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Dedication

Gerald L. Bepko

1986 SURVEY OF RECENT DEVELOPMENTS IN INDIANA LAW

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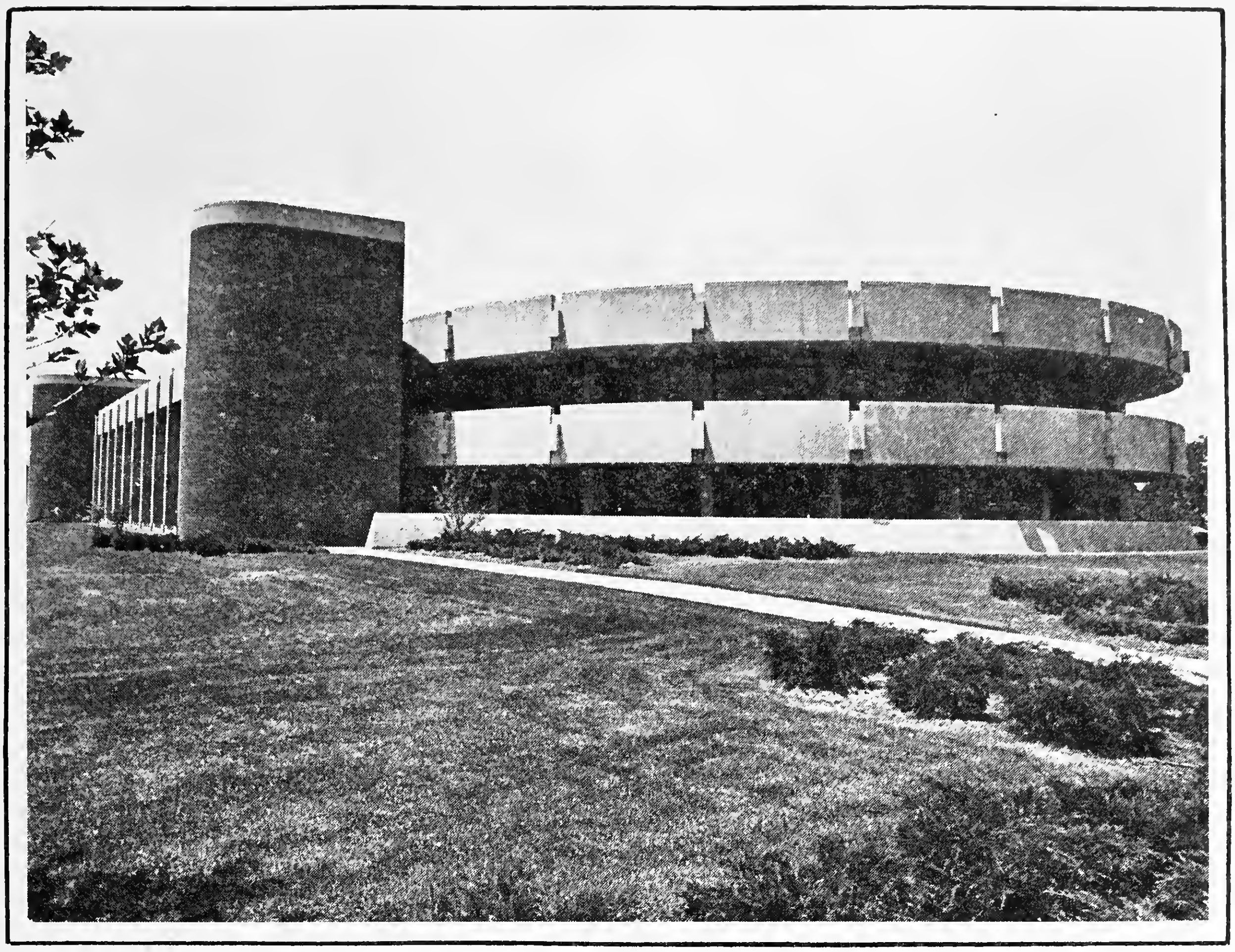

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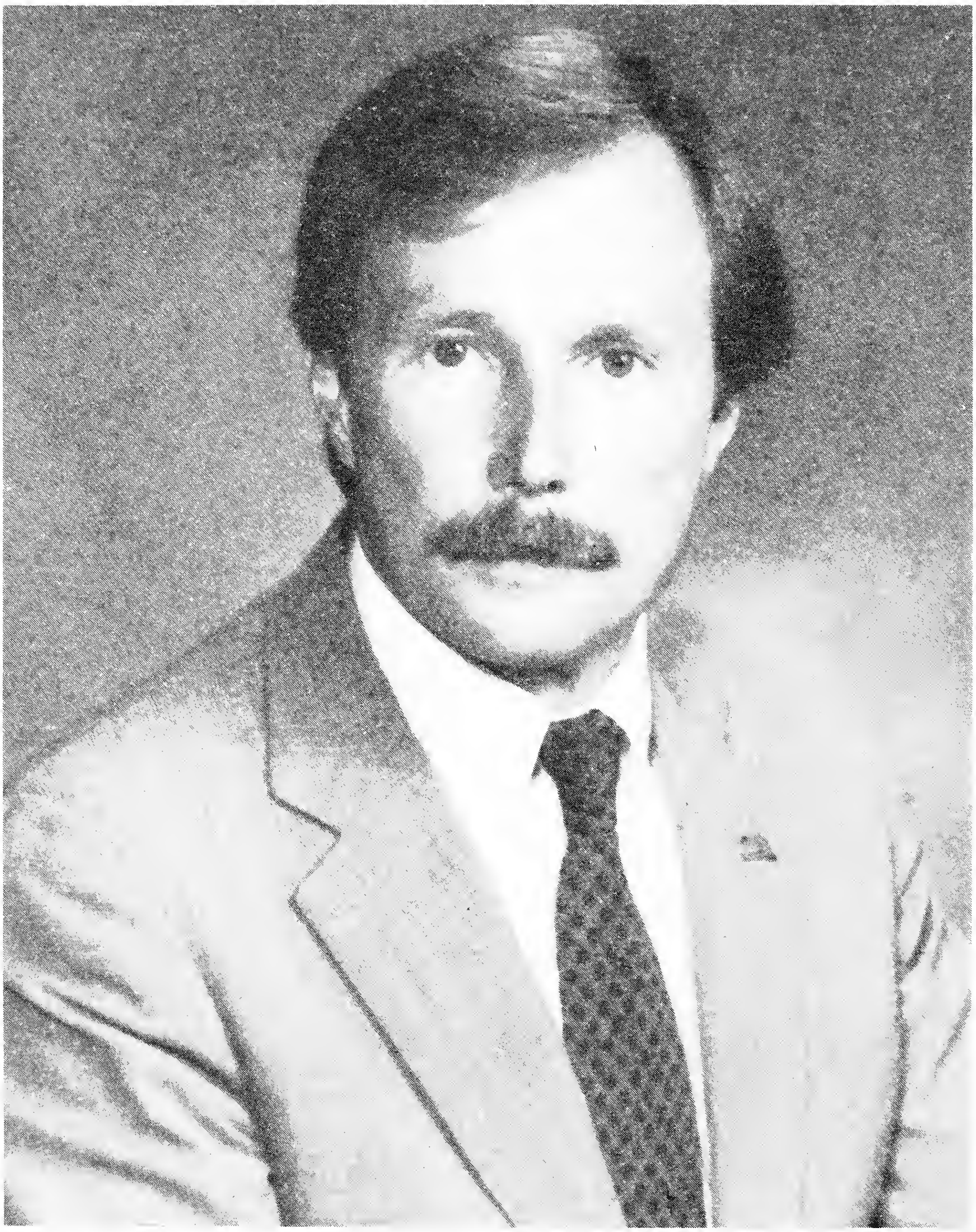

Gerald L. Bepko

DEDICATION

I am honored to have been asked to comment on the significance of Gerald Bepko's appointment to the position of Vice President of Indiana University-Purdue University at Indianapolis. His selection to this post is a source of great enthusiasm and deep satisfaction for all who sense the importance of this excellent university.

Two days after being asked to write this dedication, I came across an ancient dispute resolution technique, the shadows of which sometimes reappear during heated moments in federal court.

The information came to me while I was helping our sixth-grader review for a test in social studies. It seems that the early Eskimos, who were indeed wise in prizing self-control while simultaneously allowing the world to ventilate, developed a process referred to as "name-calling." When two people were in dispute, the tribe set up a contest in which the two faced off and were encouraged to be as foul-mouthed to one another as was humanly possible. (Imagine the partisan cheering on the sidelines!) This barrage of abuse went on until the crucial, telling moment: when one of the participants finally grew red-hot and lost his temper. The price of such loss of self-control was vanquishment: the one who lost control lost the contest.

This dedication assignment and that piece of historical information miraculously coincided, allowing me to find a beginning for this assessment of Jerry's unique gifts, which hold so much promise for the University. I'll begin by observing that Jerry would have been a good Eskimo. In all my experience, I have never known him to lose his temper. That capacity will probably prove to be more significant in terms of his ultimate success as a university administrator than anything else.

Jerry's ability to undergo great provocation without losing either perspective or control is related to a number of other aspects in his character. There is, first of all, a twinkle in him, a droll, self-effacing wit that is wonderfully easy and wonderfully understated. But there is also in that wit a certain quickness, like the flash of gold discreetly hidden, which signifies a mind ready to communicate fully and efficiently without trekking through endless details. Jerry is not only humorous, he is also fully alert, and it is that alertness which informs his political instincts so adroitly and enables him to foster collegiality among the faculty and cooperation in the community. He perceives and knows how to merge and mobilize various factions, and he knows instinctively how to manuever this already great institution, whose leadership he has assumed, toward even more noble accomplishment.

Jerry's abilities don't end with his adeptness at mobilizing people and at tapping into their potentialities for the good of the University. He remains, on a personal basis, both sensitive and loyal. While he is very good at getting people to help the University, he is also a genuinely nice person. His upbeat, contagious enthusiasm makes you want to sign on to help. People wound up wanting to give their services to the Indianapolis Law School because they wanted to do right by Dean Bepko. I know, because I have many times myself been the subject of his appeals to speak, to do seminars and committee work and so forth. But even when you're being enlisted in such projects, Jerry has a masterful touch: first, he does not exploit those who would help; second, he does not push willing helpers into areas in which they have no legitimate background or business; and third, he senses when he might be coming to the well once too often; he is careful not to cross that fine line beyond which he risks asking too much.

At a time when the fortunes of the Indianapolis campus and the city of Indianapolis are closely intertwined, and when the University can profit richly by drawing upon civic expertise and leadership throughout Indianapolis, this level of prudent regard for individuals is essential. It promises to the University that inestimable gift: lasting goodwill.

In canvassing Jerry's extraordinary fitness for his new appointment, I must mention another trait which I think stands at the center of his ability to mobilize people: his personal modesty. Jerry is not a flashy man, and the lights of his ego are toned down enough to let others do most of the shining. And just as human beings almost instinctively attack and seek to bring down the flashy egotist, so they are moved in some inner way to augment and assist the soul who is modest. Jerry's modesty draws people to him, and through him, to the University, and all this gives him great potential to serve the cause of education.

Many of the characteristics which we see so clearly in Jerry — his easy self-control, his sensitivity to others, his prudence, modesty, and self-effacing wit — are each traits which point in a certain direction. They add up to a superior sense of human balance which we sometimes call detachment, and which leads a human being to levels of objectivity and clarity that, when possessed by persons in public life, serve everyone's interest.

One final word: Some will not be aware that in his past, Jerry Bepko was for a time an FBI agent. I suppose there are a few who would find in that a flaw, undervaluing the high sense of justice that motivates most, though, of course, not all, agents. As for myself having been a United States Attorney and an assistant United States Attorney and having put together many cases with a variety of agents, I have come to know that the best agents exemplify that same persistence, discretion, loyalty, and balance that are Jerry's mark as well. I have always thought I would like to have had the opportunity to try a case with Jerry on my side. In the larger sense, I know now that I have gotten my wish.

The Honorable Sarah Evans Barker
Judge, United States District Court
Indianapolis

Indiana Law Review

Volume 20 1987 Number 1

Administrative Adjudication—Revised and Recodified

KATHLEEN GIVENS LUCAS*

I. INTRODUCTION

For nearly forty years, the Administrative Adjudication Act[1] (AAA) has governed the procedures of most Indiana agencies, boards and commissions. Unless specifically exempted,[2] the various individuals and bodies acting on behalf of the state must adhere to the AAA. Except for relatively few minor amendments, the AAA had remained unchanged since its enactment in 1947.

With the passage of Public Law 361-1985, the 1985 General Assembly created a commission to study state administrative procedures and recommend any necessary changes.[3] The bipartisan group, composed of four senators, four representatives, and four citizen members, convened and operated as the Administrative Adjudication Law Recodification and Revision Commission (Commission).[4] The Commission held eleven

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[1]IND. CODE §§ 4-22-1-1 to -30 (1982) (repealed, effective July 1, 1987).

[2]*See id.* § 4-22-1-2, which specifically exempted from the definition of "agency" the courts, the Governor, military officers or boards, state-funded colleges and universities, benevolent, reformatory, or penal institutions, the Industrial Board, the State Board of Tax Commissioners, and the Public Service Commission. The section also exempted most functions of the Department of State Revenue, but indicated that the provisions of the AAA were "supplementary" to those of the revenue acts. The definition of "administrative adjudication" provided further exemptions from the AAA for specific functions of certain agencies. *Id.*

[3]Pub. L. No. 361-1985, §§ 1-7 (noncode sections).

[4]The Commission members were Representatives Richard Regnier (Chairman), Mitchell V. Harper, Robert F. Hellmann, and W. Laverne Tincher; Senators John B. Augsburger, William H. Vobach, Lindel O. Hume and James Jontz; and lay members David Allen, Susan Davis Smith, Brian G. Tabler, and Tony Zaleski. ADMIN. ADJUDICATION LAW RECODIFICATION AND REVISION COMM'N, 1985 GEN. ASSEMBLY, FINAL REPORT OF THE ADMINISTRATIVE LAW RECODIFICATION AND REVISION COMMISSION (1985) [hereinafter FINAL REPORT].

official sessions and periodically convened subcommittees to address specific issues. During the course of its study, the Commission received written or oral testimony from at least thirty-nine witnesses.[5] The final draft approved by the Commission was introduced in the 1986 Session of the General Assembly as House Bill 1339. With some amendments, House Bill 1339 became Public Law 18-1986, which revised and recodified the AAA.[6] This survey will examine some of the more noteworthy provisions of the new law.

II. Structure and General Concepts of the New Law

Public Law 18-1986 created within title 4 a new article 21.5 (new article), effective July 1, 1987, which governs administrative orders and procedures.[7] Article 21.5 is divided into six chapters,[8] beginning with a definitional chapter.

Most of chapter 1 is unremarkable in that it sets forth definitions well-established by other laws. However, "agency action" is more broadly defined in the new article than in the AAA. In addition to meaning an order or part of an order, agency action now also refers to the agency's performance of, or failure to perform, any duty, function, or other activity under article 21.5.[9] Although inclusion of an agency's failure to perform was not part of the AAA definition of administrative adjudication, it is contained in the Uniform Law Commissioners' Model State Administrative Procedure Act (Model Act).[10]

The term "order" is also comprehensively defined. It now means more than just a decision following adjudicative proceedings, and specifically includes licenses.[11] That definition becomes important in determining when appeal rights accrue under the new article.

Chapter 2 describes the application of the new law by stating that article 21.5 "creates minimum procedural rights and imposes minimum

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[5]*Id.* at 1.

[6]*See* Ind. Code §§ 4-21.5-1-1 to -6-7 (Supp. 1986).

[7]*Id.* The Act also established a committee to study the efficacy of creating a pool of administrative law judges and to study the effect of the Act on such issues as the adequacy of public notice of proceedings, and to propose any appropriate legislation. Pub. L. No. 18-1986, §§ 5-6 (noncode sections).

[8]The new article contains a chapter each on definitions, application, adjudicative proceedings, special proceedings (emergency and temporary orders), judicial review and civil enforcement.

[9]Ind. Code § 4-21.5-1-4 (Supp. 1986).

[10]The definition of "agency action" in new Ind. Code § 4-21.5-1-4 is the same as the definition in the Model State Admin. Procedure Act § 1-102(2) (1981). However, the Indiana statute replaces "discretionary or otherwise" in subsection (3) with "under this article." *See* Ind. Code § 4-21.5-1-4(3) (Supp. 1986).

[11]Ind. Code § 4-21.5-1-9 (Supp. 1986).

procedural duties."[12] An agency may afford greater procedural rights as long as they are not inconsistent with the new article or do not substantially prejudice rights conferred upon other persons by any law.[13] Unless precluded by another law, a person may waive any right conferred upon him, but may not waive any procedural duty.[14] For example, a person can waive the right to a hearing, but he cannot agree to extend the time for appeal.

The new article applies to agencies and agency actions unless specifically exempted by statute. A review of the agencies and agency functions exempted from the new article reveals that the Commission generally followed the former Indiana Code chapter 4-22-1 regarding application of the procedural law.[15] Notable additional exceptions in the new article include internal agency policy and organizational or procedural actions unrelated to an agency's licensing or enforcement functions.[16] Examples include budget, personnel, or contract reviews performed by one state agency for another. Certain grant and incentive programs under the auspices of the Lieutenant Governor's office are also exempted.[17]

Chapter 3 of the new article contains the most extensive provisions, those relating to adjudicative proceedings that occur under the agency's jurisdiction.[18] The Commission changed some requirements that had been established either by the former statute or by case law. However, the Commission adopted other court decisions and agency rules by codifying these into the new article.

The new article provides in chapter 3, section 1, that notice and service may be made by United States mail or personal service.[19] Agencies no longer have to give notice and service by registered (or certified) mail.[20] However, because the new law also provides that the agency

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[12] *Id.* § 4-21.5-2-1.

[13] *Id.* § 4-21.5-3-35.

[14] *Id.* § 4-21.5-2-2.

[15] *See Minutes of the Administrative Adjudication Law Recodification and Revision Commission* 1 (Sept. 3, 1985) [hereinafter *Minutes*, Sept. 3, 1985]. The draft before the Commission on that date "exempt[ed] the same agencies and agency actions from the application of IC 4-21.5 that IC 4-22-1-2 currently exempts." *Id.*

[16] Ind. Code § 4-21.5-2-5(5) (Supp. 1986).

[17] *Id.* § 4-21.5-2-5(7). *See Minutes of the Administrative Adjudication Law Recodification and Revision Commission* 1 (Nov. 7, 1985) [hereinafter *Minutes*, Nov. 7, 1985].

[18] Ind. Code §§ 4-21.5-3-1 to -37 (Supp. 1986).

[19] *Id.* § 4-21.5-3-1(b). Although the Commission spoke in terms of first class mail, it may be possible to utilize post cards or other forms of United States mail service.

[20] Ind. Code § 4-22-1-6 (1982) (repealed, effective July 1, 1987) required agency notification by "registered or certified mail" of the matters in issue and the hearing time and place, when the agency was the moving party. Ind. Code § 4-22-1-25 required the use of "registered letter, return receipt requested" for notices of initial determinations. *But see* Ind. Code § 1-1-7-1 (Supp. 1986), which provides that where a statute or duly

must maintain a record of service[21] and has the burden of persuasion that it has identified and notified persons entitled to notice,[22] circumstances may dictate the use of certified mail to establish receipt of service. Service may also be made by publication when the identity, address, or existence of a person is not ascertainable or when allowed by another statute.[23] The former AAA made no provision for service by publication.[24]

The Commission examined and rejected the holding of a case decided under the old statute, which required notice to be "addressed to the person or persons against whom an order or determination may be made at their last known place of residence, or place of business . . . ."[25] Citing that statutory language, the Court of Appeals of Indiana, in *Solar Sources, Inc. v. Air Pollution Control Board*,[26] held that notice to the person's attorney was not notice to the client.[27] In rejecting this holding, the Commission reasoned that if a party had retained counsel or had authorized another representative to receive service, the agency should be allowed to serve that designated entity. Service on the party's attorney should be sufficient and may even be more beneficial than requiring service on the party. An attorney or other representative familiar with administrative procedure may be better able timely to comply with procedural requirements for appeal. Also, authorizing service on the attorney or representative may promote administrative efficiency where an appearance is made on behalf of multiple parties or a class.[28] Therefore, the new article allows service upon either the individual or an authorized representative.[29]

In contrast to the new notice provision, the Commission accepted and codified, in Indiana Code section 4-21.5-3-2, a case that interpreted Indiana Trial Rule 6 regarding computation of time in administrative proceedings.[30] The language of trial rule 6(A)[31] is reflected almost verbatim in the new article, which provides that when the last day of a designated

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promulgated rule requires notice to be given by registered mail, the use of certified mail constitutes compliance.

[21]Ind. Code § 4-21.5-3-1(b) (Supp. 1986).

[22]*Id.* § 4-21.5-3-5(f).

[23]*Id.* § 4-21.5-3-1(d).

[24]Ind. Code § 4-22-1-6 (1982) (repealed, effective July 1, 1987).

[25]*Id.*

[26]409 N.E.2d 1136 (Ind. Ct. App. 1980).

[27]*Id.*

[28]*See generally Minutes of the Administrative Adjudication Law Recodification and Revision Commission* 1 (July 23, 1985) [hereinafter *Minutes*, July 23, 1985].

[29]Ind. Code § 4-21.5-3-1(c) (Supp. 1986).

[30]Ball Stores, Inc. v. State Bd. of Tax Comm'rs, 262 Ind. 386, 316 N.E.2d 674 (1974).

[31]Ind. R. Tr. P. 6(A).

time period falls on a weekend or holiday, the time period is extended to the next business day.[32] Further, if the time period allowed is less than seven days, weekends and holidays are excluded from the calculation. The new article is also consistent with trial rule 6(E) in that it provides that three days are added to any required period when notice is served by mail.[33]

Another significant incorporation of the trial rules in the new article involves motions for summary judgment.[34] The AAA made no reference to the applicability of summary decisions where only a question of law existed, although at least one agency provided for a summary decision procedure by rule.[35] In a recent case, the Indiana Court of Appeals discussed the requirement for exhaustion of administrative remedies.[36] The court stated that one factor to be considered is whether the question before the agency is one of fact or law, suggesting that purely legal questions are particularly suited for the judiciary.[37] Its review of other factors in the case led the court to conclude that exhaustion of administrative remedies was required before parties could proceed in court.[38]

With the enactment of summary judgment provisions of the new article, the issue of whether purely legal questions can provide an escape clause from exhaustion requirements seems to be resolved. Because an administrative law judge (ALJ) can entertain motions for summary judgment, which presuppose the absence of a genuine issue as to any material fact,[39] the legislature clearly intended that agencies may decide legal issues. Efficiency of the judicial process is served by allowing agencies the opportunity to correct their own errors, to reflect on policy preferences, and to resolve controversies without interruption.[40] As a practical matter, the question of whether the issues to be determined are purely

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[32]Ind. Code § 4-21.5-3-2(a)-(b) (Supp. 1986).

[33]Ind. Code § 4-21.5-3-2(e) (Supp. 1986); *see also* Ind. R. Tr. P. 6(E).

[34]Ind. Code § 4-21.5-3-23 (Supp. 1986) is patterned after the trial rule on summary judgment, Ind. R. Tr. P. 56.

[35]*See* Department of Natural Resources Administrative Procedures, Ind. Admin. Code tit. 310, r. 0.5-1-11 (Supp. 1986).

[36]Scott County Fed'n of Teachers v. Scott County School Dist. No. 2, 496 N.E.2d 610 (Ind. Ct. App. 1986).

[37]The court discussed factors affecting the analysis of whether the issue was one of fact or of law, compiled in 4 K. Davis, Administrative Law Treatise § 26:1 (2d ed. 1983), and held that the factors in favor of exhaustion outweigh the factors counseling a departure from the exhaustion requirement. Citing also Uniroyal, Inc. v. Marshall, 579 F.2d 1060 (7th Cir. 1978), where the federal court refused to create a *per se* exception for purely legal issues, the Indiana Court of Appeals declined to accept the argument that the absence of factual questions warrants a retreat from the exhaustion requirement. *Scott*, 496 N.E.2d at 614.

[38]*Id.*

[39]Ind. Code § 4-21.5-3-23(b) (Supp. 1986).

[40]K. Davis, *supra* note 37.

legal or are a mixture of factual and legal questions remains unresolved until a hearing on summary judgment. Unless arguments are initiated before the administrative tribunal, a trial court may be required to remand the case upon discovering a factual issue.

Possibly the most extreme illustration of a legal question is where a party raises constitutional issues in an agency proceeding. In *Drake v. Department of Natural Resources*,[41] the appellant argued denial of due process. The court of appeals stated that the AAA provided an adequate means for an agency to review constitutional issues, and therefore, equitable relief in court was not available.[42]

A comparison of two recent cases may assist in defining the parameters of an agency's ability to determine the constitutionality of specific laws. In *Midwest Steel Erection Company v. Commissioner of Labor*,[43] the court of appeals apparently looked favorably upon a hearing officer reviewing the constitutionality of a rule, but in *Sunshine Promotions, Inc. v. Ridlen*,[44] the court stated that an administrative officer has no authority to pass on the constitutional validity of a statute. Such determinations are within the exclusive jurisdiction of the courts under the Declaratory Judgment Act.[45]

With the exception of challenges to the constitutionality of a legislative act, it appears that all other questions of law arising out of agency adjudications are to be decided in the administrative forum, subject to judicial review. The codification of the summary judgment rule in the new article provides a mechanism for agencies to decide those purely legal questions within their jurisdiction.[46]

By using the language of the trial rules,[47] the new article narrows a line of cases holding that the trial rules do not govern the operations of administrative agencies.[48] The only trial rules that formerly applied specifically to administrative actions were those regarding discovery.[49]

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[41]453 N.E.2d 288 (Ind. Ct. App. 1983).

[42]*Id.* at 293.

[43]482 N.E.2d 1369 (Ind. Ct. App. 1985).

[44]483 N.E.2d 761 (Ind. Ct. App. 1985).

[45]Ind. Code §§ 34-4-10-1 to -16 (1982).

[46]*See* Ind. Code § 4-21.5-3-23 (Supp. 1986).

[47]*See, e.g., id.* § 4-21.5-3-5(b)(6), requiring that notice to parties is needed for just adjudication pursuant to Ind. R. Tr. P. 19; Ind. Code § 4-21.5-3-21, (Supp. 1986), which reflects Ind. R. Tr. P. 24 regarding intervention; Ind. Code § 4-21.5-3-23 (Supp. 1986), which adopts the summary judgment principles of Ind. R. Tr. P. 56; Ind. Code § 4-21.5-5-6(c) (Supp. 1986) stating that the rules regarding change of venue apply to judicial review.

[48]*See, e.g.*, State v. Board of Trustees of South Bend, 474 N.E.2d 520 (Ind. Ct. App. 1985); Margrat, Inc. v. Indiana State Bd. of Tax Comm'rs, 448 N.E.2d 684 (Ind. Ct. App. 1982); Solar Sources, Inc. v. Air Pollution Control Bd., 409 N.E.2d 1136 (Ind. Ct. App. 1980).

[49]*See* Ind. R. Tr. P. 28(F).

The Commission heard testimony from one of the drafters of the Model Act,[50] who explained that more than one category of administrative procedure is necessary to prevent too many "trial-type" proceedings. The drafter explained that the Indiana Act differs from the Model Act in that the Model Act avoids the burden of having too many "trial-type" proceedings. While the AAA used broad definitions to cover all agency decisions and then specifically exempted many agencies, the Model Act exempts fewer agencies and instead provides several categories of procedures that meet due process requirements but are less complicated than trials.[51] The Model Act also provides for two types of informal proceedings, conference and summary, to handle less controversial issues.[52] While the Commission declined to name specific procedural categories, the effect of chapter 3 of the new article is to provide for and to differentiate among various types of agency proceedings.[53]

III. Categories of Notice Provisions

A. Permit Provisions

Four basic categories of proceedings are established in the notice provisions of chapter 3. Sections 4 and 5 affect notification regarding permits, and sections 6 and 8 apply to regulatory enforcement.[54]

Section 4 concerns the issuance of individual licenses by agencies, including drivers' licenses, noncommercial hunting and fishing licenses, and certain professional licenses.[55] These types of licenses do not generally arouse controversy or objections by other people. Personnel decisions by agencies are also governed by section 4 because they are not of general applicability. Therefore, notice is required to be given only to the person to whom the order is specifically directed and any others required under another law.[56]

Section 5 applies to permit or status determinations that may be of broad public concern.[57] Of the many topics addressed by the Commission, the most controversial was probably the question of who receives notice

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[50]Dr. L. Harold Levinson, Professor of Law at Vanderbilt University, participated in development of the 1981 version of the Model States Procedure Act, drafted by the National Conference of Commissioners on Uniform State Law. *Minutes of the Administrative Adjudication Law Recodification and Revision Commission* 3 (July 30, 1985) [hereinafter *Minutes*, July 30, 1985].

[51]*Id.* at 4.

[52]*Id.*

[53]Ind. Code §§ 4-21.5-3-1 to -37 (Supp. 1986).

[54]*Id.* §§ 4-21.5-3-4, -5, -6, -8.

[55]*Id.* § 4-21.5-3-4(a).

[56]*Id.* § 4-21.5-3-4(b).

[57]*Id.* § 4-21.5-3-5.

of the "general interest" type of administrative permit proceedings. The notice issue was a primary focus in illustrating the need for revision of the AAA.[58]

The Commission was established as an outgrowth of Senate Enrolled Act No. 341.[59] The Natural Resources Advisory Committee[60] had initiated this bill in the 1985 session in an effort to amend, not rewrite, the AAA. Prominent among the considerations of the Natural Resources Advisory Committee was the formidable notice problem created by *Indiana Environmental Management Board v. Town of Bremen.*[61]

The *Town of Bremen* case involved construction and operation permits for a sanitary landfill granted by the Indiana Environmental Management Board (EMB).[62] The town and several private citizens sought to obtain judicial review of the permit issuance and to enjoin its effectiveness pending review. The trial court eventually ordered that the EMB's action be set aside and vacated.[63] The Indiana Court of Appeals found that the town and the citizens were entitled to pursue administrative remedies under the AAA, including the opportunity for settlement and for an adjudicatory hearing.[64] The court further found that the AAA required the agency to notify all "affected persons" by registered (or certified) mail or in person of its initial determination.[65] Failure to provide the appellees with their due process rights under the AAA rendered the permits void *ab initio.*[66]

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[58]*Minutes of the Administrative Adjudication Law Recodification and Revision Commission* App. E, at 2 (July 2, 1985) [hereinafter *Minutes*, July 2, 1985].

[59]The original bill, as introduced by Senator Augsburger, would have amended several sections of the AAA to clarify problematic areas. It was eventually determined that the entire 1947 Act might be in need of careful review by a study committee, so the bill was amended to create the Commission.

[60]Ind. Code § 2-5-5-1 (1982) created the Natural Resources Advisory Committee which consists of eight members of the General Assembly. The statute was amended in 1985 to change the name to the Natural Resources Study Committee. Ind. Code § 2-5-5-1 (Supp. 1986).

[61]458 N.E.2d 672 (Ind. Ct. App. 1984).

[62]The Solid Waste Management Board now issues these permits pursuant to Pub. L. No. 143-1985, § 49 (codified at Ind. Code § 13-1-12-8 (Supp. 1985)).

[63]*Town of Bremen*, 458 N.E.2d at 673.

[64]Ind. Code §§ 4-22-1-4, -25 (1982) (repealed, effective July 1, 1987) specifically afforded the opportunity for settlement and adjustment of all claims, controversies, and issues. The court of appeals found the "public hearing" provided for under the EMB law, Ind. Code § 13-7-17-1 to -2 (1982), was preliminary and supplementary to the AAA hearing requirements. *Town of Bremen*, 458 N.E.2d at 675.

[65]Citing as authority Grether v. Indiana State Bd. of Dental Examiners, 239 Ind. 619, 159 N.E.2d 131 (1959), the court of appeals found that the apparently permissive notification language of Ind. Code § 4-22-1-25 (1982) (repealed, effective July 1, 1987) was mandatory. *Town of Bremen*, 458 N.E.2d at 675 n.1.

[66]*Town of Bremen*, 458 N.E.2d at 676.

The *Town of Bremen* decision created the potential that a permit issued by an agency acting under the AAA might be voided at any subsequent time when an affected person complained that he was not given proper notice of the issuance of the permit. Identification of "affected persons" is relatively simple in some types of agency actions. However, other areas regulated by AAA agencies, such as the recently created environmental protection programs, almost defy definition of who may be affected. The Commission heard evidence concerning the need for clarification as to whom the agencies must notify.[67] Notification is important because it allows for administrative appeal if objections are timely filed.[68]

The Commission minutes reflect that the first draft of the new article incorporated notice provisions from the introduced version of Senate Bill No. 341.[69] The essence of the original bill is probably most apparent in the new article's notice provisions regarding permits of public concern. Much of the Commission's work centered on defining and balancing an individual's right to receive notice against a permit applicant's right to proceed within a reasonable time frame.

The final version of the new article requires notice of an agency order to a list of persons, beginning with the person to whom the order is directed and any others required by law, as described in section 4.[70] In addition to the requirements of section 4, the public participation type of permits under section 5 also require notice to each competitor in cases of mutually exclusive licenses, to each person who files a written request for notice, to each person with a substantial and direct proprietary interest, and to each person needed for just adjudication as described in the language of Indiana Trial Rule 19.[71] The Commission decided that if the agency was aware that a person had the type of interest described in the trial rule, he should be afforded an opportunity for participation early in the decision-making process. The agency may request the permit applicant to assist in identifying these persons.[72] Failure

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[67]*See, e.g.*, *Minutes*, July 30, 1985, *supra* note 50, at 2, regarding statements by a representative of the Indiana Manufacturers' Association; *Minutes of the Administrative Adjudication Law Recodification and Revision Commission Subcommittee* 2-3 (July 16, 1985) [hereinafter *Minutes*, July 16, 1985], regarding statements by representatives of the Indiana State Board of Health, by an independent hearing officer under contract to the State Board of Health, and by a representative of the Department of Natural Resources; *Minutes*, July 2, 1985, *supra* note 58, at App. E, 2, regarding the results of a survey of state agencies by the Office of Attorney General. *See also Minutes*, July 30, 1985, *supra* note 50, at 7, for the contrary views of the Hoosier Environmental Council.

[68]*See supra* note 67.

[69]*Minutes*, Sept. 3, 1985, *supra* note 15, at 2.

[70]Ind. Code § 4-21.5-3-4(b) (Supp. 1986).

[71]*Id.* § 4-21.5-3-5(b)(1)-(6).

[72]*Id.* § 4-21.5-3-5(f).

to notify the persons defined in section 5(b) can result in the invalidation of the order granting or denying the permit if the unnotified person can sustain his burden of persuasion that he has been substantially prejudiced by the agency decision.[73]

B. Enforcement Provisions

Indiana Code section 4-21.5-3-6 codifies a type of regulatory enforcement that was not specifically recognized by the former statute. The AAA provided that when an investigation or inspection revealed a violation, no final order could be issued without a hearing and notice.[74]

Certain agency practices allow for the issuance of an order which becomes final if no objections are filed.[75] The Commission heard testimony that often a respondent did not wish to invoke the hearing process for minor violations because of the time and complicated process; representatives of various agencies stressed the importance of expediting the administrative process whenever possible.[76] The new article thus recognizes orders that impose a sanction or terminate a legal interest, other than in permit situations, which become effective by statute without an adjudicative proceeding unless review is timely requested.[77]

The more traditional type of enforcement action is described in section 8 of chapter 3. The section describes enforcement actions that can be pursued only through filing a complaint and conducting a proceeding under chapter 3.[78] These types of suits might arise in regulatory areas for which the agency has no statutory authority to proceed under Indiana Code section 4-21.5-3-6 or for which the streamlining of the action is not of prime importance.[79]

Both types of enforcement proceedings require the agency to give notice to each person to whom an order may be directed and to any other person required by law to be notified.[80]

IV. Parties and Intervention

Corollary to the issue of notice is that of intervention. A person who is entitled to notice is not necessarily a party unless he is designated

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[73]*Id.*

[74]Ind. Code § 4-22-1-5 (1982) (repealed, effective July 1, 1987).

[75]*See, e.g.*, procedures under Ind. Code §§ 22-8-1.1-1 to -50, 13-4.1-1-1 to -15-15 (1982).

[76]*See Minutes*, July 30, 1985 *supra* note 50, at 5, 9; *Minutes*, July 16, 1985, *supra* note 67, at 3.

[77]Ind. Code § 4-21.5-3-6(a) (Supp. 1986).

[78]*Id.* § 4-21.5-3-8.

[79]*Id.* § 4-21.5-3-6.

[80]*Id.* §§ 4-21.5-3-6(b), -8(b).

as a party in the record of proceeding.[81] The only exception is a person against whom any resulting enforcement order under chapter 3, section 8, will be specifically directed.[82] That person will automatically be a party, as will any other persons who properly file a petition for review of an agency order under chapter 3, section 7. For all other persons, the new article creates rights of intervention in the agency hearing process which are consistent with state and federal trial rules.

Prior to a hearing, mandatory intervention is recognized for persons granted an unconditional right to intervene by any other statute.[83] Permissive intervention exists for those who demonstrate that they may be substantially prejudiced or who have a conditional right to intervene under another statute.[84]

During a hearing, intervention may be allowed if the petitioner has a conditional right to intervene or presents a common question of law or fact.[85] The ALJ must also determine that allowing intervention after the hearing has begun will not impair either the interests of justice or the prompt conduct of the proceedings.[86] Reflective of the state and federal rules on this subject, the new article requires the ALJ to consider whether the intervention will unduly delay or prejudice the legal interests of the parties.[87]

A person eligible to receive notice of an initial agency order, who did not have actual notice in time to intervene or who was wrongfully denied intervention, may have standing to obtain judicial review of that agency order if the requisite prejudice is shown.[88] The placement of this provision in chapter 5 suggests that the proper time to appeal a denial of party status is when all of the issues are considered on judicial review. The absence of an interlocutory appeal for denial of intervention differs from a 1981 amendment to Indiana Trial Rule 24.[89]

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[81] *Id.* §§ 4-21.5-3-4(b), -5(b), -6(b).

[82] *Id.* § 4-21.5-3-8(b).

[83] *Id.* § 4-21.5-3-21(a)(1). Certain statutes and rules guarantee broad rights of intervention. *See, e.g.*, IND. CODE §§ 13-6-1-1 to -6 (1982 & Supp. 1986), regarding environmental lawsuits; IND. ADMIN. CODE tit. 310, r. 12-1-3 (1984), regarding surface mining.

[84] IND. CODE § 4-21.5-3-21(a)(2) (Supp. 1986).

[85] *Id.* § 4-21.5-3-21(c).

[86] *Id.*

[87] *Id.*; *see also* FED. R. CIV. P. 24; IND. R. TR. P. 24.

[88] IND. CODE § 4-21.5-5-3 (Supp. 1986).

[89] IND. R. TR. P. 24(C) was amended in 1981. The previous rule stated that "The court's determination upon a motion to intervene may be challenged only by appeal from the final judgment or order in the cause." IND. R. TR. P. 24(C) (amended 1981). But in Indiana Bankers Ass'n v. First Fed. Sav. & Loan Ass'n of East Chicago, 180 Ind. App. 157, 387 N.E.2d 107 (1979), the court of appeals found that there may be facts and circumstances which support the use of an interlocutory appeal under IND. R. APP. P. 4(B)(5) when a motion to intervene is denied. The 1981 amendment changed the quoted language of the trial rule to read, "The court's determination upon a motion to intervene

The new article does contain a provision for judicial review of a nonfinal agency action if a person establishes both that an immediate and irreparable harm would occur and that no adequate remedy exists at law. The new law also specifically provides that the failure to comply with procedural requirements may not be used as the basis for finding an inadequate remedy at law.[90] This precludes a person from missing his statutory deadline for filing a petition for review, and then claiming that he has no adequate remedy at law. The provision allowing limited review of nonfinal agency actions may potentially allow challenges in court of decisions on petitions for stay or intervention if the requisite standards can be satisfied.

V. Effective Date of Orders and Stay Provisions

Another major issue addressed by the new article is when an order, particularly one concerning a license, becomes effective. The AAA provided that "every order or determination so made shall be in full force and effect after it is duly entered and spread of record in the permanent records of the agency . . . ."[91] The revocation of a license or permit was effective as of the date of revocation "until and unless set aside by a court on review."[92]

This AAA language sometimes created dual effective dates for agency orders. If an order both revoked a permit and required remedial measures or the payment of a fine, the revocation was effective as soon as the ultimate authority voted to revoke. However, the portion of the order requiring corrective action or a civil penalty was not effective until the order was "spread of record," a term not defined in the AAA. Because the time for filing a petition for judicial review of a final order ran from the receipt of notice,[93] most agencies used the date of service of the notice as the effective date of all fully adjudicated orders.

The old AAA did not resolve the problem of determining the effective date of licenses or permits approved by an agency without full adjudication. Section 25 of the AAA stated that if no objections were filed,

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shall be interlocutory for all purposes unless made final under Trial Rule 54(B)." Ind. R. Tr. P. 24(C). *Cf.* Developmental Disabilities Residential Facilities Council v. Metropolitan Dev. Comm'n of Marion County, 455 N.E.2d 960 (Ind. Ct. App. 1983), which held that on appeal, a denial of permissive intervention is reviewable only for an abuse of discretion.

[90] Ind. Code § 4-21.5-5-2(c) (Supp. 1986).

[91] Ind. Code § 4-22-1-13 (1982) (repealed, effective July 1, 1987).

[92] *Id.*

[93] *Id.* § 4-22-1-14 required the petition to be filed fifteen days after the receipt of notice. The new article gives parties thirty days after service of notice to file a petition for review. Ind. Code § 4-21.5-5-5 (Supp. 1986).

a permit was effective fifteen days after service.[94] If objections were filed by the applicant or another affected person, there was authority suggesting that the effectiveness of a permit was automatically delayed until all procedural requirements were met and a final order was entered.[95]

Some agencies, however, have differing statutory language regarding permits. For example, the Environmental Management Act provides that the decision of the Commissioner of the Indiana Environmental Management Board to approve or deny a permit is effective immediately unless otherwise stated.[96]

The Commission heard divergent views on many issues, including the effectiveness of orders.[97] Its members recognized that some agency orders require a meaningful opportunity for appeal before they take effect, while others are more appropriately effective upon issuance. The requirements for the effectiveness of orders follow a rationale similar to that of the notice categories in terms of allowing an opportunity for public reaction.

Individual permits or licenses of minor public concern are effective when served.[98] Other permits become effective when the time allowed for seeking administrative review expires.[99]

If both a petition for review and a petition for stay of effectiveness are filed before an order becomes effective, any part of the order within the scope of the petition for stay may be delayed for an additional fifteen days while the ALJ conducts a preliminary hearing.[100] The ALJ may stay the order in whole or in part.[101]

When the ALJ orders a partial stay, an applicant may elect to proceed with the unaffected portions of the permit.[102] The applicant assumes the risk that the entire permit could be later voided following a hearing, but that risk may be preferable to the complete standstill created by the filing of an objection under the AAA. The partial stay provisions expedite the adjudicative proceedings and protect the interests of the applicant and other affected persons by isolating for adjudication those contested portions of the permit which are severable.

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[94] Ind. Code § 4-22-1-25 (1982) (repealed, effective July 1, 1987).

[95] *Id.*; *see also* Indiana Envtl. Management Bd. v. Town of Bremen, 458 N.E.2d 672 (Ind. Ct. App. 1984).

[96] Pub. L. No. 143-1985, § 149 (codified at Ind. Code § 13-7-10-2.5(b) (Supp. 1985)).

[97] Final Report, *supra* note 4, at 3.

[98] Ind. Code § 4-21.5-3-4(d) (Supp. 1986).

[99] The period for seeking administrative review is fifteen days unless a longer time is granted by another statute. Thus, most orders are effective under Ind. Code § 4-21.5-3-5(f) (Supp. 1986) within fifteen days unless petitions for review and for stay of effectiveness have been filed.

[100] Ind. Code § 4-21.5-3-5(f) (Supp. 1986).

[101] *Id.* § 4-21.5-3-5(h).

[102] *See id.*

The express ability of an agency to stay the effectiveness of orders may be the most fundamental change in administrative law created by the new article. Under the AAA, only the courts had jurisdiction to stay agency action pending judicial review.[103] Caselaw interpreting the AAA provided that the stay mechanism could be used as an equitable remedy for preserving the status quo to avoid undue hardship.[104] The language of the new article concerning judicial stay is practically unchanged from the AAA.[105] Thus, presumably the same principles will apply to the new article after a final order or determination is made by the agency.

Under the new law, the ALJ can stay agency orders in both categories of licensing during the course of administrative adjudication.[106] This change is consistent with the 1981 revision of the Model State Administrative Procedure Act, which provides that the presiding officer may take action on a petition for stay, either before or after the effective date of the initial or final order.[107] The new article also gives the ultimate authority discretion to grant petitions for stay during efforts to modify a final order.[108]

VI. Emergency and Other Temporary Orders

Acting upon requests by several agencies,[109] the Commission expanded upon the brief allusion in the AAA to emergency and temporary orders.[110] The new article includes chapter 4, which applies if an emergency exists or if a statute authorizes immediate agency action.[111]

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[103] *See* Ind. Code §§ 4-22-1-13, -17 (1982) (repealed, effective July 1, 1987), which recognized an "automatic stay of agency action where expressly provided for by law."

[104] However, the court could not extend a permit beyond its effective date, thus constituting a judicially created renewal permit. Alcoholic Beverage Comm'n v. Lake Super. Ct. Room 4 Sitting at Gary, 259 Ind. 123, 284 N.E.2d 746 (1972).

[105] *Compare* Ind. Code § 4-22-1-17 (1982) (repealed, effective July 1, 1987) *with* Ind. Code § 4-21.5-5-9 (Supp. 1986).

[106] Ind. Code §§ 4-21.5-3-4(e), -5(f), -5(h) (Supp. 1986).

[107] Model State Admin. Procedure Act § 4-217 (1981). The comment following that section indicates that "[t]he 1961 Revised Model Act mentioned a stay granted by the agency or ordered by the court only in the context of judicial review, Section 15(c)," *Id.* § 4-217 comment.

[108] Ind. Code § 4-21.5-3-31(b) (Supp. 1986).

[109] *See, e.g.*, *Minutes*, July 23, 1985, *supra* note 28, at 4, regarding statements by a representative of the Health Professions Bureau; *Minutes*, July 16, 1985, *supra* note 67, at 3, regarding statements by a representative of the Department of Natural Resources; *Minutes*, July 2, 1985, *supra* note 58, at App. E, at 3, regarding a survey of state agencies by the Office of Attorney General.

[110] Ind. Code § 4-22-1-5 (1982) (repealed, effective July 1, 1987) provided only that "in a case of emergency a temporary order may be made by such agency to be effective only until notice may be given and hearing had as herein provided." No other guidance was provided for emergency proceedings.

[111] Ind. Code § 4-21.5-4-1 (Supp. 1986).

The chapter provides for an order with or without notice or hearing, that is effective when issued.[112] The agency is, however, required to give "such notice as is practicable" to persons required to comply with the order.[113]

Upon request, the agency must set the matter for evidentiary hearing "as quickly as is practicable."[114] At hearing the ALJ may void, terminate, modify, stay, or continue the order.[115] The order expires on the date set in the order, the date set by statute, or the elapse of ninety days, whichever is earliest.[116] As long as the adjudicative process is being pursued under chapter 3, the order may be renewed for successive ninety day periods unless precluded by law.[117]

The emergency provisions are available as an adjunct to the other categories of proceedings described in chapter 4,[118] chapter 5,[119] chapter 6,[120] and chapter 8,[121] of the new article.

VII. Judicial Review and Civil Enforcement

The new article codifies most of the old statutory requirements and court interpretations of the AAA regarding judicial review. Since it heard few complaints about the standards for court review of agency action, the Commission retained the core provisions of the AAA in this area.[122] Certain scattered caselaw principles were legislatively enacted so that all the requirements for administrative adjudication are in one article.

For example, countless cases have held that a party must exhaust his administrative remedies before seeking judicial review.[123] The exhaustion requirement is specifically stated in chapter 5 of the new article.[124] As was true under the AAA,[125] the new article provides that

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[112]Some statutes require a hearing prior to the issuance of a temporary order. *See, e.g.*, Ind. Code § 13-4.1-11-8 (1982).

[113]Ind. Code §§ 4-21.5-4-2, -3 (Supp. 1986).

[114]*Id.* § 4-21.5-4-4.

[115]*Id.*

[116]*Id.* § 4-21.5-4-5.

[117]*Id.*

[118]*Id.* § 4-21.5-3-4(d).

[119]*Id.* § 4-21.5-3-5(g).

[120]*Id.* § 4-21.5-3-6(d).

[121]*Id.* § 4-21.5-3-8(a).

[122]*See id.* §§ 4-21.5-5-1 to -16.

[123]*See, e.g.*, Scott County Fed'n of Teachers v. Scott County School Dist. No. 2, 496 N.E.2d 610 (Ind. Ct. App. 1986); Drake v. Indiana Dep't of Natural Resources, 453 N.E.2d 293 (Ind. Ct. App. 1983); Thompson v. Medical Licensing Bd., 180 Ind. App. 333, 389 N.E.2d 43 (1979), *cert. denied*, 449 U.S. 937 (1980).

[124]Ind. Code § 4-21.5-5-4 (Supp. 1986).

[125]Ind. Code § 4-22-1-18 (1982) (repealed effective July 1, 1987); *see also* Indiana Bd. of Chiropractic Examiners v. Chamberlain, 495 N.E.2d 794 (Ind. Ct. App. 1986); Indiana Alcoholic Beverage Comm'n v. Johnson, 158 Ind. App. 467, 303 N.E.2d 64 (1973).

a court on review may not substitute its judgment for that of the agency, nor may it try the case *de novo*.[126]

The new article also retains the AAA's standards for granting relief on judicial review.[127] If substantial prejudice is shown under these standards, the reviewing court may set aside an agency action. Consistent with the AAA, the court may remand the case for further proceedings and compel agency action when it is unreasonably delayed or unlawfully withheld.[128]

One major change from the AAA is that the new article gives a party thirty days to file a petition for judicial review,[129] instead of the previous fifteen day period.[130] Likewise doubled is the time for filing the agency record with the court.[131]

Cognizant of the case of *Shettle v. Meeks*[132] in which the court of appeals held that an agency must bear the cost of preparing a transcript for judicial review, the Commission clarified the procedures for obtaining a record of the proceedings. The ALJ must have the hearing recorded at the agency's expense, but the agency is not required to prepare a transcript.[133] Any party may, at his own expense, cause a reporter to prepare a transcript.[134] Despite the provisions of the Access to Public Records Law,[135] the agency may charge a petitioner the reasonable costs of preparing necessary copies and transcripts for the court.[136]

Reasonable costs would include the charge by a reporting service for preparing, upon request, a hearing transcript that would not otherwise have been transcribed. The party making the request would pay for the transcript unless indigency was established.[137]

Chapter 6 of the new article concerns civil enforcement of agency orders. A verified petition for civil enforcement is the proper mechanism to request court-ordered compliance.[138] The state[139] or any party, under

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[126] IND. CODE § 4-21.5-5-11 (Supp. 1986).

[127] *Compare* IND. CODE § 4-22-1-18 (1982) (repealed, effective July 1, 1987) *with* IND. CODE § 4-21.5-5-14(d) (Supp. 1986).

[128] *Compare* IND. CODE § 4-22-1-18 (1982) (repealed, effective July 1, 1987) *with* IND. CODE § 4-21.5-5-15 (Supp. 1986).

[129] IND. CODE § 4-21.5-5-5 (Supp. 1986).

[130] IND. CODE § 4-22-1-14 (1982) (repealed, effective July 1, 1987).

[131] *Compare* IND. CODE § 4-22-1-14 (1982) (repealed, effective July 1, 1987) *with* IND. CODE § 4-21.5-5-13 (Supp. 1986).

[132] 465 N.E.2d 1136 (Ind. Ct. App. 1984).

[133] IND. CODE § 4-21.5-3-25(g) (Supp. 1986).

[134] *Id.*

[135] IND. CODE §§ 5-14-3-1 to -10 (Supp. 1986).

[136] IND. CODE § 4-21.5-5-13(d) (Supp. 1986).

[137] *Id.*

[138] *Id.* § 4-21.5-6-1.

[139] *See id.* § 4-21.5-6-1, which provides that the petition for enforcement may be filed by an agency in its own name, by an agency in the name of the state, by the Attorney General in his own name, or by the Attorney General in the name of the state at the request of an agency.

specified conditions,[140] may file a petition to enforce an agency's order by injunction, restraining order, or other appropriate relief.[141] The resulting court orders are appealable through the rules governing civil appeals from the courts.[142]

Chapter 6 also addresses the enforcement of subpoenas, discovery orders, and protective orders issued by an agency.[143] The Commission considered testimony that the procedure under the AAA, in which only the Attorney General could seek enforcement[144] of subpoenas, on behalf of the agency involved, created an undue burden and possible conflicts of interest for that office.[145] As a result, the new article provides that any party to an agency proceeding can seek enforcement of the agency's discovery orders.[146]

VIII. Conclusion

The new article addresses many issues that have arisen since the enactment of the AAA in 1947. It incorporates the principles of numerous court decisions and trial rules in recognition of the increased sophistication of questions presented to modern agencies as they attempt to effectuate state and federal requirements. Because of the complexity of the legislation, the Commission provided, in the House Enrolled Act 1339,[147] for a second summer study committee to examine certain issues and recommend appropriate legislation to the Indiana General Assembly during the 1987 session. This second committee, named the Administrative Adjudication Commission, met during the summer of 1986 to propose minor changes in the new article. A bill that makes several technical corrections and minor revisions received the consensus of the summer group and will be introduced to the General Assembly as a Commission bill in 1987.[148]

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[140]*See id.* § 4-21.5-6-3(b), which precludes commencement of an enforcement action by a party if sixty days have not elapsed since notice of intent to sue was given, if the agency is diligently prosecuting a petition for civil enforcement of the same order, or if a petition for review of the order is pending.

[141]*Id.* § 4-21.5-6-6.

[142]*Id.* § 4-21.5-6-7.

[143]*Id.* § 4-21.5-6-2.

[144]Ind. Code § 4-22-1-21 (1982) (repealed, effective July 1, 1987).

[145]*See Minutes*, July 2, 1985, *supra* note 58, at App. E; Final Report, *supra* note 4.

[146]Ind. Code § 4-21.5-6-2(b) (Supp. 1986).

[147]Pub. L. No. 18-1986, §§ 5, 6 (non-code section).

[148]When the Administrative Adjudication Commission met in 1986, it considered making changes in the new article in the areas of the pooling of administrative law judges, state employee arbitration, civil enforcement, and notice provisions concerning landfills. The Commission declined to recommend any new legislation on these subjects to the General Assembly during the 1987 session. Admin. Adjudication Comm'n, 1986 Gen. Assembly, Final Report of the Administrative Adjudication Commission, November 1, 1986 (1986).

Developments in Business Association Law

Paul J. Galanti*

I. Foreign Limited Partnerships

The Indiana Uniform Limited Partnership Act (ULPA)[1] is the original version of the ULPA promulgated in 1916. One of the great weaknesses of the ULPA was that it did not deal with limited partnerships with multistate operations. This is not surprising considering that the drafters of the act contemplated that limited partnerships would be small, local enterprises. Times change, and limited partnerships with multistate operations have become common. Consequently, one of the great advances of the Revised Uniform Limited Partnership Act (1976) (RULPA)[2] and its successor, the Uniform Limited Partnership Act (1985) (ULPA 1985),[3] is that they clarify the status of foreign limited partnerships.[4] A few states had enacted procedures for recognizing foreign limited partnerships before RULPA,[5] and some courts recognized such enterprises by applying choice of law rules.[6] This practice, however, was not universal. This presented the risk of a court holding that a certificate of limited partnership filed in another state was not "substantial compliance" with the formalities of forming a limited partnership under ULPA.[7] The venture would then be considered a general partnership, subjecting the limited partners to unlimited liability.[8] Consequently, a cautious attorney representing a limited partnership formed under the laws of another state that wishes to transact business in Indiana would qualify it as an Indiana

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[1]Ind. Code §§ 23-4-2-1 to -31 (1982).

[2]Revised Uniform Limited Partnership Act, 6 U.L.A. 215 (Supp. 1986).

[3]Uniform Limited Partnership Act, 6 U.L.A. 285 (Supp. 1986).

[4]*See generally* Sell, *An Examination of Articles 3, 4 and 9 of the Revised Uniform Limited Partnership Act*, 9 St. Mary's L.J. 459, 471-77 (1978).

[5]*See, e.g.*, Cal. Corp. Code § 15700 (Deering Supp. 1974); Tex. Rev. Civ. Stat. Ann., art. 6132a, § 32 (Vernon Supp. 1986).

[6]*See, e.g.*, Cheyenne Oil Corp. v. Oil & Gas Ventures, Inc., 42 Del. Ch. 100, 105, 204 A.2d 743, 746 (1964); Gilman Paint & Varnish Co. v. Legum, 197 Md. 665, 668, 80 A.2d 906, 907-08 (1951); King v. Sarria, 69 N.Y. 24, 30-31 (1877); *see also* Plaza Realty Investors v. Bailey, 484 F. Supp. 335 (S.D.N.Y. 1979) (New York federal court applied Indiana law to an Indiana limited partnership in a diversity action); Partnership Equities, Inc. v. Marten, 15 Mass. App. 42, 443 N.E.2d 134 (1982). *See generally* J. Crane & A. Bromberg, Law of Partnership § 26 n.30 (1968).

[7]Ind. Code § 23-4-2-2(2) (1982). *See generally* J. Crane & A. Bromberg, *supra* note 6, § 26(b); H. Henn & J. Alexander, Laws of Corporations § 29 (3d ed. 1983).

[8]*See* Arrow Petroleum Co. v. Ames, 128 Ind. App. 10, 142 N.E.2d 479 (1957).

limited partnership under the ULPA—at least, that is, until Indiana adopts the ULPA 1985.

The only Indiana decision involving the limited liability of a foreign limited partnership is the recent decision in *Radio Picture Show Partnership v. Exclusive International Pictures.*[9] Perhaps a more accurate statement would be that *Radio Picture Show might* have involved the limited liability status of a foreign limited partnership. A purported Texas limited partnership, 3622 Limited, was one of the entities found liable in the case.[10] In turn, 3622 Limited was the purported limited partner in Radio Picture Show Partnership, which was a purported California limited partnership. The court refused to limit 3622 Limited's liability, pointing out that not only had the venture not filed a certificate of limited partnership in Indiana but also that defendants had not presented evidence they were properly formed limited partnerships in their respective states of organization.[11] The only evidence presented by defendants was the bare characterization by one of the parties that 3622 Limited was a limited partnership. This assertion was not sufficient to meet defendants' burden of proof on the issue.[12]

It might be possible for a foreign limited partnership planning to transact business in Indiana simply to file a copy of the certificate of limited partnership prepared and filed in its state of organization. However, because ULPA requires the certificate to specify the location of the principal place of business in Indiana in order to determine where the certificate should be filed,[13] the only safe procedure is to prepare and file a certificate specifically drafted to comply with the Indiana ULPA. This is a very cumbersome procedure if a limited partnership does business in many states because the provisions for organizing limited partnerships in ULPA jurisdictions are not completely uniform. The problem is compounded by the frequent need to amend limited partnership certificates.[14] The multiple filing requirements for multistate limited partnerships were simplified significantly in the RULPA and the ULPA 1985.[15]

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[9] 482 N.E.2d 1159 (Ind. Ct. App. 1985).

[10] *Id.* at 1168.

[11] *Id.*

[12] *Id.* at 1168-69. The limitation on liability of limited partners is a matter of defense. *See* Howard v. Gray's Warehouses, Inc., 242 Ky. 501, 46 S.W.2d 787 (1932).

The *Radio Picture Show* court stated that "a limited partnership [sic] is not a proper party in a proceeding against the partnership" under Ind. Code § 23-4-2-26. 482 N.E.2d at 1168. The reference should have been to a "limited partner," but the error is understandable because the purported limited partner, 3622 Limited, was itself a limited partnership.

[13] Ind. Code § 23-4-2-2(1) (1982).

[14] *Id.* § 23-4-2-24.

[15] Revised Uniform Limited Partnership Act § 902, 6 U.L.A. 267 (Supp. 1986); Uniform Limited Partnership Act § 902, 6 U.L.A. 296-97 (Supp. 1986).

There is no Indiana authority on point,[16] but it is clear that a foreign corporation that is the general partner of a foreign limited partnership doing business in Indiana must qualify to transact business as a foreign corporation under the Indiana General Corporation Act (IGCA).[17] This is not necessary if a foreign corporation is a limited partner of a foreign, or even an Indiana, limited partnership. The requirement that limited partners not partake in control of the business to maintain limited liability status[18] in effect precludes a corporation that is a limited partner from transacting business in the state. Presumably a foreign corporation that is a limited partner partaking in control of the business of a limited partnership would be subject to sanctions for failing to qualify to do business in Indiana under the IGCA[19] and would be liable to creditors of the limited partnership under the ULPA.[20]

II. Corporate Management and Shareholder Suits

A rather unusual case decided during the survey period is *Scott v. Anderson Newspapers, Inc.*[21] In *Scott*, the court affirmed in part, reversed in part, and remanded with instructions certain holdings of the Hancock Superior Court in a declaratory judgment action.[22] In reaching this result, the *Scott* court appeared to follow traditional corporate law maxims to some degree while doing violence to other maxims.

The dispute was between two factions in Anderson Newspapers, Inc. (ANI), which publishes the two newspapers in Anderson, Indiana, the *Bulletin* and the *Herald*. The plaintiffs represented the *Herald* group and the defendants represented the *Bulletin* group. The two newspapers were owned and operated by separate corporations before 1949, but were consolidated in that year. ANI was the corporation resulting from

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[16]The issue was not discussed in *Radio Picture Show*, although the general partner in the partnership was a California corporation. 482 N.E.2d at 1162. The structure of the Radio Picture Show enterprise was rather complex, which could explain why the court observed that "no argument . . . [was] made concerning knotty problems of what law would govern." *Id.* at 1168.

[17]*See* Ind. Code § 23-1-11-1 (1982). *See generally* Note, *The Corporation as Managing Partner in a Limited Partnership*, 55 N.D.L. Rev. 271 (1979). This also will be true under the new Indiana Business Corporation Law, Ind. Code § 23-1-49-1 (Supp. 1986).

[18]Ind. Code § 23-4-2-7 (1982). *See* Port Arthur Trust Co. v. Muldrow, 155 Tex. 612, 291 S.W.2d 312 (1956).

[19]Ind. Code § 23-1-11-14 (1982).

[20]*Cf.* Mursor Builders, Inc. v. Crown Mountain Apartment Ass'n, 467 F. Supp. 1316 (D.V.I. 1978).

[21]477 N.E.2d 553 (Ind. Ct. App. 1985).

[22]*Id.* at 556. Perhaps the result is not too surprising considering the somewhat convoluted nature of the parties. Defendants in the action had filed a counter claim and both parties appealed from the lower court decision. Thus there were plaintiffs, counter-defendants, appellants, and cross-appellees on one side and defendants, counter-claimants, appellees, and cross-appellants on the other. *Id.*

the consolidation.[23] The former *Herald* interests became minority shareholders and directors of ANI following the consolidation.[24] Each group nominated its own directors although they were elected by all ANI shareholders. In turn, the president and secretary were elected from the *Bulletin* group and the vice president from the *Herald* group. Each group appointed the editor of its own newspaper.[25] Satisfactory relations between the two groups apparently ended in 1981 when the founder of the *Herald*, who was the ANI vice president, died. His son voluntarily assumed the editorship of the *Herald* without any action by the ANI board.

At this point, the *Bulletin* group, armed with a legal opinion, attempted to gain complete control of ANI's affairs including the selection of the vice president, who had traditionally come from the *Herald* group; the right to nominate and elect the three *Herald* directors; and the right to name the *Herald*'s editor. They offered amendments to ANI's "articles of consolidation" and bylaws to provide that all corporate business and affairs could be transacted by a simple majority vote of the shareholders or directors. The declaratory judgment suit followed because these amendments would have effectively ended the rights of the *Herald* group in ANI.[26]

The *Scott* court, in discussing the issues in the case, consistently referred to the "Herald group's preemptive right to publish the Herald."[27] This terminology is unfortunate. It is not clear from the opinion whether ANI shareholders had "preemptive rights" as authorized by the IGCA.[28] The term preemptive rights refers to the right of shareholders to subscribe to or purchase additional shares of a corporation under certain circumstances.[29] It would not be surprising if ANI shareholders had preemptive rights because they are quite common in closely held corporations.[30] Perhaps the parties in *Scott* referred to the right of each group to publish its own newspaper as a "preemptive right," but the court should have refrained from using a term of art of corporation law in such an inaccurate fashion.

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[23]*Scott*, 477 N.E.2d at 557. *See* Ind. Code §§ 23-1-5-1, -3 (1982). *See generally* H. Henn & J. Alexander, *supra* note 7, § 346.

[24]*Scott*, 477 N.E.2d at 557. Initially there were five ANI directors, three from the *Bulletin* group and two from the *Herald* group. The number of directors was raised to seven, with four from the *Bulletin* group and three from the *Herald* group. *Id.*

[25]*Id.*

[26]*Id.*

[27]*Id.*

[28]Ind. Code § 23-1-2-6(i) (1982).

[29]*See generally* H. Henn & J. Alexander, *supra* note 7, §§ 127, 175.

[30]Under the IGCA, shareholders do not have preemptive rights except to the extent that such rights are provided for in the articles of incorporation or a resolution of the board of directors. Ind. Code § 23-1-2-6(i) (1982).

The *Scott* court had to examine the original consolidation of the two newspapers to determine the rights of the two groups. The court started with the truism that corporations "can be created and exist only by virtue of statutory authority, and by that authority alone,"[31] and that while "there may be a contract among individuals to enter into a corporation; . . . when the contemplated corporations [sic] comes into existence, the charter, not the contract, determines their rights. Its provisions are supreme."[32]

The latter observation is overbroad. Certainly corporations are creatures of statutes, but many courts have long departed from the strict corporate norm. They now clearly recognize and enforce contracts among the parties to closely held corporations as to how the corporation is to be governed if the interests of third parties are not adversely affected.[33] This contemporary view of the corporate norm clearly has been accepted in Indiana by decisions recognizing the highly fiduciary nature of the so called incorporated partnership.[34] The *Scott* court recognized that the relationship between a corporation and its shareholders is a "contract in which the articles of incorporation, bylaws, provisions of the stock certificate, and the pertinent statutes are embodied,"[35] but it failed to acknowledge that the contract is in fact more inclusive. This narrow view did not have any impact on the result in *Scott*, but it is unfortunate that the court intentionally or inadvertently seems to be retreating from the view of the contemporary cases.

The *Scott* court correctly characterized the articles of consolidation as ANI's articles of incorporation.[36] Thus, it was appropriate to look to the articles of consolidation to determine the rights of the two disputing groups with respect to the *Herald*. The court was satisfied that the provisions of the articles made it clear that the two newspapers were to be controlled by their respective groups. This arrangement included

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[31]*Scott*, 477 N.E.2d at 558. *See* Ohio Ins. Co. v. Nunnemacher, 15 Ind. 294 (1860); Indiana Bond Co. v. Ogle, 22 Ind. App. 593, 54 N.E. 407 (1899). *See generally* H. Henn & J. Alexander, *supra* note 7, § 78.

[32]*Scott*, 477 N.E.2d at 558.

[33]*See, e.g.*, Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1964); McQuade v. Stoneham, 263 N.Y. 323, 189 N.E. 234 (1934).

[34]*See* Dotlich v. Dotlich, 475 N.E.2d 331 (Ind. Ct. App. 1985), *discussed in* Galanti, *Business Law, 1985 Survey of Recent Developments in Indiana Law*, 19 Ind. L. Rev. 67, 82-88 (1986); Cressy v. Shannon Continental Corp., 177 Ind. App. 224, 378 N.E.2d 941 (1978), *discussed in* Galanti, *Business Associations, 1979 Survey of Recent Developments in Indiana Law*, 13 Ind. L. Rev. 133, 150-55 (1980); Hartung v. Architects Hartung/Odle/Burke, Inc., 157 Ind. App. 546, 301 N.E.2d 240 (1973), *discussed in* Galanti, *Business Associations, 1974 Survey of Recent Developments in Indiana Law*, 8 Ind. L. Rev. 24, 42-46 (1974).

[35]477 N.E.2d at 558.

[36]*Id.* at 559. *See* Ind. Code § 23-1-5-5(f) (1982).

not only the right to maintain separate editorial policies but also that the shareholders and directors of one group would not interfere with the operation of the other newspaper.[37] No fault can be found with this conclusion, although the choice of the term "preemptive right" was unfortunate.

The *Scott* court's treatment of ANI's bylaws was somewhat inconsistent with its emphasis on the primacy of the articles of consolidation. The bylaws, adopted shortly after ANI was organized, provided in part that provisions relating to the proportion of directors from each group and the right of each group to fill board vacancies were not to "be changed except by the affirmative vote of six-eighths of all outstanding stock of this corporation."[38] The court gave effect to this bylaw, as it should have, although under the IGCA, any provision requiring a greater than majority vote for shareholder action must be included in the articles of incorporation.[39] The IGCA permits the bylaws to establish the quorum of outstanding shares for a meeting of shareholders.[40] There is nothing wrong with giving effect to the bylaw, particularly because both groups substantially complied with the bylaw until the present litigation,[41] although the result is inconsistent with the court's expressed understanding of the requirements of Indiana corporation law.[42]

The court next considered the contention of the *Bulletin* group that a simple majority vote could amend the articles to eliminate these provisions. The *Bulletin* group argued that the phrase "without limi-

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[37]*Scott*, 477 N.E.2d at 559-60.

[38]*Id.* at 560.

[39]Ind. Code § 23-1-2-9(m) (Supp. 1986).

[40]*Id.* § 23-1-2-9(n). Presumably the bylaws were adopted by the shareholders acting as shareholders rather than by the directors. Under the IGCA, the power to make, alter, amend, or repeal bylaws is vested in the board of directors unless otherwise provided in the articles of incorporation. *Id.* § 23-1-2-8.

Either the ANI articles of consolidation vested authority in the shareholders with respect to the bylaws, or at least provided that with respect to the composition of the board, any change would require shareholder approval with a high enough vote that no change could occur unless both factions agreed. This would be permissible under Indiana Code section 23-1-2-8 although the greater than majority voting requirement should have appeared in the articles of incorporation.

It is possible the articles of consolidation did require a greater than majority vote for shareholder action and this simply was not mentioned by the court. This does seem unlikely, however, because the court substantially set out the provision in the articles of consolidation relating to the make up of the board of directors. *Scott*, 477 N.E.2d at 559-60.

[41]*Scott*, 477 N.E.2d at 560.

[42]There is an old Indiana decision, Green v. Felton, 42 Ind. App. 675, 84 N.E. 166 (1908), holding that a bylaw providing that bylaws could be amended by a two-thirds vote required a vote of two-thirds shares represented at a meeting rather than a vote of two-thirds of all shares. However, *Green* was decided before the IGCA was adopted.

tation'' contained in the IGCA provision[43] relating to amending articles of incorporation meant that a simple majority could amend the articles regardless of any other provisions in the corporate documents. This is clearly erroneous. Certainly, the articles of consolidation *could* be amended under the IGCA to give the *Bulletin* group total control of both papers. However, the problem is not the possible absence of a provision in the articles requiring a greater than majority vote of shareholders to amend the articles, but that the operating terms of the articles prohibited either group even from taking steps to propose an amendment to the articles. Thus, the *Scott* court was right in concluding that the provisions in the articles relating to control over each newspaper could be amended only if the directors or shareholders of the group concurred.[44]

The court characterized the *Bulletin* group's proposal to eliminate the rights of the *Herald* group as ''ultra vires.''[45] The ultra vires doctrine is severely limited by the IGCA, but in some cases it can be raised by a shareholder.[46] The court unfortunately misused the term ''ultra vires,'' which should be limited to situations where a corporation has attempted to do something not authorized by its purposes or powers. ANI did not lack capacity to do what the *Bulletin* group wanted. Rather, the *Bulletin* group was trying to do something in an improper manner. Furthermore, characterizing the *Bulletin* group's efforts as ultra vires is totally inconsistent with the court's determination that the *Scott* action was a derivative rather than a direct action. An action by a shareholder to enjoin an ultra vires act would be an action brought to enforce a right of the shareholder rather than a right of a corporation. The latter is the essence of a shareholder derivative action.[47]

The court rejected the *Bulletin* group's contention that Indiana law does not provide for separate approval of amendments by shareholder ''groups'' where the corporation has a single class of shares.[48] The court's approach to this issue is intriguing. It relied on the ''import''

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[43]Ind. Code § 23-1-4-1(a) (Supp. 1986).

[44]It is possible that the opinion of the *Bulletin* group that they could amend the articles by a simple majority was premised on the lack of a greater than majority voting requirement provision in the articles of consolidation. It is clear that a better drafting job would have included such a provision in the articles. The argument of the *Bulletin* group, of course, was not specious and could have been accepted by the *Scott* court with its somewhat misbegotten emphasis on the controlling nature of the corporation statute over corporate conduct.

[45]477 N.E.2d at 561.

[46]*See* Ind. Code § 23-1-10-4(a) (1982). *See generally* W. Cary & M. Eisenberg, Cases and Materials on Corporations 40 (5th ed. unabr. 1980); H. Henn & J. Alexander, *supra* note 7, § 184.

[47]*See generally* H. Henn & J. Alexander, *supra* note 7, § 360.

[48]*Scott*, 477 N.E.2d at 561-62.

of the IGCA section authorizing provisions in articles "creating, defining, limiting or restricting the powers . . ., of the shareholders of any *class* . . . of shareholders."[49] The court apparently rejected the idea that there was more than one class of shares while at the same time recognizing the *Herald* interests and the *Bulletin* interests as separate "groups."[50] The court concluded the statement that there was "no division" of the shares in the printed articles of consolidation prescribed by the Indiana Secretary of State simply meant that there was only one class of shares so that no statement of voting rights was required because there was only one class. The court in effect treated the two groups as separate classes while denying that it was doing this because the arrangement was not sanctioned in the articles of consolidation.

There is nothing wrong with rejecting the *Bulletin* group's argument, and the court reached the right result. However, if the court had been willing to depart from its preternatural position that the "contract" to be construed was within the four corners of the articles of consolidation and simply gave effect to the obvious intent of the parties, as was done in *Cressy v. Shannon Continental Corp.*,[51] the same result could have been reached in a less circuitous way.

One of the most questionable aspects of the *Scott* decision was the court's determination that the suit was a derivative action warranting recovery of attorney's fees and expenses by the *Herald* group.[52] The *Bulletin* group argued unsuccessfully that the action was personal to the plaintiffs because it sought to protect and defend their rights as shareholders and did not seek relief benefiting the corporations. The court responded that "[i]t is only in exceptional cases that stockholders will be permitted to sue or defend a suit for and on behalf of themselves as stockholders of such corporation."[53] This statement is absolutely extraordinary in light of the court's own characterization of the *Bulletin* group as "illegally and oppressively pursuing a course of action in the name of the corporation calculated to destroy the Herald group's"[54] interests. There is no simple and foolproof method for distinguishing a derivative action from a shareholder's direct or individual action.[55] Gen-

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[49]*Id.* at 562 (emphasis in original) (quoting IND. CODE § 23-1-3-2(12) (1982)).

[50]*Id.* A better way of handling this issue when ANI was organized would have been to create two classes of shares: a *Herald* class and a *Bulletin* class. This is a very effective way to insure that each constituent group in a corporation will have its interests protected. *See* Lehrman v. Cohen, 43 Del. Ch. 222, 222 A.2d 800 (1966).

[51]177 Ind. App. 224, 378 N.E.2d 941 (1978), *discussed in* Galanti, *Business Associations, 1979 Survey of Recent Developments in Indiana Law*, 13 IND. L. REV. 133, 150-55 (1980).

[52]477 N.E.2d at 562-64.

[53]*Id.* at 563.

[54]*Id.*

[55]H. HENN & J. ALEXANDER, *supra* note 7, § 360.

erally speaking, however, "the breach of the shareholder's membership contract give[s] rise to a *direct or individual* action while a wrong to the incorporated group as a whole (i.e. breach of some duty to the corporation) is the basis for derivative action."[56] The derivative action is appropriate to recover damages or profits where a controlling interest is harming the corporation,[57] but whatever harm the *Bulletin* group was causing was to the *Herald* group and not to ANI. Furthermore, derivative actions are constrained by the provisions of trial rule 23.1.[58] There was no evidence that plaintiffs complied with these requirements, or at least none was mentioned by the court.

Furthermore, the court in discussing the ultra vires issue recognized that the action may be brought in a proceeding "against the corporation."[59] The derivative action, of course, is an action on behalf of the corporation. The court in fact stated that suits for and on behalf of shareholders as shareholders are permitted "where a majority of the stockholders are illegally and oppressively pursuing a course in the name of the corporation, which is in violation of the right of the other stockholders, and can only be restrained by a court of equity."[60] It is clear that if the *Scott* litigation can be characterized as anything, it can be characterized as an attempt by the *Bulletin* group to oppress the *Herald* group. Despite reaching this conclusion, the court determined that the action was derivative. The position taken in *Scott* is supported by neither Indiana nor general authority.

It is possible the court characterized the action as a derivative suit to uphold the order that ANI pay the *Herald* group's costs and attorneys' fees.[61] It is well settled that attorneys' fees and expenses can be awarded to a successful plaintiff in a shareholder derivative suit under Indiana law.[62] This approach is the converse of the not uncommon situation of a court straining to characterize an action as direct rather than derivative

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[56]*Id.* (emphasis added). Henn and Alexander have noted that among other things, the following have been held to be direct actions by shareholders: (1) suits to protect preemptive rights (presumably referring to the traditional preemptive right to subscribe to shares of the corporation, rather than as the term is used in *Scott*); (2) suits to enforce the right to vote; (3) suits to enjoin an ultra vires act or other threatened wrong before its consummation; (4) suits for breach of a shareholder agreement. *Id.*

[57]*Id.*

[58]Ind. R. Tr. P. 23.1.

[59]*Scott*, 477 N.E.2d at 561 n.2.

[60]*Id.* at 563 (citing McFarland v. Pierce, 151 Ind. 546, 45 N.E. 706 (1897), *reh'g overruled*, 151 Ind. 549, 47 N.E. 1 (1897)).

[61]*Id.* at 564. The fees and expenses awarded totaled $122,818.82. *Id.*

[62]*See* Neese v. Richer, 428 N.E.2d 36 (Ind. Ct. App. 1981), *discussed in* Galanti, *Business Associations, 1982 Survey of Recent Developments in Indiana Law*, 16 Ind. L. Rev. 25, 25-29 (1983); *see also* Cole Real Estate Corp. v. Peoples Bank & Trust Co., 160 Ind. App. 88, 310 N.E.2d 275 (1974).

where an unsuccessful shareholder in a derivative action can be liable for the expenses of the corporation under a security for expenses statute.[63] Still, a well intentioned motive of making a corporation bear the expenses of litigation does not justify characterizing a direct shareholder action as a derivative action.

The court next rejected the *Bulletin* group's argument that ANI should recover the salary paid plaintiff Scott for his services as interim editor of the *Herald* until he was removed from that position by court order.[64] The court concluded that the trial court was justified in rejecting the argument that Scott was an "officious intermeddler" and in concluding that there was an implied contract between ANI and Scott because someone had to be the editor of the *Herald*.[65]

The final issue considered in *Scott* was whether the *Herald* group's directors had the right to name the ANI vice president.[66] The ANI vice president apparently had come from the *Herald* group from the time ANI was organized in 1949 to the death of Scott's father in 1981. The *Herald* group argued that this history impliedly amended the articles of consolidation and the bylaws to provide in effect that the ANI vice president would come from the *Herald* group. The court rejected this argument and noted that the *Herald* group cited "no Indiana cases supporting that contention, only cases from foreign jurisidictions so stating."[67] This too is an extraordinary statement. It is well established that relationships, even if reflected in corporate documents, can be impliedly amended by the conduct of the parties if the interests of third parties are not harmed.[68] The fact that no Indiana case had so held simply means that the issue had not previously arisen in Indiana. Interestingly the court did not cite any Indiana cases holding that this cannot be done.

The court noted that the *Herald* group made no attempt to show the corporation laws of the states from which the cases arose were

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[63]*See, e.g.,* Reifsnyder v. Pittsburgh Outdoor Advertising Co., 405 Pa. 142, 173 A.2d 319 (1961). *See generally* H. Henn & J. Alexander, *supra* note 7, § 372.

[64]*Scott*, 477 N.E.2d at 564-65.

[65]*Id.* The court also declined to order Scott to reimburse the corporation for telephone calls charged to and paid by ANI. The argument that the calls were personal was rejected because the calls were related to the litigation. Although the court's determination that the cost of the litigation should be assessed against ANI might be questionable, it certainly follows that these expenses were properly considered costs of the litigation. If Scott had been ordered to repay the corporation, he could then petition the court to order the corporation to reimburse him in the same amount. *Id.* at 565.

[66]*Id.* at 565.

[67]*Id.*

[68]*See, e.g.*, Magnus v. Magnus Organ Corp., 71 N.J. Super. 363, 177 A.2d 55 (1962). *Compare* Galler v. Galler, 32 Ill. 2d 16, 203 N.E.2d 577 (1964) *with* Somers v. AAA Temporary Serv., Inc., 5 Ill. App. 3d 931, 284 N.E.2d 462 (1972).

substantially the same as Indiana corporation law.[69] Although the plaintiffs might have been well advised to have checked those statutes, citing such authority should not have been necessary because this is a general principle of corporate law, which exists apart from statutes. The *Scott* court also ignored the fact that Indiana courts have recognized the estoppel doctrine. In *Bossert v. Geis*,[70] the court held that a corporation was estopped by long continued conduct of its president, with its implied knowledge and consent, from denying his authority to execute contracts and borrow money, though not expressly authorized by articles, bylaws, or the directors. This rationale should have applied in *Scott*, or at least it should have been considered by the court.

As it is, the court concluded that because ANI's charter, meaning the articles of consolidation, did not spell out "a preemptive right" for the *Herald* group to name the vice president, "it does not exist. ANI officers may be nominated by any director, come from any group, and be elected by simple majority vote of the ANI directors."[71] In other words, the *Herald* group could name the newspaper's editors but they were forever a minority block on the board with very little influence on the day to day operations of ANI as a corporation. This result is both unfortunate and unnecessary. It is fairly certain the parties who formed ANI contemplated that the vice president would come from the *Herald* group, and it is also clear that the most effective way of insuring that each group would have rights with respect to its own paper was to have one of the ANI officer positions filled by the *Herald* group.

All in all, the opinion in *Scott v. Anderson Newspapers, Inc.* strikes this author as unfortunate. This is not so much for the result, because the *Bulletin* group certainly was interfering with the intended structure of ANI. Rather, it is because of the court's unnecessary and improper use of the term "preemptive rights," and its insistence on staying within the four corners of the articles of consolidation notwithstanding other decisions of the Indiana Court of Appeals that have recognized the highly fiduciary nature of the relationships among owners of closely held corporations.[72] Hopefully, if a similar dispute occurs before another district, the analysis of *Scott* will not be followed, and the fourth district will reconsider the views expressed in *Scott* if another opportunity arises.[73]

III. Corporate Control

The attempt by Dynamics Corporation of America (DCA) to obtain control of CTS Corporation has become a prolific source of legal issues

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[69]*Scott*, 477 N.E.2d at 565.

[70]57 Ind. App. 384, 107 N.E. 95 (1914).

[71]*Scott*, 477 N.E.2d at 565.

[72]*See* cases cited *supra* note 34.

[73]The battle between the ANI factions continues. Most recently there appears to be

and judicial decisions. The battle took place in both state and federal courts. DCA failed in its effort to oust the incumbent CTS management, but the biggest loser as of this writing is the new Indiana Business Corporation Law (IBCL) or, more specifically, the control share acquisition chapter of the IBCL.[74]

All told there have been five opinions in the control battle: one in state court,[75] three in the United States District Court for the Northern District of Illinois,[76] and one in the Seventh Circuit Court of Appeals.[77] There will be at least one more because the United States Supreme Court will hear an appeal from the Seventh Circuit decision.[78] The Indiana action involved the issue of DCA's right as a substantial shareholder to obtain corporate information from CTS. The federal litigation involved DCA's challenge to the defensive moves by CTS's management.

Anyone who opposes attempts to acquire or obtain control of Indiana corporations will be pleased by the result in *DCA I*, which for all intents and purposes blocks offerors or insurgents from access to corporate books and records under the record keeping provisions of the Indiana General Corporation Act (IGCA).[79] Theoretically they can still gain access to the records as shareholders if they can persuade a local court that they have a "proper purpose" for seeking disclosure of corporate information, and *DCA I* does not on its face impose on the shareholder the burden of establishing proper purpose.[80] However, by taking an extraordinarily narrow view of what is a proper purpose, the result of *DCA I* is tantamount to putting the burden on the shareholder.

In *DCA I*,[81] the Indiana Court of Appeals affirmed an order of the Elkhart Circuit Court denying relief to DCA in its mandamus action to compel CTS to disclose corporate information.[82] The court stated that the trial court could infer that this information was not sought for

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some question as to who owns ANI. It was reported that the two newspapers may have been sold to a newspaper chain, but this was denied by the president of ANI. Indianapolis Star, Oct. 31, 1986, at 35, col. 2.

[74]IND. CODE §§ 23-1-42-1 to -11 (Supp. 1986).

[75]Dynamics Corp. of America v. CTS Corp., 479 N.E.2d 1352 (Ind. Ct. App. 1985) [*DCA I*].

[76]Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 406 (N.D. Ill. 1986) [*DCA II*]; Dynamics Corp. of America v. CTS Corp., 635 F. Supp. 1174 (N.D. Ill. 1986) [*DCA III*]; Dynamics Corp. of America v. CTS Corp., Fed. Sec. L. Rep. (CCH) ¶ 92,765 (N.D. Ill. May 3, 1986) [*DCA IV*].

[77]Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir.), *prob. juris. noted*, 107 S. Ct. 258 (1986) [*DCA V*].

[78]107 S. Ct. 258 (Oct. 6, 1986) (noting probable jurisdiction for appeal).

[79]IND. CODE § 23-1-2-14 (1982).

[80]*DCA I*, 479 N.E.2d at 1353. In fact it seems to take the position that the burden is on management to prove a lack of a proper purpose. *Id.* n.2.

[81]479 N.E.2d 1352 (Ind. Ct. App. 1985).

[82]*Id.* at 1353.

a proper purpose but rather to assist DCA in its non-derivative battle against incumbent management for control of CTS.[83] This does not mean, however, that steps taken to oust incumbent management were adverse to the best interests of the corporation.

The particular litigation was instituted in 1981 after DCA had demanded to inspect numerous CTS records. It appears that some of the requested information had been furnished to DCA as a result of discovery in pending litigation or had been furnished to all CTS shareholders. Apparently DCA filed the mandamus action before CTS had formally responded to its request, but it is certainly disingenuous to think that considering the hostility between DCA and CTS management, CTS would have produced the requested records without a court order.[84]

DCA I treated the burden of proof issue in suits to enforce a shareholder's inspection rights in a summary fashion. Apparently the trial court had made a preliminary ruling that the IGCA required DCA to state its purposes in seeking to inspect CTS's books and records before it could sue, and that it had the burden of proving that those purposes were proper.[85] The court of appeals indicated that it was "inclined" to the view that Indiana authority as reflected in *Charles Hegewald Co. v. State*[86] supported the position of the trial court, but that any error was "harmless" because the court's findings clearly imposed the burden on CTS.[87] It certainly is possible that the trial court did impose the burden on CTS and that its preliminary rulings were just that, but it does appear that the *DCA I* court gave *Hegewald* an unduly narrow reading. *Hegewald* requires the purpose of the examination to be germane to the shareholder's interest as a shareholder, but the Indiana Supreme Court was not clearly departing from the position taken by other courts that impose the burden of establishing a *lack* of proper purpose on the corporation.[88] Furthermore, nothing in *Hegewald* actually requires a shareholder to state his purposes in seeking inspection before filing a mandamus action,[89] and the IGCA is silent on this point.[90]

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[83] *Id.* at 1355.

[84] *See id.* at 1354-55. The fact that the shareholder already has available the information being sought might be grounds for denying inspection under common law for lack of good faith. *See* People *ex rel.* Giles v. Klauder-Weldon Dyeing Mach. Co., 180 A.D. 149, 167 N.Y.S. 429 (1917). *See generally* H. Henn & J. Alexander, *supra* note 7, § 199.

[85] *DCA I*, 479 N.E.2d at 1353 n.2.

[86] 196 Ind. 600, 149 N.E. 170 (1925).

[87] 479 N.E.2d at 1353 n.2.

[88] *Hegewald*, 196 Ind. at 605-06, 149 N.E. at 173. *See generally* H. Henn & J. Alexander, *supra* note 7, § 199 n.2.

[89] Failure to state the purpose might, however, go against the good faith element of the shareholder's right to examine corporate books and records.

[90] Ind. Code § 23-1-2-14 (1982).

The inspection provisions of the IBCL[91] require the shareholder to disclose the purpose of the inspection before being given access to books and records. This is true even under the comparable provisions of the Revised Model Business Corporation Act,[92] which takes a more liberal view in balancing the right of shareholders to inspect corporate records and the interest of management in freedom from harassment by shareholders.

DCA sought to inspect records and minutes of the 1981 CTS annual meeting of shareholders, books of account reflecting expenditures for research and development since 1978, books of account reflecting all legal fees paid or incurred in connection with the litigation between CTS and DCA, all fees paid or owed to an investment banking firm since 1980, and the minutes of all regular and special meetings of the board of directors of CTS since August 1980.[93]

The *DCA I* court also relied on *S.F. Bowser & Co. v. State.*[94] *Bowser* held that mandamus would not lie unless and until the corporation knew or was given reasonable assurance that the party making a request was really a shareholder. It is difficult to see how *Bowser* supported CTS's position. CTS clearly knew DCA was a shareholder because management and DCA had been battling for several years. The court also cited the Illinois decision in *People ex rel. Miles v. Bowen Industries, Inc.*[95] This too seems of questionable import because *Miles* also involved the issue of whether the requesting party was a shareholder and entitled to inspect the corporate records under the applicable provisions of the Illinois Business Corporation Act.[96]

The *DCA I* court was correct in noting that both statutory and common law require a shareholder to have a proper purpose to be entitled to inspect corporate books and records.[97] The problem with the decision is that the court seemingly required that every purpose of the shareholder be "proper." Sounder authority recognizes that a shareholder is not entitled to corporate information for purely personal or commercial reasons, but permits inspection where there is a proper purpose even

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[91]Ind. Code § 23-1-52-2(c)(2) (Supp. 1986).

[92]4 Model Bus. Corp. Act Ann. § 16.02 (3d ed. 1985). The balance of the RMBCA is aimed at protecting management from harassment by shareholders with small holdings, which was not the case with DCA, the largest shareholder of CTS.

[93]*DCA I*, 479 N.E.2d at 1353. The court of appeals cryptically noted that "[w]e do not suggest that all this information was discoverable under the Statute. The trial court determined that some was not." *Id.* n.3. It appears that the court applied some of the restrictions imposed by discovery rules to a shareholder's right to inspect corporate records, although there does not appear to be a basis for this.

[94]192 Ind. 462, 137 N.E. 57 (1922).

[95]327 Ill. App. 362, 64 N.E.2d 213 (1945).

[96]Ill. Rev. Stat., ch. 32, para. 157.45 (1945).

[97]*DCA I*, 479 N.E.2d at 1354.

though there might be some ulterior motive.[98] Thus, even if DCA's purpose in wanting the information to aid "its non-derivative litigation and competitive goals against CTS" was improper (and this is not clearly the case), DCA had indicated the possibility of a suit against CTS management for waste of corporate assets in continuing counterclaims against DCA.[99] Utilizing corporate records as the basis of possible litigation against management has long been held to be a proper purpose.[100] Even if the propriety of the possible litigation was a "close call," CTS should have lost if the burden of proof was in fact on it rather than on DCA.

Furthermore, even cases that narrowly construe the right of shareholders to inspect corporate records such as *State ex rel. Pillsbury v. Honeywell, Inc.*[101] emphasize that the shareholder's purpose must be related to his investment. Clearly DCA, which had been acquiring CTS shares since 1980, was concerned with its "investment." Consequently it seems that DCA's purpose was proper, and it is dubious to say that the trial court's finding was supported by the evidence.

The *DCA I* court also upheld the determination that DCA lacked a proper purpose in demanding disclosure of research and development expenditures of CTS.[102] The decision on this point appears to hinge upon a statement by DCA's president following the 1981 CTS shareholder meeting praising "the manner in which CTS had answered the questions [about the reclassification of CTS's research and development expenses] at the meeting."[103] The court stated that DCA had given no explanation to CTS for "withdrawing its expressed approval of Mr. Hostetler's response at the annual meeting."[104] The court also noted that information on CTS's research and development was contained in "work papers" prepared by CTS accountants and not in a separate account and that

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[98]*See, e.g.*, State *ex rel.* Theile v. Cities Serv. Co., 31 Del. 514, 115 A. 773 (1922) (purpose to sell list improper); General Time Corp. v. Talley Indus., Inc., 43 Del. Ch. 531, 240 A.2d 755 (1968) (desire to solicit proxies in opposition to management directly related to shareholder status and any secondary purpose irrelevant); Hannahan v. Puget Sound P. & L. Co., 332 Mass. 586, 126 N.E.2d 499 (1955) (possible use of shareholder list for commercial purposes by securities dealer no bar to inspection). *See generally* H. Henn & J. Alexander, *supra* note 7, § 199.

DCA clearly was attempting to oust CTS management which cannot, objectively speaking, be deemed improper harassment of management justifying denial of inspection rights. *See* Sawers v. American Phenolic Corp., 404 Ill. 440, 89 N.E.2d 374 (1949). CTS management obviously would disagree, but they cannot be considered "objective" on this issue.

[99]*DCA I*, 479 N.E.2d at 1354.

[100]*See, e.g.*, Rochester v. Indiana County Gas Co., 246 Pa. 571, 92 A. 717 (1914).

[101]291 Minn. 322, 191 N.W.2d 406 (1971).

[102]*DCA I*, 479 N.E.2d at 1355.

[103]*Id.*

[104]*Id.*

the information was considered confidential by CTS.[105] The use of the term "work papers" suggests that the court applied evidentiary rules and doctrines to shareholder rights to information. If DCA in fact misused any information that contained trade secrets, trade regulation law would amply protect the interests of CTS. The main point seemed to be DCA's "change of heart" on management's responses. It is an extraordinarily thin reed to support a conclusion that seeking information on expenditures for research and development is not a proper purpose simply because the shareholder or, in this case, the president of a corporate shareholder, praised a response to a question at a shareholder meeting. Certainly this cannot seriously be considered an appropriate application of the estoppel concept.

It is within the purview of a shareholder's interest to determine how the funds of the corporation are expended and whether those expenditures will produce the most appropriate return to investors.[106] CTS management of course believed that its decisions as to the appropriate directions for CTS research and development were correct, but this view does not preclude a shareholder from disagreeing and attempting to show that the management's efforts were ill advised.

If CTS were threatened by DCA hiring away its employees, it could protect itself by employment contracts containing covenants not to compete. Furthermore, if employment contracts were not terminable at will, CTS could have an action for inducing a breach of contract.[107] Even in the absence of contractual obligation, the fiduciary duty owed by an agent to a principal can act as a bar against improper conduct by a former employee.[108]

The last item of information DCA sought related to the retention of an investment banker and the minutes of board meetings where legal advice received by CTS regarding litigation with DCA and tentative CTS business plans were discussed. The court merely listed these items and concluded that "there was a reasonable inference available to the trial court that DCA was not seeking the requested information for a 'proper purpose' but sought it instead to assist DCA in its non-derivative litigation and competitive goals against CTS."[109] Although this may be so, there was no analysis of why this information had no impact on the investment interests of corporate shareholders. The bald conclusion that DCA did

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[105]*Id.*

[106]H. Henn & J. Alexander, *supra* note 7, § 199.

[107]*See generally* Harper, *Interference with Contractual Relations*, 47 Nw. U.L. Rev. 873 (1953).

[108]*See, e.g.*, Duane Jones Co. v. Burke, 281 A.D. 662, 121 N.Y.S.2d 107 (1953), *aff'd as modified*, 306 N.Y. 172, 117 N.E.2d 237 (1954).

[109]*DCA I*, 479 N.E.2d at 1355.

not have a proper purpose is appropriate only if the burden of proving a proper purpose is on the shareholder. The lack of analysis of this issue raises the possibility that both the trial court and the court of appeals *were* putting the proper purpose burden on DCA.

The court cited numerous cases for the proposition that courts reviewing inspection statutes have adopted the general rule that the primary purpose of the inspection must not be adverse to the best interest of the corporation.[110] This is, of course, a truism, but interestingly in one case cited by the court, inspection was granted.[111]

It seems that under a decision such as *DCA I*, a "proper purpose" to entitle a shareholder to inspect corporate records is not so much in the eye of the beholder as it is in the eye of management. Certainly management of corporations that are or are perceived to be likely takeover targets will find much comfort in *DCA I*, particularly because the inspection rights of shareholders under the IGCA are broader than under the IBCL. Under the new law, a "proper purpose" is statutorily mandated and a shareholder must disclose that purpose and indicate that the request is directly connected with that purpose.[112] The requirement of disclosing the purpose and the nexus between the documents and the purpose could easily be satisfied by a shareholder in the position of DCA. However, with the narrow view of "proper purpose" in *DCA I*, which will still be good authority under the IBCL, the tender offeror or insurgent in a proxy contest will find a less than hospitable atmosphere in Indiana courts.

The offeror or insurgent might find the atmosphere in federal courts more hospitable, at least if the Supreme Court upholds Judge Posner's scholarly opinion in *DCA V*.[113] In *DCA V*, the Seventh Circuit affirmed the decision of the United States District Court for the Northern District of Illinois in *DCA II*[114] enjoining CTS's management from enforcing a "poison pill" plan adopted by CTS during a proxy contest between management and DCA. DCA sought injunctive relief under section 14(a) of the Securities Exchange Act of 1934,[115] alleging an unlawful proxy solicitation by CTS management.[116]

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[110] *Id.*

[111] C. M. & M. Group, Inc. v. Carroll, 453 A.2d 788 (Del. 1982).

[112] IND. CODE § 23-1-52-2(c)(2) (Supp. 1986).

[113] Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir.), *prob. juris. noted*, 107 S. Ct. 258 (1986).

[114] Dynamics Corp. of America v. CTS Corp., 637 F. Supp. 406 (N.D. Ill. 1986).

[115] 15 U.S.C. § 78n(a) (1982).

[116] *DCA II*, 637 F. Supp. at 407. The day DCA filed suit, it announced a tender offer for up to one million CTS shares at $43.00 per share and that it intended to wage a proxy contest to elect its own slate of directors to the CTS board. The offer increased DCA's holdings in CTS to 27.7% of the outstanding shares. *Id.*

DCA II involved DCA's motion for a preliminary injunction against the shareholder rights plan adopted by the CTS board shortly after DCA filed suit. The plan adopted by the CTS board gave CTS shareholders a distribution of one "right" per share. The rights had no value unless and until certain triggering events occurred. The first, known as a "flip-in," occurred when a person or group acquired fifteen percent or more of CTS's common shares. At such time, the rights became nonredeemable and entitled all CTS shareholders except the acquiror to purchase a unit of CTS securities consisting of a fractional share of common stock and debentures at a price equal to twenty-five percent of the pretrigger value of the securities. The purpose of the "flip-in" was to inflict an immediate economic loss on any hostile bidders who did not negotiate with management before making an unsolicited acquisition attempt.[117] Perhaps it would be more accurate to say that a flip-in plan or any other defensive poison pill is intended to make the target so unpalatable that there simply will not be any unsolicited acquisitions.

The CTS rights plan also contained a "flip-over" provision which was triggered if CTS were acquired in a merger or upon the sale of all or the majority of its assets. When the flip-over provision was triggered, CTS shareholders could purchase common shares of the acquiring company worth $150 for $75.

The flip-in provision was in controversy in *DCA II* because DCA's tender offer would have raised its holdings above the fifteen percent trigger threshold.[118] DCA raised numerous arguments against the CTS poison pill. It first argued that the plan established two classes of shares and discriminated among shareholders. DCA contended this was prohibited by Indiana law. It also argued that in adopting the plan in response to the DCA tender offer, CTS management breached its fiduciary duty to CTS and other shareholders.[119]

Judge Getzendanner rejected these arguments. Under both the IGCA and the IBCL, a corporation can issue "rights" that trade with shares,[120] including those owned by an acquiring corporation, even if the acquiring

[117]The rights belonging to the acquirer under the plan became null and void when the fifteen percent threshold was reached. *Id.*

[118]The court noted that according to CTS's calculations, the issuance of shares and debentures to other CTS shareholders would have imposed an economic loss of approximately $24 million on DCA. *Id.* at 408.

[119]*Id.*

[120]*See* Ind. Code § 23-1-2-7 (1982) (IGCA); *Id.* § 23-1-26-5 (Supp. 1986) (IBCL). The court stated that it had been "advised" that Indiana courts look to Delaware decisions in matters of corporate law. 637 F. Supp. at 408. This is somewhat of an overstatement.

Not surprisingly, CTS "opted in" to the IBCL on April 1, 1986, the earliest date at which corporations organized under the IGCA could opt in, although the plan was adopted before CTS was controlled by the IBCL.

corporation takes subsequent action that causes it to forfeit those rights. Shareholder approval would have been necessary if the plan had created a new class of shares, but the *DCA II* court appears correct in rejecting that contention. The plan was not a pure vote altering scheme[121] since economic consequences attached to the rights when they were triggered. This is not to say that the law is "right." Even *The Wall Street Journal* has editorialized that "[t]here is only one way to be sure that managers and shareholders are on the same side of a takeover question—shareholders should have to vote to approve defensive tactics."[122] Because DCA had not established a probability of success on its claim that the rights plan was not authorized under Indiana law, it was not entitled to a preliminary injunction.[123]

The court also rejected the argument that the rights plan discriminated against DCA and any other CTS shareholders who might acquire over fifteen percent of CTS's outstanding shares.[124] The court relied on *Unocal Corp. v. Mesa Petroleum Co.*,[125] where the Delaware Supreme Court upheld a Unocal exchange offer for its own shares that intentionally excluded shares owned by Mesa because Unocal was responding to a perceived threat presented by Mesa. *Unocal* and *Moran v. Household International, Inc.*[126] applied the business judgment rule to the adoption of defensive moves against hostile offerors and so basically supported the position of DCA. However, even assuming that *Unocal* and *Moran* did not tilt the playing field between target managers and raiders unduly in favor of the former, the *DCA II* court felt that the Delaware standards had not been met by CTS's management, which seemed more inclined to entrench itself than to protect the interest of CTS shareholders.[127] Even though the actions of a board are entitled to a presumption of validity where the majority of a board of directors is independent,[128] the court felt that DCA's independent directors had not displayed "rea-

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[121]*See* Unilever Acquisition Corp. v. Richardson-Vicks, Inc., 618 F. Supp. 407 (S.D.N.Y. 1985); Asarco, Inc. v. Court, 611 F. Supp. 468 (D.N.J. 1985).

[122]The Wall Street Journal, July 28, 1986, at 12, col. 1. The editorial commented favorably on Judge Posner's decision in *DCA V.* Of course, the editors somewhat smugly noted that the shareholders of Dow Jones & Company, which publishes the *Journal*, had approved a defensive scheme to protect management of that company. One might well wonder what the editorial stance would have been if someone had made a "play" for Dow Jones before any defensive moves could be adopted.

[123]*DCA II*, 637 F. Supp. at 409.

[124]*Id.*

[125]493 A.2d 946 (Del. 1985).

[126]500 A.2d 1346 (Del. 1985). *Moran* upheld a flip-over poison pill rights plan similar to the CTS flip-over plan. *See also* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

[127]*DCA II*, 637 F. Supp. at 411-18.

[128]*See Moran*, 500 A.2d at 1356.

sonable grounds" for believing that DCA in fact presented a danger to CTS's corporate policies. In fact, the court recognized a reasonable possibility that further evidence "might reveal some of the board's stated concerns to be sham."[129] Judge Getzendanner also noted that the testimony of CTS board members concerning the actual threat posed by DCA appeared to be in conflict.[130] This could indicate that their testimony was unreliable or that the CTS board simply had not discussed the matter thoroughly and that individual directors had different impressions of what was decided and resolved.[131] Even a gross negligence standard would not guarantee success to CTS directors, although the court felt at this junction that gross negligence had not been established because CTS did not adopt the poison pill until it had obtained legal and investment advice.[132]

CTS's plan failed because, as is likely when defensive moves follow a hostile tender offer, the conclusion that the plan was "appropriate" apparently meant that it was appropriate to defeat the DCA offer or that any response that eliminated the DCA threat was "reasonable" once the board had decided the DCA offer represented a threat.[133] The court distinguished the Delaware cases[134] cited by CTS because they were tailored to protect the interests of minority shareholders without specific regard to entrenching management. CTS also was hurt by evidence indicating that the rights plan would hamper DCA's proxy contest against incumbent management.[135] It would seem that as viewed by Judge Getzendanner, CTS was a little too "greedy" in adopting the rights plan which would deter not just repressive and hostile acquisitions, but all acquisitions, and thwart a bidding contest for CTS.

Judge Getzendanner made it clear that she was not invalidating all flip-in plans that inflict a penalty based on mere ownership, or even ownership levels as low as the fifteen percent triggering figure in the CTS plan. Rather, she was ruling that for purposes of a preliminary injunction, such a plan adopted in the heat of a proxy contest with no truly identifiable threat was unreasonable.[136]

CTS, however, did not give up its battle against DCA following *DCA II*. It subsequently adopted a shareholder rights plan as part of

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[129]*DCA II*, 637 F. Supp. at 417.

[130]*Id.*

[131]*Id.*

[132]*Id.*

[133]*Id.* at 417-18.

[134]Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

[135]*DCA II*, 637 F. Supp. at 418.

[136]*Id.* The court also concluded that DCA had established the other elements for injunctive relief. *Id.* at 418-19.

a white knight strategy for selling CTS. DCA challenged this strategy and the second rights plan as a breach of the directors' fiduciary duties in another action brought under section 14(a) of the Securities Exchange Act of 1934.[137] Judge Getzendanner denied the motion to enjoin the second rights plan in *DCA III*.[138]

In ruling for CTS in this proceeding, Judge Getzendanner started from the premise that Indiana law treats a board of directors adopting defensive mechanisms in response to a takeover threat as having a conflict of interest.[139] This conflict mandates close judicial scrutiny of directors' actions. In other words, the directors must show they acted in good faith and made a reasonable investigation in determining that a danger to corporate policy existed and that the chosen defensive mechanism was reasonable in relation to the threat. If the directors satisfy this burden, they are protected by the business judgment rule, and a shareholder challenging their actions must show the primary purpose of the defense was entrenchment rather than protection of the shareholders' interest.

Following Judge Getzendanner's order in *DCA II*, the CTS board realigned its defensive measures to DCA's actual rather than perceived threat.[140] In essence, the second CTS rights plan put CTS up for sale, thus maximizing the value to shareholders other than DCA through an orderly auction of the company.

The new shareholder rights plan gave CTS shareholders a right to exchange CTS shares for one year notes with a principal amount of $50.00 and a 10% interest rate. These notes became exercisable and traded separately from CTS common shares only if someone acquired a beneficial ownership of 28% or more of CTS common shares.[141] The rights were to be postponed if the plan were triggered by a publicly announced tender offer for all outstanding CTS shares for $50.00 or more.

The court in *DCA III* was faced with two issues: (1) were the press release and proxy statement announcing the proposed sale of CTS and the rights plan materially misleading; and (2) should the rights plan itself be enjoined.[142]

DCA was unsuccessful in *DCA III* because the probability of suc-

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[137]15 U.S.C. § 78n(a) (1982).

[138]Dynamics Corp. of America v. CTS Corp., 635 F. Supp. 1174 (N.D. Ill. 1986).

[139]*Id.* at 1176.

[140]The CTS board formed a special committee of outside directors which explored the possibility of settling with DCA, but these settlement possibilities were not productive. *Id.* at 1176-77.

[141]*Id.* at 1177. This figure was slightly above the percentage of CTS which would be owned by DCA after its tender offer.

[142]*Id.* The court in *DCA III* addressed only the second issue.

cessfully attacking the sale of CTS and the second rights plan as a breach of a fiduciary duty was decidedly lower than in *DCA II*. Also, the balance of hardships did not weigh sufficiently in DCA's favor to justify injunctive relief.[143]

Judge Getzendanner again reiterated her conclusion in *DCA II* that although CTS management had not made a reasonable investigation of DCA's partial tender offer in adopting the flip-in rights plan, such conduct did not rise to the level of gross negligence.[144] DCA contended that the second rights plan was but a single-minded, continued effort at stopping DCA's proxy contest, while CTS argued that the plan was an honest attempt to correct the inadequacies of the first plan. Judge Getzendanner was persuaded by CTS's argument because the record now reflected a greater thoroughness of discussion and informed decision making prior to the adoption of the second rights plan.[145]

DCA also argued that the decision to sell CTS was a breach of fiduciary duty because nothing had changed since CTS's unequivocal earlier view that it was an inopportune time to sell the company so as to warrant a different conclusion. In fact, DCA was hoist by its own petard in this respect because Judge Getzendanner was satisfied that DCA, which now owned just under the 28% trigger of the second rights plan, had changed the circumstances facing CTS, and that the directors had not changed their view as to the desirability of selling CTS but rather had concluded that a sale of CTS was "the lesser of two evils."[146] She also concluded that the "generalized" threat presented by DCA as a sizable minority shareholder to the sale of CTS to a third party was sufficient basis to keep the court from second guessing the advice given to CTS on the matter.[147]

The court was satisfied that the CTS board had met the reasonable investigation standard of *Moran*,[148] although Judge Getzendanner did not accept CTS's argument in its entirety. She recognized that there were alternatives to the plan adopted by CTS and that the plan actually adopted was not the most reasonable response.[149] However, the burden on the directors was not to show that the plan was *the* most reasonable response but only that it was *a* reasonable response to the threat presented by DCA.

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[143]*Id.* at 1177-78.

[144]*Id.* at 1178.

[145]*Id.*

[146]*Id.* DCA had not fully disclaimed the possibility that a future merger might be unfair to minority shareholders. Consequently the CTS board could conclude that a present sale of CTS would maximize shareholder values.

[147]*Id.* at 1179.

[148]Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

[149]*DCA III*, 635 F. Supp. at 1180.

DCA's argument that the plan was unreasonable in giving management a potent weapon against unfriendly tender offers was rejected because, as supported by dicta in *Revlon*,[150] the plan could have started orderly bidding for CTS. Also, the plan could not deter all hostile offers because the rights expired on a tender for $50 per share or more in cash. Whether DCA or anyone else thought that CTS was worth $50 per share is another matter.

Under *Revlon*, a board of directors has a duty to insure that shareholders receive maximum value once it has decided to sell a company, even as the lesser evil. The *DCA III* court felt that DCA had raised some colorable arguments against the CTS decision to sell, but concluded that the probability of success was insufficient to justify an injunction.[151]

The court also rejected DCA's argument that the rights plan was adopted primarily for entrenchment purposes. Certainly the plan would aid management in the proxy contest insofar as a white knight strategy could garner votes from shareholders interested in cashing out of CTS. However, because a successful auction would, or could, result in a loss of control by the current CTS board, the plan could not be deemed a mere ploy to be re-elected.[152] CTS had not adopted golden parachutes or other items that clearly promoted entrenchment, and even an unreasonable determination to stop DCA did not equal the goal of entrenchment. The second rights plan would not cause irreparable harm to DCA because it neither limited DCA to an equity position so low as to render successful proxy contests impossible, nor did it interfere with the ongoing tender offer as did the first rights plan.[153]

DCA evened the score with CTS in *DCA IV*.[154] *DCA IV* related to an issue not considered in *DCA III*: DCA's motion for preliminary and permanent injunctive relief with respect to the CTS press release announcing the decision to sell CTS and the adoption of the second rights plan. DCA alleged the press release contained material misrepresentations and omissions in violation of the Securities Exchange Act of 1934.[155] CTS contended that a new proxy solicitation to shareholders and accompanying letter mooted the disclosure issues raised by DCA.[156]

Clearly the new rights plan and the proposed sale of CTS were intended to affect the proxy contest and to attract potential white knights.

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[150]Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985).

[151]*DCA III*, 635 F. Supp. at 1180.

[152]*Id.* at 1181.

[153]*Id.* at 1182.

[154]Dynamics Corp. of America v. CTS Corp., Fed. Sec. L. Rep. (CCH) ¶ 92,765 (N.D. Ill. May 3, 1986).

[155]15 U.S.C. § 78n(a) (1982).

[156]*DCA IV*, Fed. Sec. L. Rep. at 93,747.

The key to the success of the CTS ploy was the price that CTS could attract. If management could sell at a high price, it would secure votes, but if the price were low, shareholders would probably prefer DCA.

The problem with the press release was obvious on its face: it "signaled" that CTS could be sold for $50 a share, which was substantially higher than DCA's then existing tender offer price with no other buyers making a play for CTS. The court clearly was correct in considering the release and mandating corrective material. The letter accompanying the proxy statement did clarify the issue somewhat by noting that the $50 value, which was the principal amount of the notes to be issued under the rights plan, was the asking price for the company and not a prediction.

There was some testimony that $50 a share was a realizable price for CTS, but this figure was substantially discounted by Judge Getzendanner because it was based on management's untested expectations and seemed contrary to CTS's actual performance.[157] Consequently, even the supposed corrective statement in the letter accompanying the proxy statement was misleading because it did not disclose the basis of the opinion by CTS's investment banker or other information about the projections to permit shareholders to understand the limitations on the projected realizable value of CTS.[158] Also the letter indicating that CTS was for sale did not make clear management's view that it did not believe it was an opportune time to sell CTS and that the plan was based both upon management's fear that DCA would win the proxy contest unless a white knight strategy were adopted and upon a general but unspecified mistrust of DCA.[159]

The final defect in CTS's disclosure related to its ability to issue the notes called for in the second rights plan if there were a triggering event. The court concluded that the letter failed to explain that to the extent CTS was unable to issue notes, shareholders would remain shareholders of a company that might have incurred substantial debt.[160] Judge Getzendanner felt that the disclosure could have been more specific and, more importantly, that management had not adequately disclosed what

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[157] *Id.* at 93,748.

[158] *Id.* There was no disclosure that the investment advisor estimated the long-term value of CTS was $75 per share realizable in two and a half years. This omission was deemed misleading because shareholders were in effect voting to sell CTS within twelve months at a maximum price of $50 per share, and probably less, without being told that CTS had received an estimated value of $75 per share if the company waited until 1988. Fed. Sec. L. Rep. at 93,749. This conclusion is somewhat ironic: management which did not want to sell erred by not disclosing information that would tend to dissuade shareholders from selling.

[159] *Id.* at 93,749.

[160] *Id.*

is perhaps the most important factor—management's belief that the rights plan would be so successful in deterring DCA or any other potential offeror from risking a triggering event that it was highly unlikely the $50 notes ever would be issued. At the same time, management was signaling that a $50 price could be realized within a year. It is irrelevant whether incumbent management or DCA could do the most for CTS shareholders, but it cannot be doubted that management had led the shareholders to, if not down, the "garden path" with a misleading proxy statement. Because of the substantial impact the press release had on the market for CTS shares, the only possible decision Judge Getzendanner could make was to enjoin CTS from voting proxies it had received subsequent to the issuance of the press release and to prevent contact with shareholders until corrective material had been sent.[161]

The most significant decision in the DCA-CTS battle to date is Judge Posner's opinion in *DCA V*[162] affirming *DCA II* on the ground that the control share acquisition provisions of the Indiana Business Corporation Law[163] violate the supremacy and commerce clauses of the United State Constitution. Of course, even though Judge Posner's opinion can be characterized as a scholarly tour de force,[164] the decision by the Supreme Court either for or against the statute will be far more significant because of its impact on takeover law and tactics in general.

The first issue considered by the court was whether a preliminary injunction was appropriate. Judge Posner concluded that the irreparable harm to DCA if the injunction were denied and the irreparable harm to CTS if the injunction were granted basically offset each other. Thus the propriety of the injunction depended upon which side was likely to prevail at the trial.[165] The court concluded that this was DCA.

The first substantive issue considered by the court was whether the CTS poison pill violated management's fiduciary obligations to shareholders. This question was governed by Indiana law.[166] The function of

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[161]*Id.* at 93,749-50.

[162]Dynamics Corp. of America v. CTS Corp., 794 F.2d 250 (7th Cir.), *prob. juris. noted*, 107 S. Ct. 258 (1986). The appeal to the Seventh Circuit was expedited. *Id.* at 252.

[163]IND. CODE § 23-1-42-1 to -11 (Supp. 1986). CTS had "opted into" the IBCL after April 1, 1986, as permitted by *id.* § 23-1-17-3(b).

[164]The opinion received favorable comment from the editors of The Wall Street Journal. The Wall Street Journal, July 28, 1986, at 12, col. 1.

[165]*DCA V*, 794 F.2d at 252.

[166]*Id.* at 253. The court stated that "Indiana takes its cues in matters of corporation law from the Delaware courts, which are more experienced in such matters since such a large fraction of major corporations is incorporated in Delaware and such a small fraction in Indiana." *Id.* This statement is not completely accurate. For example, in Gabhart v. Gabhart, 267 Ind. 370, 370 N.E.2d 345 (1977), the Indiana Supreme Court specifically declined to follow the Delaware decision in Singer v. Magnavox Co., 380 A.2d 969 (Del.

the court was to predict how Indiana courts would evaluate the CTS poison pill in the context of the perennial debate over hostile takeovers: are they detrimental because they cause managers of potential targets to worry too much about short term financial results and promote absentee ownership or control, or are they unequivocally beneficial to shareholders because someone is offering a premium above the market price of the shares which is determined by all available public information about a company. Under the latter view, management as fiduciaries should embrace rather than oppose a takeover.[167]

Judge Posner felt that Indiana courts would reject these polar views and would permit some defensive moves by target company management if they are not "insuperable barriers to hostile takeovers."[168] In fact, as the court pointed out, some defensive moves are required by federal law, such as the twenty day cooling off period between the announcement and the consummation of a tender offer.[169] Prohibiting short duration tender offers may discourage some offers because the offeror may have to compete with other offerors. The waiting period permits careful analysis of the offer and also permits other offerors to start an auction for the target. The court was even willing to recognize that "golden parachutes," where generous severance payments are triggered when managers lose their jobs because of a takeover, may benefit the shareholders if they reduce management's resistence to takeovers making a takeover more costly. Even a triggered "poison pill," if not lethal, could benefit shareholders. However, a poison pill could reduce the number of tender offers, or even the price, by making a tender offer less certain of success and more costly, thus harming all shareholders.[170]

1977), on the issue of protecting minority shareholders in squeeze out mergers. 267 Ind. at 388, 370 N.E.2d at 356. Of course, with the demise of *Singer* in Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983), it can be said that the Indiana Supreme Court guessed right. However, *Gabhart* still shows that Indiana courts will not slavishly follow Delaware law.

[167] *Compare, e.g.*, Scherer, *Takeovers: Present and Future Dangers*, BROOKINGS REV., Winter-Spring 1986, at 15 *with, e.g.*, Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981). *Cf.* SEC Office of Chief Economist, *A Study in the Economics of Poison Pills*, [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,971 (March 5, 1986).

[168] *DCA V*, 794 F.2d at 253-54.

[169] SEC Rule 14e-1(a), 17 C.F.R. § 240.14e-1(a) (1986).

[170] *DCA V*, 794 F.2d at 254-55. Of course, the ideal solution for an offeror is to trigger a poison pill that bars anyone else from bidding for the target and then have the pill invalidated in court. This is what occurred in the recent takeover of N.L. Industries, Inc. *See* Zukosky, *N.L.'s Raider Gets His Prize—Minus a Few Marbles*, BUSINESS WEEK, August 25, 1986, at 37.

Considering Judge Posner's well known inclination for economic analysis, his reference to empirical studies on the results of tender offers is not surprising. In particular, he noted a finding that targets that resist offers but are later acquired do better in maximizing shareholder wealth, at least in the short run, than targets that do not resist.[171] Of course if defensive tactics reduce the number of tender offers, shareholders may lose in the long run. Shareholders of a target that successfully resists an offer are unequivocally worse off.[172] Thus, some resistance by management might be optimal and consistent with its duty of loyalty to the shareholders.[173] Of course striking the optimal level will be difficult because management with its vested self interests determines whether or not to resist an offer.

Judge Posner acknowledged skepticism about arguments for defensive measures because they give too little weight to the effect of "defensive" measures in rendering shareholders defenseless against management.[174] He was particularly skeptical about poison pills because they tend to be more a reflex device of a management determined to hold onto power at all costs than a considered measure for maximizing shareholder wealth. He contrasted poison pills with fair price amendments which require offerors to pay the same price to nontendering shareholders in subsequent mergers or cash outs. This device discourages shareholders from stampeding to tender their shares.

Although expressing doubts about poison pills, the court acknowledged that it was understandable why state courts would hesitate to condemn all defensive measures as breaches of fiduciary duties on the basis of the present incomplete evidence as to the actual effect of these measures.[175] Consequently Judge Posner assumed that Indiana would follow Delaware law and would recognize defensive measures, including poison pills, as within the power of the target's board of directors.[176] However, there must be some nexus with the goal of maximizing return to the shareholder, and the directors must show that they had reasonable grounds for believing that the offeror presented a threat to corporate

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[171]*See* Jarrell, *The Wealth Effects of Litigation by Targets: Do Interests Diverge in a Merge?*, 28 J. LAW & ECON. 151 (1985).

[172]*DCA V*, 794 F.2d at 255.

[173]*Id.*

[174]*Id.*

[175]*Id.* at 255-56. Of course, it is possible that state courts would be less inclined to rely on economic analysis than Judge Posner, who always has advocated such an analysis both as a scholar and as a jurist.

[176]*See, e.g.*, Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986).

policy and effectiveness in adopting defensive measures. Admittedly, this burden is easily satisfied by a showing of good faith and reasonable investigation.[177] CTS had argued that the "business judgment rule" insulated its decision to adopt the poison pill from judicial scrutiny. Although the Delaware court has done some backing and filling with respect to the boundaries of the business judgment rule, there is no question that it has departed from the preternatural deference it once gave to directors reacting to any perceived threat to their continued control of a corporation.[178]

Judge Posner, not surprisingly, justified the business judgment rule in "market" terms, recognizing the penalty that competition in the market for corporate control can impose on a management that makes business mistakes, as well as recognizing the traditional justification that people running a business know more about the business than do judges.[179] However, when management interferes with the market for corporate control, the courts are less deferential because of the conflict between the interests of a management seeking to secure its position and shareholders seeking to maximize their wealth.[180]

After making these "general reflections" on the role of the courts in reviewing defensive maneuvers, Judge Posner analyzed the CTS poison pill. Not surprisingly, he felt that CTS's act was not done in a disinterested fashion and that the board had not evaluated in a cool, dispassionate, and thorough manner DCA's tender offer for shares intended as part of its proxy contest strategy. CTS's failure, in the court's eyes, was the decision by CTS inside directors to block the DCA tender offer before considering its ramifications for shareholder welfare.[181] For example, the presentation of the poison pill plan by CTS's investment advisor implied that the DCA tender offer was "unfair," although the board had not even considered the fairness of the DCA offer price. Apparently the "market" did analyze the DCA offer because the price of CTS shares rose from below $36 to above $40 when the offer was announced, only to drop when the poison pill was announced and rise again when Judge Getzendanner invalidated the poison pill.[182] Of course it is doubtful that any poison pill adopted during the heat of battle, rather than beforehand, could ever be characterized as a dispassionate act.

CTS made a rather *ad hominem* argument that it did not need to

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[177]*Id.*; *see also* Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

[178]*See, e.g.*, Cheff v. Mathes, 41 Del. Ch. 494, 199 A.2d 548 (1964).

[179]*DCA V*, 794 F.2d at 256.

[180]*Id.*

[181]*Id.* at 257. Judge Posner drolly quoted from the Queen of Hearts in ALICE IN WONDERLAND: "Judgment first, trial later." *Id.*

[182]*Id.*

investigate the DCA offer to know that it was bad because of the antagonism between DCA and CTS management. Apparently CTS management thought it was focusing on the long term while DCA was going for the quick buck. However, this attitude could be discounted considering the souring of some CTS investments that had been opposed by DCA. Furthermore, in a comment that should be noted by all those in the position of CTS management, Judge Posner stated that "[t]he friction between the companies required, if anything, more than the usual amount of care by CTS's board of directors in evaluating the proposal, to make sure that personal feelings would not be allowed to interfere with the board's fiduciary obligations."[183]

Judge Posner was not particularly impressed with the poison pill as a plausible measure for maximizing shareholder wealth. He conceded that it was not certain that CTS shareholders, other than DCA, would be worse off if the pill were triggered. It was, however, at least overkill and too high a price to pay for preventing a shift in control from incumbent CTS management to DCA. Even if the tender offer succeeded, DCA could not squeeze out remaining shareholders because it would not own a majority of shares. A reasonable defensive move would be a device that would be triggered by a transaction that created a majority shareholder or by an attempt to squeeze out minority shareholders in an unfair transaction.[184]

Judge Posner turned one CTS argument against itself. CTS apparently argued that if DCA controlled the board of directors, it would "gull" the remaining shareholders into selling their shares for too low a price.[185] As Judge Posner again drolly observed, this argument underscores the importance of not impeding tender offers too much because its premise is that management cannot be trusted to protect the interests of shareholders.[186] *Touche.*

After disposing of the validity of CTS's poison pill, the court considered the validity of the control share acquisition provisions of the IBCL. The first issue was the procedural question whether the trial court had failed adequately to notify the Indiana Attorney General that the constitutionality of the statute was being challenged.[187] The court was

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[183]*Id.* at 258.

[184]*Id.* at 259.

[185]*Id.* It is ironic that recently DCA opposed a sale of CTS, or more accurately, opposed a merger of CTS with AVX Corporation. Indianapolis Star, Dec. 18, 1986, at 73, col. 2. Of course the merger price was $35 per share, $8 less than what DCA offered in its tender offer. Then again, this development proves the court was right—the $50 was illusory, and one of the features of the AVX proposal was that AVX considered "CTS management . . . [as] one of the positive things about the company." *Id.*

[186]*DCA V*, 794 F.2d at 259.

[187]*Id.* Although a detailed discussion of notification would unduly lengthen this article, the federal statute that requires notification is 28 U.S.C. § 2403(b) (1982).

satisfied that any error in notification did not prejudice the state.[188] It is possible that the United States Supreme Court might reverse the Seventh Circuit on the ground that Indiana has not had its day in court.[189] Hopefully, however, the high court will reach the merits of the constitutionality of second generation antitakeover statutes such as the Indiana statute regardless of the outcome of preliminary issues.

The first constitutional issue considered in *DCA V* was the supremacy clause issue: was the control share acquisition statute[190] preempted by the Williams Act.[191] The Indiana statute defines a control share acquisition as an acquisition that with any previous acquisitions gives the acquiror at least twenty percent of the voting shares of the covered firm.[192] If the acquiring firm files a statement containing specific information[193] and requests a special shareholders' meeting to consider whether the shares should have voting rights, management has fifty days within which to hold a shareholders' meeting.[194] The statute requires that a majority of all shares and a majority of disinterested shares, which excludes shares owned by the acquiror and shares owned by officers and inside directors, must favor awarding voting rights.[195]

Judge Posner characterized the statute as being "cleverly drafted . . . to skirt judicial holdings that forbid states to delay tender offers beyond the period required by the Williams Act."[196] Of course the effect of the statute is to impose a fifty day delay on tender offers at the option of the target. This makes it more difficult for any tender offer to succeed, because an offeror could not accept tendered shares until the shareholder meeting where it will be determined if the shares will

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[188] *DCA V*, 794 F.2d at 260.

[189] *Cf.* Leroy v. Great Western United Corp., 443 U.S. 173 (1979). The court also dismissed two other threshold challenges to Judge Getzendanner's consitutional rulings. The Attorney General's argument that venue was improper in the Northern District of Illinois was deemed to have been waived by CTS. An argument that the district court should have abstained in favor of Indiana courts was rejected in part because of the lack of time, but more particularly because the court agreed that the statute was limited to cases where the target was an Indiana corporation. *DCA V*, 794 F.2d at 260.

[190] IND. CODE § 23-1-42-1 to -11 (Supp. 1986).

[191] 15 U.S.C. §§ 78m(d)-(e), 78n(d)-(f) (1982).

[192] IND. CODE § 23-1-42-1 (Supp. 1986).

[193] *Id.* § 23-1-42-6.

[194] *Id.* § 23-1-42-7.

[195] *Id.* §§ 23-1-42-3, 23-1-42-9. Without a majority vote of all shares, and of all disinterested shares, the acquired shares remain non-voting shares. The issue of the voting rights will be taken up at the next regularly scheduled shareholder meeting if the acquirer does not request a special meeting. *Id.* § 23-1-42-7(c). If the statement is not filed, the corporation can redeem the shares "at the fair value thereof pursuant to the procedures adopted by the corporation." *Id.* § 23-1-42-10. One might conjecture how close the "fair value" would be to what the acquirer had paid for the shares.

[196] *DCA V*, 794 F.2d at 261.

be voting or nonvoting. Thus a tender offer would have to be kept open for fifty days rather than the twenty business days required by SEC Rule 14e-1(a),[197] and even then the offeror cannot be certain of a victory because the "disinterested" shareholders must approve the vote.[198]

The key to any analysis of a supremacy clause preemption issue is *Edgar v. MITE Corp.*[199] The Seventh Circuit in *MITE* held that the Illinois takeover statute violated the supremacy clause, but this view was shared by only three Supreme Court justices.[200] However, even though the Supreme Court did not accept the preemption argument, it has held that Congress intended to strike a balance between target management and offerors in the Williams Act.[201] From this premise, courts have reasoned that states may not upset the balance struck by Congress.[202] States are free to add their own penalties if Congress passes a statute punishing some practice deemed unfair or unjust such as monopolization or misrepresentation.[203] If the Williams Act is actually an antitakeover statute, as some argue,[204] then Indiana should be able to enact more stringent antitakeover laws. However, even if Judge Posner might philosophically agree with those who oppose any interference in the market for control, the Williams Act does exist and it does strike a balance.[205] Whether or not the balance is proper, Congress probably did not want the states to tip this so-called "balanced playing field" one way or the other.

Judge Posner characterized the application of the standard preemptive power of the Williams Act to the Indiana statute as "straight forward."[206] He did not attempt to determine if the Indiana statute was more or less hostile to takeovers than the Illinois statute involved in *MITE.* In fact, he "guessed" that the Indiana statute was less inimical to tender offers, although it was still lethal. In particular, Judge Posner considered the fifty day period of the Indiana statute to be "too much" when

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[197]SEC Rule 14e-1(a); 17 C.F.R. § 240.14e-1(a) (1986).

[198]Officers and inside directors are disenfranchised as well, but their holdings are likely to be substantially less than the holdings of the offeror. Offerors are not prone to put a corporation into play if it has a strongly entrenched management.

[199]457 U.S. 624 (1982), *aff'g* MITE Corp. v. Dixon, 633 F.2d 486 (7th Cir. 1980).

[200]457 U.S. at 636-39. This portion of the opinion by White, J., was joined by Burger, C. J., and Blackmun, J.

[201]Piper v. Chris-Craft Indus., Inc., 430 U.S. 1 (1977).

[202]*See, e.g.*, Martin-Marietta Corp. v. Bendix Corp., 690 F.2d 558, 565-66 (6th Cir. 1982); National City Lines, Inc. v. LLC Corp., 687 F.2d 1122, 1128-33 (8th Cir. 1982).

[203]*DCA V*, 794 F.2d at 262.

[204]*See, e.g.*, Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 Tex. L. Rev. 1 (1978).

[205]*DCA V*, 794 F.2d at 262.

[206]*Id.*

Congress had determined that approximately a month is enough time to keep a tender offer open.[207]

It is possible that the preemption issue raised by Judge Posner could be resolved by shortening the time frame of the control share acquisition statute. However, even if this occurs, Judge Posner made it clear that in the opinion of the panel, the statute would still run afoul of the commerce clause.[208] It has been a long established tenet of constitutional law that the commerce clause will invalidate any state regulation of interstate commerce that conflicts with the presumed purpose of the clause to make the nation a common market, at least in areas where Congress has not spoken.[209] Judge Posner recognized, however, that it was possible that the "dormant" commerce clause would no longer apply when Congress has spoken and that the only ground for invalidating state legislation would be the supremacy clause.[210]

However, as the *DCA V* court pointed out, *MITE* and other cases separate the supremacy and the commerce clauses and assume that the commerce clause retains an independent force notwithstanding the enactment of the Williams Act.[211] Judge Posner, in this respect, stated that there was no indication the Williams Act was intended to insulate antitakeover statutes from complaints that they unduly burden interstate commerce.[212]

The commerce clause does not bar all state action that might impose some burden on interstate commerce; burdens will be upheld if the local benefits exceed the burden imposed upon interstate commerce.[213] Applying this test, the court concluded that the burdens the statute inflicted on nonresidents exceeded the benefits to Indiana residents.[214] Although the court did not know the geographical distribution of the DCA or CTS shareholders, Judge Posner was willing to assume that the vast majority were not Indiana residents. Consequently the statute gravely impaired DCA's ability to do business with those shareholders. As he phrased it, "Indiana has no interest in protecting residents of Connecticut from being stampeded to tender their shares to Dynamics at $43,"[215] and

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[207]*Id.* at 263.

