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Commercial Transactions

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COMMERCIAL TRANSACTIONS

*John Krahmer**

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THE Texas Legislature emerged as the major player in the area of commercial law during the 1995 Survey period.¹ The last legislative session marked not only the thirtieth anniversary of the first adoption of the Uniform Commercial Code in Texas,² but also the adoption of the most significant set of changes yet made to the Texas version of the Code. The changes included a new Chapter 3 on Negotiable Instruments,³ a substantially revised Chapter 4 on Bank Deposits and Collections,⁴ a new Chapter 8 on Investment Securities,⁵ and conforming amendments to Chapter 9 on Secured Transactions.⁶ Because of the extensive nature of these changes, discussion of the various revisions has been divided between this Article and the *Banking Law Survey* contained elsewhere in this volume.⁷ This Article includes coverage of changes made in Chapters 8 and 9, as well as some miscellaneous changes made in other Chapters of the Code. The *Banking Law Survey* covers changes made in Chapters 3 and 4.

I. GENERAL PROVISIONS

A. CONFLICT OF LAWS

Section 1.103 of the Code states a general choice of law principle allowing the parties to a transaction to choose the law of Texas or of another jurisdiction to govern their rights and duties so long as the transaction bears a reasonable relation to the state whose law is chosen, be it a sale, a lease, or a security interest.⁸ In *Jett Racing & Sales, Inc. v. Transamerican Comm. Fin. Corp.*,⁹ the court held that a "floor plan" financing arrangement between a lender and a borrower constituted a security agreement under the Code and that a clause in the agreement

1. A Survey period generally covers cases and legislation affecting Texas law reported from November of one year through October of the following year. Because of differences in timing for the release of opinions for publication, motions for rehearing, and the like, a case may be included that was reported shortly before or shortly after those dates, but the vast majority of cases and legislation discussed are within that time frame.

2. The Uniform Commercial Code was originally adopted in Texas in the 1965 legislative session with an effective date of July 1, 1966. Uniform Commercial Code, ch. 721, §§ 1-101 to 10-105, 1965 Tex. Gen. Laws 1-316. In 1967 it was reenacted as part of the new Texas Business and Commerce Code Act of May 25, 1967, 60th Leg., R.S., ch. 785, 1967 Tex. Gen. Laws 2343. In this Article all references are to the Uniform Commercial Code as enacted in chapters 1 through 11 of the Texas Business and Commerce Code, TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1991 & 1994 & Supp. 1996) [hereinafter the Code].

3. Act of May 28, 1995, 74th Leg., R.S., ch. 921, §§ 1-2, 1995 Tex. Sess. Law Serv. 4582 (Vernon).

4. Act of May 28, 1995, 74th Leg., R.S., ch. 921, § 4, 1995 Tex. Sess. Law Serv. 4582, 4626 (Vernon).

5. Act of May 27, 1995, 74th Leg., R.S., ch. 962, § 1, 1995 Tex. Sess. Law Serv. 4760 (Vernon).

6. Act of May 27, 1995, 74th Leg., R.S., ch. 962, §§ 2-14, 1995 Tex. Sess. Law Serv. 4760, 4778 (Vernon).

7. See *Banking Law, Annual Survey of Texas Law*, 49 SMU L. REV. 695 (1996).

8. TEX. BUS. & COM. CODE ANN. § 1.105(a) (Tex. UCC) (Vernon 1994).

9. 892 F. Supp. 161 (S.D. Tex. 1995).

selecting Illinois law to govern the transaction was fully appropriate. In reaching this decision, the court noted that the issue was not whether Texas or Illinois had the most significant contacts with the transaction, but whether Illinois had a reasonable relation to the transaction.¹⁰ Because the lender was located in Illinois, the loan funds were provided by an Illinois bank and loan payments were deposited in Illinois banks, the court concluded that the choice of Illinois law was reasonable.¹¹ The court rejected the argument that Texas had a fundamental public interest in protecting Texas residents from usury and held that the choice of Illinois law should stand regardless of any difference between Texas law and Illinois law on the subject of usury or interest rates.¹² The court also showed some dissatisfaction, however, with the apparent inability of the parties to settle their dispute without litigation and directed them to respond to the court's "proposal" that mediation or arbitration be considered as an alternative to litigation.¹³

B. GOOD FAITH PURCHASE

The Code is replete with rules allocating property rights between parties asserting claims to the same property.¹⁴ In *Central Appraisal Dist. v. Dixie-Rose Jewels, Inc.*,¹⁵ the conflicting claims consisted of a personal property tax lien held by an appraisal district and a security interest held by a bank that foreclosed on the property after the tax lien had come into existence. Although the bank had perfected its security interest well before the tax lien was effective, the Texas Tax Code gives tax liens priority over pre-existing security interests.¹⁶ Faced with this clear limitation on its rights as a secured party, the bank argued that it qualified as a buyer in the ordinary course of business under section 1.201 of the Code¹⁷ and, therefore, was protected from the lien under section 32.03 of the Tax Code.¹⁸ The court held that this argument failed because the

10. *Id.* at 163.

11. *Id.*

12. On this point, the court noted that this argument had been rejected previously in *Admiral Ins. Co. v. Brinkcraft Dev., Ltd.*, 921 F.2d 591, 594 (5th Cir. 1991) and no subsequent Texas case had cast doubt on this result. *Jett Racing*, 892 F. Supp. at 164.

13. 892 F.Supp. at 165. The language used by the court left no doubt about the seriousness of this "proposal."

14. See, e.g., TEX. BUS. & COM. CODE ANN. § 2.403 (Tex. UCC) (Vernon 1994) (rights of good faith purchaser or buyer in ordinary course of business as against owner); TEX. BUS. & COM. CODE ANN. § 3.305 (Tex. UCC) (Vernon Supp. 1996) (rights of holder in due course against prior parties); TEX. BUS. & COM. CODE ANN. § 9.301 (Tex. UCC) (Vernon 1991 & Supp. 1996) (rights of purchasers against unperfected security interests); TEX. BUS. & COM. CODE ANN. § 9.312 (Tex. UCC) (Vernon 1991 & Supp. 1996) (rights of secured creditors *inter se*).

15. 894 S.W.2d 841 (Tex. App.—Eastland 1995, no writ).

16. TEX. TAX CODE ANN. § 32.05 (Vernon 1992).

17. TEX. BUS. & COM. CODE ANN. § 1.201(9) (Tex. UCC) (Vernon 1994) defines the term "buyer in the ordinary course of business."

18. TEX. TAX CODE ANN. § 32.03 (Vernon Supp. 1996) provides, *inter alia*, that a tax lien is not enforceable against a buyer in the ordinary course of business who does not have actual notice of the tax lien.

definition of "buyer in the ordinary course of business" specifically excludes buyers who acquire property as security or in satisfaction of a money debt.¹⁹ Because the parties stipulated that the foreclosure on the property was to satisfy a money debt, the bank did not qualify as a buyer in the ordinary course of business and was not protected against the superior tax lien.²⁰

In *Four B's Inc. v. State*,²¹ a pawnbroker purchased a shotgun from a person who apparently bought it from the owner in exchange for a hot check. The pawnshop argued that it acquired good title to the shotgun as a good faith purchaser under section 2.403 of the Code.²² The court held that the case was controlled, not by the Code, but by section 47.02 of the Texas Code of Criminal Procedure, which requires illegally obtained property to be returned "to the person appearing by the proof to be the owner."²³ While section 47.02 requires the return of illegally acquired property, it contains no provisions on how ownership is to be determined. The court noted that nothing in this section indicated adoption of the Uniform Commercial Code standards to determine good faith purchases.²⁴ Referring to the general law governing pawnbrokers and to the Texas Pawnshop Act,²⁵ the court found a public policy that militated against the ability of pawnshops to qualify as good faith purchasers of stolen property and the order of the trial court that the shotgun be returned to the owner was affirmed.²⁶ Although not discussed by the court, additional support for the public policy limiting the ability of pawnshops to acquire goods under circumstances that might deprive prior parties of ownership can be found in the specific exclusion of pawnbrokers from the definition of "buyer in the ordinary course of business" in section 1.201 of the Code.²⁷

II. SALES OF GOODS

A. ENFORCEABILITY OF ORAL CONTRACTS

Under the Code, the basic statute of frauds rule for the sale of goods requires a written contract signed by the party against whom enforcement is sought if the contract calls for payment of five hundred dollars or

19. 894 S.W.2d at 843.

20. *Id.*

21. 902 S.W.2d 683 (Tex. App.—Austin 1995, writ denied).

22. *Id.* at 685. TEX. BUS. & COM. CODE ANN. § 2.403(a)(2) (Tex. UCC) (Vernon 1994) provides that a person with a voidable title, like that of the person who defrauded the owner with a hot check, has power to transfer a good title to a good faith purchaser for value even though the owner delivered the goods to the wrongdoer in exchange for a check which is later dishonored.

23. 902 S.W.2d at 684 (quoting from TEX. CODE CRIM. PROC. ANN. art. 47.02 (Vernon 1979)).

24. *Id.* at 685.

25. TEX. REV. CIV. STAT. ANN. arts. 5069-51.01 to .17 (Vernon 1987 & Supp. 1996).

26. 902 S.W.2d at 685-86.

27. TEX. BUS. & COM. CODE ANN. § 1.201(9) (Tex. UCC) (Vernon 1994).

more.²⁸ The Code also allows the parties to create their own statute of frauds to govern possible modification of the basic contract by including a provision that excludes modification or rescission except by a signed writing.²⁹ In *Brookside Farms v. Mama Rizzo's, Inc.*,³⁰ the court addressed the question of whether oral modifications of a contract could be enforced when the initial contract required that any modifications be in writing. The parties initially agreed in writing for the sale and purchase of 91,000 pounds of basil leaves under a one-year requirements contract at an in-domestic-season price of \$3.80 per pound and an out-of-domestic-season price of \$5.00 per pound.³¹ Deliveries were to be made daily in quantities ranging from 350 pounds to 800 pounds.³² After the contract was signed, and at the buyer's request, the seller agreed to remove the stems from the basil leaves before they were delivered at an increased price of \$.50 per pound. The buyer promised to note this price change on the buyer's copy of the contract; however, such notation was never made place, although the price change did appear on the buyer's internally generated purchase orders and payment checks as well as appearing on the seller's delivery invoices.

Besides this modification, the parties also subsequently agreed to two additional price modifications to reflect increased costs incurred by the seller when the buyer failed to place minimum weekly orders for approximately two months.³³ These modifications were also not made in writing as called for in the original contract. Approximately six months after the contract began, the buyer breached by paying for eight shipments with a check that bounced and thereafter also refused to place any further orders.³⁴ The seller sued to recover for the basil leaves already delivered and for breach of the remaining executory portion of the requirements contract.

In a well-written opinion, the court reasoned that, as to the goods that had already been received and accepted, section 2.201 contains its own statutory exception to the writing requirement and this exception would permit the seller to recover for the basil leaves that had been delivered but for which payment had not been made.³⁵ As to the executory portion

28. TEX. BUS. & COM. CODE ANN. § 2.201(a) (Tex. UCC) (Vernon 1994).

29. TEX. BUS. & COM. CODE ANN. § 2.209(b) (Tex. UCC) (Vernon 1994).

30. 873 F. Supp. 1029 (S.D. Tex. 1995).

31. *Id.* at 1031.

