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COMMERCIAL TRANSACTIONS

John Krahmer*

BECAUSE 2002 was not a legislative year in Texas, the bulk of this Survey discusses cases decided during 2002 under the Uniform Commercial Code as contained in the Texas Business and Commerce Code (the "Code").¹ During this time period, however, the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved a complete revision of the general provisions contained in Article 1 of the Code and submitted this revision to the several states for possible enactment. Because revised Article 1 may be considered during the 2003 Texas legislative session, this Survey discusses some of the more important changes made by this revision.²

I. GENERAL PROVISIONS

A. CONSPICUOUSNESS

In *Dresser Industries, Inc. v. Page Petroleum*,³ the Texas Supreme Court held that the Code standard for conspicuousness was to be applied to all contracts, whether or not the particular contract otherwise involved a subject covered by the Code.⁴ This standard was applied in *American In-*

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1. The Texas enactment of the Uniform Commercial Code is contained in the first eleven chapters of the Code. See TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Vernon 1994, 2002 & Supp. 2003). 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: Warehouse Receipts, Bills of Lading and Other Documents of Title
Chapter 8: Investment Securities
Chapter 9: Secured Transactions; Sales of Accounts and Chattel Paper
Chapter 10: (reserved for Expansion)
Chapter 11: Effective Date and Transition Provision—1973 Amendments

2. See *infra* note 18.

3. *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993).

4. TEX. BUS. & COM. CODE ANN. § 1.201(10) (Vernon 1994) provides that "[a] term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it Whether a term or clause is 'conspicuous' or not is for decision by the court."

*demnity Lloyds v. Travelers Property & Casualty Co.*⁵ to determine if an indemnity provision in a contract between a general contractor and a subcontractor was “conspicuous” so as to require the subcontractor to indemnify the general contractor for injuries suffered by an employee that arose out of work covered by the subcontract. The court held that because the indemnity provision was separately numbered and appeared on the face of the contract without being hidden by a misleading heading or surrounded by unrelated terms, it was “conspicuous” as a matter of law.⁶

Similarly, in *Ranger Insurance Co. v. American International Specialty Lines Insurance Co.*,⁷ the Houston Court of Appeals applied the Code standard to conclude that indemnity terms in an oil field drilling contract were “conspicuous” where the terms appeared on the face of a footage drilling contract in separately numbered paragraphs under a heading printed in bold, capital letters in a slightly larger font size.⁸ The court also noted that the indemnity terms were not contained within a group of unrelated terms, but were contained in the paragraphs dealing with the subject matters covered by the general heading.⁹

B. ACCELERATION CLAUSES

Section 1.208 of the Code permits terms allowing the acceleration of payment or performance “at will,” provided that the acceleration is done in the good faith belief that the prospect of payment or performance is impaired.¹⁰ A continuing issue under Texas law is determining the relationship between an acceleration clause and a usury savings clause. This issue is critical because a lender commits usury under Texas law by contracting for, charging, or receiving interest in an amount greater than that allowed by law.¹¹ Whether a savings clause prevented a contract from being usurious on its face when the same contract also contained an acceleration clause that could result in the charging of excess interest was addressed in *In re Auto International Refrigeration*.¹² The court reasoned that the mere possibility that an acceleration clause might result in the charge of excess, unearned interest would not make a contract usurious on its face if a savings clause limited the amount of interest to the maxi-

5. *Am. Indem. Lloyds v. Travelers Prop. & Cas. Co.*, 189 F. Supp. 2d 630 (S.D. Tex. 2002).

6. *Id.* at 634-35.

7. *Ranger Ins. Co. v. Am. Int'l Specialty Lines Ins. Co.*, 78 S.W.3d 659 (Tex. App.—Houston [1st Dist.] 2002, no pet.).

8. *Id.* at 665. The heading of the indemnity provisions read, “RESPONSIBILITY FOR LOSS OR DAMAGE, INDEMNITY, RELEASE OF LIABILITY AND ALLOCATION OF RISK.” *Id.*

9. *Id.*

10. TEX. BUS. & COM. CODE ANN. § 1.208 (Vernon 1994). Section 3.106 makes it clear that the negotiability of an instrument is not affected by the inclusion of an acceleration clause. *Id.* at § 3.106.

11. TEX. FIN. CODE ANN. § 305.001 (Vernon Supp. 2003).

12. *In re Auto Int'l Refrigeration*, 275 B.R. 789 (Bankr. N.D. Tex. 2002).

num allowed by Texas law.¹³ It should be noted that this result seems to be in conflict with the conclusion reached in *Armstrong v. Steppes Apartments, Ltd.*,¹⁴ where a note contained both an acceleration clause and a savings clause. The Fort Worth Court of Appeals held that the savings clause did not prevent the note from being facially usurious because the clause was directly contrary to the explicit terms of the note.¹⁵ *Armstrong* has been criticized for failing to explain why the note in question was usurious on its face.¹⁶ There seems to be a fine, if not invisible line, between the usurious and non-usurious inclusion of acceleration clauses and savings clauses in contracts and notes that are governed by Texas law.¹⁷

C. THE REVISION OF UCC ARTICLE 1

The final draft of revised Article 1 of the Code was approved by the National Conference of Commissioners on Uniform State Laws at its annual meeting in August, 2001.¹⁸ Revised Article 1 is divided into three sub-parts: Part 1, General Provisions; Part 2, General Definitions and Principles of Interpretation; and Part 3, Territorial Applicability and General Rules. Except for the renumbering and relocation of various sections contained in the present Article 1, several of the provisions remain unchanged. There are, however, four main areas where significant substantive changes have taken place.

First, revised section 1-102 explicitly states that the substantive rules of Article 1 apply only to transactions covered by other Articles of the Code. Thus, the statute of frauds provision contained in the former section 1-206¹⁹ applicable to kinds of personal property not otherwise covered by the Code has been deleted as being inconsistent with the premise of revised section 1-102. It is reasonable to expect that this change (if adopted in Texas) will eventually lead to a revisitation of the decision in *Dresser Industries, Inc. v. Page Petroleum*.²⁰ In *Dresser*, the Texas Supreme Court made the Code standards of conspicuousness generally ap-

13. *Id.* at 817. In reaching this conclusion, the court relied on the rule announced in *Smart v. Tower Land & Inv. Co.*, 597 S.W.2d 333, 341 (Tex. 1980), where the court stated that "unless the contract by its express and positive terms evidences an intention which requires a construction that unearned interest [is] to be collected in all events, the court will give it the construction that the parties intended that the unearned interest should not be collected."

14. *Armstrong v. Steppes Apartments, Ltd.*, 57 S.W.3d 37 (Tex. App.—Fort Worth 2001, pet. denied).

15. *Id.* at 47. In support of its conclusion, the court cited *First State Bank v. Dorst*, 843 S.W.2d 790, 793 (Tex. App.—Austin 1992, writ denied).

16. See DAN L. NICEWANDER, J. SCOTT SHEEHAN, RICHARD BARR WEST, TEXAS USURY LAW HANDBOOK § 20.12 (Supp. 2002).

17. Further discussion on the operation of savings clauses may be found in DAN L. NICEWANDER, J. SCOTT SHEEHAN, RICHARD BARR WEST, TEXAS USURY LAW HANDBOOK §§ 4.9 & 20.12 (West 1997 & Supp. 2002).

18. The final text as approved by NCCUSL may be found in UNIFORM COMMERCIAL CODE 2002 OFFICIAL TEXT WITH COMMENTS, App. XVII (West 2002).

19. TEX. BUS. & COM. CODE ANN. § 1.206 (Vernon 1994 & Supp. 2003).

20. *Dresser Indus., Inc.*, 853 S.W.2d at 505.

plicable to contracts of all types, whether or not otherwise governed by the Code. Nothing in revised section 1-102, however, prohibits a court from applying Code rules to non-Code cases, so it is unlikely that this statutory change would alone reverse *Dresser*.

Second, revised section 1-103 clarifies the application of supplementary principles of law and clarifies the circumstances under which the Code is preemptive. This section also restates the relationship between the purposes and procedures of the Code and other law.

Third, revised section 1-201 defines "good faith" to include observance of "reasonable commercial standards of fair dealing" in addition to "honesty in fact" as it now appears in section 1-201(19).²¹ This change conforms to the definition of "good faith" in Article 1. The revised definition of "good faith" appears in all of the other Articles of the Code, with the exception of Article 5, which continues to define "good faith" as meaning only "honesty in fact."²²

Fourth, and perhaps most importantly, revised section 1-301, derived from the former section 1-105,²³ substantially changes the default choice of law provisions. Under section 1-301, the parties may choose the law of any state to govern their transaction, regardless of whether the transaction bears a reasonable relation to that state. In the case of an international transaction, a similar rule allows the parties to choose the law of any country whether or not that country bears a reasonable relation to the transaction. However, because such an open-ended choice of law rule has an obvious potential for abuse, other provisions in revised section 1-301 provide that if one of the parties is a consumer, the choice of law provision may not deprive the consumer of legal protections afforded by the law of the state or country in which the consumer resides or of the state or country where the consumer contracts for and takes delivery of the goods. Furthermore, the use of the law of a designated state or country is ineffective to the extent that application of that law violates a fundamental public policy of the state or country that has jurisdiction to adjudicate a dispute arising out of the transaction. If a contract is silent on a choice of law, the law of the forum state will govern.

Additional reading on the revision of Article 1 may be found in the sources collected in the accompanying footnote.²⁴

21. TEX. BUS. & COM. CODE ANN. § 1.201(19) (Vernon 2002).

22. § 5.102(7) (Vernon 2002).

23. § 1.105 (Vernon 1994 & Supp. 2003).

24. A series of Reporter's Memoranda and Preliminary Drafts on Article 1 may be found at <http://www.nccusl.org> (last visited Feb. 19, 2003). An excellent series of articles in print form appears in the *Symposium on Revised Article 1 and Proposed Revised Article 2 of the Uniform Commercial Code*, 54 SMU L. REV. 469-1087 (2001). An article dealing with the choice of law provisions in revised Article 1 appears in Richard K. Greenstein, *Is the Proposed U.C.C. Choice of Law Provision Unconstitutional?*, 73 TEMP. L. REV. 1159 (2000).

