
January 2007

Commercial Transactions

John Krahrmer

Recommended Citation

John Krahrmer, *Commercial Transactions*, 60 SMU L. REV. 797 (2007)
<https://scholar.smu.edu/smulr/vol60/iss3/7>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

COMMERCIAL TRANSACTIONS

John Kraemer*

BECAUSE 2006 was not a legislative year in Texas, there were no statutory changes in the Texas Uniform Commercial Code.¹ During the year, most of the cases involved issues arising from the sale of goods under Chapter 2 of the Code, with a relative handful of cases arising under other chapters.

I. GENERAL PROVISIONS

A. CONSPICUOUSNESS OF CONTRACT TERMS

In *American Home Shield Corp. v. Lahorgue*,² a homeowner injured by the explosion of a heater for a home spa settled a claim for personal injuries with a warrantor from whom the homeowner had purchased a homeowner's warranty. The warrantor sought recovery under an indemnity contract it had with a servicing company that performed installation and maintenance work on the spa. The Dallas Court of Appeals upheld summary judgment in favor of the servicing company because the indemnity clause was not conspicuous under Section 1.201, and, despite the company owner's admission that he had read the contract, there was insufficient evidence to show that he had actual notice of the indemnity clause.³ The court reasoned that merely reading a contract is not enough to show that a party has actual notice or knowledge of its terms.⁴

* Professor of Law and Foundation Professor of Commercial Law, Texas Tech University. B.A., J.D., University of Iowa; LL.M., Harvard University.

1. The Texas enactment of the Uniform Commercial Code is contained in the first eleven chapters of the Texas Business and Commerce Code (the "Code"). See TEX. BUS. & COM. CODE ANN. §§ 1.101–11.108 (Vernon 1994, 2002 & Supp. 2006). These chapters are designated as follows:

- Chapter 1: General Provisions
- Chapter 2: Sales
- Chapter 2A: Leases
- Chapter 3: Negotiable Instruments
- Chapter 4: Bank Deposits and Collections
- Chapter 4A: Funds Transfers
- Chapter 5: Letters of Credit
- Chapter 7: Documents of Title
- Chapter 8: Investment Securities
- Chapter 9: Secured Transactions; Sales of Accounts and Chattel Paper
- Chapter 10: [Reserved for Expansion]
- Chapter 11: 1973 Transition Provisions

2. 201 S.W.3d 181 (Tex. App.—Dallas 2006, pet. denied).

3. *Id.* at 185–87.

4. *Id.* at 186–87 (citing TEX. BUS. & COM. CODE ANN. § 1.201(b)(10) (Vernon Supp. 2006)). In *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 508–10 (Tex. 1993),

B. COURSE OF DEALING

The revision of Chapter 1 in 2003 combined the rules governing course of dealing, course of performance, and usage of trade in a single section instead of continuing the former arrangement, which stated some of the rules in Chapter 1 and some of the rules in Chapters 2 and 2A.⁵ In *James L. Gang & Associates, Inc. v. Abbott Laboratories, Inc.*,⁶ a purchase agreement stated, "Seller understands and agrees that Buyer has made no guarantee or commitment hereunder to purchase any minimum quantity of these Products and that the quantities of Products actually purchased may vary from the estimates listed in Table One."⁷ The seller argued a course of dealing between the seller and the buyer, and he established a pattern of doing business, showing that the quantities listed in a "Table" accompanying the purchase agreement were commitments and not mere estimates. The Dallas Court of Appeals held that, under section 1.303, a contract's express terms control unless they are ambiguous and the ambiguity can be clarified by a course of dealing.⁸ The court ruled that the purchase agreement was unambiguous and that evidence of a course of dealing was not relevant.⁹

The seller also argued that the buyer had breached various purchase orders issued under the purchase agreement by failing to pay for goods delivered to the buyer or by failing to make certain purchases under alleged oral contracts. The court rejected these claims as well because the evidence conclusively showed that the buyer had paid for all delivered goods and because the alleged oral contracts failed to satisfy the statute of frauds or any of the section 2.201 exceptions.¹⁰ The seller's final claims

the Texas Supreme Court held that the definition of "conspicuous" contained in section 1.201 should be applied to all contracts, whether or not they arose from a sale of goods. The court further held that, even if a clause was not conspicuous, it could nonetheless be effective if there was proof that a party had actual knowledge of the clause. *Dresser Indus.*, 853 S.W.2d at 508–10.

5. Under the former Chapter 1, course of dealing and usage of trade were covered by TEX. BUS. & COM. CODE ANN. § 1.205 (Vernon 1994), while course of performance was covered in TEX. BUS. & COM. CODE ANN. §§ 2.208 & 2A.207 (Vernon 1994). As revised, all of these rules now appear in TEX. BUS. & COM. CODE ANN. § 1.303 (Vernon Supp. 2006).

6. 198 S.W.3d 434, 437–38 (Tex. App.—Dallas 2006, no pet.).

7. *Id.* at 437.

8. *Id.* at 437 (citing TEX. BUS. & COM. CODE ANN. § 1.303(e)(1) (Vernon Supp. 2005)).

9. *Id.* at 438.

10. TEX. BUS. & COM. CODE ANN. § 2.201 (Vernon 1994) requires that all contracts for the sale of goods priced at \$500 or more be in writing unless the contract meets one of the exceptions stated in this section. One of these exceptions is the "merchant's exception" allowing a written confirmation of an oral contract to satisfy the statute of frauds if a merchant receives the confirmation and the buyer gives no objection to the confirmation's contents within ten days after it is received. The court rejected the seller's argument that two of the purchase orders met this exception because the confirmations contained language referring to future orders and not to existing agreements. *James L. Gang & Assocs.*, 198 S.W.3d at 440–41. The court also rejected the seller's claim that the buyer had admitted another oral agreement because the testimony used to show the admission was a former employee's affidavit and not a current employee's statement. On this point, the court noted that admissions must be made by an employee acting "within the scope of his em-

were for fraud and fraudulent inducement. Because the court had ruled that the oral contracts were not enforceable, the court held that a fraudulent inducement claim could not logically lie.¹¹ As to the fraud claim, the court noted that the statute of frauds would prevent recovery of benefit-of-the-bargain damages, but out-of-pocket reliance damages could be recovered if the seller proved the amounts spent in reliance on the buyer's alleged fraudulent promises to make purchases.¹² The seller, however, only provided testimony of estimated expenditures and did not provide evidence of the actual amounts spent in reliance on the buyer's alleged promises. The court, therefore, rejected the fraud claim as well.¹³

II. SALE OF GOODS

A. CONTRACT FORMATION AND INTERPRETATION

Section 2.204 allows a contract for the sale of goods to be formed "in any manner sufficient to show agreement . . . even though one or more terms are left open . . . if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy."¹⁴ This does not mean, however, that a contract has been formed if the parties have agreed that certain terms have been deliberately left open for future negotiation and later agreement. In *Spinal Concepts, Inc. v. Curasan, AG*,¹⁵ the United States District Court for the Northern District of Texas applied these principles to determine that a distribution agreement between a supplier and a distributor was effective for the first two years of the five-year agreement because the parties had specified minimum purchase quantities for those years but had also included a term requiring the parties to later negotiate and agree on quantities for the subsequent three years. The court vacated an arbitrator's award of damages covering the last three years of the agreement on the ground the arbitrator had erred in finding that the quantity terms could be determined as a percentage of the quantities purchased during the first two years.¹⁶

B. INTERPRETATION OF CONTRACTS

Even if a contract has been formed, there is always the question of interpretation. In the case of written contracts, Section 2.202 allows the introduction of parol evidence to clarify ambiguous terms or to show consistent additional terms unless the parties have intended their written agreement to be the "complete and exclusive statement of the agree-

employment and made during the existence of the employment relationship." *Id.* at 441 (emphasis in original).

