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COMMERCIAL TRANSACTIONS

*James M. Wallace, Jr.**

This Article discusses significant cases reported and legislation enacted during the 1991 Survey period¹ involving issues arising under the Uniform Commercial Code as adopted in Texas.²

I. GENERAL PROVISIONS

A. *Determination by the Parties of the Standards of Performance*

IN *PPG Industries, Inc. v. Shell Oil Co.*³ the court reviewed a force majeure clause in an ethylene delivery contract. The clause excused either party from its obligations under the contract to the extent that performance was delayed or prevented by circumstances “reasonably beyond its control or by . . . explosion . . .” The clause thus made any explosion a force majeure event, including explosions within the control of a party.⁴ The court affirmed the district court’s order granting summary judgment in favor of the seller for excusable non-performance.⁵ The buyer argued that the force majeure clause contravened section 1.102(c) of the Code⁶ on the ground that the clause effectively waived the seller’s duties of good faith and diligence.⁷ Section 1.102(c) provides that parties may vary the effect of provisions of the Code by agreement, except as otherwise provided in the Code

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1. The 1991 Survey period generally covers cases reported and legislation enacted from November 1990 through October 1991.

2. TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1968 & 1991 & Supp. 1992) (hereinafter the Code).

3. 919 F.2d 17 (5th Cir. 1990).

4. While a clause of this type should not shield a party from the consequences of its intentional misconduct, it does appear to be intended to include explosions resulting from the negligence of either party. The district court noted that the seller would not intentionally blow up its refinery to escape its ethylene delivery obligation. See *PPG Industries, Inc. v. Shell Oil Co.*, 727 F.Supp. 285, 288 (E.D.La. 1989).

5. The court adopted the district court’s opinion but noted the district court’s failure to address the applicability of sections 2.615 and 1.102(c) of the Code to the force majeure clause at issue. 919 F.2d at 18. The court’s analysis of section 2.615 of the Code is discussed under the “Sales” portion of this article.

6. TEX. BUS. & COM. CODE ANN. § 1.102(c) (Tex. UCC) (Vernon 1968).

7. The buyer incorrectly asserted that section 1.102(c) of the Code creates or imposes these duties. Section 1.102(c) prevents obligations of good faith, diligence, reasonableness and care prescribed by other provisions of the Code from being disclaimed by agreement. See, for example, section 1.203 (duty of good faith), section 8.406(a)(1) (duty of transfer agent to exercise good faith and due diligence), section 9.504(c) (disposition of collateral must be commercially reasonable), and section 2.602(b)(2) (duty of buyer to hold rejected goods with reasonable care).

and except that the obligations of good faith, diligence, reasonableness and care prescribed by the Code may not be disclaimed by agreement. Section 1.102(c) further provides that "the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable."⁸ The court held that the force majeure clause at issue did not constitute a manifestly unreasonable standard of performance under section 1.102(c).⁹ It characterized the clause as the product of anticipation by and allocation of business risks between sophisticated parties.¹⁰

B. *Obligation of Good Faith*

Section 1.203 of the Code provides that "[e]very contract or duty within this title imposes an obligation of good faith in its performance or enforcement".¹¹ The court in *Schmueser v. Burkburnett Bank*¹² noted that, unlike the common law duty of good faith, the obligation imposed by section 1.203 does not require the existence of a special relationship between the parties.¹³ In *Schmueser* the sellers of a home sued the bank that issued a letter of credit in the sellers' favor for the account of the buyers. The letter of credit secured the buyers' obligations under a purchase money note. The surviving buyer defaulted on the note, and the sellers made demand on the bank for payment under the letter of credit. The bank refused the demand, and the sellers won a declaratory judgment against the bank in state court. After the bank paid all amounts due on the letter of credit pursuant to the state court judgment, the sellers brought this action for damages against the bank, asserting claims under state law for breach of the bank's duty of good faith and violations of the Texas Deceptive Trade Practices Act (DTPA).¹⁴ The basis for these claims was the sellers' allegation that the bank misled them regarding the financial condition of the surviving buyer in an attempt to avoid liability on the letter of credit. The court affirmed the district court's judgment in favor of the sellers on the breach of duty of good faith claim.¹⁵ The

8. The court incorrectly quotes this provision as permitting parties "to determine the standard [sic] by which the performance of [contractual obligations] is to be measured if such standards are not *manifestly unreasonable*". 919 F.2d at 19 (first emphasis added). Parties to a contract covered by the Code may set reasonable or unreasonable standards of performance for their respective obligations thereunder, except to the extent applicable Code provisions or general contract law limits this freedom of contract principle. Section 1.102(c) allows the parties to agree upon standards by which the performance of any applicable obligations of good faith, diligence, reasonableness and care as prescribed by the Code are to be measured, provided that the standards chosen are not manifestly unreasonable.

9. 919 F.2d at 19.

10. *Id.*

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

12. 937 F.2d 1025 (5th Cir. 1991).

13. *Id.* at 1032. The court cited *FDIC v. Coleman*, 795 S.W.2d 706, 708-09 (Tex. 1990), for the proposition that the common law duty of good faith requires the existence of a special relationship. For a summary of the *Coleman* case, see John Krahmer, *Commercial Transactions, Annual Survey of Texas Law*, 45 Sw. L.J. 119, 120-21 (1991).

14. TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon 1987 & Supp. 1992).

15. 937 F.2d at 1032. The court, however, also affirmed the district court's disallowance of damages awarded by the jury for this breach for damage to credit and loss of profits on the

court characterized the sellers' breach of duty of good faith claim as one sounding only in tort, because no contractual claim remained after satisfaction of the state court judgment.¹⁶ The court held that section 1.203 clearly applies to letters of credit since letters of credit fall within Title 1 of the Texas Business and Commerce Code.¹⁷

Section 1.208 of the Code¹⁸ limits a party's ability to exercise an option to accelerate payment or performance or to require collateral or additional collateral at will or when the party deems itself insecure. A party may accelerate based on such a provision only if the party in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the acceleration option has been exercised. In *American Bank of Waco v. Waco Airmotive, Inc.*¹⁹ the court held that sufficient evidence existed to support the jury's finding that the bank wrongfully offset a depositor's checking account balance against a promissory note obligation of the depositor to the bank, on the basis that the bank did not act in good faith in accelerating the maturity of the depositor's note to the bank (so that no matured obligation existed, a prerequisite to a right of offset).²⁰ The court held that the jury was entitled to compare the financial condition of the depositor at the time the note was signed to the depositor's financial condition at the time of acceleration (sufficient evidence existed to permit a conclusion that the depositor's financial condition had not deteriorated).²¹ Additional evidence existed that the bank officer misled the depositor about the bank's willingness to consider restructuring the loan and that the bank disregarded the concerns of its counsel about the legality of the offset.²²

ground that the damages were not supported by sufficient evidence. *Id.* at 1030. The court also agreed with the district court's conclusion that no DTPA claim existed because the sellers did not qualify as "consumers" under the DTPA. *Id.* at 1028-29.

16. 937 F.2d at 1029. The court stated that under Texas law "a breach of the duty of good faith and fair dealing will give rise to a cause of action in tort that is separate from any cause of action for breach of the underlying . . . contract." *Id.* (quoting *Viles v. Security Nat'l Ins. Co.*, 788 S.W.2d 566, 567 (Tex. 1990)).

17. 937 F.2d at 1032; see TEX. BUS. & COM. CODE ANN. ch. 5 (Tex. UCC) (Vernon 1968 and Supp. 1991). The court also noted that "at least one Texas court has indicated that the duty of good faith imposed by section 1.203 applied to letters of credit." 937 F.2d at 1032 (citing *Travis Bank & Trust v. State*, 660 S.W.2d 851, 852 n.1 (Tex. App.—Austin 1983, no writ)). The parties in the *Schmueser* case also stipulated before trial that the bank owed the sellers a duty of good faith under section 1.203. 937 F.2d at 1032. For the duty of an issuer of a letter of credit to honor a demand for payment, see section 5.114 of the Code. TEX. BUS. & COM. CODE ANN. § 5.114 (Tex. UCC) (Vernon 1968 & Supp. 1991).

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

19. 818 S.W.2d 163 (Tex. App.—Waco 1991, writ denied).

20. *Id.* at 170-73. The court, after engaging in a somewhat rambling discussion of the principles of wrongful offset and wrongful dishonor, remanded the case for a new trial based on errors made by the trial court in excluding certain testimony and evidence. *Id.* at 177-78.

21. *Id.* at 172.

22. *Id.* at 172-73. The bank officer made the offset, without warning, the day after he told the depositor that he would present the depositor's restructuring proposal to the bank's directors. The date of the offset was about two weeks after the note had been executed and about two and one-half months prior to the stated maturity date of the note.

C. *Choice of Law: the "Reasonable Relation" Test of Section 1.105*

Section 1.105(a) of the Code²³ allows the parties to choose to have the law of a state other than Texas govern their rights and duties if the transaction bears a reasonable relation to that state, unless the transaction falls within one of the specific areas listed in section 1.105(b).²⁴ In *Admiral Insurance Co. v. Brinkcraft Development, Ltd.*²⁵ the court upheld the enforceability of a clause in a promissory note that had the effect of making New York law applicable to a loan transaction that had both New York and Texas connections.²⁶ The note stipulated that it was to be governed by the laws of the state in which the original payee maintains its principal place of business. A separate provision in the note specified a New York address as the original payee's principal place of business. The transaction had the following additional New York contacts: (i) an individual general partner of the original payee was a New York resident; (ii) the other general partner of the original payee had its principal office in New York; (iii) the original payee's limited partnership certificate stated that its principal place of business was the New York office of its general partners; (iv) the note stipulated that payments were to be made at the original payee's New York office; (v) the original payee maintained its principal office at the same New York address since its formation; and (vi) the co-makers did in fact remit payments on the note to the original payee at its principal offices in New York. The court held that the New York contacts described in clauses (i), (ii), (iv), (v), and (vi) of the preceding sentence were sufficient to create a reasonable relationship to New York.²⁷ The court reached its decision notwithstanding the following facts: (i) the co-makers were a Texas resident and a Texas partnership with principal offices in Texas; (ii) the original payee was a Texas limited partnership; (iii) one of the general partners of the original payee was a Texas corporation; (iv) the note was negotiated and executed in Texas;²⁸ (v) the original

23. TEX. BUS. & COM. CODE ANN. § 1.105(a) (Tex. UCC) (Vernon 1968 and Supp. 1991). The full text of section 1.105(a) is as follows:

Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this title applies to transactions bearing an appropriate relation to this state.

24. TEX. BUS. & COM. CODE ANN. § 1.105(b) (Tex. UCC) (Vernon 1968 and Supp. 1991). The Code provisions listed in section 1.105(b) specifically address the law applicable to matters within their scope. The enforceability of a choice of law provision in a transaction not governed by the Code is determined by analyzing the transaction under section 187 of the Restatement (Second) of Conflict of Laws. See *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670 (Tex. 1990), cert. denied, 111 S.Ct. 755 (1991); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

25. 921 F.2d 591 (5th Cir. 1991).

26. After being sued for non-payment by the holder of the note, the co-makers filed an answer and counterclaim alleging that the note was usurious under Texas law. The co-makers apparently acknowledged that the note was not usurious under New York law. The co-makers also did not dispute that the note was a negotiable instrument governed by Chapter 3 of the Code. See TEX. BUS. & COM. CODE ANN. § 3.104 (Tex. UCC) (Vernon 1968).

27. 921 F.2d at 593-94.

28. The court ignored a provision in the note stating that the note is deemed to have been made in New York. *Id.* at 594.

payee's limited partnership certificate allowed it to redesignate its principal place of business; and (vi) the original payee's principal place of business may actually have been Texas rather than New York (the court deemed it unnecessary to decide this issue).²⁹

D. *Reservation of Rights with Respect to a "Full Payment" Check*

Section 1.207 of the Code allows a party to perform or assent to performance in a manner demanded or offered by the other party without prejudicing any rights explicitly reserved.³⁰ In *Robinson v. Garcia*³¹ the court held that section 1.207 (i) preempts the common law doctrine of accord and satisfaction³² and (ii) applies to the tender of a "full-payment" check³³ regardless of whether the transaction underlying the check is within the scope of the Code.³⁴ The plaintiffs in *Robinson* won a \$59,260,000 judgment against a bank, which they subsequently settled for \$10,000,000. A dispute existed between the plaintiffs and their attorney, the defendant in this case, over the amount of attorneys' fees payable to him.³⁵ The defendant received the settlement funds and tendered a check to the plaintiffs with the following language added as a restrictive endorsement: "acceptance in full and final settlement and in satisfaction of all claims Cause #C-1948-84-D (Our file #797-84R)." The plaintiffs added the following language prior to negotiating the check: "Except for disputed Attys fees and related claims Cause No. 87-35582." After cashing the check the plaintiffs sued the defendant for failing to distribute the settlement proceeds properly. The trial court granted

29. *Id.* at 593-94. In making its "reasonable relation" analysis, the court followed its opinion in *Woods-Tucker Leasing Corp. v. Hutcheson-Ingram Dev. Co.*, 642 F.2d 744 (5th Cir. 1981). The court also cited *Woods-Tucker* as foreclosing the co-makers' contentions that the transaction's contacts with New York were subterfuges designed to evade Texas usury law. The court quoted language from *Woods-Tucker* to the effect that the "contrivance exception" allows the court to disregard a choice of law provision that applies the law of a jurisdiction with no normal relation to the transaction. The court stated that the note's choice of law provision was not violative of Texas public policy (the court noted that at the time that it decided *Woods-Tucker*, no Texas case had invalidated a choice of law provision in a usury context on public policy grounds and that *Woods-Tucker* had not been undercut by any subsequent Texas cases). 921 F.2d at 594.

30. The full text of section 1.207 is as follows:

A party who with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as "without prejudice", "under protest" or the like are sufficient.

TEX. BUS. & COM. CODE ANN. § 1.207 (Tex. UCC) (Vernon 1968).

31. 804 S.W.2d 238 (Tex. App.—Corpus Christi), *writ denied per curiam*, 817 S.W.2d 59 (Tex. 1991).

32. *Id.* at 244-47.

33. The court uses this term to describe a check containing restrictive language intended to be binding on the payee if the payee cashes the check. *Id.* at 241 n.2. An example of language typically used to make a check a "full payment" check is "accepted in full payment of all amounts due and payable to payee."

34. *Id.* at 243.

35. The defendant claimed to be entitled to fifty percent plus expenses. The plaintiffs claimed that the defendant was entitled to thirty-seven and one-half percent plus expenses. The concurring opinion sets forth the facts forming the basis of the fee dispute. *Id.* at 249 (Nye, C.J., concurring).

the defendant's motion for summary judgment, which was based solely on his assertion that the plaintiff's claim was precluded as a matter of law because a common law accord and satisfaction had occurred between the parties.³⁶ The court of appeals reversed the summary judgment in favor of the defendant and remanded the case for trial on the merits.³⁷

The court criticized and rejected the holding of the Dallas court of appeals in *Hixson v. Cox*.³⁸ The court in *Hixson* held section 1.207 inapplicable to an explicit reservation of rights made by a creditor on a full payment check tendered by a debtor, apparently on the ground that the underlying transaction (*i.e.*, the transaction that gave rise to the right to payment) was not within the scope of the Code.³⁹ The court likewise criticized the Houston court of appeals' opinion in *Pileco, Inc. v. HCI, Inc.*⁴⁰ and its dictum in *Trevino v. Brookhill Capital Resources*.⁴¹ In *Pileco* the Houston court of appeals applied the accord and satisfaction doctrine in lieu of section 1.207 of the Code on the basis that section 1.207 did not displace the well-established doctrine of accord and satisfaction.⁴² In *Trevino* the accord and satisfaction doctrine was superseded by the existence of a fiduciary relationship between the parties, but the *Trevino* court took the opportunity to endorse both *Pileco* and *Hixson*.⁴³

The court rejected the *Hixson* court's narrow interpretation of section 1.207 as applicable only to transactions within the scope of Chapter 2 of the Code (Sales).⁴⁴ The court noted that Chapter 1 of the Code⁴⁵ establishes

36. 804 S.W.2d at 240.

37. *Id.* at 248.

38. 633 S.W.2d 330 (Tex. App.—Dallas 1982, writ ref'd n.r.e.). 804 S.W.2d at 243-44, 246. The court in *Hixson* held that an accord and satisfaction had occurred when the creditor negotiated the check, notwithstanding the creditor's marking through the debtor's restrictive endorsement and adding explicit language indicating that the check was accepted as part payment only and without prejudice to the creditor's right to demand full payment of the balance of the account. 633 S.W.2d at 331.

39. *Id.* at 331. The underlying transaction was the provision of engineering and related services. The court in *Hixson* observed that "none of [the Code chapters following Chapter 1] purport to deal with the engagement of personal services or with disputes over payment for such services." *Id.* The court further observed that "[n]o Texas case has applied § 1.207 to a check tendered in full settlement of a disputed account, whether the subject of the original dispute fell within one of the subjects of the code, or not." *Id.*

40. 735 S.W.2d 561 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

41. 782 S.W.2d 279 (Tex. App.—Houston [1st Dist.] 1989, writ denied). The court also noted that the Houston court of appeals applied the common law accord and satisfaction doctrine without any reference to section 1.207 in *Yelderman v. McCarthy*, 474 S.W.2d 781, 784 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.). 804 S.W.2d at 242 n.3. The court also commented on the Texarkana court of appeals' failure to consider the availability of section 1.207 in its discussion of the payee's option either to return a full payment check and sue the debtor for its full claim or to accept the check in full payment. *Id.* at 241, discussing *Roylex, Inc. v. S & B Engineers, Inc.*, 592 S.W.2d 59, 60 (Tex. Civ. App.—Texarkana 1979, no writ). The court observed that section 1.207 would not have applied had the Texarkana court considered it, since the payee failed to reserve its rights before cashing the check. 804 S.W.2d at 241.

42. 735 S.W.2d at 562-63.

43. 782 S.W.2d at 281.

44. 804 S.W.2d at 243; TEX. BUS. & COM. CODE ANN. ch. 2 (Tex. UCC) (Vernon 1968 and Supp. 1991).

45. TEX. BUS. & COM. CODE ANN. ch. 1 (Tex. UCC) (Vernon 1968 and Supp. 1991).

general rules applicable to all subsequent chapters of the Code and that section 1.207 does not contain any language limiting its application to specific transactions.⁴⁶ As the court observed, the negotiation and indorsement of and effect of payment of obligations by instruments are regulated by Chapter 3 of the Code (Commercial Paper),⁴⁷ so that the "tendering of a full payment check is a Code-covered transaction regardless of the nature of the underlying obligation."⁴⁸

The court also rejected the analysis of section 1.103 of the Code adopted by the *Pileco* court.⁴⁹ Section 1.103 embodies the recognition that the Code derives from the common law and is dependent upon the continued application of a large body of supplemental law except to the extent displaced by particular Code provisions.⁵⁰ Under the *Pileco* court's approach, however, that supplemental body of pre-Code or non-Code law would control over any conflicting Code provision unless the Code provision expressly stated that it displaces the particular common law principle in conflict. As the court in *Robinson* observed, such an interpretation of section 1.103 is inconsistent with the "liberal construction" mandate of section 1.102(a) of the Code and does not further the policies and purposes of the Code as stated in section 1.102(b) thereof.⁵¹

The court noted the reasoning of the *Hixson* court and those of other jurisdictions that since section 1.207 uses only the term "performance" it does not apply to a full payment check.⁵² It rejected that reasoning by noting that comment 1 to section 1.207 speaks of "delivery, acceptance, or payment".⁵³ The court reviewed the legislative history of the Code and found

46. 804 S.W.2d at 243.

47. TEX. BUS. & COM. CODE ANN. ch. 3 (Tex. UCC) (Vernon 1968 and Supp. 1991).

48. 804 S.W.2d at 243. The court also noted that the approach adopted by the *Hixson* court causes different results depending on the nature of the underlying transaction. *Id.* at 243. Restricting the applicability of section 1.207 in this context to checks tendered in payment for goods purchased appears to run counter to the stated purposes and policies of the Code and the rules of construction set forth in Chapter 1 thereof. *See* TEX. BUS. & COM. CODE ANN. §§ 1.102(a), (b) (Tex. UCC) (Vernon 1968).

49. 804 S.W.2d at 244-45. As noted by the court, the *Pileco* court relied primarily on a 1984 decision by Maine's highest court, *Stultz Elec. Works v. Marine Hydraulic Eng'g Co.*, 484 A.2d 1008 (Me. 1984). Section 1.103 provides that general principles of law and equity shall supplement the Code unless displaced by particular provisions of the Code. TEX. BUS. & COM. CODE ANN. § 1.103 (Tex. UCC) (Vernon 1968). Comment 1 to section 1.103 characterizes section 1.103 as indicating the continued applicability to commercial contracts of all supplemental bodies of law "except insofar as they are *explicitly* displaced by this Act" (emphasis added).

50. *See* James White & Robert Summers, Uniform Commercial Code §§ 2, 5 (3d ed. 1988).

51. 804 S.W.2d at 244. TEX. BUS. & COM. CODE ANN. §§ 1.102(a), (b) (Tex. UCC) (Vernon 1968).

52. 804 S.W.2d at 246.

