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John Krahrmer

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COMMERCIAL TRANSACTIONS

by

John Krahrmer*

THREE developments suggest that the 1987 Survey period will be remembered as a watershed year in the development of Texas commercial law. First, the Texas Supreme Court created at least two new theories of action in commercial litigation.¹ Second, application of the Uniform Commercial Code² was broader in certain factual or legal settings.³ Third, Texas courts rejected various rules developed in some earlier commercial cases.⁴ These developments occurred against the backdrop of a very active year in commercial transaction litigation.⁵ This Article collects and

* B.A., J.D., University of Iowa; LL.M., Harvard University. Professor of Law, Texas Tech University.

1. See *Arnold v. National County Mutual Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987) (general duty of good faith and fair dealing can arise as result of special relationship between parties governed or created by contract); *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987) (warranty of good workmanship arises as part of contract to repair tangible goods).

2. The Uniform Commercial Code has been adopted in Texas as TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1968 & Supp. 1988) [hereinafter referred to as the Code].

3. The Code was applied by analogy to a contract dispute in *Lassiter v. Rotogravure Committee, Inc.*, 727 S.W.2d 8, 9-10 (Tex. App.—Dallas 1987, writ ref'd n.r.e.) (parol evidence allowed between immediate parties to show that contract had been signed in representative capacity), and in a previously unlitigated setting in *Cullen Frost Bank v. Dallas Sportswear Co.*, 730 S.W.2d 668, 669-70 (Tex. 1987) (right of secured party to compel and supervise collection of accounts receivable by debtor). The Code was also applied by analogy in numerous fact variations testing the scope of the rule of "commercial reasonableness" in the disposition of collateral. See, e.g., *Myers v. Ginsburg*, 735 S.W.2d 600, 605 (Tex. App.—Dallas 1987, no writ) (failure of landlord to sell collateral securing lien in commercially reasonable time); *Carroll v. General Elec. Credit Corp.*, 734 S.W.2d 153, 154 (Tex. App.—Houston [1st Dist.] 1987, no writ) (burden of proving commercial reasonableness is on creditor, failure to carry burden bars creditor from recovering deficiency); *Carroll v. Kennon*, 734 S.W.2d 34, 37-41 (Tex. App.—Waco 1987, no writ) (notice of sale to debtors is question of fact, creditor may be barred from recovering deficiency because of failure to give notice); *Knight v. General Motors Acceptance Corp.*, 728 S.W.2d 480, 482-83 (Tex. App.—Fort Worth 1987, no writ) (improper disposition or retention of collateral bars creditor from recovering deficiency).

4. The cases of *Cantu v. Western Fire Ins. Co.*, 716 S.W.2d 737 (Tex. App.—Corpus Christi 1986), writ ref'd n.r.e., per curiam, 723 S.W.2d 668 (Tex. 1987), and *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.) held there was no duty of good faith or fair dealing in actions for breach of contract under Texas law. The decision in *Arnold v. National County Mutual Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987), is clearly contrary to this broad rejection of the theory. *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392, 393 (Tex. 1982), permitting the disclaimer of implied warranties in the sale of a dwelling, was overruled on this issue in *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349, 355 (Tex. 1987).

5. During the last several Survey periods, the number of commercial cases decided each

discusses several of these cases, including brief discussion of related matters affecting commercial practice.⁶ The topical organization parallels that of the Texas Business & Commerce Code.⁷

I. GENERAL PROVISIONS

A. Acceleration and Foreclosure

Notices Required for Proper Acceleration and Foreclosure. The sequence of legally required notices for a proper acceleration has become well established in Texas during the last few years.⁸ A variation on the problem of *legally required* notices is whether the failure of a creditor to give *contractually required* notices invalidates the acceleration or gives rise to an action for damages. In *Jasper Federal Savings & Loan Association v. Reddell*⁹ the lender was contractually required to give the debtor notice of a right to reinstate and of a right to bring an action to assert defenses to the acceleration. The lender gave the legally required notices of intent to accelerate and notice of acceleration, but omitted the contractual notices. The debtors, however, had actual notice of their right of reinstatement and right to assert defenses because of a consultation they had with their own attorney. The court held that actual notice was sufficient to comply with the contractual requirements of the deed of trust because only the relationship between the debtor and the creditor was involved.¹⁰ The court distinguished the circumstance in which notice to third parties was a necessary part of the notification process.¹¹

The issue of contractually required notices appeared in *Knight v. General Motors Acceptance Corp.*,¹² in which a security agreement required the se-

year has averaged between 40 and 50; during this Survey period, more than 75 commercial cases were reported.

6. Related subjects include the Texas Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon Supp. 1988), the TEX. TAX CODE ANN. § 151.0036 (Vernon Supp. 1988), and the Federal Bankruptcy Code, 11 U.S.C. §§ 101-1330 (1979 & Supp. IV 1986).

7. The chapters in the Code are organized as follows: Chapter 1, General Provisions; Chapter 2, Sales; Chapter 3, Commercial Paper; Chapter 4, Bank Deposits and Collections; Chapter 5, Letters of Credit; Chapter 6, Bulk Sales; Chapter 7, Documents of Title; Chapter 8, Investment Securities; and Chapter 9, Secured Transactions.

8. The best statement of the notice requirements is probably found in *Baldazo v. Villa Oldsmobile, Inc.*, 695 S.W.2d 815 (Tex. App.—Amarillo 1985, no writ). There, the court noted that if a secured promissory note grants the holder an option to accelerate the note upon the maker's default, equitable principles require the holder to give notice of several events. The holder must make presentation of the note and demand payment of all past due installments prior to acceleration. The holder must further advise the maker that acceleration will occur and the entire balance will be due and payable if the maker fails to cure the delinquency. If payment of the delinquency is not forthcoming, the holder must give the maker notice that acceleration has occurred. Once notice is served, the debtor can no longer cure the default. The entire debt becomes due and payable. "Notice that the debt has been accelerated has no legal effect unless preceded by notice that the debt will be accelerated." *Id.* at 817.

9. 730 S.W.2d 672 (Tex. 1987).

10. *Id.* at 675.

11. 730 S.W.2d at 674. The court noted the statutory twenty-one-day notice requirement of TEX. PROP. CODE ANN. § 51.002 (Vernon 1984) as an example of a notice requirement that operates both to protect the debtor by providing a period for cure and to serve the public interest by publicizing the sale in hopes of increasing interest in bidding.

12. 728 S.W.2d 480 (Tex. App.—Fort Worth 1987, no writ).

cured party to give "reasonable notification of the time and place of any public or private sale."¹³ The secured party admitted that it did not give notice of the time and place of the private sale at which the collateral was sold, but argued that it had complied with the statutory notice requirements¹⁴ by giving notice of the time *after which* a private sale would occur.¹⁵ There was no evidence that the debtor had actual knowledge of the time and place of sale. The court held that failure to give the contractually required notice barred the creditor from recovering a deficiency under the rule of *Tanenbaum v. Economics Laboratory, Inc.*¹⁶ *Jasper and Knight* provide a useful review in the area of contractual, instead of statutory, notices.

Inequitable Conduct May Preclude Acceleration. In addition to the limits on acceleration that may exist because of surrounding notice requirements, a more fundamental limit is whether the creditor is guilty of inequitable conduct in the acceleration of a debt. In *Davis v. Pletcher*¹⁷ the court found that the debtor had made good faith attempts to obtain resolution of a dispute about the quantity of land to be conveyed under the deed in question, including a tender of installments to the registry of court pending the outcome of the dispute.¹⁸ The court also found that the debtor had spent considerable sums on improvements to the land.¹⁹ Under these circumstances, the court held that the acceleration by the creditor was not for the purpose of protecting the debt or its security, but was, instead, an inequitable action used to coerce payment and to avoid a decision on the merits of the underlying dispute.²⁰ The court ruled the attempted acceleration was a nullity.²¹

B. Good Faith

Duty of Good Faith and Fair Dealing. In *English v. Fischer*²² the Texas Supreme Court held there was no implied covenant of good faith and fair dealing in *every* contract in Texas.²³ Unfortunately, the court used some hyperbole in reaching this conclusion²⁴ and the rhetorical language began to

13. *Id.* at 483.

14. The statutory notice requirements are set out in TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1988) which provides, "[R]easonable 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" *Id.*

15. 728 S.W.2d at 483.

16. 628 S.W.2d 769, 771 (Tex. 1982). Other cases decided during the Survey period under the *Tanenbaum* rule are discussed in the text *infra* at notes 288-289.

17. 727 S.W.2d 29 (Tex. App.—San Antonio 1987, writ ref'd n.r.e.).

18. *Id.* at 31.

19. *Id.*

20. *Id.* at 35-36.

21. *Id.* at 36.

22. 660 S.W.2d 521 (Tex. 1983).

23. *Id.* at 524.

24. In the course of its opinion, the court discussed the theory of an implied covenant of good faith and fair dealing in the following terms:

This concept [of an implied covenant of good faith and fair dealing] is contrary to our well-reasoned and long-established adversary system which has served us ably in Texas for almost 150 years. Our system permits parties who

lead a life of its own. In the process, the language obscured the actual holding of the court and courts cited the case for the proposition that there was no implied covenant of good faith and fair dealing in *any* contract in Texas.²⁵

In *Arnold v. National County Mutual Fire Insurance Co.*²⁶ the supreme court clarified and broadened the role of good faith and fair dealing by holding that, at least in the context of insurance contracts, an insurer owes a duty of good faith and fair dealing to its insured and that a cause of action will lie for breach of this duty. According to the court,

[A] duty of good faith and fair dealing may arise as a result of a special relationship between the parties governed or created by a contract.

.....

A cause of action for breach of the duty of good faith and fair dealing is stated when it is alleged that there is no reasonable basis for denial of a claim or delay in payment or a failure on the part of the insurer to determine whether there is any reasonable basis for the denial or delay.²⁷

A logical development from *Arnold* is recognition that the Code provides inter alia, that "[e]very contract or duty within the title imposes an obligation of good faith in its performance or enforcement"²⁸ and further provides, "[a]ny right or obligation declared by this title is enforceable by action unless the provision declaring it specifies a different and limited effect."²⁹

C. Accord and Satisfaction

"Payment in Full" Must Be Brought Home to Creditor. The traditional common law view recognizes an effective accord and satisfaction between a debtor and a creditor if the debtor clearly informs the creditor that a pay-

have a dispute over a contract to present their case to an impartial tribunal for a determination of the agreement as made by the parties and embodied in the contract itself. To adopt the laudatory sounding theory of "good faith and fair dealing" would place a party under the onerous threat of treble damages should he seek to compel his adversary to perform according to the contract terms as agreed upon by the parties. The novel concept advocated by the courts below would abolish our system of government according to settled rules of law and let each case be decided upon what might seem "fair and in good faith," by each fact finder. This we are unwilling to do.

Id. at 522.

25. *Cantu v. Western Fire Ins. Co.*, 716 S.W.2d 737 (Tex. App.—Corpus Christi 1986), writ *ref'd n.r.e., per curiam*, 723 S.W.2d 668 (Tex. 1987), and *Cluck v. Frost Nat'l Bank*, 714 S.W.2d 408 (Tex. App.—San Antonio 1986, writ *ref'd n.r.e.*), both quoted the paragraph set out *supra* in note 28 as a ground for their decision. In the *per curiam* refusal of a writ of error in *Cantu*, the supreme court noted *Arnold v. National County Mutual Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987), as the proper interpretation of *English*. See 723 S.W.2d at 668.

26. 725 S.W.2d 165 (Tex. 1987).

27. *Id.* at 167.

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

29. *Id.* § 1.106(b). A recent example of a cause of action based on these Code provisions can be found in *Reid v. Key Bank of Southern Maine, Inc.*, 3 U.C.C. Rep. Serv. 1665 (1st Cir. 1987). Although decided under the law of Maine, the Code provisions in Texas are identical on this point and the question was one of first impression in that jurisdiction. The rule in *Arnold v. National County Mutual Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987), could easily be extended along the lines of the court's reasoning in *Reid*.

ment is being tendered in full payment of a debt.³⁰ Texas, along with a majority of American jurisdictions, adopted this general rule.³¹ The enactment of section 1.207 of the Code raised the possibility that a creditor might be able to avoid the effect of the common law rule by accepting such a payment under protest and thereby reserve the right to sue at a later time for any unpaid balance.³² While some Texas cases have continued to apply the pre-Code law of accord and satisfaction,³³ *Pileco, Inc. v. HCI, Inc.*,³⁴ is the first decision in Texas to squarely address the issue of whether section 1.207 overturns the common law rule.

