id.*

71. *Id.*

72. U.C.C. § 4A-202(a) (1995).

73. *Community Bank*, 966 F. Supp. at 782.

74. *See id.* at 782-83.

75. *Id.* at 783.

76. U.C.C. § 4A-209(b)(1)(ii) (1995).

77. *Community Bank*, 966 F. Supp. at 784.

section 4A-211(c)(2).[78] Unless HomeSide could satisfy the specific requirements of this section, HomeSide could not cancel the payment order and reverse the transfer.[79] The court correctly found that HomeSide failed to demonstrate that it was entitled to cancel the payment order.[80] However, the court's application of the section appears to be somewhat flawed.

Section 4A-211(c) opens by stating that after acceptance, cancellation of the payment order "is not effective unless the receiving bank agrees or a funds-transfer system rule allows cancellation."[81] Even if the payment order were unauthorized, as argued by HomeSide but rejected by the court, the payment order, once accepted, could be canceled only if Community agreed to the cancellation.[82] Community agreed to the cancellation only as to $375,000 but not to the balance, and there is nothing in the opinion that refers to any applicable

---

78. Section 4A-211(c)(2) provides:

> (c) After a payment order has been accepted, cancellation or amendment of the order is not effective unless the receiving bank agrees or a fund-transfer system rule allows cancellation or amendment without agreement of the bank.
>
> > (2)With respect to a payment order accepted by the beneficiary's bank, cancellation or amendment is not effective unless the order was issued in execution of an unauthorized payment order, or because of a mistake by the sender in the funds transfer which resulted in the issuance of a payment order (i) that is a duplicate of a payment order previously issued by the sender, (ii) that orders payment to a beneficiary not entitled to receive payment from the originator, or (iii) that orders payment in an amount greater than the amount the beneficiary was entitled to receive from the originator. If the payment order is canceled or amended, the beneficiary's bank is entitled to recover from the beneficiary any amount paid to the beneficiary to the extent allowed by the law governing mistake and restitution.

U.C.C. § 4A-211(c)(2) (1995).

79. *See id.* § 4A-211, Official Cmt. 4 ("Under subsection (c)(2), cancellation or amendment is possible only in the four cases stated.").

80. *Community Bank*, 966 F. Supp. at 785-86.

81. U.C.C. § 4A-211(c) (1995). The Official Comment states: "Since acceptance affects the rights of the originator and the beneficiary it is not appropriate to allow the beneficiary's bank to agree to cancellation or amendment except in unusual cases. Except as provided in subsection (c)(2), *cancellation or amendment after acceptance by the beneficiary's bank is not possible unless all parties affected by the order agree.*" *Id.* § 4A-211(c), Official Cmt.

82. *See id.* (Case #1, in which the payment order was unauthorized). "Under subsection (c)(2) Originator's bank can cancel the order *if Beneficiary's bank consents.*" *Id.* (emphasis added). In *Cumis Insurance Society, Inc. v. Citibank, N.A.*, the court stated that the beneficiary's bank is "under no obligation to agree to return the funds once accepted pursuant to [§ 4A-211]." 921 F. Supp. 1100, 1110 (S.D.N.Y. 1996). The transfers in *Cumis* were sent to the beneficiary's bank by mistake, and, after acceptance and credit, that bank permitted the beneficiary to withdraw the funds. The beneficiary's bank was willing to agree to return the funds if certain conditions were met. Those conditions were not met and the bank withdrew its offer to agree to return the funds. *Id.* at 1103.

system rule. The Code says nothing about whether a beneficiary's bank can agree to a partial cancellation, but there seems to be nothing to prevent such a cancellation. By analogy, a party that takes a negotiable instrument in good faith, for value, and without notice of any problems becomes a holder in due course only to the extent that value, represented by a promise to perform, has actually been performed.[83] If this were a negotiable instruments transaction, Community would have been a holder in due course to the extent of $125,000.

An additional issue, apparently not raised and therefore not discussed, is whether Community had a right to cancel the order and return any of the funds. A proper reading of section 4-211(c) limits the beneficiary's bank ability to agree to cancellation to the four circumstances set forth in (c)(2) only; it cannot simply agree to cancel if none of the four exists.[84] As discussed below, none of the four circumstances existed, and it is questionable whether Community could even agree to the return of $375,000.

