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COMMERCIAL TRANSACTIONS

John Kraemer*

THE 1993 Survey period¹ was somewhat unusual in terms of the distribution of reported cases. Commercial paper and guaranty cases not only predominated, but almost equalled the number of cases reported under all other Chapters of the Texas Business and Commerce Code² combined. In addition to judicial activity reported during the Survey period, the legislature adopted the first major revisions to the Code since 1983 when Chapter 8 on Investment Securities³ was substantially revised. The revisions added a new Chapter 2A covering leases of personal property⁴ and a new Chapter 4A covering certain aspects of electronic funds transfers not already covered by federal law.⁵ Highlights of these revisions are discussed, later in the text.⁶ The legislature also repealed Chapter 6 of the Code dealing with bulk transfers because more recent legislation to prevent fraudulent transfers has made Chapter 6 unnecessary.⁷

I. GENERAL PROVISIONS

A. GOOD FAITH AND FAIR DEALING

Although the Texas Supreme Court has rejected the idea that a general common law duty of good faith and fair dealing should be implied in every contract,⁸ it has held that such a duty exists when a "special relationship"

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1. The 1993 Survey period runs approximately from November of 1992 through October of 1993.

2. Prior to September 1, 1993, the Texas Business & Commerce Code included eleven chapters, TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1968 & 1991 & Supp. 1993) [hereinafter the Code]. During the 1993 legislative session, Chapters 2A and 4A were added to the Code with an effective date of September 1, 1993. Act of May 29, 1993, 73d Leg., R.S., ch. 570, §§ 1-16, 1993 Tex. Sess. Law Serv. 2102 (Vernon). Chapter 2A covers leases of personal property and Chapter 4A covers certain aspects of electronic funds transfers. While there are usually several commercial paper and guaranty cases reported under Chapter 3 of the Code, Chapter 2 on the sale of goods and Chapter 9 on secured transactions, taken together, typically account for a larger number of reported cases. Relatively few cases are usually reported under the other chapters of the Code.

3. TEX. BUS. & COM. CODE ANN. §§ 8.101-8.408 (Tex. UCC) (Vernon 1991).

4. TEX. BUS. & COM. CODE ANN. §§ 2A.101-2A.532 (Tex. UCC) (Vernon 1991 & Supp. 1994).

5. TEX. BUS. & COM. CODE ANN. §§ 4A.101-4A.507 (Tex. UCC) (Vernon 1991 & Supp. 1994).

6. See discussion *infra* Parts III, IV.

7. Act of May 29, 1993. 73d Leg. R.S., ch. 570, § 16(1), 1993. Tex. Sess. Law Serv. 2147 (Vernon).

8. English v. Fischer, 660 S.W.2d 521, 522 (Tex. 1983).

exists between the contracting parties.⁹ Breach of this common law duty sounds in tort and can give rise to the recovery of both actual and punitive damages.¹⁰ Although Section 1.203 of the Code¹¹ also imposes a duty of good faith in all transactions governed by the Code, this duty has been held to create only a contractual obligation not allowing the recovery of punitive damages.¹² The dichotomy between the damages allowed in tort as opposed to the damages allowed in contract have tempted plaintiffs to argue for the existence of a "special relationship" in a variety of circumstances.¹³ Thus far these arguments have been unsuccessful.¹⁴

In *Central Savings & Loan Association v. Stemmons Northwest Bank, N.A.*¹⁵ the beneficiary under a standby letter of credit contended that the existence of the letter of credit was sufficient to create a "special relationship" between the beneficiary and the issuer of the credit. The court noted there was no evidence of a long-standing business relationship between the parties and no evidence showing an element of trust or unequal bargaining power to justify imposition of a common law duty of good faith and fair dealing.¹⁶ The court concluded the relationship of the beneficiary and the issuer was "an ordinary commercial contractual relationship" and did not "constitute the 'special relationship' necessary to give rise to a common law duty of good faith and fair dealing."¹⁷

B. ACCELERATION AND USURY

Section 1.208 of the Code is the basic statutory provision allowing acceleration of an instrument.¹⁸ Texas caselaw has added a considerable gloss, however, to the manner in which an acceleration may be effected and has imposed special notice requirements on creditors seeking to accelerate a

9. *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987).

10. *Id.* at 168.

11. TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968).

12. *Adolph Coors Co. v. Rodriguez*, 780 S.W.2d 477, 481 (Tex. App.—Corpus Christi 1989, writ denied).

13. *See, e.g., id.* (supplier-distributor does not constitute a "special relationship"); *Crim Truck & Tractor v. Navistar Int'l Transp. Corp.*, 823 S.W.2d 591, 595 n. 5 (Tex. 1992) (no "special relationship" between franchisee and franchisor); *FDIC v. Coleman*, 795 S.W.2d 706, 709 (Tex. 1990) (no "special relationship" implied between creditor and guarantor); *Cockrell v. Republic Mortgage Ins. Co.*, 817 S.W.2d 106, 116 (Tex. App.—Dallas 1991, no writ) (no "special relationship" between lender and borrower); *Lovell v. Western Nat'l Life Ins. Co.*, 754 S.W.2d 298, 303 (Tex. App.—Amarillo 1988, writ denied) (no "special relationship" between mortgagor and mortgagee).

14. *See* cases collected in the preceding note. To date the Texas courts have adhered to the "special relationship" categories described by the supreme court in *FDIC v. Coleman*, 795 S.W.2d 706 (Tex. 1990).

15. 848 S.W.2d 232 (Tex. App.—Dallas 1992, no writ).

16. *Id.* at 239-40.

17. *Id.* at 240.

18. TEX. BUS. & COM. CODE ANN. § 1.208 (Tex. UCC) (Vernon 1968).

debt.¹⁹ In *Miller v. University Savings Association*²⁰ the court considered whether the requirement that notice of intent to accelerate be given before the acceleration takes place applies to a guarantor as well as to the maker of a note. The court reasoned that, while a guaranty may incorporate some of the terms of a note, it is also a separate contract between the guarantor and the creditor creating separate obligations between those parties.²¹ The court concluded Texas law does not require a creditor to give notice of intent to accelerate to a guarantor prior to the acceleration.²² Additionally, the court held that a claim for usury asserted by the guarantor was barred for failure to assert the claim in the trial court. Regardless of the bar, the court opined that the guaranty, by its own terms, was not usurious.²³

A useful technique for avoiding a usury violation is by inclusion of a savings clause in the note or guaranty. Such a clause should specify that nothing in the instrument entitles the creditor to collect interest in an amount greater than that allowed by law and that the debtor will never be required to pay any interest in excess of the maximum legal amount. This technique was used in *First State Bank v. Dorst*²⁴ where deeds of trust allowed the creditor to increase the interest rate by not more than two percent if the property was sold while the note was still outstanding. While the escalation of interest did not state a cap and was theoretically unlimited in its effect if the property were sold several times while the note was outstanding, the court gave effect to the savings clause as an effective limit on the amount of interest that could be charged under the note.²⁵ The court cautioned, however, that an instrument usurious on its face and in direct contradiction to a savings clause would still be held usurious because a savings clause is only effective to cure open-ended provisions which may or may not amount to usury.²⁶

The court reached a similar result in *Bernie's Custom Coach of Texas, Inc. v. Small Business Administration*²⁷ where a debtor claimed a promissory note was usurious because the language of the note permitted acceleration of the entire indebtedness, including interest not yet earned at the time of acceleration, even though the creditor had never made a claim for such interest. The note also contained a savings clause expressly stating that the interest

19. The best summary of the requirements for proper acceleration is contained in *Shumway v. Horizon Credit Corp.*, 801 S.W.2d 890, 892 (Tex. 1991). The requirements specified in *Shumway* are: (1) the note must be presented or demand for payment must be made to the maker; (2) the creditor must give notice of an intent to accelerate; and (3) the maker must be separately notified of the actual acceleration. *Id.* These requirements can be waived, but any such waiver must clearly state the rights being waived.

20. 858 S.W.2d 33 (Tex. App.—Houston [14th Dist.] 1993, writ denied).

21. *Id.* at 36.

22. *Id.*

23. *Id.* at 36-37.

24. 843 S.W.2d 790 (Tex. App.—Austin 1992, writ denied).

25. *Id.* at 794.

26. *Id.* at 793. The court stated the following example to illustrate this proposition. “[A] creditor may not specifically contract for a thirty percent interest rate and then avoid the imposition of usury penalties by relying on a savings clause that declares an intention not to collect usurious interest.” *Id.*

27. 987 F.2d 1195 (5th Cir. 1993).

rate on the note would never exceed that allowed by law. Because the note, on its face, did not state a usurious rate and a usurious charge would result only if unearned interest were actually claimed as part of an acceleration, the court gave effect to the savings clause and held no usury violation had occurred.²⁸

II. SALES OF GOODS

A. SCOPE OF CHAPTER 2

A fundamental tenet of Chapter 2 is that it applies to "transactions in goods."²⁹ "Goods" are defined in Section 2.105 as "all things (including specially manufactured goods) which are moveable at the time of identification to the contract for sale"³⁰ In *Franklin v. Jackson*³¹ the court determined that a peanut allotment approved by the Agricultural Conservation and Stabilization Service³² did not qualify as "goods" under Chapter 2 and that an attempted "sale" of the allotment for a period of four years was actually a lease rather than a sale.³³ Despite use of the terms "seller" and "buyer" and references to "sale" of the allotment in the contract between the parties, the court reasoned that title to the allotment remained with the transferor and the allotment would return to the transferor at the end of the four year period.³⁴ The court was bolstered in its reasoning by a contract requirement specifying payments to be made annually based on the number of pounds of peanuts permitted under the allotment and by a contract requirement that the transferee was to return the allotment to the transferor at the end of four years in exchange for the nominal payment of one dollar.³⁵

Although a sale of goods is clearly within the scope of Chapter 2, other statutes may affect certain incidents of the sale contract. In *Maley v. 7111 Southwest Freeway, Inc.*³⁶ the court held that a seller could not charge a documentary fee for the processing of documents related to the sale of boats sold on credit to several purchasers. The seller argued that the provisions of the Texas Consumer Credit Code³⁷ permitting documentary fees in the sale of certain motor vehicles should be read to permit such fees in the sale of boats. The court held that, based on general principles of statutory construction, the Consumer Credit Code authorized documentary fees only for

28. *Id.* at 1197.

29. TEX. BUS. & COM. CODE ANN. § 2.102 (Tex. UCC) (Vernon 1968).

30. TEX. BUS. & COM. CODE ANN. § 2.104(a) (Tex. UCC) (Vernon 1968).

31. 847 S.W.2d 306 (Tex. App.—El Paso 1992, writ denied).