In *Pileco* the back of a check contained the statement, "By signature hereto, endorser acknowledges full, complete and final settlement of all claims against payer."³⁵ The creditor cashed the check after adding the words "Under Protest" as part of its indorsement and then sent a letter to the debtor demanding payment of alleged unpaid interest.³⁶ The creditor argued that the addition of the "Under Protest" language preserved its right to sue for any unpaid balance under section 1.207 of the Code.³⁷ The court held the common law doctrine of accord and satisfaction survived the enactment of the Code and that under the common law, a creditor could not simultaneously accept the benefit of a payment and reject a "Payment in Full" condition accompanying the payment.³⁸ A creditor must reject the entire tender of payment and return the check to avoid an accord and satisfaction. The creditor's attempt to use section 1.207 to avoid an accord and satisfaction defense by placing the phrase "Under Protest" on the check was ineffective.³⁹

Two other cases decided during the Survey period addressed other aspects of the accord and satisfaction defense.⁴⁰

30. See Gold, *Accord and Satisfaction by Estoppel*, 27 IOWA L. REV. 31 (1941-42) (excellent discussion and extensive citation of authority on accord and satisfaction).

31. See *First State Bank v. Knapp*, 3 S.W.2d 468 (Tex. Civ. App.—Amarillo 1928, no writ); *Stetson-Preston Co. v. H.S. Dodson & Co.*, 103 S.W. 685 (Tex. Civ. App. 1907, no writ).

32. TEX. BUS. & COM. CODE ANN. § 1.207 (Tex. UCC) (Vernon 1986) provides, *inter alia*: "A party who with explicit reservation of rights . . . assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved."

33. E.g., *Hixon v. Cox*, 633 S.W.2d 330 (Tex. App.—Dallas 1982, writ ref'd n.r.e.) (pre-Code law continues to apply in cases of payment by check for services rendered; question left often whether rule for payment by check for goods delivered changed by Code); *Roylex, Inc. v. S. & B. Engineers, Inc.*, 592 S.W.2d 59 (Tex. Civ. App.—Texarkana 1979, no writ) (pre-Code law applied but without discussion of whether Code had displaced common law).

34. 735 S.W.2d 561 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

35. *Id.*

36. *Id.*

37. *Id.* at 562.

38. *Id.* at 562-63.

39. *Id.* at 563.

40. *Tex-Goober Co. v. Los Angeles Nut House, Inc.*, 803 F.2d 1358 (5th Cir. 1986) (must be unmistakable communication to creditor that check is being tendered as full accord and satisfaction; letter held ambiguous on whether such tender was being made); *Talamas v. Bressi Int'l*, 727 S.W.2d 72 (Tex. App.—San Antonio 1987, writ ref'd n.r.e.) (burden of proving every element of alleged accord and satisfaction is on defendant; insufficient evidence shown to raise fact issue that would avoid summary judgment).

II. SALES TRANSACTIONS

A. Warranties

Creation and Disclaimer of Implied Warranties. The Texas law of warranty has undergone considerable change since the adoption of the Code, and it has been clear for some time that the interaction between the Code, the Texas Deceptive Trade Practices Act,⁴¹ and the common law has been gradually moving in the direction of increased warranty coverage.⁴² There has been a clear trend toward the expansion of warranty coverage beyond the sale of goods transactions covered by the Commercial Code into transactions involving the sale of homes and related construction. This trend continued with the controversial decision in *Melody Home Manufacturing Co. v.*

41. TEX. BUS. & COM. CODE ANN. §§ 17.41-63 (Vernon 1987).

42. The following summary helps to discern the movement toward increased warranty protection:

As implied warranty of habitability and good workmanship runs from the builder to the original purchaser of a dwelling. *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968); *Kamarach v. Bennett*, 568 S.W.2d 658 (Tex. 1978). The warranty continues to run even if the builder lives in the dwelling for several years before selling it. *March v. Thiery*, 729 S.W.2d 889 (Tex. App.—Corpus Christi 1987, no writ). The implied warranty of habitability and good workmanship also runs from the original builder to purchasers of a used home. *Gupta v. Ritter Homes, Inc.*, 646 S.W.2d 168 (Tex. 1983).

There are actually two warranties imposed in the construction of a dwelling: a warranty of habitability and a warranty of good workmanship, a breach of either warranty can give rise to an action for damages. *Evans v. J. Stiles, Inc.*, 689 S.W.2d 399 (Tex. 1985). The warranty of good workmanship extends to peripheral construction as well as to the dwelling itself. *Kish v. Van Note*, 692 S.W.2d 493 (Tex. 1985) (swimming pool); *Thrall v. Renno*, 695 S.W.2d 84 (Tex. App.—San Antonio 1985, writ ref'd n.r.e.) (brick patio).

At the same time this series of cases was being decided, the Texas courts were also considering the related issues of warranty disclaimers and limitations of remedy in light of the DTPA. The path of development in this area is less clear, but movement can be seen. A summary is also helpful here:

A clear and conspicuous disclaimer of warranties or limitation of remedy that is effective under the Code is also effective under the DTPA. *Ellmer v. Delaware Mini-Computer Systems*, 665 S.W.2d 158 (Tex. App.—Dallas 1983, no writ); *Harley-Davidson Motor Co. v. Young*, 720 S.W.2d 211 (Tex. App.—Houston [14th Dist.] 1986, no writ). In the case of warranties of habitability and good workmanship, the disclaimer need not even meet Code standards of conspicuousness. *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392 (Tex. 1982), *McCrea v. Cubilla Condominium Corp.*, 685 S.W.2d 755 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

While disclaimers may be effective to disclaim an action for breach of an implied warranty, express warranty claims may survive the disclaimer under the standards of section 2.316(a) of the Code and serve as the basis for a recovery under the DTPA. *Singleton v. LaCoure*, 712 S.W.2d 757 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.); *Mercedes-Benz of North Am., Inc. v. Dickenson*, 720 S.W.2d 844 (Tex. App.—Fort Worth 1986, no writ).

Limitation of liability clauses, as contrasted to disclaimers, are not effective to waive the right to maintain a DTPA action because of the antiwaiver provision of TEX. BUS. & COM. CODE ANN. § 17.42 (Vernon 1987). *Martin v. Lou Poliquin Enterprises, Inc.*, 696 S.W.2d 180 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.).

While disclaimers may be effective to bar actions founded on sources of law outside the DTPA, they have no effect on DTPA causes of action because of the anti-waiver provisions of TEX. BUS. & COM. CODE ANN. § 17.42 (Vernon 1987). *Mercedes-Benz of North Am., Inc. v. Dickenson*, 720 S.W.2d 844 (Tex. App.—Fort Worth 1986, no writ); *Metro Ford Truck Sales, Inc. v. Davis*, 709 S.W.2d 785, *opinion on rehearing*, 711 S.W.2d 145 (Tex. App.—Fort Worth 1986, no writ); *Reliance Universal, Inc. v. Sparks Indus. Servs., Inc.*, 688 S.W.2d 890 (Tex. App.—Beaumont 1985, writ ref'd n.r.e.).

Barnes.⁴³

The facts in *Melody* are easy to understand. The plaintiffs purchased a manufactured home from the defendant. Two years after moving in, the plaintiffs discovered that a drain had not been connected to one of the sinks and the resulting leakage had seriously damaged the sheetrock, the insulation and the flooring. The plaintiffs contacted the defendant to make repairs. After two attempts at repair, the situation was worse than before because of damage caused during the repair work and because of the failure to reconnect a washing machine that subsequently flooded and caused harm to the carpeting, cabinets, and floors. The plaintiffs prevailed in the lower courts in an action brought on an implied warranty theory under the Deceptive Trade Practices Act (DTPA).⁴⁴ On appeal the Texas Supreme Court held that contracts to repair or modify tangible goods or property carry with them an implied warranty to make the repairs or modifications in a good and workmanlike manner.⁴⁵ The court took pains to describe this new warranty in terms that would measure the quality of repair services according to the standards applied to persons skilled in the particular trade or occupation, not by a guarantee of results.⁴⁶ While the creation of a new and far-reaching

43. 741 S.W.2d 349 (Tex. 1987). The reader should be alerted that the court issued two opinions in *Melody*; only the second was actually released for official publication and it is this second opinion that is discussed in the text. The first opinion was designated as "Not for Publication" pending the result of a motion for rehearing and appears unofficially at 30 Tex. Sup. Ct. J. 489 (June 17, 1987). This opinion was withdrawn and replaced by the second opinion at 741 S.W.2d 349 (1987). Some elements of the first opinion are mentioned, *infra*, in these footnotes because of their intrinsic legal interest.

44. TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon 1987).

45. 741 S.W.2d at 354. In the first *Melody* opinion, the court had ruled that "all service providers impliedly warrant that their services will be performed in a good and workmanlike manner." *Melody Home Mfg. Co. v. Barnes*, 30 Tex. Sup. Ct. J. 489, 491 (June 17, 1987). The warranty statement in the second opinion is considerably narrower. In the first opinion, the court also extended the warranty to the rendition of professional services, *id.* at 491, overruling the decision in *Dennis v. Allison*, 698 S.W.2d 94 (Tex. 1981) (no implied warranty in doctor's psychiatric treatment of patient). In the second opinion the court said, "The question whether an implied warranty applies to services in which the essence of the transaction is the exercise of professional judgment by the service provider is not before us," 741 S.W.2d at 354, noting *Dennis* in passing, but not overruling it. One implication of this change in the second opinion is that the issue of warranties in service transaction is still open, but with two distinct branches: (1) service transactions that do not involve "professional judgment" and (2) professional services. Future litigation will no doubt test the grey area between the first and second opinions in *Melody*.

46. 741 S.W.2d at 354-55. The court is walking a fine line on this point and the ramifications of this attempt to define the warranty in terms of the quality of the work performed are not discussed in the opinion. Questions will arise in at least three areas, two of them legal and one of them practical. The first area is that of pleading and proof. If an aggrieved plaintiff sued for improper repair under theories other than breach of warranty, the plaintiff would have the burden of showing how the repair was deficient. In a breach of warranty suit the plaintiff would need only show that the repair was ineffective to make a *prima facie* case. The defendant would then have the burden of showing how a properly performed repair was nonetheless ineffective, not an impossible burden, but certainly a difficult one. The second area is related to the first. Even though courts and lawyers can draw fine distinctions about repair work that is properly done, yet ineffective as to final results, the practical effect of explaining fine distinctions to juries is problematic. The third area is that of the applicable statute of limitations. The court phrased the warranty in *Melody* as one "available to consumers suing under the DTPA." 741 S.W.2d at 354. If this means that the warranty is only available in DTPA actions, the statute of limitations issue is simple enough since the claim would fall

warranty is striking enough, the court went even further and held that the warranty of good and workmanlike repair cannot be waived or disclaimed.⁴⁷ On the disclaimer issue, the court overturned its earlier decision in the case of *G-W-L, Inc. v. Robichaux*.⁴⁸ A concurring opinion⁴⁹ by Justice Gonzalez strongly disagreed with the action of the court in creating a new warranty and overruling the *G-W-L* decision. The concurrence argued that existing theories of recovery, including breach of contract or the recognized cause of action for the negligent performance of a contract, were adequate to uphold the decision below and did not require the extension of warranty coverage.⁵⁰

In the short term, the *Melody* decision will generate considerable litigation about the scope of the new warranty as well as raising questions about the validity of disclaimers in other, related, contexts. In the long term, perhaps the most significant aspect of the *Melody* decision is the degree to which it illustrates a further blending of contract and tort, a "contort," to use Grant Gilmore's expressive term.⁵¹ Eventually, the interaction between the law of contract, the law of tort and the DTPA will require unification and rationalization by the courts and by the legislature. That time, perhaps, is almost here.

Recovery for Negligent Performance of Repairs. In a case⁵² that throws an interesting sidelight on *Melody*, a homeowner recovered \$150 from a plumber for damage caused to an air conditioner during the course of repairs

within the two-year limitations period of TEX. BUS. & COM. CODE ANN. § 17.56A (Vernon, 1987). One difficulty, however, in stating the warranty in this fashion is that other warranty claims can be maintained as either a DTPA action, if brought within the two-year limitations period, or as a contract action, if brought beyond the two-year period. The author believes it unlikely that the warranty of repair can stand as the only warranty conditionally restricted to DTPA actions because the distinction is artificial. As such, other warranties may be brought under the same condition, for example, the warranties of habitability or good and workmanlike construction, or, as is more likely, the warranty of repair will be expanded by removal of the DTPA condition. Here again, whichever result eventually occurs, further litigation can be predicted.