[208]*Id.*

[209]*Id. See* Cooley v. Board of Wardens, 53 U.S. (12 How.) 299 (1852).

[210]*DCA V*, 794 F.2d at 263.

[211]*Id.*

[212]*Id.*

[213]*See* Pike v. Bruce Church, Inc., 397 U.S. 137 (1970). A majority of the Supreme Court in *MITE* found that the Illinois statute violated the commerce clause as an undue, indirect burden on interstate commerce. Edgar v. MITE Corp., 457 U.S. 624, 640-46 (1982).

[214]*DCA V*, 794 F.2d at 264.

[215]*Id.* at 263.

"[f]or the sake of trivial or even negative benefits to its residents Indiana is depriving nonresidents of the valued opportunity to accept tender offers from other nonresidents."[216] This cannot be gainsaid because the *purpose* of the control share acquisition statute like that of any other state antitakeover statute is to impede transactions between residents of other states. This, of course, is the opposite of the purpose of state securities laws, which affect only the residents of the particular state.

Judge Posner even expressed some doubts if any appreciable number of Indiana shareholders would benefit from the statute; the only beneficiaries might be the officers and directors of CTS, not all of whom necessarily were Indiana residents.[217] He noted that no evidence had been presented that DCA's takeover of CTS would reduce the value of CTS or result in a shift of assets or employment from Indiana.[218] More importantly, and this point could well be fatal to all second generation antitakeover statutes, any shift prevented by the statute would be further grounds for condemnation because the commerce clause does not permit states to bar corporations from moving assets and employees to other states.[219] If Indiana presents a desirable environment for business,[220] there is no reason for erecting obstacles to shifts in corporate control. If the environment is desirable, the business will remain in Indiana regardless of whether management are "hometown boys" or nonresidents. For better or worse, there is an interstate and even an international market for corporate control. Indiana has attempted to opt out of this market, and to the *DCA V* court, this effort is barred by the commerce clause.

Perhaps anticipating that this case would go to the Supreme Court, Judge Posner was careful to distinguish the cases relied on by CTS. For example, *L.P. Acquisition Co. v. Tyson*[221] was different because the Williams Act did not apply to the tender offer, and the disclosures required by the particular statute conferred greater benefits on state residents than the disclosure required by the Indiana statute.[222] In other words, the court perceived *Tyson* as satisfying the balance required by *Pike v. Bruce Church, Inc.*,[223] which permits an indirect "burden" on

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[216]*Id.* at 264.

[217]*Id.*

[218]*Id.*

[219]*Id.*

[220]A recent study commended Indiana's approach to attracting new businesses to the state. Indianapolis Star, Oct. 1, 1986, at 22, col. 2. It would be interesting to know how many business executives who favor legislation such as the control shares acquisition statute would favor legislation barring them from relocating or building new plants and facilities in other states. Close to home, how many Indiana residents would have approved of legislation that would have kept the Colts in Baltimore?

[221]772 F.2d 201 (6th Cir. 1985).

[222]*DCA V*, 794 F.2d at 264.

[223]397 U.S. 137 (1970).

interstate commerce where local interests are paramount. The court also distinguished *Cardiff Acquisitions, Inc. v. Hatch*[224] on the grounds that the required disclosure was designed to furnish state residents information relevant to the takeover's impact on the state and that any delay imposed on takeovers was so slight as not to discourage them.[225] The Indiana statute, however, was perceived by the court as erecting a "barrier at once formidable and arbitrary to tender offers whose principal effects if they succeed will be felt outside Indiana."[226]

The court also rejected CTS's argument that Indiana should be permitted to control and regulate the internal affairs of Indiana corporations. The court correctly recognized that Indiana has a broad latitude in regulating internal affairs of Indiana corporations, including provisions in corporate documents that would discourage takeovers.[227] However, there are limits to this doctrine, which are exceeded when the state regulation has an effect "on the interstate market in securities and corporate control [that] is direct, intended and substantial . . . . [and] not merely the incidental effect of a general regulation of internal corporate governance."[228] As Judge Posner accurately if not elegantly phrased it, the control share acquisition statute is an explicit regulation of tender offers and is not immunized from the commerce clause because "the mode of regulation involves jiggering with voting rights. . . ."[229]

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[224]751 F.2d 906 (8th Cir. 1984).

[225]*DCA V*, 794 F.2d at 264.

[226]*Id.*

[227]The court referred to cumulative voting, which can make it difficult to oust an entire existing board of directors. A staggered board of directors also would be a permitted defensive move. *Id.*

It is possible that the Supreme Court may place more emphasis on the "internal affairs" doctrine or at least distinguish *DCA V* from *Edgar v. MITE Corp.* because in *Edgar*, it was possible for the Illinois statute to apply to a tender offer "which would not affect a single Illinois shareholder," 465 U.S. at 465, whereas the Indiana control share acquisition provisions apply only to publicly owned corporations with a substantial number of Indiana shareholders or with a substantial number of shares owned by Indiana residents. IND. CODE § 23-1-42-4(a)(3) (Supp. 1986). This position or a complete reconsideration of the *MITE* position on the "internal affairs" doctrine in effect would totally insulate state antitakeover statutes from commerce clause scrutiny as long as they are limited to domestic corporations with a "substantial" number of resident shareholders even if they are a minority of all shareholders.

It might be argued that rejection of the "internal affairs" doctrine would invalidate *any* statutory provision that might hinder a hostile takeover. That, however, is basically an *in terrorem* argument because a statutory provision that applies to all corporations regardless of whether they are the target of a hostile takeover attempt is not the same as a provision that applies only to publicly held target companies and that has as a purpose hindering the market for corporate control.

[228]*DCA V*, 794 F.2d at 264.

[229]*Id.* The court also rejected the argument that the tender offer should have been enjoined because if successful, DCA and CTS would violate section 8 of the Clayton Act, 15 U.S.C. § 19 (1982), which prohibits interlocking boards of directors that might eliminate

The court also declined to reverse on the ground that DCA's tender offer materials did not disclose its intention to oust the CTS management if it succeeded in the proxy contest. Judge Posner agreed that this omission, although material, had been cured because DCA's proxy material urged shareholders to elect the DCA slate of directors and because DCA's desire to oust the present CTS board was broadcast loudly and widely.[230] Even if the defect could not be cured by the proxy materials, an issue not resolved by the court, it was not clear that enjoining the tender offer was a proper remedy. The proper remedy was within the district court's discretion, which had not been abused in this case.[231]

It is of course impossible to know if the Supreme Court will uphold the Seventh Circuit's decision in *DCA V*.[232] There is no question that the statute was intended to and does interfere with takeovers. Judge Posner's treatment of the commerce clause issue, which was accepted by the majority in *MITE*, should be persuasive. Any statute that presents an offeror with the distinct possibility of owning a substantial block of non-voting shares in an Indiana corporation would tend to dissuade him from making a tender offer for that corporation. The adverse effect on interstate commerce is clear.

It would be unfortunate if tender offers and takeovers reduced the number of publicly held Indiana corporations. However, the answer to this potential problem is to improve the business climate in Indiana to attract and retain business in this state rather than to create artificial barriers to a shift in corporate control.

Judge Posner's supremacy clause argument also is persuasive because for better or worse, the Williams Act does establish a uniform scheme for the regulation of tender offers. Tender offers and takeovers have national impact and it would seem that even in a time of deemphasis on Washington, having one set of rules for the country is sound. If there is a problem with particular tactics by offerors, or management for that matter, the proper response is to seek change from Congress or the SEC.

An Ohio control share acquisition statute which was similar to the Indiana statute in that it required shareholder authorization for a control

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competition between the two companies. Judge Posner, an eminent antitrust scholar, noted there was no persuasive evidence that DCA and CTS were in competition, but more importantly the argument failed for the very simple reason that DCA would just find persons to serve on the board of CTS who were not DCA directors if there was a question of illegality under section 8. *DCA V*, 794 F.2d at 264-65.

[230]*DCA V*, 794 F.2d at 265.

[231]*Id.*

[232]It is difficult to forecast how the current Court will line up on the issue. Former Chief Justice Burger was in the plurality that deemed the Illinois statute involved in *MITE* preempted by the Williams Act, 457 U.S. at 636-39, while current Chief Justice Rehnquist dissented in *MITE* on the grounds of mootness. *Id.* at 664.

share acquisition was struck down in *Fleet Aerospace Corp. v. Holderman*[233] because it conflicted with the supremacy clause by frustrating the objectives of the Williams Act and because it imposed a substantial direct and indirect burden on interstate commerce.[234]

It is hard to predict the reaction of the state if *DCA V* is affirmed. Presumably efforts would be made to circumvent the decision, perhaps by a statute that applies only to corporations not subject to the Williams Act, where the predominant number of shareholders are Indiana residents and that are truly local businesses. This type of statute would apply to just the kind of small corporations that always seem to be excluded from antitakeover legislation.

IV. Statutory Developments

A. *Indiana Business Corporation Law*

The most significant statutory development during the survey period was the enactment of the Indiana Business Corporation Law.[235] By its terms, the IBCL applies to all existing Indiana corporations as of August 1, 1987.[236] It makes sense to have a single system of corporation law rather than two different and overlapping systems, and normally this approach would not cause any problems. Unfortunately this stratagem might not be available in Indiana, at least for corporations organized between July 1, 1978, and February 21, 1986, if the provisions of the IBCL are not expressly and unanimously adopted by the shareholders.

This hiatus is the time in which there was no "reserved powers" clause in the IGCA reserving to the General Assembly the right to amend or repeal the law relating to corporations. July 1, 1978, was the effective date of repeal of the clause that had been in the IGCA.[237] It is distinctly

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[233]796 F.2d 135 (6th Cir. 1986).

[234]The *Fleet* court relied on *DCA V* in deciding against the Ohio statute. *Id.* at 139.

[235]Act of March 26, 1986, Pub. L. No. 149-1986, §§ 1-69 (codified at Ind. Code §§ 23-1-17-1 to -54-2 (Supp. 1986)). *See* Simcox, *The Indiana Business Corporation Law: Tool for Flexibility, Simplicity and Uniformity*, 20 Ind. L. Rev. 119 (1987).

[236]Ind. Code § 23-1-17-3(a) (Supp. 1986).

[237]Ind. Code § 23-1-12-5 (1972) (repealed 1978). There was no reserved powers clause in the IGCA when it was adopted in 1929. It was added in 1949. Frederick Schortemeier, who chaired the Indiana Corporations Survey Commission when the IGCA was adopted later commented that it was felt the state had "inherent power" to amend the IGCA but that it was advisable to make the power express. F. Schortemeier, Indiana Corporation Law 206 n.11 (1952).

There is dictum in City of Indianapolis v. Navin, 151 Ind. 139, 143, 47 N.E. 525, 526-27 (1897), that the legislature has inherent power to regulate the fares of a common carrier as specified in the organic documents of the corporation. This might be the source of Mr. Schortemeier's comment. However, the statement was dictum because the General Assembly had reserved the power to regulate fares. Furthermore, the court recognized possible that a court can rule that in 1978, the General Assembly surrendered Indiana's authority to affect subsequently organized corporations by altering, amending, or even repealing the IGCA. Of course, it is also possible a court could rule that the repeal was a careless, unintended act. The drafters of the Revised Model Business Corporation Act took the position that the RMBCA should apply to existing as well as new corporations.[238] They also intended the act to supplant existing general incorporation statutes and recommended against retaining portions of earlier statutes.[239] The Corporation Law Study Commission, which drafted the IBCL, had the same intent. Unfortunately, the drafters of the RMBCA also operated on the premise that there had been a "universal adoption of 'reservation of power' clauses in all states for more than a century . . . ."[240] This was not the case in Indiana.

The General Assembly remedied or at least attempted to remedy this problem in 1986. On February 21, 1986, Indiana Code section 23-1-12-5.1(a) was added to the IGCA, retroactively reserving the right to "alter, amend or repeal" the IGCA.[241] This corrective legislation also contained section 23-1-12-5.1(b), which stated that

> the purpose of the General Assembly in enacting this section is to correct an error that was made in preparation of Acts 1978, P.L. 2, SECTION 2325. The general assembly finds and declares that the inclusion of IC 23-1-12-5 in the list of provisions to be repealed by Acts 1978, P.L. 2 was a clerical error, and that the general assembly did not intend to repeal IC 23-1-12-5 when it enacted Acts 1978, P.L. 2.[242]

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that it would take "clear and unmistakable language" inconsistent with the exercise of the power over fares to surrender such power. *Id.* There is no clearer or more unmistakable statement of legislative intent to surrender the reserved power than expressly repealing the clause unless, of course, a mistake has been made.

The decision in State *ex rel.* Starkey v. Alaska Airlines, Inc., 68 Wash. 2d 318, 413 P.2d 352 (1966), contrasts with the *Navin* dictum. In *Alaska Airlines*, the court held that provisions in the Model Business Corporation Act which had been adopted in Alaska could not be applied to a corporation organized under the previous territorial corporation act which had not contained a reserved powers clause. *Id.*

[238]4 Model Bus. Corp. Act Ann. § 17.01 (3d ed. 1985).

[239]*Id.* § 17.05 (Official Comment at 1800). The practice was discouraged because it could cause unnecessary confusion in determining applicable law and create possible internal statutory conflicts. *Id.*

[240]*Id.* § 17.01 (Official Comment at 1797).

[241]Act of February 21, 1986, Pub. L. No. 19-1986, § 39(a) (codified at Ind. Code § 23-1-12-5.1(a) (Supp. 1986)). The effective date of Ind. Code § 23-1-12-5.1(a) was July 1, 1978.

[242]Act of February 21, 1986, Pub. L. No. 19-1986, § 39(b) (codified at Ind. Code § 23-1-12-5.1(b) (Supp. 1986)).

This author will not quarrel with the General Assembly's statement that including Indiana Code section 23-1-12-5 in the list of provisions to be repealed was a "clerical

The General Assembly also added a reserved powers clause applicable to all general laws to the Indiana Code.[243] Thus the issue of reserved powers was clearly resolved for corporations organized under the IGCA between February 21, 1986, and the August 1, 1987, effective date of the IBCL. The IBCL, of course, contains a reserved powers clause.[244]

The problem is that it is not clear that the General Assembly can retroactively enact a reserved powers clause, or at least the extent to which it can. It has long been recognized in Indiana that the General Assembly cannot amend or otherwise materially modify the charter of a special charter corporation unless the power was expressly reserved.[245] It also has been recognized by Indiana courts that a statute cannot be applied retroactively if such application impairs vested rights.[246] Even cases such as *Wencke v. City of Indianapolis*,[247] which posit that the "power to enact statutes and ordinances has as a necessary incident the power to repeal[,]" qualify that power by subjecting it to "constitutional restrictions such as the prohibition against impairment of contract."[248]

It is very likely that the IBCL might have an impact on the interests of shareholders of corporations organized during the hiatus. There is some question whether the IBCL overruled the Indiana Supreme Court decision in *Gabhart v. Gabhart*.[249] *Gabhart* protects the interest of mi-

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error." However Indiana Code section 23-1-12-6, which was a "savings clause," also was repealed at the same time. This would seem to indicate something more than a mere error by a scrivener. The wisdom of repealing a savings clause is not readily apparent, but at least corporations organized under pre-IGCA law had limited duration unless reorganized under the IGCA and in 1978 had at most one year of corporate existence left. There was no effort to reinstate Indiana Code section 23-1-12-6 in 1986.

[243] IND. CODE § 1-1-5-2 (Supp. 1986). This provision reads:

> Each general law of the state is enacted subject to the right of the general assembly to amend or repeal that law at any time, unless the general assembly waives this right in that law. Except in the case of a law containing a covenant that the general assembly will not amend or repeal that law, the general assembly may not be construed to have waived its right to amend or repeal any general law at any time.

Id. It will be interesting to see if a law containing a "covenant" that it will not be amended or repealed in fact will be safe from amendment or repeal without more. The courts have held on several occasions that the General Assembly cannot limit the rights of future General Assemblies. *See* State *ex rel.* City of Terre Haute v. Kolsem, 130 Ind. 434, 29 N.E. 595 (1891); Wencke v. City of Indianapolis, 429 N.E.2d 295 (Ind. Ct. App. 1981); Martin v. Simplimatic Eng'g Corp., 181 Ind. App. 10, 390 N.E.2d 235 (1979).

[244] IND. CODE § 23-1-17-2 (Supp. 1986).

[245] *See* City of Terre Haute v. Evansville & T.H.R.R., 149 Ind. 174, 180, 46 N.E. 77, 78 (1897).

[246] Hinds v. McNair, 413 N.E.2d 586, 608-09 n.20 (Ind. Ct. App. 1980).

[247] 429 N.E.2d 295 (Ind. Ct. App. 1981).

[248] *Id.* at 297. *See* Trustees of Dartmouth College v. Woodward, 17 U.S. (4 Wheat.) 518 (1819).

[249] 267 Ind. 370, 370 N.E.2d 345 (1977).

nority shareholders subject to a squeeze out by means of a reverse share split. If the IBCL does overrule *Gabhart*, a minority shareholder might have a cause of action for overreaching conduct by controlling shareholders occurring before July 31, 1987, which conduct is clearly proper under the IBCL if it occurs on or after August 1, 1987. Thus, a right provided by Indiana corporation law when the corporation was organized has been taken away by the IBCL. It certainly can be argued that shareholders of corporations organized when there was no reserved powers clause are entitled to the protections accorded to minority shareholders under the law existing as of the date of incorporation. This would be the law reflected in *Gabhart*.

A not implausible example would be overreaching conduct directed against one minority shareholder on July 31, 1987, and exactly the same conduct directed against another shareholder on August 1, 1987. The first shareholder has a cause of action which would be preserved under the savings clause of the IBCL,[250] but the second shareholder will have no remedy because of a change in the organic law that was part of the "contract" the shareholder had with other shareholders and the state. This contract created certain rights; the state cannot take away those rights without having reserved the power to do so at the time the corporation was organized. At least this is how the argument for the second minority shareholder would be framed. It is far from certain that this argument will prevail. However, any lawyer worthy of the title "professional" would argue that when section 23-1-12-5 was repealed, the "contract" between the state and a corporation and its shareholders specifically excluded the right of the state to change the terms of the contract, and that the corporation and the shareholders have a vested interest in not having Indiana retroactively impose the "right" to alter, amend, or repeal.

It is possible for shareholders to waive their rights, and nothing would prohibit shareholders from unanimously subjecting themselves and the corporation to the IBCL. Such an act would bind subsequent shareholders because that will be part of the contract that goes with their shares. However, unless and until that is done, there is at least the intriguing possibility that the General Assembly's attempt to establish retroactively a reserved powers clause was unsuccessful.

It does not make any difference that the General Assembly adopted a new but retroactive reserved powers clause rather than repealing its repeal of section 23-1-12-5. The Indiana Code does provide that the repeal of an act repealing a former act can, if expressly provided, revive

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[250]The savings clause is not part of the IBCL as it is with the RMBCA, 4 Model Bus. Corp. Act Ann. § 17.03 (3d ed. 1985), but was provided for separately in Act of March 26, 1986, Pub. L. No. 149-1986, § 66(a)(b).

the former act.[251] Generally, when a statute is repealed, it is completely obliterated unless a vested right is impaired.[252] If there were a vested right in the absence of a reserved powers clause, it would survive the repeal.

It will be interesting to see if someone challenges the application of the IBCL to corporations organized between July 1, 1978, and February 21, 1986, and if so, whether such an attack is successful.

The General Assembly continued the Corporation Law Study Commission[253] to permit it to publish Official Comments on the new IBCL. The IBCL specifically authorizes courts to consider these Official Comments in construing the act, so they might be characterized as after the fact legislative history.[254]

B. Business Combinations

The General Assembly also added a new chapter to the Indiana General Corporation Act relating to business combinations.[255] This chapter is substantially the same as chapter 43 of the new IBCL[256] and will be superceded when the IBCL becomes effective.

C. Liability of Directors of Not-for-Profit Corporations

In 1985, the General Assembly enacted a statute limiting the civil liability of voluntary directors of not-for-profit corporations that have certain specified purposes.[257] The statute limits civil liability for the negligent performance of duties by individuals who serve without compensation as directors for the purpose of setting policy, controlling, or otherwise overseeing the activities or functional responsibilities of such corporations.[258] The liability is limited to the coverage provided by an insurance policy issued to the particular entity.[259]

As enacted, the provision presented the possible anomalous result of a director of a not-for-profit corporation having limited liability if there was an insurance policy but unlimited liability if there was not.

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[251] IND. CODE § 1-1-5-1 (1982).

[252] Martin v. Simplimatic Eng'g, Inc., 181 Ind. App. 10, 11, 390 N.E.2d 235, 236 (1979).

[253] IND. CODE § 23-1-17-5 (Supp. 1986).

[254] *Id.*

[255] Law of January 23, 1986, Pub. L. No. 151-1986, § 1 (codified at IND. CODE §§ 23-3-9-1 to -22 (Supp. 1986)).

[256] IND. CODE §§ 23-1-43-1 to -24 (Supp. 1986).

[257] *Id.* § 34-4-11.5-1. The purposes are: religion; charity; benevolence; providing goods or services at no charge to the general public; education; and scientific activities. *Id.*

[258] *Id.* § 34-4-11.5-2.

[259] *Id.*

This possibility was eliminated in 1986 when the General Assembly amended Indiana Code section 34-4-11.5-2 to provide that if no insurance policy issued to the entity provides liability coverage for the allegedly negligent act or omission of the qualified director, the qualified director is immune from civil liability for that act or omission.[260] This amendment eliminates the possible anomaly, but might cause not-for-profit corporations to drop insurance coverage. Hopefully, however, if insurance is available at reasonable premiums, admittedly a big "if," those in a position of responsibility would resist the temptation to drop liability insurance coverage because of their own personal immunity.

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[260]Act of March 3, 1986, Pub. L. No. 197-1986, § 2 (codified at IND. CODE § 34-4-11.5-2 (Supp. 1986)).

Article 9 of the Indiana Uniform Commercial Code in Transition

Edward A. Keirn*

I. Introduction

From July 1, 1964, through December 31, 1985, Indiana's law of secured transactions regarding personal property and fixtures was essentially that contained in Article 9 of the 1962 Official Text of the Uniform Commercial Code (Old Indiana UCC).[1] Effective January 1, 1986, however, Indiana adopted substantially all of Article 9 of the 1972 Official Text of the Uniform Commercial Code (New Indiana UCC),[2] and in doing so conformed its law of secured transactions to that of the vast majority of other jurisdictions.[3] As the result of the important changes made under the New Indiana UCC regarding transactional scope, the manner by which security interests are perfected, and the resolution of priority disputes among multiple claimants to the same collateral,[4] a logical first question is: what impact will the New Indiana UCC have on transactions entered into before its effective date? The correct answer to this question, it seems, may be: (a) very little, if any; (b) a great deal; or (c) it's anybody's guess, depending upon the particular factual circumstances and legal issues involved.

As a starting point in the analysis, it is necessary to locate a series of facially innocuous "transition rules" adopted along with the New

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[1]The Old Indiana UCC was codified at Ind. Code §§ 26-1-9-101 to -507 (1982 & Supp. 1984).

[2]The New Indiana UCC is codified at Ind. Code §§ 26-1-9-101 to -507 (1982 & Supp. 1986).

[3]*See* Johnson, *Changes in the Uniform Commercial Code, 1985 Survey of Recent Developments in Indiana Law*, 19 Ind. L. Rev. 99 (1986) [hereinafter *1985 Survey*].

[4]*See generally 1985 Survey*, *supra* note 3, at 99-114; Bepko, *Perfection & Priorities Under Revised UCC in Indiana*, Uniform Commercial Code XI-1 (ICLEF 1985); Eslick & Tyler, *A Practical Approach to the 1972 UCC Official Text of Article 9, Perfection, Remedies, Post-Insolvency Filings*, Uniform Commercial Code VIII-1 (ICLEF 1985); Falvey, *Fixtures Under the 1972 Version of the Uniform Commercial Code*, Uniform Commercial Code XIV-1 (ICLEF 1985); Meyer, *Indiana's Adoption of 1972 Amendments to Article 9*, Uniform Commercial Code X-1 (ICLEF 1985); Thorne & Hostetler, *A Practical Approach to the 1972 UCC Official Text of Article 9, Competing Liens and Interests, Multistate Transactions and Transition*, Uniform Commercial Code IX-1 (ICLEF 1985).

Indiana UCC (New Transition Rules). Unlike the transition rules adopted in connection with the Old Indiana UCC,[5] the New Transition Rules are not codified in the Indiana Code. Rather, they must literally be "discovered" from the compiler's notations to title 26 of *Burns Indiana Statutes Annotated* or *West's Indiana Annotated Code* or expressly "looked up" in the Indiana Acts.[6] The New Transition Rules are comprised of six sections (some with multiple parts) numbered sections 42 through 47, inclusive.

The next step, of course, after locating the New Transition Rules is to read them. During this initial reading, the language of the New Transition Rules may appear to be quite easy to understand. There is almost no legalese, and the rules themselves are not exceptionally long. After all, one may ask: why shouldn't the New Transition Rules be relatively easy to interpret and understand since they are nearly identical to the model transition rules prepared by the Reporters of the 1972 Official Text of the UCC,[7] and adopted in whole or in part by most of the other jurisdictions enacting the 1972 Official Text? Certainly, it is easy to overlook the fact that, unlike the 1972 Official Text itself, the model transition rules (from which the New Transition Rules were taken) have not been approved or endorsed by the National Conference of Commissioners on Uniform State Laws, any of its boards or committees, or the American Law Institute.[8]

Having now put the reader on notice that there may be more to the New Transition Rules than a casual reading may reveal, let us now turn to the substance and application of the rules themselves.

II. The New Transition Rules

A. Section 42

Section 42 contains both a validity provision and a perfection continuation provision. The validity provision states that a transaction validly entered into before January 1, 1986, under the Old Indiana UCC (and which would be subject to the New Indiana UCC if it had been entered into after December 31, 1985) and the rights, duties, and interests flowing from such a transaction remain valid after December 31, 1985, and "may be terminated, completed, consummated, or enforced as required or permitted by [the New Indiana UCC]."[9] The validity mentioned in

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[5]*See* Ind. Code §§ 26-1-10-101 to -106 (1982).

[6]1985 Ind. Acts 828-30, Pub. L. No. 93-1984, §§ 42 to 47, *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986).

[7]*Compare id. with* U.C.C. §§ 11-101 to -108 (1972).

[8]*See* U.C.C., Article 11, 3A U.L.A. 431 (1981).

[9]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 42, *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986).

this provision obviously has reference to the general validity of security agreements as between the parties (and certain third persons) described in section 9-201 of the Old Indiana UCC.[10]

Neither the Old Indiana UCC nor the New Indiana UCC directly addresses completion or consummation of transactions. Both do, however, contain specific provisions on enforcement and termination. With respect to enforcement, section 42 provides that the New Indiana UCC's enforcement provisions may be used in connection with transactions entered into under the Old Indiana UCC. Accordingly, the secured party in such a transaction may take advantage of the generally less burdensome provisions of the New Indiana UCC in giving notice of a proposed public or private sale or in proposing to retain the collateral in satisfaction of the underlying obligation.[11] This result is clear and relatively straightforward.

Now, let us turn to the more problematical termination analysis of section 42. This section, on its face, states that transactions entered into under the Old Code "may be terminated . . . as required or permitted by [the New Indiana UCC]."[12] What does this language mean? The logical initial response is that a secured party in a transaction entered into under the Old Indiana UCC may take advantage of section 9-404 of the New Indiana UCC, pertaining to the duties of the secured party in terminating financing statements when the financing relationship between the secured party and the debtor comes to an end.[13]

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[10]Ind. Code § 26-1-9-201 (1982) provides in pertinent part: "Except as otherwise provided by this Act a security agreement is effective according to its terms between the parties, against purchasers of the collateral and against creditors. . . ."

[11]*Compare* Ind. Code §§ 26-1-9-504(3) and 26-1-9-505(2) (1982) (requiring notices to be given to debtor and persons who have filed a financing statement with respect to the collateral and to persons known by the secured party to possess a security interest in the collateral, if collateral is other than consumer goods) *with* Ind. Code §§ 26-1-9-504(3) and 26-1-9-505(2) (1986) (requiring notices to be given to debtor and to other secured parties from whom secured party has received a written notice of claim of an interest in the collateral, if the collateral is other than consumer goods). Note also that the time period for the debtor or other persons to object to the secured party's proposal to accept the collateral as discharge of the obligation has been reduced from 30 days to 21 days under the New Indiana UCC. *Compare* Ind. Code § 26-1-9-505(2) (1982) *with* Ind. Code § 26-1-9-505(2) (Supp. 1986).

[12]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 42, *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986).

[13]Ind. Code § 26-1-9-404(1) (Supp. 1986) provides:

> (1) If a financing statement covering consumer goods is filed on or after January 1, 1986, then within one (1) month or within ten (10) days following written demand by the debtor after there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value, the secured party must file, with each filing officer with whom the financing statement was filed, a termination statement, which shall be identified by file number. In other cases, whenever there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value, the secured

However, upon comparing section 9-404 of the New Indiana UCC with section 9-404 of the Old Indiana UCC, the correctness of this initial response becomes suspect. Unlike the situation with respect to enforcement, the New Indiana UCC imposes an additional burden on the secured party. From the perspective of the secured party, the only real difference between the two versions of section 9-404 is that the New Indiana UCC requires the secured party actually to file appropriate termination statements with respect to financing statements covering consumer goods "within one (1) month or within ten (10) days following written demand by the debtor after there is no outstanding secured obligation and no commitment to make advances, incur obligations, or otherwise give value . . . ."[14] By contrast, section 9-404 of the Old Indiana UCC made no distinction between financing statements covering consumer goods and other financing statements; in both cases, the secured party merely was required to send the appropriate termination statement *to the debtor* "within ten (10) days after proper [written] demand therefor . . . ."[15] Simply stated, it appears to make little sense to enact a transition rule that authorizes (but apparently does not require)[16] the secured party to utilize the New Indiana UCC's more stringent termination procedures.[17]

Well then, if the reference to termination in section 42 was not intended primarily to require (or perhaps, even to authorize) compliance with section 9-404 of the New Indiana UCC as to transactions entered

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party must on written demand by the debtor send the debtor, for each filing officer with whom the financing statement was filed, a termination statement to the effect that he no longer claims a security interest under the financing statement, which shall be identified by file number. A termination statement signed by a person other than the secured party of record must be accompanied by a separate written statement of assignment signed by the secured party of record, complying with IC 26-1-9-405(2), including payment of the required fee. If the affected secured party fails to file such a termination statement as required by this subsection, or to send such a termination statement within ten (10) days after proper demand therefor, he shall be liable to the debtor for one hundred dollars ($100), and in addition for any loss caused to the debtor by such failure.

[14]*See supra* note 13.

[15]*See* IND. CODE § 26-1-9-404(1) (1982).

[16]Section 42 provides only that the "transaction . . . may be terminated . . . as required or permitted by [the New Indiana UCC]." The "may," of course, suggests that the secured party has the option of complying with either the Old Indiana UCC or the New Indiana UCC.

[17]Notwithstanding section 42, however, section 9-404(1) of the New Indiana UCC expressly applies to "a financing statement covering consumer goods . . . filed on or after January 1, 1986, . . ." *See* IND. CODE § 26-1-9-202(1) (Supp. 1986). Hence, presumably even in the case of a transaction entered into prior to January 1, 1986, if a financing statement covering consumer goods was filed in connection with the transaction and the filing took place after December 31, 1985, the secured party must file a termination statement within the time constraints described in section 9-404(1) of the New Indiana UCC.

into under the Old Indiana UCC, what other function, if any, does the language "may be terminated . . . as required or permitted by the [New Indiana UCC]" perform? If nothing else, this language should be construed to authorize the use of the New Indiana UCC termination statement forms in connection with Old Indiana UCC transactions. In other words, the secured party should be permitted to use a new UCC-3 termination statement to terminate an old UCC-1 financing statement and to use a new UCC-4 land records termination statement to terminate an old UCC-1a fixtures financing statement.[18] On the other hand, such language should *not* be construed to *require* the use of New Indiana UCC termination statement forms in connection with Old Indiana UCC transactions. The operative language is "may be terminated," *not* "shall be terminated." Consequently, the secured party should be entitled to utilize the termination copy of the originally filed old UCC-1 financing statement as well as the old UCC-3 (in the case of a UCC-1) and the old UCC-3a (in the case of a UCC-1a) in terminating financing statements filed pursuant to the Old Indiana UCC.[19]

The perfection continuation provision of section 42 applies to the same transactions as the validity provision. It states that a security interest validly entered into *and* perfected under the Old Indiana UCC remains perfected under the New Indiana UCC until it lapses (as provided in sections 44 and 45) and "may be continued as permitted by [the New Indiana UCC]," unless section 44 provides for a different rule.[20] The section 44 exception refers to the situation in which the New Indiana UCC requires a filing in an office where the Old Indiana UCC did not.[21] In that instance, section 44(3) instructs the secured party to file a "special financing statement" conforming to section 45(4) (rather than a continuation statement) in the new filing office.[22]

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[18]Even absent section 42, there really should not be any question that either the new forms or the old forms may be used to terminate financing statements filed under the Old Indiana UCC. Pursuant to section 9-404 of both the Old Indiana UCC and the New Indiana UCC, to be effective, a termination statement need only be in writing, be signed by the secured party of record (or the secured party's assignee of record), state that the secured party no longer claims a security interest under the financing statement, and identify the financing statement by file number. *See* IND. CODE § 26-1-9-404(1) (1982) and IND. CODE § 26-1-9-404(1) (Supp. 1986). The only question should be whether the termination statement is on a "non-standard" form so as to be subject to an additional filing fee. According to the Interim Rules issued by the Indiana Secretary of State on December 20, 1985, old forms formerly approved by the Secretary of State are acceptable and will not be considered to be "irregular filings." *See* Secretary of State, *Interim Rules for the Administration of the Uniform Commercial Code*, at 6 (Dec. 20, 1985) [hereinafter *UCC Interim Rules*].

[19]*See supra* note 18.

[20]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 42, *reprinted in* IND. CODE ANN. in note to 26-1-1-105 (West Supp. 1986).

[21]*See* Reporters' Discussion of 1972 changes to U.C.C. § 11-103 (1972).

[22]According to section 45(4), this "special financing statement" "may be signed by

The various perfection lapse rules will be addressed below when sections 44 and 45 are examined; however, the real "meat" of this provision appears to be its authorization to employ the New Indiana UCC perfection continuation rules in connection with transactions entered into and perfected under the Old Indiana UCC. The changes, real or cosmetic, effectuated under the New Indiana UCC with regard to perfection continuation include: (1) a different (and generally later) time to file a continuation statement when, for whatever reason, the financing statement indicates a scheduled maturity date of the obligation secured of five years or less;[23] (2) the automatic continuation of financing statements that otherwise would expire during the pendency of the debtor's bankruptcy proceeding;[24] (3) a requirement that a continuation statement signed by a person other than the secured party of record be accompanied by an appropriate statement of assignment signed by the secured party of record and the applicable filing fee for the statement of assignment;[25] (4) a "special rule" providing for indefinite duration (without need of a continuation statement) where a debtor is identified as a "transmitting utility;"[26] (5) a "special rule" providing for indefinite

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either the debtor or the secured party . . . [and] must identify the security agreement, statement, or notice (however denominated in any statute or other law repealed or modified by this act), state the office where and the date when the last filing, refiling or recording, if any, was made with respect thereto, and the filing number, if any, or book and page, if any, of recording, and further state that the security agreement, statement or notice, however denominated, in another filing office under [the New Indiana UCC] or under any statute or other law repealed or modified by [the New Indiana UCC] is still effective." Also, according to section 45(4), this "special financing statement" must comply with Ind. Code § 26-9-403(3) (Supp. 1986) pertaining to the requirements for a continuation statement, except to the extent inconsistent with the requirements described in section 45(4).

[23] *Compare* Ind. Code § 26-1-9-403(2), (3) (Supp. 1986) *with* Ind. Code § 26-1-9-403(2), (3) (1982). Section 44(1), which deals more directly with this change, is discussed *infra* at notes 41-46 and accompanying text.

[24] Ind. Code § 26-1-9-403(2) (Supp. 1986) provides that "[i]f a security interest perfected by filing exists at the time insolvency proceedings are commenced by or against the debtor, the security interest remains perfected until termination of the insolvency proceedings and thereafter for a period of sixty (60) days or until expiration of the five (5) year period, whichever occurs later." However, the courts in applying section 9-403 of the Old Indiana UCC have reached essentially this same result. *See In re* Chasely's Foods, Inc., 726 F.2d 303 (7th Cir. 1983) (applying Indiana law).

[25] This provision merely makes explicit what was formerly implicit under the Old Indiana UCC. *Compare* Ind. Code § 26-1-9-403(3) (Supp. 1986) *with* Ind. Code § 26-1-9-403(3) (1982).

[26] Ind. Code § 26-1-403(5) (Supp. 1986) provides that "[i]f a debtor is a transmitting utility (IC 26-2-9-401(5)) and a filed financing statement so states, it is effective until a termination statement is filed." Prior to the effective date of the New Indiana UCC, however, "transmitting utilities" (as defined in section 9-105(1)(n) of the New Indiana UCC) were not subject to the perfection provisions of the Indiana UCC. *See* Ind. Code §§ 8-1-2-1 and 8-1-5-1 (1982).

duration (without need of a continuation statement) of a real estate mortgage that is effective as a fixture filing;[27] and (6) a declaration that the lapse of a financing statement resulting from the failure to file a timely continuation statement will be "retroactive."[28]

Notwithstanding its other possible functions, however, the language in this provision stating that the perfection of a transaction entered into and perfected under the Old Indiana UCC "may be continued as permitted by [the New Indiana UCC]"[29] should also be construed to authorize the secured party to use the New Indiana UCC continuation statement forms in connection with transactions entered into and perfected under the Old Indiana UCC.[30] In other words, the secured party in such

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[27]Ind. Code § 26-1-9-403(5) (Supp. 1986) provides that "[a] real estate mortgage which is effective as a fixture filing under IC 26-1-9-402(6) remains effective as a fixture filing until the mortgage is released or satisfied of record or its effectiveness otherwise terminates as to the real estate." The possibility of using a real estate mortgage as a fixture filing under the New Transition Rules is the subject of section 44(4), discussed *infra* at notes 71-72 and accompanying text.

[28]Ind. Code § 26-1-9-403(2) (Supp. 1986) provides that "[i]f the security interest becomes unperfected upon lapse, it is deemed to have been unperfected against a person who became a purchaser or lien creditor before lapse."

Under the Old Indiana UCC, it was possible to argue with conviction that a secured party whose perfection in the collateral lapsed by reason of his failure to file a timely continuation statement enjoyed perfection as against any purchaser or creditor whose interest in the collateral arose prior to the lapse. *See generally* B. Clark, The Law of Secured Transactions Under the Uniform Commercial Code 2.14 (1980). However, under section 9-403(2) of the New Indiana UCC, a judgment lienor, an outright purchaser, or even a competing secured party whose interest in the collateral arose prior to the lapse in perfection will have a superior interest in the collateral. *Id.*

Although certainly not free from doubt, it would appear that section 46, not section 42, will determine whether the new rule stated under section 9-403(2) of the New Indiana UCC should be applied to a secured transaction entered into and perfected under the Old Indiana UCC. Section 46 generally provides that the New Indiana UCC applies to questions of priority unless the positions of the parties were "fixed" before January 1, 1986. 1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 46, *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986). Hence, if the lapse in perfection occurs on or after January 1, 1986, section 46 apparently would require that the harsh retroactive lapse rule dictated by section 9-403(2) of the New Indiana UCC be applied.

[29]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 42, *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986).

[30]Even absent section 42, there should not be any question that either the new forms or the old forms may be used to continue financing statements filed under the Old Indiana UCC. Pursuant to section 9-403 of both the Old Indiana UCC and the New Indiana UCC, to be effective, a continuation statement need only be in writing, be signed by the secured party of record (or the secured party's assignee of record), identify the original financing statement by file number, and provide that the original financing statement is still effective. *See* Ind. Code § 26-1-9-403(3) (1982); Ind. Code § 26-1-9-403(3) (Supp. 1986). The only question should be whether the continuation statement is on a "non-standard" form so as to be subject to an additional filing fee. According to the Interim Rules promulgated by the Indiana Secretary of State on December 20, 1985, old forms

a transaction should be entitled to use a new UCC-3 continuation statement to continue an old UCC-1 financing statement (filed in the same filing office) and a new UCC-4 land records continuation statement to continue an old UCC-1a fixtures financing statement. On the other hand, because the operative language is "may be continued," *not* "shall be continued," the secured party should also be permitted to use an old UCC-3 continuation statement to continue an old UCC-1 financing statement (filed in the same filing office) and an old UCC-3a fixtures continuation statement to continue an old UCC-1a fixtures financing statement.[31]

B. Section 43

Section 43 provides that an unperfected, but validly created security interest under the Old Indiana UCC will be deemed to be properly perfected under the New Indiana UCC effective January 1, 1986, if the New Indiana UCC either permits perfection without filing or authorizes filing in the office where a prior ineffective filing was made.[32] In other words, this section can have the effect of "curing," as of January 1, 1986, a multitude of perfection sins committed by the secured party prior to that date.

Consider, for example, the secured party who relied upon the automatic perfection of his purchase money security interest in consumer goods under the Old Indiana UCC, only later to learn that the consumer goods that he sold to the debtor had become fixtures. Under the Old Indiana UCC, a secured party's entitlement to automatic perfection for purchase money security interests in consumer goods was lost if the goods became fixtures.[33] Under the New Indiana UCC, however, it is clear that automatic perfection does operate under these facts, at least as against non-real estate parties.[34] Hence, pursuant to section 43, a secured party who erroneously relied on automatic perfection under the Old Indiana UCC will enjoy the benefits of automatic perfection under the New Indiana UCC (with respect to non-real estate parties) as of

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formerly approved by the Secretary of State are acceptable and will not be considered to be "irregular filings." *See UCC Interim Rules*, *supra* note 18, at 6.

[31]*See supra* note 30. However, the (final) *Rules for the Administration of the Uniform Commercial Code* (effective September 1, 1986) issued by the Indiana Secretary of State [hereinafter, the *UCC Final Rules*] suggest that in the case of a fixture filing made prior to January 1, 1986, it may be necessary to use a new UCC-4 land records continuation statement so as to continue the fixture filing in the real estate (mortgage) records. *See infra* note 61.

[32]1985 Ind. Acts 828-30, Pub. L. No. 93-1985 § 43, *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986).

[33]Ind. Code § 26-1-9-302(1)(d) (1982).

[34]Ind. Code § 26-1-9-302(1)(d) (Supp. 1986).

January 1, 1986,[35] without having lifted a hand and, perhaps, in complete oblivion of the original perfection blunder.

A similar result should be achieved by section 43 in connection with the perfection of proceeds.[36] Under the Old Indiana UCC, if a secured party was granted a security interest in proceeds but failed to check the "proceeds box" on the UCC-1, he had no perfected interest in proceeds after ten days from the receipt of the proceeds by the debtor.[37] The New Indiana UCC, however, changes this result in two important circumstances.

Under the New Indiana UCC, the secured party will enjoy an automatic and continuously perfected security interest in proceeds, even though the financing statement filed in connection with the original collateral is "silent" as to proceeds,[38] if: (1) the proceeds are identifiable cash proceeds;[39] or (2) the financing statement is filed in the same filing office(s) where an original security interest in the type of property constituting the proceeds should be filed (and the proceeds are not acquired with cash proceeds).[40] By operation of section 43 in these two circumstances, an unperfected security interest in proceeds under the Old Indiana UCC will automatically be transformed into a properly perfected security interest in proceeds as of January 1, 1986.

C. Section 44

Section 44(1) contains the general rule that a financing statement or a continuation statement filed prior to January 1, 1986 (and which has not lapsed prior to that date) remains effective for the period provided under the Old Indiana UCC, but not less than five years.[41] Under the

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[35]*See* Reporters' Discussion on 1972 changes to U.C.C. § 11-104 (1972).

[36]*Cf. In re* S & Z Int'l Management, Inc., 10 Bankr. 580 (Bankr. S.D. Fla. 1981) (omission of UCC § 11-104 by Florida legislature showed intent not to automatically perfect previously unperfected pre-amendment security interest in proceeds).

[37]Ind. Code § 26-1-9-306(3)(a) (1982).

[38]Pursuant to section 9-203(3) of the New Indiana UCC, the secured party is granted automatically a security interest in proceeds, unless the security agreement provides to the contrary. Ind. Code § 26-1-9-203(3) (Supp. 1986). Under the Old Indiana UCC, however, a reference to proceeds in the security agreement arguably was necessary for the secured party to have any claim to proceeds. *Cf. In re* S & Z Int'l Management, Inc., 10 Bankr. at 584 (referring to an inconsistency between section 9-203(1)(b) and section 9-306(2) of the 1962 Official Text).

[39]Ind. Code § 26-1-9-306(3)(b) (Supp. 1986).

[40]Ind. Code § 26-1-9-306(3)(a) (Supp. 1986). If the proceeds are acquired with cash proceeds, the description of the collateral in the financing must indicate the types of property constituting the proceeds. *Id.*

[41]Notwithstanding this seemingly clear rule contained in section 44(1), the recently effective *UCC Final Rules, supra* note 31, issued by the Indiana Secretary of State provide in pertinent part: "All fixtures filings made in the fixture index prior to January 1, 1986

Old Indiana UCC, a financing statement that stated a maturity date of the obligation secured of five years or less was effective until the maturity date disclosed plus sixty days.[42] All other financing statements were effective for five years from the date of filing.[43] Section 44(1) adopts the rule under the New Indiana UCC (which places a uniform five year duration on continuation and financing statements)[44] and applies it to filings made before January 1, 1986.

This automatic extension of certain financing statements mandated by section 44(1) may, of course, work to the detriment of a secured party who is not aware of the extension. For example, a secured party might erroneously file a continuation statement shortly before the pre-extension maturity of a financing statement stating an (obligation) maturity date of three years and, therefore, neglect to file a continuation statement within six months prior to the newly-extended maturity date of the financing statement (which under section 44(1) is five years from the date of filing).[45] In that case, the secured party would be holding an unperfected security interest after five years from the date of filing of the financing statement.[46]

Section 44(2) provides that if a financing statement or continuation statement filed before January 1, 1986, purports to cover collateral acquired by the debtor after December 31, 1985, perfection as to such after-acquired collateral will be effective only if the filing or filings are in the office or offices that would be appropriate to perfect the security interests in the new collateral under the New Indiana UCC.[47] The rea-

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will be effective until they expire under the prior law or until December 31, 1988, *whichever comes first. . . .*" *Id.* at 13 (emphasis in original). Simply stated, even though section 44(1) unambiguously provides that the effectiveness of a pre-1986 continuation statement or financing statement will last for a full five years, the fixtures financing statement itself will be purged from the "public record" after December 31, 1988, whether or not the five years have elapsed. If the secured party wants to prevent this pre-maturity removal of his fixtures financing statement after December 31, 1988, in this situation, it appears he must file an appropriate continuation statement in the real estate (mortgage) records during the six-month period preceding December 31, 1988. *Id.* at 13, 27-28.

As legally unjustified as the above administrative rule appears to be, secured parties and attorneys representing secured parties can at least take some solace in the fact that the Secretary of State apparently has abandoned an even more unjustified interim administrative rule providing that all "[f]ilings made under the 1962 Act up until December 31, 1985, will remain effective until they expire under the old law or until December 31, 1988, whichever comes first." *See UCC Interim Rules*, *supra* note 18, at 4.

[42]Ind. Code § 26-1-9-403(2) (1982).

[43]*Id.*

[44]*See* Ind. Code § 26-1-9-403(2), (3) (Supp. 1986).

[45]*Id.* § 26-1-9-403(3).

[46]*See, e.g.*, *In re* Callahan Motors, Inc., 538 F.2d 76 (3d Cir.), *cert. denied sub nom.* Sterns v. Princeton Bank & Trust Co., 429 U.S. 987 (1976).

[47]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 44(2), *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986).

sonable inferences from section 44(2) are that: (1) all existing financing statements and continuation statements on the effective date of the New Indiana UCC will remain effective for the remainder of the five years described in section 44(1) as to existing collateral, even though the appropriate place for filing may have changed;[48] and (2) the existing filings will also apply to collateral acquired after the effective date of the New Indiana UCC, unless the appropriate filing place is different under the New Indiana UCC.[49] Perhaps the proper application of section 44(2) can be best illustrated by the following hypothetical:

> *Facts*: On January 1, 1984, Debtor, a domestic farming corporation, grants to Creditor *A* a non-purchase money security interest in "all its equipment, whether now owned or hereafter acquired." Creditor *A* properly perfects its security interest in such collateral on January 2, 1984, pursuant to the Old Indiana UCC, by filing an appropriate financing statement with the Indiana Secretary of State.[50] On January 1, 1985, Debtor grants to Creditor *B* a non-purchase money security interest in the same collateral. On January 2, 1985, Creditor *B* properly perfects his security interest in such collateral by filing an appropriate financing statement with the Indiana Secretary of State. However, because of an ambiguity in the Old Indiana UCC's perfection requirements, Creditor *B* also files with the Recorder's Office in the county where Debtor resides and has its principal place of business.[51] On January 1, 1986, Debtor acquires $1 million in new farm equipment. Assuming that neither creditor takes any additional steps to perfect, which creditor has priority with respect to the after-acquired collateral?

Pursuant to the Old Indiana UCC's priority and perfection provisions, Creditor *A* would, of course, enjoy priority over Creditor *B* both as to the existing collateral and as to the newly-acquired collateral, because Creditor *A* filed first.[52] By contrast, under the New Indiana UCC, Creditor *B* would enjoy priority over Creditor *A* both as to the existing collateral and as to the newly-acquired collateral (unless Creditor *B* had actual knowledge of the contents of Creditor *A*'s financing statement), because only Creditor *B* would be deemed to be properly

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[48]*See* Reporter's Discussion on 1972 Changes to U.C.C. § 11-105 (1972).

[49]*See id.*

[50]*See* Second National Bank of Danville v. Massey-Ferguson Credit Corp., 470 N.E.2d 916 (Ind. Ct. App. 1985) (interpreting section 9-401 of the Old Indiana UCC).

[51]*See* Compiler's Note to IND. CODE § 26-1-9-401 (Burns 1974) (suggesting that the Indiana Legislature unintentionally repealed certain language in section 9-401 that, in this case, would require filing both locally and centrally).

[52]*See* IND. CODE § 26-1-9-312(5)(a) (1982).

perfected.[53] The New Indiana UCC clearly provides that in order for a secured party to be perfected as to farm equipment owned by a domestic (farming) corporation, it is necessary to file centrally with the Secretary of State and locally with the Recorder's Office in the county where the debtor has its residence.[54] Only Creditor *B* has satisfied this dual filing requirement.

By operation of section 44(2), however, a compromise is struck. Creditor *A* will enjoy priority over Creditor *B* as to the collateral in existence on December 31, 1985.[55] On the other hand, Creditor *B* will enjoy priority over Creditor *A* as to the collateral acquired on January 1, 1986.[56] If Creditor *A* had wanted to maintain his relative priority with respect to the collateral acquired after December 31, 1985, he should have anticipated the change in filing offices under the New Code and filed a "special financing statement" with the Recorder's Office in the county where Debtor had its residence on or before December 31, 1985.[57]

Section 44(3) contains the general rule that a financing statement or continuation statement that is filed prior to January 1, 1986, "may be continued . . . as permitted by [the New Indiana UCC];"[58] however, an express exception is made to this general rule in a case where the place for filing has changed under the New Indiana UCC. According to this exception, "[i]f [the New Indiana UCC] requires a filing in an office where there was no previous financing statement, a new financing statement conforming to Section 45 [of the New Transition Rules] shall be filed in that office."[59] In other words, a "special financing statement" (rather than a continuation statement) must be filed in the new filing office to continue perfection.

Section 44(3), like the perfection continuation provision in section 42, appears to lend support to the general proposition that a secured party may use New Indiana UCC continuation forms to continue the perfection of transactions entered into and perfected under the Old Indiana UCC. Nonetheless, a possible legal argument exists under this section that neither a new UCC-4 land records continuation statement nor an old UCC-3a fixtures continuation statement may be used to continue an old UCC-1a fixtures financing statement. This argument is based on the premise that the New Indiana UCC requires a financing statement covering a security interest in fixtures to be filed in the real estate records,

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[53]*See* IND. CODE §§ 26-1-312(5)(a), 26-1-9-401(1)(a), (2) (Supp. 1986).

[54]*See id* § 26-1-9-312(5)(a).

[55]*See supra* note 48 and accompanying text.

[56]*See supra* note 49 and accompanying text.

[57]*See, e.g.*, *In re* Painter, 39 Bankr. 544, 548 (Bankr. D.S.D. 1984).

[58]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 44(3), *reprinted in* IND. CODE ANN. in note to § 26-1-1-105 (West Supp. 1986).

[59]*Id.*

which arguably is a different "office" than the "office" where the original fixtures filing was made. In other words, it might be asserted that a "special" UCC-2 land records *financing statement* containing a legal description of the real estate should be filed in the real estate records to continue an old UCC-1a filed in the old fixtures index.[60]

It is submitted that such an argument is totally without merit for the simple reason that both the real estate records and the old fixtures index are, in fact, located in the same "office"—the County Recorder's Office. If the drafters of this section had meant to say "index" or "file" (rather than "office"), they would have said so.[61]

A much more troublesome interpretive problem arises under this section with respect to the continuation of perfection in watercraft. Under the Old Indiana UCC, a security interest in watercraft was generally perfected by the filing of an appropriate financing statement.[62] However, pursuant to the New Indiana UCC, a security interest in watercraft (other than watercraft that is inventory held for sale by a person in the business of selling goods of that kind) generally must be perfected by notation of the secured party's lien on the certificate of title issued by the Department of Natural Resources.[63] The obvious question, of course,

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[60]*See* section 45(4) quoted in pertinent part *supra* at note 22 for the required contents of the "special financing statement" mandated by section 44(3).

[61]Notwithstanding the obvious lack of merit to this argument, the recently effective *UCC Final Rules* promulgated by the Indiana Secretary of State provide that: *"[i]n no event shall a fixture filing made prior to January 1, 1986, be effective after December 31, 1988 unless re-filed or continued in the real estate (mortgage) records." See UCC Final Rules, supra* note 31, at 13 (emphasis in original). The emphasized language, of course, suggests that a "special financing statement" may be necessary to effectuate a transfer from fixtures index to the mortgage records index. Based upon a telephone conference with Beth Adams, the Director of the Uniform Commercial Code Division of the Indiana Secretary of State's Office, it appears that the appropriate continuation statement form to effectuate this transfer from the fixtures index to the mortgage records index is a new UCC-4 land records continuation statement. Telephone interview of September 17, 1986.

[62]*See* Ind. Code § 26-1-9-302(1) (1982). Automatic perfection was available as well in the case of a purchase money security interest in watercraft, if the debtor's use of the collateral was primarily for a personal, family, or household purpose, *see id.* §§ 26-1-9-109(1), 26-1-9-302(1)(d), but this was somewhat risky, because a buyer without actual knowledge of the security interest who gave value to the debtor was entitled to take the watercraft free of such security interest. *See id.* § 26-1-9-307(2). Finally, it was possible (although certainly not practical) for the secured party to perfect a security interest in watercraft by taking actual physical possession of the collateral. *See id.* § 26-1-9-302(1)(a).

[63]*See* Ind. Code § 26-1-9-302(3)(b) (Supp. 1986); *see also* United Leaseshares Inc. v. Citizens Bank & Trust, 470 N.E.2d 1383 (Ind. Ct. App. 1984) (indicating that in the case of vehicles subject to titling, the lien notation must be by an official or employee of the Bureau of Motor Vehicles). One reading of section 9-302 of the New Indiana UCC, however, suggests that it may be possible to make use of automatic perfection in

is: what impact, if any, will this change in perfection procedure have on transactions entered into and perfected by the filing of a financing statement pursuant to the Old Indiana UCC?[64]

First, pursuant to section 42, the secured party's lien on the watercraft remains perfected until it lapses under either section 44 or section 45. With respect to sections 44 and 45, only section 44(1) contains a lapse rule applicable to the type of transaction under discussion. It provides that a financing statement or a continuation statement filed before January 1, 1986, which has not lapsed before that date, remains effective for five years from the date of filing.[65]

If perfection will lapse five years after filing, what, if anything, can be done to continue perfection after that date? According to section 42, the security interest "may be continued as permitted by [the New Indiana UCC] except as stated in Section 44 . . . ."[66] Unfortunately, the New Indiana UCC does not permit the continuation of a perfected security

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the case of a purchase money security interest in a watercraft if the collateral is acquired primarily for a personal, family, or household purpose. *Compare id.* § 26-1-9-302(1)(d), (3)(b) (perfection of motor vehicles) *with id.* § 26-1-9-302(1)(d), (3)(b) (perfection of watercraft). Nevertheless, IND. CODE § 14-1-4-21 (Supp. 1986) appears to preclude automatic perfection by stating that "[a] security agreement covering a security interest in a watercraft that is not inventory held for sale can be perfected only by indication of the security interest on the certificate of title . . . by the [Department of Natural Resources]." For the same reason, it appears that the secured party may not perfect a security interest in non-inventory watercraft by taking actual physical possession of the collateral.

It should be noted that the meaning of IND. CODE § 14-1-4-21 (Supp. 1986) is somewhat "muddled" by another section of chapter 4 of title 14, which states that the chapter on "watercraft certificates of title" does not apply to "[w]atercraft other than motorboats unless the owner voluntarily wishes to become subject to this chapter." IND. CODE § 14-1-4-2(4) (Supp. 1986). In short, it is unclear how a secured party may safely perfect a security interest in a watercraft other than a motorboat if the owner does not elect to become subject to this chapter (by obtaining a certificate of title for the watercraft). Because the owner presumably could acquire a certificate of title on the boat at any subsequent time and thereby elect to be subject to the chapter, a person pondering whether to grant credit based upon a security interest in a watercraft other than a motorboat should insist that the debtor obtain a certificate of title and have the security interest duly noted thereon.

[64]For the purposes of the analysis contained in the text, it will be assumed that the watercraft at issue is a motorboat and that the security interest created did not qualify for automatic perfection pursuant to the Old Indiana UCC. *See supra* notes 62 & 63. However, even assuming that the security interest did qualify for automatic perfection under the Old Indiana UCC, it appears that section 45(1) of the New Transition Rules would operate to terminate the automatic perfection as of December 31, 1988, unless prior to that date, the secured party had his lien noted on the certificate of title by the Department of Natural Resources. *See infra* notes 76-79 and accompanying text for further discussion of section 45(1).

[65]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 44(1), *reprinted in* IND. CODE ANN. in note to § 26-1-1-105 (West Supp. 1986).

[66]*Id.* § 42.

interest in (non-inventory) watercraft to be accomplished by filing a continuation statement. As previously noted, the secured party must have his lien noted on the watercraft's certificate of title by the Department of Natural Resources for perfection to be continued under the New Indiana UCC.

Section 42, of course, contains a cross-reference to section 44. Well then, does section 44 add anything to the perfection continuation analysis? Section 44(3), the only subsection of section 44 to which the "except as stated in Section 44 . . ." language of section 42 could refer, provides that a financing statement or continuation statement filed under the Old Indiana UCC "may be continued by a continuation statement as permitted by [the New Indiana UCC] except that if [the New Indiana UCC] requires a filing in an office where there was no previous financing statement, a new financing statement conforming to Section 45 . . . shall be filed in that office."[67]

Again, the New Indiana UCC does not permit the continuation of a perfected security interest in (non-inventory) watercraft to be accomplished by the filing of a continuation statement. Moreover, the exception contained in section 44(3) also does not appear to apply. Arguably, the notation of the secured party's lien on the certificate of title is not a "filing" within the meaning of section 44(3).[68] And, in any event, the filing of a section 45 financing statement (i.e., a "special financing statement") with the Department of Natural Resources would in all likelihood be an exercise in futility. That agency simply is not equipped to receive or maintain an index for UCC financing statements or continuation statements.

The bottom-line appears to be that sometime prior to the perfection lapse under section 44(1), the secured party must present a properly completed application for certificate of title, together with the prescribed fee, to the Department of Natural Resources and have the lien noted on the face of the title.[69] Unfortunately, the title application forms

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[67]*Id.* § 44(3).

[68]*Id.*

[69]*See* Ind. Code § 14-1-4-21(b) (Supp. 1986). Arguably, the debtor-owner is under a statutory duty to obtain a certificate of title as of January 1, 1986, if the watercraft is subject to a security interest on that date. *See* Ind. Code § 14-1-4-4 (Supp. 1986) ("[A] watercraft acquired by the owner before January 1, 1986, is not required to have a certificate of title until it is mortgaged, sold, or transferred, or a lien is placed on the watercraft."). However, there appears to be no corresponding statutory duty for the debtor-owner to have the secured party's lien noted on the certificate of title once it is obtained. Assuming the statutory duty exists, the debtor-owner would be guilty of a Class C misdemeanor if he should fail to obtain a certificate of title. *See* Ind. Code § 14-1-4-22(a) (Supp. 1986). Moreover, if the debtor-owner should obtain the requisite certificate of title but fail to have the second party's lien noted thereon, he presumably would be subject to the penalties of perjury. *See UCC Final Rules, supra* note 31, at 33.

presently being used contemplate that the debtor, not the secured party, must execute the application for certificate of title.[70] Hence, if the debtor should refuse to execute the title application form, the secured party may well be "stuck" with an unperfected security interest and be at the mercy of other potential claimants to the watercraft, including judgment lien creditors and the debtor's trustee in bankruptcy.

Section 44(4) allows a real estate mortgage recorded prior to January 1, 1986, to serve as a fixtures filing of goods described in such mortgage, if the mortgage satisfies the provision pertaining to such matters under the New Indiana UCC.[71] For some unknown reason, however, this provision did not become operative until July 1, 1986,[72] six months after the effective date of the new Indiana UCC. This delay in the effective date, of course, renders the protection afforded by section 44(4) potentially meaningless. Simply stated, a fixtures secured party relying on this provision (without a back-up regular fixture financing statement) may well find that another creditor has obtained priority during the six-month "gap period."

D. Section 45

Section 45 attempts to address questions of when re-perfection should be undertaken in various circumstances and what kind of document should be used for the re-perfection. Section 45(1) provides that a security interest perfected or having priority as of December 31, 1985, without any filing or recording, must be re-perfected under the New Indiana UCC if the New Indiana UCC requires the filing of a financing statement for perfection or priority.[73] In this situation, however, the secured party

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[70]This result appears to be supported by statutory requirements. *See* IND. CODE §§ 14-1-4-8(b), -9 (Supp. 1986).

[71]Section 9-402(6) of the New Indiana UCC states as follows:

> (6) A mortgage is effective as a financing statement filed as a fixture filing from the date of its recording if:
> (a) The goods are described in the mortgage by item or type; and
> (b) The goods are or are to become fixtures related to the real estate described in the mortgage; and
> (c) The mortgage complies with the requirements for a financing statement in this section other than a recital that it is to be filed in the real estate records; and
> (d) The mortgage is duly recorded.
> No fee with reference to the financing statement is required other than the regular recording and satisfaction fees with respect to the mortgage.

IND. CODE § 26-1-9-402(6) (Supp. 1986).

[72]U.C.C. § 11-105(4) (1972) provides that "the mortgage shall be deemed effective as a fixture filing as to such goods under subsection (6) of Section 9-402 of the [new U.C.C.] on the effective date of [new U.C.C.]."

[73]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 45(1), *reprinted in* IND. CODE ANN. in note to § 26-1-1-105 (West Supp. 1986).

is granted until December 31, 1988, to file the required financing statement or to perfect the security by another method (typically, by taking possession of the collateral).[74] In the meantime, the secured party's perfection and/or priority under the Old Indiana UCC is continued. If re-perfection is to be accomplished by filing a financing statement, section 45(4) indicates that the filing should not be made until within six months before the security interest would otherwise lapse (i.e., six months before December 31, 1988).[75] Such financing statement may be signed by either the debtor or the secured party and must identify the security agreement and, presumably, must also state that the security agreement is still effective.[76]

The primary secured transactions to which section 45(1) is directed are those involving purchase money security interests in farm equipment having a purchase price of $500.00 or less.[77] Under the Old Indiana UCC, security interests in such collateral were perfected automatically without filing.[78] The New Code, however, eliminates this particular automatic perfection provision and requires the filing of an appropriate financing statement for perfection.[79] Section 45(1) allows the secured party in this case to rely on automatic perfection for three full years, during which time the secured party must take appropriate action to perfect under the New Indiana UCC.[80]

Section 45(2) provides that a security interest perfected prior to January 1, 1986, under a law, other than the Old Indiana UCC, that required no filing, refiling, or recording to continue its perfection will continue perfected until and lapse on December 31, 1988, unless: (1) a "special financing statement" complying with section 45(4) is filed within six months before December 31, 1988; (2) the security interest is perfected otherwise than by filing; or (3) the New Indiana UCC expressly defers to the other law.[81] The only secured transactions that appear to be covered by section 45(2) are those transactions subject to Indiana's public utility mortgage statute.[82] Prior to the effective date of the New Indiana

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[74]*Id.*

[75]*Id.* § 45(4).

[76]*See* section 45(4) quoted in pertinent part in note 22, *supra*, for the required contents of the special financing statement mandated by section 45(1).

[77]*See* Reporters' Discussion on 1972 changes to U.C.C. § 11-106(1) (1972). Section 45(1) may also cover purchase money security interests in watercraft if such collateral was acquired primarily for a personal, family, or household purpose. *See supra* notes 62-64 and accompanying text.

[78]IND. CODE § 26-1-9-302(1)(c) (1982).

[79]*See* Reasons for 1972 Change accompanying U.C.C. § 9-302 (1972); *see also* IND. CODE § 26-1-9-302 (Supp. 1986).

[80]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 45(1), *reprinted in* IND. CODE ANN. in note to § 26-1-1-105 (West Supp. 1986).

[81]*Id.* § 45(2).

[82]*See generally* Reporters' Discussion on 1972 changes to U.C.C. § 11-106(2) (1972).

UCC, Indiana Code section 8-1-5-1 generally provided that in order to have a valid and continuously perfected lien on the real and personal property, including the after-acquired property, of a public utility, the mortgagee had only to record a mortgage describing the property in the real estate records in the county or counties where the property covered by the mortgage was located.[83] Effective January 1, 1986, Indiana Code section 8-1-5-1 was amended to provide that, in addition to recording the mortgage in the appropriate county, it is necessary to comply with the filing requirements of the New Indiana UCC in order to perfect a security interest in the collateral of a public utility that is covered by the New Indiana UCC.[84] Accordingly, pursuant to section 45(2), the public utility mortgagee will enjoy continued perfection for all UCC-covered collateral, including after-acquired collateral,[85] through December 31, 1988. After December 31, 1988, perfection will lapse as to the UCC-covered collateral unless, prior to that date, appropriate and timely perfection of such collateral is accomplished pursuant to section 45 and the New Indiana UCC. With respect to UCC-covered collateral that properly may be perfected under the New Indiana UCC by filing a financing statement, the public utility mortgagee should file within six months prior to December 31, 1988, a "special financing statement" complying with section 45(4) in the appropriate filing office or offices.[86] However, if filing a financing statement is not a proper method of perfection under the New Indiana UCC, the mortgagee must comply with the appropriate perfection procedure mandated by the New Indiana UCC sometime prior to December 31, 1988, but not necessarily within the six-month period preceding December 31, 1988. For example, in the case of money or instruments, the mortgagee or his agent must take

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[83] Ind. Code § 8-1-5-1 (1982).

[84] Ind. Code § 8-1-5-1(b) (Supp. 1986).

[85] Section 44(2) states the rule that "[w]ith respect to any collateral acquired by the debtor after December 31, 1985, *any effective financing statement or continuation statement described in this section* applies only if the filing or filings are in the office or offices that would be appropriate to perfect the security interests in the new collateral." 1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 44(2), *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986) (emphasis supplied). Although the filing required under the New Indiana UCC with respect to public utility mortgages may be in a different filing office (generally, in the Secretary of State's office), the only effective financing statements and continuation statements described in section 44 are those which were filed pursuant to the Old Indiana UCC; consequently, public utility mortgages recorded under Ind. Code § 8-1-5-1 should not be governed by section 44(2) as to after-acquired property.

[86] If the debtor is a "transmitting utility" as defined in Ind. Code § 26-1-9-105(1)(n) (Supp. 1986), the appropriate filing office is with the Office of the Indiana Secretary of State. *See* Ind. Code § 26-1-9-402(5) (Supp. 1986); *see also* Official Comments to U.C.C. §§ 9-105(1)(n), -401(5), -403(6) (1972). Multiple filings may be necessary, however, in the case of a "public utility" as defined in Ind. Code § 8-1-2-1 (Supp. 1986) which is not a "transmitting utility." *See generally* Ind. Code § 26-1-9-401(1) (Supp. 1986).

actual physical possession of the collateral,[87] and in the case of goods subject to a certificate of title law, the mortgagee must succeed in having his lien noted on the title by the appropriate government agency.[88]

Section 45(3) purports to govern the continuation of perfection of security interests perfected under a law repealed by the New Indiana UCC that requires further filing, refiling, or recording to continue perfection. This provision appears to be superfluous because the New Indiana UCC contains no such repealer.[89]

E. Section 46

Section 46 addresses questions of priority. The "general rule" is that the New Indiana UCC applies to questions of priority unless the rights of the parties were fixed under the Old Indiana UCC. The section contains two separate sentences. The first sentence provides that "[e]xcept as otherwise provided in Sections 42, 43, 44, and 45 [the Old Indiana UCC] applies to questions of priority if the positions of the parties were fixed before January 1, 1986."[90] The second sentence of section 46 states that "[i]n all other cases, questions of priority will be determined by [the New Indiana UCC]."[91] Unfortunately, these two seemingly very simple sentences virtually defy a meaningful and consistent interpretation.

Perhaps the most perplexing interpretive problem regarding section 46 is determining the meaning of the "[e]xcept as otherwise provided" language in the first sentence. The "plain meaning" of this sentence would appear to be that the Old Indiana UCC governs priority disputes between competing claimants whose positions in the collateral are fixed before January 1, 1986, unless, under the other transition rules (sections 42, 43, 44, and 45), a different result is dictated. The question then becomes: what must these other transition rules provide in order for the Old Indiana UCC not to govern the priority dispute?

For example, must the other transition rules expressly state that the Old Indiana UCC will not govern, or that the New Indiana UCC will govern, a particular priority dispute? If that is the case, there simply are no other transition rules that would satisfy this standard. Consequently, the "[e]xcept as otherwise provided" language would be rendered totally meaningless.

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[87]*See* Ind. Code § 26-1-9-305 (Supp. 1986).

[88]*See* Reporters' Discussion on 1972 changes to U.C.C. § 11-106(2) (1972).

[89]This subsection in the model transition rules was intended to cover "the case (if any) where a prior transmitting utility provision outside the Code had a filing of limited duration." *See* Reporters' Discussion to U.C.C. § 11-106(3) (1972). Indiana had no such transmitting utility provision outside the Old Indiana UCC.

[90]1985 Ind. Acts 828-30, Pub. L. No. 93-1985, § 46, *reprinted in* Ind. Code Ann. in note to § 26-1-1-105 (West Supp. 1986).

[91]*Id.*

What about a somewhat lower standard? What if the requisite standard is that the other transition rules must express a particular priority rule (as distinguished from a particular perfection continuation rule), which, under the circumstances, is contrary to the general rule that the Old Indiana UCC governs priority disputes between parties whose positions are fixed prior to January 1, 1986? Under this standard, only section 45(1) expressly refers to priority (as distinct from perfection continuation), and it refers to the continuation of the priority which existed on December 31, 1985. Thus once again, the "[e]xcept as otherwise provided" language would appear to have no meaning.

Dropping then to the seemingly lowest possible standard: what if the requisite standard is merely that the other transition rules must refer to the continuation of perfection under the New Indiana UCC? In other words, the first sentence of section 46 should be interpreted to mean that if a particular transition rule operates to continue the perfection of a security interest under the New Indiana UCC, the rule that the Old Indiana UCC governs priority disputes between parties whose positions are fixed prior to January 1, 1986, does not apply. Or, stated another way, continuation of perfection by operation of the New Transition Rules means that the position of the party holding such a security interest will be deemed to be fixed on or after January 1, 1986. Under this interpretation, the New Indiana UCC would govern the priority dispute if perfection is continued under the New Transition Rules (pursuant to the second sentence of section 46). Although this interpretation would give real meaning to the "[e]xcept as otherwise provided" language, it also would produce the "world's worst" transition policy. Consider the following hypothetical:

> *Facts*: In late 1984, Debtor executes a document designated as a construction mortgage in favor of Creditor *A* in connection with the construction of a large office building on Blackacre. Creditor *A* properly records his mortgage on Blackacre prior to commencing any work. On January 1, 1985, before the construction of the office building is completed, Creditor *B* agrees to supply on credit to Debtor certain goods which are to become fixtures on Blackacre. Creditor *B* wisely asks Debtor to execute a security agreement covering the goods and immediately perfects the security interest so created by filing both a UCC-1 and a UCC-1a before the goods are delivered to Debtor. Subsequently, on January 1, 1986, the New Indiana UCC becomes effective. Pursuant to sections 42 and 44(1) of the New Transition Rules, the perfection of Creditor *B*'s security interest in the goods is continued beyond the January 1, 1986, effective date of the New Indiana UCC. Which of Creditor *A* or Creditor *B* has priority with respect to the goods sold to Debtor by Creditor *B*?

Pursuant to section 9-313(2) of the Old Indiana UCC, Creditor *B* clearly was entitled to priority over Creditor *A* as to the fixtures,[92] and Creditor *B* may well have relied on this priority when he extended credit to Debtor. Under section 9-313(6) of the New Indiana UCC, however, Creditor *A* would be entitled to priority over Creditor *B*, because of the New Indiana UCC's preference of construction mortgagees over parties holding purchase money security interests in fixtures.[93]

If the first sentence of section 46 were to be interpreted in the manner suggested above, the New Indiana UCC would control the priority dispute (under the second sentence), and Creditor *B* would "lose out" to Creditor *A*, even though Creditor *B* relied to his detriment on the priority rules under the Old Indiana UCC, and even though the attachment and perfection of the respective interests of the parties in the goods were accomplished before the New Indiana UCC was enacted. Can this be the intended result under section 46? Certainly not![94]

It appears then, that the *only* interpretation of the first sentence of section 46 that gives some meaning to the "[e]xcept as otherwise provided" language but that does not destroy the reliance interests of parties who perfected under the Old Indiana UCC is to read the "except as otherwise provided" language as modifying the clause "if the positions of the parties were fixed before January 1, 1986." In other words, the first sentence of section 46 should be construed to mean: if the positions of the parties are fixed before January 1, 1986, notwithstanding any continuation of perfection or priority under sections 42, 43, 44, and 45, the Old Indiana UCC governs any questions of priority. Although admittedly, this is a very strained interpretation of the existing language, it at least will not work an injustice on innocent parties. Whether or not this interpretation is the "correct" one is, of course, anybody's guess.

Another significant ambiguity in section 46 is what is meant by the parties having their positions "fixed." Fortunately, several court decisions from other jurisdictions have addressed this issue under a similar or identical transition rule. Although, to date, the courts have refrained from providing a general formulation, there are several factual contexts

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[92] *See* IND. CODE § 26-1-9-313(2), (4) (1982).

[93] *See* IND. CODE § 26-1-9-313(4)(a), (6) (Supp. 1986).

[94] In addition to being grossly inequitable, IND. CODE § 26-1-1-103 (Supp. 1986), this result appears to be subject to constitutional challenge as violating the due process requirements of the fifth amendment. *Cf.* United States v. Security Indus. Bank, 459 U.S. 70 (1982) (discussing the constitutionality of the retroactive application of section 522(f) of the Bankruptcy Code, but relying on non-constitutional grounds for the decision). Moreover, this result runs counter to section 42 which purports to preserve the sanctity and validity of security agreements as against third parties. *See* IND. CODE § 26-1-9-201 (1982).

in which the meaning of this language has been addressed. For example, the positions of the parties have been deemed to be fixed prior to the effective date of the New UCC if the security interests of each of the claimants were both acquired and perfected before that date.[95] It has also been held that if one of the claimants to the collateral is the debtor's trustee in bankruptcy, and the petition is filed after the effective date of the New UCC, the priority dispute will be resolved under the New UCC.[96] Conversely, it has been held that if the bankruptcy petition is filed by or against the debtor before the effective date of the New UCC, the positions of a (perfected or unperfected) secured party claimant to the collateral and the debtor's trustee in bankruptcy should be deemed to be fixed as of the bankruptcy petition date and, hence, prior to the effective date of the New UCC.[97] Finally, in the case of competing secured parties to after-acquired inventory, it has been held that the position of the parties as to each item of inventory is fixed only when the debtor received possession, because prior to such time the relative priorities as to the item cannot be determined.[98]

Beyond these situations, however, the determination of what it means for the positions of the parties to be fixed becomes increasingly "fuzzy." This is especially true when there are three, rather than two, claimants involved in the priority dispute. Consider the hypothetical priority dispute between the construction mortgagee and purchase money fixtures secured party described above, with the following additional facts:

> *Additional Facts*: On January 2, 1986, Creditor *C* extends credit to Debtor for services rendered and takes back a valid security interest in "all fixtures of Debtor located on Blackacre." On the same day, Creditor *C* perfects his security interest in the fixtures by filing a UCC-2 land records financing statement with the Recorder's Office in the county where Blackacre is located. Now, which of Creditor *A*, Creditor *B*, and Creditor *C* takes priority as to the goods sold to Debtor by Creditor *B*?

As between Creditor *A* and Creditor *B*, the positions of the parties should be deemed to be fixed before January 1, 1986, because the interests of each in the fixtures attached and were perfected (or recorded) before January 1, 1986.[99] This explanation should mean that the Old

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[95] *See, e.g., In re* Perrotto Refrigeration, Inc., 38 Bankr. 284 (Bankr. E.D. Pa. 1984); Citizens Sav. Bank v. Sac City State Bank, 315 N.W.2d 20 (Iowa 1982).

[96] *See, e.g., In re* Del Norte Depot, Inc., 716 F.2d 557 (9th Cir. 1983).

[97] *See, e.g., In re* Sterling Navigation Co., Ltd., 31 Bankr. 619 (S.D.N.Y. 1983).

[98] *See* David Bros. v. United Bank of Littleton, 41 U.C.C. Rep. Serv. 261 (Colo. App. 1985).

[99] *See supra* note 95 and accompanying text.

Indiana UCC controls the priority dispute, and Creditor *B* would have priority over Creditor *A*.

Then, Creditor *C* enters the priority dispute. His interest attached and was perfected after December 31, 1985; thus his interest should be deemed to be fixed after the effective date of the New Indiana UCC.[100] According to the second sentence of section 46, any priority dispute with him should be determined under the New Indiana UCC. Nonetheless, whichever version of the Indiana UCC is applied, Creditor *C*'s interest would be junior to that of both Creditor *A* and Creditor *B*.[101]

The significant question is, of course, whether the mere entry of Creditor *C* into the priority dispute means that the New Indiana UCC's priority rules should be applied for *all* of the parties. Certainly, the relative positions among the three claimants did not become fixed until Creditor *C*'s security interest was perfected. However, should the mere happenstance that a clearly junior secured creditor obtains a security interest and perfects after the New Indiana UCC's effective date be sufficient legal justification for causing Creditor *B* to "lose out" to Creditor *A*? Such would appear to be the fortuitous result of a literal interpretation of section 46.[102]

Unfortunately, it appears that the Reporters who drafted what is now section 46 of the New Indiana UCC did not anticipate the three-party priority dispute just described.[103] If and when such a dispute does occur, how it will be resolved is really anybody's guess. The courts should, however, be guided by public policy considerations, and not merely by a literal application of section 46 to the facts of the case. Any interpretation of section 46 that would cause a creditor to lose priority through events totally beyond his control should not and cannot be countenanced.

F. Section 47

Section 47 merely recites that the New Indiana UCC takes effect on January 1, 1986. This is the only one of the New Transition Rules that contains no "big surprises" and no ambiguities.

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[100]*Cf. In re* Perrotto Referigeration, Inc., 38 Bankr. at 286-87 (indicating that perfection is the key to determining when the positions of the parties are fixed under Pennsylvania's version of section 46).

[101]As to Creditor *A*, *see* Ind. Code § 26-1-9-313(3) (1982); Ind. Code § 26-1-9-313(6) (Supp. 1986). As to Creditor *B*, *see* Ind. Code § 26-1-9-312(4) (1982); Ind. Code § 26-1-9-312(4) (Supp. 1986).

[102]*See supra* note 94.

[103]*See* Reporters' Discussion on 1972 changes to U.C.C. § 11-107 (1972).

G. The "Missing" Transition Rule

Although section 47 is the last of the New Transition Rules, no discussion of the New Transition Rules would be complete without at least a reference to the transition rule that was *not* enacted in Indiana. Section 11-108 of the model transition rule provides that "[u]nless a change in law has clearly been made, the provisions of [new U.C.C.] shall be deemed declaratory of the meaning of the [old U.C.C.]."[104] In other words, provisions of the New UCC may be used to interpret the Old UCC, unless a clear change in law was made by the New UCC.

What is the significance of Indiana's omission of section 11-108 from its New Transition Rules? In the first place, the omission of this section means that a creditor may not simply point to this section when he wants a court to find that a particular provision of the New Indiana UCC is declarative of the law under the Old Indiana UCC. Without the benefit of this section, it may be a little more difficult, for example, to convince a court that a "lessor" who files a "protective financing statement" under the Old Indiana UCC should not have the filing used as a factor in determining whether or not the "lease" was intended as security.[105]

More serious, however, is the possibility that a court will consider the omission of section 11-108 as an indication by the Indiana General Assembly that any changes made in the language of the Indiana UCC by the New Indiana UCC should be construed as a change in law from the Old Indiana UCC.[106] Or, stated another way, the provisions of the New Indiana UCC that are in any respect different from the provisions of the Old Indiana UCC will *not* be deemed declaratory of the meaning of the Old Indiana UCC as a matter of law. Such a result could prove devastating to those creditors, lessors, and consignors of all kinds and descriptions who entered into transactions prior to January 1, 1986.

III. Summary and Conclusions

If nothing else, the preceding discussion and analysis illustrates that the New Transition Rules offer a plethora of potential "traps" and "windfalls" to secured creditors. Fortunately for some and unfortunately for others, these "traps" and "windfalls" are buried in uncodified law.[107]

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[104]U.C.C. § 11-108 (1972).

[105]*See* Ind. Code § 26-1-9-412 (Supp. 1986).

[106]*Cf. In re* S & Z Int'l Management, Inc., 10 Bankr. 580 (Bankr. S.D. Fla. 1981) (omission of U.C.C. § 11-104 by Florida legislature showed intent not to automatically perfect previously unperfected pre-amendment security interests); *In re* Conger Printing Co., Inc., 18 U.C.C. Rep. Serv. 224 (D. Ore. 1975) (omission of U.C.C. § 11-108 by Oregon legislature used as a basis for determining that revised U.C.C. § 9-402(7) was not declaratory of prior law).

[107]Obscurity, of course, may be the most redeeming quality of the New Transition

Because the New Transition Rules are based in major part on the so-called model transition rules[108] (which, in turn, have formed the basis for the UCC transition rules adopted in other jurisdictions enacting the 1972 Official Text), the interpretive and other problems addressed in the Article will not necessarily be unique to Indiana. For some reason, however, it appears that the other 1972 Official Text jurisdictions have not experienced any significant amount of litigation as a result of their adoption of the model transition rules (in whole or in part). At least, there are relatively few *reported* decisions dealing with these rules.

Perhaps, Indiana will be so fortunate as to share a similar experience under the New Transition Rules. Then again, Indiana may end up a "litigation hotbed" for resolving perfection, priority, and other disputes when at least one of the parties entered into a transaction or took steps to perfect a security interest pursuant to and in accordance with either the Old Indiana UCC or a law (other than the Old Indiana UCC) modified, amended, or repealed by the New Indiana UCC.

Of course, the only practical and certain solution to the many potential problems created by the New Transition Rules is a legislative one. Simply stated, it is time to ask the Indiana General Assembly to enact a *new* set of transition rules to the New Indiana UCC (perhaps, retroactively). And, unquestionably such a new set of rules should be made a part of the Indiana Code, for all of the world to see and appreciate.

Rules, and for that reason, the author had to engage in a great deal of "soul searching" before submitting this article for publication.

[108]The only major departures from the model transition rules include: (1) a very curious delayed effective date applicable to section 44(4) (pertaining to the use of recorded mortgages as fixtures filings), *see supra* notes 71-72 and accompanying text; and (2) the omission of section 11-108 of the model transition rules (designed to create a presumption that the provisions of the New UCC will be deemed declaratory of the meaning of the Old UCC). *See supra* notes 104-06 and accompanying text.

Developments in Indiana Commercial Law

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I. Introduction

Within the survey period, there have been significant developments in varied areas of commercial law. This Article will discuss recent noteworthy cases and statutes in the areas of sales, negotiable instruments, secured transactions, dishonored checks, real estate foreclosure, guaranties, mechanic's liens, and garnishment.

II. Sale of Goods

There have been several noteworthy decisions involving the sale of goods during the survey period. In *Potts v. Offutt*,[1] the Offutts, as purchasers, brought suit against Potts, a mobile home dealer, for breach of contract for the sale of a new mobile home. The parties signed an agreement that contained a provision for a $12,000 trade-in allowance on the Offutts' old mobile home. On the agreed delivery date, however, the new mobile home was not delivered. Potts contended that he could not allow the $12,000 trade-in value on the Offutts' mobile home because of a subsequent appraisal of the home. Later, the Offutts purchased the very same mobile home from another dealer for $5,000 more than the price specified in the contract with Potts and sued Potts for the additional cost of the mobile home and for the consequential damages incurred. The trial court awarded judgment to the Offutts in the amount of $5,200, and Potts appealed.

In upholding the implicit findings of the trial court, the court of appeals rejected Potts' claim that the contract language allowed him to make an inspection even after the agreement was signed.[2] Potts also contended on appeal the he was actually purchasing the plaintiffs' old home and thus was entitled to a buyer's right to inspect and reject nonconforming goods as provided in the Indiana Code sections 26-1-2-

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[1] 481 N.E.2d 429 (Ind. Ct. App. 1985).

[2] *Id.* at 432.

513[3] and 26-1-2-601.[4] On this issue, the court of appeals held that even if Potts had acquired the rights to inspect and to reject, he had failed to comply with Indiana Code section 26-1-2-602[5] regarding the procedure for properly rejecting goods.[6] In this case, Potts neither timely rejected nor explained to the Offutts that he was rejecting the trade-in home.

In *Data Processing Services, Inc. v. L.H. Smith Oil Corp.*,[7] Data brought suit against Smith after Smith refused to pay the last of several bills which Data had submitted to it in conjunction with Data's development of a computer software program. In response to Data's suit, Smith sued Data in another court for damages arising out of Data's alleged breach of contract in developing the software program. Eventually, both lawsuits were consolidated. Finding that the computer program was specifically manufactured goods within the meaning of Indiana Code section 26-1-2-501(1),[8] the trial court held in favor of Smith with respect to both lawsuits.

On appeal, Data argued that the trial court's determination that the contract was governed by Article 2 of the Uniform Commercial Code (UCC) was in error. It asserted that the contract was for the sale of

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[3]Ind. Code § 26-1-2-513(1) (Supp. 1986) provides, in pertinent part:

> Unless otherwise agreed . . ., where goods are tendered or delivered or identified to the contract for sale, the buyer has a right before payment or acceptance to inspect them at any reasonable place and time and in any reasonable manner.

[4]Ind. Code § 26-1-2-601(a) (Supp. 1986) provides, in pertinent part:

> [I]f the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may:
> (a) reject the whole, or
> (b) accept the whole, or
> (c) accept any commercial unit or units and reject the rest.

[5]Ind. Code § 26-1-2-602(1) (Supp. 1986) provides:

> Rejection of goods must be within a reasonable time after their delivery or tender. It is ineffective unless a buyer seasonably notifies the seller.

[6]*Potts*, 481 N.E.2d at 433.

[7]492 N.E.2d 314 (Ind. Ct. App.), *reh'g denied*, 493 N.E.2d 1271 (Ind. Ct. App. 1986).

[8]*Id.* at 317. Ind. Code § 26-1-2-501(1) (1982) provides, in pertinent part:

> (1) The buyer obtains a special property and an insurable interest in goods by identification of existing goods as goods to which the contract refers even though the goods so identified are nonconforming and he has an option to return or reject them. Such identification can be made at any time and in any manner explicitly agreed to by the parties. In the absence of explicit agreement identification occurs
> (a) when the contract is made if it is for the sale of goods already existing and identified;
> (b) if the contract is for the sale of future goods other than those described in paragraph (c), when goods are shipped, marked or otherwise designated by the seller as goods to which the contract refers; . . . .

services, not of goods, and thus Article 2 of the UCC was inapplicable. Although it is not clear from the appellate court's opinion, the trial court apparently based its judgment in favor of Smith upon the breach by Data of the Article 2 implied warranties of merchantability or of fitness for a particular purpose with respect to Data's development of the computer software program at issue.[9]

The court of appeals agreed with Data that a contract to provide computer programming was a sale of services even though the end result may be preserved on a magnetic tape or computer disk.[10] Nonetheless, it ruled that no reversal was necessary because, under common law principles, Smith was entitled to the same relief (i.e., damages) as was awarded by the trial court.[11] Specifically, the court of appeals found that Smith was entitled to damages from Data on the ground that Data had "breached its implied promise of having the reasonable skill and ability to do the job for which it contracted."[12]

Another significant case involving warranties was *General Foods Corp. v. Valley Lea Dairies, Inc.*[13] General Foods purchased 40,000 pounds of roller whole dry milk from Valley Lea. General Foods' standards required Valley Lea to test the milk before transferring it. Valley Lea tested the milk and ascertained that it was manufactured under appropriate sanitary conditions in conformance with federal regulations. When the shipment of milk arrived, General Foods checked it and found that one of the nine lots in the shipment proved positive for salmonella. This prompted General Foods to test the rest of the lots for contaminants at heightened levels. Upon finding no contamination, General Foods opted to release the remaining lots into its milk chocolate production channels.

After the milk chocolate was produced, General Foods took test samples; before the test results were available, however, General Foods shipped the milk chocolate to two of its customers. Thereafter, General Foods discovered salmonella contamination in the samples of the milk chocolate it had shipped. As the result of this contamination, the two customers incurred hundreds of thousands of dollars worth of losses. Subsequently, General Foods settled with the customers and brought suit in the United States District Court for the Northern District of Indiana against the supplier to recover its damages.

On appeal to the Seventh Circuit Court of Appeals after a jury verdict against it, General Foods urged that Valley Lea had breached

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[9]*Data Processing*, 492 N.E.2d at 319-20.

[10]*Id.* at 318-19.

[11]*Id.* at 319-20.

[12]*Id.* at 320.

[13]771 F.2d 1093 (7th Cir. 1985).

an express warranty contained in the purchase order,[14] which required the product to conform with General Foods' written policy on the supply of sensitive food ingredients, as well as the implied warranties of fitness for a particular purpose[15] and merchantability.[16] It argued that the trial court had tendered improper jury instructions with regard to each of these three theories of liability.

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[14]*See* IND. CODE § 26-1-2-313 (1982) which provides:

> (1) Express warranties by the seller are created as follows:
>
> (a) any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
>
> (b) any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
>
> (c) any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.
>
> (2) It is not necessary to the creation of an express warranty that the seller use formal words such as 'warrant' or 'guarantee' or that he have a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller's opinion or commendation of the goods does not create a warranty.

[15]IND. CODE § 26-1-2-315 (Supp. 1986) provides:

> Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is, unless excluded or modified under IC 26-1-2-316, an implied warranty that the goods shall be fit for such purpose.

[16]IND. CODE § 26-1-2-314 (Supp. 1986) provides:

> (1) Unless excluded or modified (IC 26-1-2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.
>
> (2) Goods to be merchantable must at least be such as:
>
> (a) Pass without objection in the trade under the contract description; and
>
> (b) In the case of fungible goods, are of fair, average quality within the description; and
>
> (c) Are fit for the ordinary purposes for which such goods are used; and
>
> (d) Run, within the variations permitted by the agreement, of even kind, quality, and quantity within each unit and among all units involved; and
>
> (e) Are adequately contained, packaged, and labeled as the agreement may require; and
>
> (f) Conform to the promises or affirmations of fact made on the container or label if any.
>
> (3) Unless excluded or modified (IC 26-1-2-316), other implied warranties may arise from course of dealing or usage of trade.

As to the express warranty theory, the appellate court noted that even if an express warranty had been made, such was waived when General Foods tested the milk, found one of the lots defective, and then failed to return the remainder of the shipment, claiming violation of the warranty.[17] The appellate court also upheld the trial court's jury instructions regarding the implied warranties of fitness for a particular purpose and merchantability. The appellate court held that the jury was correctly instructed when it was told that the implied warranty of fitness for a particular purpose was inoperative if it should be found that General Foods, in fact, relied on its own testing procedure in deciding whether to accept or reject particular lots of milk.[18] On the implied warranty of merchantability issue, the appellate court determined that a jury instruction providing that this warranty may be waived or excluded by course of dealing or performance between the parties was entirely proper.[19] In this regard, the court of appeals noted that General Foods' written policy on supply of sensitive food ingredients, which established its in-house testing procedure and right to reject nonconforming products, could have supported a jury finding that the implied warranty of merchantability was excluded or modified by the parties' dealings with each other.[20]

Finally, the appellate court upheld the jury's determination that Valley Lea was entitled to the defense of incurred risk against General Foods' claims for breach of warranties and, in so doing, found that the trial court's instructions regarding the doctrine of incurred risk either were entirely proper or, at least, were not prejudicial.[21] According to the doctrine of incurred risk, a person incurs or assumes all of the ordinary and usual risks of an act upon which he voluntarily enters, if the risks are subjectively known and understood by him, irrespective of whether or not the acceptance of the risk was reasonable under the circumstances.[22]

III. Negotiable Instruments

Several recent cases have been decided regarding the liability of various parties to negotiable instruments. The cases involve three distinct factual patterns, including one case in which an endorsement had been forged, an action wherein the person executing the instrument was sued individually because of his failure to indicate his representative capacity,

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[17] *Valley Lea*, 771 F.2d at 1099.
[18] *Id.*
[19] *Id.*
[20] *Id.*
[21] *Id.* at 1096-98.
[22] *Id.* at 1096-97.

and a case in which the drawer delivered a blank check that was completed without authority.

In *Clark v. Griffin*,[23] Griffin purchased a house on contract from the Dietrichs. In 1981, while Griffin was still making payments, a fire caused extensive damage to the house. Clark was the general contractor who was to perform the repair work on the house, and under an insurance settlement, he received two checks, one in the sum of $15,000 and another for $4,180. Each check was made payable to Clark, Griffin, and the Dietrichs. The $15,000 check was given to Clark so that he could buy materials and commence the repairs. The other check was to be kept by Griffin during the construction and then released to Clark upon satisfactory completion of the repair work. Griffin, however, endorsed his name, Clark's name, and presumably, the Dietrichs' names on the back of the $4,180 check and cashed it with Mutual Trust Bank (MTB). Griffin maintained that Clark had given him authority to sign Clark's name to the check. Clark alleged otherwise and brought an action against Griffin and MTB for conversion. The trial court held that no conversion had occurred and Clark appealed.

Clark contended, with respect to his claims against MTB, that Indiana Code section 26-1-3-419(1)(c) authorized him to sue MTB.[24] The court of appeals held, however, that the only suit contemplated by that proviso was one against the drawee bank.[25] Because MTB was the depositary bank, the applicable provision was Indiana Code section 26-1-3-419(3), which stated:

> (3) Subject to the provisions of this Act concerning restrictive endorsements, a representative, including a depositary or collecting bank, who has in good faith and in accordance with the reasonable commercial standards applicable to the business of such representative dealt with an instrument or its proceeds on behalf of one who was not the true owner is not liable in conversion or otherwise to the true owner beyond the amount of any proceeds remaining in his hands.[26]

The court of appeals held that to escape liability under Indiana Code section 26-1-3-419(3), MTB had the burden of establishing that it had acted in a commercially reasonable manner in cashing the check.[27] On the issue of commercial reasonableness, the *Clark* tribunal determined that the evidence at trial was not sufficient to carry MTB's burden and,

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[23]481 N.E.2d 170 (Ind. Ct. App. 1985).

[24]Ind. Code § 26-1-3-419(1)(c) (Supp. 1986) provides in pertinent part: "An instrument is converted when . . . it is paid over a forged endorsement."

[25]*Clark*, 481 N.E.2d at 173.

[26]Ind. Code § 26-1-3-419(3) (Supp. 1986).

[27]*Clark*, 481 N.E.2d at 173.

in fact, tended to show quite the contrary.[28] The facts that MTB's employee simply took Griffin's word that he was authorized to sign for Clark and that Griffin requested most of the check proceeds in cash with the rest to be placed in his personal account[29] were critical to the court's decision.

The court of appeals held further, however, that Clark, whose endorsement was forged, could not recover from MTB if and to the extent Griffin took the proceeds of the check and paid them to Clark. Simply stated, MTB could be held liable to Clark only to the extent he had suffered a loss, and not necessarily for the full amount of the check.[30] In addition, the court of appeals held that Griffin's liability to Clark for forging Clark's signature was restricted to the same extent.[31]

In *Campion v. Wynn*,[32] Campion was the president and sole stockholder of Chairs, Inc. In January 1984, Campion approached Wynn, an employee of Chairs, Inc., requesting that she purchase shares of stock in the corporation. Wynn declined. Later, Campion approached Wynn and told her of his need to secure money to buy supplies. Wynn lent Campion $8,000 in return for a note executed by Campion, which made no mention of Chairs, Inc., as the maker. In the entire note, the name of the corporation appeared only in the area reserved for the address of the maker. Unfortunately for Wynn, Chairs, Inc., went out of business in May 1984, before any payment had been made on the note, and Wynn brought suit on the note. The trial court found Campion individually liable on the note, and Campion appealed.

On appeal, Campion contended that although the note did not disclose his representative capacity, it did name the party that he represented. Consequently, Campion argued that he was entitled, pursuant to Indiana Code section 26-1-3-403(2)(b),[33] to introduce parol evidence to establish that he signed in a representative capacity. On this issue, the court of appeals held that the reference to Chairs, Inc., in the note could reasonably be construed merely as giving a complete address for Campion and therefore refused to reweigh the evidence.[34] Accordingly,

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[28]*Id.* at 173-74.

[29]*Id.*

[30]*Id.* at 174.

[31]*Id.*

[32]486 N.E.2d 543 (Ind. Ct. App. 1985).

[33]Ind. Code § 26-1-3-403(2)(b) (1982) provides:

> (2) An authorized representative who signs his own name to an instrument
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> . . . .
>
> (b) except as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented but does show the representative signed in a representative capacity.

[34]*Campion*, 486 N.E.2d at 545-46.

the court of appeals held that pursuant to Indiana Code section 26-1-3-403(2)(a),[35] Campion was personally liable on the note.[36] Alternatively, the court of appeals found that the wording of the note was sufficient to make Campion personally liable even if the corporation was deemed to be named as a party because the note contained a joint and several promise to pay by Campion.[37]

In *E. Bierhaus & Sons, Inc. v. Bowling*,[38] Bowling was a small contractor and a close friend of Dabney, who owned and operated four retail grocery stores. In September 1983, Dabney told Bowling that he had a cash flow problem and needed $40,000 for sixty days. At the same time, Dabney began to discuss with Bowling the possibility of Bowling purchasing a half-interest in Dabney's grocery business. Bowling eventually lent to Dabney the $40,000 as well as another $8,500 for the payment of taxes and other debts.

Sometime later, Dabney informed Bowling that he was terminating Bierhaus as the wholesale grocery supplier for his stores and would purchase elsewhere. He indicated that in contemplation of a partnership with Bowling, he needed Bowling's financial statement for a potential new supplier. Bowling furnished the requested financial statement in mid-October. Dabney did not inform Bowling that the financial statement was for Bierhaus, and nothing on the financial statement indicated that it was directed to Bierhaus.

The next month, Dabney approached Bowling and requested a check signed in blank which he could tender to the purported new supplier as security. He promised that the check would not be cashed without first notifying Bowling and promised to repay Bowling in the event the check was cashed. Bowling informed Dabney that he had only $1,500 in the bank, but Dabney assured him it would not matter. Not knowing that Dabney was then facing financial failure, Bowling signed the check in blank and delivered it to Dabney.

Dabney delivered Bowling's financial statement to Bierhaus in late October and represented to Bierhaus' treasurer that Bowling would be his partner. On November 22, 1983, Dabney, without Bowling's authority, completed the previously signed blank check for over $10,000 and delivered it to Bierhaus in exchange for grocery stock. Bierhaus made no attempt to contact Bowling even though Bowling's name, address, and telephone number were on the check and even though it had received numerous bad checks from Dabney and from other people on behalf of Dabney. At the time Bierhaus accepted Bowling's check, Bierhaus was facing a $400,000 loss on Dabney's account. The Bowling check

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[35]Ind. Code § 26-1-3-403(2)(a) (1982).

[36]*Campion*, 486 N.E.2d at 545.

[37]*Id.* at 545-46.

[38]486 N.E.2d 598 (Ind. Ct. App. 1985).

was returned for insufficient funds, Dabney went into bankruptcy, and Bierhaus sued Bowling on the dishonored check. The trial court entered judgment for Bowling, from which Bierhaus appealed.

Bierhaus relied upon Indiana Code section 26-1-3-115, which provided:

> (1) When a paper whose contents at the time of signing show that it is intended to become an instrument is signed while still incomplete in any necessary respect it cannot be enforced until completed, but when it is completed in accordance with the authority given it is effective as completed.
> (2) If the completion is unauthorized, the rules as to material alteration apply (section 3-407), even though the paper was not delivered by the maker or drawer, but the burden of establishing that any completion is unauthorized is on the party so asserting.[39]

First, Bierhaus argued on appeal that the check was properly completed with the authority of Bowling and that as a result, Bowling was liable on the check pursuant to subsection (1) of the above-quoted section. The court of appeals, however, found that the trial court was justified in concluding that the check was completed contrary to Bowling's authority.[40]

Second, Bierhaus asserted that even if Dabney completed the check contrary to Bowling's authority, Bowling was nonetheless liable to Bierhaus on the check because of Bowling's negligence and because of Bierhaus' status as a holder in due course[41] pursuant to Indiana Code sections 26-1-3-406[42] and 26-1-3-407,[43] respectively. With respect to the

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[39]Ind. Code § 26-1-3-115 (Supp. 1986).

[40]*Bierhaus*, 486 N.E.2d at 602.

[41]*Id.*

[42]Ind. Code § 26-1-3-406 (1982) provides:

Any person who by his negligence substantially contributes to a material alteration of the instrument or to the making of an unauthorized signature is precluded from asserting the alteration or lack of authority against a holder in due course or against a drawee or other payor who pays the instrument in good faith and in accordance with the reasonable commercial standards of the drawee's or payor's business.

[43]Ind. Code § 26-1-3-407 (1982) provides:

(1) Any alteration of an instrument is material which changes the contract of any party thereto in any respect, including any such change in

(a) the number or relations of the parties; or

(b) an incomplete instrument, by completing it otherwise than as authorized; or

(c) the writing as signed, by adding to it or by removing any part of it.

(2) As against any person other than a subsequent holder in due course

(a) alteration by the holder which is both fraudulent and material negligence issue, the court of appeals held that even if Bowling had been negligent in signing and delivering the blank check to Dabney, any contributory negligence (i.e., failure to observe "reasonable commercial standards") on the part of Bierhaus in taking the check would bar recovery, and the burden was on Bierhaus to establish that it had followed "reasonable commercial standards" according to an objective standard.[44]

On the issue of whether Bierhaus qualified as a holder in due course,[45] the court of appeals noted that a person claiming to be a holder in due course "has the double hurdle of proving good faith, a subjective test, plus lack of notice, an objective test."[46] Given the facts of the instant case, the court of appeals concluded that it could not say either that Bierhaus carried its burden of proof as to commercial reasonableness, or that the trial court erred in finding that Bierhaus was not a holder in due course.[47]

IV. Secured Transactions

Two noteworthy cases during the survey period involved the perfection of security interests. In *Citizens National Bank of Evansville v. Wedel,*[48] a bank brought a replevin action against an unsecured creditor who had taken a boat from the debtor in satisfaction of a pre-existing debt. The bank claimed that it had a security interest in the boat, resulting from a financing statement filed with the Secretary of State. In the financing statement, the bank had described its collateral as "new boats—all types of trailers, new jet boats—contract and lease rights for assigned security agreement dated May 31, 1979." The debtor in this case was "The Post, Inc."; however, according to the bank's financing statement, the debtor's name was "Post, Inc. d/b/a Osborne Boats &

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discharges any party whose contract is thereby changed unless that party assents or is precluded from asserting the defense;

(b) no other alteration discharges any party and the instrument may be enforced according to its original tenor, or as to incomplete instruments according to authority given.

(3) A subsequent holder in due course may in all cases enforce the instrument according to its original tenor, and when an incomplete instrument has been completed, he may enforce it as completed.

[44] *Bierhaus*, 486 N.E.2d at 603.

[45] Ind. Code § 26-1-3-302 (1982) defines a "holder in due course" as follows:

(1) a holder in due course is a holder who takes the instrument

(a) for value; and

(b) in good faith; and

(c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person.

[46] *Bierhaus*, 486 N.E.2d at 604.

[47] *Id.* at 605.

[48] 489 N.E.2d 1203 (Ind. Ct. App. 1986).

Motors." The primary issue on appeal was whether the bank had perfected its security interest in the boat.

Before taking the boat, Wedel, the unsecured creditor, had sought to ascertain whether there was any security interest in the boat by requesting the Secretary of State's office to search for any financing statements on any property of "The Post, Inc." The Secretary of State responded that it could not find any. Wedel argued that the security interest was not properly perfected because the debtor's name was listed as "Post, Inc. d/b/a/ Osborne Boats & Motors" instead of "The Post, Inc." In reversing the trial court, the court of appeals held the omission of the article "The" from the financing statement was a minor error and was not seriously misleading.[49]

Wedel also contended that the financing statement was ineffective because it expressly covered only "new boats—all types of trailers and new jet boats." Wedel argued that this description was insufficient to perfect a security interest on the 1979 model boat in question, which he alleged was "used." The court of appeals held that the purpose of the collateral description in a financing statement was merely to provide enough notice for further inquiry.[50] Based upon this standard, the court of appeals determined that the financing statement filed in 1979 sufficed to require further investigation by Wedel, especially because the "used" boat in issue was a 1979 model.[51] Ironically, Wedel was precluded from seeing the bank's financing statement as the result of the "not seriously misleading error" in the debtor's name indicated on such financing statement.

The decision in the *Citizens National Bank* case is extremely significant to those persons who rely on Uniform Commercial Code searches in making credit granting decisions. Under this case, the critical factor in determining whether an error in the debtor's name is "seriously misleading" appears to be the similarity in appearance between the debtor's correct name and the name of the debtor shown on the financing statement at issue, and not necessarily the practical ability of the search requester to be made aware of the contents of the financing statement as the result of the error.

Presently, it is the policy of the Indiana Secretary of State's office to report the existence of only those financing statements that bear the exact name of the person indicated on the search request *unless* the search request specifies that variations of the indicated name should also be searched. As a result of the *Citizens National Bank* case, persons relying on Uniform Commercial Code searches should *always* specify

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[49]*Id.* at 1207

[50]*Id.* at 1208.

[51]*Id.*

that variations of the indicated name should be searched, even though the search requester is absolutely certain that the indicated name is the correct name of the debtor. This type of search request procedure, of course, does not guarantee that the resulting search will reveal all financing statements of which the searcher may be deemed to be "on notice." Nevertheless, it at least will enhance the chances of discovering additional, legally effective financing statements.

In *Second National Bank of Danville v. Massey-Ferguson Credit Corp.*,[52] the issue was whether dual filing is required to perfect a security interest in farming equipment when the debtor is an Indiana corporation. Foster of Indiana, Inc., an Indiana corporation located in Fountain County, granted to Second National Bank a blanket security interest in all of its presently owned and after-acquired machinery and equipment. Second National Bank perfected its security interest on November 10, 1978, by filing financing statements with both the recorder of Fountain County and the Indiana Secretary of State. Massey-Ferguson, on the other hand, claimed a purchase money security interest in a combine and grain table sold by Massey-Ferguson and acquired by Foster in 1981. It asserted that this security interest was validly and timely perfected on December 8, 1981, by its filing of a financing statement with only the recorder of Fountain County.

Second National Bank maintained that its security interest in the combine and grain table was superior to that of Massey-Ferguson because the latter had failed to file with the Indiana Secretary of State. Both parties' arguments centered on the proper construction of Indiana Code section 26-1-9-401.[53] As a result of a 1971 amendment to this section, certain language that clearly provided for dual filing was deleted.[54] Second

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[52]478 N.E.2d 916 (Ind. Ct. App. 1985).

[53]At the time Second National Bank and Massey-Ferguson filed their respective financing statements, section 26-1-9-401 provided, in pertinent part:

> (1) The proper place to file in order to perfect a security interest is as follows:
>
> (a) When the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the county recorder in the county where the principal place of business of the corporation is located, and in the office of the secretary of state . . . .

IND. CODE § 26-1-9-401(1)(a) (1976).

[54]Prior to the 1971 amendment, section 26-1-9-401 provided, in pertinent part:

> (1) The proper place to file in order to perfect a security interest is as follows:
>
> (a) When the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising

National Bank argued that the deletion was purely unintentional and that the section should be construed to conform to the filing requirements in existence prior to the 1971 amendment. Massey-Ferguson, on the other hand, asserted that Indiana Code section 26-1-9-401 should be construed literally to require only a local filing in the instant case.

In finding in favor of Massey-Ferguson, the court of appeals refused to extend the plain language of Indiana Code section 26-1-9-401 to require dual filing.[55] The court apparently failed to consider (or, at least, be persuaded by) the explanation of the section in *Burns Indiana Statutes Annotated*,[56] the dual filing requirement recited in the then current Rules and Regulations for the Administration of the Uniform Commercial Code issued by the Indiana Secretary of State,[57] or a 1982 amendment to the section (to be effective after December 31, 1983) expressly providing for a single filing with the Indiana Secretary of State when the collateral is equipment used in farming operations.[58]

> from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the county recorder where the goods are kept, or if the debtor is a corporation then in the office of the county recorder in the county where the principal place of business of the corporation is located, and in the office of the Secretary of State . . . .

Second National Bank, 478 N.E.2d at 917.

[55]*Id.* at 917-18.

[56]Burns printed the apparent omission in brackets:

> (1) The proper place to file in order to perfect a security interest is as follows:
>
> (a) When the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the county recorder in the county where the [goods are kept, or if the debtor is a corporation then in the office of the county recorder in the county where the] principal place of business of the corporation is located, and in the office of the secretary of state . . . .

IND. CODE ANN. § 26-1-9-401(1)(a) (Burns 1974). The compiler's note to this section states: "The bracketed words in subsection (1)(a) were inserted by the compiler, since they appeared in the section prior to the amendment, and it appears they were unintentionally deleted in the enrolled bill." *Id.*

[57]*See* Secretary of State, *Indiana Rules and Regulations for Administration of the Uniform Commercial Code* 6 (1981).

[58]A new section 26-1-9-401.5 was added in 1982 to provide in pertinent part:

> (1) Notwithstanding section 401 of this chapter, after December 31, 1983, the proper place to file in order to perfect a security interest is in the office of the secretary of state when the collateral is equipment used in farming operations, or farm products, or accounts, contract rights or general intangibles

Ironically, effective January 1, 1986, Indiana Code section 26-1-9-401 was once again amended—this time expressly to require dual filing when the debtor is a corporation and the collateral is equipment used in farming operations.[59]

V. Dishonored Checks

One noteworthy decision was handed down during the survey period which construed Indiana's two statutes allowing an injured party to recover from the drawer well in excess of the face amount of the check in the event the check is dishonored.[60] In *Stoutco, Inc. v. Amma, Inc.*,[61] a payee-manufacturer sued the drawer-distributor on a dishonored check. The distributor stopped payment on a check drawn to pay for merchandise purchased from the manufacturer shortly after the distributor learned that the manufacturer had terminated the distribution agreement between the two parties. At all relevant times, there were sufficient funds in the distributor's account to pay the dishonored check. Subsequently, the manufacturer brought suit in the United States District Court for the Northern District of Indiana to recover the penalties then provided under Indiana's two (civil) dishonored checks statutes.

The court in *Stoutco* first addressed the question of whether the drawer-distributor was liable under Indiana Code section 28-2-8-1 for stopping payment on the check.[62] The distributor argued that at the time

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> arising from or relating to the sale of farm products by a farmer. All filings under this section shall be maintained by the secretary of state in an agricultural file separate from all other statements filed under this chapter.

Ind. Code § 26-1-9-401.5(1) (1982). The 1982 amendment, however, was repealed in 1983 prior to its effective date. *See* 1983 Ind. Acts, Pub. L. No. 255-1983, § 3.

[59]Section 26-1-9-401, as amended by Pub. L. No. 93-1985, now provides, in pertinent part:

> (1) The proper place to file in order to perfect a security interest is as follows:
>
> > (a) When the collateral is equipment used in farming operations, or farm products, or accounts or general intangibles arising from or relating to the sale of farm products by a farmer, or consumer goods, then in the office of the county recorder in the county of the debtor's residence or if the debtor is not a resident of this state then in the office of the county recorder in the county where the goods are kept, or if the debtor is a corporation then in the office of the county recorder in the county where the corporation has its residence, and in the office of the secretary of state . . . .

Ind. Code § 26-1-9-401(1)(a) (Supp. 1986).

[60]Ind. Code § 28-2-8-1 (Supp. 1986) provides for a civil penalty that includes recovery of interest, court costs, attorneys' fees, and treble the face amount of the check (maximum of $500), in certain cases, for wrongfully stopping payment or allowing dishonor of a check. Ind. Code § 34-4-30-1 (Supp. 1986) allows a person who suffers a pecuniary loss because of violation of Indiana's crimes against property laws, sections 35-43-1-1 to 35-

it stopped payment, it thought there was "valid legal cause" to do so, and therefore that it should not be held liable under the statute. In essence, the distributor contended that the phrase "valid legal cause" as used in the statute should be given a subjective meaning and should be judged as of the time the stop payment order was given. The court, however, adopted an objective, strict liability approach and ruled that a drawer can make use of this defense only if it is able to show that it actually had a "legal right to stop payment on the check."[63]

The second question addressed in *Stoutco* was whether the distributor's president could be held individually liable for the dishonored check under Indiana Code section 28-2-8-1. The payee-manufacturer argued that the president was liable because he signed the check on behalf of the corporation and because he placed the stop payment order. In this regard, the manufacturer asserted that the situation was analogous to cases involving violation of Indiana Code section 35-43-5-5, the criminal check deception statute, and that therefore, a corporate officer should be held individually liable on a dishonored check pursuant to Indiana Code section 28-2-8-1.[64]

The court disagreed with the manufacturer's analysis for two reasons. First, it concluded that the result should be different in Indiana Code section 28-2-8-1 cases because a violation of that statute does not require fraudulent intent, unlike a violation of Indiana Code section 35-43-5-5.[65] Second, the court held that the language of the statute itself precluded the imposition of individual liability.[66] Reasoning that the language of Indiana Code section 28-2-8-1 permitted liability under that section to be imposed on a corporate officer only if such person could be held personally liable on the check pursuant to Indiana Code section 26-1-3-403,[67]

43-5-8, to collect up to three times his actual damages, court costs, and attorneys' fees. Check deception, IND. CODE § 35-43-5-5 (Supp. 1986), is one of the crimes against property laws.

[61] 620 F. Supp. 657 (N.D. Ind. 1985).

[62] The statute imposes liability upon a person "who, having executed and delivered to another person a check or draft drawn on or payable at a financial institution, either without valid legal cause shown stops payment on the check or draft or allows the check or draft to be dishonored . . . ." IND. CODE § 28-2-8-1(a) (1986).

[63] *Stoutco*, 620 F. Supp. at 661.

[64] The court cited Walker v. State, 467 N.E.2d 1248, 1250 (Ind. Ct. App. 1984) and Cooper v. State, 181 Ind. App. 275, 391 N.E.2d 841 (1979) in support of the proposition that the "corporate veil" does not shield an officer from liability under the criminal check deception statute. *Id.*

[65] *Stoutco*, 620 F. Supp. at 661.

[66] *Id.* at 662.

[67] IND. CODE § 26-1-3-403(2) (1982) provides:

> (2) An authorized representative who signs his own name to an instrument
> (a) is personally obligated if the instrument neither names the person

the court concluded that no recovery could be had against the president because both his representative capacity and the name of the corporation which he represented were shown on the check.[68]

Finally, the *Stoutco* court addressed the question of whether the payee-manufacturer could collect treble damages, costs, and reasonable attorneys' fees against the drawer-distributor under Indiana Code section 34-4-30-1.[69] Finding that the criminal check deception statute (on which liability under Indiana Code section 34-4-30-1 is based) clearly required knowledge or intent on the part of the issuing party *at the time of issuance* that the check would not be paid or honored, and that the evidence indicated that the drawer-distributor intended to pay the check when it was issued, the court denied recovery to the payee-manufacturer under this section.[70]

VI. Real Estate Foreclosure

According to an express statutory provision that pertains to the foreclosure of real estate mortgages, the court "shall" include a deficiency judgment in the order of sale where a balance remains due on the mortgage after the foreclosure sale if the mortgage or a separate instrument contains a promise to pay the sum of money secured by the mortgage.[71] In *Arnold v. Melvin R. Hall, Inc.*,[72] however, the Indiana Court of Appeals rejected the position that this statute *requires* a deficiency judgment in such a situation and instead adopted the position that it *allows* a deficiency judgment.[73] The court of appeals' ruling in

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> represented nor shows that the representative signed in a representative capacity;
> (b) except as otherwise established between the immediate parties, is personally obligated if the instrument names the person represented but does not show that the representative signed in a representative capacity, or if the instrument does not name the person represented but does show that the representative signed in a representative capacity.

[68]*Stoutco*, 620 F. Supp. at 662.

[69]Presently, Indiana Code section 28-2-8-1 requires the plaintiff to elect whether to pursue the claim under section 34-4-30-1 or under section 28-2-8-1. Ind. Code § 28-2-8-1 (Supp. 1986). However, at the time the complaint in *Stoutco* was filed, there was no such election of remedies provision.

[70]*Stoutco*, 620 F. Supp. at 662.

[71]The pertinent provision states:

> When there is an express written agreement for the payment of the sum of money secured contained in the mortgage or any separate instrument, the court shall direct in the order of sale that the balance due on the mortgage and costs which may remain unsatisfied after the sale of the mortgaged premises, shall be levied of [sic] any property of the mortgage-debtor.

Ind. Code § 34-1-53-5 (1982).

[72]478 N.E.2d 696 (Ind. Ct. App.), *reh'g denied*, 481 N.E.2d 409 (Ind. Ct. App. 1985).

[73]481 N.E.2d at 413 (rejecting Melvin R. Hall, Inc.'s and amici's argument that

the *Arnold* case purported significantly to alter proceedings for the foreclosure of Indiana real estate mortgages and land contracts.

The Arnolds entered into a contract with Melvin R. Hall, Inc., for the conditional sale of real estate and personal property. When the Arnolds defaulted on their monthly installments after paying more than half of the $135,000 contract price, Hall sought and obtained a foreclosure order and deficiency judgment against the Arnolds. After the personal property was sold, the real estate was sold to Hall, the sole bidder at the foreclosure sale. Because its bid was substantially less than the outstanding balance, Hall sought to collect the deficiency. The Arnolds objected, contending that it would be inequitable to allow Hall to recover a deficiency judgment in addition to retaining the land and the installment payments. The court of appeals agreed, reversing the trial court's ruling.[74]

The court of appeals relied on *Skendzel v. Marshall*[75] to support its view that equitable principles should apply to situations in which a vendor-mortgagee purchases the property at the foreclosure sale for less than the amount of the outstanding debt.[76] Although *Skendzel* dealt with enforcement of a forfeiture clause in a land sale contract, the court of appeals availed itself of the Indiana Supreme Court's reasoning that a conditional land sale contract should be viewed as an equitable mortgage, with foreclosure constituting an equitable remedy.[77] This analysis allowed the court of appeals to inject equitable considerations into foreclosure proceedings and to rule that "absent evidence that the property's value is less than the total remaining deficiency, a mortgagee-vendor who purchases the property at the foreclosure sale is not entitled to a deficiency judgment."[78]

The court of appeals expanded upon its initial decision in a subsequent opinion denying Hall's petition for rehearing.[79] The court again relied heavily on *Skendzel* and the equitable principles announced therein and analogized the two factual situations.[80] It also distinguished the pre-*Skendzel*, factually similar case of *Markel v. Evans*[81] and its progeny, and attacked the presumption that a foreclosure sale establishes the fair

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Indiana code section 34-1-53-5 requires a trial court to grant a deficiency judgment for the balance due after the foreclosure sale, plus costs, regardless of the purchaser and purchase price).

[74]*Arnold*, 478 N.E.2d at 699.

[75]261 Ind. 226, 301 N.E.2d 641 (1973).

[76]*Arnold*, 478 N.E.2d at 697-99.

[77]*Id.* at 697-98; *see also Skendzel*, 261 Ind. at 234-41, 301 N.E.2d at 646-50 (analysis of a conditional land sale contract as an equitable mortgage and corresponding remedies for breach).

[78]*Arnold*, 478 N.E.2d at 699.

[79]481 N.E.2d at 409 (Ind. Ct. App. 1985).

[80]*Id.* at 410-11.

[81]47 Ind. 326 (1874).

market value of the property.[82] Finally, the court of appeals rejected Hall's interpretation of the Indiana statute pertaining to deficiency judgments, concluding once again that "[f]oreclosure means essentially an appeal to the equitable powers of the court."[83]

On a petition to transfer by Hall, the Indiana Supreme Court granted the petition and affirmed the trial court.[84] While agreeing with the court of appeals that equity would demand a remedy against a vendor-mortgagee who seeks what, in effect, is a double recovery, the supreme court was unable to agree with the court of appeals "that the best way to assure that such does not occur is to require every mortgagee to provide the court with evidence that the fair market value of the property at the time of the foreclosure sale is less than the balance of the debt then due."[85] Rather, according to the supreme court, it is the vendee or mortgagor who must bring the inadequacy of the price received at the foreclosure sale before the court.[86] The supreme court was quick to note, however, that in order for the sale to be set aside or for the deficiency judgment to be denied on the basis of inadequacy of price, it will be necessary for the vendee or mortgagor to show that "the disparity between the value of the property sold, and the price paid, [is] so great as to shock the sense of justice and right."[87]

VII. Guaranties

In three recent cases, the defendants to actions brought on their respective guaranty contracts failed to avoid liability when the courts strictly construed the language of guaranty instruments. A variety of defenses, including lack of notice, impairment of collateral, ambiguity, estoppel, and unconscionability were unavailing.

In *Jackson v. Farmers State Bank*,[88] the plaintiff sued to recover under a guaranty agreement in which the defendants guaranteed the debts of their closely-held corporation. Defendants Desmond and Mildred Jackson owned a car dealership doing business as D & M Motors. D

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[82]*Arnold*, 481 N.E.2d at 411-12. The court of appeals recognized the similarity of factual circumstances between *Arnold* and *Markel*, but intimated that the *Skendzel* ruling fundamentally changed the law, thus nullifying the importance of *Markel*. *Id.* Also, the court rejected numerous cases supporting the *Markel* proposition. *Id.* at n.3. Nor did the court consider the post-*Skendzel* case of Ellsworth v. Homemakers Finance Service, Inc., 424 N.E.2d 166 (Ind. Ct. App. 1981), in which the court declared the "[f]oreclosure must follow statutory procedure." *Id.* at 169.

[83]*Arnold*, 481 N.E.2d at 412-13.

[84]Arnold v. Melvin R. Hall, Inc., 496 N.E.2d 63, 66 (1986).

[85]*Id.* at 65.

[86]*Id.*

[87]*Id.* (quoting Branch v. Foust, 130 Ind. 538, 543, 30 N.E. 631, 633 (1891)).

[88]481 N.E.2d 395 (Ind. Ct. App. 1985).

& M provided financing for its purchasers by installment contracts, which gave D & M a security interest in the vehicle purchased, in exchange for monthly payments of principal and interest. In due course, D & M would assign the contracts "with recourse" to Farmers State Bank (FSB) for value. Upon the default of a vehicle purchaser, FSB presented the delinquent contract to D & M and obtained payment from Mr. Jackson. Starting in 1970 and continuing until 1979, each delinquent contract presented to D & M by FSB was paid off in full by Mr. Jackson.

Beginning in 1979, however, D & M struggled with financial problems. FSB presented Mr. Jackson with several delinquent contracts, which he refused to pay. D & M also defaulted on several short term notes owed to FSB. Subsequently, FSB sued to collect D & M's indebtedness from the Jacksons pursuant to the terms of a separate guaranty instrument.

After an adverse decision by the trial court, the Jacksons contended on appeal that they were discharged from their guaranty liability either because they had not been provided with notice of D & M's default or because the collateral securing D & M's obligation had been impaired. The court of appeals held with respect to the Jacksons' "lack of notice" argument that the plain language of the guaranty contract was sufficient to waive any otherwise available right to receive notice and that even if the waiver language were determined to be inadequate or ineffective, the Jacksons, as D & M's alter ego, were on constructive notice of the liabilities of D & M at the time the debts came due.[89]

The Jacksons also asserted two impairment of collateral defenses. First, they argued that their liability under the guaranty should be discharged because FSB released titles to three vehicles to the purchasers. The court of appeals rejected this contention because in each instance the Jacksons had, in fact, consented to the release of the titles.[90] Second, the Jacksons asserted that because the titles to certain of the repossessed vehicles securing D & M's indebtedness to FSB had not been executed by the respective owners, the collateral was impaired. On this issue, the court of appeals questioned whether this "necessarily impaired the collateral" because there was no evidence suggesting that Mr. Jackson had difficulty in selling repossessed vehicles in the past and because an Indiana statute expressly provided for obtaining a salvage title under such circumstances.[91]

Although the court of appeals' holding on each of these issues was very probably correct as a matter of common law principles of suretyship, it is submitted that the court's analysis was flawed. Rather than relying

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[89]*Id.* at 400.

[90]*Id.* at 400-01 (citing IND. CODE § 26-1-3-606(1) (1982)).

[91]*Id.* (citing IND. CODE § 9-1-3.6-2(6) (1982)).

on the common law principles of suretyship in its analysis, the *Jackson* court instead relied on various provisions of Article 3 of the UCC. Each of the provisions in Article 3 referred to by the court, however, refers to the term "instrument," which, under Indiana Code section 26-1-3-102(1)(e), is defined to mean a "negotiable instrument."[92] As a point of fact, the guaranty contract which the Jacksons executed was not itself a negotiable instrument,[93] and it is exceedingly unlikely that even the retail installment sales contracts which D & M endorsed "with recourse" were negotiable instruments.[94]

The defendants in *Hedrick v. First National Bank & Trust Co. of Plainfield*[95] also raised the defense of impairment of collateral. In *Hedrick*, the defendants executed a guaranty instrument in favor of the First National Bank and Trust Company of Plainfield, in which Mr. Hedrick and Mr. Murphy guaranteed the debts of their principals, Brown County Ski Mountain Resort, Inc., and Starlite Recreation Industries, Inc.

The guaranty contract purported to secure a $990,000 loan to the corporations; however, pursuant to the guaranty contract, the liability of each guarantor was limited to a maximum of $138,600. The $990,000 loan to the corporations was also secured by a second mortgage on certain real estate owned by the corporations. In December 1981, the corporations defaulted on the loan, and in February 1982, both corporations filed bankruptcy petitions. Subsequently, First National sued the guarantors.

On appeal after adverse judgments against them in the amount of $138,600 each (plus interest and court costs), Hedrick and Murphy argued that they were discharged from their liability under the guaranty contract because of First National's unjustifiable impairment of the collateral securing the loan to the corporations. Their primary collateral impairment claims concerned the fact that liens totalling $925,000 were placed ahead of First National's lien in the corporations' bankruptcy proceedings and the fact that First National had rejected an offer by one of the lienholders to purchase the collateral for $350,000.

The court of appeals rejected the guarantors' impairment of collateral defenses on the ground that Hedrick and Murphy had expressly consented to any impairment of collateral in the guaranty contract.[96] Nevertheless, the court went on to discuss the merits of the guarantors' impairment of collateral defenses. It found "no evidence to indicate that [First

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[92]Ind. Code § 26-1-3-102(1)(e) (Supp. 1986).

[93]*See* Ind. Code § 26-1-3-104(1) (Supp. 1986) (definition of a negotiable instrument).

[94]Ind. Code § 24-4.5-2-403 (Supp. 1986) precludes a seller from taking a negotiable instrument other than a check as the evidence of the obligation of the buyer in a consumer credit sale.

[95]482 N.E.2d 1146 (Ind. Ct. App. 1985).

[96]*Id.* at 1148-49.

National] was responsible for any circumstance which placed [it] behind lienholders.''[97] Specifically, the court of appeals noted that the $925,000 in superior liens which were at issue either were granted prior to the making of the loan to the corporations by First National or were approved by the bankruptcy court during the bankruptcy proceedings.[98]

Finally, the court of appeals determined that First National's rejection of the $350,000 offer to purchase the collateral did not harm the guarantors because ''there was evidence that sale of the collateral . . . would not have satisfied the outstanding debt owed the Bank, and that at least $227,200 (the total sum guaranteed) would remain to be satisfied.''[99] Accordingly, even if the waiver language contained in the guaranty contract had been deemed to be ineffective, the impairment of collateral defenses asserted by the guarantors would have been unavailing.

In *Amoco Oil Co. v. Ashcraft*,[100] the United States Court of Appeals for the Seventh Circuit applied Indiana law to a dispute over a guaranty the defendants executed when they purchased a franchise to sell Amoco products. The franchisee, Bowlby Oil Company, was indebted to Amoco for more than $200,000 when the Ashcrafts purchased Bowlby for $150,000. After the purchase was completed, the Ashcrafts signed a document entitled ''Unlimited Guaranty.'' The language of the document stated that the Ashcrafts ''Unconditionally Guarantee[d] Payment When Due . . . of any and all indebtedness, including interest thereon, of [Bowlby] to [Amoco], howsoever such indebtedness may arise, whether as principal, guarantor, endorser or otherwise, now or hereafter existing . . . .''[101] Upon default by Bowlby in the payment of its obligations to Amoco, Amoco sued the Ashcrafts under the guaranty contract. The district court granted summary judgment for Amoco and dismissed the Ashcrafts' counterclaims for fraud and breach of contract. The Seventh Circuit affirmed.[102]

The Ashcrafts alleged three grounds for avoidance of the debt. First, they contended that the guaranty was ambiguous. The Seventh Circuit discussed the use of the patent-latent ambiguity distinction in Indiana contract law and stated accordingly, ''[T]he court must first try, without taking any oral testimony, to figure out what the contract means; if it succeeds it will enforce the contract in accordance with that meaning.''[103] On this issue, the court concluded that the contract was clear on its

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[97] *Id.* at 1149.
[98] *Id.*
[99] *Id.*
[100] 791 F.2d 519 (7th Cir. 1986).
[101] *Id.* at 520.
[102] *Id.* at 524.
[103] *Id.* at 521.

face, that the words "now or hereafter existing" were unambiguous, and that the guaranty clearly referred to the pre-existing debts of Bowlby.[104]

The Ashcrafts' second argument was that Amoco should be estopped from enforcing the guaranty because certain false representations were made by Amoco's agent. They contended that the local manager of Amoco had assured the Ashcrafts at the time they signed the guaranty that the guaranty referred only to debts arising subsequent to the Ashcrafts' purchase of Bowlby. The Seventh Circuit held, however, that the local manager's interpretation of the document was not actionable as misrepresentation because Indiana law permits an action for misrepresentation of fact but not for misrepresentation about the meaning of a document.[105]

Third, the Ashcrafts argued that the guaranty should not be enforced on the basis of the doctrine of unconscionability. The Seventh Circuit observed, though, that Indiana law is "unfriendly to the defense of unconscionability"[106] as demonstrated by the fact that there was only one reported case in which an Indiana appellate court accepted a defense of unconscionability.[107] It noted that the facts of that case were clearly more egregious than the facts of the instant case. Furthermore, the Seventh Circuit concluded that the Ashcrafts had taken a calculated risk in purchasing Bowlby and had not attempted to negotiate more favorable terms. As a result, the Seventh Circuit required the Ashcrafts to abide by the terms of the guaranty and affirmed Indiana's resistance to embracing "a more paternalistic conception of the judicial role in enforcing contracts."[108]

VIII. Mechanic's Liens

During this survey period, the Indiana Court of Appeals decided several cases concerning mechanic's liens. Two of the controversies involved the construction of Indiana Code section 32-8-3-3.[109] In both, the Indiana Court of Appeals for the Third District took issue with a case previously decided by the First District.[110]

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[104]*Id.*

[105]*Id.* at 521-22 (citing Clem v. Newcastle & Danville R.R., 9 Ind. 488 (1857); Skrypek v. St. Joseph Valley Bank, 469 N.E.2d 774, 779-80 (Ind. Ct. App. 1984); Plymale v. Upright, 419 N.E.2d 756, 763-65 (Ind. Ct. App. 1981)).