32. Allotments are made by the Agricultural Conservation and Stabilization Service for various commodities as a means of controlling the quantities of those commodities to be grown in any given year through subsidies provided by the Department of Agriculture.

33. 847 S.W.2d at 309.

34. *Id.* at 308. The court noted that a "sale" under TEX. BUS. & COM. CODE ANN. § 2.106 (Tex. UCC) (Vernon 1968) is "the passing of title from the seller to the buyer for a price."

35. *Id.* at 309.

36. 843 S.W.2d 229 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

37. *Id.* at 231-32. The specific provision in dispute was TEX. REV. CIV. STAT. ANN. art. 5069-6.10(a) (Vernon 1987) which allows documentary fees in the sale of a "motorcycle, a motor-driven cycle, moped, or all terrain vehicle."

the classes of vehicles listed in the statute and did not encompass other modes of transportation not specifically listed.³⁸

B. GOOD FAITH PURCHASE

Simple fact situations sometimes give courts the opportunity to clearly elucidate the meaning and operation of complex statutory provisions. One such case is *Kotis v. Nowlin Jewelry, Inc.*³⁹ A jewelry store sold a Rolex watch to a purchaser for almost ninety-five hundred dollars in exchange for a check which the purchaser had forged. The store, of course, was unaware of the forgery. On the very next day the purchaser offered to sell the watch for some thirty-five hundred dollars to a used car dealer. After some discussion and a call by the car dealer to the jewelry store to verify that the purchaser had actually obtained the watch from the store, the dealer bought the watch and took possession of it. After the original purchaser's check was returned unpaid, the jewelry store sued the car dealer for conversion of the watch. In a careful analysis of Section 2.403 of the Code,⁴⁰ the court determined that the original purchaser had acquired the watch under a "transaction of purchase,"⁴¹ that the original purchaser had acquired a voidable title through the voluntary delivery of the watch in exchange for the forged check,⁴² and that the purchaser had the ability to transfer a good title to a good faith purchaser for value.⁴³ The court then considered the evidence adduced on whether the car dealer qualified as a good faith purchaser for value.⁴⁴ The court found sufficient evidence in the record to impugn the dealer's good faith, including some evidence tending to show knowledge the transaction was unlawful, admitted misrepresentations during the phone conversation with the jewelry store, and knowledge that the price asked for the watch was extremely low for a watch of this quality.⁴⁵ The court concluded the car dealer did not qualify as a good faith purchaser for value and the jewelry store, therefore, was entitled to return of the watch.⁴⁶

C. WARRANTIES

Warranties of quality may arise under the Code either as express warranties made by the seller as part of the sales transaction⁴⁷ or as implied warran-

38. 843 S.W.2d at 231.

39. 844 S.W.2d 920 (Tex. App.—Houston [14th Dist.] 1992, n.w.h.).

40. TEX. BUS. & COM. CODE ANN. § 2.403 (Tex. UCC) (Vernon 1968).

41. "Transaction of purchase" is an undefined term under the Code and the court, finding no Texas case law in point, looked to cases from other jurisdictions to aid in the interpretation of this term. 844 S.W.2d at 922.

42. Here, again, the court looked to cases from other jurisdictions because no Texas cases were in point. *Id.*

43. This analysis correctly applies the provisions of TEX. BUS. & COM. CODE ANN. § 2.403(a) and its concept of creating a voidable, rather than void, title in a purchaser who obtains goods by voluntary delivery even though the delivery may have been induced by fraudulent deception.

44. 844 S.W.2d at 923-24.

45. *Id.* at 924.

46. *Id.* at 925.

47. TEX. BUS. & COM. CODE ANN. § 2.313 (Tex. UCC) (Vernon 1968).

ties imposed by operation of law as an incident of the sale.⁴⁸ In some instances, the Code warranties may be supplemented or supplanted by another statute, such as the Manufactured Housing Act.⁴⁹ In *Thurston v. Green Tree Acceptance of Texas, Inc.*⁵⁰ the disappointed buyer of a mobile home sued the manufacturer, the seller, and the company that financed the sale for breach of express and implied warranties and for violations of the Texas Deceptive Trade Practices Act (DTPA).⁵¹ The principal defense raised by the manufacturer and financier on a motion for summary judgment was that the Manufactured Housing Act operated to bar all of the purchaser's claims because of the purchaser's failure to allow the manufacturer or retailer to perform the warranty service necessary to correct defects in the mobile home.⁵² The summary judgment evidence showed, however, that the purchaser had permitted repairs to be attempted on eight separate occasions and only after it became apparent that the repairs were unsuccessful and the same problems continued to recur did the purchaser refuse to allow further repairs. In the view of the court, the purpose of the Act would be frustrated if the purchaser could not, at some point, bring an action for breach of warranty after a series of unsuccessful attempts at repair.⁵³ Summary judgment in favor of the manufacturer and financier was reversed.⁵⁴ Summary judgment in favor of the retailer was upheld, however, on an interesting technical ground — the retailer did not exist at the time of the purchase because its articles of incorporation had not yet been issued at the time of the sale.⁵⁵ The purchaser had simply sued the wrong party.

In *Pako Corp. v. Thomas*⁵⁶ the court applied the four year limitations period contained in section 2.725 of the Code to conclude that an action for breach of warranty was barred where the action was not brought until some four years and two months after the goods were delivered to the buyer.⁵⁷ The court correctly held that attempts by the manufacturer to repair the goods did not toll the running of the statute of limitations and that no warranty was made that explicitly extended to the future performance of the goods.⁵⁸

An express warranty made by a bank in *Thigpen v. Sparks*,⁵⁹ to the effect that a trust company sold by the bank had a "continuous and uninterrupted

48. TEX. BUS. & COM. CODE ANN. §§ 2.314-2.315 (Tex. UCC) (Vernon 1968).

49. TEX. REV. CIV. STAT. ANN. art. 5221f (Vernon 1987).

50. 853 S.W.2d 806 (Tex. App.—Tyler 1993, writ denied).

51. The Deceptive Trade Practices Act appears as TEX. BUS. & COM. CODE ANN. §§ 17.41-17.63 (Vernon 1991).

52. 853 S.W.2d at 808. TEX. REV. CIV. STAT. ANN. art. 5221f, § 17(d) (Vernon Supp. 1987) provides: "A consumer's refusal to allow the manufacturer or retailer to perform warranty service pursuant to the rules of the department is a bar to any cause of action for failure to perform warranty service."

53. 853 S.W.2d at 809.

54. *Id.* at 810.

55. *Id.*

56. 855 S.W.2d 215 (Tex. App.—Tyler 1993, n.w.h.).

57. *Id.* at 219. TEX. BUS. & COM. CODE ANN. § 2.725(b) (Tex. UCC) (Vernon 1968) provides that a breach of warranty occurs upon tender of delivery of the goods.

58. *Id.* at 219-20.

59. 983 F.2d 644 (5th Cir. 1993).

status of good standing” was one of the most interesting warranty cases decided during the Survey period. Although the express warranty concerned corporate status rather than quality of goods, the fundamental issue in the case is important for express warranties under Chapter 2 of the Code as well. After the sale took place, the buyer learned that the trust company’s charter had been forfeited for a brief time due to non-payment of corporate franchise taxes. The buyer was unable to resell the trust company after making this discovery and sued the selling bank for breach of its express warranty, claiming damages for the lost sale. The selling bank subsequently failed and was placed in FDIC receivership. The FDIC asserted that, under the *D’Oench, Duhme* doctrine and its progeny,⁶⁰ the warranty claim was barred and could not be asserted as a claim against the FDIC. In a careful opinion analyzing the language and underlying policy of the doctrine and its statutory codifications, the court concluded that a breach of express warranty claim was not the type of agreement barred by operation of “*D’Oench, Duhme*.”⁶¹ The court cogently summarized its analysis by noting that such an application of the doctrine would transform it “from a provision protecting the failed bank’s loan portfolio from *D’Oench*-like secret agreements into a meat-axe for avoiding debts incurred in the ordinary course of business.”⁶²

D. REMEDIES FOR NON-DELIVERY

In *Palmco Corp. v. American Airlines, Inc.*⁶³ an airline contracted with a manufacturer of flatware to supply knives, spoons, and forks for inflight meals for a period of one year. Deliveries by the manufacturer were consistently late and some deliveries never took place at all. The airline eventually notified the manufacturer that the late deliveries were unacceptable and that the airline intended to hold the manufacturer to the contract terms. Following receipt of this notice, the manufacturer refused to make further deliveries unless the airline agreed to pay a price increase of approximately twenty-five percent for the future deliveries. The airline was unable to purchase substitute goods from other sources and ultimately agreed to the price increase. Some three months later, the airline notified the manufacturer that it was setting off all damages for delayed delivery and non-delivery against the account balance owed to the manufacturer. At this point the manufacturer refused to make any further deliveries under the contract and sued to recover the outstanding account balance. The court held the airline had adequately complied with section 2.607 of the Code requiring notification of

60. The *D’Oench, Duhme* doctrine originated in the now-famous case of *D’Oench, Duhme & Co., Inc. v. FDIC*, 315 U.S. 447 (1942), where the Supreme Court held that a bank customer was estopped from asserting a defense based on an unrecorded oral agreement with a failed bank in an action brought by the FDIC to collect a debt owed by the customer. The purpose of the doctrine was to prevent deception of bank regulators by unrecorded, secret agreements entered into by a failed bank. The doctrine has been expanded and codified in 12 U.S.C. § 1823(e) (1988) and 12 U.S.C. § 1821(d)(9)(A) (1988).

61. 983 F.2d at 649.

