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CREDITOR AND CONSUMER RIGHTS

by

Mark S. McQuality* and Eliot Shavin**

THIS Article surveys developments under Texas law in the area of creditor and consumer rights during the period November 1989 through November 1990. During the period, Texas courts issued a number of significant decisions in this broad and diverse field of law. The number and variety of cases makes it impractical to adequately address all case law developments in this area. Therefore, only select decisions which significantly impact consumers, both business and individual, and their creditors are reviewed below.

I. USURY AND THE DTPA

On November 14, 1990, the Texas Supreme Court rendered a substituted opinion in *Kinerd v. Colonial Leasing Co.*,¹ withdrawing its prior opinion of June 20, 1990.² This case involves an action for damages under both the usury statute³ and the Deceptive Trade Practices — Consumer Protection Act (DTPA).⁴ *Kinerd* is an appropriate case to begin this Survey, not only due to its tremendous legal significance, but also because of the large number of businesses in Texas it may impact. *Kinerd* examines the requisites for holding a lease to be usurious, the proper measure of damages in DTPA and usury cases, and the unconscionability of a third-party lender greatly overcharging for equipment.

Mike Kinerd purchased equipment manufactured by Radiator Aid, Inc. Radiator Aid told Kinerd that he could buy the equipment directly from the manufacturer for cash or from Colonial Leasing Company (Colonial) under an arrangement involving payments over time. Kinerd elected the latter manner of acquisition, which is often called a third-party lease. Radiator Aid sold the equipment to Colonial for \$10,000, and Colonial entered into a lease agreement with Kinerd. The lease agreement obligated Kinerd to make 60 monthly payments to Colonial and forbade prepayment. In the

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1. 34 Tex. Sup. Ct. J. 92 (Nov. 14, 1990), *rev'g* 733 S.W.2d 671 (Tex. App.—Eastland 1987).

2. 33 Tex. Sup. Ct. J. 585 (June 20, 1990).

3. TEX. REV. CIV. STAT. ANN. arts. 5069-1.01 - 1.12 (Vernon 1987 & Vernon Supp. 1991).

4. TEX. BUS. & COM. CODE ANN. §§ 17.41 - .63 (Vernon 1987 & Vernon Supp. 1991).

event of a default, the lease required immediate payment of all remaining installments. After remitting all 60 payments, Kinerd obtained the right to purchase the equipment for \$1.00.

The jury found that the transaction between Kinerd and Colonial was a loan and that Colonial committed usury.⁵ The jury also found Colonial acted unconscionably by greatly overcharging Kinerd for the equipment.⁶ The Eastland court of appeals reversed, holding that no evidence existed to sustain the jury's findings on either the DTPA or usury claims.⁷

The Texas Supreme Court, in its original opinion of June 20, 1990, reviewed the three essential elements of a usurious transaction: (1) a loan of money; (2) an absolute obligation to repay principal; and (3) exaction of a greater compensation than allowed by law for the use of money.⁸ Finding evidence of each of these elements, the court reversed the court of appeals.⁹ In a substituted opinion issued on November 14, 1990, the supreme court came to the same conclusion, but traveled a different route to reach its decision. The substituted opinion eliminated the discussion and analysis of the essential elements of a usurious transaction, and instead, focused on Article 5069¹⁰ and the time-price differential doctrine.

Article 5069 controls the amount of interest that may be legally charged in Texas.¹¹ The statute consists of three subtitles: the first subtitle deals with loans, containing general provisions and definitions on interest,¹² and the remaining two subtitles pertain to the regulation of consumer loans, certain kinds of credit sales, and consumer protection.¹³ The supreme court noted that the court of appeals did not discuss Kinerd's judgment for usury penalties, except to hold that the transaction was not a retail installment sale subject to regulation under Subtitle Two—Consumer Credit.¹⁴ Chief Justice Phillips, writing for the court, agreed with this conclusion, but noted it failed to resolve the usury question.¹⁵

The court properly focused on Kinerd's claim that the transaction was subject to the provisions of Subtitle One, and Colonial's response that the usury statute does not apply because the transaction did not involve interest charges.¹⁶ The controlling issue, therefore, was whether Colonial's sale of the equipment to Kinerd was a credit sale for a time-price differential. If so, the transaction could not be usurious because the definition of interest in the

5. 34 Tex. Sup. Ct. J. at 93.

6. *Id.*

7. Colonial Leasing Co. v. Kinerd, 733 S.W.2d 671, 674 (Tex. App.—Eastland 1987), *rev'd* 34 Tex. Sup. Ct. J. 92 (Nov. 14, 1990).