32. *Id.*

33. *Id.* These price modifications apparently took place because the seller had entered into its own supply contracts with foreign suppliers to obtain basil leaves when they could not be grown domestically. When the buyer failed to order the minimum quantities called for under the requirements contract, the seller reduced its own purchases and was forced to pay a higher price to its own suppliers when the buyer resumed making weekly orders.

34. *Id.* at 1032.

35. 873 F. Supp. at 1033. TEX. BUS. & COM. CODE ANN. § 2.201(c)(3) (Tex. UCC) (Vernon 1994) provides: "(c) A contract which does not satisfy the requirements of Subsection (a) but which is valid in other respects is enforceable (3) with respect to goods for which payment has been made and accepted or which have been received and accepted (Section 2.606)."

of the contract, the court analyzed prior Texas case law on the use of estoppel as an exception to the statute of frauds and found that Texas has recognized the doctrine of promissory estoppel to allow a party who has reasonably relied on the oral promise of another to reduce an oral agreement to writing to estop the other party from asserting the general statute of frauds as a defense to enforcement of the contract.³⁶ Based on both the statutory exception and the ground of estoppel, the court held the contract was enforceable for goods already received and accepted and for the remaining executory portion of the contract term.³⁷ The court specifically noted that, "[b]ecause of the general paucity of relevant Texas authority presented" by the parties, it did not reach the question of whether the purchase orders and invoices might themselves take the case out of the statute of frauds.³⁸ Although not mentioned in its opinion, to the extent the court was, in effect, making a policy decision to extend the estoppel doctrine approved under the general statute of frauds to the section 2.201 statute of frauds stated in the Code, it could have noted that the legislature has also approved such extension by adopting a statutory estoppel exception in section 2A.201 of the Code.³⁹ Although this provision applies only to leases of goods and not to the sale of goods, the legislature rarely amends provisions of the Code in a piece-meal fashion and no substantial revision of Chapter 2 has yet been introduced for consideration. As a statement of policy regarding the use of estoppel, the adoption of Chapter 2A in 1993 should carry some weight, particularly since the estoppel exception was added as a non-uniform Texas amendment to reflect what was perceived as the majority rule favoring use of estoppel as an exception to the statute of frauds.⁴⁰

A different statute of frauds issue was presented in *Floors Unlimited, Inc. v. Fieldcrest Cannon, Inc.*,⁴¹ where a carpet retailer entered into an oral dealership agreement with a manufacturer which was to continue indefinitely unless terminated by the manufacturer for "good cause." Three issues were before the court. First, was a contract for an indefinite term that could be terminated only for cause within the proscription of the general Texas statute of frauds requiring contracts not to be performed within a year to be in writing.⁴² Second, was section 2.201 of the

36. 873 F. Supp. at 1033, (citing "Moore" *Burger, Inc. v. Phillips Petroleum Co.*, 492 S.W.2d 934, 937 (Tex. 1972)), (a real estate case decided under the general statute of frauds contained in TEX. BUS. & COM. CODE ANN. § 26.01 (Vernon 1991)).

37. 873 F. Supp. at 1034.

38. *Id.* at 1036 n.5.

39. TEX. BUS. & COM. CODE ANN. § 2A.201(d)(4) (Tex. UCC) (Vernon 1994).

40. Chapter 2A was added to the Code by Act of May 30, 1993, 73d Leg., R.S., ch. 570 §§1-16, 1993 Tex. Gen. Laws 2098 (Vernon) and now appears as TEX. BUS. & COM. CODE ANN. §§ 2A.101-2A.532 (Tex. UCC) (Vernon 1994). An explanation of the reason for inclusion of the estoppel exception appears in the State Bar Committee Comments to § 2A.201.

41. 55 F.3d 181 (5th Cir. 1995).

42. *Id.* at 184. TEX. BUS. & COM. CODE ANN. § 26.01(b)(6) (Vernon 1994) requires that contracts not to be performed within a year be in writing and signed by the party to be charged to be enforceable.

Code applicable to a dealership contract under which a dealer engages to sell goods supplied by a manufacturer.⁴³ Third, did a fiduciary relationship exist between the manufacturer and the dealer.⁴⁴

Although the court had previously held that contracts for an indefinite term were required to be in writing under the general Texas statute of frauds,⁴⁵ and had subsequently followed this decision under the rule of *stare decisis* applicable in the Fifth Circuit,⁴⁶ a review of more recent Texas cases convinced the court that Texas law did not require contracts for an indefinite term to be in writing to be enforceable.⁴⁷ As to the first issue, therefore, the court concluded that the oral dealership contract did not need to be in writing to be enforceable.⁴⁸ In regard to the second issue, the court noted the apparent absence of any Texas cases on whether dealership contracts fall within the statute of frauds provisions in section 2.201 of the Code.⁴⁹ Because the district court had not yet addressed this issue, the question was remanded to the district court and the court declined to certify the question to the Texas Supreme Court until the district court had an opportunity to consider it.⁵⁰ As to the third issue, the court summarily concluded that the evidence was insufficient to show that a fiduciary relationship existed between the manufacturer and the dealer.⁵¹

B. WARRANTIES AND DISCLAIMERS

The Texas law of warranty is complex. The complexity arises in part because a breach of warranty constitutes a specific cause of action under the Texas Deceptive Trade Practices Act (DTPA) and carries with it the possibility of recovering treble damages.⁵² Furthermore, because the

43. *Id.* at 187.

44. *Id.*

45. *Falconer v. Soltex Polymer Corp.*, 886 F.2d 1312 (5th Cir. 1989) (unpublished opinion).

46. *Pruitt v. Levi Strauss & Co.*, 932 F.2d 458 (5th Cir. 1991). Although the court expressed doubt about its prior decision, it felt compelled to adhere to its earlier decision because the rules of the Fifth Circuit provide that one panel cannot overturn a decision of another panel absent *en banc* reconsideration or a state court decision that is clearly contrary to the federal decision. *Id.*

47. 55 F.3d at 185. The two cases cited by the court as contrary state authority were *Gerstacker v. Blum Consulting Eng'rs., Inc.*, 884 S.W.2d 845 (Tex. App.—Dallas 1994, writ denied) and *Goodyear Tire & Rubber Co. v. Portilla*, 836 S.W.2d 664 (Tex. App.—Corpus Christi 1992), *aff'd on other grounds*, 879 S.W.2d 47 (Tex. 1994), both of which were decided after the unpublished decision in *Falconer v. Soltex Polymer Corp.*, 886 F.2d 1312 (5th Cir. 1989).

48. 55 F.3d at 186.

49. *Id.* at 187.

50. *Id.* Given the lack of Texas case law on this issue, practitioners may wish to track this case occasionally to see if an answer to the dealership question is ultimately reported.

51. *Id.* at 188. On this point the court noted that, "Under Texas law, a fiduciary duty will not be lightly created as it imposes extraordinary duties," citing *Gillum v. Republic Health Corp.*, 778 S.W.2d 558, 567 (Tex. App.—Dallas 1989, no writ).

52. The Deceptive Trade Practices Act appears in TEX. BUS. & COM. CODE ANN. §§17.41-.63 (Vernon 1991 & Supp. 1996). Breach of an express or implied warranty is listed as a DTPA cause of action in TEX. BUS. & COM. CODE ANN. § 17.50(a)(2) (Vernon 1994 &

Texas Supreme Court has ruled that the DTPA does not create any warranties, but that any warranty on which a DTPA claim is based must be found outside the DTPA itself,⁵³ statutory warranties under the Code have often figured in DTPA cases.⁵⁴ Plaintiffs' attorneys have also had some success in persuading the courts to create additional common law warranties.⁵⁵ This interaction between the Code, the DTPA, and the common law has also created difficulty in determining if a particular rule should be limited to one class of cases or another, or if the rule is generally applicable to all of the classes. Thus, in *Melody Home Manufacturing Co. v. Barnes*,⁵⁶ the characterization by the court that a consumer would have the benefit of an implied warranty of good and workmanlike repair in actions "under the DTPA"⁵⁷ left open the question of whether the warranty existed only in DTPA cases (with a two year limitations period) or would be available in non-DTPA cases as well (with a four year limitations period). While this question was eventually answered in *Walker v. Sears, Roebuck & Co.*,⁵⁸ where the court held that the *Melody Home* warranty was not limited to actions brought under the DTPA, but could be used as the basis for an ordinary breach of warranty claim, the general uncertainty surrounding the relationship between Code warranties, common law warranties, and the DTPA remains.⁵⁹

Supp. 1996). The DTPA was substantially amended by Act of May 19, 1995, 74th Leg., R.S., ch. 414, 1995 Tex. Sess. Law Serv. 2988 (Vernon).

53. *La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 565 (Tex. 1984).

54. Warranties recognized by the Code appear in TEX. BUS. & COM. CODE ANN. §§ 2.312-315; (Tex. UCC) (Vernon 1994) and include implied warranties of good title (§ 2.312); express warranties (§ 2.313); implied warranties of merchantability (§ 2.314); and implied warranties of fitness for a particular purpose (§ 2.315). One or more of these warranties has frequently been used as the basis for a DTPA claim. *See, e.g.*, *Plas-Tex, Inc. v. United States Steel Corp.*, 772 S.W.2d 442 (Tex. 1989) (implied warranty of merchantability and DTPA), *Luna v. North Star Dodge Sales, Inc.*, 667 S.W.2d 115 (Tex. 1984) (combining claims for breach of express warranty, unconscionability, and DTPA violation); *Big H Auto Auction, Inc. v. Saenz Motors*, 665 S.W.2d 756 (Tex. 1984) (warranty of good title and DTPA).

55. *See, e.g.*, *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987) (holding that repair or modification of tangible goods or property includes a warranty that the repairs or modifications will be done in a good and workmanlike manner); *Evans v. J. Stiles, Inc.*, 689 S.W.2d 399 (Tex. 1985) (construction of a residence includes implied warranty of habitability and a separate warranty of good workmanship; breach of either warranty can give rise to an action for damages); *Kish v. Van Note*, 692 S.W.2d 463 (Tex. 1985) (warranty of good workmanship in construction extends to peripheral construction as well as to the dwelling itself). Not all attempts to create common law warranties have been successful, however. During the Survey period, the court refused to extend the *Melody Home* warranty to future land development services undertaken by a developer that were not provided as part of the underlying transaction. *Parkway Co. v. Woodruff*, 901 S.W.2d 434, 440 (Tex. 1995).

56. 741 S.W.2d 349, 353-54 (Tex. 1987).

57. *Id.* at 355.

58. 853 F.2d 355, 358-59 (5th Cir. 1988).

59. Another example of this uncertainty is illustrated by *Southwestern Bell Tel. Co. v. FDP Corp.*, 811 S.W.2d 572 (Tex. 1991) where the court reviewed the Code standards for limitations of liability for breach of warranty to determine if such a limitation was effective for an express warranty contained in a non-Code services contract. Here again the question becomes how far such cases can be cross-cited in DTPA, common law, and Code litigation.