62. *Id.*

63. 983 F.2d 681 (5th Cir. 1993).

breach to hold a seller liable for damages under the Code.⁶⁴ The court further held the airline could recover as damages the increased amount it spent on effecting "cover" when it purchased flatware from other suppliers after the manufacturer refused to make further deliveries.⁶⁵ In the most interesting portion of the opinion, the court considered whether the airline could also recover additional damages under a liquidated damages clause in the contract.⁶⁶ On this point the court held the liquidated damages clause compensated the airline for damage to reputation and for costs associated with revising meal schedules and serving of meals which could not be ascertained with reasonable certainty.⁶⁷ Because these damages were distinct from the damages associated with effecting cover, the award of liquidated damages did not duplicate the cover damages and could properly be awarded.⁶⁸ Damages for the price increase were also proper because the agreement to the increase had been obtained through duress when the airline was unable to find other suppliers at the time the increase was demanded.⁶⁹ The manufacturer was allowed to setoff, at the original contract rate, a balance due for unpaid past deliveries and a net judgment was entered in favor of the airline.⁷⁰

III. LEASES UNDER THE NEW CHAPTER 2A

Space is too short to do more than summarize the highlights of the new Chapter 2A in this Survey article. Chapter 2A governs leases of personal property.⁷¹ Except for the lease of fixtures, it does not affect real property leases.⁷² Perhaps the most important effect of Chapter 2A is that, for the first time, Texas now has a single, comprehensive statement of law on the subject of personal property lease transactions. The only previous source of law in this area consisted of a handful of cases and general contract or tort principles applied to the terms of the lease itself. Chapter 2A now permits more predictable drafting of leases, as well as stating the rights and responsibilities of the parties under a lease contract with each other and with third parties who might deal with the leased goods.⁷³

To a large extent, Chapter 2A is a combination of rules derived from Chapter 2 on sale of goods transactions and Chapter 9 on secured transactions. For example, Chapter 2A includes several sections whose content is

64. *Id.* at 685. TEX. BUS. & COM. CODE ANN. § 2.607(c) (Tex. UCC) (Vernon 1968) requires a buyer to give notice of breach within a reasonable time after discovery or "be barred from any remedy."

65. *Id.* at 686-87. TEX. BUS. & COM. CODE ANN. § 2.712 (Tex. UCC) (Vernon 1968) allows a buyer to purchase substitute goods as "cover" for goods that are not delivered under a sales contract.

66. *Id.*

67. *Id.* at 687.

68. *Id.*

69. *Id.* at 687-88.

70. *Id.* at 689.

71. TEX. BUS. & COM. CODE ANN. § 2A.102 (Tex. UCC) (Vernon Supp. 1994).

72. *Id.*; TEX. BUS. & COM. CODE ANN. § 2A.309 (Tex. UCC) (Vernon Supp. 1994) deals with fixture leases.

73. TEX. BUS. & COM. CODE ANN. § 2A.301 (Tex. UCC) (Vernon Supp. 1994).

almost identical to parallel sections in Chapter 2 with the substitution of the word "lease" for the word "sale." Thus, both Chapters 2 and 2A have sections dealing with offer and acceptance,⁷⁴ statute of frauds requirements,⁷⁵ parol evidence,⁷⁶ warranties of merchantability,⁷⁷ risk of loss,⁷⁸ unconscionability,⁷⁹ anticipatory repudiation,⁸⁰ substituted performance,⁸¹ and excused performance.⁸² While the parallels between Chapter 2A and Chapter 9 are less pronounced, both Chapters have sections dealing with the priority of third-party claims,⁸³ rights of the parties when goods become fixtures,⁸⁴ rights and remedies on default,⁸⁵ and standards for the disposition of repossessed goods.⁸⁶ Chapter 2A also adds some special sections, however, dealing with the unique attributes of lease transactions, such as the lessor's right to sue for the present value of unpaid rent⁸⁷ and protection of the lessor's residual interest in the goods.⁸⁸

Chapter 2A draws a major distinction between two categories of lease transactions. The first, and simplest, category is the direct lease of goods by a lessee from a lessor who is also the supplier of the goods. This category is exemplified by a transaction in which a farmer leases harvesting equipment directly from a farm implement dealer who supplies the goods under a lease agreement requiring the farmer to pay rent to the dealer for a specified term with the equipment to be returned to the dealer at the end of the term. The second, and more complex category, consists of those transactions in which the only function of the lessor is to finance the acquisition of the goods by the lessee by paying a third-party supplier for the goods and immediately delivering them to the lessee under a lease agreement. Such transactions, denominated as "finance leases" under Chapter 2A,⁸⁹ are akin to purchase money loan transactions where a financing entity pays the supplier of goods, but does not select, manufacture, or supply the goods and delivery is made directly from the supplier to the purchaser.⁹⁰ In such purchase money loan transactions, the financier is removed from disputes about the quality of the goods or the quality of performance under the sales contract and can enforce

74. TEX. BUS. & COM. CODE ANN. §§ 2.206, 2A.206 (Tex. UCC) (Vernon 1968 & Supp. 1994).

75. *Id.* §§ 2.201, 2A.201.

76. *Id.* §§ 2.202, 2A.202.

77. *Id.* §§ 2.314, 2A.212.

78. *Id.* §§ 2.509, 2A.509.

79. *Id.* §§ 2.302, 2A.108.

80. *Id.* §§ 2.610, 2A.402.

81. *Id.* §§ 2.614, 2A.404.

82. *Id.* §§ 2.615, 2A.405.

83. TEX. BUS. & COM. CODE ANN. §§ 2A.307, 9.301 (Tex. UCC) (Vernon 1991 & Supp. 1994).

84. *Id.* §§ 2A.309, 9.313.

85. *Id.* §§ 2A.525, 9.503.

86. *Id.* §§ 2A.527, 9.504.

87. TEX. BUS. & COM. CODE ANN. §§ 2A.529 (Tex. UCC) (Vernon Supp. 1994).

88. *Id.* § 2A.532.

89. The definition of a "finance lease" appears in TEX. BUS. & COM. CODE ANN. § 2A.103(a)(7) (Tex. UCC) (Vernon Supp. 1994).

90. The requirements of a purchase money security interest are described in TEX. BUS. & COM. CODE ANN. § 9.107 (Tex. UCC) (Vernon 1991).

the right to payment without regard to such disputes. Under a finance lease, the lessor also has such immunity from disputes about the goods under the provisions of Chapter 2A.⁹¹

The concept of a "finance lease" is perhaps the most important innovation added to Texas law by Chapter 2A by providing financing entities with an additional option in planning financing transactions, particularly for expensive commercial equipment or other expensive goods (for example, automobiles). The independence and irrevocability of the lessee's obligations under a finance lease are made explicit under Chapter 2A.⁹²

Consumer leases receive a degree of separate treatment under Section 2A.104 which explicitly makes Chapter 2A subject to any special protections consumers may have under other provisions of Chapter 2A or under other law.⁹³ A consumer lease is created under Article 2A if the leased goods are acquired primarily for personal, family, or household use and the lessee is obligated to pay less than \$25,000 in rental payments during the term of the lease.⁹⁴

IV. COMMERCIAL PAPER

A. ISSUES OF FORM AND FORMALITIES

Section 3.104 of the Code lists the requirements a writing must have to qualify as a negotiable instrument.⁹⁵ When signatures on an instrument are admitted or established, production of the instrument entitles the holder to recover on it unless the defendant establishes a defense.⁹⁶ In both *Texmarc Conveyor Co. v. Arts*⁹⁷ and *Edlund v. Bounds*,⁹⁸ the court held that writings forming the basis of the respective plaintiffs' claims qualified as promissory

91. The protection of the finance lessor from liability about the quality of the goods supplied under a finance lease is described in TEX. BUS. & COM. CODE ANN. § 2A.103 Cmt. g (Tex. UCC) (Vernon Supp. 1994).

92. TEX. BUS. & COM. CODE ANN. § 2A.407(a) (Tex. UCC) (Vernon Supp. 1994) provides: "In the case of a finance lease that is not a consumer lease, a term in the lease agreement that provides that the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods is enforceable."

The Official Comment of this Section points out: "This section extends the benefits of the classic 'hell or high water' clause to a finance lease that is not a consumer lease. This section is self-executing; no special provision need be added to the contract."

93. One of the most important of these protections is a cross reference to the Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. §§ 17.41-17.565 (Vernon 1991).

94. TEX. BUS. & COM. CODE ANN. § 2A.103(a)(5) (Tex. UCC) (Vernon Supp. 1994). This definition of a "consumer lease" in Chapter 2A will create some interpretive questions about the relationship between Chapter 2A and the Deceptive Trade Practices Act because the definition of "consumer" under the DTPA is much broader and includes "an individual, partnership, corporation, this state, or a subdivision or agency of this state who seeks or acquires by purchase or lease, any goods or services, except that the term does not include a business consumer that has assets of twenty-five million dollars or more." TEX. BUS. & COM. CODE ANN. § 17.45(4) (Tex. UCC) (Vernon 1991). There will presumably be leases which do not qualify as "consumer leases" under Chapter 2A and, hence, do not receive special treatment under that Chapter, but in which the lessee is still a "consumer" for purposes of the DTPA.

95. TEX. BUS. & COM. CODE ANN. § 3.104 (Tex. UCC) (Vernon 1968).

96. *Id.* § 3.307.

97. 857 S.W.2d 743 (Tex. App.—Houston [14th Dist.] 1993, writ denied).

98. 842 S.W.2d 719 (Tex. App.—Dallas 1992, writ denied).

notes under the Code and, absent proof of any valid defenses, the defendant makers were liable on the instruments.⁹⁹

In *Martin v. Ford* an instrument contained all of the requisites specified in Section 3.104, but merely stated "1986" as a date of issue without indicating a specific day, and had no statement of a date for payment.¹⁰⁰ Action was brought on the note in 1991. The court properly recognized that notes containing no time for payment are generally treated as demand notes and that the statute of limitations on demand instruments begins to run on the date of issue.¹⁰¹ Application of this general rule would have barred enforcement of the note as suit was not filed until after expiration of the four year statute of limitations.¹⁰² The court also ruled, however, that if the parties intended to require a demand before a cause of action would accrue, the statute of limitations would not begin to run until demand was made, provided the demand occurred within a reasonable time after issue.¹⁰³ The court held the evidence before it was sufficient to uphold the ruling of the trial court that demand was a required condition precedent and that demand had been made within a reasonable time after the date of issuance.¹⁰⁴ The action was timely, therefore, because it was brought within four years after the demand for payment took place.¹⁰⁵

B. NEGOTIABLE INSTRUMENTS AND STATUTES OF LIMITATIONS

One of the more important and currently unsettled questions surrounding the application of a statute of limitations to claims based on a negotiable instrument involves choosing between the state four-year limitations period and the federal six-year limitations period when an instrument is transferred by the FDIC to an assignee or holder. Conflicting results have been reached by the Texas courts of appeals and writs have been granted to resolve the conflict.¹⁰⁶ The basic fact situation arises when the assets of a failed financial institution are acquired by the FDIC, including assets in the form of instruments representing debts owed by borrowers from the institution. As

99. 857 S.W.2d at 746; 842 S.W.2d at 724.

100. 853 S.W.2d 680 (Tex. App.—Texarkana 1993, writ denied).

101. *Id.* at 682.

102. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004 (Vernon 1986).

103. 853 S.W.2d at 682-83.

