

XV. Secured Transactions and Creditors' Rights

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During the year following the summer of 1977, the Indiana Court of Appeals earned stature in the field of secured transactions and creditors' rights. Its decisions reflect scholarship and hard work in this area of private law. Thankfully, all of these cases are not without controversy, and they, along with a group of bankruptcy and federal decisions involving the state of Indiana, provide some excellent material for this part of the Survey. Lawyers are invited to give special attention to recent decisions that have imposed a duty upon a disbursing mortgagee to procure releases;¹ allowed and denied damages to a forfeiting conditional seller, and in particular, the rule of waste established in the "leaky spigot" case;² denied subrogation to a title insurer against the vendor procuring insurance for his vendee;³ dealt with the "voidable" title of a bailee;⁴ recognized the debtor's efforts to subordinate a secured party in favor of an unperfected interest;⁵ allowed a secured party to recover a deficiency even though he had not notified a debtor of the sale;⁶ permitted an outright transferee of chattel paper to enforce it against the account debtor;⁷ applied the mechanic's lien statute in new situations;⁸ and recognized established principles of suretyship in some old and some new situations.⁹ Accolades for the finest effort

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¹Prudential Ins. Co. v. Executive Estates, 369 N.E.2d 1117 (Ind. Ct. App. 1977). See notes 24-27 *infra* and accompanying text.

²Reynolds v. Milford, 375 N.E.2d 265 (Ind. Ct. App. 1978); Finley v. Chain, 374 N.E.2d 67 (Ind. Ct. App. 1978). See notes 51-58 *infra* and accompanying text.

³Lawyers Title Ins. Co. v. Capp, 369 N.E.2d 672 (Ind. Ct. App. 1977). See notes 29-31 *infra* and accompanying text.

⁴McDonald's Chevrolet, Inc. v. Johnson, 376 N.E.2d 106 (Ind. Ct. App. 1978). See notes 65-70 *infra* and accompanying text.

⁵A-W-D, Inc. v. Salkeld, 372 N.E.2d 486 (Ind. Ct. App. 1978). See notes 78-81 *infra* and accompanying text.

⁶Hall v. Owen County State Bank, 370 N.E.2d 918 (Ind. Ct. App. 1977). See notes 83-100 *infra* and accompanying text.

⁷First Nat'l Bank v. Schrader, 375 N.E.2d 1124 (Ind. Ct. App. 1978). See notes 102-04 *infra* and accompanying text.

⁸At least five recent decisions involve mechanic's liens on real estate. See notes 105-28 *infra* and accompanying text.

⁹See notes 184-204 *infra* and accompanying text. Probably the most ingenious decision relating to suretyship is American States Ins. Co. v. Staub, Inc., 370 N.E.2d 989 (Ind. Ct. App. 1977), which held that a contractor's surety for the benefit of sub-

must go to *Hall v. Owen County State Bank*,¹⁰ which dealt with the liability of a debtor for a deficiency when he received no notice of the sale; however, many students of the law may have some reservations about the result. No praise should be given to four decisions, including *Savage v. Savage*,¹¹ which correctly indicated that pension rights, like wages, are not transferable or subject to usual creditor process. In denying pension rights the status of "marital property," the court showed a lack of sensitivity to the potentially horrid social and economic consequences of its decision. *Mid America Homes v. Horn*¹² placed too much emphasis upon record titles in allowing a subcontractor to obtain a lien without the notification to the known residential owner as required by statute. *First Savings & Loan Association v. Furnish*¹³ countenanced notoriously sloppy tax sale procedures. *Rauch v. Circle Theatre*¹⁴ allowed a dissolving corporation to distribute its assets to shareholders and ignore creditors with contingent claims.

A. Consumer Legislation

Consumer legislation had its ups and downs in the courts during the last year. On the down side, the Indiana Supreme Court denied transfer to *Holmes v. Rushville Production Credit Association*¹⁵ which allowed a seemingly flagrant violation of consumer credit disclosure requirements and refused attorney's fees to a debtor asserting liability, in a counterclaim, for concededly improper disclosures in a companion note. On the up side, a scholarly dissenting opinion¹⁶ by Justice Hunter in *Holmes* pointed out the majority's failure to note that the Uniform Consumer Credit Code¹⁷ (UCCC) and the Federal Truth in Lending Act¹⁸ contemplated "strict," as

contractors is not released to a subcontractor who has taken a note extending the time for payment.

¹⁰370 N.E.2d 918 (Ind. Ct. App. 1977). See notes 83-100 *infra* and accompanying text.

¹¹374 N.E.2d 536 (Ind. Ct. App. 1978). See notes 150-58 *infra* and accompanying text. For another discussion of this case, see Garfield, *Domestic Relations, 1978 Survey of Recent Developments in Indiana Law*, 12 IND. L. REV. 157, 183-84 (1978).

¹²377 N.E.2d 657 (Ind. Ct. App. 1978). See notes 108-11 *infra* and accompanying text.

¹³367 N.E.2d 596 (Ind. Ct. App. 1977). See notes 36-41 *infra* and accompanying text.

¹⁴374 N.E.2d 546 (Ind. Ct. App. 1978). See notes 185-90 *infra* and accompanying text.

¹⁵353 N.E.2d 509, *remanded on rehearing*, 355 N.E.2d 417 (Ind. Ct. App. 1976), *transfer denied*, 371 N.E.2d 379 (Ind. 1978). For another discussion of this case, see Greenberg, *Contracts, Commercial Law and Consumer Law, 1978 Survey of Recent Developments in Indiana Law*, 12 IND. L. REV. 81, 92-93 (1978).

¹⁶371 N.E.2d 379, 379 (Ind. 1978) (Hunter, J., dissenting).

¹⁷Adopted in Indiana at IND. CODE §§ 24-4.5-1-101 to 6-203 (1976).

¹⁸15 U.S.C. §§ 1601-1667 (1976).

distinguished from “substantial,” compliance with disclosure requirements,¹⁹ and that attorney’s fees to the debtor were mandated by his “successful action to enforce liability” even though established as a partial defense by counterclaim.²⁰ Another consumer credit decision in the United States District Court for the Northern District of Indiana determined that a debtor’s claim for a truth-in-lending violation need not be asserted as a compulsory counterclaim in state proceedings on the original indebtedness and allowed a separate, later action in federal court.²¹ The Indiana Court of Appeals properly held that the UCCC provisions regulating insurance charges apply only to consumer credit, which was determined not to include loans made to enable a debtor to procure equipment for his trucking business.²² The court also held that credit granted by a subcontractor to a prime contractor for work performed on a residential owner’s property and for which a mechanic’s lien was claimed is not consumer credit within the meaning of the Federal Truth in Lending Act.²³

¹⁹Justice Hunter noted that the court of appeals found a disclosure which omitted the “total finance charge” (Regulation Z, 12 C.F.R. § 226.8(d)(3)) to be in “substantial compliance” with disclosure requirements based upon parol testimony of witnesses. 371 N.E.2d at 379. This writer was unable to find any decision allowing a required disclosure to be satisfied by parol proof, under either the Truth in Lending Act or the UCCC.

²⁰No reason was given for denying attorney’s fees in the decision of the court of appeals. It could be explained by the fact that the debtor, while awarded damages on his counterclaim for one violation of disclosure requirements, was adjudged liable to the creditor for greater damages. In other words, the court may have been reluctant to award attorney’s fees to the losing party. See *Rauch v. Circle Theatre*, 374 N.E.2d 546 (Ind. Ct. App. 1978); cf. *Bird v. Rector*, 154 Ind. 138, 56 N.E.129 (1900) (attorney’s fees normally allowed mechanic under lien law would not be allowed where set-off exceeded claim for mechanic’s lien).

²¹*Daughterty v. First Bank & Trust Co.*, 435 F. Supp. 218 (N.D. Ind. 1977). *Accord*, *Drew v. Flagship First Nat’l Bank*, 448 F. Supp. 434 (M.D. Fla. 1977). Under the Federal Truth in Lending Act, a debtor may not set off his claim to the penalty in an action by the creditor on the principal debt until the claim is reduced to judgment. 15 U.S.C. § 1640(h) (1976) (effective Oct. 18, 1974). *But cf.* *Chapman v. Rhode Island Hosp. Trust Nat’l Bank*, 444 F. Supp. 439 (D.R.I. 1978) (set-off against bankruptcy claim of creditor allowed). If the debtor sues for a truth-in-lending penalty in federal court, it has been held that the creditor may not counterclaim unless he establishes separate grounds for federal jurisdiction. *Meadows v. Charlie Wood, Inc.*, 448 F. Supp. 717 (M.D. Ga. 1978) (based upon reasoning that claim of creditor is not a compulsory counterclaim under FED. R. CIV. P. 13); cf. *Newton v. Beneficial Fin. Co.*, 558 F.2d 731 (5th Cir. 1977) (debt discharged in bankruptcy could not be set off against claim of debtor for truth-in-lending violation arising out of the same debt). *But cf.* *Binnick v. Avco Fin. Servs. of Neb., Inc.*, 435 F. Supp. 359 (D. Neb. 1977) (debtor whose obligation to creditor was discharged brought suit for truth-in-lending violation—set-off by creditor allowed).

²²*Hall v. Owen County State Bank*, 370 N.E.2d 918, 933 (Ind. Ct. App. 1977).

²³*Mid America Homes, Inc. v. Horn*, 377 N.E.2d 657 (Ind. Ct. App. 1978) (construing 15 U.S.C. §§ 1602(h), 1603(l), 1635 (1976)).

B. Real Estate Transactions

1. *Release of Liens; Duty of Disbursing Mortgagee to Obtain Releases of Junior Liens and Debts.*—A lender-mortgagee who undertakes disbursement of borrowed funds to prior lienholders and creditors is under a duty to obtain recordable releases of the liens and to obtain receipts showing that the debts have been paid. *Prudential Insurance Co. of America v. Executive Estates*²⁴ found such a duty grounded on an express agreement, the custom and practice in the local real estate community, and the relationship between the borrower-mortgagor and the mortgagee who insisted on making disbursements to prior lienholders and creditors.²⁵ In this case the mortgagee, who advanced funds for a housing development, failed to procure not only the release of a completion bond to the city but also the release of obligations and liens claimed by the contractor who later filed notice of a mechanic's lien and commenced litigation on the lien and an unpaid debt. Because of these omissions, a title cloud was placed on the development. As a result, lots could not be sold, expenses of litigation in defending against the claims of the contractor were incurred, the mortgage went into default, and the mortgagee brought suit to foreclose against the mortgagor who counterclaimed for damages resulting from the former's breach of duty. An award in excess of the mortgage debt plus a nearly equal amount of punitive damages to the mortgagor was reversed on appeal because the evidence neither showed oppressive or malicious misconduct justifying punitive damages²⁶ nor established the actual loss reflected in the judgment.²⁷ Although the final outcome of the

²⁴369 N.E.2d 1117 (Ind. Ct. App. 1977).

²⁵After finding an express agreement to procure releases and a duty arising from custom and practice, the court determined that the duty of the mortgagee also was based upon a principal-agent relationship. *Cf. Lake County Title Co. v. Root Enterprises*, 339 N.E.2d 103 (Ind. Ct. App. 1975) (duty of an escrow agent disbursing construction funds), *discussed in Townsend, Secured Transactions and Creditors' Rights, 1976 Survey of Recent Developments in Indiana Law*, 10 IND. L. REV. 310, 325 (1976).

²⁶On appeal, the court found that the record did not establish "oppression or malice" by the mortgagee's failure to procure the proper releases. The court did not consider whether the action of the mortgagee was accompanied by "oppression or malice" in declaring default and foreclosing without allowance for the loss the action had caused. In other words, suppose *M* gives a mortgage to *E* on his house which *E* negligently destroys. Without giving *M* credit for the loss, *E* demands full payment and forecloses. The decision conveys the incredible inference that *E* is acting with motives which are benign and without "oppression or malice." *But see State Farm Mut. Auto Ins. Co. v. Shuman*, 370 N.E.2d 941 (Ind. Ct. App. 1977).

²⁷Evidence supporting a loss of net profits was held inadequate and too speculative where the proof showed the average price received by showing offers for four lots multiplied by the total number of lots, less the estimated promotional and sales expenses. Failure to show that all the lots were similar or that the price was

case will depend upon a new trial with respect to damages, the case serves as an excellent warning to lenders undertaking to disburse funds to the mortgagor's creditors and junior lienholders.