During the Survey period, interaction between these areas surfaced again in *Prudential Ins. Co. v. Jefferson Assoc., Ltd.*⁶⁰ where the court held that an “as is” disclaimer contained in a contract for the sale of realty negated the element of producing cause required to recover under the DTPA.⁶¹ In support of this holding, the court cited both Code cases and DTPA cases.⁶² The court also addressed the question of whether an “as is” disclaimer constituted an impermissible waiver of rights under the DTPA.⁶³ On this issue, the court held that such a disclaimer did not purport to waive the right to sue under the DTPA, but only affected the element of producing cause because the purchaser was relying on his own examination of the property and not on any express or implied warranties.⁶⁴ Despite amendment of the DTPA in 1995 to permit a waiver of DTPA rights if the statutory formula is followed, an “as is” disclaimer may provide broader protection to a seller because of the breadth of the court’s holding on the effect such disclaimers have on the element of producing cause under the DTPA.⁶⁵

Disclaimers of warranty are also effective under the Code, of course, if they adhere to the statutory requirements of clarity and conspicuousness, but only if they are provided to the buyer!⁶⁶ In *Walter Oil & Gas Corp. v. NS Group, Inc.*,⁶⁷ a buyer purchased pipe to be used in the construction of an offshore oil pipeline from a pipe retailer who bought the pipe from a pipe manufacturer. The contract between the manufacturer and the retailer conspicuously disclaimed any implied warranties by the manufacturer. The contract between the retailer and the buyer conspicuously dis-

60. 896 S.W.2d 156 (Tex. 1995).

61. *Id.* at 161. TEX. BUS. & COM. CODE ANN. § 17.50(a) (Vernon 1994 & Supp. 1996) (the consumer “may maintain an action where any of the following constitute a producing cause of economic damages or damages for mental anguish [listing causes of action].”)

62. The cases included *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308 (Tex. 1978) (combining claims based on strict liability in tort and implied warranties under the Code); *Dubow v. Dragon*, 746 S.W.2d 857 (Tex. App.—Dallas 1988, no writ) (real estate case holding producing cause of injury by seller’s misrepresentation did not exist where buyers inspected property).

63. 896 S.W.2d at 163-64.

64. *Id.*

65. As amended in the 1995 legislative session, the DTPA now provides a method to waive the right to sue under the DTPA. See Act of June 8, 1995, 74th Leg., R.S., ch. 414, § 1, 1995 Tex. Sess. Law Serv. 2988, 2988-89 (Vernon) revising TEX. BUS. & COM. CODE ANN. § 17.42 (Vernon 1994). A statutory waiver form is contained in TEX. BUS. & COM. CODE ANN. § 17.42(c)(3) (Vernon 1994 & Supp. 1996). There is no special form for an “as is” disclaimer, but the holding of the court in *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993) makes it clear that a disclaimer must be conspicuous and that determination of conspicuousness is a question of law for the court and not a question of fact for the jury. The court reasoned that the “[UCC] standard for conspicuousness in Code cases is familiar to the courts of this state and conforms to our objectives of commercial certainty and uniformity.” 853 S.W.2d at 511. The court applied TEX. BUS. & COM. CODE ANN. § 1.201(10) (Tex. UCC) (Vernon 1991) to an indemnity clause used in an oil well servicing contract.

66. The requirements for disclaiming warranties under Chapter 2 appear in TEX. BUS. & COM. CODE ANN. § 2.316 (Tex. UCC) (Vernon 1994).

67. 867 F. Supp. 549 (S.D. Tex. 1994).

claimed any warranties by the retailer. The buyer, however, was never advised of the manufacturer's disclaimer.

After the pipeline was completed, pressure testing revealed that some of the weld seams were defective. The manufacturer refused to meet the buyer's demands to correct the problem and the buyer ultimately obtained pipe from another source to replace the pipeline.⁶⁸ The buyer sued for the cost of replacement and for lost profits, alleging breach of warranty, breach of contract, and negligence. The breach of contract and negligence claims were ultimately dropped from the case and the sole claim before the court was for breach of the implied warranty of merchantability by the manufacturer. The manufacturer argued that there were no Texas cases addressing the issue of whether a commercial buyer could recover against a remote manufacturer when the parties were not in privity. On this point the court noted that *Nobility Homes of Tex., Inc. v. Shivers*,⁶⁹ had extensively analyzed the warranty provisions under the Code and had allowed recovery for breach of implied warranty by a buyer against a remote manufacturer without distinguishing between consumer buyers and commercial buyers.⁷⁰ The court further noted that *Nobility* had later been applied in *Clark v. DeLaval Separator Corp.*⁷¹ to permit recovery by a commercial buyer against a remote manufacturer for breach of warranty.⁷² The court held, therefore, that lack of privity was not a bar to the buyer's claim.⁷³ The manufacturer also argued that the retailer's disclaimer was effective to disclaim the manufacturer's warranty even though the manufacturer's own disclaimer was never given to the buyer. This argument was also addressed in *Clark* where the court held that a manufacturer remained liable for breach of implied warranties unless the manufacturer's own disclaimer was given to the buyer or the manufacturer's liability was explicitly disclaimed in the contract between the retailer and the buyer.⁷⁴ Because neither event had occurred, the court held that the buyer's breach of implied warranty claim remained viable.⁷⁵

In *Lester v. Logan*,⁷⁶ the facts raised an interesting question about the difference between the implied warranty of merchantability and the implied warranty of fitness for a particular purpose. A warranty of merchantability is a warranty that goods are of fair average quality, while a warranty of fitness for a particular purpose is a warranty that the goods

68. *Id.* at 551.

69. 557 S.W.2d 77 (Tex. 1977).

70. 867 F. Supp. at 554.

71. 639 F.2d 1320, 1322 (5th Cir. 1981).

72. 867 F. Supp. at 555.

73. *Id.*

74. 639 F.2d at 1323-24.

75. 867 F. Supp. at 555.

76. 893 S.W.2d 570 (Tex. App.—Corpus Christi 1994), writ denied per curiam, 907 S.W.2d 452 (Tex. 1995).

are fit for some special purpose intended by the buyer.⁷⁷ The dispute in *Lester* arose when hay supplied by the seller caused the death of several head of cattle owned by the buyer because of an excess level of nitrates in the hay.⁷⁸ The jury found the hay was merchantable, but that it was unfit for the particular purpose of livestock consumption.⁷⁹ The court of appeals held the evidence was sufficient to support these findings by the jury.⁸⁰ Unfortunately, the court did not discuss the question of how the feeding of hay to livestock was a "particular purpose." Such a use would seem to be an ordinary use included in the warranty of merchantability rather than a use for a particular purpose and the case offers little guidance for distinguishing between these two warranties.⁸¹

III. LEASES OF GOODS

A. DETERMINATION OF LESSOR'S DAMAGES

Chapter 2A was adopted in Texas during the 1993 legislative session as an addition to the Code to cover leases of goods, a subject that had not been previously codified.⁸² Although decided under the common law existing prior to the adoption of Chapter 2A, *Swindell v. Bell Atlantic Tricon Leasing Corp.*⁸³ deserves mention because the result is consistent with the provisions of Chapter 2A and the case illustrates an important aspect of damage calculation under this recent addition to the Code.

The lessee in *Swindell* contracted for the lease of a computer system under a lease calling for sixty monthly payments. The remedies in the lease agreement provided that, upon default by the lessee, the lessor could accelerate the entire amount of unpaid rent for the balance of the lease term and recover that amount in addition to past due rent, less any amount received by the lessor from rental or sale of the equipment.⁸⁴

77. Compare TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1994) (warranty of merchantability) with TEX. BUS. & COM. CODE ANN. § 2.315 (Tex. UCC) (Vernon 1994) (warranty of fitness for a particular purpose).

78. 893 S.W.2d at 573.

79. *Id.* at 575.

80. *Id.*

81. Such guidance would be useful because there has been relatively little litigation under TEX. BUS. & COM. CODE ANN. § 2.315 (Tex. UCC) (Vernon 1994) on warranties of fitness for a particular purpose, but considerable litigation on the warranty of merchantability under TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1994). The only allusion the court made to the difference between these two warranties was a description of testimony by the buyer that he consulted with the seller about cattle feed and relied on the seller's skill and judgment to obtain hay fit for his cattle to consume. 893 S.W.2d at 574-75. While the buyer's testimony tracked the statutory elements of a warranty of fitness for a particular purpose, it still failed to explain how feeding hay to cattle was a "particular purpose" for hay. One would have expected additional evidence or explanation about other, non-trivial, uses for hay to show that use as cattle feed was a "particular use" as contrasted to an "ordinary use."

82. See TEX. BUS. & COM. CODE ANN. §§ 2A.101-2A.532 (Tex. UCC) (Vernon 1994). Chapter 2A became effective on September 1, 1993.

83. 889 S.W.2d 5 (Tex. App.—Fort Worth 1994, no writ).

84. *Id.* at 7. The lease also had provisions allowing recovery of sale or rental expenses and taxes. *Id.*

Upon default by the lessee, the lessor repossessed and later sold the computer equipment.⁸⁵ The lessee argued that requiring payment of rent for the balance of the lease term when the lessee no longer had the use of the goods overcompensated the lessor and was "a measure of recovery far in excess of 'just compensation.'"⁸⁶ The court found that prior Texas cases had upheld leases allowing the recovery of unaccrued rent and, noting that all but two rental payments had become due by the time the computer was repossessed, the court ruled that the terms of the lease agreement would be enforced.⁸⁷ Judgment was affirmed in favor of the lessor in an amount that included the unaccrued rent.⁸⁸

This result is consistent with the liquidated damages rule stated in section 2A.504 of the Code.⁸⁹ The important point to note is that this liquidated damages rule is substantially more flexible than the liquidated damages rule applied to sales cases in section 2.718.⁹⁰ As illustrated by *Swindell*, the inclusion of unaccrued rent in a liquidated damages formula has been acceptable to the courts under prior law and should present no difficulties under the statutory formulation under the Code.⁹¹

IV. NEGOTIABLE INSTRUMENTS

In one respect all of the negotiable instrument cases decided in this Survey period might be regarded as mere historical artifacts since a new Chapter 3 was adopted in the 1995 legislative session.⁹² Despite substantial changes, however, the new Chapter 3 was built on the foundation of

85. *Id.*

86. *Id.*

87. *Id.*

88. 889 S.W.2d at 8.

89. TEX. BUS. & COM. CODE ANN. § 2A.504(a) (Tex. UCC) (Vernon 1994) provides:

Damages payable by either party for default or any other act or omission, including indemnity for loss or diminution of anticipated tax benefits or loss or damage to lessor's residual interest, may be liquidated in the lease agreement but only at an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission. In a consumer lease, a term fixing liquidated damages that are unreasonably large in light of the actual harm is unenforceable as a penalty.

90. TEX. BUS. & COM. CODE ANN. § 2.718 (Tex. UCC) (Vernon 1994) provides:

Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in the light of the anticipated or actual harm caused by the breach, the difficulties of proof of loss, and the inconvenience or non-feasibility of otherwise obtaining an adequate remedy. A term fixing unreasonably large liquidated damages is void as a penalty.

91. The Official Comment to TEX. BUS. & COM. CODE ANN. § 2A.504 (Tex. UCC) (Vernon 1994) describes a liquidated damages formula quite similar to the one upheld in *Swindell*. It must be noted, however, that Texas adopted a non-uniform amendment to this section by specifying that liquidated damages must not be unreasonably large in relation to the actual damages in a consumer lease. See TEX. BUS. & COM. CODE ANN. § 2A.504 St. Bar Comm. Cmt. (Tex. UCC) (Vernon 1994). In a consumer lease, a provision allowing acceleration of unaccrued rent may be unreasonably large and open the door to a DTPA claim by the aggrieved consumer against the lessor seeking to enforce such a clause. The DTPA appears as TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon 1991 & Supp. 1996).

