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Commercial Transactions

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COMMERCIAL TRANSACTIONS

*John Kraemer**

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THE 2005 Survey period was marked by both legislative changes and case-law developments in the area of commercial transactions. Legislative changes included the amendment of Chapters 3 and 4 of the Texas Business and Commerce Code dealing with negotiable instruments, bank deposits, and bank collections, and the complete revision of Chapter 7 governing warehouse receipts, bills of lading, and other documents of title.¹ Most cases reported during the Survey period involved the sale of goods under Chapter 2 or the application of Chapter 3 in the context of negotiable instruments. A handful of cases addressed issues

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1. Chapters 3 and 4 were amended by Act of May 17, 2005, 79th Leg., R.S., ch. 95, §§ 1-22, 2005 Tex. Sess. Law Serv. 15768, codified as TEX. BUS. & COM. CODE ANN. §§ 3.101-.605, 4.101-.504 (Vernon 2002 & Supp. 2005). Chapter 7 was amended by Act of May 20, 2005, 79th Leg., R.S., ch. 122, §§ 1-33, 2005 Tex. Sess. Law Serv. 225-56, codified as TEX. BUS. & COM. CODE ANN. §§ 7.101-.603 (Vernon 2002 & Supp. 2005). Some of the changes in Chapter 7 required conforming amendments to other Code chapters to reflect the use of electronic records as documents of title.

arising under other chapters of the Code.² As usual, the organization of this Survey follows that of the Code.

I. GENERAL PROVISIONS

A. CONSPICUOUSNESS OF CONTRACT TERMS

Chapter 1 of the Code was amended in the 2003 legislative session to reflect the updated official text of Article 1 approved by the National Conference of Commissioners on Uniform State Laws in 2001.³ One of the few non-uniform provisions included in the Chapter 1 amendments was the retention of the choice-of-law rules in the former section 1.105 in the renumbered section 1.301. In general, these choice-of-law rules permit the parties to an agreement covered by the Code to choose the law of any state or nation that has a reasonable relation to the transaction unless a specific Code provision states a different rule.⁴ For example, section 1.105 provided that the “reasonable relation” rule did not apply to certain bank transactions governed by section 4.102.⁵

In *Drug Test USA, Quick Results, L.L.C. v. Buyers Shopping Network, Inc.*,⁶ a Texas buyer and a Florida seller entered into a sale-of-goods contract containing a provision selecting Florida law and providing for jurisdiction and venue in the Florida courts. The buyer brought an action against the Florida seller in the Texas courts, the seller made a special appearance contesting venue, and the trial court upheld it.⁷

The buyer appealed, contending that the choice-of-law clause was not conspicuous and therefore, was not enforceable. Thus, the court had to address an apparent conflict between the choice-of-law rules in section 1.105 (which the court noted as being renumbered as section 1.301 without substantive change) and the choice-of-law rules in Business & Commerce Code section 35.53 requiring that a choice-of-law clause be “conspicuous.”⁸ The conflict seemed to exist because section 35.53(a)

2. 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 2002 & Supp. 2005).

3. The 2003 Chapter 1 amendments are described in John Krahrmer, *Commercial Transactions*, 57 SMU L. REV. 699, 700-03 (2004).

4. See TEX. BUS. & COM. CODE ANN. § 1.301(a) (Vernon 2002).

5. See *id.* § 1.301(b). Section 4.102 provides that the law of the state where a bank or branch is located governs “[t]he liability of a bank for action or non-action with respect to an item handled by it for purposes of presentment, payment, or collection” *Id.* § 4.102(b). This limits the parties’ ability to choose another jurisdiction’s law and effectively supersedes the reasonable-relation test.

6. 154 S.W.3d 191 (Tex. App.—Waco 2004, no pet. h.).

7. *Id.* at 192.

8. TEX. BUS. & COM. CODE ANN. § 35.53(b) (Vernon 2002) provides:

If a contract to which this section applies contains a provision making the contract or any conflict arising under the contract subject to the laws of another state, to litigation in the courts of another state, or to arbitration in another state, the provisions must be set out conspicuously in print, type, or other form of writing that is bold-faced, capitalized, underlined, or otherwise set out in such a manner that a reasonable person against whom the provision may operate would notice. If the provision is not set out as provided by

provided that it applied, *inter alia*, to any contract for the “sale, lease, exchange, or other disposition for value of goods for the price, rental, or other consideration of \$50,000 or less” and “Section 1.301 of this Code does not apply to the contract.”⁹ The buyer contended that applying the plain meaning of the section 1.105 exclusion would lead to an “absurd result” because any contract for the sale of goods in an amount less than \$50,000 would never be governed by section 35.53, and this would make the statute meaningless.¹⁰

In an interesting analysis of the relationship between sections 1.105 and 35.53, the court concluded that the legislative history of section 35.53 indicated an intent to limit the cross-reference to section 1.105 to transactions listed in section 1.105(b) as exceptions to the reasonable-relation rule in section 1.105(a). Because the transaction between the parties was not one of the listed exceptions to the reasonable-relation rule, the clause had to be conspicuous to be enforceable. The seller did not contend that the clause was conspicuous or that the transaction did not otherwise fall within the scope of section 35.53, and the court therefore reversed and remanded for further proceedings.¹¹

In another case examining whether a contract clause was conspicuous, the court recognized that the Texas Supreme Court had adopted the standard of conspicuousness contained in section 1.201 and made it generally applicable to all contracts, whether or not otherwise governed by the Code.¹² The court did not note that the definition of “conspicuous” was clarified in the Chapter 1 revision to create a “safe harbor” for drafters in making a clause conspicuous.¹³ This omission, however, would not have made a difference in the result.

B. ACCELERATION

Although section 1.309 of the Code allows contract acceleration at will, Texas law has long surrounded acceleration with notice and presentment

this subsection, the provision is voidable by a party against whom it is sought to be enforced.

9. Section 35.53(a)(3) was amended during the 2005 legislative session to refer to section 1.301 instead of section 1.105 due to the Chapter 1 amendment, a change that had been overlooked in the 2003 session. See Act of June 17, 2005, 79th Leg., R.S., ch. 728, § 2.001, 2005 Tex. Sess. Law Serv. 2191. A parallel change was made to section 35.531(e) governing contracts made over the Internet. See Act of June 17, 2005, 79th Leg., R.S., ch. 728, § 2.002, 2005 Tex. Sess. Law Serv. 2191.

10. *Drug Test USA*, 154 S.W.3d at 193.

11. *Id.* at 195-96.

12. *ALCOA v. Hydrochem Indus. Servs., Inc.*, No. 00531, 2005 WL 608232, at *8 (Tex. App.—Corpus Christi, Mar. 17, 2005, pet. denied). The Texas Supreme Court announced that the U.C.C. standard of conspicuousness would be made generally applicable to all contracts in *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 509-11 (Tex. 1993).

13. The definition of “conspicuous” formerly appeared in TEX. BUS. & COM. CODE ANN. § 1.201(o) (Vernon 1994) but now appears in revised form in TEX. BUS. & COM. CODE ANN. § 1.201(b)(10) (Vernon 2002). The revised definition provides specific examples of ways in which a term can be made conspicuous.

requirements before it can be effective.¹⁴ These requirements can be waived, however, provided they separately and specifically state the rights being waived.¹⁵ In *Adams v. First National Bank of Bells/Savoy*,¹⁶ the court held that a waiver clause in a note was effective because it separately and specifically waived the rights of notice and presentment.¹⁷ In addition, the court rejected an argument that the clause did not waive a violation of a due-on-sale provision in the deed of trust because it was not in the same paragraph as the due-on-sale clause.¹⁸ The court construed the note and deed of trust together because the same parties signed both on the same day, they identified identical subject matter, and each document referenced the other.¹⁹ The court therefore affirmed the judgment for the bank that accelerated the note and foreclosed under the deed of trust.²⁰

II. SALE OF GOODS

A. OFFER AND ACCEPTANCE

Chapter 2 of the Code does not attempt to state detailed rules governing offer and acceptance, deferring instead to common-law principles, except for a few provisions allowing contract formation in situations in which a contract may not exist under common law. For example, section 2.204(a) provides that a contract may be made in any manner sufficient to show an agreement, including conduct by the parties.²¹ This general statement is qualified, however, by provisions allowing contracts to be formed even though some terms have been left open, such as price, or allowing offers to be irrevocable without consideration. In both of these situations, the common law might deny the existence of a contract.²²

In *In re Kyocera Wireless Corp.*,²³ the court held that a contract formed when a buyer placed purchase orders by telephone or electronic communication and the seller began manufacturing the goods before receiving written purchase orders. The court reasoned that the conduct of the parties was sufficient to show agreement, and the contract satisfied the statute of frauds through the "merchant's exception" in section 2.201(b) when the seller did not object to the written purchase orders that con-

14. See, e.g., *Ogden v. Gibraltar Sav. Ass'n*, 640 S.W.2d 232, 233-34 (Tex. 1982) (holding that proper acceleration requires (1) notice of intent to accelerate, (2) notice of acceleration, and (3) presentment); *Baldazo v. Villa Oldsmobile, Inc.*, 695 S.W.2d 815, 817 (Tex. App.—Amarillo 1985, no writ).