53. TEX. BUS. & COM. CODE ANN. § 1.207 comment 1 (Tex. UCC) (Vernon 1968) (emphasis added). The court also rejected the public policy arguments by courts in some jurisdictions that application of section 1.207 to full payment checks would destroy a valuable settlement tool and overburden the judicial system. 804 S.W.2d at 246. The court notes, to the contrary, that equitable considerations support its interpretation of section 1.207, which eliminates the dilemma and forced election otherwise created by a full payment check. *Id.* at 247.

evidence that the protections afforded by section 1.207 were intended to allow a party to accept partial payment without giving up the right to demand the balance due.⁵⁴

The supreme court, in a *per curiam* opinion denying both parties' applications for writ of error, held that the court's judgment contained no reversible error, but that the court should not have reached the issue of whether section 1.207 abrogates the common law rule of accord and satisfaction since the plaintiffs neither raised the issue in the trial court nor briefed it on appeal.⁵⁵ The supreme court stated that it neither approves nor disapproves of the court of appeals' discussion or resolution of the issue.⁵⁶

II. SALES

A. Scope of Chapter 2

In *Morey v. Page*⁵⁷ the owner of a 1967 Bentley consigned it to a third party for resale. The terms of the consignment agreement authorized the sale of the Bentley only if the sale resulted in a net return of \$20,000 to the owner. The owner retained the original title to the vehicle. The consignee sold the Bentley the following month for \$9,000. The consignee did not disclose the owner's interest to the buyer, nor did he inform the owner of the sale. After the sale the consignee absconded with the \$9,000 paid by the buyer. The buyer sued the owner, asserting claims of breach of contract and deceptive trade practices and seeking an order compelling transfer of title to the buyer. The owner asserted counterclaims, including conversion, and sought a declaratory judgment that he owned the Bentley. The court affirmed the trial court's judgment in favor of the owner.⁵⁸ The court held that the Certificate of Title Act⁵⁹ controlled over section 2.403(b) of the Code.⁶⁰

54. 804 S.W.2d at 247.

55. *Garcia v. Robinson*, 817 S.W.2d 59 (Tex. 1991).

56. *Id.* at 60. The court of appeals in *Robinson* noted that the highest courts of other states are split on the issue (with a majority holding that section 1.207 does not preempt the accord and satisfaction doctrine) and that several states have local comments to section 1.207 expressly applying it to the full payment check situation. 804 S.W.2d at 245. Professors White and Summers support the applicability of section 1.207 of the Code to a reservation of rights on a full payment check. See James White & Robert Summers, *supra* note 50, § 13-24.

57. 802 S.W.2d 779 (Tex. App.—Dallas 1990, no writ).

58. *Id.* at 787.

59. TEX. REV. CIV. STAT. ANN. art. 6687-1 (Vernon 1977 & Supp. 1992), which provides:

No motor vehicle may be disposed of at a subsequent sale unless the owner designated in the certificate of title transfers the certificate of title, at the time the motor vehicle is transferred, on a form prescribed by the [State Highway] Department. . . . No title to any motor vehicle shall pass or vest until the transfer is so executed.

Id. § 33(a).

60. TEX. BUS. & COM. CODE ANN. § 2.403(b) (Tex. UCC) (Vernon 1968), which provides: "[a]ny entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in ordinary course of business." The owner did not dispute that the consignee was a merchant who dealt in automobiles like the Bentley or that the buyer purchased the car in the ordinary course of business. See *infra* note 65.

The court acknowledged the apparent conflict between section 33(a) of the Certificate of Title Act and section 2.403(b) of the Code, but claimed to have harmonized the two provisions in its opinion in *Pfluger v. Colquitt*.⁶¹ The court simply appears to have disregarded section 2.403(b). The owner clearly entrusted the vehicle to the consignee. Section 2.403(c) of the Code defines the term "entrusting" as including any delivery regardless of any condition expressed between the parties to the delivery.⁶² The court based its decision on its determination that the consignee did not have actual or apparent authority to sell the car for \$9,000.⁶³ In the court's view, this lack of authority rendered the sale something other than a transaction between buyer and seller.⁶⁴ Thus, the exception to mandatory compliance with the Certificate of Title Act (*i.e.*, that a transfer without compliance is effective as between the parties to the sale) did not apply.⁶⁵

In *Southwestern Bell Telephone Co. v. FDP Corp.*⁶⁶ FDP sued Southwestern Bell, on grounds of negligence and violation of the DTPA, for lost profits caused by Southwestern Bell's failure to include in the Yellow Pages an advertising display for which FDP had contracted. Prior to execution of the contract a representative of Southwestern Bell had given FDP oral assurance

61. 620 S.W.2d 739 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.). The court in *Pfluger* refused to apply section 65 of the Certificate of Title Act. See TEX. REV. CIV. STAT. ANN. art. 6687-1 § 65 (Vernon 1977). Section 65 provides that in case of a conflict between the Certificate of Title Act and the Code, the Code provisions shall control. The *Pfluger* court held that both statutes could be applied without conflict. 620 S.W.2d at 741. In *Morey* the court described its harmonizing analysis in *Pfluger* as follows:

[the provision in section 2.403(b)] that a merchant is empowered "to transfer all rights of the entruster" is intended to give the merchant the same power to transfer which the owner of the goods can exercise. [Accordingly,] if the owner of a vehicle has no power to dispose of the vehicle without a proper transfer of the certificate of title, then no merchant to whom the vehicle is entrusted has the power to dispose of the vehicle without a proper transfer of the certificate.

802 S.W.2d at 784. The court, however, undercuts its analysis by pointing out that "courts have held that the sale of a car without complying with the Certificate of Title Act is valid and effective as between the parties to the sale." *Id.* (citations omitted). In such a case, the buyer has the right to demand transfer of the certificate of title. *Id.* Applying the court's analysis, since the owner can in fact effectively transfer a vehicle without complying with the Certificate of Title Act, section 2.403(b) of the Code gives the merchant the same power. See TEX. CIV. STAT. ANN. art. 6687-1 (Vernon 1977 & Supp. 1992); TEX. BUS. & COM. CODE ANN. § 2.403(b) (Tex. UCC) (Vernon 1968). See *supra* notes 59-60. The concurring opinion in *Pfluger* sets forth a better reasoned analysis that a conflict does exist between the Code and the Certificate of Title Act and that section 2.403 of the Code should prevail to make the sale effective. 620 S.W.2d at 744-48 (Stephens, J., concurring).

62. TEX. BUS. & COM. CODE ANN. § 2.403(c) (Tex. UCC) (Vernon 1968). See also James White & Robert Summers, *supra* note 50, § 3-11 n.26 (listing cases vesting title in buyer in ordinary course free of original owner's ownership rights).

63. 802 S.W.2d at 784-85.

64. *Id.* at 785.

65. 802 S.W.2d at 784-85. The court failed to indicate what the sale by the consignee to the buyer was, if not a buyer-seller transaction. A more persuasive way to harmonize the Code and the Certificate of Title Act might be to argue that a buyer who buys at a price substantially below fair market value and fails to obtain a title certificate is either not acting in good faith or has knowledge that the sale violates a third-party's ownership rights, and therefore, is not a buyer in the ordinary course of business. See TEX. BUS. & COM. CODE ANN. § 1.201(9) (Tex. UCC) (Vernon Supp. 1992).

66. 811 S.W.2d 572 (Tex. 1991).

that FDP's advertisement would be published correctly. A jury found that Southwestern Bell breached an express warranty that it would publish FDP's display correctly, but found that FDP sustained no lost profits. The court of appeals remanded the case for a new trial. The supreme court held that Southwestern Bell made and breached an express warranty but that its liability was effectively limited by the terms of the contract to a refund of the purchase price.⁶⁷ The supreme court found that the warranty provisions of Chapter 2 of the Code did not explicitly govern this case because the sale of advertising is predominantly a service transaction rather than a sale of goods.⁶⁸ The court, however, looked to the warranty provisions of the Code for guidance.⁶⁹

In *McAdams v. Capitol Products Corp.*⁷⁰ the plaintiff brought breach of warranty claims against the manufacturer of a sliding glass door installed in the apartment in which the plaintiff's daughter had been raped and murdered. The plaintiff's claims were brought under the DTPA, although based, apparently, on warranties under Chapter 2 of the Code.⁷¹ The court held that the statute of limitations applicable to all actions brought under the DTPA, including actions based on breach of warranty, was the two-year period under section 17.565 of the DTPA.⁷² The court accordingly held that the statute of limitations provided by "the statute dealing generally with the underlying cause of action brought under the [DTPA]" did not govern.⁷³

67. *Id.* at 576-77.

68. See TEX. BUS. & COM. CODE ANN. § 2.102 (Tex. UCC) (Vernon 1968) (providing that Chapter 2 applies to transactions in goods).

69. The court did so on the basis that the Code essentially codified the common law of warranty. 811 S.W.2d at 575. In particular, the court relied on section 2.313(a)(1), which states that express warranties are created by an affirmation of fact or a promise by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain. TEX. BUS. & COM. CODE ANN. § 2.313(a)(1) (Tex. UCC) (Vernon 1968). In upholding the contractual limitation of liability, the court noted that the jury found that Southwestern Bell did not commit any of the "laundry list" violations under section 17.46(b) of the DTPA, so that the prohibition of waivers under section 17.42 of the DTPA did not apply. TEX. BUS. & COM. CODE ANN. §§ 17.42, .46 (Vernon 1987 & Supp. 1992). The court also noted that the DTPA does not create any warranties. The court cited sections 2.711(a) and 2.714 of the Code to emphasize that a cause of action for breach of warranty can exist independently of any cause of action for breach of contract. TEX. BUS. & COMM. CODE ANN. §§ 2.711(a), .714 (Tex. UCC) (Vernon 1968). The court looked to section 2.316 of the Code as evidence that warranties may be limited or disclaimed. TEX. BUS. & COM. CODE ANN. § 2.316 (Tex. UCC) (Vernon 1968 & Supp. 1992).

70. 810 S.W.2d 290 (Tex. App.—Fort Worth 1991, writ denied).

71. The DTPA creates causes of action, but not warranties. Consequently, the warranties must arise independently of the DTPA. See *La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 565 (Tex. 1984). The court's opinion in *McAdams* does not specifically identify the warranties that the plaintiff claimed were breached.

72. 810 S.W.2d at 292-93 (citing *Brooks Fashion Stores v. Northpark Nat'l Bank*, 689 S.W.2d 937, 943 (Tex. App.—Dallas 1985, no writ)). See TEX. BUS. & COM. CODE ANN. § 17.565 (Vernon 1987), which provides that all actions under the DTPA must be commenced within two years after occurrence of the act on which the claim is based or within two years after the consumer discovered or in the exercise of reasonable diligence should have discovered the act.

73. 810 S.W.2d at 293; see TEX. BUS. & COM. CODE ANN. § 2.725 (Tex. UCC) (Vernon 1968). The Code provides that a breach of contract action must be initiated within four years after the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach (the parties may by the original agreement shorten the limitations period to not less than one

B. Warranties

Section 2.313 (a) of the Code provides in part that:

(1) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(2) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.⁷⁴

In *Sweco, Inc. v. Continental Sulphur & Chemical*⁷⁵ the court held that an affirmation of fact need not have been made for the purpose of inducing the buyer to purchase the item to become part of the basis of the bargain (and therefore, an express warranty) under section 2.313.⁷⁶ The court was less clear in its views on whether reliance to any extent by the buyer on the seller's statements is required for the statements to become part of the basis of the bargain.⁷⁷

year). *Id.* §§ 2.725(a), (b). Section 2.725(b) additionally provides that "[a] breach of warranty occurs when tender of delivery is made." *Id.* § 2.725(b). The court did not address the issue of whether the trial court erred in sustaining the defendant's special exception that the plaintiff did not have a DTPA claim on the ground that she was not a "consumer," because the plaintiff failed to preserve the issue for review. The court determined that the statute of limitation periods under both section 2.725(a) of the Code (had it applied) and section 17.565 of the DTPA had expired. 810 S.W.2d at 293.

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

75. 808 S.W.2d 112 (Tex. App.—El Paso 1991, writ denied).

76. *Id.* at 115. The seller represented that its grinding mill would produce a certain amount of marketable product per hour. The grinding mill produced at only twenty-five percent of the promised rate, and the ground sulphur produced was not of a marketable quality. The court affirmed the trial court's award of damages in the amount of the purchase price of the grinding mill. *Id.* at 118. The court held that sufficient evidence existed for the jury to find that the value of the goods accepted was zero. *Id.*; see TEX. BUS. & COM. CODE ANN. § 2.714(b) (Tex. UCC) (Vernon 1968) (providing that "[t]he measure of damages for breach of warranty is the difference at the time and place of acceptance between the value of the goods accepted and the value they would have had if they had been as warranted . . ."). See also *Integrated Title Data Systems v. Dulaney*, 800 S.W.2d 336, 339-41 (Tex. App.—El Paso 1990, no writ) (upholding plaintiff's recovery of product's purchase price plus related labor costs in a DTPA breach of warranty action where product delivered had no market value). The court also awarded damages for loss of net profits and attorney's fees. 808 S.W.2d at 117-18.

77. The court noted that commentators have indicated that, given the uncertainty over the legal meaning of the Code's "basis of the bargain" standard, reliance may not be required to create an express warranty. 808 S.W.2d at 115-16. See Douglas Whitman, *Reliance as an Element in Product Misrepresentation Suits: A Reconsideration*, 35 Sw. L.J. 741, 750 (1981); James White and Robert Summers, *supra* note 50, § 9-5 (White and Summers note that the extent to which the Code has changed pre-Code reliance requirements "is thoroughly unclear"; they point out that, while the Code may have created a rebuttable presumption of reliance, plaintiffs who cannot establish some reliance will usually not prevail). The court found that the buyer in *Sweco* did rely on the seller's representations about the production rate of the grinding mill, but the court did not state the extent to which this reliance influenced its finding that an express warranty was created. 808 S.W.2d at 116. The court also discussed comment 3 to section 2.313, which provides that a seller's affirmations of fact about goods are considered to be part of the description of the goods, so that "no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement." *Id.* at 115; see TEX. BUS. & COM. CODE ANN. § 2.313 comment 3 (Tex. UCC) (Vernon 1968) (this comment also suggests, however, that this presumption of reliance is rebuttable).

In *Haney v. Purcell Co.*⁷⁸ the court held that the trial court did not err in refusing to submit to the jury the plaintiffs' questions on breach of implied warranty of merchantability. The basis of the plaintiffs' complaint in *Haney* was the defendant's sale to the plaintiffs of a house containing undisclosed graves in the backyard. The court of appeals held that the implied warranty of merchantability applies only to transactions involving goods, which does not encompass the construction and sale of a house.⁷⁹

In *Keith v. Stoelting, Inc.*⁸⁰ a terminated employee sued the manufacturer of a polygraph machine. The employee had been fired after failing a polygraph test. In a *per curiam* opinion, the court rejected the employee's claim of breach of express warranty on the ground that such claims require direct privity.⁸¹ The court also rejected the employee's claims of breach of implied warranties of merchantability and fitness for intended purpose.⁸² The court noted that in situations involving personal injury Texas courts have extended the benefits of the implied warranty provisions of the Code to persons with only horizontal privity with the seller or supplier of the defective product.⁸³ The court concluded that it could not find any support under Texas law for allowing someone lacking vertical privity with the seller to maintain a cause of action for economic loss based on breach of implied warranty under the Code.⁸⁴

78. 796 S.W.2d 782 (Tex. App.—Houston [1st Dist.] 1990, writ denied). The supreme court's earlier opinion (770 S.W.2d 566 (Tex. 1989)) remanding this case to the court of appeals is discussed in the 1989 Survey. See John Krahmer, *Commercial Transactions, Annual Survey of Texas Law*, 44 Sw. L.J. 171, 176-77 (1990).

79. 796 S.W.2d at 786 (citing *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392, 394 (Tex. 1982), *overruled on other grounds by Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987). See TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1968) (implied warranty of merchantability). The definition of "goods" is contained in section 2.105 of the Code. TEX. BUS. & COM. CODE ANN. § 2.105 (Tex. UCC) (Vernon 1968).

80. 915 F.2d 996 (5th Cir. 1990).

81. *Id.* at 999 (citing *Texas Processed Plastics, Inc. v. Gray Enterprises, Inc.*, 592 S.W.2d 412 (Tex. Civ. App.—Tyler 1979, no writ)). *But see Indust-Ri-Chem Lab., Inc. v. Par-Pak Co.*, 602 S.W.2d 282, 287-88 (Tex. Civ. App.—Dallas 1980, no writ) (privity not required to maintain breach of express warranty action where manufacturer induces the purchase by furnishing samples to a middleman knowing that middleman will use the samples to induce sales of the product). Direct privity (*i.e.*, privity of contract) would have been present if the plaintiff had purchased the polygraph machine from the manufacturer. See TEX. BUS. & COM. CODE ANN. § 2.313 (Tex. UCC) (Vernon 1968). The Texas legislature expressly left the issue of privity to the courts for determination. See TEX. BUS. & COM. CODE ANN. § 2.318 (Tex. UCC) (Vernon 1968).

82. 915 F.2d at 999. Although the court's opinion does not indicate, presumably the employee was relying on sections 2.314 and 2.315 of the Code. See TEX. BUS. & COM. CODE ANN. §§ 2.314, .315 (Tex. UCC) (Vernon 1968).

83. 915 F.2d at 999 (citing *Garcia v. Texas Instruments, Inc.*, 610 S.W.2d 456 (Tex. 1980) (personal injury case)). Horizontal privity exists between the original supplier and a non-purchasing party affected by the product. 915 F.2d at 999.

84. 915 F.2d at 999. The court's opinion on this point is somewhat garbled, but this statement is a fair condensation of its holding. Vertical privity is privity that "includes all parties in the distribution chain from the initial supplier of the product to the ultimate purchaser." *Garcia*, 610 S.W.2d at 463. The court distinguished *Nobility Homes of Texas, Inc. v. Shivers*, 577 S.W.2d 77 (Tex. 1977) as a case involving vertical privity. *Keith*, 915 F.2d at 999. Although the facts in *Nobility Homes* involved vertical privity (purchaser of a mobile home from a dealer sued the manufacturer) the court did not distinguish horizontal privity. The court stated "we hold that privity is not a requirement for a Uniform Commercial Code im-

In *Jeep Eagle Sales Corp. v. Mack Massey Motors, Inc.*⁸⁵ the buyer of a Jeep Cherokee sport/utility vehicle sued the selling dealer and the manufacturer after the vehicle proved to be totally unsatisfactory for the buyer's intended purpose of towing an Airstream trailer. The Cherokee had a towing capacity of 5,000 pounds, while the Airstream trailer had a 5,800-pound gross vehicle weight rating. Prior to the buyer's purchase of the Cherokee, the sales manager for the dealer investigated the Airstream specifications and represented to the buyer that the Cherokee was suitable to tow the trailer and recommended that the buyer purchase the Cherokee. The court held that the manufacturer did not breach an implied warranty of merchantability⁸⁶ but affirmed the trial court's judgment against the dealer for violation of the DTPA and for breach of implied warranty of fitness under section 2.315 of the Code.⁸⁷ The court upheld the trial court's finding that the dealer's implied warranty of fitness had not been disclaimed, despite a statement on the purchase order that there were no dealer warranties.⁸⁸ The court noted that (i) no evidence was presented that the buyer was aware of the disclaimer, (ii) the trial court did not make a finding that the disclaimer was conspicuous as a matter of law, and (iii) the jury's finding that the dealer engaged in unconscionable action or course of action rendered the warranty disclaimer unenforceable in any event.⁸⁹

C. Terms

*Douglas Electronics, Inc. v. Pinnacle Systems, Inc.*⁹⁰ involved an action by a seller of electronic parts on a sworn account and a counterclaim by the buyer for usury. The court affirmed the trial court's finding that the seller had charged usurious interest by sending a letter to the buyer stating that "[e]ffective immediately, we will begin applying the 1.5% per month service

plied warranty action for economic loss." 557 S.W.2d at 81 (emphasis added). The court in *Nobility Homes* noted that the knowledge requirement under section 2.315 of the Code (implied warranty of fitness for a particular purpose) protects a manufacturer from unlimited and unforeseeable liability. 557 S.W.2d at 82-83. See TEX. BUS. & COM. CODE ANN. § 2.315 (Tex. UCC) (Vernon 1968). *Nobility Homes* can be interpreted as supporting the proposition that a consumer with only horizontal privity can maintain an action against a manufacturer for breach of the implied warranty of merchantability under section 2.314 of the Code. See TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1968).

85. 814 S.W.2d 167 (Tex. App.—El Paso 1991, no writ).

86. See TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1968).

87. 814 S.W.2d at 174-78; see TEX. BUS. & COM. CODE ANN. § 2.315 (Tex. UCC) (Vernon 1968), which provides:

Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose.

Section 2.316 provides that "to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous." TEX. BUS. & COM. CODE ANN. § 2.316(b) (Tex. UCC) (Vernon 1968 & Supp. 1992).

88. 814 S.W.2d at 175.

89. *Id.* On this latter point the court cited *Tri-Continental Leasing Corp. v. Law Office of Richard W. Burns*, 710 S.W.2d 604 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

90. 805 S.W.2d 852 (Tex. App.—Corpus Christi 1991, no writ).

charge on all uncontested account balances over 45 days old"⁹¹ and by including this charge on a past-due invoice sent to the buyer.⁹² The court held that sufficient evidence supported the trial court's finding that the parties had no agreement regarding the payment of any interest.⁹³ The court rejected the seller's contention that the trial court erred in not applying section 2.207 of the Code,⁹⁴ holding that section 2.207 applies "when there is an agreement, either express or implied, to pay a certain monthly interest."⁹⁵ Section 2.207(b) sets forth circumstances in which terms in addition to or different from those offered or agreed upon become part of the contract. These additional or different terms are contained in an acceptance of an offer or in a written confirmation of an agreement and are initially construed under section 2.207(a) as proposals for additions to the contract.