II. SALE OF GOODS

A. SCOPE OF CHAPTER 2

Section 2.102 of the Code applies to transactions in goods.²⁵ In *Jones v. CGU Insurance Co.*,²⁶ the plaintiff alleged that she became ill after eating some canned smoked oysters. Acting *pro se*, she sued both the producer and its insurance company. The insurance company was dismissed from the action and the producer settled with the plaintiff. The plaintiff appealed the dismissal of the insurer. The Austin Court of Appeals held that the insurer was properly dismissed from the suit because Texas law does not permit direct actions by third parties against liability insurers.²⁷ The court further held that the plaintiff's claim against the insurer for breach of express and implied warranties would not lie because the sale of an insurance policy is not a sale of goods.²⁸

B. STATUTE OF FRAUDS

The general statute of frauds rule in section 2.201 is that a contract for the sale of goods at a price of more than five hundred dollars must be in writing and signed by the party against whom enforcement is sought.²⁹ Even without a writing, however, a contract can satisfy the statute of frauds requirement if it meets one of three stated statutory exceptions: (1) if the goods are specially manufactured for the buyer and are not suitable for resale to others, (2) if the party against whom enforcement is sought admits in pleadings, testimony, or otherwise in court that a contract was made, or (3) if payment for the goods has been made and accepted, or if the goods have been received and accepted.³⁰

In *Hugh Symons Group v. Motorola, Inc.*,³¹ the plaintiff buyer attempted to satisfy the statute of frauds by using e-mail correspondence sent between the parties.³² The court rejected this contention because the e-mail did not confirm the existence of a contract but seemed to be "preliminary information" exchanged between the parties.³³ As an alternative, the plaintiff attempted to meet the payment exception by showing that payment had been made and accepted. To meet this exception, the plaintiff introduced a "*pro forma invoice*" showing the shipment of goods

25. TEX. BUS. & COM. CODE ANN. § 2.102 (Vernon 1994).

26. *Jones v. CGU Ins. Co.*, 78 S.W.3d 626 (Tex. App.—Austin 2002, no pet.).

27. *Id.* at 629.

28. *Id.*

29. TEX. BUS. & COM. CODE § 2.201(a) (Vernon 1994).

30. § 2.201(c)(1)-(3) (Vernon 1994).

31. *Hugh Symons Group v. Motorola, Inc.*, 292 F.3d 466 (5th Cir. 2002).

32. The "flurry of correspondence" noted by the court was apparently introduced to either satisfy the general statute of frauds requirement or to meet the requirement of TEX. BUS. & COM. CODE ANN. § 2.201(b) (Vernon 1994) providing that, as between merchants, "a writing [sent] in confirmation of the contract and sufficient against the sender" will also satisfy the statute of frauds requirement against the recipient provided the recipient "has reason to know [the] contents" of the writing and fails to object to the contents "within ten days after it is received." *Hugh Symons Group*, 292 F.3d at 469.

33. *Id.* at 469-70.

valued at four-hundred-sixty dollars from the seller to the buyer.³⁴ The court rejected the adequacy of this evidence because the “*pro forma invoice*” listed only the value of the goods, not their price, and did not demand payment.³⁵ The plaintiff introduced no evidence in the form of checks, receipts, drafts, or other documents indicating that any payment had been made to the seller.³⁶ The court ruled that the plaintiff failed to meet any exception to the statute of frauds.³⁷

Application of the Code standard of good faith has been the subject of considerable litigation in recent years.³⁸ In *Mathis v. Exxon Corp.*,³⁹ the court, in a carefully reasoned opinion, addressed the scope of the duty of good faith in the context of open price terms under section 2.305 of the Code.⁴⁰ The court noted that no case in Texas or in the Fifth Circuit had addressed the question of whether an agreement of the parties that the seller fix the price “in good faith” requires satisfaction of both the subjective and the objective elements of good faith.⁴¹

The issue arose because of a dispute between franchisees of retail gas stations and a major gasoline producer regarding the price fixed by the producer on a month-to-month basis for the sale of gasoline to the retail franchisees. The franchisees contended that the price fixed by the producer was not fixed in good faith because the price was consistently four to five cents higher per gallon than was economically justifiable. According to the franchisees, the higher price was intended to drive them out of business so that the producer could replace their stores with company-owned stores.⁴² The producer argued that the price charged to its franchisees was within the range of “dealer tank wagon” prices charged by its competitors and that this satisfied the good faith requirement because such a price was commercially reasonable.⁴³

34. *Id.* at 470.

35. *Id.*

36. *Id.*

37. *Id.*

38. *See, e.g.*, *El Paso Natural Gas Co. v. Minco Oil & Gas, Inc.*, 8 S.W.3d 309 (Tex. 1999) (code requirement of good faith not applicable to termination of contract to purchase natural gas contract) (discussed in John Krahmer, *Commercial Transactions*, 53 SMU L. REV. 729, 731 (2000)); *Lenape Res. Corp. v. Tenn. Gas Pipeline Co.*, 925 S.W.2d 565 (Tex. 1996) (duty of good faith is a background principle of duties under output and requirements contracts) (discussed in John Krahmer, *Commercial Transactions*, 50 SMU L. REV. 1025, 1030-31 (1997)).

39. *Mathis v. Exxon Corp.*, 302 F.3d 448 (5th Cir. 2002).

40. *Id.* at 454-57. TEX. BUS. & COM. CODE ANN. § 2.305 (Vernon 1994) permits parties to conclude a contract for sale even though the price is left open. If the parties have agreed that the price is to be fixed by the buyer or the seller, the price must be one that is fixed in good faith.

41. *Mathis*, 302 F.3d at 455. The definition of good faith applicable to Chapter 2 appears in TEX. BUS. & COM. CODE ANN. § 2.103(a)(2) (Vernon 1994 & Supp. 2003). As defined in the Code, good faith requires both “honesty in fact” and “observance of reasonable commercial standards.”

42. *Mathis*, 302 F.3d at 452-53.

43. *Id.* at 454. A “dealer tank wagon” price is the price charged from time to time for gasoline delivered by tank truck to a retail gasoline outlet.

According to the court, the heart of the dispute was whether good faith required observance of *both* subjective and objective good faith in light of the apparent “safe harbor” described in Official Comment 3.⁴⁴ The producer contended that a price that was fixed according to an established price schedule was within the safe harbor described in Comment 3. The court reasoned, however, that this safe harbor was not absolute because, based on the structure of the Code, its legislative history, and case law from other jurisdictions, the use of a price schedule is commercially reasonable only if the schedule itself is created in subjective good faith.⁴⁵ The court held that the plaintiff franchisees had produced enough evidence to show that the prices fixed by the seller were determined, not by economic factors alone, but by a desire to replace franchised outlets with company owned stores.⁴⁶ The judgment of the district court, which was based on a jury finding that the producer had not fixed the price in good faith, was affirmed.⁴⁷

C. WARRANTIES

As usual, several cases involving the Code rules dealing with warranties, disclaimers, and limitation of remedy were reported during the Survey period. Two of the cases⁴⁸ involved what appears to be a misreading of the Texas Supreme Court opinion in *Southwestern Bell Telephone Co. v. FDP Corp.*,⁴⁹ where the court held that a claim for breach of an express warranty could be asserted in the context of a services contract. The court noted that, “although the case at bar involves a service transaction, reference to the Code is instructive.”⁵⁰ In its discussion of the Code rules on express warranty, the court stated, “The UCC recognizes that breach of contract and breach of warranty are not the same cause of action.”⁵¹ In *Ellis v. Precision Engine Rebuilders, Inc.*,⁵² the Houston Court of Appeals quoted this sentence in holding that a buyer who sued a seller for breach of contract for the delivery of defective goods failed to plead

44. *Id.* at 454-55. TEX. BUS. & COM. CODE ANN. § 2.305 cmt. 3 (Vernon 1994) provides:

Subsection (2), dealing with the situation where the price is to be fixed by one party rejects the uncommercial idea that an agreement that the seller may fix the price means that he may fix any price he may wish by the express qualification that the price so fixed must be fixed in good faith. Good faith includes observance of reasonable commercial standards of fair dealing in the trade if the party is a merchant. (Section 2-103). But in the normal case a “posted price” or a future seller’s or buyer’s “given price,” “price in effect,” “market price,” or the like satisfies the good faith requirement.

45. *Mathis*, 302 F.3d at 457.

46. *Id.* at 458-59.

47. *Id.* at 462.

48. *JHC Ventures, L.P. v. Fast Trucking, Inc.*, No. 04-01-00251-CV, 2002 WL 31662057 (Tex. App.—San Antonio, November 27, 2002, no pet. h.); *Ellis v. Precision Engine Rebuilders, Inc.*, 68 S.W.3d 894 (Tex. App.—Houston [1st Dist.] 2002, no pet.).

49. *Southwestern Bell Tel. Co. v. FDP Corp.*, 811 S.W.2d 572 (Tex. 1991).

50. *Id.* at 575.

51. *Id.* at 576.

52. *Ellis*, 68 S.W.3d at 894.

his claim as a breach of warranty action. A strong dissenting opinion argued that the majority (1) misapplied *Southwestern Bell*, (2) failed to recognize that breach of warranty claims are merely a subset of breach of contract claims, and (3) created a pleading requirement akin to the common law forms of action.⁵³

In *JHC Ventures, L.P. v. Fast Trucking, Inc.*,⁵⁴ the plaintiff sued for breach of an express warranty made in connection with the sale of trucks. The plaintiff also sought recovery of attorney's fees under the Civil Practices and Remedies Code provisions allowing such recovery in contract actions.⁵⁵ Although the San Antonio Court of Appeals held that the buyer could recover for breach of warranty, it also quoted the statement from *Southwestern Bell* that the "UCC recognizes that breach of contract and breach of warranty are not the same cause of action," and denied the recovery of attorney's fees because the plaintiff had sued for breach of warranty and not for breach of contract.⁵⁶ Although this holding seems erroneous, the issue was mooted because the plaintiff also asserted that the breach of warranty was a violation of the Deceptive Trade Practices Act (DTPA).⁵⁷ Because the DTPA itself allows the recovery of attorney's fees, the fees could be awarded on that basis even if they were not recoverable for a breach of warranty claim under the Code.⁵⁸

This use of a single sentence from *Southwestern Bell* to support a questionable, if not indefensible, bright line distinction between breach of contract claims and breach of warranty claims is reminiscent of how the phrase "inextricably intertwined" was first used in *Knight v. International Harvester Credit Corp.*⁵⁹ In *Knight*, the phrase "inextricably intertwined" took on a new dimension as an additional theory of vicarious liability until the Texas Supreme Court clarified its use of the phrase in *Qantel Business Systems, Inc. v. Custom Controls Co.*⁶⁰ It is likely that the same kind of clarification will be needed in regard to the statement in *Southwestern Bell* that the "UCC recognizes that breach of contract and breach of warranty are not the same cause of action."⁶¹

In a case addressing a somewhat less philosophical issue than the relationship between breaches of contract and breaches of warranty, *Womco*,

53. *Id.* at 899-900.