Assuming that Community could and did agree to cancellation of the full payment order, the court misconstrued the application of the remainder of section 4A-211(c) with respect to the four circumstances under which the payment order may be canceled after the beneficiary's bank agrees. The court said that if the payment order was unauthorized, one of the other three circumstances had to exist.[85] The court misread the statute. The circumstances for cancellation after the beneficiary's bank agrees are stated in the alternative: accepting an unauthorized payment order *or*, because of mistake, sending a duplicate order *or* payment to someone not entitled *or* payment of too great an amount.[86] If the payment order were unauthorized and Community had agreed to the cancellation, there would have been no necessity to demonstrate more, and HomeSide would have been entitled to the full amount. But the court had already found that the payment order was not unauthorized, so that basis for cancellation was not available to HomeSide. Nevertheless, the court continued that, assuming the order was unauthorized, HomeSide also had to demonstrate that one of the three other circumstances existed. The court was correct in concluding that none of those circumstances existed. Stevens was entitled to receive payment, and the amount transferred did not exceed the amount to which Stevens was entitled. More importantly, the payment order was not a duplicate order, as HomeSide contended. In permitting cancellation where there is a duplicate order, the drafters appear to have contemplated a proper order followed by a duplicate of the very same order sent in error.[87] As the court noted, the payment order to Community was the first order, not a duplicate, and the order to Chase was not

83. *See* U.C.C. § 3-302(d) & Official Cmt. 6 (1995); *see also id.* § 3-303. With reference to Community's set-off as constituting value, see the discussion at *infra* notes 89-90 and the accompanying text.

84. *See id.* § 4A-211, Official Cmt. 4; 3 WHITE & SUMMERS, *supra* note 28, § 23-7d.

85. *Community Bank*, 966 F. Supp. at 785-86.

86. *See supra* note 77 (quoting U.C.C. § 4A-211(c)(2)).

87. *See id.* at Official Cmt. 4 (Case #2).

sent by HomeSide until days later and therefore was not a duplicate, either.[88] Thus, none of the requirements of section 4A-211 were met by HomeSide.

Fourth, was Community's set-off proper?[89] Section 4A-502(c) expressly permits a beneficiary's bank that has received a payment order to credit the beneficiary's account and then set off against the credit an obligation owed to the bank.[90] HomeSide argued that principles of law and equity outside the U.C.C. supported its claim to the $125,000, since the payment had been made by mistake and Community had not relied on the payment to its detriment.[91] The court correctly concluded that principles of law and equity outside the Code apply only where not displaced by Code provisions.[92] In this instance, the facts of the case fell squarely within the provisions of Article 4A, which controlled the entire scenario.[93] As described by the drafters:

> In the drafting of Article 4A, a deliberate decision was made to write on a clean slate and to treat a funds transfer as a unique method of payment to be governed by unique rules that address the particular issues raised by this method of payment. A deliberate decision was also made to use precise and detailed rules to assign responsibility, define behavioral norms, allocate risks and establish limits on liability, rather than to rely on broadly stated, flexible principles. . . .
>
> [C]ompeting interests were represented in the drafting process and they were thoughtfully considered. The rules that emerged represent a careful and delicate balancing of those interests and are intended to be the exclusive means of determining the rights, duties and liabilities of the affected parties in any situation covered by particular provisions of the Article. Consequently, resort to principles of law or equity outside of Article 4A is not appropriate to create rights, duties and liabilities inconsistent with those stated in this Article.[94]

Accordingly, summary judgment in Community's favor was appropriate.

Although not reflected in the opinion, it is quite likely that Stevens changed its instructions to HomeSide because Stevens knew that its debt to Community

---

88. *Community Bank*, 966 F. Supp. at 785.

89. *Id.* at 786.

90. Section 4A-502(c)(1) states:

> (c) If a beneficiary's bank has received a payment order for payment to the beneficiary's account in the bank, the following rules apply:
>
> > (1)The bank may credit the beneficiary's account. The amount credited may be set off against an obligation owed by the beneficiary to the bank or may be applied to satisfy creditor process served on the bank with respect to the account.

U.C.C. § 4A-502(c)(1) (1995).

91. *Community Bank*, 966 F. Supp. at 786-88.