2. *Rights and Remedies of Lienholder and Debtor; Insurance.*—Often an insurer paying a loss is subrogated to the rights of the insured against a third party who is liable to the insured.²⁸ In *Lawyers Title Insurance Corp. v. Capp*,²⁹ insurers were advised that the rule does not permit subrogation against a party with whom they contract for the benefit of a third party. In this case, the vendor conveying land to a purchaser had procured title insurance for the purchaser from the insurer. When a title defect was paid off by the insurer, the insurer sought subrogation against the vendor on his covenants of title. The court denied subrogation as being inequitable.³⁰ The rule of the case is also important to such persons as lienholders and mortgagors who procure insurance for the protection of others to whom they might be liable.³¹

Another decision, *Augustine v. First Federal Savings & Loan Association*,³² recognized that a lienholder that procured insurance for the protection of a debtor might be under a duty to renew the policy or to notify the debtor of its expiration.³³ Summary judgment

typical made this proof so weak as to suggest only "gross profits." The court failed to indicate whether or not interest expenses on the mortgage and liabilities incurred in connection with charges which should have been released by the mortgagee were allowable.

²⁸*E.g.*, *Hagerman v. Mutual Hosp. Ins., Inc.*, 371 N.E.2d 394 (Ind. Ct. App. 1978) (health and accident insurer subrogated to settlement obtained by insured against tortfeasor).

²⁹369 N.E.2d 672 (Ind. Ct. App. 1977).

³⁰*Id.* at 674.

³¹*Cf.* *Insurance Co. of N. America v. Martin*, 151 Ind. 209, 51 N.E. 361 (1898) (insurer paying loss to mortgagee subrogated to rights of mortgagee against mortgagor who breached terms of policy).

³²373 N.E.2d 181 (Ind. Ct. App. 1978). In this case the insurance covered the vendor's mortgagee, the vendor, and the buyer who later purchased the property on a conditional sales contract. The property was destroyed by fire a few days after the policy expired. Conflicting claims of all the parties including an insurance agent were raised on a motion for summary judgment which, according to the appellate court, had been improvidently granted because sealed depositions had not been considered by the court below.

³³373 N.E.2d at 183 n.1. The duty of the lienholder promising to procure insurance for the debtor is clear. *Sims Motor Transp. Lines, Inc. v. Davis*, 126 Ind. App. 344, 130 N.E.2d 82 (1956) (life insurance). It is less certain whether the lienholder procuring insurance or holding possession of the policy is under a duty to renew it or to notify the debtor before its termination. *Cf.* U.C.C. § 9-207(1) (secured party in possession under duty to use reasonable care in the custody and preservation of collateral). UCCC § 4.304 (notice of cancellation required to be given by creditor requesting termination of property or liability insurance). Case law in other jurisdictions is divided on the question. *See Chrysler Credit Corp. v. Friendly Ford, Inc.*, 535 S.W.2d 110, 19 UCC Rep. 849 (Mo. Ct. App. 1976), and cases cited therein.

against the debtor was reversed, leaving the scope of this duty for future resolution.

3. *Foreclosure of Liens; Right of Mortgagee to Notice of Tax Sale.*—In most mortgage and lien foreclosures, junior lienholders of record, who have possession or who are known by the foreclosing lienholders, must be made parties or the purchaser at the sale will acquire only the interest of those parties named, leaving the junior interest intact with a right to foreclose.³⁴ Early Indiana law did not apply this rule to tax foreclosures,³⁵ presumably either because the "King" should be given one of his prerogatives in such cases or because notice to the owner-mortgagor served as a fictional form of constructive notice to other lienholders. The Indiana Court of Appeals chose to follow precedent in *First Savings & Loan Association v. Furnish*,³⁶ and held that a tax foreclosure sale upon notice to the mortgagor—"owner" bound a mortgagee who was given notice of the sale only through a general notice published in a newspaper.³⁷ The decision thus attempts to resolve the unsettled question of whether the United States Supreme Court decision in *Mullane v. Hanover Bank & Trust Co.*³⁸ applies to tax lien sales. Under that decision, constructive notice by publication is inadequate when actual notice can be given to a party in judicial-type proceedings affecting his property.³⁹ Unfortunately, the court of appeals failed to consider the obvious fact that tax sales are generally known to be conducted in a careless, haphazard manner which do not produce a fair price for the property.⁴⁰ Lack of notice to interested parties more than likely is one of the reasons for low prices at tax sales. Hopefully, this decision will not end the search for due process of law.⁴¹

4. *Remedies of Conditional Sellers of Real Estate; Forfeiture: The Leaky Spigot Case.*—*Skendzel v. Marshall*⁴² has become a

³⁴*E.g.*, *Catterlin v. Armstrong*, 101 Ind. 258 (1885).

³⁵*Baldwin v. Moroney*, 173 Ind. 574, 91 N.E. 3 (1910).

³⁶367 N.E.2d 596 (Ind. Ct. App. 1977). In this case the mortgagee received actual notice of the sale in time to redeem from the purchaser, but at the added expense of redemption. The court nevertheless decided that it retained standing to challenge the constitutionality of the procedure.

³⁷*Id.* at 600-01. The Indiana tax sale statute provides for 21 days' notice to "owners" by certified mail. IND. CODE § 6-1.1-24-4 (1976).

³⁸339 U.S. 306 (1950).

³⁹*Id.* at 320.

⁴⁰The court did take judicial notice of the fact that mortgagees are generally astute in keeping abreast of tax payments and records, thus justifying a rule that omits notice of tax sales to them. 367 N.E.2d at 601.

⁴¹Lack of notice of a tax assessment to an owner may constitute a denial of due process. *F.W. Woolworth Co. v. State Bd. of Tax Comm'rs*, 369 N.E.2d 958 (Ind. Ct. App. 1977).

⁴²261 Ind. 226, 301 N.E.2d 641 (1973), *cert. denied*, 415 U.S. 921 (1974).

household name to Indiana lawyers. It held that typical conditional sales contracts of real estate, which grant the vendor a right to declare a forfeiture upon default of payments or other breaches of contract by the purchaser, are penal in nature if the buyer has paid a substantial amount on the contract.⁴³ The vendor in such a case must foreclose his interest as a mortgagee, thus giving the mortgagor a right to remain in possession and to redeem until the land is sold under judicial foreclosure procedures applicable to mortgages. Decisions of the Indiana Court of Appeals since *Skendzel*, however, have seized upon, and probably enlarged, certain equitable exceptions to the rule that such defaults are penal in nature and have allowed forfeiture if the vendee has not paid a substantial amount towards the purchase price, if he has committed waste or damage seriously affecting the value of the property, if he has abandoned possession, or if a combination of these factors is found to justify allowing the vendor to repossess and keep the payments made.⁴⁴ During the last year, the court of appeals upheld forfeiture in three cases where the vendee paid (1) \$32,000 of a purchase price of \$57,000;⁴⁵ (2) \$2,242 of a price of \$7,454;⁴⁶ and (3) \$1,000 and unstated payments on an obligation to pay \$9,815.⁴⁷ In addition, in the first case, the court found "abandonment" only because payments were not made.⁴⁸ In the second case, taxes were not paid.⁴⁹ In the third instance, the property was abandoned (vacated), waste of a trifling nature was committed, and casualty insurance had lapsed.⁵⁰

⁴³*Id.*

⁴⁴*Donaldson v. Sellmer*, 333 N.E.2d 862 (Ind. Ct. App. 1975); *Goff v. Graham*, 159 Ind. App. 324, 306 N.E.2d 758 (1974). Other decisions have followed *Skendzel* and denied forfeiture. *Ogle v. Wright*, 360 N.E.2d 240 (Ind. Ct. App. 1977); *Bartlett v. Wise*, 348 N.E.2d 652 (Ind. Ct. App. 1976); *Tidd v. Stauffer*, 308 N.E.2d 415 (Ind. Ct. App. 1974).

⁴⁵*Morris v. Weigle*, 375 N.E.2d 677 (Ind. Ct. App. 1978).

⁴⁶*Reynolds v. Milford*, 375 N.E.2d 265 (Ind. Ct. App. 1978).

⁴⁷*Finley v. Chain*, 374 N.E.2d 67 (Ind. Ct. App. 1978). Actually, the court assumed that \$6,893 had been paid on the price of \$22,815 for land priced under the contract.

⁴⁸375 N.E.2d 677. It appeared that the property was continuously occupied by a tenant of the purchaser, a Purdue professor. Evidence in this case also established that a vacant house without a bathroom deteriorated in value by \$6,000, but there was no proof of waste or that the value of the land had deteriorated below the amount of the obligation.

⁴⁹375 N.E.2d 265. In this case the vendor presented testimony of damage to the property, but the trial court over the vendor's steadfast objections refused to allow the purchaser to testify on this issue. The court of appeals held that the vendor could not support an award of damages for waste when the purchaser was not permitted to rebut the vendor's proof.

⁵⁰374 N.E.2d 67. In this case, as part of the same transaction, the vendor sold stock in the tavern to the purchaser under a separate obligation to pay and according to a distinct payment schedule along with an undertaking to pay some of the corporate debts. These payments were secured by the conditional sales contract, as was the

Of these three recent decisions allowing forfeiture, it is most interesting to note that in *Reynolds v. Milford*⁵¹ the lower court awarded the vendor possession, damages measured by the unpaid installments to the time the vendor regained possession, and overdue escrow payments for taxes and insurance. On appeal, the court held that the damage award was inequitable, and, in any event, would be limited to the reasonable rental value of the property for the wrongful occupation from the time forfeiture was declared to the time possession was recovered.⁵² On the other hand, in *Finley v. Chain*,⁵³ which should forever be known as the "leaky spigot case," the vendor of a tavern, who regained possession of the property after it was vacated, was allowed to recover overdue payments promised by the vendee in connection with the sale of stock in a corporation operating the tavern, such promise being secured by both the stock and the conditional sales contract.⁵⁴ The court also allowed damages for permissive waste described as resulting from "negligence or omission to do that which would prevent injury."⁵⁵ It then held that failure to repair several leaky water spigots was permissive waste, but that failure to fix a broken front door and a burned-out water cooler did not constitute such waste, apparently

obligation thereunder to pay a prior mortgage upon the land. Hence, the vendee's obligations were secured by a security interest in the stock and by the conditional sales contract with respect to the land. *See also* *Kruse, Kruse & Miklosko, Inc. v. Beedy*, 353 N.E.2d 514 (Ind. Ct. App. 1976). In *Beedy* the seller apparently had declared a forfeiture of the stock. Such a forfeiture, if declared, is permitted under U.C.C. § 9-501(4) which gives a secured party the same remedy with respect to both personal and real property as with realty only.

⁵¹375 N.E.2d 265 (Ind. Ct. App. 1978).

⁵²Where the vendor declares an forfeiture of a lease with an option to purchase, the purchaser is liable for rental payments accruing to the time of eviction. *Schlemmer v. Saine*, 106 Ind. App. 403, 20 N.E.2d 198 (1939); *Bernstein v. Rhoades*, 92 Ind. App. 553, 157 N.E. 463 (1927). Unlike the conditional sales contract, the payments due under a true lease with an option to purchase are considered to be rent. In the case of a conditional sale the payments usually are described in the contract as "rent" or "liquidated damages" upon forfeiture. Hence, the question always is not whether the payments are rent, but whether they are reasonable as liquidated damages. The court in *Reynolds* seems to have found that the unpaid payments along with the forfeited amount were unreasonable as liquidated damages.

⁵³374 N.E.2d 67 (Ind. Ct. App. 1978).

⁵⁴The purchaser under the conditional sales contract had promised to pay the bills of the corporation which included two liquor bills, a sewage bill, and a sales tax which were overdue and unpaid obligations at the time of forfeiture. As a type of third-party beneficiary contract, these obligations were secured by the conditional sales contract. The court held that the vendor was entitled to damages measured by these unpaid bills. Apparently, no claim was made for overdue and unpaid installments on the purchase price of the stock or on a mortgage assumed by the conditional buyer.

⁵⁵*Id.* at 79.

on the unarticulated basis that the evidence did not show that the conditional buyer made a practice of making these repairs but did repair the leaky faucets.⁵⁶ It was made clear, however, that, to be actionable, waste by a mortgagor or vendee must render the debt unsafe. In holding the conditional buyer liable for damages due to waste, the court indicated that it was adopting the same rule applicable to a mortgagor on the theory that the conditional sale was, in effect, a mortgage. This is a correct but surprising result considering that forfeiture had been declared and allowed.⁵⁷ The difficulty of measuring damages was resolved by limiting recovery to the reduced value of the property, not to exceed the difference between the unpaid obligation and the value of the land.⁵⁸ A new trial was ordered to enable the appellee-vendor to correct his deficiency in proof on the issue of damages.