In *Permian Petroleum Co. v. Petroleos Mexicanos*⁹⁶ the court found that a provision for interest on past-due account balances, which the seller stamped on invoices sent to the buyer, became part of the contract under section 2.207(b) of the Code in a situation in which the course of dealing between the parties was as follows: the buyer sent orders by telex, and the seller delivered the goods (in this case, liquified petroleum gas) with invoices containing the stamped-on interest provision, to which the buyer never objected.⁹⁷

In *OKC Corp. v. UPG, Inc.*⁹⁸ OKC and UPG were parties to an agreement under which UPG delivered crude oil to OKC's refinery. OKC later sold its refinery and assigned the crude oil agreement to the buyer of the refinery. UPG continued delivering crude oil until the buyer failed to pay for a delivery. UPG sued OKC, contending that since OKC had merely assigned the

91. *Id.* at 856.

92. *Id.* at 856-58. The 18% per annum rate was more than double the statutory 6% rate allowed in the absence of an agreement between the parties. See TEX. REV. CIV. STAT. ANN. art. 5069-1.03 (Vernon 1987).

93. 805 S.W.2d at 857-58.

94. TEX. BUS. & COM. CODE ANN. § 2.207 (Tex. UCC) (Vernon 1968).

95. 805 S.W.2d at 857 (citing *Preston Farm & Ranch Supply, Inc. v. Bio-zyme Enter.*, 625 S.W.2d 295, 298-99 (Tex. 1981)). *Preston Farm* does not stand for the proposition for which it is cited by the court in *Douglas Electronics*. In *Douglas Electronics* the seller's attempt to invoke section 2.207 was misplaced, but the court's analysis of section 2.207 is also somewhat puzzling. If the parties had an agreement that the buyer would pay a certain monthly interest on past-due account balances, application of section 2.207 to add an interest clause to the parties' contract would not be necessary. Comment 5 to section 2.207 recognizes that a clause (contained in a party's acceptance or confirmation) providing for interest on overdue invoices can be incorporated into the contract pursuant to section 2.207(b). In *Douglas Electronics*, however, the interest charge was not part of the seller's offer to sell the goods or its acceptance of the buyer's offer to purchase the goods. Instead, the seller attempted to impose the charge after it had sold and delivered the goods to the buyer and after the buyer failed to pay on the initial invoice. In *Preston Farm* the supreme court held that "the process of acceptance and confirmation to which section 2.207 is addressed stops short of a monthly statement sent after the goods have been shipped." 625 S.W.2d at 299-300. In *Preston Farm* the buyer was held to have accepted the interest charges shown on the monthly statements due to his conduct in continuing to make purchases and payments with knowledge of the charges. *Id.* at 300.

96. 934 F.2d 635 (5th Cir. 1991).

97. *Id.* at 654.

98. 798 S.W.2d 300 (Tex. App.—Dallas 1990, writ denied).

agreement, it remained secondarily liable for a breach. OKC argued that since the agreement contained no quantity term it was not an enforceable contract. The court noted that an agreement silent on the issue of quantity is generally not enforceable.⁹⁹ It also noted that the Code does not provide any gap-filler provisions to supply a missing quantity term.¹⁰⁰ The court, however, relying on sections 2.201(c)(3) and 2.204(c) of the Code,¹⁰¹ held that the contract was enforceable to the extent of the crude oil actually received and accepted by the buyer.¹⁰²

D. Damages

Section 2.710 of the Code provides that an aggrieved seller's incidental damages include any commercially reasonable charges or expenses resulting from the buyer's breach.¹⁰³ Under Texas law "actual interest expenses on money borrowed by the seller to finance the subject matter of the contract, incurred after and as a result of the buyer's breach, are incidental damages under section 2.710."¹⁰⁴ In *Permian Petroleum Co. v. Petroleos Mexicanos*¹⁰⁵ the contract between the parties specified an interest rate that would accrue on late payments. The buyer argued that awarding both contract interest and incidental damages under section 2.710 would overcompensate the seller. The court agreed, holding that the seller was not entitled to incidental damages for accrued financing charges since the contract interest provision addressed that aspect of damages.¹⁰⁶

In *Baker v. International Record Syndicate, Inc.*¹⁰⁷ the court upheld a liquidated damages provision printed on an invoice. In *Baker* a photographer was hired to take photographs of the musical group Timbuk-3. He sent 37 negatives to the group's agent. The agent returned them in a damaged condition (holes had been punched in 34 of the negatives). The trial court refused to enforce the provision printed on the photographer's invoice that stated that "[r]eimbursement for loss or damage shall be determined by a photograph's reasonable value which shall be no less than \$1500 per trans-

99. *Id.* at 305.

100. *Id.* The court cited gap-filler Code sections that supply missing terms for price and for place and time of delivery and payment. See TEX. BUS. & COM. CODE ANN. §§ 2.305, .308-.310 (Tex. UCC) (Vernon 1968).

101. TEX. BUS. & COM. CODE ANN. §§ 2.201(c)(3), .204(c) (Tex. UCC) (Vernon 1968). Section 2.201(c)(3) provides that an otherwise valid contract is enforceable, despite lack of a sufficient writing, with respect to goods that have been received and accepted. *Id.* § 2.201(c)(3). Section 2.204(c) provides that a contract for sale does not fail for indefiniteness even though one or more terms are left open if the parties intended to make a contract and a reasonably certain basis exists for granting a remedy. *Id.* § 2.204(c).

102. 798 S.W.2d at 305.

103. TEX. BUS. & COM. CODE ANN. § 2.710 (Tex. UCC) (Vernon 1968).

104. *Gray v. West*, 608 S.W.2d 771, 781 (Tex. Civ. App.—Amarillo 1980, writ ref'd n.r.e.).

105. 934 F.2d 635 (5th Cir. 1991).

106. *Id.* at 654. The court cited *Gray v. West*, 608 S.W.2d 771. The court observed that, had the buyer timely paid the amount due to the seller, the seller could have used that amount either to pay off financing charges accruing on its inventory or to earn income, but not both. 934 F.2d at 654.

107. 812 S.W.2d 53 (Tex. App.—Dallas 1991, no writ).

parency."¹⁰⁸ Instead, the trial court entered judgment for the photographer on the jury's finding of \$15,000 of actual damages. The court of appeals noted that the determination of whether a contractual clause is enforceable as a liquidated damages provision or void as a penalty is a question of law.¹⁰⁹ The court looked to section 2.718(a) of the Code.¹¹⁰ The court, in holding that \$1500 per negative was not an unreasonable estimate of actual damages, noted that the photographer had sold other photographs at varying prices (\$125—\$500) and that at least one photograph taken five years earlier had produced \$1500 in income as a result of sales of reproductions. In addition, the court noted that the music group's potential for fame was an important factor in the valuation of the negatives and that this potential was unknown at the time that the photographs were taken.¹¹¹

E. Miscellaneous

In *Richter v. Bank of America National Trust & Savings Ass'n*¹¹² the court held that a bank's foreclosure on the winery assets of its borrower did not obligate the bank to perform the borrower's contractual obligations to a third party.¹¹³ All amounts payable to the borrower under the contract had been assigned and were to be paid directly to the bank pursuant to the bank's security agreement.¹¹⁴ The court, relying on section 2.210(d) of the Code¹¹⁵ and comment 5 thereto, concluded that under Texas law an "assignment of security" does not obligate the assignee creditor to perform the assignor's duties.¹¹⁶

In *PPG Industries*¹¹⁷ the court rejected the buyer's argument that section

108. *Id.* at 54-55.

109. *Id.* at 55. The court apparently assumed that the liquidated damages provision was part of the parties' contract. It did not consider the applicability of section 2.207 of the Code. See the discussion of *Douglas Electronics and Permian Petroleum*, *supra* notes 90-97 and accompanying text.

110. TEX. BUS. & COM. CODE ANN. § 2.718(a) (Tex. UCC) (Vernon 1968), which states that:

Damages for breach by either party may be liquidated in the agreement but only at an amount which is reasonable in 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.

The court also cited Texas case law on the issue of the enforceability of a liquidated damages provision. 812 S.W.2d at 55. The court did not indicate whether it viewed this case as predominantly a sale of goods under the Code or a service transaction governed by common law.

111. 812 S.W.2d at 55.

112. 939 F.2d 1176 (5th Cir. 1991).

113. *Id.* at 1191.

114. *Id.*

115. TEX. BUS. & COM. CODE ANN. § 2.210(d) (Tex. UCC) (Vernon 1968). Section 2.210(d) provides that general language assigning a contract or all the assignor's rights under a contract "is an assignment of rights and, unless the language or the circumstances (as in an assignment for security) indicate to the contrary, it is a delegation of performance of the duties of the assignor" *Id.*

116. 939 F.2d at 1191.

117. 919 F.2d 17 (5th Cir. 1990).

2.615 of the Code¹¹⁸ imposes, as a matter of law, a requirement that all force majeure events be beyond the parties' reasonable control.¹¹⁹ According to the court, a plain reading of comment 8 to section 2.615 reveals that the only limitation is "mercantile sense and reason."¹²⁰ The court declined to substitute its mercantile sense and reason for that of the two sophisticated parties to the suit.¹²¹

Section 2.607(c) of the Code requires a buyer who has accepted a tender of goods to notify the seller of a breach within a reasonable time after the buyer discovers or should have discovered the breach.¹²² Failure timely to notify the seller of a breach bars the buyer from any remedy.¹²³ In *Leggett v. Brinson*¹²⁴ the court held that sufficient evidence existed to support the conclusion that the buyer had given the seller of a refrigerator sufficient opportunity to repair a broken ice maker.¹²⁵ Both the seller's agent and the manufacturer's service agent had attempted, unsuccessfully, to repair the ice maker. After the buyer filed a DTPA suit, the seller took a new unit to the buyer's home for installation but was refused admittance. The court cited section 2.607(c)(1) for the proposition that "a buyer is required to notify a seller that a breach of warranty has occurred in order to allow the seller an

118. TEX. BUS. & COM. CODE ANN. § 2.615(1) (Tex. UCC) (Vernon 1968). Section 2.615 provides, in part, that "non-delivery in whole or in part by a seller . . . is not a breach of his duty under a contract for sale if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made . . ." *Id.*

119. 919 F.2d at 19.

120. *Id.* Comment 8 provides, in part, as follows:

Generally, express agreements as to exemptions designed to enlarge upon or supplant the provisions of [section 2.615] are to be read in the light of mercantile sense and reason, for [section 2.615] sets up the commercial standard for normal and reasonable interpretation and provides a minimum beyond which agreement may not go.

TEX. BUS. & COM. CODE ANN. § 2.615 comment 8 (Tex. UCC) (Vernon 1968).

The court found uncontrolling its dictum in *Nissho-Iwai Co., Ltd. v. Occidental Crude Sales Inc.*, 729 F.2d 1530 (5th Cir. 1984), that section 2.615 probably would require application of a "reasonable control" exception to force majeure clauses. *PPG Industries*, 919 F.2d at 19. The court also expressly rejected a commentator's suggestion that section 2.615 imposes a non-alterable standard governing the interpretation of exemption clauses. *Id.* See *Hawkland, The Energy Crisis and § 2.615 of the Uniform Commercial Code*, 79 COM. L.J. 75, 79 (1974). The portion of comment 8 to section 2.615 that indicates that the performance exemption standard set up by section 2.615 "provides a minimum beyond which agreement may not go" is not supported by the text of section 2.615 and contravenes section 1.102(c) of the Code (which provides that the provisions of the Code may be varied by agreement except as otherwise provided in the Code). TEX. BUS. & COM. CODE ANN. § 1.102(c) (Tex. UCC) (Vernon 1968). Section 2.615 is intended to cover situations in which the seller's performance has been rendered impracticable by unforeseen intervening circumstances not contemplated by the parties at the time of contracting. See TEX. BUS. & COM. CODE ANN. § 2.615 comment 1 (Tex. UCC) (Vernon 1968). In *PPG Industries* the parties did foresee the possibility that an explosion could occur, and they allocated that risk to the buyer. Section 2.615 is inapplicable in that situation.

121. 919 F.2d at 19.

122. TEX. BUS. & COM. CODE ANN. § 2.607(c) (Tex. UCC) (Vernon 1968).

123. *Id.* § 2.607(c)(1).

124. 817 S.W.2d 154 (Tex. App.—El Paso 1991, no writ).

125. *Id.* at 158.

opportunity to cure the defect, if any."¹²⁶ Section 2.607(c)(1) requires the buyer timely to notify the seller of a breach, but it does not give the seller any cure rights.¹²⁷ Comment 4 to section 2.607 indicates that the purpose of the notification requirement is to open "the way for normal settlement through negotiation."¹²⁸

III. COMMERCIAL PAPER

A. Waiver of Notice of Intent to Accelerate

In *Shumway v. Horizon Credit Corp.*¹²⁹ the supreme court held that language in promissory notes waiving demand or presentment and notice or notice of acceleration is effective to waive presentment and notice of acceleration but not notice of intent to accelerate.¹³⁰ In *Shumway* the note stated that upon default by the borrower the lender could require that all unpaid principal and accrued interest "be paid at once without prior notice or demand."¹³¹ The lender did not dispute that it had not made demand on the borrower for payment prior to acceleration and had not given the borrower notice of intent to accelerate or notice of acceleration. The sole issue before the court was whether the waiver provision in the note was effective to waive the borrower's rights of presentment, notice of intent to accelerate, and notice of acceleration.¹³²

The court noted that demand on the maker of a promissory note for payment is called "presentment" under the Code.¹³³ It also noted the general rule that the Code does not require presentment to a maker or other party primarily liable on the note.¹³⁴ The court cited its prior decisions that recognized the following common law exception to this general rule: unless waived,¹³⁵ presentment to the maker of a note, notice of intent to accelerate and notice of acceleration are required prior to acceleration by the holder of

126. *Id.* The court also cited *Miller v. Spencer*, 732 S.W.2d 758 (Tex. App.—Dallas 1987, no writ) for this proposition. 817 S.W.2d at 158. The court in *Miller* stated in dictum that section 2.607(c)(1) of the Code requires the buyer to notify the seller that a breach of warranty has occurred and to give the seller an opportunity to cure. 732 S.W.2d at 760-61.

127. Compare section 2.508 of the Code, which does give the seller in certain circumstances a right to cure after a rejection by the buyer of non-conforming goods. TEX. BUS. & COM. CODE ANN. § 2.508 (Tex. UCC) (Vernon 1968).

128. *Id.* § 2.607 comment 4. See also James White & Robert Summers, *supra* note 50, § 11-10.

129. 801 S.W.2d 890 (Tex. 1991).

130. *Id.* at 893-94.

131. *Id.* at 892.

132. *Id.*

133. *Id.* at 892. See TEX. BUS. & COM. CODE ANN. § 3.504(a) (Tex. UCC) (Vernon 1968) ("Presentment is a demand for acceptance or payment made upon the maker, acceptor, drawee or other payor by or on behalf of the holder").

134. 801 S.W.2d at 892. The court cited section 3.501 of the Code. TEX. BUS. & COM. CODE ANN. § 3.501 (Tex. UCC) (Vernon 1968 & Supp. 1992). Section 3.501(a) sets out the circumstances in which presentment is necessary to charge a *secondary* party (*i.e.*, a drawer or indorser). Comment 1 to section 3.501 indicates that section 3.501 contains all provisions pertaining to when presentment for payment is necessary.

135. See TEX. BUS. & COM. CODE ANN. § 3.511(b)(1) (Tex. UCC) (Vernon 1968). Section 3.511(b)(1), which was cited by the court, provides that: "Presentment or notice or protest as

the time for any payment due on the note.¹³⁶ The court held that, to be effective, waivers of presentment, notice of intent to accelerate and notice of acceleration must be clear and unequivocal.¹³⁷ The court stated that “[t]he harshness of the option of accelerating the maturity of an extended obligation requires both a strict reading of the terms of the option and notice to the debtor.”¹³⁸

The court interpreted the “clear and unequivocal” standard to mean that “a waiver provision must state specifically and separately the rights surrendered.”¹³⁹ The court emphasized that notice of intent to accelerate is a right separate from notice of acceleration, and it held that waiver of “notice” or “all notice” or “any notice whatsoever” does not clearly and unequivocally indicate that the borrower intended to waive both notice of acceleration and notice of intent to accelerate.¹⁴⁰ The court’s reasoning on this latter point was that the language does not put the borrower on notice that he has the right to notice of intent to accelerate.¹⁴¹ The court held that a waiver of “notice of intent to accelerate” is effective to waive that right, and it expressly disapproved seven courts of appeals cases that held more general waivers of notice effective to waive notice of intent to accelerate.¹⁴²

Justice Mauzy wrote a concurring opinion in which he characterized as mere dicta the general discussion in the majority opinion of the enforceability of various waiver provisions.¹⁴³ He further opined that he would hold that “the contractual waiver of the maker’s right to demand for payment, notice of intent to accelerate and notice of acceleration is void as against public policy and therefore unenforceable.”¹⁴⁴ Mauzy stated that commercial lending practices have revealed that borrowers rarely read or understand these boilerplate waiver provisions, and that even if they do, they have no power to delete or modify them.¹⁴⁵ He argued that equity demands that a maker always have a meaningful opportunity to cure any default before the lender is permitted to accelerate the note, dispose of the collateral, and sue

the case may be is entirely excused when the party to be charged has waived it expressly or by implication either before or after it is due.” *Id.*

The notice referred to in section 3.511 is notice of dishonor, not notice of acceleration or intent to accelerate. The court, citing *Sydnor v. Gascoigne*, 11 Tex. 449, 456 (1854), *Ogden v. Gibraltar Sav. Ass’n*, 640 S.W.2d 232, 233 (Tex. 1982), and a plethora of Texas courts of appeals decisions, indicated that it is well established under Texas law that parties to a promissory note can waive presentment and notice of intent to accelerate and notice of acceleration. 801 S.W.2d at 892-93.

136. 801 S.W.2d at 892 (citing *Ogden*, 640 S.W.2d at 233; *Allen Sales & Servicenter v. Ryan*, 525 S.W.2d 863, 865 (Tex. 1975); *Faulk v. Futch*, 147 Tex. 253, 214 S.W.2d 614, 616-17 (1948)).

137. 801 S.W.2d at 893 (citing *Ogden*, 640 S.W.2d at 234; *Ramo, Inc. v. English*, 500 S.W.2d 461, 466 (Tex. 1973)).

138. 801 S.W.2d at 893.

139. *Id.*

140. *Id.* at 894.

141. *Id.* at 894 n.7. The court stated that a general waiver of notice is adequate to waive notice of acceleration since the waiver relates to the right of acceleration in the note. *Id.*

142. *Id.* at 894.

143. 801 S.W.2d at 895 (Mauzy, J., concurring).

144. *Id.*

145. *Id.* at 895-96.

for a deficiency judgment.¹⁴⁶

In *Athari v. Hutheson*¹⁴⁷ the court, in a *per curiam* opinion, applied the "clear and unequivocal" test set forth in *Shumway* to a waiver provision that allowed the holder to accelerate the note "without further demand, notice or presentment." The court held that the provision was not effective to waive notice of intent to accelerate.¹⁴⁸

B. Federal Holder in Due Course Doctrine

The federal holder in due course doctrine was applied in *Smith v. FDIC*.¹⁴⁹ The federal holder in due course doctrine is a federal common law principle developed by the courts to assist the Federal Deposit Insurance Corporation (FDIC)¹⁵⁰ in achieving its congressional mandate to ensure the uninterrupted operations of the banking system and the safety and liquidity of bank deposits.¹⁵¹ It facilitates the disposal of assets of failed institutions by allowing the FDIC to complete purchase and assumption transactions quickly and without discount for contingent exposure to personal defenses to enforcement of promissory notes acquired from the failed institutions.¹⁵² This doctrine generally allows the FDIC, when it acquires the assets of a failed bank, to become a holder in due course of the negotiable promissory notes included in the assets of the failed bank.¹⁵³

146. *Id.* at 896. Mauzy concluded: "To hold otherwise places this court in the position of enforcing a contract that "no man in his senses and not under delusion would make on the one hand, and [which] no honest and fair man would accept on the other." *Id.* (quoting *Earl of Chesterfield v. Janssen*, 2 Ves. Sen. 125, 155, 28 Eng. Rep. 82, 100 (1750)).

147. 801 S.W.2d 896 (Tex. 1991).

148. *Id.* at 897.

149. 800 S.W.2d 648 (Tex. App.—Houston [14th Dist.] 1990, writ *dism'd* by *agr.*).

150. The doctrine also assisted the Federal Savings and Loan Insurance Corporation. Pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989, the Federal Savings and Loan Insurance Corporation was dissolved, and its receivership functions were transferred to the FDIC and the Resolution Trust Corporation (RTC). See Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, §§ 401(a), 215(a), 501, 103 Stat. 183, 354, 252, 363 (1989).

151. For additional protections available to the FDIC, see *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942), and 12 U.S.C.A. § 1823(e) (West 1989).

152. See *Sunbelt Sav., FSB v. Montross*, 923 F.2d 353, clarified on *reh'g per curiam*, *RTC v. Montross*, 944 F.2d 227 (5th Cir. 1991) (*en banc*).