8. Kinerd v. Colonial Leasing Co., 33 Tex. Sup. Ct. J. 585, 586 (June 20, 1990).

9. *Id.* at 587.

10. TEX. REV. CIV. STAT. ANN. art. 5069 (Vernon 1987 & Vernon Supp. 1991).

11. 34 Tex. Sup. Ct. J. at 93.

12. TEX. REV. CIV. STAT. ANN. arts. 5069-1.01 - 1.12 (Vernon 1987 & Vernon Supp. 1991) (Subtitle One-Interest).

13. *Id.*, arts. 5069-2.01 - 8.06 (Subtitle Two—Consumer Credit) and arts. 5069-9.01 - 51.17 (Subtitle Three—Consumer Protection).

14. 34 Tex. Sup. Ct. J. at 93.

15. *Id.*

16. *Id.*

first subtitle excludes "any time-price differential however denominated arising out of a credit sale."¹⁷

The Texas legislature has acted to regulate certain transactions involving time-price differentials.¹⁸ That legislation, however, is not applicable to the commercial sale of equipment.¹⁹ The court, therefore, applied the common law to determine whether the transaction between Kinerd and Colonial qualified as a bona fide credit sale under the time-price differential doctrine.²⁰

Application of the time-price doctrine requires proof of three elements: (1) the seller clearly offered to sell the goods for both a cash price and a credit or time price; (2) the purchaser was aware of the two offers; and (3) the purchaser knowingly chose the higher time price.²¹ Even when these elements exist, however, if a party presents evidence indicating the entire scheme is actually designed to avoid usury laws, a question of fact is raised for the jury.²² In the trial court the jury, following an instruction that correctly defined a time-price differential, answered that Colonial's profit on the resale of the equipment was not a time-price differential.²³ The jury further found that the transaction was a means for making a loan.²⁴ The loan principal was \$10,000 and Kinerd promised to repay \$16,909.20. Applying the jury's findings to the terms of the lease agreement, the trial court calculated that the agreement between Colonial and Kinerd incorporated a rate of interest more than twice that allowed by law;²⁵ Kinerd, consequently, was entitled to the statutory penalties for usury.²⁶

The supreme court also examined several important DTPA issues in *Kinerd*. First the court evaluated Colonial's liability under Section 17.50 of the DTPA for its own unconscionable conduct in grossly overcharging for the equipment.²⁷ The Eastland court of appeals, reversing the trial court DTPA judgment against Colonial, held that Colonial was not responsible for the actions or misrepresentations of Radiator Aid.²⁸ The court of appeals, however, did not discuss the unconscionability argument raised by Kinerd. The supreme court commented on the jury's findings that Colonial unconscionably overcharged Kinerd by selling the equipment for \$10,000, while

17. TEX. REV. CIV. STAT. ANN. art. 5069-1.01(a), (d) (Vernon 1987).

18. See, e.g., TEX. REV. CIV. STAT. ANN. arts. 5069-6.01(h) (Vernon 1987) (retail installment sales) and 5069-7.01(i) (Vernon 1987) (motor vehicle installment sales).

19. 34 Tex. Sup. Ct. J. at 94.

20. See *Rotello v. International Harvester Co.*, 624 S.W.2d 249, 250-51 (Tex. App.—Dallas 1981, writ ref'd n.r.e.).

21. 34 Tex. Sup. Ct. J. at 94.

22. See *Butler v. Holt Mach. Co.*, 741 S.W.2d 169, 173 (Tex. App.—San Antonio 1987, writ denied).

23. 34 Tex. Sup. Ct. J. at 94.

24. *Id.*

25. The lease provided for payment of 60 monthly installments of \$268.40 excluding taxes. Amortizing a principal of \$10,000 over this payment schedule results in an interest rate of 20.62%.

26. TEX. REV. CIV. STAT. ANN. art. 5069-1.06(1), (2) (Vernon 1987).

27. See TEX. BUS. & COM. CODE ANN. § 17.50(a)(3) (Vernon 1987).

28. 34 Tex. Sup. Ct. J. at 95.

the actual value of the goods received was only \$2,000.²⁹ The supreme court found some evidence to support the jury's findings and remanded Kinerd's DTPA claim to the court of appeals to consider Colonial's factual insufficiency contention.³⁰

Finally, the supreme court addressed the proper computation of damages in *Kinerd*. The court held that Kinerd's usury and DTPA claims covered different aspects of the transaction and the damages arising from the separate acts did not overlap.³¹ Colonial committed a deceptive trade practice when it sold the equipment and also charged a usurious rate of interest when it financed the sale.³²