[106]*Id.* at 522.

[107]*See* Weaver v. American Oil Co., 275 Ind. 458, 276 N.E.2d 144 (1971).

[108]*Amoco*, 791 F.2d at 524.

[109]This statute provides for notice of intention to hold a mechanic's lien and sets out filing requirements. *See* Ind. Code § 32-8-3-3 (Supp. 1986).

[110]*See* Cato v. David Excavating Co., 435 N.E.2d 597 (Ind. Ct. App. 1982).

In *O.J. Shoemaker, Inc. v. Board of Trustees,*[111] Shoemaker, the mechanic's lien claimant, filed a cross-claim to foreclose its lien against real estate for certain improvements made to the property. The notice of mechanic's lien contained the following description:

> Lots 19 through 24 and east 22" Vac-Bridge Street and West 1/2 east Mill Race and Vac-alley bet Lots 21 and 22 of Lowell.[112]

The trial court found this description insufficient to satisfy the requirements for establishing a lien, relying on *Cato v. David Excavating Co.*,[113] an opinion by the First District Court of Appeals.

The mechanic's lien notice in *Cato* set forth the contractor's intention to hold a lien on certain land and buildings when, in fact, the contractor had constructed a road but no buildings. The *Cato* court held that such notice was insufficient "not only for its failure to identify the improvement which was the subject of the lien but also for its purported inclusion of the buildings within the scope of the lien when only the land was subject to the lien."[114]

In *Shoemaker*, the trial court dismissed Shoemaker's cross-claim specifically because the lien failed to refer to the particular improvement made on the real estate by Shoemaker. The Indiana Court of Appeals for the Third District reversed, finding Shoemaker's lien sufficient to withstand dismissal.[115] The Third District, disagreeing with the First District's interpretation of the statute, stated that Indiana Code section 32-8-3-3

> is designed to give the record titleholder of the property and any prospective purchasers or money lenders *notice* of a person's *intent* to hold a lien on the property. . . The express requirements of the statute accomplish that purpose: notice. The fact that 'a lien may not be had on one structure for work done on or materials furnished for a different structure,' . . . is important only to the attempted enforcement of the lien, not to the notice of it.[116]

The court reasoned that any party with an interest in particular property is capable of inquiring further once he obtains notice of a lien.[117]

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[111]479 N.E.2d 1349 (Ind. Ct. App. 1985).
[112]*Id.* at 1350.
[113]435 N.E.2d 597 (Ind. Ct. App. 1982).
[114]*Shoemaker*, 479 N.E.2d at 1351 (citing *Cato*, 435 N.E.2d at 605).
[115]*Id.* at 1352.
[116]*Id.* at 1351 (citations omitted) (emphasis in original).
[117]*Id.*

The other case dealing with a similar issue was *Thomas J. Henderson, Inc. v. Leibowitz.*[118] In *Leibowitz,* Carl and Penny Leibowitz contracted with Henderson for remodeling work on a house that Mrs. Leibowitz was purchasing on contract. When the Leibowitzes did not pay in full, Henderson filed a notice of mechanic's lien on the house. Henderson's notice named the Leibowitzes as owners, gave the street number and legal description of the property, and listed the amount of the claim. Subsequently, Henderson brought an action to enforce the lien against the Leibowitzes (equitable owners), the Trytkos (legal owners), and the mortgage company that held the first mortgage on the real estate.

The trial court held in favor of all defendants, relying on *Cato.* In *Cato,* the court had said, "The statutory requirement of a statement of intention to hold a lien upon property implies that some reference to the improvement be made which will distinguish it from other improvements to which the lien does not attach."[119] The trial court in *Leibowitz* applied this language from *Cato* to hold that the mechanic's lien notice was invalid for failure to identify the improvement that was subject to the lien.[120]

The Indiana Court of Appeals for the Third District reversed the trial court on the mechanic's lien issue, reiterating in *Leibowitz* its express rejection of the First District's *Cato* opinion.[121] The *Leibowitz* court held that "compliance with the statutory requirement of legal description, street and number is sufficient to satisfy the notice purpose of the statute,"[122] and that a mechanic's lien notice need not refer to the nature of the improvements in order to satisfy the statutory requirement.[123]

The court of appeals also rejected the defendants' contention that the lien notice was invalid because it listed only the Leibowitzes as owners, when in fact the Trytkos were the legal owners at the time the notice was filed. Although concluding that the lien could not attach to the Trytkos' interest in the real estate because they neither authorized the remodeling nor received notice of Henderson's intent to hold a lien, the court held that the lien was valid with respect to the Leibowitzes' interest, stating that the lien "attached to whatever interest the Leibowitzes had when the labor and materials were furnished and also to the interest subsequently acquired by the conveyance from the Trytkos."[124]

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[118]490 N.E.2d 396 (Ind. Ct. App. 1986).

[119]*Cato,* 435 N.E.2d at 606, *quoted in* Thomas J. Henderson, Inc. v. Leibowitz, 490 N.E.2d 396, 397 (Ind. Ct. App. 1986).

[120]*Leibowitz,* 490 N.E.2d at 397.

[121]*Id.* at 398.

[122]*Id.* (citing O.J. Shoemaker, Inc. v. Board of Trustees, 479 N.E.2d 1349, 1351 (Ind. Ct. App. 1985)).

[123]*Id.*

[124]*Id.* The court of appeals cited Mid America Homes, Inc. v. Horn, 272 Ind. 171, 396 N.E.2d 879 (1979). In *Mid America Homes,* the Supreme Court of Indiana held that

In another recent case, *Indianapolis Power & Light Co. v. Todd*,[125] Indianapolis Power & Light Company (IPALCO) contracted with a general contractor for work on certain generating stations. The general contractor engaged a subcontractor and the subcontractor in turn hired laborers. IPALCO made partial payment to the general contractor, which subsequently paid the subcontractor in full; the subcontractor, however, failed to pay its laborers. The laborers sought to recover from IPALCO by filing notice of mechanic's lien under Indiana Code section 32-8-3-1 and by filing notice of intent to hold IPALCO personally liable under Indiana Code section 32-8-3-9 for the amount of labor performed.

The trial court granted partial summary judgment, holding for IPALCO on the mechanic's lien issue and for the laborers on the personal liability issue. On appeal, IPALCO argued that the laborers of a subcontractor were not a protected class under the personal liability statute. While conceding that the language of the personal liability statute was ambiguous, the court of appeals held that the laborers were entitled to recover against IPALCO.[126] Relying both on the similarities between the mechanic's lien statute and the personal liability statute and on existing case law under the personal liability statute and its predecessor, the appellate court determined that laborers employed by a subcontractor were entitled to participate on an equal basis with laborers employed by the general contractor.[127] Of course, in order for any plaintiff to recover under the personal liability statute, it is necessary for there to be funds in the hands of the owner which have not been paid to the general contractor.[128] Because IPALCO still controlled funds under the construction contract, the appellate court held that IPALCO was personally liable to the subcontractor's laborers.[129]

Another recent case dealing with Indiana Code section 32-8-3-9, the personal liability statute, was *Lee & Mayfield, Inc. v. Lykowski House Moving Engineers, Inc.*[130] Lykowski designed new wheel dollies for use in its building-moving business and contracted with Lee & Mayfield (Lee) for their manufacture. When the wheel dollies were first used to move a building owned by Levy, they proved to be defective and Lykowski refused to complete payment for them to Lee. Lee responded by filing notice to hold Levy, as owner of the building, personally responsible for payment pursuant to Indiana Code section 32-8-3-9. The trial court ruled on summary judgment that Lee's claim against Levy was invalid.

"the owner entitled to notice . . . is the owner of that interest which may be subjected to the lien anticipated by the notice . . . ." 272 Ind. at 176-77, 396 N.E.2d at 883.

[125] 485 N.E.2d 632 (Ind. Ct. App. 1985).

[126] *Id.* at 637.

[127] *Id.* at 636.

[128] *Id.* at 635-36.

[129] *Id.* at 636-37.

[130] 489 N.E.2d 603 (Ind. Ct. App. 1986).

On appeal, the Indiana Court of Appeals noted that although the personal liability provision does protect subcontractors and materialmen, Lee was not a subcontractor or a materialman within the meaning of Indiana Code section 32-8-3-9.[131] It held that the scope of the statute does not extend to one in Lee's position "who merely provides parts for equipment belonging to and used by the contractor."[132] Because the wheel dollies were provided to Lykowski not just to move Levy's building, but for Lykowski's building-moving business in general, the court of appeals concluded that Lee had no remedy against Levy in Lee's payment dispute with Lykowski.[133]

Finally, in *Wilson v. Jenga Corp.*,[134] the Wilsons entered into a contract with Jenga for the construction of a house on certain land owned by the Wilsons. Under the contract, the Wilsons agreed to pay Jenga even if they failed to obtain financing for the house. Relying on this provision, Jenga began work, only subsequently to learn that the Wilsons were unable to obtain financing. Jenga stopped work and gave notice of intent to file a mechanic's lien. In Jenga's suit to foreclose on the lien, the trial court held that the lien was valid.[135]

On appeal, the Indiana Court of Appeals reversed and remanded. The court of appeals stated that as a general proposition in a suit to foreclose on a mechanic's lien, where a key element is the reasonable value of the labor and materials provided, "[r]easonable value is not necessarily identical to cost."[136] At trial, Jenga had attempted to establish the quantity and value of the materials it provided to the Wilsons merely by introducing into evidence the invoices it had received from its creditors; however, the witnesses responsible for laying the foundation for this evidence had no knowledge of how the invoices were prepared and offered no testimony that Jenga had actually paid the amounts invoiced or that the charges represented the reasonable value of services and materials used on the project.

The Wilson had objected at trial to the introduction of the invoices on hearsay grounds and the court of appeals agreed.[137] The court of appeals concluded that in Indiana, "the witness through which a business record is to be admitted must have personal knowledge of the various elements of the foundation."[138] Accordingly, the court of appeals held

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[131]*Id.* at 608.
[132]*Id.*
[133]*Id.*
[134]490 N.E.2d 375 (Ind. Ct. App. 1986).
[135]*Id.* at 376.
[136]*Id.* (citing Bangor Roofing & Sheet Metal Co. v. Robbins Plumbing Co., 151 Me. 145, 116 A.2d 664 (1955)).
[137]*Id.* at 377.
[138]*Id.* (citing Baker v. Wagers, 472 N.E.2d 218 (Ind. Ct. App. 1984)).

that the trial court's reliance on the invoices in determining the value of the materials used was prejudicial and required reversal.[139]

IX. Garnishment

Two decisions within the survey period have accorded greater protections to third parties in garnishment proceedings. In *Browning & Herdrich Oil Co. v. Hall*,[140] for example, the Indiana Court of Appeals determined that a judgment creditor could not garnish certificates of deposit that a judgment debtor held in a joint account, where the debtor contributed none of the funds.[141]

The facts in *Browning* strongly favored the nondebtor account holder. Plaintiff Browning obtained a default judgment against Gerald Hall. In proceedings supplemental, Browning discovered that certain certificates of deposit had been issued by the Decatur County Bank to "Opal Hall and/or Gerald Hall" in an amount sufficiently large to satisfy the judgment, and attempted to levy on them. Opal, Gerald's mother, was a seventy-two-year-old widow who contributed all of the funds for the CD's.

The mother's contributions to the CD's were from her lifetime earned income, savings, the sale of property she once owned, a settlement of her husband's personal injury claim, the sale of stock, a profit-sharing plan from her former employment, and miscellaneous rent, interest, and other income. She alone received the interest from the CD's, which she reported on her annual income tax returns. She kept the CD's in her lock box, retained the only key, entered the box alone, and renewed the CD's when they came due.

By contrast, Gerald Hall never exercised any physical control over the CD's or the lock box. Gerald had no real knowledge as to the amount of the CD's. Moreover, the trial court found that by placing the CD's in joint title, the mother intended to save administrative expenses and legal fees upon her death. The trial court ruled that at no time did she intend to make an inter vivos gift of any portion of the CD's to Gerald.

The court of appeals affirmed the trial court's denial of a garnishment of the CD's. The appellate tribunal based its decision primarily on an Indiana statute which states that a joint account "belongs, during the lifetime of all parties, to the parties in proportion to the net contributions by each to the sums on deposit, unless there is clear and convincing evidence of a different intent."[142] Because the mother contributed all of

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[139]*Id.*

[140]489 N.E.2d 988 (Ind. Ct. App. 1986).

[141]*Id.* at 992.

[142]Ind. Code § 32-4-1.5-3(a) (1982).

the funds for the purchase of the CD's and because no clear and convincing evidence existed of an intent to make an inter vivos gift to the debtor, the court of appeals concluded that she alone owned the CD's, and therefore the CD's were not subject to garnishment by Browning in its attempts to satisfy the default judgment against the son.[143]

In a concurring opinion, Judge Ratliff addressed one important issue left unresolved—which party, the judgment creditor or the debtor, ought to bear the burden of establishing the extent of a debtor's interest in a joint account. Judge Ratliff contended that the burden properly rests with the joint depositors, because the debtor is in a much better position than a judgment creditor to know or ascertain the amount, if any, that the debtor contributed to the joint account and which, therefore, would be subject to garnishment.[144]

Browning illustrates one important constraint upon judgment creditors' attempts to garnish funds that are held by third parties and in which a debtor allegedly has an interest. *Lakeshore Bank & Trust Co. v. United Farm Bureau Mutual Insurance Co.*[145] established yet another limitation on a creditor's ability to garnish assets. In *Lakeshore*, the court of appeals held that the doctrine of res judicata barred a judgment creditor who dismissed a garnishee-defendant with prejudice from proceedings supplemental from later suing the same garnishee-defendant for the improper disposition of funds to the judgment debtors.[146]

Lakeshore Bank and Trust Company held a mortgage on the debtors' home. The mortgage required the debtors to maintain insurance on the property, with the loss payable clause in favor of Lakeshore. The debtors obtained a policy from United Farm Bureau Mutual Insurance Company, Inc. (Farm Bureau), but the policy did not name Lakeshore as the loss payee. During foreclosure proceedings, which Lakeshore initiated after the debtors defaulted on their mortgage payments, fire destroyed the mortgaged premises.

Lakeshore attached the insurance proceeds and subsequently obtained a default judgment against the debtors. Thereafter, Lakeshore commenced proceedings supplemental in which Farm Bureau was named as garnishee-defendant. Farm Bureau, in its answer, alleged that it had paid the insurance proceeds directly to the debtors prior to the writ of attachment and commencement of the garnishment proceedings. Consequently, Lakeshore dismissed Farm Bureau from the proceeding with prejudice. One year later, however, Lakeshore filed suit against Farm Bureau, alleging that Farm Bureau had actual knowledge of Lakeshore's interest in the

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[143]*Hall*, 489 N.E.2d at 992.

[144]*Id.* at 992-93 (Ratliff, J., concurring).

[145]474 N.E.2d 1024 (Ind. Ct. App. 1985).

[146]*Id.* at 1027-28.

insurance proceeds and therefore wrongfully transferred the proceeds to the debtors. The trial court granted Farm Bureau's motion to dismiss on the ground that Lakeshore's action was barred by the principles of res judicata. Lakeshore appealed.

As a preliminary matter, the court of appeals agreed with Lakeshore that the debtors' covenant in this mortgage to insure the mortgaged premises for Lakeshore's benefit was sufficient to impress an "equitable lien" in favor of Lakeshore on the insurance proceeds and that once Farm Bureau became aware of Lakeshore's interest in such proceeds (whether by notification prior to garnishment or by service of summons in garnishment), Farm Bureau was legally obligated to account to Lakeshore for the funds.[147] Nevertheless, it affirmed the judgment of the trial court. The court of appeals held that because Farm Bureau's liability for the insurance proceeds was an issue which might properly have been litigated in the proceedings supplemental to which it was a party, its dismissal with prejudice from the proceedings operated as an adjudication on the merits of that issue.[148] Accordingly, the court observed, "To allow Lakeshore to sue Farm Bureau in a later cause of action for the wrongful disposition of the proceeds would be a retrial of the issue that was or should have been litigated in the earlier proceedings" and therefore would contravene the principles of res judicata.[149]

Clearly, the lesson to be learned from *Lakeshore* is that a judgment creditor should not automatically dismiss (with prejudice) a garnishee-defendant from a proceedings supplemental once the latter reports that he no longer holds property belonging to the judgment debtor. Instead, the wise judgment creditor should first determine whether the garnishee-defendant surrendered the property to be garnished to the judgment debtor or other person after becoming aware of the judgment creditor's interest, such that the garnishee may be held personally liable to the judgment creditor for the improper disposition of the property.[150]

Equally, if not more, important to the law of garnishment and attachment than either *Browning* or *Lakeshore* is the 1985 enactment of Indiana Code section 34-1-11-49, which provides:

> A person, whether designated as a garnishee defendant, an income payor, or otherwise, who complies with what purports to be a garnishment or income withholding order issued under:

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[147] *Id.* at 1026-27.

[148] *Id.* at 1027-28.

[149] *Id.* at 1028.

[150] Of course, a judgment creditor who dismisses a garnishee-defendant from proceedings supplemental, only to determine later that the garnishee-defendant is or may be liable for the amount owed by the judgment debtor, could attempt to have the dismissal set aside. *See* 474 N.E.2d at 1028; *see also* IND. R. TR. P. 41(F) and 60(B).

> (1) the Indiana rules of trial procedure;
> (2) this chapter; or
> (3) IC 31-2-10 or a similar law of this or another state pertaining to support or maintenance of any person;
>
> is not personally liable for the amounts withheld if, for any reason, the order is determined by a court to be procedurally defective.[151]

This statute was enacted to address the dilemma created for garnishee-defendants by a combination of the well-established Indiana case law to the effect that a garnishee-defendant's disposition of the judgment debtor's property pursuant to defective legal process will not protect the garnishee-defendant from personal liability to other claimants to the same property[152] and the more recent cases such as *Bowmar Instrument Corp. v. Maag*[153] and *Owens-Classic, Inc. v. Swager Tower Corp.*,[154] which illustrate that distinguishing between valid and invalid legal process can prove quite difficult.

In *Bowmar*, the court of appeals held that the child support obligor's employer, which allegedly had failed to comply with a court-ordered wage assignment, could not be held in contempt of court for such failure, because the employer was not served with a summons along with the wage assignment order.[155] As it turned out, however, the employer, in fact, made payments to the court from its employee's wages under what the court of appeals determined to be an invalid court order.[156] Although not addressed by the *Bowmar* court, the facts of the case were such that, in theory, if the employer had been served with a "valid" order in garnishment against the same employee, the employer very easily could have been held accountable to the garnishment creditor for the payments "voluntarily" made under the defective wage assignment order.

After *Bowmar*, the law appeared to be that an income payor or garnishee-defendant could, and perhaps should, refuse to honor a wage assignment order or garnishment order unless such order was served with a summons. Then came the *Owens-Classic* decision.

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[151] IND. CODE § 34-1-11-49 (Supp. 1986).

[152] *See, e.g.*, Emery v. Royal, 117 Ind. 299, 20 N.E. 150 (1889); Debs v. Dalton, 7 Ind. App. 84, 34 N.E. 236 (1893); *see also* 14 I.L.E., *Garnishment* § 13, at 472-73:

> [I]n the absence of jurisdiction in garnishment . . . , a judgment against the garnishee, and payment thereof, will afford [to the garnishee] no protection. It is the duty of a garnishee-defendant before paying money to know whether a proper judgment has been rendered, and, if through his negligence he bears a loss, he must bear it.

(footnotes omitted).

[153] 442 N.E.2d 729 (Ind. Ct. App. 1982).

[154] 480 N.E.2d 232 (Ind. Ct. App. 1985).

[155] *Bowmar*, 442 N.E.2d at 731.

[156] *Id.* at 730.

In *Owens-Classic*, the court of appeals determined that two garnishee-defendants, each of whom was served with a verified motion for proceedings supplemental and an order requiring answers to certain interrogatories, were liable to the garnishment creditor for the sums held as of the date of service of such documents, even though the actual summonses were not served until approximately two weeks later.[157] In reaching its decision, the *Owens-Classic* court reasoned that the verified motion and the order on the interrogatories contained all of the information required to be in a summons.[158] The result was that the garnishee-defendants, in effect, were required to "pay twice"—once to the judgment debtor from the judgment debtor's funds and once to the judgment creditor from the garnishee-defendant's own funds—even though *Bowmar* clearly suggested that absent service of an actual summons, a garnishee-defendant is not subject to the court's jurisdiction.

The 1985 statute offers to garnishee-defendants under garnishment orders and to income payors under income withholding orders a kind of "safe harbor." Simply stated, the statute provides that garnishee-defendants and income payors who comply with court orders that are, or later prove to be, procedurally defective cannot be held personally liable or accountable for the amounts withheld simply because of the procedural defect.[159]

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[157] *Owens-Classic*, 480 N.E.2d at 234-35.

[158] *Id.*

[159] *See* Ind. Code § 34-1-11-49 (Supp. 1986).

The Indiana Business Corporation Law: Tool For Flexibility, Simplicity and Uniformity

Edwin J. Simcox*

I. Introduction

The Indiana Business Corporation Law (IBCL)[1] is designed to propel Indiana into the forefront of states with modern laws governing corporations. Enacted by the 1986 General Assembly, the IBCL is a comprehensive revision of the for-profit corporation law with "state-of-the-art" provisions.

Growing concern among the business and legal communities that the Indiana General Corporation Act (IGCA),[2] predecessor to the IBCL, had become archaic and was not flexible enough to serve the needs of modern business organizations effectively led to enactment of the IBCL. Not only had the IGCA become outmoded, but the various piecemeal attempts to update it over the years instead created provisions that became ambiguous and lacked continuity. Thus, when the Legislature established a study commission[3] to draft and propose a new corporation

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[1]Act of Mar. 5, 1986, Pub. L. No. 149-1986, 1986 Ind. Acts 1377 (codified at Ind. Code §§ 23-1-17 to -54 (Supp. 1986)).

[2]Ind. Code §§ 23-1-1 to -12 (1982).

[3]Act of Apr. 16, 1985, Pub. L. No. 362-1985, 1985 Ind. Acts 2490. Public Law 362 established the General Corporation Law Study Commission, chaired by the Secretary of State and composed of three legal practitioners, three members of the business community, and four state legislators (two from each house and party). The legislative directive was that "[t]he commission shall study the advisability of recommending changes in, including a complete revision of, the general corporation law of this state. Among its considerations, the commission shall examine model or uniform corporation laws." *Id.* § 5, at 2491.

At the commission's organizational meeting in May, 1985, it was determined that the revision should be based on the 1983 version of the Model Business Corporation Act. The commission's goal, also established at that initial meeting, was the creation of a completely rewritten corporation act which would be modern in its concepts, flexible in its application, and simple enough to be used by small, closely-held corporations. Flexibility was singled out as the most important aspect because of the need for the new act to accommodate complex transactions and yet be simple and streamlined enough to make operation under the act feasible for small corporations, which account for the vast majority of all corporations formed in Indiana. The final goal of the commission was to create statute, the primary goal was the creation of a law that would provide flexibility, simplicity, and uniformity.

This Article will not attempt to analyze every important new provision of the IBCL but will instead focus on a limited number of the statute's more significant aspects. The practitioner is cautioned to review the new act in its entirety in order to represent corporate clients most effectively.

II. Applicability of the Indiana Business Corporation Law

The IBCL will apply automatically to all for-profit corporations that operate in Indiana effective August 1, 1987.[4] This includes corporations formed not only under the IBCL but also those corporations formed under the IGCA[5] or any other prior, for-profit corporation law in Indiana.[6] The IBCL repeals all prior for-profit corporation laws,[7] thus simplifying filing procedures, providing uniformity in application of the law, and eliminating confusion as to which act governs a particular corporation.

The IBCL also applies to all corporations transacting business within the state that are organized under the laws of another jurisdiction[8] and to certain domestic corporations engaging in a business that is subject to regulation and organized under another statute of this state to the extent that the IBCL does not conflict with the other statute.[9] Not-for-profit corporations are not governed by the IBCL.[10]

Existing domestic corporations may elect to be governed by the provisions of the IBCL prior to its August 1, 1987, effective date.[11] Once such an election is made, all of the provisions of the IBCL apply

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an act that, as much as possible, would conform to similar acts in other states. This desire for uniformity was the main consideration for using the Model Business Corporation Act as the starting point.

The commission met weekly throughout the summer and autumn of 1985 and also conducted five regional hearings across the state in order to obtain recommendations from Indiana attorneys and corporations. The commission's final product was introduced into the Legislature through the House of Representatives in the form of House Bill 1257.

[4]Ind. Code Ann. § 23-1-17-3(a) (West Supp. 1986).

[5]Ind. Code §§ 23-1-1 to -12 (1982).

[6]Ind. Code Ann. § 23-1-17-3(a) (West Supp. 1986).

[7]*Id.*

[8]*Id.* § 23-1-17-4.

[9]*Id.* This section provides that "[a] corporation engaging in a business that is subject to regulation under another statute of this state may incorporate under this article unless provisions for incorporation of corporations engaging in that business exist under that statute." For example, banks and insurance companies are incorporated under Ind. Code §§ 28-1-4 and 27-1-6 (1982) and thus may not incorporate under the IBCL although they must file with the Secretary of State to form a corporation. The provisions of the IBCL will govern these corporations, however, as long as there is no contrary provision under title 28 or title 27.

[10]*See* Ind. Code Ann. §§ 23-1-17-3(a), 23-1-20-5 (West Supp. 1986).

[11]*Id.* § 23-1-17-3(b). To so elect, a corporation's board of directors must adopt a

to the corporation with the exception of those provisions dealing with filing fees,[12] annual reports,[13] and incorporation.[14]

A foreign corporation does not have the option of electing to be governed by the IBCL prior to August 1, 1987.[15] However, a foreign corporation that transacts with a domestic corporation that has elected early must comply with those provisions of the IBCL that relate to the specific transaction.[16] The intent of this non-code provision is to alleviate possible confusion in determining which law would govern the actions of a foreign corporation in a transaction such as a merger with an electing, domestic corporation.

III. Articles of Incorporation

A. Filing Requirements

Patterned on the Model Business Corporation Act,[17] the IBCL establishes streamlined filing requirements which will also promote uni-

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resolution electing to have Ind. Code §§ 23-1-18 through -54 apply to the corporation. The resolution must be filed with the Secretary of State and must:

a. Recite the board's resolution;

b. Set forth an effective date *after* the date of filing but no later than 90 days after the date of filing;

c. Be signed by any officer or the chairman of the board;

d. Be accompanied by the $26 filing fee; and

e. Be presented along with one conformed copy.

Ind. Code Ann. §§ 23-1-17-3(b), 23-1-18-1 (West Supp. 1986).

After July 31, 1987, the provisions of the IBCL apply to all for-profit corporations; thus the election to be governed by the IBCL will no longer be necessary.

[12]Ind. Code Ann. § 23-1-18-3 (West Supp. 1986). Prior to August 1, 1987, the filing fees prescribed by Ind. Code § 23-3-2 apply to all corporations, regardless of whether a corporation has "opted-in" or elected to be governed by the IBCL prior to its August, 1987, effective date. *See* Ind. Code Ann. § 23-1-17-3(c) (West Supp. 1986).

[13]Ind. Code Ann. § 23-1-53-3 (West Supp. 1986). Prior to August 1, 1987, all corporations must continue to file annual reports pursuant to Ind. Code § 23-1-8-1. *See* Ind. Code Ann. § 23-1-17-3(c) (West Supp. 1986). The first annual report required by the IBCL will be due on April 1, 1988, since the IBCL changes the filing date for all annual reports from a July 30 filing deadline to a filing period ranging from January 1 to April 1. The old annual report filing requirements will remain effective for 1987. House Bill 1756, pending before the 1987 Indiana General Assembly, would amend the IBCL to create a quarterly filing system based upon a corporation's date of incorporation/admission. This would eliminate the strictly fiscal/calendar year filing system in which all for-profit corporations file annual reports during the same period.

[14]Ind. Code Ann. § 23-1-21 (West Supp. 1986). No incorporation provisions are effective under the IBCL until August 1, 1987. Until that date, a corporation must be formed pursuant to Ind. Code § 23-1-3 (1982). *See* Ind. Code Ann. § 23-1-17-3(c) (West Supp. 1986). However, once formed, a corporation may immediately file an election pursuant to Ind. Code § 23-1-17-3(b) to come under the provisions of the IBCL.

[15]Ind. Code Ann. § 23-1-17-4 (West Supp. 1986).

[16]Pub. L. No.149-1986, § 67, 1986 Ind. Acts 1531.

[17]Model Business Corp. Act (1983).

formity as other states adopt the Model Act. Under the IBCL, there are four items required for articles of incorporation.[18] Thus, on and after August 1, 1987, for-profit corporations will be required to set forth only the following information:

1. the corporate name;

2. the number of shares the corporation is authorized to issue;

3. the street address of the corporation's registered office and name of the registered agent; and

4. the name and address of each incorporator.[19]

Other information may be included but is not required.

Unless a delayed effective date is specified, pursuant to Indiana Code section 23-1-18-4(b), the corporate existence begins with the filing of articles of incorporation.[20] The brevity of the new filing requirements should facilitate preparation and filing of incorporation documents, particularly for small corporations.

B. Corporate Name

In the area of corporate name, the IBCL varies from the prior law in two significant respects: name availability and permissible words of incorporation. While the IBCL retains the "distinguishable" standard of name availability adopted two years ago,[21] it departs from the IGCA in the requirements for obtaining consent to use an indistinguishable name.[22] Under the IBCL, a corporation must use a name that is distinguishable upon the records of the Secretary of State from the names of all other corporations whether domestic, foreign, for-profit, or not-

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[18] IND. CODE ANN. § 23-1-21-2(a) (West Supp. 1986). Compare the abbreviated requirements of this new section with the more extensive requirements of IND. CODE § 23-1-3-2 (1982).

[19] IND. CODE ANN. § 23-1-21-2(a) (West Supp. 1986).

[20] *Id.* § 23-1-21-3(a). No delayed effective date for articles of incorporation was permitted under the IGCA.

[21] Act of Mar. 7, 1984, Pub. L. No. 130-1984, 1984 Ind. Acts 1125 (codified at IND. CODE §§ 23-1-2, 23-1-7, 23-1-11, 23-2-1, 23-3-4, 23-7-1.1). The "distinguishable" standard is met if a proposed name is in any way different from an existing name, as long as the variation is not a minor one such as a change in tense or punctuation. This standard, unlike its predecessor, the "confusingly similar" standard, does not carry with it the burden of determining whether a proposed name might be confused with an existing name. That determination is left for the private parties and courts to settle if one feels that a corporation's rights to a specific name have been infringed.

[22] IND. CODE ANN. § 23-1-23-1(c) (West Supp. 1986).

for-profit.[23] This rule also applies to reserved and registered names.[24] Under the IGCA, it was permissible to incorporate an identical or otherwise indistinguishable name as long as the prior existing corporation provided consent.[25] Under the IBCL, the prior existing corporation may continue to provide consent, but must also agree to dissolve or change its corporate name.[26]

The second and more significant change regarding corporate names is the expansion of the permissible words of incorporation. Under the IGCA, only the words "Corporation," "Incorporated," or an abbreviation of one of the two were sufficient as words of incorporation.[27] The IBCL adds the words "Company" and "Limited" and their abbreviations to the list of permissible words of incorporation.[28] This provision is consistent with the words of incorporation adopted by most states.[29]

Under the IBCL, the use of any one of these four words or their abbreviations may indicate corporate status, although the use of "Company" and "Limited" is not restricted to corporations. "Limited" has traditionally been used in Indiana to denote a limited partnership. Therefore, the presence of "Company" or "Limited" in a name does not necessarily indicate that the owner of the name is a corporation. A

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[23]*Id.* § 23-1-23-1(b).

[24]*Id.* Registered name is a term added by the IBCL which permits an existing foreign corporation to register its corporate name, if the name is distinguishable, for renewable one-year periods prior to the transaction of business in Indiana. Name reservation, on the other hand, existed for both domestic and foreign corporations under the IGCA and continues under the IBCL. The reservation period is 120 days. *Id.* § 23-1-23-2(a).

[25]Ind. Code § 23-1-2-4(b) (1982).

[26]Ind. Code Ann. § 23-1-23-1(c) (West Supp. 1986).

[27]Ind. Code § 23-1-2-4 (1982).

[28]Ind. Code Ann. § 23-1-23-1(a)(1) (West Supp. 1986).

[29]As of the introduction of the IBCL into the 1986 General Assembly, only three states required the words "Corporation" and "Incorporation" as the exclusive words of incorporation. Those states were: Alabama, Indiana, and New Jersey. Thirty-six states allowed "Corporation," "Incorporated," "Company," "Limited," or a more permissive list of words of incorporation. Those state were: Alaska, Arizona, California, Colorado, Connecticut, Delaware, Georgia, Idaho, Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Mexico, North Carolina, North Dakota, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Utah, Vermont, Virginia, Washington, West Virginia, and Wyoming. Maine, Utah and Wyoming permit any name to be incorporated. Maryland recognizes "Chartered" and Mississippi permits "Unlimited" in addition to the standard four words. Hawaii, Louisiana, New Hampshire, New York, South Carolina, and Wisconsin allowed "Corporation," "Incorporated" or "Limited," but not "Company" while Arkansas, Florida, Ohio, Tennessee, and Texas permitted "Corporation," "Incorporated," or "Company" but not "Limited." Telephone survey by Susan L. Wampler, Corporate Counsel, Office of the Indiana Secretary of State, August 14, 1985.

check should be made with the Corporations Division of the Secretary of State's Office to determine whether a corporate filing has been made.

C. Purposes and Powers

The articles of incorporation are no longer required to contain a statement regarding the purposes of the corporation, although such a clause may be added.[30] If the articles of incorporation do not limit the purposes, powers, or duration of the corporation, the corporation's purposes and powers will be as broad as allowable under the Act[31] and its duration will be perpetual.[32]

Three significant expansions of a corporation's permissible powers have been added by the IBCL. A corporation now has the power to lend money and credit to its officers, directors, employees, and agents[33] whereas such loans were prohibited under the IGCA.[34]

Another new provision defines certain emergency powers which are available to all corporations under the IBCL.[35] This section allows corporations to continue operations during an emergency by modifying lines of succession and relocating the principal office without adhering to otherwise required procedures.[36] An emergency is defined as occurring "if an extraordinary event prevents a quorum of the corporation's directors from assembling in time to deal with the business for which the meeting has been or is to be called."[37]

A third new section contains a provision that gives directors the power to adopt procedures for regulating change of control transactions and provides directors with the authority to react to changing hostile takeover tactics.[38]

D. Stock Shares

The establishment of significantly more flexible provisions relating to shares of stock and the creation of a capital structure are key developments initiated by enactment of the IBCL. The statute abandons the traditional concept of "common stock" in favor of "authorized shares," thus allowing the corporation to develop a capital structure appropriate for its specific needs.[39] The IBCL requires only that at all

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[30]IND. CODE ANN. § 23-1-21-2(a), -2(b)(2)(A) (West Supp. 1986).

[31]*Id.* § 23-1-22-1.

[32]*Id.* § 23-1-22-2.

[33]*Id.* § 23-1-22-2(11).

[34]IND. CODE § 23-1-2-18 (1982).

[35]IND. CODE ANN. § 23-1-22-3 (West Supp. 1986).

[36]*Id.* § 23-1-22-3(a).

[37]*Id.* § 23-1-22-3(d).

[38]*Id.* § 23-1-22-4. *See also infra* note 116 regarding the questioned constitutionality of the IBCL's provisions regarding takeovers.

[39]IND. CODE ANN. § 23-1-25 (West Supp. 1986).

times there be at least one class of stock with full voting rights and one class, which may be the same class, with full rights upon dissolution.[40] Any number of other special classes are allowed, including traditional preferred stock.[41]

1. Insolvency and Balance Sheet Tests for Distributions.—The concepts of "par value," "stated capital," "capital surplus," and "earned surplus" are eliminated under the IBCL, but corporations currently using or wishing to use these concepts in the future may continue to do so. The IBCL replaces these prior terms with a clear, two-fold standard for determining when a distribution is lawful: an equity insolvency test and a balance sheet test.[42] The equity insolvency test considers the corporation's ability to pay its current obligations as they become due.[43] In addition, the balance sheet test requires that the corporation's assets exceed the sum of its liabilities and preferential amounts due upon liquidation.[44] Because these tests are routinely used by businessmen and accountants, the board of directors through its collective business judgment will be permitted under the IBCL to use and rely on these more familiar standards in determining the effect to the corporation of a distribution to shareholders.

2. Treasury Shares.—Following the modern trend, the IBCL eliminates treasury shares unless a corporation elects to have them.[45] The IGCA defined treasury shares as shares that have been issued and subsequently re-acquired by the corporation but have not been cancelled or restored to the status of authorized but unissued shares.[46] They were by statute issued but not outstanding. The IBCL eliminates the concept of treasury shares and permits a corporation to acquire its own shares and either hold them as authorized but unissued shares or cancel them and reduce the total authorized shares of the corporation.[47]

3. Consideration.—The rules governing consideration for the issuance of shares are also more flexible under the IBCL. The board of directors, unless the articles of incorporation reserve this authority to the shareholders, may authorize the issuance of shares for any tangible or intangible property including promissory notes, uncertified checks, and contracts for future services,[48] none of which were recognized as valid

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[40]*Id.* § 23-1-25-1(b).

[41]*Id.* § 23-1-25-1(c).

[42]*Id.* § 23-1-28.

[43]*Id.* § 23-1-28-3(1).

[44]*Id.* § 23-1-28-3(2).

[45]*Id.* § 23-1-27-2.

[46]Ind. Code § 23-1-1-1(h) (1982); *see also* Ind. Code Ann. § 23-1-2-6 (West Supp. 1986).

[47]Ind. Code Ann. § 23-1-27-2 (West Supp. 1986).

[48]*Id.* § 23-1-26-2.

consideration under the IGCA. Additionally, there is no requirement that there be an initial paid-in capital amount of one thousand dollars ($1,000) as required by the IGCA.[49]

4. Dividends and Stock Splits.—Because the concept of par value has been eliminated, the IBCL disposes of the distinction between share dividends and splits and treats all pro rata issuances to the corporation's shareholders without consideration as dividends.[50]

5. Uncertified and Fractional Shares.—The IGCA had made no provisions for uncertificated securities or for dealing with fractional shares of stock which often result from mergers, stock splits, and dividends. With the increase in frequency of these complex corporate transactions and the modern trend toward a paperless society, explicit authorization of these types of securities has become essential.

The IBCL allows shares of stock to be issued without certificates, acknowledging the increased use of electronic and computerized devices for maintaining share records.[51] To protect shareholders, the corporation has the burden of sending shareholders a written statement of the information required to appear on certificates if the corporation does not issue certificates.[52]

In another significant change, the IBCL permits the issuance of fractional shares of stock and specifically sets out guidelines for the control of fractional shares, including the substitution of scrip for fractional shares.[53]

E. Registered Agent and Office

Every corporation must continuously maintain a registered office in Indiana and a registered agent at that office.[54] The new terminology is a departure from the prior principal office/resident agent requirement,[55] and though the concept is basically the same, there are a number of changes.

A registered office need only be an address designated by the corporation. No other connection to the corporation must exist as arguably was required for the principal office under prior law.[56] However, the IBCL does require a street address; a post office box will no longer

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[49] IND. CODE § 23-1-3-2(8) (1982).
[50] IND. CODE ANN. § 23-1-26-4 (West Supp. 1986).
[51] *Id.* § 23-1-26-7.
[52] *Id.* § 23-1-26-7(b).
[53] *Id.* § 23-1-25-4.
[54] *Id.* § 23-1-24-1.
[55] IND. CODE § 23-1-2-5 (1982).
[56] *Id.*

suffice.[57] The registered agent continues to serve the function of agent for service of process and other legal notices.[58]

Unlike the IGCA, the IBCL requires the business address of the registered agent to be identical to the address listed for the corporation's registered office.[59] A registered agent must be either an individual, a domestic for-profit or not-for-profit corporation, or a foreign for-profit or not-for-profit corporation registered in Indiana.[60] Therefore, if a law firm is to be the registered agent, either it must be a professional corporation or an individual within the firm must be willing to serve as the registered agent.

Once a corporation is subject to the provisions of the IBCL, its existing resident agent and resident agent's address will be considered the registered agent and office as required by the statute.[61] This provision relieves the corporation of the burden of changing the agent and office to conform to the definitions of the IBCL until the filing of its first annual report. Thus the records of the Secretary of State will contain only one address for each corporation until April 1, 1988, when the first annual report is filed under the IBCL. The annual report must also contain a listing of the corporation's principal office, whether inside or outside of Indiana, which the statute defines as the place where the principal executive offices are located.[62]

The procedures for changing a registered agent or office are more comprehensive than under the prior law. Under the IBCL, a new agent's written consent must be submitted with the statement of change of registered agent.[63] A registered agent may resign by filing two copies of a signed resignation statement with the Secretary of State.[64] The resignation becomes effective on the thirty-first day after the day on which it was filed.[65]

A corporation's registered agent is the proper party for service of process on a corporation.[66] If the registered agent is unavailable,[67] service

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[57] IND. CODE ANN. § 23-1-24-2(a)(2) (West Supp. 1986).
[58] *Id.* § 23-1-24-4.
[59] *Id.* § 23-1-24-1(2)(A).
[60] *Id.* § 23-1-24-1(2).
[61] Pub. L. No. 149-1986, § 66(c), 1986 Ind. Acts 1531.
[62] IND. CODE ANN. § 23-1-20-19 (West Supp. 1986).
[63] *Id.* § 23-1-24-2(a)(5).
[64] *Id.* § 23-1-24-3(a).
[65] *Id.* § 23-1-24-3(c).
[66] *Id.* § 23-1-24-4(a); IND. R. TR. P. 4.6(a)(1).
[67] IND. CODE ANN. § 23-1-24-4(b) (West Supp. 1986). The registered agent is not available if the corporation has failed to appoint a new one or if with reasonable diligence the agent cannot be located. *Id.*

may be made on the secretary or other executive officer at the corporation's principal office.[68]

F. Subsequent Documents

1. General Filing Requirements and Certifications.—The General Corporation Law Study Commission found that from a procedural standpoint, there was a need to simplify the execution of many corporate transactions, including the mechanics of filing documents with the Secretary of State.[69] Too many transactions were delayed or complicated by failure to comply with technical requirements of the IGCA. Thus, the IBCL contains a uniform, simplified filing procedure in a centralized location in the Act to clarify the technical requirements of document filing.[70]

This provision of the IBCL eliminates the verification language[71] required by the IGCA,[72] and adds a section permitting a delayed effective date of up to ninety days after the date of filing for any document.[73] If no delayed effective date is specified, the document is effective when filed rather than when approved.[74] The IBCL also clarifies and expands the list of persons who may execute corporate documents.[75]

In the area of certifications, the IBCL abandons the concept of good standing in favor of a certificate of existence or authorization.[76]

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[68]*Id.* The possibility of service on an executive officer other than the secretary was added so that this provision would track the language used in Indiana Trial Rule 4.6(a)(1).

[69]The IGCA required documents to comply with various out-dated, technical and often complicated procedures. For example, the IGCA required articles of incorporation to be presented in duplicate with both copies originally signed even though the copy is returned to the filing party and only the original is retained by the Secretary of State. Ind. Code § 23-1-3-2 (1982). The IBCL eliminates this technicality by requiring a filed document to be accompanied by one exact or conformed copy which need not be signed. The new requirement eliminates a possible filing delay when the signed incorporator or officer is not available to sign the copy. Ind. Code Ann. § 23-1-18-2 (West Supp. 1986).

[70]Ind. Code Ann. § 23-1-18 (West Supp. 1986). In addition, this section also eliminates the requirement of individual certificates issued in connection with various transactions in favor of more efficient ways to evidence the completion of a filing. This outmoded concept of issuing an individually prepared certificate for each of the thousands of transactions completed annually is replaced by a fee receipt or acknowledgement of receipt if no fee is required. *Id.*

[71]*Id.* § 23-1-18-1(g)(3).

[72]*See, e.g.*, Ind. Code §§ 23-1-3-2, 23-1-4-5, 23-1-5-2(f), and 23-1-7-1 (1982).

[73]Ind. Code Ann. § 23-1-18-4(b) (West Supp. 1986).

[74]*Id.* § 23-1-18-4(a).

[75]*Id.* § 23-1-18-1(f). This section retains the power of any officer to sign a document and adds the chairman of the board of directors. It also clarifies that an incorporator may sign if the directors have not been selected or the corporation has not been formed, and permits execution by the fiduciary if the corporation is in the hands of a receiver, trustee, or other court-appointed fiduciary. *Id.*

[76]*Id.* § 23-1-18-9.

2. Articles of Correction.—Articles of correction is a new filing permitted by the IBCL which allows the cure of deficiencies or incorrect statements in a formerly filed document.[77] A corrective filing has the effect of remedying the error as of the date the original document was filed except for persons who relied on the inaccurate document and who are adversely affected by the correction.[78]

This new corrective filing procedure provides a much needed mechanism to correct technical errors. Under the prior act, a corporation was required to file articles of amendment, even though that procedure was inappropriate, because there was no better means of correcting errors in a previously filed document.

3. Articles of Amendment and Restated Articles.—Certain "housekeeping" amendments to the articles of incorporation may now be accomplished under the IBCL without shareholder approval.[79] One such permissible amendment is changing the corporate name by substituting the word "Corporation," "Incorporated," "Company," "Limited," or an abbreviation for a similar word or abbreviation.[80]

Additionally, the IBCL specifically provides for restated articles of incorporation when a corporation has made amendments to its articles and wants to combine all currently effective provisions into one document.[81] Additional amendments may be made in the restated articles with or without shareholder approval, depending upon the subject matter being amended.[82] If the restatement is filed without amendments, no shareholders' vote is required.[83] No provision for restated articles existed under the IGCA.

IV. Directors and Officers

A. Indemnification, Standard of Conduct, and Liability

Liability of directors, officers, employees, and agents has become a critical issue in modern corporation law, necessitating a detailed and specific chapter on indemnification. Addressing the concern, the IBCL revitalizes Indiana's indemnification statute to include comprehensive definitions, criteria for advancing and/or reimbursing expenses, including defense fees, and provisions for the maintenance of liability insurance, as well as sections regarding the power to indemnify, a mechanism for

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[77] *Id.* § 23-1-18-5.
[78] *Id.* § 23-1-18-5(c).
[79] *Id.* § 23-1-38.
[80] *Id.* § 23-1-38-2(5).
[81] *Id.* § 23-1-38-7.
[82] *Id.* § 23-1-38-7(d).
[83] *Id.*

handling claims for indemnification, mandatory indemnification, and indemnification by judicial order.[84] These changes are directed at providing maximum protection for those persons who serve corporations while preserving the rights of persons to enforce legitimate claims.

The IBCL outlines a detailed standard of conduct for directors in the execution of their duties.[85] This standard basically is three-fold and requires that a director discharge his duties in good faith, with the care that an ordinarily prudent person in a like position would exercise in similar circumstances, and in a manner the director reasonably believes to be in the best interests of the corporation.[86] The IBCL also provides a mechanism for handling conflict of interest transactions in which a director has either a direct or indirect interest in the transaction.[87]

The most notable change is the relaxation of the legal standard of care required of directors from simple negligence to a standard of "willful misconduct or recklessness."[88] This change was made to alleviate the critical problem of obtaining adequate and affordable directors' liability insurance coverage.

It is important to note that the state revenue code has also been amended to impose liability in certain cases upon corporate officers and directors in the distribution of assets upon dissolution of a corporation.[89] Officers and directors are personally liable for "any acts or omissions that result in the disposition of corporate assets in violation of the interests of the state."[90] Additionally, personal liability extends to all taxes, penalties, interest, and fees associated with collection of the corporation's liability to the Department of Revenue[91] including a penalty of thirty percent of the unpaid tax.[92] These provisions become effective along with the IBCL on August 1, 1987.[93]

B. Management of the Corporation

Wide latitude in the management of corporate affairs is granted under the IBCL. A corporation with fifty or fewer shareholders may dispense with a board of directors by specifying in the articles of incorporation who will perform the board's duties.[94] This provision

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[84]*Id.* § 23-1-37.
[85]*Id.* § 23-1-35.
[86]*Id.* § 23-1-35-1(a).
[87]*Id.* § 23-1-35-2.
[88]*Id.* § 23-1-35-1(e)(2).
[89]*Id.* § 6-8.1-10-8. *See infra* text accompanying notes 117-29.
[90]Ind. Code Ann. § 6-8.1-10-8(c) (West Supp. 1986).
[91]*Id.* § 6-8.1-10-8(d).
[92]*Id.* § 6-8.1-10-8(e).
[93]*Id.* § 6-8.1-10-8.
[94]*Id.* § 23-1-33-1(c).

reflects the practice of many small corporations in which the shareholders actually conduct the operation of the corporation.

A corporation no longer must have a president, secretary, and treasurer[95] but must have one officer responsible for preparing minutes of shareholders' and directors' meetings and maintaining and authenticating the records of the corporation.[96]

Under the IBCL, the board of directors may take action without a meeting if the action is taken by all members of the board and is evidenced by written consent.[97] Such an action is effective when the last director signs or on the date specified in the action itself.[98]

V. Mergers and Share Exchanges

The IBCL updates, clarifies, and streamlines Indiana's merger and share exchange procedures to provide an expedited means of accomplishing these transactions, while retaining the same basic procedural structure.

A. Consolidation

The most notable distinction between the new act and the IGCA is that the IBCL no longer recognizes statutory "consolidation," which is similar to a merger except that all corporate participants disappear into a newly formed corporation created by the consolidation, as opposed to an existing corporate entity.[99] A similar effect, however, may be obtained under the IBCL by creating a new corporation immediately prior to the merger.

B. Merger

A significant change from the IGCA is the elimination of the thirty-day reapproval process,[100] which was designed to give directors of a merging corporation an opportunity to re-evaluate the merits of the merger. Under this section, once a plan of merger or share exchange was approved by the shareholders, the plan had to be reapproved by

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[95]Pub. L. No. 149-1986, § 65, 1986 Ind. Acts 1530 (repealing Ind. Code § 23-1-2-13). The IGCA also permitted one person to hold all positions if the bylaws so provided, but required that there be a president, secretary, and treasurer. Ind. Code § 23-1-2-13(a) (1982).

[96]Ind. Code Ann. § 23-1-36 (West Supp. 1986).

[97]*Id.* § 23-1-34-2(a).

[98]*Id.* § 23-1-34-2(b).

[99]*Id.* § 23-1-5-3.

[100]Pub. L. No. 149-1986, § 65, 1986 Ind. Acts 1530 (repealing Ind. Code § 23-1-5-2(f)).

the board of directors.[101] The provision did not apply if the shareholders' vote was unanimous.[102] In contrast, the IBCL does not require subsequent reapproval,[103] thus eliminating a burdensome process which often discouraged foreign corporations from merging with Indiana domestic corporations because of the uncertainty of the transaction even after initial approval.

Another departure from the prior law is the requirement that each shareholder of the surviving and merging corporations, whether or not entitled to vote, receive notice from the corporation of the proposed shareholders' meeting.[104] The notice must state that the purpose, or one of the purposes, of the meeting is to consider the plan of merger or share exchange and must contain a copy or summary of the plan.[105] The IGCA required that notice of the meeting be sent only to those shareholders entitled to vote.[106] Additionally, the IBCL provides that in certain cases, shareholder approval by the surviving corporation is not necessary.[107]

Subsidiary or short-form mergers are available to more corporations under the IBCL than under the prior law. The IGCA permitted any corporation owing at least ninety-five percent (95%) of the outstanding shares of each class of stock of another corporation to merge such corporation into itself without shareholder approval from either corporation.[108] The IBCL broadens this provision to include parent corporations owning at least ninety percent (90%) of the outstanding shares of stock of a subsidiary.[109]

Unlike the IGCA, the new Act specifically provides for an abandonment of either a plan of merger or share exchange at the discretion of the board of directors without shareholder approval.[110] However, the statute specifically requires the abandonment to occur prior to the filing of the articles of merger or share exchange with the Secretary of State.[111]

C. *Share Exchange*

The IBCL combines mergers and share exchanges into one chapter[112]

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[101]Ind. Code § 23-1-5-2(f) (1982).
[102]*Id.*
[103]Ind. Code Ann. § 23-1-40 (West Supp. 1986).
[104]*Id.* § 23-1-40-3(d).
[105]*Id.*
[106]Ind. Code § 23-1-5-2(a) (1982).
[107]Ind. Code Ann. § 23-1-40-3(g) (West Supp. 1986).
[108]Ind. Code § 23-1-5-8 (1982).
[109]Ind. Code Ann. § 23-1-40-4 (West Supp. 1986).
[110]*Id.* § 23-1-40-3(i).
[111]*Id.*
[112]*Id.* § 23-1-40.

because the two types of transactions are treated similarly. The provisions specifically applying to share exchanges closely follow the procedures originally enacted by the legislature in 1985 when share exchanges were first authorized.[113] However, many of the IBCL's streamlining provisions relating to mergers also apply to share exchanges as noted above.

D. *Takeover Provisions*

It is outside the scope of this Article to review the business combinations[114] and control share acquisition[115] provisions of the IBCL. Such a discussion is better suited for later treatment after resolution of *Dynamics Corp. of America v. CTS Corp.*,[116] in which the control share acquisition provision has been challenged on supremacy and commerce clause grounds.

VI. Dissolutions

A. *Voluntary Dissolution*

The provisions for voluntary dissolution of an Indiana corporation are greatly simplified under the IBCL. Most notably, the old requirement of clearances from the Department of Revenue and Employment Security Division,[117] which frequently delayed the dissolution process by two or more months, has been abolished.[118] In its place, the IBCL adopts a notice procedure in which a copy of treasury form 966 or a similar notice must be sent within thirty days following adoption of a plan of liquidation to the Department of Revenue and Employment Security Division.[119] The requirement that the Attorney General's Unclaimed Property Section be notified within ten days of the resolution to dissolve was not changed under the IBCL.[120]

The IBCL establishes a procedure whereby a corporation can settle claims shortly after dissolution.[121] Undisputed known claims can be

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[113]Act of Apr. 14, 1985, Pub. L. No. 231-1985, 1985 Ind. Acts 1582 (codified at Ind. Code §§ 23-1-5 and 23-3-2).

[114]Ind. Code Ann. § 23-1-43 (West Supp. 1986).

[115]*Id.* § 23-1-42.

[116]794 F.2d 250 (7th Cir. 1986) (Ind. Code § 23-1-42 void as violative of Williams Act and commerce clause). *See* Galanti, *Developments in Business Association Law*, 20 Ind. L. Rev. 19, 29-54 (1987).

[117]Ind. Code § 23-1-7-1 (1982).

[118]Pub. L. No. 149-1986, § 65, Ind. Acts 1530.

[119]Ind. Code Ann. § 23-1-45 (West Supp. 1986). It should be noted that Ind. Code § 23-1-45-2(f) contains a typographical error. In that section, Ind. Code § 6-8.1-10-8 is incorrectly cited as Ind. Code § 6-1.1-10-8.

[120]Ind. Code § 32-9-1-14 (1982).

[121]Ind. Code Ann. § 23-1-45-6, -7 (West Supp. 1986).

resolved by providing notice of dissolution to claimants and by paying the acknowledged amount due.[122] Disputed known claims require notification of the dispute from the claimant.[123] Unknown claims may be settled by publication which initiates the running of a two-year statute of limitations after which claimants are barred from pursuing claims.[124]

Under the IGCA, shareholders could initiate voluntary dissolution,[125] whereas the IBCL does not permit such action.[126] Another departure from prior law is the requirement under the IBCL that all shareholders, whether or not entitled to vote, receive notice.[127] The IGCA required that notice be sent only to those entitled to vote.[128]

The IBCL also creates a new concept whereby a dissolved corporation has a limited existence following the filing of articles of dissolution under which it may continue for the sole purpose of winding up its corporate affairs.[129]

Additionally, the IBCL establishes a procedure by which a corporation may revoke its dissolution by filing articles of revocation of dissolution with the Secretary of State within 120 days of the effective date of the dissolution.[130] The IGCA permitted revocation of dissolution only prior to the issuance of a certificate of dissolution by the Secretary of State.[131]

B. *Short Form Dissolution*

The requirements for short form dissolution, where the incorporators may dissolve a corporation without shareholder approval, have been modified to permit more corporations to follow this abbreviated process.[132] The IGCA imposed a one-year filing limit relating back to the date the articles of incorporation were filed, and permitted filing only if the corporation had not begun business *and* had not yet issued shares.[133] The IBCL abolishes the time constraint and permits filing if the business has not begun *or* if shares have not been issued.[134]

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[122] *Id.* § 23-1-45-6(b).

[123] *Id.* § 23-1-45-6(c).

[124] *Id.* § 23-1-45-7.

[125] Ind. Code § 23-1-7-1(b)(1) (1982).

[126] Ind. Code Ann. § 23-1-45 (West Supp. 1986).

[127] *Id.* § 23-1-45-2(d).

[128] Ind. Code § 23-1-7-1(b)(1) (1982).

[129] Ind. Code Ann. § 23-1-45-5 (West Supp. 1986). *See supra* text accompanying note 89 regarding officers' and directors' liability upon dissolution.

[130] Ind. Code Ann. § 23-1-45-4 (West Supp. 1986).

[131] Ind. Code § 23-1-7-2 (1982).

[132] Ind. Code Ann. § 23-1-45-1 (West Supp. 1986).

[133] Ind. Code § 23-1-7-1(a) (1982).

[134] Ind. Code Ann. § 23-1-45-1 (West Supp. 1986).

C. Administrative Dissolution

The Secretary of State has the power under the IBCL to seek administrative dissolution if: a corporation fails to pay within sixty days after the due date any penalties imposed by the IBCL or any other law; a corporation fails to file its annual report within sixty days after its due date; a corporation fails to appoint or notify the office of a change in the registered agent or registered office for more than sixty days; or a corporation's limited period of existence has expired.[135] Under the prior law, the Secretary of State could initiate administrative dissolution proceedings only if the corporation failed to file its annual report for two or more consecutive years[136] or if two years had elapsed since the termination of the corporation's period of existence.[137]

Where grounds for administrative dissolution exist, the Secretary of State must give the offending corporation notice of the grounds.[138] If the grounds are neither corrected nor disproved within sixty days after receipt of the notice, the Secretary of State shall administratively dissolve the corporation by issuing a certificate of dissolution setting forth the grounds for dissolution and the effective date, and serve a copy on the corporation.[139] A corporation that has been administratively dissolved continues to exist, but only for the purposes necessary to wind up and liquidate its operations[140] like the limited purposes of a voluntarily dissolved corporation.[141]

In another departure from the prior law, a corporation has only two years from the date of an administrative dissolution to seek reinstatement.[142] The IGCA imposed no time constraint.[143] When the reinstatement is effective, it relates back to the effective date of the administrative dissolution, and business is resumed as if the dissolution had never occurred.[144]

D. Judicial Dissolution

The IBCL provides for judicial dissolution by the Attorney General

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[135]*Id.* § 23-1-46-1.

[136]IND. CODE § 23-1-10-1 (1982).

[137]*Id.* § 23-1-7-3.

[138]IND. CODE ANN. § 23-1-46-2(a) (West Supp. 1986).

[139]*Id.* § 23-1-46-2(b).

[140]*Id.* § 23-1-46-2(c).

[141]*Id.* § 23-1-45-5. *See supra* text accompanying note 129.

[142]IND. CODE ANN. § 23-1-46-3 (West Supp. 1986). House Bill 1756, pending before the 1987 Indiana General Assembly, would permit administratively dissolved corporations meeting all other requirements to reinstate at any time, thereby eliminating the IBCL's two-year limitation.

[143]*Id.* § 23-3-4-1.6.

[144]*Id.* § 23-1-46-3(c).

in the event of fraud or abuse of authority; by a shareholder in the event of a deadlock; by a creditor in the event the creditor's claim has been reduced to judgment and the corporation is insolvent; or by the corporation under circumstances in which it chooses to have its voluntary dissolution continued under court supervision.[145] When the board of directors is deadlocked, a shareholder action for judicial dissolution no longer must show irreparable injury to succeed.[146]

VII. Foreign Corporations

Relaxation of the registration requirements for a foreign corporation transacting business in Indiana is another major advantage of the new Act. On the application for admission, the "Indiana shares" formula[147] has been eliminated[148] along with the requirement that foreign corporations disclose statements of business transacted and tangible property in Indiana.[149]

Another significant change from the IGCA is the IBCL's creation of specific criteria for determining what does not constitute "transacting business" within the state of Indiana.[150] A non-exhaustive laundry list is set forth to provide guidance in the determination of whether a corporation's activities require registration. The list includes maintaining, defending, or settling any proceeding, holding meetings that concern internal corporate affairs, maintaining bank accounts, maintaining offices dealing with the corporation's own securities, selling through independent contractors, soliciting or obtaining orders that must be accepted outside of Indiana to become contracts, as well as any transaction in interstate commerce or that is an isolated transaction that may be completed in thirty days.[151] The IGCA left the determination of whether an act was "transacting business in Indiana" to the judiciary.

The IBCL penalty provisions for corporations transacting business in the state without first registering are nearly identical to those of the

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[145] *Id.* § 23-1-47.

[146] *Id.* § 23-1-47-1(2)(A).

[147] *Id.* § 23-1-11-4; Ind. Code § 23-3-2-1(f) (1982). The "Indiana shares" formula was a burdensome mechanism to determine the percentage of business a foreign corporation transacted in Indiana. The percentage was multiplied by the corporation's total number of outstanding shares to determine its "Indiana shares" because the fee was based on the number of shares attributable to Indiana activity.

[148] Pub. L. No. 149-1986, § 65, 1986 Ind. Acts 1530 (repealing Ind. Code § 23-1-11-4).

[149] *Id.* (codified at Ind. Code § 23-1-11-4(g), (h) (West Supp. 1986)).

[150] Ind. Code Ann. § 23-1-49-1(b) (West Supp. 1986).

[151] *Id.*

IGCA.[152] A civil penalty of not more than ten thousand dollars, enforceable by the Attorney General, is retained by the IBCL.[153]

Many of the IBCL's other provisions regarding foreign corporations closely follow those pertaining to domestic corporations, including name availability,[154] maintenance of a registered agent and office,[155] and revocation of authority to transact business.[156]

VIII. Fees

Until passage of the IBCL, Indiana's corporate fee structure had not been significantly adjusted since 1973.[157] Additionally, Indiana's fee structure has generally been based upon the number of shares authorized by the corporation,[158] a policy that tended to penalize publicly held corporations and deter them from continuing to operate in Indiana. The minimum fee for incorporating a corporation was $36.00, while a corporation with two million authorized shares would pay $14,016 to incorporate.[159] The IBCL erases this disparity with a standard $90 fee for incorporation or admission regardless of the number of shares.[160] This provision eliminates the need for fee calculation by the corporation and the Secretary of State, and simultaneously abolishes the deterrent to conducting business in Indiana while establishing a standard fee that is not prohibitive for small corporations.

The fee to amend, dissolve, withdraw, or reinstate was raised from $26[161] to $30[162] while certifications were increased from $6[163] to $15[164] with a fee of $1 per page for copying.[165] Mergers or share exchanges will cost $90.[166] There will no longer be a fee for change of registered agent,[167] while annual report fees are unchanged at $15.[168]

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[152] Ind. Code § 23-1-11-14 (1982).
[153] Ind. Code Ann. § 23-1-49-2(d) (West Supp. 1986).
[154] *Id.* §§ 23-1-23, 23-1-49-6.
[155] *Id.* §§ 23-1-24, 23-1-49-7.
[156] *Id.* §§ 23-1-46, -51.
[157] Ind. Code § 23-3-2-2 (1973).
[158] Ind. Code Ann. § 23-3-2-2 (West Supp. 1986).
[159] *Id.* at (a).
[160] *Id.* § 23-1-18-3(a).
[161] Ind. Code §§ 23-3-2-2(h), (k), (m) and 23-3-2-3 (1982).
[162] Ind. Code Ann. § 23-1-18-3(a) (West Supp. 1986).
[163] Ind. Code § 23-3-2-3 (1982).
[164] Ind. Code Ann. § 23-1-18-3(c)(2) (West Supp. 1986).
[165] *Id.* at (c)(1).
[166] *Id.* at (a)(12).
[167] Ind. Code Ann. § 23-3-2-2(j) (West Supp. 1986). The fee was $4.
[168] *Id.* at (a)(23).

IX. Conclusion

In keeping with the goals of flexibility, simplicity, and uniformity, the IBCL provides latitude for large and small corporations to develop corporate structures to accommodate the realities of their businesses.

Business procedures for corporations not caring to change their financial structure may remain substantially the same as under the IGCA. On the other hand, for corporations requiring specialized or creative means of conducting their corporate activities, the IBCL provides a mechanism for accomplishing these goals. In either case, adjustments may need to be made in the corporation's articles of incorporation and by-laws to retain provisions from the IGCA or to take advantage of certain new provisions of the IBCL. For example, a corporation with fifty or fewer shareholders that wants to eliminate its board of directors must make alternative provisions in order to benefit from this new section of the IBCL.[169] The practitioner is cautioned to review the goals of each corporate client in light of the changes in the law in order to determine which adjustments must be made.

Finally the practitioner is cautioned that this Article did not endeavor to review thoroughly each of the many new provisions of the 145-page statute,[170] but instead merely highlighted several of the most significant developments. For example, new provisions relating to shareholders,[171] shareholder meetings,[172] voting,[173] dissenters' rights,[174] amendment of by-laws,[175] and record-keeping[176] are not even touched upon here although they are significant aspects of the IBCL. Therefore, the practitioner is urged to review *all* provisions of the IBCL thoroughly to better assist corporate clients in utilizing the new Act's dramatic improvement in corporate flexibility.

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[169] *See id.* § 23-1-33 (West Supp. 1986).

[170] Act of Mar. 5, 1986, Pub. L. No. 149-1986, 1986 Ind. Acts 1377.

[171] Ind. Code Ann. § 23-1-28 (West Supp. 1986).

[172] *Id.* § 23-1-29.

[173] *Id.* § 23-1-30.

[174] *Id.* § 23-1-44.

[175] *Id.* § 23-1-39.

[176] *Id.* § 23-1-52.

Amendments Curing Defendant Misnomers Under Trial Rule 15(C): A Bright Line Test of Prejudice for Relation Back?

Steven K. Huffer*

I. Introduction

Rule 15(C) of the Indiana Rules of Trial Procedure provides that an amended complaint will relate back to the date of the original complaint if the claim asserted in the amendment relates to the same conduct, transaction, or occurrence set forth in the original.[1] Where the amendment changes the nominal defendants, trial rule 15(C) imposes the additional requirements that the re-named defendant must "within the period provided by law for commencing the action against him"[2] (1) have received

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[1] Ind. R. Tr. P. 15(C) provides in full:

> (C) Relation Back of Amendments. Whenever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading. An amendment changing the party against whom a claim is asserted relates back if the foregoing provision is satisfied and, within the period provided by law for commencing the action against him, the party to be brought in by amendment:
>
> (1) has received such notice of the institution of the action that he will not be prejudiced in maintaining his defense on the merits; and
>
> (2) knew or should have known that but for a mistake concerning the identity of the proper party, the action would have been brought against him.
>
> The requirement of subsections (1) and (2) hereof with respect to a governmental organization to be brought into the action as defendant is satisfied:
>
> (1) in the case of a state or governmental organization by delivery or mailing of process to the Attorney General or to a governmental executive [Rule 4.6(A)(3)]; or
>
> (2) in the case of a local governmental organization, by delivery or mailing of process to its attorney as provided by statute, to a governmental executive thereof [Rule 4.6(A)(4)], or to the officer holding the office if suit is against the officer or an office.

[2] Prior to its amendment in 1966, Federal Rule of Civil Procedure 15(C) consisted solely of what is now its first sentence: "Whenever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading." The Advisory Committee's Note to the amendment states that the quoted language means "within the applicable limitations period." 39 F.R.D. 82, 83. The Indiana Supreme Court essentially adopted the amended federal rule with the adoption of the Indiana Rules of Trial Procedure in 1970. *See* Czarnecki v. Lear Siegler, Inc., 471 N.E.2d 299, 300 (Ind. 1984).

notice of commencement of the action such that he will not be prejudiced in defending the claim, and (2) have realized that but for a mistake, the original pleading would have named him as a defendant.

In a number of cases decided during the survey period, Indiana and federal courts have elaborated on the requirements for relation back of an amended complaint to avoid the intervening maturity of an applicable statute of limitations. Two conflicting policy considerations have influenced the decisions under both trial rule 15(C) and the nearly identical Federal Rule of Civil Procedure 15(c).[3] Statutes of limitations generally require commencement of an action within a specified time after its accrual.[4] Federal Rule of Civil Procedure 15(c) is intended to provide a defendant with notice of the institution of an action against him so that he will not be prejudiced in maintaining his defense.[5] Absent the necessity of changing the named parties in the original complaint by amendment, the statute of limitations does not defeat a plaintiff's claim where the complaint is filed on the last day of the applicable limitation period and served, with a summons, on a properly named defendant at some time after the statute has run.[6] Decisions construing the federal and Indiana rules on relation back may be viewed as making a policy choice between the clear

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[3]Fed. R. Civ. P. 15(c) provides:

> (c) Relation Back of Amendments. Whenever the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, the amendment relates back to the date of the original pleading. An amendment changing the party against whom a claim is asserted relates back if the foregoing provision is satisfied and, within the period provided by law for commencing the action against him, the party to be brought in by amendment (1) has received such notice of the institution of the action that he will not be prejudiced in maintaining his defense on the merits, and (2) knew or should have known that, but for a mistake concerning the identity of the proper party, the action would have been brought against him.
>
> The delivery or mailing of process to the United States Attorney, or his designee, or the Attorney General of the United States, or an agency or officer who would have been a proper defendant if named, satisfies the requirement of clauses (1) and (2) hereof with respect to the United States or any agency or officer thereof to be brought into the action as a defendant.

[4]For example, Ind. Code § 34-1-2-1 provides that certain enumerated actions must be commenced within six years after they accrue.

[5]*See* Kirk v. Cronvich, 629 F.2d 404, 408 (5th Cir. 1980); Simmons v. Fenton, 480 F.2d 133, 137 (7th Cir. 1973) (citing Martz v. Miller Bros. Co., 244 F. Supp. 246, 253-54 (D. Del. 1965)).

[6]*See* Ingram v. Kumar, 585 F.2d 566, 571 (2d Cir. 1978), *cert. denied*, 440 U.S. 940 (1979). In Cooper v. U.S. Postal Service, 740 F.2d 714, 717 (9th Cir. 1984), the court characterized its strict reading of Fed. R. Civ. P. 15(c) and denial of relation back as a "seemingly harsh result." *See also* Kaplan, *Continuing Work of the Civil Committee: 1966 Amendments of the Federal Rules of Civil Procedure,* 81 Harv. L. Rev. 356, 410 (1967), *quoted in* Schiavone v. Fortune, 106 S. Ct. 2379, 2388 (1986) (Stevens J., dissenting).

language of the Indiana and federal rules and a more equitable, inherently flexible, standard which focuses on whether the defendant, who was first correctly named in an amended complaint served on him after the limitation period has expired, was actually prejudiced.

II. *Schiavone v. Fortune*

In *Schiavone v. Fortune*,[7] the United States Supreme Court adopted the most restrictive possible interpretation of federal rule 15(c), showing its preference for following the rule's clear language.[8] Schiavone commenced a libel action against *Fortune* magazine in the United States District Court for the District of New Jersey. He alleged that certain statements published in the May 31, 1982, issue of *Fortune* defamed him. Under New Jersey law, a libel action must be commenced within one year from the date of its accrual.[9] The Court upheld the lower courts' finding that the cause of action accrued no later than May 19, 1982.[10]

Schiavone filed his complaint on May 9, 1983, within the applicable statute of limitations. He named "Fortune" as the sole defendant. Fortune is merely a trademark and an internal operating division of Time, Incorporated, a New York corporation. Fortune is not a separate legal entity with the capacity to be sued.[11]

Time's New Jersey registered agent received the complaint and summons on May 23, 1983, outside the applicable statute of limitations. The registered agent refused to accept service of process because Time was not named as a defendant in the complaint. Schiavone amended his complaint as of right,[12] changing the name of the defendant to "Fortune, also known as Time, Incorporated."[13] The amended complaint was served on Time by certified mail on July 21, 1983.[14]

The district court granted Time's motion to dismiss the amended complaint.[15] The United States Court of Appeals for the Third Circuit affirmed.[16] The United States Supreme Court affirmed the dismissal of the complaint.[17] The Court stated:

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[7]106 S. Ct. 2379 (1986).

[8]*Id.* at 2385.

[9]N.J. Stat. Ann. § 2A:14-3 (West 1952) provides: "Every action at law for libel or slander shall be commenced within 1 year next after the publication of the alleged libel or slander." N.J. Stat Ann. § 2A:14-3 (West 1952), *quoted in Schiavone*, 106 S. Ct. at 2381 n.3.

[10]*Schiavone*, 106 S. Ct. at 2384.

[11]*Id.* at 2381 n.2.

[12]*See* Fed. R. Civ. P. 15(a), which permits a plaintiff to amend his complaint before the defendant serves an answer.

[13]*Schiavone*, 106 S. Ct. at 2381.

[14]*Id.*

[15]*Id.*

[16]Schiavone v. Fortune, 750 F.2d 15 (3d Cir. 1984).

[17]*Schiavone*, 106 S. Ct. at 2386.

> The first intimation that Time had of the institution and maintenance of the three suits took place after May 19, 1983, the date the Court of Appeals said the statute ran "at the latest."
>
> Only on May 20 did petititoner's counsel mail the complaints to Time's registered agent in New Jersey. Only on May 23 were those complaints received by the registered agent, and then refused. Only on July 19 did each petitioner amend his complaint. And only on July 21 were the amended complaints served on Time.
>
> It seems to us inevitably to follow that notice to Time and the necessary knowledge did not come into being "within the period provided by law for commencing the action against" Time, as is so clearly required by Rule 15(c). That occurred only after the expiration of the applicable 1-year period. This is fatal, then, to petitioners' litigation. . . . We accept the Rule as meaning what it says.[18]

In *Schiavone*, the Court overruled a line of federal cases construing the language of federal rule 15(c) requiring notice to the target defendant "within the period provided by law for commencing the action" to mean within the statutory period plus a reasonable time for service of process.[19] However, substantial uncertainty still exists as to the interpretation of the identical clause of Indiana Trial Rule 15(C). Indiana courts have yet to consider a case under rule 15(C) in which the complaint was filed within the limitations period and first served on the target, albeit misnamed, defendant a short time after the statute has run.[20] Despite the clear holding of the United States Supreme Court in *Schiavone*, differences between other federal and Indiana rules,[21] dicta in a recent Indiana Supreme Court decision,[22] and two Indiana Court of Appeals decisions[23] call into question the adherence to *Schiavone* by Indiana courts under trial rule 15(C).

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[18]*Id.* at 2384-85 (citations omitted).

[19]*E.g.,* Ringrose v. Englebert Huller Co., 692 F.2d 403, 410 (6th Cir. 1982); Kirk v. Cronvich, 629 F.2d 404 (5th Cir. 1980); Ingram v. Kumar, 585 F.2d 566 (2d Cir. 1978); Clark v. Southern Ry. Co., 87 F.R.D. 356 (N.D. Ill. 1980). *See also Schiavone*, 106 S. Ct. at 2388 n.4 (Stevens J., dissenting).

[20]In Honda Motor Co. v. Parks, 485 N.E.2d 644 (Ind. Ct. App. 1985), the Indiana Court of Appeals considered a fact pattern substantially similar to that in *Schiavone*. The court made no finding, however, as to the date of first service. *Id.* at 646. Since the complaint was filed four days before the statute ran, first service could have been before or after the last day of the statutory period. *Id.* at 645.

[21]IND. R. TR. P. 21(A) states in relevant part: "Incorrect names and misnomers may be corrected by amendment under Rule 15 at any time." FED. R. CIV. P. 21 contains no such provision.

[22]Czarnecki v. Lear Siegler, Inc., 471 N.E.2d 299, 301 (Ind. 1984).

[23]Honda Motor Co. v. Parks, 485 N.E.2d 644 (Ind. Ct. App. 1985); Creighton v. Caylor-Nickel Hospital, Inc., 484 N.E.2d 1303 (Ind. Ct. App. 1985).

III. *Czarnecki v. Lear Siegler, Inc.*

In *Czarnecki v. Lear Siegler, Inc.*,[24] the Indiana Supreme Court readily concluded that the amended complaint did not relate back under the facts presented. The plaintiff truck driver was blinded by fragments from the shattering of a truck cab's rear window. The incident occurred on September 1, 1975. On August 31, 1977, the last day of the limitations period,[25] plaintiff filed suit against several defendants, including "Hinson Cab Company," which plaintiff believed to be the manufacturer of the cab, but which was in fact a nonexistent entity. Plaintiff's attorney could find no address for "Hinson Cab Company," but attempted service by mailing the summons to C.T. Corporation System, the resident agent of another totally unrelated defendant. By coincidence, C.T. Corporation System was also the resident agent for Royal Industries, Inc., the entity that actually manufactured the cab. The parties stipulated that Royal Industries, Inc., never received the original complaint and summons. Hinson Manufacturing Co., Inc., the successor in interest to Royal Industries, Inc., actually received service of the summons and plaintiff's amended complaint first naming it as a defendant on September 12, 1980, more than five years after the occurrence.[26]

The trial court entered summary judgment in favor of the cab manufacturer based on the statute of limitations.[27] The Indiana Court of Appeals reversed,[28] relying on a distinction between amendments that cure a "misnomer" and amendments that actually add an intended defendant.[29] The court of appeals cited Indiana Trial Rule 21(A), a rule with no counterpart in the Federal Rules of Civil Procedure, which states: "Incorrect names and misnomers may be corrected by amendment under Rule 15 at any time."[30] The court of appeals held that changing a misnomer to reflect the actual name of the party is different from changing the party against whom the claim is asserted and therefore distinguished *Simmons v. Fenton*,[31] in which the United States Court of Appeals for the Seventh Circuit denied relation back.[32]

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[24]471 N.E.2d 299 (Ind. 1984).

[25]*See* IND. CODE § 34-1-2-2(1) (1982).

[26]*Czarnecki*, 471 N.E.2d at 300.

[27]*Id.* at 299.

[28]Czarnecki v. Hinson Cab Co., 461 N.E.2d 708 (Ind. Ct. App. 1984).

[29]*Czarnecki*, 471 N.E.2d at 301.

[30]*Id.*

[31]480 F.2d 133 (7th Cir. 1973).

[32]In *Simmons*, plaintiff brought an action for personal injury arising out of an automobile accident. The complaint was filed on the last day of the limitations period. 480 F.2d at 135. The original pleading named as defendant "Teresa D. Fenton," a thirteen year old girl who plaintiff thought was the driver of one of the vehicles involved. The actual driver was "Doris J. Fenton," her mother. Service was first made at the Fenton

The Indiana Supreme Court vacated the decision of the court of appeals and clarified that correction of a misnomer under trial rule 21(A) is dependent upon compliance with the requirements of trial rule 15(C).[33] In doing so, the Indiana Supreme Court expressly noted the near identity between Indiana Trial Rule 15(C) and Federal Rule of Civil Procedure 15(c). The court specifically relied on the Seventh Circuit's decision in *Simmons*.[34] However, in dicta, the Indiana Supreme Court hedged on its adherence to the rationale of *Simmons* that the first notice to the target defendant of commencement of the action must be within the statute of limitations. The court stated:

> Rule 15(C) would relate back here if the summons addressed to Hinson Cab Company had actually been served on Royal Industries, Inc., Hinson Division, and Royal would therefore have been given notice that suit was being brought against the manufacturer of the cab, which, of course, was Royal, and that they were the intended target defendant even though misnamed by the summons served. An amended complaint served after the running of the statute of limitations which properly named Royal Industries, Inc., Hinson Division, as a defendant, would have related back under 15(C) because clearly they would have had notice of the institution of the action and would have known that but for a mistake of misnomer they were the intended target defendant.[35]

Thus, in *Czarnecki*, the Indiana Supreme Court left the door open to acceptance of the rationale adopted in some federal circuits that "the period provided by law for commencement of the action" includes a reasonable period of time for service.[36] This rule was intended to put a plaintiff who misnames his target defendant in the complaint, but effects service of process on the target defendant in the ordinary course of events after the running of the statute, on the same footing as the plaintiff who properly names his target defendant to begin with.[37] However, the dicta in *Czarnecki* is inconsistent with the rationale of *Simmons* that the "prejudice" contemplated by federal rule 15(c) may be the loss of a statute

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family's residence after the running of the statute. *Id.* The court, in holding that the attempted amendment did not relate back, stated:

> Rule 15(c) is not satisfied, since actual service on whoever was served was not effected until . . . at least three weeks after the tolling of the statute of limitations. [T]here is clearly prejudice to her [the mother] if the amendment is allowed. To allow the amendment will be to deprive her of the defense of the statute of limitations. *Id.* at 136.

[33] *Czarnecki*, 471 N.E.2d at 301.

[34] *Id.* at 300.

[35] *Id.* at 301.

[36] *See supra* note 5.

[37] Ingram v. Kumar, 585 F.2d 566 (2d Cir. 1978), *cert. denied*, 440 U.S. 940 (1979).

of limitations defense which would be available under a strict interpretation of the rule.[38]

The facts of *Czarnecki* present a clear case for denial of relation back, because the first notice of any kind to the target defendant did not occur until some three years after the running of the statute of limitations. The cab manufacturer was clearly prejudiced in maintaining its defense by the passage of time alone.[39] Therefore, *Czarnecki* should be understood as an easy application of rule 15(C).[40] Neither the dicta nor the citation to *Simmons* was necessary to reach the decision not to permit relation back.

IV. *Creighton v. Caylor-Nickel Hospital, Inc.*

In *Creighton v. Caylor-Nickel Hospital, Inc.*,[41] the Indiana Court of Appeals reversed the trial court's summary judgment, refusing relation back where the facts presented a clear conflict between equitable treatment of a plaintiff who initially misnamed his target defendant and the express language of trial rule 15(C).[42] In *Creighton*, the plaintiff brought an action for medical malpractice[43] which he alleged resulted in his injury from a slip and fall in a shower/tub unit at the Caylor-Nickel Hospital in Bluffton, Indiana. There are three units within the hospital, each bearing the name "Caylor-Nickel": the Caylor-Nickel Research Institute, the Caylor-Nickel Clinic (Clinic), and the Caylor-Nickel Hospital (Hospital).[44] All three are in close proximity, and although the Clinic and Hospital actually occupy different portions of the same building, each of the three is a separate legal entity.[45] The entities' common billing statements and other documents issued to the public also added to the confusion.[46] The alleged injury occurred on February 24, 1978. Creighton's attorney first filed a proposed complaint with the Indiana Patient's Compensation Authority (Authority), a division of the Indiana Department of Insurance (Department), on February 19, 1980, five days before the statute of limitations would have run, naming only the Clinic as a defendant.[47]

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[38]*See Simmons,* 480 F.2d at 136.

[39]*See* Swartz v. Gold Dust Casino, Inc., 91 F.R.D. 543, 548 (D. Nev. 1981) (citing Smith v. Guaranty Service Corp., 51 F.R.D. 289 (N.D. Cal. 1970)); *cf.* Ridge Co. v. NCR Corp., 597 F. Supp. 1239, 1244 (N.D. Ind. 1984) (minimum two-year delay in first notice to target defendant; summary judgment for target defendant).

[40]*See, e.g.*, Ridge Co. v. NCR Corp., 597 F. Supp. 1239 (N.D. Ind. 1984).

[41]484 N.E.2d 1303 (Ind. Ct. App. 1985).

[42]*Id.* at 1308.

[43]Under the Indiana Medical Malpractice Act, Ind. Code §§ 16-9.5-1-1 to 16-9.5-10-3, the patient plaintiff must initially file a proposed complaint for medical malpractice with the Indiana Insurance Commissioner. Ind. Code § 16-9.5-9-1 (1982).

[44]*Creighton,* 484 N.E.2d at 1304.

[45]*Id.*

[46]*Id.* at 1307.

[47]*Id.* at 1304-05, 1307.

The Authority forwarded the proposed complaint naming only the Clinic to Cecil Lockwood, Jr., the risk manager for both the Hospital and the Clinic, on February 22, 1980, two days before the running of the statute of limitations.[48] Lockwood did not receive the proposed complaint until February 28, 1980, four days after the running of the statute.[49] On the same day, the Hospital and Clinic forwarded the proposed complaint to their insurance carrier, pointing out the plaintiff's pleading mistake in Lockwood's cover letter.[50] On February 29, 1980, the Department reported to Creighton's attorney that the Authority had previously provided erroneous information which led Creighton's attorney to believe that the Hospital and Clinic were the same entity.[51] On receiving this information, Creighton's attorney amended his proposed complaint to name the Hospital as a defendant for the first time.[52] The amended proposed complaint was received by the Authority on March 3, 1980, eight days after the statutue of limitations would have expired on the claim.[53] The Hospital filed a motion for summary judgment as to the amended complaint based on the statute of limitations.[54] The trial court granted summary judgment in favor of the Hospital.[55]

The court of appeals noted that the Hospital first received actual formal notice of the institution of the action four days after the running of the statute of limitations, when Lockwood received a copy of the proposed complaint directed against the Clinic.[56] The court of appeals framed the issue as: "whether this minor delay in the receipt of actual notice precluded relation back of the amended complaint."[57]

The court of appeals discussed three factors which compelled relation back under the circumstances, in spite of the fact that the proper target defendant did not receive actual notice of institution of the action until after the running of the statute. First, the court of appeals noted that Creighton's confusion and mistake in determining the correct name was induced by misleading information from the Clinic, Hospital, and Authority.[58] Second, the Hospital and Clinic had the closest imaginable

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[48] *Id.* at 1305.

[49] *Id.*

[50] The letter stated: "We are sure, also, that it is not necessary to call your attention to the fact that the fall which resulted in the *suit* against Caylor-Nickel Clinic occurred on the premises owned and operated by Caylor-Nickel Hospital, Inc. . . . ." *Id.* at 1305.

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] *Id.*

[57] *Id.*

[58] Several federal and Indiana cases have relied on misleading information supplied by the defendant as an equitable basis for permitting relation back. *See* Ryser v. Gatchel

identity of interests.[59] Finally, the Hospital received constructive notice of institution of the action, since service of the proposed complaint was made upon the Authority, which is the statutory agent for service of process on health care providers under the Indiana Medical Malpractice Act,[60] within the statutory period.

The court of appeals distinguished *Czarnecki* by pointing out that the first notice of the claim upon the cab manufacturer in that case was more than three years after the filing of the original complaint.[61] The court of appeals stated, in justifying relation back under the circumstances:

> [T]he Hospital received actual, formal, seasonable notice and must be deemed to have received constructive notice of the claim against it on the day the action was commenced by filing the original proposed complaint with the Authority, the Hospital's agent for receipt of notice.
>
> We think a defendant to be brought in by amendment has received "such notice" as is required by the rule when, as in this case, he has received constructive notice of the claim within the period provided by law and has, thereafter, received actual, formal, seasonable notice of the claim and knew or should have known that "but for a mistake concerning the identity of the proper party, the action would have been brought against him."[62]

By relying on constructive notice, the court appealed to "essential considerations of fairness."[63] The court held:

> [T]he claimant's only duty (under the Medical Malpractice Act) is to file a proposed complaint. The claimant has no duty to serve the named defendant with notice of the claim. That

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151 Ind. App. 62, 278 N.E.2d 320 (1972); 6 C. Wright & A. Miller, Federal Practice and Procedure § 1500 n.28 (1971).

[59]The "identity of interest" exception to the requirement of actual notice to the target defendant within the limitations period is widely recognized. *See* C. Wright & A. Miller, *supra* note 58, at 516. In *Schiavone*, the Court held that this exception would still require notice to someone within the statutory period. *Schiavone*, 106 S. Ct. at 2384. In *Honda*, the Indiana Court of Appeals implied that the identity of interest exception may be satisfied even if service on the wrong, but related, party is first made outside the limitations period. *See supra* note 20.

[60]Constructive notice to the target defendant or service on the target defendant's agent within the statutory period has been held sufficient notice in a number of cases to permit relation back. *See* C. Wright & A. Miller, *supra* note 58, at 520 n.21. Here, too, the Court in *Schiavone* stated that service on the *agent* must be within the statutory period. *Schiavone*, 106 S. Ct. at 2384. ("there was no *proper* notice to Fortune that could be *imputed* to Time" *Id.* (emphasis added)).

[61]*Creighton*, 484 N.E.2d at 1308.

[62]*Id.*

[63]*Id.*

> responsibility, a ministerial act, rests on the Authority, the health care provider's agent for receipt of notice.[64]

Creighton is probably limited to its factual setting. Its holding is arguably that medical malpractice complaints in Indiana are deemed notice to the defendant (and other related parties) on the date of filing with the Authority. If so, medical malpractice actions do not give rise to the basic problem addressed in this Article: there is no time lag between commencing the action so as to toll the statute of limitations and the notice to the defendant necessary to invoke the relation back doctrine. Therefore, *Creighton* does not resolve the problem of the *Schiavone* fact pattern under trial rule 15(C).

V. *Honda Motor Co. v. Parks*

Honda Motor Co. v. Parks[65] is another recent Indiana case involving the issue of relation back when a complaint is amended under rule 15(C) to substitute a defendant after the statute of limitations has run. However, in this case, the Indiana Court of Appeals raised more questions than it answered by failing to make a finding crucial to a determination under the *Schiavone* analysis. The court engaged in an extensive discussion of prior Indiana precedent, notable for its omission of *Czarnecki*. In reversing a summary judgment for the products liability defendant, the court held that the probable existence of an identity of interest between the original and substituted defendants, the American and Japanese branches of Honda respectively, precluded summary judgment.[66] While it was clear that the complaint was filed within the statutory period, the court made no finding as to the date of original service on American Honda, the erroneously-named manufacturer. It is possible that counsel for the defendant did not raise the issue.

VI. Conclusion

While the dicta in *Czarnecki* and the holdings in *Creighton* and *Honda* would seem to indicate a tendency among Indiana appellate courts to construe trial rule 15(C) liberally, the *Schiavone* fact pattern has yet to come before them for resolution. What is clearly at stake is the availability of summary judgment to the target defendant in such a case. Under the *Schiavone* analysis, the only material fact is the date of first notice to the defendant: if that date is outside the statutory period, the plaintiff is out of court. Under the more liberal approach adopted in some federal

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[64] *Id.* at 1307-08.
[65] 485 N.E.2d 644 (Ind. Ct. App. 1985).
[66] *Id.* at 651.

circuits, but now overruled by *Schiavone*, summary judgment might be precluded by the question of whether the defendant was actually prejudiced by first receiving notice outside the statutory period.

Because of the uncertainty surrounding the Indiana courts' approach to a fact situation similar to *Schiavone*, Indiana plaintiffs' counsel should exercise extra care in correctly naming target defendants when filing an action near the expiration of the applicable statute of limitations. If Indiana courts decide to follow *Schiavone* strictly, a mistake in the designation of a defendant may be fatal to their client's claim, even if the complaint is filed in a timely manner.

Attorney's Fees for Frivolous, Unreasonable or Groundless Litigation

Andrew W. Hull*

During the survey period, the Indiana legislature enacted a statutory amendment providing for an award of attorney's fees, as a part of the costs to the prevailing party in a civil action.[1] The amendment permits a court to award attorney's fees if the court finds that either party: (1) brought the action or defense or a claim on defense that is frivolous, unreasonable, or groundless; (2) continued to litigate the action or defense after the party's claim or defense clearly became frivolous, unreasonable, or groundless; or (3) litigated the action in bad faith.[2] This legislative mandate for the award of attorney's fees is a departure from past Indiana practice and raises important questions for practitioners.

I. The American Rule

Indiana courts have traditionally adhered to the American rule that attorney's fees cannot be awarded to a prevailing party in the absence of either a specific statutory provision or an agreement between the parties.[3] This rule is based on the assumption that imposing the costs of attorney's fees on the losing party will greatly discourage use of the courts.[4] Critics of the American rule have argued for a modification of the rule for at least three reasons. First, the American rule encourages intolerably congested courts.[5] Second, it is argued that an injured party can never be made whole if he must pay his attorney's fees.[6] Finally, it is asserted that the rule encourages parties with unfounded or feeble claims to bring suit in hope of recovering at least the nuisance value of the suit because

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[1] Ind. Code § 34-1-32-1 (Supp. 1986).

[2] Ind. Code § 34-1-32-1(b) (Supp. 1986).

[3] *See, e.g.,* Kikkert v. Krumm, 474 N.E.2d 503, 505 (Ind. 1985); Trotcky v. Van Sickle, 227 Ind. 441, 443, 85 N.E.2d 638, 640 (1949). Courts have construed statutes that provide for an award of costs to the prevailing party as not to include an award of attorney's fees. *See* State v. Holder, 260 Ind. 336, 339, 295 N.E.2d 799, 800 (1973).

[4] F.D. Rich Co. v. Industrial Lumber Co., 417 U.S. 116, 129 (1974); Fleischmann Distilling Corp. v. Maier Brewing Co., 386 U.S. 714, 718 (1967). See Mallor, *Punitive Attorney's Fees for Abuses of the Judicial System*, 61 N.C.L. Rev. 613, 615-19 (1983), for a useful discussion of the policy implications of the American rule.

[5] *See* Kuenzel, *The Attorney's Fee: Why Not a Cost of Litigation?*, 49 Iowa L. Rev. 75, 79-80 (1963).

[6] *See* Ehrenzweig, *Reimbursement of Counsel Fees and the Great Society,* 54 Calif. L. Rev. 792, 797 (1966).

such a party risks nothing but the costs of his own attorney's fees.[7]

It is widely recognized that the shifting of attorney's fees can have an important impact on a litigant's rights.[8] Both Congress and the Indiana legislature have provided for an award of attorney's fees in various instances to effectuate important legislative policies.[9]

Through the exercise of their equitable powers, Indiana courts have recognized an exception to the American rule that each party to a lawsuit must bear his own attorney's fees absent expressed statutory or contractual authorization. The obdurate behavior exception permits a court to impose an award of attorney's fees[10] on a party that has litigated in bad faith.[11] The Supreme Court of Indiana first considered the obdurate

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[7]*Id.* at 792; Note, *Attorney's Fees: Where Shall the Ultimate Burden Lie?*, 20 VAND. L. REV. 1216, 1223 (1967).

[8]*See generally* Note, *Use of Taxable Costs to Regulate the Conduct of Litigants,* 53 COLUM. L. REV. 78 (1953).

[9]For a collection of federal statutes providing for an award of attorney's fees, see Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240, 260-61 n.33 (1975). Indiana statutes that provide for an award of attorney's fees include: Relocation Assistance Act, IND. CODE § 8-13-18.5-13 (1982); Crime Victim's Civil Actions for Damages, IND. CODE § 34-4-30-1 (1982); Paternity Proceedings, IND. CODE § 31-6-6.1-18 (1982); Dissolution of Marriage, IND. CODE § 31-1-11.5-16 (1982); Evidence of Indebtedness; Agreement to Pay, IND. CODE § 26-2-4-1 (1982); Deceptive Consumer Sales, IND. CODE § 24-5-0.5-4 (1982); Mechanics Lien Failure to Release, IND. CODE § 32-8-1-2 (1982); Tort Claims Against Governmental Entities and Public Employees, IND. CODE § 34-4-16.5-19 (1982); and Civil Rights Claims Against Public Employees, IND. CODE § 34-4-16.7-4 (1982).

[10]The obdurate behavior exception permits only an award of attorney's fees and does not include other litigation expenses including deposition expenses. Cox v Ubik, 424 N.E.2d 127, 131 (Ind. Ct. App. 1981).

[11]St. Joseph College v. Morrison Inc., 158 Ind. App. 272, 279-80, 302 N.E.2d 865, 870 (1973). The most versatile exception to the American rule is punitive in nature and based on the existence of bad faith on the part of one of the litigants. *See* Hall v. Cole, 412 U.S. 1, 5 (1973).

Other judicially created exceptions to the American rule include the common fund exception and the private attorney general exception. *See St. Joseph College,* 158 Ind. App. at 279-80, 302 N.E.2d at 870 (quoting La Raza Unida v. Volpe, 57 F.R.D. 94, 96 (N.D. Cal. 1972)). The common fund exception permits an award of attorney's fees when the plaintiff's successful litigation confers "a substantial benefit on the members of an ascertainable class, and where the court's jurisdiction over the subject matter of the suit makes possible an award that will operate to spread the costs proportionately among them." Mills v. Electric Auto-Lite Co., 396 U.S. 375, 393-94 (1970) (award of attorney's fees to successful shareholder plaintiffs in a suit to set aside a corporate merger). The private attorney general exception arises where a court awards attorney's fees to prevailing plaintiffs when necessary and appropriate to insure important rights or social policies. *St. Joseph College,* 158 Ind. App. at 279-80, 302 N.E.2d at 870. *But see* Alyeska Pipeline Serv. Co. v. Wilderness Soc'y, 421 U.S. 240 (1975), where the Supreme Court rejected the private attorney general exception because it required the federal courts to determine a number of issues better left to legislative resolution, such as determining which statutes were of sufficient importance to justify fee shifting. *Id.* at 269.

behavior exception to the American rule in *Kikkert v. Krumm*,[12] where the court observed that the rule is a

> protective measure which operates to help preserve the integrity of the judicial process. The nature of an attorney fee award under the obdurate behavior exception is punitive, designed to reimburse a *prevailing party* who has been dragged into *baseless litigation* and thereby subjected to *great expense.*[13]

Although several cases have discussed the obdurate behavior exception to the American rule,[14] attorney's fees are infrequently awarded because Indiana appellate courts have required "that the party's conduct . . . be vexatious and oppressive in the extreme before the court can impose special equitable sanctions."[15] For this reason, the obdurate behavior exception has limited usefulness in deterring frivolous, unreasonable, or groundless litigation practices.

Cox v. Ubik[16] is one of the few Indiana appellate cases to affirm an award of attorney's fees by a trial court under the obdurate behavior exception. Plaintiff (Cox) brought a negligence action against defendants (Ubik and Winters) for injuries sustained in an automobile accident.[17] At trial, Cox claimed that Ubik's automobile struck hers from the rear, thereby causing her collision with Winters' automobile and a retaining wall.[18] There was evidence at trial that Cox acted in bad faith in failing to dismiss Ubik from the suit. Cox admitted that she could not recall ever telling anyone prior to trial that Ubik had hit her.[19] Ubik introduced testimony by the police officer at the scene of the accident that Cox never mentioned being hit by Ubik and that the accident was caused when Cox hit a patch of ice and skidded into the retaining wall.[20] The appellate court concluded that it was within the trial court's discretion to assess Ubik's attorney's fees against Cox, based upon the above evidence that Cox maintained her claim against Ubik in bad faith.[21]

The federal bad faith exception to the American rule[22] has been

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[12]474 N.E.2d 503 (Ind. 1985).

[13]*Id.* at 505 (emphasis in original).

[14]*See, e.g., id.*; Turnpaugh v. Wolf, 482 N.E.2d 506, 510 (Ind. Ct. App. 1985); Dotlich v. Dotlich, 475 N.E.2d 331, 348 (Ind. Ct. App. 1985); Cox v. Ubik, 424 N.E.2d 127, 129 (Ind. Ct. App. 1981); Umbreit v. Chester B. Stem, Inc., 373 N.E.2d 1116, 1120 (Ind. Ct. App. 1978).

[15]*St. Joseph College*, 158 Ind. App. at 280, 302 N.E.2d at 871.

[16]424 N.E.2d 127 (Ind. Ct. App. 1981).

[17]*Id.* at 128.

[18]*Id.*

[19]*Id.* at 130.

[20]*Id.*

[21]*Id.*

[22]A trial court has inherent authority to award attorney's fees to prevailing parties

broadly construed to apply to three types of behavior: prelitigation misconduct, assertion of frivolous claims, counterclaims and defenses; and misconduct during the course of the litigation.[23] The application of the bad faith exception to prelitigation conduct is based upon the notion that the costs of litigation ought to be shifted to prevent the unfairness of imposing costs on a party who should have been entitled to enjoy his rights.[24] In addition, where a defendant causes litigation by unjustifiably resisting a meritorious claim of right, he places unnecessary costs on the courts and the public.[25]

The Indiana obdurate behavior exception has been held to apply only "at the time a party files a knowingly baseless claim or at the time a party discovers that the claim is baseless and fails to dismiss it."[26] The exception does not permit an award of attorney's fees for obdurate behavior that precedes or gives rise to a cause of action.[27] This is an important distinction from the bad faith exception to the American rule recognized by federal courts.

II. Legislative Response

Indiana, along with several other states,[28] has codified the judicially created obdurate behavior exception to the general rule that each party

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when a losing litigant has "acted in bad faith, vexatiously, wantonly, or for oppressive reasons." Alyeska Pipeline Serv. Co. v. Wilderness Soc'y., 421 U.S. 240, 258-59 (1975) (quoting F. D. Rich Co. v. Industrial Lumber Co., 417 U.S. 116, 129 (1974)). See, e.g., Hall v. Cole, 412 U.S. 1, 5 (1973); Annotation, *Award of Counsel Fees to Prevailing Party Based on Adversary's Bad Faith, Obduracy, or Other Misconduct*, 31 A.L.R. Fed. 833 (1977) for a useful collection of cases construing the federal bad faith exception to the American rule.

[23]See *Mallor, supra* note 4, at 636-61 for a useful summary of the three types of misconduct included in the federal bad faith exception. Comment, *Court Awarded Attorney's Fees and Equal Access to the Courts,* 122 U. Pa. L. Rev. 636, 661 (1974).

[24]*See, e.g.,* Rolax v. Atlantic C.R.L. Co., 186 F.2d 473 (4th Cir. 1951) (as one justification for the award of attorney's fees, the court noted the pre-litigation oppressive and discriminatory conduct of the losing litigant); Schlein v. Smith, 160 F.2d 22 (D.C. Cir. 1947) (defendant properly ordered to pay attorney's fees to plaintiffs due to grossly fraudulent actions of defendant).

[25]Haycroft v. Hollenback, 606 F.2d 128, 133 (6th Cir. 1979).

[26]*Kikkert,* 474 N.E.2d at 505.

[27]"Intentional or illegal conduct that gives rise to a cause of action is not obdurate behavior, it is merely conduct that may form the basis of a potential lawsuit." *Id.* The obdurate behavior exception has been applied through Appellate Rule 15(G) of the Indiana Rules of Appellate Procedure to give appellate courts the discretion to award attorney's fees for appeals taken in bad faith or merely to harass or delay. *See* Deetz v. McGowan, 403 N.E.2d 1160, 1165 (Ind. 1980).

[28]*See, e.g.,* Ariz. Rev. Stat. Ann. § 12-341.01(C) (1982) (upon clear and convincing evidence that the claim or defense constitutes harassment, is groundless and not in good faith); Cal. Civ. Proc. Code § 128.5 (West Supp. 1986) (tactics or actions not based on good faith which are frivolous or which cause unnecessary delay; frivolous is defined as "totally and completely without merit or . . . for the sole purpose of harassing an opposing

to a lawsuit bear his own attorney's fees. The Indiana legislature amended section 34-1-32-1, effective September 1, 1986, to provide

> (a) In all civil actions, the party recovering judgment shall recover costs, except in those cases in which a different provision is made by law.
> (b) In a civil action, the court may award attorney's fees as part of the cost to the prevailing party, if it finds that either party:
> (1) brought the action or defense on a claim or defense that is frivolous, unreasonable, or groundless;
> (2) continued to litigate the action or defense after the party's claim or defense clearly became frivolous, unreasonable, or groundless; or
> (3) litigated the action in bad faith.
> (c) The award of attorney's fees under subsection (b) does not prevent the prevailing party from bringing an action against another party for abuse of process arising in any part on the same facts, but the prevailing party may not recover the same attorney's fees twice.[29]

This statutory scheme is patterned after section 34-4-16.5-19,[30] providing for an award of attorney's fees to a governmental agency prevailing as a defendant to a tort claim, and section 34-4-16.7-2,[31] providing for an award of attorney's fees to a governmental agency prevailing as a defendant in an action under the civil rights laws of the United States.

Amended subsection 34-1-32-1(b)(3) will probably be construed by the

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party."); COLO. REV. STAT. § 13-17-101 (Supp. 1984) (action or defense, or any part thereof, which is determined to have been substantially frivolous, substantially groundless, or substantially vexatious); FLA. STAT. ANN. § 57.105 (West Supp. 1985) ("complete absence of a justiciable issue of either law or fact"); IDAHO CODE § 12-121 (1979), *limited by* IDAHO R. CIV. P. 54(e)(1) (case brought, pursued or defended frivolously, unreasonably or without foundation); MASS. ANN. LAWS ch. 231, § 6F (Michie/Law Co-op 1986) (all or substantially all the claims, defenses, frivolous and not in good faith); MINN. STAT. ANN. § 549.21 (West Supp. 1984) (bad faith claim, frivolous claim or defense, position asserted solely to harass or delay, or fraud upon the court); N.D. CENT. CODE § 28-26-01 (Supp. 1985) (claim for relief was frivolous); S.D. CODIFIED LAWS ANN. § 15-17-35 (1984) (cause of action was frivolous or brought for malicious purposes); UTAH CODE ANN. § 78-27-56 (Supp. 1986) (action or defense was without merit and not brought or asserted in good faith); WASH. REV. CODE ANN. § 4.84.185 (West Supp. 1986) (action, counterclaim . . . was frivolous and advanced without reasonable cause); WIS. STAT. ANN. § 814.025 (West Supp. 1985) (action . . . which is found to be frivolous, including both bad faith and meritless claims).

[29]IND. CODE § 34-1-32-1 (Supp. 1986). Indiana recognizes an action for abuse of process based upon a showing of misuse or misapplication of the judicial process for an end other than that which it was designed to accomplish. Display Fixtures Co. v. R.L. Hatcher, Inc., 438 N.E.2d 26, 31 (Ind. Ct. App. 1982).

[30]IND. CODE § 34-4-16.5-19 (1983).

[31]IND. CODE § 34-4-16.7-2 (1983).

courts as a codification of the previously recognized obdurate behavior exception.[32] This subsection will continue to be narrower in scope than the federal bad faith exception because its application is expressly limited to circumstances where a losing party litigated the action in bad faith.

The language of amended subsections (b)(1) and (2), however, shifts the court's inquiry from a search for the improper motives of the losing party to a review of the legal and factual basis of the losing party's claim or defense. This inquiry into whether a party "brought the action or defense" or "continued to litigate the action or defense after the party's claim or defense clearly became frivolous, unreasonable, or groundless," is both a legal and factual inquiry that goes to the very merits of a claim or defense. These subsections place an obligation on litigants to investigate the legal and factual basis of the claim when filing and to continuously evaluate the merits of claims and defenses asserted throughout litigation.

The obligation to review the merits of a party's legal position may be imposed on both the client and attorney. The statute provides for an award of attorney's fees to the prevailing party but is silent as to who is to pay the award. In *Owen v. Vaughn*,[33] the Indiana Court of Appeals for the Fourth District affirmed an award of attorney's fees against a plaintiff's attorneys under both the obdurate behavior exception and the Indiana Tort Claims Act.[34] The court relied on an early Indiana Supreme Court case, *Brown v. Brown*,[35] which upheld the discretionary power of the court to enter costs against a non-party attorney and stated that such an award will only be reversed for an abuse of discretion.[36]

Another issue raised by this statute is whether a court can award partial attorney's fees on a finding that one of several claims or defenses is frivolous, unreasonable, or groundless. Section 34-1-32-1 provides that the court "may" award attorney's fees if the elements of the statute are satisfied.[37] As a matter of statutory interpretation, the use of the word "may" grants judicial discretion in applying a provision.[38] This suggests

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[32]*See supra* notes 10-21, 26-27 and accompanying text.

[33]479 N.E.2d 83 (Ind. Ct. App. 1985).

[34]*Id.* at 88. Indiana Tort Claims Act, 1974 Ind. Acts, P.L. 142, § 1 (codified as amended at IND. CODE § 34-4-16.5-1 *et seq.*) (1982)).

[35]4 Ind. 627 (1853).

[36]*Owen,* 479 N.E.2d at 88. An interesting circumstance could arise where a party seeks to avoid responsibility (or have responsibility shifted to his counsel) for an award of attorney's fees by asserting that the claim or defense at issue was taken on the advice of counsel. Although advice of counsel can serve as a defense against an action for malicious prosecution, *see, e.g.,* Barrow v. Weddle, 161 Ind. App. 601, 605-06, 316 N.E.2d 845, 849 (1974), it is unlikely that it would prevent an award of attorney's fees for asserting a frivolous, unreasonable or groundless claim or defense.

[37]IND. CODE § 34-1-32-1 (Supp. 1986).

[38]*See* 82 C.J.S. *Statutes* § 380 (1953).

that the court's range of options is broad enough to allow a partial award of attorney's fees.[39]

The statute leaves unclear the proper manner of determining the amount of the attorney's fee award. Although there are instances where a court has taken judicial notice of what a reasonable attorney's fee would be because of familiarity with the action,[40] it is the better rule that attorney's fees be proven reasonable[41] with the opposing party having an opportunity to object.[42] Indiana courts have held that a contingent fee arrangement cannot be used as a basis for determining a reasonable fee to be paid by a non-party to the fee agreement.[43] Instead courts have considered the following factors as evidence of a reasonable award of attorney's fees:

(1) The time, labor, and skill required to perform the legal service properly,
(2) The difficulty of the issues involved,
(3) The fee customarily charged in the locality for similar legal services,
(4) The amount involved, and
(5) The time limitations imposed by the circumstances.[44]

Factors such as these should continue to be guidelines to determine a reasonable award of attorney's fees under the statute.

Another issue raised by the statute is the relationship between section 34-1-32-1 and Rules 3.1 and 3.2 of the Indiana Rules of Professional Conduct.[45] It is unclear whether an award of attorney's fees under this statute will provide a basis for disciplinary action under Indiana's Rules of Professional Conduct.[46]

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[39]Where a party prevails as to only one issue and fails on other issues, the party is entitled to only a partial award of costs. Steele v. Epson, 142 Ind. 397, 404, 41 N.E. 822, 825 (1895).

[40]Gerberin v. Gerberin, 172 Ind. App. 255, 262, 360 N.E.2d 41, 47 (1977).

[41]*See* Lystarczyk v. Smits, 435 N.E.2d 1011, 1017 (Ind. Ct. App. 1982). "A lesser standard would undermine the confidence of the public in the bench and the bar." *Id.* at n.11.

[42]*See, e.g., In Re* Marriage of Gray, 422 N.E.2d 696, 703 (Ind. Ct. App. 1981); Belcher v. Buesking, 371 N.E.2d 417, 420 (Ind. Ct. App. 1978).

[43]Contingent fee agreements are subject "to abuse if enforceable against non-agreeing promisors on notes and contracts . . ." Leibowitz v. Moore, 477 N.E.2d 946, 947, *modified*, 480 N.E.2d 607 (Ind. Ct. App. 1985) (discussing Waxman Industries, Inc. v. Trustco Dev. Co., 455 N.E.2d 376 (Ind. Ct. App. 1983) and Berkemeier v. Rushville Nat'l Bank, 459 N.E.2d 1194 (Ind. Ct. App. 1984)).

[44]*Lystarczyk,* 435 N.E.2d at 1017 (citing Fox v. Galvin, 381 N.E.2d 103, 108 (Ind. Ct. App. 1978)).

[45]Ind. Rules of Professional Conduct Rules 3.1 and 3.2. On November 25, 1986, the Indiana Supreme Court adopted the new Rules of Professional Conduct, effective January 1, 1987.

[46]Certainly one difference between an award of attorney's fees under this statute and a finding of probable cause for maintaining a disciplinary proceeding is the requirement

Under Rule 3.1, an attorney is subject to discipline if he shall "bring or defend a proceeding, or assert or controvert an issue therein, unless there is a basis for doing so that is not frivolous, which includes a good faith argument for an extension, modification or reversal of existing law."[47] Thus, an attorney who asserts a claim or defense for which there is a frivolous basis, could be subject to both an award of attorney's fees under section 34-1-32-1(b)(1) or (2) and a disciplinary proceeding under Rule 3.1. Where an attorney maintains a good faith argument for a change in existing law, he may still be subject to an award of attorney's fees for what may be deemed a frivolous, unreasonable, or groundless claim or defense.[48]

In addition, if bad faith conduct during the litigation results in an award of attorney's fees, the attorney might, under some circumstances, be subject to discipline under Rule 3.2, which requires that "[a] lawyer make reasonable efforts to expedite litigation consistent with the interests of his client."[49] Upon an award of attorney's fees for asserting a frivolous, unreasonable, or groundless claim or defense or litigating an action in bad faith, it may be difficult to show that such actions were not undertaken for the purpose of frustrating an opposing party's attempt to obtain rightful redress.

Finally, it is unclear whether the statute is applicable in federal diversity cases applying Indiana law under the *Erie* doctrine.[50] To the extent that section 34-1-32-1 is consistent with the federal bad faith exception, the question may be academic. In *Alyeska Pipeline Service Co. v. Wilderness Society*,[51] the United States Supreme Court, in dicta, noted that in an ordinary diversity case, where state law does not run counter to a valid federal statute or rule of court, a state law denying or granting the right to attorney's fees that reflects a substantial state policy should be followed.[52] Later federal diversity cases have awarded attorney's fees under applied state statutes that provided for an award of attorney's fees for failure to disclose a product flaw in a products liability action,[53] and

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that attorney misconduct be shown by clear and convincing evidence before sanctions are appropriate. *See, e.g., In Re* Allen, 470 N.E.2d 1312, 1315 (Ind. 1984); *In Re* Sekerez, 458 N.E.2d 229, 234 (Ind.), *cert. denied*, 105 S. Ct. 182 (1984).

[47] IND. RULES OF PROFESSIONAL CONDUCT Rule 3.1. This rule provides an exception in criminal proceedings that states: "A lawyer for the defendant in a criminal proceeding, or the respondent in a proceeding that could result in incarceration, may nevertheless so defend the proceeding as to require that every element of the case be established." *Id.*

[48] IND. CODE § 34-1-32-1(b)(1) and (2) (Supp. 1986).

[49] IND. RULES OF PROFESSIONAL CONDUCT Rule 3.2 (1987).

[50] "Except in matters governed by the Federal Constitution or by action of Congress, the law to be applied in any case is the law of the state." Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938).

[51] 421 U.S. 240 (1975).

[52] *Id.* at 259 n.31 (quoting 6 J. MOORE, FEDERAL PRACTICE ¶ 54.77[2] (2d ed. 1974)).

[53] Woods v. International Harvester Co., 697 F.2d 635, 640-41 (5th Cir. 1983) (applying LA. CIV. CODE ANN. art. 2545 (West 1952)).

an award to an insured party that obtains a judgment against an insurer.[54]

Because section 32-1-34-1 reflects a substantial state policy and does not run counter to federal statutes or rules of court, it can be argued that it should be applied when a federal court sits in diversity jurisdiction and applies Indiana law. Alternatively, it is arguable that the statute does not grant a party a substantive right but is procedural in nature, permitting Indiana courts to exercise their discretion to supervise the litigation process. Because the court "may" award attorney's fees, it is difficult to argue that a party has a substantive right to an award.

In *Hanna v. Plumer*,[55] the United States Supreme Court noted that *Erie* questions must be resolved by considering the dual policies of discouraging forum shopping and avoiding inequitable administration of the laws.[56] The question of whether the application of section 34-1-32-1 will achieve these policies depends in part on how Indiana courts choose to implement the statute. If the courts apply the statute in such a manner that it fails to differ substantially from the federal bad faith exception,[57] then the justification for applying the statute in federal diversity actions may be unpersuasive. Absent significant change in the application of the statute, it may not be viewed as creating a substantial state interest sufficient to justify the threat to consistency, uniformity and equity resulting from federal application of state law.

III. Conclusion

Indiana Code Section 34-1-32-1 is a narrow exception to the American rule that attorney's fees cannot be awarded to a prevailing party absent

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[54]Fritz v. Standard Security Life Ins. Co., 676 F.2d 1356, 1359 (11th Cir. 1982) (applying Fla. Stat. § 627.428 (1984)).

[55]380 U.S. 460 (1965).

[56]*Id.* at 468.

[57]In addition, Rule 11 of the Federal Rules of Civil Procedure provides for an award of attorney's fees for unmeritorious or dilatory pleadings practice. The rule provides in relevant part:

> The signature of an attorney or party constitutes a certificate by him that he has read the pleading, motion, or other paper, that to the best of his knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. If a pleading, motion, or other paper is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the pleader or movant. If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

Fed. R. Civ. P. 11.

a specific statutory provision or an agreement between the parties. Under the statute, the court may award attorney's fees to the prevailing party if it finds that the opposing party has asserted or maintained a frivolous, unreasonable, or groundless claim or defense or otherwise litigated the action in bad faith. The statute permits the exercise of judicial discretion and is flexibile enough to provide either a partial or complete award of attorney's fees against opposing counsel as well as the opposing party. Through judicial enforcement of this statute, attorneys will be compelled to carefully scrutinize the merits of positions adopted in all stages of litigation or risk an award of attorney's fees.

Indiana's Statutory Provisions for Alternative Testimony in Child Sexual Abuse Cases: Is It Live or Is It Memorex?

Susan D. Burke*

I. Introduction

At least one legal scholar believes that sexual abuse of children has provided the subject matter for the witch hunt of the eighties.[1] Whether this is true or not, the subject of sexual crimes against children has prompted numerous attempts at legislative reform within the last five years.[2] Just as hurried responses to perceived crises in other areas have sometimes caused an overreaction or backlash, there is concern that the outpouring of publicity about sex crimes against children has caused legislative reforms to go too far too fast.[3] Many of the highly publicized cases, especially those involving allegations of mass abuse, have been shown to be wholly or partially unsubstantiated.[4] Furthermore, horror stories of defendants who have been falsely accused have recently surfaced.[5] While no one wants to see children sexually abused, almost everyone would agree that there have been problems even with the warranted prosecution of individuals in cases involving the sexual abuse of children.

Troublesome questions have arisen. In our zest to protect children, is it possible that we have been too willing to sacrifice the rights of those accused of these crimes? Where should society strike the balance between protecting children and protecting those accused? Should we narrowly interpret defendants' constitutional rights to insure that our children are rigorously protected? Is a narrow interpretation necessary,

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[1]Graham, *Difficult Times for the Constitution: Child Testimony Absent Face-To-Face Confrontation*, Champion, Aug. 1985, at 18.

[2]Bulkley, *Evidentiary and Procedural Trends in State Legislation and Other Emerging Legal Issues in Child Sexual Abuse Cases*, 89 Dick. L. Rev. 645 (1985).

[3]*See, e.g.*, Graham, *supra* note 1, at 18-19.

[4]*See* Kinsley, *Civic Virtuosity and Child Abuse Chic*, Champion, Jan./Feb. 1986, at 7; *see also* Renshaw, *When Sex Abuse Is Falsely Charged*, Champion, Jan./Feb. 1986, at 8-10.

[5]*See* Renshaw, *supra* note 4, at 8-9.

or do the legal reforms enacted already fit comfortably within our constitutional framework? Although answering all of these questions is beyond the scope of this Article, these are the questions that the legislature and the judiciary have been faced with and have recently attempted to answer.

Indiana is one of many states that have adopted recent legislation aimed primarily at making it easier to bring to justice those who commit sexual crimes against children.[6] In 1984, the legislature enacted Indiana Code section 35-37-4-6.[7] This statute creates a hearsay exception that

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[6]*See* Bulkley, *supra* note 2, at 666-68. Although Indiana's new statutory provisions could apply to some non-sexual offenses, it appears that they were enacted largely to remedy problems with testimony in sex crimes. They will therefore be discussed only as they concern those crimes.

[7]Ind. Code § 35-37-4-6 (Supp. 1986). This statute provides:

Sec. 6. (a) This section applies to criminal actions for the following:
(1) Child molesting (IC 35-42-4-3).
(2) Battery upon a child (IC 35-42-2-1(2)(B)).
(3) Kidnapping (IC 35-42-3-2).
(4) Confinement (IC 35-42-3-3).
(5) Rape (IC 35-42-4-1).
(6) Criminal deviate conduct (IC 35-42-4-2).
(b) A statement or videotape that:
(1) is made by a child who was under ten (10) years of age at the time of the statement or videotape;
(2) concerns an act that is a material element of an offense listed in subsection (a) that was allegedly committed against the child; and
(3) is not otherwise admissible in evidence under statute or court rule;
is admissible in evidence in a criminal action for an offense listed in subsection (a) if the requirements of subsection (c) are met.
(c) A statement or videotape described in subsection (b) is admissible in evidence in a criminal action listed in subsection (a) if, after notice to the defendant of a hearing and of his right to be present:
(1) the court finds, in a hearing:
(A) conducted outside the presence of the jury; and
(B) attended by the child;
that the time, content, and circumstances of the statement or videotape provide sufficient indications of reliability; and
(2) the child:
(A) testifies at the trial; or
(B) is found by the court to be unavailable as a witness because:
(i) a psychiatrist has certified that the child's participation in the trial would be a traumatic experience for the child;
(ii) a physician has certified that the child cannot participate in the trial for medical reasons; or
(iii) the court has determined that the child is incapable of understanding the nature and obligation of an oath.
(d) If a child is unavailable to testify at the trial for a reason listed in subsection (c)(2)(B), a statement or videotape may be admitted in evidence under this section only if there is corroborative evidence of the act that was allegedly committed against the child.

allows the admission at trial of an extrajudicial statement or videotape of a child victim under ten years of age if certain conditions are met. Although the Indiana Court of Appeals has recently ruled that there is no facial constitutional infirmity in section 35-37-4-6,[8] interesting constitutional questions remain.

More recently, in 1986, Indiana Code section 35-37-4-8 was enacted.[9] This statute establishes alternative forms of testimony for children during

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(e) A statement or videotape may not be admitted in evidence under this section unless the prosecuting attorney informs the defendant and the defendant's attorney of:

(1) his intention to introduce the statement or videotape in evidence; and

(2) the content of the statement or videotape;

within a time that will give the defendant a fair opportunity to prepare a response to the statement or videotape before the trial.

[8]Hopper v. State, 489 N.E.2d 1209 (Ind. Ct. App. 1986), *transfer denied*, Aug. 16, 1986.

[9]Ind. Code § 35-37-4-8 (Supp. 1986). This statute provides:

Sec. 8. (a) This section applies to criminal actions for felonies under IC 35-42 and for neglect of a dependent (IC 35-36-1-4) and for attempts of those felonies (IC 35-41-5-1).

(b) On the motion of the prosecuting attorney, the court may order that:

(1) the testimony of a child be taken in a room other than the courtroom and be transmitted to the courtroom by closed circuit television; and

(2) the questioning of the child by the prosecution and the defense be transmitted to the child by closed circuit television.

(c) On the motion of the prosecuting attorney, the court may order that the testimony of a child be videotaped for use at trial.

(d) The court may not make an order under subsection (b) or (c) unless:

(1) the testimony to be taken is the testimony of a child who:

(A) is less than ten (10) years of age;

(B) is the alleged victim of an offense listed in subsection (a) for which the defendant is being tried or is a witness in a trial for an offense listed in subsection (a);

(C) is found by the court to be a child who should be permitted to testify outside the courtroom because:

(i) a psychiatrist has certified that the child's testifying in the courtroom would be a traumatic experience for the child;

(ii) a physician has certified that the child cannot be present in the courtroom for medical reasons; or

(iii) evidence has been introduced concerning the effect of the child's testifying in the courtroom, and the court finds that it is more likely than not that the child's testifying in the courtroom would be a traumatic experience for the child;

(2) the prosecuting attorney has informed the defendant and the defendant's attorney of the intention to have the child testify outside the courtroom; and

(3) the prosecuting attorney informed the defendant and the defendant's attorney under subdivision (2) within a time that will give the defendant a fair opportunity to prepare a response before the trial to the prosecuting attorney's motion to permit the child to testify outside the courtroom.

the trial of certain criminal actions if specific conditions are met. Because this statute was so recently enacted, it has yet to be interpreted by an Indiana appellate court.[10]

This Article will analyze both of these statutes in light of the constitutional and practical questions that arise when they are utilized in the prosecution of sexual crimes against children. The Article will focus on possible infringement of defendants' rights, while hopefully not losing sight of the rights of the victims.

II. The Problem

The difficulties in investigating cases involving sexual abuse of children, bringing these cases to trial, and gaining convictions are well documented.[11] The state has faced numerous problems in proving every element of these sexual offenses.[12] Initially, direct evidence or other circumstantial evidence may be minimal.[13] Second, the child allegedly involved is often the only witness available.[14] Third, the child-victim

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(e) If the court makes an order under subsection (b), only the following persons may be in the same room as the child during the child's testimony:

(1) Persons necessary to operate the closed circuit television equipment.

(2) Persons whose presence the court finds will contribute to the child's well-being.

(3) A court bailiff or court representative.

(f) If the court makes an order under subsection (c), only the following persons may be in the same room as the child during the child's videotaped testimony:

(1) The judge.

(2) The prosecuting attorney.

(3) The defendant's attorney (or the defendant, if the defendant is not represented by an attorney).

(4) Persons necessary to operate the electronic equipment.

(5) The court reporter.

(6) Persons whose presence the court finds will contribute to the child's well-being.

(7) The defendant, who can observe and hear the testimony of the child without the child being able to observe or hear the defendant. However, if the defendant is not represented by an attorney, the defendant may question the child.

(g) If the court makes an order under subsection (b) or (c), only the following persons may question the child:

(1) The prosecuting attorney.

(2) The defendant's attorney (or the defendant, if the defendant is not represented by an attorney).

(3) The judge.

[10]Ind. Code § 35-37-4-8 (Supp. 1986) had an effective date of Sept. 1, 1986.

[11]*See* Note, *The Testimony of Child Victims in Sex Abuse Prosecutions: Two Legislative Innovations*, 98 Harv. L. Rev. 806 (1985).

[12]*See id.* at 806-07.

[13]*See, e.g.*, Bulkley, *supra* note 2, at 646; Note, *supra* note 11, at 806-07.

[14]*See, e.g.*, Bulkley, *supra* note 2, at 646; Note, *supra* note 11, at 806-07.

may be found incompetent to testify.[15] Fourth, even if the child is competent to testify, there are several obstacles that a proponent of a child's testimony faces. A child may be unable to recall crucial details of what occured.[16] And, if a child does have adequate recall, the child may have difficulty relating what occurred to the jury. Furthermore, a child may be easily confused by cross-examination.[17]

Although there have been attempts to improve the investigatory process, such as special training for personnel and the development of anatomically correct dolls,[18] the legislative reforms have dealt primarily with the testimonial problems. Underlying these attempts at reform have been certain assumptions about the psychological development and functioning of children. It is important briefly to examine some of these assumptions, for if some of them are erroneous, the proper balance between the preservation of defendants' rights and the protection of children has not been and will not be achieved.[19]

Two assumptions appear to underlie recent statutory changes establishing alternative methods for a child's testimony. The first is that children are more traumatized when testifying in court about sexual abuse than when testifying about other subjects.[20] The second assumption is that this trauma is greater in a child than in an adult.[21] Although these assumptions appear plausible, it is debatable whether there has been adequate research to back them up. Possibly adults are transferring their own fears and anxieties onto the children faced with this admittedly unpleasant experience.

According to a leading article on the protection of child victims in the criminal justice system:

> The fact is that psychiatrists all over the world repeatedly warn that legal proceedings are not geared to protect the [child] victim's emotions and may be exceptionally traumatic[22] . . . [However,] the

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[15] *See* Note, *supra* note 11, at 807; *see also* IND. CODE § 34-1-14-5 (1982), which states, in relevant part: "The following persons shall not be competent witnesses: . . . Children under ten (10) years of age, unless it appears that they understand the nature and obligation of an oath."

[16] *See* Note, *supra* note 11, at 807 and authorities cited therein.

[17] *Id.*

[18] Although a discussion of changes in the investigation of child sex abuse and attendant problems is not within the scope of this Article, they are addressed in general in Frost, *"Weird Science" and Child Sexual Abuse Cases*, CHAMPION, Jan./Feb. 1986, at 17-18; Libai, *The Protection of the Child Victim of a Sexual Offense in the Criminal Justice System*, 15 WAYNE L. REV. 977 (1969); McIver, *The Case for a Therapeutic Interview in Situations of Alleged Sexual Molestation*, CHAMPION, Jan./Feb. 1986, at 11-12.

[19] *See* Libai, *supra* note 18, at 1003-05.

[20] *Id.* at 979-86.

[21] *Id.*

[22] *Id.* at 1015.

> studies do not as yet demonstrate a clear causal link between the legal proceedings and the child victim's mental disturbances; but no psychiatric study has attempted to prove, or is likely to attempt to prove in the future, such a causal link. Psychiatrists agree that they cannot isolate the effects of the "crime trauma" from the "prior personality damage" or either of the foregoing from the "environment reaction trauma" or the "legal process trauma." But psychiatrists do agree that when some victims encounter the law enforcement system, for one reason or another, the child requires special care and treatment.[23]

Although this article was published in 1969, it is still often cited and was used to substantiate a decision of the New Jersey Superior Court as recently as 1984.[24] In sum, although children may be traumatized by legal proceedings, the causal link between the legal proceedings and the trauma suffered by a crime victim has not been established, and any adverse effect of the legal proceedings cannot be isolated.

Studies of adults who were sexually abused as children have shown that a significant portion of these individuals suffered permanant emotional harm as a result of such abuse.[25] Although this result does not seem surprising, the question of what portion of the emotional harm was due to the victim's involvement in the legal system, especially court procedures, remains unanswered. One study, which compared victims who had been involved in court proceedings with a random sample of victims, found that a larger percentage of those not involved in the legal system were able to recover more quickly than their legally involved counterparts.[26] The differences, however, could not be attributed solely to court involvement.[27]

Psychiatrists often testify to the damage that will be done to children forced to testify in a courtroom proceeding.[28] Until empirical studies are performed, however, establishing that demonstrable harm to children is specifically caused by the court experience itself, it may be prudent not to abridge defendants' rights under the guise of protecting children from emotional trauma.

Furthermore, children are not born with an innate knowledge that sexual matters are "bad," "nasty," or embarrassing.[29] Information about

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[23]*Id.*

[24]*See* State v. Sheppard, 197 N.J. Super. 411, 484 A.2d 1330 (1984).

[25]*See* Libai, *supra* note 18, at 981-82.

[26]*Id.* at 982.

[27]*Id.* at n.22.

[28]*See* State v. Sheppard, 197 N.J. Super. 411, 416, 484 A.2d 1330, 1334 (1984); Libai, *supra* note 18, at 1015.

[29]E. Fantino & G. Reynolds, Introduction to Contemporary Psychology 363-66 (1975).

society's sexual taboos must instead be learned.[30] It is possible, therefore, that adults are transferring their own concerns to children regarding sexually-oriented testimony. Moreover, an adult's reaction to the initial report of sexual abuse may negatively color the experience for the child and induce part of the trauma the child experiences.[31]

Without demonstrable evidence that special trauma attributable to the courtroom experience itself is more likely to occur in child-victims of sexual abuse than in adult-victims of sexual crimes, the reforms in this area will meet with strong and valid opposition.[32] Is a young teenager or adult-victim of a sexual crime truly better prepared to withstand the trauma of testifying in open court than a child-victim of such a crime? The answer may be yes, but until there is supporting empirical evidence, caution would be wise when enacting reforms that may place defendants in these crimes in special jeopardy or narrow their constitutional protections.

III. Indiana's Legislative Solutions

A. Indiana Code Section 35-37-4-6

Indiana's child-victim hearsay exception, Indiana Code section 35-37-4-6, allows the hearsay statement of a child-victim to be admissible at trial if the court determines that the time, content, and circumstances of the hearsay statement provide sufficient indications of reliability and if the child either testifies at trial or is found to be "unavailable" as a witness.[33] The statute also provides that if the child is unavailable as a witness, there must be corroborating evidence of the act allegedly committed against the child.[34] When the child testifies at trial, the provision for the admission of the hearsay statement appears to go no farther than the *Patterson* rule, a well-established principle of Indiana law.[35]

When the hearsay statement is admitted at trial and the child-victim never testifies in open court, however, the admission represents a departure from established laws of evidence.[36] The obvious question this

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[30] *Id.* at 118-20; E. Hetherington & R. Porke, Child Psychology: A Contemporary Viewpoint 566-75 (2d ed. 1979).

[31] *See* Libai, *supra* note 18, at 980-81.

[32] *See, e.g.*, Long v. State, 694 S.W.2d 185, 191 (Tex. Ct. App. 1985).

[33] Ind. Code § 35-37-4-6 (Supp. 1986). For full text of this statute, see *supra* note 7.

[34] *Id.* § 35-37-4-6(d).

[35] The *Patterson* rule, announced in Patterson v. State, 263 Ind. 55, 324 N.E.2d 482 (1975), basically allows the admission of an otherwise excludable prior hearsay statement as substantive evidence if the declarant testifies at trial and is available for cross-examination.