⁵⁶*Id.* This may be the first Indiana case to attempt to define permissive waste. It seems that a tenant may make reasonable use of the property which is measured by the expected use to which it will be put. He is not responsible for ordinary wear and tear. *Jennings v. Bond*, 14 Ind. App. 282, 42 N.E. 957 (1895). Arguably, leaky faucets, the deterioration of the cooler, and a broken front door could be classified as ordinary wear and tear in the use of a tavern. *See also* RESTATEMENT (SECOND) OF PROPERTY § 12.2, Comment d, Illustrations 1-3 (1977). However, the tenant is responsible for non-ordinary wear and tear caused by his customers. *Id.*, Comment g. While the rule of permissive waste imposes no duty upon a tenant to repair conditions resulting from ordinary wear and tear or forces for which he is not responsible, he may be under a duty to make sufficient repairs to avoid further permanent or consequential damages which foreseeably result from the condition. *Id.*, Comment d, Illustration 5 (1977). *See also* *Ferguson v. Stafford*, 33 Ind. 162 (1870). In *Finley*, if the door had been kicked in or damaged in an abnormal way while in the conditional purchaser's possession, it seems that the burden of going forward with evidence showing that the damage was caused by a stranger should have been placed upon the purchaser. *Cf. Bottema v. Producers Livestock Ass'n*, 369 N.E.2d 1189 (Ind. Ct. App. 1977) (rule applicable to bailment situation). *But see Merritt v. Richey*, 127 Ind. 400, 27 N.E. 131 (1891).

⁵⁷*Accord, Jowdy v. Guerin*, 10 Ariz. App. 205, 457 P.2d 745 (1969) (supporting proposition that conditional buyers and mortgagors are liable in damages for permissive waste; here, vacant house allowed to become "demolished").

⁵⁸*Accord, id.* It seems that damages to a structure are estimated by the usual rules allowing cost of repair. *Ingmire v. Butts*, 334 N.E.2d 701 (Ind. Ct. App. 1975). If they are permanent, damages may be measured by the reduced value of the land. *Knisely v. Hire*, 2 Ind. App. 86, 28 N.E. 195 (1891). Equity will enjoin waste by a mortgagor or conditional buyer only when proof is offered that the debt secured is impaired. In other words, the lienholder must show that the land is inadequate to satisfy the obligation and that the mortgagor or purchaser either is insolvent or is not responsible on the debt. *Cf. State ex rel. McCaslin v. Evans*, 44 Ind. 151 (1873) (insolvent vendee enjoined from cutting timber); *Gray v. Baldwin*, 8 Blackf. 164 (Ind. 1846) (enjoined mortgagor who was cutting timber and without other property); *Gleason v. Gleason*, 43 Ind. App. 426, 87 N.E. 869 (1909) (injunction denied against life tenant committing permissive waste).

C. Security Interests in Personal Property

1. *Creation of Security Interest; Parol Evidence to Show That Title Taken in Name of Secured Party Held as Security.*—Parol evidence is admissible to show that an outright conveyance of land to another person from or for a debtor was intended as a mortgage.⁵⁹ Does this rule apply to personal property, and is parol evidence prohibited by article 9 of the Uniform Commercial Code? In *Johnson v. Johnson*,⁶⁰ titles to a mobile home and automobile were taken in the name of two parents who financed the transaction for a husband and wife. It was held that, upon divorce, the court should have disposed of the property as marital property belonging to the husband and wife on the unarticulated assumption that parol evidence had established their ownership rights.⁶¹ This matter is not directly covered by article 9, but the result is in accord with the spirit of section 1-103 of the Code which adopts supplementary rules of equity⁶² permitting parol evidence to show that an outright conveyance is held as security.

2. *Lease of Goods (Bailment) as a Security Interest; Voidable Title.*—As a general rule, a lessor or bailor of goods is protected from the dishonesty of his bailee who, without authority, sells to a third party. He may recover in trover or replevin from the third person who takes his title subject to the doctrine of caveat emptor.⁶³ The lessor is not a secured party who must perfect by filing or by other means as provided in article 9 of the Uniform Commercial Code.⁶⁴ The bailee usually does not hold a "voidable" title empowering him to convey title to a bona fide purchaser. These principles were recognized in *McDonald's Chevrolet, Inc. v. Johnson*⁶⁵ where, after misrepresenting both his name and, obviously, his intent to return a house trailer at the expiration of a thirteen-day leasehold term, the lessee ultimately caused the vehicle to be sold to an In-

⁵⁹See also *Moore v. Linville*, 352 N.E.2d 846 (Ind. Ct. App. 1976), discussed in Townsend, *Secured Transactions and Creditors' Rights, 1977 Survey of Recent Developments in Indiana Law*, 11 IND. L. REV. 253, 258-59 (1977).

⁶⁰367 N.E.2d 1147 (Ind. Ct. App. 1977).

⁶¹*Id.* at 1149.

⁶²Prior to the Code, it was clear that title to personal property transferred to or taken in the name of a creditor could be proved to be held as security, so that the debtor could regain full rights upon repaying the loan. *Maple v. Seaboard Sur. Co.*, 117 Ind. App. 627, 73 N.E.2d 80 (1947). A creditor without possession claiming a security interest based upon an unwritten outright transfer from the debtor may have difficulty establishing his title under article 9 which requires a writing signed by the debtor describing the collateral and containing words of grant. *White v. Household Fin. Corp.*, 158 Ind. App. 394, 407-08, 302 N.E.2d 828, 836-37 (1973).

⁶³*Schinler v. Westover*, 99 Ind. 395 (1884); *Ingersoll v. Emmerson*, 1 Ind. 76 (1848).

⁶⁴*DeVita Fruit Co. v. FCA Leasing Corp.*, 473 F.2d 585 (6th Cir. 1973).

⁶⁵376 N.E.2d 106 (Ind. Ct. App. 1978).

diana good faith purchaser by means of several spurious certificates of title.⁶⁶ Ordinarily, when possession of goods is obtained by the fraud of an outright buyer, the seller has an equitable right to rescind.⁶⁷ The buyer, however, has a "voidable" title with a power to transfer title to a bona fide purchaser on the ancient theory that the equitable title of the seller may be cut off by a bona fide purchaser.⁶⁸ *Johnson* properly stands for the proposition that it is not the procurement of possession by fraud which creates the power in the fraudulent transferee. It is the giving of possession with intent to transfer a specific rescindable title induced by the fraud or wrongdoing which places the risk of loss upon the seller when the buyer conveys that interest to a third party.⁶⁹ *Johnson*, thus, reflects the rule that a transferee obtaining a partial title by fraud obtains only a voidable partial title. Hence, when the lessee obtained a thirteen-day lease by fraud, he had no more than the power to convey his thirteen-day leasehold interest to a bona fide purchaser.⁷⁰

It should be pointed out that a lessee or bailee without authority to dispose of the goods may hold a "voidable" title or a power to convey a good title to a bona fide purchaser in circumstances which were not present in *Johnson*.⁷¹ A lessee or bailee may have a voidable title if he is a seller of goods who is allowed to remain in

⁶⁶In this case the trailer was taken by the lessee from Texas to Alabama where it was registered. A certificate of title was obtained by the lessee in Nebraska. Finally, after procuring an Indiana title, it was traded to an Indiana dealer. The titles were obtained by theft of a serial number stolen from another motor home in Texas. The case actually involved litigation between the Indiana dealer and his buyer who successfully brought suit for breach of warranty of title when the vehicle was seized by the Indiana State Police.

⁶⁷*E.g.*, *Woods v. Shearer*, 56 Ind. App. 650, 105 N.E. 917 (1914) (by replevin action seller recovered property traded to buyer on fraudulent misrepresentations with respect to stock exchanged in the transaction; seller excused from returning worthless stock as a condition to rescission).

⁶⁸U.C.C. § 2-403(1); *Stoner v. Brown*, 18 Ind. 464 (1862).

⁶⁹The court probably exaggerated in stating that a "bailment involves no transfer of ownership; the bailee acquires only a possessory interest." For many purposes he acquires ownership rights. *E.g.*, *The Winkfield*, [Eng.] [1904] P. 410. A lessee having exclusive use of a motor vehicle for more than 30 days is an "owner." IND. CODE § 9-1-1-2(o) (1976).

⁷⁰Arguably, since a sub-bailment ordinarily is impermissible, the bailee acquired no transferable, voidable interest. *Compare Aetna Cas. & Sur. Co. v. Higbee*, 80 Ohio App. 437, 76 N.E.2d 404 (1947) (sub-bailment by fur storage company held to be a conversion), *with* RESTATEMENT OF SECURITY § 23, Comment b (1941). If a seller is induced to transfer a one-half interest in goods by fraud, however, it seems that the buyer is empowered only to sell the one-half interest to a bona fide purchaser. His power is limited to the interest transferred. *See* U.C.C. § 2-403(1) (purchaser of limited interest acquires only the limited interest).

⁷¹376 N.E.2d 106 (Ind. Ct. App. 1978).

possession.⁷² If the lessor entrusts the bailee of a motor vehicle with a properly indorsed certificate of title (which was not the case in *Johnson*), a bona fide purchaser taking a clear title should be protected.⁷³ A lessor entrusting possession to a bailee merchant who deals in goods of that kind may be estopped from claiming his title against a buyer in the ordinary course of business.⁷⁴ In addition, a lease may become, in effect, a security transaction if the lease calls for payments which allow the lessee to become the owner upon completion of the payments or for an additional nominal consideration. The lessor must perfect under article 9 if he is to be protected against later secured parties, purchasers, and creditors.⁷⁵

3. *Discharge and Release of Secured Claim; Parol Evidence to Prove that Collateral Accepted in Discharge of Debt and to Prove Subordination.*—*Lamb v. Thieme*⁷⁶ held that a debtor may prove a parol agreement with the secured party in which the latter accepted part of the collateral in full satisfaction of the debt. A debtor, however, may object to oral proof of an alleged agreement in which he surrendered his right of redemption after default when the evidence is offered by a creditor with a security interest in the collateral.⁷⁷

*A-W-D, Inc. v. Salkeld*⁷⁸ recognized that a prior secured party may orally subordinate his security agreement to a second

⁷²IND. CODE § 32-2-1-7 (1976) (seller's possession presumed fraudulent against seller's creditors and purchasers in good faith), as modified by U.C.C. § 2-402(2). This, in effect, is a codification of the rule in *Twyne's Case*, 3 Co. Rep. 806, 76 Eng. Rep. 809 (1601). See also *Seavey v. Walker*, 108 Ind. 78, 9 N.E. 347 (1886).

⁷³See also *Fryer v. Downard*, 134 Ind. App. 226, 187 N.E.2d 105 (1963); *Dresher v. Roy Wilmeth Co.*, 118 Ind. App. 542, 82 N.E.2d 260 (1948). A bona fide purchaser is not protected by reliance upon a forged certificate of title or a spurious title obtained by forgery. *Central Fin. Co. v. Garber*, 121 Ind. App. 27, 97 N.E.2d 503 (1951); *Buckeye Union Cas. Co. v. Nichols*, 4 Ohio Misc. 131, 212 N.E.2d 685 (1965) (no title passed through certificate of title procured by use of stolen serial number). Hence, the court in *Johnson*, see note 61 *supra*, properly did not regard as significant the alleged bona fide purchaser's acquisition of a certificate of title based upon a forgery and a spurious serial number.

⁷⁴U.C.C. § 2-403(2).

⁷⁵Compare U.C.C. § 1-201(37) with *Nickell v. Lambrecht*, 29 Mich. App. 191, 185 N.W.2d 155 (1970) and *James Talcott, Inc. v. Franklin Nat'l Bank*, 292 Minn. 277, 194 N.W.2d 775 (1972).

⁷⁶367 N.E.2d 602 (Ind. Ct. App. 1977) (agreement established by admission of the secured party to whom stock was transferred by the debtor).