II. ACCELERATION CLAUSES

Acceleration clauses continue to be a minefield of strict construction by the Texas courts. Two contrasting decisions concerning acceleration clauses reported during the survey period reflect the critical importance of careful drafting by counsel preparing the loan documents. In *Brookshire v. Longhorn Chevrolet Co.*³³ two automobile buyers brought a class action lawsuit for statutory penalties under the Consumer Credit Code³⁴ against the seller and the bank that provided installment financing. The consumers alleged that the acceleration clause in their retail installment contracts was usurious because the clause contained a contingency by which the lender could receive more than the lawful rate of interest. The acceleration clause provided that "[i]n the event of default the entire *unpaid balance of the Total of Payments* shall at the option of the seller become immediately due and payable."³⁵ The buyers argued, and the court agreed, that the clear language of the contract accelerated the unpaid balance of the Total of Payments. The clause was held to be usurious because it authorized the lender to collect unearned time-price differential, plus remaining interest, in the event of default.³⁶ The court noted that a similar acceleration clause was found usurious in *Commercial Credit Corp. v. Chasteen*³⁷ and that the appellees had failed to distinguish, or even discuss, that opinion in their brief.³⁸

In contrast, an acceleration clause with similar wording was found not

29. *Id.*

30. *Id.* See *Putnam v. Missouri Valley, Inc.*, 616 S.W.2d 930, 931 (Tex. 1981).

31. 34 Tex. Sup. Ct. J. at 95.

32. This analysis is proper and distinguishable from a decision reported in last year's survey, *Hardwick v. Austin Gallery of Oriental Rugs, Inc.*, 779 S.W.2d 438 (Tex. App.—Austin 1989, writ denied). Recovery of damages under both the DTPA and usury may be proper if the damages are for separate acts. Section 17.43 of the DTPA specifically allows cumulative recovery of DTPA penalties when penalties are awarded under another statute for different acts or practices. In *Hardwick* the court concluded the jury's findings referred simply to one act and its cause.

33. 788 S.W.2d 209 (Tex. App.—Ft. Worth 1990, no writ).

34. TEX. REV. CIV. STAT. ANN. arts. 5069-2.01 - 8.06 (Vernon 1987 & Vernon Supp. 1991).

35. 788 S.W.2d at 211 (emphasis in original).

36. *Id.* at 212.

37. 565 S.W.2d 342, 345 (Tex. Civ. App.—Ft. Worth 1978, writ ref'd n.r.e.).

38. 788 S.W.2d at 212.

usurious in *Myles v. Resolution Trust Corp.*³⁹ Myles brought an action against La Hacienda Savings and Loan Association to recover statutory penalties on several allegedly usurious notes. The language of the notes allowed acceleration of the note total upon default. The court, stressing the presumption of legality and reading the notes as a whole, found the default and acceleration language nonusurious.⁴⁰ The court commented that the directional and definitional sections in the notes affirmatively stated that interest accrued over the life of the loan.⁴¹ Also the court cited the savings clause and rebate clause as strengthening the nonusurious construction.⁴²

III. FORECLOSURES AND GUARANTEES

During the survey period two significant cases dealt with foreclosure and guaranty issues. As befits the times, in both cases the creditor was the Federal Deposit Insurance Corporation (FDIC).⁴³ The defendant in each case raised the defense of a breach of the duty of good faith. In both cases the FDIC won. Although one might suppose that these defendants were doomed⁴⁴ by the doctrine established in *D'Oench, Duhme & Co. v. FDIC*,⁴⁵ the doctrine is not mentioned. Rather the cases seem to open the door, ever so slightly, to the possibility of a successful defense to a collection suit brought by the FDIC.

In *FDIC v. Nobles* the Fifth Circuit Court of Appeals assumed, without deciding, that a duty of good faith to preserve the collateral exists.⁴⁶ The court further assumed, without explicitly saying, that the FDIC could be held to have violated such a duty in the appropriate case.⁴⁷ *Nobles*, however, was not such a case.

Nobles signed a continuing guaranty of all indebtedness owed by Swivelbar, Inc. to Western Bank of Midland, Texas (Western). Swivelbar executed a promissory note to Western on the same day and pledged all of its inventory and accounts receivable to Western as security. Western failed to perfect its security interest in the inventory and accounts receivable by omitting to file a financing statement. The FDIC, who acquired the note and the guaranty when it became the receiver for Western, also failed to file a financing statement before the inventory was seized by a judgment creditor and sold at a sheriff's sale.