104. *Id.* at 683. On this point, the court noted that this rule of general contract law had survived enactment of the Code. A revised version of Article Three of the Official Text of the Uniform Commercial Code promulgated in 1990 contains more elaborate limitations provisions than the current Code and changes the rule in cases where no demand is made from an inquiry into intent of the parties and whether a reasonable time for demand has passed into an absolute limitations period of ten years when neither principal nor interest has been paid for a continuous ten year period. U.C.C. § 3-118(b) (1990). The revised version of Article Three has not yet been adopted in Texas.

105. 853 S.W.2d at 683.

106. *Federal Debt Management, Inc. v. Weatherly*, 842 S.W.2d 774 (Tex. App.—Dallas 1992, writ granted) and *Thweatt v. Jackson*, 838 S.W.2d 725 (Tex. App.—Austin 1992, writ granted). These cases were consolidated and the Supreme Court decided that a purchaser from the FDIC obtains the benefit of the 6 year Statute of Limitations. As a result, *Thweatt* was affirmed; and *Federal Debt Mgmt.* was reversed. Both cases, however, were remanded to the trial court for further proceedings. See 1994 LEXIS 39; 37 Tex. Sup. J. 555 (1994).

part of the liquidation process, such assets, including the instruments, are often sold to private entities. Under federal law, the FDIC is entitled to a six-year limitations period to sue on the instruments,¹⁰⁷ in the hands of a private party, however, Texas law allows only a four-year limitations period to commence an action.¹⁰⁸ This factual setting presents the courts with a clear choice: is a transferee of the assets bound by the shorter state limitations period, or does the transferee obtain the advantage of the longer federal limitations period?

One of the factors involved in choosing between these conflicting time periods is whether the rights of a transferee in an instrument are the same as those of the transferor.¹⁰⁹ In *Thweatt v. Jackson*¹¹⁰ the Austin Court of Appeals reasoned that this doctrine operated to give the transferee of an instrument the benefit of the six-year federal statute of limitations. In *Federal Debt Management, Inc. v. Weatherly*¹¹¹ the Dallas Court of Appeals declined to follow the reasoning in *Thweatt* and held, inter alia, that a statute of limitations limits the substantive right to assert a claim and is, therefore, not a "right" transferable to a transferee.¹¹²

Other factors to be considered in making a choice between the different limitations periods are whether federal holder in due course protection permits a transferee to utilize the federal limitation period, whether federal pre-emption mandates use of the six-year period, and whether public policy favoring use of the federal period overrides language in the statute giving the FDIC the benefit of the six-year rule, without mentioning suits brought by transferees from the agency.¹¹³ It on this last factor perhaps that resolution of the issue may turn. Although the statute clearly gives the FDIC the right to sue for a six-year period following accrual of a cause of action, the statute is silent on whether this right is itself assignable.¹¹⁴ The statute, however, is

107. 12 U.S.C. § 1821 (d)(14) (Supp. I 1989) states the six-year limitations period applicable to actions by the FDIC and the RTC. 28 U.S.C. § 2415(a) (1988) allowed a similar period for actions by the now-abolished FSLIC.

108. TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.004, 16.035 (Vernon 1986).

109. TEX. BUS. & COM. CODE ANN. § 3.201(a) (Tex. UCC) (Vernon 1968) provides that the transferee of an instrument acquires "such rights as the transferor had therein." This rule is a statutory enactment of the general common law shelter doctrine. See TEX. BUS. & COM. CODE ANN. § 3.201 Cmt. 3 (Tex. UCC) (Vernon 1968).

110. 838 S.W.2d 725 (Tex. App.—Austin 1992, writ granted).

111. 842 S.W.2d 774 (Tex. App.—Dallas 1992, writ granted).

112. *Id.* at 774-78. In *Pineda v. PMI Mortgage Ins. Co.*, 843 S.W.2d 660 (Tex. App.—Corpus Christi 1992), writ denied *per curiam*, 851 S.W.2d 191 (Tex. 1993), the court of appeals held that TEX. BUS. & COM. CODE ANN. § 3.201(a) (Tex. UCC) (Vernon 1968) gave the transferee the benefit of the longer six-year federal limitations period. In its *per curiam* denial of a writ of error, the Texas Supreme Court noted that it neither approved nor disapproved the opinion of the court of appeals on this issue.

113. *Thweatt* and *Jackson* are diametrically opposed on how these factors should be applied to the limitations issue. See also *Jon Luce Builder, Inc. v. First Gibraltar Bank*, 849 S.W.2d 451 (Tex. App.—Austin 1993, writ denied), in which the Austin Court of Appeals stated its continued adherence to use of the federal limitations period.

114. In pertinent part, 12 U.S.C. § 1821(d)(14)(A) (1988) provides "[T]he applicable statute of limitations with regard to any action brought by [the FDIC] as conservator or receiver shall be"

equally silent on whether assignability of this right is prohibited.¹¹⁵ If the FDIC has power to transfer assets in the course of a liquidation proceeding (as it does have), that power would seem to carry with it by implication the ability to sell assets at the best obtainable price. Unless prohibited from doing so, the FDIC should be able to sell its right to sue under the six-year limitations period along with the asset being sold as an implied power reasonably necessary to carry out the intent of Congress to facilitate private disposition and collection of assets. The best contrary argument against this line of reasoning is that the rights and powers of a government agency are vested exclusively in the agency and cannot be sold. In this situation, however, the FDIC is acting in the dual role of public agency to insure bank deposits and resolve claims against failed institutions and as a seller of assets that were originally issued in private transactions. In this latter role, it is much like a "value-added reseller" when it acquires an asset through a bank failure, adds a six-year limitations period, and resells the asset for an amount greater than the asset would bring under a four-year limitations period.

A variation on this issue of choosing the proper limitations period arose in *Prince v. First City, Texas — Houston*,¹¹⁶ where an instrument was transferred from a failing bank to a transferee through an open bank assistance transaction.¹¹⁷ The court held the transferee was not entitled to use of the six-year limitation period because the FDIC had never acquired the asset as a receiver and the rights of the transferee were limited, therefore, to the rights of the transferor bank under the four-year state limitations period.¹¹⁸

In *Mills v. FDIC*¹¹⁹ the court considered whether the FDIC could utilize the six year limitations rule if it chose to conduct a nonjudicial foreclosure rather than bringing a legal action. Based on the public policy underlying FDIC liquidation of failed financial institutions, the court held that the six year limitations period could be used in either judicial or nonjudicial foreclosures.

A different limitations issue was addressed in *Peterson v. Texas Commerce Bank — Austin, N.A.*¹²⁰ where the court held that filing of a bankruptcy proceeding tolled the state limitations period during the pendency of the bankruptcy. After the bankruptcy court determined that the amount owing on a note signed by the debtor was nondischargeable because the loan was obtained under false pretenses, tolling of the limitations period allowed the

115. The court recognized this point in *FDIC v. Bledsoe*, 989 F.2d 805 (5th Cir. 1993), in holding that an assignee from the FSLIC acquired the right to sue under the six-year federal limitations period provided in 28 U.S.C. § 2415(a) (1988). At this writing, Bledsoe is probably the best-reasoned and best-articulated opinion on the issue of choosing between conflicting limitations periods in the context of assignments by the FDIC.

116. 853 S.W.2d 691 (Tex. App.—Houston [1st Dist.] 1993, no writ).

117. An open bank assistance transaction is one in which the FDIC facilitates the acquisition of assets by a financially sound bank from a financially troubled bank without an intervening receivership and liquidation.

118. 853 S.W.2d at 694. The court noted that it had previously addressed the same issue in *City of Houston v. First City*, 827 S.W.2d 462 (Tex. App.—Houston [1st Dist.] 1992, writ denied), and would adhere to that opinion.

119. 821 F. Supp. 1176 (W.D. Tex. 1993).

120. 844 S.W.2d 291 (Tex. App.—Austin 1992, no writ).

creditor to sue on the debt even though more than four years had passed since maturity of the note.¹²¹

C. MAKERS' DEFENSES TO ENFORCEMENT OF NEGOTIABLE INSTRUMENTS

It is a great advantage for the transferee of a negotiable instrument to qualify as a holder in due course.¹²² To become a holder in due course, the transferee must first become a "holder," a feat accomplished by taking the instrument through "negotiation," a method of transfer defined in section 3.202 of the Code.¹²³ If a transferee does not qualify as a holder in due course, however, all is not necessarily lost; the transferee merely becomes subject to a wider range of defenses. In *Northwestern National Insurance Co. v. Crockett*¹²⁴ the defendant maker moved for summary judgment on the ground that the notes in question were not negotiable and that the transferee had acquired them by simple assignment rather than by negotiation. Although the court agreed that the transferee did not qualify as a holder and, hence, could not be a holder in due course, the defendant failed to show the existence of any defense to payment.¹²⁵ Summary judgment in favor of the defendant was, therefore, improper and the case was remanded for trial on the merits of the plaintiff's claim for payment.¹²⁶

Claims of material alteration as a defense to liability were raised in two cases decided during the Survey period.¹²⁷ In *FDIC v. Plato*¹²⁸ the alteration consisted of the issuer's changing the name of the beneficiary in an application for a letter of credit and in the letter of credit itself to conform those documents to an understanding between the account party and the beneficiary. In addition the account party signed a blank note in favor of the issuer. After a draw was made under the letter of credit, the issuer filled in the blanks in the amount of \$350,000, the amount specified in the letter of credit and previously agreed to by the account party. Although the account party subsequently made several payments on the note to the issuing bank, when the issuer failed and was taken over by the FDIC, the account party

121. *Id.* at 295.

122. Under TEX. BUS. & COM. CODE ANN. 3.305 (Tex. UCC) (Vernon 1968) a holder in due course holds an instrument free from the claims of any person to the instrument and is subject only to the limited group of defenses listed in that section. In contrast, a transferee who fails to qualify as a holder in due course is subject to the claims of other persons to the instrument and to a much wider variety of defenses. See TEX. BUS. & COM. CODE ANN. § 3.306 (Tex. UCC) (Vernon 1968).

123. TEX. BUS. & COM. CODE ANN. § 3.202 (Tex. UCC) (Vernon 1968). If a negotiable instrument is payable to bearer, it is negotiated by delivery alone; if it is payable to order, negotiation requires delivery together with the indorsement of the prior holder. If a transferee qualifies as a holder, TEX. BUS. & COM. CODE ANN. § 3.302 (Tex. UCC) (Vernon 1968) further requires that the instrument be taken for value, in good faith, and without notice of claims or defenses before the transferee can qualify as a holder in due course.

124. 857 S.W.2d 757 (Tex. App.—Beaumont 1993, no writ).

125. *Id.* at 758.

126. *Id.*

127. *FDIC v. Plato*, 981 F.2d 852 (5th Cir. 1993) and *First State Bank v. Keilman*, 851 S.W.2d 914 (Tex. App.—Austin 1993, writ denied).