⁷⁷U.C.C. § 9-506. It has been held, however, that the debtor's surety may orally consent to a release of collateral. *Indianapolis Morris Plan Corp. v. Karlen*, 28 N.Y.2d 30, 268 N.E.2d 632, 319 N.Y.S.2d 831 (1971). The Code permits the secured party to keep collateral in satisfaction of the obligation upon written notice to the debtor who does not object in writing. U.C.C. § 9-505(2).

⁷⁸372 N.E.2d 486 (Ind. Ct. App. 1978).

lienholder who changes position in reliance thereon. Subordination, however, was denied in an interesting situation in which the debtor had given an unperfected security interest in inventory to *SP1*. When seeking credit from *SP2* who sought security in the same collateral, the debtor informed *SP2* of *SP1*'s security interest and that his "first obligation" was to *SP1*. The debtor then executed a security agreement with *SP2* which covered the collateral after advising *SP2* that he would be put in "second place." However, *SP2* first perfected his security interest and claimed priority over *SP1* under the Code rule giving priority to the secured party who first perfects.⁷⁹ A lower court finding of subordination was reversed upon the ground that there was no subordination agreement as a matter of law, but simply that there was a mistake of law as to priorities.⁸⁰ A dissenting judge ingeniously found a subordination agreement in what was determined to be a third-party beneficiary contract between the debtor and *SP2* for the benefit of *SP1*.⁸¹ The case is a good candidate for transfer.

4. *Remedies of Secured Party; Right to Deficiency upon Improper Sale.*—Subject to a few specified exceptions, a secured party may recover a deficiency upon disposition of collateral when the debtor is sent reasonable notification of the time and place for the sale, and the sale is conducted in a commercially reasonable manner.⁸² *Hall v. Owen County State Bank*⁸³ dealt with the requirements for reasonable notification and for a commercially reasonable sale, as well as with the secured creditor's rights to a deficiency, when these standards have not been met. With respect to notification of the time and place for the sale, the court held that the debtor's right to notice cannot be waived by him before or after default,⁸⁴ that in the case of joint debtors, notice to one will not bind the other;⁸⁵ and that an unwritten notice of an offer to buy the col-

⁷⁹U.C.C. § 9-312(5).

⁸⁰372 N.E.2d at 488.

⁸¹*Id.* at 486, 489 (Garrard, J., dissenting).

⁸²U.C.C. § 9-504(1). Notification to the debtor is not required when the collateral is perishable, threatens to decline speedily in value, or is of a type customarily sold on a recognized market. Notice is not required to be given to junior secured parties in the case of consumer goods. *Id.*

⁸³370 N.E.2d 918 (Ind. Ct. App. 1977).

⁸⁴*Id.* at 924. The Code expressly provides that the rights of the debtor and the duties of the secured party with respect to sale or disposition cannot be waived or varied. U.C.C. § 9-501(3). *Contra*, *Holmes v. Rushville Prod. Credit Ass'n*, 353 N.E.2d 509, *remanded on rehearing*, 355 N.E.2d 417 (Ind. Ct. App. 1976) (surety waived defense where secured party consented to disposal of collateral without notice).

⁸⁵370 N.E.2d at 925-26. The case, in effect, held that a partner (although the partnership was not clearly established) was not bound individually upon a note secured by partnership property and was entitled to notification. *Accord*, *Atlas Thrift Co. v.*

lateral a few hours before the sale followed by the debtor's assent is insufficient.⁸⁶ The court held that a casual sale to an inquiring buyer after repossession was reasonable and embarked upon an in-depth lecture as to what constituted a commercially reasonable sale.⁸⁷ Price was fixed as the most important item for determining commercial reasonableness, although it was held to be no basis, standing alone, for challenging a sale which otherwise is proper.⁸⁸ Other factors, listed as important by the court, include the price received for the goods when resold by the buyer; whether the collateral is sold in a retail or wholesale market; the number of bids solicited or received; and the whole range of circumstances accompanying a sale.⁸⁹ In this case, independent evidence⁹⁰ showing that the value of the collateral was equal to the sale price justified a finding that the private sale was commercially reasonable despite the failure of the secured party to have an appraisal, the unfamiliarity of the persons conducting the sale with the subject of the sale, and the sale to the first bidder without solicitations or notice to other possible buyers. While the case furnishes few concrete rules defining when a sale is commercially reasonable or unreasonable, the decision makes clear to all repossessing creditors that a sale, well-advertised in advance, which draws the attention of a broad audience, which brings a good price, and which is conducted by a knowledgeable person, aided by a careful appraisal of the collateral, stands a good chance of meeting Code requirements. Something less may suffice, but the price received then becomes a key factor.

Most importantly, *Hall* determined that a sale without reasonable notice to a debtor, which is probably commercially unreasonable as well, will not bar a creditor from recovering a deficiency,⁹¹ subject to one qualification. The secured party may recover

Horan, 27 Cal. App. 3d 999, 104 Cal. Rptr. 315 (1972). See also *Clayton v. Fletcher Sav. & Trust Co.*, 89 Ind. App. 451, 155 N.E. 539 (1927) (notice of rescission must be given to all joint partners). A corporate officer individually bound as debtor upon a corporate obligation secured by corporate property is entitled to notification. *Hepworth v. Orlando Bank & Trust Co.*, 323 So. 2d 41 (Fla. Dist. Ct. App. 1975); *Third Nat'l Bank & Trust Co. v. Stagnaro*, 25 Mass. App. Dec. 58 (1962); *DeLay First Nat'l Bank & Trust Co. v. Jacobson Appliance Co.*, 196 Neb. 398, 243 N.W.2d 745 (1976); *T & W Ice Cream, Inc. v. Carriage Barn, Inc.*, 107 N.J. Super. 328, 258 A.2d 162 (1969).

⁸⁶370 N.E.2d at 926.

⁸⁷*Id.* at 928-30.

⁸⁸"The fact that a better price could have been obtained by a sale at a different time or in a different method . . . is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner." U.C.C. § 9-507(2).

⁸⁹370 N.E.2d at 929-30.

⁹⁰Testimony of the buyer at the sale was held sufficient to establish the collateral's value at the time of sale as being equal to the price he paid for it. *Id.* at 931.

⁹¹The court adopted what appears to be the majority rule on this point. A minority of decisions construing the Uniform Commercial Code (which does not expressly deal

only the difference between the reasonable market value of the collateral at the time of the sale and the amount of the obligation. It is presumed that the market value of the collateral equals the indebtedness, and the burden of proof is upon the secured party to show that the indebtedness was higher than the market value of the collateral. He cannot prove value by the price realized at the sale, by his own testimony, or by the testimony of his agents alone.⁹² In the case of an improper sale, the debtor may enjoin the sale, and recover damages if he can show that the value of the collateral improperly sold exceeded the obligation.⁹³ Several important questions flow from this new rule. In determining the value of collateral improperly sold, will the court consider retail value or wholesale value in fixing the market value of the goods? In the case of motor vehicles, a difference in these market values is generally recognized. It seems that the court here should bind the secured party to the retail market value of the goods when the sale is determined to be improper, at least in the case of non-inventory items. This is the rule generally followed in computing damages for injuries to goods held by an owner who is not a retailer, wholesaler, or manufacturer.⁹⁴ Although the court approved private sales which are otherwise properly conducted by a secured party in a wholesale market,⁹⁵ a valuation of non-inventory collateral fixed in that market should follow only from a sale which is preceded by proper notification and conducted in a commercially reasonable manner. The court in *Hall* denied punitive damages because the sale was determined to have

with the problem) denies a deficiency to a secured party who fails to give reasonable notification of the sale or who sells in a manner which is not commercially reasonable. In support of the minority position, the court cited decisions from six states. Other recent decisions indicate that the minority view is virulent. *E.g.*, *Nixdorf Computer, Inc. v. Jet Forwarding, Inc.*, 579 F.2d 1175 (9th Cir. 1978); *Herman Ford-Mercury, Inc. v. Betts*, 251 N.W.2d 492 (Iowa 1977); *Jackson State Bank v. Beck*, 577 P.2d 168 (Wyo. 1978).

⁹²A similar presumption may arise when a surety is released to the extent of the value of collateral held by the principal. *Cf.* *Mutual Benefit Life Ins. Co. v. Lindley*, 97 Ind. App. 575, 187 N.E. 680 (1933) (court presumed value of collateral to be equal to the amount of indebtedness when extension released surety who was secondarily liable thereon only to the extent of the collateral).

⁹³U.C.C. § 9-507(1). In the case of consumer goods, the debtor is entitled to a penalty measured by the finance charge plus 10% of the loan or the cash price of the goods. *E.g.*, *Western Nat'l Bank v. Harrison*, 577 P.2d 635 (Wyo. 1978).

⁹⁴*Cassel v. Newark Ins. Co.*, 274 Wis. 25, 79 N.W.2d 101 (1956); RESTATEMENT OF TORTS § 911, Comment d (1939). When inventory is damaged or lost, the measure of damages is based on the wholesale price. *Chicago Title & Trust Co. v. W.T. Grant Co.*, 2 Ill. App. 3d 483, 275 N.E.2d 670 (1971).

⁹⁵*Accord*, *Mount Vernon Dodge, Inc. v. Seattle-First Nat'l Bank*, 18 Wash. App. 569, 570 P.2d 702 (1977) (emphasizing that bank was not licensed to sell motor vehicles as retail dealer under licensing statute).

been conducted by the banker-secured party in good faith and after approval by the debtor, and dismissed the claim of the debtor for attorney's fees.⁹⁶ This is a correct result since the bank did not charge the debtor for its expenses in the sale or for attorney's fees and claimed no more than the deficiency it was awarded. However, *Hall* seems to recognize that punitive damages will be allowed when an improper sale is accompanied by bad faith or followed by an excessive demand for a deficiency.⁹⁷ Conceivably, since good faith is a standard governing all provisions of the Code,⁹⁸ the possibility remains that no deficiency will be allowed when the errant secured party is guilty of bad faith.⁹⁹ In no event should he be allowed attorney's fees or expenses of a bad sale, a point apparently recognized by the secured party who made no such claim in *Hall*. In fact, no decisions were found where these charges were added to a deficiency claim after a non-complying sale.¹⁰⁰

5. *Remedies of Secured Party; Right of Transferee to Collect Chattel Paper.*—A transferee of chattel paper may collect from the account debtor when the assignor (debtor of the transferee) is in default or when it is otherwise agreed.¹⁰¹ *First National Bank v.*

⁹⁶Attorney's fees were claimed under the UCCC which was held to be inapplicable. See note 23 *supra*. *Accord*, *Liberty Nat'l Bank & Trust Co. v. Acme Tool Div., Rucker Co.*, 540 F.2d 1375 (10th Cir. 1976). Usually, attorney's fees are denied in the absence of a contract or other equitable grounds. *City of Indianapolis v. Central R.R.*, 369 N.E.2d 1109 (Ind. Ct. App. 1977). Whoever heard of a security agreement giving a debtor the right to attorney's fees from a secured party when the latter violates his duties towards the former? Attorney's fees should be considered as an element of punitive damages. See *Indianapolis Journal Newspaper Co. v. Pugh*, 6 Ind. App. 510, 528, 33 N.E. 991, 996 (1892) (attorney's fees allowed as an element of punitive damages).

⁹⁷370 N.E.2d at 927 n.10. *Accord*, *Davidson v. First Bank & Trust Co.*, 559 P.2d 1228, 1232-33 (Okla. 1976); *cf.* *Nicholson's Mobile Home Sales, Inc. v. Schramm*, 330 N.E.2d 785, 790-91 (Ind. Ct. App. 1975) (secured party wrongfully repossessing mobile home).

⁹⁸U.C.C. § 1-203.

⁹⁹Because the error committed by the secured party in *Hall* was determined to have been made in good faith, the question remains whether a secured party flagrantly violating Code resale provisions should be allowed a deficiency. If good faith is a factor here, and possibly it should be, the conflicting authority in the various states may possibly be reconciled upon this basis. *Cf.* *Associates Financial Servs. Co. v. DiMarco*, 383 A.2d 296 (Del. Super. 1978) (deficiency given to secured party who "errs in good faith").

¹⁰⁰In *Cornett v. White Motor Corp.*, 190 Neb. 496, 209 N.W.2d 341 (1973), the court awarded the secured party the expenses of preparing the collateral for resale, but in that case the expenses were incurred after an improper sale to the secured party who resold the goods at a much higher price which the court determined to be the proper value in allowing a deficiency.