153. See *FSLIC v. Murray*, 853 F.2d 1251, 1256 (5th Cir. 1988). Achieving holder in due course status allows the FDIC (and its successors) to take the notes free from all third-party claims and free from all defenses of any party to the instrument with whom the holder has not dealt (with certain limited exceptions). TEX. BUS. & COM. CODE ANN. §§ 3.305, 201 (Tex. UCC) (Vernon 1968). The defenses listed in Section 3.305(b) have been called real defenses, while other defenses that are subject to being cut off by a holder in due course have been called personal defenses. See *Campbell Leasing*, 901 F.2d at 1249. See also *FSLIC v. Griffin*, 935 F.2d 691, 697 n.3 (5th Cir. 1991), *petition for cert. filed*, 60 U.S.L.W. 3420 (U.S. Nov. 18, 1991) (No. 91-809) (listing so-called real defenses). In *Campbell Leasing, Inc. v. FDIC*, 901 F.2d 1244, 1249 (5th Cir. 1990), the Fifth Circuit court of appeals held that the FDIC can become a holder in due course without complying with the requirements under the Code. *Campbell Leasing* was discussed in the 1990 Survey. See John Krahmer, *supra* note 13, at 128-29. The Code requirements for holder in due course status are that the holder takes the instrument for value, in good faith, and without notice that it is overdue or has been dishonored or of any defense against or claim to it. TEX. BUS. & COM. CODE ANN. § 3.302(a) (Vernon 1968). Section 3.302(b) of the Code was the primary stumbling block faced by the FDIC in its acquisitions, via bulk purchase and assumption transactions, of notes held by failed financial institu-

In *Smith* the FDIC acquired the borrower's note as part of a bulk purchase of the assets of a failed bank. The FDIC's purchase occurred after the failed bank sold the collateral securing the note. The sale of collateral satisfied only 10% of the outstanding balance of the note. In response to the FDIC's motion for summary judgment for collection of the balance of the note, the borrower asserted that the FDIC failed to prove the collateral was disposed of in a commercially reasonable manner."¹⁵⁴ The court first held that the issue of commercial reasonableness of a sale of collateral is a defense that must be asserted by the borrower, and it noted that pursuant to section 3.305 of the Code¹⁵⁵ a holder in due course takes the note free from this defense.¹⁵⁶ The court discussed the policies underlying the federal holder in due course doctrine¹⁵⁷ and held that the FDIC was a holder in due course and took the note free of the defense of sale of collateral in a commercially unreasonable manner.¹⁵⁸

An important limitation on the federal holder in due course doctrine was imposed by the Fifth Circuit court of appeals in *Sunbelt Savings, FSB v. Montross*.¹⁵⁹ The court refused to extend the federal holder in due course doctrine to non-negotiable instruments.¹⁶⁰ In *Sunbelt Savings* the FSLIC, as

tions. It provides that a holder does not become a holder in due course of an instrument "by purchasing it as part of a bulk transaction not in regular course of business of the transferor." TEX. BUS. & COM. CODE ANN. § 3.302(b) (Tex. UCC) (Vernon 1968).

154. See TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1991).

155. TEX. BUS. & COM. CODE ANN. § 3.305 (Tex. UCC) (Vernon 1968).

156. *Smith*, 800 S.W.2d at 651. As the court noted, the Texas courts of appeals are split on the question whether commercial reasonableness is an affirmative defense or part of the noteholder's cause of action. *Id.* at 650. *Greathouse v. Charter Nat'l Bank-Southwest*, 795 S.W.2d 1 (Tex. App.—Houston [1st Dist.] 1990, writ granted), discussed in the 1990 Survey, was argued before the supreme court on February 20, 1991, but no opinion had been issued at the time of this writing. See John Krahrmer, *supra* note 13, at 146-47.

157. 800 S.W.2d at 651. The court cited *FDIC v. Wood*, 758 F.2d 156, 159-60 (6th Cir.), *cert. denied*, 474 U.S. 944 (1985), *Campbell Leasing*, 901 F.2d at 1249, and its opinion in *NCNB v. Campise*, 788 S.W.2d 115 (Tex. App.—Houston [14th Dist.] 1990, writ denied). *Id.*

158. 800 S.W.2d at 651-52. In another recent case, the Resolution Trust Corporation was denied the benefit of the federal holder in due course doctrine when it attempted to invoke the doctrine for the first time on appeal in support of a deficiency judgment that the RTC acquired in its capacity as receiver of a failed thrift. The court reversed the deficiency judgment and rendered judgment in favor of the borrower, holding that the thrift failed to prove (after the borrower had pleaded to the contrary) that the thrift sold the collateral in a commercially reasonable manner. The court noted that the particular asset that the RTC acquired was a state court judgment on the note, which "is not a negotiable instrument." The court stated that "there is no such thing as a holder in due course of a judgment." The court seemed to recognize that the RTC also acquired the note, but apparently took the position that the judgment changed the character of the asset acquired. The court also took the position, expressly contrary to decisions of the Dallas court of appeals that the court cited, that the RTC cannot assert a holder in due course defense for the first time on appeal. See *Beach v. RTC*, 821 S.W.2d 241 (Tex. App.—Houston [1st Dist.] n.w.h.).

159. 923 F.2d 353, clarified on reh'g *per curiam*, *RTC v. Montross*, 944 F.2d 227 (5th Cir. 1991) (*en banc*). The Dallas court of appeals has adopted the same limitation in a case involving facts similar to those in *Sunbelt Savings*. See *Gibbs v. Bank One, Texas*, No. 05-90-01562-CV, 1991 WL 174352 (Tex. App.—Dallas Sept. 5, 1991, n.w.h.). The court quoted heavily from the *Sunbelt Savings* opinion. The *Gibbs* opinion had not been released for publication in the South Western Reporter as of the date of this writing.

160. 923 F.2d 354, 358. Holder in due course status is available under the Code only with respect to negotiable instruments. See TEX. BUS. & COM. CODE ANN. §§ 3.102(a)(5), .302(a) (Tex. UCC) (Vernon 1968).

part of the transfer of assets of a failed thrift, transferred to the acquiring institution (which was controlled by the FSLIC) a promissory note with a variable interest rate. The acquiring institution intervened in this deficiency suit and moved for summary judgment on the ground that the federal holder in due course doctrine barred the defenses asserted by the maker. The district court agreed.¹⁶¹

The court of appeals reversed and remanded the case, holding that as a matter of federal common law the federal holder in due course doctrine does not apply to non-negotiable instruments.¹⁶² The court narrowly construed its decisions in *FSLIC v. Murray*¹⁶³ and *Campbell Leasing, Inc. v. FDIC*,¹⁶⁴ stating that its holding in *Murray* was expressly limited to negotiable instruments acquired in purchase and assumption transactions and that *Campbell Leasing* "did not deal with negotiability at all" but rather "merely excused the FDIC from compliance with the bulk transfer exclusion of Texas holder in due course law."¹⁶⁵ The court rationalized that *Murray*, *Campbell Leasing*, *D'Oench, Duhme & Co. v. FDIC*,¹⁶⁶ and section 1823(e)¹⁶⁷ all prevent the FDIC from being disadvantaged by the acquisition of notes in purchase and assumption transactions, without altering the nature of the assets acquired, whereas applying the doctrine to non-negotiable instruments would bestow value on the FDIC that was unavailable to the predecessor bank by changing the nature of the asset from a non-negotiable instrument to a negotiable instrument.¹⁶⁸ The court also justified its holding by emphasizing the reasonable commercial expectations of makers of variable-rate notes that their defenses would remain unimpaired.¹⁶⁹

161. See 923 F.2d at 354.

162. 923 F.2d at 354, 357. In the panel decision the court assumed, without discussion, that a variable interest rate note was a non-negotiable instrument. In the *en banc* decision on rehearing the court reinstated the panel decision except to the extent that it could be read as implicitly holding that variable interest rate notes are non-negotiable instruments under the Code. The court stated "we take no position on the effect of the variable interest rate on the negotiability of the note", and it noted that both parties accepted the non-negotiability of the note. 944 F.2d at 228. The Texas supreme court, answering a certified question from the Fifth Circuit court of appeals, has just determined that "a promissory note requiring interest to be charged at a rate that can be determined only by reference to a bank's published prime rate is a negotiable instrument as defined by the Texas Uniform Commercial Code." See *Ackerman v. FDIC*, 930 F.2d 3 (5th Cir. 1991), *certified question answered sub nom.*, *Amberboy v. Societe de Banque Privee*, 35 Tex. Sup. Ct. J. 621, 625 (April 15, 1992). The *Amberboy* decision was issued too late to be included in the text of this article. It is a significant decision that overrules prior Texas case law to the contrary. For additional discussion of this issue, see *infra* note 173.

163. 853 F.2d 1251 (5th Cir. 1988).

164. 901 F.2d 1244 (5th Cir. 1990).

165. 923 F.2d at 356.

166. 315 U.S. 447 (1942).

167. 12 U.S.C.A. § 1823(e) (West 1989).

168. 923 F.2d at 356.

169. 923 F.2d at 356-57. In reality, economic factors seem more likely to drive the decisions of banks and borrowers about whether particular notes should be fixed or floating rate. Apart from its analysis of the commercial expectations of variable-rate notemakers, the court did correctly point out that the maker of a negotiable instrument is on notice that any personal defenses he may have are subject to being cut off at any time by a transfer of the instrument to a holder in due course, and that, accordingly, giving the FDIC holder in due course status with respect to these instruments does not disrupt commercial relationships predicated on state law. See *FDIC v. Wood*, 758 F.2d at 161.

The court, stating that “[a]lchemy is the province of Congress,” likened the application of the federal holder in due course status to non-negotiable instruments to giving the FDIC the ability to “transmute lead into gold.”¹⁷⁰ The court stated that “[n]egotiability is the foundation underlying all of Article Three and of holder in due course status in particular.”¹⁷¹ The negotiable/non-negotiable distinction made by the court bears scrutiny. The argument that applying the federal holder in due course doctrine to non-negotiable instruments changes their nature and provides a windfall to the FDIC is valid in the sense that the FDIC would be able to avoid personal defenses to enforcement of the instrument and to vest its transferee with the same status.¹⁷² It is equally true, however, that while applying the federal holder in due course doctrine to all negotiable instruments acquired by the FDIC in bulk transfers from failed banks does not technically “alter the nature of the asset acquired” (*i.e.*, the instruments remain negotiable instruments), it does bestow extra value on the FDIC by “transmuting” negotiable instruments with impaired value due to the existence of otherwise applicable Code-imposed impediments to holder in due course status (*e.g.*, notice of defenses, notice that the note is overdue, bulk transfer, etc.) into sanitized instruments in the hands of the FDIC, even in circumstances in which it would have been unlikely that any other transferee, as a practical matter, could have qualified for holder in due course status (for example, where a note is being litigated prior to the transfer, with lender liability counterclaims or other defenses asserted in the pleadings).

Federal policy considerations weigh heavily in the area of FDIC/RTC superpowers. By imposing an arbitrary limit on the breadth of the FDIC’s and RTC’s powers in dealing with failed financial institutions and minimizing losses, the court’s decision may elicit a legislative response. The court’s reasoning in *Sunbelt Savings*, while arguably oversimplified, might be attributable to a determination by the court to pick a convenient bright-line boundary and thereby sidestep a perceived judicial minefield by preempting any need to decide, in piecemeal fashion, whether particular non-negotiable instruments are subject to the federal holder in due course doctrine. The reasons for non-negotiability are varied. It is one thing to extend the doctrine to variable-rate notes,¹⁷³ but would be quite another, for example, to

170. 923 F.2d at 357.

171. *Id.* at 356.

172. *See supra* note 153.

173. *See Amberboy v. Societe de Banque Privee*, 35 Tex. Sup. Ct. J. 621 (April 15, 1992). The Texas supreme court, in determining that variable rate notes are negotiable instruments under the Code, relied in large part on section 1.102(b) of the Code and comment 1 to section 1.102. *See* 35 Tex. Sup. Ct. J. at 621, 624; TEX. BUS. & COM. CODE ANN. § 1.102 (Tex. UCC) (Vernon 1968). As professors White and Summers point out, the new Article 3 prepared by drafters of proposed amendments to the Uniform Commercial Code will make variable-rate notes negotiable. White and Summers also note that a number of states have amended Article 3 to make variable-rate notes negotiable instruments. *See* James White & Robert Summers, *supra* note 50, § 14-4 (Supp. 1991). White and Summers endorse extending negotiability to variable-rate notes, but believe that the existing provisions of Article 3 of the Uniform Commercial Code do not provide a basis for doing so. They cite *Tanenbaum v. Agri-Capital, Inc.*, 885 F.2d 464 (8th Cir. 1989) as one of two cases that “have recently held variable rate notes to

extend it to an instrument containing a clearly conditional promise or order.¹⁷⁴

C. Causes of Action

To maintain a cause of action on a promissory note the plaintiff must establish that he is the holder or owner of the note.¹⁷⁵ In *Jernigan v. Bank One, Texas*¹⁷⁶ the bank sued on a defaulted note that it claimed to have acquired from the FDIC in a purchase and assumption transaction. The court reversed and remanded a summary judgment in favor of the bank, holding that as a matter of law the bank failed to establish that it was the holder or owner of the note. The note in *Jernigan* had been indorsed to the Federal Reserve Bank of Dallas prior to the failure of the original payee bank, and the plaintiff bank failed to show that it had possession of the note or that the note had been further indorsed. Because of the unexplained indorsement and the possibility of an intermediate transfer, the court held as insufficient the "bare allegation of ownership" asserted in an affidavit of a vice president of the bank.¹⁷⁷

D. Action on Underlying Obligation by Subsequent Holder of Dishonored Instrument

In *J.W.D., Inc. v. Federal Insurance Co.*¹⁷⁸ three convenience stores that cashed wages checks issued by a construction subcontractor to its laborers were successful in asserting claims for payment under the general contractor's payment bond after the checks were dishonored due to insufficient

be negotiable under the existing Article 3." *Id.* at 71, n.6. They commended the *Agri-Capital* court for "doing good" but criticized it for paying "less than due respect" to the Code and to "well developed Texas state law to the contrary." *Id.* As noted above, Texas state law has just changed. In *Agri-Capital* the court purported to be interpreting section 3.104 of the Code but applied its own "commercial certainty" test as formulated in a 1904 Eighth Circuit case it cited. 885 F.2d at 468. The Texas supreme court in *Amberboy* cited *Agri-Capital* in support of its holding. 35 Tex. Sup. Ct. J. at 623.

174. See TEX. BUS. & COM. CODE ANN. §§ 3.104(a)(2), .105 (Tex. UCC) (Vernon 1968). Notwithstanding its opinion in *Sunbelt Savings*, however, the court has recognized that "[i]n the realm of commercial law, there is a continuum, from agreements which differ from negotiable instruments in only minor respects, to those, such as ordinary contracts, which fail entirely to satisfy the requirements of negotiable instruments", and it has indicated a willingness to apply section 1823(e) to non-negotiable instruments falling within the appropriate portion of this continuum. See *FDIC v. Aetna Casualty & Surety Co.*, 947 F.2d 196, 205-06 n.9 (5th Cir. 1991) (refusing to extend section 1823(e) to cut off a fraudulent misrepresentation defense to payment on a bankers blanket insurance bond acquired by the FDIC in a purchase and assumption transaction).

175. See, e.g., TEX. BUS. & COM. CODE ANN. §§ 3.301, .307(b), .804 (Tex. UCC) (Vernon 1968). To be a holder (with respect to a promissory note) the person must have possession of an instrument drawn, issued or indorsed to him or to his order or to bearer or in blank. TEX. BUS. & COM. CODE ANN. § 1.201(20) (Tex. UCC) (Vernon Supp. 1992).

176. 803 S.W.2d 774 (Tex. App.—Houston [14th Dist.] 1991, no writ).

177. *Id.* at 777. The affidavit stated that the bank acquired the note in the purchase and assumption transaction. *Id.*; see TEX. BUS. & COM. CODE ANN. § 3.201(c) (Tex. UCC) (Vernon 1968) ("Negotiation takes effect only when the indorsement is made and until that time there is no presumption that the transferee is the owner") and comment 8 to section 3.201.

178. 806 S.W.2d 327 (Tex. App.—Austin 1991, no writ).

funds in the subcontractor's account. The court held that the stores, as holders¹⁷⁹ of the dishonored checks, could bring an action on the subcontractor's underlying obligation to pay the wages for which the checks had been issued.¹⁸⁰ The basis for this holding was the court's conclusion that pursuant to section 3.802(a) of the Code any holder of an instrument — not just the original payee — is entitled to maintain an action on the underlying obligation.¹⁸¹ The court stated that, in effect, the laborers' right to receive wages from the subcontractor had been assigned to the stores by the negotiation of the checks.¹⁸² The court then held that when the wage claims were assigned the stores also became equitable assignees of the laborers' right to pursue payment from the surety under the general contractor's payment bond.¹⁸³

E. Statute of Limitations and Forged Indorsements

In *Toro v. First City Bank-Westheimer Plaza*¹⁸⁴ the court held that the two-year limitations period stipulated by section 16.003(a) of the Texas Civil Practice and Remedies Code¹⁸⁵ is the applicable limitations period for an action for conversion based on payment of an instrument on a forged in-

179. The checks were negotiable instruments that were properly indorsed and delivered to the stores. The stores, accordingly, became holders of the instruments. See TEX. BUS. & COM. CODE ANN. §§ 1.201(20), 3.202 (Tex. UCC) (Vernon 1968 & Supp. 1992).

180. 806 S.W.2d at 329.

181. *Id.* Section 3.802(a)(2) of the Code provides that if an instrument that has been taken for an underlying obligation is dishonored, an action "may be maintained on either the instrument or the obligation." TEX. BUS. & COM. CODE ANN. § 3.802(a)(2) (Tex. UCC) (Vernon 1968). Section 3.802 does not state who may maintain the action. The court relied on comment 3 to section 3.802, which uses the term "the holder" in its explanation of section 3.802(a)(2). See also TEX. BUS. & COM. CODE ANN. § 3.301 (Tex. UCC) (Vernon 1968) (right of a holder to enforce payment); § 3.507 (Tex. UCC) (Vernon 1968) (holder's right of recourse upon dishonor).

182. 806 S.W.2d at 329, 331.

183. 806 S.W.2d at 329-32. The court characterized the bond as a form of security and drew an analogy to Texas cases holding that a mortgage on real estate follows the debt it secures without the necessity of an express assignment. *Id.* at 330. It also noted that the McGregor Act expressly allows bond claims to be assigned. *Id.* at 331 (citing TEX. REV. CIV. STAT. ANN. art. 5160(C)(d) (Vernon 1987)). The court reversed the trial court's summary judgment in favor of the bonding company and rendered judgment against it in favor of the stores for the amounts of the checks cashed plus attorneys' fees, interest, and costs of court. 806 S.W.2d at 332.

184. 821 S.W.2d 633 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

185. TEX. CIV. PRAC. & REM. CODE ANN. § 16.003(a) (Vernon 1986) ("A person must bring suit for . . . conversion of personal property . . . not later than two years after the day the cause of action accrues").

dorsement.¹⁸⁶ In *Community National Bank v. Channelview Bank*¹⁸⁷ the court rejected the bank's forged indorsement defense and held that the indorsement of a cashier's check by use of a fictitious name was an authorized indorsement and therefore effective to transfer title to the instrument to the intended transferee.¹⁸⁸ The basis for the court's holding was that the person from whose account funds were debited to pay for the cashier's check authorized the bank to issue the check with the fictitious name inserted as the payee, and that same person indorsed the check using the fictitious name (as well as his real name). Accordingly, the court held that the bank that issued the cashier's check was liable to the holder who presented it for payment.¹⁸⁹ The court reviewed the Code provisions pertaining to unauthorized signatures and indorsements¹⁹⁰ and noted that the person who obtained and indorsed the cashier's check used the fictitious name "for his own personal convenience."¹⁹¹

IV. BANK DEPOSITS AND COLLECTIONS

A. *Statute of Limitations — Payor Bank Liability for Failure to Take Action Timely on an Item Payable by It*

Under section 4.302(1) of the Code a payor bank, in the absence of a valid defense, is accountable for the amount of a check presented on and received by it if it does not pay or return the check or send notice of dishonor until after midnight on its next banking day following the banking day on which it received the check.¹⁹² In *Wider v. First City Bank of Dallas*¹⁹³ the court held that the residual or "catch-all" four-year statute of limitations now

186. 821 S.W.2d at 634-35; see TEX. BUS. & COM. CODE ANN. § 3.419(a)(3) (Tex. UCC) (Vernon 1968) and comment 3 to section 3.419. The plaintiff in *Toro* argued that the applicable statute of limitations was the "four year statute" because his conversion claim was asserted under the Code. The basis for the plaintiff's argument is unclear. The only four-year limitations period provided under the Code is set forth in section 2.725 thereof; it applies to actions for breach of contracts for sale. See *supra* note 73. The four-year limitations period provided under Section 16.004 of the Civil Practice and Remedies Code is inapplicable (perhaps the plaintiff was contending that the conversion created a debt), and the residual four-year limitations period provided under section 16.051 thereof applies only in the absence of an express limitations period. See TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.004, .051 (Vernon 1986).

187. 814 S.W.2d 424 (Tex. App.—Houston [1st Dist.] 1991, no writ).

188. *Id.* at 427.

189. *Id.* The court cited *Wertz v. Richardson Heights Bank & Trust*, 495 S.W.2d 572, 574 (Tex. 1977) for the rule that a bank's issuance of a cashier's check is acceptance of the check and constitutes the bank's agreement to honor the check as presented. 814 S.W.2d at 427.

190. 814 S.W.2d at 426; see TEX. BUS. & COM. CODE ANN. §§ 3.404, .307, 1.201(43) (Tex. UCC) (Vernon 1968).