92. Chapter 3 was replaced by the Act of May 28, 1995, 74th Leg., R.S., ch. 921, §§ 1-2, 1995 Tex. Sess. Law Serv. 4582 (Vernon).

the prior law, and much of that structure has been retained. It is likely, therefore, that many cases decided under the old Chapter 3 will continue to be cited as authority when the substance of the old rule has been retained, though perhaps in reworded and renumbered form, in the new Chapter 3. The following discussion will note the correlation between the old and new versions of Chapter 3 as they apply to the facts of individual cases, but the reader should consult the *Banking Law Survey* for further discussion of the revised Chapter 3.⁹³

A. FORM OF NEGOTIABLE INSTRUMENTS

Section 3.104 is the primary section dealing with the form of negotiable instruments under both the old and the new versions of Chapter 3.⁹⁴ In *Bailey, Vaught, Robertson & Co. v. Remington Inv. Inc.*,⁹⁵ a note provided that the interest rate was "lender's prime plus one percent."⁹⁶ The court recognized that the Texas Supreme Court had previously held that variable rate notes could meet the formal requirement of a "sum certain" under section 3.104 by reference to a prime rate if the rate was publicly available and could be determined by an interested person.⁹⁷ In *Bailey*, however, the original lender was a bank that subsequently failed and the holder of the note was an assignee from the FDIC.⁹⁸ Because of the bank failure, there was no longer a lender's prime rate to use for the calculation of interest and, in the view of the court, this made the note non-negotiable.⁹⁹ Although the assignee lost this summary judgment battle, it did not lose the collection war because the court also held that the assignee could substitute a reasonable rate of interest, but such substitution was a question of fact that could not be resolved on the summary judgment evidence before the court.¹⁰⁰ The revised Chapter 3 substitutes the phrase "fixed amount of money, with or without interest" for the phrase "sum certain in money" as well as making it clear that variable rate notes are negotiable.¹⁰¹ The result in *Bailey* would remain the same under the revised Code.

93. See *Banking Law, Annual Survey of Texas Law*, 49 S.M.U. L. Rev. 695 (1996). Because of the limited space available in a *Survey* a more extensive discussion of Chapters 3 and 4 may be found in JOHN KRAHMER & AARON CLEMENTS, *TEXAS COMMERCIAL LAW FOR BANK LAWYERS: 1995 SUPPLEMENT* (1995).

94. Compare TEX. BUS. & COM. CODE ANN. § 3.104 (Tex. UCC) (Vernon 1994) with TEX. BUS. & COM. CODE ANN. § 3.104 (Tex. UCC) (Vernon Supp. 1996).

95. 888 S.W.2d 860 (Tex. App.—Dallas 1994, no writ).

96. *Id.* at 865.

97. *Id.* at 864, (citing *Amberboy v. Societe de Banque Privee*, 831 S.W. 2d 793, 797 (Tex. 1992)).

98. 888 S.W.2d at 863.

99. *Id.* at 868.

100. *Id.* at 867.

101. Compare TEX. BUS. & COM. CODE ANN. §§ 3.104(a) & 3.106 (Tex. UCC) (Vernon 1994) with TEX. BUS. & COM. CODE ANN. §§ 3.104(a) (Tex. UCC) (Vernon Supp. 1996).

B. FORM OF INDORSEMENT AND CONVERSION OF INSTRUMENTS

Both versions of the Code state that instruments made payable to the order of two or more persons are "payable to all of them and may be negotiated, discharged or enforced only by all of them."¹⁰² Depending upon one's interpretation of the opinion in *Benchmark Bank v. State Farm Lloyds*,¹⁰³ that case is either equally right or equally wrong regardless of which version of the Code is used. In *Benchmark*, an insurer issued a total of four drafts in payment of a fire insurance claim. The first two drafts named both the homeowner-mortgagors and the mortgagee as joint payees and were delivered to the homeowners.¹⁰⁴ After the mortgagee notified the insurer that the homeowners had forged the mortgagee's indorsement on these drafts, the insurer nonetheless delivered a third draft to the homeowners, but sent the fourth and final draft to the mortgagee.¹⁰⁵ In a curious opinion, the court reasoned that "[p]ayment to and possession of a draft by one joint payee is constructive possession by the other joint payee" and that the issue in the case was not whether the homeowners forged the mortgagee's indorsement, but whether the insurer discharged its obligation under the insurance policy by making payment on drafts that bore the "apparent endorsements" of both payees.¹⁰⁶ Emphasizing that its decision was based on the facts and circumstances of the case before it, the court held that the insurer had discharged its obligations by payment of the drafts and was not liable to the mortgagee.¹⁰⁷ According to the court, the mortgagee's recourse for any forged indorsement was against the homeowners and not against the insurer.¹⁰⁸ If this opinion is read literally, checks made payable to joint payees and delivered to one of them who then forged the indorsements of the other payee or payees could never serve as the basis for a conversion claim against the payor. This result would make no sense under either the old or new Code.¹⁰⁹ The emphasis by the court that its decision was based on the facts of this particular case leads one to believe that the court was either dissatisfied with the record or that it was rendering a decision based on factual nuances not fully spelled out in its opinion.¹¹⁰ Based on either

102. Compare TEX. BUS. & COM. CODE ANN. § 3.116(2) (Tex. UCC) (Vernon 1994) with TEX. BUS. & COM. CODE ANN. § 3.110(d) (Tex. UCC) (Vernon Supp. 1996).

103. 893 S.W.2d 649 (Tex. App.—Dallas 1994, no writ).

104. *Id.* at 650.

105. *Id.* There is no explanation in the opinion about why the third draft was delivered to the homeowners despite notification of the prior forgeries.

106. 893 S.W.2d at 651 (citing *Stone v. First City Bank*, 794 S.W.2d 537, 542 (Tex. App.—Dallas 1990, writ denied)).

107. *Id.*

108. *Id.*

109. This result would make meaningless the provisions requiring indorsements by all of the joint payees in either TEX. BUS. & COM. CODE ANN. § 3.116(2) (Tex. UCC) (Vernon 1994) or TEX. BUS. & COM. CODE ANN. § 3.110(d) (Tex. UCC) (Vernon Supp. 1996), as well as doing considerable violence to TEX. BUS. & COM. CODE ANN. § 3.419(a)(3) (Tex. UCC) (Vernon 1994) and TEX. BUS. & COM. CODE ANN. § 3.420(a) (Tex. UCC) (Vernon Supp. 1996).

110. At least three times in a rather brief opinion, the court alludes to "the circumstances of this case" or to the "undisputed facts presented." See 893 S.W.2d at 650-51.

reading, however, the opinion is unsatisfactory because of its lack of real explanation or analysis and may even be dangerous because of its overly broad language regarding indorsements by joint payees. To the extent the revised Code clarifies the right of joint payees to maintain conversion actions, this case is a prime candidate for relegation to the historical scrap heap and a later court could readily use the language of the revision to accomplish this purpose.¹¹¹

*Lakeland Pipe & Supply, Inc. v. First Nat'l Bank*¹¹² involved a conversion claim by the named corporate payee on two checks against a depository bank that had taken the checks for deposit in an account bearing a different corporate name than that of the payee. Neither check carried an authorized indorsement by the payee, although both had indorsements by a corporate officer and indorsements in the name of the "other" corporation.¹¹³ The bank made no inquiries in regard to either check to determine if the indorsements or deposits were authorized even though the officer who deposited the checks was known to the bank to have a history of writing checks on nonsufficient funds (NSF) drawn on his personal account.¹¹⁴ After reviewing the summary judgment evidence, the court held that the bank failed as a matter of law to deal with the checks in a commercially reasonable manner and was liable to the payee for the proceeds of both checks.¹¹⁵

Although *Lakeland* was decided as a matter of law, the scenario points to what is likely to be a much litigated question under the revised Code. Among other changes, the new Chapter 3 purports to distinguish between unauthorized signatures by agents and forgeries by other persons.¹¹⁶ The revision also introduces a comparative negligence scheme for the allocation of loss in the case of forgeries or in the case of fraudulent indorsements by employees entrusted with responsibility for dealing with instruments.¹¹⁷ In the case of a conversion action, however, like the one presented in *Lakeland*, the revised Code does not use a comparative negligence approach.¹¹⁸ A substantial amount of litigation, therefore, is likely to center on the question of whether a particular indorsement is "forged" or "unauthorized" and what this distinction (if there really is

111. In the revised Code, TEX. BUS. & COM. CODE ANN. § 3.420(a) (Tex. UCC), (Vernon Supp. 1996) now speaks to the rights of co-payees to maintain actions for conversion, a subject not addressed by the prior version of TEX. BUS. & COM. CODE ANN. § 3.419 (Tex. UCC) (Vernon 1994), and the Official Comments discuss forgeries by a joint payee as well. TEX. BUS. & COM. CODE ANN. § 3.420 cmt. 1 (Tex. UCC) (Vernon Supp. 1996).

112. 899 S.W.2d 230 (Tex. App.—Houston [14th Dist.] 1994, writ denied).

113. *Id.* at 232.

114. *Id.*

115. *Id.* at 233.

116. See TEX. BUS. & COM. CODE ANN. § 3.406 cmt. 2 (Tex. UCC) (Vernon Supp. 1996) which states in part, "Unauthorized signature is a broader concept that includes not only forgery but also the signature of an agent which does not bind the principal under the law of agency. The agency cases are resolved independently under agency law." *Id.*

117. See TEX. BUS. & COM. CODE ANN. §§ 3.405(b) & 3.406(b) (Tex. UCC) (Vernon Supp. 1996).

118. TEX. BUS. & COM. CODE ANN. § 3.420 (Tex. UCC) (Vernon Supp. 1996).

one) is supposed to mean in the context of a conversion claim. White and Summers have recently noted,

[O]ne set of events arising out of a series of signatures that are held to be 'forgeries' will lead to an allocation scheme depending heavily on comparative negligence yet nearly identical disputes arising out of signatures that are unauthorized but technically not forgeries will bypass the comparative negligence rules found in 3-404 et seq. and will instead leave 100 percent of the loss on the downstream bank, or on the upstream employer of the embezzler.¹¹⁹

In cases where a bank has failed to act in a commercially reasonable manner as a matter of law, as in *Lakeland*, the result should be the same under either version of the Code; however, if the question is deemed to be a matter of fact, the question of whether an indorsement was "forged" or "unauthorized" will be a matter of substantial concern.

C. ENFORCEMENT OF INSTRUMENTS

The standards for enforcing a note on a motion for summary judgment are well-established under Texas law. The plaintiff must (1) produce the note or account for its absence, (2) show that he or she is the holder of the note, (3) prove that the defendant is a party liable on the note, and (4) prove the balance due.¹²⁰ Ownership may be shown by producing a note made payable or indorsed to the plaintiff or accompanied by affidavit testimony showing transfer or assignment to the plaintiff.¹²¹ During the Survey period, these standards were applied in *Blankenship v. Robins*¹²² and *Bean v. Bluebonnet Savings Bank*¹²³ where the plaintiffs were allowed to recover in the absence of any evidence of a defense to payment.¹²⁴ Application of the same standards resulted in a different outcome, however, in *First Gibraltar Bank v. Farley*¹²⁵ where inconsistencies in an affidavit of ownership introduced by the holder led the court to conclude that a material issue of fact existed as to the ownership of the note, hence summary judgment was denied.¹²⁶

*Windham v. Alexander, Weston & Poehner, P.C.*¹²⁷ also concerned the standards for summary judgment enforcement of a note, but the defend-

119. 2 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: PRACTITIONER TREATISE SERIES 217 (4th ed. 1995).

120. See, e.g., *Edlund v. Bounds*, 842 S.W.2d 719, 724 (Tex. App.—Dallas 1992, writ denied) (stating requirements for enforcement of notes); *Groschke v. Gabriel*, 824 S.W.2d 607, 610 (Tex. App.—Houston [1st Dist.] 1991, writ denied) (same).