¹⁰¹The secured party (assignee) is authorized to collect from the account debtor or obligor on an instrument "[w]hen so agreed and in any event on default." U.C.C. § 9-502(1). This probably means the default of the assignor-debtor.

*Schrader*¹⁰² held, in effect, that an outright purchaser of chattel paper is authorized, by implied agreement, to collect from the account debtor and to bring suit as the real party in interest.¹⁰³ Although not decided by the court, such a transferee in possession of chattel paper seems not only to be able to collect from and to sue an account debtor in default, but also, in some circumstances, to be under a duty to do so when the assignor is secondarily liable.¹⁰⁴

D. Creditors' Rights

1. *Mechanic's Liens.*—A person furnishing work, labor, or materials to a construction project may claim a lien upon the property under the Indiana mechanic's lien statute,¹⁰⁵ subject to rules which have been carefully worked out by decisions and frequent amendments. In 1977 the period of time in which a subcontractor must give advance notice to the owner of residential property that he intends to assert a lien was extended from fourteen to sixty days after commencement of the work in the case of new construction, and from five to thirty days after commencement of the work when alteration or repair is involved.¹⁰⁶ Both the old and amended versions of this law make notice to the residential owner a condition precedent to the acquisition of a lien.¹⁰⁷ *Mid America Homes v. Horn*¹⁰⁸ held that timely notice by a materialman to the record

¹⁰²375 N.E.2d 1124 (Ind. Ct. App. 1978).

¹⁰³The court mistakenly determined that an outright assignment of chattel paper was controlled by article 2 of the Code or by common law principles. In fact, however, article 9 governs most of the rights of the parties when chattel paper is taken either as security or by outright transfer. See, e.g., U.C.C. § 9-102(b). The right of the assignee (secured party by definition) to collect from the account debtor (original obligor) is governed by § 9-502 of the Uniform Commercial Code. See note 93, *supra*. The case correctly held that an outright transferee of chattel paper by agreement is authorized to collect and is the real party in interest regarding suit against the account debtor. Compare the last sentence of § 9-502(2).

¹⁰⁴*Cf.* U.C.C. § 9-207(1) (secured party in possession under a duty to take necessary steps to preserve rights against prior parties). Whether an assignee in possession of chattel paper or a secured party in possession of an instrument is under a duty towards his debtor-surety to bring an action against the account debtor or obligor is not clearly settled. Compare *In re Johnson*, 552 F.2d 1072 (4th Cir. 1977) (bank in possession of notes required to file claim against account debtor's estate in bankruptcy), with *In re United East Coast Corp.*, 6 UCC SERV. 449 (E.D.N.Y. 1969) (pledgee of note under duty only to give pledgor opportunity to bring suit upon notes in default). For the Indiana pre-Code law, see H. PRATTER & R. TOWNSEND, INDIANA UNIFORM COMMERCIAL CODE WITH COMMENTS §§ 9-207(1), 9-502 (1963).

¹⁰⁵IND. CODE § 32-8-3-1(1) (Supp. 1978).

¹⁰⁶Act of Apr. 12, 1977, Pub. L. No. 310, § 1, 1977 Ind. Acts 1424 (codified at IND. CODE § 32-8-3-1 (Supp. 1978)).

¹⁰⁷IND. CODE § 32-8-3-1 (1976 & Supp. 1978).

¹⁰⁸377 N.E.2d 657 (Ind. Ct. App. 1978).

owner of the land was sufficient, although the prime contract was made by a purchaser who had contracted to purchase the land from the record owner and who apparently had taken possession of the land.¹⁰⁹ In any event, the materials were invoiced to the purchaser, and the materialman was informed of the deed to the purchaser one day before the time for giving notice had expired.¹¹⁰ Without imposing an obligation of good faith or a duty to inquire as to the possessory status of the property, the court held that the notice requirement in the case of residential property was satisfied when the record owner received notice. The decision is a bad one and leaves the residential "owner" who leases or who holds less than a record title at the mercy of careless or unscrupulous subcontractors who ignore the contract between the prime contractor and the person with whom the prime contractor is dealing.¹¹¹ The owner's ignorance of this technical law will cause him great dismay when he discovers that a subcontractor holds a lien even though the owner has paid the prime contractor.

As a general rule, while an owner's interest in land may be subjected to a mechanic's lien for work performed in privity with a prime contractor, the owner is not liable on the contract to the subcontractor.¹¹² Privity between the subcontractor and the owner is

¹⁰⁹*Id.* at 660. The case did not clarify whether the purchaser had taken possession, but he certainly had done so through the contractor who had caused delivery to be made to the premises. For discussion concerning the proposition that possession is sufficient to put third parties on notice, see, Townsend, *Secured Transactions and Creditors' Rights, 1974 Survey of Recent Developments in Indiana Law*, 8 IND. L. REV. 234, 235 & n.7 (1974); Townsend, *Secured Transactions and Creditors' Rights, 1975 Survey of Recent Developments in Indiana Law*, 9 IND. L. REV. 305, 306 & n.6 (1975); Townsend, *Secured Transactions and Creditors' Rights, 1977 Survey of Recent Developments in Indiana Law*, 11 IND. L. REV. 252, 254-55, 255 n.15 (1977).

¹¹⁰In *William F. Steck Co. v. Springfield*, 151 Ind. App. 671, 281 N.E.2d 530 (1972), failure to give notice to an equitable mortgagee who was the record owner was fatal to the lien. The case did not decide that notice to a record owner was adequate, nor did it hold that the subcontractor could ignore the party whose contract with the prime contractor served as the basis for the subcontractor's lien. If the contract with the prime contractor had been made by the record owner in *Horn*, notification by the subcontractor to the record owner should have been sufficient to bind the purchaser as long as the subcontractor complied with the requirements of good faith and his duty to determine the possessory status of the property. See Townsend, *Secured Transactions and Creditors' Rights, 1973 Survey of Recent Developments in Indiana Law*, 7 IND. L. REV. 226, 240, n.79 (1973).

¹¹¹It is settled that the term "owner" as used by the mechanic's lien law is not limited to record owners. *Potter v. Cline*, 161 Ind. App. 349, 316 N.E.2d 422 (1974), discussed in Townsend, *Secured Transactions and Creditors' Rights, 1975 Survey of Recent Developments in Indiana Law* 9 IND. L. REV. 305, 330 (1975).

¹¹²*Glick v. Seufert Constr. & Supply Co.*, 342 N.E.2d 874 (Ind. Ct. App. 1976) (promise not inferred when owner said he would "try to help sub get his money"). Where the prime contractor is the agent of the owner, a subcontractor dealing with the

lacking. *Lawshe v. Glen Park Lumber Co.*¹¹³ held, however, that an owner promising to pay a subcontractor, who had performed but had not been paid by the prime contractor, was liable upon his promise when the subcontractor refrained from recording notice of his lien in reliance upon the promise. The court was not required to consider the possible defense that the owner's promise to answer for the debt of another was within the Statute of Frauds¹¹⁴ since it was neither pleaded nor litigated. The court indicated, however, that under principles of constructive fraud or estoppel, the owner would be barred from interposing the statute as a defense where the evidence clearly established that the subcontractor had refrained from filing notice of his lien due to the owner's assurances.¹¹⁵

When a contractor fails to complete his promised performance, he may be denied enforcement of his express contract with the owner, but Indiana law allows him recovery in general assumpsit or on the basis of unjust enrichment.¹¹⁶ In enforcing his right on the implied contract, *Johnson v. Taylor Building Corp.*¹¹⁷ granted the contractor a mechanic's lien on the property less a deduction for damages resulting from the breach.¹¹⁸ A contractor supplying materials and labor for an eighty unit housing project was allowed to claim a lien upon an unimproved lot in the project, in *Inter-City Contractors v. Consumer Building Industries.*¹¹⁹ In another case, the lien covered both attorney's fees and prejudgment interest from the time of an account stated.¹²⁰

former may recover from the owner-principal. *Urbanational Developers, Inc. v. Shamrock Eng'r, Inc.*, 372 N.E.2d 742 (Ind. Ct. App. 1978). See text accompanying note 122 *infra*.

¹¹³375 N.E.2d 275 (Ind. Ct. App. 1978).

¹¹⁴IND. CODE § 32-2-1-1 (1976).

¹¹⁵This result is consistent with prior case law which indicates that a promise to pay a third person's obligation upon which the promisee holds a lien on the promisor's land constitutes a promise to pay the promisor's own debt. Cf. *Parker v. Dillingham*, 129 Ind. 542, 29 N.E. 23 (1891) (promise made to sub who had no lien on property). An owner promising to pay a subcontractor for previous and future work has been denied the benefit of the Statute of Frauds on the basis that the main purpose of the promise is to benefit the owner. *Board of Comm'rs v. Cincinnati Steam Heating Co.*, 128 Ind. 240, 27 N.E. 612 (1891); *Davis Constr. Co. v. Petty*, 91 Ind. App. 147, 168 N.E. 769 (1929).

¹¹⁶*Western Wheeled Scraper Co. v. Scott Constr. Co.*, 217 Ind. 408, 27 N.E.2d 879 (1940); *Cato Enterprises, Inc. v. Fine*, 149 Ind. App. 163, 271 N.E.2d 146 (1971).

¹¹⁷371 N.E.2d 404 (Ind. Ct. App. 1978). In this case the contractor had completed construction without installing a septic system because a required permit could not be obtained.

¹¹⁸*Id.* at 407. An owner may claim the right to a no-lien contract even though he later breaches the contract. *Hammond Hotel & Improvement Co. v. Williams*, 95 Ind. App. 506, 176 N.E. 154 (1931).

¹¹⁹373 N.E.2d 903 (Ind. Ct. App. 1978).

¹²⁰The right of a mechanic to recover interest and attorney's fees was recognized in *Drost v. Professional Bldg. Serv. Corp.*, 375 N.E.2d 241 (Ind. Ct. App. 1978) (award

Indiana law permits the prime contractor and the owner to enter into a no-lien contract if it is written, acknowledged, describes the property, and is recorded within five days after execution.¹²¹ *Urbanational Developers, Inc. v. Shamrock Engineering, Inc.*¹²² held that a no-lien contract in a separate writing may be ineffective against subcontractors if parol evidence establishes that the writing was executed after the original contract and was not supported by new consideration.¹²³ In addition, the decision indicates that a no-lien contract between an owner and a prime contractor will not bar later liens claimed by subcontractors when proof establishes that the prime is a wholly-owned subsidiary and, thus, the owner's agent or alter-ego.¹²⁴ Thus, it seems that a no-lien contract will bar subs only when it is made with an independent prime contractor—not with one who is a mere agent of the owner. Hence, a no-lien contract with a construction manager would be ineffective.¹²⁵ In *Imperial House of Indiana, Inc. v. Eagle Savings Association*,¹²⁶ the original contract between the owner and the prime contractor was amended by a no-lien provision drafted approximately one year later and duly recorded within five days after execution of the amendment. Several subcontractors, who had commenced work long before the new no-lien pro-

of interest and attorney's fees upheld despite an effort to avoid judgment under Trial Rule 60).

¹²¹IND. CODE § 32-8-3-1 (Supp. 1978).

¹²²372 N.E.2d 742 (Ind. Ct. App. 1978).

¹²³The original contract between the prime contractor and the owner contained a no-lien provision which was construed under the federal housing law as binding only the prime contractor and not subcontractors. *VNB Mortgage Corp. v. Lone Star Indus., Inc.*, 215 Va. 366, 209 S.E.2d 909 (1974). The separate no-lien agreement between the prime contractor and the owner was recorded and met the statutory requirements. In holding that there was no presumption of consideration for the no-lien agreement, the court of appeals overlooked Indiana Trial Rule 9.1(C) which makes lack of consideration an affirmative defense.

¹²⁴372 N.E.2d at 752. The complex facts showed that the owner was a partnership, and the sole general partner thereof was the president of the prime contractor and its parent corporation. The prime contractor was a paper corporation which was a subsidiary of its parent corporation, both having the same officers. The partnership agreement provided that the prime contractor or its parent corporation would be its agent and all contracts by the agent would bind the partnership. The court held that the case was a proper one for piercing the corporate veil, and that a subcontractor who was not paid could hold all the parties on its contract made only with the prime. *Id.* The court remanded the case for retrial of the issue of the validity of the no-lien contract since the trial court had not heard the relevant evidence. The court did not openly decide that a no-lien contract between an owner and its prime contractor who, in fact, is the owner's agent will be unenforceable against subcontractors. It should have done so.