47. 741 S.W.2d at 355. As with the statement creating the warranty of repair that it is "available to consumers suing under the DTPA," 741 S.W.2d at 354, the author believes it unlikely that the antidisclaimer ruling will remain restricted to the warranty of repair. See *supra* note 46. While it is possible that disclaimers of the warranty of repair will eventually be allowed, a much more likely result will be the gradual extension of the antidisclaimer rule to other warranty claims brought under the DTPA, a position almost reached already in some lower court decisions. See *Mercedes-Benz of North Am., Inc. v. Dickenson*, 720 S.W.2d 844 (Tex. App.—Fort Worth 1986, no writ); *Metro Ford Truck Sales, Inc. v. Davis*, 709 S.W.2d 785, *opinion on rehearing*, 711 S.W.2d 145 (Tex. App.—Fort Worth 1986, no writ); *Reliance Universal, Inc. v. Sparks Indus. Servs., Inc.*, 688 S.W.2d 890 (Tex. App.—Beaumont 1985, writ ref'd n.r.e.).

48. 643 S.W.2d 392 (Tex. 1982). In overruling *G-W-L, Inc. v. Robichaux*, the court stated, "To the extent that it conflicts with this opinion, we overrule *G-W-L, Inc. v. Robichaux*." 741 S.W.2d at 355 (citation omitted). This limited overruling open the door to litigation about the scope of the antidisclaimer rule discussed *supra* in note 46.

49. 741 S.W.2d at 356-61.

50. *Id.* at 358-59. The concurrence is more sensitive than the majority to the problems of proof arising from the description of the warranty of repair in terms of the quality of the work performed instead of in terms of the traditional warranty view of the quality of the end result. See 741 S.W.2d at 359-61.

51. See G. GILMORE, *THE DEATH OF CONTRACT* 90 (1974).

52. *Rocha v. Merritt*, 734 S.W.2d 147 (Tex. App.—Houston [1st Dist.] 1987, no writ).

to the plumbing system of a house. The homeowner's cause of action was based on the negligent performance of services under a contract, a form of action approved in *Montgomery Ward & Co. v. Scharrenbeck*.⁵³ The homeowner also sought recovery of attorney's fees as part of the claim and, on this point, the court held that the negligent "performance of services . . . may be characterized as a claim in contract and/or tort."⁵⁴ As a contract claim, the court held that attorney's fees were properly recoverable.⁵⁵

Express Warranties of Workmanship. In addition to implied warranties of habitability and good workmanship, express warranties can also arise in construction cases. In *Wood v. Component Construction Corp.*⁵⁶ a contractor succeeded in maintaining a DTPA action against a subcontractor that had expressly warranted its workmanship.

Express Warranties in the Sale of Goods. In a non-DTPA case,⁵⁷ the plaintiff cotton farmers sued for breach of an express warranty in the sale of herbicide and challenged the validity of a limitation of remedies clause on the ground that the limitation was unconscionable.⁵⁸ The plaintiffs succeeded in showing a breach of the warranty, but were unsuccessful on the issue of unconscionability.⁵⁹ The court believed that the large-scale farming operations of the plaintiffs made it appropriate to consider the contract as one made in a commercial setting.⁶⁰ As a commercial contract, the court found the limitation of liability to be conscionable because it simply allocated risks between the parties in an arm's-length bargain regarding the efficacy of the product.⁶¹ The court limited damages to the difference in the value of the product as warranted and the value of the product as delivered.⁶²

53. 146 Tex. 153, 157, 204 S.W.2d 508, 510 (1947).

54. 734 S.W.2d at 148. A true "contort." Gilmore would be pleased. *But see* *Farina v. Southwestern Bell Media, Inc.*, 658 F. Supp. 826 (S.D. Tex. 1987) (negligent performance of contract is tort claim; no liability for failure to publish advertising in telephone directory). The court noted it was not bound by decisions of the Texas courts of appeals and chose not to follow *Ruben H. Donnelly Corp. v. McKinnon*, 688 S.W.2d 612 (Tex. App.—Corpus Christi 1985, writ ref'd n.r.e.) (failure to publish advertising in telephone directory actionable as negligent performance of contract). On similar facts about the failure to publish advertising in a telephone directory, a limitation of liability clause was upheld in *Calarco v. Southwestern Bell Tel. Co.*, 725 S.W.2d 304 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.), in which the court distinguished *Donnelly* because the plaintiff sued for breach of contract instead of suing for negligent performance of contract and DTPA violations.

55. 734 S.W.2d at 148-49. Attorney's fees in contract actions are recoverable under TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (Vernon 1986).

56. 722 S.W.2d 439 (Tex. App.—Fort Worth 1986, no writ).

57. *Lindemann v. Eli Lilly & Co.*, 816 F.2d 199 (5th Cir. 1987).

58. *Id.* at 202.

59. *Id.* at 202-05.

60. *Id.* at 204.

61. *Id.*

62. *Id.* at 205.

B. Good Faith Purchase

Authority to Sell Critical to Passage of Title. In an interesting pair of cases,⁶³ the issue of an agent's authority to sell goods was the critical point in determining whether a good faith purchaser obtained a title that was good against the owner. In one case the owner recovered the goods because of a proven lack of authority to sell on the part of the agent, but only after reimbursing the purchaser for the entire purchase price paid to the defaulting agent.⁶⁴ In the other case, the buyer successfully opposed a motion for summary judgment in favor of the owner by showing a sufficient factual basis to justify trial on the question of the authority of the agent to sell the goods.⁶⁵

C. Suspension of Performance

Change of Circumstance Must Be Objective and Must Occur After the Time of Contracting. Under section 2.609 of the Code⁶⁶ a party may suspend performance of a contract if there are reasonable grounds for insecurity about whether the other party will perform. In *Universal Resources Corp. v. Panhandle Eastern Pipe Line Co.*⁶⁷ the court held that a gas buyer did not have reasonable grounds to justify suspension of performance when the only change in circumstance from the time the parties originally signed the contract was a subjective redetermination based on the buyer's reassessment of the gas production properties of the seller.⁶⁸

D. Revocation of Acceptance

Revocation Allowed When Malfunctions Cause Equipment to Be of No Value to the Buyer. Section 2.608 of Code⁶⁹ replaces the common law action of

63. *Cash v. Lebowitz*, 734 S.W.2d 396 (Tex. App.—Dallas 1987, writ ref'd n.r.e.); *Andy Mach. Co. v. Hofstadter*, 721 S.W.2d 472 (Tex. App.—Corpus Christi 1986, no writ).

64. *Andy Mach. Co. v. Hofstadter*, 721 S.W.2d 472 (Tex. App.—Corpus Christi 1986, no writ).

65. *Cash v. Lebowitz*, 734 S.W.2d 396 (Tex. App.—Dallas 1987, writ ref'd n.r.e.). *Cash* involved the additional element of the failure of the parties to transfer the certificate of title to the goods involved in the sale (an automobile). Although the Certificate of Title Act, TEX. REV. CIV. STAT. ANN. art. 6687-1, § 33 (Vernon 1977), makes such sales void, the court held that the sale could be valid as between immediate parties because the purpose of the act is to void sales that would divest the true owner of title to the vehicle. 734 S.W.2d at 398. If the true owner was a party to the sale, the purpose of the Act was not violated. This holding is consistent with earlier decisions under the Act. *E.g.*, *Drake Ins. Co. v. King*, 606 S.W.2d 812 (Tex. 1980); *Everett v. United States Fire Ins. Co.*, 653 S.W.2d 948 (Tex. App.—Fort Worth 1983, no writ).

66. TEX. BUS. & COM. CODE ANN. § 2.609(a) (Tex. UCC) (Vernon 1968) provides, in part: "When reasonable grounds for insecurity arise with respect to the performance of either party the other may in writing demand adequate assurance of due performance and until he receives such assurance may if commercially reasonably suspend any performance for which he has not already received the agreed return."

67. 813 F.2d 77 (5th Cir. 1987).

68. *Id.* at 79.

69. TEX. BUS. & COM. CODE ANN. § 2.608 (Tex. UCC) (Vernon 1968) states that:

(a) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it
(1) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or

rescission,⁷⁰ although many courts and attorneys continue to use the older term to describe a claim by the buyer to return the parties to the status quo ante. In *Bivens Winchester Corp. v. Poteet*⁷¹ the court allowed revocation of acceptance when an automatic car washer consistently malfunctioned after installation by tearing off mirrors and antennas, by trapping occupants in their vehicles due to stalling in the middle of the "run," and by failing to stop vehicles at the end of the track. Because the jury found that the equipment had a value of zero dollars to the buyer, the court did not reach the question of whether section 2.608 allows a seller to counterclaim for such value as the goods may have had to the buyer.⁷² The seller argued that the goods did not comprise a "commercial unit" and that the buyer could not, therefore, revoke acceptance of equipment components that did work properly.⁷³ The court held the jury's finding that the equipment was a commercial unit was not against the weight of the evidence because the contract had been negotiated as an integrated automatic car washer and the seller itself had treated the equipment as a single unit.⁷⁴

E. Damages

Lost Profit Claims. Section 2.708(b) of the Code⁷⁵ covers two distinct types of lost profit cases. One is that of a seller engaged in the sale of standard priced goods who loses sales volume because of the buyer's breach.⁷⁶ The other is that of a seller who stops production of goods being specially manufactured for the buyer.⁷⁷ The case of *Malone v. Carl Kisabeth Co.*⁷⁸ is instructive on why a lost volume seller should be sure that special issues submitted to the jury accurately reflect the elements of a lost profits recovery under section 2.708(b) of the Code.⁷⁹ Several things went awry for the seller

(2) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller's assurances.

70. The comment to § 2.608 says inter alia:

The section no longer speaks of "rescission," a term capable of ambiguous application either to transfer of title to the goods or to the contract of sale and susceptible also of confusion with cancellation for cause of an executed or executory portion of the contract. The under this section is instead referred to simply as "revocation of acceptance" of goods tendered under a contract for sale and involves no suggestion of "election" of any sort.

TEX. BUS. & COM. CODE ANN. § 2.608 comment 1 (Tex. UCC) (Vernon 1968).

71. 720 S.W.2d 659 (Tex. App.—San Antonio 1986, no writ).

72. *Id.* at 661.

73. *Id.* at 662. A "commercial unit" is defined in TEX. BUS. & COM. CODE ANN. § 2.105(f) (Tex. UCC) (Vernon 1968) as "such a unit of goods as by commercial usage is a single whole for purposes of sale and division of which materially impairs its character or value on the market or in use."

74. 720 S.W.2d at 662-63.

75. TEX. BUS. & COM. CODE ANN. § 2.708(b) (Tex. UCC) (Vernon 1968).

76. See J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 284-88 (2d ed. 1980).

77. *Id.*

78. 726 S.W.2d 188 (Tex. App.—Fort Worth 1987, writ ref'd n.r.e.).

79. TEX. BUS. & COM. CODE ANN. § 2.708(b) (Tex. UCC) (Vernon 1968) permits the recovery of lost profits whenever the usual measure of the difference between the market price and the unpaid contract price are inadequate to compensate the seller for the breach. Accord-

in *Malone*. The first problem was an instruction that led the jury to miscalculate the amount of lost profits.⁸⁰ Because the buyer had accepted and paid for some goods before the contract was breached, the instruction should not have included the goods already paid for as a part of the calculation base.⁸¹ By including them, the seller was, in effect, receiving a double profit on the goods already accepted.⁸² The second problem was even more serious. The seller did not request a special finding that it was a lost volume seller.⁸³ The failure to obtain this finding amounted to a waiver of that ground as a basis for recovery and the buyer was, therefore, entitled to credit for the resale of the goods (which resale was at the contract price).⁸⁴ The third problem involved the recovery of "incidental damages" for storage and care of the rejected goods.⁸⁵ On this issue, the court held there was inadequate evidence to show that the seller had incurred any expense for storage.⁸⁶ The only testimony was by the seller's president that the goods were stored in the seller's own showroom and his estimate of the value of such storage, but there was no evidence linking this testimony to any expenses incurred by the seller for storing other goods elsewhere or foreclosing the seller from using the space for its own storage requirements.⁸⁷ Since section 2.710 allows the seller to recover for "expenses reasonably incurred,"⁸⁸ the court held that a failure to show an actual incurring of expenses was fatal to this portion of the seller's claim.⁸⁹ The dissent would allow the seller to recover for the reasonable value of the storage space without the requirement of showing out-of-pocket expense or loss.⁹⁰ The court entered a take-nothing judgment against the seller.⁹¹

The second type of lost profits claim is exemplified by *Stewart & Stevenson Services, Inc. v. Enserve, Inc.*⁹² where a seller stopped production of well-service pumps after the buyer's breach. The stoppage was appropriate because of a collapse in the oil field equipment market making it highly unlikely that the pumps could be sold if they were completed.⁹³ The court

ing to the Comment, "This section permits the recovery of lost profits in all appropriate cases, which would include all standard priced goods." *Id.* § 2.708 comment 2.