191. *Id.* at 427. The court quoted comment 2 to section 3.401 of the Code, which provides in part that: "[a signature] may be made in any name, including any trade name or assumed name, however false and fictitious, which is adopted for that purpose." TEX. BUS. & COM. CODE ANN. § 3.401 comment 2 (Tex. UCC) (Vernon 1968).

192. TEX. BUS. & COM. CODE ANN. § 4.302(1) (Tex. UCC) (Vernon 1968). A check is a "demand item." See TEX. BUS. & COM. CODE ANN. §§ 3.104(b)(2), .108, 4.104(a)(7) (Tex. UCC) (Vernon 1968). The term "midnight deadline," as used in section 4.302(1), is defined in section 4.104(a)(8). TEX. BUS. & COM. CODE ANN. § 4.104(a)(8) (Tex. UCC) (Vernon 1968).

193. 804 S.W.2d 160 (Tex. App.—Dallas 1990, writ denied).

codified as section 16.051 of the Civil Practice and Remedies Code,¹⁹⁴ rather than the two-year limitations period under section 16.003 thereof,¹⁹⁵ is applicable to a suit based on section 4.302 of the Code.¹⁹⁶ In *Wider* the plaintiff sued the payor bank (alleging that it held several checks beyond the "midnight deadline") three years and eleven months after the cause of action accrued. The court first held that a suit "for violation of section 4.302 of the [Code] is properly characterized as a suit for strict statutory liability."¹⁹⁷ It then held that the applicable statute of limitations is "former article 5529, now section 16.051 of the [Civil Practice and Remedies Code]" on the basis that the plaintiff's cause of action was not specifically listed in any statute of limitations provision.¹⁹⁸

B. Damages for Wrongful Dishonor and Wrongful Offset

Section 4.402 of the Code provides that a payor bank is liable to its customer for damages "proximately caused" by the wrongful dishonor of an item, and it limits liability to actual damages proved when the dishonor occurs through mistake.¹⁹⁹ In *American Bank of Waco v. Waco Airmotive, Inc.*²⁰⁰ the court held that loss of credit is a "natural, probable, and foreseeable" consequence of an offset or dishonor and that damages for loss of credit are recoverable under either theory if the offset or dishonor is wrongful and if the damages are supported by the evidence.²⁰¹

In addition to awarding damages for loss of credit, the jury also awarded

194. TEX. CIV. PRAC. & REM. CODE ANN. § 16.051 (Vernon 1968). Section 16.051 provides that: "Every action for which there is no express limitations period, except an action for the recovery of real property, must be brought not later than four years after the day the cause of action accrues." *Id.* The plaintiff's cause of action accrued when the predecessor statutes to sections 16.003, 16.004, and 16.051 of the Civil Practice and Remedies Code were in effect. See TEX. REV. CIV. STAT. ANN. arts. 5526, 5527, 5529, repealed by Act of Sept. 1, 1985, ch. 959, sec. 9(1), 1985 TEX. GEN. LAWS 3242, 3322; TEX. CIV. PRAC. & REM. CODE §§ 16.003, .004, .051 (Vernon 1986).

195. TEX. BUS. & COM. CODE ANN. § 4.302 (Tex. UCC) (Vernon 1968). The payor bank argued that the plaintiff's cause of action sounded in tort and was therefore governed by a two-year limitations period. The trial court granted summary judgment in favor of the bank on this basis. See 804 S.W.2d at 161.

196. 804 S.W.2d at 162.

197. 804 S.W.2d at 162 (citing *New Ulm State Bank v. Brown*, 558 S.W.2d 20, 28 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ); and *Marfa Nat'l Bank v. Powell*, 512 S.W.2d 356, 358 (Tex. Civ. App.—El Paso 1974, writ ref'd n.r.e.)).

198. 804 S.W.2d at 162. See *supra* note 194. The court did not address the plaintiff's argument in the alternative that a suit for violation of section 4.302 of the Code can be characterized as an action for debt and therefore, is governed by the four-year limitations period set forth in section 16.004(a)(3) of the Civil Practice and Remedies Code (or its predecessor, art. 5527) (see *supra* note 194).

199. TEX. BUS. & COM. CODE ANN. § 4.402 (Tex. UCC) (Vernon 1968).

200. 818 S.W.2d 163 (Tex. App.—Waco 1991, writ denied). See *supra* notes 20-22 and accompanying text.

201. *Id.* at 174. The cause of action for wrongful offset of a general deposit account is based on breach of the depository agreement between the bank and the depositor. *Id.* at 170. In *Waco Airmotive* the court concluded that the jury's finding of wrongful offset also established wrongful dishonor because the dishonor occurred solely as a result of the bank's prior offset of the depositor's account. *Id.* at 173-74. The jury awarded \$25,000 for "loss of credit" damages. *Id.* at 174. The amount offset was \$31,752.68, the full balance of the depositor's account. The checks that were subsequently dishonored totaled \$15,132.50. *Id.* at 175.

\$500,000 in exemplary damages for wrongful offset and wrongful dishonor. The court held that exemplary damages are not recoverable for wrongful offset because the cause of action is based on breach of contract, and "[e]xemplary damages are not recoverable for ordinary breach of contract."²⁰² The court, however, rejected the bank's argument (which was based on section 1.106(a) of the Code²⁰³ and on the lack of express authorization under section 4.402 of the Code²⁰⁴) that exemplary damages are not recoverable for wrongful dishonor. The court noted that the Code does not specify whether the liability under section 4.402 sounds in contract or in tort,²⁰⁵ and that, while the Texas supreme court had not addressed the issue, two courts of appeals have held that the liability is more in the nature of tort than contract.²⁰⁶ The court then held that "a finding that a bank acted with malice or in reckless disregard of the rights of its depositor will support a depositor's recovery of exemplary damages for wrongful dishonor of its checks under section 4.402".²⁰⁷

V. LETTERS OF CREDIT

A. Warranties Made by the Beneficiary

Under section 5.111(a) of the Code, unless otherwise agreed, a beneficiary of a letter of credit, by making a demand for payment, "warrants to all interested parties that the necessary conditions of the credit have been complied with."²⁰⁸ In *Sun Marine Terminals, Inc. v. Artoc Bank and Trust, Limited*²⁰⁹ the Texas supreme court held that the terms of the agreement per-

202. *Id.* at 176 (citing *International Bank v. Morales*, 736 S.W.2d 622, 624 (Tex. 1987); *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986)).

203. TEX. BUS. & COM. CODE ANN. § 1.106(a) (Tex. UCC) (Vernon 1968). Section 1.106(a) provides that:

The remedies provided by this title shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this title or by other rule of law.

Id.

204. The negative implication inherent in the statement in section 4.402 limiting liability to actual damages when the dishonor occurs by mistake — *i.e.*, that damages are not so limited when the dishonor occurs on some basis more culpable than a good faith mistake — was not discussed by the court.

205. 818 S.W.2d at 176 (citing comment 2 to section 4.402).

206. *Id.* (citing *Northshore Bank v. Palmer*, 525 S.W.2d 718, 720 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.); and *Farmers & Merchants State Bank v. Ferguson*, 605 S.W.2d 320, 326 (Tex. Civ. App.—Fort Worth 1980), *reformed & affirmed*, 617 S.W.2d 918 (Tex. 1981)).

207. 818 S.W.2d at 176. *See also* *James White & Robert Summers, supra* note 50, § 18-4 at 898-99. The court did not reach the issue of the constitutionality of the jury's award of the exemplary damages due to its remand of the case for a new trial. 818 S.W.2d at 177. The court's characterization of the damages for loss of credit (in the context of its holding that the trial court's exclusion of evidence that would have tended to refute the depositor's claim of loss of credit was not harmless error) as "the only recoverable damages which were found by the jury" appears to be a mistake. *See* 818 S.W.2d at 178.

208. TEX. BUS. & COM. CODE ANN. § 5.111(a) (Tex. UCC) (Vernon 1968). *See also* TEX. BUS. & COM. CODE ANN. § 5.103(a)(1) (Tex. UCC) (Vernon 1968) (definition of "credit" and "letter of credit").

209. 797 S.W.2d 7 (Tex. 1990).

taining to the transaction underlying the letter of credit must be examined to determine whether the beneficiary's statements made to the issuer of the letter of credit in the beneficiary's presentment documents were false and therefore, in breach of the warranty under section 5.111.²¹⁰ In *Sun Marine Artoc Bank and Trust (Artoc)* brought a cause of action against the beneficiary of a letter of credit issued by another bank for the account of Artoc. The letter of credit supported certain payment obligations of Artoc's customer to the beneficiary under an agreement pursuant to which the beneficiary constructed and operated a terminal for storing and loading gasoline from the customer's refinery. When the customer failed timely to provide the beneficiary with a replacement letter of credit, the beneficiary exercised its right under the agreement to draw on letter of credit. Artoc acknowledged that the documents submitted by the beneficiary to the issuer — a sight draft for the full amount of the letter of credit, a copy of an invoice covering services rendered and not paid on the due date, and a letter stating that the customer failed to pay the invoice in accordance with the agreement — complied with the terms for payment under the letter of credit and that the issuer properly honored the sight draft. Artoc, however, sued the beneficiary for, *inter alia*, breach of the section 5.111(a) warranty on the ground that the documents submitted by the beneficiary to the issuer with the sight draft contained false statements. Artoc contended that the beneficiary misrepresented that the customer had failed to pay for services rendered when in fact the customer was current in its monthly payments under its agreement with the beneficiary.

The court acknowledged that “[t]he purpose of a letter of credit is to assure payment when its own conditions have been met, irrespective of disputes that may arise between the parties concerning performance of other agreements which comprise the underlying transaction”²¹¹ and that “the viability of a letter of credit as a payment device depends upon its independence from the transaction of which it is a part.”²¹² The court stated that this “independence principle” means that, subject to certain exceptions specified in section 5.114(b) of the Code,²¹³ whether the customer and the beneficiary have discharged their respective obligations to each other is irrelevant to determining if payment is due on a letter of credit.²¹⁴ Artoc argued that to refer to the agreement underlying the letter of credit to ascertain the truth of a beneficiary's statement made to obtain payment would violate the independence principle. The court rejected that argument, holding that the independence principle is applicable in determining whether the issuer must pay

210. *Id.* at 11-12. The court observed that judicial authority interpreting section 5.111(a) was scant, but that all authorities that have addressed the issue “agree that under section 5.111(a) a beneficiary warrants that all statements made in documents presented to obtain payment are true.” *Id.* at 11 (citing cases from other jurisdictions); TEX. BUS. & COM. CODE ANN. § 5.111(a) (Tex. UCC) (Vernon 1968).

211. *Id.* at 10.

212. *Id.*

213. TEX. BUS. & COM. CODE ANN. § 5.114(b) (Tex. UCC) (Vernon Supp. 1992).

214. 797 S.W.2d at 10. *See* TEX. BUS. & COM. CODE ANN. § 5.114(a) (Tex. UCC) (Vernon 1968).

on the letter of credit (and noting that in this case payment had been made and the letter of credit had served its purpose).²¹⁵ The court held that the underlying agreement had to be examined to determine whether the beneficiary's statements in its presentment documents were true, since the agreement, not the letter of credit, contained the parties' respective obligations.²¹⁶ The court then found that the beneficiary's statements were true since the underlying agreement provided for acceleration of all remaining payments upon the customer's failure timely to deliver a replacement letter of credit, and since the beneficiary had rendered services (construction of the terminal facility) for which it had not yet been fully compensated.²¹⁷ Accordingly, the court held that the beneficiary did not breach its warranty to Artoc under section 5.111(a) of the Code.²¹⁸

B. Demand for Payment; Modification

In *Black v. Texas Department of Labor and Standards*²¹⁹ the party who had posted cash collateral with a bank to support the bank's issuance of a letter of credit contested the beneficiary's attempt to obtain payment on the letter of credit by arguing, *inter alia*, that a demand letter sent by the beneficiary to the bank did not constitute a draft as required by the letter of credit, that the beneficiary's demand was not proper because it was mailed rather than delivered personally, and that a transmittal letter from the attorney for the bank's customer (*i.e.*, the party for whose account the letter of credit was issued) to the beneficiary was effective to modify the letter of credit. The letter of credit provided that all drafts were to be marked "Drawn under Letter of Credit No. 026, and presented at our counter at 3101 Bee Cave Road, Austin, Texas by the close of business day on February 24, 1989."²²⁰ The court held that a demand letter may constitute a draft for purposes of a letter of credit²²¹ and that the beneficiary's letter sufficed as a draft.²²² The court held that the demand complied with the letter of credit even though it was mailed rather than delivered personally, since it was received by the bank prior to the expiration date of the letter of credit, and since "[i]n this noncommercial area, absolute, perfect compliance with the letter's terms

215. 797 S.W.2d at 11.

216. *Id.*

217. *Id.* at 12.

218. *Id.* The parties agreed, and the court held, that a beneficiary's warranty under section 5.111(a) runs to interested parties, including the party for whose account the letter of credit is issued (*i.e.*, the issuer's customer). *Id.* at 11.

219. 816 S.W.2d 496 (Tex. App.—Texarkana 1991, writ requested).

220. *Id.* at 500.

221. *Id.* (citing *Temple-Eastex, Inc. v. Addison Bank*, 672 S.W.2d 793 (Tex. 1984); *Travis Bank & Trust v. State*, 660 S.W.2d 851 (Tex. App.—Austin 1983, no writ)).

222. 816 S.W.2d at 500. See TEX. BUS. & COM. CODE ANN. §§ 3.104(b)(1), .104(c) (Tex. UCC) (Vernon 1968) ("draft" is an order; as used in other chapters of the Code, the term may refer to non-negotiable as well as negotiable instruments, as the context may require). The beneficiary's demand letter in *Black* properly identified the letter of credit, stated that it was payable in its total amount, recited other information evidencing that the circumstances under which it was payable had occurred, and made demand for prompt and full payment of the total amount of the credit. See also *Temple-Eastex*, 672 S.W.2d at 797-98; *Travis Bank & Trust*, 660 S.W.2d at 854-56.

was not required."²²³ The court also held that the letter sent to the beneficiary by the attorney for the bank's customer, which was sent with the letter of credit and which attempted to modify the letter of credit by limiting the obligations for which the letter of credit served as security, did not alter the bank's obligation under its letter of credit, since under section 5.104(a) of the Code a modification of the terms of a letter of credit must be signed by the issuer.²²⁴

C. Injunction Against Beneficiary; Withdrawal

Under the Code an issuer²²⁵ must honor a draft or demand for payment that complies with the terms of the credit, even if the goods or documents do not conform to the underlying contract between the customer and the beneficiary.²²⁶ Section 5.114(b) of the Code, however, provides that, unless otherwise agreed, when a document on its face appears to conform to the requirements of the credit but is forged or fraudulent or there is "fraud in the transaction," then the issuer acting in good faith may still honor the draft or demand for payment notwithstanding notice from its customer of the forgery or fraud, but a court may by injunction prevent the honor.²²⁷

In *First City, Texas - Houston v. Gnat Robot Corp.*²²⁸ the account party sought to enjoin the beneficiary from presenting or transferring a letter of credit. In this case a letter of credit was issued by NCNB Texas National Bank for the benefit of First City, Texas - Houston for the account of H. Ross Perot. The letter of credit provided support for a loan made by First City to Modern World Media, Inc., a company owned in part by former Texas governor Mark White.²²⁹ As part of the loan transaction, Modern World, White and another guarantor of the loan, and Gnat Robot, a com-

223. 816 S.W.2d at 501 (citing *Temple-Eastex*, 672 S.W.2d 793; *New Braunfels Nat'l Bank v. Odiorne*, 780 S.W.2d 313 (Tex. App.—Austin 1989, writ denied)). The court in *Black* made the same distinction as the court in *Odiorne* between those discrepancies (between the demand for payment and the requirements for payment set forth in the letter of credit) that relate to the commercial or business aspects of the underlying transaction and those that relate to the non-commercial or banking aspects of presentment (such as proper identification in the draft or demand for payment of the credit being drawn on). The *Odiorne* court recognized the general rule that the beneficiary must strictly comply with the conditions for payment contained in the credit, but it held that *de minimis* errors in the noncommercial requirements of the credit do not violate the "strict compliance" standard. See 780 S.W.2d at 316-18.

224. 816 S.W.2d at 501. See TEX. BUS. & COM. CODE ANN. § 5.104(a) (Tex. UCC) (Vernon 1968).

225. "Issuer" is defined as "a bank or other person issuing a credit." TEX. BUS. & COM. CODE ANN. § 5.103(a)(3) (Tex. UCC) (Vernon 1968).

226. TEX. BUS. & COM. CODE ANN. § 5.114(a) (Tex. UCC) (Vernon 1968). See also comment 1 to section 5.114, and *supra* notes 211-14 and accompanying text.

227. TEX. BUS. & COM. CODE ANN. § 5.114(b) (Tex. UCC) (Vernon Supp. 1992). Section 5.114(b)(1) provides that, in certain situations involving an innocent third party (e.g., demand for honor by a negotiating bank or other person with a status equivalent to holder in due course, and, if applicable, to whom a document of title has been duly negotiated or who is a bona fide purchaser of a certificated security), the issuer must honor the draft or demand for payment notwithstanding the fraud, forgery, or other defect. *Id.*

228. 813 S.W.2d 230 (Tex. App.—Houston [1st Dist.] 1991, n.w.h.).

229. The loan provided working capital and refinanced a prior \$2,500,000 loan that was used to purchase two radio stations in Beaumont, Texas.

pany owned by Perot, entered into a stock option agreement pursuant to which Gnat Robot was entitled to withdraw the letter of credit if Modern World failed to pay Gnat Robot the costs of providing the letter of credit. The loan agreement between Modern World and First City referred to the option agreement, but the letter of credit contained no provision allowing Gnat Robot or Perot to withdraw the letter of credit; nor did the letter of credit refer to or incorporate by reference the option agreement.

Gnat Robot and Perot obtained an injunction from the trial court preventing First City from transferring or presenting the letter of credit, on the grounds that (i) Modern World failed to pay Gnat Robot for the cost of the letter of credit, (ii) Gnat Robot exercised its rights under the option agreement to withdraw the letter of credit by so notifying First City, and (iii) First City was bound by the terms of the option agreement. The court held that the trial court abused its discretion in granting the injunction.²³⁰ The bases for the court's holding were that (i) Gnat Robot and Perot did not allege fraud or forgery,²³¹ (ii) the letter of credit contained no withdrawal provision and therefore could be withdrawn only by the agreement of all the parties,²³² and (iii) "[u]nless [a] letter of credit contains an explicit reference to an underlying contract, . . . creating a condition for honoring a draft, the underlying contract does not affect liability under the letter of credit."²³³

D. *Wrongful Dishonor*

In *Agri Export Cooperative v. Universal Savings Ass'n*²³⁴ the beneficiary of a letter of credit and the beneficiary's assignee brought an action for wrongful dishonor against the issuer and sought to compel payment on the letter of credit. Universal Savings issued the letter of credit in favor of Agri Export as security for a loan made by Agri Export to a subsidiary of Universal Savings. The letter of credit was irrevocable and was payable upon default in the payment of a referenced promissory note executed by the subsidiary.

Prior to the expiration of the letter of credit Agri Export demanded pay-

230. 813 S.W.2d at 234.

231. *Id.* at 233. Accordingly, exceptions under section 5.114(b) to an issuer's duty to honor a draft or demand for payment were inapplicable. The court noted that the Texas supreme court has held that presentment of a letter of credit may not be enjoined unless there is a showing by the customer of fraud by the beneficiary (citing *Philipp Bros., Inc. v. Oil Country Specialists, Ltd.*, 787 S.W.2d 38, 40 (Tex. 1990)). 813 S.W.2d at 233.

232. 813 S.W.2d at 233 (citing *Fina Supply, Inc. v. Abilene Nat'l Bank*, 726 S.W.2d 537, 541-42 (Tex. 1987) (irrevocable letter of credit can be modified only with the consent of the beneficiary and account party)). See also TEX. BUS. & COM. CODE ANN. § 5.106(b) (Tex. UCC) (Vernon 1968) (unless otherwise agreed, an established irrevocable credit may be modified or revoked only with the consent of the beneficiary and the customer).

233. 813 S.W.2d at 233 (citing *Westwind Exploration, Inc. v. Homestate Sav. Ass'n*, 696 S.W.2d 378, 381 (Tex. 1985) ("disputes between the account party and beneficiary concerning the underlying transaction are of no concern to the issuer"); *Summit Ins. Co. v. Central Nat'l Bank*, 624 S.W.2d 222, 225 (Tex. Civ. App.—Houston [1st Dist.] 1981, writ ref'd n.r.e.) ("[t]he beneficiary's noncompliance with the underlying contract does not affect the issuer's liability unless a reference to the underlying contract explicitly creates a condition for honoring a draft").

234. 767 F.Supp. 824 (S.D. Tex. 1991).

ment on the letter of credit and presented a sight draft to Universal Savings for the total amount of the credit, together with the original letter of credit and a certification of default under the note.²³⁵ Universal Savings refused payment without explanation and retained the original letter of credit. In a letter signed by Universal Saving's vice president, the expiration date of the letter of credit was extended "in consideration of [Agri Export's] forbearance . . . in bringing an action against Universal for its alleged failure to honor the letter of credit . . ." ²³⁶ Agri Export subsequently presented another sight draft to Universal Savings for the total amount of the credit, together with a certification of default, a photocopy of the letter of credit, and a photocopy of the extension letter. Universal Savings again refused payment, and Agri Export filed suit for wrongful dishonor.