15. See *Shumway v. Horizon Credit Corp.*, 801 S.W.2d 890, 893 (Tex. 1991).

16. 154 S.W.3d 859 (Tex. App.—Dallas 2005, no pet. h.).

17. *Id.* at 868.

18. *Id.*

19. *Id.*

20. *Id.* at 878.

21. TEX. BUS. & COM. CODE ANN. § 2.204(a) (Vernon 1994).

22. See TEX. BUS. & COM. CODE ANN. §§ 2.204(c), 2.205, 2.305 (Vernon 1994).

23. 162 S.W.3d 758 (Tex. App.—El Paso 2005, no pet. h.).

firmed the earlier oral orders.²⁴ The specific point in issue was the enforceability of a forum-selection clause in the buyer's purchase orders requiring all actions under the contract to be brought in California. Because the seller failed to object to this clause in the purchase orders and did not show that the clause seriously inconvenienced its ability to maintain the action or violated public policy, the court conditionally granted a writ of mandamus, pending action by the trial court dismissing the suit in Texas.²⁵

As noted above, offers for the sale of goods can be irrevocable under the Code even without consideration.²⁶ Under common law, irrevocable offers require consideration or, in some instances, the use of promissory estoppel as a substitute for consideration.²⁷ Irrevocable offers at common law are generally referred to as "option contracts" and typically recite the consideration paid for the option, for example, "In consideration of the payment of \$10.00, receipt of which is hereby acknowledged, seller hereby grants to buyer the right to"²⁸

Due in part to the Uniform Commercial Code's influence, the Restatement (Second) of Contracts includes a rule that a recital of consideration in an option contract makes the option enforceable, *even if the consideration is not paid*.²⁹ In *1464-Eight, Ltd. v. Joppich*,³⁰ the Texas Supreme Court adopted this rule, approving the false recital of consideration in an option contract for the sale of land. In doing so, the court acknowledged that it was adopting a position rejected by most courts that had considered the issue.³¹ Nonetheless, the court was persuaded that this rule made commercial sense by enforcing option contracts as an initial step in com-

24. *Id.* at 766-67. The "merchant's exception" in TEX. BUS. & COM. CODE ANN. § 2.201(b) (Vernon 1994) provides that, between merchants, a written confirmation of an oral agreement satisfies the statute of frauds without a signed writing by the recipient if the recipient has reason to know of the writing's contents and fails to object to it within ten days after receipt.

25. *Id.* at 769. Because the amount in controversy was approximately \$250,000, the issue of whether the clause was conspicuous under TEX. BUS. & COM. CODE ANN. § 35.53(a) (Vernon 2002) was not before the court; that section is only applicable in contracts for less than \$50,000. *See supra* text accompanying note 8. The clause in the purchase orders was in boldface capitals, so the seller may have lost on that issue anyway.

26. TEX. BUS. & COM. CODE ANN. § 2.205 (Vernon 1994) provides that an offer by a merchant can be made irrevocable without consideration if the offer is in a signed writing and states that it will be held open for a specific time or, if no time is stated, for a reasonable time. The period of irrevocability cannot exceed three months. *Id.*

27. Classic cases on this subject include *James Baird Co. v. Gimbel Bros.*, 64 F.2d 344, 346 (2d Cir. 1933) (holding that a subcontractor could revoke a bid absent consideration keeping the bid open) and *Drennan v. Star Paving Co.*, 333 P.2d 757, 760 (Cal. 1958) (finding that a general contractor's reliance on a subcontractor's bid estopped the subcontractor from revoking). Both cases are discussed in some detail in E. ALLEN FARNSWORTH, CONTRACTS § 3.25 (4th ed. 2004).

28. *See* RESTATEMENT (SECOND) OF CONTRACTS: OPTION CONTRACT § 87.1 (1981).

29. *Id.*

30. 154 S.W.3d 101, 110 (Tex. 2004).

31. *Id.*

pleting a seriously intended bargain.³² This is an important development in Texas law, particularly since, as an aside and perhaps a foreshadowing, the supreme court noted that the Restatement (Second) of Contracts provides a similar rule for guaranty agreements.³³

B. WARRANTIES

The Texas law of warranty is not limited to issues arising under the Code but often overlaps with claims based on negligence, strict liability in tort, the Texas Deceptive Trade Practices Act (DTPA), and common-law warranties created by the courts.³⁴ Cases reported during the Survey period were no exception. In *Todd v. Perry Homes*,³⁵ the plaintiffs purchased a house from the home's previous owners. After the purchase, the plaintiffs discovered that improper drainage caused damage to the home and resulted in substantial repair costs. The plaintiffs sued the homebuilder, with whom they had not previously dealt, for breach of an implied warranty of habitability, negligence, construction defect, and unconscionable conduct under the DTPA. The Dallas Court of Appeals affirmed a summary judgment of the trial court in favor of the builder, holding that the plaintiffs failed to prove that the home was not habitable and that the drainage defect was unknown to them when they bought the home.³⁶ The court also held that the DTPA claim failed because the plaintiffs lacked privity with the homebuilder and because the plaintiffs did not show that the homebuilder made any direct representations to the plaintiffs about the home's quality.³⁷

In *Gym-N-I Playgrounds, Inc. v. Snider*,³⁸ tenants under a commercial lease sued their landlord for negligence, fraud, DTPA violations, and breach of the warranty of suitability. The Austin Court of Appeals upheld a partial summary judgment in favor of the landlord on the ground that the lease's "as is" clause waived the warranty of suitability and placed the risk on the tenants that the property might have latent defects affecting its suitability.³⁹ The court acknowledged that this result conflicted with the Houston and Corpus Christi courts of appeal holdings, which said that a waiver of the warranty of suitability only waived the lessor's responsibility for repairs that the lessee accepted as part of the

32. *Id.* Before reaching this conclusion, the court cited and reviewed several primary and secondary authorities that discussed why option contracts should be enforceable without the payment of consideration.

33. *Id.* at 106. The rule concerning guaranty agreements appears in RESTATEMENT (SECOND) OF CONTRACTS: GUARANTY § 88(a) (1981).

34. *See, e.g.*, *Compaq Computer Corp. v. Lapray*, 135 S.W.3d 657 (Tex. 2004); *Hyundai Motor Co. v. Rodriguez*, 995 S.W.2d 661, 665 (Tex. 1999); *Amstadt v. U.S. Brass Corp.*, 919 S.W.2d 644, 649 (Tex. 1996); *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308, 309-13 (Tex. 1978); *Signal Oil & Gas Co. v. Universal Oil Prods.*, 572 S.W.2d 320, 326-29 (Tex. 1978); *Darryl v. Ford Motor Co.*, 440 S.W.2d 630, 633 (Tex. 1969).

35. 156 S.W.3d 919 (Tex. App.—Dallas 2005, no pet. h.).

36. *Id.* at 921-22.

37. *Id.* at 922.

38. 158 S.W.3d 78 (Tex. App.—Austin 2005, pet. filed).