80. 726 S.W.2d at 189-90.

81. *Id.*

82. *Id.* The proper method of proving lost profits damages for an aggrieved seller is discussed at length in *Fleming Mfg. Co. v. Capitol Brick, Inc.*, 734 S.W.2d 405, 407-08 (Tex. App.—Austin 1987, writ ref'd n.r.e.) (proof must show lost profits with reasonable certainty).

83. 726 S.W.2d at 190.

84. *Id.* at 190-91.

85. Incidental damages are specifically allowed by TEX. BUS. & COM. CODE ANN. § 2.708(b) (Tex. UCC) (Vernon 1968) and defined in *id.* § 2.710 to include such items as commercially reasonable charges for transportation, for care and custody of goods after the buyer's breach, and for return or resale of the goods.

86. 726 S.W.2d at 191-92.

87. *Id.* at 192.

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

89. 726 S.W.2d at 192.

90. *Id.*

91. *Id.*

92. 719 S.W.2d 337 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.).

93. *Id.* at 343.

found no prior Texas cases applying section 2.708(b)⁹⁴ in these circumstances, but did find precedent in other jurisdictions applying this provision of the Code in disintegrating market situations⁹⁵ and allowed the seller to recover damages on this theory.⁹⁶ The court also properly held that under the Code, the contract did not fail for indefiniteness because it left open the price and the delivery terms.⁹⁷

Proving Sale and Delivery. In *Peregrine Metals Group, Inc. v. Leervig*⁹⁸ the court held that a seller was entitled to introduce bills of lading, shipping receipts, and letters from the buyer admitting the debt as part of the seller's proof that goods had actually been sold and delivered to the buyer.⁹⁹ For reasons that are not clear in the opinion, the trial court had allowed testimony about how these documents were prepared and the function they served, but refused to admit the documents themselves and instructed a verdict against the seller.¹⁰⁰ The court of appeals ruled this was error and remanded the case since there was some evidence showing that delivery was made and an instructed verdict was, therefore, improper.¹⁰¹

Some Appeals are Better Left Alone. Everyone has days like this. The plaintiff-appellant in *West v. Jack Criswell Lincoln-Mercury, Inc.*¹⁰² bought a used Pontiac from the appellee and also purchased a credit life and warranty service policy at the same time. There were numerous immediate problems with the car and, within two weeks, the appellant traded-in the Pontiac on a somewhat newer Mercury. The appellant again purchased credit life and warranty service for this vehicle. By mistake, the appellee failed to refund the premiums for the earlier credit life and warranty policies. When he discovered the error, the appellee promptly tendered the amounts due to the appellant's attorney, but the tender was refused.

At trial, the court found that the parties had agreed to rescind the original contract for the purchase of the Pontiac and awarded the appellant \$1,600 in damages plus attorney's fees of \$3,000.¹⁰³ Appellant was dissatisfied with this award and appealed on the ground that recovery had been sought under the DTPA and not for rescission.¹⁰⁴ The appellant also contended that the trial court had erred in calculating damages by refusing to double some of the damages under the DTPA, but did not assert as error the trial court's

94. TEX. BUS. & COM. CODE ANN. § 2.708(b) (Tex. UCC) (Vernon 1968).

95. 719 S.W.2d at 343. The cases cited were *Timber Access Indus. Co. v. U.S. Plywood-Champion Papers, Inc.*, 263 Or. 509, 503 P.2d 482, 490 (1972), and *Stanfill v. TAT (U.S.A.) Corp.*, 76 Or. App. 332, 709 P.2d 717, 718 (1985).

96. 719 S.W.2d at 344.

97. *Id.* at 345-46. TEX. BUS. & COM. CODE ANN. §§ 2.305(a), 2.309(a) (Tex. UCC) (Vernon 1968) are the provisions dealing with open price and open delivery terms.

98. 734 S.W.2d 121 (Tex. App.—Houston [1st Dist.] 1987, no writ).

99. *Id.* at 123.

100. *Id.* at 122.

101. *Id.* at 123.

102. 721 S.W.2d 500 (Tex. App.—Houston [14th Dist.] 1986, no writ).

103. 721 S.W.2d at 500-01.

104. *Id.* at 501.

finding that there had been no DTPA violation.¹⁰⁵ The third point of error was that the trial court had erred in calculating the damages to which the appellant was entitled "under any theory of recovery."¹⁰⁶ The court of appeals agreed with appellant that the trial court should not have entered a judgment based on rescission since that had neither been pleaded nor tried.¹⁰⁷ The court of appeals also agreed with appellant that the trial court erred in calculating damages "under any theory of recovery" since rescission was not a proper ground of recovery and the appellant had not appealed the ruling that there was no DTPA violation.¹⁰⁸ Because the trial court based its award on an improper theory, damages based on rescission could not stand and, because there was no DTPA violation, no damages and no attorneys fees could be awarded on that basis either.¹⁰⁹ The appellate court reversed the judgment of the trial court and rendered a take-nothing judgment against the appellant.¹¹⁰

Damages for Loss of Use. In *Town East Ford Sales, Inc. v. Gray*¹¹¹ the plaintiff fared better on a claim based on another automobile purchase. While there was a failure of proof on some issues,¹¹² the plaintiff was successful in recovering damages for loss of use as measured by the cost of buying another car as a substitute for the original, unusable vehicle.¹¹³ The court allowed this measure of damages on the authority of the leading case of *Luna v. North Star Dodge Sales, Inc.*,¹¹⁴ in which the rental cost of another vehicle was used as the measure of damage. The court in *Town East* noted that the purchase price of another car was actually a lower measure of damages on the facts before it than the cost of renting another vehicle.¹¹⁵

E. Statute of Limitations

Calculation of Time of Breach Can Be an Issue of Material Fact. Under section 2.725 of the Code¹¹⁶ a cause of action normally accrues when a

105. *Id.*

106. *Id.*

107. *Id.*

108. *Id.*

109. *Id.* at 501-02.

110. *Id.* at 502.

111. 730 S.W.2d 796 (Tex. App.—Dallas 1987, no writ).

112. The court held that the plaintiff-buyer had failed to prove the market value of the defective vehicle, 730 S.W.2d at 801-03. Proof of market value was successfully shown, however, in another case decided during the Survey period. *See McCann v. Brown*, 725 S.W.2d 822 (Tex. App.—Fort Worth 1987, no writ). The court also held the buyer had failed to prove damages for mental anguish allegedly suffered as a result of the transaction, 730 S.W.2d at 803-04. The court noted that the plaintiff's proof of mental anguish fell far short of the proof offered by the plaintiff in *Luna v. North Star Dodge Sales, Inc.*, 667 S.W.2d 115 (Tex. 1984), the seminal case on mental anguish recovery in consumer transactions under the DTPA.

113. 730 S.W.2d at 804-05.

114. 667 S.W.2d 115, 118 (Tex. 1984).

115. 730 S.W.2d at 804.

116. TEX. BUS. & COM. CODE ANN. § 2.725(b) (Tex. UCC) (Vernon 1968) provides, in part:

(b) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs

breach occurs, which is generally upon tender of delivery of the goods, but when a warranty explicitly extends to future performance, the cause of action does not accrue until the breach is or should have been discovered. In these latter instances, the date when the four-year statute of limitations begins to run is an issue of fact that may defeat a motion for summary judgment. Such a situation arose in *Trunkline LNG Co. v. Trane Thermal Co.*¹¹⁷ in which the court remanded the case for trial because part of an installment contract extended to the future performance of the goods and summary judgment evidence was inadequate to determine when the cause of action arose.¹¹⁸

In another statute of limitations case, *Muss v. Mercedes-Benz of N.Am.*,¹¹⁹ more than four years had passed since delivery of the goods, but the buyer argued that an agreement by the seller to make repairs for two years following delivery amounted to a warranty as to the future performance of the goods. Under this argument, the limitations period was essentially six years rather than four years. The court reviewed the earlier case of *Safeway Stores, Inc. v. Certaineed Corp.*¹²⁰ and concluded that the contract clause was only a promise by the seller to make repairs rather than an explicit warranty that the goods would comply in the future with some standard of performance.¹²¹ The warranty claim was, therefore, time-barred.¹²² On this point the case is more carefully reasoned than *Trunkline* since some language in *Trunkline* suggests that an agreement to repair may operate to extend the statute of limitations.¹²³ This issue was not squarely before the court in *Trunkline*, however, because of the installment nature of the contract involved in that case.¹²⁴

The buyer in *Muss* also asserted a DTPA claim based on the failure to repair. The court concluded, however, that this claim was barred by the running of the applicable two-year statute of limitations.¹²⁵

III. COMMERCIAL PAPER

A. Form and Validity of Instruments

Instrument Must Be Unconditional. To be negotiable under section 3.104,¹²⁶ an instrument must contain an unconditional promise or order to pay a sum

when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

117. 722 S.W.2d 722 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.).

118. *Id.* at 725.

119. 734 S.W.2d 155 (Tex. App.—Dallas 1987, writ ref'd n.r.e.).

120. 710 S.W.2d 544 (Tex. 1986). The court noted that the supreme court had held in *Safeway* that emphasis should be placed on the term "explicitly" in considering cases under § 2.725(b). See *Muss*, 734 S.W.2d at 158; *Safeway*, 710 S.W.2d at 548.

121. *Muss*, 734 S.W.2d at 158.

122. *Id.*

123. 722 S.W.2d at 725.

124. *Id.*

125. 734 S.W.2d at 160.

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

certain.¹²⁷ If the promise or order is conditional, the instrument is nonnegotiable and the maker or drawer may be relieved of liability on the instrument if the condition is not fulfilled.¹²⁸ In *Sun Exploration & Production Co. v. Benton*¹²⁹ the Texas Supreme Court held that a provision in a draft specifying that it was payable "15 days after sight and upon approval of title" was a condition precedent to liability on the draft.¹³⁰ The failure of the grantor to convey a valid title to the land in question allowed the grantee to avoid liability on the draft.¹³¹

Instrument Must Be Signed by the Maker or Drawer. Also under section 3.104,¹³² an instrument must be signed by the maker or drawer to become a negotiable instrument. While a "signing" may be by the use of any name or even by a word or mark, there must be some "signing" before a person will be liable on the instrument.¹³³ In *Lassiter v. Rotogravure Committee, Inc.*¹³⁴ a contract was signed in the following form:

PRINT COMPANY NAME EXACTLY AS IT SHOULD APPEAR IN THE ROTOGRAVURE:

TURTLE CREEK RACQUET CLUB

Address, Zip _____ 10th Floor Two Turtle Creek Village _____

Telephone _____ 528-3643 _____

Print Signature _____ LARRY R. LASSITER _____

Signature /s< _____ LARRY R. LASSITER _____¹³⁵

In an action against Lassiter in his personal capacity, he sought to introduce parol evidence that he had intended to sign only in a representative capacity as president of the company.¹³⁶ Although the case involved a contract rather than an instrument, the court analogized the situation to the Code provisions dealing with signatures made in a representative capacity¹³⁷ and concluded that, as between the immediate parties to the transaction, parol evidence could be introduced to show that the contract had been signed in a representative capacity.¹³⁸ Drawing from a series of earlier sec-

127. *Id.* The sum certain includes any interest provided for in the note. *Kucel v. Walter E. Heller & Co.*, 813 F.2d 67, 71 (5th Cir. 1987).

128. Simply because an instrument is nonnegotiable does not mean that the obligor is automatically relieved of liability. *E.g.*, *Hardeman v. Parish*, 730 S.W.2d 813 (Tex. App.—El Paso 1987, writ ref'd n.r.e.) (obligors estopped from enforcing condition precedent by participation in failure to fulfill the condition); *Mauricio v. Mendez*, 723 S.W.2d 296 (Tex. App.—San Antonio 1987, no writ) (obligor can be liable on nonnegotiable note if defense to payment not proven).

129. 728 S.W.2d 35 (Tex. 1987).

130. *Id.* at 37.

131. *Id.*

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

133. *See id.* § 3.401(a), which states, "No person is liable on an instrument unless his signature appears thereon."

134. 727 S.W.2d 8 (Tex. App.—Dallas 1987, writ ref'd n.r.e.).

135. *Id.* at 9.

136. *Id.* at 9-10.