54. *JHC Ventures, L.P.*, 2002 WL 31662057.

55. TEX. CIV. PRAC. & REM. CODE ANN. § 38.001(8) (Vernon 1997) allows recovery of reasonable attorney's fees if the claim is based on an "oral or written contract."

56. *JHC Ventures*, 2002 WL 31662057, at *4. It is worth noting that the court cited *Ellis*, 68 S.W.3d at 894, discussed *supra* note 52 in reaching this conclusion.

57. *JHC Ventures*, 2002 WL 31662057, at *8. The Deceptive Trade Practices Act appears as TEX. BUS. & COM. CODE ANN. § 17.43-.63 (Vernon 2002). Actions under the Act for breach of warranty are permitted by § 17.50(a)(2).

58. *JHC Ventures*, 2002 WL 31662057, at *8. The recovery of attorney's fees under the DTPA is permitted by TEX. BUS. & COM. CODE ANN. § 17.50(d) (Vernon 2002).

59. *Knight v. Int'l Harvester Credit Corp.*, 627 S.W.2d 382, 389 (Tex. 1982).

60. *Qantel Bus. Sys., Inc. v. Custom Controls Co.*, 761 S.W.2d 302, 305 (Tex. 1988). In *Qantel*, the court explained that the "inextricably intertwined" phrase had been taken out of the context in which it had been used.

61. *Southwestern Bell Tel. Co.*, 811 S.W.2d at 576.

Inc. v. Navistar International Corp.,⁶² the Tyler Court of Appeals held that a disclaimer of warranty must not only meet the requirements of section 2.316 regarding terminology and conspicuousness, but that the seller must also show that the buyer had an opportunity to examine the disclaimer prior to consummation of the contract of sale.⁶³ Because the seller failed to show that the disclaimer was communicated to the buyer prior to the sale, summary judgment was inappropriate on the issue of whether the disclaimer was effective.⁶⁴

In *Oakwood Mobile Homes, Inc. v. Cabler*,⁶⁵ the seller of a mobile home argued that a disclaimer of oral statements contained in the delivery instructions and in the Homeowners Information form amounted to an “as is” disclaimer of liability for defects in the home. The El Paso Court of Appeals held that the unequal bargaining position of the parties and the reliance of the buyers on the representations of the seller rendered the written disclaimers in a “huge stack” of documents ineffective.⁶⁶ Furthermore, the evidence indicated that the seller “did not intend to perform the repairs it promised.”⁶⁷ This evidence, coupled with the ineffectiveness of the disclaimers, resulted in the affirmance of the judgment of the trial court in favor of the plaintiff buyers for \$121,450, except for \$2,500 in expert witness fees that the plaintiffs agreed to omit from the final judgment.⁶⁸

There is a story in the legal literature, perhaps only apocryphal, about a lawyer who once argued a case before the House of Lords in London. Part of his argument concerned the question of whether the owner of land also owned the rights above and below his land. In response to the question, “Mr. Sullivan, have your clients not heard of the maxim, ‘*cujus est solum, ejus est usque ad coelum et ad inferos*?’ (the owner of land owns to the sky and to the depths),” the lawyer answered, “My lords, the peasants of Northern Ireland speak of little else.”⁶⁹ Perhaps the same could be said about FIFRA which, as we all know, is the acronym for the Federal Insecticide, Fungicide, and Rodenticide Act.⁷⁰

For matters within its scope, FIFRA preempts state law claims that rely on advertising, labeling, and marketing materials as the basis for breach of warranty, DTPA, and fraud claims. In *Dow Agrosciences, LLC v. Bates*,⁷¹ a herbicide manufacturer sought a declaratory judgment against

62. *Womco, Inc. v. Navistar Int'l Corp.*, 84 S.W.3d 272 (Tex. App.—Tyler, 2002, no pet.).

63. *Id.* at 280.

64. *Id.*

65. *Oakwood Mobile Homes, Inc. v. Cabler*, 73 S.W.3d 363 (Tex. App.—El Paso 2002, pet. denied).

66. *Id.* at 371-72.

67. *Id.* at 372.

68. *Id.* at 376.

69. Although this is not the only reference to this story, this particular version may be found in *Steel Creek Dev. Corp. v. James*, 294 S.E.2d 23, 27 n.2 (N.C. Ct. App. 1982).

70. 7 U.S.C. §§ 136a-136y (2000).

71. *Dow Agrosciences, LLC v. Bates*, 205 F. Supp. 2d 623 (N.D. Tex. 2002).

a group of peanut farmers to determine the parties' rights and liabilities under FIFRA regarding warranty, DTPA, and fraud allegations made by the farmers. As to the warranty claims, the court held that FIFRA preempted the claims because they were based on allegedly inaccurate statements on the product label.⁷² Alternatively, the court also ruled that, even if the claims were not preempted, a conspicuous disclaimer on the label would effectively foreclose the claims under state law.⁷³ As to the fraud claims, the court ruled that, to the extent that the claims were based on remarks that reflected the statements made on the product label, the claims were preempted.⁷⁴ The court further held, however, that claims based on statements that went beyond those on the product label were not preempted, but that such claims were subject to the limitation of liability stated on the label.⁷⁵ Under section 2.719 of the Code, the liability of a seller can be limited to remedies stated in the contract, such as repair, replacement, or refund.⁷⁶ The court held that the farmers' remedies were limited to refund or replacement as provided in the limitation of remedy provision stated on the product label.⁷⁷

In *American Cyanamid Co. v. Geye*,⁷⁸ another group of peanut farmers successfully avoided FIFRA preemption of their claims for crop damage based on breach of warranty, strict liability and DTPA violations. The critical difference in this case was the reasoning by the court that FIFRA only preempts state law claims when the Environmental Protection Agency (EPA) has exercised its authority to regulate the labeling of a product.⁷⁹ Because the EPA had chosen not to regulate the effectiveness of the herbicides in question, there were no labeling or packaging requirements imposed by FIFRA that would preempt the state law claims.⁸⁰

In the significant decision of *Centex Homes v. Buecher*,⁸¹ the Texas Supreme Court clarified the extent to which the warranties implied in the construction and sale of a new home can be disclaimed. A brief review of the Texas law on this subject will make the importance of *Centex* more evident.

In *Humber v. Morton*,⁸² the Texas Supreme Court held that the construction and sale of a new home carried with it a warranty of habitability

72. *Id.* at 626.

73. *Id.* at 627. TEX. BUS. & COM. CODE ANN. § 2.316(b) (Vernon 1994) permits the disclaimer of warranties.

74. *Dow Agrosciences, LLC*, 205 F. Supp. 2d at 627. On this point the court relied on the earlier Fifth Circuit decision in *Andrus v. AgrEvo USA Co.*, 178 F.3d 395 (5th Cir. 1999), holding that claims linked to statements on a product label are preempted by FIFRA.

75. *Dow Agrosciences, LLC*, 205 F. Supp. 2d at 628.

76. TEX. BUS. & COM. CODE ANN. § 2.719 (Vernon 1994).

77. *Dow Agrosciences, LLC*, 205 F. Supp. 2d at 628.

78. *Am. Cyanide Co. v. Geye*, 79 S.W.3d 21 (Tex. 2002).

79. *Id.* at 23.

80. *Id.*

81. *Centex Homes v. Buecher*, 95 S.W.3d 266 (Tex. 2002).

82. *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968).

and good workmanship. In *G-W-L, Inc. v. Robichaux*,⁸³ the court held that this warranty could be disclaimed. However, in *Evans v. J. Stiles, Inc.*,⁸⁴ the court revisited *Humber* and held that the intent of *Humber* was to create not one, but two warranties—a warranty of habitability and a warranty of good workmanship. In *Melody Home Manufacturing Co. v. Barnes*,⁸⁵ the court created an implied warranty of good workmanship in the repair or modification of tangible goods or property and further ruled that this warranty could not be disclaimed. In the same opinion, the court stated, “To the extent that it conflicts with this opinion, we overrule *G-W-L, Inc. v. Robichaux*.”⁸⁶

The difficulty with the partial overruling of *Robichaux* was determining the “extent” of the overruling, a difficulty predicted by this author soon after the opinion in *Melody* was handed down.⁸⁷ That issue has now been addressed in *Centex*.⁸⁸ Under that decision, the parties to an agreement for the sale of a new home “may supersede the implied standard for workmanship, but the agreement cannot simply disclaim it.”⁸⁹ An attempted disclaimer is effective only when the agreement “provides for the manner, performance or quality of the desired construction.”⁹⁰ As to the separate warranty of habitability, the court stated that this warranty “may not be disclaimed generally,” but added that the warranty only extends to latent defects and “does not include defects, even substantial ones, that are known by or expressly disclosed to the buyer.”⁹¹

It is important to note that *Centex* only addressed the warranty of good workmanship in connection with the sale of new homes. It does not address the question of whether the warranty of good workmanship in the repair or modification of tangible goods or property may be disclaimed.⁹²

III. NEGOTIABLE INSTRUMENTS

A. FORM OF INSTRUMENTS

Under section 3.104 of the Code, an instrument can include not only a requirement that the obligor pay a “fixed amount of money,” but also a requirement that the payment include the payment of interest.⁹³ Section

83. *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392 (Tex. 1982).