92. *Id.* at 788.

93. *Id.*

94. U.C.C. § 4A-102, Official Cmt. (1995).

was due and that Community might set-off the debt against the account into which the funds were being transferred. Although different in direction, since a payment order "pushes" the money from the debtor's account into the creditor's account, and a check "pulls" the money from the debtor's account, one might analogize to Articles 3 and 4, which deal with negotiable instruments and bank collections, respectively. If a drawer stops payment on a check and its bank fails to obey the stop payment order, the bank that makes a mistaken payment cannot recover that payment from a holder in due course.[95] Had HomeSide paid by drawing a check on itself as drawee and sent that check to the wrong bank (Community instead of Chase) for deposit into a Stevens' account, Community's set-off, which it had a right to make,[96] would have made Community a holder in due course[97] from whom a mistaken payment could not be recovered.[98] Either method of payment, pushing the funds or pulling them, yields the same result if the funds reach the equivalent of a holder in due course. That party may retain the funds paid by mistake. The result in *Community Bank* was correct.

C. Article 9—Secured Transactions

A bankruptcy case, *In re A-1 Paving and Contracting, Inc.*,[99] held that the decision of the Indiana Supreme Court in *Gibson County Farm Bureau Coop. Ass'n. v. Greer*[100] controlled the outcome of conflicting claims between two secured creditors to the same goods. In *Greer*, the supreme court held that although a standard-form UCC-1 financing statement, standing alone, is not sufficient evidence to create a security interest, "'once the Writing Requirement of section 9-203(1) is satisfied, whether the parties intended the writing to create a security interest is a question of fact for the trier of fact to determine."[101]

The conflict in *A-1 Paving* was between a conditional seller of motor vehicles and equipment and a bank, both of whom claimed a security interest in those vehicles and equipment. The conditional sales contract called for monthly payments and reserved to the seller "'all rights and remedies under the Indiana Uniform Commercial Code relating to the foreclosure of mortgages.'"[102] The seller filed with the appropriate offices a UCC-1 financing statement that listed

---

95. *See id.* §§ 4-403, 4-407.

96. *See* First Bank v. Samocki Bros. Trucking Co., 509 N.E.2d 187, 198 (Ind. Ct. App. 1987) ("A bank's right of set-off is also well entrenched in Indiana common law . . . ."); DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON PAYMENT LAW 180-82 (4th ed. 1995).

97. A person who takes a negotiable instrument in good faith, for value, and without notice of any problems. U.C.C. § 3-302 (1995). Community acted in good faith and without notice of problems, and the setoff in payment of an antecedent debt constituted value. *Id.* § 3-303(a)(3).

98. *See id.* § 3-318.

99. 116 F.3d 242, 243 (7th Cir. 1997).

100. 643 N.E.2d 313 (Ind. 1994) (discussed in Brad A. Galbraith, *1994 Developments in Commercial Law and Consumer Protection Law*, 28 IND. L. REV. 879, 880-83 (1995)).

101. *A-1 Paving*, 116 F.3d at 244 (quoting *Greer*, 643 N.E.2d at 320).

102. *Id.* at 243.

A-1 Paving as "debtor" and the seller as "secured party." After A-1 Paving filed for bankruptcy, the seller sought to recover the goods, to which the bank objected by asserting its own claim. Relying on the UCC-1 form itself and on parol evidence, the trial court found that A-1 and the seller intended the financing statement to create a security interest.[103] The court of appeals declared that, pursuant to *Greer*, both parol evidence and the UCC-1 form "are permissible sources of evidence to determine that the parties intended to create a security interest" and that the trial court's findings in favor of the seller were not in error.[104] The creditor may not create a security agreement from parol evidence, but once there is a writing that may serve as the security agreement if it was so intended, parol evidence is a proper source from which the intention of the parties in that regard may be determined.

From a practical viewpoint, the secured party who depends on the UCC-1 financing statement and any supporting parol evidence to create an enforceable security interest is inviting litigation. The better and safer course is to create a separate written agreement that creates the security interest and, when conflict arises, rely on the agreement as creating the enforceable security interest and the filed financing statement as perfecting that security interest and giving notice to all other creditors.

103. *Id.* at 245.

104. *Id.*