137. *Id.* at 9. The relevant Code provisions are contained in TEX. BUS. & COM. CODE ANN. § 3.403(b) (c) (Tex. UCC) (Vernon 1968).

138. 727 S.W.2d at 10. Even though a party may have signed in a representative capacity, he or she may still be bound if the principal was not disclosed or was not authorized to do

tion 3.403 cases,¹³⁹ the court also concluded that part of the signer's burden of proof was to show that the intent to sign in a representative capacity was communicated to the other party to the contract.¹⁴⁰ A dissenting opinion criticized the majority for analogizing the case to section 3.403 and relied on pre-Code law to reach an opposite result.¹⁴¹ The majority opinion reflects a more modern approach to this issue and should be regarded as the better view.

In another parol evidence case¹⁴² the signer of a note was allowed to introduce evidence that an instrument was signed only for the business records purposes of the plaintiff and was never intended to be a valid note.¹⁴³ This is consistent with the ordinary contract rule that parol evidence is always admissible to show that a contract never came into existence,¹⁴⁴ as contrasted to the exclusion of parol evidence that seeks to contradict or vary the terms of an otherwise valid written agreement.¹⁴⁵

Another signing case¹⁴⁶ involved a renewal note and guaranty agreement signed in the following form:

Promissory note:

The Creative Cook, Inc.
 by: /s/ William E. Harris, President
William E. Harris
/s/ Barbara Harris, Vice-President
 Barbara Harris

Guaranty agreement:

The Creative Cook, Inc.
/s/ William E. Harris, President
William E. Harris
/s/ Barbara Harris, Vice-President
 Barbara Harris¹⁴⁷

The court held that these were clear and unambiguous signings showing that the individuals had signed as representatives only and that they had incurred no personal liability for the indebtedness of the corporation.¹⁴⁸

business in the state. See *Stacy v. Energy Management Group, Ltd.*, 734 S.W.2d 149 (Tex. App.—Houston [1st Dist.] 1987, no writ).

139. The cited cases included *Griffin v. Ellinger*, 538 S.W.2d 97, 100 (Tex. 1976); *Seale v. Nichols*, 505 S.W.2d 251, 255 (Tex. 1974), and *Antil v. Southwest Envelope Co.*, 601 S.W.2d 47, 48 (Tex. Civ. App.—Beaumont 1979, no writ).

140. 727 S.W.2d at 11.

141. *Id.* at 11-12.

142. *Bill Shannon, Inc. v. San Clemente*, 724 S.W.2d 941 (Tex. App.—San Antonio 1987, no writ).

143. *Id.* at 942-43.

144. *E.g.*, *Baker v. Baker*, 143 Tex. 191, 198, 183 S.W.2d 724, 728 (1944); *Merbitz v. Great Nat'l Life Ins. Co.*, 599 S.W.2d 655, 658 (Tex. Civ. App.—Texarkana 1980, writ ref'd n.r.e.).

145. *E.g.*, *Town North Nat'l Bank v. Broadus*, 569 S.W.2d 489, 491 (Tex. 1978); *Bailey v. Gulfway Nat'l Bank*, 626 S.W.2d 70, 73 (Tex. App.—Corpus Christi 1981, writ ref'd n.r.e.).

146. *Summit Bank v. The Creative Cook*, 730 S.W.2d 343 (Tex. App.—San Antonio 1987, no writ).

147. *Id.* at 345.

148. *Id.* at 346.

Antecedent Debt. Under § 3.303(b) of the Code¹⁴⁹ a holder gives value when an instrument is taken in payment of an antecedent debt. In *Biggs v. World Air Conditioning, Inc.*¹⁵⁰ the drawer of a check made an ingenious, but strained, argument based on section 3.408 of the Code¹⁵¹ that a holder who had not immediately cancelled an antecedent debt in exchange for a check had not given value for the check and was subject to a defense of failure of consideration.¹⁵² The court properly noted that section 3.802 of the Code¹⁵³ operates to suspend the enforceability of the underlying obligation pending payment or dishonor of the check and that value is given when the check is taken¹⁵⁴ under section 3.303.¹⁵⁵ According to the court's correct interpretation of these sections, "payment" of an antecedent debt does not require immediate cancellation of a debt to constitute value.

B. Proper Presentment and Payment of Instruments

Indorsement Not a Prerequisite to Payment. Elementary commercial law holds that a forged indorsement is ineffective to transfer title to an instrument.¹⁵⁶ Equally elementary is that a bank or other payor is liable for conversion if it pays an instrument over a forged indorsement.¹⁵⁷ If the payee of an instrument requests payment, however, the payee may waive the requirement of an indorsement since the payee is a proper party to receive payment.¹⁵⁸ In this situation there is no conversion because the correct person received the proceeds.¹⁵⁹ Of course, if a person other than the named payee attempts to obtain payment, the bank or other payor is within its rights to insist on the payee's indorsement and may interplead adverse claimants if the actual ownership of the instrument is disputed.¹⁶⁰

Payment to the Wrong Person. Another improper payment situation is that of a maker who receives a notice and demand for payment from an assignee, but who ignores the notice and pays the assignor instead. In this situation, the maker is still liable to the assignee for payment of the note.¹⁶¹ A payment made to the wrong person does not work a discharge of the maker's

149. TEX. BUS. & COM. CODE ANN. § 3.303(b) (Tex. UCC) (Vernon 1968).

150. 722 S.W.2d 27 (Tex. App.—Dallas 1986, writ ref'd n.r.e.).

151. TEX. BUS. & COM. CODE ANN. § 3.408 (Tex. UCC) (Vernon 1968).

152. 722 S.W.2d at 28.

153. TEX. BUS. & COM. CODE ANN. § 3.802(a)(2) (Tex. UCC) (Vernon 1968).

154. 722 S.W.2d at 29.

155. TEX. BUS. & COM. CODE ANN. § 3.303 (Tex. UCC) (Vernon 1968).

156. *Id.* § 3.202; see J. WHITE & R. SUMMERS, *supra* note 76, at 597-603.

157. TEX. BUS. & COM. CODE ANN. § 3.419 (Tex. UCC) (Vernon 1968); see J. WHITE & R. SUMMERS, *supra* note 76, at 585-89.

158. *Gray v. Bertrand*, 723 S.W.2d 957, 958 (Tex. 1987). If the requirement of indorsement has not been waived and the proceeds are paid to the wrong person, there is a conversion. See *Ames v. Great S. Bank*, 672 S.W.2d 447 (Tex. 1984). (bank held liable for cashing certificate of deposit and paying money to bookkeeper without authorization or indorsement).

159. 723 S.W.2d at 958.

160. *Salazar v. San Benito Bank & Trust Co.*, 730 S.W.2d 21 (Tex. App.—Corpus Christi 1987, no writ).

161. *BOC Group, Inc. v. Katy Nat'l Bank*, 720 S.W.2d 229 (Tex. App.—Houston [14th Dist.] 1986, no writ).

liability¹⁶²

Early Payment as Discharge of Note. In contrast to improper payment, a situation may sometimes involve payment to a proper person at a date prior to the due date of an instrument. If the prepayment includes an agreement between the holder and the maker that a discount for prepayment is allowed, the payment of the discounted amount discharges the maker from further liability on the note.¹⁶³ In *Woods v. Applemack Enterprises, Inc.*¹⁶⁴ the court disallowed a claim by the holder for payment of the discount after the maker had already paid the agreed sum as full payment of the note.¹⁶⁵

C. Liability of Parties

Dissolution of Partnership Does Not Discharge Partners' Liability. The dissolution of a partnership does not discharge the partners from liability on notes signed by them while the partnership existed unless the instruments clearly condition liability on the continuation of the partnership.¹⁶⁶ The notes involved were nonnegotiable and the result, therefore, did not depend on the concept of negotiability to cut off defenses.¹⁶⁷

Liability of Assignee Under FTC Holder in Due Course Rule. In *Home Savings Association v. Guerra*¹⁶⁸ the Texas Supreme Court restated its interpretation of the Federal Trade Commission Holder in Due Course Rule.¹⁶⁹ Under that rule, all consumer credit notes and contracts must contain a notice that provides, inter alia, "Recovery hereunder by the debtor shall not exceed amounts paid by the debtor hereunder."¹⁷⁰ The court of appeals permitted a recovery against the assignee of a consumer note for DTPA violations committed by the seller-assignor.¹⁷¹ The supreme court reversed this portion of the judgment and ruled that the assignee was liable only to the extent of payments already made under the contract.¹⁷² The court recognized that an assignee might incur greater liability if it had itself committed DTPA violations or had been "so *inextricably intertwined* in the transac-

162. TEX. BUS. & COM. CODE ANN. § 3.603 (Tex. UCC) (Vernon 1968) requires that payment be made to the *holder* to work a discharge of the maker.

163. *Id.* § 3.601 discharges a party by any act or agreement that would discharge a simple contract for the payment of money. An agreement to accept a lesser amount is an accord and satisfaction that would discharge such a contract. See text at notes 30-40 *supra*.

164. 729 S.W.2d 328 (Tex. App.—Houston [14th Dist.] 1987, no writ).

165. *Id.* at 331. The maker could have insisted on the return or cancellation of the note when the payment was made to take advantage of the discharge provided in TEX. BUS. & COM. CODE ANN. § 3.605 (Tex. UCC) (Vernon 1968). This action would have probably saved a lawsuit.

166. *Perry v. Welch*, 725 S.W.2d 347 (Tex. App.—Corpus Christi 1987, no writ).

167. Compare the limited defenses available against a holder in due course under TEX. BUS. & COM. CODE ANN. § 3.305 (Tex. UCC) (Vernon 1968) with the panoply of defenses available under *id.* § 3.306.

168. 733 S.W.2d 134 (Tex. 1987).

169. 16 C.F.R. § 433.1-.3 (1975).

170. *Id.* § 433.2(a).

171. *Home Sav. Ass'n v. Guerra*, 720 S.W.2d 636 (Tex. App.—San Antonio), *rev'd*, 733 S.W.2d 134 (Tex. 1987).

172. 733 S.W.2d at 137.

tion as to be equally responsible for the conduct of the sale.'"¹⁷³ The court disapproved the case of *De La Fuente v. Home Savings Association*¹⁷⁴ to the extent it contains language inconsistent with *Guerra*.

Proof of Liability on Summary Judgment. The holder of a note is entitled to recover against the maker or against guarantors on a motion for summary judgment that is supported by adequate documentary evidence of the note and the default.¹⁷⁵ In *8920 Corp. v. Alief Alamo Bank*¹⁷⁶ summary judgment evidence, including the notes, a related Deed of Trust, a guaranty agreement, and an affidavit of one of the creditor's vice-presidents, was judged adequate documentary proof.¹⁷⁷ A discrepancy between the name of the vice-president in the motion and on the affidavit was held to be a minor defect that did not affect the motion.¹⁷⁸ The debtor introduced no controverting affidavits raising an issue of material fact.¹⁷⁹

In *Menendez v. Texas Commerce Bank*¹⁸⁰ a judicial admission that a party had signed a note as a guarantor precluded asserting the statute of frauds as a defense to the guaranty agreement.¹⁸¹ The court pointed out that the mere signing of an instrument as a guarantor automatically creates the contract of guaranty imposed by operation of law in section 3.416 of the Code.¹⁸²

Makers and Guarantors Have Burden of Proving Defense. In *Crawford v. Kelly Field National Bank*¹⁸³ the court held that introduction of a note by the holder put the burden of proving a defense on the makers and guarantors and that an alleged defense of failure of consideration was not proven.¹⁸⁴ In reaching this conclusion in a case tried on stipulated facts, the court relied on section 3.307 of the Code.¹⁸⁵

173. 733 S.W.2d at 136 (emphasis by the court) (quoting *Knight v. International Harvester*, 627 S.W.2d 382, 389 (Tex. 1982)). *Colonial Leasing Co. v. Kinerd*, 733 S.W.2d 671 (Tex. App.—Eastland 1987, writ ref'd n.r.e.), adds the thought that, even if the parties are "inextricably intertwined," the plaintiff must still show that the defendant engaged in wrongful conduct, either directly or through an agent, or ratified the conduct, before liability exists. *Id.* at 673. This is a narrow reading of the concept in such cases as *Mytel Int'l Inc. v. Turbo Refrigerating Co.*, 689 S.W.2d 315 (Tex. App.—Fort Worth 1985, no writ), and *Potere, Inc. v. National Realty Serv.*, 667 S.W.2d 252 (Tex. App.—Houston [14th Dist.] 1984, no writ). Further elucidation by the supreme court will be needed in this area.