39. *Id.* at 88.

bargain and did not operate as a general waiver of the warranty.⁴⁰ In reaching their conclusion, the Austin court noted that “as is” disclaimers are effective under the Code and had been held effective for other warranty and DTPA claims as well.⁴¹

The seller of hardwood flooring in *Thomas v. Omar Investments, Inc.*⁴² moved for summary judgment on the plaintiffs’ claim for breach of warranty on the ground that the claim lacked supporting evidence because of a disclaimer in the sales agreement. The trial court granted summary judgment for the seller, but the court of appeals reversed, pointing out that a disclaimer is an affirmative defense that could not be properly raised in a no-evidence motion for summary judgment. The case was remanded for further proceedings.⁴³

In *Blakeley v. Boltinghouse*⁴⁴ and *RT Realty, L.P. v. Texas Utilities Electric Co.*,⁴⁵ the courts determined that no warranties existed to support the plaintiffs’ claims. In *Blakeley*, the plaintiff alleged a breach of the warranty of fitness for a particular purpose in the sale of a home. The court held that such a warranty was limited to the sale of goods under section 2.315 of the Code and did not apply to the sale of a home.⁴⁶ *Blakeley* also held that an “as is” clause in the sales contract was not effective to defeat the plaintiff’s DTPA claim because the clause’s language did not eliminate the possibility that the seller’s alleged misrepresentations were the cause of the plaintiff’s damage.⁴⁷

In *RT Realty*, the owner of an office building sued an electric-utility company for breach of warranty and negligence, which resulted in damage that forced a building evacuation and several months of repair.⁴⁸ Basing its decision on the earlier Texas Supreme Court case, *Southwest-*

40. See *Parts Indus. Corp. v. A.V.A. Servs., Inc.*, 104 S.W.3d 671, 679-80 (Tex. App.—Corpus Christi 2003, no pet.); *Gober v. Wright*, 838 S.W.2d 794, 798 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

41. See TEX. BUS. & COM. CODE ANN. § 2.316(c)(1) (Vernon 1994) (regarding “as is” disclaimers of the warranties contained in sections 2.314 and 2.315). Disclaimers have also been held effective in warranty and DTPA cases arising outside the Code. See, e.g., *Centex Homes v. Buecher*, 95 S.W.3d 266, 274-75 (Tex. 2002) (finding that the implied warranty of good workmanship can be disclaimed if an agreement provides for manner of performance or for standard of construction); *Prudential Ins. Co. of Am. v. Jefferson Assocs., Ltd.*, 896 S.W.2d 156, 161 (Tex. 1995) (holding that an “as is” disclaimer places risk of defect on buyer); *Bynum v. Prudential Residential Servs., L.P.*, 129 S.W.3d 781, 789-90 (Tex. App.—Houston [1st Dist.] 2004, pet. denied) (stating that even an inconspicuous “as is” clause is effective if buyers are experienced real-estate buyers and read the clause when they signed the agreement); *Smith v. Radam, Inc.*, 51 S.W.3d 413, 416-17 (Tex. App.—Houston [1st Dist.] 2001, no pet.) (finding that an “as is” disclaimer defeats a showing of producing cause under the DTPA).

42. 156 S.W.3d 681 (Tex. App.—Dallas 2005, no pet. h.).

43. *Id.* at 685.

44. No. Civ.A.H-03-4901, 2005 WL 1185944, at *1 (S.D. Tex. May 4, 2005).

45. 181 S.W.3d 905 (Tex. App.—Dallas 2006, no pet. h.).

46. *Blakeley*, 2005 WL 1185944, at *4. Section 2.315 provides for an implied warranty of fitness for a particular purpose if the buyer relies on the seller’s skill and judgment in selecting particular goods to fill the buyer’s need. TEX. BUS. & COM. CODE ANN. § 2.315 (Vernon 1994).

47. *Blakeley*, 2005 WL 1185944, at *3.

48. *RT Realty*, 181 S.W.3d at 910-11.

ern Electric Power Co. v. Grant,⁴⁹ the court held that the “filed rate” doctrine prevented recovery for negligence because the utility’s filed tariff limited liability for economic loss and made the owner responsible for maintenance of electrical equipment and connections existing “at and past the point of delivery.”⁵⁰ As for breach of warranty, the court held that under *Grant* and section 2.102 of the Code, Chapter 2 does not cover the sale of electricity because applying rules governing the sale of goods would impair the electric utilities’ regulatory scheme.⁵¹

C. REMEDIES FOR BREACH

Section 2.607 of the Code requires that an aggrieved buyer give notice of breach within a reasonable time after the buyer discovers or should have discovered any breach.⁵² One issue that arises under this provision is determining what constitutes a “reasonable time.” While this is usually a fact question, it can sometimes be a question of law. In *Ketter v. ESC Medical Systems, Inc.*,⁵³ the trial court granted a motion for summary judgment in favor of a defendant seller who received notice approximately two years and seven months after the buyer received the equipment, apparently on the basis that this went beyond a “reasonable time.” On appeal, however, the court pointed out that the motion only spoke to the time between delivery and notice, rather than the time between the defect’s discovery and notice. The question of reasonable time should, therefore, have been treated as a question of fact. The plaintiff also asserted a DTPA claim based on the seller’s alleged unconscionable actions, and the court held that this claim raised issues of material fact. The case was remanded for trial on the warranty and DTPA issues.⁵⁴

Another aspect of the section 2.607 notification requirement is which party or parties must receive notice. There is a conflict in the Texas case law as to whether notice need be given only to the immediate seller or to remote sellers as well.⁵⁵ This issue can be particularly important because Chapter 82 of the Civil Practice and Remedies Code limits the liability of a non-manufacturing seller for damages resulting from personal injury,

49. 73 S.W.3d 211 (Tex. 2002).

50. *RT Realty*, 181 S.W.3d at 913-16.

51. *Id.* at 917. Section 2.102 provides, *inter alia*, that Chapter 2 does not “impair or repeal any statute regulating sales to consumers, farmers, or any other specified classes of buyers.” TEX. BUS. & COM. CODE ANN. § 2.102 (Vernon 1994).

52. TEX. BUS. & COM. CODE ANN. § 2.607(c)(1) (Vernon 1994).

53. 169 S.W.3d 791 (Tex. App.—Dallas 2005, no pet. h.).

54. *Id.* at 796, 800-02.

55. *Compare* *Vintage Homes, Inc. v. Coldiron*, 585 S.W.2d 886, 888 (Tex. Civ. App.—El Paso 1979, no writ) (requiring notice only to immediate seller) *with* *Wilcox v. Hillcrest Mem’l Park*, 696 S.W.2d 423, 424-25 (Tex. App.—Dallas 1985), *writ ref’d n.r.e.*, 701 S.W.2d 842, 843 (Tex. 1986) (per curiam) (requiring notice to remote manufacturer at the lower court; the Texas Supreme Court acknowledged the split among courts of appeal but held that it need not resolve the issue on facts before it).

death, or property damage.⁵⁶ Though not directly involving the notice issue because it was a strict-liability action, the decision in *SSP Partners v. Gladstrong Investments (USA) Corp.* is of interest because it deals with the right of a seller in the distribution chain to obtain indemnity from manufacturers, parts suppliers, and others higher in the chain.⁵⁷ To the extent that such claims are based on a breach of warranty, the provisions of section 2.607 would apply, and a failure to comply with the notification requirement could be fatal to an indemnity claim. The lesson of these cases is clear: Notice should be given to anyone in the distribution chain to avoid the possible bar of an initial cause of action or a claim for indemnity.

Section 2.608(a) of the Code allows a buyer to revoke acceptance of non-conforming goods under certain circumstances if the non-conformity substantially impairs the goods' value.⁵⁸ If acceptance is properly revoked, the buyer can "cover" by making a reasonable substitute purchase.⁵⁹ Both of these issues were involved in *Manon v. Tejas Toyota, Inc.*,⁶⁰ in which a husband and wife bought a mini-van. The buyers wanted a 2000-model vehicle with a certain exterior color, a wood-grained interior, and a trailer hitch. The dealer was unable to obtain a 2000 model in the desired color and offered to provide a similar 2001 model for the same price. The buyers agreed. Upon delivery, the vehicle did not have the wood-grained interior or the trailer hitch, but the dealer assured the buyers that these could be installed at the dealership. Unfortunately, the dealer was not able to install the wood-grained interior, and the installed trailer hitch had to be removed because of excessive rattling noise. The dealer offered to refund the value of the missing items and give the buyers a \$1,000 discount off the purchase price of a substitute vehicle. The buyers refused and traded the vehicle to another dealership to purchase a 2001-model sport-utility vehicle (SUV). The buyers sued for breach of contract, misrepresentation, and DTPA violations. The trial court granted summary judgment for the buyers on the breach-of-contract claim and allowed the misrepresentation and DTPA claims to go to the jury.⁶¹ The jury found in favor of the buyers on these claims.

On appeal, the court held that, as a matter of law, the buyers were not entitled to revoke acceptance because the impairment in value of the mini-van was only \$591, about one percent of the mini-van's total value.⁶²

56. TEX. CIV. PRAC. & REM. CODE ANN. §§ 82.001-.004 (Vernon 1997). Exceptions exist for sellers who do not manufacture the product but are involved in product design, installation, and the like, or who misrepresent the product's characteristics.

57. 169 S.W.3d 27, 35-43 (Tex. App.—Corpus Christi 2005, pet. denied).

58. TEX. BUS. & COM. CODE ANN. § 2.608(a) (Vernon 1994). Revocation of acceptance is allowed if the goods were accepted in the reasonable belief that the non-conformity would be cured or if the non-conformity's discovery was difficult or induced by the seller's assurances.