11. *James L. Gang & Assocs.*, 198 S.W.3d at 442.

12. *Id.*

13. *Id.* at 443.

14. TEX. BUS. & COM. CODE ANN. §§ 2.204(a)-(c) (Vernon 1994).

15. No. 3:06-CV-0448-P, No. 3:06-CV-0448-P, 2006 WL 2577820, at *4 (N.D. Tex. Sept. 7, 2006) (opinion not yet published).

16. *Id.*

ment.”¹⁷ In *Baroid Equipment, Inc. v. Odeco Drilling, Inc.*,¹⁸ the operator of a semi-submersible drilling rig sued the supplier of a chain-tension system used on the rig on several theories, including breach of warranty and breach of contract. The operator attempted to introduce evidence of oral representations made by the supplier that certain parts of the rig would last “for at least five years.” These representations conflicted with the terms of the written contract providing a limited warranty of one year. The Houston Court of Appeals held that the oral statements were not collateral to the contract and that a merger clause excluded parol evidence that sought to vary the terms of the written agreement.¹⁹

In *ConocoPhillips Co. v. Incline Energy, Inc.*,²⁰ the Eastland Court of Appeals held that a contract for the sale of natural gas was neither patently nor latently ambiguous and that parol evidence could not be introduced to vary the meaning of the contract’s price term.

C. ASSIGNMENT AND DELEGATION

In *Seagull Energy E & P, Inc. v. Eland Energy, Inc.*,²¹ an assignor, who had working interests in two oil and gas properties, assigned its interests as part of a sale. When neither the assignor nor the assignee reimbursed the well operator for operating expenses, the operator sued both of them. The trial court held in favor of the operator against both defendants, and the assignor appealed. The court of appeals ruled in favor of the assignor, but, on further appeal, referring to Section 2.210 and to Section 318(3) of the Restatement (Second) of Contracts, the Texas Supreme Court held that the assignment did not relieve the assignor of its duties under the contract when the operator had not released the assignor from such duties.²² The supreme court reversed the judgment of the court of appeals and rendered judgment in favor of the operator against the assignor.²³

D. UNCONSCIONABILITY

Under Section 2.302, if a court finds that a contract or clause is unconscionable, the court may refuse to enforce the contract, may enforce the contract without application of the unconscionable clause, or may limit the effect of the clause in a way that avoids an unconscionable result.²⁴ Whether a contract or clause is unconscionable is to be determined as a matter of law by the court.²⁵

17. TEX. BUS. & COM. CODE ANN. § 2.202 (Vernon 1994 & Supp. 2006).

18. 184 S.W.3d 1, 4, 9–12, 15 (Tex. App.—Houston [1st Dist.] 2005, pet. denied).

19. *Id.* at 16.

20. 189 S.W.3d 377, 381–82 (Tex. App.—Eastland 2006, pet. denied).

21. 207 S.W.3d 342, 344 (Tex. 2006).

22. *Id.* at 344–47.

23. *Id.* at 347 (citing TEX. BUS. & COM. CODE ANN. § 2.210(a) (Vernon 1994 & Supp. 2006) and RESTATEMENT (SECOND) OF CONTRACTS § 318(3)).

24. TEX. BUS. & COM. CODE ANN. § 2.302(a) (Vernon 1994).

25. *Id.*

In *Olshan Foundation Repair Co. v. Ayala*,²⁶ the San Antonio Court of Appeals held that an arbitration clause in a contract for home repair was unconscionable because the parties challenging an application for arbitration provided uncontroverted evidence that arbitration would cost more than three times the amount of the underlying claim. The unconscionability of an arbitration clause was also addressed in *In re Palm Harbor Homes, Inc.*,²⁷ in which the buyers purchased a manufactured home from a retailer. An arbitration clause in the purchase agreement provided that the right to arbitrate inured to the benefit of the manufacturer as a third-party beneficiary. The clause also provided, however, that the manufacturer had a twenty-day period to opt out of arbitration. The Texas Supreme Court held that the buyers' contention that they did not understand the clause was insufficient to show procedural unconscionability.²⁸ Furthermore, allowing the manufacturer to opt out of arbitration did not make the clause substantively unconscionable.²⁹

In *Hoover Slocacek LLP v. Walton*,³⁰ the Texas Supreme Court referred to Section 2.302 as authority for the proposition that determining whether a contingent-fee agreement between an attorney and client was unconscionable *when it was made* is a question of law. The supreme court pointed out that this determination is different from determining "whether a particular fee or contingency percentage . . . is unconscionable under all relevant circumstances of the representation."³¹ The court stated that the latter issue is a question of fact for the factfinder.³² The clause in question was held to be unconscionable as a matter of law, and the case was remanded for further proceedings.³³

E. WARRANTIES

In any given year, questions surrounding the creation, disclaimer, effectiveness, and scope of warranties are often the most commonly litigated matters under Chapter 2. This Survey period was no exception. This is due, in part, to the overlap between the Code provisions governing warranties, warranties created by common law, and the ability to sue for breach of warranty under the Texas Deceptive Trade Practices Act (DTPA).³⁴

26. 180 S.W.3d 212, 216 (Tex. App.—San Antonio 2005, pet. denied).

27. 195 S.W.3d 672, 674–75 (Tex. 2006).

28. *Id.* at 678–79.

29. *Id.* As to the opt-out provision, the court noted the manufacturer had only a limited time to opt out, and "this circumstance does not create a different relationship than provisions usually found in third-party beneficiary situations, because third-party beneficiaries generally have the right to disclaim benefits proffered by a contract." *Id.* at 678.

30. 206 S.W.3d 557, 562 (Tex. 2006).

31. *Id.* at 561–62.

32. *Id.*

33. *Id.* at 561, 566.