174. 669 S.W.2d 137 (Tex. App.—Corpus Christi 1984, no writ).

175. *E.g.*, *Zarges v. Beavan*, 652 S.W.2d 368, 369 (Tex. 1983); *Life Ins. Co. v. Gar-Dal, Inc.*, 570 S.W.2d 378, 382 (Tex. 1978); *Wooldridge v. Groos Nat'l Bank*, 603 S.W.2d 335, 343 (Tex. Civ. App.—Waco 1980, no writ); *Guardian Bank v. San Jacinto Sav. Ass'n*, 593 S.W.2d 860, 862 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.).

176. 722 S.W.2d 718 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.).

177. *Id.* at 719-20.

178. *Id.* at 720.

179. *Id.*

180. 730 S.W.2d 14 (Tex. App.—Corpus Christi 1987, no writ).

181. *Id.* at 14-15.

182. *Id.* at 14, see TEX. BUS. & COM. CODE ANN. § 3.416(a), (c) (Tex. UCC) (Vernon 1968).

183. 733 S.W.2d 624 (Tex. App.—San Antonio 1987, no writ).

184. *Id.* at 628.

185. *Id.* TEX. BUS. & COM. CODE ANN. § 3.307(b) (Tex. UCC) (Vernon 1968) provides,

Limitation on Liability of Guarantors. In *Frost National Bank v. Johnson*¹⁸⁶ the El Paso court of appeals held that a guaranty agreement on a First National Bank of Midland form limited the liability of a guarantor.¹⁸⁷

Two notes and the accompanying guaranty were assigned to Frost without recourse and were subsequently defaulted. In an action against the guarantor, the court held that the language of the guaranty insulated the guarantor from liability since all debts of the principal obligor (an oil drilling company) had not yet been paid in full to the "Creditor," meaning the FDIC as receiver of the First National Bank of Midland.¹⁸⁸ According to the court, the language of the guaranty was not ambiguous and meant that an assignee could not recover on the guaranty until the original creditor had been fully paid.¹⁸⁹ On this point, the court cited *FDIC v. Matheson*,¹⁹⁰ a case construing the same language.

No Setoff by Guarantors When Setoff is Owned by Principal Debtor. While a guarantor is entitled to assert any defenses, counterclaims, or setoffs that the guarantor may have in his or her own right, a cause of action that belongs to the principal debtor generally cannot be asserted by the guarantor unless the principal debtor is a party to the suit.¹⁹¹ In *Hart v. First Federal Savings & Loan Association*,¹⁹² the creditor sued the guarantors following a default on a promissory note. The principal debtor, a corporation, was not joined in the action by either the creditor or by the guarantors. The guarantors argued that the debtor had a valid DTPA claim against the creditor, but admitted that this claim had never been assigned to them.¹⁹³ The court held that the guarantors had no standing to assert this claim as a setoff to recovery by the creditor absent an assignment of the claim or joinder of the debtor.¹⁹⁴ The guarantors also failed to show that they fell within any of the exceptions to the general rule requiring joinder of the principal debtor.¹⁹⁵

Statute of Limitations. The statute of limitations on a demand note begins to

in part, "When signatures are admitted or established, production of the instrument entitles a holder to recover on it unless the defendant establishes a defense."

186. 729 S.W.2d 319 (Tex. App.—El Paso 1987, writ ref'd n.r.e.).

187. *Id.* at 320. The critical language in the agreement read: "This guaranty shall inure to the benefit of the transferee, assignee, or holder of the principal debt; however, all indebtedness to the Creditor shall first be paid in full, before the assignee of any debt guaranteed shall receive any benefit of this contract of guaranty." *Id.*

188. *Id.*

189. *Id.*

190. 804 F.2d 1382, 1384 (5th Cir. 1986).

191. *Hart v. First Fed. Sav. & Loan Ass'n*, 727 S.W.2d 723 (Tex. App.—Austin 1987, no writ).

192. *Id.*

193. *Id.* at 725.

194. *Id.* at 727.

195. The exceptions are: (1) When the debtor cannot be reached by ordinary process of law, (2) when the debtor cannot be found, (3) when the debtor is dead, or (4) when the debtor is actually or notoriously insolvent. These exceptions are stated in TEX. CIV. PRAC. & REM. CODE § 17.001 (Vernon 1986).

run on the date of execution or delivery.¹⁹⁶ Summary judgment in favor of the maker is proper where the note and pleadings show on their face that more than four years has elapsed since delivery of the instrument.¹⁹⁷

IV. BANK TRANSACTIONS

A. *Relationship Between Bank and Its Customers*

Ownership of Joint Accounts. One of the principal reasons for joint accounts is to provide rights of survivorship, passing ownership of an account outside a decedent's estate. The Texas Probate Code¹⁹⁸ requires there be a written agreement, signed by the decedent, providing that upon the death of any party, the interest of the deceased passes to the other party. Language such as "the account 'is held as joint tenants with rights of survivorship'" has been held sufficient to comply with the statute.¹⁹⁹

In *Dickerson v. Brooks*²⁰⁰ a signature card and application for a savings account clearly satisfied the requirements of the Probate Code.²⁰¹ The bank failed to specify on the savings certificates, however, that the accounts were joint accounts with rights of survivorship, and the decedent did not sign the certificates. The court held this omission was immaterial because the decedent had signed the signature card and this signing was adequate to satisfy the statutory requirements.²⁰²

A second issue in the case was whether a note issued to the decedent or, upon her death, to specified heirs was a valid nontestamentary transfer of any balance due on the note.²⁰³ The court held that the language of the note was sufficient to satisfy section 450 of the Texas Probate Code²⁰⁴ permitting certain instruments to operate as nontestamentary transfers.²⁰⁵ A dissenting opinion disagreed with the majority on both issues.²⁰⁶

B. *Setoff of Bank Accounts*

When is a Setoff not a Setoff? While a bank must exercise its rights of setoff

196. *McCraine v. Manz*, 730 S.W.2d 366, 367 (Tex. App.—Dallas 1987, no writ); see TEX. BUS. & COM. CODE ANN. § 3.122(a)(2) (Tex. UCC) (Vernon 1968).

197. 730 S.W.2d at 367.

198. TEX. PROB. CODE ANN. § 439(a) (Vernon 1980).

199. *Chopin v. InterFirst Bank Dallas, N.A.*, 694 S.W.2d 79 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).

200. 727 S.W.2d 652 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

201. TEX. PROB. CODE ANN. § 439(a) (Vernon 1980).

202. 727 S.W.2d at 654.

203. *Id.*

204. TEX. PROB. CODE ANN. § 450 (Vernon 1980).

205. 727 S.W.2d at 654. TEX. PROB. CODE ANN. § 450(a) (Vernon 1980) provides, in part: Any of the following provisions in [a] . . . promissory note . . . is deemed to be nontestamentary, and this code does not invalidate the instrument or any provision:

(1) that money or other benefits theretofore due to, controlled, or owned by a decedent shall be paid after his death to a person designated by the decedent in either the instrument or a separate writing, including a will, executed at the same time as the instrument or subsequently . . .

206. 727 S.W.2d at 654-55.

with caution,²⁰⁷ a direction by its depositor in the form of a check to apply the amount of the check to outstanding loans made to the customer is not a setoff, much less a wrongful setoff.²⁰⁸ According to the court in *Porter v. Security State Bank*,²⁰⁹ the bank was legally obligated to pay a check drawn by its customer and to apply the amount to the indicated loan.²¹⁰ Under these circumstances, there was no evidence to show a wrongful setoff and a directed verdict in favor of the bank was proper.²¹¹

Liability for Improper Setoff. In contrast to the decision in *Porter*, a bank may not setoff against funds that it knows are held in trust by its depositor.²¹² In a fact situation that would be comic had it not led to serious consequences,²¹³ a bank failed to follow instructions accompanying a wire transfer and put the funds into the wrong account. When the bank discovered its error, it sought to reimburse itself by setting off against trust funds held by its depositor. At the same time, the bank took twenty-six hours in redirecting a wire transfer order from a suburban branch to its downtown office (although no finding was requested or found that this was the bank's fault). The "For want of a nail" nature of the case was heightened by a backdrop of high-speed transactions between the depositor (an oil field equipment broker) and various buyers and sellers. After these errors came to light, the bank refused to return the amount of the offset and this refusal in turn caused the customer to be unable to repay a large part of an escrow deposit. The net result was ruination of the reputation of the customer and it was forced to go out of business. In a wrongful setoff action against the bank for negligence, conversion and breach of contract,²¹⁴ the customer recovered both actual and punitive damages, including recovery for lost profits

207. *E.g.*, *Reed v. Valley Fed. Sav. & Loan Co.*, 655 S.W.2d 259, 261-64 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.) (setoff against trust funds held improper); *Collin County Sav. & Loan v. Miller Lumber Co.*, 653 S.W.2d 114, 117 (Tex. App.—Dallas 1983, no writ) (setoff against trust funds disallowed); see Annotation, *Bank's Right to Apply Third Person's Funds, Deposited in Debtor's Name, on Debtor's Obligation*, 8 A.L.R.3d 235, 239 (1966). Even a proper setoff must be exercised before the depositor has effectively withdrawn the funds. *MBank Brenham v. Barrera*, 721 S.W.2d 840, 841-42 (Tex. 1986). Under the equitable setoff rule adopted in Texas, the bank must also show that it changed its position to its detriment in reliance on the setoff. See *Citibank v. Interfirst Bank*, 784 F.2d 619 (5th Cir. 1986) (bank must show change in position in reliance on depositor's continued ownership of funds); *National Indem. Co. v. Spring Branch State Bank*, 348 S.W.2d 528, 529-31 (Tex. 1961) (change of position in reliance is essential element of valid setoff).

208. *Porter v. Security State Bank*, 721 S.W.2d 556 (Tex. App.—Amarillo 1986, no writ).

209. *Id.*

210. *Id.* at 559.

211. *Id.* at 559-60.

212. *E.g.*, *Reed v. Valley Fed. Sav. & Loan Co.*, 655 S.W.2d 259, 261-64 (Tex. App.—Corpus Christi 1983, writ ref'd n.r.e.) (setoff against trust funds held improper); *Collin County Sav. & Loan v. Miller Lumber Co.*, 653 S.W.2d 114, 117 (Tex. App.—Dallas 1983, no writ) (setoff against trust funds disallowed).

213. *Allied Bank West Loop v. C.B.D. & Assoc., Inc.*, 728 S.W.2d 49 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.).

214. The bank's case was not helped by evidence that, when the depositor demanded return of the offset funds, the bank officers responded by saying, "Well, we made a mistake, and that is the way we elected to correct the mistake, and the money is not going back in," and, "Maybe we can't [setoff against a trust account], but we did." *Id.* at 58.

for a twenty-month period.²¹⁵

C. Liability to Payees

Late Return of Items. The Texas law has been clear for some time that the failure of a payor bank to dishonor or return an item by its midnight deadline will make the bank accountable under section 4.302 of the Code²¹⁶ for the amount of the item.²¹⁷ A subsidiary question, however, is "When does the midnight deadline start to run?" This question is easy to answer when only one bank is involved, but what if the bank has contracted with a data processing center to handle the initial computer processing with subsequent delivery of the checks and accounting data to the bank for review? In *First State Bank v. American Bank*,²¹⁸ the court believed that considerations of the need for speed in the collection process and the need for a rule to prevent a bank from favoring itself in the collection process over the owners of items tipped the balance in favor of holding that the midnight deadline starts to run when the checks are presented to the data processing center.²¹⁹ The court also found this was the rule adopted in the majority of cases that had decided this issue.²²⁰

V. LETTERS OF CREDIT

A. Presentment Requirements

Strict Compliance—Slippage in the Joints? While courts continue to recite the litany that strict compliance is necessary for a proper presentment under a letter of credit,²²¹ the cynical reader may be increasingly entitled to look askance at the application of this phrase. In *Breathless Associates v. First Savings & Loan Association*,²²² the court considered a situation involving two letters of credit, Nos. 4-52 and 4-53. Both credits required the beneficiary to present an original promissory note issued by named persons in specified amounts and dated April 28, 1983.²²³ Under No. 4-52 the note that was presented was correct in all respects except for being dated April 29, 1983. Under No. 4-53 the date and maker were correct, but there were two notes instead of one, although they added up to the correct dollar amount.

215. *Id.* at 52.