¹²⁵For a current decision dealing with the status of the contract manager, see *University Casework Sys., Inc. v. Bahre*, 362 N.E.2d 155 (Ind. Ct. App. 1977) (general contractor had standing to seek arbitration with a sub).

¹²⁶376 N.E.2d 537 (Ind. Ct. App. 1978).

vision and its recordation, continued to perform. Ultimately, they were not paid and they filed proper notice of mechanic's liens. Successors of the owner challenged the liens on the ground that the work for which the lien was claimed had been performed after the no-lien contract had been recorded. The court ruled that subcontractors, who commence performance under a contract without a no-lien provision being recorded within five days after its initial execution, are not charged with a subsequently recorded no-lien amendment to the original contract until they have actual knowledge of it.¹²⁷ In other words, subcontractors are not required to search the record each day before work or materials are furnished to determine whether or not a no-lien contract has been recorded. I hope the decision means that no subcontractor will be bound by a no-lien contract or subsequent no-lien amendment unless there is recordation within five days after the original contract is executed or unless the subcontractor receives actual knowledge of the no-lien provision before he supplies the work and materials for which his lien is claimed. This interpretation will enable the subcontractor to rely upon the original contract and lack of recordation within the five-day period following its execution, thus limiting his need to search the records for a later no-lien provision which should bind him only after he receives actual notice.¹²⁸

2. *Artisan and Possessory Liens.*—The Uniform Commercial Code provision granting a lien to warehousemen and allowing foreclosure by them under power of sale¹²⁹ was held by the United States Supreme Court to be immune from challenge in a civil rights action brought in federal court upon the obfuscatory ground that no "state action" was involved.¹³⁰ The Court apparently did not decide whether the statute was otherwise constitutional. Three justices

¹²⁷*Id.* at 542.

¹²⁸Suppose that the owner and prime contractor sign a no-lien contract, and it is not recorded until sixty days after execution. By the same token, suppose that the owner and the prime contractor sign a no-lien amendatory provision sixty days after execution of the original contract, and it is recorded within five days. In either case, suppose further that a subcontractor commences work more than five days after the original contract, either before or after recordation of the no-lien contract or provision. Should the subcontractor be protected? IND. CODE § 32-8-3-1 (Supp. 1978) provides that a no-lien provision or stipulation "in the contract" is effective against subcontractors performing prior to the time of recordation. It is suggested that the term "in the contract" refers to the original contract. As a result, unless the no-lien provision in the contract or one amending it is filed within five days of the original contract, the notoriety of the contract in the contracting community and the lack of recordation within five days is enough to protect all subcontractors as long as they do not have actual notice of the no-lien terms.

¹²⁹U.C.C. § 7-210.

¹³⁰*Flagg Bros., Inc. v. Brooks*, 98 S. Ct. 1729 (1978).

found that "state action" was present and that the statute in question, which delegated to a warehouseman state power to determine title in the form of a self-help remedy, constituted a denial of due process.¹³¹

3. *Federal Liens; Priority over Inchoate Liens.*—The doctrine that the King can rape his subjects at will has lost some of its literal effect, but it continues to shame the law in many areas. For example, if *E* obtains a lien first in time, a later property interest or lien claimed by the federal government will take priority if the prior lien is "inchoate." This is true even though *E*'s lien might prevail over subsequent similar claims recognized under state law.¹³² Priority is determined by federal law which has nurtured the doctrine in order to satisfy its fiscal appetite. Two recent federal decisions from Indiana have applied this rule to mechanic's lienholders involved in a construction project insured by the Department of Housing and Urban Development.¹³³ In each instance, the liens arose and were perfected under state law and, thus, would take priority under state law over the mortgagee from whom the federal government acquired title.¹³⁴ Since the liens were determined to be inchoate, apparently because no judgment had established the amount of the lien, however, they were deferred to the mortgage insured by, and subsequently assigned to, the government.¹³⁵ Another decision involving a tax lien failed to consider whether or not a prior, revocable assignment of future wages was so inchoate that an ensuing tax lien would take priority.¹³⁶ The assignment of wages, which were collected by the assignee through an escrow arrangement after the tax lien attached, was given priority. The time at which a lien becomes choate is uncertain, but is said to occur when the lien-

¹³¹*Id.* at 1745 (Stevens, White, Marshall, JJ., dissenting).

¹³²On this point, the Indiana Court of Appeals has boldly overruled the United States Supreme Court in holding that a judgment lien is choate. *Muniz v. United States*, 129 Ind. App. 433, 155 N.E.2d 140 (1958) (overruling *Thelusson v. Smith*, 15 U.S. (2 Wheat.) 396 (1817)).

¹³³*Willow Creek Lumber Co. v. Porter County Plumbing & Heating, Inc.*, 572 F.2d 588 (7th Cir. 1978) (applying the weight of precedent, but recognizing the rule that state law is "not without some merit"); *McCullough Constr. Co. v. Agricultural Prods. Corp.*, 437 F. Supp. 404 (N.D. Ind. 1977) (recognizing that the rule "may at times be inequitable and disruptive of the local commercial scheme"; the court followed what it determined to be the weight of federal decisions).

¹³⁴Under Indiana law, the mechanic's lien would take priority or at least rank in equal priority with a later construction mortgage. *McLaughlin Mill Supply Co. v. Laundry Serv. Inc.*, 95 Ind. App. 693, 184 N.E. 429 (1933); IND. CODE § 32-8-3-2 (1976).

¹³⁵572 F.2d at 590-91; 437 F. Supp. at 407.

¹³⁶*Wagner v. United States*, 573 F.2d 447 (7th Cir. 1978). The 1966 Tax Lien Act eliminated many problems of choateness and, in particular, deferred tax claims and liens to mechanic's liens. 26 U.S.C. § 6323(a) (1976).

holder, the property, and the amount of the lien are established.¹³⁷ Since the rule often conflicts with state law and commercial practice, it remains an archaic reminder that the King is entitled to his perquisites, no matter how unfair they may be.

4. *Execution; Proceedings Supplemental.*—The problem of compulsory process as a means for reaching a debtor's assets through execution and proceedings supplemental was tangentially touched upon by three cases heard by the United States Supreme Court. One permitted a search by firefighters without a warrant.¹³⁸ Another permitted the use of a search warrant in order to obtain evidence.¹³⁹ A third required a search warrant based upon something less than probable cause in order to investigate possible violations of the Occupational Safety and Health Act.¹⁴⁰ All, by analogy, infer that a sheriff armed with an ordinary writ of execution cannot break doors in his search for assets or evidence of property subject to creditor process, but he may do so when he is armed with a court order issued upon evidence of probable cause.¹⁴¹ Something less than such an order may justify an unauthorized search of a debtor's premises as indicated in the first and third cases, which afford little aid in marking the parameters of this unusual power.

*Protective Insurance Co. v. Steuber*¹⁴² recognized the purpose of Trial Rule 69(E), expediting proceedings supplemental, and permitted an appeal by a garnishee from a proceedings supplemental order without the need for filing a motion to correct errors.¹⁴³

5. *Enforcement of Equitable Decrees.*—A spouse who fails to abide by a decree awarding a property settlement in the form of a lump sum or in a specified amount payable in installments cannot be held in contempt.¹⁴⁴ This rule, which was recognized by the Indiana Supreme Court in order to avoid imprisonment for a debt, was

¹³⁷Thus, the lien obtained by an attaching creditor is inchoate. *United States v. Security Trust & Sav. Bank*, 340 U.S. 47 (1950). A lien which is unperfected as against purchasers and lien creditors probably is inchoate. *E.g.*, *Sams v. Redevelopment Auth.*, 436 Pa. 524, 528, 261 A.2d 566, 570 (1970).

¹³⁸*Michigan v. Tyler*, 98 S. Ct. 1942 (1978).

¹³⁹*Zurcher v. Stanford Daily*, 98 S. Ct. 1970 (1978) (search of a newspaper office).

¹⁴⁰*Marshall v. Barlow's, Inc.*, 98 S. Ct. 1816 (1978).

¹⁴¹A search is forbidden without a warrant. *See G.M. Leasing Corp. v. United States*, 429 U.S. 338 (1977), discussed in Townsend, *Secured Transactions and Creditors' Rights, 1977 Survey of Recent Developments in Indiana Law*, 11 IND. L. REV. 252, 277 (1977). A search warrant issued upon false testimony or evidence does not justify a search thereunder. *See Franks v. Delaware*, 98 S. Ct. 2674 (1978).

¹⁴²370 N.E.2d 406 (Ind. Ct. App. 1977). A judgment in a proceedings supplemental against a garnishee insurer was reversed when an appeal in the principal action established that a default was improperly entered without notice.

¹⁴³*Id.* at 411-12.

¹⁴⁴*State ex rel. Shaunki v. Endsley*, 362 N.E.2d 153 (Ind. 1977).

qualified by the court of appeals in *Marburger v. Marburger*¹⁴⁵ which indicated that contempt would lie against a husband who had been ordered to pay marital creditors.¹⁴⁶ After the husband failed to pay the debts for which the wife was also liable, she obtained a discharge in bankruptcy.¹⁴⁷ She then brought civil contempt proceedings against the errant husband, claiming as damages the fees paid to her attorney in the bankruptcy action. After the court noted that the husband could be held in contempt, it reasoned, nonetheless, that the wife could not enforce the decree because she had not proved damages.¹⁴⁸ The wife suffered no loss because the bankruptcy discharge had released her from the debts. The fees incurred in procuring the discharge were held to be improper as a measure of damages for civil contempt, although it was conceded that attorney's fees may be awarded to a party successfully prosecuting civil contempt proceedings.¹⁴⁹

6. *Assets Subject to Creditor Process; Pensions.*—A recent decision of the Indiana Court of Appeals held that a husband's pension is not considered marital property upon divorce.¹⁵⁰ Without taking into account the adverse social and economic consequences of the decision as it relates to the division of "marital property,"¹⁵¹ the case seems to presuppose, for traditional purposes of transferability and claims of creditors, that rights to be received under a pension plan are not a present vested property interest to be liquidated and appraised at present value.¹⁵² Therefore, creditors must treat the

¹⁴⁵372 N.E.2d 1250 (Ind. Ct. App. 1978).

¹⁴⁶The basis for this holding probably comes from a combination of precedents. In *State ex rel. Schutz v. Marion* Sup. Ct., 261 Ind. 535, 307 N.E.2d 53 (1974), the dissent had difficulty in distinguishing between decrees directing the payment in money to the other spouse, which were not subject to contempt, and decrees directing payment to a third party which were subject to contempt. *Id.* at 535, 539, 307 N.E.2d at 53, 56 (Arterburn, C.J., dissenting). Another decision held that a divorce decree directing payment of creditors may not be enforced by creditors. *Selner v. Fromm*, 145 Ind. App. 378, 251 N.E.2d 127 (1969). In *Marburger* the creditors were not parties to the proceeding.

¹⁴⁷The husband had previously taken bankruptcy but had not scheduled the wife. As a result, the court held that his obligation to her was not discharged. See notes 165-67 *infra* and accompanying text.

¹⁴⁸372 N.E.2d at 1253.

¹⁴⁹*Id.* See *Chadwick v. Alleshouse*, 250 Ind. 348, 233 N.E.2d 162 (1968) (payment ordered to be made to attorney).

¹⁵⁰*Savage v. Savage*, 374 N.E.2d 536 (Ind. Ct. App. 1978).

¹⁵¹*But see Bodenhorn v. Bodenhorn*, 567 F.2d 629 (5th Cir. 1978) (holding that unvested army pension was community property to be taken into account in dividing marital estate).