84. *Evans v. J. Stiles, Inc.*, 689 S.W.2d 399 (Tex. 1985).

85. *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987).

86. *Id.* at 355.

87. See John Krahmer, *Commercial Transactions*, 42 Sw. L.J. 217, 224 (1988).

88. *Centex Homes*, 95 S.W.3d at 266.

89. *Id.* at 274.

90. *Id.* at 275.

91. *Id.*

92. As Peter Lawrence Berra, the noted neurologist, once observed, “Prediction is difficult, particularly about the future.” The author will, nonetheless, hazard a prediction that the “anti-disclaimer rule” of *Melody Home Mfg. Co.* will eventually parallel the treatment accorded in *Centex* to the implied warranty of good workmanship in the sale of a new home.

93. TEX. BUS. & COM. CODE ANN. § 3.104(a) (Vernon 2002) provides, *inter alia*, that a “negotiable instrument” means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order”

3.112 expands on this rule by providing that interest can be stated as either a fixed or variable amount of money or expressed as a fixed or variable rate or rates.⁹⁴ In *Montgomery First Corp. v. Caprock Investment Corp.*,⁹⁵ the holder of a note moved for summary judgment to recover the balance due on the note, including interest that was tied to the base rate of a failed bank. The Eastland Court of Appeals held that, in the case of a variable interest rate tied to the base rate of a failed bank, the holder was required to establish a "reasonable rate" as a substitute for the rate stated in the note.⁹⁶ Because of a failure to establish this rate, the holder did not meet its summary judgment burden and the case was remanded for further proceedings.⁹⁷

One of the features of a negotiable instrument is the ability to transfer the instrument from one person to another by indorsement or assignment. In *Vernor v. Southwest Federal Land Bank Ass'n*,⁹⁸ the defendant makers of a promissory note argued that the note was non-assignable. The San Antonio Court of Appeals held that, as a matter of law, a provision in the note referring to the "Bank or the owner or holder of the note" indicated that the parties contemplated that the note might be transferred.⁹⁹ The court further noted that there was nothing in the note prohibiting assignment.¹⁰⁰ The assignment of the note was, therefore, proper and the plaintiff holder was entitled to recover on it.¹⁰¹

94. TEX. BUS. & COM. CODE ANN. § 3.112(b) (Vernon 2002) provides:

Interest may be stated in an instrument as a fixed or variable amount of money or it may be expressed as a fixed or variable rate or rates. The amount or rate of interest may be stated or described in the instrument in any manner and may require reference to information not contained in the instrument. If an instrument provides for interest, but the amount of interest payable cannot be ascertained from the description, interest is payable at the judgment rate in effect at the place of payment of the instrument and at the time interest first accrues, and the instrument shall not by virtue of this sentence be considered to violate the provisions of Title 4, Finance Code.

95. *Montgomery First Corp. v. Caprock Inv. Corp.*, 89 S.W.3d 179 (Tex. App.—Eastland 2002, no pet.).

96. *Id.* at 186. The court based its ruling on the prior cases of *Bailey, Vaught, Robertson & Co. v. Remington Investments, Inc.*, 888 S.W.2d 860, 866 (Tex. App.—Dallas 1994, no writ) (finding that a reasonable rate of interest should be used if a note is tied to the prime rate or base rate of a failed bank), and *Commercial Services of Perry, Inc. v. Wooldridge*, 968 S.W.2d 560, 564 (Tex. App.—Fort Worth 1998, no pet.) (same). Because of the large number of bank failures during the 1980s, the *Bailey* case, in particular, resolved an important issue about the proper rate to be applied when an interest rate was tied to the rate of a failed bank.

97. *Montgomery First Corp.*, 89 S.W.3d at 187.

98. *Vernor v. Southwest Fed. Land Bank Ass'n*, 77 S.W.3d 364 (Tex. App.—San Antonio 2002, pet. denied).

99. *Id.* at 366.

100. *Id.* On the issue of clauses prohibiting assignment, it is important to note that TEX. BUS. & COM. CODE ANN. §§ 9.406 & 9.408 (Vernon 2002), effective on July 1, 2001, now contain a number of provisions that invalidate anti-assignment clauses. A discussion and analysis of these sections appears in John Kraemer, *Anti-Assignment Clauses and Structured Settlements Under Revised Article 9*, 56 CON. FIN. L.Q. REP. 25 (2002).

101. *Vernor*, 77 S.W.3d at 367.

B. LIABILITY OF PARTIES

Chapter 3 of the Code divides instruments into two broad categories. Those that meet the formal requirements of section 3.104 are “negotiable instruments.” Those that do not meet the requirements are non-negotiable. While Chapter 3 by its own terms applies only to negotiable instruments, a court may choose to apply the rules of Chapter 3 by analogy in appropriate cases.¹⁰² Whether negotiable or non-negotiable, a promissory note is merely a specialized form of contract and is subject to the usual rules of contract interpretation. This principle was recognized in *Fein v. R.P.H., Inc.*,¹⁰³ where the Houston Court of Appeals held that a note signed by a maker “without recourse” limited the holder’s remedy to the foreclosure of collateral securing the note.¹⁰⁴ The court based this conclusion on language in the note stating that the maker was “without liability, warranty or obligation” and that there was “no personal guaranty” of the maker to pay the note.¹⁰⁵

One of the baseline rules of Chapter 3 is that a party is not liable on an instrument unless the party signed the instrument or it was signed by an agent or representative of the party.¹⁰⁶ In the ordinary course of events, this rule also means that, absent negligence, a party is not liable on an instrument if the party’s signature is forged.¹⁰⁷ However, determining whether a party was or was not negligent can be a difficult and uncertain inquiry. Due to this uncertainty, a party may want to obtain forgery insurance to guard against the risk of an adverse ruling on this issue. In *Travelers Casualty & Surety Co. of America v. Baptist Health System*,¹⁰⁸ the plaintiff purchased such insurance to protect itself against losses caused by forgery. As matters developed, a vendor with whom the plaintiff dealt submitted a series of invoices for work that was never performed, and the invoices bore the forged signatures of various managers employed by the plaintiff. Over a period of time, the plaintiff’s accounts payable department issued almost nine-hundred-thousand dollars worth of checks to the dishonest vendor. When the scheme was discovered, the

102. See TEX. BUS. & COM. CODE ANN. § 3.102(a) (Vernon 2002) (“This chapter applies to negotiable instruments.”). However, section 3.104, comment 2 (Vernon 2002) notes that “nothing in Section 3-104 or in Section 3-102 is intended to mean that in a particular case involving [a non-negotiable instrument] a court could not arrive a result similar to the result that would follow if the writing were a negotiable instrument.” TEX. BUS. & COM. CODE ANN. § 3.104 cmt. 2 (Vernon 2002).

103. *Fein v. R.P.H., Inc.*, 68 S.W.3d 260 (Tex. App.—Houston [14th Dist.] 2002, pet. denied).

104. *Id.* at 266-67.

105. *Id.* at 263. The court did not mention that the note in question provided that the maker promised to “Pay to” the payee instead of stating that the maker promised to “Pay to the order of” the payee. Except in the case of checks, the failure to make an instrument payable to order or bearer renders the instrument non-negotiable. TEX. BUS. & COM. CODE ANN. § 3.104(a), (c) (Vernon 2002).

106. See TEX. BUS. & COM. CODE ANN. § 3.401(a) (Vernon 2002).

107. See TEX. BUS. & COM. CODE ANN. § 3.406(a) (Vernon 2002).

108. *Travelers Cas. & Sur. Co. of Am. v. Baptist Health Sys.*, 313 F.3d 295 (5th Cir. 2002).

plaintiff filed a proof of loss under its forgery policy. The insurer denied the claim and the plaintiff sued. On cross-motions for summary judgment based on undisputed facts, the plaintiff prevailed in the trial court.¹⁰⁹ On appeal, however, the decision of the trial court was reversed and judgment was entered for the insurer.

The critical language in the policy dealing with forgery coverage provided that the insurer would pay for losses resulting from forgeries on “Covered Instruments” that were “made or drawn by or drawn upon [the insured]” or “made or drawn by one acting as [the insured’s] agent.”¹¹⁰ “Covered Instruments” were defined to include “checks, drafts, promissory notes or similar written promises, orders or directions to pay a sum certain in ‘Money.’”¹¹¹ Based on this language, the court found that the forged invoices were not “Covered Instruments.”¹¹² As written, the policy protected against losses caused by the forgery of a drawer’s or maker’s name as those terms are defined in section 3.103 of the Code.¹¹³ Because the invoices were neither drafts nor notes that ordered or promised the payment of money, there was no coverage under the policy.¹¹⁴

In addition to drawers and makers, another group of persons who may be liable for the payment of instruments are those who sign as guarantors. A guaranty may be part of the instrument itself and, in this case, the guarantors are termed “accommodation part[ies]” by section 3.419 of the Code.¹¹⁵ The guaranty may also take the form of a separate agreement under which the guarantor agrees to pay the instrument when it comes due if it is not paid by the principal obligor. If a guaranty takes the form of a separate agreement, a question may arise as to whether the transfer of an instrument is also effective to transfer the obligation of the guarantor. This situation arose in *Escalante v. Luckie*,¹¹⁶ where four guarantors signed guaranty agreements to secure loans evidenced by three separate promissory notes. All three notes were assigned by the original payees to the same assignee. When the makers failed to pay the notes, the assignee sued both the makers and the guarantors. The assignee proved that he had possession of the guaranty agreements and introduced them into evidence, even though the assignment of a note does not automatically assign an underlying agreement.¹¹⁷ The Eastland Court of Appeals held that possession of the agreements was sufficient to show that the guaranties had been assigned to the assignee.¹¹⁸ Although the assignee was able

109. *Id.* at 297.

110. *Id.* at 298.

111. *Id.*

112. *Id.* at 299.

113. Under TEX. BUS. & COM. CODE ANN. § 3.103(a)(3), (5) (Vernon 2002), the drawer of a draft (which includes checks) is defined as the person ordering payment; the maker of a note is defined as the person who agrees to pay.