216. TEX. BUS. & COM. CODE ANN. § 4.302(a) (Tex. UCC) (Vernon 1968).

217. *E.g.*, Hamby Co. v. Seminole State Bank, 652 S.W.2d 939, 941 (Tex. 1983); Union Bank v. First Nat'l Bank, 621 F.2d 790, 795-96 (5th Cir. 1980); Pecos County State Bank v. El Paso Livestock Auction Co., 586 S.W.2d 183, 186-87 (Tex. Civ. App.—El Paso 1979, writ ref'd n.r.e.). A bank may also become accountable for the amount of an item if it is not returned by a clearinghouse deadline under the final payment rule of TEX. BUS. & COM. CODE ANN. § 4.213(a)(3) (Tex. UCC) (Vernon 1968). See Lockhart Sav. & Loan Ass'n v. Republic Bank Austin, 720 S.W.2d 193, 194-96 (Tex. App.—Austin 1986, no writ).

218. 732 S.W.2d 404 (Tex. App.—Dallas 1987, no writ).

219. *Id.* at 406-07.

220. *Id.* at 406.

221. *E.g.*, Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, 707 F.2d 680 (2d Cir. 1983); Dubose Steel, Inc. v. Branch Banking & Trust Co., 72 N.C. App. 598, 324 S.E.2d 859 (1985); Temple-Eastex Inc. v. Addison Bank, 672 S.W.2d 793 (Tex. 1984).

222. 654 F. Supp. 832 (N.D. Tex. 1987).

223. *Id.* at 834.

The issuer dishonored the demand for payment under both credits and the beneficiary sued. Since the question of whether a presentment complies with the terms of a credit is a matter of law for the court unless the credit is patently ambiguous,²²⁴ the court considered the issue on a motion for summary judgment.²²⁵ According to the court, the issue was whether the discrepancy was one that might indicate even a "slightly increased risk of nonperformance or fraud by the beneficiary."²²⁶ Applying this standard, the court believed the incorrect date on the promissory note presented under No. 4-52 "could have no relevance whatever to performance by Plaintiff."²²⁷ Under No. 4-53, however, the discrepancy could not have resulted from inadvertence or typographical error and might indicate an increased risk of fraud or nonperformance.²²⁸ The dishonor under No. 4-53 was, therefore, proper.²²⁹

In *Willow Bend National Bank v. Commonwealth Mortgage Corp.*,²³⁰ the court considered a credit that specified, inter alia, "[t]he amount of the draft must be endorsed on reverse hereof by negotiating bank."²³¹ Instead of presenting the draft through a negotiating bank, the beneficiary presented a draft in proper form directly to the issuing bank.²³² The court held that the presentment was nonetheless proper because the language in the credit did not require presentment through a negotiating bank, but only specified the manner of indorsement if the draft were so presented.²³³ The court did not view the credit as creating a condition that presentment had to be through a negotiating bank because conditions that work a forfeiture are disfavored and will be construed as such only if no other reading of the contract is reasonable.²³⁴

B. Amendment of Credits

Extension of Expiration Date. In another letter of credit case,²³⁵ the principal issue was whether an agreement between the issuer and the beneficiary could effectively extend the coverage under the credit by modification of the expiration date by which documents were to be presented. A bank officer advised the beneficiary that the credit could be extended by such an agreement, but when a presentment was made under the extension date, it was dishonored. In an action between the beneficiary and the bank, the court held that the beneficiary and the issuer could not change the terms of the

224. *E.g.*, *Westwind Exploration v. Homestate Sav. Ass'n*, 696 S.W.2d 378, 381 (Tex. 1985).

225. 654 F. Supp. at 835.

226. *Id.* at 837.

227. *Id.*

228. *Id.*

229. *Id.* at 837-38.

230. 722 S.W.2d 12 (Tex. App.—Dallas 1986, no writ).

231. *Id.* at 14.

232. *Id.*

233. *Id.*

234. *Id.*

235. *Fina Supply, Inc. v. Abilene Nat'l Bank*, 726 S.W.2d 537 (Tex. 1987).

credit without the agreement of the account party,²³⁶ citing section 5.106 of the Code.²³⁷ Presentment under the extension date was not, therefore, in strict compliance with the terms of the original credit and dishonor was proper.²³⁸ The court also held that the representation by the bank officer was a statement of opinion as to legal effect only and was not a statement of fact that would support an action for fraud.²³⁹

C. *Actions Against Beneficiaries*

Fraud in the Transaction. Another issue that has been the subject of frequent litigation in letter of credit cases is whether there has been such fraud in the transaction between the beneficiary and the customer to justify an injunction against honor by the issuer.²⁴⁰ The verbal formula applied in such cases is that the fraud must be so "egregious" as to "vitiate" the transaction.²⁴¹ In *Paris Savings & Loan Association v. Walden*²⁴² the trial court issued a temporary injunction against honor.²⁴³ On appeal, the court held that the "fraud," if any, did not rise to the level needed to enjoin honor because the activity involved was regarded by the parties as an investment activity carrying a degree of risk without guarantee of success.²⁴⁴ In the cases considered by the court²⁴⁵ in which the court found fraud in the transaction, the beneficiary had deliberately manipulated the transaction to provide worthless goods. In this case, efforts to comply had been made and the failures were not deliberate, but resulted from an overly optimistic assess-

236. *Id.* at 541-42.

237. TEX. BUS. & COM. CODE ANN. § 5.106(b) (Tex. UCC) (Vernon 1968).

238. 726 S.W.2d at 542.

239. *Id.* at 540-41. A misrepresentation of fact is actionable under the DTPA. See *Int'l Nickel Co. v. Trammel Crow Distrib. Corp.*, 833 F.2d 150 (5th Cir. 1986) (misrepresentation by warehouse that it was conducting inventory checks held actionable). Statements of opinion about legal effect can be actionable if the plaintiff qualifies as a consumer under the DTPA. See TEX. BUS. & COM. CODE ANN. § 17.46(b)(12) (Vernon 1987).

240. *E.g.*, *Phillip Bros., Inc. v. Oil Country Specialists, Ltd.*, 709 S.W.2d 262 (Tex. App.—Houston [1st Dist.] 1986, no writ); *GATX Leasing Corp. v. DBM Drilling Corp.*, 657 S.W.2d 178 (Tex. App.—San Antonio 1983, no writ); *Siderius, Inc. v. Wallace Co.*, 583 S.W.2d 852 (Tex. Civ. App.—Tyler 1979, no writ).

241. *E.g.*, *Phillip Bros., Inc. v. Oil Country Specialists, Ltd.*, 709 S.W.2d 262, 265 (Tex. App.—Houston [1st Dist.] 1986, no writ); *Tandy Brands, Inc. v. Master Mktg. Ass'n*, 481 So. 2d 925, 926 (Fla. App. 1985). The stringent requirements to enjoin honor are consistent with the general purpose of a letter of credit. As the court said in *CKB & Assocs. v. Moore McCormack Petroleum, Inc.*, 734 S.W.2d 653 (Tex. 1987):

The very object of a letter of credit is to provide a near foolproof method of placing money in the beneficiary's hands when he complies with the terms of the letter itself. Parties to a contract may use a letter of credit in order to make certain that contractual disputes wend their way towards resolution with money in the beneficiary's pocket rather than in the pocket of the contracting party.

Id. at 655 (citation omitted).

242. 730 S.W.2d 355 (Tex. App.—Dallas 1987, writ dismissed).

243. *Id.* at 356.

244. *Id.* at 364. The activity involved was the implantation of cattle embryos for cattle production.

245. *United Bank, Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 360 N.E.2d 943, 392 N.Y.S.2d 265 (1976); *Sztejn v. J. Henry Schroder Banking Corp.*, 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941).

ment of the current state of genetic engineering.²⁴⁶

Breach of Transfer Warranties. In *Delta Brands, Inc. v. Bank Dallas, N.A.*,²⁴⁷ a confirming bank sought to recover the amount paid under a letter of credit to the beneficiary. The bank alleged the beneficiary had breached a warranty under section 5.111 of the Code²⁴⁸ that the documents conformed to the terms of the credit.²⁴⁹ The court found no cases construing section 5.111 in the context of an alleged warranty breach running to a confirming bank, but did discuss cases involving warranties running to issuing banks.²⁵⁰ The court concluded that a confirming bank was a protected party under the warranty of section 5.111 and held that a beneficiary warrants to both a confirming and an issuing bank that the documents presented under a credit strictly comply with the terms of the credit.²⁵¹

V. SECURED TRANSACTIONS

A. Perfection of Security Interests

Security Interests in Bankruptcy. Once again, the failure to file a financing statement²⁵² or the failure to properly complete a financing statement²⁵³ gave the trustee in bankruptcy an opportunity to avoid security interests under section 544 of the Bankruptcy Code.²⁵⁴ Of considerably more importance, however, was the addition of a new chapter 12 to the Bankruptcy Code²⁵⁵ governing the bankruptcy of family farmers.²⁵⁶ Under chapter 12, a family farmer has an opportunity to reorganize a farming operation free of some of the restrictions applicable to reorganization plans under chapter 11 of the Bankruptcy Code.²⁵⁷ The rejection of the "absolute priority rule"²⁵⁸

246. *Paris Sav. & Loan*, 730 S.W.2d at 364.

247. 719 S.W.2d 355 (Tex. App.—Dallas 1986, no writ).

248. TEX. BUS. & COM. CODE ANN. § 5.111(a) (Tex. UCC) (Vernon 1968) provides: "Unless otherwise agreed the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with. This is in addition to any warranties arising under Chapters 3, 4, 7, and 8."

249. 719 S.W.2d at 358.

250. *Id.* at 358-59. The court discussed *First Arlington Nat'l Bank v. Stathis*, 115 Ill. App. 3d 403, 71 Ill. Dec. 145, 450 N.E.2d 833 (1st Dist. 1983), and *First Nat'l City Bank v. Klatzer*, 28 U.C.C. Rep. Serv. 497 (N.Y. Sup. Ct. 1979).

251. 719 S.W.2d at 359.

252. *In re First City Mortgage Co.*, 69 Bankr. 765 (Bankr. N.C. Tex. 1987) (failure to file financing statement; security interest subordinate to trustee as hypothetical lien creditor).

253. *Navarro v. IBM Corp.*, 70 Bankr. 94 (Bankr. N.C. Tex. 1987) (failure adequately to describe collateral in financing statement; financing statement held ineffective to perfect security interest).

254. 11 U.S.C. § 544 (1982 & Supp. IV 1986).

255. Bankruptcy Judges, United States Trustees, and Family Farmers Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3088 (1986), codified at 11 U.S.C. §§ 1201-1231 (Supp. IV 1986).

256. "Family farmer" is defined in 11 U.S.C. § 101(17) (Supp. IV 1986).

257. 11 U.S.C. §§ 1101-1174 (1982 & Supp. IV 1986).

258. The absolute priority rule gives unsecured creditors the power to prevent confirmation of a reorganization plan if the debtor retains an equity interest in the business. The rule is codified at 11 U.S.C. § 1129(b)(2)(B) (Supp. IV 1986). In an agricultural context, this rule

and the modification of the standards for measuring "adequate protection"²⁵⁹ are two of the most striking changes in bankruptcy law made by chapter 12.²⁶⁰

The legislative history underlying the modification of the adequate protection standards influenced the Fifth Circuit Court of Appeals in *In re Timbers of Inwood Forest Associates, Ltd.*,²⁶¹ a chapter 11 case,²⁶² to reject the adequate protection standards previously announced by the Ninth Circuit in *In re American Mariner*.²⁶³ The details of the differences in the treatment of adequate protection under the two cases is beyond the scope of this Article, but the result of the differences can be briefly summarized. Under *American Mariner* a secured creditor was entitled to receive periodic payments for interest or lost opportunity costs following the filing of a chapter 11 bankruptcy petition to compensate the creditor for loss of use of the secured collateral.²⁶⁴ Under *Timbers*, no such payments were required.²⁶⁵ The decision in *Timbers* created a significant conflict between the circuits on the issue of adequate protection under the Bankruptcy Code and the Supreme Court subsequently affirmed the *Timbers* result.²⁶⁶

Continuation of Perfection After Interstate Movement of Collateral. Section 9.103 of the Code²⁶⁷ governs the perfection of security interests in multi-state transactions. In *Allegheny International Credit Corp. v. Segal*²⁶⁸ the court held that a security interest properly perfected in another jurisdiction retained its perfected status in Texas where the secured party refiled a financing statement within four months after the removal of the goods to Texas.²⁶⁹ The security interest was held to have priority over the competing claims of other secured creditors who had acquired interests in the goods after the first security interest was properly perfected.²⁷⁰

B. Priorities

Priorities of Interests in Oil and Gas. In an interesting decision,²⁷¹ the East-

meant that a farmer could not retain an equity in the farm over the objection of unsecured creditors who were not paid.