121. *Zarges v. Bevan*, 652 S.W.2d 368, 369 (Tex. 1983) (absent contrary evidence, affidavit testimony together with a copy of a note proves ownership for purposes of summary judgment); *Jernigan v. Bank One*, 803 S.W.2d 774, 776 (Tex. App.—Houston [14th Dist.] 1991, no writ) (proof that note owned by plaintiff was lost and proof of terms allows owner to recover).

122. 899 S.W.2d 236 (Tex. App.—Houston [14th Dist.] 1994, no writ).

123. 884 S.W.2d 520 (Tex. App.—Dallas 1994, no writ).

124. 899 S.W.2d at 239; 884 S.W.2d at 523.

125. 895 S.W.2d 425 (Tex. App.—San Antonio 1995, writ denied).

126. *Id.* at 429.

127. 887 S.W.2d 182 (Tex. App.—Texarkana 1994, writ denied).

ant alleged inadequacy of consideration and duress as defenses to payment.¹²⁸ In the course of a divorce proceeding, the jury found that the defendant should pay her attorneys \$43,000 as fees for representing her in the divorce. After trial, but before a final divorce decree was rendered, the defendant signed a note for some \$62,000 in favor of her attorneys.¹²⁹ In the action to enforce this note, the defendant argued that the consideration for the note was inadequate because it was in an amount greater than that found by the jury.¹³⁰ The court held that this argument was unavailing because representation in the divorce proceeding could be sufficient consideration for a note in the amount of \$62,000 and the law does not generally measure the value of consideration unless it is grossly inadequate.¹³¹ As to the duress argument, however, the court held that the difference between the amount found by the jury and the amount demanded by the attorneys might be the basis for a valid claim of duress if the defendant had not agreed to pay the larger amount prior to signing the note.¹³² Because of the disputed facts on the issue of duress, summary judgment in favor of the plaintiffs was reversed and the case was remanded for trial.¹³³

None of the cases regarding enforcement of notes in a summary judgment proceeding should be affected by the revised Chapter 3 because the standards for establishing the right to recover remain essentially the same.¹³⁴

D. STATUTES OF LIMITATIONS FOR NOTES

After the decision in *Jackson v. Thweatt*,¹³⁵ assignees from the FDIC could rest more easily knowing they had the benefit of the six-year federal limitations period instead of the shorter four-year limitations period allowed by state law.¹³⁶ This comfort has turned out to be short-lived,

128. *Id.* at 184.

129. *Id.* at 183.

130. *Id.* at 184.

131. *Id.*

132. 887 S.W.2d at 185. The court reasoned that if the attorneys were merely demanding that the defendant sign a note to evidence an amount already owed to them under an agreement between the parties, it would not have been wrongful to threaten to cease representation of the defendant during the still-pending divorce proceeding. On the other hand, if the demand was for an amount greater than that owed, the circumstances surrounding the demand might constitute duress.

133. *Id.*

134. Compare TEX. BUS. & COM. CODE ANN. § 3.307 (Tex. UCC) (Vernon 1994) with TEX. BUS. & COM. CODE ANN. § 3.308 (Tex. UCC) (Vernon Supp. 1996). The only significant change is that an undisclosed principal may now be liable on an instrument under the revised Code if the instrument has been signed by an authorized representative, even if the principal is not named in the instrument. See TEX. BUS. & COM. CODE ANN. § 3.402(a) (Tex. UCC) (Vernon Supp. 1996). In such cases, the holder has the burden of establishing that the undisclosed principal is liable on the instrument as a represented person. TEX. BUS. & COM. CODE ANN. § 3.308 (Tex. UCC) (Vernon Supp. 1996).

135. See *Jackson v. Thweatt*, 883 S.W.2d 171 (Tex. 1994), *cert denied sub nom.* *Weatherly v. Federal Debt. Mgt., Inc.*, 115 S. Ct. 196 (1994).

136. The six-year federal rule appears in 12 U.S.C. § 1821(d)(14) (Supp. I 1989). The state rule appears in TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.004, 16.035 (Vernon 1986).

however, if the assignee acquired the paper under a transfer agreement allowing the assignor to retain federal claims and defenses. In two cases decided during the Survey period,¹³⁷ the assignors were no doubt surprised to learn that their transfer agreements contained boilerplate language that allowed the court to deny them the benefit of the six-year federal limitations period and left them subject to the four-year state rule. Although the precise language of the transfer agreements varied, both courts reached the conclusion that the agreements limited the rights transferred to the assignee and caused the seller to retain the benefit of the six-year federal rule.¹³⁸ The lesson to assignors is clear: Despite the general rule that a transfer from the FDIC includes the right to enforce a note during the six-year federal limitations period, the terms of the transfer agreement may cut off that right.¹³⁹

Under the new Chapter 3, disputes about applying the six-year federal rule or the four-year state rule should disappear because the revision allows for a new six-year state law limitations period for the enforcement of notes.¹⁴⁰ The revision does create a new "four v. six" dispute; however, non-negotiable notes, which are not covered by the new Chapter 3, remain subject to the four-year limitations period.¹⁴¹ Notes secured by liens on real property will cause similar and, perhaps, more complex disputes. It is not clear whether the new limitations period under Chapter 3 or the shorter limitations period to recover deficiencies after nonjudicial foreclosures on real estate should control.¹⁴²

Limitations figured in a different way in *Miller*, *Hiersche*, *Martens* &

137. *General Fin. Serv. v. Practice Place, Inc.*, 897 S.W.2d 516 (Tex. App.—Ft. Worth 1995, no writ); *Cadle Co. v. Weaver*, 897 S.W.2d 814 (Tex. App.—Dallas 1994, writ denied), *cert. denied*, 115 S.Ct. 2002, (1995).

138. 897 S.W.2d at 522-23; 897 S.W.2d at 818.

139. In *Weaver*, the appellant noted in its brief that the FDIC had changed its practice of making limited assignments. 897 S.W.2d at 818. The court pointed out, however, that it was required to address the transfer agreement as written. To the extent assignors still hold notes purchased through the liquidation of failed financial institutions, the transfer agreements should be reviewed to determine if they contain a clause reserving federal rights to the seller in order to avoid an unexpected limitations defense being raised in suits to enforce such notes.

140. TEX. BUS. & COM. CODE ANN. § 3.118(a) (Tex. UCC) (Vernon Supp. 1996).

141. TEX. BUS. & COM. CODE ANN. § 3.102(a) (Tex. UCC) (Vernon Supp. 1996). The requirements for negotiability appear in TEX. BUS. & COM. CODE ANN. § 3.104 (Tex. UCC) (Vernon Supp. 1996).

142. This uncertainty has been noted by the State Bar U.C.C. Committee in its Comment to TEX. BUS. & COM. CODE ANN. § 3.118 (Tex. UCC) (Vernon Supp. 1996) where it states, in part:

[B]ecause of their particular nature, the statute of limitations provisions of sections 16.035 and 16.036 of the Texas Civil Practice and Remedies Code, relating to actions with respect to debts secured by liens on real property, and section 51.003 of the Texas Property Code, relating to actions to recover deficiencies after nonjudicial foreclosures, should be interpreted to control, *in appropriate circumstances*, over the provisions of section 3.118. (Emphasis added.)

The Committee did not describe what it considered to be "appropriate circumstances" and this will no doubt be a fruitful source of dispute.

*Hayward, P.C. v. Bent Tree National Bank*¹⁴³ where the court ruled that the holder of a note barred by limitations was still entitled to foreclose on collateral in the possession holder's to satisfy the barred debt.¹⁴⁴ The court explained that barring a debt only bars the remedy and does not destroy the debt itself. If a creditor has possession of property pledged as collateral for a debt, the property may be applied against the debt because the right to assert the bar of limitations is a right personal to the debtor and does not extend to the collateral.¹⁴⁵

V. BANK TRANSACTIONS

In addition to adopting a new Chapter 3, the legislature substantially revised Chapter 4 of the Code, which governs Bank Deposits and Collections.¹⁴⁶ The legislative changes are discussed in detail in the *Banking Law Survey*.¹⁴⁷

A. COLLECTING BANK'S RIGHT OF CHARGE-BACK

In *Bill Hart Auto Sales, Inc. v. Comerica Bank-Texas*,¹⁴⁸ two checks were erroneously deposited in the plaintiff's account at a collecting bank. After the error was discovered, the plaintiff authorized transfer of the erroneous deposits to another account. After the transfers were made, the payor bank dishonored the checks. For reasons that are not clear in the opinion, the payor filed an interpleader action and tendered the amount of the checks into the registry of the court. The plaintiff intervened in that action and received payment of the funds that were interpled. The plaintiff then commenced another lawsuit against the collecting bank on the theory that the collecting bank had improperly charged-back the amount of the two checks.¹⁴⁹ The court held that the plaintiff was barred from any recovery against the collecting bank because of res judicata as the bank was a party in the interpleader action and the plaintiff expressly released the collecting bank from any further causes of action. As an independent basis for its decision, the court also noted that section 4.212 of the Code allows a bank to charge-back a provisional settlement with its customer if the bank fails to receive a final settlement and this right of charge-back is not affected by prior use of the credit given for the item.¹⁵⁰ Although section 4.212 has been slightly revised, the change would not affect the right of charge-back as described by the court and

143. 894 S.W.2d 828 (Tex. App.—Dallas 1995, no writ).

144. *Id.* at 830.

145. *Id.* at 829.

146. Act of May 28, 1995, 74th Leg., R.S., ch. 961, §§ 1, 4, 1995 Tex. Sess. Law Serv. 4582, 4626 (Vernon).

147. See *Banking Law, Annual Survey of Texas Law*, 49 S.M.U. L. Rev. 695 (1996).

148. 893 S.W.2d 705 (Tex. App.—Eastland 1995, no writ).

149. *Id.* at 707-08.

150. *Id.* at 708. The right of a collecting bank to charge-back provisional credits given for an item was previously stated in TEX. BUS. & COM. CODE ANN. § 4.212 (Tex. UCC) (Vernon 1994) and now appears as TEX. BUS. & COM. CODE ANN. § 4.214 (Tex. UCC) (Vernon Supp. 1996).

the result in the case would remain the same.¹⁵¹

B. REFUSAL TO PAY CASHIER'S CHECKS

In contrast to *Bill Hart Auto Sales*, the decision in *Arline v. Omnibank*¹⁵² would be reversed under the new Code. In *Arline*, the plaintiff's father had originally opened a joint account at the bank with another person and, under the terms of the signature card, the funds in the account were payable to the survivor in the event of the death of either party.¹⁵³ After the father's death, the bank issued a new signature card naming the survivor as one of the owners of a "new" account jointly owned by the survivor and a third person.¹⁵⁴ But, the account number remained the same.¹⁵⁵ When the plaintiff later asked the bank to issue a cashier's check to him as administrator of his father's estate, the bank mistakenly did so in an amount equal to the balance in the "new" joint account.¹⁵⁶ When the plaintiff later attempted to obtain payment of the cashier's check, payment was refused and the check was stamped "payment stopped."¹⁵⁷

The plaintiff, acting in his capacity as administrator of his father's estate, sued the bank to compel payment of the cashier's check for the benefit of the estate.¹⁵⁸ Noting that "[t]he issue of whether a bank can dishonor its cashier's check when no person has changed his position in expectation of payment is a difficult one,"¹⁵⁹ the court carefully reviewed cases and commentary before reluctantly concluding that Texas precedent prevented a bank from refusing to pay a cashier's check even if it was issued by mistake.¹⁶⁰ According to the court, the only recourse for the bank would be an action to recover money paid by mistake.¹⁶¹

The holding that a bank cannot refuse to pay a cashier's check would

151. Under the revision, a collecting bank may still charge-back after the midnight deadline, but if the return of a check or the sending of notice of dishonor is so delayed, the collecting bank is now liable for any loss resulting from the delay. See TEX. BUS. & COM. CODE ANN. § 4.214(a) (Tex. UCC) (Vernon Supp. 1996).