128. 981 F.2d 852 (5th Cir. 1993).

resisted payment to the FDIC on the ground of material alteration. The court held that alteration of the application and letter of credit would not work a discharge of liability because those documents did not cross-reference the note, which was the actual instrument evidencing the debt.¹²⁹ As to the note, the court held that the *D'Oench, Duhme* doctrine¹³⁰ precluded a claim of discharge because the account party had signed a blank note that could have the effect of misleading bank examiners within the meaning of the doctrine because the note itself also had no cross-reference to the terms of the letter of credit.¹³¹

In *First State Bank v. Keilman*¹³² a renewal note signed by the makers originally provided that interest would be repaid at "the prime rate . . . plus Two percent (12.5%) per annum."¹³³ The amount stated in parentheses was later deleted by the lending bank and replaced with "(2%)." Although the jury found the change took place without the consent of the makers, there were no findings that the change was material or fraudulent.¹³⁴ Furthermore, the court noted that the change was not material as a matter of law because, by application of the usual rule that words control figures, the legal effect of the contract was not changed.¹³⁵

In *RTC v. Cook*¹³⁶ the makers borrowed money from a savings association to make home improvements. The loan was secured by a construction contract and deed of trust on the makers' residence. As required by the Federal Trade Commission, the contract contained the FTC "Holder in Due Course" notice.¹³⁷ When the contractor failed to complete the improvements, the makers refused to make further payments and sued both the contractor and the savings association for DTPA violations. At trial, the court granted a directed verdict against the makers on the DTPA claim asserted against the savings association, but permitted a trial amendment allowing the makers to state a new claim based on a theory of negligent infliction of emotional distress.¹³⁸ Under this theory the makers alleged the savings association had harassed the makers in an attempt to collect the debt, resulting

129. *Id.* at 856-57.

130. The *D'Oench, Duhme* doctrine is described in note 60, *supra*.

131. The *D'Oench, Duhme* doctrine has been routinely applied to "blank note" cases. See, e.g., *FDIC v. Caporale*, 931 F.2d 1 (1st Cir. 1991); *FSLIC v. Murray*, 853 F.2d 1251 (5th Cir. 1988); *FDIC v. Morrison*, 816 F.2d 679 (6th Cir. 1987); *FDIC v. McClanahan*, 795 F.2d 512 (5th Cir. 1986); *FDIC v. Hatmaker*, 756 F.2d 34 (6th Cir. 1985). *FDIC v. McClanahan* is a "fun" case and is required reading for anyone interested in understanding application of the *D'Oench, Duhme* doctrine. The case is discussed in John Krahmer, *Commercial Transactions, Annual Survey of Texas Law*, 41 Sw. L.J. 173, 181-82 (1987).

132. 851 S.W.2d 914 (Tex. App.—Austin 1993, writ denied).

133. *Id.* at 919.

134. *Id.*

135. *Id.* at 920. The court cited *Guthrie v. National Homes Corp.*, 394 S.W.2d 494, 495 (Tex. 1965) as authority for this rule of legal interpretation. TEX. BUS. & COM. CODE ANN. § 3.118(c) (Tex. UCC) (Vernon 1968) states the same rule.

136. 840 S.W.2d 42 (Tex. App.—Amarillo 1992, writ denied).

137. The requirement that certain consumer credit contracts contain a notice that holders of the contract remain subject to a consumer's claims and defenses appears in 16 C.F.R. § 433.2 (1993).

138. 840 S.W.2d at 44.

in emotional distress to one of the makers. The defendants moved for a short continuance on the ground of surprise, but this motion was denied.¹³⁹ After trial, but before judgment, the RTC entered the picture as conservator for the savings association, thus injecting *D'Oench, Duhme* considerations into the case. The trial court ultimately entered judgment on the jury verdict in favor of the makers on their DTPA claim against the contractor and against the savings association on the emotional distress claim. Under the FTC holder in due course rule, the trial court also ruled that damages assessed against the contractor were recoverable against the association as holder of the consumer credit contract.¹⁴⁰

Two major issues were presented on appeal. First, could the theory of negligent infliction of emotional distress be asserted against the RTC? Second, under the FTC holder in due course rule, could damages awarded against the contractor be used as the basis for a money judgment against the RTC?

The RTC argued the theory of negligent infliction of emotional distress was barred by the *D'Oench, Duhme* doctrine because the claim was based on acts not contained in the books and records of the savings association. The court properly ruled, however, that any tortious acts committed by the association were independent of any agreement with the association and, therefore, were not within the *D'Oench, Duhme* doctrine.¹⁴¹ The court of appeals did, however, uphold the RTC on the alternative argument that the trial court abused its discretion in failing to allow the short continuance requested by the defendant association.¹⁴² A retrial was ordered on the negligent infliction of emotional distress theory.¹⁴³

As to the operation of the FTC holder in due course rule, the court held that the rule permits a consumer to obtain refund of amounts paid under a consumer credit contract and that such refund can be obtained from a subsequent holder of the contract, whether or not that holder was the initial recipient of the payments.¹⁴⁴ The court ruled that a money judgment against the RTC was proper to the extent of payments the consumers had made to the contractor.¹⁴⁵

A different type of defense was asserted in *Moore v. Liddell, Sapp, Zivley, Hill & LaBoon*,¹⁴⁶ where a borrower argued that a loan made to him in his own capacity was usurious because, as a condition of the loan, he was required to guarantee a corporate debt as well as signing in the capacity of maker for his own loan. The court held that requiring the borrower to sign as guarantor of the corporate loan was not usurious because the liability was merely a secondary obligation and did not rise to the level of requiring him

139. *Id.*

140. *Id.* at 45.

141. *Id.* at 48-49.

142. *Id.* at 47.

143. *Id.* at 49.

144. *Id.*

145. *Id.*

146. 850 S.W.2d 291 (Tex. App.—Austin 1993, writ denied).

to immediately assume payment of another's debt.¹⁴⁷

Perhaps the most interesting case decided during the Survey period on a maker's defense to liability on a promissory note was *First State Bank v. Fatherlee*.¹⁴⁸ The basic defense on which the maker ultimately prevailed was a claim of fraud in the inducement, but the claim arose in an unusual factual setting. The maker's father was past due on various debts to a bank. In a scheme to repay the debts, he obtained two promissory note forms from the bank. After obtaining the forms, he called his daughter and asked her to come by his office to "sign some papers." Among the papers she signed were the two blank note forms made payable to the bank. He returned the forms to the bank and a bank employee filled in the blanks in amounts sufficient to pay a substantial part of the father's debts. The proceeds of the notes were then deposited into the daughter's account, but were promptly withdrawn by the father and used to pay his own indebtedness. After the notes went into default, the bank sued the daughter as maker of the notes. The jury found that the daughter had been induced by fraud to sign the notes and the trial court entered a take-nothing judgment against the bank.¹⁴⁹

The bank vigorously argued that the jury instruction on the elements of fraud were incomplete, but the court of appeals upheld the instruction on the ground there is no single definition of fraud and a listing of precise elements of fraud was not only unnecessary in the instruction, but would be unwise because fraud is not an exactly definable term.¹⁵⁰ The bank also argued that the maker could not assert a defense of fraud in the inducement against the bank because the maker never dealt with the bank and it did not make any representations or inducements to her.¹⁵¹ The court held that the bank was involved in the fraudulent scheme and had received benefits from the success of the plan. The bank, therefore, was subject to the fraudulent inducement defense.¹⁵² While the result in this case seems appropriate based on the court's description of the facts, the opinion never discusses application of the Code to these facts. The opinion leaves a vague impression that the court has created a caselaw theory of fraudulent inducement available to makers outside the Code.¹⁵³

147. *Id.* at 293. The court distinguished *Alamo Lumber Co. v. Gold*, 661 S.W.2d 926, 928 (Tex. 1983) which held that if payment or assumption of another's existing debt is required for the extension of credit, then the amount of the debt paid or assumed is treated as additional interest for usury calculations.

148. 847 S.W.2d 391 (Tex. App.—Amarillo 1993, writ denied).

149. *Id.*

150. *Id.* at 395-96.

151. Although not mentioned by the court, this argument appears to have been based on the theory that the bank, as payee of the notes, was a holder in due course under TEX. BUS. & COM. CODE ANN. § 3.302(b) (Tex. UCC) (Vernon 1968) and was, therefore, free of the defenses of any party with whom it had not dealt under TEX. BUS. & COM. CODE ANN. § 3.305(b) (Tex. UCC) (Vernon 1968). This latter section insulates a holder in due course from fraud in the inducement claims.

152. 847 S.W.2d at 396.

153. The opinion is curious in this omission. Official Comment 2 to TEX. BUS. & COM. CODE ANN. § 3.202 (Tex. UCC) (Vernon 1968) contains several examples of situations in which a payee can qualify as a holder in due course. In some of the examples, an agent of the maker or drawer commits a fraud on the maker or drawer and the payee qualifies as a holder

D. LIABILITY OF GUARANTORS

Like other sureties, a guarantor is entitled to assert special defenses accorded to the status of suretyship, including such defenses as impairment of collateral, release of the principal obligor, and extension of the time for payment.¹⁵⁴ It is good commercial practice to include provisions in a guaranty agreement allowing the creditor to modify the terms of the original loan and to waive the right of a guarantor to assert discharge based on such events as impairment of collateral and renewal or extension of the loan. The benefits of this practice were demonstrated during the Survey period in *Mann v. NCNB Texas National Bank*¹⁵⁵ and *Chambers v. NCNB Texas National Bank*.¹⁵⁶ In both cases guarantors signed guaranty agreements allowing changes in the structure of the original loan and, in both cases, the effectiveness of the respective guaranties was upheld.

In *FDIC v. F & A Equipment Leasing*¹⁵⁷ and *Joseph Thomas, Inc. v. Graham*¹⁵⁸ the courts were concerned with determining the capacity in which alleged contracts of guaranty had been signed. In *F & A Equipment* the original makers claimed they had become mere sureties when two other persons subsequently signed the notes for the purpose of assuming all payments on the loans as part of the purchase of an equipment business. The court ruled it was not clear from the face of the notes that a suretyship relation was intended; it was equally possible that all parties had signed as comakers.¹⁵⁹ Because of this ambiguity parol evidence was admissible to show the agreement of the parties, but the original makers had the burden of proving not only an agreement between them and the subsequent signers, but an agreement with the creditor as well showing that the subsequent signers had become primarily liable as makers and the original makers had become mere guarantors. The court found there was insufficient evidence to find such an agreement and the alleged makers/guarantors were not entitled to discharge because of a claimed impairment of collateral.¹⁶⁰ Having lost this battle, the original makers nonetheless won a significant part of the war by successfully urging that they were consumers under the DTPA with respect to the lending bank and that the bank violated the Act with respect to services rendered by the bank in providing the makers with information about the credit wor-

in due course by taking the instrument for value, in good faith, and without notice of the fraud. While these examples have some facial similarity to the situation in *Fatherlee*, the description of the facts contained in the opinion make it seem a relatively easy matter to conclude the bank had notice of the fraud, thereby depriving it of holder in due course status. Likewise, the court could seemingly have treated this as a case of material alteration under TEX. BUS. & COM. CODE ANN. § 3.407(b) (Tex. UCC) (Vernon 1968) because it was undisputed that an employee of the bank filled in the blanks. There is no indication in the opinion why these points were not addressed.