34. The Code's warranty provisions appear in TEX. BUS. & COM. CODE ANN. §§ 2.312–316 (Vernon 1994). The common-law warranty of good and workmanlike performance for the repair of goods was established in *Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349, 358–62 (Tex. 1987). An action for breach of warranty under the

In *Bossier Chrysler Dodge II, Inc. v. Rauschenberg*,³⁵ the Waco Court of Appeals held that a warranty disclaimer was ineffective because the buyer had purchased and paid for an express warranty of extended coverage on a vehicle. The court also held that the disclaimer was ineffective to disclaim the *Melody Home* implied warranty of good and workmanlike repair.³⁶ On both of these warranty claims, however, the court noted that the record did not contain conclusive evidence that the attempted repairs were not properly performed, and recovery was denied on both the express-warranty and the implied-warranty theories. The plaintiff also asserted a separate DTPA claim based on a misrepresentation that repairs had been made when, in fact, they had not.³⁷ The court upheld a verdict in favor of the plaintiff on this issue but ordered a remittitur of approximately one-half of the damages awarded by the jury.³⁸

In *G.R.A.V.I.T.Y. Enterprises v. Reece Supply*,³⁹ a neon sign manufacturer sued a company that supplied it with transformers for breach of the warranty of merchantability and breach of the warranty of fitness for a particular purpose. The plaintiff alleged that the transformers ran too hot for use with plastic components in the assembled signs, but the evidence at trial failed to support this allegation because the defendant was able to show the overheating was not caused by a defect in the transformers but by incorrect installation.⁴⁰ The Dallas Court of Appeals upheld a judgment in favor of the supplier.⁴¹

In *Everett v. TK-Taito, L.L.C.*,⁴² the Fort Worth Court of Appeals held that the plaintiffs could maintain neither an individual action nor a class action for breach of warranty because they had suffered no personal injuries and no economic loss due to seat belts that allegedly had “a defective design of the buckle giving it a ‘propensity to partially latch and potentially provide insufficient restraint during a crash.’” On this point, the court held that the plaintiffs’ attempt to recover contract damages in a breach-of-warranty suit by alleging a products-liability tort defect did not establish the existence of an injury.⁴³ The court also rejected a DTPA claim of misrepresentation on the ground that allegations of potential loss due to unmanifested defects in vehicles more than ten years old were “too remote in time to constitute an ‘injury’ for standing purposes under the DTPA.”⁴⁴

The El Paso Court of Appeals reached a similar result in *Basham v.*

DTPA is allowed by TEX. BUS. & COM. CODE ANN. § 17.50(b) (Vernon 2002 & Supp. 2006).

35. 201 S.W.3d 787, 804 (Tex. App.—Waco 2006, pet. denied).

36. *Id.* at 803.

37. *Id.* at 803–05.

38. *Id.* at 801.

39. 177 S.W.3d 537, 542, 545 (Tex. App.—Dallas 2005, no pet.).

40. *Id.* at 545–46.

41. *Id.*

42. 178 S.W.3d 844, 854–55 (Tex. App.—Fort Worth 2005, no pet.).

43. *Id.* at 855 (emphasis in original).

44. *Id.* at 858.

Audiovox Corp.,⁴⁵ in which a buyer purchased walkie-talkie radios as Christmas gifts for her son and his family. The radios were advertised as including a voice-activation feature allowing hands-free operation when used with a headset. As matters developed, headsets were not available for this particular model of radio and a different model would have to be purchased. Under the manufacturer's warranty, the purchaser could return the radios within ninety days for a full refund. Instead of returning the radios, the purchaser filed a class action against the manufacturer for breach of express warranty under the federal Magnuson-Moss Warranty Act.⁴⁶ The court held that the purchaser lacked standing to maintain her claim because she did not seek a refund within the ninety-day period.⁴⁷ Not having sought a refund, she could not show that the company failed to honor its warranty; therefore, she could not demonstrate a compensable damage.⁴⁸ Because the purchaser lacked individual standing to maintain an action, the class action was also dismissed.⁴⁹

An important and unresolved issue in Texas in regard to warranties is whether an aggrieved buyer must give notice not only to his or her immediate seller but also to remote parties in the chain of distribution as well. In *Bailey v. Smith*,⁵⁰ the Corpus Christi Court of Appeals noted the split among the courts of appeals on whether notice of breach must be sent to remote parties and concluded that requiring notice is the better rule.⁵¹ Because notice had been given only to the immediate seller in *Bailey*, recovery against remote parties was denied.⁵²

In *Carlisle Corp. v. Medical City Dallas, Ltd.*,⁵³ the Dallas Court of Appeals held that even though problems and attempted repairs to a roof extended over a period of years, a reasonable jury could find that notice of problems with roofing material was timely because the seller's failure to comply with an extended warranty was the critical event triggering a thirty-day time period for giving notice, and notice was given within that time.

45. 199 S.W.3d 9 (Tex. App.—El Paso 2006, pet. denied).

46. *Id.* at 16.

47. *Id.* at 13–14.

48. The Magnuson-Moss Warranty Act, 15 U.S.C. §§ 2301–12 (2006), permits warrantors to offer “full warranties” or “limited warranties.” A full warranty must meet the federal minimum standards in Section 2304. A limited warranty need not meet these minimum standards but can, *inter alia*, limit the remedies available to a consumer and the time within which remedy claims can be asserted. The ninety-day limitation on claims for refunds made the warranty in *Basham* a limited warranty.

49. *Basham v. Audiovox Corp.*, 198 S.W.3d 9, 13 (Tex. App.—El Paso 2006, pet. denied).

50. No. 13-05-085-CV, 2006 WL 1360846, at *4, *9 (Tex. App.—Corpus Christi 2006, no pet.).

51. *Compare Wilcox v. Hillcrest Mem'l Park of Dallas*, 696 S.W.2d 423 (Tex. App.—Dallas 1985), *writ ref'd*, 701 S.W.2d 842 (Tex. 1986) (per curiam) (notice to remote parties required to maintain breach-of-warranty claim), *with Vintage Homes, Inc. v. Coldiron*, 585 S.W.2d 886 (Tex. App.—El Paso 1979, no writ) (notice requirement applies only to immediate seller).

52. *Bailey*, 2006 WL 1360846, at *5.

53. 196 S.W.3d 855, 865 (Tex. App.—Dallas 2006, pet. granted).