152. 894 S.W.2d 76 (Tex. App.—Houston [14th Dist.] 1995, no writ).

153. *Id.* at 77.

154. *Id.*

155. *Id.* at 80. There is no explanation in the opinion as to why the account number was not changed. The failure to change the account number seems to have been the cause of the bank's later mistake in issuing the disputed cashier's check.

156. *Id.* at 77.

157. 894 S.W.2d at 77.

158. *Id.*

159. *Id.* at 82.

160. *Id.* In the court's view, the critical precedent was *Wertz v. Richardson Heights Bank and Trust*, 495 S.W.2d 572, 574 (Tex. 1973) (holding that a cashier's check is "not subject to countermand by either its purchaser or the issuing bank.").

161. 894 S.W.2d at 82. Under the old Chapter 3, the Texas Supreme Court held that a claim in restitution to recover money paid by mistake was impliedly authorized by TEX. BUS. & COM. CODE ANN. § 3.418 (Tex. UCC) (Vernon 1994) and had not been displaced by the Code. *Bryan v. Citizens Nat'l Bank*, 628 S.W.2d 761 (Tex. 1982). The new Chapter 3 makes the right to maintain such an action explicit. TEX. BUS. & COM. CODE ANN. § 3.418(b) (Tex. UCC) (Vernon Supp. 1996).

be changed by a new section 3.411 in the revised Code.¹⁶² Under this section, a bank may now refuse to pay a cashier's check and may assert any claims or defenses that it has reasonable grounds to believe are available against the holder of the cashier's check.¹⁶³ In refusing to pay, however, the bank runs the risk of liability for consequential damages if the refusal was wrongful or if the grounds for the refusal were not reasonable.¹⁶⁴

VI. INVESTMENT SECURITIES UNDER THE NEW CHAPTER 8

A. REASONS FOR CHANGE IN CHAPTER 8

The first version of Chapter 8 adopted in Texas derived from the 1962 Official Text as approved by the National Conference of Commissioners on Uniform State Laws and by the American Law Institute.¹⁶⁵ This version of Chapter 8 treated an investment security as something akin to a specialized form of negotiable instrument represented by a stock certificate or similar document that could be issued in either bearer or registered form. This specialized form of negotiable instrument would be traded between buyers and sellers on recognized exchanges like the New York Stock Exchange with changes in ownership being reflected on the books of the issuer.¹⁶⁶ By the early 1970s, the growth in share trading, the concomitant "paper crunch" of record keeping, and the physical exchange of stock certificates led to the revision of Chapter 8 by the 1978 Official Text which visualized a future of "paperless" stock ownership (i.e., "uncertificated securities") with ownership still being reflected on the issuer's books.¹⁶⁷ The drafters of this revision were realistic enough to recognize, however, that paper certificates would continue to exist for some time to come. Thus, the rules governing uncertificated securities were engrafted on the existing structure of Chapter 8 to provide something of a "parallel universe" approach with one set of rules governing ownership represented by paper certificates and another set of rules governing paperless ownership.¹⁶⁸ Unforeseen by the drafters, however, was the rise of clearing corporations and securities intermediaries as third-party depositories who keep track of securities ownership by entries in their participants' accounts, much as a bank keeps track of bank accounts

162. TEX. BUS. & COM. CODE ANN. § 3.411 (Tex. UCC) (Vernon Supp. 1996).

163. *Id.* § 3.411(c).

164. *Id.* § 3.411(b).

165. The Uniform Commercial Code was originally adopted in Texas in the 1965 legislative session with an effective date of July 1, 1966. Uniform Commercial Code, 59th Leg., R.S., ch. 721, §§ 1-101 to 10-105, 1965 Tex. Gen. Laws 1-316 (Vernon). In 1967 it was reenacted as part of the new Texas Business and Commerce Code. Act of Sept. 1, 1967, 60th Leg., R.S., ch. 785, §§ 1-6, 1967 Tex. Gen. Laws 2343-2782 (Vernon).

166. PIKE & FISCHER, INC., UNIFORM COMMERCIAL CODE REPORTING SERVICE: UNIFORM COMMERCIAL CODE AND OFFICIAL COMMENTS, Revised Article 8, Investment Securities, Prefatory Note 2-3 (1995).

167. *Id.* at 3-4.

168. *Id.*

for its customers, without the need to notify the issuer (or the United States Treasury) of precisely who owns which dollar bill on a given day.¹⁶⁹ In recognition of this unanticipated phenomena, Chapter 8 was completely revised in 1994 and was adopted in Texas during the 1995 legislative session.¹⁷⁰

The new Chapter 8 still recognizes that paper certificates will be issued, traded, and held by some investors. Also, it includes provisions to cover uncertificated securities and third-party depositories.¹⁷¹ In addition, the revision now provides coverage for a broader range of investment ownership than that traditionally viewed as a "security"¹⁷² allowing property held by a securities intermediary to be treated as a "financial asset"¹⁷³ whether or not the property involved is normally traded on financial markets. In sum, the new Chapter 8 can be viewed as a "tri-furcation" that seeks to cover not only paper and paperless ownership, but also third-party accounting for ownership of traditional investment securities and non-traditional investments.

The details of the changes in Chapter 8 cannot be covered in the relatively brief space of this Survey, but certain points can be highlighted. First, on a rather fundamental level, the new Chapter 8 abolishes any statute of frauds requirement for the sale or purchase of securities.¹⁷⁴ This change alone eliminates much of the litigation that has arisen in Texas under the prior Chapter 8.¹⁷⁵ Second, Subchapters B, C, and D of Chapter 8 dealing with securities represented by certificated securities in paper form have remained largely unchanged,¹⁷⁶ as have the provisions concerning ownership of uncertificated securities that are transferred on the books of the issuer.¹⁷⁷ Third, subchapter E of the new Chapter 8 details the rules governing the duties of security depositories with respect to the relationships between such depositories, the owners of financial

169. *Id.*

170. Act of May 27, 1995, 74th Leg., R.S., ch. 962, § 1, 1995 Tex. Sess. Law Serv. 4760 (Vernon).

171. See and compare the various provisions cited in notes 176-78 *infra*.

172. "Security" is defined in TEX. BUS. & COM. CODE ANN. § 8.102(a)(15) (Tex. UCC) (Vernon Supp. 1996) as a share or a similar financial market participation interest. See also TEX. BUS. & COM. CODE ANN. § 8.102(a)(9) (Tex. UCC) (Vernon Supp. 1996).

173. "Financial asset" is defined in TEX. BUS. & COM. CODE ANN. § 8.102(a)(9) (Tex. UCC) (Vernon Supp. 1996). The breadth of this definition may give rise to some interesting possibilities. The reader is left to his or her own imagination.

174. TEX. BUS. & COM. CODE ANN. § 8.113 (Tex. UCC) (Vernon Supp. 1996). The comment to this section states in part: "This section provides that the statute of frauds does not apply to contracts for the sale of securities, reversing prior law which had a special statute of frauds in Section 8-319 (1978) [TEX. BUS. & COM. CODE ANN. § 8.319 (Tex. UCC) (Vernon 1991)]."

175. See, e.g., *Coastal Corp. v. Atlantic Richfield Co.*, 852 S.W.2d 714 (Tex. App.—Corpus Christi 1993, no writ); *Beta Drilling, Inc. v. Durkee*, 821 S.W.2d 739 (Tex. App.—Houston [14th Dist.] 1992, writ denied); *Gannon v. Baker*, 830 S.W.2d 706 (Tex. App.—Houston [1st Dist.] 1992, writ denied), *prior decision at* 807 S.W.2d 793 (Tex. App.—Houston [1st Dist.] 1991), *aff'd in part and rev'd in part*, 818 S.W.2d 754 (Tex. 1991).

176. TEX. BUS. & COM. CODE ANN. § 8.201-8.407 (Tex. UCC) (Vernon Supp. 1996).

177. TEX. BUS. & COM. CODE ANN. §§ 8.106(d), 8.108(b)-(d), 8.112(b), (d), 8.201(a)(2) & 8.207(a) (Tex. UCC) (Vernon Supp. 1996).

assets, and the holders of security interests in these assets.¹⁷⁸ It is in this third area that most attorneys are likely to encounter Chapter 8 because of the overlap between these provisions and the conforming revisions made to Chapter 9 on secured transactions.¹⁷⁹ The balance of this section of the *Survey* concentrates on this area.

B. CREATION OF SECURITY INTERESTS IN INVESTMENT PROPERTY

The prior version of Chapter 8 separated the rules for the creation and the perfection of security interests in investment securities between Chapters 8 and 9 of the Code.¹⁸⁰ The revised Chapter 8 eliminates this separation by making several conforming changes in Chapter 9 and by adding new sections 9.115 and 9.116 to that Chapter.¹⁸¹ Under the revision, a security interest in an investment security, now termed "investment property,"¹⁸² is created in the same manner as other security interests, that is, by an agreement between the debtor and the secured party that complies with the terms of section 9.203.¹⁸³ The basic requirements of section 9.203 are: (1) there must be an agreement between the debtor and the secured party, (2) the debtor must have rights in the collateral, and (3) the secured party must give value.¹⁸⁴ The collateral must be described in the security agreement and, on this point, the new section 9.115 states the rules governing the description of investment property used as collateral.¹⁸⁵

Under Chapter 9, security interests in some types of property can be created without a written security agreement, most notably in cases where the secured party takes physical possession of the collateral.¹⁸⁶ Revised Chapter 8 allows the same treatment for some investment

178. TEX. BUS. & COM. CODE ANN. § 8.501-8.511 (Tex. UCC) (Vernon Supp. 1996).

179. In making this statement the author presumes that relatively few attorneys regularly represent issuers and transfer agents in regard to the *form* of stock to be issued, whether certificated or uncertificated, but that many attorneys may represent financial institutions or other lenders who are asked to make loans against securities or other financial assets that have already been issued.

180. See TEX. BUS. & COM. CODE ANN. §§ 9.203(a), 8.321 (Tex. UCC) (Vernon 1991).

181. TEX. BUS. & COM. CODE ANN. §§ 9.115, 9.116 (Tex. UCC) (Vernon Supp. 1996).

182. "Investment property" is defined in the new TEX. BUS. & COM. CODE ANN. § 9.115(a)(6) (Tex. UCC) (Vernon Supp. 1996) to include certificated and uncertificated securities, securities entitlements, securities accounts, commodity contracts, and commodity accounts. Because of the broader coverage of the revised Chapter 8, the term "investment property" was substituted for the earlier "investment security" term.

183. The cross-reference that formerly appeared in TEX. BUS. & COM. CODE ANN. § 9.203(a) (Tex. UCC) (Vernon 1991) to TEX. BUS. & COM. CODE ANN. § 8.321 (Tex. UCC) (Vernon 1991) has now been removed. See TEX. BUS. & COM. CODE ANN. § 9.203(a) (Tex. UCC) (Vernon Supp. 1996).