59. TEX. BUS. & COM. CODE ANN. § 2.712 (Vernon 1994).

60. 162 S.W.3d 743 (Tex. App.—Houston [14th Dist] 2005, no pet. h.).

61. *Id.* at 746.

62. *Id.* at 748-50.

The court further held that the SUV purchase for a price of nearly \$10,000 more than that of the mini-van was not a reasonable substitute purchase.⁶³ Because the buyers failed to prove proper revocation of acceptance or a reasonable cover purchase, they were limited to a recovery of \$591 on their contract claim. On the DTPA and misrepresentation claims, however, the court upheld a jury award of \$7,831 for the difference between the price of the mini-van and the trade-in value, plus an additional \$5,000 exemplary damages award.⁶⁴ The judgment of the trial court was affirmed.⁶⁵

In contrast to *Manon*, the court in *A.O. Smith Corp. v. Elbi S.P.A.*⁶⁶ upheld a jury verdict in favor of a buyer who revoked acceptance when it proved that the interior coating on 14,400 pressure tanks it had purchased had been defectively applied. The court rejected the seller's argument that the buyer should have discovered the defects by testing the tanks when they were received. Because sample tanks the seller provided had already passed testing, the court held that the buyer had acted reasonably in deciding to forego further testing, particularly because the only way to discover the defect was to cut the tanks open (destructive testing). This was inconsistent with the buyer's purpose of reselling the tanks in residential-hot water systems.⁶⁷ The court also rejected the seller's argument that the buyer had waived the right to revoke acceptance by selling some seventy-five tanks out of a total order of 14,400 after sending notice of revocation. The buyer countered that these sales were *de minimus* and inadvertent, and the court agreed that a reasonable jury could find that these sales did not invalidate the revocation.⁶⁸

The opposite side of the coin to allowing a buyer to make a cover purchase is the seller's right to resell goods if a buyer breaches.⁶⁹ Proper resale requires the seller to refer to the broken contract in the resale contract, to give the defaulting buyer reasonable notice of the proposed resale, and to resell in good faith and in a commercially reasonable manner.⁷⁰ In *Plano Lincoln Mercury, Inc. v. Roberts*,⁷¹ aggrieved sellers notified the breaching buyer that the sellers would "exercise [their] remedies for the buyer's breach pursuant to statute."⁷² The court held that this statement was insufficient to give the buyer notice of intent to resell because the sellers had several other remedies available under Chapter 2, and the notice failed to differentiate between them.⁷³ The failure to give proper notice meant that the sellers were not entitled to recover the dif-

63. *Id.* at 749.

64. *Id.* at 757-58.

65. *Id.* at 758.

66. 123 F. App'x 617 (5th Cir. 2005).

67. *Id.* at 621-22.

68. *Id.* at 620-21.

69. See TEX. BUS. & COM. CODE ANN. § 2.706(a) (Vernon 1994).

70. *Id.* § 2.706(b)-(f).

71. 167 S.W.3d 616 (Tex. App.—Dallas 2005, no pet. h.).

72. *Id.* at 624 (quoting the notice sent to the buyer).

73. *Id.*

ference between the resale price and the contract price. The sellers argued that even with this failure, they could elect to recover damages on the alternative remedy of the difference between the contract price and the market price. The court ruled that the sellers had waived this alternative by pleading for damages only on the contract/resale difference. A take-nothing judgment was rendered against the sellers.⁷⁴

D. LIMITATIONS

In *Tarrant County Hospital District v. GE Automotive Services, Inc.*,⁷⁵ a hospital district entered into a contract for the design, supply, and installation of a power-supply system for a hospital. The contract documents referred to the subject matter as a “product purchase” for electrical distribution. Five years after the system was installed, the hospital district sued for alleged defects in the system. The defendant sellers moved for summary judgment on the ground that the four-year limitations period in section 2.725 of the Code barred the action. The trial court granted the summary judgment.⁷⁶

On appeal, the hospital district contended that it was immune from the four-year limitations period under the provisions of section 16.061 of the Civil Practice and Remedies Code.⁷⁷ The court held that the contract was for the sale of goods covered by Chapter 2.⁷⁸ Furthermore, because section 16.061 specifically listed the limitation statutes from which governmental entities were immune, and section 2.725 was not among those listed, the action of the hospital district was barred.⁷⁹ As an alternative cause of action, the hospital district argued that it could maintain its suit as a tort claim arising within two years of the defect’s discovery date. The court rejected this argument on the ground that the damages sought on a tort theory were economic losses to the product itself and were not claims for losses that were independent of the contract.⁸⁰

74. *Id.* at 624-25.

75. 156 S.W.3d 885 (Tex. App.—Fort Worth 2005) (Rule 53.7(f) motion for extension granted).

76. *Id.* at 888-89.

77. TEX. CIV. PRAC. & REM. CODE ANN. § 16.061(a) (Vernon Supp. 2005-06). This section exempts the state, counties, and various governmental entities from certain limitation periods that would otherwise bar an action.

78. *G.E. Auto. Servs.*, 156 S.W.3d at 894-95.

79. *Id.*

80. *Id.* at 896. The requirement that tort claimants must seek damages other than economic damages to the product itself is well settled in Texas law. *See, e.g.*, *S.W. Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494-95 (Tex. 1991); *Signal Oil & Gas Co. v. Universal Oil Prods.*, 572 S.W.2d 320, 325 (Tex. 1978); *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308, 313 (Tex. 1978); *Murray v. Ford Motor Co.*, 97 S.W.3d 888, 892 (Tex. App.—Dallas 2003, no pet.).

III. NEGOTIABLE INSTRUMENTS AND BANK TRANSACTIONS

A. LEGISLATIVE CHANGES

The most important development to Chapters 3 and 4 during the Survey period was their amendment that bring them into conformity with the 2002 revision of the U.C.C. The following discussion describes the amendments' principal changes.

The term "record" was substituted in Chapters 3 and 4 for the term "writing" to permit the use of electronic records as well as writings. This conforms these chapters to the provisions of the Uniform Electronic Transactions Act adopted in Texas as Chapter 43 of the Business and Commerce Code.⁸¹

A provision was added to section 3.305 preserving the right of an obligor in a consumer transaction to assert claims and defenses against a holder or transferee even if the Federal Trade Commission "Holder in Due Course Notice" is omitted from the instrument.⁸² This change parallels the rule contained in Chapter 9, section 9.404 for consumer debtors.⁸³ A non-uniform Texas amendment was included to make it clear that a holder or transferee who is liable to a consumer obligor under this section has a right to indemnity against a prior party that failed to include the required FTC notice.⁸⁴

Section 3.602, dealing with payment of instruments, was amended to protect the obligor from double liability in cases in which payment was made to a prior holder and the obligor was unaware that an instrument had been transferred.⁸⁵ The amendment provides that payments made to a prior holder discharge the obligor to the extent of any payments made before the obligor received notice that the instrument was transferred.⁸⁶ This changes the rule in former section 3.602 and brings it into conformity with the Restatement of Mortgages and the Restatement of Contracts.⁸⁷

The former requirement in section 3.309, that a person seeking to recover on a lost, destroyed, or stolen instrument had to be in possession of the instrument when it was lost, has been eliminated. This change permits recovery on such an instrument if the person asserting a right to recovery acquired the instrument from a person who had possession

81. See, e.g., TEX. BUS. & COM. CODE ANN. §§ 3.106, 3.119, 3.312, 3.602, 3.604, 4.212, 4.301, 4.403 (Vernon 2002 & Supp. 2005). The Uniform Electronic Transactions Act appears as TEX. BUS. & COM. CODE ANN. §§ 43.001-.021 (Vernon 2002).

82. See TEX. BUS. & COM. CODE ANN. § 3.305(e)(2) (Vernon 2002 & Supp. 2005). The FTC "Holder in Due Course Notice" provides that the holder of a consumer note is subject to any claims or defenses that could be asserted against the seller of goods or services in a consumer transaction. See 16 C.F.R. §§ 433.1-3 (2004).