¹⁵²The court analogized the income from a pension with income from wages for the purpose of excluding it from marital property and supported its opinion with *Wilcox v. Wilcox*, 365 N.E.2d 792 (Ind. Ct. App. 1977) (holding that the future income of a college professor could not be evaluated for purposes of dividing such property).

pension as income or as earnings which may not be assigned,¹⁵³ but which, in Indiana, may be garnished by proceedings supplemental.¹⁵⁴ While Indiana has no general exemption law with respect to pensions or income therefrom,¹⁵⁵ the Federal Truth in Lending Law provides an exemption out of earnings which includes periodic pension payments and which is either twenty-five percent of the weekly earnings or the amount of weekly earnings in excess of thirty times the minimum wage, whichever is smaller.¹⁵⁶ Orders for the "support of any person" are excluded from this exemption by the federal law,¹⁵⁷ but the exclusion would probably not apply to a decree dividing marital property since the Indiana law generally does not measure property division by a duty of support.¹⁵⁸

7. *Bulk Sales*.—A return of inventory to the original seller may be a bulk sale.¹⁵⁹ An analogous problem was presented, but not recognized, in the rather vague claims which were made in *Mooney-Mueller-Ward, Inc. v. Woods*.¹⁶⁰ Here, the lessee of a drugstore agreed to maintain the inventory and its contents. After the lessor had repossessed the store, as well as the drugs, and the tenant had taken bankruptcy, a creditor of the tenant, who had supplied some of the inventory, claimed a bulk sale. The court denied relief on the ground that the tenant was not the agent of the landlord who had leased the store and the inventory to a second tenant in the mean-

¹⁵³Wages may not generally be assigned. IND. CODE §§ 24-4.5-2-410, 24-4.5-2-403 (1976). *But see* *Wagner v. United States*, 573 F.2d 447, 451 (7th Cir. 1978) which overlooked the statutes cited above and applied IND. CODE § 22-2-6-2 (1976). *Wagner* properly held that an assignment of wages was revocable and that future wages were not subject to a federal tax lien.

¹⁵⁴IND. CODE § 31-1-44-7 (1976). *See* *Mitchell v. Godsey*, 222 Ind. 527, 53 N.E.2d 150 (1944) (lien upon income or profits not exceeding 10% allowed in proceedings supplemental).

¹⁵⁵The Indiana law exempts "wages, commissions, income, rents or profits." IND. CODE § 24-4.5-5-105 (1976). *In re Power*, 115 F.2d 73 (7th Cir. 1940) held that income from a fully paid annuity contract was not exempt under a statute then exempting only "income or profits." Some statutes exempt particular pensions of government employees. *E.g.*, IND. CODE §§ 10-1-2-9, 18-1-12-11, 19-1-18-21, 19-1-24-4 (1976).

¹⁵⁶15 U.S.C. § 1673 (1976). "Periodic payments pursuant to a pension or retirement program" are included within the definition of "earnings" to which the exemption applies. *Id.* § 1672(a).

¹⁵⁷*Id.* § 1673(b).

¹⁵⁸Maintenance may be granted to a spouse only in the case of mental or physical incapacity. *Wilcox v. Wilcox*, 365 N.E.2d 792 (Ind. Ct. App. 1977) (construing IND. CODE §§ 31-1-11.5-9(c), -11 (1976)).

¹⁵⁹The bulk sales statute is article 6 of the Uniform Commercial Code. Presumably, a return of inventory will qualify as a bulk sale under that law, although no decisions on that point were found.

¹⁶⁰371 N.E.2d 400 (Ind. Ct. App. 1978). *See generally* Annot., 59 A.L.R.2d 1115 (1958).

time.¹⁶¹ The decision did not consider whether the landlord would be accountable to the first tenant's creditors as a bulk purchaser as would the second tenant if he acquired the inventory with notice of the bulk sale.¹⁶² If the provision in the lease had been construed to be a contract to sell the replenished inventory in the tenant's possession, the transaction would have been presumptively fraudulent with respect to the seller's (tenant's) creditors under the Indiana fraudulent conveyance statute.¹⁶³ In any event, the right to avoid the conveyance of the inventory passed exclusively to the lessee's trustee in bankruptcy, so that the creditor's only remedy was to proceed in the bankruptcy court.¹⁶⁴

8. *Receiverships.*—A receiver may not be appointed without providing either notice or affidavits based upon belief.¹⁶⁵ Although not considered by a recent decision applying this rule, it should be noted that a proper order appointing a receiver without notice should be followed by a prompt hearing.¹⁶⁶ Another decision refused to appoint a receiver upon request of a creditor with a contingent claim against a liquidating corporation despite the fact that the corporate assets were being distributed to shareholders without making provision for the creditor.¹⁶⁷

9. *Bankruptcy; Dischargeability of Particular Claims.*—Dischargeability of particular claims under section 17 of the Bankruptcy Act has received considerable attention in the last year. As a general rule, governmental claims for taxes are not discharged.¹⁶⁸ This rule was applied by the United States Supreme

¹⁶¹371 N.E.2d at 401. It is conceivable that the landlord retained a security interest in the inventory and after-acquired inventory. If this were the case, it was not a bulk sale. U.C.C. § 6-103. The transfer to the tenant may have qualified as a sale or return. U.C.C. § 2-326. In either instance, the security interest would not have been valid against the bankrupt's trustee in bankruptcy, unless the landlord had perfected by possession before bankruptcy in which case it could have been classified as a preference. Compare Bankruptcy Act § 70a with § 60, 11 U.S.C. §§ 96, 110(a) (1976). The language of the lease creating the landlord's right to the inventory was not set forth in the opinion.

¹⁶²U.C.C. §§ 6-104(1), 6-109.

¹⁶³IND. CODE § 32-2-1-7 (1976). See note 68, *supra*.

¹⁶⁴See generally W. COLLIER, 4A COLLIER ON BANKRUPTCY § 70.92 (14th ed. J. Moore, R. Oglebay, F. Kennedy & L. King 1978).

¹⁶⁵Meek v. Steele, 368 N.E.2d 257 (Ind. Ct. App. 1977). This case was brought to the court of appeals on appeal. A writ of prohibition, it seems, would also have been proper. State *ex rel.* Mammoth Dev. & Constr. Consultants, Inc. v. Superior Ct., 357 N.E.2d 732 (Ind. 1976).

¹⁶⁶Indianapolis Mach. Co. v. Curd, 247 Ind. 657, 221 N.E.2d 340 (1966). See also IND. R. TR. P. 65(B)(2).

¹⁶⁷Rauch v. Circle Theatre, 374 N.E.2d 546 (Ind. Ct. App. 1978). See notes 185-90 *infra* and accompanying text.

¹⁶⁸Bankruptcy Act § 17a(1), 11 U.S.C. § 35a(1) (1976).

Court to include the "penalty" imposed upon a bankrupt who fails to collect and pay over withholding taxes.¹⁶⁹ Claims for money or property obtained by "false representations" also are not discharged when contested under section 17.¹⁷⁰ *In re Blessing*¹⁷¹ held that a creditor must prove intent to defraud as one of the elements of non-dischargeability under this provision. The presumption of fraudulent intent under the old Indiana bad check law,¹⁷² which arose when a check was not paid within ten days after notice that it had been returned for insufficient funds, was inadequate to prove the necessary mens rea for denying discharge of the claim in bankruptcy. In *Blessing* the creditor had recovered a state judgment awarding him treble damages on a check which had been dishonored for insufficient funds before bankruptcy.¹⁷³ In a proceeding to establish non-dischargeability of the judgment, the bankruptcy judge found the state judgment to be res judicata on the issue of fraudulent intent. On appeal, error was found in giving a res judicata effect to the judgment which had found fraudulent intent based on state statutory presumption. In bankruptcy proceedings, fraudulent intent is a matter of federal law.¹⁷⁴ Claims for "alimony" or for support of a wife or child are excluded from discharge by section 17.¹⁷⁵ The Seventh Circuit Court of Appeals has held that an award of money to the wife as part of an order approving a property settlement or dividing marital property is "alimony" insofar as it provides for the support or maintenance of the wife.¹⁷⁶ Towards this end, if the order

¹⁶⁹United States v. Sotelo, 98 S. Ct. 1795 (1978). The court did not consider alternative grounds for reaching the same result. If this were a "penalty," the claim of the government was not provable and, therefore, was not discharged except to the extent of pecuniary loss. Compare *Sotelo* with Bankruptcy Act § 17a, 11 U.S.C. § 35(a) (1976), and 11 U.S.C. § 93(j) (1976). Failure to pay taxes withheld may have constituted "willful and malicious conversion" or misappropriation by a "fiduciary" under the provisions of § 17a(2) or (4) of the Bankruptcy Act, 11 U.S.C. § 35(a)(2), (4) (1976), which exempt the claim from dischargeability if contested within a proper period.

¹⁷⁰11 U.S.C. § 35(a)(2) (1976).

¹⁷¹442 F. Supp. 68 (S.D. Ind. 1977). *Accord*, Sanitation Recycling, Inc. v. Jay Peak Lodging Ass'n, 428 F. Supp. 1022 (D. Vt. 1977) (proof of fraudulent intent a requirement for non-dischargeability).

¹⁷²IND. CODE § 35-17-5-10 (1976) (defining crime as a deceptive practice). The new provision is *id.* § 35-43-5-5 (Supp. 1978).

¹⁷³For the statute allowing treble damages, see *id.* § 35-7-5-12 (1976). The new provision is *id.* § 34-4-30-1 (Supp. 1978).

¹⁷⁴The court held that the issue of fraudulent intent should be re-litigated in the bankruptcy court, rather than requiring the bankruptcy judge to determine the basis of the state court judgment. In other words, this case may, but does not necessarily, stand for the proposition that issues relating to dischargeability cannot be determined by res judicata principles with respect to ante-bankruptcy judgments.

¹⁷⁵Bankruptcy Act § 17a(7), 11 U.S.C. § 35a(1) (1976).

¹⁷⁶*Nichols v. Hensler*, 528 F.2d 304 (7th Cir. 1976) cert. denied, 434 U.S. 1086 (1978) (applying Indiana law prior to no-fault divorce statute).

reflects a balancing of a projected differential in the income of the parties, it is "alimony" only to that extent, which is a question of fact for the bankruptcy judge. *In re Woods*,¹⁷⁷ also decided in the Seventh Circuit, found that an order approving a division of property in which the husband agreed to pay marital debts without any other obligation to pay money was a division of property but was not based upon a differential in earning power, although the record showed a differential of thirty-eight dollars per week. Hence, the obligation of the husband to pay the marital debts was not "alimony" and was discharged in bankruptcy.¹⁷⁸ A similar holding was indicated in a footnote by the Indiana Court of Appeals in *Marburger v. Marburger*,¹⁷⁹ which, unlike the *Woods* case, involved an order under the new Indiana no-fault divorce statute.¹⁸⁰ *Marburger* also applied another provision of section 17 which states that debts which have not been duly scheduled in time for proof and allowance will not be discharged.¹⁸¹ The court noted in dictum that the husband's failure to schedule the wife as a creditor also failed to discharge him from paying marital debts as ordered under a property settlement.¹⁸² The court, however, overlooked two possible qualifications to this provision of section 17. One is that the provision does not apply to a creditor with notice of the bankruptcy, while the other provides that the creditor must be scheduled in time for proof and allowance of his claim. If the husband's bankruptcy was a no-asset case, both listed and unlisted creditors, including the wife, were not denied proof and allowance of claims because they were not required to file claims until assets were discovered.¹⁸³

10. *Suretyship; Miscellaneous.*—A tenant assigning his rights under a lease remains liable to the lessor as a surety with respect to

¹⁷⁷561 F.2d 27 (7th Cir. 1977) (applying Indiana law prior to no-fault divorce statute).

¹⁷⁸*Accord*, *Nitz v. Nitz*, 568 F.2d 148 (10th Cir. 1977) (husband's annual income exceeded that of wife by approximately \$1,000).

¹⁷⁹372 N.E.2d 1250, 1252 n.2 (Ind. Ct. App. 1978).

¹⁸⁰The new Indiana no-fault divorce statute permits an award of maintenance to the wife only when she is mentally or physically disabled. IND. CODE § 31-1-11.5-9(c) (1976). However, in distributing marital property, the court is required to consider "the earnings or earning ability of the parties." *Id.* § 31-1-11.5-11.

¹⁸¹Bankruptcy Act § 17a(3), 11 U.S.C. § 35a(3) (1976).

¹⁸²372 N.E.2d at 1252.