The notice requirement was also addressed in *Ibarra v. National Construction Rentals, Inc.*,⁵⁴ in which a rental company rented temporary fencing to a construction company for use during construction at an elementary school. The plaintiff was injured when a child who was rollerblading near the fence lost his balance, grabbed the fence, and pulled it down on top of the plaintiff. The plaintiff sued both the construction company and the rental company for breach of the implied warranties of merchantability and fitness for a particular purpose and for a DTPA violation due to breach of these warranties. The plaintiff obtained a jury verdict on a theory of premises liability and negligence against the construction company, but the court granted motions for summary judgment and for a directed verdict in favor of the rental company on the warranty and DTPA claims. On appeal, the San Antonio Court of Appeals determined that the plaintiff did not establish that the rental company's failure to anchor the fence with sandbags was a producing cause of the plaintiff's injuries.⁵⁵ The only summary-judgment evidence that the plaintiff introduced was an affidavit by one person stating that the accident was caused by the failure to properly anchor the fence with sandbags, but the same person stated in his deposition that he did not conduct any testing to determine if placing sandbags on the base of the fence would have actually prevented the accident. As to the motion for directed verdict, the court found that the plaintiff failed to give notice of her claim as required by sections 2.607 and 2A.516.⁵⁶ Although the plaintiff was neither the buyer nor the lessee of the fencing, the court reasoned that, as a beneficiary of the lease agreement, the notice requirements should apply.⁵⁷ Because the plaintiff failed to give notice of her warranty claim, the directed verdict in favor of the lessee was affirmed.⁵⁸

F. REMEDIES

Breach of warranty is not the only claim that may be asserted by an aggrieved buyer. If the seller fails to deliver, if goods are properly rejected, or if the buyer properly revokes acceptance, the buyer may maintain a claim for breach of contract.⁵⁹ In *Trident Steel Corp. v. Wiser Oil*

54. 199 S.W.3d 32, 34-35 (Tex. App.—San Antonio 2006, no pet.).

55. *Id.* at 36.

56. Section 2.607 is applicable in contracts for the sale of goods, and Section 2A.516 is applicable in contracts for the lease of goods. Both sections contain similar requirements for giving notice of breach. TEX. BUS. & COM. CODE ANN. §§ 2.607(c)(1) & 2A.516(c)(1) (Vernon 1994).

57. On this point, the court quoted TEX. BUS. & COM. CODE ANN. § 2.607 cmt. 5, which states, in part, "[T]he reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred." Although the comment to TEX. BUS. & COM. CODE ANN. § 2A.516 (Vernon 1994) does not contain a similar statement, the court reasoned that it would be "illogical" to treat beneficiaries of lease agreements differently than beneficiaries of sales agreements. 199 S.W.3d at 38.

58. *Ibarra*, 199 S.W.3d at 38.

59. TEX. BUS. & COM. CODE ANN. § 2.711 (Vernon 1994). Under the Code's remedy regime, if a seller fails to deliver or if a buyer properly rejects or revokes acceptance, the buyer has the remedies listed in TEX. BUS. & COM. CODE ANN. § 2.711 (these remedies

Co.,⁶⁰ a seller supplied steel tubing and well casing to a buyer for use in oil-drilling operations under a series of contracts. The buyer paid for the tubing upon delivery. After some of the tubing and casing had been installed in wells, the buyer discovered that the tubing would bend or crimp in use, and the casing would collapse, making the goods unsuitable for their intended purposes. The buyer revoked acceptance of the tubing and rejected the casing. In an action against the seller for damages, the buyer recovered damages for breach of contract and fraud. The seller contended that revocation of acceptance for the tubing was ineffective because the buyer had paid for the tubing and used it for more than one-hundred days. The seller further contended that, even though payment had not been made for the casing, rejection was improper because the buyer had used the casing. The Amarillo Court of Appeals rejected both arguments, holding that under Section 2.608, neither payment nor use conclusively establishes acceptance if latent defects are not discoverable until goods are put to use.⁶¹ In this case, the defects did not become apparent until the tubing and casing were installed in wells and subsequently pulled to determine why the wells were not operating as they should. The buyer's recovery for breach of contract was upheld.⁶²

In *Emerson Electric Co. v. American Permanent Ware Co.*,⁶³ a buyer purchased heating elements for toasters from a manufacturer. A number of the heating elements failed, and the buyer notified the manufacturer of the failures. Both parties worked together in an attempt to identify the reason for the failures, but they were unable to resolve the problem. During this time, the buyer continued purchasing elements in the belief that the problem would be resolved. When it became apparent that changes in production and assembly were ineffective, the buyer rejected elements it had not yet used and revoked acceptance for those already installed in toasters. The buyer sued for breach of contract and breach of

include purchasing goods from another source and asserting a claim for any increased cost, recovering the difference between the contract price and the market price, or, in limited cases, obtaining the goods themselves by specific performance or replevy). If it is too late for a buyer to reject or revoke acceptance, the buyer's remedy is to assert a claim for damages caused by any breach of warranty under TEX. BUS. & COM. CODE ANN. § 2.714. This difference in available remedies led the Texas Supreme Court to state that "[t]he UCC recognizes that breach of contract and breach of warranty are not the same cause of action." *Sw. Bell Tele. Co. v. FDP Corp.*, 811 S.W.2d 572, 576 (Tex. 1991). In fact, as recognized by the Official Comment to TEX. BUS. & COM. CODE ANN. § 2.725 cmt. 2 (Vernon 1994), both claims arise from the contract of sale, and only the remedies vary. The author has noted elsewhere that this sentence has led to doubtful results in some cases in which the court has disallowed recovery of attorneys' fees in breach-of-warranty actions on the ground that TEX. CIV. PRAC. & REM. CODE ANN. § 38.001(8) (Vernon 1997) only permits recovery of reasonable attorneys' fees for claims based on "oral or written contract." See John Krahmer, *Commercial Transactions*, 56 SMU L. REV. 1255, 1265-66 (2003).

60. No. 07-04-0357, 2006 WL 2494742, at *1-2 (Tex. App.—Amarillo, Aug. 29, 2006, pet. denied).

61. *Id.* at *4-5.

62. *Trident Steel Corp.*, 2006 WL 2494742, at *6. Recovery on the buyer's fraud claim was reversed because the damages on the claim duplicated the damages awarded on the contract claim. *Id.* at *7-8.

63. 201 S.W.3d 301, 307-09 (Tex. App.—Dallas 2006, no pet.).

warranty. The seller argued that the buyer had failed to give effective notice of rejection and revocation and had failed to adequately plead such notice. The Dallas Court of Appeals determined, however, that the seller was fully aware of the continuing failure of the elements and that the pleading was sufficient to raise the issues of rejection and revocation.⁶⁴ The court further noted that, even if the pleading was not sufficient, the issues had been tried by consent and notice had been effectively proven.⁶⁵

III. NEGOTIABLE INSTRUMENTS

A. HOLDING IN DUE COURSE

Many of the rules surrounding the concept of negotiability are designed to promote commerce by allowing the purchaser of an instrument to hold the instrument free of claims and defenses that would ordinarily be available to the assignee of a simple contract. To qualify for this protection, the purchaser must be a holder in due course under Section 3.302.⁶⁶ The basic requirements can be summarized rather easily: To qualify as a holder in due course, the holder must take the instrument for value, in good faith, and without notice of defects, defenses, or claims to the instrument.⁶⁷ In *First National Acceptance Co. v. Bishop*,⁶⁸ a mortgagee agreed to sell a note secured by a deed of trust to a company engaged in the business of purchasing secured promissory notes. This company, in turn, was the agent of another company that provided the actual financing for the purchases. The mortgagee transferred the note and deed of trust to the agent, and the agent transferred these to its principal. But the mortgagee was never paid. When the mortgagee attempted to cancel the agreement and obtain return of the note and deed of trust, the principal refused her request. The mortgagee and mortgagor brought an action for declaratory judgment, seeking return of the documents and an injunction against foreclosure. The Corpus Christi Court of Appeals held that the agent's failure to pay for the note and the principal's knowledge that payment had not been made prevented the principal from qualifying as a holder in due course.⁶⁹

B. NEED FOR PROPER INDORSEMENT

Chapter 3 of the Code contains a number of technical requirements

64. *Id.* at 309.

