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CREDITOR AND CONSUMER RIGHTS

by

Joseph G. Chumlea* and John S. Dwyre**

I. USURY, INTEREST, AND THE CONSUMER CREDIT CODE

MOST of the usury and Consumer Credit Code¹ cases decided during the Survey period dealt with the issues of contracting for, and charging, usurious interest. Several cases involved the application of usury penalties for charging interest during an interest-free period, and one case contributed to the debate concerning the appropriate calculation of prejudgment interest in Texas. Because only a small number of cases involved disclosure and compliance under the Credit Code, discussion of those topics has been incorporated into the following case review and has not been treated separately.

Many perceive usury law as requiring frustrating involvement in calculating interest and annual percentage rates and in the complexities of credit disclosure. An appropriate beginning for a survey of such cases is the complaint of Mr. and Mrs. Midgett against the Edelstein Furniture Company. In *Midgett v. J. Edelstein Furniture Co.*² a furniture retailer sued the Midgetts after the Midgetts defaulted on a retail installment contract. The Midgetts alleged usury as a defense, but failed to verify their usury pleading as required by rule 93 of the Texas Rules of Civil Procedure.³ On appeal the Midgetts asserted that the contract was usurious on its face and, therefore, exempt from the rule 93 verification requirement.

The contract contained a latent conflict: it disclosed the correct amount financed, interest rate, and finance charges; however, it also required an excess number of payments that, if the Midgetts paid, would result in payment of a sum greater than the actual principal and finance charges. The Midgetts claimed that the excess amount constituted additional, usurious interest. The question was whether the court could sufficiently determine any usurious excess from the record, or whether the court should reject the Midgetts' usury defense because discerning such usury from the Midgetts' pleadings

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1. TEX. REV. CIV. STAT. ANN., arts. 5069-1.01 to -51.19 (Vernon 1987) is commonly referred to as the Consumer Credit Code.

2. 700 S.W.2d 332 (Tex. App.—Corpus Christi 1985, no writ).

3. TEX. R. CIV. P. 93.

would involve too many calculations and require consultation with too many outside sources. The court ultimately held that the mathematics were too complex and the legal maximum rates were not sufficiently clear from the record for the court to find usury.⁴

One dissenting justice felt that the Midgetts should have been permitted to present evidence of usury.⁵ The dissent noted that no instrument charging a usurious interest rate is going to state that rate on its face in unequivocal terms.⁶ Consequently, the dissent argued, courts must engage in mathematical calculations to determine if usury exists.⁷ The dissent concluded by providing a calculation based upon the figures in the Midgetts' contract that reflected the existence of an excessive rate of interest.⁸

In *Missouri-Kansas-Texas Railroad Co. v. Fiberglass Insulators*⁹ the court considered the type of conduct that constitutes a charging of usurious interest under article 5069-1.06.¹⁰ Fiberglass Insulators alleged that the Missouri-Kansas-Texas Railroad Co. charged prejudgment interest in excess of the statutory six percent limit set by article 5069-1.03.¹¹ According to Fiberglass Insulators, the alleged act of charging occurred at trial during the direct and cross-examination of the railroad's account manager concerning Fiberglass's debt. The manager testified that he had been charging interest to Fiberglass's account since Fiberglass breached its contract with the railroad and that ten percent was a fair rate to charge for each year of default. The account manager's testimony included a calculation of the interest at ten percent per annum, compounded annually. On cross-examination the manager stated he was now charging Fiberglass ten percent interest on its remaining balance.

The court's opinion discussed the debate concerning the proper amount of prejudgment interest allowable in Texas and the rule that the six percent limit set by article 5069-1.03 clearly applies to contracts when there is no agreed-upon interest rate.¹² The court determined, however, that no charging of interest under the usury penalty statute had taken place despite the account manager's clear and unequivocal statements under oath that the railroad was charging Fiberglass ten percent interest.¹³ This holding in *Fiberglass Insulators* seems at odds with both the facts of the case and the direction of prior case law. The opinion traced a line of cases discussing the type of conduct that amounts to a charging.¹⁴ Such conduct includes unilat-

4. 700 S.W.2d at 333-34.

5. *Id.* at 334 (Utter, J., dissenting).

6. *Id.*

7. *Id.*

8. *Id.* at 339.

9. 707 S.W.2d 943 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).

10. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (Vernon 1987).

11. *Id.* art. 5069-1.03.

12. 707 S.W.2d at 948; see *infra* text accompanying notes 84-101.

13. *Id.* at 950.

14. *Id.* at 949-50.

erally placing on an account an amount due as interest;¹⁵ sending demand letters for usurious amounts,¹⁶ even though the debtor never receives the letters;¹⁷ and filing a pleading for excessive interest in a lawsuit even though the pleading is later superseded by an amended pleading omitting the excessive interest.¹⁸ The majority in *Fiberglass Insulators* distinguished these cases on the grounds that the cases did not involve a charging that occurred for the first time in testimony at trial.¹⁹ Since no precedent existed for holding an oral request for interest made in connection with a judicial proceeding as a charging, the court concluded that the account manager's testimony was insufficient to constitute usury.²⁰ The majority's distinction is obviously directed at the timing of allegedly usurious conduct rather than at the conduct itself. Article 5069-1.06 prohibits any charging of excessive interest, but it fails to mention a time limit beyond which an excessive charging is permitted.²¹ Courts have defined the conduct of charging as any act by the promisee constituting or implying a demand for payment.²² So long as a charging occurs and the other elements of the cause of action are proven, a usury finding would seem inevitable.

A justification for the result in *Fiberglass Insulators* is suggested by the court's discussion of the judicial confusion over the entitlement of successful litigants to equitable prejudgment interest at rates as high as twenty percent. The court indicated that it did not want to punish a plaintiff bold enough to ask for these higher rates.²³ This reasoning perhaps explains the court's holding better than the court's denial that sworn testimony demanding interest does not constitute a charging under article 5069-1.06.

During the Survey period two Amarillo cases discussed whether the charging of an unspecified, postmaturity rate of interest results in an agreement to charge interest or whether it is usurious. In *Morgan v. Amarillo National Bank*²⁴ the bank sued several individual partners on guaranty agreements concerning two loans to the general partner. The loans provided a floating interest rate tied to the prime rate, and the loans further allowed that past due principal and interest would bear interest at the highest lawful rate until paid. The trial court granted summary judgment in favor of the bank, and the partners appealed, asserting the defense of usury.²⁵ The partners claimed that the postmaturity interest provision was not a specification

15. *Butler v. Wright Way Spraying Serv.*, 683 S.W.2d 823, 826 (Tex. App.—San Antonio 1984), *rev'd on other grounds*, 690 S.W.2d 897 (Tex. 1985).

16. *William v. Back*, 624 S.W.2d 272, 275 (Tex. App.—Austin 1981, no writ); *Moore v. Sabine Nat'l Bank*, 527 S.W.2d 209, 211 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

17. *Williams*, 624 S.W.2d at 275.

18. *Rick Furniture Distrib. Co. v. Kirlin*, 634 S.W.2d 738, 740 (Tex. App.—Dallas 1982, writ ref'd n.r.e.).

19. 707 S.W.2d at 950.

20. *Id.*

21. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (Vernon 1987).

22. *Moore v. Sabine Nat'l Bank*, 527 S.W.2d 209, 212 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

23. 707 S.W.2d at 951.

24. 699 S.W.2d 930 (Tex. App.—Amarillo 1985, writ ref'd n.r.e.).

25. *Id.* at 933.

for a definite interest rate. They alleged, therefore, that no agreement for interest existed and that the six percent rate set by article 5069-1.03²⁶ prevailed. Since the bank admitted charging the floating rate that was in the contract on past due principal and interest at rates as high as 17.5 percent per annum, the partners claimed a charging of more than double the lawful maximum, which required a forfeiture by the bank of all principal and interest. The court saw things differently, however, and held that an agreement to charge the highest lawful interest rate is proper and does not entitle the lender to a rate greater than that provided by law.²⁷ Referring to the Texas Consumer Credit Commissioner's published calculations of usury ceilings, the court further observed that the rate actually charged by the bank was well within usury limits.²⁸ Interestingly, that usury is not available as a defense to a guarantor of a note was not addressed in *Morgan*.²⁹ Also of interest is that the litigants did not complain that postjudgment interest should have been granted at the highest lawful rate that the contract allowed, that is, eighteen percent per annum pursuant to article 5069-1.05, section 1³⁰ rather than ten percent per annum, which presumably the court awarded under article 5069-1.05, section 2.³¹

The court in *Dodson v. Citizens State Bank*,³² like the *Morgan* court, concluded that parties to a contract may agree that past due interest will run at the highest legal rate without the creditor suffering usury penalties for charging and receiving interest up to that limit.³³ The *Dodson* case involved a bank's offer to a borrower to combine into a renewal note a preexisting \$250,000 personal note and a \$35,000 note of a corporation that the borrower presumably controlled. The borrower rejected the offer and later claimed that the bank, by including the corporate debt in the offered renewal, had required the borrower to assume a third-party debt. The borrower then alleged that the corporate debt should be considered interest under the rationale of *Alamo Lumber Co. v. Gold*.³⁴ The *Dodson* court rejected the borrower's argument, stating that the court in *Alamo Lumber* emphasized the lender's refusal to extend credit absent the proposed debtor's assumption of a third party's debt.³⁵ The court noted that in *Dodson* not

26. TEX. REV. CIV. STAT. ANN. art. 5069-1.03 (Vernon 1987).

27. 699 S.W.2d at 934.