184. TEX. BUS. & COM. CODE ANN. § 9.203(a)(1)-(3) (Tex. UCC) (Vernon Supp. 1996).

185. The test of a description provided by TEX. BUS. & COM. CODE ANN. § 9.115(c) (Tex. UCC) (Vernon Supp. 1996) is, "A description of investment property collateral in a security agreement or financing statement is sufficient if it identifies the collateral by specific listing, by category, by quantity, by a computational or allocational formula or procedure, or by any other method, if the identity of the collateral is objectively determinable." *Id.*

186. See TEX. BUS. & COM. CODE ANN. §§ 9.203(a)(1) & 9.305 (Tex. UCC) (Vernon Supp. 1996).

properties. Under section 9.115, "[i]f a security certificate in registered form is delivered to a secured party pursuant to agreement, a written security agreement is not required for [the] attachment or enforceability of the security interest [and] delivery [of the certificate] suffices for perfection of the security interest" ¹⁸⁷ A security interest created and perfected in this manner has priority over a conflicting security interest perfected by the filing of a financing statement. ¹⁸⁸

Security interests may also attach to certain "financial assets" by operation of law in two limited situations. ¹⁸⁹ First, if a person buys a financial asset through a "securities intermediary" ¹⁹⁰ under an agreement obligating the buyer to pay the purchase price when the purchase is effected, and the intermediary credits the asset to the buyer's account before the price is paid, the intermediary obtains a security interest in the buyer's "security entitlement" ¹⁹¹ without the need for a security agreement. The security interest is automatically perfected by operation of law. ¹⁹² This security interest has priority over any competing security interest. ¹⁹³ Second, if a certificated security, or other financial asset represented by a writing which is usually transferred by delivery with any necessary indorsement or assignment, is delivered under an agreement between persons in the business of dealing with such securities or assets, the right to receive payment is secured by operation of law and no security agreement is necessary for attachment. The security interest is automatically perfected. ¹⁹⁴

187. TEX. BUS. & COM. CODE ANN. § 9.115(f) (Tex. UCC) (Vernon Supp. 1996). In effect, this is equivalent to a common law possessory pledge. A "security certificate" is defined in TEX. BUS. & COM. CODE ANN. § 8.102(a)(16) (Tex. UCC) (Vernon Supp. 1996) as "a certificate representing a security."

188. TEX. BUS. & COM. CODE ANN. § 9.115(f) (Tex. UCC) (Vernon Supp. 1996).

189. "Financial asset" is defined in TEX. BUS. & COM. CODE ANN. § 8.102(a)(9) (Tex. UCC) (Vernon Supp. 1996) and includes a certificated or uncertificated security and an obligation, share, participation, or other interest that is of a type dealt in or traded on financial markets or that is recognized as a medium for investment. The term also includes "any property . . . held by a securities intermediary for another person in a securities account if the securities intermediary has expressly agreed . . . that the property is to be treated as a financial asset" governed by Chapter 8. *Id.*

190. TEX. BUS. & COM. CODE ANN. § 8.102(a)(14) (Tex. UCC) (Vernon Supp. 1996) defines a "securities intermediary" to include clearing corporations, banks, or brokers that, in the ordinary course of business, maintain securities accounts for others.

191. TEX. BUS. & COM. CODE ANN. § 8.102(a)(17) (Tex. UCC) (Vernon 1996) defines "security entitlement" as "the rights and property interest of an entitlement holder with respect to a financial asset."

192. TEX. BUS. & COM. CODE ANN. § 9.116(a) (Tex. UCC) (Vernon Supp. 1996). This is a codification of the common law "broker's lien" to secure payment of the purchase price for the securities. It is, in effect, another version of the "purchase money security interest" described in TEX. BUS. & COM. CODE ANN. § 9.107 (Tex. UCC) (Vernon 1991).

193. TEX. BUS. & COM. CODE ANN. § 9.115(e)(3) (Tex. UCC) (Vernon Supp. 1996).

194. TEX. BUS. & COM. CODE ANN. § 9.116(b) (Tex. UCC) (Vernon Supp. 1996). This exception is obviously very narrow and will typically be of importance only between securities custodians who deliver certificates between themselves to execute instructions from buyers and sellers of securities. The Official Comment notes that this section is a codification of the understanding of the trade. TEX. BUS. & COM. CODE ANN. § 9.116 cmt. 3 (Tex. UCC) (Vernon Supp. 1996).

C. PERFECTION OF SECURITY INTERESTS IN INVESTMENT PROPERTY

The changes made by the revised Chapter 8 and the conforming amendments in Chapter 9 are perhaps most striking in the area of perfection of a security interest in investment property. Here the revision introduces the concept of perfection by "control."¹⁹⁵ Perfection by control essentially means that the secured party has sufficient control over the collateral to permit the secured party to sell the collateral without the need for any further cooperation from the debtor. The easiest case in which to visualize such control is a situation involving the possession of properly indorsed and publicly traded stock certificates by a lender. If the loan goes into default, the lender can simply sell the stock and recover the amount of the loan from the proceeds of the sale.¹⁹⁶

In addition to physical possession of a stock certificate, a secured party may establish "control" over investment property in two other ways: (1) if securities are transferred to an account in the secured party's own name, or (2) if a securities intermediary agrees to act on an instruction of the secured party to sell the securities, even though the debtor retains ownership rights in them.¹⁹⁷ Although the revision uses different terms, the concept of "control" in the case of investment property is analogous to the concept of control over the goods where a warehouse receipt or bill of lading has been issued by a warehouse or carrier. If negotiable, perfection in a warehouse receipt or bill of lading is accomplished by possession.¹⁹⁸ If non-negotiable, perfection is accomplished by notification to the bailee that the goods are being held on behalf of the secured party.¹⁹⁹ However, there is a significant difference in this analogy. In the case of bailed goods covered by a non-negotiable document of title, perfection dates from the time the bailee receives notification of the secured party's interest.²⁰⁰ In the case of uncertificated securities or securities entitlements, an issuer or securities intermediary is not required to enter into an agreement to follow the instructions of the secured party even if the debtor, as owner of the securities or entitlements, so directs.²⁰¹ The

195. "Control" is defined in TEX. BUS. & COM. CODE ANN. §§ 8.106, 9.115(1)(e) (Tex. UCC) (Vernon Supp. 1996). Under Chapter 8, the term "purchaser" is used as defined in TEX. BUS. & COM. CODE ANN. § 1.201(33) (Tex. UCC) (Vernon 1991) to include a secured party. It is in this sense that the word is used in TEX. BUS. & COM. CODE ANN. § 8.106 (Tex. UCC) (Vernon Supp. 1996) and includes secured parties even though the section speaks in terms of control by a purchaser.

196. See TEX. BUS. & COM. CODE ANN. § 9.504(a) (Tex. UCC) (Vernon 1991). In this case, since the stock is traded on a recognized market, the secured party is also free of the usual strictures regarding notice of sale under TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1991). Under that same section, the secured party is even entitled to buy the collateral without the need for public sale.

197. See TEX. BUS. & COM. CODE ANN. §§ 8.106(b), (c), 9.115(a)(5) (Tex. UCC) (Vernon Supp. 1996).

198. TEX. BUS. & COM. CODE ANN. § 9.304(b) (Tex. UCC) (Vernon 1991).

199. TEX. BUS. & COM. CODE ANN. § 9.304(c) (Tex. UCC) (Vernon 1991).

200. *Id.*

201. TEX. BUS. & COM. CODE ANN. § 8.106(f) (Tex. UCC) (Vernon Supp. 1996). This section also provides that an intermediary may not enter into such an agreement without the consent of the owner or entitlement holder. *Id.* § 8.106(g).

bailee of goods does not have this choice. Perfection by control of commodity contracts is defined in a similar manner in section 9.115.²⁰²

Short of obtaining control by one of the methods provided in sections 9.115 and 8.106, a secured party may elect to file an ordinary financing statement covering the investment property.²⁰³ Perfection by filing is a less desirable method of perfection since a security interest perfected by control has priority over a security interest perfected by filing.²⁰⁴

D. PRIORITY OF SECURITY INTERESTS IN INVESTMENT PROPERTY

The rules governing priority in the investment property appear in section 9.115 of the revised Code.²⁰⁵ The most basic rule is that a security interest perfected by control over the investment property has priority over a security interest that is not perfected by control. For example, a security interest perfected by control has priority over a security interest perfected by filing.²⁰⁶ If more than one secured party has perfected by control, the security interests rank equally except for security interests granted to the debtor's own security or commodity intermediary, which have a super-priority over any security interest granted to another secured party.²⁰⁷ If a broker, a securities intermediary, or a commodities intermediary is the debtor, any security interest granted by these parties that is not perfected by control rank equally.²⁰⁸ Any cases not resolved by these rules are governed by the general priority rules of section 9.312.²⁰⁹ Such an unresolved case could occur, for example, if two se-

202. See TEX. BUS. & COM. CODE ANN. § 9.115(d)(4) (Tex. UCC) (Vernon Supp. 1996).

203. TEX. BUS. & COM. CODE ANN. § 9.115(d)(2) (Tex. UCC) (Vernon Supp. 1996).

204. TEX. BUS. & COM. CODE ANN. § 9.115(e)(1) (Tex. UCC) (Vernon Supp. 1996).

205. The perfection of security interests in investment property can involve some complex choice of law issues. TEX. BUS. & COM. CODE ANN. § 9.103(f) (Tex. UCC) (Vernon Supp. 1996) now details the choice of law rules to be used in determining which jurisdiction's law controls perfection and priorities. In general, if the investment property is represented by a security certificate, and if perfection is accomplished by control, the law of the jurisdiction where the certificate is located governs. TEX. BUS. & COM. CODE ANN. § 9.103(f)(2) (Tex. UCC) (Vernon Supp. 1996). If the investment property is in the form of an uncertificated security, and if perfection is by means of control, the law of the jurisdiction of the issuer governs. TEX. BUS. & COM. CODE ANN. § 9.103(f)(3) (Tex. UCC) (Vernon Supp. 1996). If the investment property is a security entitlement or security account, and if perfection is by means of control, the law of the securities intermediary's jurisdiction governs. TEX. BUS. & COM. CODE ANN. § 9.103(f)(4) (Tex. UCC) (Vernon Supp. 1996). If the investment property consists of a commodity contract or commodity account, and if perfection is by means of control, the law of the jurisdiction of the commodity intermediary governs. TEX. BUS. & COM. CODE ANN. § 9.103(f)(5) (Tex. UCC) (Vernon Supp. 1996). If perfection is by filing, or by automatic perfection in the case of security interests granted by brokers or intermediaries (whether stocks or commodities), the law of the debtor's location governs. TEX. BUS. & COM. CODE ANN. § 9.103(f)(6) (Tex. UCC) (Vernon Supp. 1996).