65. *Id.* The court did, however, allow a deduction from the damages awarded by the jury in the amount of a settlement that the buyer had reached with a predecessor company from whom heating elements had been purchased before the defendant-seller purchased the company. *Id.*

66. TEX. BUS. & COM. CODE ANN. § 3.302 (Vernon 2002).

67. Although the requirements in TEX. BUS. & COM. CODE ANN. § 3.302 are necessarily more extensive than the brief statement in the text, the summary is a useful way of focusing on the particular requirement that may be in question.

68. 187 S.W.3d 710, 713 (Tex. App.—Corpus Christi 2006, no pet.).

69. *Id.* at 715.

governing the endorsement of instruments.⁷⁰ One rule that can be a trap for the unwary appears in Section 3.110, which allows any one of several named payees to validly indorse an instrument unless the instrument shows unambiguously that all of the payees must indorse.⁷¹ In *Mazon Assocs., Inc. v. Comerica Bank*,⁷² a check did not use the word “and” or the word “or” between the names of the two payees appearing on the check. Referring to Section 3.110, the Dallas Court of Appeals held that failure to indicate whether the check was payable jointly or in the alternative made it payable in the alternative.⁷³ The non-signing payee, therefore, did not have standing to maintain a conversion action against the drawee bank for improperly paying the check.⁷⁴

Even if a check clearly shows that all payees must indorse to effect a proper transfer, it is possible that a non-signing payee may be unable to recover in conversion if the payee has previously recovered part or all of any amount converted from another of the payees. Thus, in *AMX Enterprises, Inc. v. Bank One*,⁷⁵ a mortgage company, along with the mortgagor, contracted with a mold-removal contractor on behalf of the mortgagor. Upon completion of the mold removal, the mortgagor’s insurance company issued three insurance-settlement checks, each clearly showing that they were payable to the mortgage company, the mortgagor, and the contractor as joint payees. The mortgagor indorsed the checks and forwarded them to his mortgage company, but the mortgage company never forwarded the checks to the contractor. The mortgage company deposited the checks instead with its bank, which accepted the checks without the contractor’s endorsement. The mortgagor’s insurance company issued four more settlement checks to rebuild the house. The four checks were again deposited and credited to the mortgage company’s account. When he was not paid, the contractor sued the bank, the mortgagor, and the mortgage company for the amount due on the contract. While the suit was pending, the mortgagor paid off the mortgage, and the mortgage company mailed the mortgagor a check for the amount of the contractor’s services. The contractor settled its claim with the mortgagor, and the mortgagor assigned its claims against the mortgagee and the bank to the contractor. The bank obtained a summary dismissal, and a nonsuit was granted on behalf of the mortgage company. The issue on appeal was whether the “one-satisfaction” rule and Section 3.420 barred the contractor from recovering damages beyond the checks’ face value from the bank or the mortgage company.

The Houston Court of Appeals held the one-satisfaction rule “prohibits a plaintiff from recovering twice for a single injury” and, further, that

70. See, e.g., TEX. BUS. & COM. CODE ANN. §§ 3.110, 3.204–.206 (Vernon 2002).

71. TEX. BUS. & COM. CODE ANN. § 3.110(d).

72. 195 S.W.3d 800, 802 (Tex. App.—Dallas 2006, no pet.).

73. *Id.* at 804.

74. *Id.* at 805–06.

75. 196 S.W.3d 202, 205 (Tex. App.—Houston [1st Dist.] 2006, pet. denied).

Section 3.420 bars payment beyond the face value of a check.⁷⁶ The one-satisfaction rule applies when multiple defendants commit technically different acts resulting in the same injury. The contractor's suit against the bank was based on conversion, negligence, gross negligence, tortious interference with contract, and money had and received; but only one injury had occurred. The bank did not dispute that it had accepted checks without the contractor's endorsement but instead argued that the temporary loss of the mold-removal contract amount had been cured, barring any subsequent action. The court agreed, noting that Section 3.420 preempts common-law causes of action allowing recovery of more than face value and interest for the temporary loss of money.⁷⁷

In *First United Bank v. Panhandle Packing and Gasket, Inc.*,⁷⁸ a plaintiff sued a payor bank on theories of negligence, conversion, and breach of contract because an employee indorsed and cashed some 476 checks payable to the payee, keeping the proceeds for herself. The payee admitted that the employee had authority to indorse checks in the name of the plaintiff. The case went to the jury under a global submission on all three theories, and the jury found in favor of the plaintiff. But the jury also found that the plaintiff was fifty-one percent negligent. The jury did not, however, indicate which theory or theories led to the verdict. On appeal, the Amarillo Court of Appeals held that there was no evidence to support the conversion claim because the judicial admission that the employee had authority to indorse checks meant that the endorsements were not unauthorized endorsements and that the bank had made payment to a person entitled to receive payment as agent on behalf of the plaintiff as principal.⁷⁹ The court further held that the jury finding that the plaintiff was fifty-one percent negligent precluded recovery on the negligence claim.⁸⁰ As to the contract claim, however, the court held that there was some evidence supporting a lack of good faith on the bank's part for failing to observe its own internal policy against paying cash to individuals on checks payable to corporate payees.⁸¹ Because each of the three plaintiff's theories carried different limitations periods, the global submission on all three theories made it impossible to determine the proper limitations period.⁸² The case was remanded for further proceedings on the contract claim arising from the possible failure of the bank to comply with the deposit agreement.⁸³

76. *Id.* at 206–07.

77. *Id.* at 206, 208.

78. 190 S.W.3d 10, 12–14 (Tex. App.—Amarillo 2005, no pet.).

79. *Id.* at 16.

80. *Id.* at 18.

81. *Id.* at 17.

82. *Id.* at 18–19. The respective limitation periods were four years for breach of contract, three years for conversion, and two years for negligence. *Id.* at 18.