28. *See id.*

29. A number of courts have recently held that a usury defense is not available to a guarantor of an obligation. *See Allied Supplier & Erection v. A. Baldwin & Co.*, 688 S.W.2d 156, 160 (Tex. App.—Beaumont 1985, no writ); *Greenway Bank & Trust v. Smith*, 679 S.W.2d 592, 594-95 (Tex. App.—Houston [1st Dist.] 1984, writ ref'd n.r.e.). As noted in Chumlea & Curry, *Creditor and Consumer Rights*, *Annual Survey of Texas Law*, 40 Sw. L.J. 159, 163 (1986), the supreme court in *Houston Sash & Door Co. v. Heaner*, 577 S.W.2d 217 (Tex. 1979), ruled that the usury defense is personal to the debtor and penalty forfeitures in TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (Vernon 1987) apply only to the "immediate parties to the transaction creating the usury defense." *Id.* at 222.

30. TEX. REV. CIV. STAT. ANN. art. 5069-1.05, § 1 (Vernon 1987).

31. *Id.* § 2.

32. 701 S.W.2d 89 (Tex. App.—Amarillo 1986, writ ref'd n.r.e.).

33. *Id.* at 91.

34. 661 S.W.2d 926 (Tex. 1983).

35. 701 S.W.2d at 93.

only did the assumption of the third party's debt not occur, but the bank later renewed the underlying personal debt and advanced additional funds.³⁶ The court also refused to consider the bank's assumption offer as a charging of interest under the usury statute.³⁷ Observing that a usury action must involve proof of an absolute obligation to repay a principal indebtedness, the *Dodson* court concluded that since the proposed renewal note, including the assumption, was only an offer, which the borrower rejected, the underlying repayment element of the cause of action was missing and, thus, no charging occurred.³⁸

In *Reagan v. City National Bank, N.A.*³⁹ the court addressed the issue of when a contract for interest begins. In *Reagan* a businesswoman borrowed a sum of money on October 20, 1981, to purchase a computer for her book-keeping business. The note's interest rate was 19.5 percent, which was within the prevailing lawful maximum rate. In 1983 the business was sold to Elizabeth Reagan, the plaintiff. On September 13, 1983, Reagan signed the original note document in the space designated "co-maker." The lawful maximum rate effective on September 13, 1983, was 18.75 percent per annum. Reagan defaulted on the note, and the bank sued on the note. Reagan subsequently counterclaimed for usury.

The *Reagan* court applied the settled rule that the usurious nature of a contract is determined as of the time of the contract's inception.⁴⁰ Consequently, since the parties agreed that the note's inception was on October 20, 1981, the court held that the interest rate was proper.⁴¹ The court further dismissed Reagan's contention that, by signing the original note in 1983, she either created a new note or renewed or extended the existing note, thereby subjecting the bank to the September 1983 maximum rates.⁴²

The circumstances in the *Reagan* case are somewhat unique. Nevertheless, the holding not only fails to address the root requirement of the rule of law applied in the case, but it also avoids the article 5069-1.04⁴³ issues of what contract the parties are suing on and when did the parties execute the contract. Courts describe a contract as "a deliberate engagement between competent parties to do or abstain from doing some act for a sufficient consideration."⁴⁴ Although the *Reagan* court is correct in holding that the note had its inception in 1981, the lawsuit in *Reagan* nevertheless concerned a deliberate engagement, between two competent parties, that did not exist prior to September 13, 1983. The settled rule of law applied in the case seems to require courts to identify the date of formation of the contract between the parties. This requirement has been incorporated into article 5069-

36. *Id.*

37. *Id.*

38. *Id.*

39. 714 S.W.2d 425 (Tex. App.—Eastland 1986, writ ref'd n.r.e.).

40. *Id.* at 428.

41. *Id.*

42. *Id.*

43. TEX. REV. CIV. STAT. ANN. art. 5069-1.04 (Vernon 1987).

44. *Smith v. Thornhill*, 25 S.W.2d 597, 599 (Tex. Comm'n App. 1930), *rev'd on other grounds on reh'g*, 34 S.W.2d 803 (Tex. Comm'n App. 1931, holding approved).

1.04,⁴⁵ which allows the parties to any written contract to agree on any rate of interest that does not exceed an indicated rate ceiling as calculated for the week prior to the date of the rate contract. This language requires courts to identify the parties to the contract and the date they contracted for the particular interest rate in question.

The court in *Reagan* concluded that the parties did not create a new note in 1983.⁴⁶ Even so, Reagan was not a guarantor of the note, and contractual obligations between Reagan and the bank did not exist prior to September 13, 1983.⁴⁷ Article 5069-1.04 would, therefore, seem to impose the usury ceilings in effect for the week preceding September 13, 1983, which would require a finding of usury.

A determination of whether a transaction constituted one loan that might be usurious, or two nonusurious loans was involved in *Scalise v. McCallum*.⁴⁸ In *Scalise* the debtor gave an original, purchase money note to acquire a tract of land for development as a shopping center. The note bore interest at 9.5 percent per annum and matured after seven months, at which time interest on any unpaid principal increased to ten percent. When the note became delinquent the seller threatened foreclosure under a deed of trust securing the note. Prior to foreclosure the parties entered into a settlement agreement. Under the settlement agreement the debtor paid approximately eighty percent of the outstanding principal in return for a release of the seller's lien on the land. The debtor also executed a new \$10,000 note and assumed the seller's debt for the broker's commission that arose out of the original sale of the land. The debtor later filed suit alleging the new consideration given in the settlement agreement constituted interest on a renewal of the original loan and was usurious.

The court, without addressing the complicated issue of whether the new consideration legally was interest, determined that the two transactions were so incompatible with one another that they could not be construed as one loan transaction or even as a renewal transaction.⁴⁹ Examining the obligations and rights of the parties under the original note and deed of trust and under the settlement agreement, the court concluded the settlement agreement was obviously a new and substituted agreement superseding and extinguishing the original agreement.⁵⁰ The *Scalise* court essentially applied the same standard that the supreme court applied in *Lawler v. Lomas & Nettleton Mortgage Investors*.⁵¹ Since the settlement agreement was not otherwise tainted with usury, the *Scalise* court rendered judgment in favor of the seller on the \$10,000 note.⁵²

45. TEX. REV. CIV. STAT. ANN. art. 5069-1.04(a) (Vernon 1987).

46. 714 S.W.2d at 428.

47. The *Reagan* opinion notes there was no dispute that Reagan went to City National Bank on September 13, 1983, and signed in the space designated "co-signer" the same note originally executed in 1981. *Id.* at 426.

48. 700 S.W.2d 682 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

49. *Id.* at 684.

50. *Id.*

51. 691 S.W.2d 593 (Tex. 1985).

52. 700 S.W.2d at 685.

In *Coppedge v. Colonial Savings & Loan Association*⁵³ the Dallas court of appeals found that a lawyer's demand letter for back interest in connection with a real estate loan was a charging under article 5069-1.06.⁵⁴ Since the charging and receiving occurred after an early pay-off of the loan, the court also found that the spreading and refund provisions of article 5069-1.07(a)⁵⁵ were not applicable as a defense.⁵⁶ The borrowers in *Coppedge* paid off their thirty-year home mortgage after approximately six and one-half years. Three months after the early pay-off the lender's lawyer claimed in a demand letter that the borrowers had previously sold the property in violation of the due-on-sale provision in the deed of trust, and the lawyer demanded \$9,100 as back interest. The title company later delivered to the lender the sum, which had been escrowed at the time of the early pay-off of the loan. Approximately eight months later, after being threatened with suit, the lender returned the \$9,100 with interest to the borrowers. In the ensuing usury suit the Dallas court reversed a summary judgment for the lender and handed down a judgment for usury penalties.⁵⁷ In one of the few opinions addressing the statutory spreading doctrine of article 5069-1.07(a) the court ruled that article 5069-1.07(a) was intended to prevent an otherwise nonusurious loan from becoming usurious simply because of an early pay-off.⁵⁸ The court viewed the statute as permitting a lender to refund any excessive interest resulting from an early pay-off as a credit against any remaining principal.⁵⁹ Since the lender's unilateral act of charging interest after the early pay-off created the usurious excess in *Coppedge* rather than the early pay-off itself, the court determined that article 5069-1.07(a) had no application to the case.⁶⁰

The court in *Coppedge* also upheld the trial court's summary judgment against the borrowers' common law action to recover all of the interest paid on the loan.⁶¹ Disagreeing with the decision of the Amarillo court of appeals in *West v. Commercial Credit Equipment Corp.*⁶² the Dallas court held that the borrowers could not recover all of the interest paid in a usurious transaction.⁶³ Instead, the court ruled that the borrowers must elect between a common law action for the excessive interest only and the article 5069-1.06 penalty of three times the excess.⁶⁴

*Danziger v. San Jacinto Savings Association*⁶⁵ concerned the usurious effect of escrowing loan proceeds by agreement. The borrower in *Danziger*

53. 721 S.W.2d 933 (Tex. App.—Dallas 1986, writ requested).