154. TEX. BUS. & COM. CODE ANN. § 3.606 (Tex. UCC) (Vernon 1968).

155. 854 S.W.2d 664 (Tex. App.—Dallas 1992, no writ).

156. 841 S.W.2d 132 (Tex. App.—Houston [14th Dist.] 1992, no writ).

157. 854 S.W.2d 681 (Tex. App.—Dallas 1993, no writ) (opinion on remand).

158. 842 S.W.2d 343 (Tex. App.—Tyler 1992, no writ).

159. 854 S.W.2d at 686.

160. *Id.* at 689.

thiness of the new signers.¹⁶¹

In *Joseph Thomas, Inc.*¹⁶² a subcontractor contended the general contractor had agreed to indemnify the property owner from claims by subcontractors. Upon examination of the document in question, the court concluded instead that the general contractor had entered into a guaranty agreement rather than an indemnity agreement.¹⁶³ While the subcontractor might have been protected under either type of agreement, the critical difference between them for purposes of this case was when the statute of limitations began to run. According to the court, under an indemnity agreement, limitations would begin only after a final judgment was rendered in favor of the subcontractor against the owner.¹⁶⁴ Under a guaranty agreement, limitations would begin to run upon accrual of a cause of action by the subcontractor.¹⁶⁵ Because the court regarded this agreement as one of guaranty rather than indemnity, the subcontractor was barred by limitations because the action was brought more than four years after the cause of action accrued.¹⁶⁶

V. BANK DEPOSITS AND COLLECTIONS

A. RELATIONSHIP BETWEEN A PAYOR BANK AND ITS CUSTOMER

The only significant Chapter 4 decision reported during the Survey period was significant indeed. In *Tony's Tortilla Factory, Inc. v. First Bank*¹⁶⁷ a business customer obtained a series of commercial loans from a bank secured by deeds of trust on various real estate owned by the customer. The customer also had two checking accounts at the same bank, an operating account and a payroll account. Over a period of months, the customer wrote several insufficient funds checks on these accounts, but the overdrafts were paid by the bank and a twenty dollar service charge was assessed for each overdraft. Eventually the overdraft charges amounted to some forty-seven thousand dollars. The charges were ultimately "rolled-over" into the customer's outstanding commercial loan. When the customer defaulted on the commercial loan, the bank foreclosed on part of the real property. In a lender liability action against the bank, the customer initially alleged several theories of recovery including undue influence, negligence, DTPA violations, and usury.¹⁶⁸ After trial, a directed verdict was entered against the plaintiff on several of these theories, including usury, and judgment was rendered against the customer on the remaining theories. The customer appealed only the directed verdict on the usury theory.

The essence of this theory was that the bank committed usury by charging a twenty dollar fee for each overdraft and for most, if not all, of the over-

161. *Id.* at 690-91.

162. 842 S.W.2d 343 (Tex. App.—Tyler 1992, no writ).

163. *Id.* at 345-46.

164. *Id.* at 345.

165. *Id.*

166. *Id.* at 346-47.

167. 857 S.W.2d 580 (Tex. App.—Houston [1st Dist.] 1993, writ granted).

168. *Id.* at 583-84.

drafts this fee was in excess of the interest allowed by law.¹⁶⁹ The court analyzed this theory as involving three questions: (1) Is payment of an overdraft a loan of money?, (2) Does a customer incur an absolute obligation to repay the amount of an overdraft?, and (3) Is the fee assessed for the service of paying an overdraft greater than that allowed by law?

The court noted that Section 4.401 of the Code¹⁷⁰ expressly allows a payor bank to pay an overdraft and charge the amount of the overdraft against the customer.¹⁷¹ In addition to the statutory authorization permitting overdrafts, there was testimony by a retired banker that an overdraft was essentially a loan to the customer between the time the overdraft was paid and the time when the bank was reimbursed by the customer. Based on both the statutory authorization for overdrafts and on the evidence in the record, the court held the overdrafts amounted to loans.¹⁷²

As to the obligation of a customer to repay the amount of an overdraft, officials of both the customer and the bank testified to their understanding that the overdrafts would be paid. The actual practice between the parties also showed that the customer routinely made deposits to cover overdrafts paid by the bank. The court held this evidence showed an obligation to repay.¹⁷³

The most difficult issue was whether the service fee charged for each overdraft was an interest charge in excess of the amount permitted by law. On this issue, the court noted that the general test for usury is whether the charge is for "any distinctly separate and additional consideration, other than the simple lending of money."¹⁷⁴ If the charge is based on such separate consideration, it is not a charge of interest within the meaning of the usury statutes. The court held that whether the charge of special fees in connection with a loan transaction constitutes a charging of interest is treated as a question of fact under Texas law.¹⁷⁵ Because there was sufficient evidence in the record for a jury to conclude the service charges were not

169. Absent an interest rate agreed to by the parties, the maximum rate that can be charged is six percent. TEX. REV. CIV. STAT. ANN. art. 5069-1.03 (Vernon 1987). The court noted that most of the overdrafts ranged from one-hundred to three-hundred dollars and that the overdraft amounts were repaid in one to eight days. A twenty-dollar charge on a one to eight day loan for amounts of this type would translate into very high percentages (if such charges can properly be treated as interest).

170. TEX. BUS. & COM. CODE ANN. § 4.401(a) (Tex. UCC) (Vernon 1968).

171. 857 S.W.2d at 584-85. The court also cited the earlier cases of *Williams v. Cullen Ctr. Bank & Trust*, 685 S.W.2d 311, 312 (Tex. 1985) and *Bryan v. Citizens Nat'l Bank*, 628 S.W.2d 761, 763 n.2 (Tex. 1982) for the proposition that payment of an overdraft constitutes a loan to a customer.

172. 857 S.W.2d at 585.

173. *Id.*

174. *Id.* at 586.

175. In reaching this conclusion, the court referred to the following cases involving the charge of special fees as part of the transaction: *Gonzales County Sav. & Loan Ass'n v. Freeman*, 534 S.W.2d 903, 906 (Tex. 1976) (fact question of whether "loan fee" was a lawful commitment fee or interest); *Dryden v. City Nat'l Bank*, 666 S.W.2d 213, 216 (Tex. App.—San Antonio 1984, writ ref'd n.r.e.) (fact question of whether charge for credit life insurance was usurious when added to interest on loan); *Eckols v. Savine Bank*, 613 S.W.2d 762, 763 (Tex. App.—Beaumont 1981, writ ref'd n.r.e.) (fact issue if twenty-five dollar fee in connection with car loan was interest).

related to the actual cost of processing an overdraft and represented a return of interest on the loans instead, the case was remanded for trial on the usury issue.¹⁷⁶

Tony's Tortilla Factory presents banks with a difficult problem. The most obvious solution is legislative action approving overdraft charges in some fixed amount or according to some formula, but this solution must await the next legislative session. In the meantime, a bank could simply refuse to pay overdrafts, but this could present a serious customer relations problem. Another approach would be to have agreements with customers to honor overdrafts at a specified legal rate of interest or to have accurate information demonstrating the actual cost of processing an overdraft to show the fee charged did not result in an income yield to the bank.

VI. FUNDS TRANSFERS

The primary focus of the new Chapter 4A is a specialized form of electronic fund transfer commonly called a "wholesale wire transfer,"¹⁷⁷ although the Chapter also covers other types of funds transfers that are not necessarily processed by electronic means.¹⁷⁸ The Chapter specifically excludes funds transfers to the extent they are covered by the federal Electronic Funds Transfer Act.¹⁷⁹ The main purpose of the federal act is the regulation of consumer transactions, such as withdrawals from automatic teller machines and point-of-sale transfers through the use of debit cards.¹⁸⁰

The best way to understand the scope of Chapter 4A and to identify the principal issues with which it deals is by describing a typical funds transfer situation. Debtor owes a debt to Creditor. Instead of paying the debt by check, Debtor sends an instruction to her bank, First Bank, telling the bank to credit the appropriate amount of money to Creditor who has an account at Second Bank. First Bank carries out Debtor's instruction by telling Second Bank to credit the specified sum to Creditor's account at Second Bank. Second Bank carries out the instruction from First Bank. In this situation, Chapter 4A identifies Debtor as the "sender" of a "payment order" with respect to the instruction sent to First Bank.¹⁸¹ First Bank is termed a "receiving bank" with respect to Debtor's instruction.¹⁸² When First Bank instructs Second Bank to credit the account held by Creditor in Second Bank, First Bank becomes a "sender" with respect to that instruction and Second Bank is now a "receiving bank" with respect to that same instruction.¹⁸³ Because the instruction by First Bank merely helps to effectuate the original

176. *Id.* at 591.

177. See TEX. BUS. & COM. CODE ANN. § 4A.102 Cmt. (Tex. UCC) (Vernon Supp. 1994).

178. See *id.* § 4A.104 Cmt. 6.

179. TEX. BUS. & COM. CODE ANN. § 4A.108 (Tex. UCC) (Vernon Supp. 1994). The federal Electronic Funds Transfer Act appears at 15 U.S.C. § 1693 (1988 & Supp. IV 1992).

180. See 15 U.S.C. § 1693a(6) (1988 & Supp. IV 1992).

181. "Sender" and "payment order" are defined respectively in TEX. BUS. & COM. CODE ANN. §§ 4A.103(a)(5), 4.103(a)(1) (Tex. UCC) (Vernon Supp. 1994).