[36] As a general rule, hearsay testimony is inadmissible at trial unless it falls within certain exceptions. *See generally* McCormick on Evidence §§ 244-53 (E. Cleary 2d ed. 1972).

situation raises is whether such admission violates the defendant's right of confrontation guaranteed by both the United States[37] and Indiana Constitutions.[38] In *Hopper v. State*,[39] the defendant raised just such an objection to the admission of a child-victim's hearsay statement, and the Indiana Court of Appeals found that the admission of the statement did not deny the defendant his right of confrontation.[40] In determining the constitutionality of section 35-37-4-6, the court relied on the United States Supreme Court's decision in *Ohio v. Roberts*.[41] In *Roberts*, the Court held that an extrajudicial statement may be admitted when the witness has been shown to be unavailable if the statement possesses "sufficient indicia of reliability."[42] Furthermore, no additional showing of reliability need be made if the evidence falls within a firmly rooted hearsay exception.[43]

In *Hopper*, the Indiana court noted section 35-37-4-6 required "that the time, content, and circumstances of the statement provide sufficient indications of reliability" and therefore was fully in compliance with the mandates of *Roberts*.[44] The court found that the witness in *Hopper* satisfied the requirement of unavailability because she was found to be incapable of understanding the nature and obligation of an oath.[45] Moreover, the witness's statement fell within the excited utterance or spontaneous exclamation exception to the traditional hearsay rule, thus satisfying the reliability requirement.[46] In addition, the statute appears to go even farther than the requirements of *Roberts*, because it requires that when a statement is to be admitted because of unavailability, there must be corroborative evidence of the act allegedly committed.[47]

Ohio v. Roberts, however, did not involve the extrajudicial statement of a child and, therefore, did not address the controversial issue of finding a child witness to be unavailable because of psychiatric testimony

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[37]U.S. Const. amend. VI provides: "In all criminal prosecutions, the accused shall enjoy the right . . . to be confronted with the witnesses against him." This amendment is often referred to as the confrontation clause. *See* Ohio v. Roberts, 448 U.S. 56, 62 (1980).

[38]Ind. Const. art. 1, § 13 states: "In all criminal prosecutions, the accused shall have the right . . . to meet the witnesses face to face, and to have compulsory process for obtaining witnesses in his favor."

[39]489 N.E.2d 1209 (Ind. Ct. App. 1986).

[40]*Id.* at 1212-13.

[41]448 U.S. 56 (1980).

[42]*Id.* at 66.

[43]*Id.*

[44]489 N.E.2d at 1212.

[45]*Id.*

[46]*Id.*

[47]Ind. Code § 35-37-4-6(d) (Supp. 1986) provides that "If a child is unavailable to testify at the trial for a reason listed in subsection (c)(2)(B), a statement or videotape may be admitted in evidence under this section only if there is corroborative evidence of the act that was allegedly committed against the child."

that testifying would be traumatic, or because the child is incapable of understanding the nature and obligation of an oath.[48] At first glance, incompetency as a basis for unavailability would seem to be a logical anomaly—allowing the hearsay statement of an incompetent witness to be admitted for the very reason that the witness is incompetent. When the defendant in *Hopper* raised this argument, however, the court noted that the incompetence of children under ten who are unable to understand the nature and obligation of an oath pertains only to in-court testimony, not to out-of-court statements.[49] In addition, however logically inconsistent this position may seem, finding child witnesses to be unavailable because they are incompetent to testify, in order to admit their statements, appears to be an increasingly accepted position.[50]

The opposite position is not without its adherents, however. In *State v. Ryan*,[51] the Supreme Court of Washington found that statements admitted under a child hearsay statute very similar in its procedure to Indiana's were inadmissible.[52] Although part of the problem in *Ryan* was a stipulation to incompetence, the court noted that if the judge had examined the witnesses and found them incompetent based on their inability to receive a just impression of the facts, then their testimony would be too unreliable for admission.[53] The *Ryan* court held that the declarant's competency is a precondition to the admission of his hearsay statements, with the exception of res gestae utterances.[54] Under this strict standard for admissibility, however, *Hopper* is not inconsistent with *Ryan*, because the child's testimony in *Hopper* fell under the traditional hearsay exception of excited utterance or spontaneous exclamation.[55]

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[48]IND. CODE § 35-37-4-6(c)(2)(B) (Supp. 1986) provides for a finding of unavailability on either of these grounds.

[49]489 N.E.2d at 1212 n.4 (citing Jarrett v. State, 465 N.E.2d 1097 (Ind. 1984)).

[50]For a discussion of child-victim hearsay statutes in general, see Bulkley, *supra* note 2, at 649-52, 666-67.

[51]103 Wash. 2d 165, 691 P.2d 197 (1984).

[52]Washington's statute, WASH. REV. CODE § 9A.44.120 (Supp. 1986), provides for the admission of the extrajudicial statement of a child under the age of ten which concerns an act of sexual conduct if:

> (1) The court finds, in a hearing conducted outside the presence of the jury that the time, content, and circumstances of the statement provide sufficient indicia of reliability; and
> (2) The child either:
> (a) Testifies at the proceedings; or
> (b) Is unavailable as a witness: *Provided*, That when the child is unavailable as a witness, such statement may be admitted only if there is corroborative evidence of the act.

Although this statute does not specify the grounds for unavailability, the issue in the case was the child's incompetence.

[53]103 Wash. 2d at 177, 691 P.2d at 204.

[54]*Id.*, 691 P.2d at 203-04.

[55]489 N.E.2d at 1212.

Given the number of states that have enacted similar statutes, the child hearsay exception as enacted in Indiana seems here to stay.[56] The United States Supreme Court, however, has yet to rule on the constitutionality of any of these statutes.

A second basis for a court to find a child unavailable as a witness, provided in section 35-37-4-6, is that a physician has certified that the child cannot participate in the trial for medical reasons.[57] A finding of medical unavailability under this subpart should receive little opposition because it reflects a traditional basis for the unavailability of any witness.[58]

The third basis upon which a court may find a child unavailable as a witness, provided by section 35-37-4-6, is that a psychiatrist has certified that the child's participation in the trial would be a traumatic experience for the child.[59] This basis of unavailability raises the issue of whether defendants' rights are being narrowed based on unsupported assumptions about child-witnesses. No Indiana appellate court has addressed the constitutionality of this specific subpart of section 35-37-4-6.

In *Long v. State*,[60] however, the Court of Appeals of Texas delineated and balanced the competing interests involved when it scrutinized a state statute allowing a videotaped statement of a child to be admitted at trial.[61] The court recognized the state's legitimate and substantial interest

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[56]*See* Bulkley, *supra* note 2, at 666-67.

[57]Ind. Code § 35-37-4-6(c)(2)(B)(ii) (Supp. 1986).

[58]*See* McCormick on Evidence § 253 (E. Cleary 2d ed. 1972).

[59]Ind. Code § 35-37-4-6(c)(2)(B)(i) (Supp. 1986).

[60]694 S.W.2d 185 (Tex. Ct. App. 1985).

[61]The Texas statute involved was Tex. Code Crim. Proc. Ann. art. 38.071, § 2 (Vernon Supp. 1985), which states:

> Sec.2. (a) The recording of an oral statement of the child made before the proceeding begins is admissible into evidence if:
>
> (1) no attorney for either party was present when the statement was made;
>
> (2) the recording is both visual and aural and is recorded on film or videotape or by other electronic means;
>
> (3) the recording equipment was capable of making an accurate recording, the operator of the equipment was competent, and the recording is accurate and has not been altered;
>
> (4) the statement was not made in response to questioning calculated to lead the child to make a particular statement;
>
> (5) every voice on the recording is identified;
>
> (6) the person conducting the interview of the child in the recording is present at the proceeding and available to testify or be cross-examined by either party;
>
> (7) the defendant or the attorney for the defendant is afforded an opportunity to view the recording before it is offered into evidence; and
>
> (8) the child is available to testify.
>
> (b) If the electronic recording of the oral statement of a child is admitted into evidence under this section, either party may call the child to testify, and the opposing party may cross-examine the child.

in protecting a child from emotional harm[62] and even acknowledged that children who testify may be more damaged by their traumatic role in the court proceedings than they were by their abuse.[63] Nevertheless, when these concerns were pitted against a defendant's constitutional rights, the balance struck was in favor of the defendant and his right of confrontation.[64]

Notably, the statute at issue in *Long* required several procedures not required by Indiana Code section 35-37-4-6. For example, the Texas statute required that the declarant be available to testify at trial and provided that either party could call the declarant for examination and cross-examination.[65] In this respect, therefore, the statute seemed to present no more than a videotaped version of Indiana's *Patterson* rule.[66] Nevertheless, the court found that the tape was hearsay with no indicia of reliability;[67] the interposition of a camera might distort the evidence;[68] the evidence of reduced trauma during videotaping was insufficient;[69] a belated opportunity to cross-examine a witness was not sufficient to protect confrontation rights;[70] and the statute compelled the defendant to forgo either his right to confrontation or his right to remain silent.[71] The court also expressed concern over the lack of empirical evidence that in-court testimony traumatizes children, especially in light of possible abridgement of the defendant's rights.[72]

While the decisions in *Long* and *Ryan* have no direct precedential value in Indiana, they do reflect the lack of uniformity in this area of the law. In addition, the decisions to date have not addressed all of the grounds for unavailability contained within section 35-37-4-6. The Indiana appellate court in *Hopper*, while upholding the facial constitutionality of section 35-37-4-6, did not address all of the issues raised above, nor did it preclude future findings of unconstitutional application of the statute. It therefore remains to be seen just how far Indiana courts will go in upholding the constitutionality of section 35-37-4-6.

B. *Indiana Code Section 35-37-4-8*

Indiana's alternative testimony for children provision, code section 35-37-4-8, provides two methods by which a child may testify at trial

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[62]*Long*, 694 S.W.2d at 190.

[63]*Id.* (citing State v. Sheppard, 197 N.J. Super. 411, 484 A.2d 1330 (1984)).

[64]*Id.* at 192-93.

[65]Tex. Code Crim. Proc. Ann. art. 38.071, § 2(a)(8), 2(b) (Vernon Supp. 1985). See the full text of these subsections *supra* note 61.

[66]*See supra* note 35.

[67]*Long*, 694 S.W.2d at 189.

[68]*Id.*

[69]*Id.* at 190-91.

[70]*Id.* at 191-92.

[71]*Id.* at 192.

[72]*Id.* at 191-92.

while the child is separated from the trial by either time, or space, or both.[73] The first allows the child to be in a room separated from the courtroom.[74] Questions by the defense and the prosecution are transmitted to the child via closed circuit television.[75] The child's testimony is transmitted to the courtroom via the same closed circuit connection.[76] The second method entails having the child's testimony videotaped and later presented at trial.[77] The defendant, the defendant's attorney, the prosecuting attorney, and the judge are all in the same room as the child.[78] The defendant is allowed to see and hear the child without the child being able to observe or hear the defendant.[79] As with the previously discussed hearsay exception statute,[80] this "alternative testimony for children" statute raises constitutional questions regarding the confrontation clauses of the United States Constitution[81] and the Indiana Constitution.[82] Notably, the statute, while allowing the defendant's attorney[83] to question the child,[84] does not specifically preserve for the defendant's attorney the right to *cross-examine* the child.[85] The right specifically to cross-examine the child will most likely be read into the statute to avoid confrontation clause problems.

Section 35-37-4-8 is interesting in that a court does not need to find that a child is "unavailable" as a prerequisite to use of the alternative procedures. The court merely must find that the child "should be permitted to testify outside the courtroom" because of certain specific reasons.[86] This lack of a requirement of unavailability appears to place

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[73]Ind. Code § 35-37-4-8 (Supp. 1986). For the entire text of the statute, see *supra* note 9.

[74]Ind. Code § 35-37-4-8(b)(1) (Supp. 1986).

[75]*Id.* § 35-37-4-8(b)(2).

[76]*Id.* § 35-37-4-8(b)(1).

[77]*Id.* § 35-37-4-8(c).

[78]*Id.* § 35-37-4-8(f).

[79]*Id.* § 35-37-4-8(f)(7). If the defendant is not represented by an attorney, however, the defendant may question the child. *Id.*

[80]*Id.* § 35-37-4-6.

[81]U.S. Const. amend. VI.

[82]Ind. Const. art. 1, § 13.

[83]If the defendant is not represented by an attorney, the defendant may question the child. Ind. Code § 35-37-4-8(f)(7) (Supp. 1986).

[84]The child may be the victim of or a witness to one of the applicable offenses.

[85]Ind. Code § 35-37-4-8(g) (Supp. 1986) states that certain persons may question the child.

[86]Ind. Code § 35-37-4-8(d)(1)(C) (Supp. 1986) states the following reasons:

> (i) a psychiatrist has certified that the child's testifying in the courtroom would be a traumatic experience for the child;
> (ii) a physician has certified that the child cannot be present in the courtroom for medical reasons; or
> (iii) evidence has been introduced concerning the effect of the child's

section 35-37-4-8 in conflict with the requirements of *Ohio v. Roberts*[87] and, therefore, lay the groundwork for a constitutional challenge unless the lower courts consistently read this requirement into the statute.

Although Indiana Code section 35-37-4-8 has received no judicial interpretation, caselaw from other jurisdictions is helpful in its analysis. In *McGuire v. State*,[88] the Arkansas Supreme Court found that the admission of a previously videotaped deposition of a child victim as a substitute for the child's in-court testimony did not violate the defendant's constitutional right to confrontation.[89] The deposition was admitted in a rape prosecution solely because the child's grandparents testified that her appearance before a jury might cause serious harm.[90] The defendant had the right to confront and cross-examine the witness at the deposition.[91] The court distinguished such cases as *United States v. Benfield*,[92] a case that involved an adult witness and a non-sexual offense. The court in *Benfield* had held the witness's deposition was inadmissible because the defendant had not been allowed to participate actively in the deposition.[93] The witness's unavailability was due to a psychiatric impairment so severe that it required hospitalization.[94] The defendant's inability to participate in the deposition was the primary impediment to its admissibility.[95]

A statute very similar to Indiana Code section 35-37-4-8(c) was under constitutional attack in *Powell v. State*.[96] The Texas statute[97] at issue

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> testifying in the courtroom, and the court finds that it is more likely than not that the child's testifying in the courtroom would be a traumatic experience for the child; . . .

[87]448 U.S. 56 (1980).

[88]288 Ark. 388, 706 S.W.2d 360 (1986).

[89]*Id.* at 393, 706 S.W.2d at 362.

[90]*Id.* at 391, 706 S.W.2d at 361.

[91]*Id.* at 393, 706 S.W.2d at 362.

[92]593 F.2d 815 (8th Cir. 1979).

[93]*Id.* at 821-22.

[94]*Id.* at 817.

[95]*Id.* at 821-22.

[96]694 S.W.2d 416 (Tex. Ct. App. 1985).

[97]Tex. Code Crim. Proc. Ann. art. 38.071, §§ 4, 5 (Vernon Supp. 1985). These sections read as follows:

> Sec. 4. The court may, on the motion of the attorney for any party, order that the testimony of the child be taken outside the courtroom and be recorded for showing in the courtroom before the court and the finder of fact in the proceeding. Only those persons permitted to be present at the taking of testimony under Section 3 of this article may be present during the taking of the child's testimony, and the persons operating the equipment shall be confined from the child's sight and hearing as provided by Section 3. The court shall permit the defendant to observe and hear the testimony of the child in person, but shall ensure that the child cannot hear or see the defendant. The court shall also ensure that:

provided that upon the motion of the attorney for either party, the court could order that the child's testimony be taken outside the courtroom and recorded for admission at trial.[98] The statute provided that when this procedure was used, the child could not be required to testify in open court[99] and that while the defendant was entitled to see and hear the child giving testimony, the child must not see or hear the defendant.[100] In these respects, the Texas statute was almost identical to section 35-37-4-8.[101]

In reaching its decision that the statute was unconstitutional, the Texas court cited *Davis v. Alaska*[102] for the proposition that "[c]onfrontation means more than being allowed to confront the witness physically,"[103] and then surmised that this phrase "surely implied that confrontation means *at least* being allowed to confront the witness physically."[104] The Texas statute, in denying the defendant the right to be seen and heard by his accuser, violated this right to physical face-to-face confrontation.[105] Furthermore, the state's interest in the emotional well-being of its children did not outweigh this right to direct confrontation.[106] The court cited with approval a passage from *Vasquez v. State*,[107] a case dealing with child rape:

> The little girl was nervous and exited [sic] and this was relied upon as a reason for the State not offering her as a witness, though she was an unusually smart child. We do not believe that it is sufficient under the facts stated to defeat the right of the accused to be confronted by the witness against him. The

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(1) the recording is both visual and aural and is recorded on film or videotape or by other electronic means;
(2) the recording equipment was capable of making an accurate recording, the operator was competent, and the recording is accurate and is not altered;
(3) each voice on the recording is identified; and
(4) each party is afforded an opportunity to view the recording before it is shown in the courtroom.

Sec. 5. If the court orders the testimony of a child to be taken under Section 3 or 4 of this article, the child may not be required to testify in court at the proceeding for which the testimony was taken.

[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] IND. CODE § 35-37-4-8 (Supp. 1986) does not provide for the additional in-court testimony of the child, and IND. CODE § 35-37-4-8(f)(7) (Supp. 1986) contains a provision for keeping the defendant hidden from the sight and sound of the witness.

[102] 415 U.S. 308 (1974).

[103] *Powell*, 694 S.W.2d at 419 (quoting Davis v. Alaska, 415 U.S. 308, 315 (1974)).

[104] *Id.*

[105] *Id.* at 420.

[106] *Id.*

[107] 145 Tex. Crim. App. 376, 167 S.W.2d 1030 (1942).

> writer shares all of the sympathy which the State and the jury may have had for the child in her unfortunate situation and would like to relieve her completely of the embarrassment, but it would set a precedent too dangerous to be sanctioned. It would be better that a guilty person may go unpunished than that this important provision of our Constitution should be ignored. The rights of the accused in the instant case, however important to him, are infinitesimal when compared to the rights of the millions which are protected by the constitutional provision involved.[108]

The court in *Powell* also found that the right of confrontation and cross-examination is personal to the accused and that the statute impermissibly required him to delegate to his attorney *entirely* this cross-examination.[109] While the same type of delegation appears to be present in Indiana Code section 35-37-4-8,[110] it is unlikely that Indiana courts would reach the same conclusion as the *Powell* court on this issue.[111] As to the other defects in the Texas statute noted by the court, how Indiana courts will rule on parallel provisions necessarily remains unclear.

A California case that squarely addressed the issue of physical face-to-face confrontation in a sex crime prosecution was *Herbert v. Superior Court*.[112] In *Herbert*, the trial court concluded that the child witness was disturbed by the courtroom and especially by the presence of the defendant and therefore ordered a seating arrangement where the defendant, although present in the courtroom, could not see or be seen by the witness.[113] The defendant was further instructed to raise his hand if he could not hear or if he wished to confer with his counsel.[114] Although the prosecution argued that the essential purpose of the confrontation clause was to provide for adequate cross-examination, the court found that this was not the only purpose. The court took note of a long line of United States Supreme Court decisions that stressed the face-to-face nature of confrontation[115] and stated that "[b]y allowing the child to

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[108]*Powell*, 694 S.W.2d at 420 (quoting Vasquez v. State, 145 Tex. Crim. App. 376, 380, 167 S.W.2d 1030, 1032 (1942)).

[109]*Id.* at 420-21.

[110]Ind. Code § 35-37-4-8(g)(2) (Supp. 1986) provides that the defendant is entitled to question the child only if he is not represented by an attorney.

[111]*See, e.g.*, Abner v. State, 479 N.E.2d 1254 (Ind. 1985); Gallagher v. State, 466 N.E.2d 1382 (Ind. Ct. App. 1984), where defense counsel's presence and participation at a deposition of prosecution witnesses were held to constitute a waiver of objection to admission of the depositions on the grounds of confrontation.

[112]117 Cal. App. 3d 661, 172 Cal. Rptr. 850 (1981).

[113]*Id.* at 664, 172 Cal. Rptr. at 851.

[114]*Id.* at 665, 172 Cal. Rptr. at 851.

[115]The court cited Dowdell v. United States, 221 U.S. 325 (1911); Kirby v. United

testify against defendant without having to look at him or be looked at by him, the trial court not only denied defendant the right of confrontation but also foreclosed an effective method for determining veracity."[116] Although the procedure in *Herbert* was court-initiated rather than statutory, the confrontation issues involved remain the same as those raised by the new statutory schemes.

In another California decision, *Hochheiser v. Superior Court*,[117] the court considered similar issues in relation to the use of closed circuit television for testimony. Although this television procedure was instituted by a court rather than provided for by statute, the procedure involved was very similar to the provisions for closed circuit testimony in Indiana Code section 35-37-4-8.[118] The court in *Hochheiser* did not reach the constitutional issues involved with closed circuit testimony because it held that the trial court did not have the inherent power to use it absent statutory authorization.[119] However, the court did note several reservations about the procedure. After considering several possible negative consequences of camera presentation of evidence, the court concluded that closed circuit television might affect a juror's impressions of the witness's credibility and demeanor.[120] The court also considered the possible adverse effect of the closed circuit procedure on the presumption of the defendant's innocence.[121] Finally, the court considered the insufficiency of the evidence that such a procedure was necessary.[122] The court noted that the United States Supreme Court, in *Globe Newspapers v. Superior Court*,[123] stated that when considering children's testimony, the measure of the state's interest in a procedure is not the extent to which minors are injured by testifying, but the increase in injury caused by testifying in front of the jury and the defendant.[124] The *Hochheiser* court then stated:

> In our research of the professional literature on the matter, we have not discovered any study, based on empirical data, which

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States, 174 U.S. 47 (1899); and Mattox v. United States, 156 U.S. 237 (1895). *Herbert*, 117 Cal. App. 3d at 667, 172 Cal. Rptr. at 853.

[116]*Herbert*, 117 Cal. App. 3d at 668, 172 Cal. Rptr. at 853.

[117]161 Cal. App. 3d 777, 208 Cal. Rptr. 273 (1985).

[118]The court conducted a hearing on the prosecutor's motion that two child witnesses be allowed to testify by closed circuit television and received testimony that the children would be psychologically stressed from testifying in open court. The proposed procedure provided for the witness being able to see the defendant and cross-examiner, and the defendant being able to see the witness. *Id.* at 781, 208 Cal. Rptr. at 275.

[119]*Id.* at 787, 208 Cal. Rptr. at 279.

[120]*Id.* at 786, 208 Cal. Rptr. at 278-79.

[121]*Id.* at 787, 208 Cal. Rptr. at 279; *see infra* notes 149-53 and accompanying text.

[122]*Hochheiser,* 161 Cal. App. 3d at 792-93, 208 Cal. Rptr. at 282-83.

[123]457 U.S. 596 (1982).

[124]*Id.* at 607 n.19.

> deals with the damaging psychological effect of giving testimony in the presence of the jury and the accused, on the sexually abused child. Rather, we found that such literature merely contains generalized statements to this effect.[125]

The viewpoints expressed by the California courts are not without their opponents, however. In *State v. Sheppard,*[126] the New Jersey Superior Court vigorously upheld the use of a closed circuit procedure. Because *Sheppard* is a leading case for proponents of these alternative methods of testimony, it will be examined at length. *Sheppard* involved a sexual offense against a ten year old child, and upon a motion by the state to allow the child to testify via closed circuit television, a hearing was held to consider the propriety of the procedure.[127] The chief testimony at the hearing was presented by a forensic psychiatrist who had interviewed the child witness. He testified that the witness had the capacity to testify truthfully, but that the use of the video equipment would improve the accuracy of her testimony.[128] The psychiatrist further stated that while the courtroom atmosphere makes an adult more likely to testify truthfully, the opposite was true of a child witness, especially when the alleged abuse was perpetrated by a relative.[129] He felt that the child's ambivalent feelings accompanied by the fear, guilt, and anxiety produced by the situation would mitigate the truth and result in inaccurate testimony.[130] The psychiatrist believed that the video arrangement would relieve these feelings and improve the accuracy of the testimony.[131] Furthermore, he testified that while the witness was basically psychologically-fit, probable long-range consequences of her in court testimony would include behavioral problems, nightmares, depression, and problems with eating, sleeping, and school.[132] Nothing in the published opinion, however, indicated just how the psychiatrist reached his prognosis.

There was also testimony in *Sheppard* from two attorneys who had prosecuted child abuse cases. They both testified primarily as to problems with the prosecution of such cases caused by difficulties with child-victim testimony.[133] The state's final witness was a video expert, who testified as to the proposed video arrangement and conducted a demonstration.[134]

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[125]161 Cal. App. 3d at 793, 208 Cal. Rptr. at 283.
[126]197 N.J. Super. 411, 484 A.2d 1330 (1984).
[127]*Id.* at 415, 484 A.2d at 1332-34.
[128]*Id.* at 416, 484 A.2d at 1332.
[129]*Id.*
[130]*Id.*
[131]*Id.*
[132]*Id.* at 416-17, 484 A.2d at 1332-33.
[133]*Id.* at 417, 484 A.2d at 1333.
[134]*Id.* at 418, 484 A.2d at 1333-34.

The defendant in *Sheppard* objected that his constitutional right to confrontation was violated, but the court noted that the right of confrontation was not absolute.[135] After an extensive discussion of the meaning of confrontation, the court appeared to conclude that the primary constitutional guarantee was that of cross-examination, not direct face-to-face confrontation.[136] The court also analogized the case at bar to an earlier New Jersey case[137] where the defendant was excluded from the judge's private interview with a child while being permitted to hear the interview in another room. In that case, there was found no abridgement of the defendant's right of confrontation. The earlier case, however, involved custody and was not a criminal trial.

The *Sheppard* court also addressed the defendant's due process contentions concerning possible technical distortions of the medium, as well as its failure accurately to present demeanor and dramatic components of testimony.[138] The court noted that the "filtering" effect of the medium would equally benefit both sides and found that videotaped testimony was sufficiently similar to live testimony that the jury could still properly perform its function.[139] The court also took judicial notice of the widespread availability of television in American households, and the resultant familiarity with its technical characteristics and distortions.[140] The court did not address, however, the idea that a large portion of what we view on television is fiction as opposed to real life presentations.[141] The court in *Sheppard* stated:

> Any zeal for the prosecution of these cases, however, cannot be permitted to override the constitutional rights of the defendants involved. They are at great disadvantage in these cases. The testimony of a small child can be very winsome (more winsome, perhaps, if she testifies in person than by videotape.) The difficulty of cross-examining a young child may prevent the exposure

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[135]*Id.* at 426, 484 A.2d at 1339.

[136]*Id.*

[137]New Jersey Youth & Family Servs. v. S.S., 185 N.J. Super. 3, 447 A.2d 183 (1982).

[138]197 N.J. Super. at 430, 484 A.2d at 1341.

[139]*Id.*

[140]*Id.*

[141]This point is crucial to the issues involved. People are accustomed to viewing horrible things on television while at the same time they are not always able to separate fictional characters from real life people. This is especially a concern with children. One need only view the cartoons on television to learn that a character can be killed in one scene and happily go about his business in the next. This indoctrination may make what is seen on the video screen in the courtroom less real to the viewer and thereby diminish the gravity of the situation. *See, e.g.*, Note, *The Criminal Videotape Trial: Serious Constitutional Questions*, 55 Or. L. Rev. 567, 577-78 (1976).

> of inaccuracies. The charge of child abuse carries its own significant stigma. Defendants in these cases may find themselves ostracized, whether they are guilty or not. Like children, they too have ambivalent feelings and may decide, even though they believe they will be acquitted, that it is better for the child, the family and themselves to accept a plea agreement than to subject everyone involved to a trial. These problems must also be weighed in deciding the dimensions of the constitutional right of confrontation.[142]

The court found, however, that given all of the circumstances of the case at bar, any erosion of the defendant's rights would be modest and warranted by the protection of the child-victim.[143] The *Sheppard* decision reflects the crucial nature of the balancing of rights and protections; if the assumptions upon which the balancing is predicated are erroneous, an unwarranted and potentially dangerous modification of the legal system may occur.

Almost all of the cases and scholarly writings addressing the confrontation issue raised by statutory or judicial testimonial schemes similar to those in Indiana Code section 35-37-4-8 have been concerned with whether the defendant can see the witness's demeanor so that he can assist in his defense. Another element of confrontation, the witness being confronted by the one he is accusing, is an equally important consideration.[144]

When considered in light of social psychological theory, this second element takes on even greater significance. It has been well documented that guilt accompanying aggression toward another person is reduced when the target of that aggression is "dehumanized." In other words, if we conceive of another as not being human, the inhibitions against acting aggressively are reduced.[145] Also, inhibitions against injuring another are reduced when feedback from that other person is reduced.[146] In a classic study involving electric shocks, subjects in a position to observe personally the suffering of their victims were less likely to administer severe shocks.[147] Similar phenomena have been observed in modern warfare: because the enemy can be far away due to modern technology, there are diminished feelings of guilt and remorse in those inflicting the harm.[148] While this type of dehumanization might arguably be advantageous in time of war,

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[142] *Sheppard*, 197 N.J. Super. at 432, 484 A.2d at 1342.
[143] *Id.* at 431-32, 484 A.2d at 1342-43.
[144] *See, e.g.*, Mattox v. United States, 156 U.S. 237, 242-43 (1895).
[145] P. Middlebrook, Social Psychology and Modern Life 299-300 (1974).
[146] *Id.* at 299.
[147] *Id.*
[148] *Id.*

its possible role in a legal system founded on a presumption of innocence is questionable. When the unreality of a large portion of what people, especially children, view on television is coupled with this concept of dehumanization, the consequences could be severe for a defendant tried under the proposed closed circuit procedures. While we do not wish to upset unnecessarily a witness already facing a difficult experience, we also do not want to so distance a witness from the defendant that the witness fails to sense the seriousness of the accusations and the concomitant stimulus to be scrupulously honest.

An additional issue, not widely addressed by courts or scholars, is the effect of videotaped presentations and closed circuit television on the presumption of the defendant's innocence. The concept that a defendant is innocent until proven guilty is basic to the American system of jurisprudence.[149] If the proposed procedures impinge upon this presumption, the defendant will be denied his constitutional right to a fair and impartial trial.[150] As noted by the court in *Hochheiser v. Superior Court*,[151] "[T]he presentation of a witness' testimony via closed-circuit television may affect the presumption of innocence by creating prejudice in the minds of the jurors towards the defendant similar to that created by the use of physical restraints on a defendant in the jury's presence."[152] Thus, the procedures at issue might violate the same type of proscription against bringing a defendant to trial in handcuffs or prison clothing.[153] Jurors involved in a trial using closed circuit testimony might conceivably wonder why the child has to be protected from even being in the defendant's presence. The presumption of innocence would then disappear.

Another consideration regarding videotape and closed-circuit procedures is the possibility of an abridgement of the defendant's right to a fair trial.[154] This concern is based on the possible distortion of evidence of the witness' demeanor and therefore of credibility.[155] As noted in *Hochheiser*, the video camera in essence becomes the jurors' eyes by selecting and commenting on what is seen.[156] In addition, the video

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[149] "The principle that there is a presumption of innocence in favor of the accused is the undoubted law, axiomatic and elementary, and its enforcement lies at the foundation of the administration of our criminal law." Coffin v. United States, 156 U.S. 432, 453 (1895).

[150] *See* U.S. Const. amend. XIV, § 1.

[151] 161 Cal. App. 3d 777, 208 Cal. Rptr. 273 (1985).

[152] *Id.* at 787, 208 Cal. Rptr. at 279.

[153] *See, e.g.*, Flowers v. State, 481 N.E.2d 100, 105 (Ind. 1985); *see also* Smith v. State, 475 N.E.2d 27 (Ind. 1985).

[154] *See* Bulkley, *supra* note 2, at 659.

[155] *Id.*

[156] 161 Cal. App. 3d at 786, 208 Cal. Rptr. at 278.

equipment may make a witness look small and weak or large and strong, and off-camera evidence is necessarily excluded.[157]

This last criticism is especially relevant to Indiana Code section 35-37-4-8, because the statute provides for the presence in the videotaping room of "persons whose presence the court finds will contribute to the child's well-being."[158] However well intentioned such persons may be, their body language or non-verbal cues may affect the child's testimony, while the jury cannot see this influence.[159] Additionally, if the camera is focused primarily on the child's face to gain information about his or her expression, it may not portray the witness' overall demeanor, and vice versa. Also, the interposition of a screen between the viewer and the evidence may reduce a juror's attention span and lessen his concentration.[160] Finally, by legitimizing the status of the individual being televised, the medium may bestow prestige and enhance his authority.[161] This concept, termed "status-conferral,"[162] might be especially relevant where a child is involved, because under ordinary circumstances a child does not have a great deal of status.

Other concerns raised by alternative testimony procedures include possible infringement of a defendant's right to a jury trial[163] and interference with a jury's common-law right to question witnesses.[164] The defendant's right to a jury trial may be infringed upon because the factors discussed above may interfere with the jury's decisionmaking function[165] The jury's right to question the witness is obviously curtailed if the witness is removed from the courtroom.

IV. Conclusion

It is unquestioned that there have been problems with convicting persons who sexually abuse children. However, it is questionable whether modification of trial and evidentary procedures is the proper way to deal with these problems. Furthermore, once it is decided that modifications of trial and evidentiary procedures are necessary, the extent of such modifications must be determined. If a legislative modification of

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[157] *Id.*

[158] Ind. Code § 35-37-4-8(e)(2) (Supp. 1986).

[159] For example, the nod of a head or a smile by one outside the range of the camera is necessarily lost to the jury, and in fact the jury will probably not even know such a person is there.

[160] Note, *supra* note 141, at 577.

[161] *Hochheiser*, 161 Cal. App. 3d at 787, 208 Cal. Rptr. at 279.

[162] *Id.*

[163] *See* Bulkley, *supra* note 2, at 659.

[164] Although apparently not frequently exercised today, this common-law right of the jury to question witnesses is apparently still good law. *See* Note, *supra* note 141, at 580.

[165] *Id.* at 578-82.

trial and evidentiary procedures will possibly abridge a defendant's constitutional rights, the legislature should alter such procedures no more than is absolutely necessary.

The trial testimony of a child-victim can possibly be made less traumatic without resorting to drastic legislative measures. Reducing the number of interviews with the child, reducing the number of continuances, and preparing the child for the courtroom experience are examples of measures that have been proposed as alternatives to the extreme intervention of videotaped testimony or closed-circuit television.

Just how often the provisions of sections 35-37-4-6 and 35-37-4-8 will be invoked remains to be seen. Whether the provisions of the new Indiana Code section 35-37-4-8 will pass constitutional muster also remains to be seen. Given the constitutional implications of these procedures for the defendant, however, these statutes should be closely examined and any underlying assumptions should be adequately supported by empirical evidence.

Evidentiary Use of Other Crime Evidence: A Survey of Recent Trends in Criminal Procedure

Susan Stuart*

I. Introduction

When writing a survey article, there is a tendency for the author to search for some defect in the law of the surveyed cases, in order to demonstrate the author's acumen in theoretical reasoning, as opposed to that of the courts'. However, this survey topic—the admissibility of evidence of other bad acts and crimes in a criminal trial—does not lend itself to such a self-serving exercise. The law in Indiana with respect to this relatively narrow subject area is instead well-established and generally well-reasoned. This survey period did include, however, several cases in which the practical application of the extant law rested upon a questionable foundation or was altogether improper. In most instances, the error was harmless, but the precedential use of such improper reasoning could well prove damaging in later cases. The purpose of this Article, therefore, is not to remedy any flaw in the law but to suggest a more temperate and circumspect approach to its practical application. Because of the frequency with which one specific context occurred during the survey period, the Article will particularly emphasize the principles governing the admissibility of unrelated crimes and other bad acts as they are relevant to the charges at trial.

II. Trial Admission of Other Crimes and Misconduct Generally

The general rule in Indiana is that evidence of crimes and misconduct of a criminal defendant, other than of the charged offenses, is not admissible at trial.[1] However, there are various exceptions to this rule of exclusion. Their application arises either when the defendant's character is at issue or when the proffered evidence is relevant to an element of the charged offense. The four exceptions most widely recognized in Indiana relate to (1) the defendant's bad character, (2) proof of the

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[1] *E.g.*, Lee v. State, 271 Ind. 307, 312, 392 N.E.2d 470, 474 (1979); Bruce v. State, 268 Ind. 180, 245, 375 N.E.2d 1042, 1077, *cert. denied*, 489 U.S. 988 (1978); Paulson v. State, 181 Ind. App. 559, 560, 393 N.E.2d 211, 212 (1979).

crime on trial, (3) the *res gestae* of the charged offense, and (4) cumulative and/or explanatory evidence after the defendant himself has broached the subject.

A. *Admissibility to Prove Defendant's Character*

There are two reasons why a court may admit evidence of other crimes to show a defendant's unsavory character. The foremost reason is to impeach the defendant's credibility as a witness.[2] This particular "bad character" exception has statutory underpinnings,[3] but its evidentiary use is limited to a defendant's "prior convictions for crimes which would have rendered a witness incompetent. These crimes are: treason, murder, rape, arson, burglary, robbery[,] kidnapping, forgery and wilful and corrupt perjury."[4] The rationale for allowing such use is that the nature of the convictions reflects upon a witness's propensity for truth and veracity while testifying at trial.[5]

The second use of "bad character" evidence, on the other hand, permits introduction of a wider array of bad conduct but can only be applied on a more limited scope. This use occurs when a criminal defendant places his character directly into evidence as part of his defense strategy. Once a defendant's reputation for good character is at issue, the state may then offer specific acts of prior misconduct into evidence as contradictory proof of bad character.[6] However, use of bad character evidence for this purpose is limited by rules of relevance and therefore must go directly to contradict the defense's evidence.[7] Such a limitation is to assure, to the extent possible, that the bad character evidence is circumscribed for use only as rebuttal evidence rather than as substantive proof of the defendant's guilt of the charged offense.[8] Therefore, in

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[2]*See* Slough, *Impeachment of Witnesses: Common Law Principles and Modern Trends*, 34 Ind. L.J. 1, 23 (1958).

[3]Ind. Code § 34-1-14-14 (1982) states, "Any fact which might heretofore be shown to render a witness incompetent, may be hereafter shown to affect his credibility."

[4]Ashton v. Anderson, 258 Ind. 51, 63, 279 N.E.2d 210, 217 (1972); *see also* Daniels v. State, 274 Ind. 29, 32, 408 N.E.2d 1244, 1246 (1980).

[5]*Ashton*, 258 Ind. at 62, 279 N.E.2d at 217 ("only those convictions for crimes involving dishonesty or false statement shall be admissible"). The Indiana Supreme Court has further declared that a witness' credibility may be impeached only by *convictions*, not generic bad acts. Hensley v. State, 256 Ind. 258, 262, 268 N.E.2d 90, 92 (1971).

[6]*E.g.*, Hauger v. State, 273 Ind. 481, 483, 405 N.E.2d 526, 527 (1980); Robertson v. State, 262 Ind. 562, 565, 319 N.E.2d 833, 835 (1974).

[7]*See* Bond v. State, 273 Ind. 233, 240-41, 403 N.E.2d 812, 818 (1980); *Robertson*, 262 Ind. at 566, 319 N.E.2d at 836.

[8]*See, e.g.*, Fed. R. Evid. 404, which states: "Evidence of a person's character or a trait of his character is not admissible for the purpose of proving that he acted in conformity therewith on a particular occasion . . . ."; 22 C. Wright & K. Graham, Jr., Federal Practice & Procedure § 5236, at 397 (1978) [hereinafter Federal Practice & Procedure].

either of these two situations, a prosecutor may not generally impute bad character through evidence of other crimes unless the defendant first places his character at issue, either directly or by merely taking the witness stand. However, there are other situations in which a prosecutor may offer such evidence for the purpose of substantively proving guilt, aside from bad character generally.

B. *Admissibility to Prove Charged Offense*

A second method of circumventing the general prohibition against use of other crime evidence is to proffer other unrelated crimes and bad acts as relevant proof that the defendant committed the offense with which he is charged.[9] The Indiana Supreme Court adopted this exclusion long ago when it stated:

> "It is only on rare occasions that proof of the commission of another crime by a defendant is either necessary or helpful towards establishing the crime with which he is charged. Hence the evidence is ordinarily irrelevant, while at the same time its admission would necessarily operate to so prejudice a jury against a defendant as that in a doubtful case it might control the verdict. * * * But it has never been held by any court of responsible authority that the people cannot prove the facts constituting another crime, when those facts also tend to establish that the defendant committed the crime for which he is on trial. Such a holding would accomplish the absurd result of permitting a rule intended to prevent a defendant from being prejudiced in the eyes of the jury because of his life of crime to so operate in certain cases as to prevent the people from proving the facts necessary to convict him of the crime charged."[10]

Further refinement of this principle has especially focused on the relevancy of the other crime evidence to specific facts in dispute.

Indiana appellate courts look chiefly at whether the evidence of unrelated crimes proves or tends to prove a fact in issue at trial.[11] This connection has been variously characterized as "a fact in issue,"[12] "any

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[9]*See, e.g.*, Hergenrother v. State, 215 Ind. 89, 18 N.E.2d 784 (1939).

[10]*Id.* at 94-95, 18 N.E.2d at 787 (quoting People v. Molineux, 168 N.Y. 264, 340, 61 N.E. 286, 312 (1901)).

[11]*See, e.g.*, Tippett v. State, 272 Ind. 624, 627, 400 N.E.2d 1115, 1117-18 (1980); Bruce v. State, 268 Ind. 180, 245, 375 N.E.2d 1042, 1077, *cert. denied*, 439 U.S. 988 (1978); Maldonado v. State, 265 Ind. 492, 495, 355 N.E.2d 843, 846 (1976); Kallas v. State, 227 Ind. 103, 114, 83 N.E.2d 769, 773 (1949).

[12]*Tippett*, 272 Ind. at 627, 400 N.E.2d at 1118; *Maldonado*, 265 Ind. at 495, 355 N.E.2d at 846; Gaston v. State, 451 N.E.2d 360, 363 (Ind. Ct. App. 1983).

material fact,"[13] "any essential element of the crime charged,"[14] and "an issue in serious dispute at the trial."[15] As succinctly stated by the Indiana Supreme Court: "[T]he law will not permit the State to depart from the issue, and introduce evidence of other extraneous offenses or misconduct that have no natural connection with the pending charge . . . ."[16] This restriction obviously prevents the introduction of other crime evidence merely to present the defendant to the jury as a person with a "criminal bent."[17] The state therefore is constrained to present other crime evidence only in the context and within the confines of the charged offense. This principle is the rule of logical relevance.[18]

Typically, other crime evidence can be fitted into specific categories of logical relevance. The list of categories—intent, motive, purpose, identity, common scheme or plan, and guilty knowledge—has been recited so frequently as to approach the form of a litany.[19] And the admission of evidence within these categories may be appropriate not only for proving the commission of the charged offense but also for disproving a defense.[20] There exists a further well-recognized category in Indiana law in which evidence of a more general pattern (rather than of discrete offenses) is admissible. This pattern is admitted for its tendency to prove a defendant's guilt at a sex offense trial under the "depraved sexual instinct" exception.[21] Under the current state of the law then, Indiana courts have established fairly well-defined guidelines for admitting evidence of other crimes under the relevancy exception.

There is, however, a further limit on this exception, regardless of the evidence's logical relevance to the trial. Even if the logical relevance of other crime evidence is established within the categories listed above,

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[13]*Kallas*, 227 Ind. at 114, 83 N.E.2d at 773.

[14]*Hergenrother*, 215 Ind. at 96, 18 N.E.2d at 787.

[15]Thornton v. State, 268 Ind. 456, 458, 376 N.E.2d 492, 493 (1978).

[16]Dunn v. State, 162 Ind. 174, 182, 70 N.E. 521, 523 (1904).

[17]*Bruce*, 268 Ind. at 245, 375 N.E.2d at 1077; *see also* Lee v. State, 271 Ind. 307, 312, 392 N.E.2d 470, 474 (1979).

[18]*See, e.g.*, FED. R. EVID. 401, which defines relevant evidence as "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable than it would be without the evidence."

[19]*See* Haynes v. State, 411 N.E.2d 659, 664 (Ind. Ct. App. 1980); *see also* Cobbs v. State, 264 Ind. 60, 62, 338 N.E.2d 632, 633 (1975); Paulson v. State, 181 Ind. App. 559, 560, 393 N.E.2d 211, 212 (1979).

[20]*E.g.*, Jackson v. State, 267 Ind. 62, 66, 366 N.E.2d 1186, 1189 (1977), *cert. denied*, 435 U.S. 975 (1978); Henderson v. State, 259 Ind. 248, 251, 286 N.E.2d 398, 400 (1972); *Kallas*, 227 Ind. at 122, 83 N.E.2d at 777.

[21]*E.g.*, Bowen v. State, 263 Ind. 558, 563, 334 N.E.2d 691, 694 (1975); Miller v. State, 256 Ind. 296, 299, 268 N.E.2d 299, 301 (1971); Lamar v. State, 245 Ind. 104, 109, 195 N.E.2d 98, 101 (1964). The "depraved sexual instinct" exception is utilized only where the offenses exhibit an "unnatural" sexual proclivity, such as for sodomy or for incest. *Cobbs*, 264 Ind. at 62-63, 338 N.E.2d at 633-34.

a court may still exclude it if such evidence lacks legal relevance.[22] Evidence is legally irrelevant if it will mislead the jury or if it is too remote from the charged offense.[23] Evidence of other crimes is inherently prejudicial to some extent. For such other crime evidence to be admissible, therefore, its probative value must substantially outweigh its prejudicial effect on the jury.[24] Otherwise, it may seriously affect the defendant's right to a fair trial,[25] and trial courts, in their discretion, may exclude it.[26]

In sum, the chief concern with respect to legal relevance is whether the jury is likely to find a defendant guilty due to his mere participation in other crimes rather than upon proof of the elements of the charged offense. The relevancy exception for the introduction of other crime evidence is therefore in counterpoise to the bad character exception because the trial court's primary purpose is to exclude evidence that is relevant only to showing a defendant's bad character. In contrast, the *res gestae* and cumulative evidence exceptions evince very little concern regarding the substantive effect of evidence of bad character.

C. Admissibility Under Miscellaneous Exceptions

There are two other instances in Indiana where the general rule of exclusion can be overridden by the circumstances of the individual case. The first, the *res gestae* exception, permits the admission of evidence of other crimes where they are part of the same transaction. Such evidence includes "acts, statements, occurrences and circumstances substantially contemporaneous with the crime charged."[27] This exception, too, is not without bounds and is committed to the sound discretion of the trial court.[28]

The final exception is more an estoppel of the defendant's right to object to the admission of other crime evidence than a true exception. This estoppel occurs when the defense "opens the door" by eliciting

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[22]*See, e.g.*, FED. R. EVID. 403, stating that "[a]lthough relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence."

[23]*Hergenrother*, 215 Ind. at 94, 18 N.E.2d at 786.

[24]*See supra* note 22; *see also Paulson*, 181 Ind. App. at 561, 393 N.E.2d at 212.

[25]*Thornton*, 268 Ind. at 458, 376 N.E.2d at 493.

[26]Malone v. State, 441 N.E.2d 1339 (Ind. 1982); Wilson v. State, 432 N.E.2d 30 (Ind. 1982); *Tippett*, 272 Ind. at 627, 400 N.E.2d at 1117-18; *Thornton*, 268 Ind. at 458, 376 N.E.2d at 493; Manuel v. State, 267 Ind. 436, 438, 370 N.E.2d 904, 905-06 (1977).

[27]Lee v. State, 267 Ind. 315, 320, 270 N.E.2d 327, 329 (1977) (citation omitted); Gross v. State, 267 Ind. 405, 407, 370 N.E.2d 885, 887 (1977) (quoting Kiefer v. State, 241 Ind. 176, 178, 169 N.E.2d 723, 724 (1960)).

[28]Blankenship v. State, 462 N.E.2d 1311, 1313 (Ind. 1984).

testimony of other crimes directly[29] or by introducing testimony of only part of a story, the completion of which includes evidence of other crimes.[30] Clearly, a defendant has no right to complain of the state's use of such evidence when he was the party who broached the subject in the first instance. Beyond these two miscellaneous exceptions, the main inquiry into the admissibility of other crimes evidence is still whether the defendant has placed his reputation in issue or whether the state can convince the court that the evidence is both logically and legally relevant to a material fact at issue.

III. Recent Cases

Most of the notable recent cases concerned the relevancy exception, although a few cases pertained to the other three exceptions. The surveyed cases range from the well-reasoned *Burch v. State*,[31] where the Indiana Court of Appeals was faced with an alibi defense and the dilemma of proving identity with evidence of another crime, to the scantily reasoned *Stout v. State*,[32] which upheld the admissibility of an accomplice's testimony to a defendant's participation in prior crimes by relying on but a single precedent which had no rationale. Between these two extremes were cases addressing the use of an evidentiary "harpoon" and proper and improper admissions of police investigations, as well as an assortment of cases where the court reached the right result despite the reasons given.

Critiquing these cases is difficult because any analysis of relevancy is necessarily subjective. No bright-line objective template can be applied by appellate courts to such cases because the standard of review is whether the trial court abused its discretion.[33] It is clear in some cases, however, that the evidence had little, if any, relevance to the case and its admission would have been prejudicial error but for the harmless error doctrine.[34] This Article attempts to demonstrate flaws in the applications of the law and to suggest how these problems may be resolved.

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[29]*See, e.g.*, Gilliam v. State, 270 Ind. 71, 76-77, 383 N.E.2d 297, 301 (1978).

[30]*See, e.g.*, Davis v. State, 481 N.E.2d 387, 389-90 (Ind. 1985).

[31]487 N.E.2d 176 (Ind. Ct. App. 1985).

[32]479 N.E.2d 563 (Ind. 1985).

[33]*E.g.*, Wagner v. State, 474 N.E.2d 476, 493 (Ind. 1985); Fisher v. State, 468 N.E.2d 1365, 1368 (Ind. 1984); Mayes v. State, 467 N.E.2d 1189, 1194-95 (Ind. 1984) ("Trial courts have wide discretion in determining whether proffered evidence is relevant. We will not disturb the court's ruling upon such a matter, absent a clear abuse of that discretion.").

[34]*See* Fed. R. Civ. P. 61; *see also* Fed. R. Crim. P. 52(a), which states that "[a]ny error, defect, irregularity or variance which does not affect substantial rights shall be disregarded."

A. Right Result, Right Reason

One of the best reasoned cases of the survey period also included one of the closest judgment calls. In *Burch v. State*,[35] a jury found the defendant guilty of attempted robbery and battery, both while the defendant was armed with a deadly weapon.[36] The state's case relied upon the following salient facts: On Thursday, November 3, 1983, at 7:45 p.m., the defendant accosted a Ball State University co-ed on the second level of a parking garage on the university campus. The defendant "goosed" the victim and then followed her to her car, questioning her about her plans for the evening. When they reached the victim's car, the defendant drew a knife and ordered her into her car. After she refused, the defendant pressed the knife to her chest and demanded her backpack from the car. A struggle ensued, and the defendant fled. The victim identified Burch as her assailant. Burch interposed an alibi defense.[37] To impeach the alibi, the state presented evidence of a similar uncharged attack.

Another Ball State co-ed testified to an incident that occurred the following Thursday evening, in the same location of the same parking garage and with similar sexual overtones. The victim of this second incident, however, recognized her attacker and was able to locate his—the defendant's—photograph in her high school yearbook. The state argued this other crime testimony was essential to surmount the defendant's alibi.[38] The court of appeals agreed.[39]

After a thorough analysis of the factual similarities and the differences in the two incidents, the court determined that the key similarities in the two occurrences—time, location, and sexual characteristics—presented a similar and distinctive "modus operandi," relevant to the question of the assailant's identity raised by the defendant's alibi defense.[40] The court admitted that the facts presented "a very close question," but because "identity was *the* primary issue," the other crime evidence was crucial to the state's case and therefore was admissible.[41] However close the question, under the abuse of discretion standard, the court reached the correct conclusion.

The "modus operandi" exception to the general rule is a well-recognized method of proving identity.[42] To fit within this category,

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[35]487 N.E.2d 176 (Ind. Ct. App. 1985).
[36]*Id.* at 177.
[37]*Id.* at 179.
[38]*Id.*
[39]*Id.*
[40]*Id.*
[41]*Id.* (footnote omitted).
[42]*See* Federal Practice & Procedure, *supra* note 8, § 5246, at 512.

"[t]he acts or methods employed must be so similar, unusual, and distinctive as to earmark them as the acts of the accused."[43] The difficulty with the facts in *Burch* is that sexual attacks upon women in parking garages are not uncommon. However, repeated attacks at the same time on the same day of the week at the same location do create a distinctive pattern. The fact that both victims positively identified the defendant as their assailant greatly lessened the opportunity for error and added yet another distinguishing feature to the "modus operandi" of the attacks. The nature of the other crime evidence was also not so inflammatory as to make it legally irrelevant. Therefore, this evidence was properly admitted because the exception's requirements were scrupulously applied.

The "modus operandi" exception was also the compelling reason for admitting evidence of other bad acts in *Eakins v. State*.[44] In *Eakins*, a high school music teacher was charged with battery and telephone harassment arising out of an incident with one of his female students.[45] During her freshman year, the young girl had complained to school authorities about the defendant's amorous attentions to his female students as well as his physical contacts with them. During the following school year, the defendant hugged and kissed the complainant. Not long afterward, the girl's family began to receive harassing and obscene telephone calls that were later traced to the defendant's home. The girl identified the defendant as the caller. However, the defendant evidently denied the allegation because the identity of the caller became the focal issue at trial.[46] In response to the defendant's apparent denial, the state introduced testimony of a former student who described her sexual relationship with the defendant.[47] This former student testified that when she terminated her involvement with the defendant, she received an abusive telephone call from him as well as repeated hang-ups. Although the similarity of events is perhaps not as distinctive as in *Burch*, the two incidents here were significantly unique because both girls were familiar with the defendant and the sound of this voice. Because telephone offenses are so intrinsically difficult to prove inasmuch as the victim does not see the perpetrator, the other crime evidence in this case was extremely logically relevant to the issue of the caller's identity.[48] Thus,

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[43]Willis v. State, 268 Ind. 269, 272, 374 N.E.2d 520, 522 (1978) (citation omitted).

[44]484 N.E.2d 607 (Ind. Ct. App. 1985).

[45]*Id.* at 608.

[46]*Id.* The facts are not clear with respect to the defendant's case. The only other issue addressed on appeal concerned "newly discovered" evidence that the defendant's son had made similar telephone calls. *Id.* at 609. One can therefore assume that the defendant denied any part in the offense; otherwise, this newly discovered evidence would not have been necessary.

[47]*Id.* at 608.

[48]The appellate court could have easily sidestepped the issue entirely. *Eakins* was tried to the court, rather than before a jury, and there exists a presumption in Indiana

the logical relevance exception to the general rule of exclusion was properly applied under the circumstances, and the evidence was properly admitted.[49]

One other notable case in which the identity of the perpetrator was seriously in dispute was *Henderson v. State*.[50] In *Henderson*, the defendant was on trial for burglary and theft arising from facts relayed to police by an eyewitness.[51] The witness observed a man leave a neighbor's home with a television set and place the set in a gold Ford LTD bearing Indiana license plate number 99H8889. The police later discovered that the defendant owned a Ford with Indiana license plate number 99T8889, but the witness had some difficulty identifying the defendant.[52]

At trial, defendant challenged her identification evidence.[53] In response, the state offered and the trial court admitted the testimony of one Alonzo Bellmar.[54] Bellmar, in a later incident, had chased a man he discovered exiting his home through a window. This man, identified as the defendant, ran toward a tan Ford with Indiana license plate number 99T8889 parked nearby before Bellmar lost sight of him. The Indiana Supreme Court dismissed the state's argument that Bellmar's other crime testimony fit within the common scheme or plan exception[55] but declared the evidence highly relevant to the issue of identity and therefore admissible.[56] The only significantly identifiable feature here, besides the witnesses' identification, was the license plate number. That

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law that a trial court ignores improperly admitted evidence, absent any indication it significantly affected the court's decision. *E.g.*, Pinkston v. State, 436 N.E.2d 306, 308 (Ind. 1982); Phelan v. State, 273 Ind. 542, 546, 406 N.E.2d 237, 239 (1980).

[49]*Eakins*, 484 N.E.2d at 609. The court also stated that the evidence fit the common plan or scheme exception. *Id.* Indiana courts seem frequently to confuse the "modus operandi" exception with the common plan or scheme exception. This latter exception is used to "prove the existence of a larger continuing plan, scheme, or conspiracy, of which the present crime on trial is a part." E.W. CLEARY, MCCORMICK'S HANDBOOK OF THE LAW OF EVIDENCE § 190, at 448 (2d ed. 1972) (footnote omitted) [hereinafter HANDBOOK OF EVIDENCE]. It is apparent from the facts in *Eakins* that there were two separate, distinguishable incidents that were not smaller parts of any larger, deliberate scheme to seduce and then harass the female student population of the high school. The defendant could not have had a deliberate plan in mind that both relationships would be ended by the victim and he would subsequently harass them by telephone. Rather, the cause and effect nature of both offenses would make the "motive" exception to the rule much more applicable than the common scheme or plan exception.

[50]489 N.E.2d 68 (Ind. 1986).

[51]*Id.* at 69.

[52]*Id.* at 70. She was acquainted with and recognized the defendant but had at first confused his name with that of someone else. *Id.*

[53]*Id.*

[54]*Id.* at 70-71.

[55]*Id.*

[56]*Id.* (presumably, although not denominated so, under the "modus operandi" exception).

evidence was so specific and so singular as to be the hypothetical "silver cross-bow" regarded as ideal signature evidence of a perpetrator.[57] Such a perfect example of the "modus operandi"/identity exception is obviously rare. Where identity was the issue and the jury would not be misled, there could be no argument that the evidence was neither logically nor legally relevant. The evidence was properly admitted.

The unfortunate Leroy Williams was the defendant in two cases during the survey period.[58] In the first *Williams v. State*,[59] Williams was apprehended in the home of 74-year-old Mabel Carpenter. Williams advised the police that he had stolen a television set earlier that evening during the burglary of another home. On appeal, Williams argued that the trial court had improperly admitted this statement during his trial for the burglary of Carpenter's home.[60] The Indiana Supreme Court upheld the trial court's admission on the grounds that it was relevant to establish Williams' intent and/or motive for the burglary.[61] The supreme court aptly and succinctly declared: "[T]here is no substantial question that the defendant committed the acts which led to the charge, but rather the issue is the defendant's motive or criminal intent" in breaking and entering.[62] Williams' confession of the television theft from another home was the only evidence of his motive and intent to commit the felony of theft in Carpenter's home and was crucial to proving all the elements of the charged burglary. This evidence would not have prejudiced the defendant before the jury and was therefore not legally irrelevant.

A similar Indiana Supreme Court decision just five weeks prior to *Williams* came to a similar conclusion but without the same reasoned analysis. In *Sizemore v. State*,[63] the facts were not nearly as clear as in *Williams*. A Mr. Abel chased the defendant and another intruder out of the ransacked second story of his home and forced them to surrender after he fired a shot into the rear of their car. Upon investigation, the

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[57]*See* Federal Practice & Procedure, *supra* note 8, § 5246, at 513.

[58]Williams v. State, 489 N.E.2d 53 (Ind. 1986); Williams v. State, 481 N.E.2d 1319 (Ind. 1985).

[59]481 N.E.2d 1319 (Ind. 1985).

[60]*Id.* at 1321.

[61]*Id.* The then extant burglary statute defined the charged offense as follows:

> A person who breaks and enters the building or structure of another person, with intent to commit a felony in it, commits burglary, a Class C felony. However, the offense is a Class B felony if it is committed while armed with a deadly weapon or if the building or structure is a dwelling, and a Class A felony if it results in either bodily injury or serious bodily injury to any person other than a defendant.

Ind. Code § 35-43-2-1 (1982).

[62]*Williams*, 481 N.E.2d at 1321.

[63]480 N.E.2d 215 (Ind. 1985).

police and Abel discovered on Abel's premises several items that had been stolen from two other homes that same day. The supreme court, in upholding the admission of these items into evidence, relied upon the intent and the common scheme or plan exceptions.[64]

The court did not precisely explain how the intent exception applied in *Sizemore*. However, the facts of this case fit within the *Williams* analysis described above. The evidence was relevant to show that the defendant intended to commit theft once he had entered the premises.[65] The court did explain that the items taken from other residences established a common plan or scheme of the defendant and his accomplice to burglarize residences that particular day.[66] The problem with the court's reasoning is that the court injected the "signature" requirement of the "modus operandi" exception into its explanation of the common scheme or plan exception, thereby confusing evidence of identity with evidence of intent.[67] There was no need for identity evidence because identity was never in question. The court's common scheme or plan analysis was also weak because the "distinctive" feature upon which the court focused was the manner of entry into the burglarized homes—kicking in the front door.[68] Such kicking is hardly distinctive, however, when even homeowners have been known to do the same thing to their own homes. Other than this flawed dictum, the court's review of the trial court's admission of the other crime evidence of theft, which circumstantially linked the defendant to all three locations, was sound.

A rather perfunctory result arose in *Brackens v. State*.[69] In that case, the defendant was accused of sexually molesting his seven-year-old niece by marriage.[70] The challenged evidence was the victim's testimony that the defendant had engaged in prior sexual acts with her.[71] The issue addressed by this evidence was the defendant's denial of the prior acts and his further denial that he had even touched the victim that day. The trial court allowed the testimony under the "depraved sexual instinct" exception, to show that the defendant had had prior sexual contact with the victim, despite his denial of the charged offense.[72]

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[64]*Id.* at 217.

[65]*Id.*

[66]*Id.* Such a conclusion might also have been appropriate to show the intent element, particularly since the defendant relied upon the defense of intoxication despite his testimony that he had accompanied the accomplice throughout the day. *See also* Handbook of Evidence, *supra* note 49, § 190, at 448-49.

[67]*See supra* notes 42 and 43 and accompanying text.

[68]*Sizemore*, 480 N.E.2d at 217.

[69]480 N.E.2d 536 (Ind. 1985).

[70]*Id.* at 538.

[71]*Id.* at 539.

[72]*Id.*

The supreme court supported the trial court's ruling. However, the evidence of past acts in this case may not have been relevant to any specific factual dispute at issue. Such a blanket application of the depraved sexual instinct exception regardless of the facts exemplifies how courts tend to use this exception as a general rule when certain sex offenses are charged and there is evidence that the defendant has committed the same or a similar offense at another time.[73] Such uncritical application of the exception seems to undermine the general rule of exclusion. However, one commentator has defended this type of general use of the depraved sexual instinct exception by arguing that it creates an "issue" akin to a motive for committing the offense.[74] This "motive" is that the defendant has "a passion or propensity for illicit sexual relations *with the particular person* concerned in the crime on trial."[75] An implication that the defendant has a character flaw, such as a general propensity for this kind of behavior, is mitigated by limiting the evidence to a relationship with only the victim.[76] On this restricted basis, the admission of the evidence in *Brackens* was entirely appropriate and was no more prejudicial than the charged offense itself.[77]

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[73]*See* HANDBOOK OF EVIDENCE, *supra* note 49, § 190, at 449 n.40.

[74]*Id.* at 449-50.

[75]*Id.* at 449 n.38 (emphasis added).

[76]It would appear, however, that some Indiana cases have used the "depraved sexual instinct" exception without regard to whether the victim is the same in all of the offenses. *See, e.g.*, Austin v. State, 262 Ind. 529, 319 N.E.2d 130 (1974), *cert. denied*, 421 U.S. 1012 (1975); Miller v. State, 256 Ind. 296, 268 N.E.2d 299 (1971). The rationale for this expansion of the exception may be that the unnaturalness of the sex act is distinctive in and of itself. *See* HANDBOOK OF EVIDENCE, *supra* note 49, § 190, at 449. This is especially important now that the Indiana Supreme Court no longer categorizes rape among the exceptions for depraved sexual instinct (at least where consent is the only issue). *See, e.g.*, Jenkins v. State, 474 N.E.2d 84 (Ind. 1985); Malone v. State, 441 N.E.2d 1339 (Ind. 1982); Meeks v. State, 249 Ind. 659, 234 N.E.2d 629 (1968). But any extension of admissibility on the basis of the unusual nature of sex crimes lends itself to the dangers of admitting offenses that may only show a repeated commission of the same sort of crime rather than evidence of crimes with unusual features. Such a result has been decried by Indiana courts. *See, e.g.*, Duvose v. State, 257 Ind. 450, 452, 275 N.E.2d 536, 537 (1971) (rape); *see also* Raines v. State, 251 Ind. 248, 240 N.E.2d 819 (1968) (evidence of homosexual acts has no relevance at murder trial).

[77]The supreme court also noted that most of the victim's challenged testimony came forth during her cross-examination by the defense, as if to imply that any error in admission was harmless because the defendant "opened the door." *Brackens*, 480 N.E.2d at 539. *See also* Haynes v. State, 411 N.E.2d 659, 664 (Ind. Ct. App. 1980); Gilliam v. State, 270 Ind. 71, 76-77, 383 N.E.2d 297, 301 (1978). Such implication though misses the point when it was the *state* that first raised the topic on direct examination, although defendant's cross-examination on the subject could arguably be a waiver of any objection to the original direct testimony.

The irony is that the court misapplied the "opened door" exception later in the case. Brackens took the stand in his own defense to deny the charges. *Brackens*, 480

An interesting set of facts arose in *Gibbs v. State*,[78] where the defendant was convicted of attempted murder for a vehicular attack on a woman he later married.[79] On appeal, the defendant argued that the trial court erred in allowing the state to question him and the victim about their prostitution-related activities.[80] The defendant had a business as well as a romantic relationship with the victim, involving the victim's employment as a prostitute. At the time of the attack, the victim was preparing to leave the defendant's employ. The Indiana Supreme Court held that such evidence could well provide information about the defendant's motive for the attack.[81] Such evidence was deemed particularly

N.E.2d at 539. In doing so, he put his credibility as a witness at issue. The state was thus justified in introducing evidence of his prior convictions for theft and robbery—infamous crimes—to impeach him. The court declared the defendant had "opened the door" for impeachment purposes. *Id.* at 540. While this evidence fits the classic Ashton v. Anderson, 258 Ind. 51, 279 N.E.2d 210 (1972), formula for impeachment of Brackens' credibility, it has nothing to do with the "opened door" exception. *See supra* notes 4 and 5 and accompanying text. Although theft was not originally considered in the *Ashton v. Anderson* genre, the Indiana Supreme Court considered it a crime involving dishonesty and added it to the *Ashton* list in Fletcher v. State, 264 Ind. 132, 136-37, 340 N.E.2d 771, 774-75 (1976). However, admission of theft convictions can be prohibited if they "arise from factual situations which do not indicate a lack of veracity on the part of the witness." *Id.* at 137, 340 N.E.2d at 775. This limitation can only be triggered by defense counsel, preferably by motion in limine. *Id.* In the absence of a proper foundation by defense counsel, one must assume that Brackens' theft conviction was properly admitted for impeachment purposes.

A classic "opened door" testimony did arise in the murder/battery case of Davis v. State, 481 N.E.2d 387 (Ind. 1985). The defendant called one Coomes as a witness to buttress his claim of self-defense. Coomes testified about a conversation the defendant had had with his two victims during which the victims discussed their prison experiences. This evidence was adduced to substantiate the defendant's fear that these two men would seriously injure or kill him and to explain why he stabbed them during a fight. *Id.* at 389. What the defendant tried to "close the door" on was the fact that during that same conversation, he revealed to the victims that he too had been in prison. The trial court had allowed this fact to be brought out on Coomes's cross-examination. *Id.* The Indiana Supreme Court ruled that not only was this testimony highly relevant to rebut defendant's factual defense, but that he had also opened the door on direct examination. *Id.* As the court remarked:

> [O]ur courts frequently have held in other contexts that a party may not submit evidence of part of a conversation, transaction, deposition or the evidentiary material without giving the other party an opportunity to introduce the remaining material if it is necessary to explain or illustrate the context from which the excerpted evidence was taken, or to mitigate the prejudice caused by introduction of only part of the evidence in question.

Id. This correct statement of the exception contrasts starkly with the court's statements in *Brackens*.

[78] 483 N.E.2d 1365 (Ind. 1985).

[79] *Id.* at 1366.

[80] *Id.* at 1368.

[81] *Id.* A similar set of facts was present in Harms v. State, 156 Ind. App. 123, 295

relevant where motive was tied to the specific intent element of the attempted murder charge and where the victim denied that the defendant struck her intentionally.[82] Because the unrelated prostitution activities could hardly prejudice a jury trying an attempted murder case, the probative value of the evidence substantially outweighed any dangers of legal irrelevance, and the supreme court properly upheld the trial court.

The last example of a correctly-decided case dealt with a problem all too frequently encountered in trial courts. In *Riley v. State*,[83] the Indiana Supreme Court reversed a drug dealing conviction because the state had injected an "evidentiary harpoon" into the trial, under the guise of the common scheme or plan exception.[84] The trial court had granted the defendant's motion in limine to protect him from any mention of prior drug use or sales.[85] In spite of the court's order and the defendant's repeated objections, the prosecutor persisted in questioning the state's sole witness about prior buys from the defendant.[86] The trial court eventually relented and allowed the evidence upon a showing that there were similarities among all of the defendant's sales to the witness.[87]

In reversing, the supreme court declared there were no distinctive characteristics of the transactions to fit within the common scheme exception.[88] Thus, the evidence had been improperly admitted, particularly with respect to drug *use*.[89] The court then astutely observed that because the state's sole evidence was from a single witness, the "evidentiary harpoon"[90] of improper evidence injected by the state could only have bolstered its case unfairly before the jury.[91] The defendant was therefore granted a new trial.[92]

N.E.2d 156 (1973), where the deceased victim threatened to withdraw from a burglary ring and go to the police.

[82]*Gibbs*, 483 N.E.2d at 1366.

[83]489 N.E.2d 58 (Ind. 1986).

[84]*Id.* at 61.

[85]*Id.* at 59.

[86]*Id.* at 59-61.

[87]*Id.* at 61.

[88]*Id.* The court would probably have been more correct if it had addressed the "modus operandi" exception.

[89]*Id.*

[90]"Evidentiary harpoon" is defined in Indiana as that circumstance "where the prosecution through its witnesses successfully places evidence before the jury which is improper . . . in situations where such evidence would not be admissible." Grimes v. State, 258 Ind. 257, 262, 280 N.E.2d 575, 578 (1972) (citation omitted).

[91]*Riley*, 489 N.E.2d at 61. The evidence of prior sales was also not crucial to show that the witness could identify the defendant because they were also friends. *See, e.g.*, United States v. Juarez, 561 F.2d 65 (7th Cir. 1977).

[92]*Riley*, 489 N.E.2d at 61.

B. Right Result, Wrong Reason

In this next group of cases, the appellate courts reached the proper conclusion that evidence of other crimes fell within one of the permitted exceptions to the general rule of exclusion. However, the specific exceptions invoked by the courts were not necessarily correct.

In *Jones v. State*,[93] the supreme court clearly demonstrated the respect given to trial court discretion in ruling on the admissibility of evidence. The defendant was convicted of robbery and criminal deviate conduct for robbing a savings and loan association and forcing one of the female employees to disrobe and commit oral sodomy.[94] At trial, the victim of a similar crime testified to events occurring several weeks earlier at a gas station one-half block from the savings and loan. This witness had been unable to identify her attacker until the police showed her a picture of the savings and loan perpetrator. The defendant argued that evidence of the gas station incident was inadmissible at trial.[95]

The supreme court ruled the evidence admissible to prove the perpetrator's identity and to prove a common plan or scheme, because of the distinctive characteristics present in both crimes.[96] However, the common plan or scheme exception is used to "prove the existence of a larger continuing plan, scheme, or conspiracy, of which the present crime on trial is a part."[97] Such a larger plan did not exist here nor did the court so hold. What the court was actually using, without properly identifying it, was the "modus operandi" exception wherein other crime evidence is admissible on the grounds of relevance because of the same distinct, unusual, or unique method employed in committing the charged offense.[98]

By repeated, improper use of the term "common scheme or plan," Indiana courts have bastardized the "modus operandi" exception by requiring something less than an unusual or unique device. Perhaps by connoting "common," "scheme," and "plan" instead of "modus operandi," the courts have felt compelled to admit evidence as meager as some vague pattern of behavior. As a consequence, many decisions have upheld the admission of evidence evincing no characteristics distinct from other crimes committed by other defendants under the rubric of "common

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[93]479 N.E.2d 44 (Ind. 1985).

[94]*Id.* at 44.

[95]*Id.* at 46.

[96]*Id.*

[97]Handbook of Evidence, *supra* note 49, § 190, at 448-49 (footnote omitted).

[98]*See supra* notes 42 and 43 and accompanying text. One could argue that this is a hypertechnical distinction when in fact the unique features of both offenses, and not the name of the exception, were the actual test of admissibility in the case and the correct result was reached. The distinction is valid.

scheme or plan."[99] In other words, "similarities" has become the operative term, rather than "uniqueness." This lapse creates problems in a case such as *Jones v. State* where the only truly distinctive element of each offense was the combination of armed robbery at a business establishment with the commission of an act of oral sodomy upon a female employee.

But for the nature of the premises and the specific nature of the deviate sex act involved, *Jones* would be no different from any other offense combining violent larceny with a violent sex act. It is not unusual for rape and robbery to be combined during a residential burglary,[100] but it is arguable that forcing a victim to commit fellatio where the perpetrator risks detection during business hours of the targeted establishment is unique. Thus, in *Jones* there was minimal logical relevance of the other crime evidence to the issue of Jones' identity.[101] As for

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[99]In Wiles v. State, 437 N.E.2d 35 (Ind. 1982), the state put on the testimony of a prior rape victim during the burglary/attempted rape trial of the defendant. The "identification" exception (presumably common scheme or plan) was invoked to show the following similarities between the two events:

(1) the perpetrator threatened the victim with a knife;
(2) money and jewelry were stolen;
(3) the perpetrator wore a long-sleeved shirt in mid-summer;
(4) the attacks occurred in the same area of Indianapolis;
(5) the attacks were seventeen days apart; and
(6) the attacker cut the cords to the victims' extension phones.

Id. at 39. Unfortunately, this scenario is common in other run-of-the-mill rape/burglary offenses. *See, e.g.*, Williams v. State, 275 Ind. 434, 417 N.E.2d 328 (1981); Willis v. State, 268 Ind. 269, 374 N.E.2d 520 (1978). In fact, the common scheme or plan exception was also used in Williams v. State to admit factual similarities in two separate incidents of rape. The admitted facts were:

(1) two perpetrators;
(2) one wore a ski mask, the other a red hooded sweatshirt;
(3) obscene phone calls preceded the attacks;
(4) the victims' husbands worked nights, which was when the attacks occurred;
(5) the attackers pried open the back door and left it open afterwards;
(6) a butcher knife was used to threaten the victims;
(7) the victims' hands were tied;
(8) the perpetrators cut the phone wires;
(9) the attacks were about a week apart; and
(10) the attackers stole personal property.

Williams, 275 Ind. at 440, 417 N.E.2d at 332. The red hooded sweatshirt was perhaps a distinctive enough feature in *Williams* to justify admission of the evidence. However, there does not appear to have been any question of identity involved in the case.

[100]*See, e.g.*, Jenkins v. State, 474 N.E.2d 84 (Ind. 1985); Wiles v. State, 437 N.E.2d 35 (Ind. 1982); Williams v. State, 275 Ind. 434, 417 N.E.2d 328 (1981).

[101]The facts of *Jones* are not the least bit illuminating with regard to the defense of the case and whether identity was in serious dispute. Due to the seriousness of the crime, one can presume that the defendant denied any involvement, thereby putting his identity at issue.

legal relevance, prejudice to the defendant was diminished by the fact that both crimes were of the same inflammatory nature. Because the charged crime was highly offensive, a jury was unlikely to have been prejudiced by evidence of a second evil act. It would appear then that the Indiana Supreme Court's affirmance of Jones' conviction upon evidence having such a tenuous relevancy connection was a deferral to the trial court's discretion to admit such evidence.[102]

The next case in the "right result, wrong reason" genre is *Schoffstall v. State.*[103] Schoffstall was convicted of reckless homicide for the death of his infant son, which occurred while the baby was in Schoffstall's custody.[104] During trial, Schoffstall objected to the admission of autopsy photographs and to the testimony of a forensic pathologist that prior to the date of death, the baby had sustained numerous injuries to his spleen, left lung, lip, eye and cheek, and brain.[105] The pathologist concluded the baby was a victim of child abuse syndrome.[106] Schoffstall's wife also testified to circumstantial evidence of his abuse of the baby, and Schoffstall himself admitted during statements to police that he had hit the child. Schoffstall objected to the admission of this evidence on grounds of irrelevancy and immateriality.[107] The court of appeals concluded that the evidence was admissible under the relevancy exceptions of motive, intent, or common scheme or plan.[108]

The evidence was indeed admissible but not under any of these named exceptions. Although the facts are not clear with respect to what offense Schoffstall was charged with, it is clear he was convicted of reckless homicide.[109] The statutory elements of this crime are: "A person who recklessly kills another human being commits reckless homicide, a Class C felony."[110] Reckless homicide is not an "intentional" crime for

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[102]An argument can also be made for reversal. It appears that there was sufficient independent evidence of identity by the employees of the savings and loan to obviate the need for the other victim's testimony. One could also contend, obversely to the author's conclusion, that because the very nature of the crimes was so inflammatory, evidence of a second such crime by the defendant would have prejudiced the jury. Precedential authority would have permitted reversal under such circumstances. *See, e.g.*, Riddle v. State, 264 Ind. 587, 348 N.E.2d 635 (1976); Brooks v. State, 156 Ind. App. 414, 296 N.E.2d 894 (1973). Because of the abuse of discretion standard, however, the issue of reversal in *Jones* becomes an academic question the answer to which is dependent upon evidence which may be in the record but is not clearly set forth in the opinion.

[103]488 N.E.2d 349 (Ind. Ct. App. 1986).

[104]*Id.* at 351.

[105]*Id.* at 351-54.

[106]*Id.* at 351.

[107]*Id.* at 354.

[108]*Id.* at 355.

[109]*Id.* at 350.

[110]Ind. Code § 35-42-1-5 (1982).

which prior child abuse evidence would be relevant to show motive or intent, as it would for murder.[111] Use of the common scheme or plan exception is not justified either because typically child abuse is not a continuing *deliberate* plan or scheme but rather is the result of uncontrollable and/or irrational behavior continuing in an unplanned and erratic fashion throughout a parent (adult)/child relationship.

The valid relevance exception better suited for child abuse cases, although not yet adopted by Indiana courts, is the "corpus delicti" exception. The "corpus delicti" exception allows the admission of evidence of other crimes as proof that a criminal act took place.[112] This exception is particularly useful where the defendant acknowledges that harm occurred but denies that the harm was caused by any criminal instrumentality.[113] Refuting the defense of absence of "corpus delicti" requires a showing that the defendant has, in the past, engaged in similar criminal conduct.[114] The risk inherent in the "corpus delicti" exception is that it may be easily abused to show only propensity, a result scrupulously rejected by the case law.[115] However, in *Schoffstall*, evidence that the defendant's relationship with his son was characterized by instances of other criminally violent acts of physical abuse tended directly to rebut defendant's allegation that the child was injured by accident.[116]

Application of this "corpus delicti" exception should be limited to admission of evidence of a pattern of child abuse between the defendant and the victim. If so applied, the exception would be consistent with an ideal application of the depraved sexual instinct exception where evidence of criminal acts with *other* victims is excluded. Such a limitation would avoid the problems arising in cases such as *United States v. Woods*,[117] where the defendant's propensity for abusing children in general

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[111]*See* Worthington v. State, 273 Ind. 499, 405 N.E.2d 913 (1980), *cert. denied*, 451 U.S. 915 (1981) (defendant charged and convicted of second degree murder for death of seven-year-old adopted daughter); O'Conner v. State, 272 Ind. 460, 399 N.E.2d 364 (1980) (defendant charged with second degree murder of three-year-old child); Corbin v. State, 250 Ind. 147, 234 N.E.2d 261 (1968) (defendant indicted first degree, convicted second degree murder of 21-month-old daughter). In each of these cases, prior evidence of child abuse was admitted for the purpose of showing malice, premeditation, intent, or motive. These exceptions were appropriately applied because of the intentional nature of the charged and/or convicted offenses. *See* Ind. Ann. Stat. § 10-3404 (Burns 1956) (second degree murder). For current version, see Ind. Code § 35-42-1-3 (1986).

[112]*See* Federal Practice & Procedure, *supra* note 8, § 5239, at 460 (footnotes omitted).

[113]*Id.*

[114]*Id.*

[115]*Id.* at 460-61.

[116]*Schoffstall*, 488 N.E.2d at 354-55.

[117]484 F.2d 127 (4th Cir. 1973). In *Woods*, the defendant was convicted for the smothering death of her eight-month-old foster son, who died of cyanosis. *Id.* at 128-29.

became the chief characteristic of the evidence.[118] In *Schoffstall*, the evidence of previous abuse to the same infant was highly relevant to establish that a "corpus delicti" existed despite Schoffstall's representations of an accident. The logical relevance by sheer necessity substantially outweighed any potential prejudice. The court of appeals' reasoning notwithstanding, the evidence was properly admitted.

Hossman v. State[119] is not analyzed for its result as much as for the improper logic of its dicta. Hossman was convicted of burglary, conspiracy, and receiving stolen property.[120] The burglary and conspiracy convictions rested upon evidence that the defendant directed two other men to break into a home to steal some drinking glasses.[121] The defendant challenged testimony, allowed by the trial court, alleging that one of these same men had sold other goods to the defendant on prior occasions.[122] Pointing out that there was no criminality attached to these sales, the court of appeals noted that the sole purpose for their admission was to show an earlier connection between the defendant and this other man by reason of a business relationship.[123] However, the court went further and declared that even if the state's evidence had evinced criminality, it would have fit within the common scheme or plan exception to show identification, intent, or state of mind.[124] This declaration incorrectly invoked the common scheme or plan exception because there was no evidence that such a plan even existed or that the burglary was a part thereof. The common plan or scheme exception was therefore irrelevant.

What the court did point out, perhaps unwittingly, was that the evidence was relevant to show intent or motive. A close analysis of the facts and the targeted offenses reveals that the court made an excellent connection between the charged crime and the intent and motive ex-

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The prosecution was allowed to submit evidence that the defendant had been involved in twenty earlier cyanotic episodes with nine different children, seven of whom died. *Id.* at 130. The controversy, of course, was balancing the difficulty of proving that the death of the infant was caused by a criminal instrumentality and thus "corpus delicti" with the prejudice inherent in admitting the evidence purely to show the defendant's character flaw. The controversy will continue to rage but is really of no moment in the classic parent/battered child relationship, such as in *Schoffstall*, where the abuse is part of a continuing relationship.

[118] *Id.* at 130-32.

[119] 482 N.E.2d 1150 (Ind. Ct. App. 1985).

[120] *Id.* at 1152-53. His conviction for receiving stolen property was reversed on a separate appeal. *Id.* at 1153. The burglary and conspiracy convictions resulted from a new trial after the first was declared a mistrial. *Id.* at 1152-53.

[121] *Id.* at 1152.

[122] *Id.* at 1157.

[123] *Id.*

[124] *Id.*

ceptions for relevancy. Evidence of Hossman's prior receipt of stolen goods would supply a motive[125] for his vicarious involvement in the burglaries committed by other parties, as well as show the specific intent of theft, the predicate for burglary. Although Hossman's conviction for receiving stolen property was overturned, the relevancy link is clear and is sufficient to justify the admission of this evidence going to issues that could not help but be in dispute because of Hossman's limited role in the commission of the crime.

C. *No Harm, No Foul*

Several cases in the survey period improperly upheld the admission of other crime evidence; however, a thorough examination reveals that in each case the admission was harmless. One example is *Foster v. State*,[126] which otherwise would be an excellent example of the common scheme or plan exception. In *Foster*, a jury found the defendant guilty of forgery for signing his employer's name on a stolen blank payroll check and then cashing it.[127] Among the evidence presented were three other payroll checks cashed the same day that were within the numerical sequence of the subject check. The conclusion was that the defendant had embarked upon a calculated plan to obtain money through fraud.[128]

This is a classic example of a common scheme or plan, where evidence is excepted from the general rule of exclusion because it tends to prove a fact at issue, such as the identity of the perpetrator or the defendant's intent. The problem in *Foster* is that, contrary to the court's rationale, there appears to have been no question of the defendant's identity at trial.[129] Nor would these checks necessarily have presented any more definite evidence of intent to defraud than the single check upon which the information had been filed. There appears to have been no serious dispute over any issue requiring this evidence to make the state's case. If not, the three "unrelated" checks should have been ruled inadmissible. However, any error was rendered harmless when the defendant's brother testified, evidently without objection, to the defendant's illegal transactions with these other checks, thereby making the erroneously admitted evidence cumulative only.[130] The improperly admitted

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[125]For good examples of the use of the motive exception, see Jenkins v. State, 263 Ind. 589, 590-92, 335 N.E.2d 215, 216-17 (1975); Thomas v. State, 263 Ind. 198, 199-201, 328 N.E.2d 212, 212-13 (1975).

[126]484 N.E.2d 965 (Ind. 1985).

[127]*Id.* at 966.

[128]*Id.* at 967.

[129]Bank employees, called as witnesses, identified the defendant. *Id.* The court ruled that the other checks "reinforced identification testimony." *Id.*

[130]*Id.*; *see* Wallace v. State, 486 N.E.2d 445, 461 (Ind. 1985) (improperly admitted

other crime evidence in *Foster* was therefore rendered nonprejudicial as a matter of law.

Clarkson v. State[131] presented another classic example of a common scheme or plan. The defendant was convicted of theft and violation of state securities laws for defrauding an elderly couple under the guise of an investment plan.[132] The questionable evidence here was the testimony of three other elderly women, who told of their own experiences with the defendant's confidence scheme.[133] As in *Foster*, the evidence was presumably admitted to show intent to defraud.[134] And as in *Foster*, such testimony had no greater tendency to show intent than the evidence of the charged offense itself. The other three incidents were unnecessary to the prosecution's case. The error here is particularly acute because intent is not required to violate the securities laws,[135] and the court never addressed the requirement of "intent to deprive" of use under the theft statute.[136] Therefore, the evidence was irrelevant to any question of intent to defraud under the securities laws because this was not an issue at trial. And clearly the theft intent was also not the issue. Because the other women's testimony had no logical relevance to any issue of intent, the evidence was inadmissible on this basis.

The court though did state that the women's testimony was crucial to show a *scheme* to defraud,[137] which is an element of a securities law violation. Again however, the testimony had no greater probity than the evidence of the subject offense and was therefore an unnecessary presentation of cumulative evidence on an issue already adequately supported by other evidence. But, as in *Foster*, any error was rendered harmless by the defendant's failure to object to the testimony of two of the witnesses.[138]

A third common scheme or plan was present in *Alvers v. State*.[139] Alvers was a jeweler who had a habit of receiving stolen property and of substituting cubic zirconias for diamonds in jewelry left in his care for repair. The grand jury indicted him for corrupt business influence upon seven predicate offenses of this nature.[140] At trial, the objectionable

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evidence does not require reversal if cumulative of other evidence); Johnson v. State, 251 Ind. 369, 374, 241 N.E.2d 270, 272 (1968).

[131]486 N.E.2d 501 (Ind. 1985).

[132]*Id.* at 503.

[133]*Id.* at 506.

[134]*Id.*

[135]Briefly, Indiana state securities laws presume criminal intent from a defendant's acts. *Id.* at 507. *See* Ind. Code § 23-2-1-1 (1982).

[136]*See* Ind. Code § 35-43-4-2(a) (1986).

[137]*Clarkson*, 486 N.E.2d at 506.

[138]*Id.*

[139]489 N.E.2d 83 (Ind. Ct. App. 1986).

[140]*Id.* at 85; *see* Ind. Code § 35-45-6-2 (1982).

evidence was the testimony of two other victims of Alvers' operation.[141] The testimony was allowed as proof of a common scheme or plan.[142] But of what practical necessity was this testimony when the seven predicate offenses raised the inference of such scheme anyway? The evidence was improperly admitted. Its admission was harmless, though, because the testimony of the other victims could have had little, if any, prejudicial effect on the jury's deliberations.[143] The trial's outcome would not have been different even had this testimony been excluded because the great weight of the evidence of a common scheme or plan presented by the seven separate charges would have convicted Alvers anyway.

In *Graham v. State*,[144] the defendants were charged with and convicted of involuntary manslaughter, reckless homicide, and the unlawful practice of medicine in the death of one Sybil Bennett.[145] The Grahams had established Hoosier Health House in order to treat individuals with medical problems by naturopathic means, in accordance with the teachings of a prophet of the Seventh Day Adventist Church. Bennett went to the Grahams for treatment of a lump on her breast. Without the benefit of conventional medical treatment, Bennett eventually died under the Grahams' care from complications of breast cancer. At trial, the state introduced evidence that the Grahams were administering and charging for similar services provided to other people.[146] The court of appeals upheld the admission of this evidence for purposes of showing "intent, motive, purpose, identification, or a common scheme or plan."[147] This bare recital of the general exception, with no further explanation, was the only rationale given. At most, the evidence showed a common scheme to engage in the unlawful practice of medicine, but there was no issue in dispute requiring the evidence as proof of identity or intent. The evidence pertinent to Bennett's death was sufficient to show the defendants' unlawful practice of medicine. More evidence of the same character, presented even as part of a scheme, would not have had any tendency to make the existence of the unlawful practice of medicine any more probable than without it. Nor was the evidence relevant to any material issue of fact as to the manslaughter and reckless homicide charges. The evidence was irrelevant and therefore improperly admitted. However, as in *Alvers*, because of the sheer weight of the state's case, there was no danger that the improper admission misled or unfairly prejudiced the jury; it was harmless error.

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[141]*Alvers*, 489 N.E.2d at 89.

[142]*Id.* at 90.

[143]*See, e.g.*, Gill v. State, 467 N.E.2d 724, 725 (Ind. 1984); Brewster v. State, 450 N.E.2d 507, 510 (Ind. 1983).

[144]480 N.E.2d 981 (Ind. Ct. App. 1985).

[145]*Id.* at 983-84 (footnotes omitted).

[146]*Id.* at 992.

[147]*Id.*

The second *Williams v. State*[148] case involved Williams' conviction for the other burglary he confessed to committing after his apprehension in Mrs. Carpenter's home.[149] To review briefly, Williams was convicted for burglary of the Carpenter home. His confession to an earlier burglary and theft was used to establish his intent to commit theft in the Carpenter home.[150] The state's case here, the prosecution of that other burglary, was based upon Williams' confession, the presence of a stolen television nearby, and fresh blood matching Williams' blood type found on the burglarized premises.[151] During trial, the state was granted leave to describe Williams' arrest in Carpenter's home, especially the fact that he was bleeding at the time.[152] There is no problem with the admission of evidence that Williams was bleeding at the time of his arrest; what was error was the admission of evidence of the situs of the arrest. The state's evidence of Williams' presence at the first house (blood) and of the theft of the television therefrom was sufficient for conviction. The fact that Williams was in Carpenter's house at the time of his arrest and had committed another burglary there had no probative value to the state's case and was erroneously admitted. It was harmless error, however, for the same reason as in *Graham* and *Alvers*; the evidence of the charged offense and of the defendant's guilt was not so equivocal as to have unfairly affected the jury.

The error in the next "no harm-no foul" case was also harmless by reason of the very limited effect the improper evidence could have had on the jury. *Forehand v. State*[153] involved the defendant's conviction for dealing in phencyclidine (PCP), a Schedule II controlled substance.[154] During the state's examination of the arresting officers, an earlier sale of marijuana, made at the defendant's direction, was revealed.[155] The Indiana Supreme Court upheld the admission of the testimony on the basis of *res gestae*.[156] The marijuana sale was held to be part and parcel of the negotiation and sale of the PCP even though the marijuana sale was three days before the commission of the charged offense.[157]

The application of the *res gestae* exception was stretched beyond its limits. As the court itself stated, "Under the *res gestae* exception evidence may be introduced which completes the story of the crime by proving its *immediate* context . . . ."[158] There was no "immediacy" to the context

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[148]489 N.E.2d 53 (Ind. 1986).
[149]*See supra* notes 58-60 and accompanying text.
[150]*See supra* note 61 and accompanying text.
[151]*Williams*, 489 N.E.2d at 55.
[152]*Id.*
[153]479 N.E.2d 552 (Ind. 1985).
[154]*Id.* at 554.
[155]*Id.*
[156]*Id.*
[157]*Id.* at 554-55.
[158]*Id.* at 554 (emphasis added).

here of three days' passage of time.[159] Even the civil application of the *res gestae* doctrine could not be extended to justify such a broad application.[160] The *res gestae* exception simply did not apply, and it was error to admit the evidence of the marijuana sale.

One could perhaps argue that the common plan or scheme exception would be appropriate, but the relevancy of a marijuana sale would be difficult to establish at a trial for dealing in PCP. However, there is the possibility that the marijuana sale exhibited a common plan to sell controlled substances of all kinds. The problem though is that there was no issue in dispute requiring proof of such a plan. When the strength of the state's direct evidence from the testimony of the undercover officers is considered, there was no element left to be proven that was not brought out by their statements. However, because of this strength of the state's case and the discretion given to the trial court, the error in admission of this other crime evidence can only be deemed harmless.

The last of the "harmless error" cases is *Wooden v. State*,[161] in

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[159]*See, e.g.*, Moster v. Bower, 153 Ind. App. 158, 170, 286 N.E.2d 418, 425 (1972); Tenta v. Guraly, 140 Ind. App. 160, 170-71, 221 N.E.2d 577, 582-83 (1967) (*res gestae* statements must relate to main event).

[160]The court cites to a case expanding the *res gestae* exception outside the immediate time frame to justify the evidence here. *Id.* at 555. (citing Altman v. State, 466 N.E.2d 716 (Ind. 1984)). But that still does not prevent the conclusion that use of the *res gestae* exception in criminal trials in Indiana has been stretched far beyond the definition of the term given in Lee v. State, 267 Ind. 315, 320, 370 N.E.2d 327, 329 (1977) (citation omitted) as "acts, statements, occurrences and circumstances substantially contemporaneous with the crime charged." In the civil context, *res gestae* refers to a "spontaneous and instinctive reaction to a startling or unusual occurrence during which interval certain statements are made under such circumstances as to show lack of forethought or deliberate design in the formulation of their content" and is used as an exception to the hearsay rule. *Moster*, 153 Ind. App. at 170, 286 N.E.2d at 425 (emphasis deleted). *See also Tenta*, 140 Ind. App. at 170-71, 221 N.E.2d at 582-83. Its application in criminal law should ideally have the same immediacy limitations but not necessarily as an exception to anything, much less as a rule of exclusion of other crime evidence.

What reflection can other crimes committed as part of or immediately with reference to the charged offense have upon the defendant's character? How can it prejudice a defendant's case as being unfairly entered into evidence? There seems to be no valid reason for applying the rule of exclusion to "necessary parts of the proof of an entire deed," "inseparable elements of the deed," or "concomitant parts of the criminal act." 1A J.H. Wigmore, Evidence in Trials at Common Law § 218 (3d ed. 1983). So why even have a *res gestae* exception in criminal law? *See* Wilson v. State, 491 N.E.2d 537 (Ind. 1986) (application of *res gestae* exception conforms to Wigmore's non-exception). If there is evidence of other crimes that are part and parcel of a common plan or scheme, but which are inadmissible under *res gestae* because of a lack of immediate context, other exceptions already exist to allow admissibility. It therefore might be wise to consider the abolition of the rule altogether in the criminal context and either admit the other crime evidence as an inseparable portion of the charged crime or under the common scheme or plan exception.

[161]486 N.E.2d 441 (Ind. 1985).

which the defendant was on trial for robbery.[162] The trial court granted his motion in limine to prohibit the state from eliciting testimony that he may have been involved in any other offense while armed with a gun.[163] The testimony of the officer who investigated the instant offense revealed that the defendant's mug shot was shown to the victim for identification. The trial court overruled a defense motion for mistrial, and the Indiana Supreme Court affirmed.[164] The court declared that the testimony did not exceed the boundaries of the motion in limine and only explained the officer's investigation.[165]

Besides the fact that the officer's investigation appeared to be of little relevance to the charged offense, there was absolutely no need for his testimony that the police had a photograph of the defendant in their files. Mug shots and any references thereto are, with rare exceptions, inadmissible because of their tendency to show that a defendant has committed or was a suspect in other crimes.[166] The gratuitous injection of this information may well have been inadvertent, but it was nonetheless improper. The defendant's motion for mistrial was properly denied, though, because he could not possibly have been prejudiced by the improper evidence. The victim positively and unequivocally identified the defendant as the robber. In fact, shortly after the crime, the victim recognized him on the street and followed him before calling the police. Any error in the reference to the defendant's police photograph was therefore harmless.

D. *Wrong Result*

The only case during the survey period in which an error in admission of other crime evidence may well have been prejudicial was *Stout v. State*.[167] This conclusion is based upon the facts revealed in the opinion. A review of the actual trial transcript might lead to a different conclusion, but this analysis is confined to the recitation of facts in the reported case.

In *Stout*, the offending evidence was initially entered via testimony of the defendant's accomplice in burglary and theft.[168] The accomplice

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[162]*Id.* at 442.

[163]*Id.*

[164]*Id.* at 443.

[165]*Id.*

[166]Police investigation evidence was properly restricted in Williams v. State, 491 N.E.2d 540, 541 (Ind. 1986) (police officer not allowed to testify to defendant's initial arrest on unrelated charge), but was not in O'Grady v. State, 481 N.E.2d 115, 119-20 n.1 (Ind. Ct. App. 1985) (conviction reversed where police officer's testimony of informant's story went beyond established bounds of non-objectionable hearsay).

[167]479 N.E.2d 563 (Ind. 1985).

[168]*Id.* at 567.

implicated the defendant as a participant in multiple burglaries committed prior to the charged offense. The Indiana Supreme Court upheld the admission of this evidence "to show common scheme or plan, intent, purpose or identity."[169] It furnished no further illumination than a citation to another case, *Foresta v. State*.[170] Unfortunately, *Foresta* is as scantily reasoned as *Stout* and refers only to other crime evidence pertinent to proof of identity.[171] Identity was not at issue in *Stout*. The common plan or scheme exception might be relevant if the facts of the case were clearer because the defendant and his accomplice apparently committed several burglaries within a short time period. However, there is no evidence in the opinion to justify a conclusion that the defendant engaged in a common plan or scheme for a singular purpose. The defendant's activities were simply a series of multiple unrelated offenses of which the charged offense was only one.[172] The only other value the evidence had was to show criminal propensity, which is an impermissible use. The admission of the accomplice's testimony cannot be deemed legally harmless because other improper evidence was later admitted upon the ground that the accomplice's testimony was properly admitted.

During the further course of the state's case, a police officer testified to the course of his investigation leading to the arrest of the defendant.[173] During this testimony, the officer discussed the whereabouts of the defendant and his accomplice on the days prior to the charged crime.[174] Although the opinion does not recite the actual testimony, it is evident that it concerned the other break-ins and the defendant's role in them. The supreme court upheld the admission of the officer's testimony based in part upon the admissibility of the accomplice's testimony.[175] But, as already pointed out, that testimony was improperly admitted. Therefore, the officer's testimony was also improperly admitted. The sum effect of these two errors added to the posture of the case as otherwise set forth in the opinion indicates that reversal was required.

The other crime evidence elicited from these two witnesses had no logical relevance to any material fact at issue in the trial. The majority of the state's case appears to have rested on the credibility of the accomplice's testimony as to the facts.[176] His credibility could only have been bolstered by the corroborating testimony of a police officer. Ad-

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[169]*Id.*

[170]274 Ind. 658, 413 N.E.2d 889 (1980).

[171]*Id.* at 660, 413 N.E.2d at 890-91.

[172]In fact, the supreme court itself treated the charged offense as being motivated by a need for money, which is presumably in contradistinction to whatever undisclosed reason motivated the other offenses. *Stout*, 479 N.E.2d at 565.

[173]*Id.* at 567.

[174]*Id.* at 568.

[175]*Id.*

[176]Also diminishing the persuasiveness of the state's case is the fact that the home

mission of the other crime evidence obviously enhanced the prosecutor's case in the eyes of the jury. However, the evidence was used only to show the defendant's propensity for crime rather than substantively to prove his guilt of the charged offense. Therefore, this evidence, both legally and logically irrelevant, caused prejudicial error and the case should have been reversed for a new trial.[177]

IV. Conclusion

After this cursory glance at the notable cases in this survey period, it is apparent that the appellate courts of Indiana have properly applied the other crime exceptions less than fifty percent of the time, at least in published opinions. It is difficult to determine why there is a problem in this area. It is not difficult to imagine that in the heat of trial, minor errors will be made by both the bench and the trial attorneys. Some of these exceptions are based on subtle nuances in the facts, and the speed at which a trial is conducted is not always conducive to sorting through these nuances to reach a proper decision. Under the circumstances, it is remarkable that even though the published opinions improperly applied the law so often, the trial courts actually erred only once.

There is a remedy which will prevent the occurrence of the errors made in the survey opinions which are more often errors of analysis than of substance. That solution is to know the facts of each case. Only a thorough knowledge of the facts present in *both* the state's and the defense's cases can give one a proper perspective of the context in which other crime evidence can be examined. This knowledge must be supplied by the trial attorneys in both their presentation at trial and on appeal. When the attorneys have supplied the cogent facts, the trial courts can apply the law. In doing so, the courts must assume the exclusion applies unless and until the facts and their unique juxtaposition warrant the application of a specifically tailored exception for a specifically accepted purpose. The law in Indiana allowing admission of other crime evidence despite the general prohibition is not without logic and reason, but by its very principles, it can be applied only sparingly. Such a thoughtful approach to the law will clarify the exceptions for the trial bench and will establish proper guidelines for the trial bar.

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where the stolen items were found was not within the defendant's exclusive control and was accessible to other parties, including the accomplice. *See id.* at 565.

[177]*See, e.g.*, Brooks v. State, 156 Ind. App. 414, 296 N.E.2d 894 (1973) (prejudicial error to admit evidence of other thefts not reduced to conviction of defendant to show behavioral pattern).

Family Law: Equitable Distribution and Proper Valuation of Marital Property

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I. Introduction

Three developments during this survey period had an important impact on the division and valuation of marital property when a couple undergoes a divorce. The Indiana Court of Appeals rejected the approach that the starting point for determining an equitable distribution of marital property is to split the property equally between the spouses. In two other important cases, Indiana courts faced the issue of the proper valuation of marital property in the contexts of jointly held stock and professional partnership interests. This Article will discuss the theory and development of equitable distribution in Indiana and will show that Indiana courts have taken unique approaches in valuating certain types of marital property for purposes of dividing it between divorced spouses.

II. Equitable Distribution After *Luedke*

During this survey period, the Indiana Supreme Court decided that it would not join other states that have adopted the theory that the starting point for an equitable distribution of property upon marriage dissolution should be an equal split between the spouses.[1] In *Luedke v. Luedke*,[2] the Fourth District Court of Appeals of Indiana had held that when considering the contribution of each spouse to the acquisition of property pursuant to Indiana Code section 31-1-11.5-11(b)(1), a potentially equal division of the marital property should be the starting point for the trial court's analysis of the evidence relevant to property distribution upon marriage dissolution.[3] The Indiana Supreme Court rejected this approach and stated that while perhaps one's mind *ought* to lean toward an equal division, to *require* such would impose an artificial structure on the fact-finding process that may hinder a trial judge's ability to weigh openly all the facts in the case.[4]

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[1] *See* Luedke v. Luedke, 487 N.E.2d 133 (Ind. 1985).

[2] 476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[3] *Id.* at 865.

[4] *Luedke*, 487 N.E.2d at 134 (emphasis in original). A bill, House Bill 1452, was in-

The following discussion will review the theory and history of the concept of equitable distribution, consider the process of the law in Indiana concerning equitable distribution up to the time of *Luedke*, analyze the circuit and supreme court decisions in *Luedke*, and conclude with its effect on subsequent cases.

A. The Theory of Equitable Distribution

Equitable distribution is a method of dividing property upon divorce premised upon the theory that marriage is a voluntary partnership where both spouses contribute, whether such contribution is in the form of monetary contributions or nonfinancial contributions such as homemaker services.[5] This view is not new in that it has its "doctrinal roots" in community property law.[6] The theory behind community property law is that marriage is an economic unit where each spouse makes his or her unique contributions.[7] The contribution of the homemaker is considered to have equal significance with that of the wage earner, regardless of which spouse performs which service.[8] It has been noted that the primary difference between equitable distribution and community property states is that the latter states restrict the manner in which the parties can deal with marital property during the marriage and prior to divorce.[9]

The application of community property concepts to equitable distribution theory can be contrasted with the common law theory of property distribution upon marriage dissolution. At common law, upon marriage dissolution, all rights to property were based upon which spouse had title.[10] Thus, a spouse who had no assets in his or her own name was forced to rely upon alimony to obtain financial support.[11] Thus a major difference arose between the common law and equitable distribution theories. Under the latter, one could consider noneconomic factors when disposing of marital property, such as homemaking contributions, a spouse's lost opportunities for employment when staying home, and

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troduced in the 1987 session of The Indiana Legislature which, if passed, would significantly influence property distribution in Indiana. Therefore, practitioners faced with this issue should investigate the impact of recent legislature developments, if any.

[5]L. Golden, Equitable Distribution of Property 1-2 (1983).

[6]*Id.* at 2. Community property law is practiced in eight southern and western states: Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. *Id.* at 5 & n.22.

[7]*Id.* at 2.

[8]*Id.*

[9]Annotation, *Divorce: Equitable Distribution Doctrine*, 41 A.L.R.4th 484, 484-85 (1985).

[10]L. Golden, *supra* note 5, at 4-5.

[11]*Id.* at 5. The concept of alimony is tied to a fault-based system of divorce, whereas equitable distribution principles are generally founded upon a no-fault theory of divorce. *Id.* at 4-5; *see also* Lacayo, *Second Thoughts About No-Fault*, Time, Jan. 13, 1986, at 55, col. 1.

a spouse's performance of various social obligations on behalf of his or her spouse.[12] Many jurisdictions rejected the inequities of common law distribution theory by adopting equitable distribution status. Currently at least thirty-eight states have adopted some form of equitable distribution by statute.[13] These statutes typically mandate either a "just," "equitable," or "just and reasonable" disposition.[14] Indiana's equitable distribution statute similarly calls for a division of property which is "just and reasonable."[15] In defining a just or equitable distribution, most courts consider that this does not require a property division to be equal,[16] while a few states consider that such a property division should be as equal as possible.[17] In those states that do not require an equal division of property in order to effect a just or reasonable distribution, the trial judge is typically vested with much discretion to apportion property.[18] This approach has been criticized in that such discretion results in prejudice and increased costs and delay at trial.[19]

B. *The Roots of Equitable Distribution in Indiana*

Prior to the time of the decision of the Indiana Court of Appeals in *Luedke v. Luedke,*[20] Indiana recognized that trial judges have wide authority to allocate property upon divorce and should be reversed on appeal only for an abuse of discretion.[21] In dividing property upon divorce, Indiana courts are guided by Indiana Code section 31-1-11.5-11, which mandates that property be distributed in a just and reasonable manner whether the property is owned by either spouse prior to marriage or acquired individually during marriage, or acquired jointly during marriage.[22] The court is mandated to consider the following five factors in determining what is a just and reasonable disposition:

> (1) The contribution of each spouse to the acquisition of the property, including the contribution of a spouse as homemaker.

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[12]Annotation, *supra* note 9, at 487.

[13][Reference File] Fam. L. Rep. (BNA) 400: i-ii (1986).

[14]L. Golden, *supra* note 5, at 240-41.

[15]Ind. Code § 31-1-11.5-11(b) (Supp. 1986).

[16]Annotation, *supra* note 9, at 502-04. *See infra* text accompanying notes 70-71.

[17]*Id.* at 505-07. *See infra* text accompanying notes 67-69, 74-78.

[18]L. Golden, *supra* note 5, at 3-4.

[19]*Id.* The National Conference of Commissioners on Uniform State Laws responded to these criticisms by proposing The Uniform Marital Property Act. The Prefatory Note to the Act indicates that it is a property law, the aim of which is to recognize shared property rights of spouses during marriage. Unif. Marital Property Act, Prefatory Note, 9A U.L.A. 21 (Supp. 1986).

[20]476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[21]Swinney v. Swinney, 419 N.E.2d 996, 997-98 (Ind. Ct. App.), *transfer denied*, 426 N.E.2d 658 (Ind. 1981).

[22]Ind. Code § 31-1-11.5-11(b) (Supp. 1986).

(2) The extent to which the property was acquired by each spouse prior to the marriage or through inheritance or gift.

(3) The economic circumstances of each spouse at the time the disposition of the property is to become effective, including the desirability of awarding the family residence or the right to dwell in that residence for such periods as the court may deem just to the spouse having custody of any children.

(4) The conduct of the parties during the marriage as related to the disposition or dissipation of their property.

(5) The earnings or earning ability of the parties as related to a final division of property and final determination of the property rights of the parties.[23]

The court of appeals in *Luedke* observed that while factors two and four could be readily identified and traced and factors three and five are economic factors susceptible of proof, factor one, involving the contribution of each spouse, is nebulous and therefore not subject to any precise measurement.[24]

The standard of review when determining whether the trial court abused its discretion is to determine whether the result reached is clearly against the logic and effect of all facts and circumstances before the court.[25] In *Swinney v. Swinney*,[26] the court of appeals stated that a "just and reasonable" distribution under Indiana Code section 31-1-11.5-11 requires fairness; however, it does not require equality in distribution between the spouses.[27] In reviewing whether it was an abuse of discretion to award the wife ninety-seven percent of the marital assets including a house that had been given to both parties by the wife's father, the court reviewed each statutory factor enumerated in section 31-1-11.5-11(c). In examining the second statutory factor, the extent to which property was acquired by each spouse prior to marriage through inheritance or gift, the court determined that where *both* parties had received a gift from the wife's father, such gift should be included in the marital pot.[28] Thus by considering the "total circumstances," the court could determine whether a substantial contribution by one spouse under one subparagraph offset the contribution of the other spouse under a different subparagraph.[29] After engaging in this analysis and weighing

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[23] *Id.* § 31-1-11.5-11(c).

[24] 476 N.E.2d at 863-64 n.11.

[25] *Swinney*, 419 N.E.2d at 997-98.

[26] 419 N.E.2d 996 (Ind. Ct. App. 1981).

[27] *Id.* at 998.

[28] *Id.*

[29] *Id.* at 999.

the evidence in favor of the appellee, the court concluded that the trial court had abused its discretion in awarding the wife ninety-seven percent of the assets.[30] Thus, it appears that the standard of review for the trial court's abuse of discretion is not totally toothless.

Subsequent cases in Indiana similarly held that the just and reasonable division of property does not require that the division be equal.[31] In acknowledging the presumption that the trial court's division of property is correct, the appellate court looks at the evidence most favorable to the judgment and often surmises circumstances that the trial court could have considered to support its decision.[32]

In considering the first statutory factor under section 31-1-11.5-11(c)(1), the contribution of each spouse to the acquisition of property, including the contribution of a spouse as a homemaker, Indiana recognizes that this provision mandates the consideration of the homemaking endeavors of both husband and wife in a marriage.[33] Thus, it is evident that noneconomic factors should be considered in achieving equitable distribution.[34] In *Temple v. Temple*,[35] the wife on appeal challenged the award of sixty-nine percent of the marital property to her, contending among other matters that the trial court had not considered her contribution financially as the primary homemaker to the acquisition of marital assets. The court reiterated the standard that it does not weigh the evidence or substitute its discretion for that of the trial judge.[36] Thus, the court concluded that inevitably the trial court considered the very factors that the appellant contended had been omitted.[37]

Indiana also recognizes that forgone career opportunities by a spouse should be recognized in achieving equitable distribution.[38] In *Taylor v. Taylor*,[39] the husband on appeal contended that the lower court decision

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[30]*Id.*

[31]*See, e.g.*, Kaply v. Kaply, 453 N.E.2d 331, 332, 335 (Ind. Ct. App. 1983) (court upheld a lower court decision awarding husband approximately twenty percent of the marital property and awarding wife eighty percent); *In re* Marriage of Salas, 447 N.E.2d 1176, 1180 (Ind. Ct. App. 1983) (court reversed lower court because it failed to consider parties' debts when it issued its award); Dean v. Dean, 439 N.E.2d 1378, 1381, 1383 (Ind. Ct. App. 1982) (court upheld award to husband of two and one-half times more property than to his wife); Cunningham v. Cunningham, 430 N.E.2d 809, 814 (Ind. Ct. App. 1982) (court upheld trial court's order for wife to reconvey real estate to husband where parties had been in a short term marriage and both were financially independent).

[32]*Cunningham*, 430 N.E.2d at 814.

[33]Temple v. Temple, 435 N.E.2d 259, 262 (Ind. Ct. App. 1982).

[34]Annotation, *supra* note 9, at 510-15.

[35]435 N.E.2d 259 (Ind. Ct. App. 1982).

[36]*Id.* at 262.

[37]*Id.*

[38]Taylor v. Taylor, 420 N.E.2d 1319, 1323 (Ind. Ct. App. 1981); *see also* Annotation, *supra* note 9, at 509-15.

[39]420 N.E.2d 1319 (Ind. Ct. App. 1981).

was erroneous since his share of the assets upon dissolution amounted to less than those he had brought into the marriage. The court acknowledged that all factors in section 31-1-11.5-11(c) must be balanced against one another when awarding marital property.[40] The court observed that while the husband was a skilled businessman, the wife was unskilled, having forgone a career outside the home.[41] Thus, the court concluded that the trial court's distribution of property was not clearly against the logic and effect of the facts and circumstances before it.[42]

The standard of review for determining whether a trial court has abused its discretion has not gone uncriticized although the trial court's job has been described as a "Herculean task."[43] While the court applied this standard again in *Lord v. Lord*,[44] it acknowledged that such a standard is imprecise and gives a trial judge a limitless range of choice. Therefore, such a review is meaningless.[45] The court contrasted this with the more measurable objective of obtaining a "just and proper" alimony distribution. Specifically, this term required that the alimony award leave an injured wife in as good a condition as she would have been had her husband died.[46]

C. Luedke v. Luedke: *Rejection of the Equal Split Starting Point*

In *Luedke v. Luedke*,[47] the Indiana Court of Appeals approved of the "just" criticism of the abuse of discretion standard as previously made in *Lord v. Lord*[48] and determined that this situation was in need of repair.[49] In *Luedke*, the court addressed the issue of whether the trial court abused its discretion in awarding fifty-seven percent of the property to the husband and forty-three percent to the wife.[50] In an unprecedented opinion, the court, while recognizing perhaps that this was a change in the law, held that the language of section 31-1-11.5-11(c)(1) regarding the marital contribution of the parties means that a *potentially* equal division of the marital property should be the starting point for a trial

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[40]*Id.* at 1323.

[41]*Id.*

[42]*Id.* at 1324.

[43]Temple v. Temple, 435 N.E.2d 259, 262 (Ind. Ct. App. 1982).

[44]443 N.E.2d 847 (Ind. Ct. App. 1982).

[45]*Id.* at 850-51 n.4.

[46]*Id.* The appellate court in *Luedke* similarly acknowledged that the standard applicable to an alimony distribution under the prior Indiana divorce statute provided the judge with a range of choice within which to act, contrary to the current dissolution act. Luedke v. Luedke, 476 N.E.2d 853, 859 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[47]476 N.E.2d 853 (Ind. Ct. App.), *vacated*, 487 N.E.2d 133 (Ind. 1985).

[48]443 N.E.2d 847 (Ind. Ct. App. 1982).

[49]*Luedke*, 476 N.E.2d at 859-60, 865.

[50]*Id.* at 855.

court's analysis of the other statutory factors.[51] If, however, one spouse has neglected his or her role, this fifty-fifty split under section 31-1-11.5-11(c)(1) is not required.[52]

The parties in *Luedke* had been married for nineteen years and had three children. At the time of the divorce, Robert was an executive with Eli Lilly and Company while his wife, Shari, had returned to school to prepare for a job as a respiratory therapist after having been out of the work force for their nineteen years of marriage. During those years, Shari was a full-time homemaker and mother. The trial court awarded fifty-seven percent of the marital property to Robert and forty-three percent to Shari.[53] On appeal, Shari contended that the trial court abused its discretion in this division of the marital property.

The court proceeded to an analysis of the relevant statutory factors, sections 31-1-11.5-11(c)(1), (3), and (5). In reviewing the economic circumstances of each spouse at the time of property disposition, it was evident that Robert had the advantaged position due to his secure position with a stable company.[54] In reviewing the earnings abilities of the parties, it was also evident that Robert had the superior position.[55] The court then turned to an analysis of section 31-1-11.5-11(c)(1) to determine if this would offset the favorable position of Robert under sections 31-1-11.5-11(c)(3) and (5), thereby justifying an award in his favor of fifty-seven percent of the property. The court recognized, as previously held in *Temple v. Temple*,[56] that this section recognized the contribution of homemaking endeavors to the acquisition of marital property.[57] Furthermore, a necessary corollary is the rebuttable presumption that the contribution of the homemaker is equal to that of the wage earner.[58] Thus, the court held that the starting point for the division of property is a potentially equal one under section 31-1-11.5-11(c)(1), which can be rebutted by either party's proof that an equal division would not be just and reasonable.[59] Therefore, a burden is placed on each party to prove that an equal division of property would not be just or reasonable.[60] Thus the court emphasized that its holding is not in contravention of prior cases which held that the division of property need not be equal in order to effect a just and reasonable division of property.[61]

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[51] *Id.* at 865 (emphasis original).
[52] *Id.* at 859-60.
[53] *Id.* at 855.
[54] *Id.* at 861.
[55] *Id.* at 862.
[56] 435 N.E.2d 259 (Ind. Ct. App. 1982).
[57] *Luedke*, 476 N.E.2d at 863. *See supra* text accompanying notes 33-34.
[58] *Luedke*, 476 N.E.2d at 864-65.
[59] *Id.* at 865.
[60] *Id.*
[61] *Id. See supra* note 31.

In supporting its decision to begin with an equal division of property in a marital dissolution, the court offered several reasons. First, a definite starting point for property distribution provides the "necessary structure" in which the trial court can weigh evidence in rebuttal to an equal division.[62] Second, it provides a more meaningful appellate court review because there is an articulated starting point, contrary to the prior limitless range of choice exercised by the trial court.[63] Third, litigants would be aided in negotiating property settlements because they would have a starting point from which to begin negotiations.[64] Fourth, the court reasoned that the legislature meant to recognize the marriage relationship as "a common enterprise, a voluntary union of co-equals in which the parties define and agree upon their roles."[65]

Thus, in effect the court applied a formula approach in reviewing the trial court. Because factors two and four in section 31-1-11.5-11(c) were irrelevant, factor one established a rebuttable presumption of an equal division of property. However, factors three and five were in Robert's favor. "[B]ecause of Robert's superior economic circumstances and earning ability[,]"[66] the presumption of equal distribution was rebutted, in favor of Shari. It therefore followed that the award of fifty-seven percent of the property to Robert was an abuse of discretion.

The appellate court in *Luedke* supported its position that a potentially equal division of property should be the starting point for a trial judge in a dissolution action by reference to other jurisdictions adopting this same approach.[67] The court also noted that two states, Arkansas and North Carolina, maintain a rebuttable presumption of an equal distribution of property by statute.[68] In analyzing the interpretation of the North Carolina statute, the North Carolina Court of Appeals, in *White*

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[62]*Luedke*, 476 N.E.2d at 865.

[63]*Id.*

[64]*Id.*

[65]*Id.* at 866.

[66]*Id.* at 867.

[67]*Id.* at 865-66. *See, e.g.*, Cherry v. Cherry, 66 Ohio St. 2d 348, 348, 353-56, 421 N.E.2d 1293, 1294, 1298-99 (1981), where the Supreme Court of Ohio rejected the contention that an irrebuttable or rebuttable presumption existed that mandated an equal division of property under the Ohio dissolution statute, but accepted the proposition that a potentially equal division should be the starting point from which a trial judge should proceed. *Accord*, Paul W. v. Margaret W., 8 Fam. L. Rep. (BNA) 3013, 3015-16 (C.P. Allegheny County (Pa.) Dec. 1, 1981).

[68]*Luedke*, 476 N.E.2d at 866; *see also* Ark. Stat. Ann. § 34-1214(A)(1) (Supp. 1985) ("All marital property shall be distributed one-half [1/2] to each party unless the court finds such a division to be inequitable, in which event the court shall make some other division that the court deems equitable . . . ."); N.C. Gen. Stat. § 50-20(c) (Supp. 1983) ("There shall be an equal division . . . unless the court determines that an equal division is not equitable. If the court determines that an equal division is not equitable, the court shall divide the marital property equitably. . . ."). In Glover v. Glover, 4 Ark.

v. White,[69] compared the statute to other equitable distribution statutes. The court noted that the vast majority of states vest the decision regarding the distribution of property in the individual judge's discretion, given the particular circumstances at hand.[70] In such states no presumption of equality in distribution exists.[71] The court contrasted these states with North Carolina's statute which was deemed indistinguishable from the Arkansas statute, which also establishes a rebuttable presumption of an equal division of property.[72] Thus the court rejected the wife's contention that the trial court's equal distribution of property was erroneous where she had contributed services that exceeded the value of her interest in jointly and separately held property.[73]

In addition to Arkansas and North Carolina, Wisconsin has a statute that presumes an equal division of property as to property not acquired prior to or during marriage through gift, bequest, or inheritance.[74] This distribution can be offset, however, by considering various statutory factors.[75] In *Jasper v. Jasper*,[76] the Wisconsin Supreme Court considered the rationale behind Wisconsin's statute to be that marriage should be viewed as a partnership where the contribution of a full-time homemaker has value at least as great as that of the contribution of the breadwinner. Specifically, the homemaking partner has forgone career opportunities

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App. 27, 29, 627 S.W.2d 30, 31, *reh'g denied*, 628 S.W.2d 882 (Ark. App. 1982), the court interpreted the above Arkansas statute and stated that when a trial court distributes property in an unequal manner, it must give its reasons for such disposition.

[69] 64 N.C. App. 432, 308 S.E.2d 68 (1983), *aff'd as modified*, 312 N.C. 770, 324 S.E.2d 829 (1985).

[70] 308 S.E.2d at 71.

[71] *Id.*

[72] *Id.*

[73] *Id.* at 72.

[74] Wis. Stat. Ann. § 767.255 (West 1981). Wisconsin also adopted the Uniform Marital Property Act (UMPA), which became effective in that state on January 1, 1986. Wis. Stat. Ann. § 766.001 to -.97 (West Supp. 1986). The Prefatory Note to the UMPA states that the Act is a property law merely governing the rights of spouses to property during marriage. Unif. Marital Property Act, Prefatory Note, 9A U.L.A. 21 (Supp. 1986). The theory behind the act is that the contributions of both spouses during a marriage are equal such that they share equal undivided ownership of marital property. Two propositions behind the Act are that: (1) marriage involves a mode of sharing, and (2) that this sharing mode is an ownership right upon divorce. *Id.* at 22. Thus, the UMPA merely takes the parties "to the door of the divorce court." *Id.* at 23. The comments emphasize that the appropriate procedures for dividing property should be determined from individual states' dissolution statutes. *Id.* The Indiana General Assembly has twice rejected Senate Bill No. 6, which would adopt the UMPA in Indiana. It will be before the General Assembly again in 1987 with some amendments. *See* S. 6, 1986 Gen. Assembly §§ 1-25 (1986); Middleton, *Confusion, Uncertainty Surround Equitable Distribution*, Nat'l L. J., May 26, 1986, at 31, col. 1.

[75] Wis. Stat. Ann. § 767.255 (West 1981).

[76] 107 Wis. 2d 59, 318 N.W.2d 792 (1982).

to further those of that partner's spouse.[77] In spite of the above reasoning, the court upheld an unequal division of property where the evidence supported the finding that the husband had contributed more to the marriage financially and in caring for minors than the wife had.[78]

The *Jasper* court's explanation of the rationale behind the Wisconsin statute is strikingly similar to the propositions of Indiana courts as previously set forth in *Temple* and *Taylor v. Taylor*,[79] where the contributions of a homemaker to the marriage as well as that individual's forgone career opportunities were recognized as factors to be considered in achieving equitable distribution. Thus, the recognition of marriage as a partnership permeates all equitable distribution statutes regardless of whether or not those statutes are accompanied by a mandate for the trial judge to begin his analysis with a rebuttable presumption of equality in distribution. One commentator has said that the doctrine of a fifty-fifty split as the starting point for equitable distribution is merely a means to "structure the court's deliberative process" in reviewing the statutory factors.[80] In other words, this commentator surmised that perhaps the true reasoning behind this "starting point analysis" is that one cannot expect judges to adhere to the policies recognizing a homemaker's contributions and forgone career opportunities to the marriage partnership when attempting to achieve an equitable distribution.[81]

The Indiana Supreme Court rejected this distrust of the ability of trial court judges properly to apply the policies of equitable distribution when the supreme court reviewed the lower court's decision in *Luedke*. In a cursory opinion, the Indiana Supreme Court rejected the appellate court's interpretation of section 31-1-11.5-11(c)(1) and stated that while perhaps one's mind "*ought* to lean toward an equal division" of property, "to *require* [such] as a matter of law . . . impinge[s] [upon] the trial judge's ability to openly weigh all the facts and circumstances . . . ."[82] The court reasoned that the daily actions of people are not readily susceptible to mathematical application when it comes to marital dissolution actions.[83] Thus the court rejected the appellate court's formula-like application of section 31-1-11.5-11(c). The court also reasoned that due to the sensitive and difficult task at hand in a property dissolution action, a trial judge should be vested with broad discretion. The court also cited many prior cases holding that the statutory term mandating

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[77]*Id.* at 68, 318 N.W.2d at 797.

[78]*Id.*

[79]420 N.E.2d 1319 (Ind. Ct. App. 1981).

[80]L. Golden, *supra* note 5, at 244.

[81]*Id.* at 245 n.64; *see also* Foster, *Commentary on Equitable Distribution*, 26 N.Y.L. Sch. L. Rev. 1, 31-32 (1981).

[82]*Luedke*, 487 N.E.2d at 134.

[83]*Id.*

a "just and reasonable" distribution does not require an equal or relatively equal division of property.[84] Thus, it appears that the partnership theory of marriage behind equitable distribution should be a sufficient guide for trial judges dividing property upon marriage dissolution without imposing upon them an analytical framework for their "Herculean task."[85]

Cases decided subsequent to *Luedke* during this survey period have followed *Luedke*, although not without criticism. In *Baker v. Baker*,[86] the Fourth District Court of Appeals that had decided *Luedke* was again faced with the issue of whether the trial court's division of marital property was just and reasonable where the wife was awarded sixty percent of the marital assets. The husband contended that this distribution was not just and reasonable in light of *Luedke*.[87] Relying on the supreme court's decision in *Luedke*, the court of appeals in *Baker* rejected the husband's contention, finding that the great earnings disparity in favor of the husband supported the lower court's decision.[88] The court reaffirmed the prior principles established in *Temple* and *Swinney v. Swinney*[89] that in a property dissolution action a trial court's action will be presumed to be correct, and a trial court will be reversed only for an abuse of discretion.[90]

Judge Young, in a concurring opinion, criticized this result in several respects. In a somewhat cynical view, he first concurred on the basis that the supreme court's decision in *Luedke* virtually precluded an appellate court's review of a trial court's discretion. He stated, "[O]ur supreme court has reinstated the pre-*Luedke* situation in which a trial court's range of choice is virtually limitless and our review little more than pretense."[91] He argued that the distribution of assets will vary from court to court based on the particular "disposition or whim" of a certain judge who may be tempted to resort to who was "good" or "bad," thereby reinstating fault-based concepts of divorce.[92] He further argued that the fifty-fifty starting point of *Luedke* would have provided a real basis for appellate review and precluded the possibility that the "financial

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[84]*Id.* at 135. *See, e.g.*, Van Riper v. Keim, 437 N.E.2d 130 (Ind. Ct. App. 1982); Irwin v. Irwin, 406 N.E.2d 317 (Ind. Ct. App. 1980); *In re* Marriage of Julien, 397 N.E.2d 651 (Ind. Ct. App. 1979); Dahlin v. Dahlin, 397 N.E.2d 606 (Ind. Ct. App. 1979); *In re* Marriage of Davis, 182 Ind. App. 342, 395 N.E.2d 1254 (1979).

[85]Temple v. Temple, 435 N.E.2d 259, 262 (Ind. Ct. App. 1982).

[86]488 N.E.2d 361 (Ind. Ct. App. 1986).

[87]*Id.* at 364.

[88]*Id.* at 365.

[89]419 N.E.2d 996 (Ind. Ct. App.), *transfer denied*, 426 N.E.2d 658 (Ind. 1981).

[90]*Baker*, 488 N.E.2d at 364.

[91]*Id.* at 366.

[92]*Id.* at 366-67.

well-being of [dissolution litigants] [would be] left to the good graces of a particular trial judge . . . ."[93] Indeed, one commentator has mentioned that with the advent of no-fault divorce, society has merely changed its focus of unpleasantness from the reasons for a marriage break-up to disputes over factors affecting property distribution.[94]

In *Planert v. Planert*,[95] another case subsequent to *Luedke*, the court of appeals seemed to come to a merely talismanic conclusion that the property distribution was just and reasonable after determining that the lower court based its decision upon the conduct of the parties during the marriage as it related to the disposition of their property. Thus, the court affirmed the pre-*Luedke* abuse of discretion standard as a means to review a trial court's decision.[96] Another case decided during the survey period, however, indicated that the appellate court's standard of review is not totally toothless. In *Schnarr v. Schnarr*,[97] the court of appeals overturned the trial court's decision that had awarded the wife ninety-six percent of the marital assets in spite of the fact that both spouses had identical training in the operation of a business and the same work experience. The court rejected the lower court's reasoning that the future earnings ability of the husband supported an award in the wife's favor in accordance with Indiana Code section 31-1-11.5-11(c)(5).[98]

Luedke essentially did not change the state of the law in Indiana regarding property distribution upon marriage dissolution. While the contributions of a homemaking spouse like Shari Luedke will not be unrecognized in a property distribution, such a spouse also cannot assume an automatic right to one-half of the marital property. Due to the fact-sensitive nature of each dissolution action, Indiana trial judges have been vested with broad discretion in determining such issues. As long as the bench and bar remain cognizant of the policies behind equitable distribution and seek to implement them in their decisions, it should not be too detrimental that a trial judge is not required to begin with a fifty-fifty division of the property when determining a property distribution case.

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[93]*Id.* at 367.

[94]LaCayo, *supra* note 11, at 55, col. 1; *see also* Middleton, *supra* note 74, at 31, col. 1 (the author also raised concerns regarding how equitable distribution laws are being applied, quoting Judge Young's opinion in *Baker*).

[95]478 N.E.2d 1251 (Ind. Ct. App. 1985).

[96]In another case decided during the survey period, Neffle v. Neffle, 483 N.E.2d 767 (Ind. Ct. App. 1985), the court found the lower court did not abuse its discretion in awarding the husband most of the assets but requiring him to pay a cash award. The court recognized that Indiana code section 31-1-11.5-11(b)(2) permits marital assets to be distributed in kind as well as in money. *Id.* at 768-69.

[97]491 N.E.2d 561 (Ind. Ct. App. 1986).

[98]*Id.* at 564-65.

III. Valuation of Marital Property: Jointly Held Stock and Partnership Interests

Two other important cases were decided in this survey period. Both *Eyler v. Eyler*[99] and *Peddycord v. Peddycord*[100] dealt with the proper valuation of marital property. However, each case addressed the concept of valuation in the context of two distinct types of marital property, jointly held stock and professional partnership interests.

A. Eyler v. Eyler: *Jointly Held Stock*

The case of *Eyler v. Eyler*[101] presents an interesting approach to the valuation of jointly held shares of stock. In this case, the husband and wife were joint owners of 90.2% of the outstanding stock in the husband's business, Superior Training Services, Inc.[102] The couple subsequently divorced and the trial court was required to decide how this jointly held property should be divided in order to achieve a just and equitable result.

The trial court had determined that the husband would retain all of the couple's stock in the business and the wife would receive a money judgment equal to the value of one-half of the jointly owned stock.[103] In theory the trial court split the stock in half and awarded the wife a sum of money equal to the value of 45.1% of the stock. However, the trial court also decided that the wife's 45.1% of the stock represented a minority share of the total outstanding stock in the business.[104] When valuing minority shares, discounts are normally applied to the total value of the minority shares in order to compensate for the difference in real value between majority and minority shares of stock.[105] In this case, the value of the wife's shares of stock was discounted by 25% in order to arrive at its "true value."[106] The trial court decided that the 45.1% shares of stock which the wife was theoretically "selling" to her husband were worth 25% less than their "book value" because her stock represented only a minority interest in the business. Her corresponding money judgment was reduced by the equal percentage.[107]

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[99]492 N.E.2d 1071 (Ind. 1986).

[100]479 N.E.2d 615 (Ind. Ct. App. 1985).

[101]492 N.E.2d 1071 (Ind. 1986).

[102]*Eyler*, 492 N.E.2d at 1073.

[103]Eyler v. Eyler, 485 N.E.2d 657, 661 (Ind. Ct. App.), *vacated*, 492 N.E.2d 1071 (Ind. 1986).

[104]*Id.* at 661.

[105]*See* Perlman v. Permonite Mfg. Co., 568 F. Supp. 222, 230 (N.D. Ind. 1983), *aff'd*, 734 F.2d 1283 (7th Cir. 1984).

[106]*Eyler*, 485 N.E.2d at 661.