¹⁸³Under the new bankruptcy rules, if no assets are available for distribution, the first notice to creditors may advise them that it is unnecessary to file claims unless later notice of assets is given. BANKRUPTCY R. 203(b). If a dividend later becomes available, creditors are given additional time of not less than 60 days or the usual six-month period, whichever is later, in which to file their claims. BANKRUPTCY R. 302(e)(4). Hence, in a no-asset case a failure to schedule a creditor will not make his claim dischargeable, except possibly in a situation where he must bring a proceeding to determine dischargeability under § 17(3) of the Bankruptcy Act, 11 U.S.C. § 35(a) (1976).

covenants running with the land or those expressly assumed by the assignee.¹⁸⁴ This general principle was recognized in *Rauch v. Circle Theatre*.¹⁸⁵ There the lessor brought suit after the assignment against the assignor-tenant, a corporation in the process of dissolving and distributing its assets to shareholders. The court held that dissolution by the lessee, under the circumstances, constituted an anticipatory breach of the covenants in the lease upon which the lessee was a surety.¹⁸⁶ Since the assignee was solvent and performing the covenants of the lease, however, no damages were proved. No relief was granted to the landlord, who was left with the new tenant's obligation for covenants running with the land.¹⁸⁷ The court, through a receivership,¹⁸⁸ or other equitable machinery, should have required the dissolving surety to provide protection against the possibility of future loss.¹⁸⁹ By denying a receivership for this purpose, the court sanctioned a means by which a corporate surety may escape its contingent liabilities—dissolution. Since a form of fraudulent conveyance is involved, equity retains the power to protect the innocent creditor with a contingent claim in such a case.¹⁹⁰

¹⁸⁴*Cf.* *Powell v. Jones*, 50 Ind. App. 493, 98 N.E. 646 (1912) (tenant-assignor liable on the express covenant to pay rent unless landlord releases tenant from the obligation).

¹⁸⁵374 N.E.2d 546 (Ind. Ct. App. 1978).

¹⁸⁶*See* *Bushnell v. Kraft*, 133 Ind. App. 474, 183 N.E.2d 340 (1962) (liquidation of corporate obligor constitutes breach of an executory contract).

¹⁸⁷The case did not make clear whether the assignee of the tenant assumed the covenants of the lease by contract. If not, the assignee would not have been liable for covenants which did not run with the land. *See also* *Geyer v. Lietzan*, 230 Ind. 404, 103 N.E.2d 199 (1952).

¹⁸⁸The landlord petitioned for a receiver which was denied, but the court on appeal in upholding the decision below stated that a receiver would have been proper. "The other remedies available to Lessors—the right to file an action for damages and petition for the appointment of a receiver under IC 1971, 34-1-2-1 (Burns Code Ed.) to preserve and collect the corporate assets—were sufficient to protect Lessor's interest." 374 N.E.2d at 553.

¹⁸⁹*E.g.*, *Specialty Furniture Co. v. Rusche*, 212 Ind. 184, 6 N.E.2d 959 (1937) (appointment of receiver for voluntarily dissolving corporation held proper). The Probate Code protects a creditor holding a contingent obligation of the decedent. IND. CODE §§ 29-1-14-7, 29-1-14-8 (1976) (imposing liability upon devisees and heirs to the extent of the value of the property received on distribution). It seems that this procedure also applies to receivership proceedings for a dissolving corporation. IND. TR. R. 66(D) (probate procedures adopted in receivership proceedings with respect to claims). Remedies against a dissolving corporation, its officers, and shareholders are preserved for two years in case of voluntary dissolution. IND. CODE § 23-1-7-1 (1976).

¹⁹⁰Traditionally, a fraudulent conveyance by a surety will not be set aside when the principal is solvent. *Boyd v. Vickrey*, 138 Ind. 276, 37 N.E. 972 (1894). However, equity may enjoin a transfer when a debtor is threatening to dispose of his assets at a time when the creditor's action is not due. *McCormick v. Hartley*, 107 Ind. 248, 6 N.E. 357 (1886). *See also* *McKain v. Rigsby*, 250 Ind. 438, 237 N.E.2d 99 (1968). A lessor whose claim is one for future rent not yet due may set aside a fraudulent conveyance. *Wright v. Haley*, 208 Ind. 46, 194 N.E. 637 (1935) (bulk sale by tenant).

As a general rule, a creditor who releases or impairs collateral furnished by the principal debtor will discharge a surety to the extent of the value of the security.¹⁹¹ In addition, a binding agreement between the creditor and debtor extending the time of performance will discharge a surety who has not assented to the arrangement.¹⁹² These principles have evolved in order to protect the surety against risks of subsequent dealings between the debtor and creditor in which the surety did not take part and which tend to prejudice performance by the debtor. A surety upon a public construction contract for the benefit of subcontractors claimed that he was discharged by an application of both these rules in *American States Insurance Co. v. Staub, Inc.*¹⁹³ There the municipality had retained funds which were owed to the prime contractor. Under an Indiana statute,¹⁹⁴ a lien could be placed upon this fund by persons to whom the prime contractor was indebted on the contract as long as a claim was made within sixty days after the last work or material was furnished by the claimant. When the unpaid subcontractor failed to file his claim to this fund within the time limit, the surety asserted that it was released to the extent that the fund would have satisfied the unpaid bill. The court rejected this argument on the basis that the subcontractor had not impaired the collateral by failing to file.¹⁹⁵ The court applied the general rule that a surety is not discharged by mere passiveness of the creditor who owes no duty to take affirmative action to sue.¹⁹⁶ The same holds true when the creditor fails to

¹⁹¹This rule often is applied to situations where an owner-creditor is required by his contract with the principal-contractor to keep a retainage from work progress payments. A surety is discharged to the extent that the retainage is paid to the principal. *Weik v. Pugh*, 92 Ind. 382 (1884); *State ex rel. Hartford Accident & Indem. Co. v. Martin*, 94 Ind. App. 531, 159 N.E. 21 (1927). If the surety's promise is conditioned upon the retainage, he will be totally discharged if it is paid to the principal. *State ex rel. National Sur. Co. v. Board of Comm'rs*, 93 Ind. App. 435, 153 N.E. 421 (1926); *Hubbard v. Reilly*, 51 Ind. App. 19, 98 N.E. 886 (1912).

¹⁹²The rule here is based on the idea that the surety did not bargain for the extension and, therefore, should not be bound. *Post v. Losey*, 111 Ind. 74, 12 N.E. 121 (1887) (extension to principal granted by creditor after principal discharged in bankruptcy—surety discharged). Under the Uniform Commercial Code, an extension of time to the principal will discharge the surety only if he has a right of recourse against the principal. U.C.C. § 3-606(1)(a).

¹⁹³370 N.E.2d 989 (Ind. 1977).

¹⁹⁴IND. CODE § 5-16-5-1 (1976). If a materialman or subcontractor fails to file his claim within 60 days after his last performance, he loses his right to the fund. *MacDonald v. Calumet Supply Co.*, 210 Ind. 536, 19 N.E.2d 567, *modified*, 21 N.E.2d 400 (1939) (contractor completing performance for surety took fund to the exclusion of subcontractors who did not file within the statutory time).

¹⁹⁵*See also* *Board of Educ. v. Pacific Nat'l Fire Ins. Co.*, 19 Ill. App. 2d 290, 153 N.E.2d 498 (1958).

¹⁹⁶370 N.E.2d at 992.

preserve other rights against the debtor.¹⁹⁷ A release of the retainage after the time for filing a claim to it had lapsed was held not to prejudice the rights of the subcontractor or the surety.¹⁹⁸ The surety also claimed that it was discharged by the subcontractor-creditor's acceptance of a promissory note from the prime contractor which, apparently, extended the time for payment. Under the Uniform Commercial Code, this action presumptively operated as an extension of time.¹⁹⁹ Although the court needlessly emphasized that the note was not accepted in payment of the underlying debt, the decision clarified some old case law²⁰⁰ by holding that since the time of payment to a subcontractor or materialman on a construction contract is uncertain and continuing in nature, the extension of time was authorized by the undertaking of the prime contractor and the contract of the surety.²⁰¹ Therefore, the extension did not discharge the surety.

Other recent decisions have recognized the rule that a creditor who releases several co-sureties will discharge the others to the ex-

¹⁹⁷Under this principle, a creditor is not required to take affirmative action to sue the principal to foreclose collateral, to pay taxes, etc. *Barnes v. Mowry*, 129 Ind. 568, 28 N.E. 535 (1891); *Wasson v. Hodshire*, 108 Ind. 26, 8 N.E. 621 (1886); *Hogshead v. Williams*, 55 Ind. 145 (1876). Old law held that he was not under a duty to perfect a mortgage or security furnished by the debtor. *Philbrooks v. McEwen*, 29 Ind. 347 (1868). However, a creditor in possession of collateral or one who possesses the means for perfecting the mortgage or security interest may have a duty to do so. *White v. Household Fin. Corp.*, 158 Ind. App. 394, 302 N.E.2d 828 (1973) (criticizing *Philbrooks*).

¹⁹⁸370 N.E.2d at 994.

¹⁹⁹"Unless otherwise agreed where an instrument is taken for an underlying obligation . . . the obligation is suspended pro tanto until the instrument is due" U.C.C. § 3-802(1)(b) (applicable to a note where a bank is not the maker).

²⁰⁰Under U.C.C. § 3-802 (*see note 181 supra*) the taking of a note for a prior debt which advances the time of payment is presumed to be conditional payment, not payment. But notwithstanding that there is no presumption of payment, the taking of the note is presumed to bind the creditor to the extension. Pre-Code cases in Indiana sometimes created the inference that, if the note was not taken in "payment," the note did not operate as an agreement to extend the time of payment. *Hughes v. Adams*, 187 Ind. 165, 118 N.E. 680 (1918) (note taken by beneficiary of surety bond). Parol evidence is admissible under the Code and under prior law to rebut the presumption that the extension note was accepted. *See Beck v. O'Dell*, 193 Ind. 386, 140 N.E. 527 (1923). The presumption of extension may be rebutted by proof that the new note was taken as security upon the understanding that all rights under the original obligation should remain intact. *See also Kelley v. York*, 183 Ind. 628, 109 N.E. 772 (1915). Unlikely as it may be, parol proof will be allowed to show that the note is taken in payment as a full accord and satisfaction, in which event the surety on the prior obligation will be discharged.

²⁰¹A creditor extending time to a principal upon a continuing contract of guaranty does not discharge a surety who undertakes to pay the successive obligations of the principal. *Morgan v. Smith Am. Organ Co.*, 73 Ind. 179 (1880); *National Exch. Bank v. Gay*, 57 Conn. 224, 17 A. 555 (1889).

tent of their right of contribution from the sureties released.²⁰² Parol evidence was admitted to establish that two of four co-makers on a promissory note were sureties or accommodation makers who were not discharged by a tender of the principal sum and interest when the debtors failed to include in the tender attorney's fees required by the note. Tender was made after suit had been filed by the holder of the note.²⁰³ A promisee entitled to attorney's fees by agreement is not entitled to enforce the provision in litigation when he fails to win an affirmative judgment.²⁰⁴

XVI. Taxation

*John W. Boyd**

A. Case Law Developments

During this year's survey period, the Indiana courts reported nine noteworthy decisions in the area of state taxation. Two of those nine cases were decided by the Indiana Supreme Court.

1. *Property and Excise Taxes.—a. Ad Valorem Taxes, Commerce Clause Exemption.*—The Indiana Supreme Court considered the exemption to the personal property tax for property in interstate commerce¹ in *State Board of Tax Commissioners v. Carrier*

²⁰²*Carvey v. Indiana Nat'l Bank*, 374 N.E.2d 1173 (Ind. Ct. App. 1978).

²⁰³*Stockwell v. Bloomfield State Bank*, 367 N.E.2d 42 (Ind. Ct. App. 1977).

²⁰⁴*Rauch v. Circle Theatre*, 374 N.E.2d 546 (Ind. Ct. App. 1978).

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¹Act of Mar. 18, 1975, Pub. L. No. 47, §§ 29-30, 1975 Ind. Acts 317 (current version at IND. CODE 6-1.1-10-30 (1976)), provided that personal property of nonresidents of the state who are able to show by adequate records that such personal property has been shipped into this state and placed in the original package in a public warehouse for the purpose of transshipment to an out-of-state destination, shall not, while so in the original package in such warehouse, be subject to the tax imposed by IND. CODE §§ 6-1-20 to 39 (1971) and that portion of a premises owned or leased by a consignor or consignee, shall be deemed to be a public warehouse.

Personal property of nonresidents of the state shipped into this state and placed in the original package in a public or private warehouse for the purpose of transshipment to an out-of-state or within-the-state destination and so designated on the original bill of lading, or personal property of residents or nonresidents of the state placed in the original package in a public or private warehouse for the purpose of transshipment to an out-of-state destination and so designated on the original bill of lading, shall not, while so in the original package in such warehouse, be subject to tax imposed by this act. In construing this section, goods, wares and merchandise shall be exempt only to the extent that they are exempt from ad valorem taxes under the commerce clause of the Constitution of the United States. *Id.*