206. TEX. BUS. & COM. CODE ANN. § 9.115(e) (Tex. UCC) (Vernon Supp. 1996).

207. TEX. BUS. & COM. CODE ANN. § 9.115(e)(2) (Tex. UCC) (Vernon Supp. 1996).

208. TEX. BUS. & COM. CODE ANN. § 9.115(e)(5) (Tex. UCC) (Vernon Supp. 1996).

209. TEX. BUS. & COM. CODE ANN. § 9.115(e)(6) (Tex. UCC) (Vernon Supp. 1996). This section expressly cross-references TEX. BUS. & COM. CODE ANN. §§ 9.312(e)-(g) (Tex. UCC) (Vernon 1991) and specifies that the purchase money rule of TEX. BUS. & COM. CODE ANN. § 9.312(d) (Tex. UCC) (Vernon 1991) does not apply to investment property.

cured parties each perfected by filing instead of by control. In this instance, priority would be determined by the order of filing under section 9.312.²¹⁰

VII. SECURED TRANSACTIONS

A. PERFECTION OF SECURITY INTERESTS

Under section 9.302 of the Code, security interests in goods covered by a certificate of title must be perfected by notation on the certificate rather than by the filing of a financing statement.²¹¹ In the case of automobiles, even if the security interest is not perfected by notation on the certificate of title, the Texas courts have held that the secured party still prevails over the buyer of an automobile if the certificate of title is not transferred to the buyer as part of the sales transaction.²¹² Does the same rule apply in the case of boats? According to the court in *Pierce v. First National Bank of Alvin*,²¹³ the answer is no. The reason for this difference is that perfection of security interests in boats and boat motors is governed by the Texas Parks and Wildlife Code rather than by the Texas Certificate of Title Act.²¹⁴ The court correctly reasoned that the Parks and Wildlife Code does not render a sale void if a certificate of title is not transferred as part of the sale.²¹⁵ Because the sale is not made void, the transaction is governed by section 9.301 of the Code, and that section gives the purchaser priority over an unperfected security interest if the purchaser acted without knowledge of the security interest.²¹⁶ This disparity in result is another example of a situation where serious thought should be given to finding a better system for perfecting and tracking security interests in different types of collateral.²¹⁷ A strong argument can be made that the lack of correlation between the Code and other statutes dealing with the

210. TEX. BUS. & COM. CODE ANN. § 9.312(e) (Tex. UCC) (Vernon 1991).

211. TEX. BUS. & COM. CODE ANN. § 9.302(c)(2) (Tex. UCC) (Vernon 1991).

212. This rule originated in *Phil Phillips Ford, Inc. v. St. Paul Fire and Marine Ins. Co.*, 465 S.W.2d 933 (Tex. 1971) and has been followed in subsequent decisions. See, e.g., *Drake Ins. Co. v. King*, 606 S.W.2d 812 (Tex. 1980) (buyer obtains no title to automobile unless certificate is transferred as part of sale) and 620 S.W.2d 739 (Tex. App.—Dallas 1981, writ ref'd n.r.e.) (same, holding that buyer is entitled to demand transfer of certificate of title from seller to insure that buyer has received good title).

213. 899 S.W.2d 365 (Tex. App.—Houston [14th Dist.] 1995, no writ).

214. For perfection of security interests in boats and boat motors, TEX. PARKS & WILD. CODE ANN. § 31.052 (Vernon Supp. 1996) provides for notation on a certificate of title issued by the Parks and Wildlife Department. TEX. REV. CIV. STAT. ANN. art. 6687-1, § 41 (Vernon 1991) provides that perfection of security interests in automobiles is by notation on a certificate of title issued by the Texas Department of Transportation.

215. 899 S.W.2d at 370.

216. *Id.* at 370-71.

217. Another example is *Giese v. NCB Tex. Forney Banking Center*, 881 S.W.2d 776 (Tex. App.—Dallas 1994, no writ) where a seller's attempt to continue perfection of her security interest in a mobile home by a fixture filing in the real estate records was held to be ineffective so long as a certificate of title issued by the Texas Department of Licensing and Regulation was outstanding on the home. This department is yet another issuer of certificates of title for another class of property that requires one more record to be checked. The relevant certificate of title statute for mobile homes is TEX. REV. CIV. STAT. ANN. art. 5221f, § 19 (Vernon 1991).

perfection of security interests is needlessly complex and adds unnecessary expense to the transaction costs for all parties involved.²¹⁸

In *Crutcher v. Continental National Bank*,²¹⁹ a bank had taken security interests in twenty-seven trailers as part of the security for a letter of credit issued on behalf of the owners of a distributing company.²²⁰ The liens were perfected by notation on the certificates of title.²²¹ When the owners subsequently sold the company, they requested that and the unused letter of credit be canceled and the liens on the trailers released.²²² The former owners retained the certificates of title as partial security in the sale of the company, but did not have their liens noted on the titles. The purchaser subsequently misrepresented to the bank that the original certificates had been lost or destroyed, and a new statement was needed showing that the bank's liens had been released. Armed with the statement of release, the purchaser obtained new, clean certificates of title and sold some of the trailers to other parties. The purchaser eventually defaulted in making payments to the original owners of the company and they belatedly sought to have their liens noted on the certificates of title. At that time they learned, to their dismay, that clean titles had been issued to the purchaser and that some of the collateral was missing. After obtaining a judgment against the purchaser, the owners sued the bank, arguing that the bank owed a duty to notify them when the purchaser sought the additional lien release.²²³ The court held that there was no banking relationship between the bank and the owners as the letter of credit was canceled more than three years earlier, and the bank owed no continuing duty, whether fiduciary or otherwise, to notify the owners when the purchaser, as the title owner of the vehicles, sought a statement showing that the bank's liens had been released.²²⁴ The owners could have perfected their security interests by notation on the certificates of title when the company was sold or at any time before clean certificates were issued. Having failed to take this step, the owners' only recourse was against the defaulting purchaser.²²⁵

B. RECOVERY OF DEFICIENCIES

Much of the litigation arising under Chapter 9 concerns the right of a secured party to recover a deficiency after default and disposition of col-

218. For a discussion of the benefits and defects of filing systems as a means of perfecting security interests, as well as an analysis of the associated costs, see James W. Bowers, *Of Bureaucrats' Brothers-in-law and Bankruptcy Taxes: Article 9 Filing Systems and the Market for Information*, 79 MINN. L. REV. 721 (1995).

219. 884 S.W.2d 884 (Tex. App.—El Paso 1994, no writ).

220. *Id.* at 885.

221. *Id.* Notation of a lien on vehicles, trailers, and the like is accomplished by the issuance of a certificate of title by the Department of Transportation showing the existence of a security interest in the collateral covered by the certificate. TEX. REV. CIV. STAT. ANN. art. 6687-1 § 41 (Vernon Supp. 1996).

222. 884 S.W.2d at 885.

223. *Id.*

224. *Id.* at 887.

225. *Id.* at 889.

lateral, and this Survey period was no exception. In *Hairgrove v. Cramer Financial Groups, Inc.*,²²⁶ the court had little difficulty in holding that the sale of a loan with an accompanying assignment of the secured party's rights in the collateral was not a "disposition" of the collateral under section 9.504 of the Code. Also, there was no requirement that the debtor be notified of the sale and assignment.²²⁷

In *Long v. NCNB-Texas National Bank*,²²⁸ there had clearly been a foreclosure sale, but the collateral in that case was real estate, and the deficiency claim was against the guarantors who had guaranteed the original loan. Notice of the foreclosure was given to the principal debtor, but separate notice was not given to the guarantors.²²⁹ In the deficiency action, the guarantors argued that they were "debtors" within the meaning of the Texas Property Code and, as such, were entitled to notice of the foreclosure sale.²³⁰ The court noted that the requirements of Chapter 9 of the Code only apply to foreclosures on personal property and not to foreclosures on realty.²³¹ The underlying question, however, was whether the interpretation of the term "debtor" under sections 9.504 and 9.505 of the Code to include guarantors should be extended to the same term under the Property Code.²³² On this point, the court reviewed the history and purpose of the Texas real property statutes and concluded that the express use of the terms "guarantor" and "guarantors" in some sections of the Property Code, and omission of those terms in the sections dealing with notice, indicated a legislative intent that guarantors do not have a right to notice of a foreclosure sale of real estate.²³³

226. 895 S.W.2d 874 (Tex. App.—Fort Worth 1995, writ denied).

227. *Id.* at 875. As used in TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1991), a disposition of collateral occurs when the secured party seeks to foreclose on the collateral for the purpose of liquidating it and applying the proceeds to the outstanding indebtedness. The sale of a loan, along with the secured party's rights, under a security agreement is not a foreclosure.

228. 882 S.W.2d 861 (Tex. App.—Corpus Christi 1994, no writ).

229. *Id.* at 862.

230. *Id.* at 863. TEX. PROP. CODE ANN. § 51.002(b)(3) (Vernon 1995) requires that notice of a foreclosure sale be given to "each debtor who, according to the records of the holder of the debt, is obligated to pay the debt."

231. *Id.* at 863-64. TEX. BUS. & COM. CODE ANN. § 9.104(10) (Tex. UCC) (Vernon 1991) explicitly states that it does not cover "the creation or transfer of an interest in or lien on real estate."

232. 882 S.W.2d at 864. The right of guarantors to receive notice of a disposition of collateral under TEX. BUS. & COM. CODE ANN. §§ 9.504, 9.505 (Tex. UCC) (Vernon 1991) is well-established in Texas law. *See, e.g.,* FDIC v. Payne, 973 F.2d 403 (5th Cir. 1992) (guarantor entitled to notice of sale of collateral; right not waived by pre-default waiver of notice of sale contained in guaranty agreement because § 9.504(c) allows only post-default waivers to be effective); Bexar County Nat'l Bank v. Hernandez, 716 S.W.2d 938 (Tex. 1986) (notice is required for proper sale of collateral); and MBank Dallas v. Sunbelt Manuf., Inc., 710 S.W.2d 633 (Tex. App.—Dallas 1986, writ ref'd n.r.e.) (notice to guarantors is required before sale of collateral, but oral notice is sufficient to satisfy the requirements of 9.504).

233. 882 S.W.2d at 865-66. The court placed particular emphasis on TEX. PROP. CODE ANN. §§ 51.003, 9.005 (Vernon Supp. 1996) to show a legislative intent to include guarantors within the scope of the statute. *Long* contains an extensive review of the Texas cases and statutory law on the issue of notice to guarantors and should be a valuable reference source for cases involving this issue.

The burden of pleading and proving that a disposition of collateral was conducted properly was settled in *Greathouse v. Charter National Bank-Southwest*.²³⁴ Despite the resolution of this question, the more mundane issue of exactly what must be pled and proven still remains, as illustrated in *Wilson v. General Motors Acceptance Corp.*²³⁵ In an opinion that should bring joy to the heart of every secured creditor, a majority of the court held that the secured party met the requirements of *Greathouse* with pleadings and a motion for summary judgment that never used the phrase "commercially reasonable" nor alleged that all conditions precedent to the sale had occurred.²³⁶ The majority found that an affidavit submitted in support of the motion was sufficient to establish the commercial reasonableness of the sale and shift the burden to the debtors to raise a fact issue that effectively contested notice and sale.²³⁷ In the majority's view, the debtors did not carry this burden and summary judgment was affirmed in favor of the secured party.²³⁸ A strong dissenting opinion argued that the requirements of *Greathouse* had not been met when the secured party failed to allege in any of the pleadings that the sale was conducted in a commercially reasonable manner and that all conditions precedent had been met.²³⁹ The dissent would have remanded the case for trial.²⁴⁰ Whether other courts will follow the "pleadings lite" flavor of this case remains to be seen, but a secured party would be well-advised to be cautious in relying on this case as a guide to pleading a deficiency claim.

234. 851 S.W.2d 173 (Tex. 1992).

235. 897 S.W.2d 818 (Tex. App.—Houston [1st Dist.] 1995, no writ).

236. *Id.* at 822.

237. *Id.* In terms of short-form affidavits, the affidavit described in the opinion is a masterpiece. As summarized in both the majority and dissenting opinions, the affidavit established six points, each of them only one line long. *Id.* at 822, 825.

238. *Id.* at 823.

239. *Id.* at 824.

240. 897 S.W.2d at 825.