54. TEX. REV. CIV. STAT. ANN. art. 5069-1.06(1) (Vernon 1987).

55. *Id.* art. 5069-1.07(a).

56. 721 S.W.2d at 938.

57. *Id.* at 941.

58. *Id.* at 937-38.

59. *Id.*

60. *Id.* at 938.

61. *Id.* at 938-39.

62. 677 S.W.2d 699 (Tex. App.—Amarillo 1984, writ ref'd n.r.e.).

63. *Id.* at 939.

64. *Id.*

65. 708 S.W.2d 1 (Tex. App.—Houston [1st Dist.] 1986, writ granted).

made a home improvement loan subject to chapter five of the Credit Code.⁶⁶ The lender allegedly escrowed the loan proceeds and paid them out to the borrower's home improvement contractor over an eleven-month period. The borrower later claimed no true escrow existed, and that since the lender had complete control over the money, the rule in *First State Bank v. Miller*⁶⁷ applied, rendering all, or at least some, of the loan proceeds as interest. The *Miller* court based its decision upon the usury rule that the true principal of a loan is that amount of money that the borrower actually can use.⁶⁸ Under the *Miller* principle a court may declare as interest any sum concealed in a loan or, as was the case in *Miller*, any sum frozen in escrow.⁶⁹

The *Danziger* court declined to accept the borrower's *Miller* argument because the court found that some evidence of a true escrow account existed and that since the money from the account was used to pay the contractor, the borrower had use of the money.⁷⁰ The court noted that in *Miller* the lender placed the loan proceeds in the borrower's account and then froze \$14,000 of the proceeds to insure payment of interest.⁷¹ The *Danziger* court viewed the lender's use in *Miller* of the borrower's frozen funds as general operating capital to make other loans as the determining factor in rendering the captive funds as interest.⁷² The court found that no similar circumstance existed in *Danziger*.⁷³

The borrowers in *Danziger* also alleged that the escrow procedure violated the single cash advance requirement for chapter five secondary mortgage loans. Specifically, the borrower claimed that the requirement in article 5069-5.02(2) that interest be computed on "the cash advance at the time the loan is made"⁷⁴ prohibited a loan being made in more than one advance. The lender did not dispute this interpretation. The lender, however, claimed that it had made a single advance to the borrower's escrow account and that the multiple payments out of the account did not constitute multiple advances on the loan. The court agreed with the lender and emphasized that the borrowers had agreed to the payment procedure and had acknowledged receipt of the loan proceeds when they were paid into the escrow account.⁷⁵ The borrowers argued that they were nevertheless deprived of the use of the escrowed funds while the funds were in escrow. To the extent that article 5069-5.02(2) requires a single cash advance on secondary mortgage loans, one might question what material differences exist between a prohibited multiple advance loan and the escrow procedure utilized in *Danziger*.

66. TEX. REV. CIV. STAT. ANN. arts. 5069-5.01 to .05 (Vernon 1987) (secondary mortgage loans).

67. 563 S.W.2d 572 (Tex. 1978).

68. *Id.* at 575.

69. *Id.*

70. 708 S.W.2d at 3-4.

71. *Id.* at 3.

72. *Id.* at 3-4.

73. *Id.* at 4.

74. TEX. REV. CIV. STAT. ANN. art. 5069-5.02(2) (Vernon 1987).

75. 708 S.W.2d at 5.

In *Ceco Corp. v. Steves Sash & Door Co.*⁷⁶ the court held that charging interest during an interest-free period on an open account constituted usury. In a case reminiscent of the circumstances, if not the name, of *Houston Sash & Door Co. v. Heaner*,⁷⁷ Steves Sash & Door Co. sued Ceco for \$71,702.95 on a sworn account arising from the sale of 1600 doors for the San Antonio Hyatt Regency Hotel. Steves's shipping order stated that payment was due thirty days from the invoice date and that a service charge would be imposed at the highest rate allowable for each month, or fraction thereof, that the account was past due. Steves sent Ceco an invoice for the doors on October 23, 1981, and it included a service charge of \$245.69, which Steves described as arising from a "past due invoice from date of invoice [August 31, 1981] to Sept. 30, 1981."⁷⁸ The court of appeals cited *Heaner* as authority for rendering judgment in favor of the debtor, *Ceco*.⁷⁹ According to the court, by imposing an interest charge from August 31, 1981, through September 30, 1981, Steves obviously charged Ceco interest during a period that was supposed to be free from interest.⁸⁰ Interestingly, the interest-free period in this case was based upon an agreement between the parties that no interest would be due for the first thirty days after the date of the invoice, whereas the rule in *Heaner* was founded upon the statutory thirty-day interest-free period under article 5069-1.03.⁸¹ The court in *Ceco* indicated that the result would have been the same, usury, even if the terms in the shipping order constituted an agreement to charge interest.⁸² The court's conclusion is debatable to the extent that it sanctions the imposition of usury penalties for the breach of an agreement not to charge interest, as opposed to the imposition of penalties for violations of a statute limiting interest rates. Nevertheless, the creditor in *Ceco* suffered the cancellation of its claim, as well as a judgment against it for \$94,251.50, which represented principal actually paid, a \$2000 usury penalty, and \$37,000 in attorneys' fees.⁸³

The recurring question concerning the proper rate for prejudgment interest was squarely and thoroughly discussed in *Missouri-Kansas-Texas Railroad Co. v. Fiberglass Insulators*.⁸⁴ This case, as already discussed, involved a usury judgment resulting from an alleged charging of ten percent interest that occurred during the testimony of the creditor's accounts manager at trial. The creditor, on appeal, contended that ten percent was a lawful prejudgment rate under article 5069-1.05,⁸⁵ the postjudgment interest statute. The court dismissed the creditor's contention by noting that article 5069-1.03 clearly and unambiguously limits the rate of prejudgment interest in all contract cases to six percent per annum when the contract fails to specify a

76. 714 S.W.2d 322, 325 (Tex. App.—San Antonio 1986, writ requested).

77. 577 S.W.2d 217 (Tex. 1979).

78. 714 S.W.2d at 325 (emphasis added by court).

79. *Id.*

80. *Id.*

81. TEX. REV. CIV. STAT. ANN. art. 5069-1.03 (Vernon 1987).

82. 714 S.W.2d at 324.

83. *Id.* at 328.

84. 707 S.W.2d 943 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).

85. TEX. REV. CIV. STAT. ANN. art. 5069-1.05 (Vernon 1987).

rate.⁸⁶ The court recognized, however, that a sizable group of Texas and federal courts had, on equitable grounds, approved prejudgment interest rates at the higher, postjudgment rates contained in article 5069-1.05.⁸⁷ Nevertheless, the *Fiberglass* court declined to follow those cases because they not only ignored explicit limits set by article 5069-1.03, but also misinterpreted prior Texas Supreme Court authority.⁸⁸

The *Fiberglass* court identified the holding in *Behring International, Inc. v. Greater Houston Bank*⁸⁹ as clearly, but incorrectly, addressing and explaining this equitable prejudgment interest theory.⁹⁰ According to the *Fiberglass* court, the *Behring* decision rested in part upon the supreme court's decision in *Phillips Petroleum Co. v. Stahl Petroleum Co.*⁹¹ The court in *Fiberglass* stated that although *Stahl* recognized the possibility of the recovery of prejudgment interest in equity for the use of detention or money, the case did not hold that such equitable prejudgment interest could be awarded in excess of the statutory six percent limit when a contract or an account was involved.⁹² The court in *Fiberglass* read the *Stahl* opinion to stand for the proposition that an equitable prejudgment interest rate is to be the legal rate, the rate that article 5069-1.03 identifies as legal.⁹³

The *Fiberglass* opinion discussed no less than five federal decisions that, according to the court, incorrectly allowed equitable prejudgment interest at the postjudgment rates authorized by article 5069-1.05.⁹⁴ Observing that these opinions reflected the law's confusion,⁹⁵ the *Fiberglass* court stated that the holding in *Crown Central Petroleum Corp. v. National Union Fire Insurance Co.*,⁹⁶ the most recent and perhaps most often cited of the federal decisions, ignored the 1980 Texas Supreme Court holding in *Miner-Dederick Construction Corp. v. Mid-County Rental Service, Inc.*⁹⁷ that the proper rate for prejudgment interest in contract cases is six percent.⁹⁸ According to *Fiberglass*, the court in *Crown* misinterpreted the *Stahl* decision and misconceived the issues in *Cavnar v. Quality Central Parking, Inc.*⁹⁹ The *Fiberglass* court correctly observed that *Cavnar* only permitted equitable prejudgment interest at the higher article 5069-1.05 rates with respect to wrongful death,

86. 707 S.W.2d at 945.

87. *Id.*

88. *Id.* The *Fiberglass* court identified the misinterpretation of *Phillips Petroleum Co. v. Stahl Petroleum Co.*, 569 S.W.2d 480 (Tex. 1978), and the court noted that the cases under consideration neglected the Texas Supreme Court's holding in *Miner-Dederick Constr. Corp. v. Mid-County Rental Serv., Inc.*, 603 S.W.2d 193 (Tex. 1980), that the proper rate of prejudgment interest is six percent per annum.