The Resolution Trust Corporation, in its capacity as receiver of Universal Savings,²³⁷ denied liability on the basis that (i) presentment of the letter of credit was improper, (ii) the letter of credit was void because neither the note nor the extension of the letter of credit was supported by consideration, (iii) the letter of credit was invalid because it was executed without proper authority, and (iv) the *D'Oench, Duhme* doctrine²³⁸ and 12 U.S.C. § 1823(e)²³⁹ barred recovery since the letter of credit was neither approved by the issuer's board of directors nor properly recorded in the issuer's records.

The issuer contended that Agri Export's presentment was improper because two presentment requirements expressly provided for on the face of the letter of credit were not satisfied, specifically (i) Agri Export failed to present the original letter of credit or the original extension letter at the time payment was demanded, and (ii) the certification of default delivered with the demand for payment identified the note as one "payable to Agri-Export"

235. The terms of the letter of credit provided for payment upon the presentment of these three items.

236. *Agri Export*, 767 F. Supp. at 826, 827.

237. The receivership followed a FSLIC conservatorship that began subsequent to the date on which Agri Export filed suit. For convenience of reference, the term "issuer" is hereinafter used for both Universal Savings and the RTC.

238. This federal common law doctrine is based on *D'Oench, Duhme & Co. v. FDIC*, 315 U.S. 447 (1942). In *D'Oench* a securities firm executed a series of notes payable to a bank under an agreement that the notes would never be collected, the sole purpose of the notes being to allow the bank to show "good" assets on its books. The bank subsequently failed, and the notes were acquired by the FDIC in a purchase and assumption transaction. When the FDIC sued to collect on the notes the maker raised defenses based on the side agreement and on lack of consideration. The Supreme Court reviewed the statutory scheme that created the FDIC and found a federal policy to protect the FDIC and the public against misrepresentations as to the assets of insured institutions. To further this policy the court created a common law rule of estoppel that precludes a borrower from asserting defenses against the FDIC based upon secret or unrecorded "side agreements" that alter the terms of assets acquired by the FDIC.

239. See 12 U.S.C. § 1823(e)(Supp J. 1989). This provision was enacted in 1950 as an amendment to the Federal Deposit Insurance Act (Pub. L. No. 81-797, § 2(13)(e), 64 stat. 931). It renders invalid as against the FDIC any agreement adverse to the interest of the FDIC in any asset acquired by it from a failed financial institution unless the agreement is in writing, was entered into at the same time that the asset to which it relates was acquired by the institution, was approved by the board of directors or the loan committee of the institution (with such approval reflected in the minutes), and has been at all times an official record of the institution.

rather than "payable to the order of Agri Export." The court rejected the issuer's first argument on the basis that the issuer's own actions in retaining the original letter of credit after Agri Export's initial presentment prevented Agri Export from presenting the original letter of credit with its second demand for payment.²⁴⁰ The court further observed that the terms of the extension letter did not contain any requirement that the original extension letter be presented.²⁴¹ The court then held that the discrepancy between the language in the default certification presented to the issuer and the form of certification required by the letter of credit was probably insufficient to justify dishonor.²⁴²

The court also held that even if the issuer's arguments concerning improper presentment were valid, the issuer was barred from asserting them since (i) the letter of credit provided that the controlling law for any disputes concerning payment would be (except for any conflicts with Texas or federal law) the Uniform Customs and Practices for Documentary Credits (UCP),²⁴³ (ii) Article 16(d) of the UCP requires the issuer of a letter of credit to give notice of its decision to refuse the documents and to state the discrepancies,²⁴⁴ and (iii) Article 16(e) of the UCP provides that if the issuing bank does not act in accordance with the notice requirements, the bank shall be precluded from claiming that the documents are not in accordance with the terms and conditions of the credit.²⁴⁵ The court held that the UCP was controlling and that the issuer failed to comply with the notice provisions set forth therein.

The court rejected the argument that the letter of credit was void because of a failure of consideration on the underlying loan and a lack of consideration for the additional time granted in the extension letter. The court refused to examine the loan transaction based on the independence principle,²⁴⁶ and it noted that the extension letter specifically provided that the extension was granted in consideration of Agri Export's forbearance in bringing action against the issuer for its failure to honor the letter of credit.²⁴⁷

The RTC also contended that the president of the issuer lacked board authority to issue the letter of credit and that it was therefore issued without

240. 767 F. Supp. at 828.

241. *Id.* The court also noted that the original extension letter was in the issuer's possession in any event. *Id.*

242. *Id.* The court noted that under Texas law the beneficiary of a letter of credit must comply strictly with the conditions of payment before the beneficiary is entitled to receive payment thereunder (citing *Temple-Eastex Inc. v. Addison Bank*, 672 S.W.2d 793, 795 (Tex. 1984)), but that the language used in the letter of credit at issue could be construed as requiring only that the certification clearly identify the note, rather than requiring exact adherence to a specific recital. *Id.* See *supra* note 223 (*de minimis* errors with respect to the noncommercial aspects of presentment are not fatal).

243. International Chamber of Commerce, UNIFORM CUSTOMS AND PRACTICES FOR DOCUMENTARY CREDITS (1984).

244. *Id.*, Article 16(d).

245. *Id.*, Article 16(e).

246. 767 F. Supp. at 829. See *supra* notes 211-14 and accompanying text.

247. 767 F. Supp. at 829.

authority and in violation of the Texas Savings and Loan Act.²⁴⁸ The issuer's files contained no board of directors' minutes specifically approving the issuance of the letter of credit, and the evidence was unclear on whether the president had actual authority to execute the letter of credit. The court, however, held that the president nonetheless had apparent authority to execute the letter of credit.²⁴⁹ The court also refused to find that the issuer's failure to comply strictly with certain rules and regulations promulgated under the Texas Savings and Loan Act rendered the letter of credit invalid, noting that these rules and regulations were not communicated to the issuer's customers (and therefore could not diminish its officers' apparent authority) and that public policy is better served by protecting innocent third parties who properly rely upon the apparent authority of an agent to act for his principal.²⁵⁰

The RTC further argued that the *D'Oench, Duhme* doctrine and 12 U.S.C. § 1823(e) barred recovery by the plaintiff since there was no proper record of the approval and issuance of the letter of credit in the books and records of the issuer.²⁵¹ The court held that the *D'Oench, Duhme* doctrine did not apply since the letter of credit was a "pure obligation" of the institution, rather than a side agreement relating to a loan or other asset of the institution.²⁵² The court noted that this case involved no scheme or arrangement likely to mislead banking authorities, and it refused to characterize the letter of credit as a "secret agreement" merely because the issuer had poor record keeping procedures.²⁵³ The court also held that even if the *D'Oench, Duhme* doctrine were applicable to a letter of credit, the "completely innocent" exception articulated in *FDIC v. Meo*²⁵⁴ would have applied in this case.²⁵⁵ The court noted that the RTC had "essentially agreed that Agri Export [was] completely innocent of wrongdoing with regard to the letter of

248. TEX. REV. CIV. STAT. ANN. art. 852A (1964 & Supp. 1991).

249. 767 F. Supp. at 830. The court stated that "Texas courts have long held that lending money of a bank in the ordinary course of business would be within the authority of the bank's officers It also has been held that issuing a letter of credit is within the scope of apparent authority ordinarily entrusted to a chief executive officer of a bank". *Id.* (citing *Goldstein v. Union Nat'l Bank*, 109 Tex. 555, 562, 213 S.W. 584, 591 (1919); *FDIC v. Texas Bank*, 783 S.W.2d 604, 607 (Tex. App.—Dallas 1989, no writ)).

250. 767 F. Supp. at 830 (citing *FDIC v. Texas Bank*, 783 S.W.2d 604, 609 (Tex. App.—Dallas 1989, no writ) ("before the FDIC is entitled to rely upon operating policies and procedures to diminish an agent's apparent authority, it was the bank's responsibility to communicate its operating policies to [its] customers")).

251. *See supra* notes 238-39.

252. 767 F. Supp. at 832.

253. *Id.* The court saw no basis for extending the *D'Oench, Duhme* doctrine to bar liability under any unrecorded agreement that diminishes the general assets of the insuring institution. While it stated that the Fifth Circuit court of appeals had not directly addressed the issue, it observed that the Eleventh Circuit court of appeals had declined to so expand the FDIC's powers. *Id.*; *see Vernon v. RTC*, 907 F.2d 1101, 1108 (11th Cir. 1990). The court acknowledged that several federal district courts have been willing to apply the *D'Oench, Duhme* doctrine even when no particular asset was involved, but that those cases all involved "secret arrangements likely to mislead banking authorities." 767 F. Supp. at 832; *see Royal Bank of Canada v. FDIC*, 733 F. Supp. 1091, 1096-97 (N.D. Tex. 1990).

254. 505 F.2d 790, 793 (9th Cir. 1974).

255. 767 F. Supp. at 832.

credit."²⁵⁶

The court held that section 1823(e) applies only to protect an interest in particular assets acquired from failed financial institutions and that no such asset was involved in this case.²⁵⁷ The court declined to broaden section 1823(e) to operate as a general shield against any claims against the failed institution that do not meet the "official record" requirement of the statute.²⁵⁸

VI. DOCUMENTS OF TITLE

A. *Scope and Enforcement of Warehouseman's Lien*

In *Import Systems International, Inc. v. Houston Central Industries*²⁵⁹ the court held that attorney's fees incurred by a bailee in attempting to collect a debt secured by a possessory warehouseman's lien are not secured by the warehouseman's lien.²⁶⁰ Section 7.209(a)(1) of the Code provides that a warehouseman has a lien against the bailor on goods in the warehouseman's possession covered by a warehouse receipt.²⁶¹ This lien secures "charges for storage or transportation . . . , insurance, labor, or charges present or future in relation to the goods, and . . . expenses necessary for preservation of the goods or reasonably incurred in their sale pursuant to law."²⁶² The attorney's fees at issue in *Import Systems* were incurred by the bailee in connection with its attempts to collect accrued storage and freight fees from the bailor.²⁶³ The court held that the attorney's fees incurred by the bailee to enforce the warehouseman's lien or settle the dispute were not "reasonably attributable to the sale of the goods."²⁶⁴ The court further held that expenses of sale that may be secured by a warehouseman's lien are "storage, advertising, rental of facilities for the sale, and payment of auctioneers or salesmen."²⁶⁵ The court observed that other authorities do not support the

256. *Id.*

257. *Id.* at 833.

258. *Id.* at 833-34. The court noted that the effect of extending section 1823(e) and the *D'Oench, Duhme* doctrine in the manner urged by the RTC would leave customers unsure of the validity of banks' obligations to them. *Id.* at 834.

259. 752 F. Supp. 745 (S.D. Tex. 1990).

260. *Id.* at 745, 747-48.

261. TEX. BUS. & COM. CODE ANN. § 7.209(a)(1) (Tex. UCC) (Vernon 1991). See also TEX. BUS. & COM. CODE ANN. § 7.102(a) (Tex. UCC) (Vernon 1991) (definitions of "bailee" and "warehouseman"); TEX. BUS. & COM. CODE ANN. § 1.201(45) (Tex. UCC) (Vernon 1968) (definition of "warehouse receipt").

262. TEX. BUS. & COM. CODE ANN. § 7.209(a)(1) (Tex. UCC) (Vernon 1991).

263. 752 F. Supp. at 746. The bailor at the same time was attempting to retrieve its goods from the bailee. The dispute arose after a buyer in Massachusetts rejected a portion of the goods (shoes, in this case) that the bailee had shipped from Houston to the buyer at the direction of the bailor. The basis for the buyer's refusal to accept the shipment was its claim that the shoes were infested with cockroaches. The bailee returned the shoes to its Houston facility. *Id.*

264. 752 F. Supp. at 747 (emphasis original).

265. *Id.* The court noted that "[n]othing in the statute requires the retention of attorneys." *Id.* The bailee perhaps should have argued that the attorney's fees were "charges present or future in relation to the goods." See TEX. BUS. & COM. CODE ANN. § 7.209(a)(1) (Tex. UCC) (Vernon 1991).

inclusion of attorney's fees within the charges and expenses secured by a section 7.209(a)(1) warehouseman's lien.²⁶⁶ The court was also influenced by a Texas court of appeals decision²⁶⁷ that held that attorney's fees are not secured by a Texas statutory mechanic's lien, even though the statutory provisions as then in effect expressly allowed a mechanic's lien holder to recover reasonable attorney's fees.²⁶⁸

The bailor in *Import Systems* claimed that the bailee converted the goods when it enforced its lien by selling the goods pursuant to section 7.210 of the Code.²⁶⁹ Section 7.210(c) permits any person claiming a right in goods to avoid a sale by paying the amount necessary to satisfy the lien plus the reasonable expenses incurred by a warehouseman in enforcing its lien under section 7.210. Prior to the sale the bailor tendered to the bailee a check in the amount of the bailee's bill less the portion comprising attorney's fees. The tender, however, was part of a settlement offer that contained a number of conditions to its effectiveness. The court noted the common-law rule that a tender of payment must be unconditional to be effective.²⁷⁰ The court further held that the bailor's conditional tender failed to discharge the warehouseman's lien and that, accordingly, since the bailee was entitled to sell the goods, the bailee did not convert the bailor's property.²⁷¹

VII. SECURED TRANSACTIONS

A. Scope

Section 9.104(10) of the Code provides that Chapter 9 does not apply to the creation or transfer of an interest in or lien on real estate.²⁷² In *Kimsey v. Burgin*²⁷³ the San Antonio court of appeals held that a contract for deed²⁷⁴ created an interest in land and was therefore not governed by the Code.²⁷⁵ The court quoted language from an earlier opinion by it and from

266. *Id.* (citing 78 AM. JUR. 2d § 214; 60 TEX. JUR. 2d § 29; National Cold Storage Co. v. Tiya Caviar Co., 276 N.Y.S.2d 57 (N.Y. Sup. Ct. 1966)).

267. *Palomita, Inc. v. Medley*, 747 S.W. 2d 575, 577-78 (Tex. App.—Corpus Christi 1988, no writ).

268. 752 F. Supp. at 748. See, e.g., TEX. PROP. CODE §§ 53.156, .176 (Vernon 1984). The court concluded: "This court will not read attorney's fees into the warehouseman's lien statute when the legislature has declined to include them, and where a similar, but more specific, statute on mechanic's liens has been held not to include them." 752 F. Supp. at 748.

269. TEX. BUS. & COM. CODE ANN. § 7.210 (Tex. UCC) (Vernon 1991).

270. 752 F. Supp. at 748-49. The court cited *Collision Center Paint and Body v. Campbell*, 773 S.W.2d 354, 357 (Tex. App.—Dallas 1989, no writ), as well as several other courts of appeals cases that applied the unconditional tender rule. 752 F. Supp. at 748-49.

271. 752 F. Supp. at 749.

272. TEX. BUS. & COM. CODE ANN. § 9.104(10) (Tex. UCC) (Vernon 1991). An exception (which is recognized in section 9.104(10)) is made for fixtures. See TEX. BUS. & COM. CODE ANN. § 9.313 (Tex. UCC) (Vernon 1991).

273. 806 S.W.2d 571 (Tex. App.—San Antonio 1991, writ denied).

274. A contract for deed is "[a]n agreement by a seller to deliver the deed to the property when certain conditions have been met, such as completion of payments by purchaser." BLACK'S LAW DICTIONARY 325 (6th ed. 1990).

275. 806 S.W.2d at 576-77.

another court of appeals case²⁷⁶ to the effect that under Texas law a purchaser under an executory contract for the sale of real property acquires equitable title to the property when the contract is executed or, in any event, when the purchaser takes possession of the property.²⁷⁷ The court in *Kimsey* rejected the seller's argument that the contract for deed was an executory contract to purchase land upon fulfillment of the contract's obligations and was therefore personal property until it ripened into real estate ownership.²⁷⁸ The court held that the trial court correctly granted judgment for foreclosure of the seller's deed of trust lien on the purchaser's interest in the contract.²⁷⁹

B. Continuous Security Interest in Minerals

The Code was amended in 1991 by the addition of a new section 9.203(c), which provides that a security interest applicable under Chapter 9 to minerals upon extraction and that also qualifies under applicable law as a lien on the minerals before extraction shall constitute, before and after production, "a single continuous and uninterrupted lien on the property."²⁸⁰ Section 9.203(c) also provides that it is declaratory of the law of Texas "as it has heretofore existed and shall apply with respect to oil, gas, and other minerals heretofore and hereafter produced."²⁸¹ The legislative history of section 9.203(c)²⁸² indicates that it was enacted in response to a position asserted by agents of the Internal Revenue Service that oil and gas, upon extraction from the ground, become new property not previously in existence,²⁸³ with the effect that security interests in the oil and gas taken by a lender prior to production — when the oil and gas are real property²⁸⁴ — lose their priority to a subsequently-arising federal tax lien.²⁸⁵

276. *Furman v. Sanchez*, 523 S.W.2d 253 (Tex. Civ. App.—San Antonio 1975, no writ); *City of Garland v. Wentzel*, 294 S.W.2d 145 (Tex. Civ. App.—Dallas 1956, writ ref'd n.r.e.).

277. 806 S.W.2d at 576.

278. *Id.* at 575-77. The seller's characterization of the contract for deed as personal property governed by the Code is puzzling in light of the parties' original treatment of the purchaser's interest in the contract as a real property interest (*see infra* note 279) and the trial court's judgment in favor of the seller for foreclosure of the seller's deed of trust lien.

279. 806 S.W.2d at 577. The seller had assigned to the purchaser seller's interest as purchaser under a prior contract for deed on the same tracts of land. The purchaser defaulted under a purchase-money promissory note payable to the seller. The note was secured by a deed of trust lien in favor of the seller. The parties thus appear to have treated the purchaser's interest as a real property interest from the inception of the transaction.

280. TEX. BUS. & COM. CODE ANN. § 9.203(c) (Tex. UCC) (Vernon 1991); added by Acts 1991, 72nd Legislature, ch. 139, § 1.

281. *Id.*; *see Hess v. Bank of Oklahoma (In re Hess)*, 61 B.R. 977 (Bankr. N.D. Tex. 1986).

282. *See* Testimony on Tex. H.B. 2092 before the House Comm. on Energy, 72nd Leg. C.S. (April 17, 1991).

283. This position is apparently based on the change in character of minerals upon extraction from real property to personal property. *See, e.g., Phillips Petroleum Co. v. Mecom*, 375 S.W.2d 335, 339 (Tex. Civ. App.—Austin 1964, no writ); *Chapman v. Parks*, 347 S.W.2d 805, 807 (Tex. Civ. App.—Amarillo 1961, writ ref'd n.r.e.); *W.B. Johnson Drilling Co. v. Lacy* 336 S.W. 2d 230, 234 (Tex. Civ. App.—Eastland 1960, no writ).

284. *See Stephens County v. Mid-Kansas Oil & Gas Co.*, 113 Tex. 160, 254 S.W. 290, 292 (1923).

285. Section 6321 of the Internal Revenue Code creates the federal tax lien and provides that it covers all real and personal property belonging to the debtor. I.R.C. § 6321 (West

Section 9.203(c) confirms the effectiveness, as a continuous lien on minerals before and after production, of a security interest created under both Chapter 9 of the Code and applicable real property law. For a lender with a security interest covering minerals upon extraction and a deed of trust lien covering the same minerals in the ground, section 9.203(c) provides assurance that the legal nature of the minerals as real or personal property will not affect the validity of the lender's security interest, and that the priority of the security interest in extracted minerals will relate back to the time that the security interest initially attached (by virtue of the deed of trust) to the minerals in the ground.²⁸⁶

C. Perfection and Priorities

1. Chattel Paper

Chattel paper is defined under the Code as "a writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods"²⁸⁷ A security interest in chattel paper may be perfected by filing or possession.²⁸⁸ In *First Interstate Bank of Arizona v. Interfund Corp.*²⁸⁹ the court affirmed a trial court judgment awarding actual and puni-

1989). Section 6322 of the Internal Revenue Code provides that the lien arises at the time that the assessment is made. *Id.* § 6322. Section 6323(a) of the Internal Revenue Code provides that the lien imposed by Section 6321 shall not be valid as against any holder of a security interest (or as against certain other enumerated parties) until notice of the lien has been properly filed. *Id.* § 6323(a). This language has been interpreted to mean that a tax lien primes security interests (and the other enumerated interests) coming into existence after, but not before, the time that notice of the tax lien has been properly filed. The implication inherent in section 6323 is that the lien is valid from its inception as against all parties not expressly protected by section 6323. Section 6323(b) and section 6323(c) give "super-priority" status to certain interests. *See Id.* §§ 6323(b), (c). Under section 6323(h)(1) "[a] security interest exists at any time (A) if, at such time the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth." *Id.* § 6323(h)(1). Given this statutory framework, the reasoning behind the IRS agents' argument may have been along the following lines: a lender's security interest, taken prior to production (typically at the same time that the lender acquires its deed of trust lien on oil and gas in the ground), in extracted oil and gas is ineffective as a "security interest" vis-à-vis an intervening federal tax lien filed prior to the commencement of production, on the ground that the property covered by the security interest (extracted oil and gas, which is personal property under Texas law) did not "exist" at the time that the tax lien arose — so that (i) the lender cannot avail itself of the "time of filing" rule set forth in section 6323(a), (ii) under Section 6322 the tax lien became effective when the assessment of tax liability was made against the mineral-interest owner, and (iii) under section 6323(a) the tax lien primes the lender's security interest in extracted oil and gas when the lender's security interest comes into existence upon the commencement of production.