[107]*Id.*

The wife appealed this decision on the basis that the trial court erred in applying a minority discount to the value of her portion of the stock.[108] She argued that because she had always been a joint owner of 90.2% of the outstanding shares, her stock had never been treated as a minority interest. The Indiana Court of Appeals upheld the trial court's determination with little discussion.[109] The court of appeals simply recognized that the wife owned 45.1% of the stock after the property was divided. This percentage was less than 50% and was, therefore, a minority share of stock subject to a minority discount.[110]

On appeal, the Indiana Supreme Court reversed the court of appeals.[111] Instead of analyzing the issue in terms of the percentage of stock owned by each spouse *after* the property division, the supreme court concentrated on the nature of the joint ownership of stock *before* the property division.[112] "[T]he shares constituting the 90.2% share of the business were at all . . . times held in joint ownership and not burdened by the factors which may warrant consideration of the 'minority interest' discount."[113] Although the wife's share of stock was technically a minority share, her stock had always been exercised as part of a majority block and, therefore, was not worth less than any of the other stock in the business. Thus, the wife was awarded a money judgment equal to the full value of her shares of stock.

The decision of the supreme court rests upon a recognition of common law principles on the nature of joint ownership.[114] Joint tenants own a single, unified interest in personal or real property.[115] Each joint tenant owns an undivided share of the whole property.[116] If the husband and wife jointly owned 90.2% of the outstanding shares, both owned a majority interest in the corporation. The court reasoned that minority discounting was not necessary because neither spouse had ever been relegated to the position of minority shareholder.[117]

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[108]*Id.*

[109]"Candace was to receive a money judgment corresponding to the value of 45.1% of the outstanding stock in Superior Training Services, which percentage represented a minority interest. Application of a minority discount was supported by law." *Id.*

[110]*Id.*

[111]Eyler v. Eyler, 492 N.E.2d 1071, 1074 (Ind. 1986).

[112]*Id.*

[113]*Id.*

[114]The supreme court's decision is similar to the court of appeals decision in that neither court engaged in a lengthy discussion of the nature of joint ownership.

[115]*See* Duncan v. Suhy, 378 Ill. 104, 37 N.E.2d 826 (1941); Richardson v. Richardson, 121 Ind. App. 523, 98 N.E.2d 190 (1951); Clausen v. Warner, 118 Ind. App. 340, 78 N.E.2d 551 (1948); *In re* Lorch's Estate, 33 N.Y.S.2d 157 (Sur. Ct. 1941).

[116]Welsh v. James, 408 Ill. 18, 95 N.E.2d 872 (1950), *rev'd*, 7 Ill. 2d 106, 129 N.E.2d 699 (1955); Rogers v. Rogers, 437 N.E.2d 92 (Ind. Ct. App. 1982); Clovis v. Clovis, 460 P.2d 878 (Okla. 1969); Turner v. Turner, 185 Va. 505, 39 S.E.2d 299 (1946).

[117]*Eyler*, 492 N.E.2d at 1074.

At first glance, it would appear that the supreme court was ignoring a fundamental fact of the couple's divorce. At some point the corporate stock had to be divided and would no longer be held in joint ownership.[118] After division, the wife would have owned 45.1% of the stock, numerically a minority interest. If the wife was entitled to a money judgment equal to *her share* and numerically her share was a minority one, her money judgment should have been discounted to reflect its minority status.

However, the decision of the supreme court correctly recognized the practical reality surrounding the wife's "minority" interest. First, inherent in a trial court's power to grant a divorce is the power to determine how the marital property should be divided.[119] A value must be placed on the marital property in order for the court to determine how an equitable and just division can be achieved. The trial court has the discretion to designate a particular date at which valuation of property will officially occur.[120] Logically, however, valuation would have to occur prior to the actual division of the property.[121] Without knowing the value of a particular piece of marital property, the trial court would be unable to make a decision that is just and equitable to all parties.

In *Eyler*, the couple's marital property was valued as of the date of separation.[122] At the date of separation, the marital property had not been divided. Although they no longer lived together, the husband and wife still owned 90.2% of the stock as joint owners. Both were still majority owners. Thus, the value of the wife's shares could not be discounted in value as minority shares because at the time of valuation, she was owner of the whole majority interest.

In addition, the Indiana Supreme Court correctly rejected the minority discount theory because of the true nature of the wife's stock. Minority shares are normally discounted because the owner lacks the power to control corporate decision making.[123] For this reason, minority

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[118]Joint tenancies may be severed in a number of ways. Severance will normally result in the creation of a tenancy in common. *See* Mann v. Bradley, 188 Colo. 392, 535 P.2d 213 (1975), where the wife "conveyed" her share of property to her husband, the other joint holder, thus destroying the joint tenancy. *See also* Jackson v. O'Connell, 23 Ill. 2d 52, 177 N.E.2d 194 (1961).

[119]Taylor v. Taylor, 436 N.E.2d 56, 58 (Ind. 1982).

[120]*Id.* at 58 & n.1. In *Taylor*, an issue arose as to whether the marital home should be valued at the time of separation or at the time the dissolution action commenced. The Indiana Supreme Court decided that a trial court is not "limited to a specific date of valuation." *Id.* at 59. If the property division is just and reasonable, the trial court's decision will not be overturned. *Id.*

[121]See Annotation, *Proper Date for Valuation of Property Being Distributed Pursuant to Divorce*, 34 A.L.R. 4th 63, 63-85 (1984), for a discussion of how different jurisdictions determine the proper date for valuation of marital property.

[122]*Eyler*, 492 N.E.2d at 1074.

[123]Perlman v. Permonite Mfg. Co., 568 F. Supp. 222, 230-31 (N.D. Ind. 1983), *aff'd*, 734 F.2d 1283 (7th Cir. 1984), stated

shares are not worth as much as majority shares, even though they both have the same "book value."[124] Prior to the divorce, the wife exercised her shareholder rights as a majority owner. The 45.1% of the total shares designated as belonging to the wife were never "minority" shares in the sense that the owner lacked the power to direct corporate affairs. As the supreme court properly stated, the shares were "not burdened by the factors which may warrant consideration of the 'minority interest' discount."[125]

For these reasons, the supreme court reached the correct decision in the *Eyler* case. Although in the pure numeric sense, the wife owned only a minority interest once the shares of stock were divided, these shares were never burdened by the deficiencies normally attributed to true minority shares, such as a stock owner's inability to control corporate decision making. Because the wife's shares were always part of a majority block of shares, subjecting her interest to a minority discount was unwarranted.

B. Peddycord v. Peddycord: *Professional Partnership Interests*

Property valuation was the subject of another recent Indiana decision, *Peddycord v. Peddycord*.[126] At the time of the husband and wife's divorce in *Peddycord*, the husband was a partner in a law firm.[127] The parties agreed that his interest in the professional partnership was a marital asset subject to division in the dissolution action.[128] In order to divide this asset, the trial court had to place a value on the partnership interest and award the wife a money judgment equal to her equitable share of the husband's interest.[129]

Placing a value on a spouse's partnership interest was not a simple task. The trial court decided to use a formula found in the partnership

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"A minority shareholder could not have expected to receive a proportionate share of the going concern value of the assets if he had remained a stockholder of Amnest as a going concern, unless the assets as a whole, or the company as a whole, were to be sold. As a minority stockholder, he would have had no voice in a corporate policy, and no power to influence decisions as to whether to sell and, if so, when and how. The control of these decisions is an element of value . . . ."

Id. at 231 (citing Moore v. New Ammest, Inc., 6 Kan. App. 2d 461, 474-75, 630 P.2d 167, 177 (1981)).

[124] *Perlman*, 568 F. Supp. at 231.

[125] *Eyler*, 492 N.E.2d at 1074.

[126] 479 N.E.2d 615 (Ind. Ct. App. 1985).

[127] *Id.* at 616.

[128] *Id.*

[129] *Id.*

agreement, which was used to calculate a partner's interest at the time of his death.[130] Most partnership agreements contain formulas for calculating the amount of money the partnership will give a partner in order to "buy out" his share upon his death or withdrawal from the partnership.[131] According to the partnership agreement in *Peddycord*, at the time of his death the husband would be entitled to $20,673.73, the amount of his capital account, plus a death benefit payment of $53,630.89.[132] From the total of these two figures, the trial court subtracted $16,908.02 for the liabilities owed by the husband to the partnership.[133] The trial court arrived at a net valuation of the husband's interest totalling $57,396.60.[134]

On appeal, the husband argued that the trial court erred in using the partnership death benefit formula for calculating the value of his present interest in the partnership.[135] The husband argued that the value of his interest should be calculated according to the partnership's formula for reimbursing partners who withdraw from the firm. The Indiana Court of Appeals found that the wrong formula had indeed been used to calculate the husband's interest and reversed the trial court's decision.[136]

The court of appeals began its analysis by recognizing that partnership agreements normally contain several formulas for determining the amount of money a former partner is entitled to receive upon his withdrawal from the firm.[137] This amount is different depending on whether the partner withdraws from the firm, becomes disabled, dies, or retires.[138] While recognizing that at least one other jurisdiction has used the death benefit formula for calculating a husband's present interest, the court of appeals decided that the formula used for reimbursing partners who withdraw from the firm represented the correct formula for calculating a husband's present interest in a dissolution action.[139]

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[130] *Id.*

[131] Walzer, *Developing the Financial Circumstances of a Marital Community*, 1978 Economics of Divorce 111, 127-33.

[132] *Peddycord*, 479 N.E.2d at 616.

[133] *Id.*

[134] *Id.*

[135] *Id.*

[136] *Id.* at 616-17.

[137] *Id.* at 616.

[138] *Id.* See Annotation, *Evaluation of Interest in Law Firm or Medical Partnership for Purposes of Division of Property in Divorce Proceedings*, 74 A.L.R.3d 621, 621-29 (1976), for a further discussion of formulas available for valuing a partner's interest in a partnership.

[139] *Peddycord*, 479 N.E.2d at 617; *see also* Fonstein v. Fonstein, 53 Cal. App. 3d 846, 126 Cal. Rptr. 264 (1975), *vacated*, 17 Cal. 3d 738, 131 Cal. Rptr. 873, 552 P.2d 1169 (1976); Johnson v. Johnson, 277 N.W.2d 208 (Minn. 1979); Weaver v. Weaver, 72 N.C. App. 409, 324 S.E.2d 915 (1985); Holbrook v. Holbrook, 103 Wis. 2d 327, 309 N.W.2d 343 (Wis. Ct. App. 1981).

In deciding this issue, the court drew an analogy between partnership agreements and life insurance policies.[140] An insurance company will pay a different amount to a life insurance policyholder depending on whether the holder dies or voluntarily cashes in his policy.[141] The distinction between these two amounts rests on the element of volition.[142] Presumably, a policyholder never voluntarily dies, while cashing in the insurance policy is a discretionary decision which rests solely within the policyholder's control. Likewise, withdrawing from a partnership is a decision a partner freely undertakes, but dying, retiring, or becoming disabled are decisions "involuntarily" imposed upon him.[143]

Thus, just as "[a]n insurance policy's value, for the purposes of a marriage dissolution, is its cash value . . .," the *Peddycord* court decided that the value of a partner's interest in a marriage dissolution is determined as if the partner "cashed in" or withdrew from the firm.[144]

The *Peddycord* decision illustrates the difficulty a court faces when valuing an interest in a professional or small partnership business arrangement. The value of most business interests is measured by the fair market value.[145] However, an interest in a professional partnership usually has no hypothetical outside marketplace in which its value can be determined.[146] Instead, it is generally more reliable to ascertain the value according to an internal marketplace which determines what the business or practice is worth to the spouse who will continue to operate in that business.[147] As one author has noted, there is a distinct difference between these two marketplace scenarios:

> What an "outsider" is willing to pay is generally considerably less than what the practice or business will yield to its present proprietor. Many businesses and virtually all practices have a personal element that is non-transferrable. Yet, too great a dis-

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[140]*Peddycord*, 479 N.E.2d at 617.

[141]*Id.* Upon death the holder's beneficiaries receive the full proceeds owed under the insurance contract. If the holder decides to "cash in" his policy before death, he is entitled only to the present value of his policy determined by the premiums previously paid. *Id.*

[142]*Id.*

[143]Retiring may be seen as a voluntary decision, although it is usually tied to a factor over which an individual has no control — his age.

[144]*Peddycord*, 479 N.E.2d at 617.

[145]Walzer, *supra* note 131, at 128.

[146]In the case of a law partnership, the partners must be attorneys who practice law in the partnership. Attorneys cannot form law partnerships with non-attorneys who do not practice law in the partnership. *See* MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 3-103 (codified at IND. CODE ANN. § DR 3-103 (Burns 1984)). For this reason, the partnership in *Peddycord* was the *only* entity that could theoretically buy out the husband's partnership interest.

[147]Walzer, *supra* note 131, at 128.

> count does not do [sic] justice to the non-proprietor spouse, generally the wife. For a divorce is not the same as a sale. The day after the divorce the husband will continue to earn what he previously earned. Some incremental value should be allowed for this continuity of earning power when determining the value of a business or professional practice.[148]

The court of appeals correctly determined that the partnership agreement was the best source for establishing a marketplace for the husband's interest. Deciding which formula to use from the agreement is a matter of choosing which scenario most accurately represents the husband's interest at the time of dissolution. Death benefit formulas are normally funded by insurance policies.[149] For this reason, the value placed on the departing partner's interest is normally higher under the death benefit formula. This money, however, would not be available at the time of a couple's divorce.[150]

Because the withdrawal formula is usually not funded by insurance, it is probably "close to pure book value—the lowest price" of all the categories.[151] The withdrawal formula does not include any additional benefit that would normally be awarded a partner who has lost his status with the partnership under "involuntary" circumstances. Instead, the withdrawal formula represents the present value of his interest—the amount of his capital account minus liabilities owed to the partnership. Under this formula, the other spouse could not take advantage of benefits that arise from factual scenarios that may never occur—namely that the partner dies, retires, or becomes disabled while he is still a partner in the firm. For these reasons, the withdrawal formula represents the most logical formula for calculating a partner's present interest in a partnership at the time of dissolution.

IV. Conclusion

Indiana courts were not willing to assume that a fifty-fifty division of marital property was the proper starting point for purposes of equitable distribution. Although other states have adopted this presumption either by caselaw or by statute, Indiana preferred to give trial judges wide discretion to determine what a fair and reasonable division should be.

In the area of valuation of marital property, Indiana took an interesting approach to how to value jointly held stock and partnership interests. In refusing to allow a wife's shares of stock to be subject to

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[148] *Id.*
[149] *Id.* at 128-29.
[150] *Id.* at 129.
[151] *Id.*

a minority discount, the Indiana Supreme Court noted that although numerically the wife's share was a minority one, the wife and her husband at the date of separation still owned all the stock in joint tenancy. In valuating a husband's professional partnership interest, the Indiana Court of Appeals rejected the death benefit formula and decided that the withdrawal formula was the fairest and most logical way to evaluate the present interest at the time of divorce.

Indiana courts in some ways are maintaining the status quo regarding the best way to divide marital property, and are developing some trends in the area of valuation of special kinds of marital property. Practitioners and divorcing couples should be aware of the trends in marital property, considering the wide discretion given to trial judges to divide property as well as the different types of marital property that can be divided.

Developments in Insurance Law: Agents' and Brokers' Liability

Donna H. Fisher*

During this survey period, Indiana courts again had the opportunity to address a myriad of insurance-related issues.[1] One issue, in particular, received the repeated attention of our courts. That issue concerned the duties and related liabilities of insurance agents and brokers to their principals, including both insureds and insurers.

Traditionally, insurers use the terms "agents" and "brokers" to describe "field" personnel responsible for selling policies. The two terms are distinguished by the activity undertaken. Generally, an "agent" is a representative of the insurer and a "broker" represents the insured for most purposes.[2] A "broker" is essentially an independent contractor "who acts as a middleman between the insured and the insurer, and who solicits insurance from the public under no employment from any special company, and who, upon securing an order, places it with a company selected by himself."[3] Most often, the insured bears the risk of a broker's error while the insurer bears the risk of its agent's negligence.[4]

Until 1977, Indiana distinguished between agents' and brokers' liability by statute. Indiana Code section 27-1-15-1(d) provided:

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[1]This article deals only with insurance law cases during the survey period in the area of agents' and brokers' liability. Other cases of note, however, should not go unmentioned. *See, e.g.*, B & R Farm Servs. v. Farm Bureau Mut. Ins., 483 N.E.2d 1076 (Ind. 1985) (products hazard exclusion does not exclude coverage for product accidentally released into property of others); Eli Lilly & Co. v. Home Ins. Co., 482 N.E.2d 467 (Ind. 1985) (Indiana adopts multiple-trigger interpretation of comprehensive general liability injury/occurence policy language); Allstate Ins. Co. v. Boles, 481 N.E.2d 1096 (Ind. 1985) ("household exclusion" clause of automobile liability policy does not contravene public policy); Loving v. Ponderosa Sys., Inc., 479 N.E.2d 531 (Ind. 1985) (distribution of insurance proceeds among lessor, lessee, and mortgagee); Erie Haven, Inc. v. Lippman Refrigeration Construction, 486 N.E.2d 646 (Ind. Ct. App. 1985) (scope of insurable interest on unexpired lease and leasehold improvements); Hartford Ins. Co. v. Vernon Fire & Casualty Co., 485 N.E.2d 902 (Ind. Ct. App. 1985) (scope of omnibus clause permitted use provision); Milwaukee Guardian Ins., Inc. v. Reichhart, 479 N.E.2d 1340 (Ind. Ct. App. 1985) (duty to defend absent prior notice); State Farm Mut. Auto. Ins. Co. v. Glasgow, 478 N.E.2d 918 (Ind. Ct. App. 1985) (insurer not collaterally estopped from litigating the issue of insured's negligence in proceedings supplemental).

[2]B. Harnett, Responsibility of Insurance Agents and Brokers §§ 2.02-2.07 (Supp. 1984).

[3]3 M. Rhodes, Couch on Insurance 2d § 25:93 (Rev. ed. 1984).

[4]*Id.*

> The word "broker" . . . shall mean an individual, co-partnership, or a corporation authorized by its charter or by law to do an insurance agency business, resident in any state, and not an officer or agent of the company interested, who or which for compensation acts or aids in any manner in obtaining insurance for a person other than himself . . . . An insurance broker is hereby declared to be the agent of the insured for all purposes in connection with such insurance.[5]

In 1977, Indiana Code sections 27-1-15-1 through 27-1-15-9 were repealed[6] and replaced by Indiana Code sections 27-1-15.5-1 through 27-1-15.5-18, which address the licensing of "insurance agents, surplus line agents, insurance consultants, and limited insurance representatives."[7] The term "broker" is not separately defined by the new chapter; rather, the earlier definition of "broker" has been partially incorporated into the definition of "insurance agent." "Insurance agent" is defined by the Code as

> [a]ny individual or corporation who, for compensation, acts or aids in any manner in soliciting applications for a policy of insurance or in negotiating policies of insurance on behalf of an insurer. An individual or corporation not licensed as an insurance agent, surplus lines insurance agent, or limited insurance representative who solicits a policy of insurance on behalf of others or transmits for others an application for a policy of insurance to or from an insurance company, or offers or assumes to act in the negotiations of such insurance, shall be an insurance agent within the intent of this chapter, and shall thereby become liable for all the duties, requirements, liabilities, and penalties to which such licensed agents are subject.[8]

Despite this change, post-1977 Indiana case law has continued to distinguish between "brokers" and "agents" and to apportion liability based upon a distinction between the terms.[9] Such case law has confirmed

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[5]IND. CODE § 27-1-15-1(d) (1971).

[6]IND. CODE §§ 27-1-15-1 to 27-1-15-9 were repealed by 1977 Ind. Acts, Pub. L. 280, § 3.

[7]IND. CODE § 27-1-15.5-1 (1982).

[8]*Id.*

[9]*See, e.g.*, Monarch Ins. Co. v. Siegel, 625 F. Supp. 693 (N.D. Ind. 1986); Augustine v. First Fed. Sav. & Loan of Gary, 270 Ind. 238, 384 N.E.2d 1018 (1979); Town & Country Mut. Ins. Co. v. Savage, 421 N.E.2d 704 (Ind. Ct. App. 1981); Stockberger v. Meridian Mut. Ins. Co., 182 Ind. App. 566, 395 N.E.2d 1272 (1979); Bulla v. Donahue, 174 Ind. App. 173, 366 N.E.2d 233 (1977). The *Bulla* and *Stockberger* decisions do not rely upon Indiana statute as authority for their finding that "[a]n insurance agent or broker who undertakes to procure insurance for another is an agent of the proposed insured . . . ." *Bulla*, 174 Ind. App. at 126, 366 N.E.2d at 236. The decisions cite instead J. APPLEMAN, INSURANCE LAW & PRACTICE, as well as C.J.S., AM. JUR. 2D and A.L.R.3D.

that although the definitions of the terms agent and broker appear clear, the lines distinguishing the two roles are often hazy and are highly dependent upon the facts of each case. The determination of legal responsibility for agents' and brokers' acts rests more with the extent of and authority behind such acts than with the pure application of either term. This year's survey cases concerning agents' and brokers' liability are instructive in continuing to define the respective duties of agents and brokers and the extent to which insurance companies will be bound by breach of such duties.

A. Breach of Duty to Procure Insurance Coverage

Several cases during this survey period examine the insurance agent's duties in regard to procuring insurance on behalf of a future insured. In *Monarch Insurance Co. v. Siegel*,[10] the United States District Court for the Northern District of Indiana found that the insurance company was not liable for the acts of an independent insurance broker through whom its insured had placed a policy of aircraft insurance.[11]

Defendant Siegel, the co-owner of a Piper Turbo Seminole aircraft, had originally purchased a Global Insurance policy on his airplane through Dickens & Company, insurance brokers, and Dickens' agent, Terry Campton. In September 1982, Siegel conferred with Campton as to whether his pilot, Ackerman, would meet the Global policy's coverage requirements. Siegel advised Campton that Ackerman had 250 hours of multi-engine flight time, although, in fact, Ackerman had not. Based upon Siegel's representation, Campton informed Siegel that Ackerman would qualify with five additional flight hours.

In 1983, Siegel cancelled the Global policy and arranged with Campton to purchase a Monarch policy providing similar coverage. In his application, Siegel represented that the plane was for "[p]rivate business and pleasure"[12] and not rental use. The Monarch policy required, among other things, that the aircraft pilot have 250 hours of flying time in multi-engine aircraft.

In February 1983, four couples, including pilot Ackerman and his wife, rented the Seminole from Siegel for a flight to Tennessee. Ackerman piloted the aircraft and, upon return, crash-landed at Indianapolis, injuring his passengers.

Stockberger, 182 Ind. App. at 576, 395 N.E.2d at 1279; *Bulla*, 174 Ind. App. at 126, 366 N.E.2d at 236. In each of these cases, except *Monarch*, the facts concerned insurance policies issued prior to the 1977 statutory change. *Monarch*, which concerned a policy issued in 1983, cited *Stockberger* and *Augustine* in continuing to recognize the "broker"/ "agent" distinction. 625 F. Supp. at 697.

[10]625 F. Supp. 693 (N.D. Ind. 1986).

[11]*Id.*

[12]*Id.* at 696.

Monarch filed a declaratory judgment action seeking a determination that it had no coverage for the occurrence.[13] In his defense, Siegel raised the issue of whether Campton and Dickens & Company had adequately discharged their duty to him in procuring the Monarch policy and whether Monarch was responsible for the negligent acts of Dickens & Company and Campton, Monarch's "agent."[14] After a brief analysis, the district court held that Monarch was not liable.[15] It found that because Campton placed insurance with several companies, he was an "insurance broker" and was thus an "independent contractor" working for the insurer.[16] The court also held that any negligence on the part of Campton, as an independent contractor, or any statement made by Campton in regard to the Monarch policy would not bind the insurance company.[17]

The court next examined the issue of whether Campton breached a duty to Siegel in failing to warn him that Ackerman was not covered by the Monarch policy. The court noted that in Indiana, an agent who undertakes to procure insurance and "through fault and neglect fails to do so, . . . may be liable for breach of contract or for negligent default in the performance of a duty imposed by contract."[18] The court also noted the corresponding duty "on the part of the insured to provide the agent or broker with the information necessary to implement the policy[.]"[19] The court, therefore, found that the issue of Campton's and Dickens & Company's negligence was a factual issue which would turn upon the jury's finding as "to what Campton knew and what Siegel told him prior to the procurement of the Monarch policy."[20] Because of this fact question, a trial was necessary, and summary judgment was denied.

In *Nahmias Realty, Inc. v. Cohen*,[21] the Indiana Court of Appeals had occasion to address a similar procurement issue. In *Nahmias*, the plaintiff, Nahmias, owner of a commercial building, relied upon defendants, Alvin Cohen and Affiliated Agencies, Inc., to procure adequate fire insurance for his building. Affiliated placed Nahmias' coverage through American Insurance Company, but through error, failed to procure replacement cost coverage. Affiliated also failed to inform Nah-

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[13]*Id.*

[14]*Id.* at 697, 699, 702.

[15]*Id.* at 697.

[16]*Id.* The court cited as authority Stockberger v. Meridian Mut. Ins. Co., 182 Ind. App. 566, 395 N.E.2d 1272 (1979) and other cases decided prior to the 1977 changes in the Indiana Code.

[17]*Monarch*, 625 F. Supp. at 697.

[18]*Id.* at 702 (citing Stockberger v. Meridian Mut. Ins. Co., 182 Ind. App. 566, 576, 395 N.E.2d 1272, 1279 (1979)).

[19]*Id.*

[20]*Id.* at 703.

[21]484 N.E.2d 617 (Ind. Ct. App. 1985).

mias that Nahmias could obtain building and fire code update coverage under its American policy.

Nahmias' building burned in 1977 and Nahmias decided to repair. American denied replacement coverage and eventually Nahmias bought another building, sold his condemned, damaged building to the city of Indianapolis for $250,000, and sued American and Affiliated.[22] The insurer, American, entered into a covenant not to sue, paying Nahmias $357,000. At trial, Affiliated admitted liability; however, the trial court determined that Nahmias had been fully compensated by American and awarded no damages.[23] Nahmias appealed, seeking the full cost of repair to its building.[24]

The court of appeals found that an insurance agent's negligent failure to procure insurance renders the agent liable for "*any* damage resulting from his failure."[25] The court held that the measure of damages should, therefore, be "(a) the amount which would have been due under the policy which Affiliated should have obtained . . . , plus (b) any consequential damage resulting from Affiliated's breach of duty, less (c) the cost of unpaid premiums . . . ."[26] The court noted that it was uncontested that Nahmias had wanted to restore its building and that "[b]ut for Affiliated's neglect, Nahmias would have so recovered."[27]

Noting that replacement cost coverage was not a pure indemnity contract, the court held that Nahmias was entitled to the full cost of repairs.[28] This was true despite the fact that Nahmias had failed to repair his building, a condition precedent to recovering replacement costs under his American policy. The court found that policy defenses were not available to Affiliated, "a non-party to the insurance contract."[29]

The court further found that Nahmias was also entitled to the cost to bring "both the damaged and undamaged parts of Nahmias' reconstructed building into compliance with all applicable building codes . . . ."[30]

The *Nahmias* decision does not address the nature of the relationship between Affiliated and American and, therefore, leaves unanswered the question of whether Affiliated's negligence would have been imputed to American had American not entered into a covenant with Nahmias. Further, the opinion contains little factual background for its finding

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[22]*Id.* at 619.

[23]*Id.*

[24]*Id.*

[25]*Id.* at 620 (citing Bulla v. Donahue, 174 Ind. App. 123, 126, 366 N.E.2d 233, 236 (1977)) (emphasis added).

[26]*Id.* at 620-21 (citations omitted).

[27]*Id.* at 621.

[28]*Id.* at 624.

[29]*Id.* at 623.

[30]*Id.* at 624.

that Affiliated breached its duty and was negligent in failing to advise Nahmias that Nahmias could obtain code update coverage by purchasing a waiver of American's exclusion concerning such coverage.[31] Although prior Indiana case law has recognized an affirmative duty on the part of an agent to make inquiries into all necessary information concerning desired coverage, such cases have based this duty upon either a "long-established relationship of entrustment . . . between the insured and the agent"[32] or upon facts known to the agent which would put the agent on notice that certain coverages would be necessary.[33] On its face, *Nahmias* holds that an agent has an affirmative duty to advise a proposed insured who relies on its services of all coverages available or to face the risk that the insured will claim the benefit of such coverage after a loss. Under the facts of *Nahmias*, it appears that the insured will not have to claim or establish that it would have agreed to purchase the coverage if offered.

In *State Farm Life Insurance Co. v. Fort Wayne National Bank*,[34] the Indiana Court of Appeals found an insurer and its agent liable to a decedent's estate for failure to place ownership of a life insurance policy in the proper party.[35] In 1975, James Zimmerman purchased life insurance from Robert Houser, State Farm's local agent, and State Farm's agency manager, Vernon Deutsch. James Zimmerman was ninety-five percent owner of Zimmerman's Excavating Service with his son, Steven. The acknowledged purpose of the life insurance policy was to fund Steven's purchase of outstanding stock in the event of his father's death. The policy named James Zimmerman as owner. When he died, the policy proceeds passed through James' estate with a tax consequence of approximately $34,000 and resulted in an insufficient balance to cover the stock purchase. This deficit would not have occured if the policy had been credited to the ownership of Steven, who paid all premiums.

The personal representatives of the estate sued State Farm and its agents, contending that they were negligent in failing to accomplish the undisputed purpose of the policy.[36] Neither Houser nor Deutsch was permitted to testify against the estate pursuant to Indiana's dead man

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[31]*Id.* at 621, 623.

[32]United Farm Bureau Mut. Ins. Co. v. Cook, 463 N.E.2d 522, 528 (Ind. Ct. App. 1984) (agent had duty to inquire into information necessary for coverage and to inform the insured that he could not procure the requested coverage).

[33]*See, e.g.*, Automobile Underwriters, Inc. v. Hitch, 169 Ind. App. 453, 349 N.E.2d 271 (1976) (agent who had knowledge that proposed insured, a service station operator, offered shotgun shells for sale at station, was negligent in failing to procure liability insurance covering incident in which customer was injured by defective shell).

[34]474 N.E.2d 524 (Ind. Ct. App. 1985).

[35]*Id.*

[36]*Id.* at 526.

statutes.[37]

Plaintiffs offered evidence, "including a retail credit report and the testimony of Steven's wife," which the court found established that State Farm knew the policy was meant to fund the stock purchase.[38] Further, the plaintiff provided expert testimony which established that State Farm's act in failing to properly identify the policy owner was "inconsistent with the skill, knowledge, diligence and care ordinarily exercised in the insurance industry."[39]

State Farm raised the defense of contributory negligence on the part of James Zimmerman.[40] The appellate court found, however, that Zimmerman "was not familiar with the legal means" to accomplish the intended purpose of his insurance "but relied on State Farm to properly execute his intentions," and therefore was not negligent.[41]

In *State Farm*, the court identified Houser and Deutsch as State Farm's local agents and, therefore, incompetent witnesses based upon the fact that they "actively negotiated" a contract with the deceased on their principal's (State Farm's) behalf.[42] Were Houser and Deutsch held to be independent brokers, thus Zimmerman's agents, the results may have been different in that their testimony would not automatically be incompetent under Indiana Code section 34-1-14-8, nor would it automatically be classified as "adverse" and improper under Indiana Code section 34-1-14-6.[43]

In *Pekin Insurance Co. v. Wheeler*,[44] the court of appeals found

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[37]Indiana statutes provide that a witness is incompetent to testify against an estate if -

a. The action is one in which an administrator or executor is a party or one of the parties is acting in the capacity of an administrator or executor;

b. The action involves matters which occurred within and during the lifetime of the decedent;

c. The action is a case in which a judgment or allowance may be made or rendered for or against the estate represented by such executor or administrator;

d. The witness is a necessary party to the issue and not merely a party to the record;

e. The witness is adverse to the estate and must testify against the estate.

Ind. Code § 34-1-14-6 (1982). The section that involves contracts is as follows:

> No person who shall have acted as an agent in the making or continuing of a contract with any person who may have died, shall be a competent witness, in any suit, upon, or involving, such contract, as to matters occurring prior to the death of such decedent, on behalf of the principal to such contract, against the legal representatives, or heirs of the decedent, unless he shall be called by such heirs or legal representatives.

Ind. Code § 34-1-14-8 (1982).

[38]*State Farm*, 474 N.E.2d at 528.

[39]*Id.*

[40]*Id.*

[41]*Id.*

[42]*Id.* at 527.

[43]*See supra* note 37.

[44]493 N.E.2d 172 (Ind. Ct. App. 1986).

that an insurance policy "never came into existence" after an agent signed the insured's name to an application absent the insured's knowledge.[45] In *Pekin*, the plaintiff, Pekin Insurance Company, brought suit, claiming that its insureds, the Wheelers, were covered under another valid policy issued by Celina Insurance Company.[46] The Wheelers had originally purchased a Republic Mutual Insurance policy (a Celina Group member), which had an expiration date of March 1, 1978, through McClain, an independent insurance agency. In February 1978, McClain contacted Celina about issuing a second policy to be effective on the expiration of the first. Celina suggested that McClain forward an application, but cautioned that acceptance would be dependent upon a driving record check. Thereafter, someone at McClain signed the Wheelers' name to an application and forwarded it to Celina.

In the interim, the Wheelers contacted another agency and purchased automobile coverage through Pekin Insurance to replace their Republic policy.

Celina issued a policy to the Wheelers on the basis of the application signed by McClain, completed its investigation into Jimmie Wheeler's questionable driving record, and notified McClain that it was cancelling the policy effective April 20, 1978. In 1982, Pekin named Celina as a defendant in a lawsuit concerning an accident on April 11, 1978, involving Jimmie Wheeler. Pekin claimed Celina had coverage. Through discovery, Celina learned that the Wheelers had not signed the Celina application nor were they aware the application had been made. Celina counterclaimed against Pekin and sought a declaratory judgment that Celina's policy was void from its inception.[47]

The sole issue addressed by the court of appeals was whether McClain had the authority to bind Celina and the Wheelers to an insurance contract. The court held it did not.[48] The court found that Celina had no duty to ascertain the extent of McClain's authority from Wheeler in that Jimmie Wheeler's forged signature was on the application and Celina was entitled to "believe it was dealing with a bona fide applicant."[49] Further, the court found that because there was no "meeting of the minds" between Celina and the Wheelers, no contract had ever been formed.[50]

The case presents an interesting reversal of a fact situation. Here, the issue was an unauthorized attempt to procure rather than a failure to procure coverage. The case invites speculation as to whether McClain would have been liable for failure to procure automobile insurance

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[45] *Id.* at 174.
[46] *Id.* at 173-74.
[47] *Id.* at 173.
[48] *Id.* at 174.
[49] *Id.* at 173.
[50] *Id.* at 174.

coverage had it not contacted Celina and had the Wheelers' Republic policy expired without replacement. Although it has been held that an agent has no obligation to renew term insurance,[51] that finding would be dependent upon facts concerning the Wheelers' reliance on McClain.

B. Insurer's Liability for Punitive Damages Assessed Against Its Agents, Brokers, and Claims Representatives

In *Liberty Mutual Insurance Co. v. Parkinson*,[52] plaintiff Mary Ann Parkinson sued Liberty Mutual Insurance Company for punitive damages for its failure to settle an uninsured motorist claim.[53] Plaintiff Parkinson was involved in a hit-and-run collision and reported the incident to Liberty Mutual, her insurer. She asked Liberty Mutual's claim representative about her coverage for the accident and the effect of her claim upon her insurance rates. Liberty's claim representative informed Parkinson "that her rates would go 'sky high'."[54] She was also told that her policy coverage did not include the cost of a rental car.

Parkinson relied on this information, hired an attorney, and attempted to sue the hit-and-run driver, who could not be located. Parkinson then saw a second attorney, who told her that she was covered under the uninsured motorist provisions of her Liberty Mutual policy. Parkinson's attorney eventually settled her uninsured motorist and property damage claims with Liberty Mutual for approximately $6,000. In settling, however, Parkinson reserved her right to sue Liberty Mutual for bad faith and eventually did so.[55] At trial, the court awarded Parkinson compensatory damages of $2,000 and punitive damages of $40,000.[56] Liberty Mutual appealed, alleging, among other errors, that the award of compensatory damages was contrary to law in that Parkinson had been fully compensated for her loss pursuant to the settlement agreement. Liberty Mutual also claimed that the trial court's award of punitive damages was contrary to law.[57]

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[51]*See* 16A J. Appleman, Insurance Law & Practice § 8832 (1981 & Supp. 1986).

[52]487 N.E.2d 162 (Ind. Ct. App. 1985).

[53]*Id.* at 163.

[54]*Id.*

[55]*Id.*

[56]*Id.*

[57]*Id.* Liberty Mutual also contended that Indiana did not recognize the independent tort of bad faith, upon which Parkinson's suit was premised. The court found that while the tort had been adopted by many jurisdictions, it had not been specifically adopted in Indiana. *Id.* at 164-65. The court, however, held that Indiana's "special contractual remedy" providing punitive damages when an insurer's breach of contract "is accompanied by an independent tort or where a serious wrong of a tortious nature was committed and the public interest would be served by the deterrent effect of punitive damages" was sufficient to support plaintiff's cause of action. *Id.* (citing Travelers Indem. Co. v. Armstrong, 442 N.E.2d 349 (Ind. Ct. App. 1982)).

The court of appeals found that although Parkinson may have settled for "all benefits due under the policy, [she] did not receive all she was due under the contract."[58] The court noted that the contract "contained a promise, implied in law, that Liberty Mutual would deal fairly with [Parkinson] in settlement of any claim,"[59] and that Liberty Mutual breached this promise "by discouraging Parkinson from filing a claim that could not in good faith be disputed."[60] Parkinson was therefore entitled to compensation for the breached implied promise, including damages incurred by the delay in settlement.[61]

The appellate court also reaffirmed the trial court's award of punitive damages against Liberty Mutual based upon the claim representative's acts of dissuading Parkinson from filing her claim and misrepresenting the terms of the policy.[62] As an additional basis for the punitive damage award, the court of appeals cited Liberty Mutual's practices of instructing its representatives "never to admit coverage or volunteer information about a policy to the policyholder," and of providing no training for its representatives in policy interpretation.[63]

The court found that although it may be sound business practice for representatives not to volunteer coverage information, "*at a minimum*, . . . a claims representative should assist a policyholder in filing a claim."[64] The court held that Liberty Mutual's failure to assist Parkinson, coupled with the "use of 'scare tactics' " was "convincing evidence of oppression [which justified] the imposition of punitive damages."[65]

Liberty Mutual petitioned for rehearing, contending that the appellate court failed to address the issue of the company's liability for the acts of its claims representative.[66] The court denied Liberty's petition for rehearing, noting that Liberty's corporate policy of "intentionally keep[ing] claims representatives ignorant of uninsured motorist coverage," together with other evidence, supported the award.[67]

In *Bymaster v. Bankers National Life Insurance Co.*,[68] applicants for a life insurance policy sued both the insurance company and the agent for failure to refund their complete advance premium.[69] On Feb-

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[58] *Id.* at 165.
[59] *Id.*
[60] *Id.*
[61] *Id.*
[62] *Id.* at 166.
[63] *Id.*
[64] *Id.* (emphasis added).
[65] *Id.*
[66] Liberty Mut. Ins. Co. v. Parkinson, 491 N.E.2d 229, 230 (Ind. Ct. App. 1986).
[67] *Id.*
[68] 480 N.E.2d 273 (Ind. Ct. App. 1985).
[69] *Id.* at 276.

ruary 6, 1979, plaintiffs Glenn and Rosemary Bymaster applied for two $100,000 Bankers National Life (Bankers) policies and prepaid the first year premiums. They made application for their policies through defendant Pat Mattmann. Mattmann was an officer of Continental National Corporation (CNC).

In 1977, CNC had entered into a general agent's agreement with Bankers to sell its policies as an independent contractor. Later, Bankers entered into a licensing agreement identifying CNC as "general agent." Mattmann was appointed as CNC's agent to solicit sales of Bankers policies and was paid by CNC.

The agreement between Bankers and CNC required that all premiums collected by CNC be kept in a trust account due and payable immediately to Bankers, although only ten percent was required to be forwarded immediately to Bankers. No commission was earned by CNC until it delivered the policy to the insured.

When Mattmann made his sales presentation to the Bymasters, he represented that he was Bankers' agent. He had them fill out an application, which revealed that Mrs. Bymaster had a history of cancer and that Mr. Bymaster had had heart problems. Nonetheless, Mattmann accepted their first year premium payment and gave them a conditional receipt signed by himself and Bankers' secretary. Mattmann also gave the Bymasters CNC's written guarantee that their premiums would be returned if the policies were not issued. CNC then forwarded ten percent of the Bymasters' premium to Bankers.

The Bymasters' application was denied by Bankers in May 1979, and ten percent of their premium was returned from Bankers in June. They were instructed by Bankers to contact CNC regarding the balance.

At the time it returned the Bymasters' ten percent premium, Bankers had already terminated its agency agreement with CNC and had lodged a formal complaint against CNC with the Illinois Insurance Commissioner, alleging that "CNC had repeatedly misrepresented the terms of certain policies and had repeatedly violated regulations concerning the return of monies held in their premium trust accounts."[70]

When the Bymasters demanded their premium from CNC, Mattmann told them he was also an agent for Equitable Life Insurance Company and could transfer their premiums to that account. The Bymasters again signed applications, but demanded that their premium be returned when they learned they would have to have additional medical examinations.

Bankers did not learn that the Bymasters had not received the full return of their premium until eight months after it had sent the Bymasters the ten percent check. Bankers knew of the intervening transaction with Equitable and assumed the refund problem had been resolved.

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[70] *Id.* at 275.

CNC subsequently filed bankruptcy and the Bymasters sued CNC, Mattmann, Bankers, and Equitable for actual and punitive damages.[71] At trial, the jury awarded verdicts against CNC and Mattmann for actual and punitive damages, and against Bankers for actual damages in the amount of $28,353.[72] Bankers obtained a judgment on the evidence in its favor on the punitive damage issue.[73] The Bymasters appealed the grant of judgment on the evidence for Bankers, and Bankers cross-appealed the award of compensatory damages.[74]

The Bymasters claimed that the trial court erred in failing to award punitive damages against Bankers. They argued that "CNC and Mattmann were Bankers' agents and were permitted to solicit the sale of policies, collect premiums, . . . issue conditional receipts, . . . and maintain a premium trust account" on behalf of Bankers.[75] The court of appeals found that no "fraud or other substandard conduct" occurred by CNC, Mattmann, or Bankers in soliciting the policies or processing applications.[76] In other words, no substandard conduct occurred while CNC and Mattmann were acting as Bankers' agents. The court noted that the fraud allegation pertained only to the retention of the ninety percent premium balance, an act that occurred after Bankers' agency contract with CNC had terminated.[77] The court further indicated that even if the agency relationship were not terminated, Bankers would not automatically be subject to a punitive damage award if CNC and Mattmann had engaged in fraud.[78] Citing *Husted v. McCloud*,[79] the court reiterated that "where an agent commits independent fraud for his own benefit, he ceases to act as an agent for his principal."[80] The court held that because Bankers never condoned CNC's failure to return the Bymasters' premium, Bankers was not liable for punitive damages.[81]

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[71]*Id.* at 276.

[72]*Id.*

[73]*Id.*

[74]*Id.*

[75]*Id.* The Bymasters also argued that Bankers had been reckless in employing CNC and Mattmann and was, therefore, liable for punitive damages under the authority of Orkin Exterminating Co. v. Traina, 461 N.E.2d 693 (Ind. Ct. App. 1984) (later reversed on appeal by the Indiana Supreme Court, 486 N.E.2d 1019 (Ind. 1986)).

[76]*Bymaster*, 480 N.E.2d at 278.

[77]*Id.*

[78]*Id.* at 279.

[79]450 N.E.2d 491 (Ind. 1983). In *Husted*, one law firm partner defrauded a client and the law partnership by converting the client's funds. The Indiana Supreme Court found that the innocent partner, although liable for actual damages, could not be assessed punitive damages. *Id.*

[80]*Bymaster*, 480 N.E.2d at 279.

[81]*Id.*

Developments in Employment Discrimination Law

Lynn Brundage Jongleux*

During the survey period, the United States Supreme Court and the United States Court of Appeals for the Seventh Circuit decided a number of significant employment discrimination cases. This Article will survey those cases that are most interesting and significant to Indiana attorneys practicing in that area. Developments under Title VII of the Civil Rights Act of 1964,[1] particularly the subject of sexual harassment, will be the primary focus.

I. Sexual Harassment

Meritor Savings Bank v. Vinson[2] marks the Supreme Court's first opinion on the subject of sexual harassment in the workplace. The Equal Employment Opportunity Commission (EEOC) and most courts that have considered the issue have found sexual harassment to be a violation of Title VII.[3] There nevertheless have been many unresolved issues, such as the extent of an employer's liability for actions of its supervisors.[4] The Court in *Vinson* resolved some issues, but left others for a later day.

Mechelle Vinson was hired in 1974 by Sidney Taylor, a vice-president of what later became Meritor Savings Bank, to be a teller trainee in the branch of which Taylor was the manager. Vinson worked in the same branch for four years, moving through the ranks as teller, head teller and assistant manager. In September 1978, Vinson left work to take an indefinite sick leave. She was terminated by the bank in November 1978 for abuse of that leave.[5]

Vinson filed suit against the bank and Taylor under Title VII, claiming that she had been sexually harassed by Taylor throughout the four years of her employment.[6] She sought injunctive relief, compensatory and punitive damages, and attorney's fees.[7]

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[1]42 U.S.C. §§ 2000e-2000e-17 (1982) [hereinafter Title VII].

[2]106 S. Ct. 2399 (1986).

[3]*See, e.g.*, the EEOC's guidelines on sexual harassment, 29 C.F.R. § 1604.11 (1986); Phillips v. Smalley Maintenance Serv., Inc., 711 F.2d 1524 (11th Cir. 1983); Katz v. Dole, 709 F.2d 251 (4th Cir. 1983); Bundy v. Jackson, 641 F.2d 934 (D.C. Cir. 1981).

[4]Jongleux, *Developments in Employment Discrimination Law*, 19 Ind. L. Rev. 215, 225-26 (1986).

[5]*Vinson*, 106 S. Ct. at 2402.

[6]*Id.*

[7]*Id.* Vinson initially did not seek reinstatement nor allege that her discharge violated Title VII. Shortly before trial, her attempt to amend her complaint to add those elements

At trial, the district court heard eleven days of testimony.[8] Vinson testified that shortly after she had completed the teller trainee program, Taylor had invited her to dinner and suggested that they have a sexual relationship.[9] She testified that she had declined at first, but then acquiesced for fear of losing her job.[10] She testified that over the next several years, Taylor demanded sexual favors on numerous occasions, fondled her in front of other employees, and forcibly raped her on several occasions.[11]

Taylor flatly denied that he had sexually harassed or engaged in a sexual relationship with Vinson.[12] He claimed that Vinson's accusations were motivated by a business dispute.[13] The bank's evidence was that it had no knowledge of Vinson's being sexually harassed, and that if harassment had occurred, it was without the bank's consent or approval.[14]

The district court ruled against Vinson, finding that she "was not the victim of sexual harassment or sexual discrimination" when she was employed by the bank.[15] The court did not resolve the credibility dispute between Vinson and Taylor. Rather, its decision was based on a finding that if there had been a sexual relationship, it was voluntary and had "nothing to do with [Vinson's] continued employment at [the bank] or her advancement or promotions at that institution."[16] The district court apparently believed that sexual harassment, in order to be actionable, must be accompanied by tangible job detriment.[17]

Even though the trial court found no sexual harassment, it nevertheless went on to discuss the bank's potential liability for Taylor's acts. The court noted that the bank had an express policy against discrimination and an internal process by which complaints could be remedied.[18] It found that since Vinson had not notified the bank of the alleged sexual harassment through the procedure or otherwise, the bank was without notice and not liable for Taylor's actions.[19]

Vinson appealed to the United States Court of Appeals for the District of Columbia Circuit.[20] The circuit court, drawing from its earlier deci-

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and non-federal claims was denied by the district court. Vinson v. Taylor, 753 F.2d 141, 143 n.12 (D.C. Cir. 1985).

[8] *Vinson*, 106 S. Ct. at 2402.

[9] *Id.*

[10] *Id.*

[11] *Id.*

[12] *Id.* at 2403.

[13] *Id.*

[14] *Id.*

[15] Vinson v. Taylor, 23 Fair Empl. Prac. Cas. (BNA) 37, 43 (D.D.C. 1980).

[16] *Id.* at 42 (footnote omitted).

[17] *Id.*; 106 S. Ct. at 2403.

[18] *Vinson*, 106 S. Ct. at 2403.

[19] *Vinson*, 23 Fair Empl. Prac. Cas. at 41.

[20] Vinson v. Taylor, 753 F.2d 141 (D.C. Cir. 1985).

sion in *Bundy v. Jackson*,[21] described two types of sexual harassment. The first is the so-called quid pro quo type of harassment, involving conditioning of concrete employment benefits on sexual favors. The second is the hostile environment type of sexual harassment, involving no economic detriment but rather affecting the work environment to such an extent that it becomes hostile or offensive.[22] The circuit court concluded that Vinson had stated a claim for the hostile environment kind of sexual harassment and remanded because the district court had not considered whether the testimony described that kind of violation.[23]

The circuit court also held that Vinson's voluntariness was not relevant to a finding that sexual harassment had occurred.[24] The appropriate inquiry was whether Taylor had made toleration of his sexual advances a condition of Vinson's employment.[25] The court, uncertain what the district court meant by its voluntariness conclusion, speculated that certain evidence that had been admitted by the district court about Vinson's "dress and personal fantasies" had led that court to conclude that her participation in the sexual relationship had been voluntary.[26] The circuit court concluded that that evidence "had no place in this litigation."[27]

The D.C. Circuit rejected the district court's conclusion that the bank could not be liable for Taylor's actions because it had no notice of them.[28] Instead, the court concluded that general Title VII principles should be applied to impose vicarious liability on employers for sexual harassment, just as it is imposed for other types of discrimination.[29] The court relied in part on Title VII's definition of employer as including "agents," and held that Taylor was an agent of the bank with respect to the other employees in the branch of which he was manager.[30] Ironically in light of the EEOC's arguments before the Supreme Court, the court attached "considerable weight" to the EEOC's guidelines, which provide for liability "regardless of whether the specific acts complained of were authorized or even forbidden by the employer and regardless of whether the employer knew or should have known of their occurrence."[31]

The Supreme Court thus had before it several issues. First, the divergence between the district court and the circuit court decisions raised

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[21] 641 F.2d 934 (D.C. Cir. 1981).

[22] *Vinson*, 753 F.2d at 144-45 (citing *Bundy*, 641 F.2d 934; Barnes v. Costle, 561 F.2d 983 (D.C. Cir. 1977)); *see also* Jongleux, *supra* note 4, at 225 n.94.

[23] *Vinson*, 753 F.2d at 145 (footnotes omitted).

[24] *Id.* at 146.

[25] *Id.* ("[A] victim's capitulation to on-the-job sexual advances cannot work a forfeiture of her opportunity for redress.").

[26] *Id.* at n.36.

[27] *Id.*

[28] *Id.* at 147.

[29] *Id.* at 149.

[30] *Id.* at 147-48.

[31] *Id.* at 149 (quoting 29 C.F.R. § 1604.11(c) (1984)).

the issue of whether a hostile environment created by sexual harassment without tangible economic loss was a violation of Title VII. The second issue presented to the Court was whether the fact that Vinson voluntarily entered into the sexual relationship with Taylor precluded her succeeding in her Title VII case. Finally, and most significantly, the Court was presented with the issue of whether an employer can be liable for actions of a supervisor that create a hostile working environment if the supervisor's behavior has not been brought to the employer's attention.[32]

The Court first ruled unequivocally that no tangible economic loss was necessary for sexual harassment to constitute a violation of Title VII.[33] The Court first looked to the statute itself and found no indication that Congress intended to limit Title VII's scope as urged by the bank.[34] The Court then approved the definition of sexual harassment in the EEOC's guidelines.[35] Reviewing the "substantial body of judicial decisions and EEOC precedent" upon which the EEOC's guidelines were based, the Court concluded that the EEOC's guidelines "were fully consistent with . . . existing law" in providing that "hostile environment" sexual harassment is sex discrimination.[36] Thus, "a plaintiff may establish a violation of Title VII by proving that discrimination based on sex has created a hostile or abusive work environment."[37] But the Court went on to caution that sexual harassment must be "sufficiently severe or pervasive 'to alter the conditions of [the victim's] employment and create an abusive work environment' " in order to constitute actionable sexual harassment.[38]

The Court then examined two alternative bases for the district court's conclusion that Vinson had not been the victim of sex discrimination, to determine whether that conclusion had disposed of Vinson's claims. It held that both bases were erroneous as a matter of law and upheld the appellate court's order to remand.[39] First, the trial court had failed to consider a hostile environment theory of sexual harassment because of an erroneous view that some economic effect on Vinson's employment was necessary.[40] A second possible basis for the district court's decision

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[32]Some courts, while imposing strict liability in quid pro quo cases, have applied a "knew or should have known" standard in hostile environment cases. *See, e.g.*, Katz v. Dole, 709 F.2d 251 (4th Cir. 1983).

[33]*Vinson*, 106 S. Ct. at 2404.

[34]*Id.* at 2404-05.

[35]*Id.* at 2405.

[36]*Id.* The EEOC's guidelines provide that "unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature" are actionable sexual harassment where "such conduct has the purpose or effect of unreasonably interfering with an individual's work performance or creating an intimidating, hostile, or offensive working environment." 29 C.F.R. § 1604.11(a)(3) (1986).

[37]*Vinson*, 106 S. Ct. at 2405-06.

[38]*Id.* at 2406 (citing Henson v. Dundee, 682 F.2d 897, 902 (11th Cir. 1982)).

[39]*Id.*

[40]*Id.*

may have been its conclusion that Vinson engaged in the relationship with Taylor voluntarily; the Court rejected that basis as well.[41] Instead of focusing on the fact that Vinson was not forced against her will to participate in the sexual relationship, the district court should have determined whether Vinson "by her conduct indicated that the alleged sexual advances were unwelcome . . . ."[42]

Having determined that a remand was necessary, the Court disagreed with the D.C. Circuit's flat prohibition of any evidence of Vinson's provocative dress or speech, and concluded that "such evidence is obviously relevant" to the issue of whether Vinson found Taylor's sexual advances in fact to be unwelcome.[43] In response to Vinson's contention that the relevance of such evidence is outweighed by its prejudicial effect, the Court held that that determination was best made by the district court.[44]

Finally, the Court addressed the question of whether an employer may be held strictly liable for the acts of its supervisors in creating a hostile environment, even if the employer neither knew nor should have known of the misconduct, and whether the existence of an internal grievance procedure and antidiscrimination policy has an effect on that issue. The Court's majority ultimately declined to answer this question, noting that the issue had a "rather abstract quality" given the record before the Court.[45] The Court's discussion leading to that conclusion provides helpful guidelines for employers seeking to prevent liability for sexual harassment.

The Court first addressed the EEOC's arguments. In an apparent departure from its own guidelines,[46] the EEOC, appearing as amicus curiae, argued that strict liability to employers for sexual harassment by supervisors was appropriate in quid pro quo incidents, but not in hostile environment situations.[47] The agency reasoned that Congress had intended that agency principles apply to analyses under Title VII.[48] Application of those principles in hostile environment cases might not lead to a conclusion of liability on an agency theory. Rather, the EEOC advocated that in cases where an employer has available a complaint procedure " 'reasonably responsive to the employee's complaint,' " the employer should be shielded from liability for hostile environment sexual harassment if the employee fails to avail herself of the procedure.[49] Thus, the

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[41] *Id.*

[42] *Id.* The Court recognized that the determination of whether advances were unwelcome "presents difficult problems of proof . . . ." *Id.*

[43] *Id.* at 2407.

[44] *Id.*

[45] *Id.* at 2408.

[46] *See supra* note 36.

[47] *Vinson*, 106 S. Ct. at 2407-08.

[48] *Id.* at 2408.

[49] *Id.* (quoting the EEOC's amicus curiae brief, at 26).

EEOC advocated strict liability for quid pro quo sexual harassment but liability for hostile environment sexual harassment only if the employer has notice or has no internal complaint procedure designed to resolve sexual harassment claims.

While refusing to "issue a definitive rule" on the subject, the Supreme Court did eliminate two possibilities. First, it rejected the circuit court's conclusion that employers are absolutely liable for the actions of their supervisors, "regardless of the circumstances of a particular case."[50] Second, it concluded that an employer's lack of notice of sexual harassment does not protect the employer from liability.[51]

The Court approved the application of agency principles in determining liability under Title VII, concluding that Congress intended to "place some limits on the acts of employees for which employers under Title VII are to be held responsible."[52] There is thus the possibility that the Court would approve an employer's assertion of the common law defense that the supervisor was acting outside the scope of his authority when he committed acts of sexual harassment. The bank argued that it was protected from liability because it had in place an internal grievance procedure and anti-discrimination policy that Vinson failed to use.[53] The Court noted that those facts were relevant but not dispositive.[54] The bank's procedure did not address sexual harassment in particular, and it required complaints to be made to the employee's supervisor.[55] The Court left open the possibility that an employer could insulate itself from liability "if its procedures were better calculated to encourage victims of harassment to come forward."[56]

Four members of the Court joined in a concurring opinion authored by Justice Marshall that did address the issue of employer liability and rejected the EEOC's position.[57] The opinion took issue with the EEOC's position that supervisors' responsibilities begin and end with hiring, firing, and disciplinary decisions, and concluded that "a supervisor is charged with the day-to-day supervision of the work environment and with ensuring a safe, productive, workplace."[58] The concurring justices thus rejected the concept that an employer is not liable for a hostile environment created by sexual harassment unless he has notice. Rather, they advocated the application of the same rule applied in all other Title VII cases: "sexual

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[50]*Id.* at 2409.
[51]*Id.* at 2408.
[52]*Id.*
[53]*Id.* at 2408-09.
[54]*Id.* at 2409.
[55]*Id.* Vinson thus would have had to file her complaint with Taylor, the alleged harasser.
[56]*Id.*
[57]*Id.* (Marshall, J., concurring).
[58]*Id.* at 2410 (Marshall, J., concurring).

harassment by a supervisor of an employee under his supervision, leading to a discriminatory work environment, should be imputed to the employer for Title VII purposes regardless of whether the employee gave 'notice' of the offense.''[59]

The Supreme Court's opinion and the EEOC's position in this case make it clear that in order to avoid liability for sexual harassment, employers should institute internal policies that prohibit discrimination in general and sexual harassment in particular. Internal complaint or grievance procedures should be established and communicated to employees. The identity of the person to whom complaints should be directed should be carefully considered, to avoid the possibility that an employee would have to complain to the alleged harasser. Complaints under these procedures should be investigated and dealt with quickly and appropriately, including taking disciplinary action against violators. Given the EEOC's position in *Vinson*, it is likely that the existence of such policies and procedures can be a significant factor in that agency's handling of a charge of sexual harassment. In addition, the Court's opinion provides a basis for a court in future Title VII litigation to consider the existence of such a procedure and the victim's failure to use it as relevant in a hostile environment case.

In *Zabkowicz v. West Bend Co.*,[60] the Seventh Circuit decided several interesting issues that may arise in sexual harassment cases in federal court. Zabkowicz sued West Bend, her employer, and three supervisors for failing to protect her from sexual harassment by her co-employees after she had notified them that it was taking place.[61] As a result of the harassment, she had developed physical and emotional symptoms that required her to be off work for approximately three months. West Bend eventually put a stop to the harassment after she filed a charge with the EEOC. Zabkowicz then also sued four of her co-workers, West Bend, the three supervisors, and the union representing her, alleging intentional infliction of emotional distress.[62] The parties agreed that the tort claims against the individual co-workers would be severed for trial.[63] Before trial, the trial court dismissed the intentional infliction of emotional distress claims against West Bend and the supervisors on the ground that they were barred by the exclusive remedy provision of Wisconsin's Worker's Compensation Act.[64]

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[59]*Id.* at 2411 (Marshall, J., concurring). The concurring justices acknowledged that there may be circumstances in which some limitation on liability is appropriate, giving the example of a supervisor who commits harassment in an area to which he is not assigned. *Id.*

[60]789 F.2d 540 (7th Cir. 1986). *Zabkowicz* was decided on April 24, 1986, some two months before the Supreme Court's decision in *Vinson*. The Court's decision in *Vinson* did not affect the outcome of any issues in this case.

[61]Zabkowicz v. West Bend Co., 589 F. Supp. 780, 781-82 (E.D. Wis. 1984).

[62]*Zabkowicz*, 789 F.2d at 542.

[63]*Id.*

[64]*Id.* at 543; Wis. Stat. Ann. § 102.03(1) (West 1973).

The sexual harassment issues under Title VII and the Wisconsin Fair Employment Act were tried to the court, which found that West Bend was liable under both statutes for failing to take corrective measures when it became aware of Zabkowicz' co-workers' offenses.[65] The court awarded Zabkowicz back pay of $2,763.20, which represented pay lost during medical leaves.[66] Having decided all of the federal claims in the case, the court then dismissed the state tort law claims against the co-workers on the ground that it had no independent basis of federal jurisdiction over them and should not assert "pendent party" jurisdiction.[67] The court also denied Zabkowicz' petition for attorney's fees, asserting that the fee request of some $127,000 was exaggerated and did not distinguish between hours spent on her Title VII claim and those spent on her other claims.[68] Zabkowicz appealed the dismissal of her tort claims and the denial of attorney's fees.[69]

The Seventh Circuit first examined the question of whether worker's compensation was Zabkowicz' exclusive state remedy for emotional distress occasioned by sexual harassment. Declining to certify the question to the Wisconsin Supreme Court, the Seventh Circuit consulted cases decided under Wisconsin's statute and determined that under Wisconsin law, emotional distress is compensable as an "injury."[70] Definitions and cases under Wisconsin's statute provided that emotional stress or strain without accompanying physical trauma could be deemed covered injuries.[71] Further, noting that the focus is on the injury itself and not the acts causing the injury when determining whether an injury was accidental, the court concluded that Zabkowciz' injuries were accidental, even if the sexual harassment was intentional.[72] Thus, the court upheld the district court's dismissal of those claims as being barred under Wisconsin law.[73]

The court then turned to the pendent parties doctrine. Issues of pendent jurisdiction are difficult enough in sexual harassment cases when the same parties are involved in both federal and state claims. The courts must in each case determine, pursuant to the test set out in *United Mine*

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[65]*Zabkowicz*, 589 F. Supp. at 785.

[66]*Id.*

[67]*Zabkowicz*, 789 F.2d at 543.

[68]*Id.*

[69]*Id.*

[70]*Id.* at 543-44.

[71]*Id.* Wis. Stat. Ann. § 102.01(2)(c) (West Supp. 1986) defined a covered injury as "mental or physical harm to an employee caused by accident or disease . . . [including] mental harm or emotional stress or strain without physical trauma, if it arises from exposure to conditions or circumstances beyond those common to occupational or nonoccupational life."

[72]*Zabkowicz*, 789 F.2d at 545.

[73]*Id.*

Workers v. Gibbs,[74] whether the proof, scope of issues, remedies sought, and other aspects of the state law claims predominate over the federal Title VII claims. An affirmative answer dictates the denial of pendent jurisdiction.[75] The addition to that equation of parties as to whom only state law claims are asserted—pendent parties—makes the courts' decision in each case even more difficult.

The Seventh Circuit analyzed the pendent parties issue in Zabkowicz' case by applying a two-part test it drew from the Supreme Court's decision in *Aldinger v. Howard*.[76] The first part of the test is constitutionally based.[77] There must be a federal claim of sufficient substance to confer federal jurisdiction, and the federal and state claims must arise from a "common nucleus of operative fact" such that the claims would be expected to be tried in one forum—the *United Mine Workers v. Gibbs* test.[78] The second prong of the pendent parties test requires the court to look to the basis for federal jurisdiction and deny jurisdiction if it appears that Congress did not intend for a particular pendent claim to be brought in federal court.[79] As with all pendent jurisdiction decisions, the ultimate exercise of jurisdiction is in the discretion of the trial court, which looks to " 'considerations of judicial economy, convenience and fairness to litigants.' "[80]

Zabowicz' Title VII claims satisfied the first prong of the test, but the court had some difficulty concluding that Congress intended for co-employees to be brought into the case by way of pendent state claims when they could not have been sued under Title VII.[81] The court noted, however, that the Supreme Court under *Aldinger* would permit combination of such claims despite an apparent lack of congressional intent if the grant of federal jurisdiction were exclusive.[82] Assuming but explicitly not holding that Title VII jurisdiction is exclusively federal,[83] the court

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[74]383 U.S. 715 (1966).

[75]*See, e.g.*, Bouchet v. National Urban League, 730 F.2d 799 (D.C. Cir. 1984), wherein the court somewhat colorfully concluded that "[the state claims] would be pendent to this Title VII litigation much as a dog is pendent to its tail." *Id.* at 805-06.

[76]427 U.S. 1 (1976).

[77]*Zabkowicz*, 789 F.2d at 546 (citing U.S. CONST. art. III).

[78]*Id.* (citing *Gibbs*, 383 U.S. 715).

[79]*Id.* (citing Owen Equip. & Erection Co. v. Kroger, 437 U.S. 365, 373 (1978) (quoting *Aldinger*, 427 U.S. at 18)).

[80]*Id.* (quoting *Gibbs*, 383 U.S. at 726).

[81]The court affirmed the district court's conclusion that "Title VII does not provide a means for an employee to sue non-supervisory co-workers for discriminatory acts." *Id.* (citation omitted). *See* 42 U.S.C. § 2000e-5(f)(1) (1982).

[82]*Zabkowicz*, 789 F.2d at 547.

[83]The court has in at least one other case suggested that federal jurisdiction over Title VII claims may *not* be exclusive. Patzer v. Board of Regents, 763 F.2d 851, 855 n.4 (7th Cir. 1985).

nevertheless found the district court's dismissal of the claims to be proper because the tort claims had been severed for trial.[84] The interests of judicial economy, which might have been present if the state law claims had been tried along with the Title VII claims, would not have been served by a separate trial of the state claims in federal court.[85] It appears that both the district court[86] and the Seventh Circuit[87] would have approved the assertion of pendent parties jurisdiction had it not been for the severance of the state claims. That fact should be a tactical consideration for parties in sexual harassment cases involving pendent claims or parties.

The Seventh Circuit then held that the district court's total denial of attorney's fees had been an abuse of discretion.[88] Conceding that Zabkowicz' fee request was probably "excessive and unreasonable," the court nevertheless held that it was not so egregious as to justify a complete denial of fees.[89] The court then addressed two issues raised by the parties that should be considered by the district court on remand in deciding the fee to be awarded. First, the circuit court concluded that fees could be awarded for time spent on the non-Title VII claims so long as the other claims arose "out of a common factual core or [were] based on related legal theories."[90] According to the court, to attempt to separate the time spent on different legal theories would be an " 'exercise in futility.' "[91] The tort claims against West Bend, the supervisors, and the co-workers were considered by the court clearly to involve a "common core of facts."[92] State tort law claims by Zabkowicz' husband, on the other hand, were held to be noncompensable.[93] Finally, because Zabkowciz had stipulated to the dismissal of labor law and tort claims against West Bend and the union, apparently without receiving any payment, she should not be entitled to attorney's fees for those claims because they had done nothing to "advance the vindication of . . . her civil rights."[94] The Seventh

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[84]*Zabkowicz*, 789 F.2d at 548.

[85]*Id.*

[86]589 F. Supp. 780.

[87]The Seventh Circuit's attitude toward pendent parties jurisdiction has softened considerably over the past several years. *Compare* Hixon v. Sherwin-Williams Co., 671 F.2d 1005 (7th Cir. 1982) *and* Johnson v. Miller, 680 F.2d 39 (7th Cir. 1982) *with* Thomas v. Shelton, 740 F.2d 478, 487 (7th Cir. 1984) ("Although pendent party jurisdiction is not dead, neither is it in the best of health") *and* Moore v. Marketplace Restaurant, Inc., 754 F.2d 1336, 1359 (7th Cir. 1985) ("The 'pendent parties' concept has, it is true, wobbly constitutional foundations.").

[88]*Zabkowicz*, 789 F.2d at 549.

[89]*Id.* at 550.

[90]*Id.* at 551.

[91]*Id.* (quoting Garrity v. Sununu, 752 F.2d 727, 734-35 (1st Cir. 1984)).

[92]*Id.*

[93]*Id.* at 551-52.

[94]*Id.* at 552 (citing Christiansburg Garment Co. v. EEOC, 434 U.S. 412 (1978)).

Circuit ordered the district court to reexamine the attorney's fee request in light of its decision and to determine which fees were reasonably expended in pursuing her claims.[95] In the court's view, the small amount of back pay recovered by Zabkowicz should not preclude her recovering a substantial fee; but because she sought only pecuniary and no injunctive or declaratory relief, neither should she or her attorney be permitted a windfall.[96] The ultimate amount of the fee award was left to the discretion of the district court.[97]

The court's holdings in this case are instructive to Indiana practitioners in the employment discrimination area. Defendant employers have, in some lower federal court cases, asserted with mixed success that worker's compensation was a sexual harassment victim's exclusive remedy for emotional injury. Indiana's worker's compensation law[98] is not as clear as Wisconsin's apparently was to the Seventh Circuit. While "injury by accident" is defined in terms similar to those in Wisconsin's statute,[99] it is unclear whether emotional stress can constitute a covered injury without some actual physical trauma associated with it, although one district of The Indiana Court of Appeals has held that no physical injury is necessary.[100] Ultimately, this question may have to be certified to the Indiana Supreme Court for a ruling.

II. Affirmative Action

The subject of affirmative action continues to be confusing to analysts and alarming to employers attempting to identify standards to avoid liability to both minorities and nonminorities. The United States Supreme Court decided one affirmative action case during the survey period that did little to alleviate the confusion.[101]

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[95] *Id.* at 553.

[96] *Id.* at 552-53.

[97] *Id.* at 553.

[98] Ind. Code Ann. §§ 22-3-1-1 to -10-3 (West 1981 & Supp. 1986).

[99] " 'Injury' and 'personal injury' mean only injury by accident arising out of and in the course of the employment and do not include a disease in any form except as it results from the injury." Ind. Code Ann. § 22-3-6-1(e) (West Supp. 1986).

[100] *Compare* Campbell v. Kiser Corp. & Diecast, 137 Ind. App. 366, 208 N.E.2d 727 (1965) *and* Sollitt Constr. Co. v. Walker, 127 Ind. App. 213, 135 N.E.2d 623 (1956) *with* Hansen v. Von Duprin, Inc., 496 N.E.2d 1348 (Ind. Ct. App. 1986).

[101] The Court decided two more affirmative action cases on July 2, 1986, each featuring multiple opinions and alignments of justices. Local 28, Sheet Metal Workers v. EEOC, 106 S. Ct. 3019 (1986); Firefighters Local 93 v. Cleveland, 106 S. Ct. 3063 (1986). Both cases involved interpretation under section 706(g) of Title VII, which protects bona fide seniority systems. In *Sheet Metal Workers*, 106 S. Ct. at 3034, the Court upheld court-ordered hiring quotas based on evidence of pervasive past discrimination. In *Cleveland*, 106 S. Ct. at 3072, the Court approved a voluntary consent decree setting up an affirmative action plan that gave blacks preference over whites for promotion even though those benefited

In *Wygant v. Jackson Board of Education*,[102] nonminority teachers who had been laid off in favor of less-senior minority teachers challenged on equal protection grounds a collectively-bargained layoff provision that was enacted for affirmative action purposes.[103] The parties had agreed upon hiring goals geared to the percentage of minority students in the school system. The layoff provision at issue was intended to preserve the minority percentage achieved by the hiring goals by providing that the percentage of minority teachers laid off could not exceed the percentage that minority teachers represented in the entire workforce.[104]

Both the district court[105] and the United States Court of Appeals for the Sixth Circuit[106] upheld the provision despite the lack of any demonstrated prior discrimination. Rather, the lower courts held that the school board's articulated goal of remedying societal discrimination by providing role models for school children was an adequate justification under the equal protection clause for race-conscious layoffs.[107] The Supreme Court reversed.[108] The plurality opinion[109] first held that the "role model" theory did not constitute a compelling state purpose and was not an adequate basis for the race-conscious layoff provision.[110] To the extent that the purpose of the provision was to remedy past actual discrimination, as opposed to societal discrimination, the Court held that a finding by the district court of prior discrimination was constitutionally necessary to justify the layoff provision.[111]

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were not actual victims of discrimination. Two more affirmative action cases under Title VII are set to be argued in the Court's current term. One, U.S. v. Paradise, *cert. granted*, 106 S. Ct. 3331 (1986), involves a challenge to promotion goals in an affirmative action plan adopted by the state of Alabama for its state police force. The other, Johnson v. Transportation Agency, *cert. granted*, 106 S. Ct. 3331 (1986), involves a challenge to an affirmative action plan intended to remedy sex discrimination.

[102]106 S. Ct. 1842 (1986).

[103]*Id.* at 1845-46. Because no Title VII claim was asserted, the discussion of this case will be somewhat limited, as the Court's discussion was primarily on constitutional grounds.

[104]*Id.* at 1845.

[105]Wygant v. Jackson Bd. of Educ., 546 F. Supp. 1195 (E.D. Mich. 1982).

[106]Wygant v. Jackson Bd. of Educ., 746 F.2d 1152 (6th Cir. 1984).

[107]*Id.* at 1156-57.

[108]*Wygant*, 106 S. Ct. at 1852.

[109]There were five separate opinions. The majority was fashioned through a plurality opinion, most of which was joined by Justice O'Connor, and two opinions by Justices White and O'Connor concurring in the judgment. Justice Marshall filed one dissenting opinion, joined by Justices Brennan and Blackmun, and Justice Stevens authored a second dissenting opinion.

[110]*Wygant*, 106 S. Ct. at 1847-48. The dissent authored by Justice Marshall concluded that the school board's purpose was more than adequate to justify the race-conscious provision. *Id.* at 1862-63. The dissent noted that the provision was voluntarily adopted pursuant to collective bargaining negotiations, distinguishing Firefighters v. Stotts, 467 U.S. 561 (1984), and should be given effect. *Id.* at 1860 (Marshall, J., dissenting).

[111]*Id.* at 1848.

Even if the existence of past discrimination had been demonstrated, however, the Court held that the layoff provision was not "sufficiently narrowly tailored" to accomplish otherwise legitimate purposes.[112] Hiring goals were given as an example of a less intrusive means of accomplishing the same objectives.[113] The Court left little doubt that preferential layoff provisions such as the one at issue here impermissibly burden nonminority employees and will not be approved, while hiring goals "do not impose the same kind of injury that layoffs impose."[114]

III. Time Limits for Filing Title VII Charges

Title VII requires that a charge of discrimination must be filed with the EEOC within 180 days of the alleged discriminatory act, except that in states with so-called deferral agencies, a complainant who institutes a proceeding before the state agency has 300 days within which to file with the EEOC.[115] A timely EEOC charge is a prerequisite to a Title VII plaintiff's right to file suit in federal district court.[116] The Indiana Civil Rights Commission (ICRC) is a deferral agency under Title VII. Pursuant to Indiana law, charges of discrimination must be filed with the ICRC or a local human rights commission within 90 days of the alleged discrimination.[117] At least since the Supreme Court's decision in *Mohasco Corp. v. Silver*,[118] commentators and courts have debated whether a Title VII complainant must file a timely state charge in order to be entitled to the extended 300-day filing period, or whether any filing, timely or not, satisfies the deferral requirement. The debate was spurred by a footnote in *Mohasco*:

> Under the *Moore* decision, which we adopt today, a complainant in a deferral State having a fair employment practices agency over one year old need only file his charge within 240 days of the alleged discriminatory employment practice in order to insure that his federal rights will be preserved. If a complainant files later than that (but not more than 300 days after the practice complained of), his right to seek relief under Title VII will nonetheless be preserved if the State happens to complete its consideration of the charge prior to the end of the 300-day period.[119]

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[112] *Id.* at 1852 (footnote omitted).

[113] *Id.* at 1850-51.

[114] *Id.* at 1851. While recognizing the burden that layoffs represent to nonminorities, the dissent concluded that the layoff provision at issue was sufficiently narrow so as not to be an unconstitutional burden. *Id.* at 1865. (Marshall, J., dissenting).

[115] 42 U.S.C. § 2000e-5(e) (1982).

[116] Mohasco Corp. v. Silver, 447 U.S. 807 (1980).

[117] Ind. Code Ann. § 22-9-1-3 (West 1981).

[118] 447 U.S. 807 (1980).

[119] *Id.* at 814 n.16 (citing Moore v. Sunbeam Corp., 459 F.2d 811 (7th Cir. 1972)).

In *Martinez v. UAW Local 1373*,[120] the Seventh Circuit addressed the issue for the first time. The state involved happened to be Indiana. Martinez was a union member who brought suit under Title VII and other statutes against her union for alleged race discrimination.[121] On the 251st day after the alleged discrimination, she filed a charge with the Fort Wayne Human Relations Commission. That agency, declining to process it because it was untimely, transferred the case to the EEOC on the 258th day. The district court granted summary judgment for the union on the ground that Martinez's claim was barred by the applicable statute of limitations.[122]

The issue presented to the Seventh Circuit was whether Martinez was entitled to the extended filing period despite the fact that the deferral agency had no opportunity to act. The court acknowledged that the "purpose of the longer statute of limitations . . . is to give states an opportunity to remedy problems of discrimination before the federal government gets involved."[123] Under the deferral formulation set out in Title VII, a complainant may not file an EEOC charge until the state agency has had the charge for sixty days, unless the state completes its process earlier.[124] Thus, *Mohasco* and other cases have held that the complainant must file with the state agency on or before the 240th day to ensure a valid EEOC filing by the 300th day.[125]

In Martinez's case, the purpose of state filing was obviated by her untimeliness. The Fort Wayne Commission did not have the 60 days intended by Congress within which to attempt to remedy the alleged discrimination. While it was obviously disturbed by the prospect of complainants being able deliberately to bypass the deferral portion of the Title VII formulation,[126] the Seventh Circuit nevertheless refused to conclude that Martinez had forfeited her right to the extended filing period.[127]

The court noted cases under the Age Discrimination in Employment Act (ADEA)[128] that have permitted untimely state filings to satisfy the deferral requirement,[129] but distinguished them because of the absence of a deferral period in the ADEA.[130] Referring to other circuits that have decided the issue similarly under Title VII, the Seventh Circuit declined

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[120]772 F.2d 348 (7th Cir. 1985).

[121]*Id.* at 349.

[122]*Id.*

[123]*Id.* at 350.

[124]42 U.S.C. § 2000e-5(c) (1982).

[125]*Supra* note 119.

[126]*Martinez*, 772 F.2d at 351.

[127]*Id.* at 353.

[128]29 U.S.C. §§ 621-634 (1982).

[129]*Martinez*, 772 F.2d at 351 (including the Seventh Circuit decision in Anderson v. Illinois Tool Works, Inc., 753 F.2d 622 (7th Cir. 1985)).

[130]Indiana's age discrimination statute does not cover any entity subject to the ADEA. Ind. Code Ann. § 22-9-2-1 (West 1981). Accordingly, Indiana is not a deferral state under

to make a comprehensive ruling on the subject.[131] Rather, it limited its ruling to the facts of the case and the 90-day filing period in Indiana.[132] The court concluded that it was inconsistent with congressional intent to allow complainants less than 180 days to file with deferral agencies and at the same time to make that filing a condition to a federal right of action.[133] Because Indiana's statute of limitations was only half the 180 days intended by Congress to be permitted, failure to file a timely charge could not be held to preclude the filing of an EEOC charge within the 300-day filing period.[134] While the court did not address longer state filing periods, the court's holding strongly indicates that it might rule otherwise in a case involving a state filing period of 180 days or longer.

If, as the Supreme Court held in *Mohasco*, the purpose of the extended filing period was to permit states an opportunity to redress discrimination, it makes little sense to say a discrimination plaintiff should have 300 days within which to file if the state agency is powerless to act because of a late filing. Despite authority to the contrary in other circuits,[135] it is hoped that the Seventh Circuit will apply the logic of this decision to bar a plaintiff who fails to file a timely state charge where the state has a 180-day or longer filing period.

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the ADEA, and age discrimination claimants must uniformly file charges with the EEOC within 180 days.

[131] *Martinez*, 772 F.2d at 351-52.

[132] *Id.* at 352.

[133] *Id.* at 352-53.

[134] *Id.*

[135] *See* cases cited *id.* at 351.

Recent NLRB Developments

David L. Swider*

I. Introduction

Decisions of the National Labor Relations Board ("Board" or "NLRB") during this survey period[1] may be the first indication that the conservative swing in Board policy brought about by Reagan appointees to the Board is slowing. During the last survey period,[2] Chairman Donald Dotson, appointed by President Reagan in 1984, led the way in continuing expressly to overrule numerous prior Board decisions and in significantly departing from the policies underlying those earlier decisions.[3] To be sure, the Board decisions of the current survey period continue to reflect the views of a very conservative Board. Nonetheless, for the most part, these cases do not expressly depart from previous Board holdings. A flurry of decisions in which Chairman Dotson dissented were handed down in late May of 1986, in anticipation of Member Dennis' imminent departure from the Board, and strongly suggest that the labor law pendulum may finally have reached its right-most point.[4]

Because this survey period was not filled with far-reaching changes in Board policy, the cases in this discussion were more difficult to select than those included in last year's survey. Subjective considerations necessarily played a greater role in the selection process. Nonetheless, an effort has been made to select cases which will be of most interest and benefit to *all* attorneys representing clients in labor matters, regardless of whether those clients are employees, unions, or employers. In addition to Board cases, this Article will discuss pertinent United States Supreme

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[1]The survey period extends from June, 1985 through May, 1986.

[2]June, 1984 through May, 1985.

[3]*See* Swider, *Recent NLRB Developments*, 19 Ind. L. Rev. 241, 244-56 (1986).

[4]*See* Trover Clinic, 280 N.L.R.B. No. 2 (May 30, 1986), 122 L.R.R.M. (BNA) 1172 (1986); Dorothy Shamrock Coal Company, 279 N.L.R.B. No. 174 (May 30, 1986), 123 L.R.R.M. (BNA) 1048 (1986); Armon Company, 279 N.L.R.B. No. 158 (May 30, 1986), 122 L.R.R.M. (BNA) 1166 (1986); Lucky Stores, Inc., d/b/a/ Gemco, 279 N.L.R.B. No. 153 (May 29, 1986), 122 L.R.R.M. (BNA) 1180 (1986); Woodcliff Lake Hilton Inn, Inc., 279 N.L.R.B. No. 146 (May 22, 1986), 123 L.R.R.M. (BNA) 1061 (1986); Armco, Inc., Eastern Steel Division, Ashland Works, 279 N.L.R.B. No. 143 (May 30, 1986); Metropolitan Teletronics Corp., 279 N.L.R.B. No. 134 (May 10, 1986), 122 L.R.R.M. (BNA) 1107 (1986); Getty Refining and Marketing Co., 279 N.L.R.B. No. 126 (May 14, 1986), 122 L.R.R.M. (BNA) 1150 (1986). Of course, depending on who is selected to replace Member Dennis on the Board, future decisions may resume the conservative slide.

Court and Seventh Circuit Court of Appeals decisions which involve recent and important developments under the National Labor Relations Act ("Act" or "NLRA").

II. An Employer's Duty to Supply Financial Information During Bargaining

At least twice during the past year, the Board had the opportunity to clarify its position regarding an employer's obligation to release financial information to a requesting union. In *Buffalo Concrete*[5] and *Cowin & Co.*,[6] the Board demonstrated that it will look behind an employer's asserted reasons for requesting concessions at the bargaining table to determine whether the company's position is grounded upon the inability to continue paying present wages and benefits or whether the company is simply basing its request upon an unwillingness to do so.[7] It is clear from the Board's decision in *Buffalo Concrete* that a management request for concessions will not in itself trigger an obligation to release financial information upon a union's request.[8] It is equally plain, however, from *Cowin & Co.* that simply paying lip service to an unwillingness to continue paying at the current levels will not necessarily protect an employer from a union's request for financial data.[9]

In *Buffalo Concrete*, six employer-members of a construction industry bargaining association sought concessions at the bargaining table upon the premise of competition. The employers attempted to convince the union that because nonunion contractors had made such substantial inroads into the concrete industry in their location, unionized contractors had lost the ability to compete effectively. To regain competitiveness in the industry, the employers expressed the need to "narrow the cost gap between the union and nonunion companies."[10]

In response to the employers' requests for concessions, the union asked to see the employers' financial records to determine whether the requests were justified. After repeated requests for the information by the union and after repeated denials by the employers, the union filed refusal-to-bargain charges against the employers. After a hearing on these charges, an Administrative Law Judge (ALJ) held for the union on this issue. The ALJ concluded that an assertion of an "inability to compete" is tantamount to an "inability to pay" bargaining stance, thus triggering

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[5]276 N.L.R.B. No. 40 (Sept. 30, 1985), 120 L.R.R.M. (BNA) 1139 (1985).
[6]277 N.L.R.B. No. 82 (Nov. 26, 1985), 121 L.R.R.M. (BNA) 1029 (1985).
[7]*See infra* notes 10-20 and accompanying text.
[8]276 N.L.R.B. No. 40, slip op. at 7, 120 L.R.R.M. at 1141.
[9]*See infra* notes 18-20 and accompanying text.
[10]276 N.L.R.B. No. 40, slip op. at 3, 120 L.R.R.M. at 1140.

the duty to turn over financial information to the union upon request.[11] Upon appeal, the Board disagreed.

Before overturning the ALJ's decision on this question, the Board expressly agreed with his statement of applicable law: "[W]hen an employer objects to a union's bargaining demands on the basis that it is unable to afford the cost of the proposal, it is under a duty to let the union see its books and records so that the union can verify the truthfulness of the employer's contentions."[12] The Board also concurred with the ALJ's view of the permissible implications of concession bargaining: "[W]hen concession bargaining does take place, an implied major premise of the employer's position necessarily is that it has been paying wages and benefits which it could afford at one time but which it no longer wishes to pay."[13] The Board parted with the ALJ, however, in his effectively equating concession bargaining demands with "inability to pay" assertions. The Board explained, "[W]e will not assume that an employer who no longer *wishes* to pay wages and benefits it once agreed to is *unable* to make such payments."[14] Applying this rationale to the facts before it, the Board concluded that even though the employers had maintained that concessions were needed to increase their competitiveness in their industry and had referred to a general loss of jobs in the unionized sector of that industry, the employers had stopped short of claiming that they were *unable* to afford the union's proposals.[15] Accordingly, the Board held that the employers had not violated sections 8(a)(1) and (5) of the NLRA[16] by refusing the union's request for financial information.[17]

In *Cowin & Co.*, the Board demonstrated that it does not consider an employer's obligation to turn over financial information to a requesting union as simply a matter of semantics. The Board upheld an ALJ's determination that the employer violated sections 8(a)(1) and (5) of the Act by refusing to provide the union with requested financial information,

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[11]276 N.L.R.B. No. 40, JD slip op. at 17-18 (quoting United Steel Workers of Am. v. NLRB (Stanley Artex Windows), 401 F.2d 434 (1968)).

[12]276 N.L.R.B. No. 40, slip op. at 6, 120 L.R.R.M. at 1141.

[13]*Id.*

[14]*Id.* slip op. at 7, 120 L.R.R.M. at 1141 (emphasis in original).

[15]*Id.*

[16]§ 158 Unfair labor practices.

(a) It shall be an unfair labor practice for an employer

(1) to interefere with, restrain, or coerce employees in the exercise of the rights guaranteed in section 157 of this title;

. . . .

(5) to refuse to bargain collectively with the representatives of his employees, subject to the provisions of section 159(a) of this title.

29 U.S.C. §§ 158(a)(1), (a)(5) (1982).

[17]276 N.L.R.B. No. 40, slip op. at 7, 120 L.R.R.M. at 1141.

despite the employer's repeated assertion that its request for concessions was based only on an unwillingness to provide the wages and benefits of the past.[18] In reaching this conclusion, the Board relied primarily on other statements made by the employer during the course of bargaining which indicated an inability to pay higher wages.[19] The employer also raised as a justification for its bargaining position that it had suffered financial losses during each of the previous three years. Hence, the Board concluded: "Under these circumstances we find that the [employer], despite its assertions to the contrary, was in fact expressing financial inability to pay."[20]

III. A Union's Right to Fine Financial Core Members

During the last survey period, the United States Supreme Court held that a union cannot impose fines against members whose tendered resignations are invalid under the union's constitution.[21] The Court, in *Pattern Makers' League v. NLRB*,[22] ruled that a union's attempt to so limit a member's right to resign violates section 8(b)(1)(A)[23] of the Act.[24] During the present survey period, the Board extended the *Pattern Makers* rationale to include a union's attempt to impose discipline upon "financial core" members.[25] Previous Supreme Court, Court of Appeals and Board

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[18]277 N.L.R.B. No. 82, slip op. at 1 n.1, 121 L.R.R.M. at 1029.

[19]*Id.* For example, at the onset of the bargaining, the employer related to the union that there was "a real question of whether we shall be in business at the termination of this contract unless prior contractual concepts are radically changed." *Id.*

[20]*Id.*

[21]Pattern Makers' League v. NLRB, 105 S. Ct. 3064 (1985). *See* Swider, *supra* note 3 at 250.

[22]105 S. Ct. 3064 (1985).

[23]§ 158 Unfair labor practices.

> (b) It shall be an unfair labor practice for a labor organization or its agents—
>
> (1) to restrain or coerce (A) employees in the exercise of the rights guaranteed in section 157 of this title: *Provided*, That this paragraph shall not impair the right of a labor organization to prescribe its own rules with respect to the acquisition or retention of membership therein.

29 U.S.C. § 158(b)(1)(A) (1982) (emphasis in original).

[24]105 S. Ct. at 3071.

[25]A "financial core" union member is one whose only obligation to the union is to pay all initiation fees and dues uniformly required by the union to maintain membership. This enables an employee who does not wish to maintain full union membership status to avoid a threat of discharge under section 8(a)(3) of the Act (*see infra* note 23) while covered by a collective bargaining agreement containing a union-security provision. The following is an example of a typical union-security clause:

> All present Employees in the bargaining unit shall maintain membership in good standing in the Union as a condition of employment. All new Employees shall as a condition of employment, become members of the Union within sixty (60) calendar days, to the extent of paying initiation fees and membership dues as required of all Union Members.

decisions have held that a union cannot demand, under section 8(a)(3),[26] that a financial core member take an oath or attend union meetings,[27] fill out application forms,[28] accept membership[29] or do anything other than tender dues and fees.[30] However, until this survey period, the precise question of whether a union can impose discipline on financial core members had not been squarely faced.

In *Tacoma Boatbuilding*,[31] two unions were engaged in an economic strike against the same employer. During the course of the strike, several union members submitted (or tried to submit) a letter to their respective

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The failure of any Employee to maintain his Union membership in good standing as required herein, upon written notice to the Company by the union to such effect and to further effect that Union membership was available to such person on the same terms and conditions generally available to other members, shall obligate the Company to discharge such Employee within ten (10) calendar days of such notice.

[26]§ 158 Unfair labor practices.

(a) It shall be an unfair labor practice for an employer—

. . . .

(3) by discrimination in regard to hire or tenure of employment or any term or condition of employment to encourage or discourage membership in any labor organization: *Provided*, That nothing in this subchapter, or in any other statute of the United States, shall preclude an employer from making an agreement with a labor organization (not established, maintained, or assisted by any action defined in this subsection as an unfair labor practice) to require as a condition of employment membership therein on or after the thirtieth day following the beginning of such employment or the effective date of such agreement, whichever is the later, (i) if such labor organization is the representative of the employees as provided in section 159(a) of this title, in the appropriate collective-bargaining unit covered by such agreement when made, and (ii) unless following an election held as provided in section 159(e) of this title within one year preceding the effective date of such agreement, the Board shall have certified that at least a majority of the employees eligible to vote in such election have voted to rescind the authority of such labor organization to make such an agreement: *Provided further*, That no employer shall justify any discrimination against an employee for nonmembership in a labor organization (A) if he has reasonable grounds for believing that such membership was not available to the employee on the same terms and conditions generally applicable to other members, or (B) if he has reasonable grounds for believing that membership was denied or terminated for reasons other than the failure of the employee to tender the periodic dues and the initiation fees uniformly required as a condition of acquiring or retaining membership.

29 U.S.C. § 158(a)(3) (1982) (emphasis in original).

[27]Union Starch & Refining Co., 87 N.L.R.B. 779 (1949).

[28]United Stanford Employees, Local 680, 232 N.L.R.B. 326 (1977), *enforced*, 601 F.2d 980 (9th Cir. 1979).

[29]Hershey Foods Corp., 207 N.L.R.B. 897 (1973), *enforced*, 513 F.2d 1083 (9th Cir. 1975).

[30]NLRB v. General Motors Corp., 373 U.S. 734, 742-43 (1963).

[31]277 N.L.R.B. No. 20 (Nov. 19, 1985), 120 L.R.R.M. (BNA) 1329 (1985).

unions giving notice of their intent to alter their membership status from "full" membership to "financial core" status.[32] The employees who submitted this letter then crossed the picket line and returned to work. In response, the unions initiated internal charges against the employees and imposed fines against most of them for crossing a sanctioned picket line. The employees responded by filing section 8(b)(1)(A) charges against their unions.[33]

After a hearing, an ALJ dismissed the employees' unfair labor practice charges, finding that the charging parties had never "clearly and unequivocally" resigned from their unions.[34] The ALJ reasoned that the submitted letters did not provide the unions with reasonable notice of resignation and, therefore, that the employees' membership status had not changed. Having made this determination, the ALJ avoided the need to address the issue of whether financial core members can legally be subject to union discipline.

The Board reversed the ALJ's decision and concluded that the unions had violated the Act by initiating charges and imposing fines against the employees after they had changed their membership status.[35] The Board characterized its holding as a simple extension of previous limitations imposed on unions with respect to financial core members.[36] The Board also premised its holding on *Pattern Makers'* and other Board decisions that permitted a union member to resign from full membership and, thereby, avoid subsequent union disciplinary attempts.[37] Relying on this latter line of cases, the Board summarily rejected the unions' argument that provisions in the unions' constitutions purporting to limit members' resignation rights precluded giving any effect to the employees' resignation letters.[38] In supporting its holding, the Board also responded to the unions' argument that had the employees wished to avoid subsequent union discipline

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[32]*Id.* slip op. at 2-3, 120 L.R.R.M. at 1330. The letter provided in pertinent part:

> This letter will serve as notification that I am changing my membership status . . . from that of a "full" member to that of a "financial core" member. As a "financial core" member, I will continue to pay to the union all initiation fees and dues uniformly required of all members for maintaining membership. I am not resigning from the union, I am only changing my membership status. I will not, henceforth, be subject to any obligations of membership other than that of paying uniformly required dues and initiation fees required of all . . . members.

Id.

[33]*Id.* slip op. at 3, 120 L.R.R.M. at 1330.

[34]*Id.*

[35]*Id.*

[36]*Id.* slip op. at 6, 120 L.R.R.M. at 1331.

[37]*Id.* slip op. at 7 n.7, 120 L.R.R.M. at 1331 n.7.

[38]*Id.* slip op. at 6, 120 L.R.R.M. at 1331.

for crossing the picket line they could have resigned completely from their unions. The Board explained:

> [W]hile there is a voluntary aspect to the assumption of financial core status, when there is a union-security clause in effect an employee must retain financial core status as a condition for employment. To then say, however, that a financial core member is subject to the same discipline as a full member is to render meaningless the third part of the *Scofield* test, namely, that a member is free to leave the union and escape the rule.[39]

In effect, the Board's holding in *Tacoma Boatbuilding* is an acknowledgment that to permit a union to discipline a financial core member is to countenance an unlawful restraint on an employee's section 7[40] right to refrain from union activity.[41]

IV. Hiring Temporary Replacements During an Offensive Lockout

If there was one decision during the survey period which struck organized labor harder than any other, that decision must be *Harter Equipment, Inc.*[42] In *Harter*, the Board concluded that an employer's use of temporary workers during a lockout initiated to bring economic pressure to bear upon legitimate bargaining demands is not unlawful.[43]

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[39]*Id.* In Scofield v. NLRB, 394 U.S. 423, 430 (1969), the Court explained that "Section 8(b)(1) leaves a union free to enforce a properly adopted rule which reflects a legitimate union interest, impairs no policy Congress has embedded in the labor laws, and is reasonably enforced against union members who are free to leave the union and escape the rule."

[40]Employees shall have the right to self-organization, to form, join, or assist labor organizations, to bargain collectively through representatives of their own choosing, and to engage in other concerted activities for the purpose of collective bargaining or other mutual aid or protection, and all of such activities except to the extent that such right may be affected by an agreement requiring membership in a labor organization as a condition of employment as authorized in section 158(a)(3) of this title.

29 U.S.C. § 157 (1982).

[41]*See, e.g.*, Carpenters District Council (Gordon Construction, Inc.) 277 N.L.R.B. No. 19 (Nov. 19, 1985), 120 L.R.R.M. (BNA) 1327, 1329 (1985) stating:

> Accordingly, we find that because Viskovich notified the Respondent of this change in membership status prior to crossing the picket line and returning to work, the Respondent's bringing charges and imposing a fine against him constituted an unlawful restraint on his Section 7 right to refrain from union activity in violation of Section 8(b)(1)(A) of the Act.

[42]280 N.L.R.B. No. 71 (June 24, 1986), 122 L.R.R.M. (BNA) 1219 (1986).

[43]*Id.* slip op. at 2, 122 L.R.R.M. at 1220. The majority opinion, joined by Chairman Dotson and Members Johansen and Babson, met with a lengthy dissent by Member Dennis.

This decision has given management a powerful new weapon to use in achieving its collective bargaining objectives.

The salient facts of *Harter* are not complicated and are capable of frequent recurrence. The employer and the union, parties to a series of collective bargaining agreements, began negotiating a new agreement in October of 1981. Their existing contract was scheduled to expire on December 1, 1981. When little bargaining progress was made in the face of the employer's demands for concessions and changes in the contract's union security clause, the union offered to extend the existing contract for another six months so that bargaining could continue. The employer replied that it would not let its employees work without a contract and would agree to no extension of the December 1 expiration date. When no agreement was reached by December 3rd, the employer locked out its employees to pressure the union into accepting the employer's "final" offer. In mid-January 1982, with no agreement yet achieved, the employer began hiring temporary employees so that operations could continue during the lockout. The union responded to the employer's hiring of temporary replacements with section 8(a)(1) and (3) charges. After a hearing, an ALJ concluded that the employer's lockout and temporary replacement of the union workers did not constitute a violation of the NLRA.[44]

In reviewing the ALJ's decision, the Board first noted that there was no evidence in the record suggesting that the employer's action was motivated by unlawful union animus. Indeed, the record reflected that the parties had had an amicable bargaining history.[45] The Board also recognized that the record contained no evidence that the employer had engaged in bad-faith bargaining either before or after the lockout.[46] Because the union had adduced no proof of anti-union motivation on the employer's part, the Board's analysis was necessarily governed by principles established by the Supreme Court in *NLRB v. Great Dane Trailers, Inc.*[47] There, the Court elaborated guidelines for determining the circumstances in which a 8(a)(3) violation may be found even in the absence of anti-union animus.[48]

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[44]*Id.*

[45]*Id.*

[46]*Id.*

[47]388 U.S. 26 (1967).

[48]*Id.* at 34.

First, if it can reasonably be concluded that the employer's discriminatory conduct was "inherently destructive" of important employee rights, no proof of an antiunion motivation is needed and the Board can find an unfair labor practice even if the employer introduces evidence that the conduct was motivated by business considerations. Second, if the adverse effect of the discriminatory conduct on employee rights is "comparatively slight," an antiunion motivation must be proved to sustain the charge *if* the employer has come forward with evidence of legitimate and substantial business justifications for the conduct. Thus, in

In determining the effect on employee rights of Harter's lockout and subsequent hiring of temporary replacements, the Board looked to two other Supreme Court decisions, *American Ship Building Co. v. NLRB*[49] and *NLRB v. Brown.*[50] In each of these cases the Court "found sufficient business justification for both employer weapons in the course of economic conflicts"[51] and "found that the impact of the employer conduct on employee rights was comparatively slight, rather than inherently destructive."[52]

Accordingly, in holding that an employer does not violate the Act by temporarily replacing employees in conjunction with a lawful lockout in support of legitimate bargaining demands, the Board in *Harter* found that the use of temporary employees reasonably serves the same legitimate business purpose served by the lockout itself, *i.e.*, bringing economic pressure to bear in support of a valid bargaining position.[53] The Board also found that utilizing temporary replacements in conjunction with a lawful lockout is no more destructive of employee rights than locking out employees in the first place.[54] Because of the "temporary" status of the replacements, "[t]he Union or its individual members have the ability to relieve their adversity [in either situation] by accepting the employer's less favorable bargaining terms and returning to work."[55] On these bases, the Board affirmed the ALJ's decision to dismiss the union's complaint.[56]

In dissent, Member Dennis disagreed with the Board's refusal to distinguish between "offensive" and "defensive" lockouts in assessing

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> either situation, once it has been proved that the employer engaged in discriminatory conduct which could have adversely affected employee rights to *some* extent, the burden is on the employer to establish that he was motivated by legitimate objectives since proof of motivation is most accessible to him.

Id. (emphasis in original).

[49]380 U.S. 300 (1965). In *American Ship Building*, the Court held that an employer may temporarily lock out its employees during a bargaining impasse for the sole purpose of bringing economic pressure to bear in support of a legitimate bargaining position without violating either section 8(a)(1) or (3). *Id.* at 318.

[50]380 U.S. 278 (1965). In *Brown*, the Court held that members of a multi-employer bargaining association may lock out and temporarily replace employees after their union has commenced a "whipsaw" strike against another association member. *Id.* at 288-90. A "whipsaw" strike is one aimed at a single employer who is part of a group of employers from whom the union is seeking benefits. The objective is to gain favorable terms from the targeted employer, which can then be used as a pattern or a base to obtain the same or better terms from the other employers under the same threat of pressure exerted against the first employer.

[51]280 N.L.R.B. No. 71, slip op. at 3, 122 L.R.R.M. at 1220.

[52]*Id.* slip op. at 4, 122 L.R.R.M. at 1220.

[53]*Id.* slip op. at 10, 122 L.R.R.M. at 1222.

[54]*Id.* slip op. at 9-10, 122 L.R.R.M. at 1222.

[55]*Id.* slip op. at 10, 122 L.R.R.M. at 1222.

[56]*Id.* slip op. at 11-12, 122 L.R.R.M. at 1223.

the relative effect of hiring temporary replacements on employee rights. In *Brown*, the Court permitted the hiring of temporary replacements in the narrow context of a "defensive" lockout,[57] whereas in *Harter*, the majority was now condoning the same action in the context of an "offensive" lockout.[58] Dennis reasoned that this offensive use was "inherently destructive" of employee rights and, therefore, violative of the Act, notwithstanding the absence of improper motivation and the presence of a legitimate and substantial employer business objective.[59]

V. Hiring "Permanent" Replacements During an Economic Strike

In *NLRB v. Mackay Radio & Telegraph Co.*,[60] the Supreme Court held that economic strikers are entitled to immediate reinstatement upon their unconditional offer to return to work, unless their positions have been filled by "permanent" replacements.[61] If permanent replacements have been hired, then the striking employees are placed on a preferential recall list and are called back to work as new job openings occur or as their replacements are separated from employment.[62] The question whether replacements are temporary or permanent was addressed and resolved by the Board during this survey period in a manner that may give organized labor some hope that Chairman Dotson's conservative hold on the Board is weakening.[63]

In *Hansen Brother's Enterprises*,[64] the employer maintained that the strike replacements it had hired during the course of an economic strike had "permanent" status for three reasons. First, the employer relied on a letter it sent to the strikers which provided in pertinent part: "You

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[57]*I.e.*, one commenced by members of a multi-employer bargaining association who were defending themselves against a whipsaw strike against another of their members.

[58]*I.e.*, the lockout was commenced for the sole purpose of placing economic pressure on the union to accept the employer's lawful bargaining demands.

[59]*Id.* slip op. at 22, 122 L.R.R.M. at 1226 (Dennis, Member, dissenting).

> [A]llowing an employer to take the offensive and temporarily replace locked-out employees renders nugatory the employees' right to strike, and places an unacceptable burden on employees' rights to engage in collective-bargaining and union activities. I therefore find the Respondent's temporary replacement of its employees in these conditions unlawful under Section 8(a)(1) and 8(a)(3) of the Act as inherently destructive of rights guaranteed in Sections 7 and 13 of the Act.

Id.

[60]304 U.S. 333 (1938).

[61]*Id.* at 345-46.

[62]Laidlaw Corporation, 171 N.L.R.B. 1366 (1968), *enforced*, 414 F.2d 99 (7th Cir. 1969).

[63]*See also* note 4 *supra*.

[64]279 N.L.R.B. No. 98 (April 30, 1986), 122 L.R.R.M. (BNA) 1057 (1986).

should further be aware that if a replacement is hired for your position, you may lose your right to reemployment if you later change your mind and wish to come back to work.''[65] Second, the employer supported its position by relating statements made to the replacements to the effect that the employer ''wanted'' to consider them as permanent employees and ''wanted'' the replacements to consider themselves as such.[66] Third, the employer cited its repeated refusal of the union's demand during negotiations to terminate the employment of the strike replacements.[67]

The Board rejected all these arguments, and disagreed with the ALJ's conclusion that the striking employees' offer to return to work was conditional because it was, at all times, coupled with a demand of reinstatement to former positions and a demand for the discharge of the replacements.[68] The Board relied upon the employer's use of the word ''may'' in its letter to the strikers apprising them that they ''may'' lose reemployment rights if replacements are hired.[69] The Board also found that the employer's statements to the replacements were non-committal in that the replacements were never actually told that they were permanent.[70] Rather, the employer had merely told them that it ''wanted'' to consider them as permanent.[71] The Board was also unconvinced of the permanent nature of the replacements by the employer's alleged bargaining statements. At most, these statements showed the employer's *intent* to replace the strikers permanently, but the Board explained: ''Such a showing fails to satisfy the employer's burden; rather, the employer must show a *mutual* understanding between itself and the replacements that they are permanent.''[72] Accordingly, the Board concluded that, because the replacements were not ''permanent,'' the strikers' offer to return to work was ''perfectly appropriate'' in its concurrent demand that the replacements be discharged.[73] The Board ordered the employer, *inter alia*, to offer the strikers immediate and full reinstatement to their former jobs and to make them whole for any loss of earnings suffered as a result of the refusal to honor their ''unconditional'' offer to return to work.[74]

Chairman Dotson wrote a stinging dissent. He began: ''My col-

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[65]*Id.* slip op. at 3 n.5, 122 L.R.R.M. at 1057 n.5.
[66]*Id.* slip op. at 3, 122 L.R.R.M. at 1057 (footnote omitted).
[67]*Id.* slip op. at 2, 122 L.R.R.M. at 1057.
[68]*Id.*
[69]*Id.* slip op. at 3, 122 L.R.R.M. at 1057.
[70]*Id.*
[71]*Id.*
[72]*Id.* (emphasis in original) (citing Associated Grocers, 253 N.L.R.B. 31 (1980)).
[73]*Id.* slip op. at 2, 122 L.R.R.M. at 1057.
[74]*Id.* slip op. at 5.

leagues' handling of the evidence in this case gives rise to a disquieting concern. Briefly stated, the majority's analytic approach to the evidence reflects an undue taste for verbal analysis rather than a recognition of the real world facts."[75] In addition to its "overconcern for verbal precision," the majority, in Dotson's view, also ignored the effect of the Supreme Court's recent decision in *Belknap, Inc. v. Hale*[76] on the employer's statements to the replacements.[77] In *Belknap*, the Court held that strike replacements who were told by their employer that they would be "permanent" were not pre-empted by federal law from bringing a state court action for misrepresentation and breach of contract when they were subsequently laid off pursuant to a strike settlement agreement reached in the context of an unfair labor practice case.[78] Dotson argued that it was the legitimate concern raised by *Belknap* that caused the employer in *Hansen* to tell the replacements that it "wanted" to consider them permanent and that it "wanted" the replacements also to consider themselves permanent.[79] Dotson concluded:

> The preponderance of the evidence in this case demonstrates that the Respondent sought to hire permanent replacements while protecting itself against the adverse possibilities posed by the *Belknap* case, which had issued only a few weeks prior to the strike. Two-and-a-half years later, this Board sits in judgment on the verbal constraints employed to that end and finds them inadequate. Looking only to these verbalisims, the majority imposes a 2-1/2-year backpay remedy essentially because it would have phrased two items in a different way. By so doing, the majority has, in my view, adopted a wholly unrealistic approach to labor matters.[80]

VI. Misrepresentations and Altered Board Materials in Union Election Campaigns

During the survey period, the Board continued along its "anything goes" course in dealing with campaign misrepresentations. Also in the

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[75] *Id.* slip op. at 8, 122 L.R.R.M. at 1058 (Dotson, Chairman, dissenting).

[76] 463 U.S. 491 (1983).

[77] 279 N.L.R.B. No. 98, slip op. at 8-9, 122 L.R.R.M. at 1058 (Dotson, Chairman, dissenting).

[78] *Belknap*, 463 U.S. at 512. The Court suggested that an employer could protect itself from such liability by promising permanent employment subject to the possible contingencies of a Board order or an unfair labor practice settlement agreement. *Id.* at 502.

[79] 279 N.L.R.B. No. 98, slip op. at 8-9, 122 L.R.R.M. at 1058 (Dotson, Chairman, dissenting).

[80] *Id.* slip op. at 11, 122 L.R.R.M. at 1059 (Dotson, Chairman, dissenting).

past year, the Seventh Circuit placed its imprimatur upon the Board's liberal approach, by enforcing one of the seminal cases in the Board's recent permissive trend, *Riveredge Hospital*.[81] In *NLRB v. Affiliated Midwest Hospital*,[82] the Seventh Circuit agreed with the Board's *Riveredge Hospital* decision that misrepresentations of Board processes or actions by a party no longer constitutes *per se* grounds for vacating an election.[83]

In *Riveredge Hospital*, the employer sought to have an election set aside on the basis of several alleged misrepresentations made by the union in the time period between the filing of two election petitions and the resulting election. The most controversial piece of union campaign propaganda during this period was a leaflet entitled "U.S. Government Issued Complaint Against Riveredge." In fact no action had been taken by the Board against the employer; rather, a charge that had been filed against the employer had resulted in a settlement agreement containing a non-admission provision. The Regional Director, following *Formco, Inc.*,[84] overturned the election results on the ground that the union's misrepresentations had "injected the Board into the campaign and caused its neutrality to be impaired."[85] The Board, however, reversed.[86] Relying on its new *Midland National Life Insurance Co.*[87] position that "we will no longer probe into the truth or falsity of the parties' campaign statements, and . . . we will not set elections aside on the basis of misleading campaign statements"[88] the Board reasoned that there was "no sound reason why misrepresentations of Board actions should be on their face objectionable or be treated differently than other misrepresentations."[89]

In challenging the Board's change of policy announced in *Riveredge Hospital* before the Seventh Circuit, the employer was faced with a difficult onus: "In order to challenge the Board's policies directly, as opposed to its application of those policies, the movant must establish that the NLRB's interpretation of the law is unreasonable."[90] Attempting to sustain that burden, the employer cited the Board's "on again off

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[81]264 N.L.R.B. 1094 (1982).

[82]789 F.2d 524 (7th Cir. 1986).

[83]*Id.* at 529.

[84]233 N.L.R.B. 61 (1977). The Board set aside an election based on the union's false statement that the employer had been "found guilty of engaging in unfair labor practices and was ordered to post a 60-Day Notice." *Id.* at 61. The Board explained: "[A]ny substantial mischaracterization or misuse of a Board document for partisan election purposes is a serious misrepresentation warranting setting an election aside." *Id.*

[85]264 N.L.R.B. at 1094.

[86]*Id.*

[87]263 N.L.R.B. 127 (1982).

[88]*Id.* at 133.

[89]264 N.L.R.B. at 1095.

[90]NLRB v. Affiliated Midwest Hospital, Inc., 789 F.2d at 528 (citing NLRB v. Action Automotive, Inc., 105 S. Ct. 984, 988 (1985)).

again" treatment of general campaign misrepresentations as compared to the Board's uniform and consistent approach to misrepresentations concerning Board actions or processes. The Seventh Circuit, unmoved by this argument, stated: "The fact that a policy has existed for a long period of time does not alone establish that all alternatives are incorrect or untenable."[91]

The Seventh Circuit also addressed the propriety of the Board's abandonment of its rationale for distinguishing misrepresentation of Board actions from other types of misrepresentations, namely, that the former situation impugns the neutrality of the NLRB. After reviewing the Board's justifications for departing from its rationale, the court concluded: "Given the judicial acceptance of *Midland*, the Board's extension of that policy to the type of conduct involved here cannot be deemed to be unreasonable as a matter of law."[92] Accordingly, the court enforced *Riveredge Hospital* on the issue of mischaracterizations of Board actions by a party in an election campaign.

One of the reasons given by the Board in justifying its change of policy in *Riveredge Hospital* and which the Seventh Circuit found not to be unreasonable in *Midwest Hospital*, was that "misrepresentation was viewed as different from the alteration of a Board document, an action that *Midland* considered to be *per se* objectionable . . . on the grounds that when the speaker is a party rather than the agency itself the voters are less likely to consider the statement truthful."[93] The distinction between the Board's treatment of misrepresentations and alterations of Board documents has narrowed significantly since *Midland*. This is evidenced by three Board decisions on the issue of altered Board documents during the survey period. All three of the cases interpreted and applied the new standards recently established in *SDC Investments, Inc.*[94]

In *SDC*, the Board held that it would no longer find that reproduction of Board documents for partisan purposes is *per se* objectionable conduct.[95] Rather, the Board explained:

> [W]e believe that the crucial question should be whether the altered ballot in issue is likely to have given voters the misleading impression that the Board favored one of the parties to the election. When it is evident that the altered ballot is the work of a party, rather than the Board, employees are perfectly capable of judging its persuasive value.[96]

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[91] *Id.* at 528

[92] *Id.* at 529 (referring to NLRB v. Best Products, Inc., 765 F.2d 903, 911-13 (9th Cir. 1985) (detailing the acceptance of the *Midland* rule)).

[93] *Id.* (emphasis in original).

[94] 274 N.L.R.B. No. 78 (Feb. 28, 1985), 118 L.R.R.M. (BNA) 1410 (1985).

[95] *Id.* slip op. at , 118 L.R.R.M. at 1412.

[96] *Id.*

Accordingly, the Board adopted as its new position that when the altered material on its face clearly identifies the party who prepared it the alteration is not objectionable and will not serve as the basis for setting aside an election.[97] The Board also expressly embraced a case-by-case analysis for instances in which the source of the alteration is not clearly identified on the document at issue.[98] The case-by-case approach requires an examination of the nature and content of the material in order to determine whether the document has the tendency to mislead employees into believing that the Board favors one party over the other.[99] The Board applied the *SDC* standards liberally and in favor of the party altering Board documents during the survey period.

In *Professional Care Centers of North America, Inc.*,[100] for example, the Board found unobjectionable a copy of its sample ballot that had been altered in the following manner: (1) the Board's name and seal had been deleted and replaced by the union's name, address, and seal; (2) the "Yes" box on the ballot had been marked with an "X"; and (3) the phrase "The National Labor Relations Board protects your right to a free choice" had been lifted from another portion of the notice and inserted below the ballot.[101] The Board also found permissible the following modifications to a copy of its "Rights of Employees" publication: (1) The Board's seal and heading had been removed from the top of the page; and (2) the Board's seal and heading had been exised from the lower portion of the page and replaced with, "you have the right to vote by secret ballot—the boss will not know how you vote. Vote union—vote to improve your conditions [—] stand up for your rights" and "Distributed by—Local Union 410—AFSME, AFL-CIO, St. Louis, MO."[102]

The Board majority comprising Chairman Dotson and Member Dennis, concluded that the alterations were not objectionable because the name, address, telephone number and seal of the union appeared on the face of the election notice and because the reverse side of the notice identified the union as the party responsible for its distribution.[103] The Board found that voters were not likely to be misled into believing that the Board favored the union in the election.[104] Member Johansen, dissenting from the majority's conclusion, stated: "The document in dispute fails to note that alterations were made, what the alterations were, and who

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[97] *Id.*
[98] *Id.* (footnote omitted).
[99] *Id.*
[100] 279 N.L.R.B. No. 106 (April 30, 1986), 122 L.R.R.M. (BNA) 1076 (1986).
[101] *Id.* slip op. at 3, 122 L.R.R.M. at 1077 (Johansen, Member, dissenting).
[102] *Id.* slip op. at 3-4, 122 L.R.R.M. at 1077.
[103] *Id.* slip op. at 1 n.1, 122 L.R.R.M. at 1076-77.
[104] *Id.*

made them. This can mislead voters who may perceive the document as emanating from the Board in that form."[105]

Even when the name of the party making the alterations is unquestionably omitted from the altered Board documents, the Board has still shown reluctance to find the document objectionable. In *C.J. Krehbiel Company*,[106] with Member Johansen again dissenting, the Board concluded that an altered portion of an ALJ's decision distributed by a union in a representation election was not likely to mislead employees into believing that the Board supported the union.[107] Because the name of the union was not on the flyer, although the flyer had been mailed to employees in envelopes bearing the union's name,[108] the Board had to examine the nature and content of the altered material to determine whether it had the tendency to mislead the employees as to the Board's neutrality in the election.[109]

The remedy section of the ALJ's decision, which was reproduced in the flyer, involved another company in the same industry as the employer. On the same page as the ALJ's decision was a 5-inch "crowing rooster," the words "Vote Yes," a box with an "X" in it, and other prounion cartoons. The union had also undescored certain portions of the opinion. Two days after distributing the first flyer, the union distributed a second flyer that referred to the first flyer as being an "actual copy" of a portion of an ALJ's decision.

Contrary to Member Johansen's view that the "two documents, taken together, were likely to mislead the employees into believing that an administrative law judge, and by extension the Board, was encouraging the employees to 'Vote Yes' in the election,"[110] Chairman Dotson and Member Dennis credited the employees with greater power of discernment:

> We cannot find that the 17 June flyer had a tendency to mislead employees into believing that the Board endorsed the Union. No reasonable employee would believe that an administrative law judge would embellish his decision with cartoons, slogans, and crowing roosters . . . . Further, the sheer physical size and placement of the cartoons and slogans on the leaflet support the conclusion that these items were additions made by the preparer of the flyer.[111]

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[105]*Id.* slip op at 3, 122 L.R.R.M. at 1077 (Johansen, Member, dissenting).

[106]279 N.L.R.B. No. 114 (May 7, 1986), 122 L.R.R.M. (BNA) 1105 (1986).

[107]*Id.* slip op. at 3, 122 L.R.R.M. at 1105.

[108]*Id.* slip op. at 2 n.2, 122 L.R.R.M. at 1055 n.2.

[109]*Id.* slip op. at 2, 122 L.R.R.M. at 1105. *See SDC,* 274 N.L.R.B. No. 78, slip op. at , 118 L.R.R.M. at 1412.

[110]279 N.L.R.B. No. 114, slip op. at 5, 122 L.R.R.M. at 1106 (Johansen, Member) dissenting).

[111]*Id.* slip op. at 3, 122 L.R.R.M. at 1105.

Accordingly, the Board certified the results of the election.[112]

Based on Member Johansen's dissenting opinions in *Professional Care* and *C.J. Krehbiel*, it is difficult to understand why he joined with Chairman Dotson in deciding *Rosewood Manufacturing Co.*[113] in favor of an employer who had altered an official NLRB sample ballot. Johansen's position in *Rosewood* is especially perplexing in the face of Member Dennis' dissent. *Rosewood* is factually very close to *SDC*, in which the Board found objectionable a hand-written facsimile of an official sample ballot altered by the addition of the phrase "remember to vote yes."[114]

In *Rosewood*, the employer altered and then posted official NLRB election documents from an election between the same parties some nine months earlier. The modification consisted of a handwritten caption, "Vote No," on the top half of the election notice with an arrow drawn to the "No" portion of the sample ballot. The union contended that the employer had also placed an "X" in the "No" box on the actual materials posted. Nowhere on the altered documents did the employer identify itself.[115]

Nonetheless, the Board found that the campaign material was permissible reasoning that "the handwritten message . . . as well as the drawn arrow was clearly discernible as [an] addition made by the Employer and sufficiently distinct from the printed notice and sample ballot so as to preclude the suggestion that the Board was endorsing the Employer."[116] The Board also based its conclusion on the fact that the altered documents stemmed from the first election between the parties, and explained that this fact somehow "would have alerted voters that the alteration was not endorsed by the Board."[117]

Relying on *SDC* and *Silco, Inc.*,[118] the latter of which is almost factually indistinct from *Rosewood*, Member Dennis strongly disagreed with the Board's position:

> In Silco, Inc., cited with approval footnote 5 of SDC, above, the Board found objectionable the Employer's posting of hand-printed facsimile sample ballots with the words "Vote 'No' ON JULY 2!" written just beneath the facsimile and an arrow drawn to the "No" box. The Board observed the document did not show the Employer was responsible, and reasoned that, although

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[112] *Id.* slip op. at 1, 122 L.R.R.M. at 1105.
[113] 278 N.L.R.B. No. 103 (Feb. 26, 1986), 121 L.R.R.M. (BNA) 1225 (1986).
[114] 274 N.L.R.B. No. 78 (Feb. 28, 1985), 118 L.R.R.M. (BNA) 1410 (1985).
[115] 278 N.L.R.B. No. 103, slip op. at 1, 121 L.R.R.M. at 1225.
[116] 278 N.L.R.B. No. 103, slip op. at 3, 121 L.R.R.M. at 1225 (footnote omitted).
[117] *Id.* slip op. at 4, 121 L.R.R.M. at 1225-26.
[118] 231 N.L.R.B. 110 (1977).

> not an exact NLRB ballot replica, "this facsimile necessarily tends to suggest that the material appearing thereon bears the board's approval."
>
> As no meaningful distinction exists between the instant facts and those in Silco, a case remaining viable after SDC, I would set aside the election.[119]

Because *Rosewood* was a three-member decision, had Johansen agreed with Dennis, as his positions in *Professional Care* and *C.J. Krehbiel* suggested, *Rosewood* would have been decided in favor of setting aside the election.[120]

VII. Threats of Reprisal Implied Through an Employer's Use of Copies of Board Cases in Election Campaigns

In *National Micronetics, Inc.*,[121] the Board changed its view regarding the distribution and highlighting of certain sections of previous Board decisions by an employer during a representation campaign. In an earlier case, *Glassmaster Plastics Co.*,[122] the Board had upheld an ALJ's determination that altering and disseminating the Board's opinion in *Oxford Pickles*[123] was objectionable conduct.[124] The employer had summarized *Oxford Pickles* and marked it up in such a way as to emphasize only certain portions of the decision. The manner in which the employer presented these materials during the election campaign was viewed by the ALJ as "clearly designed and . . . clearly hav[ing] the effect of a not so subtle threat of reprisal . . . ."[125]

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[119]278 N.L.R.B. No. 103, slip op. at 5-6, 121 L.R.R.M. at 1226 (Dennis, Member, dissenting) (citations omitted). In response to Dennis' dissent, the majority pointed out that "[i]n Silco, the message, 'Vote "No" on July 2!' was hand-printed in the same style as the hand-printed sample ballot posted by the employer. The partisan message was not sufficiently distinct from the facsimile ballot and tended to suggest that the alteration bore the Board's approval." *Id.* slip op. at 3 n.8, 121 L.R.R.M. at 1225.

[120]One must hope that Johansen's apparent inconsistent positions in these three cases were not caused by the fact that *Professional Care* and *C. J. Krehbiel* involved union-altered Board materials and union-won elections, whereas it was the employer who had made the modifications and won the election in *Rosewood.*

[121]277 N.L.R.B. No. 95 (Dec. 9, 1985), 121 L.R.R.M. (BNA) 1035 (1985).

[122]203 N.L.R.B. 944 (1973).

[123]190 N.L.R.B. 109 (1971). *Oxford Pickles* is frequently used by employers during election campaigns because of some of the statements made by the Board in the case in upholding an employer's campaign representations. For instance, in one paragraph of the decision, the Board said: "[T]here is no requirement in the Act that an employer accede to all union demands or, after bargaining, retain all current benefits. Nor does the presence of a union prohibit an employer from moving its plant should ecenomic conditions so dictate. Similarly, an employer may permanently replace economic strikers." *Id.* at 109.

[124]203 N.L.R.B. at 944.

[125]*Id.* at 951.

Similarly, the employer in *National Micronetics* distributed copies of *Oxford Pickles*, as reported in LRRM, but added a handwritten statement at the top saying: "HERE'S THE FACTS from the NATIONAL LABOR RELATIONS BOARD—THEY ARE NEUTRAL. THIS IS THE LAW—READ IT." The LRRM headnotes had been underlined and characterized as follows:

> FACT # 1 — *LMRA does not require that employer accede to all union demands or, after bargaining, retain all current benefits*;
>
> . . . .
>
> FACT # 2 — . . . *in fact employer may permanently replace economic strikers and presence of union does not prohibit an employer from moving its plant should*
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> FACT # 3 — *economic conditions dictate;*
>
> . . . .
>
> FACT # 4 — . . . *that all union promises of improved benefits are not attainable without prior employer assent*;
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> . . . .[126]

The text of the decision had also been bracketed, underlined, and characterized as "TRUE" in certain places.

Applying *Glassmaster*, the ALJ in *National Micronetics* found the employer's alteration and distribution of *Oxford Pickles* objectionable because it constituted an unlawful threat of reprisals against employees if they selected the union as their bargaining representative.[127] The Board reversed the ALJ on this issue and expressly overruled *Glassmaster Plastics* to the extent that it was inconsistent with the Board's new view.[128] The Board concluded:

> The highlighted portions of the LRRM report are accurate statements of the law, and the Respondent had a right to disseminate such information, especially when the Union had misstated the law on these points during the election campaign. . . . We find that distributing accurate copies of a Board decision with portions highlighted and characterized as "true" can in no way be construed as an illegal threat or as objectionable conduct.[129]

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[126] 277 N.L.R.B. No. 95, slip op. at 4, 121 L.R.R.M. at 1037.
[127] *Id.*
[128] *Id.* slip op. at 5, 121 L.R.R.M. at 1037.
[129] *Id.*

VIII. Employer's Right to Refuse to Bargain After Union Affiliation Election in which Nonunion Employees were not Permitted to Vote

In *Amoco Production Co.*[130] the Board held that all employees in a bargaining unit, not just union members, must be given the opportunity to participate in a union affiliation election.[131] Otherwise, the Board explained, it will not amend the union's certification or require the employer to bargain with the reorganized union.[132] The Fifth Circuit upheld the Board's decision in *Amoco*,[133] and the Seventh Circuit later followed suit by upholding the Board's new rule in *United Retail Workers Union Local 811 v. NLRB*.[134] During the survey period, the Supreme Court, in "one of those rare departures from [the] Court's long history of special deference to the Board's decisions concerning the selection of an exclusive bargaining unit representative by employees,"[135] struck down the Board's new policy.

In *NLRB v. Financial Institution Employees of America*,[136] an employer-bank refused to bargain with a reorganized union purporting to represent the bank's employees because nonunion employees in the bargaining unit had been excluded from participating in the union affiliation election. In dismissing the new union's sections 8(a)(1) and (5) charges against the bank, the Board held that because nonunion employees were not allowed to vote in the affiliation election, the election did not meet minimal "due process" standards and the affiliation was therefore invalid.[137] Upon the union's petition for review, the Ninth Circuit reversed and remanded the case, and thus created a conflict between itself and the Fifth and Seventh Circuits.[138] The appellate court concluded that the Board's requirement that nonunion employees be permitted to vote on affiliation questions "[was] irrational and inconsistent with the National Labor Relations Act."[139] The Supreme Court agreed with the Ninth Circuit.[140]

The Court acknowledged that there are instances in which employee

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[130] 262 N.L.R.B. 1240 (1982).

[131] *Id.* at 1241.

[132] *Id.*

[133] Local Union No. 4-14, Oil, Chem. & Atomic Workers Int'l Union v. NLRB, 721 F.2d 150 (5th Cir. 1983).

[134] 774 F.2d 752 (7th Cir. 1985).

[135] NLRB v. Financial Inst. Employees of Am., Local 1182, 106 S. Ct. 1007, 1017 (1986) (Burger, C.J., concurring).

[136] 106 S. Ct. 1007 (1986).

[137] Seattle-First National Bank, 265 N.L.R.B. 426 (1982).

[138] 752 F.2d 356 (9th Cir. 1984).

[139] *Id.* at 362.

[140] 106 S. Ct. at 1017.

support for a certified union may be eroded by changed circumstances.[141] The Court also recognized an employer's right to allege these changed circumstances and effect an election to determine whether a union representing its employees continues to enjoy majority support.[142] But to accomplish this result the Court added that the employer "must 'demonstrate by objective considerations that it has some reasonable grounds for believing that the union has lost its majority status.' "[143] The Court noted that one such objective consideration might be an independent union's affiliation with a national or international organization.[144] However, the Court explained that affiliation has long been considered an internal matter that does not affect the union's status as bargaining representative and emphasized that the employer remains obligated to recognize the reorganized union if the affiliation election is conducted with adequate "due process" safeguards and there is substantial continuity between the pre- and post-affiliation union.[145]

Finding that the Board's new rule "dramatically changes this scheme,"[146] because it permits an employer to challenge a union's continuing majority support even if the organizational changes resulting from the affiliation are not substantial enough in themselves to raise a question of representation,[147] the Court held that the rule exceeds the Board's statutory authority. Rejecting the Board's arguments that the new rule minimized industrial strife and was a reasonable means of protecting employees' rights to select a bargaining representative, the Court reasoned that the new rule "violated the policy Congress incorporated into the Act against outside interference in union decision-making."[148] Accordingly, the Court concluded that the Board must determine under traditional standards whether union affiliation raises a question of representation.[149] If the question is raised, then an election must be held to decide whether the new union is still the choice of the majority of employees in the unit. Neither the Board nor the employer will any longer be permitted to circumvent this procedure simply by relying on the fact that nonunion employees were denied participation in the affiliation election. Conversely, the Board may no longer interfere in internal union affairs by requiring that nonunion employees be allowed to vote in affiliation elections for such elections to be valid.

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[141]*Id.* at 1011.

[142]*Id.* (citing 29 U.S.C. § 159(c)(1)(A)(ii); 29 C.F.R. §§ 101.17, 102.60(a)(1985).

[143]106 S. Ct. at 1011 (quoting United States Gypsum Co., 157 N.L.R.B. 652, 656 (1966)).

[144]*Id.* (footnote omitted).

[145]*Id.* at 1012.

[146]*Id.* (footnote omitted).

[147]*Id.* at 1017.

[148]*Id.* at 1014.

[149]*Id.* at 1014-15 (footnote omitted).

Developments in Professional Liability

Donald L. Jackson*

Judicial developments in the Indiana courts during the survey period have yielded a number of interesting decisions dealing with professional liability and responsibility.[1] However, there was a paucity of unique judicial determinations that resolved conflicts between the appellate districts or that established new law. This summary discussion is, therefore, intended as a forum to briefly inform legal practitioners and scholars of two cases involving the liability of attorneys.

I. Statute of Limitations

One important development during the survey period concerned the tolling of the statute of limitations in legal malpractice suits involving fraudulent concealment by an attorney. The First District Court of Appeals of Indiana confronted this issue in *Lambert v. Stark*,[2] a case which dealt with the tolling effect of a continuing attorney-client fiduciary relationship on the statute of limitations.

The Indiana Supreme Court's 1985 decision in *Whitehouse v. Quinn*[3] had settled the uncertainty as to which statute of limitations applied to a legal malpractice action. Prior to *Whitehouse*, there was a conflict among different districts of the Court of Appeals of Indiana as to which statute of limitations applied.[4] *Whitehouse* affirmed with apparent finality that a legal malpractice cause of action is limited by Indiana Code section 34-1-2-2.[5] Because an attorney's act of malpractice results in an injury to or a loss of a personal right or interest in property, a claim

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[1]*See, e.g.*, *In re* Stanton, 492 N.E.2d 1056 (Ind. 1986); *In re* Long, 486 N.E.2d 1031 (Ind. 1986); *In re* Duffy, 482 N.E.2d 1137 (Ind. 1985); Baily v. Martz, 488 N.E.2d 716 (Ind. Ct. App. 1986).

[2]484 N.E.2d 630 (Ind. Ct. App. 1985).

[3]477 N.E.2d 270 (Ind. 1985).

[4]*See* Jackson, *Indiana's Development of a Definitive Legal Malpractice Statute of Limitations*, 19 Ind. L. Rev. 275 (1986).