89. 662 S.W.2d 642 (Tex. App.—Houston [1st Dist.] 1983, no writ).

90. 707 S.W.2d at 946.

91. 569 S.W.2d 480 (Tex. 1978).

92. 707 S.W.2d at 947.

93. *Id.*

94. *Id.*

95. *Id.*

96. 768 F.2d 632 (5th Cir. 1985).

97. 603 S.W.2d 193 (Tex. 1980).

98. 707 S.W.2d at 947.

99. 696 S.W.2d 549 (Tex. 1985).

survival, and personal injury actions.¹⁰⁰ *Fiberglass* concluded that in contract cases with no agreed rate of interest prejudgment interest is limited to six percent by article 5069-1.03.¹⁰¹

A final case concerning usury, *Village Mobile Homes, Inc. v. Porter*,¹⁰² held that article 5069-6A.05(2)¹⁰³ did not require the seller of a mobile home to disclose the existence of a prior outstanding lien on the home. After buying a used mobile home the purchaser in *Porter* discovered that in addition to a number of defects in the mobile home, the home was subject to an outstanding lien held by a mortgage company that had financed the original sale of the home. The buyer of the used home sued the seller for violating the Credit Code's requirement that all known creditors be identified.¹⁰⁴ In reviewing the case the *Porter* court used a statutory definition of the term "creditor" that addressed the relationship of the alleged creditor to the buyer's credit transaction.¹⁰⁵ Since the buyer in *Porter* did not have a credit relationship with the previous mortgage company, the court concluded that the Credit Code did not require the seller to inform the buyer of the mortgage company's outstanding lien even though the seller knew of the lien's existence.¹⁰⁶ This finding prevented the assessment of a \$4000 penalty under chapter 8 of the Credit Code.¹⁰⁷ The court, however, apparently found that the seller's conduct constituted a violation of the provisions of the Deceptive Trade Practices Act (DTPA)¹⁰⁸ concerning the failure to disclose material facts to a buyer.¹⁰⁹

II. SECURED CREDITORS' DUTY TO DEBTORS—NOTICE AND A COMMERCIALY REASONABLE DISPOSITION OF COLLATERAL

A. *No Summary Judgment on Sworn Account*

In *Achimov v. J.I. Case Credit Corp.*¹¹⁰ the trial court dismissed a creditor plaintiff's motion for summary judgment in a deficiency suit on a sworn account because the creditor's sworn pleadings failed to allege facts of notice, including the date that proper notice was given to the defendant debtor, and facts of the commercially reasonable sale. On appeal the creditor argued that the trial court erred in dismissing its motion because rule 185¹¹¹ barred the debtor from denying the debt. Rule 185 mandates that a debtor who wishes to resist a suit on a sworn account must file a written denial, under oath, or waive the right to deny the claim on the debt.¹¹² The creditor ar-

100. 707 S.W.2d at 948.

101. *Id.*

102. 716 S.W.2d 543, 551 (Tex. App.—Austin 1986, no writ).

103. TEX. REV. CIV. STAT. ANN. art. 5069-6A.05(2) (Vernon 1987).

104. *Id.*

105. *See* 716 S.W.2d at 551.

106. *Id.*

107. *See* TEX. REV. CIV. STAT. ANN. arts. 5069-8.01 to .06 (Vernon 1987).

108. TEX. BUS. & COM. CODE ANN. §§ 17.41-.826 (Vernon Supp. 1987).

109. 716 S.W.2d at 549.

110. 715 S.W.2d 73 (Tex. App.—Dallas 1986, no writ).

111. TEX. R. CIV. P. 185.

112. *Id.*

gued that because the debtor failed to make a sworn denial, rule 185 precluded the debtor from denying the claim, and that, therefore, summary judgment was appropriate. The court analyzed the creditor's cause of action and found that the creditor failed to state that the debt was owed on a sworn account.¹¹³ The court held that the creditor's burden of proving that the sale was made pursuant to the Business and Commerce Code¹¹⁴ was not met merely by the debtor's failure to answer with a sworn denial.¹¹⁵ Further, the court held that because the creditor failed to assert facts related to the commercial reasonableness of the sale, it failed to establish a liquidated money demand under rule 185.¹¹⁶ A concurring opinion in the case also pointed to the deficiencies in summary judgment proof concerning notice and commercially reasonable sale as grounds for denying the creditor's motion for summary judgment.¹¹⁷

B. Disposal Sales—Notice Does Not Have to be Written

Since the 1982 Texas Supreme Court decision in *Tanenbaum v. Economics Laboratory, Inc.*¹¹⁸ the success of a deficiency judgment has often depended upon whether the creditor gave the debtor adequate notice of the sale of collateral¹¹⁹ as required by section 9.504 of the Texas Uniform Commercial Code (UCC).¹²⁰ In *MBank Dallas, N.A. v. Sunbelt Manufacturing, Inc.*¹²¹ the court considered section 9.504's "reasonable notification" requirement. The undisputed evidence in *MBank* indicated that MBank had failed to give written notice before it sold Sunbelt's collateral. Some evidence existed, however, that MBank orally notified Sunbelt of the time and place of the disposal sale. The jury answered a special issue regarding notice in MBank's favor.¹²² The trial court, however, granted judgment n.o.v. on the notice issue.¹²³ Because of the trial court's decision regarding notice, there was a take-nothing verdict against MBank.¹²⁴ The court of appeals reversed, holding that section 9.504(c) only required MBank to send Sunbelt reasonable notice of the time and place of the proposed sale.¹²⁵ The interpretation of

113. 715 S.W.2d at 75.

114. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1987).

115. 715 S.W.2d at 76.

116. *Id.*

117. *Id.* at 77 (Stephens, J., concurring).

118. 628 S.W.2d 769 (Tex. 1982).

119. See, e.g., *First City Bank v. Geux*, 677 S.W.2d 25, 29 (Tex. 1984); *Commercial Credit Equip. Corp. v. West*, 677 S.W.2d 669, 678 (Tex. App.—Amarillo 1984, writ ref'd n.r.e.); *Barr v. White Oak State Bank*, 677 S.W.2d 707, 711 (Tex. App.—Tyler 1984, writ ref'd n.r.e.); *Gentry v. Highlands State Bank*, 633 S.W.2d 590, 591 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd).

120. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1987) provides: "reasonable notification of the time and place of any public sale or reasonable notification of the time after which any private sale or other intended disposition is to be made shall be sent by the secured party to the debtor . . ."

121. 710 S.W.2d 633 (Tex. App.—Dallas 1986, no writ).

122. *Id.* at 635.

123. *Id.*

124. *Id.*

125. *Id.* at 635-36.

“send” in section 9.504(c) was central to the court’s determination.¹²⁶ Also, the court recognized that the phrase “reasonable notice” was not defined in the Texas UCC and that other jurisdictions were split on the term’s meaning.¹²⁷ The court, therefore, analyzed the UCC definition of “send” in conjunction with the definitions of “notifies” and “gives” notice.¹²⁸ The court concluded that formal notice, whether written or oral, is only one factor in determining whether or not there was reasonable notification of the disposal sale.¹²⁹ Since the record supported the jury’s answer regarding the sufficiency of MBank’s oral notice to Sunbelt, the court ultimately rendered judgment on the jury’s verdict and reversed the trial court’s judgment n.o.v.¹³⁰

C. FDIC Excused from Notice Requirement

A question arises concerning the applicability of the Texas UCC when the Federal Deposit Insurance Corporation (FDIC) becomes a creditor by virtue of taking over a failed bank. Is a debtor who gives up collateral subsequent to an FDIC takeover entitled to the notice guaranteed under section 9.504? Because of the large number of Texas banks and savings and loans that have failed, one Nebraska case, *FDIC v. Ritchie*,¹³¹ is important because Nebraska, like Texas, absolutely bars any recovery for a deficiency judgment from a debtor who received inadequate notice of the sale of collateral.¹³² *Ritchie* may cause each of us who borrows money to pause and consider the meaning of the advertising slogan, “This bank is insured by the FDIC.”

In *Ritchie* a bank creditor initiated an action against an individual for a deficiency judgment after the collateral that secured the debtor’s note was sold. The state trial court granted the debtor’s motions for judgment and dismissal based upon grounds that the debtor had not been given proper notice as required by section 9.504 of the Nebraska UCC.¹³³ The creditor appealed to the Nebraska Supreme Court. While the appeal was pending, the FDIC took over the creditor bank. The FDIC was substituted as plaintiff in the action, and it removed the action from state court to federal district court.

In simplest terms, the FDIC argued that if the court upheld the notice

126. *See id.*; TEX. BUS. & COM. CODE ANN. § 1.201(38) (Tex. UCC) (Vernon 1968).

127. 710 S.W.2d at 635-36. The *MBank* court asserted that other jurisdiction had held that written notice must be given to a debtor prior to a disposal sale. *Id.* *See* Executive Fin. Serv., Inc. v. Garrison, 722 F.2d 417, 419 (8th Cir. 1983) (applying Missouri law); Savings Bank v. Booze, 34 Conn. Supp. 632, 382 A.2d 226, 228 (Super. Ct. 1977); McKee v. Mississippi Bank & Trust Co., 366 So. 2d 234, 238 (Miss. 1979); DeLay First Nat’l Bank & Trust Co. v. Jacobsen Appliance Co., 196 Neb. 398, 243 N.W.2d 745, 749 (1976); Foundation Discounts, Inc. v. Serna, 81 N.M. 474, 468 P.2d 875, 877 (1970).