83. *Id.*

C. DEFENSES

In *In re Ekuban*,⁸⁴ a bank attempted to enforce a guaranty agreement against a guarantor. There was no reference in the guaranty agreement to a specific loan or account number showing that the guaranty was related to the loan that the bank was attempting to collect. Because the guaranty agreement lacked reference to the loan, it did not contain all of the elements of a guaranty. The Fifth Circuit ruled that the guaranty did not satisfy the statute of frauds's requirements applicable to loan agreements under Texas law and could not be enforced against the guarantor.⁸⁵

In *Mid-South Telecommunications Co. v. Best*,⁸⁶ following default by the maker of a note, two individuals signed a guaranty promising "the prompt and complete payment of all amounts that borrower owes [Plaintiff] under the note, in strict accordance of its terms."⁸⁷ The note remained unpaid. More than four years after the guaranty was signed, the plaintiff sued the guarantors for recovery under the guaranty. Because the plaintiff did not present any grounds for finding accrual of a claim under the guaranty other than the original default, the Austin Court of Appeals held that the action was barred by limitations.⁸⁸

Limitations also barred recovery on a note made payable on demand in *Shankles v. Shankles*.⁸⁹ The limitation period on demand notes begins to run from the date that the note is issued.⁹⁰ Because the action was not commenced for almost eighteen years after the date of issue, the note was unenforceable as a matter of law.⁹¹

IV. BANK TRANSACTIONS

A. DISHONOR OF CHECKS

In *Guerra v. Regions Bank*,⁹² a bank established an account for a customer under the same name as that of another person who was not a customer of the bank. When the account holder wrote several insufficient-funds checks on the account and was subsequently arrested for forgery, the bank closed the account. Afterward, several merchants who received the insufficient-funds checks filed check-fraud information sheets with the local District Attorney. The bank did not file any complaints or provide any information to the District Attorney. An arrest warrant was issued in the name of the account holder, but, because that name was identical to that of the non-customer, the non-customer was

84. 177 F. App'x 407, 409–10 (5th Cir. 2006).

85. *Id.* at 409. Under TEX. BUS. & COM. CODE ANN. §§ 26.01–.02 (Vernon 2002) (loan agreements and guaranties for loans in amounts greater than \$50,000 must be in writing).

86. 184 S.W.3d 386, 387 (Tex. App.—Austin 2006, no pet.).

87. *Id.* at 388.

88. *Id.* at 389, 391–92. The four-year limitations period applicable to the guaranty appears in TEX. CIV. PRAC. & REM. CODE § 16.004(a)(3) (Vernon 2002).

89. 195 S.W.3d 884, 885 (Tex. App.—Dallas 2006, no pet.).

90. *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 16.035 (Vernon 2002)).

91. *Id.*

92. 188 S.W.3d 744, 745–46 (Tex. App.—Tyler 2006, no pet.).

arrested and held in jail for almost a month before being released. The non-customer sued the bank for negligence on the theory that the bank had failed to adequately verify the identity of the person who opened the account. The trial court granted summary judgment for the bank.⁹³

On appeal, the Tyler Court of Appeals noted that a negligence claim requires a defendant to owe a duty to the plaintiff, and whether a duty exists is a question of law.⁹⁴ The plaintiff conceded that Texas law did not create a duty running from the bank to him but urged the court to determine whether a duty should exist based on the Alabama case of *Patrick v. Union State Bank*.⁹⁵ In *Patrick*, the Alabama Supreme Court found a duty existed where a bank opened an account for an impostor who used the plaintiff's lost driver's license and credit card as identification in opening the account. The court in *Guerra* distinguished *Patrick* on the ground that it was foreseeable to some extent in *Patrick* that a person whose lost identification was used to open a bank account could be harmed by misuse of the account.⁹⁶ In the case at bar, the impostor did not supply identification that had been lost by or stolen from the plaintiff, and the bank did not even know of the plaintiff's existence until suit was filed. On this basis, the court held that the bank could not foresee that another person with the same name who lived more than two hundred miles away might be affected by use of the account.⁹⁷ Summary judgment in favor of the bank was affirmed.⁹⁸

B. INTERBANK COLLECTION OF ITEMS

In *Wells Fargo Bank, N.A. v. Citizens Bank of Texas, N.A.*,⁹⁹ a construction company maintained accounts in three banks. One of the banks was located in Texas ("Bank A"). The other two banks were related but separately chartered entities owned by the same parent company, one of which was located in Texas ("Bank B") and the other in Ohio ("Bank C"). Bank A had a correspondent banking relationship with Bank B. Under this arrangement, checks drawn on Bank C and deposited in Bank A were handled for collection by Bank B. Bank B and Bank C also had a "controlled-disbursement account" for the construction company's accounts; whenever a company check was presented for payment from the Bank C account in Ohio, funds would be electronically transferred to Bank C from the company's account in Bank B in Texas. These arrangements worked satisfactorily for several years, but Bank B became concerned that the construction company was engaged in a check-kiting scheme and placed a hold on the company funds in the Bank B account, causing a collapse of the kite. At this point, Bank A was left with unpaid

93. *Id.* at 745.

94. *Id.* at 747.

95. *Id.* at 747. The *Patrick* case appears at 681 So.2d 1364 (Ala. 1996).

96. *Guerra*, 188 S.W.3d at 747-48.

97. *Id.*

98. *Id.* at 748.

99. 181 S.W.3d 790, 792-93 (Tex. App.—Waco 2006, pet. denied).

company checks totaling slightly more than \$8 million. Bank A was able to return almost \$3 million of these checks to Bank B. However, because of the delay resulting from the processing of checks through the controlled-disbursement account with Bank C in Ohio, Bank A suffered a loss of about \$5 million due to the company's overdrawn checks. In an action by Bank A against Bank B, the trial court rendered judgment in favor of Bank A.¹⁰⁰ Bank B appealed.

The Waco Court of Appeals noted that the Federal Reserve disfavors "controlled-disbursement accounts" that extend "float" time but that such accounts are not unlawful.¹⁰¹ Therefore, nothing turned on the mere fact that Bank B and Bank C used such an account arrangement.¹⁰² As to the liability of Bank B for alleged delay in collecting and returning checks, breach of duty of good faith, and breach of duty of ordinary care, the court reasoned that Bank B and Bank C, although owned by the same parent, were separate banks under the definitions in sections 1.201(1) and 4.107.¹⁰³ As separate banks, the collection of three of the four "batches" of checks in question complied with the time limits imposed by section 4.202 on collecting banks and for the return and notice of dishonor time periods required by Reg. CC.¹⁰⁴ As to the fourth "batch," the court held that Bank B did delay in forwarding the checks to the Federal Reserve for transmittal from Texas to Ohio but that no harm was caused to Bank A due to this delay, since the checks would not have been paid by Bank C even if they had reached Bank C a day earlier.¹⁰⁵ The judgment in favor of Bank A was reversed, and judgment was rendered in favor of Bank B.¹⁰⁶

V. LETTERS OF CREDIT

A. PARTIES ENTITLED TO DRAW ON CREDIT

In *Cobb Restaurants, L.L.C. v. Texas Capital Bank*,¹⁰⁷ an applicant obtained a letter of credit from a bank to secure the applicant's obligation for a commercial-lease agreement with the beneficiary. When the letter of credit was near expiration, another entity drew on the letter of credit as a successor-in-interest to the original beneficiary. The bank refused the first attempt to draw on the credit, but, subsequently, the draw was allowed over the applicant's objection. The applicant sued the bank, claiming that the credit was wrongfully honored. The bank counter-claimed for reimbursement and breach-of-the-loan agreements.