[5]Ind. Code § 24-1-2-2 (1982) provides in part:

> The following actions shall be commenced within the periods herein prescribed after the cause of action has accrued, and not afterward: (1) For injuries to person or character, for injuries to personal property, and for a forfeiture of penalty given by statute, within two (2) years . . . .

to compensate for such an injury must be commenced within two years after the occurrence of the injury.[6]

With the limitation period thus established, conditions for tolling the statute of limitations received judicial attention in *Lambert*. The Lamberts had sought the advice of counsel, Kesler & Stark, regarding financial problems. Kesler & Stark allegedly advised the Lamberts to dispose of certain property, which the Lamberts did. Kesler & Stark then filed a petition for bankruptcy on behalf of the Lamberts. A few months later, a creditor of the Lamberts objected to the discharge in bankruptcy, alleging fraud in the transfer of such property. Kesler & Stark informed the Lamberts that a complaint opposing their discharge had been filed. The attorneys continued to represent the Lamberts and responded to the creditor's complaint opposing the discharge. On March 19, 1982, the bankruptcy judge denied the Lamberts a discharge in bankruptcy, finding that they intentionally defrauded creditors by transferring property for less than adequate consideration within one year of filing the bankruptcy petition.[7]

Within two years after the denial of the discharge, the Lamberts filed suit against Kesler & Stark.[8] In response to the attorneys' motion for summary judgment asserting that the suit was barred by the statute of limitations, the Lamberts argued that the existence of a continuing fiduciary relationship with their attorneys tolled the commencement of the statute of limitations until they discovered that their attorneys' advice had been incorrect.[9]

There is no question that the statute of limitations period applicable to a legal malpractice cause of action may be tolled by reason of fraudulent concealment. The limitations period will not shield a person who conceals the fact that he is liable for an action.[10] Indiana's statutory basis for tolling the commencement of a limitations period based upon concealment[11] requires that the party actively and intentionally conceal the cause of action.[12]

A corollary to this concept of fraudulent concealment applies where a fiduciary relationship exists and where the fiduciary fails to disclose

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[6]*Whitehouse*, 477 N.E.2d at 274; Shideler v. Dwyer, 275 Ind. 270, 281, 417 N.E.2d 281, 288 (1981).

[7]*Lambert*, 484 N.E.2d at 631.

[8]*Id.*

[9]*Id.* at 632.

[10]IND. CODE § 34-1-2-9 (1982) provides:

> If any person liable to an action shall conceal the fact from the knowledge of the person entitled thereto, the action may be commenced at any time within the period of limitation after the discovery of the cause of action.

[11]*Id.*

[12]*See, e.g.*, Dorsey Mach. Co. v. McCaffrey, 139 Ind. 545, 38 N.E. 208 (1894); Keilman v. Hammond, 124 Ind. App. 392, 116 N.E.2d 515 (1953); Van Spanje v. Hostettler, 68 Ind. App. 518, 119 N.E. 725 (1918).

to the person to whom the fiduciary owes a duty of good faith and loyalty the possible existence of a cause of action against the fiduciary.[13] The Indiana appellate courts have had few occasions to determine whether an attorney's failure to disclose to a client the existence of a possible cause of action for malpractice tolls the commencement of the statute of limitations.[14] In *Lambert*, the First District Court of Appeals of Indiana made clear that in order "to avoid the bar of limitations by claiming fraudulent concealment, [clients must] show that they used due diligence to detect the fraud."[15] A naked assertion that the misconduct was not in fact discovered does not satisfy a client's burden of proving that even if he used reasonable care and diligence, he would not have discovered the possibility of actionable malpractice. Therefore, the Lamberts had the burden of showing they used reasonable care and diligence to detect their attorneys' fraudulent concealment. Because the Lamberts failed to meet this burden, they could not toll the commencement of the statute of limitations. Therefore, their claim for legal malpractice was barred, and summary judgment in favor of Kesler & Stark was proper.[16]

Judge Ratliff's dissent in *Lambert*[17] brings into focus the full ramification of this holding. Judge Ratliff wrote that "[a]lthough Kesler and Stark claim to have advised Lamberts of the petition to deny discharge, an inference could be drawn from the fact of their continued representation opposing the petition to deny discharge, that they were concealing their original malpractice."[18] Thus, in Judge Ratliff's view, where a third party alleges that an attorney's client acted improperly and the attorney continues to defend the propriety of his client's conduct that was based on the erroneous advice of the attorney, there is a sufficient factual basis to infer fraudulent concealment, if the client has no actual knowledge of the legal malpractice.[19] This is true at least for purposes of ruling on a motion for summary judgment.[20]

In contrast to the dissent, the majority in *Lambert* appears to require a client to at least question, if not investigate, possible acts of legal malpractice when the client is given information that may indicate that the attorney's legal advice was possibly in error. Thus, at least in the context of a summary judgment, *Lambert* holds that a client has the

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[13]Such a duty has long been recognized in the context of a physician-patient relationship. *See* Guy v. Schuldt, 236 Ind. 101, 138 N.E.2d 891 (1956).

[14]*See* Keystone Distribution Park v. Kennerk, 461 N.E.2d 749 (Ind. Ct. App. 1984); Whitehouse v. Quinn, 443 N.E.2d 332 (Ind. Ct. App. 1982), *vacated and rev'd on other grounds*, 477 N.E.2d 270 (Ind. 1985).

[15]484 N.E.2d at 632.

[16]*Id.*

[17]*Id.*

[18]*Id.* at 634.

[19]*Id.* at 634-35.

[20]*Id.* at 635.

burden of showing that he used reasonable care and diligence to detect the fraud.[21] A mere showing that the legal advice was discovered to be in error after the attorney-client relationship ended is not sufficient.[22]

Formerly, in one line of Indiana cases, the statute of limitations was tolled if one who had a duty to disclose (as in a fiduciary relationship) failed to do so.[23] However, the *Lambert* court engrafted onto this rule the additional requirement of due diligence mentioned in another line of Indiana cases.[24] It now appears that a victim of legal malpractice who seeks to toll the statute of limitations must present evidence that he used reasonable care and diligence, and that even by the use of such diligence, the victim was not able to discover that the advice was incorrect in order for an attorney to be found guilty of fraudulent concealment. A showing of continued representation by the attorney will not be sufficient to prove fraudulent concealment and therefore to toll the statute of limitations. This result, while possibly harsh, appears to be consistent with the strong policy underlying the statute of limitations.[25]

II. Additional Client and Attorney Exposure

A second noteworthy development during the survey period was the expansion of vicarious liability in the context of the attorney-client relationship. In addition to expanding the potential for damages to be assessed against a client by a third party for the acts or omissions of an attorney, an attorney's total exposure to a client for such wrongful acts could be greater. In *United Farm Bureau Mut. Ins. Co. v. Groen*,[26] a case of first impression in Indiana, the Indiana Court of Appeals held an insurance company liable for the alleged negligence and abuse of process by its attorney in a subrogated claim brought on behalf of the insurer.[27]

The facts of *Groen* clearly illustrate the cause for concern. In *Groen*, the insurance company retained an attorney to bring suit to recover on a subrogated claim arising from an automobile accident. A default judgment was granted against Thomas Groen. When a copy of the default judgment was forwarded to the Bureau of Motor Vehicles by the insurer's attorney, Groen's license was suspended. Groen was later arrested for driving with a suspended license. Groen succeeded in setting the default judgment aside on the grounds that he was never served

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[21]*Id.* at 632.

[22]*Id.*

[23]Dotlich v. Dotlich, 475 N.E.2d 331 (Ind. Ct. App. 1985). *But see* Forth v. Forth, 409 N.E.2d 641 (Ind. Ct. App. 1980) (court held that there was no tolling).

[24]*See Keystone Distribution Park*, 461 N.E.2d 749; *Whitehouse*, 443 N.E.2d at 332.

[25]*See* Shideler v. Dwyer, 275 Ind. 270, 273, 417 N.E.2d 281, 283 (1981).

[26]486 N.E.2d 571 (Ind. Ct. App. 1985).

[27]*Id.*

with process and therefore the court never obtained jurisdiction over him. Groen filed suit against the insurance company and the attorney for negligence and abuse of process.[28] The insurance company was held to be accountable for damages caused by the negligence and abuse of process occasioned by the acts of its attorney.[29]

While in a representative capacity, an attorney has long been considered an agent of a client;[30] but no Indiana authority had fully considered the capacity in which an attorney serves a client in relation to notions of vicarious liability for tortious conduct. Traditional notions of vicarious liability are based upon the doctrine of respondeat superior and require determination of such issues as the power or right to control and the existence of a master-servant relationship.[31]

In *Groen*, the insurance company asserted that the doctrine of respondeat superior applied in order to determine a client's liability for the acts of its attorney.[32] Within this framework, the company argued that an attorney is an independent contractor whose acts are not under the immediate control of a client, and thus, a client should not be held liable for an attorney's tortious conduct.[33] The court, however, rejected the premise that a master-servant relationship was necessary to hold a client liable for the acts of its attorney.[34]

Without a great deal of analysis of the numerous policy considerations in this area, the court held:

> Because of the close identity of an attorney with the client he represents, we hold that neither the absence of a master-servant relationship nor the characterization of the attorney as an independent contractor is a bar to the liability of the client for the torts of the attorney acting within the scope of his authority.[35]

While such a result is not inconsistent with decisions in other states,[36] it represents a significant expansion of traditional notions of vicarious liability for tortious acts if it is applied to other than the attorney-client

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[28]*Id.* at 572.

[29]*Id.* at 574.

[30]*See* State *ex rel.* Peoples Nat'l Bank & Trust Co. v. Dubois Cir. Ct., 250 Ind. 38, 233 N.E.2d 177 (1968), *reh'g denied*, 250 Ind. 38, 234 N.E.2d 859 (1968); Kreite v. Kreite, 93 Ind. 583 (1883).

[31]*See, e.g.*, Railway Express Agency, Inc. v. Bonnell, 218 Ind. 607, 33 N.E.2d 980 (1941); Trinity Lutheran Church v. Miller, 451 N.E.2d 1099 (Ind. Ct. App. 1983); Gibbs v. Miller, 152 Ind. App. 326, 283 N.E.2d 592 (1972); RESTATEMENT (SECOND) OF AGENCY §§ 212-67 (1957); W. SEAVEY, HANDBOOK OF THE LAW OF AGENCY (1964).

[32]486 N.E.2d at 573.

[33]*Id.*

[34]*Id.* at 573-74.

[35]*Id.* at 574.

[36]*Id.* Cited in *Groen* in support of its holding:

Hewes v. Wolfe, 74 N.C. App. 610, 330 S.E.2d 16 (1985) (where attorney tortiously institutes or continues civil proceedings or is guilty of oppressive or relationship. It should not be. The attorney-client relationship is unique in that the attorney has almost unbridled authority to act on behalf of his client. No other principal-agent relationship exists in which the agent occupies a position as special as that of the attorney to his client.

While earlier cases clearly have held that an attorney's acts as an agent are binding upon his client,[37] these cases involved the effect of an attorney's actions upon the actual case being litigated by the attorney. Because an attorney is specifically engaged to act on behalf of a client in a legal proceeding, it is not surprising that his actions bind a client for purposes of those proceedings. The *Groen* decision can be said to be a logical extension of these decisions. By holding the insurance company liable to Groen for the negligence of its attorney, *Groen* appears to conclude that the attorney acted as the agent of the company, and therefore, the negligence of the attorney was the negligence of the insurance company.[38]

Authority also exists for assessing monetary sanctions against a client for costs incurred by an opposing party as a result of an attorney's conduct.[39] Such liability is predicated upon procedural rules[40] and is intended to facilitate the efficient operation of the courts.

Not only is the concept of vicarious liability set forth in *Groen* of substantial concern to a client, an attorney's potential liability for damages for wrongful or negligent acts is expanded. As the insurance company

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> wrongful conduct during course of proceeding in order to enforce claim of client, client is liable for attorney's wrongful acts); *Racoosin v. LeSchack & Grodensky*, 103 Misc. 2d 629, 426 N.Y.S.2d 707 (1980) (utility liable for damages for willful interference with property where judgment against customer for unpaid utility bills was later declared void for lack of jurisdiction over customer); *Flight Kitchen, Inc. v. Chicago Seven-Up Bottling Co.*, 22 Ill. App. 3d 558, 317 N.E.2d 663 (1974) (corporate defendant liable for acts of attorney who wrongfully ordered levy against plaintiff's property to enforce judgment rendered on behalf of defendant).

Accord, Peterson v. Farmers Casualty Co., 226 N.W.2d 226 (Iowa 1975). *But see* Lynn v. Superior Court, 225 Cal. Rptr. 427, 180 Cal. App. 3d 346 (1986) (client is not liable for the negligent or intentional infliction of emotional distress caused by its attorney because an attorney is an independent contractor); Plant v. Trust Co. of Columbus, 168 Ga. App. 909, 310 N.E.2d 745 (1983); Evans v. Steinberg, 40 Wash. App. 585, 699 P.2d 797 (1985) (insurer not liable for malpractice claims against an attorney because an attorney is an independent contractor).

[37]*See, e.g.*, International Vacuum, Inc. v. Owens, 439 N.E.2d 188 (Ind. Ct. App. 1982) (citing Kuhn v. Indiana Ice & Fuel Co., 104 Ind. App. 387, 390, 11 N.E.2d 508, 509 (1937)); *see also supra* note 30.

[38]486 N.E.2d at 573-74.

[39]In Brutus v. Wright, 163 Ind. App. 366, 324 N.E.2d 165 (1975), costs were assessed against a client for expenses associated with a continuance caused by an attorney's delay.

[40]Ind. R. Tr. P. 53.5 provides in part "the court may award such costs as will reimburse the other parties for their actual expenses incurred from the delay." *See also* Ind. R. Tr. P. 11; Fed. R. Civ. P. 11, 37(b).

did in *Groen*, a client will most likely contest such claims of vicarious liability for the acts of the attorney. Generally, any attorney's fees reasonably incurred in such defense to reduce or avoid damages caused by an attorney's negligent or wrongful actions are recoverable as consequential damages in a subsequent malpractice action against an attorney.[41] Thus, in addition to being liable in damages for tortious conduct, an attorney may also be liable to a client for expenses incurred by the client to mitigate or defend against the damages claimed by a third party and caused by the acts constituting malpractice.

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[41] *See, e.g.*, United Fidelity Life Ins. Co. v. Law Firm of Best, Sharp, Thomas & Glass, 624 F.2d 145 (10th Cir. 1980); Spering v. Sullivan, 361 F. Supp. 282 (D. Del. 1973); McGregor v. Wright, 117 Cal. App. 186, 3 P.2d 624 (1931); Ninth Ave. & Forty-Second St. Corp. v. Zimmerman, 217 A.D. 498, 217 N.Y.S. 123 (1926); Hiss v. Friedberg, 201 Va. 572, 112 S.E.2d 871 (1960); R. Mallen & V. Levit, Legal Malpractice § 309 (2d ed. 1981).

Claims By and Against Decedents' Estates

Debra A. Falender*

I. Introduction

Several cases decided during the survey period resolved issues concerning claims made by and against decedents' estates and decedents' successors.[1] The discussion of these cases will be divided into three parts: claims and actions by decedents' estates; claims against decedents' estates; and actions to impose constructive trusts on decedents' successors.

II. Claims by Decedents' Estates

The most interesting of the recent cases[2] involving claims made by

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[1]An important development related to claims and actions by decedent's successors was the amendment of the will contest statute, Ind. Code § 29-1-7-17 (Supp. 1986), changing the contest filing period to "five months after the [will] has been spread of record or the date of the first published notice to creditors, whichever occurs later." The legislature removed the former unfortunate reference to the time the will was offered for probate. The amendment is certainly applicable to estates of decedents who die after its effective date, which is September 1, 1986. *See* Ind. Code § 1-1-3-3 (1982). Perhaps it is also applicable to estates opened after its effective date or to contests filed after its effective date, because the amendment extends and clarifies the time for contest.

Two will contest cases were decided during the survey period: Farner v. Farner, 480 N.E.2d 251 (Ind. Ct. App. 1985) (affirming the trial court's judgment in favor of the will over allegations of undue execution, undue influence, and unsoundness of mind), and *In re* Estate of Parlock, 486 N.E.2d 567 (Ind. Ct. App. 1985) (holding that inconsistency between the attestation clause and the will was not fatal to the will's validity when the inconsistency concerned something not required for the will's validity, namely, the testator's signature on every page). The *Farner* case extensively reviews the law of undue influence and evidence in will contest actions.

[2]One recent, interesting case held that the personal representative could sue to recover a lump-sum child support arrearage owed the deceased custodial parent. In that case, Lizak v. Schultz, 480 N.E.2d 962 (Ind. Ct. App. 1985), the court decided that the divorce court does not lose "subject-matter jurisdiction to reduce support arrearage to a lump sum upon the death of the custodial parent." 480 N.E.2d at 963. The court applied an exception to the general rule, *see* State *ex rel.* Paxton v. Porter Superior Court, 467 N.E.2d 1205 (Ind. 1984), that divorce proceedings terminate entirely upon the death of one of the parties. Furthermore, the court held that the support arrearage is "money owed" the deceased custodial parent at the time of his death, if he had expended his own funds to satisfy the support needs of the children; thus, pursuant to Ind. Code § 29-1-13-3 (1982), the custodial parent's personal representative may sue the noncustodial parent to recover this "money owed." *Lizak*, 480 N.E.2d at 964.

Two other cases concerned actions to recover damages for wrongful death. The courts' decisions in these cases were based on well-settled Indiana precedent. In Andis v. Hawkins, decedents' estates and decedents' successors was *Bailey v. Martz*,[3] which arose out of an action to recover damages for malpractice against attorneys who allegedly let the statute of limitations run on actions to recover for personal injury suffered by a deceased minor.[4] In resolving the malpractice issue, the *Bailey* court considered the relationship among three sections of the statutes of limitations,[5] namely, Indiana Code section

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489 N.E.2d 78 (Ind. Ct. App. 1986), the court held that punitive damages are not recoverable in an action by parents under IND. CODE § 34-1-1-8 (1982) to recover for the wrongful death of their child, because Indiana judicial decisions have restricted the recovery to pecuniary loss. *See, e.g.*, Boland v. Greer, 409 N.E.2d 1116 (Ind. Ct. App. 1980) (transfer denied). In dicta, the *Andis* court stated that punitive damages also are not recoverable in an action for the wrongful death of an adult, because IND. CODE § 34-1-1-2 (1982) specifies the elements of recoverable damages, and punitive damages are not specified. 489 N.E.2d at 82.

In another wrongful death case, Community Hospital of Anderson v. McKnight, 482 N.E.2d 280 (Ind. Ct. App. 1985), the court held that pursuant to the wrongful death statute, IND. CODE § 34-1-1-2 (1982), the only person who can bring an action for wrongful death based on medical malpractice is the decedent's personal representative, who must be appointed within two years of the decedent's death. The decedent's widow and child unsuccessfully argued that an order of no administration within two years of death was a substitute for appointment of a personal representative.

[3]488 N.E.2d 716 (Ind. Ct. App. 1986).

[4]The child's father first asked one lawyer to pursue each of at least three actions: one to recover for the personal injuries suffered when the child was rendered quadriplegic as a result of a motorcycle collision with a train; another to recover for injuries suffered when the child was burned by a malfunctioning heart monitor; and another to recover for the child's wrongful death, allegedly caused by a malfunction in lung stimulation equipment and by delay in sending an ambulance when the child had stopped breathing. The child's father discharged the first lawyer, who had not pursued any of the claims, and hired two other lawyers to pursue all claims, including a possible malpractice action against the first lawyer.

Twenty months after the child's death, the two lawyers withdrew their representation because they saw a potential conflict of interest between themselves and their client. They concluded that the eighteen-month survival-of-action statute, IND. CODE § 34-1-2-7 (1982), possibly had run while they were representing the father; and if it had run, the father had a cause of action for malpractice against them. When they withdrew, the two lawyers had not filed an action against anyone.

Exactly two years after his child's death, the father retained other counsel. Six months later, an estate was opened for the child, and two months after that, the instant malpractice action was filed by the father against the two lawyers. The alleged malpractice consisted of failure to file any of the actions described above and wrongful withdrawal from representation. One of the lawyers' defenses was that neither their withdrawal nor their failure to file the actions caused harm to the father or to his son's estate. They contended, inter alia, that no statute of limitations had run against the claims while they were representing the father, and that the father had four months left on the applicable statute of limitations after their withdrawal to seek other counsel to pursue the claims. The trial court entered summary judgment in favor of the lawyers. The two-year statute of limitations on the wrongful death actions clearly had not run by the time of the lawyers' withdrawal. IND. CODE § 34-1-1-2 (1982). Arguments in the case centered around the personal injury statutes of limitations.

[5]488 N.E.2d at 723-24.

34-1-2-2(1), which is the two-year statute of limitations for personal injuries;[6] Indiana Code section 34-1-2-5, which provides that "[a]ny person . . . under legal disabilities when the cause of action accrues may bring his action within two . . . years after the disability is removed;"[7] and Indiana Code section 34-1-2-7, which provides an eighteen-month extension of the limitations period for persons who die before bringing an action or being sued.[8]

The court in *Bailey* reasoned that the applicable personal injury statute of limitations of two years, Indiana Code section 34-1-2-2(1), was not running when the minor died because it was tolled by Indiana Code section 34-1-2-5 until the minor's eighteenth birthday.[9] When the minor died prior to attaining majority, the two-year personal injury limitations period of section 34-1-2-2(1) *then* began to run.[10] Thus, the court held, the eighteen-month death time survival period of Indiana Code section 34-1-2-7 would not apply for two reasons: first, because the applicable two-year personal injury statute had not begun to run and consequently could not be "extended" when the minor died, and secondly, because application of the eighteen-month period would have shortened the two-year personal injury statute of limitations.[11]

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[6]Ind. Code § 34-1-2-2(1) (1982) [hereinafter personal injury statute of limitations] provides: "The following actions shall be commenced within the periods herein prescribed after the cause of action has accrued, and not afterwards: (1) For injuries to person or character, for injuries to personal property, and for a forfeiture of penalty given by statute, within two (2) years."

[7]Ind. Code § 34-1-2-5 (1982) [hereinafter disability statute of limitations].

[8]Ind. Code § 34-1-2-7 (1982) [hereinafter death-time survival statute of limitations] provides:

> If any person entitled to bring, or liable to, any action, shall die before the expiration of the time limited for the action, the cause of action shall survive to or against his representatives, and may be brought at any time after the expiration of the time limited within eighteen (18) months after the death of such person.

[9]The court said, "Thus, had Mark lived, running of the applicable statute of limitations would have been tolled until . . . his 18th birthday." 488 N.E.2d at 722.

[10]Using the court's analysis, if the minor had survived to majority, then the two-year personal injury statute, Ind. Code § 34-1-2-2(1) (1982), would have begun to run on his eighteenth birthday.

[11]The court stated:

> Contrary to Bailey's claim, I.C. 34-1-2-7 does not apply here. Our [s]upreme [c]ourt has determined this code section applies only to cases where the party dies after the applicable statute of limitations has begun to run and before the time limit has expired. Here, however, the applicable limitations statute was not running at the time Mark died. Further, the [s]upreme [c]ourt determined the effect of this section is to *extend* the time of limitations only, *never* to diminish it. . . . The application for which Bailey contends would have shortened the 2 year period for the filing of this action by 6 months. I.C. 34-1-2-7 is not the statute of limitations which applies here.

488 N.E.2d at 722 (citations omitted, emphasis in original).

The error in the court's analysis is its view that when a disability exists on the day a cause of action accrues, the general statute of limitations is tolled at the outset and does not begin to run. This approach is not supported by the language or the logic of the statutes. An approach consistent with the language of the statutes would identify two separate statutes of limitations under the special circumstances of disability or death. In all cases, by its terms, the applicable general statute of limitations begins to run when the cause of action accrues.[12] If at that time the plaintiff is under a disability, the general statute continues to run, but in addition, a special statute will begin to run when the disability is removed.[13] Then, if the plaintiff (or defendant) dies while either statute is running, another special death-time survival statute begins to run at the time of death.[14] In any event, under firmly entrenched Indiana Supreme Court precedent, the disability statute of limitations will never operate to shorten the general statute of limitations; likewise, the eighteen-month death-time survival statute will never operate to shorten either the general statute or the disability statute of limitations.[15]

The *Bailey* court correctly stated this well-entrenched precedent, but incorrectly applied it when the court determined that the death-time survival statute would shorten the general two-year statute, which according to the court began to run when the deceased minor died. Actually, when the minor died more than two years after the injuries, the only potentially applicable statutes of limitations were the two-year disability statute and the death-time survival statute. One could argue that the two-year disability statute was operable because when the minor died, his disability was removed for the first time.[16] Alternatively, one could argue that the only relevant statute of limitations at the time of the child's death was the death-time survival statute.[17] The *Bailey* court should have wrestled with the choice between the disability statute and the death-time survival statute, not the choice between the general statute and the death-time survival statute. The court should have decided whether the disability of minority is removed by a minor's death, kicking in the two-year disability statute, or whether the disability statute never kicks in, leaving the death-time statute as the only applicable statute.[18] If the

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[12]*See* IND. CODE § 34-1-2-2(1) (1982), *supra* note 6.

[13]*See* IND. CODE § 34-1-2-5 (1982), *supra* text accompanying note 7.

[14]*See* IND. CODE § 34-1-2-7 (1982), *supra* note 8.

[15]Harris v. Rice, 66 Ind. 267 (1879); McNear v. Roberson, 12 Ind. App. 87, 39 N.E. 896 (1894).

[16]The *Bailey* court said, "Mark's death removed his legal age disability." 488 N.E.2d at 722.

[17]Obviously, to the extent that the estate's claim was for wrongful death, the statute of limitations on that claim would not begin to run until the date of death. IND. CODE § 34-1-1-2 (1982).

[18]The following hypothetical illustrates more clearly the difference between the *Bailey* court's approach and the suggested approach. Assume that a minor inherited real estate

decision was in favor of the former approach, summary judgment for the lawyers could have been affirmed.

III. Claims Against Decedents' Estates

A. Claims in General

In three claims cases, straightfoward fact situations resulted in non-controversial holdings. A personal representative was not unqualified to serve merely because he was a claimant.[19] A bank in which the decedent had made a general deposit of funds, and to whom the decedent owed money, was permitted to set off the deposit against the debt,[20] thereby, to the extent of the set-off, avoiding the claim-filing rules and claim-payment

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in 1970. In 1972, an adverse possessor began using the real estate actually, openly, notoriously, adversely, and exclusively, and continued his use through 1986. Assume that the minor died in 1983, at the age of 16. The statute of limitations for the recovery of possession of real estate is ten years. Ind. Code § 34-1-2-2 (1982). Ordinarily, that statute would have barred the owner's cause of action against the adverse possessor in 1982, but because of the owner's disability, the cause of action was not barred at the owner's death. Under the suggested approach, the minor's estate would have either eighteen months or two years after his death to bring an action to recover possession depending on whether the death-time survival statute or the disability statute was held to apply; using the *Bailey* court's approach, the minor's estate would have ten years after his death to recover possession.

[19]Estate of Jaworski v. Jaworski, 417 N.E.2d 89, 92 (Ind. Ct. App. 1985) (the personal representative properly was removed on the ground of unsuitability where the "animosity and ill-feeling" between the personal representative and other heirs "would interfere with and affect the orderly administration of the estate"). *See In re* Estate of Baird, 408 N.E.2d 1323 (Ind. Ct. App. 1980) (the personal representative was not unsuitable merely because he was a claimant and a legatee, but he was unsuitable because the animosity between him and other heirs would have interfered with orderly estate administration).

[20]First Nat'l Bank of Martinsville v. American Fletcher Nat'l Bank & Trust Co., 480 N.E.2d 964 (Ind. Ct. App. 1985). *First National* was a case of first impression in Indiana, but the result is supported by what the court identified as the "weight of authority." *Id.* at 966. In *First National*, the debt was unmatured, but the loan documents gave the bank the right to accelerate whenever it deemed itself insecure. The documents also referred to a possible right of set-off " 'under applicable law.' " *Id.* at 965 (quoting the note). The bank did not deem itself insecure until after the debtor-depositor's death, at which time it appeared that the debtor-depositor's estate was insolvent. The *First National* court believed that its holding was more in line with the "true relationship between the bank and its depositor" — namely, the bank owns the deposited funds; the depositor is a creditor of the bank, entitled to be paid what the debtor-bank owes him. *Id.* at 968. In *First National*, after the permitted set-off, the bank owed the decedent nothing.

Courts that have refused to permit an after-death set-off have been concerned with according the bank a priority. *E.g.*, *In re* Schenck's Estate, 63 Misc. 2d 721, 313 N.Y.S.2d 277 (1970), cited in *First National*, 480 N.E.2d at 966-67. If the bank has reserved the rights to accelerate and set-off when it deems itself insecure, recognizing those rights after death would not be according the bank more than it had bargained for.

priorities of the Probate Code.[21] A widow's claim was allowed against her husband's estate for the amount she had spent on her husband's funeral.[22] An heir or other person interested in the estate who pays claims against the estate is subrogated to the rights of the payee against the estate.[23] The payor, of course, is subject to the same claim-filing time constraints to which the payee was subject.[24]

The widow in *Kroslack v. Estate of Kroslack*[25] asserted her right to a survivor's allowance,[26] but the decedent's estate was insolvent. There were, however, funds held by the decedent and his son in multi-party accounts; these funds by statute are liable to pay the survivor's allowance if the estate is insufficient, a demand has been made of the personal representative, and proceedings to assert the liability are begun within a year after the decedent's death.[27] The son was prepared to argue that he had no liability to pay the allowance from the accounts because the widow did not commence a proceeding to assert that liability within one year after the decedent's death.[28] In the face of this argument, the special administrator of the husband's estate, with proper court approval, compromised the son's liability at less than the full amount of the survivor's allowance.[29] A majority of the court of appeals affirmed the compromise, while the dissenting judge would have disapproved it and ordered full payment of the allowance out of the accounts, because of the son's "*contemptible* self-dealing."[30]

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[21]Ind. Code § 29-1-14-1 (Supp. 1986) (five-month claim-filing requirement); Ind. Code § 29-1-14-9 (Supp. 1986) (claim-payment priorities, which would put unsecured creditors seventh in line after expenses of administration, reasonable funeral expenses, the survivor's allowance, debts and taxes preferred under the law of the United States, reasonable medical expenses, and debts and taxes preferred under Indiana law).

[22]Estate of Stack v. Venzke, 485 N.E.2d 907 (Ind. Ct. App. 1985). The *Stack* court also affirmed the trial court's decision that the widow's alleged post-nuptial waiver was unenforceable because the husband had failed to disclose more than $44,000 out of more than $149,000 worth of assets.

[23]*Id.* at 911 (citing Owen Creek Presbyterian Church v. Taggart, 44 Ind. App. 393, 89 N.E. 406 (1909); Chamness v. Chamness' Estate, 53 Ind. App. 225, 101 N.E. 323 (1913)).

[24]*Id.*

[25]489 N.E.2d 650 (Ind. Ct. App. 1986).

[26]*See* Ind. Code § 29-1-4-1 (Supp. 1986).

[27]Ind. Code § 32-4-1.5-7 (1982).

[28]*Kroslack*, 489 N.E.2d at 653.

[29]*Id.* at 652.

[30]The son refused to turn over funds in the accounts, in defiance of a court order and two contempt citations. Eventually, a special administrator had to be appointed to attempt to collect. The dissent concluded:

> I cannot agree with a result which allows an executor to wrongfully withhold funds clearly due an estate, in effect blackmailing the special administrator into a compromise so that the widow can get at least some portion of her statutory allowance. Such a result is not consistent with the law, principles of equity, or

In *Estate of Nay*,[31] the court held that the county welfare department is an arm of the state and is therefore exempt from the five-month claim-filing requirement.[32] This decision serves as a reminder that state and county reimbursement claims may be asserted against the personal representative at any time before the estate is closed.[33] Presumably, even after the estate is closed, reimbursement claims may be asserted against the decedent's successors.[34] This and every other exception[35] to the five-month claim-filing requirement diminishes the certainty that ordinarily follows the expiration of the claim-filing period and the closing of an estate. This decreased certainty, however, clearly was contemplated and intended by the legislature.[36]

B. Joint and Several Obligations

Upon the death of one who is jointly and severally liable on an

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> good policy. The trial court's approval of the "compromise" was an abuse of discretion. I would reverse.

Id. at 655-56 (footnote omitted) (Staton, J., dissenting).

[31]489 N.E.2d 632 (Ind. Ct. App. 1986). The county's claim was for reimbursement for old age assistance provided to the decedent. *Id.* at 633.

[32]IND. CODE § 29-1-14-1(a) (Supp. 1986) provides in part: "All claims against a decedent's estate, other than . . . claims . . . of the state and any subdivision thereof. . . shall be forever barred against the estate" unless they are filed within "five months after the date of the first published notice to creditors." Before 1954, the claim filing provision did not contain any exceptions for a state or its subdivisions. 489 N.E.2d at 634.

[33]In *Nay*, the claim was filed more than a year after the expiration of the five-month period, but the estate was still open. 489 N.E.2d at 634.

State and county reimbursement claims also may be asserted against guardians. *See In re* Estate of Keeler, 476 N.E.2d 917 (Ind. Ct. App. 1985), upholding a judgment ordering payment of the county's claim for reimbursement out of funds received by the minor's guardian in settlement of a wrongful death action following the death of the minor's parents. The county's claim was for reimbursement for expenditures made on behalf of the minor while the minor was a ward of the welfare department. The court held that the wrongful death proceeds were assets of the minor and were "available for the care and support furnished . . . dependents during their minority, whether furnished by the Welfare Department or by anyone else." *Id.* at 921.

[34]Of course, the claims must be asserted within the applicable statute of limitations. *See, e.g.*, Lee v. Cain, 476 N.E.2d 922, *on rehearing*, 479 N.E.2d 105 (Ind. Ct. App. 1985) (fifteen-year statute of limitations of IND. CODE § 34-1-2-3 (1982) applied and barred a substantial portion of a former spouse's claim against her deceased former husband for back child support). The claims should not be enforceable beyond the amount received by the decedent's successors from the decedent.

[35]Other exceptions to the claim-filing bar include claims of subdivisions of the United States, claims for expenses of administration, and claims of liens and other property interests. IND. CODE §§ 20-1-14-1(a), (d); -14-21 (1982). The exception for tort claims contained in IND. CODE § 29-1-14-1(f) will not affect estate assets. There is also uncertainty caused by the availability of constructive trust actions. *See infra* notes 50-78 and accompanying text.

[36]The *Nay* court held that the exceptions contained in IND. CODE § 29-1-14-1(a) are unambiguous. 489 N.E.2d at 634.

obligation,[37] the creditor may choose to file a claim for all or part of the debt against the estate of the deceased joint obligor,[38] or the creditor may forgo the filing of a claim and collect the entire debt from the surviving joint obligor.[39] When the joint obligation is secured by a mortgage, the creditor's choices increase. The secured creditor may rely solely on the security for repayment, or rely solely on the personal obligation of one or both of the joint obligors, or if the security is inadequate, rely on the security to the extent of its value and the personal obligation of one or both of the joint obligors to the extent the security is deficient.[40] If the creditor intends to rely in whole or in part on the personal obligation of the deceased joint obligor, the creditor must file a claim against the deceased obligor's estate within the five-month claim-

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[37]IND. CODE § 29-1-14-5 (1982) provides:

> Every contract executed jointly by the decedent with any other person or persons, and every joint judgment founded on such contract, shall be deemed to be joint and several for the purpose contemplated in section 4 of this chapter [requiring the filing of a claim to enforce such joint obligation]; and the amount due thereon shall be allowed against the estate of the decedent as if the contract were joint and several.

[38]The only way the creditor may collect from the decedent's estate is by filing a claim. IND. CODE § 29-1-14-4 (Supp. 1986) so provides:

> No action shall be brought by way of complaint and summons against any personal representative and any other person or persons, or his or their legal representatives, upon any contract executed jointly, or jointly and severally, by the deceased and such other person or persons, or upon any joint judgment founded thereon; but the holder of said contract or judgment shall enforce the collection thereof against the estate of the decedent only by filing his claim as provided in section 2 [IND. CODE § 29-1-14-2] of this chapter.

[39]*E.g.*, McLochlin v. Miller, 139 Ind. App. 443, 217 N.E.2d 50 (1966).

[40]The secured creditor need not file a claim to protect his right to foreclose against the security, because the five-month claim-filing period does not apply to an action to enforce a lien or mortgage. IND. CODE § 29-1-14-1(e) (Supp. 1986). Unless authorized by the court, foreclosure proceedings may not be commenced until five months after the decedent's death; and if a foreclosure action is initiated while the estate is open, the personal representative must be joined. IND. CODE § 29-1-14-16 (Supp. 1986). Of course, foreclosure is not available until an event of default has been properly noticed by the creditor.

Unless otherwise provided in the note or mortgage, the creditor may forgo the security, sue on the note, obtain a personal judgment against the obligor, and collect the judgment out of other assets of the debtor. *See, e.g.*, Mitchell v. Ringle, 151 Ind. 16, 50 N.E. 30 (1898).

The creditor's right to elect to file a claim against the estate of the deceased obligor, or to forgo filing and collect the debt from the survivor seems to give the creditor some control over distribution of the deceased obligor's estate. The court of appeals observed, however, that the apparent "control" accorded the creditor is accorded "because that is what the parties themselves agreed to." Estate of Leinbach v. Leinbach, 486 N.E.2d 2, 3 (Ind. Ct. App. 1985).

filing period.[41] The creditor may file a claim whether the obligation is due or not, contingent or absolute, or current or in default.[42]

If the surviving joint obligor intends to pursue a right to contribution from the deceased joint obligor, the survivor should file a claim against the decedent's estate within the five-month claim-filing period.[43] *Estate of Leinbach v. Leinbach*[44] contains holding and dicta that are instructive regarding the proper procedure to follow in asserting rights to payment and contribution when one of two joint obligors dies. In *Leinbach*, a husband and wife both had signed a note and mortgage securing real estate which they owned as tenants by the entireties. When the husband died, the mortgagee filed a claim against his estate for the full outstanding balance of the mortgage debt.[45] The widow also filed a claim against the husband's estate for contribution for one-half the amount due on

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[41]IND. CODE § 29-1-14-1 (Supp. 1986).

[42]The secured creditor need not file a claim to protect his right to foreclose against the security, because the five-month claim-filing period does not apply to an action to enforce a lien or mortgage. IND. CODE § 29-1-14-1(e) (Supp. 1986).

[43]The right to contribution is an equitable right between the debtors, permitting "one who has paid the debt to recover from the other the portion he should have borne." Estate of Leinbach v. Leinbach, 486 N.E.2d 2, 3 (Ind. Ct. App. 1985) (citing Judd v. Small, 107 Ind. 398, 8 N.E. 284 (1886)). If the estate paid the entire debt, it would be entitled to contribution from the surviving joint obligor. Magenheimer v. Councilman, 76 Ind. App. 583, 125 N.E. 77 (1919).

The survivor may file a claim for contribution whether the joint obligation is due or not, and whether the liability of the decedent is contingent or absolute. IND. CODE § 29-1-14-1 (Supp. 1986). If the survivor does not file a claim, and if the survivor eventually is forced to pay more than his share (normally one-half) of the joint obligation, the survivor could claim an equitable lien on property relieved of the security interest by the survivor's payment. Enforcement of this lien would not be barred by failure to file a claim. IND. CODE § 29-1-14-1(e) (Supp. 1986). Enforcement of the lien could be an effective substitute for assertion of the right of contribution via the claims procedure only if an ownership interest in the mortgaged property was distributed to the deceased obligor's heirs or devisees. If the mortgaged property was owned by the joint obligors with right of survivorship, then the surviving joint obligor would have no lien to enforce as a substitute for the barred right of contribution. The survivor, however, would have succeeded to ownership of the entire property.

[44]486 N.E.2d 2 (Ind. Ct. App. 1985).

[45]This claim was properly filed whether the mortgage debt was due or not. In *Leinbach*, the mortgagee asserted in its claim that the balance was due and payable at the decedent's death. *Id.* at 2. Perhaps the mortgage contained an acceleration clause that operated in the event of death of one of the obligors.

Even if the mortgage balance was not due and payable at the deceased co-owner's death, the mortgagee could have filed a claim for all or part of the mortgage debt. In fact, if the mortgagee failed to file a claim, the mortgagee would have been barred from pursuing the deceased obligor's personal liability against his successors. If the mortgage balance was not due at the time of decedent's death, the court would allow it at its present value and order it paid "as in the case of an absolute claim." IND. CODE § 29-1-14-3 (Supp. 1986).

the mortgage note. The court of appeals held that the widow was entitled to contribution only if and when she paid more than her share (presumably one-half) of the mortgage debt.[46]

In dicta, the court commented upon a portion of the trial court's ruling that was not appealed. The trial court had ordered the estate to pay only one-half the debt to the mortgagee and had held that the estate was liable for the other half only if the widow did not pay and only if the security was insufficient.[47] The court of appeals indicated that if the mortgagee had appealed, it would have found error: "As to the trial court's judgment in favor of the bank, we think the court erred in anticipating a right to contribution and granting judgment outright for only half the debt and finding the [e]state secondarily liable for the other half."[48] One could add that the trial court was creative but incorrect when it conditioned the estate's secondary liability on the adequacy of the security.

Leinbach serves as a reminder to estate planners that they must understand joint and several liability to understand the potential ultimate distribution of a client's estate when that client is a joint obligor and particularly when the joint obligation is secured by survivorship property. The entire ownership interest in survivorship property may end up in the surviving joint owner, but the deceased joint owner's estate may be obligated to pay half of the joint obligation.[49] This result occurs because the parties agreed to it; the planner must be aware of and take into account such agreements.

IV. Actions to Impose Constructive Trusts

If a claimant seeks to recover specific property from the decedent or his successors, the claimant could bring an action to impose a constructive trust on that property. A constructive trust will be imposed when the decedent or his successors would be unjustly enriched by retention of the property.[50] If the constructive trust action is begun within the five-month claim-filing period, and if the subject property is in the

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[46]486 N.E.2d at 5 (following McLochlin v. Miller, 139 Ind. App. 443, 217 N.E.2d 50 (1966)).

[47]*Id.* The trial court then concluded that the widow's claim for contribution was moot. *Id.*

[48]*Id.*

[49]The assumption is made that if the estate is asked to pay the creditor the full amount of the debt, the estate will pursue its right of contribution against the surviving obligor.

[50]*E.g.*, Melloh v. Gladis, 261 Ind. 647, 309 N.E.2d 433 (1974). Unjust enrichment may occur because the property was obtained by the decedent or his successors "through fraud, duress, undue influence or mistake, or through a breach of a fiduciary duty, or through the wrongful disposition of another's property." *Id.* at 656, 309 N.E.2d at 438, *quoted in* Given v. Cappas, 486 N.E.2d 583, 589 (Ind. Ct. App. 1985).

possession of the decedent's personal representative, the action may be asserted against the personal representative.[51] If the action is begun after the five-month claim-filing period,[52] or if the subject property is not in the possession of the personal representative,[53] the action can be asserted against only the decedent's successors.

A. Given v. Cappas

In two recent constructive trust cases, the trusts were asserted against the decedent's successors. In *Given v. Cappas*,[54] the trial court found that certain shares of stock were assets of a law partnership, acquired in part by purchase and in part as compensation for services rendered to a client. At the time of the lawsuit, the shares were held by a spouse of a deceased partner as trustee of an express trust for his children.[55] In order to prevent unjust enrichment of the spouse and children at the expense of the surviving partners, the trial court imposed a constructive trust and directed the spouse to transfer the other partners' shares to them, and the court of appeals affirmed.[56] The court of appeals stated

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[51]IND. CODE § 29-1-14-21 (Supp. 1986). *See* Williams v. Williams, 427 N.E.2d 727 (Ind. Ct. App. 1981) (even though enforcement of a property interest was barred against the personal representative because of failure to assert the interest within the five-month period, enforcement outside the estate proceeding against the decedent's successors was not barred); *In re* Estate of Williams, 398 N.E.2d 1368, 1371 (Ind. Ct. App. 1980) (a petition claiming an interest in property in the possession of the personal representative, here the enforcement of a corporate stock buy-sell agreement, must be filed within the five-month period if the claimant "desires the issue to be adjudicated *as a part of the estate proceeding*") (emphasis in original).

[52]Williams v. Williams, 427 N.E.2d 727 (Ind. Ct. App. 1981) (even though a claim of property interest was barred against the personal representative because of failure to assert it within the five-month period, enforcement outside the estate proceeding against the decedent's successors was not barred).

[53]For example, if the property interest is claimed in survivorship property or property placed or held by the decedent in an inter vivos trust, the personal representative would not be involved in the action.

[54]486 N.E.2d 583 (Ind. Ct. App. 1985).

[55]*Id.* at 585. The *Given* court discussed the dead man's statute, IND. CODE § 34-1-14-6 (1982), and held that if assets of the decedent's estate will not be affected by the judgment, the dead man's statute will not render witnesses incompetent to testify. 486 N.E.2d at 588. The fact that the personal representative of the decedent's estate has been made a party does not necessarily mean that assets of the decedent's estate will be affected by a judgment in the action. *Id.* Furthermore, the dead man's statute does not apply unless the witness is a party to the issue to be tried; to be a party to the issue, the witness must have a present, certain, vested interest that will be won or lost by the direct operation of the judgment. *Id.* at 583; *see also* Satterthwaite v. Satterthwaite, 420 N.E.2d 287 (Ind. Ct. App. 1981). In *Given*, the stock at issue was not an asset of the decedent's estate, and therefore the dead man's statute was inapplicable. 486 N.E.2d at 588. Furthermore, the witnesses were not parties to the issue. *Id.*

[56]*Given*, 486 N.E.2d at 585.

that the relationship among partners is a fiduciary relationship.[57] Thus, fraud is presumed or inferred without proof of actual dishonesty when one partner benefits from the use of partnership property.[58]

A constructive trust will not be imposed if the transferee is a bona fide purchaser for value. In *Given*, although the transferee was innocent of wrongdoing, and did not have notice of wrongdoing, she was a donee and not a purchaser for value; thus, the transferee's bona fide purchaser defense did not succeed.[59]

Because a constructive trust is an equitable remedy, imposition of the trust may be barred by the equitable doctrine of laches. In *Given*, however, because there was no inexcusable delay in the trust claimant's assertion of rights, and no prejudice to the transferee-defendant, the defense of laches was properly rejected by the trial court.[60] The right

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[57]*Id.* at 589-90. The court cited McKinley v. Long, 222 Ind. 639, 88 N.E.2d 382 (1949), and Ind. Code § 23-4-1-21 (1982), a section of the Indiana Partnership Act.

[58]*Given*, 486 N.E.2d at 590 (citing Hunter v. Hunter, 152 Ind. App. 365, 283 N.E.2d 775 (1972)).

[59]The court suggested in passing the possibility that love and affection between a parent and child may constitute sufficient consideration to render the transferee a purchaser and not a donee. *Id.* at 591 (citing 76 Am. Jur. 2d *Trusts* § 275 (1975) and reciting the proposition that "the parent child relationship may constitute sufficient consideration to support the transfer of property"). The court ultimately avoided application of this proposition by finding that while the parent-partner was "instrumental in effecting the transfer [to the spouse as trustee for his children, that fact] does not make him the grantor of the property so that we may impute a meritorious consideration such as love and affection for his children." *Id.*

The court's discussion of the consideration issue is somewhat unfortunate. The court stated a parent-child consideration rule that is not necessarily applicable to a bona fide purchaser case. Even the cited source of the rule, 76 Am Jur. 2d *Trusts* § 275, at 496 (1975), fudges a bit when it cites a consideration-of-marriage case and states: "It has been held that marriage does constitute value for an antenuptial settlement on a wife of trust property or funds so as to cut off equities of the beneficiaries, where the wife takes in good faith and without notice." (citing Johnson v. Peterson, 101 Neb. 504, 163 N.W. 869 (1917)).

Whether the consideration of love and affection between a parent and child is sufficient to overcome the equities of the constructive trust claimant is a question that should be addressed directly. An underlying policy of the bona fide purchaser doctrine is protection of the reliance interest of a person who gave value in exchange for a transfer of property. *See generally* J. Cribbet, Principles of the Law of Property 286 (2d ed. 1975). The kind of value that gives rise to protectable reliance is usually money or money's worth, as opposed to love and affection. *Id. See, e.g.*, Strong v. Whybark, 214 Mo. 341, 102 S.W. 968 (1907); Ten Eyck v. Witbeck, 135 N.Y. 40, 31 N.E. 994 (1892). Even if love and affection are considered to be value under the bona fide purchaser doctrine, they should not be sufficient to overcome automatically the equities of the constructive trust claimant, who has been deprived of property due to fraud or constructive fraud.

Furthermore, it is misleading for the court to state that "the parent-child relationship may constitute sufficient consideration to support the transfer of property." *Given*, 486 N.E.2d at 591. No consideration is necessary to support a transfer of property.

[60]486 N.E.2d at 592; *see also* Duran v. Komyatte, 490 N.E.2d 388 (Ind. Ct. App. 1986), discussed *infra* notes 67-78 and accompanying text, wherein the court stated that

to assert a trust may also be waived, but an effective waiver entails an intentional relinquishment of rights, which did not exist in *Given*.[61]

Expiration of the appropriate statute of limitations will bar a constructive trust action.[62] In *Given*, the transferee asserted expiration of the six-year statute of limitations for fraud,[63] because the transfer to her had occurred more than six years prior to commencement of the constructive trust action. Ordinarily, the limitations period begins to run when the fraud is accomplished; concealment of material facts, however, will toll the statute.[64] In *Given*, the court found concealment and tolling of the statute until the concealing partner died; before then, the constructive trust claimants did not actually know of that partner's claim of ownership of the partnership property, and the partner's fiduciary duty to disclose such material information excused his co-partners' duties to exercise due diligence to discover it.[65]

B. Duran v. Komyatte

As with any trust, a constructive trust requires a trust res—separate, identifiable, existing property that can be held in the trust.[66] In *Duran v. Komyatte*,[67] the lack of a trust res sounded the death knell for a

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the trust claimant's "failure to act . . . until now is another consideration we employed to determine that the equitable remedy of a constructive trust is not appropriate in this instance." 490 N.E.2d at 393.

In *Duran*, the plaintiff claimed a constructive trust as a remedy for breach of her former husband's breach of an agreement to make a will. *Id.* at 390. The will was to have been executed within ten days of the parties' final divorce decree and a copy was to have been sent to the plaintiff within another ten days. The plaintiff did not assert the breach of agreement until ten years later, after her former husband died. *Id.* Actually, the plaintiff's assertion of a remedy for her former spouse's breach of contract to make a will was timely. Such a contract is not breached until the death of the promisor, because the promisor could at any time before his death perform the agreement by executing the will. *See* B. Sparks, Contracts To Make Wills 179 (1956). The *Duran* court's language must relate to the plaintiff's failure to complain about her spouse's failure to make a will and send her a copy within ten days of the divorce decree.

[61] 486 N.E.2d at 592.

[62] *See generally* Forth v. Forth, 409 N.E.2d 641 (Ind. Ct. App. 1980).

[63] *See* Ind. Code § 34-1-2-1 (1982).

[64] *Forth*, 409 N.E.2d at 644.

[65] 486 N.E.2d at 592-93; *see also* Dotlich v. Dotlich, 475 N.E.2d 331 (Ind. Ct. App. 1985) (fiduciary relationship among corporate directors excused duty to exercise due diligence to discover a director's fraud).

[66] In a constructive trust, usually the property is "held" in trust only fictionally because the trust arises and is executed by the judgment of the court imposing it. There have been long-lived constructive trusts, however. *E.g.*, David v. Russo, 415 N.E.2d 531 (Ill. Ct. App. 1980), *remanded and appealed*, 456 N.E.2d 342 (Ill. Ct. App. 1983) (imposing a constructive trust on the holders of legal title, finding that they held such title only as security for a loan to the trust beneficiaries, and ordering an accounting by the trustees to the beneficiaries).

[67] 490 N.E.2d 388 (Ind. Ct. App. 1986).

constructive trust claim. The asserted trust was to be in favor of the plaintiff's children and was to consist of all property owned by the plaintiff's former husband at the time of their divorce.[68] The basis for the trust was the former husband's breach of an agreement, made as part of the divorce settlement, to make a will leaving all his property to his and plaintiff's three children. The husband died ten years after the divorce without having made such a will. The court agreed that the husband had breached "his fiduciary duty to execute a will,"[69] but the court held that a constructive trust was not an available remedy.[70] The expenses of the husband's last illness had rendered his estate insolvent, so that even if he had made a will, there would have been no property left to pass under it to the three children.[71] Furthermore, the agreement to make a will did not refer to or require that any specific property be left to the children. Thus, the alleged constructive trust lacked a trust *res*.[72]

Because the decedent's estate was insolvent, a claim for damages for breach of the decedent's agreement to make a will would have gone unsatisfied. Furthermore, borrowing the court's analysis of the constructive trust issue, perhaps no damage would have been suffered. Under the court's interpretation of the property settlement agreement, the decedent's breach was merely a technical one of not signing a document called a will. According to the court, there was no other substance to that agreement:

> John was ordered to do no more than execute a will. No mention of any specific property to be left to the children is present. Nor is there any mandate that John have property at the time of his demise to leave to his children.[73]

The troubling feature of this interpretation of the agreement is its failure to consider the fundamental duty of good faith and fair dealing between parties to a contract. In an analogous case interpreting an antenuptial contract, *Russell v. Walz*,[74] the court of appeals stated that

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[68]*Id.* at 390.

[69]*Id.* at 393. A property settlement incorporated into the final decree of divorce is a binding contract. *Id.* at 392 (citing Anderson v. Anderson, 399 N.E.2d 391 (Ind. Ct. App. 1979)).

[70]*Id.*

[71]*Id.* at 392.

[72]*Id.*

[73]*Id.* The agreement itself provided, in pertinent part: "Husband agrees to have drawn and execute a last Will and Testament leaving all of his assets, real and personal to his living *3* children surviving at the time of his death and said will shall not be changed until his youngest present living child shall become emancipated. . . ." *Id.*

[74]458 N.E.2d 1172 (Ind. Ct. App. 1984).

a transferor breaches an implied obligation of good faith if he makes a transfer with " 'an actual intent thereby to subvert the antenuptial agreement,' " or if the transfer is " 'of a disproportionate and unreasonable amount of assets in relationship to the balance of the promisor's property.' "[75] An investigation into whether the husband's depletion of his estate was in good faith would seem similarly appropriate in the property settlement context of *Duran*.[76]

In any event, the *Duran* case and its dicta certainly serve as a warning that very careful drafting of will contracts is called for. It is not enough that the promisor agrees merely to make a will. A meaningful, enforceable agreement should include express provisions regarding the kinds or values of property that the parties agree will be devised by the will.[77] It is not in the promisor's best interest to guarantee that a certain property or value will be owned and be unencumbered at the promisor's death; yet, it is not in the promisee's best interest to leave the description of certain property or its value out of the will contract. Both parties'

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[75]*Id.* at 1185 (dicta) (quoting Dubin v. Wise, 354 N.E.2d 403, 408-09 (Ill. Ct. App. 1976), and citing for its dicta Crawfordsville Trust Co. v. Ramsey, 55 Ind. App. 40, 100 N.E. 1049 (1913)). According to *Dubin*, the disproportionate transfer test establishes "fraud implied in law." 354 N.E.2d at 409. *See also* Lawrence v. Ashba, 115 Ind. App. 485, 59 N.E.2d 568 (Ind. Ct. App. 1944), stating that a promisor under a contract not to revoke a will should "have the right to dispose of any or all of the corpus of the estate for his reasonable needs in the event the income should be inadequate for that purpose, but he could not dispose of it to defraud or defeat his obligation." *Id.* at 494, 59 N.E.2d at 572.

[76]In *Duran*, the court of appeals affirmed a summary judgment against the constructive trust claimant and in favor of the decedent's second wife. 490 N.E.2d at 393. One issue raised by the constructive trust claimant was that there was a genuine issue of material fact concerning the deceased husband's state of mind when he failed to execute the will and when he and his second wife purchased entireties property. *Id.* at 392. The former spouse alleged that the entireties purchase was "tainted by fraud." *Id.* Both of plaintiff's arguments indicated that she was concerned generally with the deceased husband's good faith.

The catch-22 in the *Duran* case is that there was no property in the husband's estate to remedy the breach of his obligation of good faith. There was, however, the entireties property. If it was purchased with funds of the deceased promisor, and if the second spouse was not a bona fide purchaser for value without notice of the contractual claims, then the entireties property could have been subjected to a constructive trust as a method of enforcing the contractual claims of the ex-spouse and children. The burden would be on the ex-spouse and children to prove the decedent's lack of good faith in divesting himself of property to avoid compliance with the will contract, and that might not be an easy burden to meet, considering the fact that the decedent's divestitures were in favor of his second spouse (by the purchase of the entireties property) and in favor of creditors, primarily those who rendered him medical service.

[77]One approach might be to use a kind of best efforts clause — for example, the promisor agrees to use his best efforts to retain *x* property or *y* amount of property in his estate.

perspectives might be best satisfied with the inclusion of a flexible and open-ended, express good faith clause.[78]

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[78]Different considerations apply to a contract to devise specific property and to a contract to make a will devising all or part of the promisor's net estate, whatever it may be at the time of the promisor's death. When the contract is of the latter variety, the parties need to include a more detailed definition of acceptable future conduct. For example, both parties should demand an express provision regarding the kinds of gifts that the promisor is entitled to make. *See generally* B. SPARKS, CONTRACTS TO MAKE WILLS 50-69 (1956).

Developments in Property Law

Walter W. Krieger*

I. Adverse Possession: The Element of Notoriety

In Indiana, the time period required to acquire title by adverse possession is ten years.[1] The possession during this period, in order to meet the requirements of adverse possession, must be: (1) hostile and under a claim of right, (2) actual, (3) open and notorious, (4) exclusive, and (5) continuous.[2] In addition, Indiana Code section 32-1-20-1 requires the adverse possessor to pay all taxes and special assessments on the land during the period he claims to have had adverse possession.[3]

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[1]Indiana Code section 34-1-2-2(6) is a statute of limitations which runs against the title holder. Actions for the recovery of the possession of real estate must be brought within ten years in Indiana, Ind. Code § 34-1-2-2(6) (1983); property will vest in the adverse possessor if other elements of adverse possession are present. Greene v. Jones, 490 N.E.2d 776, 777 (Ind. Ct. App. 1986).

[2]Worthley v. Burbanks, 146 Ind. 534, 539, 45 N.E. 779, 781 (1897). The Appellate Court of Indiana expressed the elements of adverse possession in slightly different terms: "such possession must be actual, visible, open, notorious, exclusive, hostile, under claim of ownership, and continuous for the statutory period . . . ." Smith v. Brown, 126 Ind. App. 545, 552, 134 N.E.2d 823, 826 (1956). However, the Indiana appellate court has also determined that the terms "under a claim of right" and "under claim of ownership" mean nothing more than "hostile" and the use of these terms does not create an additional element of adverse possession. Poole v. Corwin, 447 N.E.2d 1150, 1152 n.1 (Ind. Ct. App. 1983); Kline v. Kramer, 179 Ind. App. 592, 599, 386 N.E.2d 982, 988 (1979).

[3]Ind. Code Ann. § 32-1-20-1 (West Supp. 1986). The requirement that the adverse possessor pay taxes on the land was added by the Indiana legislature to put an end to the situation in the northern portion of the state where squatters were obtaining title to large tracts of land while absentee owners were paying taxes. Echterling v. Kalvaitis, 235 Ind. 141, 145, 126 N.E.2d 573, 575 (1955). The tax requirement was intended to provide notice to the record owner that an intruder was making a claim to his land. *Id.*; *Kline*, 179 Ind. App. at 600, 386 N.E.2d at 989.

In boundary line disputes, however, the supplementary element of payment of taxes has been held inapplicable by the Indiana courts. The tax duplicates are generally too sketchy to provide notice to the true owner that a claim is being made to a small portion of his land, and as a result both parties believe they are paying taxes on the disputed land. *See, e.g.*, *Echterling*, 235 Ind. at 146, 126 N.E.2d at 675; Ford v. Eckert, 406 N.E.2d 1209 (Ind. Ct. App. 1980); Berrey v. Jean, 401 N.E.2d 102 (Ind. Ct. App. 1980); *Kline*, 179 Ind. App. at 592, 386 N.E.2d at 982; Penn Cent. Transp. Co. v. Martin, 170 Ind. App. 519, 353 N.E.2d 474 (1976). In addition, if any structures have been placed in the disputed area, the taxes on such improvements have undoubtedly been assessed against the adverse possessor.

In *Greene v. Jones*,[4] the Indiana Court of Appeals examined the element of notorious possession. In 1970, Robert and Janet Jones (Joneses) purchased Lot No. 2 in a residential subdivision in Jefferson County, Indiana. The lot had not been landscaped and four flags were placed at what the Joneses believed were the corners of their lot. In fact, the two flags on the west side of their lot were set approximately seven feet to the west of the true property line. In 1974, the Joneses purchased a portion of Lot No. 10 located behind Lot No. 2. Once again, the Joneses believed the western property line of Lot No. 10 extended seven feet beyond the true property line. In 1981, Richard and Linda Greene (Greenes) purchased Lot No. 1 and the remaining portion of Lot No. 10 immediately to the west of the Jones property. A survey conducted by the Greenes in 1983 revealed that the Greenes' true eastern property line extended seven feet into what the Joneses considered to be their property. They informed the Joneses of this fact, and the Joneses subsequently brought suit to quiet title to the seven foot strip adjacent to their western property line.[5] The trial court quieted title in the Joneses seven foot strip adjacent to Lot No. 2 and their portion of Lot No. 10.[6]

On appeal, the Greenes raised two issues. The first issue involved the Joneses' claim to title by adverse possession of the seven foot strip adjacent to the western boundary of their portion of Lot No. 10. The Joneses had not purchased their portion of Lot No. 10 until 1974. Since the suit to quiet title was filed in 1983, the Greenes argued that the Joneses had not possessed the property for the ten year period necessary to acquire title by adverse possession and that the trial court's judgment was contrary to law. The appellate court agreed with the Joneses' contention and reversed the trial court's judgment pertaining to Lot No. 10.[7]

The second issue raised by the Greenes was whether the acts of possession by the Joneses were sufficient to meet the requirements for adverse possession as to Lot No. 1.[8] The court noted that the elements of adverse possession which the Joneses were required to show were that "the possession was actual, visible, notorious, exclusive, under a claim of ownership, hostile to the owner of record title, and continuous

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[4]490 N.E.2d 776 (Ind. Ct. App. 1986).

[5]*Id.* at 777.

[6]*Id.*

[7]*Id.* In a footnote, the court noted that prior to 1974, both portions of Lot No. 10 were owned by one person and thus no adverse possession as to a portion of Lot No. 10 could exist before 1974. Had the Joneses' grantor been in adverse possession of the seven foot strip, the Joneses could have tacked on his period of adverse possession to meet the required statutory period. *Id.* at 777 n.1.

[8]*Id.* at 777.

for the full period of the statute."[9] The court primarily focused on the element of notorious possession. In explaining this element, the court relied heavily upon the discussion of notorious possession by the Indiana Supreme Court in *McCarty v. Sheets*.[10]

Adverse possession was at issue in *McCarty* due to the fact that defendants' garage encroached upon plaintiff's land. The defendants mowed the grass, cut thistles, and removed weeds in the area around the garage. The trial court quieted title in defendants to a strip of land four feet and two inches wide along the entire east side of plaintiff's property, a distance of one hundred and fifty feet.[11] In reversing the trial court's judgment, the supreme court held that "while maintenance activities in a residential area are a factor in a property dispute, standing alone, they are not sufficient to support a divesture of property based upon adverse possession."[12] The *McCarty* court did not find such acts to be open and notorious[13] and cited *Philbin v. Carr*[14] for its explanation of notorious possession:

> [P]ossession must be notorious. It must be so conspicuous that it is generally known and talked of by the public—at least by the people in the vicinity of the premises. It must be manifest to the community. In the course of twenty years a visible occupancy naturally ought to become notorious. It ought to be so well known and commonly understood that the people residing in the neighborhood could testify with substantial unanimity concerning its existence. Where the persons who have passed frequently over and along the premises have been unable to see any evidence of occupancy, evidently the possession has not been of the character required by the rule.[15]

The *Greene* court, after quoting the same passage from the *Philbin* opinion, noted that "[i]n *McCarty*, the supreme court ruled that yard maintenance activities in a residential area such as mowing grass and weeding are sporadic and periodic acts of ownership and insufficient to constitute adverse possession."[16] On the other hand, the court held that erecting improvements on a disputed portion of the property is sufficiently conspicuous for purposes of adverse possession.[17]

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[9] *Id.* at 778.

[10] 423 N.E.2d 297 (Ind. 1981).

[11] *Id.* at 300.

[12] *Id.* at 300-01.

[13] *Id.* at 300.

[14] 75 Ind. App. 560, 129 N.E. 19 (1920).

[15] *McCarty*, 423 N.E.2d at 301 (quoting Philbin v. Carr, 75 Ind. App. 560, 584, 129 N.E. 19, 27-28 (1920)).

[16] *Greene*, 490 N.E.2d at 778.

[17] *Id.* The court cites as examples of such activities Penn Cent. Transp. Co. v. Martin,

Having thus determined the standard for notorious possession in a residential area,[18] the court next examined the activities of the Joneses in the disputed area. They had plowed, graded, and planted grass up to the mistaken property line and had periodically mowed and fertilized the area. The Joneses had also planted a fruit tree in the disputed area approximately four years before trial.[19] There were two additional activities in the disputed area which the court found irrelevant. A wood fence had been erected along the mistaken property line by a prior owner, but the fence had stood for only seven years (1972 to 1979) at the most.[20] The utility company also had placed the Joneses' water meter in the disputed area. The court could find no authority, and none was cited, for the proposition that the placement of equipment by a utility company in a disputed area, whether within or without their easement, could be used as evidence to establish the boundary line of the adverse possessor.[21] The court noted that the meter was placed in the area by the utility company, not the Joneses, and therefore could not be interpreted as a manifestation of the Joneses' control over the property.[22]

The court concluded that "applying these facts to the standard enunciated for notorious possession, we must conclude no activity or conduct by the Joneses was sufficiently conspicuous to give persons who frequently pass the premises the ability to see occupancy other than the periodic and sporadic yard maintenance which was held insufficient by our supreme court in *McCarty* . . . ."[23] Thus the court reversed the trial court's judgment as to the disputed area adjacent to Lot No. 2 and held the Greenes' title had not been defeated.[24]

In a dissenting opinion, Judge Young argued that grading and planting grass and trees in a disputed area are sufficient acts of ownership to establish title by adverse possession "when the owner of record has

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170 Ind. App. 519, 353 N.E.2d 474 (1976) (erecting a garage and adding a house in addition to mowing the grass); Smith v. Brown, 126 Ind. App. 545, 134 N.E.2d 823 (1956) (erecting concrete curbing, driveway, and hedge fence along with yard maintenance).

[18]Throughout the opinion, the court is careful to limit its holding to adverse possession of property in a "residential area." In the *McCarty* decision, which the court indicates is controlling, the Indiana Supreme Court's determination of what constituted open and notorious possession of land in a residential area was greatly influenced by the nature and use of the property being adversely possessed: "Cases of adverse possession must, of necessity, be decided on a case by case basis, for what constitutes possession of a 'wild' land may not constitute possession of a residential lot, just as possession of the latter may not constitute possession of a commercial lot." *McCarty*, 423 N.E.2d at 300.

[19]*Greene*, 490 N.E.2d at 778.

[20]*Id.* at 778-79, 779 n.3.

[21]*Id.* at 779 n.4.

[22]*Id.*

[23]*Id.* at 779.

[24]*Id.*

actual notice of the possessor's claim.''[25] In such a situation, the requirement that the possession be notorious would serve no useful purpose, since the sole purpose of this requirement is to put the record owner on notice of the claim.[26] Judge Young cited several Indiana decisions which indicate that the purpose of notorious possession ''is to put the record owner on notice of the adverse claim.''[27] By implication, the cases cited by Judge Young appear to suggest that where the owner has actual notice of the claim, open and notorious possession is not required.[28] Judge Young noted that there are no Indiana decisions that have explicitly held that possession must be notorious where the owner has actual notice of the adverse claim.[29]

Judge Young inferred that there was evidence that the Greenes were aware of the existence of the fence or at least that they were aware the Joneses were making an adverse claim to the mistaken boundary line where the fence once stood: ''Here, it was undisputed that the Greenes and their predecessors in title knew the Joneses claimed the property to the line where the fence had once been located.''[30] If the majority of the court was of the view that the Greenes had actual notice of the Joneses' claim, it was not expressed in the written opinion.[31] The only reference to actual notice in the majority opinion was the statement that ''[t]he discrepancy in the boundary line between Lots Nos. 1 and 2 was discovered by the Greenes in 1983 when they had the land surveyed in order to construct a fence on the west side and a drainage ditch on the east side of their property.''[32]

A second issue raised in the dissenting opinion relates to the suf-

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[25]*Id.* at 779 (Young J., dissenting).

[26]*Id.*

[27]*Id.* (citing Houston v. United States Gypsum Co., 652 F.2d 467, 475 (5th Cir. 1981); Marengo Cave Co. v. Ross, 212 Ind. 624, 627, 10 N.E.2d 917, 921 (1937); Poole v. Corwin, 447 N.E.2d 1150, 1152 (Ind. Ct. App. 1983); Philbin v. Carr, 75 Ind. App. 560, 585, 129 N.E. 19, 28 (1920)).

[28]In illustration of this observation, Judge Young quoted from *Philbin*: ''[W]here there has been no actual notice, the possession must have been so notorious as to warrant the inference that the owner ought to have known that a stranger was asserting dominion over this land.'' 490 N.E.2d at 780 (Young, J., dissenting) (quoting *Philbin*, 75 Ind. App. at 585, 129 N.E. at 28).

[29]*Greene*, 490 N.E.2d at 779 (Young, J., dissenting).

[30]*Id.* at 780.

[31]Since the fence was removed in 1979, there was no direct evidence that the Greenes were aware that it ever existed when they purchased Lot No. 1 and the remaining portion of Lot. No. 10 in 1981. *Id.* at 779 n.3. This would leave only the maintenance activities to establish notice of the adverse claim.

[32]*Id.* at 777. Perhaps Judge Young was inferring such notice from the activities in the disputed area, i.e. how could the owner of a residential area fail to see the grading and planting of grass and trees or the existence of a water meter in the disputed area. However, such implied notice would seem to require the activities to be notorious.

ficiency of the activities by the Joneses. Judge Young clearly believed that the activities by the Joneses were sufficient to acquire title by adverse possession.[33] In *McCarty*, however, the supreme court found maintenance activities in residential areas insufficient to establish title by adverse possession, not only because they failed to meet the standard for open and notorious possession, but because they were not continuous.[34] The supreme court found such maintenance activities to be periodic or sporadic acts of ownership insufficient to constitute adverse possession.[35] Thus, even if the fence or other activities such as the planting of grass and trees gave the owner notice of a claim, the activities must have been continuous for the statutory period.[36]

One final observation regarding the decision in *Greene* can be made. It can be inferred from the majority opinion that some evidence of a visible marker must exist establishing the boundaries of the area being adversely claimed. Judge Young read the majority opinion as requiring such evidence when he observed that "[t]he majority's view that the entire neighborhood must be able to recognize the property line between the two neighbors' residences would limit adverse possession to situations where the act of possession is evidenced by a visible marker such as a fence, garage, or driveway."[37] The *McCarty* decision, relied upon extensively in the majority opinion, appears to suggest even more strongly that some visible evidence of the location of the disputed boundary line is required before the possession can be adverse.[38] Clearly the requirement that there be visible evidence of the disputed boundary line is an element of notorious possession. It is also suggested that this requirement can be viewed as part of other elements of adverse possession such as "exclusive" or "under claim of ownership." Without some evidence of the exact area of the encroachment, it is hard to impute actual or constructive notice to the owner that a claim of ownership has been made. This point was made by Judge Hoffman, in a separate dissenting opinion in the court of appeals decision in *McCarty*,[39] when he remarked: "No fence or markings of any kind showed where the boundary line

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[33]*Id.* at 779 (Young, J., dissenting). "Improving the disputed area by grading and planting grass and trees constitutes sufficient acts of ownership to establish adverse possession of a residential property when the owner of record title has actual notice of the possessor's claim." *Id.*

[34]*McCarty*, 423 N.E.2d at 300.

[35]*Id.* at 301.

[36]*Id.* at 297; Echterling v. Kalvaitis, 235 Ind. 141, 126 N.E.2d 573 (1955); *Greene*, 490 N.E.2d at 776; Philbin v. Carr, 75 Ind. App. 560, 129 N.E. 19 (1920).

[37]*Greene*, 490 N.E.2d at 779 (Young, J., dissenting).

[38]For a discussion of the supreme court's decision in *McCarty*, see Krieger, *Survey of Recent Developments*, 16 Ind. L. Rev. 283, 287-88 (1983).

[39]391 N.E.2d 834 (1979), *rev'd*, 423 N.E.2d 297 (Ind. 1981).

existed. It is a sad day in Indiana when the courts take a man's land from him on evidence of mowing grass on the side and behind a garage."[40]

II. Easements: Scope

In *Brock v. B & M Moster Farms, Inc.*,[41] the Indiana Court of Appeals discussed several issues relating to the scope of an express easement. In 1911, John Roemer conveyed a forty acre tract of land in Franklin County, Indiana, to Clarence Schreiber. At that time of the conveyance, the only access from the forty acre tract to a public road was over the land retained by the grantor.[42] The Roemer/Schreiber deed contained the following express easement: "Also, a right-of-way for wagon, horses and footpassers, and no hauling can be done over said right-of-way when the ground is soft from heavy rains or when thawing out in the spring of the year."[43]

The court noted that had the deed not contained an express easement, the law would have implied a way of necessity to afford Schreiber access to a public road.[44] In the case of an implied way of necessity, the easement would have come to an end in 1971, when Roemer Road was extended to provide direct access to the property thereby eliminating the necessity of the easement.[45] However, because this was an express easement, neither the fact that direct access to a public road was subsequently made available nor the fact that the easement had been used only occasionally caused the easement to terminate.[46]

The defendants, John and Jean Brock, acquired title to the land previously owned by Schreiber from Alice Blair. The deed indicated that there was "a right of way for ingress and egress for horses, wagons, vehicles and persons on foot . . . [as] set forth in deed from John

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[40]*Id.* at 838 (Hoffman, J., dissenting).

[41]481 N.E.2d 1106 (Ind. Ct. App. 1985).

[42]*Id.* at 1107.

[43]*Id.*

[44]*Id.* at 1108. Where land is conveyed in such a manner that the grantee is completely landlocked, the law will imply an easement for a way of necessity over the lands of the grantor not conveyed. Ritchey v. Welsh, 149 Ind. 214, 48 N.E. 1031 (1898). Such an easement is favored by the public policy that land should not be rendered unfit for use or occupancy by a grant which provides no means of ingress or egress. Moore v. Indiana & Mich. Elec. Co., 229 Ind. 309, 95 N.E.2d 210 (1950).

[45]*Brock*, 481 N.E.2d at 1107. A way of necessity ends when the necessity no longer exists. Wilson v. Glascock, 74 Ind. App. 255, 126 N.E. 231 (1920).

[46]*Brock*, 481 N.E.2d at 1108-09. The rule that an implied easement by necessity terminates with the necessity does not apply to right-of-ways acquired by express grant or by prescription. *See, e.g.*, Reder v. Radtke, 132 Ind. App. 412, 177 N.E.2d 669 (1961). The fact that the easement is used intermittently does not terminate an easement created by express grant. *Brock*, 481 N.E.2d at 1108-09. An express easement by grant is generally not lost by mere nonuse. Jeffers v. Toschlog, 178 Ind. App. 603, 383 N.E.2d 457 (1978).

Roemer to Clarence W. Schreiber. . . ."[47] Even without the express reference to the easement in the deed, the easement appurtenant would have passed with the sale of the dominant estate "like a dog's tail goes along with a sale of the dog."[48] The easement in this case was clearly appurtenant because it benefited the forty acre tract (dominant estate).[49] Had the intent of the parties been that the easement was to benefit Schreiber personally rather than as owner of the forty acre tract (an easement in gross), there would have been a serious problem raised regarding the assignability of the easement.[50]

In 1978, the portion of the land formerly owned by Roemer, on which the disputed right of way was located (servient estate), was conveyed to B & M Moster Farms, Inc. (Moster). A clause in an addendum to the contract to purchase stated that the conveyance was "subject to a right-of-way for wagons, horses and foot passers on and over [land] . . . described in a warranty deed to Clarence W. Schreiber."[51] Even without this express statement in the contract, however, it seems unlikely Moster could have successfully claimed that it took the land without notice of the easement. Moster would be charged with constructive notice of the easement because the Roemer/Schreiber deed was in its chain of title.[52] In addition, Moster would be charged with inquiry notice if there were any evidence of the existence of the easement visible by a physical inspection of the premises.[53]

Moster filed suit in 1983 to prevent the Brocks from constructing a private drive over its land and the Brocks counterclaimed seeking an injunction prohibiting Moster from interfering with their use of the right of way. The trial court held that use of the right of way granted in the deed was exclusively limited to agricultural purposes and enjoined the Brocks from entering upon Moster's land for any other purpose and

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[47]*Brock*, 481 N.E.2d at 1107.

[48]R. CUNNINGHAM, W. STOEBUCK & D. WHITMAN, THE LAW OF PROPERTY § 8.10 (1984) [hereinafter CUNNINGHAM].

[49]The court refers to the Brocks' land as the "dominant estate:" "Nor may Brocks subdivide the dominant estate such that there would be increased traffic . . ." *Brock*, 481 N.E.2d at 1109.

[50]At common law, easements in gross were not transferable but created a personal right only in the grantee. CUNNINGHAM, *supra* note 48, § 8.10, at 461. Under Indiana statute, easements in gross created after July 6, 1961, may be alienated, inherited, and assigned if the instrument that created the easement so states. IND. CODE ANN. § 32-5-2-1 (West Supp. 1986).

[51]*Brock*, 481 N.E.2d at 1107.

[52]A purchaser is charged with constructive notice of all interests recorded within the chain of title. Willard v. Bringolf, 103 Ind. App. 16, 30, 5 N.E.2d 315, 321 (1936).

[53]A purchaser is charged with notice of anything he could have discovered from a physical inspection of the premises. Mishawaka St. Joseph Loan & Trust Co. v. Neu, 209 Ind. 433, 196 N.E. 85 (1935).

from constructing a private drive over the right of way. The Brocks appealed the order.[54]

The court of appeals began its analysis by noting that in interpreting the meaning of an instrument creating an easement, the intent of the parties must be ascertained and given effect. The intent of the parties

> is determined by a proper construction of the language in the instrument from an examination of all the material parts thereof. Where the provision is ambiguous, the court may consider the situation of the property and the parties, and the surrounding circumstances at the time the instrument was executed to determine intent . . . . In the case of doubt or uncertainty, the grant of an easement will ordinarily be construed in favor of the grantee.[55]

The Roemer/Schreiber deed was construed to contain an ambiguity. The 1911 language authorizing the use of the right of way by "wagons, horses and footpassers" became ambiguous by "the mere passage of time and development of society."[56] The court observed that the function of an easement "should be gleaned by contemplating not the character of the traffic intended to travel the way, but rather the purpose to be served by the traffic."[57] The court noted that the term "right-of-way" traditionally refers to an easement of access arising out of necessity upon the severance of a tract of land.[58] The use of the term "wagons, horses and footpassers" was only a statement of the types of transportation existing in 1911.[59] The court concluded that Roemer intended the easement granted to Schreiber to be a general right of ingress and egress "with no limitation to traffic used for agricultural purposes."[60]

Having established that the easement created a general right of ingress and egress to the Brocks' property, the court addressed the issue of expanded use of or construction on the right of way by the Brocks. The meaning of the term "expanded use" is not fully explained in the decision. The court's discussion indicates, however, that the proposed

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[54]*Brock*, 481 N.E.2d at 1107-08.

[55]*Id.* at 1108 (citations omitted).

[56]*Id.*

[57]*Id.*

[58]*Id.*

[59]*Id.* (citing Jeffers v. Toschlog, 178 Ind. App. 603, 383 N.E.2d 457 (1978)). In *Jeffers*, the court construed a 1907 instrument containing a provision authorizing "teams and wagons" as intending to permit present day vehicles to travel the way. *Jeffers*, 178 Ind. App. at 605-07, 383 N.E.2d at 458-59. For further cases discussing this point, see Annotation, *Type of Vehicle or Mode of Travel Permissible on Express Easement of Way Created in Limited Terms*, 156 A.L.R. 1050 (1945); Annotation, *Automobile Traffic as Additional Burden on Right of Way*, 53 A.L.R. 553 (1928)).

[60]*Brock*, 481 N.E.2d at 1108.

construction of the private drive was part of a plan to subdivide the dominant estate and provide each owner with access to the easement.[61] The general rule is that the use of an easement cannot be changed to subject the servient estate to a greater burden than was agreed upon.[62] In light of this general rule, the court concluded that the Brocks could not "subdivide the dominant estate such that there would be increased traffic over Moster's land, creating an extra burden on the servient estate."[63] The court found that when the easement was created, the parties clearly had not intended for the servient estate to be burdened to the extent which would result from the proposed subdivision.[64] This finding was somewhat unexpected in light of the court's earlier conclusion that the grant of the easement created a general right of ingress and egress not limited to traffic for agricultural purposes.[65] When a right of way is created by grant in general terms, the right to use the way is not limited to activities conducted on the dominant estate at the time of the grant. A degree of change or growth of the dominant estate is permitted.[66] This natural development of the dominant estate is presumed to have been contemplated by the parties.[67] Where the dominant estate is subdivided, the general rule is that those who succeed to the possession of each of the parts into which the dominant estate has been subdivided are entitled to use the easement appurtenant.[68] Some increased burden to the servient estate will result from the increased number of users, unless forbidden by the terms of the grant or unless the increased burden is material. Nevertheless, the right to use the easement attaches to each of the parts of the dominant estate.[69] Thus, the court's conclusion that use of the easement by each owner of a subdivided dominant estate would be an "expanded use" of the easement which would create an "extra burden" on the servient estate seems unwarranted on the facts presented.

Selvia v. Reitmeyer,[70] cited by the *Brock* court as authority for this position, does not in fact support such a broad generalization. The

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[61]The only expanded use actually discussed by the court relates to the subdivision of the dominant estates. *Id.* at 1109.

[62]*Id.*

[63]*Id.*

[64]*Id.*

[65]*Id.* at 1108.

[66]Cunningham, *supra* note 48, § 8.9, at 459-60.

[67]Restatement of Property § 484 (1944).

[68]*Id.* § 488 (1944); *see also* Annotation, *Right of Owners of Parcels into Which Dominant Tenement Is or Will Be Divided to Use Right of Way*, 10 A.L.R.3d 960 (1966).

[69]Cunningham, *supra* note 48, § 8.9, at 460; Restatement of Property § 488 comment b (1944).

[70]156 Ind. App. 203, 295 N.E.2d 869 (1973).

Selvia defendants were using the easement not only to reach the portion of their property that was part of the dominant estate, but also were using the easement for ingress and egress to lands that were never part of the dominant estate. The court prohibited the use of the easement to reach lands that were not part of the dominant estate, holding that this use amounted to an unreasonable burden on the servient estate.[71] The *Selvia* opinion recognized the general rule that the owners of each portion of the subdivided dominant estate may use the appurtenant easement unless the increased or additional use "materially burdens" the servient estate.[72] The *Brock* court appears to have assumed that any increase in traffic constituted an "expanded use" and a material burden beyond the scope of the easement.[73] However, this conclusion is not unreasonable considering that the *Brock* court determined that apportionability of the appurtenant easement was not intended when the easement was created.[74]

The final issue raised by the *Brock* court involved the right of the Brocks to improve the easement. The court acknowledged the general rule that the owners of an easement have a right to make improvements and repairs that are reasonably necessary to effectuate the grant of an easement.[75] However, the court did not believe improvements were necessary to the Brocks easement, as the right of way was passable and "mere inconvenience provides no basis for changing its construction."[76] Once the court determined that there could be no increased traffic over the easement, the issue of the right of the Brocks to make improvements most likely became moot. Had the court found the increased traffic resulted from the natural development of the dominant estate and did not create an undue burden on the servient estate, the court might have determined the paving of the right of way across Moster's pasture was reasonably necessary to the effectual use of the easement.[77]

III. Landlord and Tenant: Assignments

A leasehold interest is freely transferable by a tenant unless there

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[71]*Id.* at 210, 295 N.E.2d at 874.

[72]*Id.* at 209-10, 295 N.E.2d at 873-74 (citing Annotation, *Right of Owners of Parcels into Which Dominant Tenement Is or Will Be Divided to Use Right of Way*, 10 A.L.R.3d 960 (1966).

[73]*Brock*, 481 N.E.2d at 1109. If an increase in traffic is viewed as a change in degree of use rather than as a change in the character of the use, such change should not be viewed as an increased burden on the servient estate. *See, e.g.*, Burgess v. Sweet, 662 S.W.2d 916, 919 (Mo. Ct. App. 1983).

[74]*Brock*, 481 N.E.2d at 1109.

[75]*Id.*

[76]*Id.*

[77]For cases discussing the right of an owner of a right of way easement to make

is a covenant against such transfer in the lease.[78] Where the tenant transfers possession of the leasehold to the transferree for the entire remaining term of the lease, the transfer creates an assignment.[79] Where the tenant transfers his interest in the lease for less than the entire term, i.e. where the tenant retains a reversion in the leasehold, the transfer creates a sublease and not an assignment.[80] The difference between an assignment and a sublease is very technical and the intent of the parties is often ignored by the courts.[81] The two transfers, however, create entirely distinct legal relations between the parties. In the case of an assignment, the original tenant ceases to have a possessory interest in the leasehold, and the privity of estate between the original tenant and the landlord comes to an end. The assignee-transferree, on the other hand, is now in privity of estate with the landlord and is liable to the landlord for the performance of all covenants that run with the land, including the covenant to pay rent.[82] Unless the assignee agrees to assume the obligations under the lease for the remainder of the term, however, the assignee remains liable for the performance of the covenants only while the privity of estate continues. If the assignee reassigns the leasehold estate, his liability comes to an end.[83] Because the original tenant was a party to the lease agreement, he remains secondarily liable for the performance of obligations in the lease even after an assignment because of this privity of contract unless the landlord releases him from this liability.[84]

In the case of a sublease, the original tenant retains a reversion in the leasehold estate, and therefore the privity of estate between the original tenant and the original landlord continues. The law does not recognize any privity of contract or privity of estate between the sublessee and the original landlord. Instead, the sublease (new lease) creates a new landlord and tenant relationship between the original tenant (new

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repairs or improvement, see Annotation, *Right of Owner of Easement of Way to Make Improvements or Repairs Thereon*, 112 A.L.R. 1303 (1938).

[78]W. Burby, Handbook of the Law of Real Property 144 (3d ed. 1965); J. Cribbet, Principles of the Law of Property 219 (2d ed. 1975). Covenants prohibiting the tenant from transferring his leasehold estate without the consent of the landlord, however, are standard "boilerplate" in most leases. Cunningham, *supra* note 48, § 6.69, at 386.

[79]J. Cribbet, *supra* note 78, at 219; Cunningham, *supra* note 48, § 6.66, at 381.

[80]*See* sources cited *supra* note 79.

[81]*See* sources cited *supra* note 79.

[82]J. Cribbet, *supra* note 78, at 221; Cunningham, *supra* note 48, § 6.67, at 382.

[83]W. Burby, *supra* note 78, at 141-42; J. Cribbet, *supra* note 78, at 221-22. If the assignee agrees to assume the obligations under the lease, he would then remain liable for the performance of the obligations under privity of contract. Cunningham, *supra* note 48, § 6.67, at 382.

[84]J. Cribbet, *supra* note 78, at 221; Cunningham, *supra* note 48, § 6.67, at 382.

landlord) and the sublessee (new tenant), and the original landlord must continue to look to the original tenant for the performance of the obligations under the original lease.[85]

In *Shadeland Development Corp. v. Meeks*,[86] the Indiana Court of Appeals examined some of the common and not so common problems involved in the transfer of leasehold estates. In *Shadeland*, the owner lessors, Mary R. Meek and J. Perry Meek Realty Co., Inc. (the Meeks), brought suit against Shadeland Development Corp. (Shadeland), the tenant assignor, and its parent corporation, Holiday Inns, Inc. (Holiday Inns), for breach of a sixty year commercial lease. Shadeland had transferred the lease to San Antonio Inns, Inc. (San Antonio), who subsequently defaulted on the rental payments.[87] The trial court denied the motion of Shadeland and Holiday Inns for summary judgment and granted the Meeks' motion for summary judgment on the issue of liability.[88]

Three major issues were addressed by the court on the appeal by Shadeland and Holiday Inns.[89] The first issue discussed was the right of Shadeland to assign its interest under the lease. The lease was signed by Fred C. Tucker, Jr., as agent for a nominee, an Indiana corporation to be formed by Tucker and others. The lease specifically provided that the lease could be assigned by Tucker at any time to the nominee corporation and that upon the assumption of the lease by such corporation, "it shall be the Lessee hereunder as if it were the original party and solely liable and Fred C. Tucker, Jr. shall have no further liability hereunder."[90] Tucker subsequently assigned the lease to 1920 North Meridian Corp. (North Meridian), which later merged with Shade-

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[85]J. Cribbet, *supra* note 78, at 221; Cunningham, *supra* note 48, § 6.68, at 384.

[86]489 N.E.2d 1192 (Ind. Ct. App. 1986).

[87]*Id.* at 1193. There was actually an earlier assignment from Shadeland to Key Host Inn of Indianapolis, Inc. (Key Host) on July 22, 1977. Holiday Inns loaned Key Host the funds to pay the consideration for the transfer from Shadeland. Subsequently, financial difficulties arose and a "resettlement statement" was issued by Shadeland and Robert Weber, President of Key Host, whereby Shadeland assigned the lease to San Antonio with Weber as guarantor for San Antonio. Again, Holiday Inns loaned San Antonio the money to pay the consideration for the assignment from Shadeland. *Id.* at 1194. After briefly mentioning these facts, the opinion never again refers to this assignment or to Key Host. However, clause (8) of the assignment from Shadeland to San Antonio provided that "[t]he parties hereto previously entered into an Assignment of Lease on the premises dated July 22, 1977. Upon execution hereof by both Assignor and Assignee this previous Assignment of Lease shall be deemed null and void." *Id.* at 1198.

[88]*Id.* at 1193.

[89]*Id.* A fourth issue, whether Holiday Inns was liable to the Meeks as Shadeland's parent corporation became moot when the court found that Shadeland had not breached any contractual duty under the lease. *Id.* at 1202.

[90]*Id.* at 1195.

land, which emerged as the surviving corporation.[91] The lease further provided that after the completion of certain improvements on the leased premises called for by the lease, "Lessee shall have the free right to assign this Lease without the consent of the Lessor; and, upon such assignment becoming effective and the assumption by the assignee of all obligations of this Lease, Lessee shall have no further liability hereunder."[92] The court noted that the construction of a motel building, an improvement on the leased premises called for by the lease, was completed "sometime in the early 1960's."[93] Because the assignment by Shadeland to San Antonio did not occur until October 13, 1977, it would appear that the consent of the lessor was not required. The Meeks, however, while conceding that the term "lessee" as used in the lease was meant to include both Tucker and the nominee corporation, argued that North Meridian and not Shadeland, its successor by merger, was the nominee.[94] Thus, arguably Shadeland did not have a right of assignment.[95] The court rejected this argument for two reasons. First, the lease contained a specific provision which stated "[t]he covenants and agreements herein contained shall inure to the benefit of and be binding upon the parties hereto and their respective successors and assigns."[96] Thus as a successor corporation, Shadeland would have the right to assign. Second, the court pointed out that under Indiana Code section 23-1-5-5, dealing with the effect of corporate merger or consolidation, a surviving corporation after merger possesses all the rights of each corporation merged.[97] Thus, Shadeland possessed all the rights of North Meridian including the right to assign.[98]

The second issue discussed by the court was the liability of Shadeland to Meeks after the transfer to San Antonio. The trial court had found Shadeland liable based on the general rule that the original tenant remains liable for the performance of the covenants in the lease under privity of contract even after a valid assignment. The court agreed with Shadeland that the trial court's reliance on the general rule was misplaced due to the express release contained in the lease.[99] Meeks, however, made several additional arguments concerning the validity of the assignment to San Antonio. The assignment agreement stated that San Antonio took subject to the payment of rent and subject to the observance

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[91]*Id.* at 1193-94.

[92]*Id.* at 1195.

[93]*Id.* at 1193.

[94]*Id.* at 1195.

[95]*Id.*

[96]*Id.*

[97]*Id.* at 1196 (citing Ind. Code § 23-1-5-5 (1979) (repealed effective August 1, 1987. Ind. Code Ann. § 23-1-5-5 (Burns Supp. 1986)).

[98]*Shadeland*, 489 N.E.2d at 1196.

[99]*Id.* at 1196-97.

and performance of each and every covenant and condition in the lease.[100] Meeks argued that this made the assignment conditional on the performance of the obligation in the lease and that when the assignee failed to pay the rent, the lease reverted to Shadeland.[101] The court found this argument unpersuasive and held the "subject to" language was merely a statement of explanation of the rights being assigned.[102] Meeks' argument regarding the "subject to" language appears to have been limited to the question of whether or not the assignment was conditional and does not appear to raise the issue of whether the assignee "assumed" the obligations under the lease. Before the tenant was to be released from liability under the lease in question, the lease required that there be an "assumption by the assignee of all obligations under this Lease."[103] Although this point does not appear to have been raised, the language of the assignment agreement clearly indicates that the assignee is assuming the performance of the covenants and conditions of the lease for the remainder of the term:

> And the Assignee . . . does hereby promise, covenant, and agree to and with the said Assignor and to and with the Lessor above named, that Assignee will, effective as of and from the date of the execution of this instrument and during the remainder of the term of the Lease, pay the rents thereby reserved . . . and will also faithfully observe and perform all of the covenants and conditions contained in the Lease.[104]

The second argument made by Meeks regarding the validity of the assignment involved the effect of a right of reentry (power of termination) clause contained in the assignment agreement. Meeks argued that this clause was a retention by the tenant of a reversion in the leasehold making the transfer a sublease and not an assignment.[105] The court noted that there is a split of authority as to whether a right of reentry is a sufficient reversionary interest to make an otherwise valid assignment a sublease.[106] In *Indian Refining Co. v. Roberts*,[107] the court held that a

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[100]*Id.* at 1197.
[101]*Id.* at 1198-99.
[102]*Id.* at 1199.
[103]*Id.* at 1195.
[104]*Id.* at 1197.
[105]*Id.* at 1199.
[106]*Id.* at 1200 (citing Indian Refining Co. v. Roberts, 97 Ind. App. 615, 181 N.E. 283 (1932)). The majority of jurisdictions do not consider a right of reentry to be a sufficient interest to make an otherwise valid assignment a sublease. The minority view, the Massachusetts rule, followed in some states, does consider a right of reentry the retention of a reversionary interest by the tenant turning the transfer into a sublease. CUNNINGHAM, *supra* note 48, § 6.66, at 381.
[107]97 Ind. App. 615, 181 N.E. 283 (1932).

right of reentry for the nonpayment of rent was not a reservation of a reversion but was instead merely a chose in action.[108] While in *Roberts* the right of reentry was only for the nonpayment of rent, the *Shadeland* court held that the rationale was still applicable even though in the present case, the conditions giving rise to the right of reentry included unauthorized structural modification, an unauthorized sublease, and the lack of premises insurance.[109] The *Shadeland* court also noted that in any event, the right of reentry was intended only to insure the repayment of the loan from Holiday Inns, and thus, it ended when the debt was paid and the assignment was recorded on September 6, 1978.[110] The breach by San Antonio did not occur until much later when rent was not paid after March 1980.[111]

The last issue addressed by the court is perhaps the most interesting. The trial court concluded that Shadeland and Holiday Inns owed a duty to the Meeks to use reasonable care in selecting and securing an assignee capable of performing its obligations for the remainder of the lease term, roughly forty-five years.[112] In reversing the trial court, the court of appeals found no duty as a matter of law to use reasonable care in selecting an assignee:

> [S]uch duty would be a restriction on alienation of land and such restrictions are not favored in law. How and to whom a leasehold may be assigned is a matter for contract law to be decided by the landlord and tenant each bargaining in his own interest. The existence of a duty to find a solvent assignee would unduly inhibit the parties from fashioning an agreement in their own best interests.[113]

The court could find nothing in the language of the lease implying a duty in the selection of an assignee. The lessee was given the " 'free right to assign this lease without the consent of the lessor.' "[114]

Finally, the court noted that the nature of the transaction made it hesitant to infer any duty in the selection of the assignee.[115] The lease

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[108]*Id.* at 631, 181 N.E. at 289.

[109]*Shadeland*, 489 N.E.2d at 1200.

[110]*Id.* The court apparently agreed with Shadeland's assertion that the right of reentry was merely security for the repayment of the loan made to San Antonio to finance its venture. *Id.* at 1199.

[111]*Id.* at 1200.

[112]*Id.*

[113]*Id.* at 1200-01 (citations omitted). There is also authority for the position that an assignee does not have any duty to use care to select a solvent assignee in the case of a reassignment. A.D. Julliard & Co. v. American Woolen Co., 69 R.I. 215, 32 A.2d 800 (1943).

[114]*Shadeland*, 489 N.E.2d at 1201.

[115]*Id.*

required Shadeland to construct, at its own expense, a building sufficient to operate a motel with all allied services and facilities. Only after this was accomplished could the tenant assign without the consent of the lessor.[116] This suggests the lessor was looking to the improvement erected on the leased premises as security for the tenant's future performance of the lease.[117] The court quoted from several treatises indicating that it is not uncommon where the lease requires the tenant to erect a building on the leased premises to provide that upon completion of the structure, the tenant may freely assign the lease with no further personal liability under the lease.[118] The court also quoted from decisions in other jurisdictions reaching the same conclusion based on similar factual situations.[119] Thus, because no duty to use particular care in the selection of an assignee was expressed in the lease and because none could be inferred from the nature of the transaction, the decision of the trial court was reversed and remanded for entry of summary judgment in favor of Shadeland and Holiday Inns.[120]

IV. Recording Statutes, Notice, and Bona Fide Purchaser

Without a recording system, the priority among deeds, mortgages, and other interests in property is determined by the effective date of the conveyance.[121] The owner, having once conveyed his interest, has nothing left to convey a second time. Thus the second purchaser of the same interest, even if he has paid value and is without notice of the prior conveyance, takes nothing.[122] A recording system changes this "first in time, first in priority" rule by requiring the first purchaser to record his conveyance or run the risk of losing it to a subsequent purchaser.[123] The vast majority of recording systems, however, give priority to a subsequent purchaser only if he qualifies as a bona fide purchaser, i.e. one who pays value and who acquires the interest without notice of the prior conveyance.[124] In addition, about half the states, including Indi-

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[116]*Id.*

[117]"Because of this security it is not unreasonable for the parties to place no duty on Shadeland to choose a particular assignee." *Id.*

[118]The court quoted from 1 M. Friedman, Friedman on Leases § 7.1 (1983); 2 R. Powell, The Law of Real Property 242 (1983).

[119]Alexander v. Theatre Realty Corp., 253 Ky. 674, 70 S.W.2d 380 (1934); Jenkins v. John Taylor Dry Goods, 352 Mo. 660, 179 S.W.2d 54 (1944).

[120]*Shadeland*, 489 N.E.2d at 1203.

[121]J. Cribbet, *supra* note 78, at 279.

[122]*Id.*

[123]Cunningham, *supra* note 48, § 11.9, at 775.

[124]*Id.* § 11.10, at 783. Only under a pure race statute could a subsequent purchaser with actual or constructive notice take over a prior unrecorded interest. *Id.* § 11.9, at 776.

ana,[125] also require that the subsequent bona fide purchaser record his conveyance first, before the prior conveyance is recorded.[126]

Notice is an essential element of the recording system. When a conveyance is properly recorded, it is said to give "constructive notice" to the world of the conveyance.[127] Thus, a person will be charged with notice of the conveyance because had he checked the public records, he would have discovered it. Thus if the prior conveyance has been properly recorded, the subsequent purchaser cannot qualify as a bona fide purchaser. The converse, however, is not true. The mere fact that a prior conveyance has not been properly recorded does not necessarily mean the subsequent purchaser is without notice. If the subsequent purchaser has actual notice of the prior unrecorded conveyance, he will not be protected by the recording system in most states.[128] Actual notice can come from a variety of sources.[129] An interesting situation in which an arguably improper recording of a memorandum of an installment land contract gave actual rather than constructive notice to the subsequent purchaser of the prior interest was presented in *Altman v. Circle City Glass Corp.*[130]

In *Altman*, Bert and Elsie Brown executed a conditional sales contract in 1968, conveying the property in question to the Circle City Glass Corp. (Circle City). Circle City subsequently paid the full consideration pursuant to the contract, but a deed was never received from the Browns.[131] Elsie Brown died in 1972 and her son, Bert, acquired title to the property.[132] Bert died in 1973, and his widow and sole heir,

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[125]Indiana has a typical "race-notice" statute:

> Every conveyance or mortgage of lands or of any interest therein, and every lease for more than three (3) years shall be recorded in the recorder's office of the county where such lands shall be situated; and every conveyance, mortgage or lease shall take priority according to the time of the filing thereof, and such conveyance mortgage or lease shall be fraudulent and void as against any subsequent purchaser, lessee or mortgagee in good faith and for a valuable consideration, having his deed, mortgage or lease first recorded.

IND. CODE § 32-1-2-16 (1982).

[126]CUNNINGHAM, *supra* note 48, § 11.9, at 775-76. For a discussion of the various types of recording statutes, see Johnson, *Purpose and Scope of Recording Acts*, 47 IOWA L. REV. 231 (1962).

[127]J. CRIBBET, *supra* note 78, at 282.

[128]*See supra* note 124.

[129]For a discussion of the sources of actual notice, see CUNNINGHAM, *supra* note 48, § 11.10, at 787.

[130]484 N.E.2d 1296 (Ind. Ct. App. 1985).

[131]*Id.* at 1297. It appears from the wording the consideration was paid over a period of time, but the date on which the full consideration was eventually paid is not stated.

[132]*Id.* The facts indicate that Bert and his mother executed the conditional sales contract as sellers, but the exact nature of Bert's interest in the property at the time the contract was executed is not made clear. Because the opinion later indicates that Bert

Gertrude, inherited the property.[133] On June 21, 1976, Circle City recorded a memorandum of the conditional sales contract.[134] On January 26, 1983, Gertrude Brown conveyed the property to Daniel B. Altman by a warranty deed. Several months prior to the conveyance, Altman had received a commitment for title insurance from Lawyers Title Insurance Corp. (Lawyers Title). The written commitment informed Altman that before title insurance could be obtained, "Altman would first have to obtain a quitclaim deed from Circle City 'to terminate its interest in a Conditional Sales contract, a Memorandum thereof having been recorded on June 21, 1976.' "[135] After purchasing the property, Altman brought suit to quiet title against Circle City, which counterclaimed to quiet title in its name.[136] The trial court granted summary judgment in favor of Circle City, holding that Altman had constructive notice of Circle City's interest by reason of the recorded memorandum of the conditional sales contract and actual notice of its interest from the written commitment for title insurance.[137]

Altman raised two issues on appeal. The first issue was whether the recording of the memorandum of the conditional sales contract gave Altman constructive notice of Circle City's interest in the property.[138] The court of appeals' conclusion that Altman had actual notice of Circle City's interest from the commitment for title insurance made it unnecessary for the court of appeals to address this issue.[139] Nevertheless several observations should be made. Altman did not appear to be arguing that a conditional sales contract could not be recorded.[140] Instead,

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"acquired title" to the property at his mother's death, it seems likely that he and his mother held title as joint tenants with right of survivorship.

[133] *Id.* It is not clear if Circle City had completed the payments under the contract before Elsie and Bert's death. It is irrelevant, however, since the heirs of a record owner have the power to transfer title to a bona fide purchaser whether or not the record owner had any valid interest in the land at the date of his death. *See* Earle v. Fisk, 103 Mass. 491 (1870).

[134] *Altman*, 484 N.E.2d at 1297. It is not clear from the facts why Circle City did not record the conditional sales contract itself rather than a memorandum. One can only speculate, but one possibility is that the instrument might not have been entitled to recordation because it lacked one of the formalities. It is a common practice when executing long term conditional sales contracts to leave out one or more of the requirements necessary to record the document. Thus, in the event of default by the purchaser, the seller will have clear record title and will not have a recorded contract clouding the title. CUNNINGHAM, *supra* note 48, § 11.9, at 782. The requirements for an instrument to be entitled to be received and recorded are contained in IND. CODE § 36-2-11-16 (1982).

[135] *Altman*, 484 N.E.2d at 1297.

[136] *Id.*

[137] *Id.*

[138] *Id.*

[139] *Id* at 1300.

[140] It would appear that a conditional contract can be recorded under the Indiana

he appeared to be arguing that there is no statute authorizing the recording of a "memorandum" of the conditional sales contract.[141] The fact that the legislature passed a statute authorizing the recording of a memorandum of a lease[142] would appear to support Altman's position. Until this question is resolved by case law or until the legislature enacts specific legislation, it would be unwise to record a memorandum of a conveyance (other than a lease) instead of the instrument itself. Additionally, Altman may have been arguing that even if a memorandum could be recorded, this memorandum did not comply with the statutory requirements for the recording because the memorandum was signed only by Circle City's representative.[143]

The second issue raised by Altman related to the trial court's finding that he had actual notice of Circle City's interest.[144] Altman argued that because the memorandum is not entitled to be recorded, it does not impart either actual or constructive notice of the interest.[145] Further, Altman argued that because he did not actually see the memorandum or the conditional sales contract himself, he did not have actual notice.[146]

The court of appeals began with the observation that while an instrument that is not entitled to be recorded, or is improperly recorded, or is recorded outside the chain of title does not operate as constructive notice, it may nevertheless bind persons having actual notice of its existence.[147] While it was true that Altman did not actually see the memorandum in the public records, the information he received from Lawyers Title placed a duty on him to make a reasonable inquiry. Had he inquired with reasonable diligence, he would have discovered the nature of Circle City's interest in the property.[148] The court of appeals noted the general principle of law that where a person becomes aware of facts that are sufficient to place a reasonable and prudent person under a duty to inquire, the person will be charged with the knowledge

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recording system. Case v. Bumstead, 24 Ind. 429 (1865); Ind. Code Ann. § 32-1-2-32 (West Supp. 1986).

[141]*Altman*, 484 N.E.2d at 1297.

[142]Indiana Code section 36-2-11-20 provides for the recording of a memorandum of lease.

[143]The court noted that the memorandum was signed only by Circle City's representative. *Altman*, 484 N.E.2d at 1297. Assuming arguendo that a memorandum of the contract could be recorded, it does not appear that the memorandum meets the other requirements for recordation. However, because it was accepted for recordation by the recorder's office and was in fact recorded, there may be a conclusive presumption that it complied with the requirements. *See* Ind. Code Ann. § 36-2-11-16(e) (West Supp. 1986).

[144]*Altman*, 484 N.E.2d at 1297.

[145]*Id.*

[146]*Id.* at 1299.

[147]*Id.* at 1298. The court of appeals cited Rogers v. City of Evansville, 437 N.E.2d 1019 (Ind. Ct. App. 1982).

[148]*Altman*, 484 N.E.2d at 1299.

that such inquiry would impart if reasonably prosecuted.[149] Some courts refer to inquiry notice as constructive notice;[150] however, the Indiana Supreme Court defined inquiry as implied actual notice in *Mishawaka, St. Joseph Loan & Trust Co. v. Neu*:

> [A]ctual notice has been divided into two classes, (1) express and (2) implied, which is inferred from the fact that the person charged had means of knowledge which he did not use. "Whatever fairly puts a person on inquiry is sufficient notice, where the means of knowledge are at hand; and if he omits to inquire, he is then chargeable with all the facts which, by a proper inquiry, he might have ascertained."[151]

The *Altman* court observed that "[t]he *Mishawaka* decision stands for the equitable principle that the means of knowledge combined with the duty to utilize that means equate with knowledge itself."[152] The court concluded that the information which Altman had received imparted a duty to inquire, which if pursued with reasonable diligence would have led to the discovery of Circle City's interest in the property. Thus Altman had implied actual knowledge of the prior conveyance and could not be considered a subsequent bona fide purchaser.[153]

It may at first appear strange that the discovery of an instrument not entitled to be recorded in the public records can give actual or inquiry notice to the person making the discovery, while it would not give constructive notice to a person who failed to search the public records. In theory, such a rule appears to punish the party who conducts a diligent search of the public records and discovers an instrument not entitled to be recorded. At the same time, this rule appears to reward the lazy individual who did not bother to search the records and therefore is not charged with actual or inquiry notice of the interest. In practice, however, it would be extremely foolish not to search the public records because of the extremely remote possibility of discovering an instrument not entitled to be recorded and thereby run the risk of not discovering numerous recorded interests.

V. The Rule Against Perpetuities: A Potpourri

The rule against perpetuities is without doubt one of the most complex and misunderstood concepts in the whole of law.[154] In Indiana, the common law rule has been codified in Indiana Code section 32-1-4-1:

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[149] *Id.* at 1298-99.
[150] Cunningham, *supra* note 48, § 11.10, at 787.
[151] 209 Ind. 433, 442-43, 196 N.E. 85, 89 (1935).
[152] *Altman*, 484 N.E.2d at 1298.
[153] *Id.* at 1300.
[154] The rule against perpetuities has been described by the late Professor W. Barton

> An interest in property shall not be valid unless it must vest, if at all, not later then twenty-one (21) years after a life or lives in being at the creation of the interest. It is the intention by the adoption of this chapter to make effective in Indiana what is generally known as the common law rule against perpetuities . . . .[155]

In dealing with the rule against perpetuities it is important to keep in mind that it is a rule against the remoteness of vesting of interests—it invalidates interests that vest too remotely.[156] The rule has nothing to do with how long an interest may last or when an interest becomes possessory.[157] An interest may become vested long before it becomes possessory.[158] Likewise, the rule has nothing to do with the duration of trusts.[159]

The term "vested interest" refers to an interest that does not contain a condition precedent to its becoming possessory at the natural termination of all preceding estates.[160] A condition precedent is a condition that must occur or happen before a future interest can become vested.[161] Where there is a condition precedent, the future interest is contingent

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Leach as "a technicality-ridden legal nightmare . . . . a dangerous instrumentality in the hands of most members of the bar." Leach, *Perpetuities Legislation, Massachusetts Style*, 67 HARV. L. REV. 1349 (1954). The Supreme Court of California went so far as to hold that an attorney who drafted an instrument that violated the rule was not guilty of malpractice because he had not "failed to use such skill, prudence and diligence as lawyers of ordinary skill and capacity commonly exercise." Lucas v. Hamm, 56 Cal. 2d 583, 592, 15 Cal. Rptr. 821, 826, 364 P.2d 685, 690 (1961), *cert. denied*, 368 U.S. 987 (1962). It is unclear whether these and similar remarks are intended as an indictment of the bar or the rule.

[155]John Chipman Gray's classic definition of the common law rule against perpetuities, adopted by the courts in both the United States and England, states: "No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest." J. GRAY, THE RULE AGAINST PERPETUITIES § 201 (4th ed. 1942).

[156]Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638, 639-40 (1938).

[157]*Id.*; T. BERGIN & P. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS, 180 (2nd ed. 1984).

[158]L. SIMES & A. SMITH, THE LAW OF FUTURE INTEREST § 1233, at 137 (2d ed. 1956). Professor Leach gives as an example a device "[T]o A for life, remainder to A's children for their lives, remainder to B." B's interest is valid because it is vested. Yet it may not become possessory until after the death of a child of A yet unborn who might live more than twenty-one years after the death of the measuring lives in being at the creation of B's interest. Leach, *supra* note 156, at 647.

[159]As long as the equitable interests are vested in the beneficiaries, the duration of the trust can exceed the period in the rule against perpetuities. T. BERGIN & P. HASKELL, *supra* note 157, at 184, 224-25.

[160]L. SIMES, HANDBOOK OF THE LAW OF FUTURE INTERESTS § 90, at 186 (2d ed. 1966).

[161]T. BERGIN & P. HASKELL, *supra* note 157, at 72-73.

and is subject to the rule against perpetuities.[162] One of the more common types of conditions precedent is the age contingency. Often a donative transfer will state that the beneficiary is not to receive the property until he or she attains a named age. Traditionally the courts have treated the age contingency as a condition of survivorship, i.e. that the beneficiary must survive to the designated age to take the property.[163] For example, if a testator devised property "to *A* if *A* should attain the age of twenty-five (25)," a court would most likely view the age contingency as a condition precedent requiring *A* to reach the age twenty-five to take the property. If *A* should die before reaching twenty-five, the devise to *A* would fail.[164] In this example, the age contingency would not cause a violation of the rule against perpetuities because *A* is a life in being. *A* will either reach the designated age or fail to do so within his own lifetime.[165] However, where the gift is to a class of beneficiaries and there is a possibility of additional members being added to the class after the creation of the interest, an age contingency in excess of twenty-one years can create serious problems.[166]

The concept of "lives in being" can also create major problems for the drafters of future interests and those attempting to ascertain their validity. The term refers to a person or persons alive at the creation of the interest, which the court can use as measuring lives to determine whether the interest vested within the rule.[167] The measuring lives are usually named in the instrument creating the interest and these persons are often donees under the instrument, but neither of these conditions is required.[168] For example, a devise by the testator "to my grandchildren

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[162]L. Simes & A. Smith, *supra* note 158, § 1235, at 139.

[163]L. Simes, *supra* note 160, § 93, at 193. Words such as "if" or "provided" the beneficiary reaches a certain age are generally held to create a condition precedent. *Id.* However, words such as "to be paid at" a certain age or "to be paid when" the beneficiary reaches a certain age are viewed by the courts as merely postponing the time of enjoyment and not as creating a condition precedent to vesting. *Id.*; T. Bergin & P. Haskell, *supra* note 157, at 132-34. If the wording does not create a condition precedent but only delays the time of enjoyment (possession), and the beneficiary dies before the time for distribution, the property passes to his estate. *Id.* at 127; L. Simes & A. Smith, *supra* note 158, § 586, at 32.

[164]T. Bergin & P. Haskell, *supra* note 157, at 133; L. Simes & A. Smith, *supra* note 158, § 575, at 8.

[165]L. Simes, *supra* note 160, § 127, at 268; L. Waggoner, Future Interests in a Nutshell § 12.7, at 181 (1981).

[166]*See infra* notes 176-81 and accompanying text.

[167]L. Simes, *supra* note 160, § 127, at 265-67. The lives must be human lives and not lower animals or a corporation. *Id.* § 127, at 265. These measuring lives must not be so numerous as to make it unreasonably difficult for the court to determine the last survivor of the group. T. Bergin & P. Haskell, *supra* note 157, at 183-84.

[168]T. Bergin & P. Haskell, *supra* note 157, at 182-83.

who reach twenty-one (21)" is valid because the testator's children are implied as lives in being, even though they were not named in the instrument nor given any interest under it.[169]

A gift to a class[170] such as children or grandchildren can create special problems both with regard to the time of vesting and the determination of the lives in being. Unlike a gift to an individual, the membership in a class can increase or decrease after the interest has been created because of new births or deaths.[171] Where the class is closed, i.e. where no additional members can be added at the time the interest is created, the members of the class can be used as the measuring lives.[172] For example, if the testator devised property "to my children who shall attain the age of twenty-five (25)," there would be no violation of the rule against perpetuities. The age contingency would create a condition precedent to vesting, but the interest of the testator's children will vest, if at all, within the lives of the children,[173] who were all alive at the testator's death[174]—the time when the interest was created.[175] Where the class is not closed at the time the interest is created, special problems are created. For example, if the testator devised property "to my children for life, remainder to my grandchildren who attain the age of twenty-five (25)" and the testator left children surviving him, the gift to the grandchildren violates the rule against perpetuities. It would be possible for a surviving child of the testator to have a child (testator's grandchild) after the testator's death and for this grandchild's interest to vest more than twenty-one years after the death of all the measuring lives in being at the time the interest was created. The testator's children and all the grandchildren alive at the testator's death could all die before the afterborn grandchild reached the age of four, and because the interest must vest within twenty-one years of the last death of a measuring life

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[169]L. Simes, *supra* note 160, § 127, at 265-66; L. Waggoner, *supra* note 165, § 12.7, at 180.

[170]A class gift is a gift to a group of persons having some common characteristic. The share of each person in the class will be determined by the number of members. L. Simes, *supra* note 160, § 101, at 204-05.

[171]*Id.*

[172]L. Simes & A. Smith, *supra* note 158, § 1226, at 115; L. Waggoner, *supra* note 165, § 12.7, at 179-80.

[173]T. Bergin & P. Haskell, *supra* note 157, at 191, L. Waggoner, *supra* note 165, § 12.7, at 181.

[174]It is possible that if the testator's last surviving child is a male, a grandchild *en ventre sa mere* could be born after the last child's death and thus reach twenty-one more than twenty-one years after the death of lives in being. However, the rule against perpetuities includes periods of gestation within the period of the rule. T. Bergin & P. Haskell, *supra* note 157, at 187; L. Simes, *supra* note 160, § 12.7, at 266; L. Waggoner, *supra* note 165, § 12.7, at 178-79.

[175]An interest created by will becomes effective at the testator's death. L. Simes, *supra* note 160, § 12.7, at 267; L. Waggoner, *supra* note 165, § 12.5, at 174.

in being, the twenty-five year limitation on the vesting of the afterborn grandchild's interest could be outside the twenty-one year limit. For example, under the above provision, suppose the testator had two children, *A* and *B*, and grandchild *C*, who were alive upon the testator's death. Suppose further that *A* had a child, *D*, after the testator had died. Then upon *D*'s first birthday, *A, B,* and *C* all die suddenly. Thus, *D*'s interest must vest within twenty-one years of *A*'s, *B*'s, and *C*'s deaths or be void under the rule against perpetuities. However, according to the devising language, *D*'s interest may not vest until he attains the age of twenty-five, which is twenty-four years from the date of the measuring lives in being's (*A*, *B*, & *C*) deaths. Therefore, this provision is void under the rule.[176] The fact that this is unlikely to occur does not prevent the rule from operating. The rule against perpetuities is based on possibilities and not probabilities.[177]

In addition, class gifts under the rule against perpetuities are treated as a unit, and under the "all or nothing" rule, unless the interest of each and every member of the class vests within the rule, the gift to the entire class fails.[178] Thus the gift to all the grandchildren will fail even though the interests of the grandchildren alive at the testator's death will vest, if at all, within their own lifetimes, and even though some of the grandchildren are already twenty-five years old at the testator's death.[179] It should be noted that if there had been no age contingency in the example but simply a remainder to the testator's grandchildren,[180] or if the age contingency had been twenty-one instead of twenty-five,[181] the interests of the grandchildren would not have violated the rule against perpetuities.

In *Merrill v. Wimmer*,[182] the Supreme Court of Indiana found the provisions for the distribution of the corpus of a testamentary trust violated the rule against perpetuities, and as a result, the testator died intestate. The *Merrill* decision raises a number of interesting issues: (1) why did the interests in the testamentary trust violate the rule against

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[176] L. WAGGONER, *supra* note 165, § 12.7, at 186 example 12-8; Waggoner, *Perpetuity Reform*, 81 MICH. L. REV. 1718, 1746 (1983) [hereinafter *Perpetuity Reform*].

[177] L. SIMES, *supra* note 160, § 133, at 285-89.

[178] *Id.* § 134, at 289-92.

[179] L. SIMES & A. SMITH, *supra* note 158, § 1265, at 197-98; L. WAGGONER, *supra* note 165, § 12.7, at 186 example 12-8.

[180] With no age contingency, the interest will vest in the class of grandchildren when all of them are born, which will occur within the lifetime of the testator's children, who are the lives in being. Leach, *supra* note 156, at 641.

[181] L. SIMES, *supra* note 160, § 127, at 265. Because the children of the testator are the measuring lives, all the grandchildren will reach twenty-one no later than twenty-one years after the death of the testator's last surviving child. L. WAGGONER, *supra* note 165, § 12.7, at 180.

[182] 481 N.E.2d 1294 (Ind. 1985).

perpetuities; (2) what could the drafter have done to avoid a rule violation; and (3) is there a need for legislative reform to mitigate the harshness and inequities resulting from a violation of the rule.

In *Merrill*, the will of Newell M. Merrill left a life estate to his wife and the residue of the estate in trust. The life estate to Merrill's wife became irrelevant when his wife predeceased him.[183] The income from the trust was left to the Merrill's three children, Judith, Dennis, and Walter, and to the wife of any son who might die before the termination of the trust.[184] The distribution of the corpus of the trust was provided for in Item 3(E) of the will:

> That when my youngest grandchild reaches the age of twenty-five (25) years, said Trust shall terminate as to two-thirds (2/3) of the corpus of said Trust, and that said two-thirds (2/3), together with the accumulated income to be credited to said two-thirds (2/3) interest, shall be divided as follows, to wit: One-Third (1/3) shall be divided one-half (1/2) to my daughter, Judith I. Yarling, and one-half (1/2) to her children, share and share alike; One-Third (1/3) shall be divided one-half (1/2) to my son, Dennis A. Merrill, and one-half (1/2) to his children, share and share alike; One-Third (1/3) of the corpus of said Trust, together with any accumulated income, to be credited to said one-third (1/3) interest, shall be continued in Trust for my son, Walter O. Merrill, and he shall have the income from this Trust for and during his natural life and upon his death, if he has bodily issue, then one-half (1/2) of his one-third (1/3), in Trust, shall go to his bodily issue and the other one-half (1/2) of the one-third (1/3), in Trust, or all of said one-third (1/3), in Trust, in the event he has no bodily issue, shall go to my grandchildren, living at the time of the termination of said Trust, share and share alike.[185]

The trial court, adopting the findings of the probate commissioner, held that the trust provisions distributing two-thirds of the corpus to Judith, Dennis, and their children violated the rule against perpetuities and awarded Judith and Dennis each one-third of the corpus outright.[186] The trial court also upheld the entire provision regarding the one-third

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[183] *Id.* at 1297. The entire will is reproduced in the opinion. *Id.* at 1296-97.

[184] *Id.* at 1296. The court does not appear to question the validity of the income provisions of the trust. However, the court finds the entire trust void, apparently under the doctrine of "infectious invalidity." *Id.* at 1300. *See infra* note 190. The income provisions may create an accumulations problem, but the issue was not addressed by the court and will not be discussed in this survey.

[185] *Merrill*, 481 N.E.2d at 1297.

[186] *Id.*

share of the corpus relating to Walter.[187] The court of appeals agreed with the trial court that the provisions for the distribution of the two-thirds corpus violated the rule against perpetuities, but the court of appeals was critical of the trial court's decision to distribute the two-thirds interest directly to Judith and Dennis, thereby extinguishing the interests of their children in the trust.[188] The court of appeals also found the trial court had erred in upholding the provisions of the trust regarding Walter.[189] While the court of appeals agreed that the provision regarding Walter did not violate the rule against perpetuities, the court of appeals concluded that the provision could not stand alone because it was an integral part of an interrelated testamentary distributional scheme.[190] Instead of declaring the entire trust void, however, the court of appeals saved the trust by applying "the equitable doctrine of approximation."[191] In order to avoid the harshness of the rule against perpetuities and to give effect to the testator's intent, the court of appeals held the word "grandchild" appearing in the first line of Item 3(E) of Newell's will should be construed to mean grandchild alive at the testator's death.[192] Under this construction, the provisions in Item 3(E) of the will would not violate the rule against perpetuities.[193] On transfer, the Indiana Supreme Court was highly critical of the court of appeals' attempt to rewrite the will under the guise of merely construing the will. Resort to rules of construction to ascertain the testator's intent can be made only in cases where there is an actual or latent ambiguity, and here the supreme court found "there is no ambiguity whatsoever in the will, with regard to either the identity of the beneficiaries or the time of termination of the trust."[194] While the court expressed remorse over the fact that

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[187]*Id.*

[188]*Merrill*, 453 N.E.2d 356, 360 (Ind. Ct. App. 1983), *vacated*, 481 N.E.2d 1294 (Ind. 1985).

[189]*Id.*

[190]*Merrill*, 453 N.E.2d at 360. The rule against perpetuities destroys only those interests in the instrument that violate the rule. The other interests in the instrument take effect as if the void interest had never been created. T. Bergin & P. Haskell, *supra* note 157, at 208-10. On occasion, however, the courts will strike the other portions of a will or trust if the court finds they are not severable. *Id.* at 210; G.G. Bogert & G.T. Bogert, Law of Trusts 185-86 (5th ed. 1973). This is known as the doctrine of "infectious invalidity." L. Simes, *supra* note 160, § 133, at 284.

[191]*Merrill*, 453 N.E.2d at 361. For a detailed discussion of the court of appeals application of the doctrine of equitable approximation, see Falender & Fruehwald, *Trusts & Decedents' Estates, 1984 Survey of Recent Developments in Indiana Law*, 18 Ind. L. Rev. 435, 450-57 (1985).

[192]*Merrill*, 453 N.E.2d at 362.

[193]If the interest vests (trust terminates) when the youngest grandchild alive at the testator's death reaches twenty-five, the rule against perpetuities is not violated because the grandchild would be a life in being at the creation of the interest. *See* T. Bergin & P. Haskell, *supra* note 157, at 211.

[194]*Merrill*, 481 N.E.2d at 1298.

the testator's intent had been frustrated, it noted that it was the rule against perpetuities and not the court that had subverted his intent.[195] The supreme court appeared unwilling to use the doctrine of equitable approximation to save the trust. While noting that "[i]n some jurisdictions, where the rule exists only by virtue of the common law, courts have taken certain liberties [with the rule]," the supreme court felt restrained from making any attempt to prevent its mischief because the rule exists by statute in Indiana.[196] Having found that the provisions for the distribution of the corpus of the trust, including the provision regarding Walter,[197] violated the rule against perpetuities, the court concluded that Newell Merrill died intestate.[198]

A logical place to begin any discussion of the *Merrill* decision is with the finding by the court that the trust provisions in Item 3(E) of the will violated the rule against perpetuities. The probate commissioner, the trial court, and the court of appeals were all in agreement that the proposed distribution of two-thirds of the corpus to Judith, Dennis, and their children violated the rule. In fact, the appellants conceded that the proposed distribution violated the rule.[199]

Before discussing the supreme court decision, however, it might be useful first to examine the court of appeals opinion to ascertain the rationale for that court's determination that the proposed distribution of two-thirds of the corpus to Judith, Dennis, and their children violated the rule against perpetuities. The most explicit passage in the opinion discussing this issue states:

> Here, it is possible the youngest grandchild may reach the age of 25 years more than 21 years after the death of the lives in being, Newell's children, at the creation of the interests. . . .
>
> Such class must close within the period of the rule. . . . Here it may not close until after the period prescribed in the rule. . . . Therefore, the possibility exists that grandchild's interest would not vest within the time required by the rule. For that reason, the entire gift fails.[200]

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[195]*Id.* at 1299.

[196]*Id.* at 1298-99 n.2.

[197]*Id.* at 1299-1300.

[198]*Id.* at 1300. From a literal reading of the decision, the supreme court has declared the entire trust, including the income provisions, void. The supreme court apparently applied the doctrine of infectious invalidity to destroy the income provision of the trust.

[199]*Merrill*, 453 N.E.2d at 359. The authors of *Trusts and Decedents' Estates, 1984 Survey of Recent Developments in Indiana Law*, berate the attorneys in *Merrill* for conceding a rule violation that arguably did not exist. Falender & Fruehwald, *supra* note 191, at 457.

[200]*Merrill*, 453 N.E.2d at 359 (citations omitted).

There can be little doubt from the wording of this passage that the court of appeals viewed the gift to the children of Judith and Dennis as a class gift.[201] Because the class members were all grandchildren of the testator, the court viewed the age contingency "when my youngest grandchild reaches the age of twenty-five (25) years" as applying to the members of the class. It is also clear from the wording that the court of appeals viewed the contingency as a condition of survivorship, creating a condition precedent to the vesting of the class gift.[202] Here the youngest grandchild, or for that matter any afterborn grandchild, might reach the age of twenty-five more than twenty-one years after the death of the lives in being (testator's children) at the creation of the interest. Because a class gift, under the all or nothing rule, must vest in each and every member of the class within the period of the rule against perpetuities, the entire gift failed.[203]

Returning to the supreme court decision, it is equally clear that the supreme court viewed the trust instrument as creating class gifts: "The beneficiaries were the Testator's children and grandchildren, all of them, and the trust was to terminate, as to two-thirds (2/3), when the youngest grandchild attained the age of twenty-five (25) years."[204] While the supreme court likewise viewed the age contingency as creating a condition of survivorship, the decision reads as if the court considered the age contingency as a condition precedent to the vesting of all the interests in the corpus of the trust, not just the interests of the children of Judith and Dennis. In discussing the interests of Judith and Dennis, the court remarked that "[s]ince the identity of the youngest grandchild cannot be determined until all of the Testator's children have died, the intended gift to these two children fails. . . ."[205] Further, in discussing the one-

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[201]It is not clear whether the court of appeals also viewed Judith and Dennis as members of the class. It is suggested that they should not be viewed as class members because their shares are fixed. Each is to receive one-half (1/2) of a one-third (1/3) share of the corpus. Only their children's shares are dependent on the number of class members. If, however, Judith and Dennis are not viewed as members of the class, then technically their interests do not violate the rule against perpetuities. Nevertheless, had the court of appeals not saved the trust by applying the doctrine of equitable approximation, it seems certain the court would not have allowed the interests of Judith and Dennis to survive the destruction of their children's interests for the same reason the court would not have allowed the one-third share regarding Walter to stand alone. The distribution provisions of the trust were all part of an interrelated testamentary scheme. *Merrill*, 453 N.E.2d at 360.

[202]It is not clear from the opinion whether, in addition to each grandchild reaching the age of twenty-five, each grandchild must also survive to the time of distribution when the youngest grandchild reaches twenty-five to take a share of the corpus. *See* L. Simes & A. Smith, *supra* note 158, § 656, at 120.

[203]*See supra* notes 178-81.

[204]*Merrill*, 481 N.E.2d at 1298.

[205]*Id.* at 1298 n.1.

third share to be distributed at the death of Walter, the supreme court concluded that since this one-third share of the corpus was to "continue" to be held in trust after the youngest grandchild reached the age of twenty-five, "if the corpus of two-thirds cannot vest within the time allowed, . . . the gift of the one-third interest fails for the same reason as does the gift of the two-thirds interest."[206]

It should be noted that if the language "that when my youngest grandchild reaches the age of twenty-five (25) years" is viewed as creating a condition of survivorship requiring the beneficiaries to survive to the time of distribution, the supreme court correctly concluded that the provisions for distribution of the corpus of the trust violate the rule.[207] It is suggested, however, the supreme court could have reached the conclusion that the language did not create a condition precedent of survivorship. In such case, the trust, except for one provision,[208] would not have violated the rule against perpetuities.[209] Traditionally, when an interest is given to a beneficiary "if," "at," "when," or "provided" the beneficiary attains a stated age, the courts have viewed the language as creating a condition of survivorship requiring the beneficiary to reach the stated age in order to take the interest.[210] Nevertheless there are numerous age-postponement cases finding no condition of survivorship

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[206] *Id.* at 1300.

[207] Even though all the grandchildren will be born within the rule against perpetuities, i.e. no additional grandchildren can be born after all the testator's children have died, if the grandchildren must survive until the youngest grandchild reaches twenty-five to take a share of the corpus, then the size of the class cannot be determined within the period of the rule. In the case of a class gift the entire gift will fail where the class can increase or decrease beyond the period of the rule. L. Simes & A. Smith, *supra* note 158, § 1265, at 196; L. Waggoner, *supra* note 165, § 13.2, at 238.

[208] The provision for the distribution of one-half (1/2) of one-third (1/3) of the corpus "to my grandchildren living at the time of termination of the trust" does violate the rule against perpetuities because the trust cannot be terminated until the youngest grandchild reaches twenty-five, beyond the period of the rule. Even if the court had not found an implied condition of survivorship requiring all the beneficiaries to survive until the time of distribution, the court might have declared the entire trust void under the doctrine of infectious invalidity. *See supra* note 190.

[209] If the phrase "that when my youngest grandchild reaches the age of twenty-five (25) years" is viewed as referring solely to the time of distribution of the corpus and not as a condition of survivorship, the interests of the grandchildren would have vested at the time of their births. T. Bergin & P. Haskell, *supra* note 157, at 193-94.

[210] *Id.* at 132-34; L. Simes & A. Smith, *supra* note 158, § 586, at 31-37. It has been suggested that words such as "if" or "provided" the beneficiary attains the stated age clearly indicate a condition of survivorship, whereas words such as "at" or "when" are often used in situations where the drafter intended an absolute gift to the beneficiary with only the time of enjoyment postponed until the stated age. Colt v. Hubbard, 33 Conn. 281 (1866); Fuller v. Fuller, 58 N.C. 223 (1859), *both cited in* L. Simes & A. Smith, *supra* note 158, § 586, at 33-36; *see also* Halbach, *Future Interests: Express and Implied Condition of Survival*, 49 Cal. L. Rev. 297, 301-04 (1961).

and holding that the interest of the beneficiary vests before reaching the named age.[211] A close reading of these age contingency cases suggests that the courts will look to see if there are other factors suggesting the transferor intended to create an immediate interest in the beneficiary with only the time of enjoyment postponed.[212] It is suggested that there are other factors in the *Merrill* case from which the court could have concluded that the interests in the children of Dennis and Judith were vested and not contingent.[213]

One factor which suggests that the interests of Judith, Dennis, and their children were vested and not contingent is that the words postponing the distribution of the corpus of the trust to the time that the youngest grandchild reaches the age of twenty-five are separated from the words creating the interests and appear to relate solely to the time of distribution.[214] Item 3(E) of the will states that when the youngest grandchild

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[211]*See, e.g., In re* Welch's Estate, 83 Cal. App. 2d 391, 188 P.2d 797 (1948) (despite language that beneficiary "shall have no vested right" until age twenty-five, court found beneficiary did not have to survive to age twenty-five to have a transferrable interest); Stinson v. Palmer, 146 Conn. 335, 150 A.2d 600 (1959) (trust estate to pass to children of testator's son alive at widow's death when "each one shall reach the age of thirty (30) years" vested at widow's death); Carter v. Berry, 243 Miss. 321, 140 So. 2d 843 (1962) (where trust for benefit of testator's grandchildren was to terminate "when the youngest should become twenty-five years of age," interests of grandchildren vested at testator's death); Wachovia Bank & Trust Co. v. Taylor, 255 N.C. 122, 120 S.E.2d 588 (1961) (held will provision providing that legacy was to be divided among children of testator's daughters "when they reached age of twenty-five (25) years" created a vested interest and did not violate the rule against perpetuities); Wurst v. Savings Deposit Bank & Trust Co., 47 N.E.2d 676 (Ohio Ct. App. 1940) (trust for children of testator's son to be distributed when the youngest child attained the age of thirty (30) valid because children's interest vested at birth); South Carolina Nat'l Bank of Charleston v. Johnson, 260 S.C. 585, 197 S.E.2d 668 (1973) (trust proceeds to be distributed among grandchildren "when my youngest grandchild shall reach the age of twenty-one (21)" vested at the death of the testator subject to opening to let in after-born grandchildren).