128. 710 S.W.2d at 636; *see* TEX. BUS. & COM. CODE ANN. § 1.201(26) (Tex. UCC) (Vernon 1968).

129. 710 S.W.2d at 636 (citing *Crest Inv. Trust, Inc. v. Alatzas*, 264 Md. 571, 287 A.2d 261, 264 (1972)).

130. *Id.* at 638.

131. 646 F. Supp. 1581 (D. Neb. 1986).

132. *Id.* at 1583.

133. NEB. REV. STAT. § 9-504 (1980).

requirement, the FDIC would lose the case. If, however, the court did not require notice, the FDIC would win even though the bank it insured would lose. The federal district court applied federal common law¹³⁴ and created a rebuttable presumption that the FDIC met all of the notice requirements.¹³⁵ The court found that presumption should apply when the FDIC attempts to recover a deficiency judgment following a commercially reasonable sale.¹³⁶

In essence, the holding recognized that the bank would lose the deficiency judgment action because of its failure to provide notice of the sale, but that the bank's insurer and successor in interest may win regardless of the failure. The effect of the decision is to allow the FDIC to take over a bank that has violated the statutory commercial law of a state, yet, by invoking the federal common law, escape the statutory sanctions of the bank's violations. This holding has severe implications for bank patrons. Because a bank's regulatory reports are protected from public scrutiny,¹³⁷ a bank patron has no warning that its bank is in danger of collapse or has mismanaged other patrons' accounts. The bank patron must, therefore, depend on the government to insure that all goes well.

Every bank insured by the FDIC touts its status proudly. Member banks display the FDIC emblem at their entrances and advertise that the banks and their depositors are insured by the FDIC. Perhaps, in light of *Ritchie*, truth-in-lending¹³⁸ should require the following notice just below the FDIC seal:

WARNING: ACCOUNTS OF DEPOSIT ARE INSURED BY THE FEDERAL DEPOSIT INSURANCE CORPORATION. ALL BORROWERS ARE ADVISED THAT THE FDIC MAY, WITHOUT NOTICE OR HEARING TO YOU, TAKE THE ASSETS OF THE BANK INCLUDING ITS LOAN TO YOU. IF THE FDIC TAKES THE ASSETS, YOUR OTHERWISE VALID CLAIMS OF FRAUD, CONVERSION, USURY, AND IMPROPER NOTICE MAY NOT BE VALID AGAINST THE FDIC, EVEN AS A SET-OFF OF THE AMOUNT YOU OWE.

134. The *Ritchie* court used the test set forth in *United States v. Kimball Foods, Inc.*, 440 U.S. 715 (1979), to determine whether state or federal law controlled the case. The three considerations under *Kimball Foods* are "whether the federal program is one which by its nature requires nationwide uniformity, whether adopting state law would frustrate the specific objectives of the federal program, and whether applying federal law would disrupt commercial relations predicated on state law." 646 F. Supp. at 1583 (citing *Kimball Foods*, 440 U.S. at 728-29). The *Ritchie* court answered all three considerations in favor of the FDIC. *Id.* at 1583-84.

135. 646 F. Supp. at 1584.

136. *Id.*

137. See generally 5 U.S.C. § 552(b)(8) (1982) (bank matters contained in reports concerning bank's examinations, operation, or condition are exempt from disclosure if prepared for, or under guidance of, agency responsible for regulating or supervising bank).

138. Compliance with the requirements of 15 U.S.C. §§ 1601-1693r (1982) (Truth-in-Lending Act) is enforced under the provisions of 12 U.S.C. § 1818 (1982) (termination of status as insured bank) against both federal and state banks belonging to the FDIC. Nothing, however, requires the FDIC to inform bank customers that it has the ability to raise defenses and immunities to claims and actions for set-off. See 12 U.S.C. § 1823(e) (1982).

III. LIS PENDENS

One case during the Survey period discusses whether mandamus is proper to cancel lis pendens. Under section 12.007 of the Texas Property Code lis pendens is proper when an action is pending that involves title to real property, an interest in real property, or an encumbrance against real property.¹³⁹ In *Hensley-Spear of Texas, Inc. v. Blanton*¹⁴⁰ the court determined that lis pendens is not proper when the lien sought only affects real property collaterally and not directly. The court held that mandamus is proper to compel a trial judge to cancel lis pendens not properly issued within the provisions of section 12.007 of the Texas Property Code.¹⁴¹ The court went on to state that there is no need to comply with the statutory methods of cancelling a lis pendens under section 12.008 of the Property Code¹⁴² if the lis pendens does not comply with section 12.007.¹⁴³

IV. THE FTC RULE—NO STATUTE OF LIMITATIONS ON SET-OFF

According to one case decided during the Survey period, a consumer paying on a retail installment contract has, in certain circumstances, defenses against the holder of the contract even after the statute of limitations has run on a claim against the original vendor. In *Cooper v. RepublicBank Garland*¹⁴⁴ the court addressed the effect of the statute of limitations on a consumer note, the procedural requirements to preserve the claim, and the liability of the party holding the consumer credit installment contract. The plaintiffs in *Cooper* purchased a pool under an installment sales contract. The vendor immediately assigned the contract to RepublicBank. In accordance with Federal Trade Commission regulations, the contract bore the FTC rule legend.¹⁴⁵

After discovering several serious defects in their pool the Coopers brought suit against the vendor for breach of warranty, seeking declaratory relief in the form of a set-off.¹⁴⁶ The Coopers continued making their monthly payments to RepublicBank under the installment contract while the suit was

139. TEX. PROP. CODE ANN. § 12.007 (Vernon 1984).

140. 699 S.W.2d 643 (Tex. App.—Houston [14th Dist.] 1985, no writ).

141. *Id.* at 645.

142. TEX. PROP. CODE ANN. § 12.008 (Vernon 1984).

143. 699 S.W.2d at 645.

144. 696 S.W.2d 629 (Tex. App.—Dallas 1985, no writ).

145. In accordance with the requirements of 16 C.F.R. § 433.2 (1984) (FTC rule) the installment contract bore the following legend:

NOTICE—ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF, RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.

696 S.W.2d at 631.

146. Although the court characterized the Cooper's action as a claim, it is important to note that a set-off is a defense to payment. The court's rationale clearly demonstrates that the set-off is a defense, not an affirmative claim.

pending. The trial court rendered judgment against the vendor,¹⁴⁷ but the judgment was never satisfied. Subsequently, the Coopers notified RepublicBank that they were discontinuing their installment payments. The Coopers also demanded that the bank cancel the contract and return all the monies that they had paid thereunder. RepublicBank responded by threatening to foreclose on the pool if the Coopers ceased to perform the contract.

In a suit against RepublicBank for rescission of the contract and, alternatively, for declaratory relief in the nature of an offset the Coopers contended that the bank was responsible for their claim against the vendor by virtue of the contract's FTC rule legend and the existing judgment against the vendor. The Coopers conceded that the statute of limitations would have run on their claim against RepublicBank had the claim accrued when they first discovered the vendor's breach. The Coopers argued, however, the statute of limitations did not bar their claims because the statute commenced running only after the bank repudiated the contract by refusing to comply with the demand for rescission. The trial court rendered a take-nothing judgment against the Coopers, finding that the statute of limitations barred both the Coopers' defense against the vendor as well as their claims against RepublicBank for rescission and offset.¹⁴⁸

The court of appeals held that the FTC rule allowed debtors to assert against a holder of a credit contract claims or defenses arising out of the sale, but not new claims or defenses.¹⁴⁹ Since the Coopers could have included RepublicBank in their original suit against the vendor, their claim against the bank accrued when the vendor's breach was discovered.¹⁵⁰ The court went on to hold, however, that with respect to consumer installment sales contracts the statute of limitations did not bar declaratory relief in the form of an offset of damages.¹⁵¹ The court noted that the contract's FTC rule legend placed RepublicBank in the vendor's shoes.¹⁵² The court reasoned that the FTC rule denied RepublicBank, as the holder of the contract, any benefits that it might otherwise have under the holder-in-due-course doc-

147. 696 S.W.2d at 630.

148. *Id.* at 632-33.

149. *Id.* at 632.

150. *Id.* at 632-33.

151. *Id.* at 634. The *Cooper* court relied on *Morris-Buick Co. v. Davis*, 127 Tex. 41, 91 S.W.2d 313 (1936), which provided:

It is the law of this state that where the subject-matter of a defense . . . constitutes an independent cause of action which does not go to the foundation of the plaintiff's demand, it cannot effect a reduction of the amount of the plaintiff's recovery except by way of set-off, and the statutes of limitation are available in respect to such defense. On the other hand, if the subject matter of the defense be of an intrinsically defensive nature, which, if given effect, will operate merely as a negation of the plaintiff's asserted right to recover, or in abatement, either wholly or partially, of the amount claimed, the statute of limitation does not apply.

Id. at 43, 91 S.W.2d at 314 (citations omitted).