100. *Id.* at 792.

101. *Id.* at 795-96.

102. *Id.* at 796.

103. *Id.* at 798-99; *see* TEX. BUS. & COM. CODE ANN. §§ 1.201(b)(7), 4.107 (Vernon 1994 & Supp. 2006).

104. *Wells Fargo Bank, N.A.*, 181 S.W.3d at 803. 12 C.F.R. § 229.30 (2005); *see* TEX. BUS. & COM. CODE ANN. § 4.202 (Vernon 2002).

105. *Wells Fargo Bank, N.A.*, 181 S.W.3d at 809.

106. *Id.* at 810.

107. 201 S.W.3d 175, 176-77 (Tex. App.—San Antonio 2006, no pet.).

The San Antonio Court of Appeals held that payment under the credit would only be proper if the entity was a successor beneficiary by operation of law.¹⁰⁸ The record failed to show that there was a vertical relationship between the beneficiary and the successor; rather, the parties shared a horizontal relationship.¹⁰⁹ Because of the horizontal relationship, the successor did not automatically succeed to the rights of the beneficiary upon dissolution of the beneficiary.¹¹⁰

VI. SECURED TRANSACTIONS

A. WRONGFUL FILING OF FINANCING STATEMENTS

The most common method of perfecting a security interest under Chapter 9 is by filing a financing statement.¹¹¹ One problem with filing, however, is that nothing in Chapter 9 requires verification of the authority of the party making the filing.¹¹² While Section 9.518 allows the filing of a correction statement to identify a filing as a wrongfully filed record, it does not provide penalties for wrongful filing.¹¹³ Texas has addressed this matter by adopting a non-uniform Section 9.5185, which allows a party harmed by a wrongful filing to recover damages and attorney's fees and also allows for criminal prosecution.¹¹⁴

*Federal National Mortgage Association v. Okeke*¹¹⁵ illustrates how costly it may be for a person to make a fraudulent UCC filing. Following default on a mortgage, the debtor contested an order to vacate the property. On the same day that she lost this battle, she filed a UCC-1 stating that she had a security interest in the property. Due to this filing, the foreclosing creditor incurred damages of some \$5,700 in additional costs associated with the foreclosure. In the creditor's action to recover these costs, the United States District Court for the Southern District of Texas found that the debtor had introduced no evidence to support the existence of a security interest and that the creditor had proven the amount of its increased expenses.¹¹⁶ Referring to Section 9.5185, the court ruled that the creditor was entitled to recover its actual costs, its reasonable attorneys' fees, an order releasing the debtor's asserted lien on the property, and \$5,000 in exemplary damages.¹¹⁷ In reaching this decision, the

108. *Id.* at 179.

109. *Id.* at 180.

110. *Id.*

111. See TEX. BUS. & COM. CODE ANN. § 9.310 (Vernon 2002 & Supp. 2006). The same section contains a list of exceptions for certain transactions, but perfection by these methods is less common than filing a UCC-1.

112. This was a deliberate choice by the drafters to make the question of authorization a question for the court rather than an issue to be determined by the filing office. See TEX. BUS. & COM. CODE ANN. § 9.509 cmts. 2-3 (Vernon 2002).

113. See TEX. BUS. & COM. CODE ANN. § 9.518 (Vernon 2002 & Supp. 2006).

114. See TEX. BUS. & COM. CODE ANN. § 9.5185 (Vernon 2002). Damages under this section are allowed in the amount of \$5,000 or the amount of actual damage, whichever is greater.

115. No. Civ. H-04-4405, 2006 WL 355241, at *1-2 (S.D. Tex. 2006).

116. *Id.* at *3.

117. *Id.*

court also held that the filing of the fraudulent financing statement constituted gross negligence on the part of the defendant debtor because she acted with conscious indifference to the effect that such a filing would have on the plaintiff's ability to convey the property.¹¹⁸

B. RIGHTS OF ASSIGNEES

In *Clovis Corp. v. Lubbock National Bank*,¹¹⁹ a company entered into a contract for the sale of accounts receivable to a factor. The factor later sold its interest in the accounts to a bank. The bank subsequently raised the amount of reserve required under the agreement from 12.75% to 17.75%. This action, the company alleged, breached the agreement and constituted both tortious interference with contract and fraud. The company sued the bank and the factor for damages. According to the company, the bank and the factor acted in bad faith in raising the reserve. The trial court granted summary judgment in favor of the bank and the factor but denied recovery of attorneys' fees and court costs. All three parties appealed. The company appealed the grant of summary judgment; the bank and factor appealed denial of attorneys' fees and court costs.

The agreement allowed an increase in reserves if "deemed necessary" by the factor.¹²⁰ The company argued that an implied term required the factor to act in good faith. The Amarillo Court of Appeals ruled that the company could not imply a term if an express term covering a particular subject already existed.¹²¹ The company also failed to explain why the increased reserve was not necessary. As to the recovery of attorneys' fees, the court held that the bank and the factor had only provided unsworn statements of the fees, and this was inadequate to support an award of fees.¹²² As prevailing parties, however, the bank and the factor were entitled to recover court costs.¹²³

C. PRIORITIES

In a case of first impression, the court in *In re Huber Contracting, Ltd.*¹²⁴ addressed the issue of priorities between a bank that held a perfected security interest in a deposit account maintained with the bank and subcontractors that held perfected mechanics' liens. The debtor, a general contractor, obtained a working-capital loan from a bank to finance a construction project. The debtor granted a security interest in its deposit account in favor of the bank. The debtor subsequently hired several subcontractors to complete the project. The subcontractors were never paid,

118. *Id.*

119. 194 S.W.3d 716, 719 (Tex. App.—Amarillo 2006, no pet.).

120. *Id.* at 719.

121. *Id.*

122. *Id.* at 720.

123. *Id.* at 720–21.