[212]L. Simes & A. Smith, *supra* note 158, § 586, at 33-35.

[213]These factors negating a requirement of survival are set forth in Falender & Fruehwald, *supra* note 191, in the discussion of the court of appeals opinion in *Merrill*:

> Under the *Merrill* facts, several factors existed negating the implication of a survivorship condition: the absence of an alternative or a supplanting limitation, the gift of income to the future interest owners during the time preceding termination of the trust, and the lack of a word or phrase describing the beneficiaries as ones who must survive to a later date, such as "if living." The existence of these negative factors, coupled with the commitment of Indiana courts to the earliest possible vesting of interests, makes it unlikely that a condition precedent of survivorship should have been implied in the *Merrill* trust provision.

Id. at 459.

[214]Where the condition is attached to the interest itself, the vesting is postponed to the time stated, but where the condition is annexed to the time of payment, only the gift vests immediately. 2A R. Powell, The Law of Real Property ¶ 331, at 786 (P. Rohan rev. ed. 1986); L. Simes & A. Smith, *supra* note 158, § 576, at 11.

shall reach twenty-five, the "Trust shall terminate as to two-thirds (2/3) of the corpus of said Trust, and . . . shall be divided as follows. . . ."[215] Item 3(E) then provides that one-third (1/3) of the corpus shall be divided one-half (1/2) to Judith and one-half (1/2) to her children and that one-third (1/3) of the corpus shall be divided one-half (1/2) to Dennis and one-half (1/2) to his children.[216] There are no express words of survivorship contained in the language creating these interests. In addition, a gift to the children of Judith and Dennis is not the same as a class gift to the testator's grandchildren. The share that each child of Judith shall receive will be determined by the number of children born to Judith, not by the number of children born to Dennis or the total number of testator's grandchildren. Likewise, the share received by each child of Dennis will be determined solely by the number of children born to Dennis. In fact, the youngest grandchild might turn out to be a child of Walter, and there is no gift to the children of Walter, although the children of Walter who survive him would be included in the class gift to his "bodily issue."[217] Thus it is hard to see how the youngest grandchild reaching the age of twenty-five is directly related to the vesting of the interests of Judith, Dennis, and their children.

Two additional factors strengthen the argument that the interests were vested. First, the trust provides that the income from the trust is to be paid to the testator's children, Judith, Dennis, and Walter for and during the duration of the trust.[218] When an intermediate gift of income is given to a beneficiary who is to receive a share of the corpus at a stated age, the presumption is raised that the beneficiary's interest is vested and not contingent.[219] Thus the interests of Judith and Dennis would be presumed to be vested. Second, the provision for the distribution of the one-third of the corpus regarding Walter contains an express condition of survivorship. One-half (1/2) of the one-third (1/3) share, or all of the one-third (1/3) share if Walter should have no bodily issue, is to be distributed "to my grandchildren, living at the time of the termination of the trust."[220] The use of this express condition of sur-

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[215]*Merrill*, 481 N.E.2d at 1297.

[216]*Id.*

[217]A child of Walter would not be considered a "bodily issue" unless he survived Walter. The term "bodily issue" creates a condition of survivorship. R. POWELL, *supra* note 214, ¶ 327, at 761-62. In addition the word "issue" would include more remote descendants than children. L. SIMES & A. SMITH *supra* note 158, § 738, at 215.

[218]*Merrill*, 481 N.E.2d at 1296.

[219]R. POWELL, *supra* note 214, ¶ 332, at 786-91, L. SIMES & A. SMITH, *supra* note 158, § 588, at 37-38. While the children of Judith and Dennis were not given an intermediate gift of the income, the fact that their parents' share would be presumed to be vested would appear to lend some support to the argument that their interests should likewise be considered vested.

[220]*Merrill*, 481 N.E.2d at 1297. This provision clearly violates the rule against perpetuities since it requires the grandchildren to survive to the time of distribution—when

vivorship with regard to the distribution of the one-third share of the corpus suggests the testator had no intent to create such a condition with regard to the distribution of the two-thirds share to Judith, Dennis, and their children. Had there been an implied condition of survivorship requiring the beneficiaries to survive to the time of distribution, there would have been no need for the testator to have expressly created one with regard to distribution of the one-third share. The fact that the testator created an express condition of survivorship with regard to the distribution of the one-third share strongly suggests he did not intend to create one with regard to the distribution of the two-thirds share.[221] If any doubt then remained as to whether the interests were vested or contingent, the court could have applied the general rule favoring vesting of interests at the earliest possible time.[222]

Within the opinion there is some language which suggests the supreme court may have found a violation of the rule against perpetuities because the duration of the trust exceeded the period of the rule:

> Here, there is no ambiguity whatsoever in the will, with regard to either the identity of the beneficiaries or the *time of termination* of the trust. The beneficiaries were the Testator's children and grandchildren, all of them, and the trust was to *terminate*, as to two-thirds (2/3), when the youngest grandchild attained the age of twenty-five (25) years. What could be more clear? The problem is not one of ascertaining the Testator's intentions, as to *time for vesting*, but simply that our statute will not permit such intention to be carried out.[223]

It is not clear from this passage whether the court believed the phrase "when my youngest grandchild reaches the age of twenty-five (25) years" created a condition of survivorship requiring the beneficiaries of the trust to survive until such time or whether the court found a rule violation to exist because the time of termination was when the youngest grandchild reached the age of twenty-five—a time beyond the period of the rule. The latter viewpoint is suggested by the court's

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the youngest grandchild reaches the age of twenty-five—a time beyond the period of the rule. It is somewhat shocking therefore that both the trial court and the court of appeals reached the conclusion that the provisions of the trust regarding Walter did not violate the rule against perpetuities. *Merrill*, 453 N.E.2d at 360.

[221]*See, e.g.*, Pyne v. Pyne, 154 F.2d 297, 300 (D.C. Cir. 1946); *In re* Stanford's Estate, 49 Cal. 2d 120, 133-35, 315 P.2d 681, 689 (1957); Pechin v. Medd, 476 N.E.2d 526, 530 (Ind. Ct. App. 1985); *see also* Falender & Fruewald, *supra* note 191, at 459 n.160.

[222]*See, e.g.*, Alsman v. Walters, 184 Ind. 565, 111 N.E. 921 (1916); Aldred v. Sylvester, 184 Ind. 542, 111 N.E. 914 (1916); Moorman v. Moorman, 156 Ind. App. 606, 297 N.E.2d 836 (1973).

[223]*Merrill*, 481 N.E.2d at 1298 (emphasis added).

discussion of the validity of the provision for the distribution of the one-third share of the corpus regarding Walter. The supreme court noted that two-thirds of the trust was to terminate when the youngest grandchild reached the age of twenty-five, but that the remaining one-third of the corpus was to be "continued" in trust until Walter's death.[224] From this fact the court reasoned:

> The use of the word "continued" as to the one-third share following the provisions for termination as to the two-thirds share permits no conclusion other than that the one-third share will not *vest* until some time *subsequent to* the *vesting of* the *two-thirds share*. Obviously, if the corpus of two-thirds cannot vest within the time allowed, and the *vesting* of the remaining one-third may be *deferred until* an even *later date*, the gift of the one-third interest fails for the same reason as does the gift of the two-thirds interest.[225]

Because it was the time of termination that was being deferred, it would appear that the court viewed the time of termination as the time of vesting. If, as one suspects, the court was concerned with allowing the duration of a private irrevocable trust to exceed the period of the rule because of its effect upon the free alienability of property, the court could have approached the problem differently. While the rule against perpetuities does not prevent the duration of a trust from exceeding the period of the rule,[226] there is a small body of caselaw[227] as well as the comments of numerous legal scholars suggesting that a private trust cannot remain indestructible beyond the rule against perpetuities.[228] The trust, according to these authorities, should not be declared void, but merely terminable by the beneficiaries. There seems to be some disagreement between these authorities as to whether the trust is terminable by the beneficiaries from its inception or only after the end of lives in being plus twenty-one years.[229] Under this approach, the trust

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[224]This remark by the court is most interesting because the court had earlier concluded that the indentity of the youngest grandchild could not be determined until all the testator's children had died. *Id.* at 1298 n.1.

[225]*Id.* at 1300 (emphasis added).

[226]The equitable interests in a trust can vest long before the trust terminates, and if the interests are certain to vest, if at all, within the rule against perpetuities the rule is satisfied. T. Bergin & P. Haskell, *supra* note 157, 184, 224-25; L. Simes, *supra* note 160, § 144, at 314-15.

[227]*See* cases cited in L. Simes, *supra* note 160, § 145.

[228]*See, e.g.*, *id.*; T. Bergin & P. Haskell, *supra* note 157, at 225-26; Restatement (Second) of Trusts § 62 comment o (1959); Restatement (Second) of Property (Donative Transfer) § 2.1 (1983); A. Scott, The Law of Trusts § 62.10(2) (3d ed. 1967); L. Simes & A. Smith, *supra* note 158, § 1393, at 245-46.

[229]Simes and Smith argue for the position that it would be more in accord with the analogy to the period of the rule to strike down the provision for indestructibility as of

would not be destroyed, but its indestructibility would be limited to the period of the rule, or if the court preferred, from the inception of the trust, thus allowing the beneficiaries to terminate the trust.

The testamentary trust in *Merrill* is less than a paragon of legal draftsmanship. There were a number of mistakes made by the drafter leading to the apparent rule violation. The first was the use of an age contingency in excess of twenty-one years.[230] Where an interest is given to an individual or to a class that is closed at the time the interest is created, a requirement that the individual or members of the class attain a certain age in excess of twenty-one in order to take the interest presents no problem because they are measuring lives in being at the creation of the interest and they will attain the stated age, if at all, within their own lifetimes.[231] However, where an interest is given to a class (testator's grandchildren) that is not closed at the time the interest is created, an age contingency in excess of twenty-one years may cause the gift to fail because the interest might vest more than twenty-one years after the death of the last measuring life in being at the creation of the interests.[232] For example, a gift to the testator's grandchildren or to the testator's grandchildren who reach the age of twenty-one is valid, since the testator's children can be used as the measuring lives in being and the grandchildren will all be born and reach the age of twenty-one no later than twenty-one years after the death of the testator's last child. If, however, the age contingency for vesting is in excess of twenty-one, the gift to the grandchildren may fail. In *Merrill*, the interests would not have failed had the drafter reduced the time of distribution to "when the youngest grandchild reaches the age of twenty-one (21)." It is very possible, however, as the court of appeals suggested, that the testator did not want the corpus of the trust distributed until the grandchildren were mature enough to handle their inheritance wisely—apparently at the age of twenty-five.[233] Faced with this dilemma, the drafter should have done two things. First, he should have attempted to word the trust in such a manner as to be absolutely clear that the interests of the grandchildren

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the time of creation. L. Simes, *supra* note 160, § 145, at 317; L. Simes & A. Smith *supra* note 158, § 1393, at 246. The other authorities cited *supra*, note 228, suggest the trust is terminable by the beneficiaries only at the end of the period of the rule.

[230] "Regard with particular suspicion any gift which is contingent upon the taker attaining an age in excess of 21. Such gifts constitute the largest single group of invalid limitations." Leach, *supra* note 156, at 670.

[231] *See supra* notes 172-75 and accompanying text.

[232] *See supra* note 176 and accompanying text.

[233] *Merrill*, 453 N.E.2d at 360. To prevent a rule violation, the court of appeals excluded grandchildren born after the testator's death from the term "grandchild" in 3(E) of the will, thus closing the class at the testator's death. *Id.* at 362. The supreme court found no indication of an intent to exclude after-born grandchildren from the wording of the trust and as a result it violated the rule. *Merrill*, 481 N.E.2d at 1298.

were to vest at their birth and not when they reached the age of twenty-five, and that the distribution of the corpus to the grandchildren when they reached the age of twenty-five was related solely to the time of the enjoyment and not to the time of vesting. One proposed solution is to give the income from one-third of the corpus to each of the testator's children for so long as they shall live. This would not change the time of distribution of the trust as written in *Merrill* because, as the supreme court pointed out, the youngest grandchild cannot be determined until all the testator's children are dead.[234] Thus the testator's children in *Merrill* would never have been able to enjoy any of the corpus. Following the income provisions for Dennis and Judith, another provision would provide for the distribution of the corpus to their children. For example, following the income provision to Judith, the clause might read:

> Upon the death of my daughter, Judith, the trustee shall divide the one-third (1/3) of the corpus from which Judith was receiving the income into as many shares as there are children of Judith then living, and the trustee shall set aside and designate one such share as a separate trust fund for the benefit of each living child of Judith. The trustee shall thereafter pay the income from each share to the child for whose benefit the share was set off until the termination of the trust with respect to such share. When such child shall attain the age of twenty-five (25) years, or shall have attained the age of twenty-five (25) years at the death of Judith, or when such child, having survived Judith, shall die under the age of twenty-five (25), the trust shall terminate as to such share and the trustee shall distribute such share, together with any accrued income, to such child or, if he be dead, to his executor or administrator.[235]

This provision would not require the grandchildren to survive to the time of distribution, and the income provision to each of the grandchildren, as well as the payment of the share of the corpus to the estate of any grandchild who should die before reaching the age of twenty-five, clearly indicate the interests are "vested" at the death of Judith and Dennis. Because Walter did not have any children at the time the instrument was drafted, it might be prudent to include a gift over in the event Walter should die without children.

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[234]*Id.* at n.1. By providing that one-half (1/2) of the two-thirds (2/3) of the corpus was to go to Judith and Dennis and that the trust of the other one-third (1/3) of the corpus might "continue" after the time of distribution until Walter's death, the drafter did not appear to have been aware of the legal effect of the words employed.

[235]This provision is a modified version of the clause contained in L. Simes & A. Smith, *supra* note 158, § 1294, at 236.

Second, to avoid any question of a rule violation, the drafter should include a saving clause.[236] A blanket saving clause in the *Merrill* trust would have prevented a rule violation.[237] Such a clause might have read:

> This trust shall terminate in any event not later than twenty-one years after the death of the last survivor of all beneficiaries of this trust who are in being at the time of my death, and, unless sooner terminated by the terms of this trust, the trustee shall, at the termination of such period make distribution to my then living descendants per stirpes.[238]

The harshness that can result from a rule violation is clearly reflected in the *Merrill* decision. The testator wanted a substantial portion of his estate to pass to his grandchildren, and one of his children, Walter, to receive only the income for life from one-third of the corpus of the trust. Instead, because of the rule violation, the entire trust was destroyed and the testator's estate passed intestate to his second, childless wife and his three children.[239] The testator's grandchildren received nothing and his children, including Walter, received their shares of the estate outright. The testator's intent was totally frustrated. One might argue that the frustration was caused by the ineptness of the testator's attorney. To some degree this is true, but the rule is so technical and full of pitfalls for even the most experienced drafters that Professor Gray was led to remark: "[T]here are few lawyers of any practice in drawing wills and settlements who have not at some time either fallen into the net which the Rule spreads for the unwary, or at least shuddered to think how narrowly they have escaped it."[240]

The ease with which a technical violation of the rule can occur and the harshness of the consequences of a violation have led most legal scholars and experts in the field to conclude that some type of perpetuities reform is needed.[241] The court of appeals in *Merrill* attempted to reform the instrument to make it comply with the rule by applying the doctrine

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[236]*Id.* § 1295, at 236; T. Schaffer, The Planning and Drafting of Wills and Trusts 143 (2d ed. 1979); L. Waggoner, *supra* note 165, § 12.7(c), at 188; Leach & Logan, *Perpetuities: A Standard Saving Clause to Avoid Violations of the Rule*, 74 Harv. L. Rev. 1141 (1961).

[237]*Merrill*, 481 N.E.2d at 1298-99 n.2.

[238]This provision is a modified version of the saving clause contained in L. Simes & A. Smith, *supra* note 158, § 1295, at 236.

[239]The facts indicate that the testator is survived by a second, childless wife and three children by a prior marriage. *Merrill*, 481 N.E.2d at 1297. Under Ind. Code § 29-1-2-1 (1982), the decedent's estate would be distributed to his wife and his three children from the first marriage.

[240]J. Gray, The Rule Against Perpetuities xi (4th ed. 1942).

[241]Unfortunately there is no general agreement as to the method of reform to be used. *Perpetuity Reform*, *supra* note 176, at 1718.

of equitable approximation.[242] The supreme court rejected the court of appeals' attempt to save the instrument, finding the court had no authority to rewrite the will.[243] Courts in only four states, Hawaii, Mississippi, New Hampshire, and West Virginia, have presumed to reform an instrument without legislative authority in order to avoid a violation of the common law rule.[244] In light of the *Merrill* decision, it appears that modification of the rule in Indiana must come, if at all, from the legislature.

At the present time, legislation that to some degree or another modifies the common law rule against perpetuities exists in twenty-three states. In a few states, this legislation is directed towards the correction of specific drafting errors resulting in rule violations of a technical nature such as age contingencies in excess of twenty-one years, the presumption of lifetime fertility, and the unborn widow problem.[245] In most states, however, the reform has been more extensive and has attempted to address all potential rule violations. Sixteen states have adopted variations of the wait-and-see rule.[246] In these jurisdictions, the courts wait to see if in fact the interest vests or fails to do so within the rule. Only if the interest remains contingent after the period of the rule does a violation occur.[247] The wait-and-see doctrine will eliminate those violations based on remote possibilities which in fact never occur and in many cases will permit the instrument to operate as written without any modification.[248] The main objection to the doctrine is that title to property could be tied up for the period of the rule.[249] It should be observed that the drafter can easily create his own wait-and-see provision in an instrument by use of the blanket saving clause.[250]

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[242]*See supra* notes 191-92 and accompanying text.

[243]*See supra* notes 194-96 and accompanying text.

[244]*Perpetuity Reform, supra* note 176, at 1757; *see* cases cited in *Merrill*, 481 N.E.2d at 1298-99 n.2.

[245]*Perpetuity Reform, supra* note 176, at 1726-50. Professor Leach in his quest for reform of the rule went so far as to give names to certain categories of rule violations, such as "the fertile octogenarian," "the unborn widow," "the precocious toddler" and "the magic gravel pit." Leach, *Perpetuities in Perspective: Ending the Rule's Reign of Terror*, 65 HARV. L. REV. 721 (1952); Leach, *Perpetuities, Staying the Slaughter of the Innocents*, 68 L.Q. REV. 35 (1952).

[246]For specific statutes, see T. BERGIN & P. HASKELL, *supra* note 157, at 213-14 n.6 and 7.

[247]For specific statutes, see T. BERGIN & P. HASKELL, *supra* note 157, at 213-14 nn.6-7. *supra* note 176, at 1759-84.

[248]L. WAGGONER, *supra* note 165, § 15.3, at 298-99.

[249]*Id.* at 300. T. BERGIN & P. HASKELL, *supra* note 157, at 218. Another problem created by the wait-and-see doctrine is that of deciding who are to be used as the measuring lives in determining the waiting period. This problem is discussed in some detail in *Perpetuity Reform, supra* note 176, at 1762-82.

[250]*Perpetuity Reform, supra* note 176, at 1776, 1778 n.155.

Fifteen states have enacted reformation type statutes which employ the doctrine of cy pres or equitable approximation to reform instruments that violate the rule.[251] In some of these states, the statutes allow the court to reform the instrument immediately where there is a rule violation, but in other states, the reformation statutes are combined with wait-and-see statutes so that the court must wait to see if a violation in fact occurs; only if the interest remains contingent at the end of the waiting period is the court permitted to modify the instrument in order to comply with the rule.[252]

It is beyond the scope of this survey to discuss in any detail the pros and cons of legislative reform of the rule, nor is this limited discussion intended as an endorsement of such reform. Instead this discussion is intended merely to alert the reader that there is some momentum for perpetuities reform. The American Law Institute (ALI) recently adopted both a wait-and-see provision[253] and a reformation (cy pres) provision[254] in the Restatement (Second) of Property, Donative Transfers. Similarly at the August 1986 meeting of the National Conference of Commissioners on Uniform State Laws, a massive eighty page "Draft for Approval" Statutory Rule Against Perpetuities was introduced by the Drafting Committee on Rule Against Perpetuities Act, Professor Lawrence Waggoner of the University of Michigan Law School, Reporter. It is unclear at this time if these recent legislative activities or the *Merrill* decision will spark any interest in perpetuity reform in the Indiana legislature.

The *Merrill* decision should stand as a warning to those members of the bar who draft wills, trusts, and other documents involving future interests. The drafter must be ever mindful of the rule against perpetuities and each provision should be tested to insure no violation exists. Where possible, beneficiaries should be described by name rather than class,

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[251] T. BERGIN & P. HASKELL, *supra* note 157, at 218 n.14.

[252] L. WAGGONER, *supra* note 165, § 15.2, at 291-92; *Perpetuity Reform, supra* note 176, at 1755 n.97.

[253] The wait-and-see provision provides the vesting requirement with respect to donative transfers: "[E]xcept as provided in § 1.6 [which applies to charitable gifts], a donative transfer of an interest in property fails, if the interest does not vest within the period of the rule against perpetuities." RESTATEMENT (SECOND) OF PROPERTY (DONATIVE TRANSFERS) § 1.4 (1983).

[254] The reformation provision states the consequences of the failure of an interest under the rule against perpetuities in a donative transfer:

> If under a donative transfer an interest in property fails because it does not vest or cannot vest within the period of the rule against perpetuities, the transferred property shall be disposed of in the manner which most closely effectuates the transferor's manifested plan of distribution and which is within the limits of the rule against perpetuities.

Id. § 1.5.

and age contingencies in excess of twenty-one years should be avoided. Where any doubt exists, a saving clause should be included in the instrument.

Recent Developments Under the Social Security Act

KENNETH J. FALK*

I. INTRODUCTION

The Social Security Act[1] has been described by the United States Supreme Court as "among the most intricate ever drafted by Congress,"[2] and the Court has stated that the Act is "almost unintelligible to the uninitiated."[3] To most persons, Social Security means only a government benefit program for retired or disabled persons. But the Social Security Act provides the legislative basis for such diverse programs as Aid to Families with Dependent Children (AFDC), Medicaid, and child welfare programs, as well as child support collection programs. The Code sections are further explained and detailed in numerous volumes of the Code of Federal Regulations. And each state has added further glosses to the Act with state administrative rules and regulations.

A survey of recent developments under the Social Security Act therefore necessarily encompasses a wide area. However, certain patterns quickly emerge in reviewing decisions under the Act. Litigation under the Act can take two directions. The first is to challenge the constitutionality of a portion of the Act itself, or of omissions in the Act.[4] The second approach is to assume that Congress acted properly in enacting a portion of the Act, but to argue that the federal or state agency erred in enacting regulations to implement the Act.[5]

The above approaches are highlighted in recent federal court cases in and around Indiana under the Social Security Act. A review of these decisions also establishes patterns that provide insight into potential future litigation in this area.

II. AFDC

A. *Sibling Deeming*

Prior to October 1, 1984, AFDC applicants had the option of excluding from the filing unit any child in the family.[6] Thus, if the

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[1]42 U.S.C. § 301 (1982).

[2]Schweiker v. Gray Panthers, 453 U.S. 34, 43 (1981).

[3]*Id.* (quoting Friedman v. Berger, 547 F.2d 724, 727 n.7 (2d Cir. 1976), *cert. denied*, 430 U.S. 984 (1977)).

[4]*See, e.g.*, Mathews v. Lucas, 427 U.S. 495 (1976).

[5]*See, e.g.*, Malloy v. Eichler, 628 F. Supp. 582 (D. Del. 1986).

[6]*See* Shonkwiler v. Heckler, 628 F. Supp. 1013, 1014 (S.D. Ind. 1985).

family unit was made up of a mother and half-siblings, if one of the half-siblings received a substantial amount of child support from the absent father or Social Security benefits from a deceased father, that half-sibling could be excluded from the family unit for purposes of AFDC eligibility. The family could therefore maximize its benefits by excluding from the family unit persons who had income, but who were under no legal obligation to share that income with other members of the family. Given the paltry sums received under AFDC,[7] even with this maximization, these families continued to be poor.

In 1984, in the Deficit Reduction Act, Congress enacted a change designed to reduce or eliminate AFDC benefits to those perceived by Congress to be less needy than persons with no resources whatsoever.[8] Specifically, Congress amended the Social Security Act to provide that all brothers and sisters living in the same home, including half-brothers and sisters, shall have their available income counted towards AFDC eligibility.[9] That is, the available income of all siblings is deemed to be shared by all other siblings and is therefore counted towards the family's income. The Secretary of Health and Human Services quickly promulgated regulations stating that all income of brothers and sisters, including half-siblings, was available to the family.[10]

This sibling deeming rule has spawned a great deal of litigation by low income persons.[11] The litigation has attacked both the constitution-

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[7]In Indiana, for example, the maximum combined amount of AFDC that one dependent child and one needy relative can receive is $196 per month. Not more than $60 per month may be awarded for each additional child. INDIANA DEP'T. OF PUB. WELFARE, INDIANA'S ASSISTANCE TO FAMILIES WITH DEPENDENT CHILDREN PROGRAM (June, 1985) (available in the office of the Indiana Department of Public Welfare). *See also* IND. ADMIN. CODE tit. 470, r. 10.1-3-3 (Supp. 1986); *infra* notes 31-33 and accompanying text.

[8]*Shonkwiler*, 628 F. Supp. at 1017.

[9]*See* Deficit Reduction Act of 1984, § 2640(a), 42 U.S.C. § 602(a)(38)(B) (Supp. III 1985), which states in pertinent part:

> [I]n making the determination under paragraph (7) with respect to a dependent child and applying paragraph (8), the State agency shall . . . include—
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> . . . .
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> any brother or sister of such child . . . and any income of or available for such parent, brother or sister shall be included in making such determination and applying such paragraph with respect to the family . . . .

[10]45 C.F.R. § 206.10(a)(1)(vii)(B) (1985). It states: "For AFDC only, in order for the family to be eligible, an application with respect to a dependent child must also include, if living in the same household and otherwise eligible for assistance . . . [a]ny blood-related or adoptive brother or sister."

[11]*See, e.g.*, Ardister v. Mansour, 627 F. Supp. 641 (W.D. Mich. 1986) (ruling on preliminary injunction); Whitehorse v. Heckler, 627 F. Supp. 848 (D.S.D. 1985); Gorrie v. Heckler, 624 F. Supp. 85 (D. Minn. 1985); Frazier v. Pingree, 612 F. Supp. 345 (M.D. Fla. 1985) (ruling on preliminary injuction); Shonkwiler v. Heckler, 628 F. Supp. 1013 (S.D. Ind. 1985) (ruling on preliminary injunction); *see also* Shonkwiler v. Bowen, No. IP84-1612-C (S.D. Ind. Aug. 11, 1986); Gilliard v. Kirk, 633 F. Supp. 1529 (W.D.N.C.

ality of the statute on its face as well as the propriety of the implementing regulations.[12] The constitutional arguments have been that the statute and/or regulations violate a right of privacy and family integrity because the statute forces families that are not one unit to merge into one;[13] that the statute effects an unconstitutional taking;[14] and that the statute creates an unconstitutional irrebuttable presumption.[15] These arguments have met with varying success. A number of courts have found the statute and/or regulations unconstitutional on their face.[16] However, other courts have found them constitutional.[17]

In Indiana, the issue was presented in the case of *Shonkwiler v. Heckler*.[18] The United States District Court for the Southern District of Indiana held that the statute and implementing regulations were proper.[19]

Brenda Shonkwiler was the head of the AFDC household in this case. Ms. Shonkwiler had three children living with her. One was the child of Mikel Shonkwiler and the other two were children from a former marriage. Mr. Shonkwiler paid $360 a month in court-ordered child support for his child's benefit. Prior to sibling deeming, the Shonkwiler child was not included in the family unit. Thus, he received $360 a month in support and the rest of the family, Brenda and the two half-siblings, received $256 a month in AFDC. However, the sibling deeming rule, as interpreted by the Department of Health and Human Services and the Indiana Department of Public Welfare, mandated that the Shonkwiler child and his support income be included in the family unit; as a consequence the family became ineligible for AFDC.[20] Thus, Mikel Shonkwiler's support for his son was deemed as being used to support his son's half-siblings and his ex-wife. Other plaintiffs in the litigation experienced similar harsh results because of sibling deeming.[21]

In finding against the plaintiffs, the district court relied on a theme often voiced by both courts and defendants in current litigation under

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1986); Oliver v. Ledbetter, 624 F. Supp. 325 (N.D. Ga. 1985); Creaton v. Heckler, 625 F. Supp. 26 (C.D. Cal. 1985).

[12]*See* cases cited *supra* note 11.

[13]*See, e.g.*, *Shonkwiler*, slip. op. at 10-11.

[14]*See, e.g.*, *Gorrie*, 624 F. Supp. at 90-91.

[15]*See, e.g.*, *Shonkwiler*, slip. op. at 11.

[16]*See, e.g.*, Gilliard v. Kirk, 633 F. Supp. 1529 (W.D.N.C. 1986); Whitehorse v. Heckler, 627 F. Supp. 848 (D.S.D. 1985); Gorrie v. Heckler, 624 F. Supp. 85 (D. Minn. 1985); Frazier v. Pingree, 612 F. Supp. 345 (M.D. Fla. 1985).

[17]*See, e.g.*, Shonkwiler v. Bowen, No. IP84-1612-C (S.D. Ind. Aug. 11, 1986); Ardister v. Mansour, 627 F. Supp. 641 (W.D. Mich. 1986); Oliver v. Ledbetter, 624 F. Supp. 325 (N.D. Ga. 1985); Creaton v. Heckler, 625 F. Supp. 26 (C.D. Cal. 1985).

[18]628 F. Supp. 1013 (S.D. Ind. 1985).

[19]*Id.*

[20]*Id.* at 1016.

[21]*See id.* at 1016-17.

the Social Security Act: the need to reduce the costs of welfare programs.[22] The court stated:

> The primary purpose of Section 2640, the Secretary's regulation, and the State's AFDC Manual provision is to reduce or eliminate welfare benefits for those considered by Congress to be less needy than those completely without resources such as households that have available other income or resources with which to support themselves. . . . Given Congress' legitimate purpose of redistributing limited resources, the standard filing unit provision is rationally related to achieving that purpose. It is appropriate to assume the following proposition: that individuals who live in the same household share expenses. If the contributions of the siblings added to the AFDC unit are not direct payments to assist with household expenses, there will at least be indirect payments through the sharing of fixed expenses.[23]

Given the split in district court decisions around the country,[24] it is not unreasonable to expect that the United States Supreme Court will ultimately review this issue. The Supreme Court recently gave an indication of how it might rule on some of the issues presented in *Shonkwiler*. In *Lyng v. Castillo*,[25] the Court was faced with a challenge to sibling deeming under the Food Stamp Act,[26] a program not under the Social Security Act. There, Congress had amended the statute to provide that a food stamp household must include all siblings living together.[27] The Court upheld the law and found no impingement on a fundamental right and no equal protection violation.[28] According to the Court, the law was rationally based.[29] This decision continued a trend, recognizable in *Shonkwiler*, of extending great deference to Congress' determination of what eligibility guidelines are appropriate under the Social Security Act.[30]

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[22] *Id.* at 1018.

[23] *Shonkwiler*, slip. op. at 12 (citing Brown v. Heckler, 589 F. Supp. 985, 992-94 (E.D. Pa. 1984)).

[24] *See supra* notes 16-17.

[25] 106 S. Ct. 2727 (1986).

[26] U.S.C. §§ 2011-29 (1982).

[27] *Lyng*, 106 S. Ct. at 2728 n.1.

[28] *Id.* at 2727-28.

[29] *Id.* at 2730-32.

[30] "Moreover, the Legislature's recognition of the potential for mistake and fraud and the cost-ineffectiveness of case-by-case verification of claims that individuals ate as separate households unquestionably warrants the use of general definitions in this area." *Id.* (footnotes omitted).

In discussing the power of Congress to require a disabled dependent child's Social Security benefits to terminate upon marriage to a disabled spouse, the Supreme Court

The *Lyng* decision did not address the AFDC program. Nor did it address all the constitutional arguments raised by opponents of sibling deeming in the AFDC programs. However, in upholding sibling deeming in the Food Stamp program, the Court did emphasize points presented in *Shonkwiler*: courts are reluctant to find legislation under the Social Security Act unconstitutional and, concomitantly, decisions by Congress in changing the Social Security Act are accorded great deference. *Lyng* will therefore undoubtedly have an impact on sibling deeming in the AFDC context.

B. Lump Sum Budgeting

The sibling deeming cases in the AFDC context exemplify one method of attack on programs under the Social Security Act, a constitutional attack on the legislation itself. A recent Indiana case regarding lump sum budgeting illustrates the other method, attacking agency interpretation of the legislation.

In order to be eligible for AFDC, an applicant must satisfy both an income and a resource test.[31] Eligibility will be found only if an applicant's income is below a needs standard established by each state,[32] and if his resources are not in excess of $1,000.[33]

The issue presented in the lump sum context is how to treat the receipt of a large sum of unearned income, whether through inheritance, Social Security award, or some other means. If it is treated as a resource, then once the individual has spent it down to less than $1,000, he would again be eligible for AFDC. If, however, the lump sum is treated as income, it must somehow be budgeted in the monthly AFDC budget.

Prior to 1981, lump sums were treated as resources, but in that year, Congress amended the Social Security Act to

> provide that if a child or relative applying for or receiving aid to families with dependent children, or any other person whose

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stated that "[g]eneral rules are essential if a fund of this magnitude is to be administered with a modicum of efficiency, even though such rules inevitably produce seemingly arbitrary consequences in some individual cases." Califano v. Jobst, 434 U.S. 47, 53 (1977) (citing Weinberger v. Salfi, 422 U.S. 749, 776 (1975)).

[31]42 U.S.C. § 602 (1982).

[32]In Indiana, needs are computed according to a set formula, regardless of actual needs. IND. ADMIN. CODE tit. 470, r. 10.1-3-3(a)(2) (Supp. 1986). For example, an applicant is allotted no more than $100 a month for basic shelter costs, regardless of his actual shelter costs. A person's basic needs, comprising food, clothing, personal, household supplies, and utilities are budgeted at no more than $85.25 a month for the first person in the household and $73.50 for the second, regardless of actual costs. Then when a total needs figure is reached, it is automatically reduced ten percent to create an adjusted total needs figure. The maximum AFDC benefit that can be received is this adjusted total needs figure. IND. CODE § 12-1-7-3.1 (1982).

[33]43 U.S.C. § 602(a)(7)(B) (1982).

> need the State considers when determining the income of a family, receives in any month an amount of earned or unearned income which, together with all other income for that month not excluded under paragraph (8), exceeds the State's standard of need applicable to the family of which he is a member—
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> (A) such amount of income shall be considered income to such individual in the month received, and the family of which such person is a member shall be ineligible for aid under the plan for the whole number of months that equals (i) the sum of such amount and all other income received in such month, not excluded under paragraph (8), divided by (ii) the standard of need applicable to such family, and
>
> (B) any income remaining (which amount is less than the applicable monthly standard) shall be treated as income received in the first month following the period of ineligibility specified in subparagraph (A) . . . .[34]

In *Watkins v. Blinzinger*,[35] the Court of Appeals for the Seventh Circuit explained this provision by stating that under it,

> the state's welfare officials divide the lump sum by the monthly "standard of need" . . . . The quotient gives the number of months the person will be ineligible for aid. For example, if a person receives $20,000 and the monthly standard of need is $500, the state will divide $20,000 by $500, producing a quotient of 40. The recipient will be ineligible for AFDC for 40 months. This method treats the lump sum as if the amount of the "standard of need" had been received as monthly income during the months following receipt of the lump sum. A recipient who spends a lump sum classified as "income" and becomes destitute remains ineligible for the program nevertheless, while if the lump sum had been called a "resource" eligibility would have been restored.[36]

Neither the statute nor the federal regulations promulgated under it define the word "income." While it might be concluded that income is something easily determined, a specific problem arises in considering personal injury awards. In Indiana, as elsewhere, compensation for personal injury has always been treated as restoring the wronged individual to his preinjured state.[37] The individual is made whole but nothing more.

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[34] *Id.* § 602(a)(17).

[35] 789 F.2d 474 (7th Cir. 1986).

[36] *Id.* at 475 (footnote omitted).

[37] *See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Mid-Century Ins. Co., 259 N.E.2d 424 (Ind. Ct. App. 1970).

Nevertheless, the Secretary of Health and Human Services and the Indiana Department of Public Welfare have both taken the position that a personal injury award is income. As a result, aggrieved AFDC recipients in *Watkins* brought suit in the United State District Court for the Southern District of Indiana. The district court rendered judgment in favor of the Secretary and the State.[38] The Seventh Circuit affirmed the district court's decision.[39]

The Seventh Circuit attempted to define income and to show why an award designed to compensate for injuries is income.[40] However, the key to the court's decision is the fact that Congress did not, in the Social Security Act, define the term income. Therefore, the Secretary was free to define income or else allow the states to define the term. The Seventh Circuit reasoned:

> Because AFDC is a program of cooperative federalism, and because states control most of the important variables, the Secretary's position . . . is entitled to considerable respect. If the Secretary (or a court) forced a state to exclude an item from income, it might respond by reducing the payments to all recipients of AFDC. A court should require such a revamping of the program only if the legislation at hand leaves no alternative.[41]

The Seventh Circuit acknowledged that the Secretary's position "may produce harsh results."[42] Nevertheless, it upheld that position.

Not all courts facing the lump sum budgeting question have sustained the Secretary's discretion in this manner, however. In *Reed v. Health and Human Services*,[43] the Court of Appeals for the Fourth Circuit determined that in the absence of a specific legislative definition of income, it should be given its plain and ordinary meaning, which had been consistently followed by Congress in such things as the Internal Revenue Code.[44] This plain and ordinary meaning dictated a conclusion that a lump sum personal injury award was not income.[45]

The Supreme Court has agreed to review the *Reed* case.[46] It is uncertain whether the Court will defer to agency discretion as in *Watkins*,

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[38]Watkins v. Blinzinger, 610 F. Supp. 1443 (S.D. Ind. 1985), *aff'd*, 789 F.2d 474 (7th Cir. 1986).

[39]*Watkins*, 789 F.2d 474.

[40]*Id.*

[41]*Id.* at 478.

[42]*Id.* at 482.

[43]774 F.2d 1270 (4th Cir. 1985), *cert. granted*, 106 S. Ct. 3271 (1986); *see also* Payne v. Toan, 626 F. Supp. 553 (W.D. Mo. 1985); LaMadrid v. Hegstrom, 599 F. Supp. 1450 (D. Or. 1984). *But see* Jackson v. Guissinger, 589 F. Supp. 1288 (W.D. La. 1984).

[44]*Reed*, 774 F.2d at 1274-75.

[45]*Id.*

[46]Lukhard v. Reed, 106 S. Ct. 3271 (1986).

or to common sense as in *Reed*. Nevertheless, *Watkins* stands as a reminder of the great deal of latitude that courts grant to agencies interpreting the statutes they are charged with administering.[47]

III. Medicaid

Watkins can be explained as the Seventh Circuit's way of bowing to agency discretion. However, another recent Indiana case shows that courts can be less deferential to an agency's interpretation of law.

Medicaid is a program designed to furnish "medical assistance on behalf of families with dependent children and of aged, blind, or disabled individuals, whose income and resources are insufficient to meet the costs of necessary medical services."[48] It is funded and administered through the cooperation of the federal and state governments pursuant to Title XIX of the Social Security Act.[49] A state participating in Medicaid must develop a state plan, which must comply with various income and eligibility requirements contained in the Social Security Act.[50]

Persons who receive AFDC also receive Medicaid.[51] However, in certain situations the income and resources eligibility requirements of AFDC and Medicaid differ. The Secretary has addressed this situation in regulations by stating that "[t]he [state] agency must provide Medicaid to individuals who would be eligible for AFDC except for an eligibility requirement used in that program that is specifically prohibited under Title XIX."[52] Thus, not only must states provide Medicaid to persons who receive AFDC assistance, but states must also provide Medicaid to persons who would receive AFDC but for an AFDC eligibility requirement that is specifically prohibited in the Medicaid statute.

In amending the AFDC statute to provide for sibling deeming, Congress did not make any comparable amendment to the Medicaid Act. Instead, for quite some time, the Medicaid Act has contained a strict prohibition against counting the income of a child as available to meet the needs of the child's siblings or parents.

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[47]*See, e.g.*, Young v. Community Nutrition Inst., 106 S. Ct. 2360, 2364 (1986), where the Supreme Court noted:

> [I]f the statute is silent or ambiguous with respect to the specific issue, the question for the [reviewing] court is whether the agency's answer is based on a permissible construction of the statute . . . . [A] court may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency.

(quoting Chevron, U.S.A., Inc. v. Natural Resources Defense Council, 467 U.S. 837 (1984)).

[48]42 U.S.C. § 1396 (1982).

[49]*Id.*

[50]*Id.*

[51]*Id.* § 1396a(a)(10)(A)(i).

[52]42 C.F.R. § 435.113 (1985).

> A State plan for medical assistance [Medicaid] must. . . .
>
> . . . .
>
> . . . include reasonable standards . . . for determining eligibility for and the extent of medical assistance under the plan which . . . do not take into account the financial responsibility of any individual for any applicant or recipient of assistance under the plan unless such applicant or recipient is such individual's spouse or such individual's child who is under age 21 . . . .[53]

The effect of this statute is of great importance. If deeming of sibling income is prohibited by Medicaid, then even if a family loses AFDC benefits because one sibling's income is deemed to be available to the whole family, the family should still be eligible to receive Medicaid. Thus, the Social Security Act would at least assure that the family is able to receive necessary medical care.

Despite the clear text of the statute and regulation, the Secretary of Health and Human Services and the Indiana State Department of Public Welfare applied the sibling deeming rule to Medicaid recipients, thereby discontinuing the Medicaid benefits of thousands of indigent persons. In *Reed v. Blinzinger*,[54] low income persons challenged this extension of the sibling deeming rule, claiming that a conflict existed between the Secretary's AFDC regulations and the clear language of the Medicaid prohibition. The United States District Court for the Southern District of Indiana held for the plaintiffs, stating it could not see a distinction between merely requiring a sibling to be included in the filing unit and deeming the sibling's income available to the Medicaid applicant.[55] The court enjoined the Secretary and the State Welfare Department from utilizing sibling deeming in determining Medicaid eligibility.[56]

In its decision, the court simply found that the Secretary had gone too far in interpreting the statute and then claiming his interpretation was entitled to deference.

> An administrative interpretation is given controlling weight only if it is reasonable and reflects the policies underlying the leg-

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[53]42 U.S.C. § 1396a(a)(17)(D) (1982). The implementing regulations, 42 C.F.R. § 435.602 (1985), state:

> (a) Except for a spouse of an individual or a parent for a child who is under age 21 or blind or disabled, the agency must not—
>
> (1) Consider income and resources of any relative available to an individual; nor
>
> (2) Collect reimbursement from any relative for amounts paid by the agency for services provided to an individual.

[54]639 F. Supp. 130 (S.D. Ind. 1986), *appeal pending*.

[55]*Id.* at 134.

[56]*Id.*

> islation. Moreover, an agency is bound by its own regulations. The interpretation cannot be inconsistent with the plain meaning of a regulation or nullify the intent or wording of a regulation.
>
> The Secretary's interpretation of § 602(a)(38) does not comport with the plain language of the Medicaid statute or with the Secretary's own regulations. The language of the statute and regulations is unambiguous. A court "must give effect to the unambiguously expressed intent of Congress." When the statute is analyzed as a whole, as defendants argue it should be, the statute provides that the Secretary may set standards for determining the availability of income actually received by an individual and of income assumed to be available. The latter is limited to income from a spouse or parent.[57]

The court's decision was in accord with holdings of other circuits and districts.[58] Agency discretion in statutory interpretation is therefore not limitless, but must be a rational and consistent interpretation of the statute.

IV. Social Security

Another area in which arguments about agency discretion in statutory interpretation have raged in the recent past is the area of disability determinations under the Social Security Act. Although there has been no seminal Indiana case on this issue, it has been addressed by the Court of Appeals for the Seventh Circuit, and because it will be addressed by the United States Supreme Court this term, the issue must be mentioned.

Depending on insured status, one is entitled to either Social Security or Supplemental Security Income if one is "under a disability."[59] The Act defines "disability" as the "inability to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which . . . can be expected to last for a continuous period of not less than 12 months."[60] Disability exists only if the claimant's impairments "are of such severity that he is not only unable to do his previous work but cannot, considering his age, education, and

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[57]*Id.* at 132-33 (citations omitted). The Secretary and the state had argued that the Secretary's extension of the sibling deeming rule to Medicaid eligibility clearly reflected the intent of Congress and that this interpretation was entitled to great deference. *Id.* at 131-32.

[58]*See, e.g.*, Vance v. Hegstrom, 793 F.2d 1018 (9th Cir. 1986); Malloy v. Eichler, 628 F. Supp. 582 (D. Del. 1986); Sundberg v. Mansour, 627 F. Supp. 616 (W.D. Mich. 1986); Gibson v. Puett, 630 F. Supp. 542 (M.D. Tenn. 1985).

[59]42 U.S.C. § 423(a)(1)(D)(1982); *see also id.* § 1381a.

[60]*Id.* § 423(d)(1)(A); *see also id.* § 1382c(a)(3)(A).

work experience, engage in any other kind of substantial gainful work which exists in the national economy. . . ."[61] Thus, disability is a factor both of medical status and of various vocational considerations.

The Secretary of Health and Human Services promulgated a five-step sequential evaluation procedure for determining disability.[62] As noted in *Yuckert v. Heckler*,[63] in framing the issue relevant here,

> The first step requires the ALJ to determine whether the claimant is currently working. 20 C.F.R. § 404.1520(b) (1985). If the

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[61] *Id.* § 423(d)(2)(A); *see also id.* § 1382c(a)(3)(B).

[62] *See* 20 C.F.R. § 404.1520 (1986), which provides:

(a) Steps in evaluating disability. We consider all material facts to determine whether you are disabled. If you are doing substantial gainful activity, we will determine that you are not disabled. If you are not doing substantial gainful activity, we will first consider your physical or mental impairment(s). Your impairment(s) must be severe and meet the duration requirement before we can find you to be disabled. We follow a set order to determine whether you are disabled. We review any current work activity, the severity of your impairment(s), your residual functional capacity and your age, education, and work experience. If we can find that you are disabled or not disabled at any point in the review, we do not review further.

(b) If you are working. If you are working and the work you are doing is substantial gainful activity, we will find that you are not disabled regardless of your medical condition or your age, education, and work experience.

(c) You must have a severe impairment. If you do not have any impairment or combination of impairments which significantly limits your physical or mental ability to do basic work activities, we will find that you do not have a severe impairment and are, therefore, not disabled. We will not consider your age, education, and work experience. However, it is possible for you to have a period of disability for a time in the past even though you do not now have a severe impairment.

(d) When your impairment(s) meets or equals a limited impairment in Appendix 1. If you have an impairment(s) which meets the duration requirement and is listed in Appendix 1 or is equal to a listed impairment(s), we will find you disabled without considering your age, education, and work experience.

(e) Your impairment(s) must prevent you from doing past relevant work. If we cannot make a decision based on your current work activity or on medical facts alone, and you have a severe impairment(s), we then review your residual functional capacity and the physical and mental demands of the work you have done in the past. If you can still do this kind of work, we will find that you are not disabled.

(f) Your impairment(s) must prevent you from doing any other work. (1) If you cannot do any work you have done in the past because you have a severe impairment(s), we will consider your residual functional capacity and your age, education, and past work experience to see if you can do other work. If you cannot, we will find you disabled. (2) If you have only a marginal education, and long work experience (i.e., 35 years or more) where you only did arduous unskilled physical labor, and you can no longer do this kind of work, we use a different rule (see § 404.1562).

[63] 774 F.2d 1365 (9th Cir. 1985), *cert. granted*, 106 S.Ct. 1967 (1986).

> claimant is working, the ALJ must find her not disabled. *Id.* If the claimant is not working, however, the second step requires the ALJ to determine whether the claimant suffers a severe impairment. 20 C.F.R. § 404.1520(c) (1985). The regulations define a severe impairment as one that significantly limits the claimant's "ability to do basic work activities." 20 C.F.R. § 404.1521(a) (1985). Basic work activities mean "the abilities and aptitudes necessary to do most jobs." 20 C.F.R. § 404.1521(b) (1985). The ALJ must evaluate the severity of an impairment without reference to vocational factors. 20 C.F.R. § 404.1520(c) (1985). Only if the ALJ finds the claimant's impairment(s) severe does he proceed to the next three steps of the sequential analysis, under which he is required to consider the claimant's age, education, work experience, and ability to perform past work. *See* 20 C.F.R. § 404.1420(d)-(f) (1985).[64]

Step two of the regulation, therefore, allows an individual to be denied disability status without considering vocational factors. Moreover, step two requires an applicant who has shown inability to do past work nevertheless to carry a further burden. Thus, despite the fact that

> [t]he courts of all twelve circuits have unanimously held that, while the ultimate burden of proving disability lies with the claimant, the plaintiff makes a prima facie showing when he demonstrates an impairment which prevents him from performing his previous work. The burden then shifts to the Secretary to show that the claimant remains capable of performing other work in view of the vocational factors of age, education, and work experience. . . . All the circuits agree that it is the language of the Act itself which requires "that disability determinations be made according to a two step process," with the first step placing the burden on the claimant to demonstrate an inability to perform past work.[65]

Step two appears to be an example of an administrative agency interpreting the Act in ways contrary to the statute. Therefore the Seventh Circuit, in *Johnson v. Heckler*,[66] along with a number of other courts,[67] has declared step two to be unlawful. The discretion of the Secretary does not stretch that far.

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[64] *Id.* at 1368 (footnotes omitted).

[65] Johnson v. Heckler, 769 F.2d 1202, 1210 (7th Cir. 1985), *appeal pending* (citing Valercia v. Heckler, 751 F.2d 1082, 1086 (9th Cir. 1985)).

[66] 769 F.2d 1202 (7th Cir. 1985), *appeal pending.*

[67] *See* Baeder v. Heckler, 768 F.2d 547 (3rd Cir. 1985); *Yuckert*, 774 F.2d at 1365.

> The Secretary's argument that step two is a reasonable exercise of her broad rule-making authority necessary to the proper and efficient functioning of "an already overburdened agency" . . . is a fall-back argument merely, and a thoroughly unpersuasive one. The district court rejected the Secretary's reliance on her broad rule-making authority, reasoning that, to merit deference, the Secretary's regulations and rules must be consistent with the Act . . . . Because we have held the Secretary's regulations to be inconsistent with the statute, no deference to her rule-making authority is required.[68]

This has not been the holding of all courts facing this issue; a number have found that the severity regulations, as interpreted by the courts, can be utilized.[69] Illustrative of these is *Farris v. Secretary of Health and Human* Services,[70] where the Court of Appeals for the Sixth Circuit attempted to resolve agency discretion with an apparent violation of the Social Security Act. The court interpreted the step two inquiry as allowing rejection of a claim for a non-severe impairment only if the impairment is a "slight abnormality which has such a minimal effect on the individual that it would not be expected to interfere with the individual's ability to work, irrespective of age, education and work experience."[71] Thus, these courts interpret step two as merely a "*de minimis*" requirement. This interpretation is problematic because there is no assurance that the agency interprets the severity regulation as a *de minimis* step.

This debate, like the debate over lump sum budgeting, should be resolved within the next year. The Supreme Court has agreed to review *Yuckert*, and the Court should resolve this debate between agency discretion and legislative pronouncements.

V. Paternity/Support Establishment

Title IV-D of the Social Security Act[72] appropriates money to the states to establish paternity and support for children born out of wedlock. To receive funding, each state must submit a state plan whose requirements are enumerated in the Act.[73] Among other things, the state plan must provide that each state will "undertake . . . in the case of a child

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[68]*Johnson*, 769 F.2d at 1212.

[69]*See* Estran v. Heckler, 745 F.2d 340 (5th Cir. 1984); Evans v. Heckler, 734 F.2d 1012 (4th Cir. 1984); Brady v. Heckler, 724 F.2d 914 (11th Cir. 1984).

[70]773 F.2d 85 (6th Cir. 1985).

[71]*Id.* at 90 (quoting Brady v. Heckler, 724 F.2d 914, 920 (11th Cir. 1984)).

[72]42 U.S.C. § 651 (1982).

[73]*Id.* § 654.

born out of wedlock . . . to establish paternity."[74] The only prerequisite for receiving such services is that the applicant must either be on AFDC or have applied for paternity determination services as prescribed in the state plan.[75] These services are open to everyone.

In Indiana, the State Department of Public Welfare administers the Title IV-D plan. However, through cooperative agreements allowed by the Act,[76] the state has delegated the responsibility for prosecuting paternity cases to the various county prosecutors.

The Marion County Prosecutor enacted a policy, which became effective in September 1982, of refusing to file paternity cases whenever there was a possibility of there being more than one father.[77] Specifically, if the woman had sexual relations with more than one man before, during, or after the probable month of conception, no paternity case would be filed.[78] This policy was modified orally in 1983 to allow for a number of exceptions.[79]

In 1984, a mother of an infant born out of wedlock applied for paternity services from the Marion County Prosecutor's Office.[80] The office refused to assist because of the above policy, despite the fact that she had menstruated between the probable time of conception and the time she had relations with another man.[81]

The woman, labeled Ms. Doe, brought suit in *Doe v. Blinzinger*.[82] She claimed that the policy violated the Social Security Act in that the state and its designate, the prosecutor, were not undertaking to establish paternity.[83] The United States District Court for the Southern District of Indiana agreed and enjoined the use of the policy.[84]

Unlike the cases discussed previously, *Doe* did not involve a dispute between plaintiffs and the federal government. Moreover, *Doe* is the only known case of its kind in the country, in contrast with the above cases, which involve issues litigated in other districts and circuits. However, *Doe* does involve an agency, the State Department of Public Welfare, and the Marion County Prosecutor's Office, both of which attempted to interpret the Act broadly to deny assistance to low-income

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[74] *Id.* § 654(4)(A).
[75] *Id.* § 654(4)(A)(6).
[76] *Id.* § 654(7).
[77] Doe v. Blinzinger, No. IP84-1044-C, at 4 (S.D. Ind. July 9, 1986).
[78] *Id.* at 4.
[79] *Id.*
[80] *Id.* at 2-3.
[81] *Id.*
[82] No. IP84-1044-C (S.D. Ind. July 9, 1986).
[83] *Id.* at 7-10.
[84] *Id.* at 2-3 Judgment.

women in paternity cases.[85] In this case, the district court found that interpretation was too far-reaching.[86]

VI. Conclusion

The five cases and areas presented above are diverse. Indeed, they illustrate the expansiveness of the Social Security Act. Although it is difficult to draw conclusions from them, some general themes emerge.

First, poor persons and their advocates face an uphill battle in attacking the constitutionality of parts of the Social Security Act. Strong presumptions of validity attach to congressional pronouncements. Therefore, the focus must be on whether the agencies administering the Act have interpreted the Act in a manner contrary to the legislative language, intent, or purpose. While deference is given to the agencies' interpretation, their discretion is not boundless.

The third theme is not really a theme, but a hypothesis. Four of the five cases discussed above involved plaintiffs arguing that agencies had gone too far in interpreting Congress' intent as expressed in the Social Security Act. Of course, this is nothing new. Plaintiffs have always claimed that agencies have gone too far. What is disquieting is the reliance agencies have put on fiscal considerations in advancing narrow interpretations of the Act. In *Reed v. Blinzinger,*[87] for example, the Department of Health and Human Services, by extending the sibling deeming rule for determining eligibility for AFDC to determining eligibility for Medicaid, advanced an interpretation of the Act that has been rejected by every court considering the issue. Yet the Department continues to advocate a narrow interpretation of the Act, arguing that such an interpretation is fiscally sound and advances the intent of Congress. As a result, hundred of thousands of needy persons are denied Medicaid. Yet, given the current conservative sentiment generally, the argument that a specific interpretation will save money carries weight.

The 1960's saw the War on Poverty. In the 1980's, through restrictive amendments to the Social Security Act and through restrictive interpretations of the Act, we are seeing a war on the poor. As can be seen, much of the battle is being waged in Indiana. Undoubtedly, it will continue to be.

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[85] *Id.* at 3-6.

[86] *Id.* at 10-11.

[87] 639 F. Supp. 130 (S.D. Ind. 1986), *appeal pending.*

Some Very Significant Developments in Indiana Taxation

J.B. King*

I. Introduction

Certain recent legislative enactments and judicial decisions promise to have a material impact upon the structure of Indiana tax law. This Article will discuss three areas that promise to have the most extensive effects. The first topic is those changes in procedure created along with Indiana's new tax court. The next area of discussion will be Indiana's response to world-wide taxation of multinational corporations. Finally, two recent decisions on the issue of uniformity of property tax valuation will be analyzed.

II. The New Indiana Tax Court—How Will It Work?

A. *Some Basic Observations Regarding the Court*

After years of debate, the Indiana Legislature finally created a special tax court which commenced business on July 1, 1986.[1] Over the years, proponents for the establishment of a special tax court had vigorously argued that state tax litigation requires adjudications by a tribunal that has a first-hand working knowledge of the intricacies of Indiana's tax laws. Conversely, opponents had critically viewed the prospect of a tax court as removing locally elected judges from a grass roots determination as to the propriety or impropriety of assessments by the State of tax liabilities against the citizenry.

The debate is over. The right decision was reached by the Legislature but, as shall be discussed in this Article, the 1985 act creating the court provides a number of unanswered questions that may plague the court in its infancy.

The two critical questions concerning the new tax court are (a) what is the real scope of the court's so-called "exclusive jurisdiction"[2] and (b) what will be the kind or character of judicial review to be followed by the court in adjudicating tax appeals. Each of these key questions is separately discussed later in the Article. However, some preliminary

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[1]1985 Ind. Acts 2278, Pub. L. No. 291-1985 (codified at Ind. Code §§ 33-3-5-1 to 33-3-5-19 (Supp. 1986)).

[2]"The tax court has exclusive jurisdiction over any case that arises under the tax laws of this state . . . ." Ind. Code § 33-3-5-2(a) (Supp. 1986).

observations regarding the structure of the court and its statutory powers are initially appropriate.

First, the tax court, while denominated an appellate court in the tax court act,[3] will essentially serve as the exclusive trial court to hear statutory tax appeals from final determinations of the revenue department and the state tax board, i.e. tax appeals that prior to the creation of the tax court were filed in the state's trial courts of general jurisdiction.[4] Thus, the basic thrust of the tax court act is simply to substitute the tax court for the state's trial courts as the tribunal to hear tax appeals filed pursuant to existing tax appeal statutory procedures. Cases falling within the court's exclusive jurisdiction are denominated "original tax appeals."[5]

As established in the 1985 statute, the tax court consists of one judge.[6] The original tax court bill, as introduced in the legislature, had provided for three judges,[7] and it may prove necessary to enlarge the court if the case load of the court develops to the magnitude many anticipate. The principal office of the court is in Indianapolis, but the act requires taxpayers to elect any one of seven designated counties as the place where evidentiary hearings will be held by the court.[8] The clerk of the supreme court and court of appeals serves as the clerk of the tax court and the tax court is vested with authority to employ necessary court personnel.[9]

The supreme court has adopted modified trial rules of practice, known as the Rules for the Indiana Tax Court, which are essentially those provisions of the Indiana Rules of Trial Procedure that would be applicable to the tax court's judicial review function.[10] Tracking the statute, Rule TC-2 and Rule TC-3 provide the fundamentals for the form and commencement of an action in the tax court as follows:

Rule TC-2
One Form of Action

(A) In the Indiana Tax Court, there shall be one form of

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[3]"An appellate court to be known as the 'Indiana Tax Court' is established." *Id.* § 33-3-5-1.

[4]*Compare* Ind. Code § 6-8.1-9-1(c) (1982) *with* Ind. Code 6-8.1-9-1(c) (Supp. 1986).

[5]Ind. Code § 33-3-5-2(b) (Supp. 1986).

[6]*Id.* § 33-3-5-3. The Honorable Thomas G. Fisher has been appointed by the governor to serve as judge of the new court.

[7]H. 1861 (1985) (as introduced).

[8]Those counties are Allen, Jefferson, Lake, Marion, St. Joseph, Vanderburgh, and Vigo. Ind. Code § 33-3-5-1(c) (Supp. 1986).

[9]*Id.* § 33-3-5-10.

[10]The rules for the Indiana Tax Court were formally adopted on July 18, 1986. They are reprinted in Ind. Code Ann, *Interim Ann. Serv. No. 1*, 66 (West, October 1986).

action in the nature of a civil action to be known as an "original tax appeal."

(B) An original tax appeal is an action that arises under the tax laws of the State of Indiana by which an initial judicial appeal of a final determination of the Department of State Revenue or the State Board of Tax Commissioners is sought.[11]

Rule TC-3
Commencement of an Action

(A) An original tax appeal is commenced by filing a petition in the Tax Court.[12]

Rule TC-4 eliminates the necessity to serve a summons on the attorney general, the revenue department, or the state tax board in an original tax appeal in the tax court and instead provides that the clerk of the court shall promptly transmit copies of the taxpayer's petition to the attorney general and to the agency named as defendant in the petition.[13]

The Indiana Tax Court Rules also address the exclusive venue of the tax court as follows:

Rule TC-13
Venue

The Tax Court has exclusive statewide jurisdiction over all original tax appeals, and venue of all original tax appeals shall lie only in the Tax Court.[14]

All tax court trials are to be tried without the intervention of a jury,[15] and the tax court is required to render its decisions in writing.[16] As shall be discussed, the court is granted limited authority to enjoin tax collections,[17] and the tax court is directed to establish a simplified procedure for the handling of small tax claims.[18]

But, as noted, the real question regarding the new tax court concerns the actual scope of its jurisdiction and the nature of its judicial review.

B. The Tax Court's Exclusive Jurisdiction— Is It Really Exclusive?

Effective July 1, 1986, the tax court has been vested with "exclusive

[11] *Id.* at 66.

[12] *Id.*

[13] *Id.* at 66-67.

[14] *Id.* at 69.

[15] Ind. Code § 33-3-5-13(a) (Supp. 1986).

[16] *Id.* § 33-3-5-15.

[17] *See infra* notes 82-90 and accompanying text.

[18] *See infra* notes 91-95 and accompanying text.

jurisdiction" over any case that arises under the tax laws of the state and that is an initial appeal of a final determination made by (1) the Indiana Department of Revenue or (2) the Indiana State Board of Tax Commissioners.[19] Under section 20 of the act creating the court,[20] the court does not have jurisdiction over any case before July 1, 1986, but a case that is pending in another court on or after June 30, 1986, and that is otherwise within the exclusive jurisdiction of the court may be transferred to the tax court if all parties agree to the transfer.[21]

The tax court's exclusive jurisdiction clearly applies to all appeals of final assessment determinations made by the state tax board pursuant to Indiana Code sections 6-1.1-15-4[22] and 6-1.1-15-5,[23] and indeed the act creating the tax court explicitly amended the latter to specify that appeals from a final assessment determination by the state tax board shall be lodged with the new tax court.[24]

Likewise, the tax court's exclusive jurisdiction clearly applies to all appeals of a denial of a tax refund claim by the revenue department. The provision that empowers the revenue department to receive and grant or deny claims for the refund of income taxes, sales and use taxes, intangibles taxes, and several listed excise taxes was similarly amended in the 1985 tax court act to specify that appeals from the department's denial of any such claims for refund shall be filed with the tax court.[25]

Although the tax court's exclusive jurisdiction to hear statutory appeals from the revenue department and the state tax board is plain on the face of the act creating the court,[26] jurisdiction is nonetheless still contingent upon the taxpayer having first complied with all of the statutory preconditions for initiation of the action.[27]

Contrary to popular belief, however, the tax court's exclusive jurisdiction may not be exclusive as to all tax litigation. As noted, the court's jurisdiction is statutorily restricted to initial appeals of final

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[19]Ind. Code § 33-3-5-2(a) (Supp. 1986).

[20]1985 Ind. Act. 2278, 2290, Pub. L. No. 291-1985, § 20.

[21]*Id.*

[22]This section provides for an appeal when the state tax board does not act on a taxpayers request for review. Ind. Code § 6-1.1-15-4 (1982).

[23]This section provides for judicial review of the state tax board's final determination. Ind. Code § 6-1.1-15-4 (Supp. 1986).

[24]1985 Ind. Acts 2278, 2283, Pub. L. No. 291-1985, § 5.

[25]*Id.* at 2286-87, Pub. L. No. 291-1985, § 12 (amending Ind. Code § 6-8.1-9-1 (1982)).

[26]*Id.* at 2279, Pub. L. No. 291-1985, § 1 (codified at Ind. Code § 33-3-5-2(a) (Supp. 1986)).

[27]"If a taxpayer fails to comply with any statutory requirement for the initiation of an original tax appeal, the tax court does not have jurisdiction to hear the appeal." Ind. Code § 33-3-5-11(a) (Supp. 1986).

determinations by either the state tax board or the revenue department.[28] However, not all tax cases will involve a "final determination" by one or the other of these state agencies.

The first jurisdictional question that will require resolution is whether the tax court has jurisdiction over property tax refund claims. An Indiana statute allows a taxpayer to file a claim for a refund of all or a portion of property tax paid.[29] The property tax refund claim must be filed within three years after the tax was paid and must be filed with the auditor of the county in which the taxes were originally paid. This statutory property tax refund procedure establishes three grounds upon which a refund claim may be based:

> (1) Taxes on the same property have been assessed and paid more than once for the same year;
> (2) The taxes, as a matter of law, were illegal; or
> (3) There was a mathematical error either in the computation of the assessment upon which the taxes were based or in the computation of the taxes.[30]

The statutory procedure further provides that a property tax refund claim may or in some instances shall be forwarded to the state tax board for its review and its approval or disapproval.[31] The county board of commissioners is, however, vested with the authority to take the final administrative step in the allowance or disallowance of a property tax refund claim, and an Indiana statute explicitly states that "when the county board disallows a claim, the claimant may appeal that decision to the county circuit court."[32] Unlike the explicit amendments to both Indiana Code sections 6-1.1-15-5 and 6-8.1-9-1, which expressly substituted the tax court as the court to which appeals under those sections were to be taken, section 6-1.1-26-4 was left unamended. It therefore appears that a sound argument can be made that the new tax court has no jurisdiction over property tax refund claims since (1) the state tax board does not make the final determination of the refund claim, and (2) the judicial review provision specifying appeals to the circuit court was left intact.

A similar cloudy situation exists as to the tax court's jurisdiction relative to the correction by a county auditor of errors found in tax duplicates respecting either the proper assessment of property or the

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[28] *Id.* § 33-3-5-2(a).
[29] IND. CODE § 6-1.1-26-1 (1982).
[30] *Id.* § 6-1.1-26-1(4).
[31] *Id.* § 6-1.1-26-2.
[32] *Id.* § 6-1.1-26-4(c).

correct imposition of property tax. An Indiana statute requires a county auditor, subject to certain limitations, to correct errors that are discovered in the tax duplicate for any one or more of the following reasons:

> (1) The description of the real property was in error.
> (2) The assessment was against the wrong person.
> (3) Taxes on the same property were charged more than one (1) time in the same year.
> (4) There was a mathematical error in computing the taxes or penalties on the taxes.
> (5) There was an error in carrying delinquent taxes forward from one (1) tax duplicate to another.
> (6) The taxes, as a matter of law, were illegal.
> (7) There was a mathematical error in computing an assessment.
> (8) Through an error of omission by any state or county officer the taxpayer was not given credit for an exemption or deduction permitted by law.[33]

This correction of errors procedure does not provide a specific statutory judicial review remedy. However, as to the sixth, seventh and eighth grounds for correction, as noted above, the auditor is prohibited from correcting an error without first obtaining the approval of the state tax board if either (1) the challenged tax is "based on an assessment made or determined by the state board of tax commissioners,"[34] or (2) if the requested correction has failed to receive the approval of any two of the following officials: the township assessor, the county auditor, the county treasurer, and the county assessor.[35] As to corrections requiring state tax board approval, it is possible that the tax court has jurisdiction over any state tax board disapproval of a requested correction of error. Such disapproval should constitute a "final determination" by the board so as to come within the tax court's "exclusive jurisdiction." But as to the other grounds for corrections of error and possibly even as to corrections requiring state tax board approval, it would appear that taxpayers should have a mandamus remedy entitling the taxpayer to seek relief in his local circuit or superior court by way of a mandate to compel the auditor to discharge his statutory duty to make the required correction.[36] Consequently, there is substantial doubt whether the tax

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[33]Ind. Code § 6-1.1-15-12(a) (Supp. 1986).

[34]*Id.* § 6-1.1-15-12(d).

[35]*Id.*

[36]"The action for mandate may be prosecuted against any . . . public or corporate officer . . . to compel the performance of . . . any duty resulting from any office . . . ." Ind. Code § 34-1-58-2 (1982). *See* State *ex. rel.* Land v. Board of Trustees of Springs Valley School Corp., 430 N.E.2d 791, 794 (Ind. Ct. App. 1982).

court possesses jurisdiction as to either the property tax refund procedure[37] or to the property tax correction of errors procedure.[38]

Compounding this uncertainty as to the real scope of the tax court's so-called "exclusive jurisdiction" is a body of well-established Indiana law that has long recognized that apart from the statutory assessment appeals procedures and apart from the statutory property tax refund procedures, a property taxpayer may be entitled to enjoin the collection of property taxes, at least if the property was not lawfully assessable in the first instance.[39]

In the seminal case of *Croop v. Walton*,[40] the Indiana Supreme Court rejected a contention that the property tax refund procedure was the exclusive remedy for challenging an unlawful property tax levy: "[W]here the property is not subject to taxation, the assessment is void, and its collection can be restrained by injunction, regardless of the [statutory] right to appeal."[41] This right to injunctive relief would appear still to be available to enjoin an attempted imposition of property taxes on (1) property not subject to assessment (such as property not in the state on the assessment date), (2) property that has been misclassified as being taxable and therefore erroneously assessed, and possibly (but importantly) (3) property that is exclusively used in interstate commerce and that has been assessed at 100% of its value. It is, of course, problematic whether the Indiana appellate courts, with the advent of the tax court, will continue to adhere to this principle, but if it remains a recognized exception to the basic statutory procedures for challenging assessments and seeking property tax refunds, jurisdiction for equitable injunctive relief will not lie with the tax court but rather with the general trial courts of the state.

In the case of appeals from revenue department tax determinations, the tax court's jurisdiction will be virtually exclusive, but there may be perplexing exceptions. The first such question is whether taxpayers will have recourse to the trial courts of general jurisdiction for injunctive relief. Shortly after the 1933 enactment of the Indiana gross income tax,[42] the Indiana Supreme Court, in *Department of Treasury of Indiana*

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[37] IND. CODE §§ 6-1.1-26-1 to 6-1.1-26-6 (1982).

[38] IND. CODE § 6-1.1-15-12 (Supp. 1986).

[39] *See* Croop v. Walton, 199 Ind. 262, 157 N.E. 275 (1927); Board of Comm'rs of County of Sullivan v. Heap, 155 Ind. App. 633, 294 N.E.2d 182 (1973); Scott v. Abke, 130 Ind. App. 199, 163 N.E.2d 257 (1960); Sluder v. Mahan, 124 Ind. App. 661, 121 N.E.2d 137 (1954). *Cf.* Board of Comm'rs of Madison County v. Midwest Assocs., Inc., 253 Ind. 551, 255 N.E.2d 807 (1970) (no right to enjoin collection of real estate taxes when taxing unit is a third party beneficiary of a contract provision that requires purchaser of land to pay real estate taxes).

[40] 199 Ind. 262, 157 N.E. 275 (1927).

[41] *Id.* at 265, 157 N.E. at 276.

[42] 1933 Ind. Acts, ch. 50.

v. Ridgely,[43] faced the question of whether a taxpayer could seek to enjoin an attempted imposition of the gross income tax by the revenue department, even though the gross income tax act contained a specific procedure for court review of denied refund claims. In *Ridgely*, the state argued that the statutory procedure for appealing denials by the revenue department of gross income tax refund claims was the exclusive procedure for challenging an imposition of gross income tax. Rejecting the state's position, the Indiana Supreme Court held:

> The fact that the statute provides a method of obtaining a refund if the taxpayer sees fit to pay the tax does not necessarily make this remedy exclusive, nor does it rob a court of equity of jurisdiction to afford equitable relief by way of injunction.
>
> . . . So we conclude the remedy afforded a taxpayer who has paid tax for which he is not liable either voluntarily or involuntarily, to recover the unauthorized tax, is additional and cumulative and not exclusive.[44]

The 1937 General Assembly quickly responded to the *Ridgely* decision and enacted the following anti-injunction provision:

> No injunction to restrain or delay the collection of any tax claimed to be due under the provisions of this act [the gross income tax act] shall be issued by any court, but in all cases in which, for any reason, it be claimed that any such tax about to be collected is wrongful or illegal in whole or in part, the remedy, except as otherwise expressly provided in this act, shall be by payment and action to recover such tax as provided in this section.[45]

In 1963, this same anti-injunction provision was incorporated into the then newly enacted Indiana sales and use tax[46] and the Indiana adjusted gross income tax.[47]

Citing the 1937 anti-injunction provision, the Supreme Court in 1971 emphatically confirmed that the statutory tax refund appeal procedure was to be considered the sole and exclusive remedy for challenging a gross income tax imposition.[48] The court accordingly said:

> It is clear that the remedy thus provided by the Legislature is and is intended to be the sole and exclusive remedy available

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[43]211 Ind. 9, 4 N.E.2d 557 (1936).

[44]*Id.* at 15, 4 N.E.2d at 560.

[45]1937 Ind. Acts, ch. 117, § 14(d).

[46]1963 Ind. Acts (Spec. Sess.), ch. 30, § 16.

[47]1963 Ind. Acts. (Spec. Sess.), ch. 32, § 604.

[48]State *ex rel.* Indiana Dep't of Revenue v. Marion Circuit Court, 255 Ind. 501, 265 N.E.2d 241 (1971).

> to question the legality of the imposition of a tax under the Indiana Gross Income Tax Law.
>
> We hold, therefore, that the respondent court is without subject matter jurisdiction to enjoin or restrain the petitioner from attempting to collect the taxes in question from the plaintiff.[49]

This holding, of course, also directly confirmed the exclusivity of the sales and use tax and the adjusted gross income tax statutory refund appeal procedures.

Consequently, it would seem that the tax court's exclusive jurisdiction is indeed exclusive, at least to the judicial disposition of taxpayers' challenges to the imposition of the major state taxes administered by the revenue department, namely, the gross income tax, the sales and use tax, and the adjusted gross income tax, along with its companion, the supplemental net income tax. Such is not the case, however.

First, a cloud has been cast on the exclusivity of these statutory refund appeal procedures as the result of the enactment of the 1980 Tax Administration Code[50] that established uniform provisions for the administration by the revenue department of most of the taxes administered by that agency, including particularly the income taxes and the sales and use taxes. The 1980 Tax Administration Code repealed the anti-injunction provision as enacted in 1937[51] and substituted therefor the following provision:

> (d) *The* court [referring to the court to which the appeal is taken] shall hear the appeal de novo [referring to the refund claim appeal] and without a jury, and after the hearing may order or deny any part of the appealed refund. . . . *The* court may not enjoin, restrain or delay collection of any of the listed taxes, regardless of the facts or legal theory on which the suit requesting that relief is brought. The only relief that *a* court may grant is to allow a refund of taxes, interest and penalties that have been paid to and collected by the department.[52]

At first blush, this substituted provision would seem to be substantively a virtual replication of the forerunner 1937 anti-injunction provision. But, on scrutiny, the provision does not prohibit the issuance of an injunction "by any court;"[53] instead, it literally prohibits the issuance of an injunction only by the court to which the refund claim

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[49] *Id.* at 504, 265 N.E.2d at 243.

[50] 1980 Ind. Acts 660, Pub. L. No. 61.

[51] 1937 Ind. Acts, ch. 117, § 14(d).

[52] 1980 Ind. Acts 660, 679, Pub. L. No. 61 (codified at IND. CODE § 6-8.1-9-1(d) (Supp. 1980)) (emphasis added).

[53] 1937 Ind. Acts, ch. 117, § 14(d).

is appealed, in stark contrast to the original language of the 1937 provision, which stated:

> No injunction to restrain or delay the collection of any tax claimed to be due under the provisions of this act *shall be issued by any court*, but *in all cases* in which, for any reason, it be claimed that any such tax about to be collected is wrongful or illegal in whole or in part, the remedy, except as otherwise expressly provided in this act, shall be by payment and action to recover such tax as provided in this section.[54]

While the last sentence of the Tax Administration Code's reworded anti-injunction provision might have saved the dichotomy between the old and the new anti-injunction provisions,[55] the 1980 Tax Administration Code's anti-injunction provision was in fact expressly deleted in the 1985 enactment of the tax court act. The provision, as amended in 1985, now reads as follows:

> The tax court shall hear the appeal de novo and without a jury, and after the hearing may order or deny any part of the appealed refund. The court may assess the court costs in any manner that it feels is equitable. The court may enjoin the collection of any of the listed taxes under IC 33-3-5-11. The court may also allow a refund of taxes, interest, and penalties that have been paid to and collected by the department.[56]

The 1985 deletion of any express prohibition on the issuance of injunctions by any court could resurrect the *Ridgely* holding.[57] The judicial and legislative history concerning the *absence*, then the *presence*, and now once again, the *absence* of an express anti-injunction provision may allow taxpayers to contend that in the absence of an express anti-injunction provision, the refund appeal procedure is no longer the exclusive procedure and, consequently, injunctive relief under *Ridgely* is available from the general trial courts.

It would seem that if the Indiana appellate courts are disposed to focus state tax litigation in the new tax court, there is a strong likelihood that the ultimate outcome of this question will be a recognition that the deletion of an express anti-injunction provision does not alter the

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[54]*Id.* (emphasis added).

[55]The last sentence of the 1980 Tax Administration Code's anti-injunction provisions provides as follows: "The only relief that a court may grant is to allow a refund of taxes, interest and penalties that have been paid to and collected by the department." *Id.* This sentence, unlike the prior language in the provision, can be read to apply to all courts, thus impliedly restricting any court from issuing injuctive relief.

[56]Ind. Code § 6-8.1-9-1(d) (Supp. 1986).

[57]*See supra* notes 43-44 and accompanying text.

exclusivity of the statutory refund procedures and that the limited authority granted to the new tax court to enjoin collection of a contested tax is to be construed as the sole and exclusive means *for a taxpayer* to obtain injunctive relief *in any court.*

The tax court's "exclusive jurisdiction" may also be diluted by two relatively recent judicially recognized exceptions to the exclusivity of the statutory refund procedures. In *Mathis v. Cooperative Vendors, Inc.,*[58] the Indiana Court of Appeals held that a retail merchant could properly initiate a declaratory judgment action to challenge the revenue department's attempt to hold the retailer liable for uncollected sales tax. The court reasoned that a retailer who is statutorily identified as an agent of the state to collect sales tax[59] is *not* the taxpayer and, therefore, the retailer in the *Mathis* case was not obliged to follow the refund appeal procedure established for "taxpayers."[60] The *Mathis* court concluded that the retailer could properly challenge the revenue department's attempted assessment by way of a declaratory judgment action without having first to pay the assessed tax as would be otherwise required pursuant to the conventional statutory refund appeal procedure.[61] Under the reasoning of *Mathis*, the tax court would not have jurisdiction of such declaratory judgment actions, particularly since Indiana Code section 33-3-5-11 expressly provides that "the tax court does not have jurisdiction to hear the appeal" unless the taxpayer has complied with all statutory pre-appeal conditions[62] and, of course, the key statutory condition to a revenue department appeal is the payment of the contested tax, a condition avoided by the employment of a declaratory judgment action.

The *Mathis* precedent could conceivably be answered by a broad brush response that the overriding intention of the legislature was to vest exclusive jurisdiction in the tax court "over any case that arises under the tax laws of this state and that is an initial appeal of a final determination made by . . . the department of state revenue."[63] However, the context of the entire law, including the requirement that all statutory preconditions to an appeal must be first satisfied, strongly suggests that the focal point of the court's jurisdiction was indeed limited, in the case of revenue department determinations, to "taxpayers" who are seeking redress of tax refund denials.[64]

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[58]170 Ind. App. 659, 354 N.E.2d 269 (1976).

[59]The statutory identification of the retail merchant as an agent of the state is contained in IND. CODE § 6-2.5-2-1(b) (Supp. 1986).

[60]*Mathis*, 170 Ind. App. at 666, 354 N.E.2d at 274.

[61]*Id.*

[62]IND. CODE § 33-3-5-11 (Supp. 1986).

[63]*Id.* § 33-3-5-2.

[64]It should be noted that the holding in *Mathis* was distinguished by the court of appeals in Ind. Dep't of State Revenue v. Indiana Gamma Gamma, 181 Ind. App. 664, 394 N.E.2d 187 (1979), where the court held that an association charged with failure to

State v. Indianapolis Airport Authority[65] portends a second exception to the tax court's jurisdiction. In this case, the court of appeals first concluded that the Airport Authority was not a person or taxpayer within the purview of the statutory tax refund appeal procedure; the court accordingly held that because the refund appeal procedure did not apply to the Airport Authority, it could properly seek and obtain an injunction permanently enjoining the revenue department from attempting to impose the gross income tax on the Authority's gross receipts from its operations.[66] The *Indianapolis Airport Authority* decision, by reason of its narrow application to just those entities that can claim they are neither a "taxpayer" nor a "person" should not have significant impact on the tax court's jurisdiction. And, as in the case of *Mathis*, this ruling may eventually be overridden by an ultimate appellate holding that notwithstanding these possible technical deficiencies, the pervasive intention of the legislature was to empower the tax court to hear all appeals from final determinations by the revenue department, whether affecting taxpayers or others against whom the department has sought to assess tax liability.

One final observation about the new tax court's jurisdiction regards the availability of mandamus actions by taxpayers to compel the performance of ministerial functions of the taxing agencies and to assure that the taxpayer has been accorded full due process of law in the administrative process.[67] To the extent appropriate, trial courts of general jurisdiction should continue to have jurisdiction over taxpayer mandamus actions that seek equitable relief against a taxing agency before the agency has issued a final determination.[68] Clearly, the tax court will not have such jurisdiction because its authority is expressly limited to appeals from final determinations. While resort to mandamus should indeed be rare, that remedy is available in Indiana.[69] For example, in *State ex rel. Montgomery Ward & Co. v. Indiana Department of State Revenue*,[70] the Marion Superior Court entered a judgment mandating the revenue department to hold a hearing and to make a final determination of the taxpayer's duly filed claim for refund as required by the statutory procedures.[71]

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collect sales tax could not seek declaratory judgment relief because the association had voluntarily paid the tax and filed a claim for refund, thereby bringing itself within the exclusive judicial remedy afforded by the statute.

[65]173 Ind. App. 55, 362 N.E.2d 200 (1977).

[66]*Id.* at 59, 362 N.E.2d at 202.

[67]Ind. Code § 34-1-58-2 (1982) provides the statutory authority for mandamus action. *See supra* note 36.

[68]*See supra* notes 33-36 and accompanying text.

[69]Ind. Code § 34-1-58-1 (1982).

[70]No. S482-1606 (Marion Superior Court 1983).

[71]The applicable procedure is codified at Ind. Code § 6-8.1-9-1(b) (1982) (amended 1985). *See* State Tax Bd. v. Oliverius, 156 Ind. App. 46, 294 N.E.2d 646 (1973).

C. *The Kind of Judicial Review to Be Conducted by the Tax Court*

The new Indiana statute provides that the character or kind of judicial review to be conducted by the tax court shall be determined by the statutory law governing the particular original tax appeal.[72] This provision is especially significant because of the existing disparity in the character of the procedure statutorily established for appeals from the revenue department as compared to the character of the procedure statutorily established for appeals from the state tax board.[73]

Revenue department tax appeals are statutorily denominated de novo appeals.[74] No administrative record is made (and none is required) by the revenue department in its disposition of tax refund claims. Indeed, the statutory procedure governing the department's disposition of tax refund claims does not even require a hearing,[75] and the department frequently, if not customarily, determines a refund claim without a hearing. Commenting on this revenue department tax appeal procedure, the Indiana Court of Appeals, in *United Artists Theatre Circuit, Inc. v. Indiana Department of State Revenue*,[76] has recently said:

> [T]he right to administrative hearing is discretionary with the Department. Furthermore, there is nothing within the language of the Gross Income Tax Act to indicate that the refund procedure is a review of an administrative determination. Moreover, we have previously reviewed the trial court's findings as findings from a trial *de novo*. In *Wayne Pump Co. v. Department of Treasury*, (1953) 232 Ind. 147, 110 N.E.2d 284, the supreme court held it was the trial court's duty to determine the issues in tax refund suits upon the merits. . . .[77]

Taxpayers, the department, and the courts have accordingly approached judicial reviews of revenue department final determinations as a de novo fact-finding process.

Conversely, court appeals from the state tax board have been subjected to a much narrower scope of judicial review. The principal reason for this more limited scope of review is that the statutory procedure

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[72]Sec. 14. With respect to determinations as to whether any issues or evidence may be heard in an original tax appeal that was not heard in the administrative hearing or proceeding, the tax court is governed by the law that applied before the creation of the tax court to appeals to trial courts of final determinations made by the department of state revenue and the state board of tax commissioners.
Ind. Code § 33-3-5-14 (Supp. 1986).

[73]*Compare* Ind. Code § 6-8.1-9-1 (Supp. 1986) *with* Ind. Code § 6-1.1-15-4 (1982).

[74]Ind. Code § 6-8.1-9-1(d) (Supp. 1986).

[75]*Id.* § 6-8.1-9-1.

[76]459 N.E.2d 754 (Ind. Ct. App. 1984).

[77]*Id.* at 759 (citations omitted).

for the administrative determination of assessment challenges requires the state tax board to hold a hearing, with at least ten days notice to the taxpayer, and then to render its decision after the hearing.[78] Stressing the existence of this administrative hearing requirement, the Indiana Court of Appeals has emphasized that in appeals from the state tax board, the taxpayer is confined to the matters presented to the state tax board.[79] This more limited scope of judicial review was described as follows:

> We conclude that . . . only those witnesses who testified at the board's hearing may testify at the judicial review hearing, and they may testify only to those facts to which they testified at the board's hearing. Similarly, only those exhibits introduced at the board's hearing may be introduced on judicial review.[80]

The preservation of these two distinct judicial review procedures is desirable. But taxpayers and taxpayers' counsel must remain especially alert to the necessity to make a complete factual record in proceedings before the state tax board because that record will govern the scope of the tax court's judicial review of the tax board's final determination.

D. The Tax Court's Authority to Enjoin the Collection of Tax

Indiana Code section 33-3-5-11 now provides that a taxpayer who wishes to enjoin the collection of tax *pending the original tax appeal* may petition the tax court for such relief.[81] The petition must set forth a summary of the issues and a statement of the equitable considerations for which the tax court should enjoin collection of the tax.[82] However, the tax court may enjoin collection only if the court finds:

> (1) The issues raised by the original tax appeal are substantial;
> (2) The petitioner has a reasonable opportunity to prevail in the original tax appeal; and
> (3) The equitable considerations favoring the enjoining of the collection of the tax outweigh the state's interests in collecting the tax pending the original tax appeal.[84]

This provision was a last minute insertion by the Legislature in the

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[78] IND. CODE § 6-1.1-5-4 (1982). *See* Whirlpool Corp. v. State Bd. of Tax Comm'rs., 167 Ind. App. 216, 338 N.E.2d 501 (1975).

[79] State Bd. of Tax Comm'rs. v. Gatling Gun Club, Inc., 420 N.E.2d 1324 (Ind. Ct. App. 1981).

[80] *Id.* at 1328.

[81] IND. CODE § 33-3-5-11(b) (Supp. 1986).

[82] *Id.*

[83] *Id.* § 33-3-5-11(c).

[84] *Id.* § 33-3-5-11(a).

tax court bill; consequently, it is fundamentally flawed. First, it simply disregards the fact that the tax court does not have jurisdiction to hear an appeal unless the taxpayer has complied with all of the statutory requirements for the initiation of the tax appeal. In the case of appeals from the revenue department, the taxpayer is statutorily required first to pay the challenged tax, then to file a claim for refund; the statutory appeal lies from the department's denial of the refund claim.[85] If the taxpayer cannot initiate his appeal without first paying the contested tax, the stark question is: what purpose is served by the injunction procedure?

Obviously, this is a technical snafu, and it is understood that with the department's cooperation, the tax court is going to receive and consider petitions to enjoin the collection of taxes assessed by the revenue department, notwithstanding this jurisdictional cloud. However, the further question remains that if the court actually preliminarily enjoins the collection of tax, does it have jurisdiction to proceed to hear the case since the statute explicitly states that "if a taxpayer fails to comply with any statutory requirement for the initiation of the tax appeal, the tax court does not have jurisdiction to hear the appeal."[86] Presumably this paradox will be corrected by the 1987 General Assembly.

Another fundamental inconsistency with the new tax collection injunction provision is that it is unnecessary in the case of a taxpayer appeal challenging property tax assessment increases by the state tax board. Under Indiana Code section 6-1.1-15-10, property tax taxpayers are basically relieved from paying tax on contested assessment increases during the pendency of a court appeal challenging such increases.[87] Arguably, the new law could be construed as an implied repeal of the existing law, but in view of the general judicial admonition that implied repeals are not favored,[88] it seems unlikely the courts would apply this principle to defeat the long-established statutory provision that exonerates taxpayers from paying property taxes on an assessment or assessment increase that is being challenged either at the administrative level or in the courts.[89]

Nonetheless, for taxpayers appealing revenue department final determinations, the new procedure for the granting of injunctive relief by the tax court, assuming the technical glitches are quickly solved, should

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[85] *Id.* § 6-8.1-9-1(c).

[86] *Id.* § 33-3-5-1(a).

[87] *Id.* § 6-1.1-15-10.

[88] "Repeals of statutes by implication are not favored, and in construing statutes the courts will avoid a construction effecting a repeal by implication, if possible." 26 Ind. L. Ency. *Statutes* § 83 (1953).

[89] Ind. Code § 6-1.1-15-10 (Supp. 1986).

be helpful relief if the statutory conditions permitting the issuance of an injunction can indeed be met.

E. Small Tax Claims

The tax court has been empowered, indeed directed, to establish a small claims docket for processing (a) refund claims from the revenue department that do not exceed $5,000 for any year, and (b) appeals from the state tax board of assessments of property that do not exceed $15,000 for any year.[90] While commendable in its objective, the efficacy of this new small claims procedure remains to be seen. Presumably, the goal of the tax court will be to establish simplified procedures for the filing and administration of small tax claims but, with the simplification of procedures, the court may find itself faced with a ponderous burden. If such occurs, the Legislature will have to provide the court with the necessary resources to carry out the program.

The Supreme Court has adopted special rules for the filing of small tax claims.[91] These rules are denominated "Small Tax Case Rules" and they incorporate to the extent not inconsistent with the tax court's jurisdiction the "Indiana Rules for Small Claims." Rule STC-2 provides a simplified form of notice for the filing of a small tax claim as follows:

> Rule STC-2
> Notice of Claim
>
> The notice of claim to be used under Small Claims Rule 2 shall contain:
>
> (1) the name of the Tax Court;
>
> (2) the name, address and telephone number of claimant;
>
> (3) a designation of the type of tax the claim involves;
>
> (4) a statement of the taxable period involved or, in the case of a claim relating to property taxes, the effective date of any assessment at issue;
>
> (5) a brief statement of the nature of the claim;
>
> (6) a statement of the amount of tax at issue or, in the case of a claim relating to property taxes, the assessed value of the property at issue; and
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> (7) any additional information which may facilitate proper service or processing of the claim.[92]

The filing of the notice of claim is considered to be a summons as to

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[90] *Id.* § 33-3-5-12.

[91] These rules were formally adopted on July 18, 1986. They are reprinted in Ind. Code Ann., *Interim Ann. Serv. No. 1,* 71 (West, October 1986).

[92] Ind. Small Tax Case R. 2.

the state agency,[93] but rule STC-3 requires that the notice of claim shall be served upon the attorney general by registered or certified mail, return receipt requested.[94]

II. Indiana's Response to the Issue of World-Wide Taxation of Multinational Corporations

Following a series of decisions by the United States Supreme Court in the early 1980's that addressed the issue of state taxation of the world-wide or foreign source income of multicorporate unitary businesses,[95] Indiana has grappled with the economically sensitive question of how far Indiana should expand its now recognized constitutional jurisdiction to impose the Indiana adjusted gross and supplemental income taxes on the taxable income of unitary businesses. Coupled with this question is the companion question of how far Indiana should go in taxing the foreign source income of United States domestic companies.

In 1984, Governor Orr, in order to allay expressions of grave concern by many taxpayers as to what Indiana's policy would be in view of the 1983 United States Supreme Court decision in *Container Corp. of America v. Franchise Tax Board*[96] issued the following statement:

> The attached Indiana Department of Revenue directive is in response to the many reports that have greatly misrepresented Indiana's unitary tax policy. I wish to make Indiana's position absolutely clear. Except when requested by the taxpayer or in cases where there is evidence of a blatant attempt to avoid Indiana taxes, Indiana has not, does not, and will not require combined reporting of taxpayers conducting unitary businesses. This has been our policy. The United States Supreme Court decision in the Container Corporation of America case has not altered that policy.[97]

The revenue department directive identified in Governor Orr's statement further explained the department's policy as to its application of the unitary business taxation method as follows:

> The Department has no intention of using combined income of unitary businesses as a means of gaining additional tax revenues,

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[93]Ind. Small Tax Case R. 3.

[94]*Id.*

[95]Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159 (1983); F.W. Woolworth Co. v. Taxation & Revenue Dep't, 458 U.S. 354 (1982); ASARCO, Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982); Exxon Corp. v. Department of Revenue, 447 U.S. 207 (1980); Mobil Oil Corp. v. Commissioner of Taxes, 445 U.S. 425 (1980).

[96]463 U.S. 159 (1983).

[97]Public announcement by Governor Robert D. Orr of Indiana (February 23, 1984).

> but will only use the method for the fair reporting and reflection of income attributed to Indiana when the standard three-factor formula clearly does not fairly reflect income. To categorize Indiana as a "unitary state" is not an accurate description of the policy Indiana has followed for years.[98]

In 1985, the Indiana Legislature further addressed the issue of unitary business taxation and enacted an amendment to the adjusted gross income tax act (popularly called the "Sony amendment")[99] that essentially provides that Indiana will not impose the unitary business tax concept on a world-wide basis, but restricts the revenue department's application of that concept to a "water's edge" jurisdiction.[100] Broadly speaking, "water's edge unitary taxation" essentially means that the revenue department may apply the unitary business method to combine the income of a multicorporate business only to the extent such business is conducted within the United States. Conversely stated, the department may not tax a unitary business on the basis of world-wide income. Because numerous articles,[101] as well as numerous court decisions,[102] have dealt with this unitary business concept, the objective of this comment is to focus on where Indiana stands today on the issue of unitary taxation.

The 1985 enactment of a "water's edge" unitary business taxation limitation has produced two unresolved serious concerns. First, Indiana has not dealt with the question of the taxability of foreign source income (generally dividends and royalties) of United States based multinational businesses. American multinationals may well argue that "water's edge" taxation will place them at a great tax disadvantage with foreign-based multinationals if Indiana taxes the domestic companies' foreign source income while exempting from taxation the overseas income of the foreign multinationals. It is significant at this point to note that all of the states bordering Indiana have provided tax relief for the foreign source income of American companies.[103] This issue has been presented to our legislature but no action has yet been taken by the General Assembly to rectify the asserted disparity in the taxation of U.S. incomes vs. foreign companies.

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[98]Commissioner's Directive No. 10 (Ind. Revenue Dep't, Feb. 1984).

[99]1985 Ind. Acts 658, 663, Pub. L. No. 75-1985, § 4 (codified at IND. CODE § 6-3-2-2(o) (Supp. 1986).

[100]*Id.*

[101]*See, e.g.*, Buresh & Weinstein, *Combined Reporting: The Approach and Its Problems*, J. STATE TAX'N, Spring 1981, at 5; Corrigan, *Interstate Corporate Income—Recent Revolutions and a Modern Response*, 29 VAND. L. REV. 423 (1976); Frankel, *Basic Principles and Significant Issues in State Taxation of Unitary Corporate Income*, 37 TAX EXEC. 1 (1984).

[102]*See supra* note 95.

[103]*See, e.g.*, ILL. ANN. STAT ch. 120, para. 15-1501(a)(28) (Smith-Hurd Supp. 1986).

The second unresolved problem emanating from the 1985 enactment of the "water's edge" unitary business limitation concerns a companion limitation that restricts the department's application of the unitary concept even as to domestic multicorporate businesses.

> [T]he department may not require that income, deductions, and credits attributable to a taxpayer and another entity . . . be reported in a combined income tax return for any taxable year, unless the department is unable to fairly reflect the taxpayer's adjusted gross income for the taxable year through use of other powers granted to the department . . . .[104]

This provision has received little attention to date, but it may bear considerable significance as to the department's real authority to apply the unitary business concept.

The legislative history behind the enactment of this provision reflects that it was adopted to ensure that the state's application of the unitary business concept was to be a last resort tool to determine the Indiana taxable income of a multistate, multicorporate business. The provision requires the department first to seek to establish whether Indiana taxable income can be fairly determined without resort to the unitary method.[105] For example, the department may now be required to determine whether Indiana taxable income is ascertainable on a separate accounting basis (such as making adjustments for intercompany transactions) before the department may fall back on the unitary method.

It can be argued that this statute is nothing more than a recitation of the existing law and that it imposes no new limitations on the department. The answer to such a contention should be that under long-established principles of statutory construction, the legislature is presumed not to have enacted a useless, redundant, or meaningless law and that it is incumbent on agencies and the courts to attribute a meaningful purpose to an enactment of the legislature.[106]

Assuming that the new provision is to be given a meaningful interpretation, the legislature has imposed a more restrictive standard upon the revenue department as to its employment of the unitary tax method; therefore, Indiana taxpayers facing unitary taxation by the department may be well advised to seek factually to demonstrate that such taxation is unwarranted. If so construed, this law is certainly consistent with and responsive to Governor Orr's statement that "except when requested by

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[104]IND. CODE § 6-3-2-2-(p) (Supp. 1986).

[105]*Id.*

[106]"It is a rule of statutory interpretation that courts will not presume the legislature intended to do a useless thing or to enact a statute that is a nullity." Northern Ind. Bank v. State Bd. of Finance, 457 N.E.2d 527, 532 (Ind. 1983).

the taxpayer or in cases where there is evidence of a blatant attempt to avoid Indiana taxes, Indiana has not, does not, and will not require combined reporting of taxpayers conducting unitary businesses."[107]

III. Uniformity in Valuation—A Mounting Property Tax Assessment Problem

The Indiana Court of Appeals in two recent decisions has relied upon article 10, section 1 of the Indiana Constitution[108] to set aside the state tax board's assessment of business inventory for lack of uniformity in the valuation of property of like kind. In *State Board of Tax Commissioners v. Pioneer Hi-Bred International, Inc.*,[109] the court examined regulation 16's[110] mandatory trade leveling adjustment to inventory for manufacturers who have assumed the role of retailers. *State Board of Tax Commissioners v. PolyGram Records, Inc.*,[111] involved regulation 16's mandatory adjustment for royalty fees in determining the valuation of inventory. In both of these cases, the court found that the application of regulation 16 resulted in identical or similar property being assessed at different assessed values. Absent evidence that this was necessary to achieve equality among different taxpayers, the court concluded that this result violated the Indiana Constitution's mandate that there be "a uniform and equal rate of assessment and taxation and . . . a just valuation for all property, both real and personal."[112]

In *Pioneer Hi-Bred International*,[113] Pioneer (the taxpayer) produced and sold various types of seed grain. On the assessment date, Pioneer owned seed grain that was stored at its Indiana production facilities and also owned seed grain in the hands of its Indiana sales representatives for retail sale. Pioneer reported the assessed value of all of its seed in Indiana on the assessment date (whether held at its facilities or held by its salesmen) at the same value. The state tax board rejected Pioneer's valuation on the basis of rule 3, section 2(A) of regulation 16, which requires a manufacturer or processor who assumes the role of a retailer to value its inventory located at the retail level of trade differently than

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[107]Public Announcement by Governor Robert D. Orr of Indiana (February 23, 1984).

[108]"The General Assembly shall provide, by law, for a uniform and equal rate of property assessment . . . ." Ind. Const. art. 10, § 1.

[109]477 N.E.2d 939 (Ind. Ct. App. 1985).

[110]Regulation 16 was enacted by the state board of tax commissioners pursuant to the authority granted by Ind. Code § 6-1.1-31-1 (1982). It requires that manufacturers or processors who also act as retailers must value inventory at the retail level as though purchased from the manufacturing plant. It is codified at Ind. Admin. Code tit.50, § 4.1-3-2 (1984).

[111]487 N.E.2d 444 (Ind. Ct. App. 1985).

[112]Ind. Const. art. 10, § 1.

[113]477 N.E.2d 939 (Ind. Ct. App. 1985).

inventory not ready for retail.[114] The state tax board then valued Pioneer's seed at the production level on a cost per books method, but in valuing the seed in the hands of Pioneer's sales representatives (at the retail level), the tax board included the cost of materials, labor, manufacturing and operating expenses, and intracompany profit (essentially the costs of distribution to the retail level).[115]

The state tax board argued that this trade leveling adjustment was justified because it assured that all seed at the retail level of trade would be valued equally whether it was owned by a retailer who purchased it from a producer or by a producer assuming the role of retailer. The board asserted that "[t]he inequality of tax liability assessed against the same property of a single taxpayer is justified because equality of assessment occurs among different taxpayers."[116] The state tax board, however, never presented any evidence to the court that substantiated its argument. No evidence was introduced comparing the valuation of similar inventory owned by a retailer with Pioneer's assessed values, nor did the state provide any evidence showing that uniformity and equality between Pioneer and other retailers was achieved by regulation 16's trade-leveling adjustment.[117] Therefore, the court rejected the state tax board's contention that regulation 16's trade leveling adjustment leads to uniformity and equality among taxpayers.[118]

The court then addressed the issue of whether the disproportionate tax liability assessed against Pioneer's seed is legally permissible. Relying upon the 1977 decision in *State Board of Tax Commissioners v. Lyon & Greenleaf Co.*,[119] the court ruled that the state tax board's classification and different valuations of Pioneer's seed based upon its level of trade violated article 10, section 1 of the Indiana Constitution.[120] Observing that the state tax board had failed to show that such classification was required to achieve a just valuation of all property, the court concluded:

> Inventory stored at Pioneer's facilities is distinguished from the same inventory in the hands of Pioneer's sales representatives. Such a distinction is probably more artificial than in *Lyon & Greenleaf*. In this case, not only is identical property valued differently but the same owner of identical property is taxed

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[114] IND. ADMIN. CODE tit. 50, § 4.1-3-2(A)(5) (1984).
[115] *Pioneer Hi-Bred Int'l*, 477 N.E.2d at 941.
[116] *Id.* at 942.
[117] *Id.*
[118] *Id.* at 943.
[119] 172 Ind. App. 272, 359 N.E.2d 931 (1977). In this case, the Indiana Court of Appeals ruled that the assessing of fungible, commingled grain stored in the same warehouse at different values depending upon whether the grain was owned by the warehouse itself or by farmers was violative of the Indiana Constitution. *Id.*
[120] *Pioneer Hi-Bred Int'l*, 477 N.E.2d at 943.

differently. We therefore conclude that the Board's higher valuation of Pioneer's seed grain at the retail level of trade was impermissible and the trial court properly set it aside.[121]

In *PolyGram Records*,[122] the court of appeals again held that the state tax board's assessment of tangible personal property violated article 10, section 1 of the Indiana Constitution. PolyGram is a company that produces, promotes, and distributes records and tapes. It operates a distribution center for its products in Beech Grove, Indiana. In the record and tape industry, the artist first contracts with a record label company to make a master copy of the recording. The record label company than contracts with companies like PolyGram to produce, promote, and distribute the recording. According to the court, PolyGram generally subcontracted out the actual manufacturing of the record to record-pressing companies.[123] PolyGram was compensated by retaining a percentage of the wholesale price with the remainder going to the record label company, which in turn used the funds for expenses, including the payment of royalties to the artist. The court found that the record label company was solely responsible for any royalty payments to the recording artist and that PolyGram was in no way involved with royalty agreements between the record label company and the artist.[124]

The state tax board increased PolyGram's business inventory assessment by 127% to cover the value of royalties on the records that PolyGram held on the assessment date in Indiana.[125] This adjustment was made in accordance with rule 3, section 2(A)(6) of regulation 16,[126] which provides that if the taxpayer's cost per books of inventory excludes any royalty fees, an adjustment increasing such cost to reflect those fees must be made.[127]

The taxpayer prevailed in this case by establishing (1) that it was not responsible for any royalties on its records, (2) that if a record was in its inventory, no royalty had accrued because there had been no sale (the event that triggered the obligation to pay royalty), and (3) *most importantly*, that PolyGram was in no different position than an Indiana record-presser, i.e. the manufacturer of recordings, and that the state tax board did not include royalty values in assessing records owned by record-pressers.[128]

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[121] *Id.*

[122] 487 N.E.2d 444 (Ind. Ct. App. 1985).

[123] *Id.* at 445.

[124] *Id.*

[125] *Id.*

[126] IND. ADMIN. CODE tit.50, § 4.1-3-2(A)(6) (1984).

[127] *PolyGram Records*, 487 N.E.2d at 445.

[128] PolyGram is in no different position, according to the record, than an Indiana located record-presser, i.e., the manufacturer, of recordings, where royalty values

The sum of these recent valuation decisions casts a mounting threat to the valuation standards employed by the state tax board. If the courts mean that all property of like kind must be valued at the same amount, then the board's "cost" approach to valuation is certainly jeopardized. But if the decisions stand only for the proposition that property similarly situated in the same marketplace is to be assessed pursuant to uniform valuation standards, then the board's general procedures may withstand further judicial scrutiny. In the board's defense, its use of "cost" as a starting point for valuation has considerable merit, not only as to the uniformity of the standard, but also, and importantly, this starting point permits a sound and defensible audit procedure.

> are not assessed. We believe the situation is sufficiently similar to the seed corn in *State Bd. of Tax Com'rs. v. Pioneer Hi-Bred*, (1985) Ind. App., 477 N.E.2d 939, and the stored wheat in *Ind. St. Bd. of Tax Com'rs. v. Lyon & Greenleaf Co.*, (1977) 172 Ind. App. 272, 359 N.E.2d 931, that these cases control the PolyGram inventory because the Board has created an artificial distinction which results in an assessment which is not uniform or results in a just valuation. As a result, the PolyGram assessment contravenes Ind. Const. Art. 10, § 1.

Id. (footnote omitted).

The Disappearing Rights of Plaintiffs Under a Legal Disability

Roger L. Pardieck*

I. Introduction

Historically, limitations on actions were generally held to be in derogation of the common law and were looked upon with disfavor.[1] As we moved into the twentieth century, the courts began to look favorably upon statutes of limitation as a method to prevent claims against governmental entities and to encourage diligence among plaintiffs.[2] In the 1970's, special interest legislation produced limitations on the rights of children; these statutes have been liberally construed by the courts in Indiana.[3] In Indiana, as well as other states, the trend appears to limit actions through arbitrary time constraints. One exception to this trend was the adoption of a modified discovery rule in *Barnes v. A.H. Robins Co., Inc.*,[4] where the Indiana Supreme Court recognized that the strict application of a statute of limitations may create, in some instances, a great and intolerable injustice.[5]

As limitations on actions crept into the early English common law, savings statutes were passed which protected children and others under

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[1]Shideler v. Dwyer, 417 N.E.2d 281, 283 (Ind. 1981). Statutes of limitations, as we know them, originated in England. Originally, there was no limitation on when a person could bring an action against another for a particular wrong. Eventually, statutes of limitation were utilized. At the same time, rules developed which prevented the statute from running during a period when a person was under some legal disability. The rules were thought necessary to protect the individual's right to seek redress for the wrong done against him after his disability was removed. Infants were among the individuals protected under these rules. W. Ferguson, Statutes of Limitation Saving Statutes 7-59 (1978).

[2]*Shideler,* 417 N.E.2d at 283; Spoljaric v. Pangan, 466 N.E.2d 37, 43 (Ind. Ct. App. 1984).

[3]*See Shideler*, 417 N.E.2d at 283.

[4]476 N.E.2d 84 (Ind. 1985).

[5]For example, many courts now apply discovery rules in various types of actions. The Indiana Supreme Court recently adopted such a rule for cases in which the plaintiff suffered an injury as the result of protracted exposure to a foreign substance. *Id.* In these types of cases, the statute of limitations begins "to run from the date the plaintiff knew or should have discovered that she suffered an injury or impingement, and that it was caused by the product or act of another." *Id.* at 87-88. The court declined to extend the rule to all types of tort cases but did not preclude that possibility from happening in the future. *Id.* at 87.

a legal disability from the harsh result of having their rights extinguished before they were legally competent to exercise them.[6] Similarly, many states in this country enacted savings statutes to preserve the actions of those under a legal disability.[7] While this was once true in Indiana, the legislation of the seventies, coupled with judicial interpretations of this legislation, has whittled away at the protection provided children and those under a legal disability. A recent illustrative case is *Orr v. Turco Manufacturing Co., Inc.*,[8] in which the Indiana Court of Appeals found that the products liability statute[9] requiring minors to bring a products liability claim within two years from the date of the injury, regardless of the minor's age, barred the claim of an injured child. As shall be seen from the legislative history discussed later in this Article, the legislation was squarely aimed at limiting liability without regard to whether the case was good or bad and without consideration for its impact on children.[10] Without more distance between ourselves and the issue, it may be impossible definitively to determine the present effect of the trend to eliminate rights of the legally disabled, but it is pertinent to question the direction in which we are headed.

II. The Granting of an Extension of Time

In Indiana, an infant is permitted to bring an action "(1) in his own name; (2) in his own name by a guardian ad litem or a next friend; [or] (3) in the name of his representative," if the representative has been appointed by the court.[11] By statute, "[a]ny person being under legal disabilities when the cause of action accrues may bring his action within two (2) years after the disability is removed."[12] This provision does not, in the literal sense, stop the statute of limitations from running; rather, the statue of limitations begins to run when the cause of action accrues.[13] However, because of his minority status, the child is given two years after attainment of majority to bring his cause of action if the full statute of limitations runs while he is still a minor.[14] Yet, in the last decade, this extension of time has been narrowed by legislative and court action.

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[6]*See* W. Ferguson, *supra* note 1, at 13-14.

[7]*See id.* at 7-59.

[8]484 N.E.2d 1300 (Ind. Ct. App. 1985).

[9]Ind. Code § 33-1-1.5-5 (1982).

[10]*See infra* text accompanying notes 45-48.

[11]Ind. R. Tr. P. 17(c) (1986).

[12]Ind. Code § 34-1-2-5 (1982). This does not prohibit children from pursuing an action while they are still minors. Rather, it merely preserves their right to bring an action within two years of their attaining majority status. Norris v. Mingle, 217 Ind. 516, 29 N.E.2d 400 (1940).

[13]King v. Carmichael, 136 Ind. 20, 35 N.E. 509 (1893).

[14]*Id.*

III. Taking Away the Child's Safety Net

A. The Products Liability Act

In 1978, the Indiana legislature passed the Indiana Products Liability Act, which included the following:

> This section *applies to all persons regardless of minority or legal disability. Notwithstanding I.C. 34-1-2-5*, any product liability action must be commenced within two years after the cause of action accrues or within ten (10) years after the delivery of the product to the initial user or consumer; except that, if the cause of action accrues more than eight (8) years but not more than ten (10) years after that initial delivery, the action may be commenced at any time within two (2) years after the cause of action accrues.[15]

This statute became the focus of the Indiana Court of Appeals' decision in *Orr v. Turco Manufacturing Co., Inc.*[16]

B. *The* Orr *Decision*

In *Orr*, Nicolette Orr was injured on a swing set in 1979 when she was ten years old. Paul Orr was appointed guardian of Nicolette's estate on June 23, 1983. On June 30, 1983, an action was filed against Turco, the manufacturer of the swing set. In response, Turco filed a motion to dismiss, asserting that the action had been filed more than two years after the injury occurred and was, therefore, barred by the products liability statute of limitations.

Orr attempted to argue that Indiana Code section 33-1-1.5-5 did not apply to persons with a legal disability or minority status. In addition, Orr argued that courts had the authority and responsibility to determine when a cause of action accrued.[17] In rejecting both of these arguments,

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[15]Ind. Code § 33-1-1.5-5 (1982) (emphasis added). Prior to the enactment of this statute, minors had two years after attaining majority to file product liability actions. *See* D'Andrea v. Montgomery Ward & Co., Inc., 571 F.2d 403 (7th Cir. 1978) (applying Indiana law).

[16]484 N.E.2d 1300 (Ind. Ct. App. 1985).

[17]*Id.* at 1302 (relying on the Indiana Supreme Court's decision in Barnes v. A.H. Robins, Inc., 476 N.E.2d 84 (Ind. 1985)). In *Barnes*, the plaintiffs had utilized a contraceptive device known as the Dalkon Shield. Each plaintiff had suffered injuries in 1972-1979 due to the use of the device but did not discover the connection between their use of the shield and their illnesses until they saw a 60 Minutes program in 1981. The plaintiffs, upon learning of the association between the Dalkon Shield and the problems they suffered, filed actions in 1981. The supreme court was asked to determine when the statute of limitations would begin to run in such actions, and in response to this inquiry adopted the discovery rule. *Barnes*, 476 N.E.2d at 87.

the court of appeals noted that the statute in question was clear and unambiguous and provided no exceptions for either minority or legal disability.[18] Therefore, the court was bound to follow the mandate of the legislature and bar Orr's claim which was brought more than two years after the injury was suffered.[19]

Perhaps more importantly, the court also rejected Orr's argument that the statute violated article 1, section 12 of the Indiana Constitution.[20] In doing so, the court relied on two prior Indiana decisions, *Dague v. Piper Aircraft Corp.*[21] and *Rohrabaugh v. Wagoner.*[22]

C. *The* Dague *Decision*

In *Dague*, the Indiana Supreme Court was asked to determine whether the products liability statute of limitations violated article 1, section 12 of the Indiana Constitution.[23] This section provides in part that: "All

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[18]*Orr*, 484 N.E.2d at 1302.

[19]*Id.* The court of appeals subsequently determined in a companion case that the intent of the legislature was so clearly expressed that an award of attorney fees was proper. Orr v. Turco Mfg. Co., Inc., 496 N.E.2d 115 (Ind. Ct. App. 1986). The court determined that in light of the statutory language, Orr could not in good faith argue that minors were not covered by the two year provision in the products liability statute. The arguments made by Orr were deemed meritless. The appeal was found "to be frivolous because wholly without merit, and thus presumptively taken in bad faith." *Orr*, 496 N.E.2d at 118.

The award of attorney fees in this action creates an untenable problem for plaintiffs' attorneys. Although Orr's argument based on the wording of the statute may have been tenuated, Orr also asserted that the statute violated the Indiana Constitution. The products liability statute of limitations had previously withstood a constitutional attack but had not been questioned with regard to minors' claims. *Orr*, 484 N.E.2d at 1302; *see also* Dague v. Piper Aircraft Corp., 275 Ind. 520, 530, 418 N.E.2d 207, 313 (1981). Even if Orr inartfully presented her case, and that is not to say that she did, would this fact make the case so meritless as to justify an award of attorney fees especially when similar statutes had been successfully attacked in other states? The court of appeals relied on the fact that Indiana's medical malpractice statute had been upheld with respect to minors and that the decision in that case was dispositive of the issue raised by Orr. *Orr*, 484 N.E.2d at 1303 (citing Rohrabaugh v. Wagoner, 274 Ind. 661, 413 N.E.2d 891 (1980)). Because the court believed the decision was dispositive, it determined that Orr's appeal was meritless. This decision leaves attorneys in the position of having to decide whether to launch a constitutional attack on a statute where another, but not identical, statute has been upheld and risk being assessed for attorney fees or forgo the attack.

Presumably, the assessment of attorney fees is intended to discourage "frivolous" lawsuits. The extent to which it will accomplish that objective may never be known; however, it is certain to have a chilling effect on lawyers when they consider taking on controversial litigation.

[20]*Orr*, 484 N.E.2d at 1302.

[21]275 Ind. 520, 418 N.E.2d 207 (1981).

[22]274 Ind. 661, 413 N.E.2d 891 (1980).

[23]In *Dague*, the plaintiff filed a four count complaint against Piper Aircraft seeking to recover damages for the wrongful death of her husband. Her husband had died as a

courts shall be open; and every person, for injury done to him in his person, property, or reputation, shall have remedy by due course of law."[24] The plaintiff argued that the ten-year limitation contained in Indiana's product liability statute cut off her actions based on the theories of strict liability and negligence without providing an alternative remedy.[25] This effectively deprived her of access to the courts and therefore, the provision violated article 1, section 12 of the Indiana Constitution.[26]

The supreme court disagreed. The court reasoned that the legislature is entitled to change the common law[27] and that the legislature was within its authority in enacting legislation that narrowed the time frame in which an action could be brought. The court concluded that there is no vested right in a rule of common law and that the right to bring a common law action is not a fundamental right.[28] The court ultimately decided that the Products Liability Act did not contravene article 1, section 12 of the Indiana Constitution.[29] Significantly, the court never discussed the portions of the statute dealing with minors and persons under a disability. This issue was never presented to the court. The *Dague* case merely held that in general, the statute of repose was constitutional. Because the *Dague* court did not consider the constitutionality of the clause making the limitation applicable to children, the *Dague* decision should not have been considered dispositive of the *Orr* case.

D. *The Child and the Medical Malpractice Action*

Rohrabaugh v. Wagoner,[30] although instructive, did not deal with

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result of injuries sustained when the Piper Pawnee aircraft he was piloting crashed on July 7, 1978. The decedent passed away on September 5, 1978, and his wife filed her complaint on October 1, 1979, alleging that the decedent's injuries and death were caused by a defective condition in the aircraft. It was undisputed that the aircraft had been manufactured in 1965 and placed into the stream of commerce on March 26, 1965. A federal district court granted Piper Aircraft's motion for summary judgment on the basis of Indiana's ten-year statute of repose. On appeal, the Seventh Circuit certified several issues to the Indiana Supreme Court, including the issue of whether the ten-year statute of repose violated the Indiana Constitution. *Dague*, 275 Ind. at 522-23, 418 N.E.2d at 209.

[24] IND. CONST. art. I, § 12 (1851, amended 1984).

[25] *Dague*, 275 Ind. at 529, 418 N.E.2d at 212. The statutory provision provides in pertinent part: "[A]ny product liability action . . . must be commenced within two [2] years after the cause of action accrues or *within ten [10] years after the delivery of the product to the initial user or consumer* . . . ." IND. CODE ANN. § 34-4-20A-5 (Burns Supp. 1986) (emphasis added).

[26] *Dague*, 275 Ind. at 529, 418 N.E.2d at 212.

[27] *Id.*, 418 N.E.2d at 213.

[28] *Id.*

[29] *Id.* at 530, 418 N.E.2d at 213.

[30] 274 Ind. 661, 413 N.E.2d 891 (1980).

the products liability statute questioned in *Orr*. Rather, *Rohrabaugh* dealt solely with the medical malpractice statute of limitations.[31] The plaintiff in *Rohrabaugh* was a minor between age six and eighteen, both when her action was brought and when the alleged acts of malpractice occurred.[32] The medical malpractice statute of limitations provided that minors under the age of six had until their eighth birthday to pursue an action while all other minors had only two years "from the date of the alleged act, omission or neglect" to pursue their action.[33] The plaintiff brought her malpractice action in 1979, more than two years after the enactment of the medical malpractice statute and more than two years after the effective date of the Act.[34] The trial court dismissed the plaintiff's action as being untimely filed and the supreme court affirmed that decision.

The plaintiff asserted that the medical malpractice statute violated the rights guaranteed by both the fourteenth amendment of the United States Constitution and article 1, sections 12 and 23 of the Indiana Constitution.[35] The court first noted that the legislature was not required to exempt children from the operation of statutes of limitation.[36] The

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[31]*Id. Rohrabaugh* was not the first Indiana case to address the medical malpractice statute's limitation of minors' claims. In Chaffin v. Nicosia, 261 Ind. 698, 310 N.E.2d 867 (1974), the Indiana Supreme Court determined that the statute of limitations in the old medical malpractice statute did not override the special statute of limitations for persons under a legal disability. *Id.* at 703, 310 N.E.2d at 870. The court noted that requiring a minor to file his action within the two-year period provided by the medical malpractice statute would be "extraordinarily harsh" and inconsistent with the legislature's intention of creating a legal disability to protect minors. *Id.* at 704, 310 N.E.2d at 871. However, after this ruling, the medical malpractice statute was amended to set up the current system. *See infra* note 33 and accompanying text. Nevertheless, the court's focus on the impact on children and their right to access to the courts is instructive in reviewing the present situation.

[32]274 Ind. at 662, 413 N.E.2d at 892.

[33]*Id.* at 663, 413 N.E.2d at 892 (quoting Ind. Code § 16-9.5-3-1 (1976)). The Act also provided that any action which accrued before the enactment of the statute had to be brought within: "(a) Two years of the effective date of this article; or (b) The period described in section 1 of this chapter." Ind. Code § 16-9.5-3-2 (1976). The plaintiff had missed both of these deadlines. *Rohrabaugh*, 274 Ind. at 663, 413 N.E.2d at 892.

[34]*Rohrabaugh*, 274 Ind. at 663, 413 N.E.2d at 892.

[35]*Id.*, 413 N.E.2d at 893. Article 1, section 23 of the Indiana Constitution states: "The General Assembly shall not grant to any citizen, or class of citizens, privileges or immunities, which upon the same terms, shall not equally belong to all citizens." Ind. Const. art. I, § 23.

[36]274 Ind. at 664, 413 N.E.2d at 893 (citing Sherfey v. City of Brazil, 213 Ind. 493, 13 N.E.2d 568 (1938), in which the court stated that neither infancy nor incapacity suspended the requirement to give notice of injury to a municipality as required by statute. Again, this decision made no examination of the historical use of savings statutes with regard to minors. It merely stated that children, like adults, had to meet the statutorily imposed notice provision.)

court then decided that children were not a suspect class and did not require strict judicial scrutiny.[37] Therefore, the constitutional analysis utilized by the court only required the classification in the statute to "be reasonable, not arbitrary," and that it "rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike."[38] Unfortunately, the court did not appear then to consider the peculiar situation in which all children are placed in seeking redress for an injury.

Rather than examining children's need for access to the legal system, the court focused entirely on the purpose of the legislation, i.e. to reduce physicians' exposure to medical malpractice suits by limiting the time period in which suits could be brought and thereby to assure the availability of malpractice insurance at a reasonable cost.[39] The legislature apparently feared that health care services would be withdrawn from the public if such measures were not taken.[40] In weighing the benefit of such a limitation to the medical profession and insurance industry against the burden placed on children, the court stated:

> [T]he Legislature: 'may well have given consideration to the fact that most children by the time they reach the age of six years are in a position to verbally communicate their physical complaints to parents or other adults having a natural sympathy with them. Such communications and the persons whom they reach may to some appreciable degree stand surrogate for the lack of maturity and judgment of infants in this matter. The Legislature may well have considered the fact of some importance that many health care providers are specially trained professional persons meeting state standards for licensing, and are, therefore, entitled to a special degree of trust.'[41]

The court concluded that the classification utilized in the medical malpractice statute was reasonably related to the purpose of the legislation and that "children of this class and adults are similarly circumstanced

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[37]*Rohrabaugh*, 274 Ind. at 666, 413 N.E.2d at 893-94.

[38]*Id.* (quoting Johnson v. St. Vincent Hospital, Inc., 273 Ind. 374, 392, 404 N.E.2d 585, 597 (1980)).

[39]274 Ind. at 666, 413 N.E.2d at 894.

[40]*Id.* This again raises the interesting question of whether the recurring insurance crises are caused by 1) the tort system, 2) the unrestrained investment practices of the insurance industry, 3) the competitive forces of the marketplace in which the insurance industry operates, 4) the insurance industry itself for its own benefit, or 5) all of the above.

[41]*Id.* at 667, 413 N.E.2d at 895 (quoting Johnson v. St. Vincent Hospital, Inc., 273 Ind. 374, 404, 404 N.E.2d 585, 604 (1980)).

with regard to their ability to bring malpractice actions.''[42] Therefore, the statute was held to be constitutional and ''consistent with the protection offered by our State and Federal Constitutions to equal protection of the laws.''[43]

Notably, the *Rohrabaugh* decision dealt solely with the statute of limitations in the medical malpractice statute. When evaluating the statute, the court had to determine whether the provisions of the statute were a reasonable method of dealing with the perceived health care and insurance crisis. This evaluation involved an examination of the provision with that particular goal in mind. The decision does not stand for the proposition that any statute of limitations is per se constitutional. The *Orr* decision, however, treated the *Rohrabaugh* case as controlling precedent even though the goals of the two statutes were not the same.

The products liability statute was passed because of an alleged insurance crisis. No public service such as health care was involved. Thus, the determination in *Rohrabaugh* that limiting minors' rights was reasonable for the medical malpractice statute should not mean the same was true for the products liability statute. The court in *Orr* simply relied on the *Rohrabaugh* decision without conducting a separate analysis of the different factors involved in the products liability legislation. In fact, the court refused to consider the Minutes of the Select Joint Committee on Products Liability on the basis that the language in the statute was unambiguous.[44] This raises a question regarding the role of the Minutes and whether legislative history is relevant in determining whether the limitation on the child's right to bring an action was a reasonable method of dealing with the problem confronting the legislature.

A review of the Minutes would have revealed that the major concern was the ten-year limitation and that the enactment of the limitation was not expected to decrease insurance rates paid by Indiana manufacturers, although that was the stated goal of the legislation.[45] The insurance industry nevertheless urged the passage of the limitations so that Indiana ''could serve as an example to the other states in drafting their laws.''[46] It was acknowledged that it is ''fitting and appropriate for counsel or injured parties to seek to make recoveries under the tort system and it is proper for them to have the tools with which to bring their cases.''[47]

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[42]274 Ind. at 667, 413 N.E.2d at 895.

[43]274 Ind. at 668, 413 N.E.2d at 895. Considering the specific reasons for the passage of the medical malpractice statute, *Rohrabaugh* should not have been treated as being dispositive of the *Orr* case without an independent analysis of the purpose of the products statutes.

[44]*Orr*, 484 N.E.2d at 1302.

[45]Minutes of the Select Joint Committee on Products Liability (Sept. 19, 1977).

[46]*Id.*

[47]Minutes of the Select Joint Committee on Products Liability (Sept. 1977) (statement presented by William F. Burfeind, Asst. Counsel, American Insurance Assoc.)

Yet, the statute takes the tools needed for seeking redress away from minors. Although the committee acknowledged that it might be appropriate to give children additional time to file an action, no such provision was included in the final draft.[48] A review of the evidence presented to the committee fails to reveal the basis for excluding such a provision. No testimony appears to have been given concerning the impact such a provision would have had on the "perceived crisis" or the impact on children of failing to protect their access to the courts. An examination of the legislative history provides substantial evidence for the contention that the purpose of the legislation could have been accomplished without encroaching on the rights of children. Other courts have examined similar legislative histories to determine the impact of such legislation on children and have concluded that the elimination of the historic savings provision was unreasonable.

E. An Alternative Analysis

Illustrative of cases in which courts have examined legislative histories in construing statutes of limitations similar to that in Indiana's Products Liability Act is *Sax v. Votteler*,[49] in which the Texas Supreme Court determined that the statute of limitations applied to minors' claims in medical malpractice actions was unconstitutional.[50] The Texas statute, which is similar to that of Indiana, provided that minors under the age

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[48]Minutes of the Select Joint Committee on Products Liability (Oct. 14, 1977). The products liability statute is a political response to the alleged insurance crisis. One cannot doubt the reality of the crisis today as well as at the time this statute was passed. Yet its cause is another matter. Some point to a litigation explosion and frivolous lawsuits as the cause, but the allegation is yet to be proven. The Justice Department set up the Willard Commission to study tort reform. It reported a 758% increase in federal products liability litigation in the past ten years. *Extent and Policy Implications of the Current Crisis in Insurance Availability*, I Tort Policy Working Group 42 (1986). However, it ignored data which shows that a substantial portion of the increase relates to one product, asbestos. Even considering the impact of mass tort litigation involving asbestos, Bendectin, Agent Orange and the Dalkon Shield, such suits have outpaced population growth by only two percentage points. Farrell & Glaberson, *The Explosion in Liability Lawsuits is Nothing But a Myth*, Business Week, April 21, 1986 at 24. Generally, civil cases have declined 10% since 1981 in state court systems according to the National Center for State Courts and the Rand Institute for Civil Justice. That there is and was an insurance crisis is beyond dispute, but surely there must be some relationship between the remedy and the alleged wrong to justify radical legislation that overturns well established common law. The legislative history of the products liability statute merely identifies the problem. There is no evidence to establish that the restriction on children's rights is related to the availability or cost of insurance. If victims have less access to the courts, we will have less litigation—not because we have fewer wrongs but because it is harder to pry open the court house door.

[49]648 S.W.2d 661 (Tex. 1983).

[50]*Id.*

of six years had until their eighth birthday to file their claims.[51] All other children had two years from the date of medical treatment or from the date the tort was committed to file their action.[52]

The plaintiff in *Sax* had undergone an operation for the removal of her appendix on May 10, 1976, when she was eleven years old. The physician continued his treatment of the plaintiff until August 5, 1976. On February 20, 1979, the plaintiff filed her action against the physician, alleging that the doctor had mistakenly removed one of her fallopian tubes rather than her appendix. The physician filed a motion for summary judgment, arguing that the claim was barred by the two-year statute of limitations. The trial court granted the motion and the court of appeals affirmed the judgment. The supreme court, however, reversed the decision in part and remanded the case for trial on the merits.[53]

In reversing, the court noted that Texas had historically tolled the statute of limitations for minors' claims.[54] At the time of the medical malpractice statute's passage, minors had until two years after they attained majority to bring a tort action.[55] The Saxes attacked the Texas statute, arguing that the minor was being deprived of her rights to due process and equal protection of the law as guaranteed by the fourteenth amendment of the United States Constitution and the Texas Constitu-

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[51]*Id.* at 663. The Texas statute at issue in the *Sax* case provided:

> Notwithstanding any other law, no claim against a person or hospital covered by a policy of professional liability insurance covering a person licensed to practice medicine or podiatry or certified to administer anesthesia in this state or a hospital licensed under the Texas Hospital Licensing Law, as amended (Art. 4437f, Vernon's Texas Civil Statutes), whether for breach of express or implied contract or tort, for compensation for a medical treatment or hospitalization may be commenced unless the action is filed within two years of the breach or the tort complained of or from the date the medical treatment that is the subject of the claim or the hospitalization for which the claim is made is completed, *except that minors under the age of six years shall have until the eighth birthday in which to file, or have filed on their behalf such claim.* Except as herein provided, this section applies to all persons regardless of minority or other legal disability.

Professional Liability Insurance for Physicians, Podiatrists, and Hospitals Act, ch. 330, 1975 Tex. Gen. Laws 864 (emphasis added) (expired 1977) (substantially similar provision regarding statute of limitations present at TEX. REV. CIV. STAT. ANN. art. 4590li (Vernon 1977), except the amended law substitutes age 12, thus providing minors would have until age 14 to file).

[52]*Sax*, 648 S.W.2d at 663.

[53]*Id.* The court reversed the decision with respect to the minor's cause of action, but affirmed the holdings of the lower court that the parents' claim for medical expenses and loss of earnings during the minority of the plaintiff-child was barred by the statute of limitations. *Id.* at 667.

[54]*Id.*

[55]*Id.* This was also the situation in Indiana prior to the passage of the medical malpractice and products liability statutes of limitations legislation. *See supra* text accompanying notes 13 and 35.

tion.[56] The Texas court held that "the right to bring a well-established common law cause of action cannot be effectively abrogated by the legislature absent a showing that the legislative basis for the statute outweighs the denial of the constitutionally-guaranteed right of redress."[57] Like the Indiana statute, the Texas statute had been passed in an effort

> to provide an insurance rate structure that would enable health care providers to secure liability insurance and thereby provide compensation for their patients who might have legitimate malpractice claims. The specific purpose of the provision in question was to limit the length of time that the insureds would be exposed to potential liability.[58]

The court noted that in order to meet her burden of proof, the plaintiff had to show that she had a "cognizable common law cause of action that [was] being restricted" and that "the restriction was unreasonable or arbitrary when balanced against the purpose of the statutes."[59] There was no question that a child had a common law cause of action that was being restricted.[60] The problem was, therefore, to determine whether the restriction was unreasonable.