114. *Id.*

115. TEX. BUS. & COM. CODE ANN. § 3.419(a) (Vernon 2002).

116. *Escalante v. Luckie*, 77 S.W.3d 410 (Tex. App.—Eastland 2002, pet. denied).

117. *Id.* at 416.

118. *Id.*

to show that all three notes and guaranties had been assigned, he was able to recover on only two of them because one of the three guaranties was a limited guaranty that did not show it was related to the particular note in question.¹¹⁹ As to one of the notes, judgment was rendered in favor of the guarantors; as to the other two notes, judgment was rendered in favor of the assignee.¹²⁰

In *El Paso Refining, Inc. v. Scurlock Permian Corp.*,¹²¹ a guarantor attempted to avoid liability under a continuing guaranty by asserting the defense of usury. The El Paso Court of Appeals first considered whether a claim that a transaction was usurious had to be proven by clear and convincing evidence or by a preponderance of the evidence.¹²² After reviewing conflicting lines of authority on this issue, the court held that the better view was to apply a preponderance of the evidence standard as being consistent with the general burden of proof standard in civil cases.¹²³ Having settled the burden of proof issue, the court turned to the question of whether the guarantor had standing to assert usury as a defense to its guaranty.¹²⁴ Based on the language of the guaranty agreement and on prior Texas case law, the court held that the guarantor lacked standing to raise the defense of usury.¹²⁵

In *La Salle Bank, N.A. v. Sleutal*,¹²⁶ the guarantor asserted a right of offset as a defense in a deficiency action following the foreclosure sale of real estate securing a promissory note. The guarantor argued that he was permitted an offset under section 51.003 of the Texas Property Code because the foreclosure price was below the fair market value of the property.¹²⁷ Although the court agreed that the statute permits a right of offset when a foreclosure price is below fair market value, the critical issue before the court was whether the guarantor had waived the right of offset by the terms of the guaranty agreement. The court found that no Texas cases had addressed the issue of waiver of the right of offset; therefore, it had to rely on statutory interpretation to determine if this right

119. *Id.* at 417.

120. *Id.* at 423.

121. *El Paso Ref., Inc. v. Scurlock Permian Corp.*, 77 S.W.3d 374 (Tex. App.—El Paso 2002, pet. denied).

122. *Id.* at 380-81.

123. *Id.* at 382. In reaching this conclusion, the court rejected the contrary line of case that began with *Great Southern Life Insurance Co. v. Williams*, 105 S.W.2d 277 (Tex. Civ. App.—Amarillo 1937, no writ), characterizing the case as “nothing more than an anomaly.” *Id.*

124. *Id.*

125. *Id.* at 386. The cases relied on by the court included *Ginsberg 1985 Real Estate Partnership v. Cadle Co.*, 39 F.3d 528, 534 (5th Cir. 1994) (under Texas law a guarantor does not escape obligation by asserting usury); *Houston Sash & Door Co. v. Heaner*, 577 S.W.2d 217, 222 (Tex. 1979) (same); and *Universal Metals & Machinery v. Bohart*, 539 S.W.2d 874, 878 (Tex. 1976) (use of the term “primary obligor” does not make a guarantor a co-maker or co-obligor jointly liable for repayment).

126. *LaSalle Bank v. Sleutal*, 289 F.3d 837 (5th Cir. 2002).

127. *Id.* at 839; TEX. PROP. CODE ANN. § 51.003(c) (Vernon 1995) provides, in part, that “[i]f the court determines that the fair market value [of the real property] is greater than the sale price of the real property at the foreclosure sale, the persons against whom recovery of the deficiency is sought are entitled to an offset against the deficiency”

could be waived. Applying the principle of *inclusio unius est exclusio alterius*, the court found that numerous other provisions in the Property Code specifically prohibited waivers.¹²⁸ Because it was evident that the “Texas Legislature knows how to preclude waiver of statutory provisions when it so desires,” the court held that the Legislature’s failure to preclude waiver of the right of offset indicated that waivers were allowed and that the guaranty agreement had effectively waived that right.¹²⁹

C. STATUTE OF LIMITATIONS

Section 3.118 of the Code provides a variety of limitation periods applicable to different kinds of instruments.¹³⁰ While most of the provisions in section 3.118 do not require examination of other law, section 3.118(h) is an exception because of its reference to the Texas Civil Practice and Remedies Code.¹³¹ In *Aguero v. Ramirez*,¹³² the plaintiff filed suit on a promissory note some five years after its due date. The defendant contended that because the note was secured by real property, the applicable statute of limitations was the four-year period specified in the Civil Practice and Remedies Code.¹³³ The Corpus Christi Court of Appeals disagreed, pointing out that the plaintiff was not seeking to foreclose a real property lien, but was seeking to enforce a right to payment. Because the plaintiff was only seeking to enforce a note, the six-year limitation period applicable to notes payable at a definite time was the appropriate limitation period to apply.¹³⁴

IV. BANK TRANSACTIONS

In *Southwest Bank v. Information Support Concepts, Inc.*,¹³⁵ an employee stole checks payable to her employer and deposited them in her

128. *La Salle Bank*, 289 F.3d at 841. The court noted that waivers were prohibited in, e.g., TEX. PROP. CODE ANN. § 28.006(a) (Vernon 2000) (waiver of prompt payment to contractors and subcontractors); § 54.043(b) (waiver of rights concerning landlord’s liens); § 59.004 (waiver of rights in self-service facility contracts); and § 62.022 (waiver of real estate broker’s right to lien).

129. *La Salle Bank*, 289 F.3d at 841.

130. See, e.g., TEX. BUS. & COM. CODE ANN. § 3.118(a) (Vernon 2002) (limitation period for notes payable at a definite time is six years from the due date); § 3.118(c) (action on unaccepted draft must be brought within three years after dishonor or within ten years after issue if no dishonor occurs); § 3.118(d) (action on certified check, teller’s check, cashier’s check, or traveler’s check must be brought within three years after demand for payment).

131. TEX. BUS. & COM. CODE ANN. § 3.118(h) (Vernon 2002) provides, “This section does not apply to an action involving a real property lien covered by Section 16.035 or 16.036, Civil Practice and Remedies Code.”

132. *Aguero v. Ramirez*, 70 S.W.3d 372 (Tex. App.—Corpus Christi 2002, pet. denied).

133. *Id.* at 374. TEX. CIV. PRAC. & REM. CODE § 16.035(a) (Vernon 2002) provides that “[a] person must bring suit for the recovery of real property under a real property lien or the foreclosure of a real property lien not later than four years after the day the cause of action accrues.”

134. *Aguero*, 70 S.W.3d at 375. The six year limitation period for notes payable at a definite time appears in TEX. BUS. & COM. CODE ANN. § 3.118(a) (Vernon 2002).

135. *Southwest Bank v. Info. Support Concepts, Inc.*, 85 S.W.3d 462 (Tex. App.—Fort Worth 2002, pet. filed).

personal account. The checks were not indorsed by the employer, and the employer did not have an account with the bank; however, the bank still accepted the deposits. The employer sued the employee's bank for conversion under section 3.420.¹³⁶ The bank argued the employer was contributorily negligent, had assumed the risk of its employee's dishonesty, and had failed to mitigate its damages. The bank also sought to add the employee to the suit through the proportionate responsibility statute.

The Fort Worth Court of Appeals held that the trial court properly denied the bank's motion to join the employee as a responsible third party because the UCC provides the rules for loss allocation in a negotiable instruments setting, and the Texas Civil Practice and Remedies Code conflicts with the Code on this subject.¹³⁷ The court noted that the Code provides banks with proportionate responsibility defenses when an employer's negligence contributes to forgeries and alterations of an instrument, but it does not apply the idea of proportionate responsibility to conversion cases arising under section 3.420, which utilizes an absolute liability standard.¹³⁸ While the court agreed that the Code provided the employee's bank with a claim against the employee for breach of transfer warranties, the employee's bank had no claim against the employer because the bank was in the best position to discover the missing indorsements.¹³⁹

In *Moorehouse v. Chase Manhattan Bank*,¹⁴⁰ a non-customer payee cashed a check drawn on a bank customer's business account and the bank charged a fee for cashing the check. The payee sued the bank alleging that such a fee (1) was a conversion under the Code, (2) violated the Texas Theft and Liability Act,¹⁴¹ (3) resulted in unjust enrichment of the bank, and (4) constituted fraud. The bank's motion for summary judgment was granted on all causes of action. The payee appealed.¹⁴²

The San Antonio Court of Appeals held that the motion for summary judgment was properly granted. As to the conversion claim, the court found that the holder failed to show that she had demanded return of the check and that the bank failed to return it on demand.¹⁴³ The court also held there was no violation of the Texas Theft and Liability Act because the payee consented to the bank's possession of the check.¹⁴⁴ Further-

136. *Id.* at 463. TEX. BUS. & COM. CODE ANN. § 3.420 (Vernon 2002) permits actions for conversion if an instrument is taken by improper transfer or if payment is made to a person who is not entitled to enforce the instrument.

137. *Southwest Bank*, 85 S.W.3d at 467. The conflict noted by the court concerned the loss allocation rules in TEX. BUS. & COM. CODE ANN. §§ 3.405-406 (Vernon 2002) and the proportionate responsibility rules in TEX. CIV. PRAC. & REM. CODE § 33.002(a) (Vernon 1997).

138. *Southwest Bank*, 85 S.W.3d at 467.

139. *Id.* at 467-68.

140. *Moorehouse v. Chase Manhattan Bank*, 76 S.W.3d 608 (Tex. App.—San Antonio 2002, no pet.).

141. TEX. PENAL CODE ANN. §§ 31.03, 31.06 & 31.08 (Vernon 2003).

142. *Moorehouse*, 76 S.W.3d at 611.

143. *Id.* at 613.