124. 347 B.R. 205, 206–07 (Bankr. W.D. Tex. 2006).

and they perfected mechanics' liens under Chapter 53 of the Texas Property Code.¹²⁵

The Western District of Texas Bankruptcy Court held that Section 53.121 of the Texas Property Code does not give subcontractors priority over a contractor's secured creditors.¹²⁶ First, the court stated that, in accordance with Section 9.327, the bank's security interest in the deposit account took priority over any conflicting security interest held by another secured creditor.¹²⁷ Next, after extensive analysis of statutory and legislative history concerning mechanics' liens, the court determined that the phrase "preference over other creditors" in Section 53.121 of the Property Code should be construed as a means of defeating secret liens and fraudulent conveyances, which were serious concerns in the 19th century.¹²⁸ The court stated that the preference language, having arisen in common law in connection with those concerns, was properly understood in a nineteenth-century context and should not be construed to mean that mechanics' liens have priority over the liens of other secured creditors.¹²⁹

In sum, the court decided that the word "preference" and the word "priority" were not synonymous in the context of secured transactions. Finally, the court suggested that the legislature should, for purposes of clarity, insert the word "unsecured" before the word "creditors" in Section 53.121 of the Property Code.¹³⁰ With this change, the Property Code would clearly state the priority relationship between secured creditors and mechanics' liens.

Priority in deposit accounts was also addressed in *Madisonville State Bank v. Citizens Bank of Texas*.¹³¹ Following defaults by a construction company, two banks reached an agreement allocating funds in an account that the company maintained at one of the banks to pay company debts owed to each of the banks. A third bank asserted that it had a superior right to all of the funds as proceeds of company accounts in which the third bank had a superior security interest.

The court rejected the claim of the third bank because the bank failed to introduce sufficient evidence that the funds were, in fact, proceeds of accounts covered by the third bank's security interest.¹³² Because the third bank failed to show that its security interest extended to funds in the deposit account, the court affirmed summary judgment in favor of the

125. *Id.* at 209; see TEX. PROP. CODE § 53.101 (Vernon 2004 & Supp. 2005) et seq. In the context of this case, it is important to note that the mechanics' liens asserted here were not mechanics' liens on goods for which a priority rule is stated in TEX. BUS. & COM. CODE ANN. § 9.333 (Vernon 2002), but mechanics' liens on realty governed by the Texas Property Code.

126. *In re Huber Contracting, Ltd.*, 347 B.R. at 221 (citing TEX. PROP. CODE § 53.121 (Vernon 2005)).

127. *Id.* at 210.

128. *Id.* at 214–15.

129. *Id.* at 220–21.

130. *Id.* at 221–22.

131. 184 S.W.3d 835, 837 (Tex. App.—Beaumont 2006, no pet.).

132. *Id.* at 839.

other banks and upheld the agreement allocating the funds between those banks.¹³³

In *First National Bank in Munday v. Lubbock Feeders, L.P.*,¹³⁴ a debtor entered into an agreement with a feedlot under which the feedlot would lend money to the debtor to finance cattle purchases in exchange for a purchase-money security interest (“PMSI”) in the purchased cattle. The arrangement provided that the debtor would purchase cattle from third-party vendors, and the cattle would be delivered directly from the vendors to the feedlot; thus, the debtor never had possession of the cattle financed by the feedlot. A bank sued the debtor for defaulting on several loans, claiming a security interest in all cattle owned by the debtor “wherever located and whenever acquired.”¹³⁵ The feedlot intervened in the bank’s action, claiming that the feedlot had a superior perfected PMSI in the debtor’s cattle being fed on the feedlot’s property. Summary judgment was granted in favor of the feedlot. The bank appealed, claiming priority in the cattle because the feedlot failed to give notice of its security interest as required by Section 9.324.

The Eastland Court of Appeals reasoned that the loans made by the feedlot allowed the debtor to acquire rights in the collateral sufficient to permit attachment of a security interest.¹³⁶ Furthermore, the loans enabled the debtor to purchase the cattle and qualified as a purchase-money loan perfected by the feedlot taking possession of the cattle.¹³⁷ As to the priority of the purchase-money loan, the court ruled that the notice provision in Section 9.324 did not apply because the requirement is triggered when a debtor takes possession of collateral.¹³⁸ In this case, the debtor never took possession of the cattle, and the feedlot could obtain priority in the cattle without notification.¹³⁹

D. DISPOSITION OF COLLATERAL FOLLOWING DEFAULT

Under Chapter 9, a secured party must dispose of collateral after default in a commercially reasonable manner.¹⁴⁰ In an action for a deficiency, if the debtor challenges the disposition the secured party must prove that all elements of the disposition were reasonable, including the method, manner, time, place, and other terms of the disposition.¹⁴¹ If a disposition is not commercially reasonable, the debtor’s liability may be

133. *Id.* at 839–40.

134. 183 S.W.3d 875, 879–80 (Tex. App.—Eastland 2006, pet. denied).

135. *Id.* at 877–78.

136. *Id.* at 884–85. TEX. BUS. & COM. CODE ANN. § 9.324(d) (Vernon 2002) allows a party with a PMSI to obtain priority over an earlier perfected security interest if the purchase-money party gives notice of its interest before the debtor receives possession of the collateral.

137. *Id.* at 883.

138. *Id.* at 885.

139. *Id.* at 883.

140. TEX. BUS. & COM. CODE ANN. § 9.610(a) (Vernon 2002).

141. TEX. BUS. & COM. CODE ANN. § 9.610(b).

reduced or even eliminated entirely.¹⁴² The mere fact that a low price is obtained for the collateral does not, in itself, show that a disposition was commercially unreasonable.¹⁴³

In *Lister v. Lee-Swofford Investments, L.L.P.*,¹⁴⁴ an auction sale of tractor parts and equipment following default by the debtors resulted in gross proceeds of \$13,544. After expenses were deducted, the sale yielded \$6,304.19. In a challenge to the secured party's deficiency claim, the secured party provided evidence about the advertising, location, time, manner, and method of disposition of the collateral. The debtors countered with evidence that the value of the collateral was much higher, though just how much higher was unclear; the testimony ranged from a low of about \$84,000 to a high of over \$1 million.¹⁴⁵ The debtors also introduced evidence that a sale by auction was not the way to sell inventory and equipment of this kind and that better prices could have been obtained by more individualized, direct sales.¹⁴⁶ This was disputed, in turn, by evidence that another method of sale would have been prohibitively expensive.

The Amarillo Court of Appeals concluded that reasonable persons could differ on whether the disposition was commercially reasonable, and it upheld the trial court's judgment that the evidence supported a commercially reasonable disposition.¹⁴⁷

This case makes interesting reading because of the court's detailed discussion of the evidence introduced by both parties on the issue of commercially reasonable disposition. To the extent it describes the evidence introduced by the parties, it is a useful guide for discovery and preparation for trials on this issue.

142. TEX. BUS. & COM. CODE ANN. § 9.626(a) (Vernon 2002).

143. TEX. BUS. & COM. CODE ANN. §§ 9.626(a)-(b).

144. 195 S.W.3d 746, 748 (Tex. App.—Amarillo 2006, no pet.).

145. *Id.* at 750-51.

146. *Id.* at 751.

147. *Id.* at 753.