152. Although not stated, it is clear that those statutes of limitations defenses that would be effective for the vendor would also be effective for the assignee of the note, RepublicBank. The court did not suggest that a claim for breach of warranty existed against RepublicBank.

trine.¹⁵³ The court observed that the FTC rule, therefore, prevented the separation of the Coopers' duty to pay from the vendor's duty to perform.¹⁵⁴ The *Cooper* court was nevertheless concerned about the inherent unfairness that would result if RepublicBank was forced to pay on the judgment against the vendor without having the opportunity to appear and defend itself at trial.¹⁵⁵ The court allowed the Coopers an offset, however.¹⁵⁶

Cooper teaches two practical lessons. First, a buyer's defenses are available so long as money is due under the contract. Second, note holders must be sued within the vendor's statute of limitations in order to assert claims under the contractual provisions of the FTC rule. As a practical matter, suit must be filed simultaneously against the current holder of a disputed installment contract and the vendor.

V. AVAILABILITY OF PUNITIVE DAMAGES

A. Availability of Punitive Damages Under the DTPA

In *Nabours v. Longview Savings & Loan Association*¹⁵⁷ a majority of the Texas Supreme Court reaffirmed the rule of law prohibiting the award of punitive damages absent an award of actual damages. The dissent, however, criticized the court's five-to-four decision in *Nabours* as an analytical blunder that discarded over one hundred years of Texas common law.¹⁵⁸

Nabours initiated a lawsuit seeking injunctive relief and damages when his home mortgage lender posted the Nabourses' home for foreclosure. In his complaint *Nabours* alleged common law fraud, violation of the DTPA, and waiver of foreclosure right. The trial court held that a consent clause in the mortgage was violated; therefore, the court enjoined the lender from foreclosing on the Nabourses' home.¹⁵⁹ The court denied *Nabours*'s claim for both actual and punitive damages because the jury found no diminution in the market value of the Nabourses' house. On appeal both the court of appeals and the Texas Supreme Court affirmed the trial court's holding.¹⁶⁰ The Supreme Court decision is solvent as to the reason the injunction was granted.

The majority criticized the plaintiff for limiting the damages that the jury could consider to the decrease in market value of the Nabourses' home attributable to the lender's misconduct.¹⁶¹ The majority speculated that if the jury's consideration of actual damages had not been so limited, a finding of damages may have been made.¹⁶² Since the jury found no actual damages,

153. 696 S.W.2d at 632 (citing *De La Fuente v. Home Savings Ass'n*, 669 S.W.2d 137, 142 (Tex. App.—Corpus Christi 1984, no writ)).

154. *Id.*

155. *Id.* at 633.

156. *Id.* at 634.

157. 700 S.W.2d 901, 904 (Tex. 1985) (5-4 decision).

158. *Id.* at 905 (Kilgarlin, J., dissenting).

159. *Id.* at 902-03.

160. *Id.* at 905.

161. *Id.*

162. *Id.*

however, the court relied on dictum in the *City Products Corp. v. Berman*¹⁶³ decision to deny Nabours's claim for punitive damages even though injunctive relief had been granted.¹⁶⁴

The logic of requiring actual damages to allow an award of punitive damages is founded on the basic premise that punitive damages must bear some reasonable proportion to actual damages.¹⁶⁵ Although such a rule of reasonable proportion is not a rigid rule,¹⁶⁶ it is one of several factors considered in determining the appropriateness and reasonableness of an award of punitive damages.¹⁶⁷ The ratio between punitive damages and actual damages serves as one gauge of the effect of bias, prejudice, or passion on a jury.¹⁶⁸

The general rule is that punitive damages are recoverable only after proof of a distinct, willful tort, whether the action arises out of tort, contract, or a plea for equitable relief.¹⁶⁹ Since actual damages are an element of the tort, punitive damages are contingent on a finding of actual damages.¹⁷⁰ Thus, only a finding of actual damages will support an award of punitive damages.¹⁷¹

The majority conceded that when rescission is warranted, punitive damages may be awarded; when conveyances induced by fraud are involved and a court orders the return of property, punitive damages are approved.¹⁷² The property's return is deemed to be a substitute for actual damages.¹⁷³ The majority approved a jury finding of the value of the property returned to the plaintiff.¹⁷⁴

The dissent, written by Justice Kilgarlin and joined by Justices Spear, Ray, and Robertson, criticized the majority opinion in harsh terms. According to the dissent, the majority's approach of rigidly adhering to the requirement of actual damages ignored that Nabours spent four years and thousands of dollars defending the title to his home.¹⁷⁵ The dissent asserted that the nature of the defendant's conduct, not the particular remedy sought, should determine the availability of punitive damages.¹⁷⁶ The dissent asserted that the majority decision was inconsistent with the court's decision in *International Bankers Life Insurance Co. v. Holloway*.¹⁷⁷ According to the

163. 610 S.W.2d 446 (Tex. 1980).

164. 700 S.W.2d at 904 n.2.

165. *Id.* at 904 (citing *Alamo Nat'l Bank v. Kraus*, 616 S.W.2d 908, 910 (Tex. 1981); *Southwestern Inv. Co. v. Neeley*, 452 S.W.2d 705, 707-08 (Tex. 1970); *International Bankers Life Ins. Co. v. Holloway*, 368 S.W.2d 567, 584 (Tex. 1963)).

166. *Alamo Nat'l Bank v. Kraus*, 616 S.W.2d 908, 910 (Tex. 1981).

167. *Id.*

168. 700 S.W.2d at 904 (citing with approval *Nolan v. Bettis*, 577 S.W.2d 551 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.)).

169. *Id.*

170. The majority clearly limited its decision to the facts in this situation. In this case a special issue inquiring about actual damages was answered “-0-.” *Id.* at 905.

171. *Id.*

172. *Id.*

173. *Id.*

174. *Id.* at 904-05.

175. *Id.* at 907-09.

176. *Id.* at 906-07.

177. 368 S.W.2d 567 (Tex. 1963).

dissent, the *Holloway* court affirmed a recovery of exemplary damages when the plaintiff there did not recover actual damages.¹⁷⁸ The *Holloway* decision, as interpreted by the dissent, mandates the recovery of punitive damages whenever the defendant's conduct amounts to a willful tort, regardless of whether the plaintiff seeks a legal or equitable remedy.¹⁷⁹ Such punitive damages are consistent with equitable notions of deterrence of condemnable conduct.¹⁸⁰

Since both the majority and dissent in *Nabours* cited *Holloway* with approval, *Nabours* must be read in light of the *Holloway* holding. The majority cautioned that its holding in *Nabours* should not be construed as an absolute refusal to award punitive damages to plaintiffs seeking equitable relief.¹⁸¹ Although the plaintiff in *Nabours* was ultimately granted equitable relief and nothing else, the majority purportedly subscribes to the theory that Texas courts, contrary to the apparent majority rule, will not deny exemplary damages simply because the action is equitable rather than legal.¹⁸²

The court's holding in *Nabours* only confuses the issue of when equitable relief will also sustain an award of punitive damages. The *Nabours* court provides no litmus test; nor does it give any indication as to what factors the court will consider in allowing punitive damages. Thus, the holding is sure to breed future litigation on this issue.

B. Recovery of Punitive Damages in Tort

Possibly as a sign of the economic times, the Survey period has seen an increase in banks' collection efforts against cosigners of notes. The cases concerning unsuccessful attempts by banks to collect debts are especially noteworthy. In particular, *Texas National Bank v. Karnes*¹⁸³ is an example of how not to handle the repossession of secured property.

The bank in *Karnes* held a security interest in a van as the result of a purchase money loan to a nineteen-year-old debtor. The debtor's parents cosigned the note. In addition to the automobile loan, the debtor's parents also kept a joint account at the bank. After the debtor defaulted on the car loan the bank repossessed the van and charged the \$3,474.41 still due on the note to the cosigner parents' joint account.

Although the bank repossessed the van in May of 1979, it had not disposed of the collateral at the time of the trial, July 9, 1984. The bank admitted that its procedure in handling the van was not "recommended as standard operating procedure[] for use by secured creditors."¹⁸⁴ In fact, the bank admitted that it failed to comply with the disposition provisions of

178. 700 S.W.2d at 909.

179. *Id.*

180. *Id.*

181. *Id.* at 905.

182. *Id.*

183. 711 S.W.2d 389 (Tex. App.—Beaumont), *rev'd per curiam*, 717 S.W.2d 901 (Tex. 1986).

184. 711 S.W.2d at 391.

chapter 9 of the Texas UCC.¹⁸⁵

In affirming the trial court's judgment awarding the plaintiffs actual damages for the lender's breach of contract, the court of appeals held that every aspect of a disposition of collateral after repossession must be commercially reasonable, including "the method, manner, time, place and terms" of the disposition.¹⁸⁶ The court's conclusion that the lender in this case failed to make appropriate efforts to dispose of the collateral¹⁸⁷ implies that impounding the van for five years with no disposition, as a matter of law, was not a commercially reasonable disposition of the collateral. Since the bank failed to make a commercially reasonable distribution of the collateral, the court ruled that the bank lost its right to any set-off deficiency.¹⁸⁸

The appellate court also affirmed the trial court's judgment awarding the plaintiffs exemplary damages.¹⁸⁹ The bank had argued that exemplary damages are not available for a simple breach of contract.¹⁹⁰ The court of appeals held, however, that a tort accompanied the breach of contract in the case, and thus, exemplary damages were available to the plaintiffs.¹⁹¹ The court concluded that the bank committed seven acts of a tortious nature towards the plaintiffs and that each tort was a separate, independent, and distinct injury justifying some exemplary damages.¹⁹² The appellate court did, however, remit the jury's award of \$50,000 in exemplary damages to \$20,000.¹⁹³ The court specifically disapproved of the trial court's finding that attorney's fees constituted an element of actual damages to be considered in awarding punitive damages.¹⁹⁴ Rather, the court of appeals held that

185. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1987) provides: "[s]ale or other disposition may be as a unit or in parcels and at any time and place and on any terms but every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."