182. TEX. BUS. & COM. CODE ANN. § 4A.103(a)(4) (Tex. UCC) (Vernon Supp. 1994).

183. TEX. BUS. & COM. CODE ANN. §§ 4A.103(a)(4), 4A.103(a)(5) (Tex. UCC) (Vernon Supp. 1994).

instruction given by Debtor, Debtor becomes an "originator" when this instruction is given by First Bank.¹⁸⁴ Creditor is denominated the "beneficiary" of both the instruction by Debtor and the instruction by First Bank.¹⁸⁵ When First Bank carries out the instruction from Debtor, it is said to have "executed" that instruction.¹⁸⁶ When Second Bank credits funds to Creditor's account, it has "accepted" the instruction from First Bank.¹⁸⁷ Second Bank is entitled to payment from First Bank in the amount of the credit added to Creditor's account and First Bank is entitled to payment from Debtor for the amount paid to Second Bank as specified in Debtor's instruction.¹⁸⁸ In most instances, the instructions sent by First Bank to Second Bank are likely to be by electronic means through the Federal Reserve wire transfer network (Fedwire) or through the New York Clearing House Interbank Payments Systems (CHIPS) to facilitate immediate payment of the amount specified in the instructions. The "bank to bank" aspect of the situation described above is the genesis of the term "wholesale wire transfer." Chapter 4A is not limited, however, to electronic transfers and will also apply to transfers effected by other means, including ordinary first class mail.

While a complete analysis is beyond the scope of this Survey, it is possible to identify some of the principal issues covered by the rules of Chapter 4A. As might be expected, there are risks of loss that could occur at several points in the course of a funds transfer. These include such matters as the incorrect identification of the beneficiary or an incorrect statement of the amount to be transferred to the beneficiary in an initial payment order. An incorrect identification or incorrect statement of amount could be either a mistake or the result of deliberate fraud. Chapter 4A has several provisions dealing with the issue and acceptance of payment orders, including provisions relating to security procedures, that attempt to allocate such risks by the authentication of payment orders.¹⁸⁹ Even if a payment order is originated correctly, errors might occur between banks during the execution of the order. Such errors obviously involve the potential liability of a bank in the execution of a payment order and are dealt with in Chapter 4A.¹⁹⁰ Rights to payment are an integral part of the funds transfer process in each step of the transfer and these are dealt with as well.¹⁹¹ Externalities, such as bank failure, bankruptcy, and creditor process, may interrupt the progress of a funds transfer. To the extent possible, Chapter 4A attempts to prevent interruption of a funds transfer already in progress or to allocate loss if the transfer cannot be completed.¹⁹² Because funds transfers are often interstate

184. *Id.* § 4A.104(3).

185. *Id.* § 4A.103(2).

186. *Id.* § 4A.301.

187. *Id.* § 4A.209.

188. *See id.* § 4A.406 Cmt. 6.

189. *See id.* §§ 4A.201-4A.212.

190. *See id.* §§ 4A.301-4A.305.

191. *See id.* §§ 4A.401-4A.406.

192. As a matter of state law, Chapter 4A can prevent some interruptions caused by creditor process, such as injunctions or garnishment orders. TEX. BUS. & COM. CODE ANN. §§ 4A.502, 4A.503 (Tex. UCC) (Vernon Supp. 1994) contain rules limiting such interruptions.

or international in scope, Chapter 4A also contains an elaborate choice of law provision to determine the law applicable to the various parties involved in a funds transfer.¹⁹³

VII. INVESTMENT SECURITIES

In *Coastal Corp. v. Atlantic Richfield Co.*¹⁹⁴ a plaintiff buyer sued for breach of a contract to sell securities based on a memorandum of sale prepared by the sellers and sent to the buyer shortly after negotiations were concluded. The memorandum, however, was not signed by the sellers and included a paragraph specifying that it was not binding until it was signed by all of the parties.¹⁹⁵ The court held that the unsigned memorandum failed to satisfy the statute of frauds requirements of the Code and was, therefore, unenforceable.¹⁹⁶ The plaintiff made an alternative argument that promissory estoppel should bar the sellers from asserting the statute of frauds. As to this argument the court held that Texas law limits the use of promissory estoppel as an exception to the statute of frauds only when a party promises to sign a written contract that is already in existence when the promise is made.¹⁹⁷ Because the contract in question had not been reduced to writing when the sellers allegedly agreed to sign a contract, the promissory estoppel exception was not applicable.¹⁹⁸ The buyer also claimed the sellers had tortiously interfered with formation of the contract and had fraudulently induced the buyer to enter into the contract. The court rejected the claim of tortious interference by pointing out that a party cannot tortiously interfere with a contract to which it is itself a party; at most it might be liable for breach of contract.¹⁹⁹ The claim of fraudulent inducement was likewise rejected because the alleged misrepresentations never resulted in the formation of a contract; the subjective belief of the buyer that a contract had been formed did not give rise to a valid fraudulent inducement claim.²⁰⁰

VIII. SECURED TRANSACTIONS

A. CREATION AND PERFECTION OF SECURITY INTERESTS

Chapter 9 of the Code attempts to simplify the perfection of security inter-

Federal law, or course, will override Chapter 4A in cases of bank failure or bankruptcy, but Chapter 4A can still establish some rights of the parties unless federal law compels a different result. TEX. BUS. & COM. CODE ANN. §§ 4A.502(d), 4A.503 (Tex. UCC) (Vernon Supp. 1994) contain some rules establishing such rights, but recognizes that these rules may be ineffective depending on action taken by the federal reserve. See also TEX. BUS. & COM. CODE ANN. § 4A.107 (Tex. UCC) (Vernon Supp. 1994) expressly stating that Chapter 4A is subject to regulations and operating circulars of the federal reserve.

193. TEX. BUS. & COM. CODE ANN. § 4A.507 (Tex. UCC) (Vernon Supp. 1994).

194. 852 S.W.2d 714 (Tex. App.—Corpus Christi 1993, no writ).

195. The paragraph is set out in full in the opinion. See *id.* at 717.

196. *Id.* at 717-18. The statute of frauds requirement for the sale of investment securities appears in TEX. BUS. & COM. CODE ANN. § 8.319 (Tex. UCC) (Vernon 1991).

197. 852 S.W.2d at 718-19.

198. *Id.*

199. *Id.* at 720.

200. *Id.* at 720-21.

ests in personal property by allowing parties to use a "reasonable description" of collateral in their security agreements and financing statements instead of requiring extensive detailed descriptions.²⁰¹ This is accomplished in part by a fairly elaborate scheme for classifying collateral under Chapter 9 into various categories, such as inventory, equipment, accounts, and the like.²⁰² While this arrangement is satisfactory for many standardized transactions, it sometimes breaks down when a transaction involves collateral that cannot be readily classified under the classification scheme. This difficulty was illustrated in *Orix Credit Alliance, Inc. v. Omnibank, N.A.*,²⁰³ and in *In re Newman*.²⁰⁴ In *Orix* a secured party took a security interest in all of a debtor's "goods, chattels, machinery, equipment, inventory, accounts, chattel paper, notes receivable, accounts receivable, furniture, fixtures and property of every kind and nature, wherever located, now or hereafter belonging to [mortgagor]."²⁰⁵ A copy of the security agreement was properly filed as a financing statement.²⁰⁶ The debtor subsequently sold all of his stock in the business and, as part of the sale, signed a covenant not to compete under which he was to receive a series of payments for five years after the sale. A second secured creditor took a security interest in the proceeds the debtor was to receive under the noncompetition agreement. The security agreement and the financing statement covering this loan specifically identified the contract under which the noncompetition payments were to be made. The first secured creditor claimed it had a superior right to payments under the noncompetition agreement because of its earlier filing. On appeal the court held that, despite the earlier filing, the description of collateral was insufficient to create a security interest in the proceeds of the noncompetition agreement.²⁰⁷ The court reasoned the phrase "property of every kind and nature, wherever located" referred only to tangible property because intangible property, such as a right to payment, does not have a physical location and, therefore, did not cover rights to payment.²⁰⁸ The court also held that the interest claimed in "accounts" did not cover proceeds of the noncompetition agreement because accounts are defined as a "right to payment for goods sold or leased or for services rendered" and there were no goods sold or leased and no services to be rendered under the covenant not to compete.²⁰⁹ The court opined that the proper classification of such a right to payment was a "general intangible."²¹⁰ Ironically, this was virtually the only

201. See TEX. BUS. & COM. CODE ANN. § 9.110 (Tex. UCC) (Vernon 1991).

202. The several categories established by Chapter 9 are defined in TEX. BUS. & COM. CODE ANN. §§ 9A.105, 9A.106, 9A.109 (Tex. UCC) (Vernon 1991).

203. 858 S.W.2d 586 (Tex. App.—Houston [14th Dist.] 1993, writ granted).

204. 993 F.2d 90 (5th Cir. 1993).

205. 858 S.W.2d at 588.

206. *Id.* TEX. BUS. & COM. CODE ANN. § 9.402(a) (Tex. UCC) (Vernon 1991) permits the filing of a security agreement as a financing statement if the agreement contains the necessary requisites.

207. 858 S.W.2d at 594.

208. *Id.* at 591.

209. *Id.* at 593-94 (citing TEX. BUS. & COMM. CODE ANN. § 9.106 (Tex. UCC) (Vernon 1991)).

210. 858 S.W.2d. at 594.

collateral classification omitted from the description in the first security agreement.

A similar question arose in *In re Newman*²¹¹ where a secured party took a security interest in an annuity contract and attempted to perfect the interest by taking an assignment of the annuity. When the debtor filed for bankruptcy, the trustee contended the security interest was unperfected because the annuity contract was a general intangible requiring filing for perfection. The secured party argued the certificate of assignment qualified as an "instrument" under Chapter 9 and possession was the appropriate method of perfection. The court applied what it termed a "reasonable professional standard" to determine if annuities are regularly traded by professionals or regarded as transferable by indorsement or by transfer of possession so as to qualify as "instruments."²¹² The court found no indication in the record that annuities were so regarded and classified the annuities, therefore, as general intangibles.²¹³ Since no filing had been made to cover the annuities, the security interest was unperfected and the trustee was entitled to avoid the security interest.²¹⁴

B. ACTIONS IN CONVERSION

Section 9.306 of the Code allows a security interest to continue in collateral even after disposition of the collateral by the debtor unless the disposition is authorized by the secured party or by a specific provision in Chapter 9.²¹⁵ In *Amarillo National Bank v. Komatsu Zenoah America, Inc.*²¹⁶ a secured party held a properly perfected security interest in all of a debtor's inventory. The debtor subsequently transferred to a supplier all inventory that had been obtained from the supplier. The secured party sued the supplier for conversion claiming a superior interest in the inventory on the basis of section 9.306. While it was clear the supplier could have obtained a purchase money security interest when the inventory was first sold to the debtor that would have had priority over the bank, it was equally clear the supplier had not done so. The supplier contended, however, that the secured party had authorized the sale by the terms of the security agreement which permitted the transfer of "goods identified herein as inventory."²¹⁷ The court interpreted this clause to authorize transfers of inventory *in the ordinary course of business* as suggested in the definition of inventory in the Offi-

211. 993 F.2d 90 (5th Cir. 1993).