When Swivelbar and *Nobles* defaulted on the note and the guaranty, respectively, the FDIC sued *Nobles*. The trial court, granting the motion for summary judgment filed by the FDIC, held that the guaranty itself pre-

39. 787 S.W.2d 616, 619 (Tex. App.—San Antonio 1990, no writ).

40. *Id.*

41. *Id.*

42. *Id.*

43. See *FDIC v. Nobles*, 901 F.2d 477 (5th Cir. 1990); *FDIC v. Coleman*, 795 S.W.2d 706 (Tex. 1990).

44. A pun is intended.

45. 315 U.S. 447 (1942).

46. 901 F.2d at 480.

47. *Id.*

cluded any good faith defense. The court stated further that the FDIC owed no such duty to Nobles.⁴⁸

Although guarantors or borrowers may find little solace, the case is significant upon consideration that the creditor was the FDIC. No mention of *D'Oench* is made in *Nobles*. Thus, one might infer that if such a good faith defense exists, *D'Oench* does not preclude it. Of course, this inference is speculation based on the lack of any reference to the dreaded *D'Oench* doctrine in the *Nobles* opinion. Borrower's and guarantor's counsel must look for solace wherever they can find it.

Three weeks after *Nobles*, the Texas Supreme Court closed the door a bit further. In *FDIC v. Coleman* the court rejected the idea that a duty of good faith or fair dealing obligates a secured creditor to foreclose its lien promptly after the debtor's default on the note.⁴⁹ The guarantor/defendants in *Coleman* alleged that the FDIC increased their liability on the guarantees by delaying foreclosure and sale of the property securing the note when the FDIC knew the market value of the property was declining.⁵⁰

The dissenting opinion of Justice Mauzy objected to the majority's characterization of the defendants' claim as one of good faith and fair dealing.⁵¹ Instead, Justice Mauzy noted that "[defendants] pled and argued this case on a theory of 'commercial reasonableness.'" ⁵² In fact, the characterization of the defense as one of good faith and fair dealing seems to be belied by the majority's own rejection of the defendants' UCC claim because the claim was not one of good faith but a lack of diligence.⁵³ Thus the majority apparently created a straw man to tear down rather than address the viable defense of commercial reasonableness raised by the defendants. In so doing, the court leaves open the possibility that a commercial reasonableness defense under the UCC might be available to guarantors and borrowers even when the FDIC is the secured creditor, notwithstanding *D'Oench*.

IV. LENDER LIABILITY

When *D'Oench* is raised by the FDIC or Federal Savings and Loan Insurance Corporation (FSLIC) in state court, even after the case is appealed, the doctrine bars all defenses and claims based on misrepresentations or actions not revealed in the bank's records.⁵⁴ The Dallas court of appeals rejected or distinguished one Houston court of appeals case⁵⁵ and three United States

48. *Id.* at 479.

49. 795 S.W.2d at 707.

50. *Id.* at 708.

51. *Id.* at 711.

52. *Id.*

53. *Id.* at 708. "[Defendants'] complaint in this case is not that the FDIC was dishonest, but that it was not diligent. The UCC does not require diligence for good faith." *Id.*

54. See *FSLIC v. T. F. Stone - Liberty Land Ass'n*, 787 S.W.2d 475, 482 (Tex. App.—Dallas 1990, writ granted); *FDIC/Manager Fund v. Larsen*, 793 S.W.2d 37, 42 (Tex. App.—Dallas 1990, writ granted).

55. *FSLIC v. Kennedy*, 732 S.W.2d 1 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).

Court of Appeals cases⁵⁶ in its opinion.⁵⁷ In *Stone* the FSLIC became the receiver for the insolvent defendant eighteen days after the trial court had entered its judgment, but the FSLIC did not raise the *D'Oench* defenses until twelve days after the judgment became final. In *Larsen* the FSLIC did not acquire the assets of the failed bank until more than a year after the trial court entered its judgment. Despite this important distinction, the court held that regardless of whether federal defenses were preserved for appeal, they can be raised if the judgment is appealable.⁵⁸ Since the supreme court granted writ of error in both of these cases, an open question remains as to when the *D'Oench* doctrine can be raised for the first time.

56. *Thurman v. FDIC*, 889 F.2d 1441 (5th Cir. 1989); *Olney Sav. & Loan Ass'n v. Trinity Banc Sav. Ass'n*, 885 F.2d 266 (5th Cir. 1989); *Grubb v. FDIC*, 868 F.2d 1151 (10th Cir. 1989). *Grubb* was called into doubt by *Rayman v. Peoples Sav. Corp.*, 735 F. Supp. 842 (N.D. Ill. 1990).

57. 787 S.W.2d at 481-85.

58. 793 S.W.2d at 42.