286. The security interest under the Code should attach at the same time. *See TEX. BUS. & COM. CODE ANN.* §§ 9.203(a), (b) (Tex. UCC) (Vernon 1991). The lender should perfect its security interest under the Code by filing a financing statement in the office of the County Clerk in the county where a mortgage on the real estate would be filed. *See TEX. BUS. & COM. CODE ANN.* §§ 9.302(a), .401(a)(2), .402 (Tex. UCC) (Vernon 1991). The lender's mortgage may also serve as its financing statement. *See TEX. BUS. & COM. CODE ANN.* § 9.402(f) (Tex. UCC) (Vernon 1991). The lender should also file a financing statement in the office of the Secretary of State to cover oil and gas in transit after severance.

287. *TEX. BUS. & COM. CODE ANN.* § 9.105(a)(2) (Tex. UCC) (Vernon 1991).

288. *TEX. BUS. & COM. CODE ANN.* §§ 9.304(a), .305 (Tex. UCC) (Vernon 1991).

289. 924 F.2d 588 (5th Cir. 1991).

tive damages for conversion to a lender that held a prior, perfected security interest in chattel paper comprised of (i) a contract between the lender's borrower and the borrower's customer for the sale for \$100,000 of an Arabian horse named AK Kadira, (ii) a purchase-money note, and (iii) a security agreement.²⁹⁰ After the lender had acquired and perfected its security interest in this chattel paper, the borrower entered into an agreement with the defendant that set forth the manner in which the borrower could sell certain horse sales contracts to the defendant. The agreement also allowed the defendant to retain additional property of the borrower as security for any indebtedness owed by the borrower to the defendant. The borrower subsequently asked the lender to return the note evidencing the borrower's loan to its customer in connection with the sale of AK Kadira, so that the borrower could forward the note to the defendant for inspection for possible purchase. The borrower forwarded the note, which was still indorsed to the lender, to the defendant. In a series of deliveries over the next three months, the lender sent to the defendant the original certificate of registration on AK Kadira, an unrecorded UCC-3 evidencing an assignment of the lender's security interest in the horse to the defendant, and the note endorsed to the defendant.²⁹¹ With each delivery to the defendant, the lender included a cover letter expressing the lender's understanding that the defendant planned to purchase the chattel paper and instructing the defendant to return all documents to the lender if the defendant did not purchase the chattel paper. The defendant failed to purchase or return the paper. It did not respond to two written requests from the lender for the return of the documents; instead, it recorded the UCC-3 and sent in the registration certificate for reissuance in its name as the owner of record.

The court rejected the defendant's contention that retaining the chattel paper was lawful due to a provision in its agreement with the borrower giving the defendant the right to hold and apply (against indebtedness owed by the borrower to the defendant) any of the borrower's property that came into the defendant's possession. The court pointed out that the lender had a prior security interest in the chattel paper that was perfected by filing and possession.²⁹² The court also held that ample evidence, namely the lender's

290. *Id.* at 596. The lender's borrower owned and operated an Arabian horse farm. The lender financed the borrower's operations with a line of credit secured by, *inter alia*, the borrower's chattel paper and most of its horses and other inventory. The lender perfected its security interest by proper filings. The borrower assigned and delivered chattel paper to the lender as the borrower generated it through horse sales. Under criteria set forth in the loan agreement between the lender and the borrower, some of the sales contracts were ineligible to serve as the basis for an advance. The borrower began dealing with the defendant in this case after the lender suggested that it sell its ineligible contracts and apply the proceeds to reduce the borrower's indebtedness under its line of credit with the lender. *Id.* at 590-91.

291. The defendant had returned the note to the lender after a representative of the lender informed the defendant that to complete the purchase of the chattel paper on AK Kadira the lender needed to endorse and assign the note to the defendant.

292. 924 F.2d at 593-94 (citing TEX. BUS. & COM. CODE ANN. §§ 9.105(a)(2), .304(a), .305, .301(a), .312(e)(1) (Tex. UCC) (Vernon 1991)). The court also noted that the defendant did not acquire priority under section 9.308 of the Code as a purchaser of chattel paper, since the defendant arguably never gave new value for the paper and, in any event, had knowledge of

transmittal letters to the defendant describing the conditional nature of the lender's delivery of the chattel paper and the lender's expectation that the defendant was going to purchase the chattel paper, supported the jury's findings that the lender neither consented to the defendant's retention of the chattel paper nor waived its security interest therein.²⁹³ In upholding the jury's award of punitive damages in an amount equal to the actual damages awarded, the court said that sufficient evidence was in the record for a reasonable jury to have determined that the defendant's actions were willful, wanton, and malicious.²⁹⁴

2. Proceeds of Collateral

In *Aycock v. Texas Commerce Bank*²⁹⁵ a creditor with a perfected security interest in certificated securities prevailed over a judgment creditor in a dispute involving conflicting claims to a special account into which the issuer of the securities had deposited liquidating dividends paid on the securities pledged to the secured creditor.²⁹⁶ The issuer of the securities had issued dividend checks to the debtors who had pledged the securities to the secured

the lender's security interest. 924 F.2d at 594 n.2. See TEX. BUS. & COM. CODE ANN. § 9.308 (Tex. UCC) (Vernon 1991).

293. 924 F.2d at 595. The court stated that section 9.306(b) of the Code "specifically provides for the express waiver of a security interest." *Id.*; see TEX. BUS. & COM. CODE ANN. § 9.306(b) (Tex. UCC) (Vernon 1991). Section 9.306(b) provides that, except as otherwise provided in Chapter 9, a security interest in collateral continues notwithstanding disposition of the collateral unless the secured party authorized the disposition. TEX. BUS. & COM. CODE ANN. § 9.306(b) (Tex. UCC) (Vernon 1991). For another case within the survey period discussing the application of section 9.306(b), see *Permian Petroleum Co. v. Petroleos Mexicanos*, 934 F.2d 635, 649-51 (5th Cir. 1991) (provision in loan agreement allowing debtor to sell collateral to a particular buyer did not authorize disposition of collateral where buyer offset its obligation to pay for the goods against a pre-existing obligation of the debtor to the buyer).

294. 924 F.2d at 596. The court was unable to resist taking a final dig at the defendant's position. It concluded: "We have examined the equine that Interfund presented for our inspection. Finding it to be a nag, not a thoroughbred, we dutifully relegate it to its proper stall." *Id.*

295. 127 B.R. 17 (Bankr. S.D. Tex. 1991).

296. The secured creditor, some three years prior to the time that the judgment creditor obtained its judgment against the same debtors, received the debtors' stock certificates, stock transfer powers, and a written security agreement, as security for payment of a promissory note executed by the debtors to back up a letter of credit issued by the secured creditor for the debtors' account. These steps were sufficient to give the secured creditor a perfected security interest in the securities. Chapter 8 of the Code governs the transfer of securities, including certificated securities. See TEX. BUS. & COM. CODE ANN. §§ 8.102(a)(1), (a)(3) (Tex. UCC) (Vernon 1991). Section 8.321 of the Code provides, *inter alia*, that (i) a security interest in a security is enforceable and can attach only if the security is transferred to the secured party (or the secured party's designee) pursuant to a provision of section 8.313(a) of the Code, (ii) a security interest so transferred pursuant to an agreement by a transferor who has rights in the security to a transferee who has given value is a perfected security interest, and (iii) Chapter 9 applies to the security interest, but no filing is required to perfect it. TEX. BUS. & COM. CODE ANN. §§ 8.321(a), (b), (c)(1) (Tex. UCC) (Vernon 1991). Section 8.313(a) of the Code provides an exclusive list of methods of transfer effective to constitute a valid "transfer" of a security (including a limited interest therein, such as a security interest) to a purchaser. TEX. BUS. & COM. CODE ANN. § 8.313(a) (Tex. UCC) (Vernon 1991). A "purchaser" under the Code includes a person taking the interest as security. TEX. BUS. & COM. CODE ANN. §§ 1.201(32), (33) (Tex. UCC) (Vernon 1968)). One of the authorized methods of transfer for certificated securities is delivery of the stock certificates to the purchaser. TEX. BUS. & COM. CODE ANN. § 8.313(a)(1) (Tex. UCC) (Vernon 1991).

creditor. The debtors, however, never cashed the checks, so the full amount of the funds deposited into the special account as dividends remained in the account. The judgment creditor attempted to assert a garnishment or set-off against the account, and the secured creditor intervened, asserting its security interest.²⁹⁷

The court noted that a security interest continues in proceeds of collateral, and that money, checks, and deposit accounts qualify as proceeds.²⁹⁸ Accordingly, it held that the secured creditor obtained a perfected security interest in the liquidating dividends.²⁹⁹ Section 9.306(d) of the Code provides that, with respect to a debtor who is the subject of insolvency proceedings, a secured party with a perfected security interest in proceeds has a perfected security interest only in certain proceeds.³⁰⁰ The types of proceeds subject under section 9.306(d) to a secured party's perfected security interest in proceeds include "separate deposit accounts containing only proceeds."³⁰¹ The court determined that the account at issue qualified as such a separate account because it contained only proceeds attributable to the pledged stock. The proceeds thus remained identifiable and traceable.³⁰² Under section 9.306(c) of the Code a security interest in proceeds is a continuously perfected interest if the interest in the original collateral was perfected, but it ceases to be a perfected security interest ten days after receipt of the proceeds by the debtor (except under limited circumstances enumerated in section 9.306(c)).³⁰³ The judgment creditor argued that the dividend checks drawn on the special account and received by the debtors were the proceeds. The court rejected that argument, holding instead that since the debtors never cashed the checks, they never exercised dominion or control over, or received, the funds in the account.³⁰⁴

3. *Rights of Buyer in Ordinary Course of Business Against Secured Party*

A "buyer in the ordinary course of business" means a person who buys in ordinary course from a person in the business of selling goods of the kind bought and who acts in good faith and without knowledge that the sale violates the ownership rights or security interest of a third party.³⁰⁵ Section

297. The court noted that, whether the judgment creditor was asserting setoff or garnishment, "priority determines the winner." 127 B.R. at 19.

298. 127 B.R. at 18 (citing, respectively, TEX. BUS. & COM. CODE ANN. §§ 9.306(b), (a) (Tex. UCC) (Vernon 1991)).

299. 127 B.R. at 19.

300. TEX. BUS. & COM. CODE ANN. § 9.306(d) (Tex. UCC) (Vernon 1991). The debtors in *Aycock* were in bankruptcy proceedings.

301. *Id.* § 9.306(d)(1).

302. 127 B.R. at 19. The court, in an opinion denying the judgment creditor's motion for rehearing, held that the account did not lose its "separate account" status under section 9.306(d) of the Code because the depositing into the account of funds unrelated to the dividends on the pledged stock constituted a commingling by the issuer, rather than by the debtors (the unrelated funds were subsequently withdrawn). 133 B.R. 190 (Bankr. S.D. Texas 1991); TEX. BUS. & COM. CODE ANN. § 9.306(d) (Tex. UCC) (Vernon 1991).

303. TEX. BUS. & COM. CODE ANN. § 9.306(c) (Tex. UCC) (Vernon 1991).

304. 127 B.R. at 19.

305. TEX. BUS. & COM. CODE ANN. § 1.201(9) (Tex. UCC) (Vernon Supp. 1992).

9.307(a) of the Code establishes a general rule that a buyer in the ordinary course of business takes free of a security interest created by the seller, even if the security interest is perfected and even if the buyer is aware of the security interest.³⁰⁶ In *Bures v. First National Bank, Port Lavaca, Texas*³⁰⁷ the court held that a lender that held the title certificate for a travel trailer pursuant to a floor plan financing arrangement with its borrower (a travel trailer dealer) may be liable to the buyer of the trailer for conversion for refusing to deliver the title to the buyer.³⁰⁸ The floor plan financing arrangement in *Bures* worked as follows: the lender retained the manufacturer's certificates of origin as security for its loans to the dealer; when the dealer sold a travel trailer he was obligated to remit the proceeds to the lender for application against the dealer's indebtedness to the lender, and upon receipt of the proceeds the lender would release the title to the trailer sold. The dealer sold a travel trailer to Bures but failed to remit the sales proceeds to the lender. The lender never released the title certificate to Bures' trailer. Instead, the lender suggested that Bures consult an attorney, and it sent him a letter, via certified mail, return receipt requested, (i) demanding either payment of the amount that was due from the dealer, plus interest, or surrender of the trailer, and (ii) indicating that the lender would accelerate, foreclose, and file suit against Bures if its demands were not met. Bures did not pick up this letter, nor did he make demand on the lender for the title.

The trial court ordered the lender to release the title certificate to Bures free of all liens, but it also instructed a verdict against Bures on his counterclaim for conversion. The court of appeals reversed and remanded, holding: (i) a cause of action may be maintained for conversion of a document of title;³⁰⁹ (ii) a demand for the title and a refusal of the demand — usual elements of a cause of action for conversion — were not required, because the evidence was sufficient for the jury to have found that a demand by Bures on the lender for the certificate would have been useless and/or that the lender's actions amounted to a clear repudiation of Bures' ownership rights in the certificate;³¹⁰ and (iii) damages for conversion include loss of use, and Bures' evidence showing inability to use the trailer and the amount it would have cost to rent a comparable trailer was legally sufficient to establish damages.³¹¹

A person cannot qualify as a buyer in the ordinary course of business unless he buys the goods. The Code provides that "buying" does not include

306. TEX. BUS. & COM. CODE ANN. § 9.307(a) (Tex. UCC) (Vernon 1991).

307. 806 S.W.2d 935 (Tex. App.—Corpus Christi 1991, no writ).

308. *Id.* at 938.

309. *Id.* (citing *Lee County Nat'l Bank v. Nelson*, 761 S.W.2d 851, 852 (Tex. App.—Beaumont 1988, writ denied); *Nueces Trust Co. v. White*, 564 S.W.2d 798, 806 (Tex. Civ. App.—Corpus Christi 1978, no writ.)).

310. 806 S.W.2d at 938-39 (citing, *inter alia*, *McVea v. Verkins*, 587 S.W.2d 526, 531 (Tex. Civ. App.—Corpus Christi 1979, no writ); and *Loomis v. Sharp*, 519 S.W.2d 955, 958 (Tex. Civ. App.—Texarkana 1975, writ dismissed)).

311. 806 S.W. 2d at 939 (citing *Southwind Aviation Inc. v. Avendano*, 776 S.W.2d 734, 737 (Tex. App.—Corpus Christi 1989, writ denied)).

a transfer "in total or partial satisfaction of a money debt."³¹² In *Permian Petroleum Co. v. Petroleos Mexicanos*³¹³ the court held that the use of a contract credit by the transferee of liquified petroleum gas as an offset against its obligation to pay for the gas was not "buying," since the transferee gave no new value (the credit was a debt of the transferor that was in existence prior to the time of the transfer of the gas).³¹⁴ Accordingly, the court held that the transferee was not a buyer in the ordinary course of business and therefore, did not cut off the lender's perfected security interest in the transferor's gas inventory.³¹⁵

4. *Rights of Holder of Worker's and Garageman's Possessory Liens Against Secured Party*

Section 9.310 of the Code gives a possessory lien held pursuant to non-Code law priority over a perfected security interest (unless the lien is statutory and the statute provides otherwise).³¹⁶ For the possessory lienholder to achieve this priority the lienholder must have furnished services or materials with respect to the goods in the ordinary course of his business.³¹⁷ In *First State Bank of Odessa v. Arsiaga*³¹⁸ a bank holding a prior, perfected security interest in a truck was unsuccessful in a conversion claim against a repair shop owner. The owner asserted possessory liens under subchapter 70.A of the Texas Property Code for repairs and storage.³¹⁹ Section 70.001(a) of the Texas Property Code allows a worker who repairs a vehicle to retain possession of the vehicle until he is paid, and section 70.003(c) of the Texas Property Code gives a garageman with whom a vehicle is entrusted a lien on the vehicle for charges for care of the vehicle.³²⁰ The bank argued that the possessory liens lost their priority status because the repairman failed to observe the notice requirements under section 70.006 of the Texas Property Code.³²¹ Section 70.006(a) provides that the holder of a lien on a motor vehicle under subchapter 70.A of the Texas Property Code who retains possession of the vehicle for thirty days after the date on which the charges accrue must notify the owner and each lienholder recorded on the certificate of title.³²² The

312. TEX. BUS. & COM. CODE ANN. § 1.201(9) (Tex. UCC) (Vernon Supp. 1992).

313. 934 F.2d 635 (5th Cir. 1991).

314. *Id.* at 649.

315. *Id.* at 648. See TEX. BUS. & COM. CODE ANN. §§ 9.306(b), .307(a) (Tex. UCC) (Vernon 1991). The court rejected the transferee's argument that "buying" occurs if on the date of the transfer the transferee intends in good faith to give new value (the transferee in *Permian* did not determine until after the transfer of the gas that it was entitled to the offset credit, but all the operative facts giving rise to the credit occurred prior to the date of the transfer). 934 F.2d at 649. The court noted that neither section 1.201(9) nor section 9.307 contains timing or intent provisions. *Id.*; TEX. BUS. & COM. CODE ANN. § 1.201(9) (Tex. UCC) (Vernon Supp. 1992); TEX. BUS. & COM. CODE ANN. § 9.307 (Tex. UCC) (Vernon 1991).

316. TEX. BUS. & COM. CODE ANN. § 9.310 (Tex. UCC) (Vernon 1991).

317. *Id.*

318. 804 S.W.2d 343 (Tex. App.—Eastland 1991, writ denied).

319. See TEX. PROP. CODE ANN. §§ 70.001 (a), .003(c) (Vernon 1984 and Supp. 1992).

320. *Id.* These statutes give possessory and lien rights with respect to other items as well.

321. TEX. PROP. CODE ANN. § 70.006 (Vernon 1984).

322. TEX. PROP. CODE ANN. § 70.006(a) (Vernon 1984).

notice must be sent by certified mail, return receipt requested, and must include the amount of the charges and a request for payment.³²³ The lienholder may sell the vehicle at a public sale if the charges are not paid before the thirty-first day after the date on which the notice was mailed.³²⁴

The court held that the notice requirement contained in section 70.006 of the Texas Property Code is a condition to a possessory lienholder's right to conduct a nonjudicial foreclosure sale, rather than a condition to perfection of a possessory lien.³²⁵ Section 70.006 does not stipulate any time period within which a possessory lienholder must give the written notice; the lienholder simply cannot sell the collateral until thirty-one days after proper notice is given. The court in *Arsiaga* declined to interpret section 70.006 as imposing any deadline for giving the notice of possession and charges and the request for payment described therein. The court pointed out that the bank could have contested the reasonableness and necessity of the storage and repair charges at trial.³²⁶

5. *Priority of Purchase Money Security Interest Over Conflicting Security Interest*

Section 9.312(d) of the Code gives a purchase money security interest in collateral (other than inventory) priority over a conflicting security interest in the same collateral or its proceeds if the purchase money security interest is perfected at or within twenty days after the time that the debtor receives possession of the collateral.³²⁷ In *Cockrell v. Citizens National Bank of Denton*³²⁸ the court had to determine the meaning of the term "possession." The court held that "possession means that condition of facts under which one can exercise power over property at his pleasure to the exclusion of all other persons."³²⁹

In *Cockrell* the parties entered into an agreement, dated August 1, 1985, for the sale of the seller's mini-blind business, including the equipment at issue. At the same time, the buyers paid a portion of the purchase price and executed a promissory note for the balance. The note was secured by a security interest in the equipment. Neither the contract of sale nor any other closing document mentioned delivery of possession of the equipment. During the ensuing sixty days, both parties had keys to the warehouse in which the equipment was located. The seller during this time remained involved, along with the buyers, in the day-to-day operations of the business, including

323. *Id.*

324. TEX. PROP. CODE ANN. § 70.006(b) (Vernon 1984).

325. 804 S.W.2d at 345.

326. 804 S.W.2d at 345. The court stated that storage charges would not be reasonable if the facts showed that a mechanic secretly stored the vehicle until the storage charges exceeded the value of the vehicle. *Id.* In this case the storage charges almost equaled the value of the truck.

327. TEX. BUS. & COM. CODE ANN. § 9.312(d) (Tex. UCC) (Vernon 1991).

328. 802 S.W.2d 319 (Tex. App. — Fort Worth 1990, writ requested).

329. *Id.* at 323 (citing *Citizens First Nat'l Bank v. Rushing*, 433 S.W.2d 741 (Tex. Civ. App.—Tyler 1968, no writ); BLACK'S LAW DICTIONARY 1047 (5th ed. 1979)).

the operation of the equipment.³³⁰ On October 3, 1985, the seller surrendered his keys to the warehouse, and the buyers changed the locks and executed financing statements covering the equipment. The seller filed these financing statements on October 7, 1985.

The buyers' bank subsequently foreclosed on the equipment and sold it pursuant to its security interest in after-acquired property under a security agreement that was prior in time to the seller's security interest. The court upheld the jury's finding that the seller perfected his security interest in the equipment at or within twenty days after the buyers received possession of the equipment, and it upheld the jury's awards of actual and punitive damages for conversion in favor of the seller against the buyers' bank.³³¹

The court noted that the Code does not define the term "possession" as that term is used in section 9.312(d).³³² Since the jury charge did not proffer a definition, the court held that the term "was to be given its usual and ordinary meaning."³³³ The court concluded that there was probative evidence before the jury to establish that the buyers did not receive possession of the equipment until October 3, 1985.³³⁴

6. *Effect on Security Interest in Accounts Receivable of Modification of Underlying Contract.*

Section 9.318(b) of the Code provides that, to the extent that the right to payment under an assigned contract has not been earned, any modification of or substitution for the contract is effective against an assignee unless the account debtor has otherwise agreed, notwithstanding notification of the assignment, "but the assignee acquires corresponding rights under the modified or substituted contract."³³⁵ This section is applicable to a creditor (the assignee) holding a security interest in the accounts receivable of a debtor.³³⁶

In *Bank One, Texas v. Communication Specialists, Inc.*³³⁷ the bank held a perfected security interest in all accounts receivable of its debtor. The debtor entered into a contract with a third party (account debtor) pursuant to which the debtor would receive \$47,780. The debtor, the account debtor,

330. The seller's continued involvement related to his retention of the right to receivables and orders and his retention of liability for indebtedness accrued prior to August 1, 1985.