212. *Id.* at 94.

213. *Id.*

214. *Id.* at 95. The court noted that, "This case painfully illustrates the problems that creditors encounter when they fail to account for Article 9 problems. The best practice in cases where a precise categorization is elusive, would be to comply with both requirements. Creditors who foresee Article 9 problems when acquiring collateral are 'handsomely rewarded for their knowledge of the breadth of Article 9.'" 993 F.2d at 94 n.7 (quoting in part from Barkley Clark, *The Law of Secured Transactions Under the Uniform Commercial Code*, 1.03 (2d Ed. 1988)).

215. TEX. BUS. & COM. CODE ANN. § 9.306(b) (Tex. UCC) (Vernon 1991).

216. 991 F.2d 273 (5th Cir. 1993).

217. *Id.* at 275.

cial Comment to Section 9.109 of the Code.²¹⁸ Because the supplier did not acquire the inventory in the ordinary course of business, but as partial satisfaction of a debt owed to the supplier, the security interest continued in the collateral and the supplier was liable for converting the inventory.²¹⁹

In another conversion action by a secured party, the creditor sought to recover from a debtor and a stock broker for failure of those parties to replace pledged securities with securities of approximately equal value.²²⁰ The principal issue in the case was whether the secured party had given the debtor either actual or apparent authority to deal with the securities as he saw fit and whether evidence in the record supported a trial court judgment notwithstanding the verdict in favor of the broker.²²¹ The court held the evidence in the record, coupled with the broker's failure to assert the agency defense at trial, could not support the agency defense and a judgment N.O.V. and instructed the trial court to enter a judgment on the jury verdict in favor of the secured party.²²²

In *Whitaker v. Bank of El Paso*²²³ a conversion claim was asserted by the alleged buyer of eight used mobile homes against a secured party who repossessed the mobile homes under a writ of sequestration before the buyer took physical possession of them. Faced with a record that the court termed "far from a model of clarity,"²²⁴ the court held the conversion action failed because the alleged buyer failed to show either a demand or a refusal to return any particular identified mobile home.²²⁵ The only evidence bearing on the question of a demand was a letter from the alleged buyer to the secured party requesting information about the mobile homes and a deposition statement by the alleged buyer that he had sent the letter and "they chose to ignore it and I figured to hell with them, and I filed the suit."²²⁶ The secured party responded with a request for additional information for the debtor to identify the mobile homes in question, but received no response. The court held the alleged buyer failed to establish the required elements of a conversion claim.²²⁷

C. PRIORITY DISPUTES

Perhaps the most intellectually challenging case decided during the Survey period was *Citizens National Bank v. Cockrell*,²²⁸ where the Texas Supreme Court addressed the previously unanswered question of whether a debtor's possession of collateral must be exclusive to begin the running of the

218. *Id.* at 276. The court referred to TEX. BUS. & COM. CODE ANN. § 9.109 Cmt. 3 (Tex. UCC) (Vernon 1991), as the source of this interpretation.

219. 991 F.2d at 278.

220. *Allied Bank-West, N.A. v. Stein*, 996 F.2d 111 (5th Cir. 1993).

221. *Id.* at 113-14.

222. *Id.* at 116.

223. 850 S.W.2d 757 (Tex. App.—El Paso 1993, no writ).

224. *Id.* at 759.

225. *Id.* at 761-62.

226. *Id.* at 761.

227. *Id.* at 762.

228. 850 S.W.2d 462 (Tex. 1993).

twenty day time period for filing under Section 9.312(d).²²⁹ In *Cockrell* the secured party sold a mini-blind manufacturing business to the debtor, including the equipment used in the manufacturing process. Although the debtor began operating the business on August 1st, the sale date, the seller retained a set of keys to the premises and actively assisted the debtor in learning how to use the equipment and operate the business until October 3rd. On that date the seller turned the keys over to the debtor and the debtor assumed exclusive possession of the premises and equipment. The seller filed a financing statement on October 7th. In a priority dispute between the secured seller and a bank which held a general security interest covering all equipment acquired by the debtor, the seller argued that the twenty day period for filing did not begin to run until the debtor had exclusive possession and control of the equipment on October 3rd. The court held the proper test for determining if the debtor had sufficient possession to trigger the twenty day time period is "the impression conveyed to an observer not involved in the transaction, not . . . private limitations contained in the contract between the buyer and seller."²³⁰ The Court ruled the debtor had acquired sufficient ostensible possession of the equipment on August 1st to trigger the twenty day time period. Because the seller delayed filing beyond this period, the Court held the purchase money security interest did not qualify for a first-priority position and the general secured creditor who had filed earlier had the superior claim to the equipment.²³¹

In *Western Auto Supply Co. v. Brazosport Bank*²³² a bank holding a first priority position in a debtor's inventory, accounts receivable, equipment, and fixtures agreed to subordinate its priority to a second secured party. The second secured party subsequently assigned its rights in the subordination agreement to yet another secured party. During the next two years, the third secured party advanced additional funds to the debtor which had the effect of increasing the debt owed by the debtor to that secured party. Ultimately, the debtor defaulted on its obligations to the bank and to the third secured party. The court held the issue was whether the bank intended the subordination agreement to be assignable to a third party who could create new debt that effectively further subordinated the bank's security interest.²³³ Based on the language of the subordination agreement the court ruled that further assignment of the agreement was not contemplated by the bank and the new debt incurred in favor of the third secured creditor was subject to the bank's first priority position.²³⁴

229. TEX. BUS. & COM. CODE ANN. § 9.312(d) (Tex. UCC) (Vernon 1991) allows a twenty day time period after the debtor receives possession of collateral for a financing statement to be filed for priority purposes against a previously perfected security interest. The author has previously noted that this twenty day time period can be a trap for the unwary because of the ten day limitation contained in the federal Bankruptcy Code. See John Krahrmer, *Commercial Transactions, Annual Survey of Texas Law*, 45 Sw. L.J. 119, 142-43 (1991).

230. 850 S.W.2d at 465.

231. *Id.* at 466.

232. 840 S.W.2d 157 (Tex. App.—Houston [1st Dist.] 1992, no writ).

233. *Id.* at 160.

234. *Id.*

D. DISPOSITION OF COLLATERAL FOLLOWING DEFAULT

In *Thomas v. Price*²³⁵ a debtor argued that a private foreclosure sale under Section 9.504 of the Code should be nullified because the purchaser of the collateral had not purchased the collateral in good faith.²³⁶ Finding no Texas cases on this point, the court considered decisions from other jurisdictions and concluded the good faith or bad faith of a purchaser was relevant only if the disposition of the collateral was not commercially reasonable under Section 9.504.²³⁷ Because the notice of sale and the sale itself met the standards of commercial reasonableness under the Code, the court held there was no basis for setting aside the sale even if the purchaser had acted in bad faith.²³⁸

In *Lake Forest Developments v. FDIC*²³⁹ the debtor directly challenged the commercial reasonableness of a sale where the public advertisement of the sale proposed to sell twenty-one promissory notes in bulk at public auction and stated the range of principal amounts and interest rates, but did not specify the makers, principal amounts, interest rates, or maturity rates of the individual notes. The court held the advertisement was sufficient to attract the attention of interested bidders and any bidders could have obtained more specific information from the seller either before or at the time of the sale.²⁴⁰ The court ruled as a matter of law that the sale was advertised and conducted in a commercially reasonable manner.²⁴¹

In *FDIC v. Moore*²⁴² a guarantor contended the secured party was not entitled to sue for a deficiency because of failure to notify her of the proposed sale of collateral. The court agreed that guarantors are included within the term "debtor" under section 9.504 and are, therefore, entitled to notice of sale of collateral.²⁴³ The court also agreed that failure to give notice will bar recovery of a deficiency.²⁴⁴ The court did not agree, however, that the guarantor met the proof requirements to obtain a summary judgment on this issue because of a procedural error in the submission of three depositions showing that notice was never received.²⁴⁵ Judgment in favor of the guaran-

235. 975 F.2d 231 (5th Cir. 1992).

236. *Id.* at 237-38. TEX. BUS. & COM. CODE ANN. §§ 9.504(c), 9.504(d) (Tex. UCC) (Vernon 1991) prescribes the requirements for a sale of collateral under Chapter 9 and the effect of a purchaser's lack of good faith.

237. 975 F.2d at 239. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1991) requires that notice of sale and the sale itself be "commercially reasonable."

238. 975 F.2d at 240.

239. 989 F.2d 197 (5th Cir. 1993).

240. *Id.* at 201.

241. *Id.*

242. 846 S.W.2d 492 (Tex. App.—Corpus Christi 1993, writ denied).

243. *Id.* at 495-96. See TEX. BUS. & COM. CODE ANN. § 9.105(a)(4) (Tex. UCC) (Vernon 1991); see also *Adams v. Waldrop*, 740 S.W.2d 32, 33 (Tex. App.—El Paso 1987, no writ); *Carroll v. General Elec. Credit Corp.*, 734 S.W.2d 153, 154 (Tex. App.—Houston [1st Dist.] 1987, no writ); *Hernandez v. Bexar County Nat'l Bank*, 710 S.W.2d 684, 687 (Tex. App.—Corpus Christi, writ ref'd n.r.e.), per curiam, 716 S.W.2d 938 (Tex. 1986); and *Peck v. Mack Trucks*, 704 S.W.2d 583, 586 (Tex. App.—Austin 1986, no writ).

244. 846 S.W.2d at 495. The "deficiency bar rule" was originally adopted in Texas in the case of *Tannenbaum v. Economics Laboratory, Inc.*, 628 S.W.2d 769 (Tex. 1982).

245. 846 S.W.2d at 496.

tor was reversed and the case was remanded for trial.²⁴⁶

In *Greathouse v. Charter National Bank*²⁴⁷ the Texas Supreme Court announced rules allocating the burdens of pleading and proving the commercial reasonableness of a sale of collateral.²⁴⁸ *Greathouse* was applied in *SRSB-IV, Ltd. v. Continental Savings Association*,²⁴⁹ where the court held it was error to require a guarantor to prove that a sale was not commercially reasonable instead of placing the burden of proof on the secured party.²⁵⁰

246. *Id.*

247. 851 S.W.2d 173 (Tex. 1992).

248. The rules announced in *Greathouse* are discussed in the 1992 Annual Survey. See John Krahmer, *Commercial Transactions, Annual Survey of Texas Law*, 46 SMU L. REV. 1095, 1121-22 (1993).

249. 979 F.2d 39 (5th Cir. 1993).

250. *Id.* at 40.