259. The concept of adequate protection is defined in 11 U.S.C. § 361 (Supp. IV 1986). That section is made inapplicable in farm bankruptcy cases brought under Chapter 12 by 11 U.S.C.A. § 1205(a) (Supp. 1988).

260. Chapter 12 has been described by some bankruptcy judges as "pro-debtor legislation." Super Saver Weekly Shopping Guide, Nov. 11, 1987, at 1, col. 1.

261. 808 F.2d 363 (5th Cir.), cert. granted, sub nom. United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Inc., 107 S. Ct. 2459, 95 L. Ed. 2d 868 (1987), aff'd, 98 L. Ed. 2d 740 (1988).

262. 11 U.S.C. §§ 1101-1174 (Supp. IV 1986).

263. 734 F.2d 426 (9th Cir. 1984).

264. 734 F.2d at 435.

265. 808 F.2d at 363-64.

266. 98 L. Ed. 2d 740 (1988).

267. TEX. BUS. & COM. CODE ANN. § 9.103 (Tex. UCC) (Vernon Supp. 1988).

268. 735 S.W.2d 552 (Tex. App.—Dallas 1987, no writ).

269. *Id.* at 555.

270. *Id.* at 553-55.

271. MBank Abilene v. Westwood Energy, Inc., 723 S.W.2d 246 (Tex. App.—Eastland 1986, no writ).

land court of appeals ruled that extracted oil and gas are goods under section 9.105 of the Code²⁷² and that a security interest in them can be perfected by possession.²⁷³ The court also interpreted section 13.001 of the Texas Property Code²⁷⁴ to be a nonsubstantive revision of the former statute,²⁷⁵ with the effect that the claim of a secured creditor was subordinated to the claim of an oil operator that had perfected its claim by possession and whose lien for expenses was binding on the secured party even though unrecorded because of references to the lien in the chain of title.²⁷⁶ A claim by the secured party that it held the earliest perfection in the oil and gas and was therefore entitled to priority was deemed waived by failure to raise the issue at trial and by the failure to seek findings of fact on this issue.²⁷⁷

Priorities in Inventory. One of the problems that haunts secured creditors is the dual use of property and the concomitant difficulties of classification.²⁷⁸ In *Stone Fort National Bank v. Citizens State Bank*,²⁷⁹ the court found that a tractor used by a debtor for excavation work on the debtor's property was also regarded by the debtor as being available for sale as part of the debtor's equipment business.²⁸⁰ A secured creditor who had perfected a security interest in the tractor as equipment was held not to have priority in the tractor as inventory.²⁸¹

In *Crocker National Bank v. T.O.S. Industries, Inc.*,²⁸² the court held that a security interest covering after-acquired inventory was subordinate to the claim of a seller who retained possession of goods ordered, but not delivered, to the debtor.²⁸³ The court reasoned that the debtor never obtained sufficient rights in the collateral to permit attachment of the after-acquired property clause of the inventory financier to create rights superior to those of the seller who retained possession.²⁸⁴

In contrast to the decision in *Crocker*, the court in *Teton International v. First National Bank*,²⁸⁵ held that a secured creditor with an unperfected security interest in inventory had priority over the claim of manufacturers who delivered goods to the debtor without obtaining a security interest in

272. TEX. BUS. & COM. CODE ANN. § 9.105(a)(2) (Tex. UCC) (Vernon 1968 & Supp. 1988).

273. 723 S.W.2d at 253.

274. TEX. PROP. CODE ANN. § 13.001 (Vernon 1985).

275. TEX. REV. CIV. STAT. ANN. art. 6627 (Vernon 1969), *repealed by* Acts 1983, 68th Leg. p. 3729, Ch. 576, § 6, Jan. 1, 1984.

276. 723 S.W.2d at 250.

277. *Id.* at 253.

278. See 8 W. HAWKLAND, UNIFORM COMMERCIAL CODE SERIES 259-61 (1986); T. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST ¶ 9-109[A][1] (Supp. No. 1, 1987).

279. 722 S.W.2d 508 (Tex. App.—Beaumont 1986, no writ).

280. *Id.* at 510.

281. *Id.*

282. 660 F. Supp. 186 (S.D. Tex. 1987).

283. *Id.* at 191-92.

284. *Id.* Regarding the time at which the debtor obtains rights in the collateral, see 8 W. HAWKLAND, *supra* note 278, at 456; J. WHITE & R. SUMMERS, *supra* note 76, at 917.

285. 718 S.W.2d 838 (Tex. App.—Corpus Christi 1986, no writ).

them.²⁸⁶ The manufacturers, at best, were mere unsecured creditors.²⁸⁷

C. Proceedings After Default

Notice of Disposition of Collateral. In *Carroll v. General Electric Credit Corp.*,²⁸⁸ the secured creditor sued two guarantors to recover the balance due after a note went into default and after the collateral was repossessed. While the suit was pending, a notice of public sale of the collateral was given to one of the guarantors. Summary judgment against the guarantors was granted in the pending action before the date of public sale. After the sale was held, the creditor filed an affidavit to credit the judgment with the amount of the sale proceeds. The court held that this sequence of events allowed the creditor to both retain the collateral and still sue for the entire amount of the debt, a position that it regarded as violative of *Tanenbaum v. Economic Laboratories, Inc.*²⁸⁹ The court also held that the creditor had "the burden of proving notice of sale and commercially reasonable disposition of collateral."²⁹⁰ In the court's view, this burden had not been met and the court remanded the case.²⁹¹

In another notice case²⁹² the court held that whether the debtors received adequate notice of a proposal to retain collateral in satisfaction of a debt presented a question of fact precluding an instructed verdict in favor of the debtors.²⁹³ Two aspects of this issue were whether the notices were properly addressed and whether the debtors had "actual notice" of the disposition (retention) of the collateral.²⁹⁴ The decision is not clear on how actual notice would satisfy the statutory requirement of "written notice" in section 9.505 of the Code.²⁹⁵ Had the case involved disposition by resale under sec-

286. *Id.* at 840.

287. *Id.* The manufacturers in this case could easily have qualified for purchase money security interest protection. See TEX. BUS. & COM. CODE ANN. §§ 9.107, .312(c) (Tex. UCC) (Vernon Supp. 1988).

288. 734 S.W.2d 153 (Tex. App.—Houston [1st Dist.] 1987, no writ).

289. 628 S.W.2d 769 (Tex. 1982).

290. *Carroll*, 734 S.W.2d at 155 (citing *Sunjet, Inc. v. Ford Motor Credit Co.*, 703 S.W.2d 285 (Tex. App.—Dallas 1985, no writ), discussed in Krahmer, *Commercial Transactions, Annual Survey of Texas Law*, 41 Sw. L.J. 173, 198 (1987)).

291. *Id.* at 155. While the court is on solid ground about the burden of proof matter, the decision may be questioned in its interpretation of *Tanenbaum v. Economic Laboratory, Inc.*, 628 S.W.2d 769 (Tex. 1982), since it does not address the issue of how TEX. BUS. & COM. CODE ANN. § 9.501(a) (Tex. UCC) (Vernon 1968) fits into the case. That section provides, inter alia, "The rights and remedies referred to in this subsection are cumulative." *Id.* An argument can certainly be made that this sentence rejects an election of remedies doctrine and allows a secured party to move forward simultaneously with all available remedies. It does not appear inherently wrongful for a secured party to conduct a sale during the pendency of an action for the debt or even after judgment has been entered, provided it otherwise complies with the notice and disposition provisions of TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1968). Nonetheless, the court seemed to view such action as one of the evils that *Tanenbaum* sought to avoid. On the election of remedies issues, see *Bennett v. State Nat'l Bank*, 623 S.W.2d 719 (Tex. Civ. App.—Houston [1st Dist.] 1981, no writ), and *Unicut, Inc. v. Texas Commerce Bank*, 704 S.W.2d 442 (Tex. App.—Houston [14th Dist.] 1986, no writ).

292. *Carroll v. Kennon*, 734 S.W.2d 34 (Tex. App.—Waco 1987, no writ).

293. *Id.* at 40.

294. *Id.* at 41.

295. TEX. BUS. & COM. CODE ANN. § 9.505(b) (Tex. UCC) (Vernon 1968 & Supp. 1988)

tion 9.504 of the Code,²⁹⁶ the court could have cited *MBank Dallas v. Sunbelt Manufacturing, Inc.*²⁹⁷ to support at least an oral notice rule and, perhaps, an actual notice rule.²⁹⁸ Section 9.505, however, unlike section 9.504, is explicit in its requirement of written notice and the court did not discuss this difference.²⁹⁹

Disposition of Accounts Receivable. In contrast to the hazards faced by a secured party who seeks to resell tangible collateral, the disposition of intangible collateral like accounts and chattel paper is simple. In *Cullen Frost Bank v. Dallas Sportswear Co.*,³⁰⁰ after default, the secured party properly accelerated the debt and directed the debtor to deposit all proceeds from the collection of accounts receivable in a special bank account under the control of the secured party. A representative of the secured party was also to be permitted on the debtor's premises to review the debtor's operation and collections. Ultimately, the entire debt was paid. The supreme court held the secured party had acted properly under section 9.502 of the Code,³⁰¹ governing collection of accounts and chattel paper, because section contained no requirement paralleling the section 9.504 requirement of notice before disposition.³⁰²

This collection technique should be included in security agreements covering security interests in accounts, chattel paper, and instruments.

D. Sales Tax Implications of Foreclosures

Sales Tax Provisions on Debt Collection. Under section 151.0036 of the Tax

provides, inter alia: "[A] secured party in possession may, after default, propose to retain the collateral in satisfaction of the obligation. Written notice of such proposal shall be sent to the debtor . . ."

296. *Id.* § 9.504(c) provides, in part: "[R]easonable 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 . . ."

297. 710 S.W.2d 633 (Tex. App.—Dallas 1986, writ ref'd n.r.e.).

298. *Id.* at 635-36.

299. Equity might nonetheless support the court's position since it seems to smack of form over substance to require that written notice be given to someone who already has actual notice. *But see* *MBank Dallas v. Sunbelt Manuf., Inc.*, 710 S.W.2d 633, 635-36 (Tex. App.—Dallas 1986, writ ref'd n.r.e.), on which the court recognized the difference between TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1968 & Supp. 1988) and *id.* § 9.505(b) on the type of notice required by the statute. In *Carroll*, however, the court was at least trying to apply the correct rules. The same cannot be said of *Stra, Inc. v. Seafirst Commercial Corp.*, 727 S.W.2d 591 (Tex. App.—Houston [1st Dist.] 1987, no writ), in which the court made no mention of the deficiency bar rule of *Tanenbaum v. Economics Laboratory, Inc.*, 628 S.W.2d 769 (Tex. 1982), but instead cited and relied on the pre-*Tanenbaum* case of *O'Neil v. Mack Trucks, Inc.*, 533 S.W.2d 832 (Tex. Civ. App.—El Paso 1975), *rev'd on other grounds*, 542 S.W.2d 112 (Tex. 1976), *mandate recalled and reissued*, 551 S.W.2d 32 (Tex. 1977), applying the presumption rule specifically rejected by *Tanenbaum*. *Stra* is simply wrong on this point and should be overruled.

300. 730 S.W.2d 668 (Tex. 1987).

301. TEX. BUS. & COM. CODE ANN. § 9.502 (Tex. UCC) (Vernon 1968 & Supp. 1988).

302. 730 S.W.2d at 669-70. On the notice issue, the Court said, "Notice to the debtor is not required when the secured party collects directly from the account debtor. We hold that when the collection is indirect and the debtor is collecting the accounts for the secured party, prior notice is not required." 730 S.W.2d at 670.

Code,³⁰³ "debt collection service" is defined as an "activity to collect a debt or claim, to adjust a debt or claim, or to repossess property subject to a claim."³⁰⁴ The only exception specified in the statute provides that "'[d]ebt collection service' does not include the collection of a judgment by an attorney or by a partnership or professional corporation of attorneys if the attorney, partnership, or corporation represented the person in the suit from which the judgment arose."³⁰⁵ The Tax Code defines "taxable services" to include "debt collection services."³⁰⁶ While the statutory language is broad enough to include prejudgment debt collection activities by attorneys, the attorney-general has ruled that the legislative history indicates the legislature did not intend to make legal services subject to the sales tax.³⁰⁷

303. TEX. TAX CODE ANN. § 151.0036 (Vernon Supp. 1988).

304. *Id.* § 151.0036(a).

305. *Id.* § 151.0036(b).

306. *Id.* § 151.009(a)(8).

307. Op. Tex. Att'y Gen. No. TM-823 (Nov. 30, 1987).