83. See TEX. BUS. & COM. CODE ANN. § 9.404(d) (Vernon 2002).

84. See *id.* § 3.305(f) (Vernon 2002 & Supp. 2005).

85. See *id.* § 3.602(b)-(d) (Vernon 2002 & Supp. 2005).

86. *Id.*

87. See RESTATEMENT (THIRD) OF PROPERTY (MORTGAGES) § 5.5 (1997); RESTATEMENT (SECOND) OF CONTRACTS § 338(1) (1981).

when it was lost, destroyed, or stolen.⁸⁸

Various provisions in Chapters 3 and 4 were amended to more effectively deal with third parties who draw drafts on a bank account and purport to have been given such authorization by the account holder but who in fact do not have such authority.⁸⁹ The changes cover transferors and presenting parties (including collecting banks) who warrant that such drafts are authorized and permit recovery for breach of warranty if they are not authorized.⁹⁰ A non-uniform Texas variation includes a choice-of-law provision to protect Texas banks from warranty liability if the bank does not receive a similar warranty from an out-of-state bank.⁹¹ This provision was deemed necessary because only a few states had adopted the amended versions of U.C.C. Articles 3 and 4 when Texas enacted these amendments.⁹²

B. NEGOTIABILITY OF INSTRUMENTS

To be negotiable under section 3.104 of the Code, a note must contain an unconditional promise to pay a fixed amount of money, be payable to order or to bearer, and be payable on demand or at a definite time.⁹³ If a note is negotiable, it can be transferred by indorsement, and the note holder is entitled to enforce it.⁹⁴ If a note is non-negotiable, it can still be assigned, but ownership must be proven; until then, the person in possession is not entitled to enforce the note.⁹⁵

In *FFP Marketing Co., Inc. v. Long Lane Master Trust IV*,⁹⁶ the court held that the notes in issue were non-negotiable because the amount payable could not be determined from the notes themselves, and the instru-

88. See TEX. BUS. & COM. CODE ANN. § 3.309(a)(1)(B) (Vernon 2002 & Supp. 2005). This reverses the result reached by the court in *Dennis Joslin Co. v. Robinson Broad. Corp.*, 977 F. Supp. 491, 495 (D.D.C. 1997) and is consistent with the proposal to amend section 3.309 suggested in Timothy R. Zinnecker, *Extending Enforcement Rights to Assignees of Lost, Destroyed, or Stolen Negotiable Instruments under U.C.C. Article 3: A Proposal for Reform*, 50 KAN. L. REV. 111, 136-41 (2001).

89. See TEX. BUS. & COM. CODE ANN. §§ 3.103(a)(16), 3.416-417, 4.207-208 (Vernon 2002 & Supp. 2005).

90. See *id.* §§ 3.416-417, 4.207-208 (Vernon 2002 & Supp. 2005).

91. See *id.* §§ 3.416(e), 3.417(g), & 4.208(g) (Vernon 2002 & Supp. 2005).

92. The need for this non-uniform provision now seems to have been eliminated by the Board of Governors of the Federal Reserve System that amended Regulation J, 12 C.F.R. § 210, and Regulation CC, 12 C.F.R. § 229, which became effective on July 1, 2006. As preemptive federal regulations, the choice-of-law issue will no longer be of concern since the regulations will apply uniformly to banks in all jurisdictions. See Fed. Reserve System Docket No. R-1226 (Nov. 21, 2005).

93. TEX. BUS. & COM. CODE ANN. § 3.104(a) (Vernon 2002).

94. *Id.* §§ 3.201, 3.301 (Vernon 2002).

95. See, e.g., *Diversified Fin. Sys., Inc. v. Hill, Heard, O'Neal, Gilstrap & Goetz, P.C.*, 99 S.W.3d 349, 357 (Tex. App.—Fort Worth 2003, no pet.) (finding no presumption of ownership upon assignment of non-negotiable note); *Dillard v. NCNB Tex. Nat'l Bank*, 815 S.W.2d 356, 360 (Tex. App.—Austin 1991, no writ), *overruled on other grounds*, *Amberboy v. Societe de Banque Privee*, 831 S.W.2d 797 (Tex. 1992) (holding that a non-negotiable note can be transferred by assignment). See also TEX. BUS. & COM. CODE ANN. § 3.203 cmt. 2 (Vernon 2002).

96. 169 S.W.3d 402 (Tex. App.—Fort Worth 2005, no pet. h.).

ments were conditional because the terms of other documents were incorporated by reference. Because the notes were non-negotiable, the transferees were required to prove ownership and were subject to any valid defenses the makers might be able to raise. Summary judgment in favor of the transferees was reversed, and the case was remanded for trial.⁹⁷

In *Nelson v. Regions Mortgage, Inc.*,⁹⁸ a note went into default and the holder sought to foreclose on the mortgage securing the note. The maker's father purchased the note from the holder by taking an assignment of the mortgage and copies of the note and deed of trust, but he never received the original documents. Even though the note went into default, the father as transferee never attempted to enforce the note or foreclose on the mortgage. He did, however, seek to rescind the purchase and recover damages from the holder for fraud, DTPA violations, and breach of contract because he never received the original documents. The trial court granted summary judgment in favor of the holder, and this judgment was affirmed on appeal. The court reasoned that even though the transferee did not qualify as a holder because he did not possess the original note and mortgage, he could still enforce it by proving ownership. However, because he had not attempted to enforce it, the transferee was not damaged and was not entitled to rescind the transaction or recover damages from the holder.⁹⁹

C. RIGHTS OF HOLDERS AND HOLDERS IN DUE COURSE

In *First Commerce Bank v. J.V.3, Inc.*,¹⁰⁰ a borrower obtained a one-million dollar loan from a bank in March of 1983. The note was guaranteed by several guarantors. In January 1988, the bank accelerated the balance due on the note, notified the borrower and the guarantors, and gave the borrower the option of paying the balance with interest on March 30, 1988 or renewing the loan on that date. The borrower and the bank chose to renew the loan without the guarantors' knowledge or signatures. On August 10, 1988, the borrower obtained the guarantors' signatures on the renewed loan. The loan eventually went into default again, and the bank sued to enforce the note. The guarantors defended on the ground that their guaranty was unenforceable for lack of consideration.¹⁰¹

The court agreed with the guarantors. The court reasoned that consideration is sufficient if the promise to become a surety or guarantor on a debt is made at or before the time the debt is created, but any subsequent guaranty made independently of the initial transaction must be supported by new consideration distinct from that of the debt. Because the loan's

97. *Id.* at 413.

98. 170 S.W.3d 858 (Tex. App.—Dallas 2005, no pet. h.).

99. *Id.* at 865.

100. 165 S.W.3d 366 (Tex. App.—Corpus Christi 2004, pet. filed).

101. *Id.* at 367-68.

renewal was a subsequent transaction and the guarantors did not promise to guaranty the renewed loan before or at the time of renewal, there was no consideration and the guarantors were not obligated on the renewed loan.¹⁰²

In *First National Acceptance Co. v. Dixon*,¹⁰³ a maker executed a note secured by a deed of trust on the maker's business property. However, the payee gave no consideration for the note. A bank subsequently purchased sixty installments of the note under an indorsement that read, "Pay without recourse to the order of" the bank. Although the bank had only purchased sixty payments, the indorsement purported to convey the entire note. The bank eventually foreclosed and purchased the property, securing the note at a trustee's sale. The maker sued the bank and the payee to set aside the foreclosure sale and to void the note and sale for lack of consideration. The trial court ruled in favor of the maker.¹⁰⁴

On appeal, the court held that the note was enforceable because the bank was not subject to the maker's defenses. The court reasoned that the transfer was not a mere assignment; rather, the bank was a holder in due course because the payee negotiated the note by indorsement and transfer of possession, and the parties clearly contemplated that the bank would have the sole power to enforce the note, to foreclose, and to dispose of the property after foreclosure. Although the bank only bought the next sixty payments due on the note, neither the note nor the indorsement indicated an attempt to transfer a partial interest. As indorsed and transferred, the maker could have paid the note's entire amount to the bank with perfect safety against any claim of the payee. The judgment was reversed and the case was remanded.¹⁰⁵

In *EMC Mortgage Corp. v. Davis*,¹⁰⁶ a husband and wife obtained a loan from a savings bank. When the bank failed, the note was transferred several times and finally ended up in the hands of the defendant mortgage company. The note specified the amount, interest rate, starting date, maturity date, and monthly payment, all of which were based on a thirty-year amortization schedule. A capitalized statement at the top of the note stated that its terms included a balloon payment at maturity, but it contained no details about this provision. When the note was transferred to the holder, the holder refused to apply the balloon payment provision. The borrowers ultimately paid the amount that the holder demanded and sued for the difference.

The borrowers alleged that the loan was structured as a fifteen-year loan with a balloon payment at maturity, with payments based on a thirty-year amortization schedule. The borrowers had received and signed several disclosures at the same time that they executed the note,

102. *Id.* at 370.

103. 154 S.W.3d 218 (Tex. App.—Beaumont 2004, pet. denied).

104. *Id.* at 219-22.

105. *Id.* at 225.