186. 711 S.W.2d at 392; see TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1987).

187. 711 S.W.2d at 392-93.

188. *Id.* at 393.

189. *Id.* at 397.

190. The bank cited *A.L. Carter Lumber Co. v. Saide*, 140 Tex. 523, 168 S.W.2d 629 (1943).

191. 711 S.W.2d at 393.

192. The court found that the bank committed torts against the Karneses in seven ways:

1. In failing to make a reasonable disposition of the collateral;
2. In keeping possession of the collateral beyond a reasonable time;
3. In taking or converting the money out of the [Karneses'] savings account after losing its right to offset;
4. In failing to notify . . . [the Karneses] of the deduction from their savings account;
5. In concealing the fact from [the Karneses] . . . that the bank had deducted from their savings the sum of \$3,474.41 for the period of time from July, 1979, to December, 1979;
6. In failing to return the certificate of title to the van while holding possession of the van from May, 1979, to July, 1984; and,
7. In failing to establish the value of the collateral in a commercially acceptable manner and within a reasonable time after repossessing the same.

Id. at 396.

193. *Id.* at 397.

194. *Id.*

attorney's fees were in the nature of compensation.¹⁹⁵

The supreme court, in a per curiam decision,¹⁹⁶ struck down the court of appeals' award of attorney's fees and punitive damages.¹⁹⁷ The award of attorney's fees was reversed because the court of appeals based the award on unassigned error.¹⁹⁸ According to the supreme court, the parties did not raise the issue of the trial court's failure to award attorney's fees; therefore, the matter was not properly brought before the court of appeals for adjudication.¹⁹⁹

The supreme court also reversed the award of punitive damages and noted that punitive damages are generally not recoverable for breach of contract.²⁰⁰ A party seeking punitive damages in an action on a contract must obtain a finding of an independent tort with actual damages accompanying the contract breach.²⁰¹ The supreme court held that the court of appeals exceeded its authority by implying actual damages in tort.²⁰² The supreme court noted that actual damages were awarded only in connection with the bank's failure to dispose of the collateral in a commercially reasonable manner.²⁰³ The court found that the plaintiffs' cause of action sounded only in contract because section 9.504²⁰⁴ rights to a commercially reasonable disposition are implied covenants in contract.²⁰⁵ Since the cause sounded in contract no punitive damages were available.²⁰⁶

By emphasizing that the plaintiffs in *Karnes* did not prove actual damages in tort, the court protected the viability of future claims in tort based upon facts similar to those in *Karnes*. While holding against the plaintiffs in *Karnes* on procedural grounds, the court seemed to warn financial institutions by expressly refusing to condone the bank's practices.²⁰⁷

VI. GARNISHMENT

One case decided during the Survey period serves as a particularly pungent reminder that garnishees must comply with the Rules of Civil Procedure or suffer the consequences. In *First National Bank v. Peterson*²⁰⁸ the bank had a policy of simply freezing any garnished accounts and waiting until someone contacted them. The bank's policy did not include filing a sworn written answer in response to the writ of garnishment as required by

195. *Id.*

196. 717 S.W.2d 901 (Tex. 1986).

197. *Id.* at 903.

198. *Id.*

199. *Id.*; see *Central Educ. Agency v. Burke*, 711 S.W.2d 7, 8 (Tex. 1986).

200. 717 S.W.2d at 903; see *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617, 618 (Tex. 1986).

201. 717 S.W.2d at 903.

202. *Id.*

203. *Id.*

204. TEX. BUS. & COM. CODE ANN. § 9.504 (Tex. UCC) (Vernon Supp. 1987).

205. 717 S.W.2d at 903.

206. *Id.*

207. *Id.*

208. 709 S.W.2d 276 (Tex. App.—Houston [14th Dist.] 1986, no writ).

rule 667.²⁰⁹ At the time the bank received the writ of garnishment at issue the bank held \$312.68 in the debtor's account. When the bank failed to file its sworn answer, a default judgment was entered against the bank in the amount of \$48,831.77, together with post-judgment interest and costs.²¹⁰ The trial court refused to grant a new trial, and the bank appealed.

The court of appeals, relying on *Butler v. Dal Tex Machine & Tool Co.*,²¹¹ affirmed the trial court and concluded that the fact that three bank officers read the writ of garnishment and did not obtain assistance in understanding the citation constituted negligence and conscious interference.²¹² The court of appeals flatly rejected the bank's plea for a new trial based upon equitable principles.²¹³ The court distinguished *Sunshine Bus Lines v. Craddock*²¹⁴ and rejected the bank's contention that it made a good faith attempt to comply with the writ.²¹⁵ The validity of a default judgment, the court insisted, cannot be tested merely by the amount of the judgment ultimately entered.²¹⁶ That the judgment was entered for a sum much greater than the amount garnished did not, ipso factor, require a new trial.²¹⁷ The result in *Peterson* should caution all financial institutions to maintain adequate procedures to insure that the procedural requirements of rule 667 are strictly observed in order to avoid liability on a default judgment.

VII. HOMESTEAD—IMPROVEMENTS MADE WITH EMBEZZLED FUNDS

During the Survey period one court intimated that homestead protection is available even for embezzled funds when it refused to allow a forced sale of a homestead that was improved with embezzled funds. In *Curtis Sharp Custom Homes, Inc. v. Glover*²¹⁸ the defendant used embezzled funds to improve an existing homestead. The victim of the embezzlement brought a civil suit against the defendant and received actual damages and an equitable lien on the defendant's homestead property. The judgment was not satisfied, so the victim filed suit to foreclose on the defendant's homestead. The trial court granted the defendant's motion for summary judgment, ruling that the equitable lien could not be foreclosed because the property was the defend-

209. TEX. R. CIV. P. 667 provides:

If the garnishee fails to file an answer to the writ of garnishment at or before the time directed in the writ, it shall be lawful for the court, at any time after judgment shall have been rendered against the defendant, and on or after appearance day, to render judgment by default, as in other civil cases, against such garnishee for the full amount of such judgment against the defendant together with all interest and costs that may have accrued in the main case and also in the garnishment proceedings.

210. 709 S.W.2d at 277.

211. 627 S.W.2d 258 (Tex. App.—Fort Worth 1982, no writ).

212. 709 S.W.2d at 279.

213. *Id.* at 279-80.

214. 134 Tex. 388, 133 S.W.2d 124 (1939) (default judgment may be set aside if defendant was not culpable and if plaintiff would not be prejudiced).

215. 709 S.W.2d at 280.

216. *Id.*

217. *Id.*

218. 701 S.W.2d 24 (Tex. App.—Dallas 1985, no writ).

ant's homestead.²¹⁹ The court of appeals affirmed, concluding that the Texas Constitution protects all homesteads against forced sale for payment of all debts.²²⁰

The majority opinion in *Glover* provoked a strong dissent that pointed out that the use of the stolen money for home repairs created a constitutionally valid and foreclosable lien in the embezzlement victim.²²¹ Although a valid home repair lien technically requires that the improvements be contracted for in writing,²²² the dissent noted that the victim of an embezzlement would most likely never receive such a writing. The dissent argued that if the money for the improvements to the homestead were borrowed rather than stolen, the lender would certainly have the necessary document to create a foreclosable lien.²²³ Thus, the dissent contended that the majority's holding penalized the honest borrower while it insulated the wrongdoer from foreclosure.

The essence of this case is that a victim of embezzlement sought and obtained a judgment and an equitable lien in a homestead. The victim, however, has received no money, but rather has had the court of appeals award costs against it.²²⁴ If this result was intended by the Texas Constitution, perhaps a new criminal exception to the homestead exemption should be added to the constitution.

VIII. DTPA—ATTORNEY'S FEES

A major case decided during the Survey period suggested that successful DTPA plaintiffs may not be entitled to attorney's fees for DTPA actions in equity. Until *Nabours v. Longview Savings & Loan Association*²²⁵ it was thought that the plain language of section 17.50(d) of the DTPA²²⁶ would

219. *Id.* at 24.

220. *Id.* at 28; see TEX. CONST. art. XVI, § 50.

221. 701 S.W.2d at 29 (Akin, J.).

222. TEX. CONST. art. XVI, § 50.

223. 701 S.W.2d at 29.

224. *Id.* at 28.

225. 700 S.W.2d 901 (Tex. 1985); see *supra* text accompanying notes 157-82.