144. *Id.* at 614.

more, no fraud existed because there was no fiduciary relationship between the payee and the bank requiring disclosure of the fee until the holder sought to cash the check. Because the bank did disclose the fee at that time, the fraud claim would not lie.¹⁴⁵ Judgment in favor of the bank was affirmed.¹⁴⁶

In *FNFS, Ltd. v. Security State Bank & Trust*,¹⁴⁷ an embezzler who had authority to sign checks for his employer cashed more than one hundred thousand dollars worth of checks at the payor bank. Most of the checks named the payor bank as the payee, but a few checks named third parties as the payee. The Austin Court of Appeals correctly held that no indorsement was required for the checks made payable to the payor bank because the act of payment was not a “negotiation” of the checks but was instead a final settlement of those checks.¹⁴⁸ As to the checks made payable to third parties, the court held that, while an indorsement was required for those checks, the employer was required to offer some evidence that the intended payees did not receive the funds. No such evidence was produced. Summary judgment was affirmed in favor of the bank.

In *Community Bank & Trust, S.S.B. v. Fleck*,¹⁴⁹ the personal representative of a deceased bank customer sued the bank to recover the amount of five checks that had been forged on the customer’s account prior to the customer’s death. Although the deposit agreement provided that claims based on unauthorized signatures or alterations had to be made within fourteen days after the bank sent a statement of account to the customer, some eleven months passed before the representative asserted a claim against the bank. Based on the deposit agreement, the bank refused to pay. In an action against the bank, the representative alleged that all conditions precedent to the representative’s right to maintain the suit had been performed. The bank answered with a pleading that asserted the limitations rules in section 4.406 of the Code, including a requirement that notice of a claim be given with “reasonable” promptness.¹⁵⁰ Inexplicably, however, the bank did not assert the fourteen day limitation contained in the deposit agreement in its pleading (a point that initially seemed to be of no consequence, but took on great significance when the case reached the Texas Supreme Court).

145. *Id.* at 614-15.

146. *Id.* at 615.

147. *FNFS, Ltd. v. Sec. State Bank & Trust*, 63 S.W.3d 546 (Tex. App.—Austin 2001, pet. denied).

148. The purpose of a negotiation is to give the transferee the status of a holder under TEX. BUS. & COM. CODE ANN. § 3.201 (Vernon 2002). Because the function of a payor bank is to pay an instrument, a signature made by the person presenting an instrument at the time of presentment is not an indorsement, but rather a signed receipt for payment. See TEX. BUS. & COM. CODE ANN. § 3.501(b)(2)(C) (Vernon 2002).

149. *Cmty. Bank & Trust, S.S.B. v. Fleck*, No. 00-1122, 2002 WL 31719856 (Tex. Dec. 5, 2002) (per curiam) (opinion not yet released for publication).

150. *Id.* at *1; TEX. BUS. & COM. CODE ANN. § 4.406(c) (Vernon 2002).

At trial, the representative moved for summary judgment and the bank responded by arguing that it did not receive notice within the fourteen days required by the deposit agreement. The representative objected that the bank did not plead the terms of the deposit agreement in its answer and had not specifically denied the allegations of the complaint. Because of this failure on the part of the bank, the representative was not required to prove that the conditions precedent had been met and judgment was entered in favor of the representative. Even after this issue was raised, the bank did not amend its pleadings.

On appeal to the Beaumont Court of Appeals, the bank again raised the fourteen day limitation period contained in the deposit agreement.¹⁵¹ Addressing this contention, the court affirmed the trial court on the theory that section 16.071(a) of the Texas Civil Practice and Remedies Code invalidates contract provisions requiring a claimant to give notice of a claim for damages within ninety days as a condition of bringing suit.¹⁵² On further appeal, the Texas Supreme Court held that the court of appeals erred because the supreme court had previously ruled that section 16.071(a) did not apply to deposit agreements because the notice required by such agreements is not notice of a claim for damages, but notice that an account transaction was unauthorized.¹⁵³ The supreme court specifically disapproved this portion of the court of appeals' decision. Notwithstanding this error, the judgment of the trial court and the court of appeals was upheld because the bank had never raised the deposit agreement in its pleadings as a defense to the eleven-month delay by the representative.¹⁵⁴ The supreme court pointed out, however, that it intimated no view on whether the fourteen day notice requirement in the deposit agreement was reasonable.¹⁵⁵

V. LETTERS OF CREDIT

Letters of credit are a curious creation of the law. On the one hand, they resemble guaranties; on the other hand, they resemble independent contracts. On top of this, they are governed, sometimes, by Chapter 5 of the Uniform Commercial Code.¹⁵⁶ The parties are free, however, to choose other applicable law if they so desire, most commonly the Uniform Customs and Practice for Documentary Credits (UCP), a document copyrighted by the International Chamber of Commerce (ICC). The

151. The opinion of the court of appeals is reported in *Community Bank & Trust, S.S.B. v. Fleck*, 21 S.W.3d 923 (Tex. App.—Beaumont 2000, pet denied).

152. *Cnty. Bank & Trust, S.S.B.*, 21 S.W.3d at 924-25. TEX. CIV. PRAC. & REM. CODE ANN. § 16.071(a) (Vernon 1997) provides, in part, that “[a] contract stipulation that requires a claimant to give notice of a claim for damages as a condition precedent to the right to sue on the contract is not valid unless the stipulation is reasonable. A stipulation that requires notification within less than 90 days is void.”

153. On this point, the court cited its prior decision in *American Airlines Employees Federal Credit Union v. Martin*, 29 S.W.3d 86, 97 (Tex. 2000).

154. *Cnty. Bank & Trust, S.S.B.*, 2002 WL 31719856, at *2.

155. *Id.*

156. TEX. BUS. & COM. CODE ANN. §§ 5.101 -.118 (Vernon 2002).

UCP has not been enacted as law in any jurisdiction and the contents are often unknown to the parties who adopt it (and they may adopt any one of the five different iterations that have been published by the ICC, the most recent being UCP 500).¹⁵⁷

In *Voest-Alpine Trading USA Corp. v. Bank of China*,¹⁵⁸ to facilitate a purchase, a buyer of plastics obtained a letter of credit from the Bank of China providing for payment to the seller of 1.2 million dollars upon the seller's presentation of specified documents to the issuer. The letter of credit incorporated UCP 500. The seller presented the documents to the issuer on August 9, 1995. Under UCP 500, the issuer had until August 18, 1995 to refuse to honor the letter of credit.¹⁵⁹ The issue before the court was whether a telex from the issuer sent on August 11th constituted an effective notice of refusal to honor, particularly since it contained a clause stating, "We [the issuer] are contacting the applicant for acceptance of the relative documents of the relative discrepancy. Holding documents at your risk and disposal."¹⁶⁰

Under both Chapter 5 of the Code and under the UCP, whether an issuer has acted properly in honoring or dishonoring a presentation under a letter of credit is measured by the "standard practice" of issuers.¹⁶¹ The court held that the language of the telex failed to use the standard language for refusal of a presentation and created an ambiguity as to whether the documents might be accepted at a later date if waiver by the applicant was obtained. Judgment in favor of the beneficiary was affirmed.

In *Synergy Center, Ltd. v. Lone Star Franchising, Inc.*,¹⁶² a restaurant lessee entered into a commercial lease agreement. A condition of the lease required the lessee to establish a "credit line of \$100,000 for the sole purpose of acting in lieu of a monetary guarantee in the event of [the lessee's] default."¹⁶³ Prior to the end of the lease term, the lessee ceased operating the restaurant. The lessor immediately notified the lessee that it was in default under the lease and demanded accelerated payments of all the rent remaining under the lease. If the lessee did not pay the accelerated rent within seven days of the notice, the lessor threatened to draw under the letter of credit. The lessee sought a temporary injunction to enjoin the lessor from making a presentation.

157. INT'L CHAMBER OF COMMERCE PUB. NO. 500, ICC UNIFORM CUSTOMS & PRACTICE FOR DOCUMENTARY CREDITS (1993) [hereinafter UCP]. Prior versions were numbered as 100, 200, etc.

158. *Voest-Alpine Trading USA Corp. v. Bank of China*, 288 F.3d 262 (5th Cir. 2002).

159. Under UCP 500, Art. 14(d), the issuer must give notice of dishonor within seven banking days following the date of presentation. TEX. BUS. & COM. CODE ANN. § 5.108(b) (Vernon 2002) requires that notice be given in the same length of time.

160. *Voest-Alpine Trading USA Corp.*, 288 F.3d at 266.

161. See TEX. BUS. & COM. CODE ANN. § 5.108(c) (Vernon 2002) and the description of "standard practice" under UCP 500 outlined by the court. *Voest-Alpine Trading USA Corp.*, 288 F.3d at 266-67.

162. *Synergy Ctr., Ltd. v. Lone Star Franchising, Inc.*, 63 S.W.3d 561 (Tex. App.—Austin 2001, no pet.).

163. *Id.* at 563.

The Austin Court of Appeals held that a party cannot enjoin a presentation under a letter of credit unless there is evidence of fraud and, in this case, there was no such evidence.¹⁶⁴ According to the court, a mere contractual dispute between the parties would not bar the lessor from exercising its rights under the lease.¹⁶⁵ Moreover, the lessor had not acted unscrupulously so as to deny it the right to make a presentation under the letter of credit.¹⁶⁶

In *Parkans International LLC v. Zurich Insurance Co.*,¹⁶⁷ a buyer purchased scrap metal from an exporter under a letter of credit. The exporter failed to ship the scrap metal, but obtained payment by using fraudulent documents. The buyer suffered a heavy loss and sought compensation from its insurer under the forgery coverage clause in its insurance policy. The insurer contended that the claim was not covered by the buyer's policy. The critical language in the policy provided that the insurer would pay for the loss of "Covered Instruments such as checks, drafts, promissory notes, or similar written promises, orders or directions to pay a sum certain in 'money' that are made or drawn by or drawn upon [the insured.]"¹⁶⁸ The insurer denied the claim on the ground that, because the insured did not "draw" the documents, the loss was not covered.¹⁶⁹

The court agreed with the insurer and held that the forgeries were not "covered instruments" because the forged documents had not been "drawn by or upon" the insured.¹⁷⁰ The documents, instead, had been forged by the beneficiary and the draw was made on the issuer of the letter of credit, not on the beneficiary.¹⁷¹

VI. SECURED TRANSACTIONS

A. SCOPE OF CHAPTER 9

In addition to covering true security interests, revised Chapter 9 now covers agricultural liens; sales of accounts, chattel paper, payment intangibles, and promissory notes; consignments; and security interests aris-

164. An injunction against honor may be obtained under TEX. BUS. & COM. CODE ANN. § 5.109(b) (Vernon 2002) if "honor of the presentation would facilitate a material fraud by the beneficiary." On this point, the court noted that Chapter 5 of the Code had been substantially amended in 1999. *Synergy Ctr., Ltd.*, 63 S.W.3d 565, 566 n.3. In the view of the court, however, the amendments did not change the circumstances when fraud might form the basis for injunctive relief under the interpretation of the prior version of Chapter 5 by the Texas Supreme Court in *Phillip Bros. v. Oil Country Specialists, Ltd.*, 787 S.W.2d 38, 40-41 (Tex. 1990).