106. 167 S.W.3d 406 (Tex. App.—Austin 2005, pet. denied).

which showed the intent of the parties to structure the loan as the borrowers alleged. The disclosures accompanied the note and were known to the holder before the purchase. The holder argued that all of the loan's terms were clear on its face, which showed that it was simply a thirty-year amortizing loan. Over the holder's objection, the trial court admitted the disclosures, and a jury found in favor of the borrowers. The holder appealed.¹⁰⁷

On appeal, the court held that the signed disclosures defining the note's balloon-payment obligation and the balloon-payment requirement were sufficient to show that the note was ambiguous as to the loan's structure.¹⁰⁸ The holder argued that the *D'Oench, Duhme* doctrine and its statutory counterpart protected it from the separate agreement defining the balloon payment's calculation.¹⁰⁹ The court disagreed, holding that the balloon-payment disclosure agreements and other extraneous information were not being used as a defense to paying the note but instead, to clarify and explain an ambiguity in the note. Thus, the doctrine did not apply.¹¹⁰ The court also held that because the holder knew of the disclosures before it purchased the note, it had knowledge of the balloon-payment requirement, negating any argument about the doctrine's applicability due to lack of notice.¹¹¹ For similar reasons, the court held that the Code's holder-in-due-course provisions made the holder subject to claims and defenses apparent on the face of the instrument, which included notice of the ambiguous balloon-payment provision.¹¹² The judgment of the trial court was affirmed.¹¹³

In *Wheeler v. Security State Bank, N.A.*,¹¹⁴ a bank sued to recover on two promissory notes. The maker alleged that he did not sign the larger of the two notes, but he did not make this allegation by a verified pleading. The bank moved for summary judgment (1) by attaching photocopies of the notes to its motion, (2) by an affidavit of a bank officer who testified that the maker executed and delivered the notes to the bank, (3) by stating under the same affidavit that the maker signed the note, and (4) by stating the balance due on the note and the reasonable and necessary attorney's fees required for the note's collection. Because the maker only contested his signature's validity, but did not do so by a verified pleading, the trial court entered judgment in favor of the bank.¹¹⁵

107. *Id.* at 410-12.

108. *Id.* at 415.

109. The *D'Oench, Duhme* doctrine is derived from *D'Oench, Duhme & Co. v. F.D.I.C.*, 315 U.S. 447 (1942). The doctrine "is a rule of estoppel that precludes a borrower from asserting defenses . . . that are based either on secret or unrecorded agreements that alter the terms of an obligation." *EMC Mortgage*, 167 S.W.3d at 416. The doctrine's statutory counterpart appears in 12 U.S.C. § 1823(e).

110. *EMC Mortgage*, 167 S.W.3d at 417.

111. *Id.*

112. *Id.* at 415 n.5.

113. *Id.* at 419-20.

114. 159 S.W.3d 754 (Tex. App.—Texarkana 2005, no pet. h.).

115. *Id.* at 755 n.1, 757.

On appeal, the court held that the maker's failure to respond to the motion for summary judgment allowed the maker to raise only a single issue, that is, that the proof supporting the motion for summary judgment was insufficient as a matter of law.¹¹⁶ Because the maker failed to file a verified pleading contesting his signature, his signature's validity was fully proved. None of the other elements of the bank's summary-judgment proof had been contested below, so judgment in favor of the bank was affirmed.¹¹⁷

In *Duong v. Bank One, N.A.*,¹¹⁸ an employee of a law firm and translating service fraudulently indorsed twenty-eight checks made payable to the attorneys and their clients and indorsed one check issued in his employer's name. He then converted the checks by depositing them into an account he opened in his employer's name. When the law firm sued the bank for conversion, the bank requested that the firm stipulate that the employee had authority to supply the bank with the payees' names and addresses. When the law firm responded, the bank contended that it had proven the "faithless employee defense" under section 3.405 of the Code as a matter of law. Summary judgment was entered in favor of the bank.¹¹⁹

The court of appeals held that the bank did not prove the faithless-employee defense as a matter of law except for one of the checks. The court described the faithless-employee defense as one that adopts a comparative-negligence system to allocate responsibility between an employer and a bank when the employer has entrusted the employee with responsibility for instruments.¹²⁰ Reviewing the official comment to section 3.405, the court noted the Code's distinction between checks made payable to the employer and those issued by the employer.¹²¹ The court held that section 3.405 applied to the latter but not to the former, and any admission made by the law firm would be effective only with respect to the one check it had issued. The bank was required, therefore, to prove the faithless-employee defense with respect to the twenty-eight checks made payable to the employer.¹²²

In *Bank of America, N.A. v. Amarillo National Bank*,¹²³ an unknown person created a check that resembled a company's legitimate checks. The counterfeit check differed from the real checks in paper and size, but the counterfeit bore a check number that was the same as the check number of a real check that the company actually issued. The payee named on the counterfeit check deposited the check in his account at the depository bank, and the payor bank paid it. Upon reviewing its bank state-

116. *Id.* at 757.

117. *Id.* at 758.

118. 169 S.W.3d 246 (Tex. App.—Fort Worth 2005, no pet. h.).

119. *Id.* at 248-49.

120. *Id.* at 250.

121. *Id.* at 252 (citing TEX. BUS. & COM. CODE ANN. § 3.405 cmt. 1 (Vernon 2002)).

122. *Id.* at 352-54.

123. 156 S.W.3d 108 (Tex. App.—Amarillo 2004, no pet. h.).

ment, the company discovered the counterfeit and notified the bank. The company's account was recredited. The payor bank sought recovery from the depositary bank under section 4.208 of the Code for breaching its warranty against alteration.¹²⁴ The trial court granted summary judgment in favor of the payor bank, and the depositary bank appealed.¹²⁵

The court of appeals reviewed the Code's definition of "alteration" and concluded that the term "presupposes the existence of an instrument."¹²⁶ The definition also connoted "a change to, or on, that preexisting instrument."¹²⁷ Drawing an artistic analogy, the court then said, "If change is being done 'to an instrument,' reason suggests that the physical instrument itself undergo change, not some other document. For instance, there is but one 'Mona Lisa.' While it may be subject to alteration, one does not do so by making a copy of the masterpiece and then changing the confident smile of the woman appearing in the copy."¹²⁸ Citing earlier cases dealing with counterfeit checks, the court held that an alteration must "be made on the body of the original instrument, as opposed to appearing simply on a copy of the original."¹²⁹ Simply because the counterfeit happened to bear a check number that was the same as the number of an actual check did not turn the counterfeit into an altered instrument. Therefore, summary judgment in favor of the payor bank was reversed, and a take-nothing judgment was rendered on the breach-of-warranty claim.¹³⁰

In *Time Out Grocery v. Vanguard Group, Inc.*,¹³¹ a drawer issued a check to a payee who indorsed it to a grocery store. The drawer stopped payment on the check, and the check was dishonored when presented. The holder sued the drawer for the check's amount, a statutory fee for the returned check, and attorney's fees. The claim for attorney's fees was based on Texas Civil Practice and Remedies Code provisions allowing recovery of attorney's fees in actions founded on an oral or written contract.¹³²

The court denied recovery of attorney's fees on the ground that the holder's claim was not "contractual in nature."¹³³ The court distinguished several cases relied on by the plaintiff because they did not in-

124. *Id.* at 109-10 (discussing TEX. BUS. & COM. CODE ANN. §§ 3.417(a), 4.208(a) (Vernon 2002 & Supp. 2005)). Sections 3.417(a) and 4.206(a) require that a presenting bank and prior transferors give four different warranties to a payor bank. The warranty given under sections 3.417(a)(2) and 4.208(a)(2) is that a draft (which includes a check) has not been altered.

125. *Bank of Am.*, 156 S.W.3d at 110.

126. *Id.* at 111 (discussing TEX. BUS. & COM. CODE ANN. § 3.407 (Vernon 2002)).

127. *Id.*

128. *Id.*

129. *Id.* (citing *Charter Bank Nw. v. Evanston Ins. Co.*, 791 F.2d 379 (5th Cir. 1986); *Firststar Bank, N.A. v. Wells Fargo Bank, N.A.*, No. 02-C-186, 2004 WL 1323942 (N.D. Ill. June 14, 2004)).

130. *Id.* at 112.

131. 187 S.W.3d 41 (Tex. App.—Dallas 2005, no pet. h.).

132. *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (Vernon 1997)).