In Texas, children have no right to bring a cause of action on their own until the disability of minority is removed.[61] This does not distinguish Texas minors from Indiana minors. Although Indiana minors are technically permitted access to the courts,[62] they are effectively prohibited from gaining access unless a third party assists them in retaining counsel and managing the case.[63] This effectively places Indiana children in the same situation as Texas children because any action they bring as minors is dependent on the actions of third parties.

In Texas, as in Indiana, the parents, guardians, or next friends of

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[56]*Sax*, 648 S.W.2d at 667. The traditional due process guarantee is provided in the Texas Constitution art. I, § 19, which states: "No citizen of this state shall be deprived of life, liberty, property, privileges or immunities, or in any manner disfranchised, except by the due course of the law of the land." In addition, the Texas Constitution art. I, § 13, which is similar to the Indiana Constitution art. I, § 12, provides: "Excessive bail shall not be required, nor excessive fines imposed, nor cruel or unusual punishment inflicted. All courts shall be open, and every person for an injury done him, in his lands, goods, person or reputation, shall have remedy by due course of law." This second provision is sometimes referred to as the "Open Courts Provision," but is considered a due process guarantee. *Id.* at 664. *Compare* Tex. Const. art. I, § 13 *with* Ind. Const. art. I, § 12.

[57]*Sax*, 648 S.W.2d at 665-66.

[58]*Id.* at 666.

[59]*Id.*

[60]*Id.*

[61]*Id.*

[62]*See* Ind. R. Tr. P. 17(c).

[63]*See generally* State *ex rel* Keating v. Bingham, 233 Ind. 504, 121 N.E.2d 727 (1954).

the child may institute an action on behalf of the child while the child is a minor.[64] Under the Texas medical malpractice statute, the failure of the parent or guardian to institute the action in a timely fashion precluded the child from asserting her cause of action. The child also had no recourse against the parents for their failure to pursue an action because of the doctrine of parent-child immunity.[65] As a result, the court stated:

> The child, therefore, is effectively barred from any remedy if his parents fail to timely file suit. Respondents argue that parents will adequately protect the rights of their children. This Court, however, cannot assume that parents will act in such a manner. It is neither reasonable nor realistic to rely upon parents, who may themselves be minors, or who may be ignorant, lethargic, or lack concern, to bring a malpractice lawsuit action within the time provided by [the medical malpractice statute].[66]

Although the court acknowledged that the length of time an insured is exposed to liability will affect insurance rates, it concluded that the statute in question was an unreasonable method of dealing with the problem because it abrogated the child's right of redress without providing a reasonable alternative.[67] This approach assures that minors will continue to have a right to seek redress for injuries, while the Indiana approach severely curtails this right. Unlike the Indiana courts, the Texas court also squarely faced the problems confronted in seeking redress in the legal system.

IV. Conclusion

The analysis utilized by the Texas Supreme Court attempts to balance the loss of the right of redress against the need to limit the time frame in which actions may be brought. In contrast, Indiana decisions have ignored the realities of the child's inability to pursue an action on his own. It is time for both the courts and the legislature to recognize that the child's right to bring an action in Indiana is gradually being eroded. Children are totally dependent on third parties to pursue their actions and now, in both the areas of products liability and medical malpractice, children may lose their right of redress if their parents, guardians or next friends, either from ignorance or lack of concern, do not pursue

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[64]Tex. Civ. Code Ann. § 1994 (Vernon 1964).

[65]*Sax*, 648 S.W.2d at 667. Indiana also recognizes the continued vitality of the doctrine of parent-child immunity. *See* Buffalo v. Buffalo, 441 N.E.2d 711 (Ind. Ct. App. 1982).

[66]648 S.W.2d at 667.

[67]*Id.*

the child's legal remedies. A child of eight may be able to say "I am hurt," but this does not translate into the ability to recognize that he has a right to seek legal redress or to seek out a third party who is willing to pursue that right for him. The historical protection afforded minors still has validity in the area of statutes of limitations. The right to seek legal redress for wrongs committed against a person is one of the corner stones of our society and legal system. The current trend of legislation and case law in Indiana threatens this right. Unless these statutes are reevaluated by the courts and legislature and their impact on the child's right to seek redress is considered, the minor's right to seek legal redress for wrongs committed against him may be further reduced in situations where the child has no one willing to pursue his action for him.

An exceedingly logical friend recently related that when he was ten years old, he was playing with his brothers when his father suddenly picked him up and spanked him. He turned in hurt and bewilderment and asked, "What did I do to deserve that?" "Nothing," his father replied. "Then why was I spanked?" "To teach you that this is not a rational world," was the answer. Lawyers and judges learn sooner than most that this is not a rational world. It should be part of our responsibility, however, to make it more so. The limitations on the rights of the legally disabled, as modified recently by the legislature, do not do that.

A Multi-Perspective Critique of Indiana's Legislative Abrogation of the Collateral Source Rule

Lawrence P. Wilkins*

I. Introduction

From an early date in Indiana jurisprudence, courts have denied defendant tortfeasors the ability to present evidence that the plaintiff has obtained compensation for the injuries from other sources and avoid liability by arguing that the plaintiff has no need for compensation through the torts system. So, for example,[1] where the plaintiff's loss has been covered by a contract of insurance purchased by the plaintiff or the plaintiff's employer, Indiana courts, in accordance with a rule adopted in virtually every American jurisdiction, have steadfastly refused to permit the defendant, "by way of set-off, recoupment, or in mitigation of damages,"[2] to avoid compensating the plaintiff in an amount equal to the assessed value of the injuries.

Effective September 1, 1986, the "collateral source rule," as this judicial position has come to be known, no longer governs the trial of personal injury actions. By declaring a *new* collateral source rule which *requires* the admission of evidence of certain types of compensation payments to plaintiff from outside sources, and *permits* consideration of those payments in the assessment and review of damages, the Indiana

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[1]Other sources of benefits may be involved. The rule of exclusion discussed here applies to direct provision of benefits, such as disability payments from plaintiff's own carrier or plaintiff's employer's insurance, pension plans, free medical services, welfare benefits, social security benefits, and gifts. It also applies to benefits that are more indirect, such as tax savings from the nontaxability of judgments for damages or income and services of a second spouse. The justifications for excluding evidence of benefits may vary according to the type of benefit. *See generally* Averbach, *The Collateral Source Rule*, 21 Ohio St. L.J. 231 (1960); Esdaile, *The Collateral Source Rule: A Proposal to Regulate Admission of Evidence to Avoid Prejudice*, 68 Mass. L. Rev. 102 (1983); Fleming, *The Collateral Source Rule and Loss Allocation in Tort Law*, 54 Cal. L. Rev. 1478 (1966); Hogan, *The Collateral Source Rule: Its Justification and Its Defense*, Trial, Feb. 1983, at 58; Lambert, *The Case for the Collateral Source Rule*, 1966 Ins. L.J. 531; Maxwell, *The Collateral Source Rule in the American Law of Damages*, 46 Minn. L. Rev. 669 (1962); Peckinpaugh, *An Analysis of the Collateral Source Rule*, 1966 Ins. L.J. 545; Note, *Unreason in the Law of Damages: The Collateral Source Rule*, 77 Harv. L. Rev. 741 (1966) [hereinafter *Unreason*]. Where significant, the differences will be treated below, but in most parts the discussion will proceed without distinguishing the various sources.

[2]Sherlock v. Alling, 44 Ind. 184, 199 (1873).

General Assembly has reversed the judicial rule of exclusion.[3] In this enactment, one of a series of important legislative modifications and abrogations of the common law in this state in recent years, the General Assembly has terminated an unbroken line of precedent extending back nearly to the middle of the 19th century. Any legislative rewriting of common law is significant, but when such a solidly established doctrine as the collateral source rule is overturned, the event is especially noteworthy. The rule has been under steady attack since it was first pronounced in the courts and has garnered severe criticism from commentators over the years. This Article will examine the enactment[4] in detail and comment upon its operation and apparent effect in the common law of torts from several perspectives. It will also briefly review the criticisms leveled at the rule and evaluate the statutory abrogation in light of those criticisms.

II. Common Law Background of the Collateral Source Rule

The main justification offered in the early decisions for refusing to entertain defenses of this nature has been that the defendant has no interest in the transactions of the injured party. The view of the courts was clear: the mere fortuity that the defendant had injured someone who had obtained protection of personal fiscal resources from expenses occasioned by physical injury bore no relationship to the defendant's liability. As will be demonstrated below, the courts have been so resolutely opposed to defendants' arguments based on the premise that no net loss has occurred because of the collateral payments, that judicial analyses of this rule of exclusion have been truncated or nonexistent.[5] A logical framework for the judicial collateral source rule can be inferred, however, and an overall review of the common law history of its application reveals a shift in emphasis upon justifications for the rule, if not a shift in the essence of the rule itself. This section of the Article will examine the case law background of the rule and attempt to develop the inferred logical framework of the courts in applying the rule. This background will then serve as a basis for analysis of the effects of the statute.

Early in the rule's development in Indiana, the approach of the courts applying the rule began with an assumption that the defendant's

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[3]Act of March 11, 1986, Pub. L. No. 201-1986, 1986 Ind. Acts 1959 (codified at Ind. Code §§ 34-4-33-14; 34-4-35-1; 34-4-36-1 to -3 (Supp. 1986)).

[4]The act is entitled "Reductions of Subrogation or Lien for Collateral Benefits—Jury Instructions in Personal Injury Cases—Collateral Source Evidence." Senate Enrolled Act 394 (1986). It does not have a short title, but needs one badly. Some plaintiffs' attorneys have suggested "The Liability Insurance Relief Act," others think it might better be called the "Reduced Compensation Act," while some defense counsel have been calling it the "One Bite at the Apple Act."

[5]See *infra* note 8 and text accompanying notes 20-27.

attempt to mitigate was an attempt to address the issue of the defendant's culpability. Given that approach, the fact that the injured party had received some financial balm from another was viewed as *non sequitur*. The attempt to prove that a plaintiff, once injured, had been requited from another source would not serve as a premise for the offered conclusion that the defendant was not at fault in invading the plaintiff's interest.

The courts were concerned with the effect of recognizing a rule that would allow an interloper to profit from the contractual security arranged by others, as evidenced in the statement by the court in *Cunningham v. Evansville and Terre Haute R. Co.*:[6]

> The payment of such moneys not being procured by the defendant, and they not having been either paid or received to satisfy in whole or in part his liability, he can derive no advantage therefrom in mitigation of damages for which he is liable. As has been said by another, to permit a reduction of damages on such a ground would be to allow the wrong-doer to pay nothing, and take all the benefit of a policy of insurance without paying the premium.[7]

Reduced to essential terms, the truth of this proposition is not self-evident. Nor does the court offer any further explanation, preferring instead merely to recite other holdings.[8] No reason in logic is suggested on the face of the statement why *C* cannot benefit from a transaction between *A* and *B*. Even beyond the explicit recognition of third-party beneficiary contracts, common experience teaches that members of a market society benefit daily from others' transactions. If considerations of fairness are adopted as the perspective, so long as *A* and *B* get what they bargained for, no reason is suggested for disallowing *C* to enjoy the fruits of the bargain as well. However, the quotation from the *Cunningham* court does demonstrate that the person seeking the mitigation was not simply a third-party interloper; he was not the neutral "*C*" in the abstract statement. The would-be interloper in the case was a "wrongdoer." So stated, the recitations take on a certain tone of moral indignation at the suggestion that someone clothed in fault could avail himself of the preparedness of another.[9]

The combination of a simply stated rule backed by an attitude of moral indignation proved to be a formidable obstacle to the rule's

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[6]102 Ind. 478 (1885).

[7]*Id.* at 484 (quoting 1 SUTHERLAND, DAMAGES 242 (1916)).

[8]The court quoted Sherlock v. Alling, 44 Ind. 184 (1873), and cited The Ohio and Mississippi R.W. Co. v. Dickerson, 59 Ind. 317 (1877), thereby establishing a pattern of substituting recitation for analysis by subsequent courts.

[9]One is reminded of Aesop's fable of the grasshopper and the ant.

opponents. The courts remained steadfastly unwilling to permit the tortfeasor to avoid paying reparation to the plaintiff on the ground that plaintiff had already recovered for the injuries.

Not long after the rule was first articulated, the courts applied it to bar evidence of gratuitous services rendered to the plaintiff.[10] This development is noteworthy because in such cases the justification that plaintiff's foresight and preparedness in dealing with contingencies that might place a burden on the plaintiff's fiscal fortunes was unavailable. That the rule was nevertheless applied to such situations demonstrates just how focused upon assuring that the defendant paid for the wrongful injury the courts were. Having emphasized the accountability of the tortfeasor as the justification for the rule, and having refused to inquire whether a debit upon the financial status of the plaintiff actually existed, the courts' application of the rule of exclusion to gratuitous benefits conferred upon the plaintiff was a simple application of the basic logical construct of the rule, not an extension or modification of it. In the view adopted by the judiciary, the nature of the source of compensation that the plaintiff had received was simply inconsequential to the issue of defendant's accountability for the injury.

This basis for the rule clearly has roots in a philosophy of corrective justice. An important element of a system pursuing the corrective model is retribution for wrongs.[11] If the view is adopted that a primary aim

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[10]City of Indianapolis v. Gaston, 58 Ind. 224, 227 (1877).

[11]In an attempt to lay out the "raison d'etre of the law of tort," Professor Glanville Williams posited "four possible bases of the actions for damages in tort," which are:

> 1. Appeasement "By this means the victim is induced to 'let off steam' within the law rather than outside it."
>
> 2. Justice "Two variants of this theory may be perceived: (1) The first places emphasis upon the fact that the payment of compensation is an evil for the offender, and declares that justice requires that he should suffer this evil. This is the principle of ethical retribution, . . . (2) The second variant looks at the same situation from the point of view of the victim; it emphasizes the fact that the payment of compensation is a benefit to the victim of the wrong, and declares that justice requires that he should receive this compensation. We may call this ethical compensation."
>
> 3. Deterrence "Ranged against the theory of tort as part of the moral order are those who believe that it is merely a regime of prevention. The action in tort is a 'judicial parable,' designed to control the future conduct of the community in general."
>
> 4. Compensation ". . . according to which one who has caused injury to another must make good the damage whether he was at fault or not. This is the same as the theory of ethical compensation except that it does not require culpability on the part of the defendant."

Williams, *The Aims of the Law of Tort*, 4 Current Legal Probs. 137, 140-53 (1951).

These concepts are elements of a corrective theory of justice and form part of the backdrop for discussion of the enactment in the context of its satisfaction of the objectives of the torts system in holding actors liable for the consequences of their actions is retribution, to permit a "wrongdoer" to elude accountability where the injured party turns out to have provided coverage for disability (or is the recipient of largess) would be dysfunctional. The system would be deprived of the opportunity to deal with a wrong, to correct the wrongdoer, and in so correcting deter that wrongdoer from further injurious conduct. It would also deny the system's objective of presenting the assessment of accountability as an example to others who would engage in like behavior, thereby impairing the wider deterrence goal of the system. For some courts, this view was so fundamental that to them the conclusion, embodied in the statement of the rule,[12] was obvious and required reference to no other principle.[13]

The early establishment of such a view did not quell the efforts of defendants subject to its effect to try to breach the logic of its foundation, however. Examples of bids to proffer evidence of compensation from collateral sources to reduce defendants' ultimate judgment debt are prevalent in the case law. For example, in a 1915 case, pointing to an Indiana statute pertaining to railroads, which conferred an insurable interest in lands along rail routes, one defendant railroad claimed that when it destroyed the owner's property, insurance proceeds collected by the owner inured to the defendant's benefit and reduced its liability to the owner's subrogated insurer by the amount paid.[14] The Indiana Su-

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of a system having components derived from such a theory. This is not to suggest that Professor Williams captures all of corrective theory; indeed, scholars have developed sophisticated variations and even (mildly?) disagree on some fundamental ideas. *See generally* Posner, *The Concept of Corrective Justice in Recent Theories of Tort Law*, 10 J. Legal Studies 187 (1981), and authorities cited therein. However, complete explication of those variations and points of departure is beyond the scope of this article.

[12]The judicial treatment accordingly given to such cases became tautological in form: The defendant should not be permitted to reduce liability because it would be improper for wrongdoers to reduce liability. *See, e.g.*, *infra* note 13 (quoted language of the court in Cincinnati R. Co. v. McCullom, 183 Ind. 556 (1915)).

The irreducibility of the principle prevented the courts adhering to it from expressing it any other way. Professor Williams explains: "Those who adopt the doctrine of ethical retribution do not, and cannot, refer it to any other principle. It is a postulate—an ultimate value-judgment which can only be accepted or rejected." Williams, *supra* note 11, at 141.

[13]*E.g.*, Cincinnati R. Co. v. McCullom, 183 Ind. 556, 571 (1915), where the court said: "Under such an instruction [where the defendant had requested that the jury determine damages by crediting defendant with the amounts plaintiff had received from insurance proceeds] pecuniary benefit received by an injured party to which a defendant had not contributed could be used as a defense in mitigation of damages resulting from the wrongful act of such defendant. The impropriety of such an instruction can readily be seen." The court cited no authority.

[14]Pittsburgh, C., C. & St. L. Ry. Co. v. Home Ins. Co., 183 Ind. 355, 362, 108 N.E. 525, 528 (1915).

preme Court, acknowledging the statutory creation of an insurable interest, nevertheless rejected the argument on the ground that the statute gave no rights to the defendant in the insurance contract procured by the land owner and did not affect the "ordinary rule" of exclusion of evidence of collateral sources of compensation.[15] Trying a reverse-twist variation on the theme of interests, a trucker defendant in a case brought nearly forty years later argued that because the plaintiff had received insurance benefits for the injury to his property caused by the defendant, and because the plaintiff had subrogated its rights to the carrier, the plaintiff was no longer the sole party in interest in the action.[16] The strategy was designed to compel the naming of the insurance carrier as a party, enabling the defendant to compel plaintiff to answer interrogatories pertinent to insurance proceeds received. The strategy failed with the theory, however, when the Indiana Supreme Court, reciting the "general rule," held that the defendant had no concern with the transaction between the plaintiff and the insurer, could not be subrogated to the rights of the insured, and was concerned only with having to pay double for the injury. Having obtained an adverse judgment, which when satisfied would "fully release the appellant from further liability to anyone," the defendant's rightful concerns had come to an end, and he would not be permitted to unseat the plaintiff as a party, interrogate the plaintiff, or join the carrier.[17] Eight years earlier, a defendant who had collided with a fire truck and injured the plaintiff argued that because the plaintiff was covered by a hospitalization plan of the city, which was mandated by statute, the city was thereby rendered primarily liable and defendant could not be liable for plaintiff's medical expenses.[18] Relying generally on the rule, the Indiana Court of Appeals refused to adopt the defendant's theory, stating "[w]here the wrongdoer is liable for damages, he is liable for all damages and it is no concern of such wrongdoer who ultimately gets the money."[19]

The language of the courts in resisting such persistent and creative attempts to overcome the rule is consistently couched in fundamental, unqualified terms, which probably explains in large measure the resiliency of the rule to attacks. In *Sherlock v. Alling*,[20] the first Indiana case to decide that a defendant could not offer evidence of the proceeds of insurance[21] to mitigate damages, the Indiana Supreme Court stated:

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[15]*Id.* at 362, 108 N.E. at 528.

[16]Powers v. Ellis, 231 Ind. 273, 108 N.E.2d 132 (1952).

[17]*Id.* at 281, 108 N.E.2d at 136.

[18]Mullins v. Bollinger, 115 Ind. App. 167, 55 N.E.2d 381 (1944).

[19]*Id.* at 171, 55 N.E.2d at 382.

[20]44 Ind. 184 (1873).

[21]The insurance proceeds were from a life insurance policy on plaintiff's decedent. *Id.* at 199.

> To allow such a defence would defeat actions under the law, when the party killed had by his prudence and foresight, made provision or left means for the support of his wife and children, and the wrong-doer would thus be enabled to protect himself against the consequences of his own wrongful act.
> . . . No case has been found recognizing the doctrine claimed, and we are not willing to be the first to sanction it.[22]

By 1893, the courts considered the rule to be "well settled" that the plaintiff could "recover his entire loss from [defendant] without regard to the amount of insurance he may have been paid thereon."[23] The rule remained "settled" everywhere but in the minds of defense counsel until the General Assembly reversed the rule in the 1986 session.

Modern courts have taken to simply quoting the encyclopedic statement of the rule, as was done in *Evans v. Breeden*:[24]

> 'Compensation for the loss received by plaintiff from a collateral source, independent of the wrongdoer, as from insurance, cannot be set up by the wrongdoer in mitigation of damages.'[25]

On these terms, to reach the opposite conclusion and permit reduction of defendant's judgment debt to plaintiff on the premise that plaintiff's loss has been covered, would require defendants to demonstrate some reason why they should be permitted to ride the beneficial coat-tails of the injured party's transactions. Having had no input into the transactions, and being cast as a "wrongdoer," the typical defendant is unable to make such a showing and is thereby counted out with two strikes. A case frequently relied upon is *Ohio and Mississippi Ry. Co. v. Dickerson*,[26] where the Indiana Supreme Court declared, in response to defendant's argument that the damages were excessive because of plaintiff's receipt of full salary after the injury:

> This forms no ground for the reduction of the damages. In such cases, damages are assessed according to uniform principles, and are not to be affected by the mere accidental business relations of the party injured. The liberality of his employer forms no reason why the appellee should not be compensated for the injury he sustained.[27]

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[22] *Id.* at 200.

[23] Lake Erie & W.R. Co. v. Griffin, 8 Ind. App. 47, 50 (1893) (citing Cunningham v. Evansville & Terre Haute R. Co., 102 Ind. 478 (1885)).

[24] 164 Ind. App. 558, 330 N.E.2d 116 (1975).

[25] *Id.* at 561, 330 N.E.2d at 118 (quoting 9 I.L.E., *Damages* § 86 at 253).

[26] 59 Ind. 317 (1877).

[27] *Id.* at 324.

Try as they might, defendants in this state and most others[28] have simply been unable to overcome this view of the rule.

Yet attempts to overcome it have recurred, and in some instances have succeeded in knocking some chinks loose by way of exceptions.[29] If the proposition is so fundamental, that is, if it is based upon an irreducible principle viewed as part of the fabric of our system of justice, one would expect opposition to it to wane, exceptions to be nonexistent, and efforts to overturn it eventually to stop. The fact that these expectations have not been fulfilled in the 115 years since the rule was first judicially pronounced in this country[30] suggests that perhaps the rule is not so fundamental after all; that even though the rule has been *taken* to be fundamental in nature, it may actually be further reducible to more fundamental parts; and that its resiliency is more attributable

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[28]*See generally* C. McCormick, Handbook on the Law of Damages 323 (1935); Averbach, *supra* note 1; Annotation, *Third Party Tortfeasor's Rights to Have Damages Recovered by Employee Reduced by Amount of Employee's Workers' Compensation Benefits*, 43 A.L.R.4th 849 (1986); Annotation, *Validity and Construction of No-fault Insurance Plans Providing for Reduction of Benefits Otherwise Payable by Amounts Receivable From Independent Collateral Source*, 10 A.L.R.4th 996 (1981); Annotation, *Collateral Source Rule: Injured Person's Hospitalization or Medical Insurance as Affecting Damages Recoverable*, 77 A.L.R.3d 415 (1977); Annotation, *Admissibility of Evidence That Injured Plaintiff Received Benefits from Collateral Source, on Issue of Malingering or Motivation to Extend Period of Disability*, 47 A.L.R.3d 234 (1973); Annotation, *Right of Tortfeasor or Liability Insurer to Credit for Amounts Already Disbursed to Injured Party Under Medical Payments or Funeral Expense Clause in Liability Policy*, 11 A.L.R.3d 1115 (1967); Annotation, *Collateral Source Rule: Right of Tortfeasor to Mitigate Opponent's Damages for Loss of Earning Capacity by Showing That His Compensation, Notwithstanding Disability, Has Been Paid By His Employer*, 7 A.L.R.3d 516 (1966); Annotation, *Collateral Source Rule: Injured Person's Receipt of Statutory Disability Unemployment Benefits as Affecting Recovery Against Tortfeasor*, 4 A.L.R.3d 535 (1965); Annotation, *Application of the Collateral Source Rule in Actions Under the Federal Tort Claims Act*, 12 A.L.R.3d 1245 (1962).

[29]*E.g.*, Jackson v. Beard, 146 Ind. App. 382, 398, 255 N.E.2d 837, 847 (1970) (admitted evidence of receipt of social security benefits on the grounds that plaintiff waived the collateral source rule by opening up testimony with respect to reduced income); *accord* Cox v. Winklepleck, 149 Ind. App. 319, 271 N.E.2d 737 (1971) (evidence through plaintiff's testimony of sick leave and vacation, failure to object to instructions, if given, relating to such compensation, failure to argue application of the rule in brief on appeal, constituted waiver). Some states have permitted an exception to the rule for the purpose of establishing that the plaintiff is a malingerer. *See* Hogan, *supra* note 1, at 58-59. *Contra* Eichel v. New York Central R. Co., 375 U.S. 253, 254-55 (1963). No case in Indiana has directly ruled on the matter, but in dictum the court in *Cox*, 149 Ind. App. 319, 271 N.E.2d 731, stated that the jury could properly consider whether the period of time that the plaintiff was off work was the "proximate result" of the defendant's tortious conduct. *Id.* at 322, 271 N.E.2d at 739.

[30]Harding v. Townshend, 43 Vt. 536, 538 (1871) has been said to be the first case where the rule was using the term "collateral." Averbach, *supra* note 1, at 233; *see also* Esdaile, *supra* note 1. The Propeller Monticello v. Mollison, 58 U.S. (17 How.) 152 (1854) is claimed to be the first case where the doctrine was applied. Maxwell, *supra* note 1, at 671.

to the courts' attitudes about it as well as a general resistance of a system based upon stare decisis to examine its commitment to pronounced rules. This further suggests that other principles of at least equal value have continued to underlie attempts to strike the rule from the system, and that while the assertions of these competing principles have fallen on judicial ears deafened by stare decisis, the legislature has listened to proponents of the competing principles.

Correcting the defendant is not the only aim of the common law torts system, however. The system also purports to correct the wrong by making the injured plaintiff whole, at least so far as monetary compensation will allow. This aspect has been, to date, the focus of defense-oriented attempts to overturn the rule. Reduced to their essence, the arguments have been that because the plaintiff has already received some compensation for the injury, the need to make the injury whole through torts compensation no longer exists, and defendant ought to be excused from accountability through that system. By placing the arguments on this foundation, the opponents of the rule have anchored themselves to an equally fundamental principle from which to gather the strength of conviction to reiterate their pleas for reform.

So cast, the competing arguments have placed the corrective system of justice in a position of internal conflict. To emphasize the retributive aim of the system and deny the mitigation is to ignore the possibility that the compensatory function will be duplicated. To recognize the duplication and allow the "wrongdoer" to escape liability through mitigation is to ignore the retributive and deterrent functions. The tensions created by this conflict have produced some stultification of policy in some instances, and judicial ground-shifting in others, as courts attempt to answer the repeated challenges. The next section of this Article will examine the criticisms of the rule and responses to those criticisms, with a view toward identifying the alternative justifications developed in support of the rule.

III. Criticisms of the Rule

The earliest attempts to allow collateral sources to be considered in mitigation were grounded in good measure upon considerations of fairness. Defendants argued that to permit the plaintiff to benefit from a judgment that did not take into account the fact that the injury had already been compensated would permit a double recovery. Some judicial responses to that argument were as much bottomed upon the retributive function of the torts system and the moral position which refused to aid a tortfeasor as were the seminal statements of the rule itself: If a windfall is to result, better that the windfall be enjoyed by the innocent injured party than by a wrongdoer.[31]

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[31]No reported Indiana case has addressed this argument. For an example of a judicial

Critics of the rule have questioned the core idea of this proposition by suggesting that it may not be true in all cases that the plaintiff is the better recipient of the windfall. An inquiry into the bases of liability is central to this position, because in one form it is a direct attack upon the assumption that the tortfeasor is a "wrongdoer." Where the tortfeasor is subject to liability on a theory of strict liability, the status of the parties relative to the issue of fault is roughly equal. Thus in this application of the rule, the justification that it advances the retributive function of tort law is unavailable.[32] Making this observation, the critics have maintained that there is no indication that refusals to mitigate have been "sensitive to varying degrees of moral fault."[33] However, strict liability as a regime of accountability has seen the development of alternative justifications for imposing the burden on the tortfeasor at the outset that more directly address the question of who should bear the loss. Risk allocation, cost spreading, accident prevention, cost-benefit analysis, market forces, and related concepts are elements of the economic theories dominating discussions of accountability for injuries arising out of modern trade and transportation.[34] To the extent that imposition of the collateral source rule permits the allocation of costs in a manner consistent with the objectives and criteria of the regime within which the rule is applied, the rule is justified independent of the traditional notion that an injured party is to be favored over a "wrongdoer." To be certain, the courts no longer have the ability to declare the ruling upon a stark comparison between a *blameworthy* defendant and an *innocent* injured party, but the foundation for the objection to the moral justification will have disappeared as well. If the analysis of cheapest risk-avoider or most efficient cost-bearer has taken place independent of the question of who is to "blame," and has identified the tortfeasor as a proper person to subject to liability under the requirements of strict liability, then to suggest that the plaintiff's insurer ought to bear the cost because defendant is not a "wrongdoer" begs the question. The real issue becomes whether allowing the plaintiff to be compensated

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statement from another jurisdiction, see Grayson v. Williams, 256 F.2d 61, 65 (10th Cir. 1958); Annotation, *Admissibility of Evidence That Injured Plaintiff Received Benefits from Collateral Source, on Issue of Malingering or Motivation to Extend Period of Disability*, 47 A.L.R.3d 234 (1973).

[32]*See Unreason*, *supra* note 1, at 749.

[33]*Id.*

[34]Complete exploration of the economic justifications for and criticisms of the strict liability system of compensation is beyond the scope of this article. *See generally* P. Keeton, D. Dobbs, R. Keeton & D. Owen, Prosser and Keeton on Torts §§ 75, 97, 98 (5th ed. 1984); M. Polinsky, An Introduction to Law and Economics ch. 13 (1983); R. Posner, Economic Analysis of Law §§ 6.5, 6.6 (3d ed. 1986). For a discussion of cost allocation in the context of theories of corrective justice and a proposal for a non-fault based system, see G. Calabresi, The Cost of Accidents (1970).

from two sources is an efficient allocation of resources. Nothing in the critical literature has explored that issue.[35] The legislative abrogation applies to "personal injury" actions and contains no exclusion for actions based upon strict liability. By permitting strictly liable defendants to shift the ultimate allocation of costs to the injured party's insurer, the Act may well have thrown the strict liability system into imbalance.

Even in the context of a fault-based theory of liability, the rule's critics have contested the moral basis for applying the rule. Arguments cast in this mold attack the rule using several premises,[36] but those having the greatest bearing upon Indiana's legislative abrogation are the related notions that no even-handed method of determination of damages exists in the law of torts, and that the method employed is subject to evaluations that are primarily affected by factors other than the tortfeasor's degree of culpability. As expressed in an ambitious student comment in the *Harvard Law Review*, the criticism is that no "norm of damages" for assessing the extent of liability exists, and the variables upon which the size of the judgment debt depends are "the extent of injury, the physical idiosyncracies and earning capacity of the injured person, and . . . the latter's own degree of culpability."[37] So long as the purpose of dispensing justice on an individualized basis remains a vital part of the torts compensation system, it is difficult to envision a mechanism that would not determine compensation according to factors

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[35]*Cf.* R. KEETON & J. O'CONNELL, BASIC PROTECTION FOR THE TRAFFIC VICTIM 278, 400-03 (1965). The authors' proposed no-fault plan provides "reimbursement limited to net loss" to avoid "wasteful overlapping of basic protection and benefits from other sources." The authors acknowledge that the plan "is based on a principle contrary to that underlying the collateral source rule of tort law." Compare the detailed approach of Professors Keeton and O'Connell in limiting reimbursement to net loss with the General Assembly's broad approach.

[36]*See Unreason, supra* note 1, at 749. One premise of such arguments is that "wrongdoers" are treated uniformly under the rule and are not so treated in the larger scheme of tort liability, pointing out that "[e]ven the most flagrant wrongdoer ordinarily is not liable for damages unless harm in fact results from his conduct." *Id.* Even assuming the validity of the statement, it is difficult to grasp its logic in the context of the argument that the rule should not be applied. The assertion seems to be that because the torts system operates so that those whose conduct has caused no harm, even though the conduct is "wrongful," are not subject to liability, those who have wrongfully caused harm should not be subject to liability for compensation to an already compensated plaintiff. So stated, it is susceptible to the interpretation that it means because some "wrongdoers" escape liability, others should too (an argument often heard by state troopers who have stopped speeding motorists). It makes sense only if the elements of "no harm" and "harm already compensated" are equated. Reduced to these terms, the argument becomes one that asks the courts to ignore the retribution function and concentrate on the need for applying the compensation function, something that the courts are bound not to do at common law. This suggests the prime issue of the legislative abrogation, about which see *infra* text accompanying notes 57-61.

[37]*Unreason, supra* note 1, at 749.

that vary with the peculiar make-up of the injured party. If "norms of damages" is translatable to a schedule of amounts recoverable arranged by category of injuries, the criticism seems more a disenchantment with the torts compensation system in general than a revelation of a fallacy of the collateral source rule.

Concern for an assurance of appropriate relationship between compensation and levels of culpability is legitimate. That concern has reshaped the face of the torts compensation system in the more than twenty years since the quoted criticism was written. Lawyers, judges, and juries working in tort cases in nearly every state now do so within the controlling principle of liability apportioned according to fault. With the adoption of a comparative fault system, the business of finding fault with the conduct that has led to the injury is not aimed exclusively in the direction of the named tortfeasor. This is not to say that cases will not still occur where the defendant is the only wrongdoer, but many cases are decided where fault is assessed to both the plaintiff and the defendant, and among those are some where the terms "plaintiff" and "defendant" are meaningful only to the extent of designating who was first to bring a lawsuit. In a system of comparative fault, the concept of culpability has changed significantly from the traditional notions of moral blameworthiness. However, the *degree* of culpability is certainly a focal point of the inquiry into who should bear responsibility, and juries are instructed to reach their verdicts by referring directly to the relative culpability of the parties. That fact alone, of course, does not provide a "norm of damages,"[38] but sensitivity to degrees of fault has been built into the system, and the assessor of fault and damages is charged with the responsibility for apportioning responsibility accordingly. This fundamental change in the system means that at least in some cases, the courts are no longer dealing with a blameless plaintiff, and the underpinnings for the moral assertion that windfalls should not be enjoyed by *the* wrongdoer have eroded away.

IV. A Critique of the Legislative Abrogation

Against this background, an assessment of the legislative abrogation should take into account the effect that proof of collateral benefits would have on the ultimate assignment of responsibility. To the extent

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[38]It is not precisely clear just what is meant by "norm of damages" in this context, but if it means something like a schedule of damages such as applied in the workers' compensation field, the reference for the norm would at any rate be the type of injury and not degrees of culpability. If it means a schedule of damages related to the type of conduct, it would resemble the system of fines and penalties employed in the criminal law. With the difficulty of categorizing the myriad of ways that negligent conduct manifests itself, such a schedule would seem to be infeasible beyond a general sweeping "fine" for conduct failing to satisfy the standard of the ordinary and prudent person.

that proof of collateral benefits will allow an admittedly culpable tort-feasor to escape liability altogether, it would appear to suffer from the same criticism leveled at the rule: it is susceptible to the charge that it remains insensitive to degrees of fault (it would actually run counter to the cardinal principle of the system). To the extent that it becomes operable only with respect to plaintiffs who had received outside payments and permits defendants to offset liability in direct one-to-one proportions, it remains vulnerable to the argument that such proof allows gross, one-sided results which would vary solely upon the idiosyncratic circumstances of the person injured.

However, the enactment does not permit the inclusion of evidence of collateral benefits on a wholesale basis. The legislature has been careful to limit its rule of inclusion by setting out an express list of exceptions. The court must permit offers of:

> (1) proof of collateral source payments, *other than:*
> (A) payments of life insurance or other death benefits;
> (B) insurance benefits for which the plaintiff or members of the plaintiff's family have paid for directly; or
> (C) payments made by the state of Indiana or the United States, or any agency, instrumentality, or subdivision thereof, that have been made before trial to a plaintiff as compensation for the loss or injury for which the action is brought[.][39]

To these exceptions must be added the separate section of the Act which requires the court, if requested, to "instruct the jury that the jury *may not* consider the tax consequences, if any, of its verdict."[40] The exceptions draw a rather tight boundary around the new rule's application, and the required jury instruction[41] even allows some assurance that the jury will not, through surmise, debit the verdict amount by assumed tax savings.

With respect to these exceptions, the common law rule remains in effect, presumably accompanied by all of the problems assigned to it by the critics. Reflective examination of the statute reveals that the new rule is not conceptually revolutionary, and may not even fully discharge the ambitious assertion of purpose that the General Assembly included in the Act.[42] The enactment by its own terms purports to open the door

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[39]IND. CODE § 34-4-36-2(1) (Supp. 1986) (emphasis added).

[40]*Id.* § 34-4-35-1 (emphasis added).

[41]The provision appears to be merely directory, but it states that "the court *shall*, if requested" give the instruction and the content is set out specifically. The instruction will be requested in every case, and the court does not have the usual discretion to refuse it. For further discussion, see *infra* notes 91-93 and accompanying text.

[42]The Act declares in the first section of the new chapter that:

The purpose of this chapter is:

to evidence of collateral source benefits, then promptly closes it to all but third-party purchased accident and hospitalization insurance proceeds, wage maintenance plans (excluding workers' compensation and governmental entitlements), gratuitous services, and gratuitous benefit payments. It seems not to have taken full leave of the important notion in *Sherlock v. Alling*[43] that the defendants ought not to avail themselves of plaintiffs' "prudence and foresight" in providing for future contingencies through insurance. Minimal departure in concept does not mean minimal difference in effect, however. Certainly, given the heavy incidence of third-party purchased accident and hospitalization insurance coverage and sick pay, most cases will be affected by the rule.

Given this adherence to the idea which supplied part of the foundation for the exclusionary common law rule, the statutory rule contains some flaws in language and logic which may present difficulties in application that will require judicial interpretation. The facial resemblance to the underlying concept of the common law rule of exclusion may lead to problems in application in doubtful cases. For example, the Act excepts from its coverage "insurance benefits for which the plaintiff or members of the plaintiff's family have paid for directly,"[44] while it excepts "payments of life insurance or other death benefits"[45] without reference to whether the life insurance benefits were paid for "directly" by the plaintiff or were received gratuitously. Opposition in the critical literature to excluding evidence of life insurance proceeds has been mild at best,[46] on the basis that in forms other than term-type policies, it is not a contract of indemnity transacted for the purpose of covering expenses in connection with a loss; rather, it represents an effort to save and invest part of the family finances; and that the wrongful conduct of the defendant only hastened the day on which the contract obligations of the carrier became due.[47] Without an official legislative history, it

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(1) to enable the trier of fact in a personal injury or wrongful death action to determine the actual amount of the prevailing party's pecuniary loss; and

(2) to provide that a prevailing party not recover more than once from all applicable sources for each item of loss sustained.

Act of March 11, 1986, Pub. L. No. 201-1986, 1986 Ind. Acts 1959.

Considered against the exceptions clauses quoted above, it seems doubtful that the General Assembly has enabled the trier of fact to do much at all in some cases "to determine the actual amount of the prevailing party's pecuniary loss" or to prevent a plaintiff from recovering "more than once from all applicable sources for each item of loss sustained."

[43] 44 Ind. 184 (1873). *See supra* text and quotation accompanying note 22.

[44] Ind. Code § 34-4-36-2(1)(B) (Supp. 1986).

[45] *Id.* § 34-4-36-2(1)(A).

[46] *See* Fleming, *supra* note 1, at 1500; *Unreason*, *supra* note 1, at 750-51.

[47] *See* Fleming, *supra* note 1, at 1500; *Unreason*, *supra* note 1, at 750-51. *See generally* 1 Rhodes, Couch on Insurance 2d §§ 1:18, 1:30, 1:51, 1:60, 1:62, 1:72, 1:73, 1:74, 1:75 (1984).

cannot be known what persuaded the General Assembly to maintain the exclusionary rule with respect to such policies, but clearly the type of insurance is important in the legislative scheme. However, given the thrust of the Act, it seems incongruous generally to exclude life insurance of all types, stemming from all sources. Because the legislature has chosen to categorize insurance benefits by type and then, with respect to the general category of "insurance," further categorize on the basis of who paid for it, the sweeping treatment of life insurance is inconsistent and puzzling. Avoidance of complexity seems a weak explanation in light of the General Assembly's willingness to create the complexity of categories in the first instance.

Complexity cannot be avoided in any case where the gratuitously conferred policy has come from a family member. Section 2(3) of the Act permits "proof of the cost to the plaintiff or to members of the plaintiff's family of collateral benefits received by the plaintiff or the plaintiff's family."[48] The Act does not say that life insurance benefits *are not* collateral benefits. It acknowledges that they *are* collateral benefits but renders them exceptional by the use of the words "other than" in the operative clause.[49] Exclusion of the benefits with inclusion of the costs where a family member has purchased the policy is bound to lead to confusion.

The unfortunate choice of language in the two subsections has provided fertile ground for contention in the context of gratuitously conferred policies. A party might argue that even though life insurance is involved, the evidence of benefits received from the policy should nevertheless be admitted on the grounds that plaintiff has not paid for the benefits "directly" and subsection 1(B) thereby controls. Giving credence to the purpose clause, which emphasizes the actual pecuniary losses of the plaintiff and states the objective of a single recovery, no apparent reason exists for excluding evidence of life insurance benefits generally. Plaintiffs who have "indirectly" purchased life insurance benefits through employment plans or other means that satisfy the unstated "indirect" concept will have recovered for the pecuniary losses that concerned the legislature. Likewise, it is not clear, upon analysis, why those who have purchased term life policies should not be required to try to convince the trier of fact that the proceeds were not purchased as a hedge against accidental losses rather than as an investment strategy utilizing family finances. Perhaps the exclusion represents a sympathetic recognition that since life insurance proceeds are the bone of contention, loss of life will have occurred, and the survivors should be spared the humility of arguing over who should be credited with the assigned monetary value of the life of the decreased. Only the legislators know.

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[48] IND. CODE § 34-4-36-2(3) (Supp. 1986).

[49] *Id.* § 34-4-36-2(1).

The argument might be resolved by observing that the first subsection, 1(A), does not contain the word "or" following the semicolon ending the clause. If the legislature intended the omission, it might mean that the two clauses are not alternatives but are disjunctive and the first clause stands alone without modification or supersession by the other. However, drafting conventions indicate that when the disjunctive is intended, use of the word "or" is recommended.[50] Grammatical and typographical omissions and errors are not so rare in legislative codes, however, that a court can be sanguine about an interpretation that assumes an intentional omission, especially one that runs counter to drafting conventions. Interpretation of the effect of a statute on the basis of what is *not* present in the legislative language is tricky business, and opens the door to some rather sweeping arguments.

A court would have similar difficulty trying to interpret the statute adhering to the principle that a more specific statutory statement governs a general statement. If the type of insurance mentioned in the two clauses is the basis for comparison, the first clause is more specific by virtue of the inclusion of the modifier "life" to operate on "insurance." On the other hand, if the manner of purchase is the comparison, the phrase "for which the plaintiff or members of the plaintiff's family have paid for directly," makes the second clause more specific. Additionally, the third subsection, 1(C), seems even more specific than the previous two, because it appears that if the state or federal government is the source of the funds, it does not matter whether the funds could be characterized as from life insurance or otherwise, or whether the plaintiff purchased the benefits directly or otherwise. It might be argued on the strength of this observation that the three clauses are set out in ascending order of specificity. Again, without an official history, the courts are left to conjecture and surmise. The legislature could have been more cognizant of drafting conventions and stated clearly and affirmatively what evidence should be included. Interpreters should not be left to an analysis of a

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[50]*See* R. Dickerson, The Fundamentals of Legal Drafting 76-78 (1965). *E.g.*, Council of the District of Columbia, Legislative Drafting Manual 63 (Rev. ed. 1982).

[51]*E.g.*, Commonwealth v. Kelly, 177 Mass. 221, 58 N.E. 691 (1900). The court held that innkeepers could not sell intoxicating liquor to guests after 11 P.M. on the strength of a comma, which was included in the first publication of the statute in question, but was dropped in favor of a semicolon in later printings, and potential fortunes were lost. *See also Ex parte* John Hill, 172 Eng Rep. 397 (1827). The absence of the word "bull" in an enumeration which made it a crime to mistreat "any horse, mare, gelding, mule, ass, ox, cow, heifer, steer, sheep, or other cattle" rendered the enactment inapplicable to bull-baiting against the interpretive device employed by the judges, which excludes from the general words items of higher rank than the words enumerated. Thus the "sport" of bull-baiting was legally the attribution of many made and lost fortunes in merrye olde England.

series of exceptions to determine what limited types of benefits remain affected by the rule of inclusion. Legal lore and folklore contains stories about how fortunes were made and lost on the basis of the presence or absence of a word or a punctuation mark.[51] The point of the stories is always that precision of language is important in the law, but they also provoke negative reactions from those who think that the substance of the law, not its form, should control decisions. Indiana courts should not have been placed in the difficult position of determining accountability upon such a technical point by such an easily curable grammatical structure.

More generally, the exception for "directly" purchased benefits is curious and fraught with problems. In a hospitalization plan to which employer and employee both contribute, an issue is bound to arise in litigation whether evidence of benefits is to be included or excluded. Counsel handling such cases should be prepared to present arguments pro and con on the question of whether the trier of fact should divide the proceeds in proportion to the relative amounts paid by the parties to the employment contract and credit the defendant with only the amount "paid for" by employer contributions.

If the legislature intended to inject such complications into the trial of damages, it is a fair question whether it carefully considered the added administrative costs. The potential for confusion will be so great in some cases that the inquiry to determine the "actual amount of the party's pecuniary losses"[52] will come at greater administrative costs than the legislature may have contemplated. In light of the inconsistency with which the legislature has treated the criterion of actual pecuniary loss as a truly primary consideration in the two subsections, it is doubtful that it intended trials to delve so deeply into such a determination. Evidence that the legislature was motivated to avoid complications in the evaluation of damages is contained in another part of the enactment itself. In section 2 of the Act, the General Assembly declared: "In a tort action for personal injuries tried by a jury, the court shall, if requested, instruct the jury that the jury may not consider the tax consequences, if any, of its verdict."[53]

The Internal Revenue Code of 1954, section 104(a)(2) excludes from gross income "the amount of any damages received . . . on account of personal injuries or sickness."[54] In effect, the section produces the possibility that a person recovering for lost or impaired earnings will receive a net amount greater than if no injury had occurred, because plaintiff is entitled to receive the full amount of the damages without

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[52]IND. CODE § 34-4-36-1(1) (Supp. 1986).
[53]*Id.* § 34-4-35-1.
[54]26 U.S.C.A. 104 (a)(2) (1984).

the tax reduction that would occur if the same amount had been received as ordinary taxable income. If a jury were to take section 104(a)(2) into account and try to adjust the verdict to reflect the tax savings, it would be required to perform computations using estimates or evidence of the plaintiff's tax rate, which could get quite complicated. Furthermore, even though the amount of the verdict is not taxable, the *interest* generated by investments of the monies generated by the damages award *is* taxable, adding another layer of complication. Courts have, in general, refused to permit the jury to consider such evidence, some on the basis of the collateral source rule, and others simply because they were skeptical about juries' ability to make the adjustments.[55] If the jury instruction section of the Act is viewed as contrary to the general thrust of the Act's rule of inclusion, it represents strong evidence that the General Assembly preferred that the common law rule of exclusion remain intact where the inclusion of collateral benefit evidence would compel a complicated set of computations in order to adjust the verdict to reflect those benefits.

Furthermore, the significance of "direct" in the analysis of the transaction giving rise to the entitlement to benefits presents a potentially troublesome issue. An employee who has settled for a lower wage or salary in return for employer-paid accident and hospitalization insurance or wage maintenance is likely to assert with legitimate conviction that contributions have been directly made to the provision of the protection plans. The statute has made such arguments by plaintiff's counsel possible by virtue of the subsection permitting evidence of "proof of the cost to the plaintiff or to members of the plaintiff's family of collateral benefits received by the plaintiff or the plaintiff's family."[56]

No limitation on "direct" versus "indirect" cost is mentioned in the subsection. It is apparent from the inclusion of evidence of cost that the jury is to consider that evidence in some way in rendering its verdict for damages. Nothing in the statute explicitly says what *effect* that evidence is to have. It makes sense to assume that the section authorizes the jury to deduct the plaintiff's costs from the collateral benefits before deducting those benefits from the defendant's liability. That is not the only plausible interpretation of the clause, however. It may also be interpreted to mean that the jury should consider the existence of costs ("direct" or "indirect") to the plaintiff as determinative of whether the benefits should be deducted from the damages award at all. By pointing out the exclusion of evidence accomplished by the statute's first two exceptions, a bona fide argument could be offered that the legislature's

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[55]*See Unreason, supra* note 1, at 747 (citing Highshew v. Kushto, 235 Ind. 505, 134 N.E.2d 555 (1956), and other cases). *Contra* Norfolk & Western Ry. Co. v. Liepelt, 444 U.S. 490 (1980).

[56]Ind. Code § 34-4-36-2(3) (Supp. 1986).

choice of peculiar language has left it open to jury discretion whether to permit defendants to enjoy the beneficial effect of plaintiff's financial arrangements. The rule, after all, is only a rule of evidentiary inclusion. It does not dictate what conclusions the trier of fact must draw from that evidence. In a proper case, the jury, having found that the plaintiff has incurred costs for the benefits, might well decide to refuse to offset the damages by the amount of the benefits.

It might be counter-argued with some force that such an interpretation would place subsection 2(3) in conflict with subsection 2(1)(B), on the grounds that 2(1)(B) would be nullified if 2(3) were given such effect. However, the arguments cannot be settled on the face of the statute, and courts presented with such issues will have to decipher the language. Without a single definitive interpretation, the potential for inconsistency among courts is real, and a controlling pronouncement from the supreme court could be several years in coming.

Courts charged with the task of making some sense of the language might well be disposed to avoiding an interpretation that draws two parts into conflict, but if the legislature's basic design is the source of the conflict, the courts are limited in what they can do. The courts might be able to save a statute from minor errors of construction, but they should not be expected to repair major design flaws. When it is recalled that in addition to the difficulty between these two clauses, subsections 2(1)(A) and 2(1)(B) also contain conflicting terms and that interpretation is needed to apply them consistently, the statute's design becomes suspect.

Determining the principles of design that govern the statute is difficult because, as demonstrated, so much of the enactment is internally inconsistent. One thing is certain: in permitting a defendant to escape accountability completely, solely on the basis that the plaintiff's collateral benefits are large enough to have covered the "pecuniary losses," the legislature has eradicated the retributive and deterrent functions of the torts system, important justifications for the common law rule. Degrees of culpability are of no consequence; the effect can be the same whether the defendant is a mere bumbler or an intentional wrongdoer. Emphasis has now been shifted to the compensatory function, but only in a limited sense. The legislature has concentrated on the *need* for compensation, and has attempted to swing the balance of concern in the torts system in that direction. New emphasis does not necessarily mean expansive refinement, however. In concentrating the pursuits of the system upon recovery of "pecuniary losses," the General Assembly has allowed a much narrower concept of compensation to become operable than has previously characterized the common law. It goes beyond the mere mechanical difference between the common law rule of exclusion and the legislative rule of inclusion. The triers of fact and law are now to evaluate cases by concentrating upon and giving primacy to the "actual amount of . . . pecuniary losses''[57] proven by the complaining party, and to assure that no more than one compensation is made, ''from all applicable sources.''[58] In so doing, if it turns out that a proven wrongdoer escapes an obligation to pay for the wrong, then so be it; that effect is among the costs of seeing to it that the injured party gets no more than is due. This shift in emphasis clearly reflects the legislative preference for a torts system in which distributive theories of justice dominate corrective theories. This is not to say that corrective justice has been discarded, since ''correction'' includes compensation for the injury as well as retribution, and the enactment certainly allows for both in a proper case.[59] The compensatory correction is based upon an assessment of the injured party's need, and establishing need becomes a threshold for determining whether the system will seek payment of retribution as a source of the compensation. In a general sense, this has always been true in the common law.[60] But now, the determination of need is confined by a pecuniary concept of loss or detriment, in contrast to the more abstract notion of loss or detriment in the common law, which would include not only those injuries evidenced by pecuniary harm, but also harms not directly translatable into pecuniary terms.[61]

This distinction between a requirement of concrete, limited-means establishment of need on the one hand, and a broader, more abstract and flexible means of assessing the appropriateness of compensation is important in understanding the thrust of the statute and evaluating its possible repercussions in the torts system. By focusing upon the compensatory side of the corrective justice equation using a pecuniary loss concept as the lens by which to ascertain ''need,'' the legislature may have given short shrift to both distributive and corrective functions even though it has expressed objectives grounded in distributive theory.

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[57]*Id.* § 34-4-36-1(1).

[58]*Id.* § 34-4-36-1(2).

[59]A ''proper case'' in this sense would be one where no collateral source benefits were received by the plaintiff or one in which collateral sources that were received fell within one of the statutorily excepted categories.

[60]It has been true at least in negligence law, which requires the plaintiff to establish a prima facie case by proving actual damages.

[61]This idea can be illustrated by the concept of ''general'' versus ''special'' damages in tort law. ''General'' damages are those damages recoverable for injuries expected or assumed to have resulted from the invasion of the defendant, and which are viewed as so usually accompanying the invasion that some courts do not require that they be specifically pleaded and proved. Pain and suffering, humiliation, fear, fright, and anxiety are usually counted among the harms for which ''general'' damages are recoverable. ''Special'' damages, on the other hand, are assessed for ''natural'' consequences of the conduct, but are not expected or assumed in the same sense of inevitability as those in the category of ''general'' damages, and hence must be specially pleaded and proved. *See generally* C. McCormick, *supra* note 28, at 32-39, 315-19.

A full description of the distributive theories of justice is beyond the scope of this Article. For this analysis it should be sufficient only to point out some elements in simplified form and their bearing upon this enactment. First, concerns of justice from a perspective of distributive principles are usually addressed on the "higher" order of things and people. The orientation is to matters social in scale: the rights, entitlements, powers, duties, and obligations of groups of society *qua* segments of that society in interaction. First principles, designed to order the interaction between groups and ensure that each operates at a level of benefits and burdens that is fair to all, guide the choice among alternative courses of action and establishment of relationships.[62] Those principles also establish the basic framework of institutions designed to maintain and adjust the apportionment and dispersal of social resources and provide the criteria for evaluating their work.[63] The "share" appropriate to each group is determined by reference to the particular content of the first principles, and so it follows that the "justness" of allocation can be ascertained by how closely it adheres to the principle of entitlement, not necessarily to the relative sizes of the shares. Because the content of the first principles varies across models, the "justness" of entitlement may be determined by whether (to present some examples): it tends to maximize the net of gains over losses in a utilitarian system; it is equal to the entitlements of others in an egalitarian system; it represents what society has chosen through some rational process of collective decisionmaking in, for example, a majoritarian democratic system; or it represents an accumulation brought about by conscientious effort in a system based upon moral desert.[64] Beyond this, distributive principles and the various theories for distributive justice are not generally concerned, so that what is actually produced as a result in a particular case is not generally addressed.[65] Further refinement of assessment within the respective systems is possible by examining what "losses" are to be measured against what "gains;" what counts as "equal" and how is it measured; who is entitled to vote or otherwise participate in the mechanism for collective choice; and what intermixture of effort and accumulated resources is "natural" or "moral."[66] But confined to the level

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[62]*See generally* J. RAWLS, A THEORY OF JUSTICE 4, 7, 84-85 (1971); Hoffman & Spitzer, *Entitlements, Rights and Fairness: An Experimental Examination of Subjects' Concepts of Distributive Justice*, 14 J. LEGAL STUD. 259, 262-67 (1985); Sadurski, *Social Justice and Legal Justice*, 3 LAW & PHIL. 329, 330-31, 334 (1984).

[63]J. RAWLS, *supra* note 62, at 274-80.

[64]*Id.* at 22-33, 221-34, 312-15; Hoffman & Spitzer, *supra* note 62, at 262-66.

[65]*See* Franaszek, *Justice and the Reduction of Litigation Cost: A Different Perspective*, 37 RUTGERS L. REV. 337, 350-60 (1985).

[66]J. RAWLS, *supra* note 62, at 22-33, 221-34, 312-15; Hoffman & Spitzer, *supra* note 62, at 262-66.

of distributive principles, any debate between competing theories can proceed no further than these issues and cannot address the matter of what is a just resolution of a controversy between individuals.[67] Thus, in a distributive system governed solely by the principle of "first-come-first-served," for example, the competing theories for distributive justice could come to different conclusions on the question of whether the system was "good" or "just," as measured by the doctrine of each theory, and so judge the result at that level.[68] But within a system that ratifies the "first-come-first-served" principle, the controversy between the late-comer who was shut out by the first-comer who takes all of the offered resources cannot be resolved in the context of the dominant distributive theory. That debate must take place in the context of corrective principles, which provide the justification for nonconsensual transfers to adjust maldistribution. The corrective principles may limit the distributive principle within certain circumstances that prevail between individuals. So, for example, the "first-come-first-served" principle could still operate in a system that included a corrective principle of allowing a late-comer to compel the transfer of the proceeds of the race upon a showing that the putative first-comer was not "really" first, or was "first" only because of some culpable behavior during the race. Pressed against this elementary, and perhaps oversimplified, framework of analysis, the Indiana statute contains features that are difficult to integrate into the common law of torts.

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[67]Professor Glanville Williams illustrated the problem in the context of his discussion of the deterrence function:

> Lundstedt denies that there is necessarily a moral basis for the law of tort, even where liability is confined to cases of *culpa*. He seeks to prove this denial by an example. 'Through the negligence of a poor man a millionaire has suffered damage estimated at £500. Surely it would not be in accordance with the sentiment of justice that the poor man should eventually be forced to beg for his living in order that the millionaire might obtain his "satisfaction"?' In Lundstedt's opinion, not only is such a transfer unjust; it is, if regarded in isolation, socially undesirable. Only by taking a broad view can we discover it to be for the public good to maintain, without exception, a rule whereby damage ought regularly to be so transferred.

Williams, *supra* note 11, at 145.

[68]That is, a utilitarian would say that the principle and hence the system is just to the extent that it maximizes social utility, and the resulting distribution to a single individual would be irrelevant. An egalitarian would maintain that the principle (thereby the system) is unjust because it permits an unequal distribution, and the resulting distribution to a single individual demonstrates the injustice. A social choice theorist would say that so long as society rationally has chosen the principle to govern (perhaps on the basis that it "knew" such results were possible), the result is what society wanted and is therefore just, and so on.

The statute purports to establish the distributive principle of entitlement to compensation upon demonstration of need to repair a pecuniary loss. It purports to correct maldistribution (the burdens of personal injury) by requiring compensation, but from only one source among all "applicable sources." The definite shift in emphasis from corrective retributive and deterrent functions to distributive and corrective compensation functions will be difficult to harmonize with the established common law of torts.[69] For example, as demonstrated above,[70] the statement of the distributive principle does not help the triers of law and fact to ascertain "applicable sources" in doubtful cases, because the corpus of the Act in large part contradicts the principle.

From the perspective of distributive theories of justice on the "higher" order of coordination of lives and fortunes, the Act is not likely to bring about drastic change, because decisions about whether to insure oneself from accident or liability or both are affected more directly by other social and psychological forces. Likewise, persons will be no more able to predict whether they will hurt or be hurt by someone with insurance after the Act than they were before its enactment. But once the law of "personal injury actions" contained in the statute is invoked by those who appeal to the justice system to reorder their lives, the culmination of the corrective process as modified by the Act is bound to affect the view of those subject to it. As cognizance of the statute's inconsistent treatment of "direct" and "indirect" benefits grows, for

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[69]For the remainder of the article, the discussion will evaluate the statute using John Rawls' "fundamental social problems" of "coordination, efficiency, and stability" as the criteria. Rawls expressed his ideas in this way:

> Some measure of agreement in conceptions of justice is, however, not the only prerequisite for a viable human community. There are other fundamental social problems, in particular those of coordination, efficiency, and stability. Thus the plans of individuals need to be fitted together so that their activities are compatible with one another and they can all be carried through without anyone's legitimate expectations being severely disappointed. Moreover, the execution of these plans should lead to the achievement of social ends in ways that are efficient and consistent with justice. And finally, the scheme of social cooperation must be stable; it must be more or less regularly complied with and its basic rules willingly acted upon; and when infractions occur, stabilizing forces should exist that prevent further violations and tend to restore the arrangement.

J. Rawls, *supra* note 62, at 6.

In some respects the critique will directly apply Rawls' criteria and in the same context as he expressed them. In others, the critique will be more general; for example, with respect to coordination, Rawls speaks of the problem of *individual* plans fitting together. Here the problem of coordination will also be addressed as one of fitting the legislative declaration of "personal injury law" into the established common law of torts, which also involves the matter of coordinating the sometimes conflicting institutional powers of the legislature and the courts.

[70]*See supra* notes 44-61 and accompanying text.

example, and members of society assess the justice they and others have received against the distributive principle declared in the Act, some disappointment and disenchantment with the system will likely result. To the extent that the retributive and deterrent functions of the common law corrective theory of justice are ingrained in social attitudes about the litigation system for redressing tortious conduct, the statute will significantly change that system. Persons who seek corrective justice through the torts system must establish their claims by reference to concepts of fault. Many who successfully meet the requirements of a prima facie case will nevertheless see tortfeasors at every level of blameworthiness escape liability. When it is explained that the law dictated such a result *because* of the insurance planning of the injured party, some are apt to wonder if the principle of liability apportioned by "fault" is meaningful at all.[71]

The distributive principle declared by the Act is that one should be compensated based on need, which is determined by whether the person seeking compensation has received payment from one of the sources not excepted by the Act. The necessary corollary to that principle is a mirror image of another distributive principle, which maintains that one is entitled to benefits on the justification of conscientious effort and expenditure of one's resources. That is, under the Act, the defendant becomes entitled to benefit from someone else's planning and expenditure when he produces injury through conduct that society has otherwise deemed culpable. The potential for a system employing such a principle to satisfy those who believe the torts system is *also* for the purpose of correcting faulty conduct is minimal. It is likely to produce pressures for redistribution to permit injured parties to participate in the insurance planning of defendants on the grounds of an amalgam of principles of equalization and moral desert. The argument is likely to take this form: If defendant is able to participate in plaintiff's transactions on the basis of an assessment of need for corrective compensation, so too should the plaintiff be entitled to participate in defendant's insurance planning on the basis of an assessment of a need for corrective retribution and deterrence, and the balance should be struck by equalizing the competing claims. That could be done by allowing *partial* participation by both. Plaintiff would not receive full compensation because he would not deserve double recovery. Defendant would not be able fully to escape

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[71]To the extent that the enactment succeeds in transferring the burden of the cost of accidents to accident and health insurers, the effect will have been to move the torts compensatory system into a "no-fault" regime without modifying the substantive law requiring a showing of fault or other refinements. *See generally* G. Calabresi, *supra* note 34; R. Keeton & J. O'Connell, *supra* note 35.

liability because he would deserve to pay some retribution and feel some effects of a deterrent sanction.[72]

Objection to the views just articulated is bound to arise on grounds of efficiency—yet another criterion for evaluating the system of justice. That objection, stemming from the distributive principle of the Act, would maintain that if a plaintiff were able to obtain more than the pecuniary value of the injury, the system would be requiring a corrective transfer of wealth from the defendant to the plaintiff where no correction was necessary. To the extent that the plaintiff would be getting more than the cost of the transaction contemplated, the argument proceeds, the system would be inefficient.

These efficiency arguments would bear a close relationship to the objections raised in the critical literature against the common law rule of exclusion and the responses to those objections. In that debate, the assertion has been that double recovery amounts to a windfall, and that plaintiffs are no more entitled to windfalls than defendants. The criticism was offered in the form of an argument grounded in concepts of moral desert, not so much as a challenge to the common law's moral assertion that blameworthy defendants deserve to pay, but that plaintiffs may not always deserve to get a windfall.[73] In a clash of moral claims, some tension is created that produces an impetus to identify a neutral principle with which to resolve the conflict. Here the assertion would be that who deserves the windfall can be decided by reference to the distributive principle that reflects society's desire to be efficient in allocations and transfers of pecuniary resources. The argument would continue that if the aim of the compensation function is to redress injury by putting the injured party back in the position enjoyed prior to the injury, and the best way to do that is to compel a transfer of defendant's assets to cover the plaintiff's pecuniary loss, a transfer greater in amount than the loss would be dysfunctional and inefficient.

The responses to the critics' challenge to the moral justification for applying the rule may be apt, even in the absence of a moral contrast between "wrongdoer" and injured party. In response to the assertion that the plaintiff may not be more entitled to a windfall than the

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[72]The justification for this result is grounded on both the distributive principle that one should receive no more than a fair share, and the corrective principle that involuntary transfers of wealth are necessary when one has injured another through culpable conduct. Neither principle is fully satisfied, but to the extent that full satisfaction of one means no satisfaction of the other, the two are in conflict and cannot coexist. The three possible alternatives in such situations are: (1) one principle is discarded in favor of the other; (2) the two alternate in applicability; or (3) a new principle synthesizing the two originals is developed. The result of this solution is an example of the exercise of the third option and maintains essential relationship to both competing principles.

[73]*See* Peckinpaugh, *supra* note 1, at 550-51; *Unreason*, *supra* note 1, at 748-49.

defendant, the proponents of the basic rule have challenged the assumed truth of the assertion that plaintiff would receive a double recovery. Such responses take two forms: (a) a general recognition that contracts of insurance sometimes permit the insurer to be subrogated to the rights of the insured and entitle the insurer to reimbursement from the proceeds of the judgment; (b) a counter-assertion that the compensation received is frequently not "full."[74] This latter approach, in turn, branches to mean: (1) that accident insurance is not perfect, and some items of injury are usually not covered by the insurance policy, such as expenses governed by deductibles clauses, or pain and suffering; and (2) that other detriments to the plaintiff arose by virtue of having to resort to litigation to obtain recompense from the tortfeasor, such as time, trouble and aggravation, or attorney's fees, which traditionally are not compensable items in tort damages.[75]

With respect to the justification for the common law rule that plaintiffs are often required to repay insurance carriers from the proceeds of judgments, the General Assembly has responded to concern about the effect of the new rule of inclusion. The Act specifically makes admissible "proof of the amount of money that the plaintiff is required to repay, including workmen's compensation benefits, as a result of the collateral benefits received; . . ."[76]

Because the Act's purpose clauses establish pecuniary loss and a single recovery as the primary considerations for evaluating personal injury claims, admission of evidence of subrogation rights is clearly consistent with the distributive and corrective principles of the legislative declaration.[77] The jury may thereby take into account the fact that the

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[74]*See Unreason*, *supra* note 1, at 750, where the author discusses the argument posed here. The argument is treated as a general justification for the rule rather than as a counter-assertion to opponents of the rule. *See also* McWeeney v. New York, N.H. & H.R.R., 282 F.2d 34, 37-39 (2d Cir. 1960), *cert. denied*, 364 U.S. 870 (1960); Hudson v. Lazarus, 217 F.2d 344, 346 (D.C. Cir. 1954), *cert. denied*, 350 U.S. 856 (1954); 2 V. Harper & F. James, The Law of Torts § 25.22 (1956).

[75]*See* Fleming, *supra* note 1, at 1499; Lambert, *supra* note 1, at 542.

[76]Ind. Code § 34-4-36-2(2) (Supp. 1986).

[77]The Act also appears to adjust subrogation rights to more nearly reflect the jury's assessment of the pecuniary losses in the case. The first section of the Act provides:

> In any action tried under this chapter, any subrogation or lien for collateral benefits received by the prevailing party shall be reduced by the ratio of the lower of the prevailing party's judgment or collected judgment to the amount of damages the trier of fact found the prevailing party to have sustained.

Act of March 11, 1986, Pub. L. No. 201-1986, 1986 Ind. Acts 1959 (codified at Ind. Code § 34-4-33-14 (Supp. 1986)).

It might appear that the General Assembly has enacted a duplication of an existing section which already affects subrogation claims, in light of the section of the Comparative Fault Act, Ind. Code § 34-4-33-12 (Supp. 1986), that reduces subrogation claims and liens in the same proportion as the claimant's recovery is diminished, and in some instances the two sections do operate identically.

subrogation rights of the insurer will offset any potential for double recovery by the plaintiff. This places a responsibility upon plaintiff's counsel to present clearly the obligation to repay and request instructions designed to assure that the jury understands the effect of that obligation in producing the net amount of pecuniary loss. Other problems with

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Important differences exist, however, as demonstrated below. The differences seem to indicate an intention to assure that injured parties not at "fault" will not be under-compensated as a result of the operation of the rule of inclusion in conjunction with subrogation rights.

The section is inartfully drafted, but seems to mean that when a plaintiff recovers less than the damages assessed in an action covered by the Comparative Fault Act, the subrogee or lien holder can recover only that amount that is in the same proportion to the original claim as the plaintiff's recovery bears to the assessed damages. That amount is determined mathematically by first finding the quotient of the recovery divided by the damages amount and then multiplying the amount of the original subrogation or lien by that quotient.

To demonstrate the effect of the provision, several illustrations are necessary, each with an increasing amount of complexity. The simplest will deal with the case where injuries are fully covered by insurance: Assume that Plaintiff incurred medical expenses in the amount of $10,000, which were paid by Insurer. Insurer now has a potential subrogation claim in the amount of $10,000. If Plaintiff's damages are assessed at $10,000 and the jury also finds Plaintiff to be at fault by 50%, the verdict will be for $5,000. If Plaintiff recovers the full $5,000, Insurer's claim will be reduced by 50% ($5,000 ÷ $10,000 = .50) to $5,000. In this way, the enactment assures Plaintiff (and the triers of law and fact) that Insurer will not be able to recover more on the subrogation claim than Plaintiff has recovered. This arrangement prevents the possibility that Plaintiff will bear more responsibility for the injury than the jury's apportionment of "fault" would allow.

The more complicated version operates the same way: Again, assume that Plaintiff proved medical expenses of $10,000, which were covered by Insurer's policy, but this time only to the extent of 80%. At that point, Insurer's subrogation rights would total $8,000. Suppose further that the jury, after finding Plaintiff's damages to be $10,000, also found Plaintiff to be 50% at fault, and rendered a verdict for $5,000. If Plaintiff recovers the full $5,000, Insurer's claim is reduced by 50% ($5,000 ÷ $10,000 = .50) to $4,000. In this illustration Plaintiff must bear responsibility for $1,000 of the $2,000 that the injury has cost.

The two previous illustrations have ignored the effect of the legislative rule of inclusion. Here is what happens when Defendant attempts to introduce evidence of Plaintiff's receipt of insurance benefits in the second illustration: Assume that the insurance cost Plaintiff $1,000. If Plaintiff has "directly purchased" the insurance, the receipt of collateral benefits is inadmissible and the jury may not consider them. (Also, Defendant's counsel, being fair, did not first ask Plaintiff if any benefits were received from insurance and then ask how those benefits were purchased.)

If the transaction somehow falls outside the Act's exceptions and amounts to an "indirect" purchase, the importance of the effect of the new rule of inclusion becomes apparent: "damages" are no longer measured by simply using the concepts of "special" and "general" damages, but are a function of the determination of the "pecuniary losses" Plaintiff has suffered. The jury determines damages by offsetting the amount of the expenses by the amount of the benefits, less the cost to Plaintiff for those benefits. In determining Plaintiff's "pecuniary loss," the jury, doing the computation correctly, would start with the $10,000 medical expenses. From that amount it would deduct the $8,000 in collateral benefits. To respect to this aspect of the statute will be discussed below,[78] but so long as the focus is upon avoiding the potential for recovering more than the economic cost of the injury, the Act squarely meets the common law rule's defenders' arguments for retaining the exclusionary effect; any allowance of damages greater than the actual pecuniary loss would represent an economically dysfunctional transfer of resources. Proponents of the equalized partial compensation/retribution approach would be required to justify the transfer on other grounds[79] which overcome this

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the $2,000 remainder it would then add back the $1,000 it cost Plaintiff to get those benefits. Plaintiff's "pecuniary losses" would then total $3,000. The jury would then determine "damages" to be $3,000. If it finds Plaintiff's "fault" to be 50%, the verdict would be in the amount of $1,500. Insurer's lien would then be reduced by 50% ($1,500 ÷ $3,000 = .50) to $4,000. Plaintiff would be required to repay the subrogation claim, if at all, only to the extent of the judgment. A strong argument could be maintained that the subrogee cannot recover anything on the grounds that Plaintiff's recovery has not exceeded his actual losses, and he would therefore not be "unjustly enriched" by retaining the full amount of the proceeds of judgment. On the adjustment of subrogation rights which exceed the amount of judgment, see generally Wilkins, *The Indiana Comparative Fault Act at First (Lingering) Glance*, 17 IND. L. REV. 687, 740-46 (1984).

When Plaintiff is found to be free of "fault," the "ratio of the lower of the prevailing party's judgment or collected judgment to the amount of damages the trier of fact found the prevailing party to have sustained" is, of course, 1:1, or 100%. The operation of the enactment means that the subrogation rights or lien are reduced by 100%, and the faultless Plaintiff is not required to bear any of the cost of the injury. Thus, in this situation, the difference between the new subrogation reduction section and the original one can be seen: Under the original section, because "diminution" of Plaintiff's recovery is the triggering device, no reduction occurs unless such diminution occurs. Under the new section, reduction occurs "by the ratio" of (collected) judgment to damages, and if Plaintiff recovers full damages, that ratio is 100%.

[78]*See infra* notes 86-89 and accompanying text.

[79]Such an approach would have to maintain that what might appear to be a breach of the compensatory function is actually a cost imposed against the defendant and in favor of the plaintiff to reflect the corrective aims of the system. See *supra* note 34 and accompanying text for discussion of other aspects of this approach.

Professors Keeton and O'Connell have articulated the idea this way:

> It is often stated that the principal objective of tort law, and of any automobile claims system, is to compensate for loss. More precisely, however, the objective is to determine whether to compensate, and if so, how. Tort law prescribes the negative of compensation—the circumstances under which compensation will not be awarded—as well as the affirmative. Underlying the whole body of tort law is an awareness that the need for compensation, alone, is not a sufficient basis for an award. When a plaintiff receives a defendant's payment in satisfaction of a judgment obtained in court, loss is not compensated in the sense that it is somehow made to disappear. It is only shifted: To the extent that the plaintiff gains, the defendant loses. Moreover, the machinery for adjudicating whether and how loss is to be shifted is provided at considerable economic cost to the community and to the parties. To the costs of courts to society and the costs of lawyers to the parties must be added other less tangible and direct costs; for example, the costs of missing work to testify in court, the discomfiture and even agony of recreating the accident at the trial, and the anger and frustration

economic efficiency argument or expand the scope of the economic efficiency inquiry to include consideration of other costs and benefits and directly refute the claim of efficiency.[80]

Considerations of efficiency in the system of justice include not only the efficiency of allocations and transfers of monetary resources, but also the efficiency of the legal processes by which those allocations and transfers are accomplished. On this plane of analysis, the enactment has reversed the emphasis of the common law rule of exclusion. Under the common law, the potential for loss of efficiency in the occasional case involving a plaintiff who was not obligated to repay was offset by the gain of efficiency in not requiring presentation to the jury of evidence and instructions concerning the existence of such an obligation. In order to assure that the occasional case will be captured by the distributive and corrective principles operative in the Act, the General Assembly has required that every other case include the evidence of repayment obligation. The marginal gains made possible under the new rule therefore are achieved at significant administrative costs,[81] and those costs are

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> of a courtroom fight. When loss is shifted by way of an award, these costs of adjudication, tangible and intangible, produce a net loss from an over-all point of view unless advantages outweighing them are realized.
>
> From a recognition of this truth emerges a basic principle underlying both tort law generally and that segment of tort law concerned with automobile cases: An award is not made unless there exists some reason other than the mere need of the victim for compensation. Otherwise, the award will be an arbitrary shifting of loss from one person to another at a net loss to society due to the economic and sociological costs of adjudications.

R. Keeton & J. O'Connell, *supra* note 35, at 242.

[80]Judge Richard Posner provides an analysis that would challenge the fundamental validity of the argument on the larger scale of economics, and one that is clearly grounded in corrective theory. In his text, he sets out the following analysis of the collateral source rule:

> If an accident insurance policy entitles me to receive $10,000 for a certain kind of accidental injury and I sustain that injury in an accident in which the injurer is negligent, I can both claim the $10,000 from the insurance company and obtain full damages (which let us assume, are $10,000) from the injurer, provided I did not agree to assign my tort rights to the insurer (subrogation). To permit the defendant to set up my insurance policy as a bar to the action would result in underdeterrence. The economic cost of the accident, however defrayed, is $10,000, and if the judgment against him is zero, his incentive to spend up to $10,000 (discounted by the probability of occurrence) to prevent a similar accident in the future will be reduced. Less obviously, the double recovery is not a windfall to me. I bought the insurance policy at a price presumably equal to the expected cost of my injury plus the cost of writing the policy. The company could if it wished have excepted from the coverage of the policy accidents in which the injurer was liable to me for the cost of the injury, or it could have required me to assign to it any legal rights that I might have arising from an accident. In either case my premium would have been less.
>
> Some courts have had trouble when the collateral source benefit was not

imposed against the cases that would have come out the same under the common law rule as they will under the new rule anyway.

On this scale of efficiency, the new statute presents some serious problems that the General Assembly should address at its earliest opportunity. In addition to the problems discussed above, the statute contains other flaws which not only bring it into conflict with existing sections of the Comparative Fault Act, but which also turn the enactment on itself and present opportunities for results not in keeping with its objective.

First, with respect to the existing subrogation claims and liens reduction section of the Comparative Fault Act, the new enactment does not contain exceptions that are prominent in the former provision. Section 12 of the Comparative Fault Act reduces all such claims and liens "*other than* a lien under IC 22-3-2-13 [workers' compensation] or IC 22-3-7-36 [occupational disease]."[82] The new enactment applies to "*any* subrogation or lien for collateral benefits."[83] Whether this difference represents a shift in policy by the legislature to permit the imposition of some responsibility upon some employers who were at fault in producing a worker's injury, or is simply an oversight is not clear.[84] It is clear that courts will be faced with a dilemma concerning which section to apply.[85]

When juries begin to apply the new enactment against the background of the evidence that can now be admitted, some problems of coherency will result from its poor construction by the legislature. The source of this difficulty is subsection 2(3), which permits the fact-finder to hear

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> rendered pursuant to a contract but was "gratuitous." However, most gratuitous benefits turn out to be ones for which the beneficiary has paid indirectly. If an employer gives his injured employees medical treatment free of charge, this means only that the employer pays for their labor partly in money and partly in kind, so that the money wage would be higher if the "gratuitous" benefits were lower. (What about social security benefits?)

R. Posner, *supra* note 34, at 186.

[81]Those costs may be reflected in the complexity of the activity needed to evaluate the point in contention, and in the consequent potential for confusion and error, as well as in the more direct costs of time and expense. The Act may well involve such costs, as illustrated *supra* note 77 in the discussion of how the subrogation reduction section of the Act works.

[82]Ind. Code § 34-4-33-12 (Supp. 1986) (emphasis added).

[83]*Id.* § 34-4-33-14 (emphasis added).

[84]See generally Wilkins, *supra* note 77, at 751-56 for discussion of the workers' compensation lien exception in section 34-4-33-12.

[85]Conventional techniques of statutory interpretation would suggest an "implied repeal" of the earlier statute, if it is unavoidably in conflict with the later one. *See* Payne v. Buchanan, 238 Ind. 231, 238, 148 N.E.2d 537, 540 (1957); *see also* Schrenker v. Clifford, 270 Ind. 525, 387 N.E.2d 59 (1979); Lloyd v. State, 270 Ind. 227, 383 N.E.2d 1048 (1979).

evidence of "proof of the amount of money that the plaintiff is required to repay, including workmen's compensation benefits, as a result of the collateral benefits received; . . ."[86]

Because the statute provides no statement other than the general statements of purpose about *how* the newly admitted evidence is to affect the findings of fact, the jury might rationally conclude that an obligation to repay offsets the effect of reduction for receipt of the benefits. That is, a jury trying to compute its verdict might well decide that because the plaintiff is obligated to repay the benefits received, the amount of those benefits should be reflected in the recovery so that the plaintiff will not be required to incur further out of pocket expenses.[87] The problem is that the plaintiff's obligation to repay cannot be definitely ascertained until *after* the verdict has been rendered, and if a jury misapprehends the purpose of the evidence of the plaintiff's obligation to repay, in the manner suggested above, it may well inadvertently *change* the plaintiff's obligation.[88] Considering the statute as a whole, such a result would run directly counter to the apparent intent. The language of the enactment permits such a result, however, and unless the jury is carefully and completely instructed on the effect it is to give to such evidence, the statute will be permitted to cannibalize itself.[89] Even if no error occurs, the adjustment will have come at the expense of greater administrative costs.

Another form of the arguments critical of the common law rule in this context posits that the courts have been so concerned that juries would be "prejudiced" by the inclusion of evidence of collateral com-

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[86]IND. CODE § 34-4-36-2(3) (Supp. 1986).

[87]To illustrate:

The jury considers Plaintiff's $10,000 expenses as the starting point. Hearing evidence that the Plaintiff received $8,000 in benefits and charged that it is to determine Plaintiff's "actual pecuniary loss," it would then deduct that $8,000 from the expense, leaving $2,000. Having hard that Plaintiff is obligated to repay that $8,000, however, the jury might well decide to adjust its findings to assure that Plaintiff does not have to repay those benefits out of pocket. If it adds back the $8,000 and the verdict is $10,000, the intended effect of having it consider evidence of collateral source benefits is frustrated.

[88]That would happen in this way:

In the example given *supra* note 87, the verdict was for full damages. When damages and the verdict are equal, the "ratio" is 1:1 or 100%, and the subrogation rights are extinguished. In its effort to give Plaintiff a source of funds out of which to satisfy the subrogation claim, the jury will have actually erased the obligation and would permit a double recovery, even though it believed, correctly at the time it began its adjustment, that Plaintiff was required to pay the benefits back.

[89]Given the indirectness of such evidence, the complexity of comparative fault in general, the complexity of subrogation claims and liens and the reduction factor, and the number of mathematical computations that the jury has to perform, it is doubtful that even the most careful instruction will be able to prevent errors.

pensation sources that the exclusionary effect of the rule must reflect a belief that juries applying common morality would find it unconscionable for the plaintiff to obtain double recovery.[90] This argument finds support in empirical studies conducted thirty years ago at the University of Chicago.[91] Proponents of the rule have not come forward with countering empirical evidence and (consequently?) have not directly responded to the argument. Of course the common law rule was well in place long before any empirical data on jury behavior were available. The judicial attitude may well reflect a concern for prejudice to defendants' interests as well as plaintiffs'. The justification that the rule was prejudicial to the plaintiff was a relatively recent development in Indiana, and supports the view that courts are concerned about the jury deciding issues of liability and damages in favor of defendant when it is presented evidence of collateral source benefits.[92] It is interesting to note, however, that the court in *Brindle v. Harter*,[93] which articulated this view, relied upon decisions that the admissibility of evidence of insurance was prejudicial to *defendants*, and applied this reasoning to collateral source evidence "by analogy."[94] The *Brindle* court's reasoning thereby reflects a judicial approach that is rooted as much in a concern about the prejudicial effect of evidence of insurance toward the defendant as the plaintiff. The legislative attitude reflected in the Act rejects that approach. It may be true that in this modern day of personal injury litigation, with financial responsibility laws inducing the purchase of automobile insurance and the widespread utilization of health and accident coverage plans, juries will assume that insurance protection is available.[95] If that is true, then the concern should be with what effect that assumption has on the dispensation of justice at the hand of the jury. No clear answer is available; the same empirical study that supports the rule of inclusion also suggests that where uncertainty about coverage exists, jurors operate somewhat erratically in the atmosphere of doubt about the appropriateness of taking it into account. Some people might see the "absence" of insurance as defendant's fault, while others might

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[90]Esdaile, *supra* note 1, at 105; Peckinpaugh, *supra* note 1, at 550-51; *Unreason*, *supra* note 1, at 749.

[91]*See* Esdaile, *supra* note 1, and authorities cited therein. In his article, Mr. Esdaile cites an empirical study by Professor Harry Kalven, in which Professor Kalven provides a brief overview of the study conducted by The Jury Project of the University of Chicago Law School. In his article, Professor Kalven observes that the persons who participated in the study expressed a sensitivity to situations where the plaintiff has obtained compensation from other sources and tended to reduce damages in such cases. Kalven, *The Jury, The Law and the Personal Injury Award*, 19 Ohio St. L. J. 158, 169 (1958).

[92]Brindle v. Harter, 138 Ind. App. 692, 311 N.E.2d 513 (1965).

[93]*Id.*

[94]*Id.* at 699-700, 211 N.E.2d at 517-18.

[95]*See* Kalven, *supra* note 91, at 171.

favor the plaintiff and attempt some rough "equity" at the risk of putting the burden on the carrier.[96] The modern torts system wrought by the "reform" of common law by the General Assembly places importance upon the efficiency of allocation and transfer of resources, while it also confers an increased responsibility upon the jury to evaluate the cases brought before it, on issues of liability as well as damages. In such a system, opening up matters of insurance coverage purchased by the plaintiff to jury consideration while keeping the matter of insurance coverage purchased by the defendant for protection in the event of liability seems to be giving the jury only half the facts it needs to decide the ultimate issue. That issue includes matters of correction in the retributive and deterrence sense as well as in the sense of needed compensation. The jury's input into the evaluation of the case ought to include its decision about which side of the controversy should bear the costs of the accident, and whose insurance fund should reflect them. An objection that such a system would be allowing the jury to get involved with "questions of law," when its proper function is to deal with "questions of fact," begs the question. The present system already lets jurors do that, and sends them off to deliberate in secret with only part of the facts and law involved in the case and the hope that they will properly do justice equipped with that partial knowledge. If the response is that this type of system is an adjustment too far the other way, then perhaps a middle-ground approach could be identified. A system that permitted instructions of law based upon the partial equalized compensation/retribution approach might help keep the jury in line and address both sides of the debate.[97]

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[96]*Id.*

[97]Professors Keeton and O'Connell recognized the advisability that the system address both sides of the controversy:

> This principle is not a denial of the central importance in tort law of the need to compensate for loss. Rather it is a recognition that good rules of law for determining when and how losses are to be compensated must reflect concern for the interests of those who pay awards as well as those who receive them. Also, recognition of this basic principle of preserving the status quo when lacking good reason for change does not imply that the principle is ordinarily decisive. Doing justice, after all, is the main objective. Surely the costs of adjudication, calculated in even the most inclusive terms, are a modest price to pay if the system achieves this end. It has long been assumed that doing justice ordinarily requires a wrongdoer to compensate his innocent victim; and since it is so often concluded that there is good reason for regarding one party as a wrongdoer and the other as his innocent victim, the principle of preserving the status quo in order to save the costs of adjudication will rarely be controlling. The principle remains valid, however, for occasionally it will be decisive, and it serves also as a reminder that the search for defensible bases for shifting loss must be pressed beyond the simple need for compensation.

R. Keeton & J. O'Connell, *supra* note 35, at 243.

The third criterion for evaluating a system of justice, the social need for stability in that system, is also implicated in the interjection of the new rule of inclusion into the common law of torts. In shifting the business of courts and juries away from the traditional corrective approaches to resolving personal injury disputes and more narrowly focusing that business upon a distributive principle, the Act is likely to generate repercussions in the process of accommodating the system to the change.

Much of what has already been discussed is relevant in this consideration of stability. For example, to the extent that the new rule's potential for defeating the expectations of those who seek judicial dispute resolution is realized, satisfaction with the manner in which the system adjusts competing claims will wane. A realization of the possibility that the complexities in applying the new rule will produce higher economic and administrative costs or greater potential for error will also lower estimations of the quality of justice the system has to offer. Impetus for change or a search for alternatives might result from the decline in gratification or unwillingness to incur greater costs. Loss of the opportunity to obtain retribution against the background of requirements focused upon proof of "fault" might induce some pressure to modify those requirements. It is certainly too early to leap to any conclusions on these issues, but just as when a stone is thrown into a pond, the level of the pond is raised, and the ripples linger long after the stone has come to rest, the new rule will have a similar effect on the common law. The pond and the common law are flexible enough to find new points of equilibrium, thereby adjusting to accommodate the new part into the entire system. But the nature of the pond and the common law are nevertheless forever changed.

Recognition that the legislative rule emphasizes the compensatory function and that it does so by exclusive reference to pecuniary losses will possibly refuel efforts to induce the common law to recognize costs of personal injury litigation as compensable pecuniary losses. Arguments for the recovery of attorney's fees are to be expected on the grounds that such fees represent a pecuniary loss to the plaintiff, occasioned by the defendant's culpable conduct, effectively reducing the recovery amount, which the Act blithely treats as a refined method of identifying what the plaintiff has been required to give up as a result of the injury caused by the defendant.[98]

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[98]The General Assembly has already declared a policy in favor of recovery of attorney's fees, and has thereby established a position directly opposed to the common law rule. An enactment passed in the same session as the one here discussed provides:

> In any civil action, the court may award attorney's fees as part of the cost to the prevailing party if it finds that either party:
>
> (1) brought the action or defense on a claim or defense that is frivolous, unreasonable, or groundless;

Less likely, perhaps, but still plausible, are arguments that the common law should recognize what the legislature has not, concerning other costs of litigation not reimbursed by collateral benefactors. Such arguments will ask the courts to permit awards reflecting the inconvenience, aggravation, or humiliation experienced by those forced to resort to litigation in order to obtain redress. To be certain, these items of damage were not arguable in the common law prior to the Act, but they were barred by other rules of exclusion which may come under new scrutiny in the atmosphere of change brought about by the adoption of the new rule of inclusion. The common law rules of exclusion were not pronounced and intended to be applied in a vacuum; they were developed within a coherent system. In such a system, modification of one rule is likely to produce secondary effects, placing pressure on other rules. The legislature's piecemeal change in the rules of the process will produce efforts to reassess the continued vitality of the other rules of exclusion.

The new roles and responsibilities imposed on juries by this enactment and the Comparative Fault Act perhaps signal a public view that juries ought to have more to hear and say in the adjustment of disputes between their peers. The legislature's readiness to open juries' eyes and minds to complex issues of percentages of "fault" and pecuniary losses reflects a greater faith in jurors' abilities than the common law's rules of exclusion have shown. The light of comparison casts an unflattering shadow of paternalism across the face of the common law. If the General Assembly's faith is fulfilled, perhaps it should not lie in the mouths of common law judges to refuse to consider whether they ought to give the jury all of the information it needs to decide how the disputants' resources and losses should be distributed.

Finally, inasmuch as the Act is another in a series of legislative incursions into the common law of torts,[99] stability is implicated on the scale of institutional coordination. On this scale, the perspective is that of concern with the relationship between the courts and the legislature as institutions of government in fashioning the law to be applied and

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(2) continued to litigate the action or defense after the party's claim or defense clearly became frivolous, unreasonable or groundless; or

(3) litigated the action in bad faith.

Act of March 11, 1986, Pub. L. 193-1986, 1986 Ind. Acts 1944 (codified at Ind. Code § 34-1-32-1(b) (Supp. 1986)).

"Groundless" may be a relatively concrete standard by which to judge the appropriateness of actions and defenses. "Frivolousness" and "unreasonableness" are far more abstract and flexible standards, providing considerable leeway for assertion of the right to recover.

[99]The Comparative Fault Act, Ind. Code §§ 34-4-33-1 to -14 (Supp. 1986); the Medical Malpractice Act, Ind. Code §§ 16-9.5-1-1 to -10-5 (1984 & Supp. 1986); the Products Liability Act, Ind. Code §§ 33-1-1.5-1 to -8 (1984 & Supp. 1986); and the seatbelt statute, Ind. Code §§ 9-8-14-1 to -6 (Supp. 1986).

the manner of application in the trial of disputes involving personal injuries. The issue becomes whether a conflict exists between the legislature's exercise of power and that of the courts. To be certain, the legislature does have some power to affect the judiciary by adopting rules of procedure, jurisdictional requirements, limits on and bases of recovery, and the like. Mixed judicial and legislative functions are necessary complexities in ordering the system of justice in a complex society. But a dual role is not inescapable, and the courts have maintained an area of exclusivity with respect to procedural rules. As students of the law soon discover and are frequently reminded thereafter, deciding which rules are substantive and which are procedural is not always clear cut, however. The Indiana Supreme Court has attempted to state some guidelines in establishing the dividing line:

> In general terms substantive law can be defined as including that body of rules which regulates the conduct and relationship of members of society and the state itself as among themselves apart from the field of litigation and jurisdiction. In general form procedural law can be defined as that body of law regulating the conduct and relationship of individuals, courts, and officers in the course of judicial litigation.[100]

Challenges to the constitutionality of this Act may not be inevitable, but to the extent that it is perceived to be a legislative declaration that goes beyond the bounds of that necessary area of mixed functions, it may induce a reaction on constitutional grounds. In the new chapter created by the Act entitled "Jury Instructions in Personal Injury Actions"[101] and in the first purpose clause,[102] the General Assembly has created the issue of whether the statute amounts to an impermissible legislative rule of procedure or merely a new statement of substantive law.[103]

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[100]State v. Gibson Circuit Court, 239 Ind. 394, 399, 157 N.E.2d 475, 478 (1959) (quoting 1 Gavit, Ind. Pleading and Practice § 5 at 11 (1950)). The court expanded upon the treatise definitions by stating:

> As a general rule laws which fix duties, establish rights and responsibilities among and for persons, natural or otherwise, are substantive in character, while those which merely prescribe the manner in which such rights and responsibilities may be exercised and enforced in a court are procedural.
>
> The time, place and method of doing an act in court properly fall within the category of procedural rules and are appropriate subjects for such regulation.

Id. (citation omitted). The court held that the rule of court pertaining to change of venue superseded a statute on the same subject, upon finding that the statute was a rule of procedure.

[101]Ind. Code § 34-4-35-1 (Supp. 1986).

[102]*Id.* § 34-4-36-1.

[103]According to case law, if the supreme court has not issued a rule on the matter, the legislature is within the proper exercise of its power to declare procedural rules, and

V. Conclusion

The common law collateral source rule, being a rule of exclusion, has created tension in the trial of torts cases since its inception. Its definite, one-sided effect on the outcome of cases has provoked strong and polarized positions on both sides of the bar.[104] The approach of the courts to the rule was couched in fundamental terms giving the appearance that the rule itself was considered fundamental. So viewed, the need for further analysis seemed unnecessary to the courts, and the force of stare decisis perpetuated the rule's application for over a century

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may even declare such rules in an area where the supreme court has spoken, so long as the two rules are not in conflict. State v. Bridenhager, 257 Ind. 699, 279 N.E.2d 794 (1972). The supreme court has promulgated rule 51 of the Indiana Rules of Trial Procedure pertaining to jury instructions. That rule does not contain any language relating to the effect of tax consequences, of course, and the rule is stated generally in any event, so direct conflict between the Act's instruction and the trial rule does not exist. The striking feature of the trial rule is the discretion that it confers upon the judge in deciding whether and what to instruct the jury. The rule's mandatory effects are directed toward "the parties," and no part of the rule permits the parties to *compel* the reading of any instruction. *Cf.* Hobby Shops, Inc. v. Drudy, 161 Ind. App. 699, 317 N.E.2d 473 (1974). The new chapter of the Code created by the Act requires that the court "*shall* if requested, instruct the jury that the jury may not consider the tax consequences, if any, of its verdict." Ind. Code § 34-4-35-1 (Supp. 1986) (emphasis added). In contrast to trial rule 51, the statute removes the trial court's discretion, and the legislature has spelled out the content of the instruction. Clearly the General Assembly has taken a different approach and has gone further than the supreme court itself has to direct the conduct of the participants in litigation. Whether this direction will amount to an impermissible incursion into the exclusive realm of the courts will have to await review by the courts.

The first purpose clause of the Act purports: "to enable the trier of fact in a personal injury or wrongful death action to determine the actual amount of the prevailing party's pecuniary loss." Ind. Code § 34-4-36-1 (Supp. 1986). The provision is not clearly purely substantive or procedural, which gives rise to the issue. One might argue that "to enable" has a procedural connotation, but the remainder of the clause surely deals with the substantive content of the legislature's notion of the proper measure of damages (*quaere*, indeed, whether the *measure* of damages is substantive or procedural). *How* the jury determines "pecuniary losses," however, is surely a matter of procedure, and it is arguable that the limited rule of inclusion determines how the jury goes about determining what is counted as "pecuniary loss." The General Assembly has been careful in its language selection, however, steering clear of imposing mechanical requirements upon the jury. Furthermore, the rule is one of inclusion of evidence that the courts have not previously recognized. In Johnson v. St. Vincent Hosp. Inc., 273 Ind. 374, 404 N.E.2d 585 (1980), the supreme court observed that the challenged statute (the Medical Malpractice Act) made evidence admissible rather than inadmissible, and that the evidence that had been made admissible had been "expressly sanctioned by rules of evidence as declared by the courts." *Id.* at 393, 404 N.E.2d at 598. From those observations, the court concluded that the statute did not "take away from the courts their judicial authority." *Id.* The factual distinctions in the case of the enactment under discussion may prove to be crucial.

[104]*E.g.*, the juxtaposed articles, Lambert, *The Case for the Collateral Source Rule*, 1966 Ins. L.J. 531, and Peckinpaugh, *An Analysis of the Collateral Source Rule*, 1966 Ins. L.J. 545.

in this state. Upon close examination, the rule can be seen to have been a means of addressing several, even competing, principles; and the common law position had given primacy to the retributive and deterrent functions of the torts system, giving double effect to the compensatory function in some cases. The legislature, in declaring a new rule of inclusion, has answered the pleas of those who opposed the rule on the strength of arguments stemming from principles driving the compensatory function, and in doing so has shifted the balance to the other side. Such a dramatic shift would, in any case, be difficult to accommodate in our system of litigation, because of ingrained habits of conduct, and familiar patterns of thought and speech, to say nothing of the existence of 113 years of unbroken precedent. But the legislative rule as declared contains conceptual and mechanical difficulties which will magnify the expected problems. Some were perhaps avoidable. Given the legislative preference for distributive and corrective principles apparent on the face of the statute, some of these difficulties were unavoidable. So the old tension has not been relieved; rather, the beneficiaries of institutional resolution of the controversies producing it have merely been reversed. Moreover, the enactment is merely the latest in a series of efforts by the General Assembly to transport tort law out of the common law and into a legislative conceptualization, thereby raising issues of institutional coordination within the system. Mobilization of opposition to the rule is to be expected, not only in the form of direct challenges to the rule itself, but also in the form of increasing demands for further modification of the common law to accommodate the interests given primacy by the abrogated rule. The resulting debates should prove to be interesting.

New Developments in Workmen's Compensation Law: Accident Defined and New Thoughts on Crediting

Joseph M. Forte*

I. Introduction

Three areas of workmen's compensation law were significantly affected by Indiana decisions during the current survey period.[1] Two of these major developments occurred in *Evans v. Yankeetown Dock Corp.*,[2] a wrongful death action brought against an employer by the decedent-employee's personal representative. In *Evans*, the Indiana Court of Appeals and subsequently the Indiana Supreme Court, in vacating the appellate court's opinion, greatly impacted traditional views of both jurisdictional exclusivity and compensability[3] by redefining a workmen's compensation term of art, "injury by accident." The third major development in Indiana workmen's compensation law related to the crediting of non-workmen's compensation payments made to the employee by the employer against the employee's compensation award.[4]

This Article focuses on the historical backdrop against which each development occurred, the substantive changes resulting from each development and, lastly, what each development means for the Indiana practitioner.

II. Accident — Revisited and Redefined

A. *The History*

The Indiana Court of Appeals' revisiting and subsequent redefining of accident in *Evans* changed the classical definition of accident which

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[1]The survey period runs from June 1, 1985, to May 31, 1986. During this twelve-month period, seven decisions were rendered in the area of workmen's compensation law. A bill, Senate Bill 426, was introduced in The 1987 Indiana Legislature which, if passed would significantly influence the definition of "accident" for workmen's compensation purposes. Therefore, practitioners faced with this issue should investigate recent legislature developments, if any.

[2]481 N.E.2d 121 (Ind. Ct. App. 1985), *rev'd*, 491 N.E.2d 969 (Ind. 1986).

[3]Liability of the employer under the Compensation Act to any employee or employee's dependent for personal injury or death by accident arising out of or in the course of employment is established under Indiana Code § 22-3-2-6 (1982). The Act requires as prerequisites compensation: (1) an injury; (2) that the injury be by accident; (3) that the injury by accident arise out of the employment; and (4) that the injury occur while in the course of the employment. Ind. Code § 22-3-2-5 (1982).

[4]Indiana State Highway Dep't v. Robertson, 482 N.E.2d 495 (Ind. Ct. App. 1985); Jones & Laughlin Steel Corp. v. Kilburne, 477 N.E.2d 345 (Ind. Ct. App. 1985).

had been in existence for nearly seventy years.[5] Historically, the outcome of numerous actions brought under Indiana's Workmen's Compensation Act turned upon the applicability of the definition of accident, which required a sudden, untoward event.[6] Such results were consistent with judicial decisions of other jurisdictions having statutory language similar to that of Indiana's Workmen's Compensation Act.[7]

Yet, a definition of accident that focused on an "event" often created confusion as to which event was the event at issue. Was an unexpected injury or an unexpected source of injury required for the Workmen's Compensation Act to apply? In response, the Indiana Court of Appeals appeared to sidestep this dilemma in *Ellis v. Hubbell Metals, Inc.*[8] by ruling that the happening necessary to fulfill the accident requirement was an unexpected result as opposed to an unexpected event. However, *Calhoun v. Hillenbrand Industries*[9] and several subsequent cases[10] did essentially dispose of the unexpected result theory, leaving intact the traditional unexpected event definitional requirement of accident as Indiana law.[11]

B. The Winds of Change

While the Indiana Supreme Court reinstated the unexpected event requirement of accident in *Calhoun*,[12] Judge DeBruler's dissent critically

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[5]*See* Haskell & Baker Car Co. v. Brown, 67 Ind. App. 178, 187, 112 N.E. 555, 557 (1917).

[6]*See* Calhoun v. Hillenbrand Indus., 269 Ind. 507, 381 N.E.2d 1242 (1978); Young v. Smalley's Chicken Villa, 458 N.E.2d 686 (Ind. Ct. App. 1984); Houchins v. J. Pierpont's, 469 N.E.2d 786 (Ind. Ct. App. 1984); Estey Piano Corp. v. Steffen, 164 Ind. App. 239, 328 N.E.2d 240 (1975); City of Anderson v. Borton, 132 Ind. App. 684, 178 N.E.2d 904 (1962); American Maize Produce Co. v. Nichiporchick, 108 Ind. App. 502, 24 N.E.2d 801 (1940); Indian Creek Coal & Mining Co. v. Calvert, 68 Ind. App. 474, 119 N.E. 519 (1918).

[7]*See generally* 81 Am. Jur. 2d *Workmen's Compensation* § 227 (1976).

[8]174 Ind. App. 86, 366 N.E.2d 207 (1977).

[9]269 Ind. 507, 381 N.E.2d 1242 (1978).

[10]Young v. Smalley's Chicken Villa, 458 N.E.2d 686 (Ind. Ct. App. 1984); Houchins v. J. Pierpont's, 469 N.E.2d 785 (Ind. Ct. App. 1984).

[11]The two conflicting views as to satisfying the "accident" requirement through either the untoward event or unexpected result theory came before the court of appeals in Calhoun v. Hillenbrand Industries, 374 N.E.2d 54 (Ind. Ct. App. 1978). The Industrial Board had denied compensation. The court of appeals concluded an injury was "by accident" if the result was unexpected, even though no unexpected event had occurred. In *Calhoun*, the unexpected result was a backache suffered by the claimant. Accordingly, the court of appeals reversed the Industrial Board's denial of compensation. However, the supreme court, on transfer, disagreed and vacated the opinion of the court of appeals, stating in its now famous language, "It is well settled under our law that in order to show an accident there must be some untoward or unexpected event . . . . It is not sufficient to merely show that a claimant worked for the employer during the period of his life in which his disability arose." *Calhoun*, 269 Ind. at 510-11, 381 N.E.2d at 1244 (citations omitted).

[12]269 Ind. 507, 381 N.E.2d 1242 (1978).

concluded that the Industrial Board had inappropriately isolated a causation question, that is—whether the personal injury had been caused by an accidental means or method, within its analysis of the accident issue.[13] Judge DeBruler was not alone in his criticism of this definition of accident.[14]

Judge Ratliff, in a concurring opinion in *Kerchner v. Kingsley Furniture Co.*,[15] previewed the court of appeals decision in *Evans* by recalling his concurring opinion in *Lovely v. Cooper Industrial Products*,[16] in which he expressed his displeasure with the "unexpected cause" theory of accident. Judge Ratliff adamantly contended that the unexpected cause theory, which is predicated on a sudden, untoward event traceable to a precise date, place, and time, departs from the underlying philosophy and legislative intent of Indiana's Workmen's Compensation Act.[17] Under Judge Ratliff's analysis, the proper focus of an "accident" analysis is on an unexpected or untoward result "arising out of and in the course of employment" rather than on an unexpected or untoward event.[18] While ultimately yielding to the precedential case law in effect, Judge Ratliff concluded by expressing a hope that the courts' current use of the unexpected cause definitional requirement of accident would be overturned and replaced by an unexpected result theory of accident.[19] Two months after *Kerchner*, Judge Ratliff's hopes were realized by the Indiana Court of Appeals decision in *Evans v. Yankeetown Dock Corp.*[20] Yet this fulfillment of Judge Ratliff's hopes was to be short-lived—in less than a year, the Indiana Supreme Court would vacate the appellate court's decision[21] and in doing so, would clarify or, depending on your point of view, totally change the judicial interpretation of the term "injury by accident" as used in Indiana's Workmen's Compensation Act.

C. Evans v. Yankeetown Dock Corp.: *The Decision*

1. The Court of Appeals

a) The facts.—The *Evans* case was a wrongful death action brought against the decedent's employer by the decedent's personal representative-spouse.[22] Mrs. Evans contended that the employer was negligent in that

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[13] *Id.* at 512, 381 N.E.2d at 1245 (DeBruler, J., dissenting).

[14] *See* Forte, *It Was No Accident That . . .* , 19 Ind. L. Rev. 207, 210 (1986).

[15] 478 N.E.2d 74 (Ind. Ct. App. 1985).

[16] 429 N.E.2d 274, 279-81 (Ind. Ct. App. 1981) (Ratliff, J., concurring), *transfer denied.*

[17] *Id.* at 279.

[18] *Kerchner,* 478 N.E.2d at 78 (Ratliff, J., concurring).

[19] *Id.*

[20] 481 N.E.2d 121.

[21] *Evans*, 491 N.E.2d 969.

[22] 481 N.E.2d at 123.

it had knowingly employed a mentally ill individual who posed a physical threat to fellow employees and who unquestionably was a proximate cause of her husband's death.[23] Shortly before the start of the workday, a co-employee, Harlan Miller, shot the decedent five times while suffering a hallucinatory delusion that his wife and the decedent were conspiring to kill him by poisoning; these delusions resulted from an alcohol-induced paranoia.[24] Evidence further indicated that the employer's superintendent knew that Harlan Miller had threatened Oscar Evans with bodily harm and shortly after the shooting stated, "[M]aybe I should have done something to prevent it [the shooting]."[25]

In response, the defendant-employer, Yankeetown, generally denied Mrs. Evans' allegations and moved for summary judgment by essentially challenging the trial court's jurisdiction over the complaint.[26] From Yankeetown's point of view, this was a workmen's compensation complaint, which was governed by Indiana's Workmen's Compensation Act and rightfully within the jurisdiction of the Industrial Board.[27] The trial court granted summary judgment in favor of the defendant by holding that an action for workmen's compensation was the sole and exclusive remedy available for the death of Oscar Evans.[28] To support its decision, the trial court found that (1) Oscar Evans and Harlan Miller were indeed co-employees of the defendant, (2) on the date in question, Evans was shot and killed by Miller, and (3) Evans' death was the result of an "accident which arose out of and in the course of" his employment with Yankeetown Dock Corporation.[29]

b) Accident defined.—Simply put, the issue before the court of appeals in *Evans* was whether Indiana's Workmen's Compensation Act granted the Industrial Board exclusive jurisdiction over negligence claims brought against an employer for the wrongful death of an employee.[30] From the vantage point of this issue, the court of appeals quickly grasped the opportunity to attack and clarify the definition of accident, a term of art which had given rise to judicial confusion on more than one occasion.[31] The *Evans* court launched its attack by noting the absence of the qualifying language, "arising out of and in the course of" in the workmen's compensation jurisdictional statute, Indiana Code section 22-3-2-6.[32] This absence, when compared with the qualifying language's

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[23]*Id.*
[24]*Id.*
[25]*Id.*
[26]*Id.*
[27]*Id.*
[28]*Id.*
[29]*Id.* at 123-24.
[30]*Id.* at 123.
[31]*Id.* at 125.
[32]*Id.*

presence in the actual compensation statute, Indiana Code section 22-3-2-2, was of great significance to the court of appeals in that it created a distinction between requirements necessary for jurisdiction and requirements necessary for actual compensation; it was this distinction that, in the words of the *Evans* court, meant "this court for more than a half century has on occasion misconstrued workers' compensation law by contorting pristinely simple legislative language into a virtually unworkable definition of 'accident'."[33]

The court then focused on the actual language of the jurisdictional statute, which states that the Industrial Board is to have exclusive jurisdiction in a claim based on "personal injury or death by accident."[34] After noting that "personal injury or death" is "self-explanatory," the *Evans* court emphasized that the precise language used by Indiana legislators is "by accident," rather than "by an accident," as Indiana courts have frequently construed the jurisdictional statute.[35] Thus, the court of appeals used the omission of the article "an" as the basis for ruling that the jurisdictional requirements of Indiana Code section 22-3-2-6 are met by any accidental injury, where accidental injury is defined as one that was not expected to occur or one that did not occur by design of the employer or injured employee.[36]

Philosophically, the *Evans* court found that a definition of accident that focused on a sudden, untoward event presumed that Indiana's Workmen's Compensation Act was "meant to remedy an 'accident' and thereby be regulated by an 'event'."[37] Such a presumption was clearly erroneous under the court of appeals' interpretation of Indiana'a Workmen's Compensation Act. According to the *Evans* court, "[W]orkmen's compensation laws were enacted to cover liability without fault for *injuries* or *death* in the workplace, as social legislation whereby employers (and ultimately consumers) would bear the burden of risk of insecurity and poverty of injured employees."[38] Therefore, under the *Evans* approach, a court, in determining whether the threshold requirement of "accident" had been met, should focus on the resultant injury to the employee rather than either the injury's unexpected source or the unexpected event that had caused it.[39]

c) A causal connection required.—However, the court of appeals circumscribed the parameters of the change wrought in *Evans* by indicating that considerations relating to the time, manner, and causation of the employee's injury would be shifted from judicial determinations of jurisdic-

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[33] *Id.*
[34] *Id.* at 126.
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] *Id.* (citing B. Small, Workmen's Compensation Law of Indiana § 1.1 (1950)).
[39] *Id.* at 126-27.

tion to determinations of compensability; that is, these factors would be critical in determining whether the employee's injury "arose out of and in the course of employment" and was therefore compensable.[40]

To illustrate the proper approach towards issues of jurisdiction and compensability, the *Evans* court utilized an example of an employee suffering a heart attack while engaged in routine labor.[41] Because the employee's injury was clearly unintended by both employee and employer, the injury was accidental and clearly within the jurisdictional ambit of the Industrial Board.[42] Yet the injury's cause is determinative of the issue of compensability. If the employee's heart attack is shown to have resulted from a pre-existing heart condition, the injury did not arise from his employment and is not compensable.[43] However, if the heart attack resulted from unusual exertion demanded by the employee's work, his injury is deemed to have arisen out of and in the course of employment.[44]

The *Evans* court went on to note that a critical reading of cases such as the classic heart attack case of *United States Steel Corp. v. Dykes*[45] reveals that the claims in these cases were not decided upon an interpretation of "accident," but rather were decided upon the fact that the injuries either did not arise out of employment or did not occur in the course of employment.[46] The court then concluded that its approach to redefining accident would not change the law as it has been applied — that is, the causal connection required for compensability would remain unscathed.[47] However, from this point forward, the causal requirement would be a critical element of an analysis of whether the accident "arose out of and was suffered in the course of" the employment.

d) Jurisdictional questions.—In attempting to clarify the interaction between the compensation statute, Indiana Code section 22-3-2-2, and the jurisdictional statute, Indiana Code section 22-3-2-6, the *Evans* court held that the qualifying language "arising out of or in the course of" was not to be considered in analysis of the jurisdictional question.[48] However, later in the main opinion, the court noted:

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[40]*Id.* at 129-30. Acts of willful or wanton misconduct by the employer against the employee were "most likely" not included within the definition of accident. *Id.* Additionally, the court did not change or criticize the prohibition of compensation for the employee's injury that is knowingly self-inflicted, a result of intoxication, a commission of an offense, a failure to use safety appliances, or a failure to obey a reasonable written or printed rule of the employer conspicuously posted under Indiana Code § 22-3-2-8. *Id.* at 128 n.7.

[41]*Id.* at 129.

[42]*Id.*

[43]*Id.*

[44]*Id.*

[45]238 Ind. 599, 154 N.E.2d 111 (1958).

[46]*Evans,* 481 N.E.2d at 129.

[47]*Id.*

[48]*Id.* at 125.

> [T]hus, the language "arising out of and in the course of employment" qualifies, not just "accident," but the entire jurisdictional threshold, "personal injury or death by accident." To do otherwise, of course, would cause a conflict in identical phraseology merely because it was located in separate statutes: "accident" as "event" in Indiana Code 22-3-2-2 and "accident" as "condition" in Indiana Code 22-3-2-6. We can hardly credit our legislature with such an absurd intention. Thus, our definition of "by accident" from the jurisdictional statute necessarily alters the meaning of the claim statute.[49]

While this apparent inconsistency was not addressed by the *Evans* majority, Judge Conover, in his concurring opinion, urged that the jurisdictional rule must retain the qualifying language "arise out of and in the course of employment."[50] Judge Conover stated that if this were not the case, the Industrial Board would be given exclusive jurisdiction over cases that involved off-the-job injury or death.[51] To illustrate the absurdity of this result, Judge Conover posed the hypothetical of an employee injured when struck by his employer's truck in the middle of town; under the majority's approach, the Industrial Board would be given exclusive jurisdiction in this hypothetical.[52] Because such jurisdiction was never intended by the legislature, Judge Conover opined that "the qualifier 'arising out of and in the course of employment' is an integral part of the rule."[53]

In *Segally v. Ancerys*,[54] the Third District Court of Appeals apparently agreed with Judge Conover because it failed to follow the *Evans* jurisdictional decision as to the judicial removal of the qualifying phraseology "arise out of and in the course of employment." While *Segally* did not formally address *Evans* in its decision, its analysis clearly relied on a pre-*Evans* jurisdictional test.[55] Similarly, in *Ski World, Inc. v. Fife*,[56] the First District Court of Appeals explicitly refused to apply the *Evans* test and chose for its jurisdictional analysis the pre-*Evans* test set forth in *Skinner v. Martin*.[57] Thus, with *Segally* and *Ski World* standing in direct conflict with *Evans*, a situation ripe for supreme court clarification arose.

2. *The Indiana Supreme Court*

a) Setting the stage.—Resolution of this conflict between the districts

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[49] *Id.* at 129.
[50] *Id.* at 130 (Conover, J., concurring).
[51] *Id.*
[52] *Id.*
[53] *Id.* at 131.
[54] 486 N.E.2d 578 (Ind. Ct. App. 1986).
[55] *Id.* at 580-83.
[56] 489 N.E.2d 72 (Ind. Ct. App. 1986).
[57] 455 N.E.2d 1168 (Ind. Ct. App. 1983).

came with the Indiana Supreme Court's acceptance of transfer and vacation of the court of appeals' decision in *Evans v. Yankeetown Dock Corp.*[58] On transfer, the supreme court addressed three issues: (1) whether the qualifying language "arising out of and in the course of employment" was necessary to jurisdictional analysis; (2) what was the appropriate definition of the term "by accident;" and (3) whether summary judgment was proper under the facts of the case.[59]

The analysis of these issues was prefaced by the court's focus on broad public policy considerations of workmen's compensation in general, which serves the interest of the injured worker by providing a perhaps more limited compensation in return for a guarantee of compensation by avoiding common law defenses.[60] The court found that the employer and his insurance carrier also benefitted by relief from the prospect of large damage verdicts and a guarantee of some degree of certainty in planning for anticipated costs of employee injuries.[61] Finally, the court postured itself by noting that the duty and the responsibility to determine such public policy and to adopt legislation reflecting these public policy considerations are those of the legislature and that the courts are limited to the interpretation of ambiguous statutes.[62]

b) Clarifying questions of jurisdiction.—With fundamental public policy in place, the *Evans* court quickly decided that Indiana Code section 22-3-2-6 was clear and unambiguous; as a result, the court was prohibited from construing it.[63] Specifically, the court focused on the interplay of Indiana Code section 22-3-2-6 with other portions of the Workmen's Compensation Act, including the express definition of injury and personal injury,[64] and found this interplay to be clear, unambiguous, and without need of judicial construction.[65]

In considering the court of appeals' decision in *Evans*, the supreme court noted that the appellate court had rejected the statutory definition.[66] Such rejection was inappropriate, given the unambiguous nature of the statutes relating to the definition of accident and their use in the jurisdiction and compensation sections of the Indiana Workmen's Compensation Act.[67]

To clarify Indiana law, the supreme court reinstated the pre-*Evans*

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[58]491 N.E.2d 969 (Ind. 1986).

[59]*Id.* at 971.

[60]*Id.*

[61]*Id.*

[62]*Id.*

[63]*Id.* at 972.

[64]Ind. Code § 22-3-6-1(c) (1982).

[65]*Evans,* 491 N.E.2d at 973.

[66]*Id.*

[67]*Id.*

jurisdictional test originally formulated in *Skinner v. Martin*.[68] Under this test, Indiana Code section 22-3-2-6 "excludes all rights and remedies of an employee against his employer for personal injury or death if the following three statutory jurisdictional prerequisites are met:

A. personal injury or death by accident;
B. personal injury or death arising out of employment;
C. personal injury or death arising in the course of employment."[69]

Any action for employee injury or death that does not meet all three prerequisites is not within the jurisdiction of the Industrial Board and therefore may be brought in court.[70]

c) Looking at the definition of accident.—Turning to the definition of accident, the *Evans* court consistently reinforced its finding that Indiana Code section 22-3-2-6 is unambiguous. To the court, application of the statutory language "by accident" was to be done on a literal basis rather than by a re-interpretation of the language which necessitated the insertion of the article "an" before the word "accident."[71] In effect, the supreme court, in focusing on the statutory language, redefined accident without the finding of ambiguity made by the court of appeals. As a result, the statutory terminology "injury or death by accident," as used under Indiana's Workmen's Compensation Act, was held to be any unexpected injury or death, and previous case holdings were expressly overruled to the extent that they were inconsistent with this definition.[72]

Yet the supreme court carefully circumscribed the boundaries of its decision by distinguishing the jurisdictional issue of *Evans* from the causation issue of *Calhoun v. Hillenbrand Industries*.[73] To clarify this distinction, the court simply noted that analysis of causation issues is most properly addressed under the portion of the statute dealing with the term, "arising out of" the employment.[74] Accordingly, the *Calhoun* decision remains correct as it relates to a required showing of the causal connection between injury and employment—that is, a claimant must make more than a mere showing that he was working for the employer during the period in which the disability arose in order to establish causation.[75] Implicitly, by such reference to *Calhoun*, the supreme court steadfastly preserved the causation requirement for compensability.

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[68]*Id.*
[69]*Id.*
[70]*Id.*
[71]*Id.* at 974.
[72]*Id.* at 975.
[73]269 Ind. 507, 381 N.E.2d 1242 (1978).
[74]*Evans*, 491 N.E.2d at 975.
[75]*Id.*

Finally, the court applied its interpretation of Indiana's Workmen's Compensation Act to the case at bar. Because the trial court had correctly found that Oscar Evans was an employee and that he suffered death by accident that arose out of and in the course of his employment,[76] the exclusive remedy provisions of Indiana's Workmen's Compensation Act barred an action at law against Evans' employer.[77] Therefore the lower court's grant of summary judgment in favor of the employer was appropriate.[78]

D. Evans' *Effect on the Practitioner*

Although the court of appeals did attempt to establish a new jurisdictional test, the *Evans* case ultimately served to affirm a jurisdictional test already in place and in use. However, in this reaffirmation, the supreme court appeared to alter radically the definition of accident. But on closer analysis, this alteration has less impact on practice under Indiana's Workmen's Compensation Act than would appear upon an initial reading of the case.

While it is true that a small number of cases will be affected by *Evans'* definitional change, a practitioner, in all likelihood, would have resolved most of these clear accident cases, or at least the issue of accident, prior to a hearing before the Industrial Board. In the remaining cases, the changing of the definition of accident will place more importance on medical-legal analysis. *Evans* requires that the practitioner pay closer attention to the claimant's prior medical history as it relates to the issue of whether the accident was unexpected or the result of a pre-existing condition and therefore more probably expected. A gray area may emerge from those cases defended on the basis of "no accident" with regard to the expectation of injury. Consequently, further clarification will undoubtedly be forthcoming as this approach is taken and collides with the granting of compensation for the aggravation of pre-existing injuries.

Nevertheless, the *Evans*' decision greatly clarifies the accident issue; such clarification will unquestionably result in less litigation on the issue of accident. In the future, the practitioner's emphasis will shift to the causal connection under the "arising out of the employment" portion of the statute. In the area of causation, negligible event cases such as *City of Anderson v. Borton,*[79] *Young v. Smalley's Chicken Villa,*[80] and *Houchins v. J. Pierpont's,*[81] will remain good law, either under the

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[76] *Id.*

[77] *Id.* at 976.

[78] *Id.*

[79] 132 Ind. App. 684, 178 N.E.2d 904 (1962).

[80] 458 N.E.2d 686 (Ind. Ct. App. 1984).

[81] 469 N.E.2d 786 (Ind. Ct. App. 1984).

approach that the accident was expected or, alternatively, that the situation is not compensable because the injury did not "arise out of" the employment and accordingly fails to satisfy the proximate causation requirement of the Act. Thus the practitioner will, for the most part, make the same analysis under a different section of the Act in the future.

III. Credits

A. The Historical Trilogy

While Indiana Code section 22-3-3-10(a) clearly limits disability payments for injuries occurring after July 1, 1979, to fifty-two weeks of temporary total disability benefits,[82] uncertainty arose in terms of credits for payments under Indiana Code section 22-3-3-23.[83] Historically, the provision appears to have been an attempt to bar an employee from benefits to which he was entitled under Indiana's Workmen's Compensation Act if the injured employee received benefits under a group disability policy.[84]

However, in *United Toolcraft v. Sousley*,[85] the Indiana Court of Appeals held that acceptance of group benefits, which were paid to the employee under the mistaken belief that his condition had resulted from illness and not injury "arising out of and in the course" of his employment, did not bar recovery of workmen's compensation benefits. Rather the *Sousley* court, by noting the employee's concession that the employer was properly allowed a credit against the workmen's compensation award for payments made under the disability policy, implicitly agreed with the crediting.[86]

Following *Sousley*, the law of payment crediting was somewhat confused due to conflicting approaches and narrowly drawn exceptions. In *Inland Steel Co. v. Almodovar,*[87] the parties' factual stipulation to the single hearing member clearly indicated that both a credit for overpayment of temporary total disability benefits and a credit for receipt of nonoccupational group insurance benefits would be allowed to the employer.

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[82]Ind. Code § 22-3-3-10 (1982).

[83]Ind. Code § 22-3-3-23(a) (1982) reads:

> Any payments made by the employer to the injured employee during the period of his disability, or to his dependents, which by the terms of Chapters 2 through 6 were not due and payable when made, may, subject to the approval of the industrial board, be deducted from the amount to be paid as compensation. However, the deduction shall be made from the distal end of the period during which compensation must be paid, except in cases of temporary disability.

[84]*See* United Toolcraft v. Sousley, 128 Ind. App. 181, 147 N.E.2d 558 (1958).

[85]*Id.*

[86]*Id.* at 188, 147 N.E.2d at 562.

[87]172 Ind. App. 556, 361 N.E.2d 181 (1977).

On review, the court seemed to agree that the claimant should not be allowed a double recovery by retaining both the non-occupational disability benefits and the workmen's compensation benefits.[88] Yet the *Almodovar* court subsequently ruled that the Industrial Board did not have jurisdiction to make such a crediting determination because insufficient facts to establish jurisdiction were presented in the record.[89]

Of apparent concern to the *Almodovar* court was the need for some type of plaintiff indemnification in the event that a non-occupational carrier was involved and sought recovery from the plaintiff for funds paid erroneously under the belief that the incident was non-work-related.[90] Consequently, the court of appeals established an implied rule that if the employer, and not some insurance company, paid the "non-occupational" benefit to the plaintiff pursuant to a contract that gave the employer a right to deduct such payments from its liability to the plaintiff for the compensation award of the Industrial Board, then the Industrial Board would have jurisdiction to make an appropriate award for such credits.[91] However, if the benefits were paid by an insurance company, which was not the employer's compensation carrier, the Industrial Board had no jurisdiction to attempt to adjudicate the plaintiff's liability or non-liability to such insurer.[92]

Although the Indiana Supreme Court denied transfer in *Almodovar,* Justice Pivarnik dissented from this denial and Justice Prentiss concurred with the dissent.[93] The dissent noted that the majority, in failing to grant transfer, supported the lower court's failure to state the grounds for its denial of credits for the money expended for hospital and medical costs.[94] In addition, the dissent found the stipulations entered into by the parties at the beginning of the hearing to be anything but ambiguous.[95] In this regard, Justice Pivarnik noted that both parties stipulated to the amounts paid and further stipulated that Inland was to receive full credit for the amounts paid in the event that there was a workmen's compensation award in favor of the petitioner.[96]

The decision in *Freel v. Foster Forbes Glass Co.*[97] completes this historical trilogy. In *Freel*, the surviving dependents of the disabled employee appealed an Industrial Board award of temporary total disability

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[88]*Id.* at 566-67, 361 N.E.2d at 188.

[89]*Id.* at 567, 361 N.E.2d at 188.

[90]*Id.*

[91]*Id.*

[92]*Id.*

[93]Inland Steel Co. v. Almodovar, 266 Ind. 638, 366 N.E.2d 169 (1977) (Pivarnik, J. dissenting).

[94]*Id.* at 639, 366 N.E.2d at 170.

[95]*Id.*

[96]*Id.*

[97]449 N.E.2d 1148 (Ind. Ct. App. 1983).

benefits made subject to a credit equaling amounts paid by the employer under a wage continuation plan.[98] The wage continuation plan in *Freel* was not a part of a union contract and was silent as to the interplay with benefits available to injured employees under workmen's compensation.[99] The employer was self-insured for Workmen's Compensation Act benefits as well as for sickness and accident benefits.[100] The *Freel* court, in its analysis, noted the absence of authority for the proposition that a contract that provides benefits to an employee on some basis other than workmen's compensation should specifically provide for credits to the workmen's compensation carrier before the same may be applied.[101]

In addition, the court of appeals focused on the purposes of Indiana's Workmen's Compensation Act, which it saw as the avoidance of litigation and the placement of the burden of caring for the injured employee upon the industry employing the employee and the consumers of that industry's products.[102] The court reasoned that if a credit was not available, the employee would recover twice for the same injury; in addition, the injured employee would receive more money for the period of disability than he would have been able to earn had there been no injury.[103] To the *Freel* court, such a potential situation was totally inconsistent with the purposes of Indiana's Workmen's Compensation Act.[104] Moreover, the court of appeals opined that any employer who voluntarily paid an employee in his time of need should not be penalized by the denial of a full credit against any workmen's compensation award for such payments — any ruling to the contrary would inevitably cause employers to be less generous.[105]

B. Changes in Crediting

It was against this historical backdrop that two Indiana cases dealing with credits occurred. In *Jones & Laughlin Steel Corp. v. Kilburne*,[106] the court of appeals addressed the issue of whether amounts paid pursuant to a union-established permanent disability pension plan should be set-off against workmen's compensation awards. While the pension plan in *Kilburne* was funded entirely by the employer, the court found that it was a separately bargained employment benefit which was designed to supplement workmen's compensation and that pension benefits paid in

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[98] *Id.* at 1149.
[99] *Id.* at 1149-50.
[100] *Id.* at 1150.
[101] *Id.* at 1151.
[102] *Id.*
[103] *Id.*
[104] *Id.*
[105] *Id.*
[106] 477 N.E.2d 345 (Ind. Ct. App. 1985).

fulfillment of this plan were separate and apart from workmen's compensation awards.[107] As a result, the *Kilburne* court approved of the Industrial Board's refusal to deduct the pension plan benefits from its award.[108]

Of particular import to the *Kilburne* decision was the pension plan's contractual language addressing deductions for the payment of workmen's compensation.[109] Also contained within this portion of the pension plan was an exemption for payments received by participants for a permanent incapacity retirement occurring prior to age 65; the exemption prohibited the crediting of payments against a compensation award.[110] Finally, the *Kilburne* court dispelled the notion of "double recovery" involved in this particular factual situation by indicating that the claimant would not receive payments greater than his regular salary if he received both workmen's compensation and pension benefits.[111]

In the second crediting case in the survey period, *Indiana State Highway Department v. Robertson,*[112] the claimant demonstrated a novel approach to Indiana Code section 22-3-3-23. In *Robertson*, the employee sought to avoid the Workmen's Compensation Act's exclusive remedy provision in an action against her employer, the State Highway Department; the action was premised on allegations of negligent design, construction, and maintenance of an intersection where the employee was injured.[113] Although the trial court denied the defendant-employer's motion for summary judgment based upon workmen's compensation's exclusive remedy provisions, the Indiana Court of Appeals found the plaintiff's injury to be a compensable work-related accident and, therefore, any action at law was barred by the exclusive remedy provisions.[114]

In attempting to persuade the appellate court, the plaintiff argued that the State Highway Department should be subject to suit based upon a dual capacity theory.[115] Alternatively, the plaintiff contended that the exclusivity provision of Indiana's Workmen's Compensation Act was inapplicable because the employee received wage compensation as a merit employee for disabilities from injuries occurring while on the job under a provision of the Indiana Administrative Code, rather than under the provisions of the Workmen's Compensation Act.[116]

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[107] *Id.* at 349.
[108] *Id.* at 348.
[109] *Id.*
[110] *Id.*
[111] *Id.*
[112] 482 N.E.2d 495 (Ind. Ct. App. 1985).
[113] *Id.* at 496.
[114] *Id.* at 498.
[115] *Id.* at 497.
[116] *Id.*

In overturning the lower court's denial of summary judgment, the *Robertson* court noted that under 31 Indiana Administrative Code 2-11-5, the state provided the employee full pay for lost time as opposed to temporary total disability benefits of 66⅔% of statutory wages as provided under Indiana's Workmen's Compensation Act.[117] In addition, the court found that payments under the administrative code provision were "not due and payable when made" and would therefore not operate to remove the matter from the Act or its exclusive remedy provisions because removal would render Indiana Code section 22-3-3-23(a) a nullity.[118] Finally, the *Robertson* court found support for crediting payments made against workmen's compensation awards under the terms of 31 Indiana Administrative Code 2-11-5 itself, which provides for a credit offset of funds paid under it when an employee also seeks temporary total disability compensation during the single year of applicability.[119]

C. *Meaning for the Practitioner*

While the area of crediting remains somewhat unclear, several general rules for the application of Indiana Code section 22-3-3-23 can be gleaned from the above cases. These rules are:

(1) while it appears that a contractual agreement giving rise to such credit is most helpful to the employer seeking to enforce a credit, such agreement is really not necessary;

(2) if payments for workmen's compensation are made directly from the employer or from the employer's insurer, it appears that the credit will be granted;

(3) a troublesome area arises where there may be a subrogation or lien claim against the employee for repayment of funds by the insurance carrier or entity making medical or disability payments;

(4) where a pension plan or other benefits are bargained for as a part of negotiations in a union contract, payments made under such plans will not be allowed as a credit against a workmen's compensation award in the absence of specific contractual provisions granting credits; and

(5) excess payments amounting to more than the employee's normal wages apparently provide strong grounds for allowing a credit, although a failure to exceed wages does not necessarily result in a denial of credits.

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[117] *Id.* at 498.
[118] *Id.*
[119] *Id.*

These guidelines appear to arise from public concern over the possibility of an employee being subject to subrogation actions by non-workmen's compensation insurance carriers or other entities providing such funds and competing public policy against double recovery by the claimant. Crediting is also an area where further judicial interpretation is expected.