331. 802 S.W.2d at 324-25. The court reversed the trial court's judgment n.o.v. for the bank and rendered judgment for the seller in accordance with the jury's findings. *Id.* The jury found that the seller had made a demand on the bank for the return of the equipment, which the bank refused, and that the bank acted with "wanton disregard" for the rights of the seller. *Id.* at 324. The punitive damages were in an amount equal to approximately one-third of the actual damages awarded. *Id.*

332. 802 S.W.2d at 323. The court was also unable to find any guidance from case law. *Id.*

333. *Id.* (citing *Pena v. Ludwig*, 766 S.W.2d 298 (Tex. App.—Waco 1989, writ requested per TEX. R. APP. P. 130(d))).

334. 802 S.W.2d at 323.

335. TEX. BUS. & COM. CODE ANN. § 9.318(b) (Tex. UCC) (Vernon 1991). The modification or substitution must be made in good faith and in accordance with reasonable commercial standards; the agreement between the assignee and the assignor may provide that modification or substitution is a breach by the assignor. *Id.*

336. See TEX. BUS. & COM. CODE ANN. § 9.318 comment 2 (Tex. UCC) (Vernon 1991).

337. 813 S.W.2d 755 (Tex. App.—Texarkana 1991, n.w.h.).

and a subcontractor of the debtor subsequently entered into a substitute contract pursuant to which the account debtor agreed to pay the subcontractor directly. This change reduced to \$24,206.61 the amount due from the account debtor to the debtor. A third party sought to garnish amounts payable by the account debtor to the debtor. The bank intervened, contending that its perfected security interest in the debtor's accounts receivable gave it priority with respect to the entire \$47,780 over all other claims, including those of the subcontractor. The bank argued that the substituted contract was not effective against it under section 9.318(b) of the Code because the bank did not receive corresponding rights under the substituted contract.³³⁸ The court observed that section 9.318(b) would be rendered meaningless if the court interpreted the "corresponding rights" clause in that section to mean that a modified or substituted contract is effective against an assignee only if it does not affect the assignee's collateral.³³⁹ The court further observed that if under the substituted contract an account receivable no longer existed due to a change in contractual privity, "then there is no corresponding right to which the assignee can be entitled."³⁴⁰ The court concluded that the bank was entitled to \$24,206.61, which constituted the remainder of the account receivable after the modification.³⁴¹

D. *Disposition of Collateral by Secured Party After Default*

1. *Background*

Section 9.504(a) of the Code provides that after a default by the debtor a secured party may sell the collateral.³⁴² Section 9.504(b) provides that the debtor is liable for any deficiency unless otherwise agreed.³⁴³ Section 9.504(c) allows public or private sale but requires that every aspect of the disposition be commercially reasonable.³⁴⁴ The secured party must send to the debtor reasonable notification of the time and place of any public sale.³⁴⁵ With respect to a private sale, the secured party must send to the debtor reasonable notification of the time after which the sale is to be made.³⁴⁶ Notice is not required, however, if after default the debtor has waived in writing its right to notification, or if the "collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized mar-

338. Although not clear in the opinion, the only apparent basis for this claim was the reduction in the amount payable due to the carving out of the payments to be made to the subcontractor.

339. 813 S.W.2d at 757.

340. *Id.* (citing *FDIC v. Registry Hotel Corp.*, 658 F. Supp. 311 (N.D. Tex. 1986)).

341. 813 S.W.2d at 758. The court stated that "[t]he corresponding rights to which the assignee is entitled must be interpreted to mean that the assignee will still be entitled to such collateral or accounts receivable to which the account creditor is entitled under the modified or substituted contract". *Id.* at 757.

342. TEX. BUS. & COM. CODE ANN. § 9.504(a) (Tex. UCC) (Vernon 1991).

343. *Id.* § 9.504(b). If the underlying transaction was a sale of accounts or chattel paper, however, the debtor is liable for any deficiency only if the security agreement so provides. *Id.*

344. *Id.* § 9.504(c).

345. *Id.*

346. *Id.*

ket."³⁴⁷ The Texas supreme court, in *Tanenbaum v. Economics Laboratory, Inc.*,³⁴⁸ held that a creditor disposing of collateral under section 9.504 is barred from suing for a deficiency if the disposition is not commercially reasonable, or if the disposition is made prior to notification to the debtor (if such notification is required under section 9.504).³⁴⁹ Accordingly, the typical defenses asserted by the debtor or other liable parties in a secured party's action to recover a deficiency are that proper notice was not given and/or that the sale of the collateral was not conducted in a commercially reasonable manner. Not surprisingly, therefore, a number of cases published during this survey period dealt with notice, commercial reasonableness, and deficiency issues arising under section 9.504.

2. Notice of Sale and Commercial Reasonableness

In *Adcock v. First City Bank of Alice*³⁵⁰ the court affirmed a deficiency judgment in favor of a secured creditor against guarantors of the indebtedness. The court held that an agreed sale of collateral pursuant to a work-out arrangement between the secured creditor and a guarantor (who owned the collateral) was not a sale "after default" and was not, therefore, subject to the notice and commercial reasonableness requirements of section 9.504.³⁵¹ Although the collateral was sold following default by the debtor on the indebtedness owed to the secured creditor, the court pointed out that the secured creditor effectively waived the default by electing to work out an agreement with one of the guarantors to sell the collateral and apply the proceeds against the indebtedness.³⁵²

In *All Valley Acceptance Co. v. Durfey*³⁵³ the court affirmed an award of damages and attorneys' fees in favor of the debtors against a secured party that sold the collateral (a mobile home) privately following the debtors' de-

347. *Id.* See, e.g., *FDIC v. Blanton*, 918 F.2d 524, 527-28 (5th Cir. 1990) (notice not required for sale of securities on New York Stock and Bond Exchanges, since they are recognized markets, even though the securities were those of a thinly traded corporation in bankruptcy proceedings).

348. 628 S.W.2d 769 (Tex. 1982).

349. *Id.* at 771.

350. 802 S.W.2d 305 (Tex. App.—San Antonio 1990, no writ).

351. *Id.* at 307. The guarantor would have been considered a debtor for purposes of section 9.504 had that section been applicable. See TEX. BUS. & COM. CODE ANN. § 9.105(a)(4) (Tex. UCC) (Vernon 1991); see also *Adams v. Waldrop*, 740 S.W.2d 32, 33 (Tex. App.—El Paso 1987, no writ); *Carroll v. General Elec. Credit Corp.*, 734 S.W.2d 153, 154 (Tex. App.—Houston [1st Dist.] 1987, no writ); *Hernandez v. Bexar County Nat'l Bank*, 710 S.W.2d 684, 687 (Tex. App.—Corpus Christi), writ ref'd n.r.e. per curiam, 716 S.W.2d 938 (Tex. 1986); *Peck v. Mack Trucks*, 704 S.W.2d 583, 586 (Tex. App.—Austin 1986, no writ); but see *James White & Robert Summers*, *supra* note 50, § 27-12 at 128-30 (Supp. 1991).

352. 802 S.W.2d at 306. The court also noted that to allow a debtor to avoid liability for any deficiency remaining after an agreed sale of collateral would allow the debtor to take advantage improperly of the secured creditor's good faith in seeking to bring its loan current and avoid foreclosure. *Id.* at 307. The court noted that the potential for the type of abuse targeted by *Tanenbaum*, 628 S.W.2d 769 (Tex. 1982), was not present (in addition to being an agreed sale, the collateral — shares of stock — was sold for book value, and the owner was given a repurchase right). The court also observed that the evidence showed that the sale satisfied the requirements of section 9.504. 802 S.W.2d at 307 n.3.

353. 800 S.W.2d 672 (Tex. App.—Austin 1990, writ denied) (per curiam).

fault. The court held that (i) a letter sent by the debtors' attorney informing the secured party that the debtors had vacated the mobile home and were seeking damages did not constitute a renunciation or modification by the debtors of their right under section 9.504 of the Code to notification of the sale, because the letter was not signed by the debtors and did not mention any waiver of the debtors' right to notice of sale,³⁵⁴ (ii) voluntary surrender of collateral does not constitute waiver of a debtor's right to notice of sale,³⁵⁵ and (iii) no genuine issue of material fact existed as to whether the debtors received reasonable notification of the sale of the collateral, since the agreement between the debtors and the secured party provided that the secured party could comply with the statutory requirement of reasonable notification by mailing notice of the sale at least ten days prior to the sale, and instead the secured party sold the collateral four days after mailing the notice of sale.³⁵⁶

In *FDIC v. Lanier*³⁵⁷ guarantors, asserting defective notice under section 9.504, challenged a deficiency judgment granted to the secured party following sale of the collateral. The secured party's notice of sale stated that it would sell the collateral at either a public or private sale ten days after the date of the letter. The secured party sold the collateral (inventory) at a private sale four months after it sent the notice letter. The court held that the secured party gave proper notice of sale.³⁵⁸ It stated that "[t]he notice is not defective simply because it does not specifically state that the goods would be sold privately."³⁵⁹ The court also rejected the guarantors' argument that the notice was invalid because the sale occurred four months, rather than ten days, after the notice letter was sent.³⁶⁰ The guarantors in *Lanier* also con-

354. *Id.* at 674-75.

355. *Id.* at 675. Unless otherwise agreed, a secured party has the right to take possession of the collateral after default. See TEX. BUS. & COM. CODE ANN. § 9.503 (Tex. UCC) (Vernon 1991). *Sanchez v. MBank*, 792 S.W.2d 530 (Tex. App.—El Paso 1990, writ granted), which was discussed in the 1990 Survey, was argued before the supreme court on February 27, 1991, but no opinion had been issued at the time of this writing. See John Krahrmer, *supra* note 13, at 145-46.

356. 800 S.W.2d at 675-76.

357. 926 F.2d 462 (5th Cir. 1991).

358. *Id.* at 465.

359. *Id.* The court's reasoning was that the notice "was adequate to 'inform reasonable business persons' that their property would be sold within ten days or more . . ." *Id.* (citing *Siboney Corp. v. Chicago Pneumatic Tool Co.*, 572 S.W.2d 4, 6 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref'd n.r.e.)); see also *Hall v. Crocker Equipment Leasing, Inc.*, 737 S.W.2d 1, 2-3 (Tex. App.—Houston [14th Dist.] 1987, writ denied). The court noted that the notice would have been defective had the secured party conducted a public sale, since the notice did not specify the time and place of sale. 926 F.2d at 465 n.1.

360. 926 F.2d at 465-66. The court cited comment 6 to section 9.504, which states that, except for the ninety-day period applicable under section 9.505(a) to consumer goods in certain instances, "to encourage disposition by private sale through regular commercial channels" no time period is established within which disposition of the collateral must be made. The comment observes, however, that a secured party who delays a sale runs a risk of being found not to have acted in a commercially reasonable manner or in good faith. TEX. BUS. & COM. CODE ANN. §§ 9.504 comment 6, .505(a) (Tex. UCC) (Vernon 1991). See also TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968); *James White & Robert Summers*, *supra* note 50, § 27-12 at 604-06. But see *FDIC v. Blanton*, 918 F.2d 524, 529-30 (5th Cir. 1990) (holding that even if the four-year delay by the secured party in selling the collateral after

tested the commercial reasonableness of the sale on the ground that the sale price was twenty percent of the collateral's cost and about fifty percent of the price that the guarantors' expert asserted he would have been willing to pay. The court held that the deficiency was not large enough to overturn the trial court's finding that the sale was not commercially unreasonable, particularly since the guarantors could show no procedural irregularities or any other reason for the low sale price.³⁶¹

In *Knights of Columbus Credit Union v. Stock*³⁶² the court held that the cross collateralization of three loans was not a basis for including the unpaid balances of two of the loans in the deficiency remaining after the sale of a portion of the collateral following default on the third loan.³⁶³ The court held that the notice of sale was defective as a matter of law because it referred only to a possible sale of the collateral and did not state the time and place of any public sale or the time after which a private sale would be made.³⁶⁴ More significantly, the court held that the deficiency-bar rule of *Tanenbaum*³⁶⁵ did not prevent the secured party from maintaining its security interests in the collateral not sold and its right to recover the balances due under loans that were secured, in part, by the collateral sold at the defective sale.³⁶⁶ The court noted that each loan advance was applied for separately, had separate monthly payments, and had separate security agreements covering different collateral (each agreement provided that the described collateral secured all advances to the debtor under a particular open-end credit agreement, as well as any other amounts owed to the secured party at any time).³⁶⁷ The court stated that "[t]he notice letter itself is dispositive on what deficiency is affected by the insufficient notice."³⁶⁸ Since the letter referred to only one of the loan advances, the court limited the secured party's loss of deficiency to that loan.³⁶⁹ The court also held that

default rendered the sale commercially unreasonable, the debtor was entitled only to credit for the fair market value of the collateral at the time the collateral should have been sold, and that the facts did not warrant presuming that the secured party had elected to retain the collateral in full satisfaction of the debt; this decision imposed a questionable limitation on the *Tanenbaum* decision, 628 S.W.2d 769 (Tex. 1982) (see *supra* note 349 and accompanying text), by apparently interpreting *Tanenbaum* as applicable only in situations in which the creditor's actions prevent the debtor from determining the value of the collateral at the time of disposition).

361. 926 F.2d at 467 (citing TEX. BUS. & COM. CODE ANN. § 9.507(b) (Tex. UCC) (Vernon 1991), and noting that the debtor could have protected its interests by arranging financing for a bid or by selling the collateral itself prior to the secured party's sale).

362. 814 S.W.2d 427 (Tex. App.—Dallas 1991, writ denied).

363. *Id.* at 431-32.

364. *Id.* at 430-31.

365. 628 S.W.2d 769 (Tex. 1982); see *supra* note 349 and accompanying text.

366. 814 S.W.2d at 431-33.

367. *Id.*

368. *Id.*

369. *Id.* at 432. The court stated that "[c]ross collateralization does not magically transform three separate loans into one loan." *Id.* at 431-32. The court also noted that even if it had accepted the debtor's argument that the defective sale barred any suit for a deficiency under any of the cross-collateralized loans, the deficiency could not be determined until all the collateral securing all the loans was sold. *Id.* at 432 n.2 (observing also that *Tanenbaum*, 628 S.W.2d 769 (Tex. 1982), does not suggest that the creditor's security interest is invalidated; instead, it precludes any deficiency remaining after disposition of the collateral).

the debtor's remedies under section 9.507(a) were likewise limited to losses recoverable in connection with the loan identified in the letter.³⁷⁰

Van Brunt v. BancTexas Quorum,³⁷¹ which is comprised of two opinions and two dissents (the original opinion and a dissent therefrom and the opinion and a dissent on rehearing), is a significant decision that insulates lenders holding loans secured by personal property and real property from the adverse consequences of *Tanenbaum*.³⁷² In its original opinion the court held that the secured party failed to give reasonable notification to the debtor of the secured party's sale of the personal property collateral at a private sale,³⁷³ and therefore, the secured party was not entitled to any deficiency judgment.³⁷⁴ The court's opinion on rehearing left intact its original opinion except as it applied to the secured party's right to seek a deficiency judgment on the note that it determined was secured both by the personal property collateral sold at the defective sale and by real property.³⁷⁵ The court, in interpreting section 9.501(d) of the Code,³⁷⁶ held that any defect in the secured party's disposition of the personal property collateral under the Code had no effect on the secured party's rights under its mortgage on the real property, including its right to seek a deficiency on the note that was secured by both the real and personal property.³⁷⁷ Judge Baker, in a well-reasoned

370. 814 S.W.2d at 432-33 (since the collateral was consumer goods, the debtor was able to recover the minimum penalty set forth in section 9.507(a) without being required to prove any loss). See TEX. BUS. & COM. CODE ANN. § 9.507(a) (Tex. UCC) (Vernon 1991).

371. 804 S.W.2d 117 (Tex. App.—Dallas 1990, no writ). This case was decided during the 1990 Survey period but published during the current Survey period.

372. 628 S.W.2d 769 (Tex. 1982). The breadth of protection provided by *Van Brunt* to these lenders may, however, prove to be unavailable to lenders with cases outside the jurisdiction of the Dallas court of appeals; for lenders with cases within such jurisdiction, the insulation may prove to be frayed if and when the supreme court addresses the issue presented in *Van Brunt*. See *infra* notes 377-79 and accompanying text.

373. *Van Brunt*, 804 S.W.2d at 121-22. The secured party first notified the debtor that it intended to sell the collateral. It sent another letter stating that it would hold a public auction and informing the debtor of the time and place. The secured party rejected all bids at the auction and subsequently sold the collateral for a higher price in a private sale to one of the bidders. The secured party did not give any notice to the debtor beyond the two letters described above. The court essentially held that notice of a public sale is not sufficient notice of a subsequent private sale. *Id.* Compare *FDIC v. Lanier*, 926 F.2d 462, 464-65 (5th Cir. 1991) (notice of a "public or private" sale on a specified date was adequate notice of a subsequent private sale). The dissent from the original opinion in *Van Brunt* argues persuasively that the secured party's notices constituted reasonable notification of a public sale and/or a subsequent private sale. 804 S.W.2d 123-25 (Kinkeade, J., dissenting).

374. 804 S.W.2d at 122.

375. *Id.* at 126-27. The other four notes were secured only by the personal property. The court denied the secured party a deficiency judgment on those notes. *Id.* at 130.

376. TEX. BUS. & COM. CODE ANN. § 9.501 (d) (Tex. UCC) (Vernon 1991). Subsection (d) of section 9.501 provides:

If the security agreement covers both real and personal property, the secured party may proceed under this subchapter as to the personal property or he may proceed as to both the real and personal property in accordance with his rights and remedies in respect of the real property in which case the provisions of this subchapter do not apply.

Id.

377. *Id.* at 130. The court's analysis in support of this holding seems disjointed and is not particularly persuasive. The court cited various cases from other jurisdictions for the proposition that under section 9.501(d) of the Code a secured creditor may proceed against the real

dissenting opinion on rehearing, pointed out that the majority's opinion eviscerates *Tanenbaum* in any case in which the debt is secured by both real and personal property.³⁷⁸ Judge Baker argued that the defective sale under the Code should bar any deficiency remaining on the note following foreclosure of the secured party's deed of trust lien on the real property.³⁷⁹

and personal property collateral in separate actions and that if it does so, the default provisions of the Code apply only to the personal property. 804 S.W.2d at 128. This proposition is inherent in the language of section 9.501(d) and is not dispositive of the issue (comment 5 to section 9.501(d) also indicates that the Code defers to non-Code law to determine whether a secured party can proceed against the personal property under applicable real estate law in a separate action following an action against the real property, and that if such separate proceedings are allowed the default provisions of Chapter 9 of the Code would not apply to either action). The court invoked policy considerations, citing, *inter alia*, section 1.106 of the Code, which provides for liberal administration of Code remedies to make an aggrieved party whole and which limits the availability of penal damages. 804 S.W.2d at 128, 129; TEX. BUS. & COM. CODE ANN. § 1.106 (Tex. UCC) (Vernon 1968). The general mandate provided by section 1.106 should not serve as a basis for overriding the consequences of a creditor's breach of a remedial provision under the Code; rather, it should bear on a court's analysis of whether such a breach occurred. The court misinterprets both *Tanenbaum*, 628 S.W.2d 769 (Tex. 1982), and the arguments made in the dissenting opinion in *Van Brunt* on rehearing. The court states that *Tanenbaum* held that the creditor was deemed to have elected to retain the collateral in complete satisfaction of the debt because the creditor failed to comply with the notice provisions of section 9.504(c). 804 S.W.2d 128, 129. In *Tanenbaum* the supreme court held that the creditor in effect retained the collateral in full satisfaction of the debt pursuant to section 9.505 of the Code because the creditor *destroyed* the collateral. 628 S.W.2d at 772; see TEX. BUS. & COM. CODE ANN. § 9.505 (Tex. UCC) (Vernon 1991). The court in *Tanenbaum* also held that a creditor's failure to comply with the notice and commercial reasonableness provisions of section 9.504 in connection with a disposition of the collateral bars a suit for a deficiency. 628 S.W.2d at 771-72. As the dissenting opinion in *Van Brunt* pointed out on rehearing, "[f]oreclosing on the real property is not the seeking of a deficiency, so such action is not barred by *Tanenbaum*." 804 S.W.2d at 131 (Baker, J., dissenting). The Dallas court of appeals has apparently discarded its interpretation of *Tanenbaum* as set forth in *Van Brunt* in favor of the interpretation espoused by Baker in his dissenting opinion. See *Knights of Columbus Credit Union v. Stock*, 814 S.W.2d 427 (Tex. App.—Dallas 1991, writ denied) (discussed *supra* in notes 362-70 and accompanying text).

378. 804 S.W.2d at 131 (Baker, J., dissenting). Baker stated:

[T]he majority effectively holds that *Tanenbaum's* prohibition against suing for a deficiency is really not a prohibition if the debt was also secured by real property, despite the fact that the creditor has not complied with the provisions of section 9.501(d) allowing avoidance of the Code default provisions as to the personal property.

Id.

379. *Id.* See *supra* note 377.