133. *Id.* at 45.

volve actions on negotiable instruments. Of particular note, however, was the basis on which the court distinguished *Barham v. Sugar Creek National Bank*¹³⁴—*Barham* was a case in which an indorsee sued a prior indorser, whereas the case at bar was one in which the payee was suing the drawer.¹³⁵ This distinction seems strained at best, particularly since the sections dealing with drawer and indorser liability that were in effect when *Barham* was decided were titled, respectively, “Contract of Maker, Drawer and Acceptor” and “Contract of Indorser; Order of Liability.”¹³⁶ The court failed to note this parallelism under the former version of Article 3. Nonetheless, the court held that *Barham* did not support the plaintiff’s claim against the drawer as a contract action.¹³⁷ The court also distinguished *Compass Bank v. Ameristar Jet Charter, Inc.*¹³⁸ because that case involved the liability of a bank as the drawer of a cashier’s check.¹³⁹ In distinguishing *Compass Bank*, as it did with *Barham*, the court did not note the parallelism between the sections dealing with indorser and drawer liability, including a bank’s liability as drawer of a cashier’s check. Under the 1995 revision of Chapter 3, which became effective in Texas on January 1, 1996, the sections dealing with the liability of drawers and indorsers were retitled as “Obligation of Drawer” and “Obligation of Indorser.”¹⁴⁰ The provisions dealing with banks as the drawers of cashier’s checks were restated in a separate section titled “Obligation of Issuer of Note or Cashier’s Check.”¹⁴¹ Given that the 1995 change from “Contract” to “Obligation” in the titles of these sections might imply a change in the basis of an action, the court did not rely on this (and, indeed, the change seems to be nothing but a stylistic rewording since the substance of these sections was not changed). The court in *Compass Bank* made nothing turn on use of the word “obligation” instead of “contract.”

Judgment was rendered in favor of the plaintiff for the amount of the check and for the returned check charge, but no recovery was allowed for attorney’s fees.¹⁴² At best, the decision in *Time Out Grocery* is suspect and, more likely, simply wrong.

IV. DOCUMENTS OF TITLE

A. LEGISLATIVE CHANGES

As with Chapter 3, the principal developments dealing with documents of title were the legislative changes made in Chapter 7 of the Code. Unlike the relatively few amendments to Chapter 3, Chapter 7 was completely revised to modernize its treatment of warehouse receipts, bills of

134. 612 S.W.2d 78 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ).

135. *Time Out Grocery*, 187 S.W.3d at 44.

136. See TEX. BUS. & COM. CODE ANN. §§ 3.413-.414 (Vernon 1968) (emphasis added).

137. See *Time Out Grocery*, 187 S.W.3d at 44.

138. No. 05-00-01803-CV, 2001 WL 1486199 (Tex. App.—Dallas Nov. 26, 2001, no pet.).

139. *Time Out Grocery*, 187 S.W.3d at 45.

140. See TEX. BUS. & COM. CODE ANN. §§ 3.414-.415 (Vernon 2002).

141. See *id.* § 3.412.

142. *Time Out Grocery*, 187 S.W.3d at 45.

lading, and other documents of title issued by a carrier or warehouse to represent goods that are in shipment or in storage.¹⁴³ A “certificate of title” is not a “document of title” since it is used to record ownership and security interests in certain types of property, primarily motor vehicles, and is issued by a state agency rather than a person in the business of shipping or storing goods for hire.¹⁴⁴

While bills of lading and warehouse receipts have similar characteristics in that both are issued by bailees for hire who are in the business of shipping or storing goods, they also have some differences. For this reason, Chapter 7 includes several provisions applicable to both types of documents and other provisions dealing separately with bills of lading and warehouse receipts. Subchapters 1, 4, 5, and 6 deal with documents of title in general.¹⁴⁵ Special provisions covering warehouse receipts are contained in Subchapter 2, and Subchapter 3 does the same for bills of lading.¹⁴⁶

Chapter 7 deals only with the civil issues surrounding the issuance and use of documents of title. It does not deal with regulatory or criminal matters concerning shipping or warehousing, including laws prescribing the form or content of a document of title or the services or facilities required of bailees.¹⁴⁷ Chapter 7 is subject to any treaty or statute of the United States to the extent such statute is applicable to a transaction.¹⁴⁸

Chapter 7 was part of the Code when it was first adopted in Texas and remained essentially unchanged until 2005, when Texas adopted the 2003 revision of the Official Text.¹⁴⁹ While many of the rules dealing with warehouse receipts and bills of lading remain the same, there are a number of significant changes. First, and perhaps foremost, is the statutory recognition of electronic documents of title.¹⁵⁰ Under the former Chapter 7, many of the rights and liabilities depended upon possession of a negotiable document of title in written form or written instructions delivered to a carrier or warehouse. Under revised Chapter 7, written documents of title continue to exist, but the intangible nature of electronic documents

143. See TEX. BUS. & COM. CODE ANN. §§ 7.101-106, 7.201-210, 7.301-309, 7.401-404, 7.501-509, 7.601-603 (Vernon Supp. 2005).

144. For purposes of perfecting a security in a secured transaction, certificates of title are defined in TEX. BUS. & COM. CODE ANN. § 9.102(a)(10) (Vernon 2002), and the method of perfection is specified in TEX. BUS. & COM. CODE ANN. § 9.109(c)(2) (Vernon 2002).

145. TEX. BUS. & COM. CODE ANN. §§ 7.101-106, 7.401-404, 7.501-509, 7.601-603 (Vernon Supp. 2005).

146. *Id.* §§ 7.201-210, 7.301-309.

147. *Id.* § 7.103.

148. *Id.* Federal laws with preemptive effect include the Federal Bills of Lading Act, 49 U.S.C. § 80101 *et seq.* (2000); Carmack Amendment, 49 U.S.C. § 11707 (2000); Carriage of Goods by Sea Act, 46 U.S.C. § 1301 *et seq.* (2000); United States Warehouse Act, 7 U.S.C. § 241 *et seq.* (2000).

149. See *supra* note 81 and accompanying text.

150. Because the recognition of electronic documents of title not only affects provisions in Chapter 7 but also has an impact on Sales and Secured Transaction, the definitions in Chapter 1 were amended to make the concept applicable throughout the Code. See TEX. BUS. & COM. CODE ANN. § 1.201(b)(6), (16), (31), (42) (Vernon Supp. 2005).

of title required inclusion of the concept of “control” to determine the rights of parties dealing with electronic documents. Under section 7.106, a person has control of an electronic document of title if a system exists for evidencing the issue and transfer of the document and the system provides for the retention of a single authoritative copy and a means by which the person in control must consent to any modifications or transfers.¹⁵¹ By conforming amendments to Chapter 9, control of an electronic document of title is also a proper means of perfecting a security interest in the document.¹⁵²

Other changes in Chapter 7 are summarized in the Prefatory Note accompanying the Official Text of the revision.¹⁵³ These include new definitions, clarifications, deletions, broadening rights, conforming language to modern practice, adding references, giving courts greater flexibility, and conforming to the U.C.C.¹⁵⁴

V. SECURED TRANSACTIONS

A. SCOPE OF A SECURITY INTEREST

In *First Union National Bank v. Richmond Capital Partners I, L.P.*,¹⁵⁵ a debtor borrowed money from a bank (“Bank A”) under a security agreement granting Bank A a security interest in most of the debtor’s assets. This loan exceeded \$34 million. The debtor later obtained additional financing in the amount of \$50 million from another bank (“Bank B”) by granting a security interest in the same collateral and by having a guarantor provide a guaranty of \$10 million of the \$50 million amount. The banks entered into an intercreditor agreement, establishing their priorities and order of payment in the collateral. The guarantor was not a party to this agreement, and rights in the guaranty were not specifically mentioned in the agreement. When the debtor eventually needed more money, the intercreditor agreement was amended in a series of complicated amendments, but, like the original agreement, the guaranty was not specifically mentioned and the guarantor was not a party to the amendments.¹⁵⁶

The debtor ultimately filed for bankruptcy, triggering an action by Bank B. Bank A intervened, claiming it had a right to payment under the guaranty on three different grounds: (1) it had a security interest in the guaranty under the intercreditor agreement; (2) it was a third-party beneficiary under the guaranty; and (3) the guarantor was unjustly enriched by a settlement with the Bank B limiting the guarantor’s liability to \$7.8 million. The trial court granted summary judgment and ordered that the

151. TEX. BUS. & COM. CODE ANN. § 7.106 (Vernon Supp. 2005).

152. See *id.* § 9.310(b)(8) (Vernon 2002 & Supp. 2005).

153. U.C.C., Official Text and Comments, Article 7 Prefatory Note, 698 (West 2004).

154. *Id.*

155. 168 S.W.3d 917 (Tex. App.—Dallas 2005, no pet. h.).