165. *Synergy Center, Ltd.*, 63 S.W.3d at 566.

166. *Id.*

167. *Parkans Int'l LLC v. Zurich Ins. Co.*, 299 F.3d 514 (5th Cir. 2002).

168. *Id.* at 516. This policy language is almost identical to that considered in *Travelers Casualty & Surety Co. of America v. Baptist Health System*, 313 F.3d 295 (5th Cir. 2002), where a similar result was reached in the context of negotiable instruments. See *supra* note 108.

169. *Parkans Int'l LLC*, 299 F.3d at 517.

170. *Id.*

171. *Id.*

ing under Chapters 2, 4, and 5.¹⁷² *Tri-State Chemicals, Inc. v. Western Organics, Inc.*,¹⁷³ a consignment case, provides an interesting fact situation illustrating some of the changes made by revised Chapter 9 in regard to consignments.

In *Tri-State*, a consignor provided goods to a consignee under an arrangement in which the consignee was to sell the goods on behalf of the consignor. The consigned goods and any proceeds from their sale were to be kept separate from other property or funds of the consignee. In violation of the agreement, the consignee deposited proceeds in its general operating account and, from time to time, used those proceeds to purchase equipment or other assets for use by the consignee. Approximately two years after the consignment relationship began, the consignee sold its entire business to a purchaser. Because the consignor had not been paid for all of the consigned goods, it sued the purchaser to recover the shortfall. The Amarillo Court of Appeals held that the arrangement between the parties was a "true" consignment and not merely a consignment intended to create a security interest.¹⁷⁴ Because this was a true consignment, an action by the consignor to recover the value of its property would lie. The purchaser responded by arguing that title to the consigned goods vested in the consignee by virtue of the former section 2.326, and that the consignee therefore acquired title to the goods and their proceeds when it purchased the business.¹⁷⁵ The court disagreed, pointing out that the protections of the former section 2.326 applied to creditors of the consignor, not to purchasers.¹⁷⁶ The purchaser further argued that proceeds from the sale of consigned goods could not be traced to its hands. The court noted, however, that deposition testimony by the president of the consignee provided some basis for tracing the proceeds to various assets purchased by the consignee.¹⁷⁷ Because this was an appeal from a summary judgment granted in favor of the purchaser, the court concluded that there were genuine issues of material fact as to whether the purchaser was a creditor of the consignee and whether the proceeds could be adequately traced.¹⁷⁸

172. TEX. BUS. & COM. CODE ANN. § 9.109(a) (Vernon 2002).

173. *Tri-State Chems, Inc. v. W. Organics, Inc.*, 83 S.W.3d 189 (Tex. App.—Amarillo 2002, pet. denied).

174. *Id.* at 197. This determination was important because the former Chapter 9 only applied to transactions "intended to create a security interest." See the former TEX. BUS. & COM. CODE ANN. § 9.102(a)(1) (Vernon 1994).

175. *Tri-State Chems., Inc.*, 83 S.W.3d at 197-98. TEX. BUS. & COM. CODE ANN. § 2.326(c) (Vernon 1994 & Supp. 2003) formerly protected creditors of a consignee from claims by the consignor unless the consignee was generally known by either reputation or sign posting to be selling consigned goods or the consignor filed a financing statement under Chapter 9. Because revised Chapter 9 now covers most commercial consignments, TEX. BUS. & COM. CODE ANN. § 2.326 (Vernon 1994 & Supp. 2003) no longer contains these provisions.

176. *Tri-State Chems., Inc.*, 83 S.W.3d at 198.

177. *Id.*

178. *Id.*

Analyzing this fact situation under revised Chapter 9 reveals some important changes. First, the former Chapter 9 covered consignments intended to create a security interest, but it did not cover true consignments.¹⁷⁹ This rule has now been changed, and Chapter 9 applies to consignments generally.¹⁸⁰ Revised Chapter 9 now clarifies the rights of “creditors” and “purchasers” *vis-à-vis* a consignee in section 9.319.¹⁸¹ The Comment to this section notes that the revision “to a considerable extent reformulates the former law . . . without changing the results.”¹⁸² Under revised Chapter 9, the inquiry as to whether the case involved a creditor or a purchaser still seems to be relevant. There is, however, one

179. See former TEX. BUS. & COM. CODE ANN. § 9.102(a) (Vernon 1994).

180. There are modest exceptions to the coverage of revised Chapter 9 in regard to consignments. Section 9.102(a)(20) (Vernon 2002) defines a consignment as:

“Consignment” means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:

(A) the merchant:

- (i) deals in goods of that kind under a name other than the name of the person making delivery;
- (ii) is not an auctioneer; and
- (iii) is not generally known by its creditors to be substantially engaged in selling the goods of others;

(B) with respect to each delivery, the aggregate value of the goods is \$1,000 or more at the time of delivery;

(C) the goods are not consumer goods immediately before delivery;

(D) the transaction does not create a security interest that secures an obligation; and

(E) the transaction does not involve delivery of a work of art to an art dealer, as provided by Chapter 2101, Occupations Code.

Under this definition, certain transactions, *e.g.*, consumer goods valued at less than \$1000 per delivery, and works of art, are not “consignments” and would not be covered by Chapter 9.

181. TEX. BUS. & COM. CODE ANN. § 9.319 (Vernon 2002) now provides:

(a) Except as otherwise provided in Subsection (b), for purposes of determining the rights of creditors of, and purchasers for value of goods from, a consignee, while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods identical to those the consignor had or had power to transfer.

(b) For purposes of determining the rights of a creditor of a consignee, law other than this chapter determines the rights and title of a consignee while goods are in the consignee’s possession if, under this subchapter, a perfected security interest held by the consignor would have priority over the rights of the creditor.

182. TEX. BUS. & COM. CODE ANN. § 9.319 cmt. 2 (Vernon 2002), 2 which states in part:

Insofar as creditors of the consignee are concerned, this Article to a considerable extent reformulates the former law, which appeared in former Sections 2-326 and 9-114, without changing the results. However, neither Article 2 nor former Article 9 specifically addresses the rights of non-ordinary course buyers from the consignee. Former Section 9-114 contained priority rules applicable to security interests in consigned goods. Under this Article, the priority rules for purchase-money security interests in inventory apply to consignments. See Section 9-103(d). Accordingly, a special section containing priority rules for consignments no longer is needed. Section 9-317 determines whether the rights of a judicial lien creditor are senior to the interest of the consignor, Sections 9-322 and 9-324 govern competing security interests in consigned goods, and Sections 9-317, 9-315, and 9-320 determine whether a buyer takes free of the consignor’s interest.

difference that may change the result in a case like *Tri-State*. Because of the expanded coverage of consignments in revised Chapter 9, it now appears critical to determine whether the consignor filed a financing statement showing its consignment interest. This is so because revised section 9.317 allows a non-ordinary course buyer to take free of a security interest (which includes a consignment under the revision) if the buyer gives value and receives delivery without knowledge of the security interest before it is perfected.¹⁸³ Although the consignment agreement in *Tri-State* permitted the consignor to file a financing statement, there is no indication in the opinion as to whether it actually did so. The revision, therefore, would inject a new issue into the case.

B. CREATION OF SECURITY INTEREST

*Van Hattem v. Dublin National Bank*¹⁸⁴ nicely illustrates the importance of having a proper description in both a security agreement and a related financing statement. In *Van Hattem*, a husband signed a promissory note and security agreement granting a security interest to Creditor 1 in “dairy cows owned by [husband and wife].”¹⁸⁵ A financing statement was filed describing the collateral as “ALL farm products, inventories, accounts receivable and livestock (including all increases and supplies) including but not limited to all livestock, now owned or hereafter acquired, and all proceeds thereof.”¹⁸⁶ The wife did not sign the note, the security agreement, or the financing statement. Husband and wife subsequently borrowed money from Creditor 2 and granted a security interest in all dairy cattle then owned or thereafter acquired by them. Both husband and wife signed the documents for this loan without listing the prior security interest on their financial statement.

Some two years later, the debtors sold their dairy herd at auction. Creditor 2 did not know that this sale was to occur but, after the sale, was contacted by the auction house for instructions on how the proceeds were to be distributed. Creditor 2 instructed the auction house to issue three checks made jointly payable to husband and Creditor 2. All three checks were indorsed by husband, and he delivered them to Creditor 2. At that time, Creditor 2 had no knowledge of the prior debt owed to Creditor 1. The amount of the checks was credited to the debt owed to Creditor 2. After learning that Creditor 2 had the proceeds of the sale, Creditor 1 sued Creditor 2 for conversion.¹⁸⁷

The court held that, even if the security agreement was enforceable against both husband and wife on the theory that the property was joint management community property, there was a discrepancy between the

183. TEX. BUS. & COM. CODE ANN. § 9.317(c) (Vernon 2002).

184. *Van Hattem v. Dublin Nat'l Bank*, No. 4:01-CV-0706-A, 2002 WL 245981 (N.D. Tex. Feb. 15, 2002) (not reported in F. Supp. 2d).

185. *Id.* at *2.

186. *Id.* at *3.