226. TEX. BUS. & COM. CODE ANN. § 17.50 (Vernon 1984) (Deceptive Trade Practices Act) provides:

(b) In a suit filed under this section, each consumer who prevails may obtain:

(1) the amount of actual damages found by the trier of fact. In addition the court shall award two times that portion of the actual damages that does not exceed \$1,000. If the trier of fact finds that the conduct of the defendant was committed knowingly, the trier of fact may award not more than three times the amount of actual damages in excess of \$1,000;

(2) an order enjoining such acts or failure to act;

(3) orders necessary to restore to any party to the suit any money or property, real or personal, which may have been acquired in violation of this subchapter; and

(4) any other relief which the court deems proper, including the appointment of a receiver or the revocation of a license or certificate authorizing a person to engage in business in this state if the judgment has not been satisfied within three months of the date of the final judgment. The court may not revoke or suspend a license to do business in this state or appoint a receiver to take

allow prevailing consumers under the DTPA to recover attorney's fees even when the statutory relief sought was purely equitable.²²⁷ In *Nabours*, however, a majority of the Texas Supreme Court refused to award attorney's fees to a plaintiff who successfully sought to enjoin a lender from wrongfully foreclosing on a home. The court held that the plaintiff failed to recover statutory damages under the DTPA; thus, the plaintiff was not entitled to recover attorney's fees under the DTPA.²²⁸

It is difficult to determine what the supreme court meant by this holding. In addition to providing generous money damages, one of the purposes of the DTPA would seem to be to prevent the effects of unlawful conduct by injunction, restoration, or other relief.²²⁹ The Texas Legislature's description of the private remedies available for violations of the DTPA²³⁰ leaves little doubt that the legislature intended the DTPA to prevent damages as well as compensate for them; three out of the four specific statutory remedies created by the DTPA are equitable in nature.²³¹

IX. SPECIAL ISSUES—SUBMISSION OF GLOBAL SPECIAL ISSUES

During the Survey period the Texas Supreme Court considered the propriety of submitting global special issues to juries on such complex matters as waiver and performance. In *Island Recreational Development Corp. v. Republic of Texas Savings Association*²³² Island Recreational purchased a mortgage commitment from Republic for \$40,000. After the original commitment expired Island purchased a second commitment for \$20,000. The second commitment obligated Republic to fund all of Island's loans that closed prior to the expiration of the commitment. After the second commit-

over the affairs of a person who has failed to satisfy a judgment if the person is a licensee of or regulated by a state agency which has statutory authority to revoke or suspend a license or to appoint a receiver or trustee. Costs and fees of such receivership or other relief shall be assessed against the defendant.

(c) On a finding by the court that an action under this section was groundless and brought in bad faith, or brought for the purpose of harassment, the court shall award to the defendant reasonable and necessary attorneys' fees and court costs.

(d) Each consumer who prevails shall be awarded court costs and reasonable and necessary attorneys' fees.

227. See D. BRAGG, J. LONGLEY & P. MAXWELL, *TEXAS CONSUMER LITIGATION* § 8.13 (2d ed. 1985).

228. 700 S.W.2d at 905.

229. TEX. BUS. & COM. CODE ANN. § 17.44 (Vernon 1984) describes the DTPA's purpose as follows: "This subchapter shall be liberally construed and applied to promote its underlying purposes, which are to protect consumers against false, misleading, and deceptive business practices, unconscionable actions, and breaches of warranty and to provide efficient and economical procedures to secure such protection."

230. TEX. BUS. & COM. CODE ANN. § 17.50 (Vernon Supp. 1987) enumerates those remedies available to the private consumer, while *id.* § 17.44(c)-(e) enumerates remedies available to the state. In both instances a fundamental remedy is the right to a statutory injunction.

231. TEX. BUS. & COM. CODE ANN. § 17.50(b)(1) (Vernon Supp. 1987) describes the primary damage remedy available to consumers under the DTPA. TEX. BUS. & COM. CODE ANN. § 17.50(d)(2)-(4) (Vernon Supp. 1987) enumerates the consumer's equitable remedies under the DTPA.

232. 710 S.W.2d 551 (Tex. 1986).

ment lapsed Island asserted a right to an additional loan. Island claimed that it technically complied with the commitment by filing a loan application the day before the commitment expired. Republic contended that Island's application failed to satisfy the commitment, and therefore, Republic denied its obligation to fund the loan. Island brought suit for breach of the commitment, alleging that Republic waived its right to strict compliance with the commitment's terms.

The trial court purportedly submitted both the issue of Island's performance and the issue of Republic's alleged waiver to the jury in a very broad, conclusory form of special issue often referred to as a global special issue. The special issue incorporated the result of Republic's alleged waiver into one central inquiry concerning Island's performance under the commitment.²³³ On its face the special issue submitted to the jury appeared to address only the issue of Island's performance. Furthermore, no instructions explaining the relevance of Republic's alleged waiver accompanied the special issue. Neither party, however, objected to the lack of instructions. The trial court rendered judgment for Island after the jury found that Island had performed all of the conditions precedent to its right to demand a loan under the commitment.²³⁴ The court of appeals reversed the trial court and remanded the case because the special issue did not fairly raise the issue of waiver.²³⁵

On appeal before the Texas Supreme Court, Republic argued that the trial court erred in submitting a single global issue to the jury rather than two distinct issues on waiver and performance. Republic asserted that the trial court's submission of a global issue favored Island because it blended the issue of Island's performance and Republic's alleged waiver, thereby giving the jury unbridled discretion to decide for Island.

In affirming the trial court's judgment a majority of the supreme court gave unqualified approval to the use of global special issues in general.²³⁶ The majority approved the *Island Recreational* type of submission and stated that although the issue form underemphasized the waiver issue, the error did not prejudice Republic.²³⁷ The majority noted that the critical issue was whether Island performed the conditions required by the commitment and therefore had a right to the disputed loan, and that this issue of performance was submitted by the trial court to the jury.²³⁸ As a result, the majority concluded that the form of the issue was sufficient and that neither the absence of the waiver issue nor the lack of instructions on the waiver issue were fatal.²³⁹

233. Although both parties objected to the issue's breadth, the trial court submitted the following special issue to the jury: "Do you find from a preponderance of the evidence that plaintiffs performed their obligations under the commitment letter in question?" *Id.* at 554.

234. *Id.* at 553.

235. 680 S.W.2d 588, 595 (Tex. App.—Beaumont 1984), *rev'd per curiam*, 710 S.W.2d 551 (Tex. 1986).

236. 710 S.W.2d at 554.

237. *Id.* at 554-55.

238. *Id.* at 555.

239. *Id.*

The majority's holding provoked two independent dissents, both of which argued that the global form of special issue was not a broad submission of two issues but rather the submission of a single issue on performance.²⁴⁰ The dissents argued that the failure to distinguish the issues prejudiced Republic by allowing Island "two bites at the apple";²⁴¹ that is to say, the jury could find for Island by determining either that Island performed its obligations under the commitment or that Republic waived the required performance.²⁴² The dissent criticized the use of global special issues because the drafter of the special issues can defend their form by simply arguing that they are broad enough to encompass all of the relevant issues in a case.²⁴³ Further, according to the dissent, submitting such all-encompassing forms of special issues produces jury verdicts unattuned with recognized theories of recovery and makes review of the judgments virtually impossible.²⁴⁴

The supreme court's decision in *Island Recreational* removes all doubt concerning the viability of global special issues in Texas. By approving the use of global special issues, however, the court has complicated appellate review of special issues and, in effect, altered rule 279's scheme of objection burdens.²⁴⁵ Hereafter, *Island Recreational* dictates that any party objecting to the breadth of a particular special issue either (1) object to the form's complexity before it is submitted; (2) request the contemporaneous submission of accompanying instructions identifying and explaining the incorporated issues; or (3) risk a deferential appellate review of the form based upon no record of the jury's rationale.

240. Justice Spears, dissenting, noted "[t]his charge simply does not submit waiver and performance broadly, but only submits performance specifically." *Id.* at 558. Justice Gonzalez, also dissenting, remarked "the submitted issue does not ask about waiver . . ." *Id.* at 562. Justice Gonzalez further noted, "the word 'waiver' does not appear in the issue," *id.* at 564, rather, "[t]he liability issue submitted to the jury only addresses performance," *id.* at 561 n.1.

241. *Id.* at 563.

242. In his dissent Justice Spears noted that the special issue could have been reworded to raise both the issue of performance and the issue of waiver by explicitly incorporating the waiver issue and adding an accompanying instruction. Justice Spears suggested the following issue:

Do you find from the preponderance of the evidence that [plaintiff] performed all of the obligations under the commitment letter which [defendant] did not waive?

You are instructed that waiver is defined as intentionally giving up a known right.

You are instructed that performed means carrying out obligations as required by the contract.

Id. at 557 n.1.

243. *Id.* at 563 (Gonzales, J.).

244. *Id.*

245. *Id.* at 564. Justice Gonzalez argued in dissent that since Island bore the burden of proving Republic's waiver, TEX. R. CIV. P. 279 allocated to Island the burden of incorporating the waiver issue into the special issue form. 710 S.W.2d at 564. Under rule 279, therefore, if Island failed to include the waiver issue, it failed to prove its case. Approving the form of special issue used in the instant case, according to Justice Gonzalez, effectively shifted the rule 279 burden to Republic because the waiver issue's presence in the special issue is presumed unless Republic objects. *See id.* at 265. As a result, the majority's holding shifts the affirmative duty to act, and the risk of failing to act, from Island to Republic in contravention of rule 279. *See id.*