156. *Id.* at 921.

intervenor take nothing on any of its claims.¹⁵⁷

On appeal, the court noted that under Texas law, a guaranty agreement is construed strictly in favor of the guarantor.¹⁵⁸ Reviewing the intercreditor agreements and the subsequent amendments in this light, the court held that the guaranty was not “collateral” in which Bank A had a security interest under the intercreditor agreement.¹⁵⁹ Similarly, none of the various agreements indicated an intent to make Bank A either a donee or a creditor beneficiary, and the court rejected the third-party beneficiary claim.¹⁶⁰ As to the unjust-enrichment claim, the court pointed out that Bank A could have bargained to give the itself an express interest in the guaranty, and the theory of unjust enrichment could not be used to rescue Bank A from a bad bargain.¹⁶¹ The judgment of the trial court was therefore affirmed.¹⁶²

In *Calpine Producer Services, L.P. v. Wiser Oil Co.*,¹⁶³ the court addressed a case arising from the ripple effect of the Enron failure. A natural-gas producer sued a natural-gas reseller for breach of contract when the reseller failed to pay for gas it had purchased from the producer and resold to Enron. The dispute hinged on a contract provision stating that payment was due after the reseller “receives payment from its customers.”¹⁶⁴ The reseller argued that this language was a condition precedent to its duty to pay, and, since it had not been paid by its customer, its obligation to pay the producer never arose. The producer argued that this language should not be interpreted as an absolute condition but as a statement that payment was to be made within a reasonable time after the reseller sold the gas. The producer also argued that it had a security interest under section 9.343 of the Code to secure the obligation to pay for the gas, and this indicated a legislative intent to protect producers by assuring that purchasers paid.¹⁶⁵ Even though conditions are not favored under Texas law, the court nonetheless held that the contract’s express language could not be construed to mean that payment was due after the reseller *should* have received payment from its customers.¹⁶⁶ As to the security interest under section 9.343, the court reasoned that the security interest only arose when a right to payment existed, and no right existed because payment had not been made. Because the reseller had not breached the contract by failing to pay when it did not receive payment from its own customer, no right to payment accrued to support the statutory security interest.¹⁶⁷

157. *Id.* at 922-23.

158. *Id.* at 924.

159. *Id.* at 928.

160. *Id.* at 930.

161. *Id.* at 932.

162. *Id.*

163. 169 S.W.3d 783 (Tex. App.—Dallas 2005, no pet. h.).

164. *Id.* at 788.

165. *Id.* (discussing TEX. BUS. & COM. CODE ANN. § 9.343 (Vernon 2002)).

166. *Id.* at 791.

167. *Id.*

Under Chapter 9, the terms “debtor” and “obligor” are separately defined.¹⁶⁸ A “debtor” is a person having an ownership interest in collateral. An “obligor” is a person who owes payment on or performance of the obligation.¹⁶⁹ The same person may be both a “debtor” and an “obligor,” or the debtor and obligor may be different persons. An example of the latter situation appeared in *Wagner v. Compass Bank*,¹⁷⁰ in which a company (the “obligor”) obtained a loan by using its own inventory as collateral and by granting a security interest in shares of stock in another company that were owned by an individual who was a co-owner of the company (the “debtor”). The security agreement provided that all of the collateral secured not only the initial loan, but also any future advances made to the company. Additional advances were made over a period of time.¹⁷¹

When the company defaulted, instead of liquidating the inventory, the secured party sold enough of the debtor’s collateral to satisfy the debt and returned the balance to the debtor.¹⁷² The debtor contended that the secured party had acted improperly by liquidating the debtor’s collateral and applying the proceeds to pay subsequent loans to the obligor.¹⁷³ The court held that the security agreement signed by the debtor provided that the debtor’s collateral secured both present and future advances made to the obligor and did not require that the secured party first liquidate the inventory.¹⁷⁴ The debtor also argued that his liability under a guaranty he had signed in connection with the loans was limited to \$50,000, and the amount realized from the liquidated collateral exceeded this amount. The court agreed that the debtor’s *personal* liability was limited to \$50,000 but pointed out that the limitation of personal liability did not operate to limit secured party’s right to liquidate collateral.¹⁷⁵ The court concluded that the secured party had proven the amount of the debt and, under the terms of the security agreement, had the right to liquidate any of the collateral securing the debt.¹⁷⁶

B. PERFECTING A SECURITY INTEREST

Although not arising under the Texas U.C.C., the decision in *In re Spearing Tool & Manufacturing Co.*, deserves mention.¹⁷⁷ Under section 9.310 of the Code, a financing statement must be filed to perfect a secur-

168. See TEX. BUS. & COM. CODE ANN. § 9.102(a)(28), (60) (Vernon 2002).

169. *Id.*

170. 170 S.W.3d 220 (Tex. App.—Dallas 2005, no pet. h.).

171. *Id.* at 221-22.

172. Although not mentioned in the opinion, the secured party probably determined that it was easier to sell the debtor’s stock on the stock market than it was to repossess and dispose of the obligor’s inventory because the disposition requirements for collateral sold in a recognized market are less stringent than those for other types of collateral. See TEX. BUS. & COM. CODE ANN. § 9.611(d) (Vernon 2002).

173. *Wagner*, 170 S.W.3d at 222.

174. *Id.* at 225.

175. *Id.*

176. *Id.* at 226.

177. 412 F.3d 653 (6th Cir. 2005).

ity interest except for certain limited situations listed in that section.¹⁷⁸ Under section 9.509 of the Code, if a debtor is a registered organization (corporation, for example), the financing statement must provide the organization's name as indicated in the public records of the jurisdiction where the debtor is organized.¹⁷⁹ In *Spearing Tool*, the Internal Revenue Service filed a notice of federal tax lien identifying the delinquent taxpayer as "Spearing Tool & Mfg. Company, Inc." instead of the registered organization name "Spearing Tool and Manufacturing Co."¹⁸⁰ In a priority dispute between a secured party that had filed under the registered organization name and the IRS, the bankruptcy court found in favor of the IRS, and the district court reversed.¹⁸¹ On appeal to the Sixth Circuit, the court held that the IRS filing was sufficient as a matter of federal law under the Federal Tax Lien Act, which provides that the form and content of a notice of tax lien "shall be prescribed by the [Treasury] Secretary" and "be valid notwithstanding any other provision of law regarding the form or content of a notice of lien."¹⁸²

The secured party argued, and the court agreed, that the electronic-search capabilities of the Michigan filing system placed limitations on creditors's ability to locate filings that varied from the registered organization's name. Nonetheless, the court held that the secured party should have searched for variations on the registered name, particularly since the abbreviation of "Mfg." and the use of an ampersand in place of "and" are common.¹⁸³ Furthermore, the Michigan Secretary of State had suggested that the secured party search using these abbreviations, and the secured party failed to do so.¹⁸⁴

The court also rejected an argument that it is unreasonable to require a secured party to make multiple searches when the name of a debtor can be abbreviated in several ways. On this point, the secured party submitted an example using the name "ABCD Christian Brothers Construction and Development Company of Michigan, Inc." and 288 possible abbreviations of that name. Describing this as "an extreme example," the court pointed out that, in the case at bar, "only two relevant words could be, and commonly are, abbreviated: 'Manufacturing' and 'and'—and the Secretary of State specifically recommended searching for those abbreviations."¹⁸⁵ The court added, "We express no opinion about whether creditors have a general obligation to search name variations. Our holding is limited to these facts."¹⁸⁶

178. See TEX. BUS. & COM. CODE ANN. § 9.310 (Vernon 2002).

179. See *id.* § 9.503(a)(1).

180. *Spearing Tool*, 412 F.3d at 654.

181. *In re Spearing Tool & Mfg. Co.*, 292 B.R. 579 (Bankr. E.D. Mich. 2003), *rev'd*, 412 F.3d 653 (6th Cir. 2005).

182. *Spearing Tool*, 412 F.3d at 655 (quoting 26 U.S.C. § 6323(f)(3) (2000)).

183. *Id.* at 656.

184. *Id.*

185. *Id.*

186. *Id.*

Spearing Tool points out the need for a secured party to recognize that a search of U.C.C. filings should take federal law into account, since the standards for federal tax lien filings, according to the Sixth Circuit, are less stringent than those required by section 9.509 of the Code and allow variations on a registered organization's name from that appearing on the public record.¹⁸⁷ It should be noted, however, that the search systems used for U.C.C. filings are not uniform from one state to another. Some systems may automatically search for name variations or common abbreviations; others may not. Obtaining information from the administrator of a particular state's search system about the system's capabilities can be a worthwhile endeavor for a secured party.

187. See *id.* at 656-57.