187. *Id.* at *1.

narrow description in the security agreement and the broader description in the financing statement.¹⁸⁸ Given this discrepancy, the description in the security agreement controlled, and the security interest was limited to cattle owned at the time the security interest was created.¹⁸⁹ Creditor 1 was not entitled to recover, therefore, because there was no showing that the cattle sold by the debtors were the ones covered by the security agreement.¹⁹⁰ Even if such a showing had been made, the court went on to hold that, because of the lack of knowledge on the part of Creditor 2 about Creditor 1's interest in the cattle, Creditor 2 would qualify as a holder in due course of the checks issued as proceeds of the sale and would be entitled to priority under section 9.309 of the former Chapter 9.¹⁹¹ Summary judgment was granted in favor of Creditor 2.¹⁹²

C. PERFECTION AND PRIORITY

In *In re Stage Stores, Inc.*,¹⁹³ a finance lessor (creditor) purchased an airplane and leased it back to a debtor. The lease was recorded with the Federal Aviation Administration (FAA) to show the respective interests of the lessor and lessee in the airplane.¹⁹⁴ The debtor also used the airplane as collateral to secure other obligations owed to the lessor as a secured creditor. The security interest covering these other obligations was perfected by filing with the Texas Secretary of State, but no additional filing was made with the FAA.¹⁹⁵ The debtor eventually sold the airplane in the course of a Chapter 11 bankruptcy for more than the lease termination value. The creditor claimed the excess sale proceeds as part of the collateral securing the debtor's other obligations. The debtor asserted that the failure to make a further recording with the FAA limited the creditor's security interest to the lease termination value.

The court awarded the excess proceeds from the sale of the airplane to the creditor, even though the lien agreement had not been recorded with the FAA.¹⁹⁶ The court reasoned that filing the lease with the FAA satisfied the notification requirement to alert other creditors that an alienated interest existed in the airplane.¹⁹⁷ The debtor and the creditor deliber-

188. *Id.* at *4.

189. *Id.* at *3.

190. *Id.*

191. *Id.* at *5. The same result would be reached under revised Chapter 9. See TEX. BUS. & COM. CODE ANN. § 9.331 (Vernon 2002).

192. *Van Hattem*, 2002 WL 245981, at *5.

193. *In re Stage Stores, Inc.*, 269 B.R. 343 (S.D. Tex. 2001).

194. The conveyance of an interest in an aircraft must be recorded with the Federal Aviation Administration to be effective. 49 U.S.C. § 44107 (2000). This rule has been continued under revised Chapter 9. TEX. BUS. & COM. CODE ANN. § 9.109(c) (Vernon 2002).

195. Because the transaction took place before the July 1, 2001 effective date of revised Chapter 9, filing was made under the former TEX. BUS. & COM. CODE ANN. § 9.402 (Vernon 1994). Under the transition provisions of revised Chapter 9, earlier filings remain effective until their usual lapse date. See TEX. BUS. & COM. CODE ANN. § 9.705(c) (Vernon 2002).

196. *In re Stage Stores, Inc.*, 269 B.R. at 346.

197. *Id.*

ately structured the transaction so that the creditor acquired title to the plane and leased it to the debtor, an arrangement that the creditor relied upon to secure the debtor's other obligations.¹⁹⁸ Although the exact amount of the debtor's obligation was not determinable at the time of filing, the court held that "it was absolutely owed and became due once it could be calculated."¹⁹⁹ Uncertainty as to the exact amount owed did not bar the use of excess proceeds to satisfy the other debts owed to the creditor.²⁰⁰

Under the former Chapter 9, the proper method of perfecting a security interest in collateral covered by a certificate of title was by notation of the lien on the certificate.²⁰¹ This rule has been continued under revised Chapter 9.²⁰² Retention of this rule, however, does not resolve the continuing question of the relationship between the Certificate of Title Act and the Code when certificated collateral is sold without an accompanying transfer of the certificate of title.²⁰³ In *Arcadia Financial, Ltd. v. Southwest-Tex Leasing Co., Inc.*,²⁰⁴ a car leasing company had an arrangement under which a car dealer would sell used cars that were retired from the leasing company's fleet of vehicles. The agreement between the parties was that the leasing company would deliver the cars to the dealer but would not deliver the certificates of title until proceeds from the sale of a vehicle were remitted to the leasing company. The car dealer sold four cars to individual buyers. The dealer then assigned the installment sales contracts to a finance company. The dealer failed to remit the proceeds to the leasing company and shortly thereafter went out of business. The finance company sued the leasing company to obtain the certificates of title so that the finance company could perfect its security interest in the vehicles. The Austin Court of Appeals held that because stipulated facts showed that the sale of vehicles from the leasing company to the car dealer was contingent upon the receipt of payment from the dealer, the dealer did not acquire title to the vehicles when it failed to remit the proceeds.²⁰⁵ Because the dealer never acquired title to the vehicles, it could not transfer a security interest in them to the finance company.²⁰⁶

198. *Id.* at 346-47.

199. *Id.* at 347.

200. *Id.*

201. This rule formerly appeared in TEX. BUS. & COM. CODE ANN. § 9.302(c)(2) (Vernon 1994).

202. See TEX. BUS. & COM. CODE ANN. § 9.109(c)(2) (Vernon 2002).

203. This issue usually arises in regard to the sale of a motor vehicle. The Certificate of Title Act, TEX. TRANSP. CODE ANN. § 501.0071(a) (Vernon 1999), provides, "A motor vehicle may not be the subject of a subsequent sale unless the owner designated in the certificate of title transfers the certificate of title at the time of the sale."

204. *Arcadia Fin. Ltd. v. Southwest-Tex Leasing Co., Inc.*, 78 S.W.3d 619 (Tex. App.—Austin 2002, pet. denied).

205. *Id.* at 623-24.

206. *Id.* at 625. TEX. BUS. & COM. CODE ANN. § 9.203(b) (Vernon 2002) requires that a debtor have rights in the collateral as one of the elements needed to create a valid security interest.

D. SATISFACTION OF SECURED CLAIM

In *Foster v. Centex Capital Corp.*,²⁰⁷ a debtor bought a car under a retail installment contract. Before the final payment was due, the debtor exercised his statutory right to pay the loan in full. The creditor assessed a \$25 “acquisition fee” on the debtor’s payoff. The debtor sued for recovery of the fee on a breach of contract theory. The trial court granted summary judgment for the creditor.²⁰⁸ The Austin Court of Appeals held that the \$25 “acquisition fee” was permitted by the same statute that authorized the debtor’s pre-payment of the loan.²⁰⁹ Because this was a statutorily authorized fee, the court ruled that the deduction of the fee from the rebate payment was not a breach of contract and affirmed summary judgment for the creditor.²¹⁰

A cautionary note must be added concerning the \$25 acquisition fee. Under section 9.210 of revised Chapter 9, a debtor is entitled to request an accounting or a statement of account once every six months without charge.²¹¹ Secured parties should not mistake the \$25 charge permitted in *Foster* as permission to assess a charge when responding to a section 9.210 request. The fee was allowed in *Foster* because the debtor was actually pre-paying the loan and was not making a mere request for accounting under section 9.210.

E. PROCEEDINGS AFTER DEFAULT

*In re Cadiz Properties, Inc.*²¹² is one of the first reported cases to consider some of the provisions in the revised Chapter 9 that became effective on July 1, 2001.²¹³ The principle issue in this case was whether a creditor had properly accepted stock in a debtor corporation in satisfaction of a debt owed to the creditor to give the creditor the right to elect a new board of directors for the debtor.²¹⁴ Under revised Chapter 9, except in consumer cases, a creditor can accept collateral in whole or partial satisfaction of a debt.²¹⁵ Such acceptance requires that the debtor either consent to the arrangement in a record signed after default, or that the

207. *Foster v. Centex Capital Corp.*, 80 S.W.3d 140 (Tex. App.—Austin 2002, pet. denied).

208. *Id.* at 141.

209. *Id.* at 144-45. The statute in question was TEX. FIN. CODE ANN. §§ 348.119 -.121 (Vernon 1998).

210. *Foster*, 80 S.W.3d at 146.

211. TEX. BUS. & COM. CODE ANN. § 9.210(f) (Vernon 2002).

212. *In re Cadiz Props., Inc.*, 278 B.R. 744 (Bankr. N.D. Tex. 2002).

213. Revised Chapter 9 was adopted in Texas during the 1999 legislative session to become effective on July 1, 2001. See Act of June 18, 1999, 76th Leg., R.S., ch. 414, § 1.01, 1999 Tex. Gen. Laws 2639. Several technical amendments were made during the 2001 legislative session, but the effective date remained the same. See Act of June 13, 2001, 77th Leg., R.S., ch. 705, §§ 1-26, 2001 Tex. Gen. Laws 1403 (codified as TEX. BUS. & COM. CODE ANN. §§ 9.101 -.709 (Vernon 2002)).

214. *In re Cadiz Props., Inc.*, 278 B.R. at 745.

215. TEX. BUS. & COM. CODE ANN. § 9.620(a) (Vernon 2002). In a consumer transaction, the creditor may only accept collateral in full satisfaction of the debt. TEX. BUS. & COM. CODE ANN. § 9.620(g) (Vernon 2002).

creditor send a notice to the debtor describing the intention to accept the collateral in full satisfaction.²¹⁶ If the debtor does not object to the proposed acceptance of the collateral, the arrangement becomes final, and the collateral becomes the property of the creditor.²¹⁷ The requirement that, after default, the debtor consent either by signing record or by failing to object to the creditor's retention of the collateral cannot be waived.²¹⁸ In *Cadiz*, the court found that the creditor had not obtained the debtor's consent in an authenticated record and had not sent a proposal to retain the collateral in satisfaction.²¹⁹ Because of this failure on the part of the creditor, the stock was never effectively transferred to the creditor so as to permit the creditor to exercise voting rights in the stock to elect a new board of directors of the debtor corporation.²²⁰ The existing board of directors, therefore, could authorize the filing of a Chapter 11 bankruptcy petition. The creditor's motion to dismiss the bankruptcy case was dismissed.²²¹

216. TEX. BUS. & COM. CODE ANN. § 9.620(a) (Vernon 2002).

217. *Id.* § 9.620(c) (Vernon 2002).

218. *Id.* § 9.602(10) (Vernon 2002).

219. *In re Cadiz Props., Inc.*, 278 B.R. at 749.

220. *Id.*

221. *Id.*