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## Commercial Transactions

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# COMMERCIAL TRANSACTIONS

by  
John Kraemer\*

**T**HIS Article summarizes developments in Texas commercial law during the 1988 Survey period.<sup>1</sup> Because 1988 was not a legislative year, this Article primarily analyzes Texas case law rather than statutory matters, although a few statutory references appear because of possible future legislative action. Some federal cases involving the application of Texas law have also been included. For ease of reference, this Article follows the organization of the Uniform Commercial Code adopted in Texas as the Texas Business and Commerce Code.<sup>2</sup>

## I. GENERAL PROVISIONS

### A. Acceleration and Foreclosure

*Waiver of Notices.* The Texas law surrounding the proper method of accelerating a debt in preparation for foreclosure remains settled. The general requirements can be briefly summarized: Proper acceleration requires a notice of intent to accelerate the balance of the debt; this notice is to be followed by notice of the acceleration.<sup>3</sup> The right to receive either or both of these notices, however, may be waived by appropriate language in the note and accompanying security agreement or deed of trust.<sup>4</sup>

These propositions were reaffirmed in *Stricklin v. Levine*<sup>5</sup> where the court held that the language of a note and a deed of trust, read together as part of

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1. The comparable South Western Reporter coverage during this period was from approximately volume 736 through volume 756.

2. As adopted in Texas, the Uniform Commercial Code appears as TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1968 & Supp. 1989) [hereinafter referred to as the Code]. 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.

3. See, e.g., *Williamson v. Dunlap*, 693 S.W.2d 373 (Tex. 1985) (no right to accelerate when no notice of intent to accelerate was given); *Baldazo v. Villa Oldsmobile*, 695 S.W.2d 815 (Tex. App.—Amarillo 1985, no writ) (both a notice of intent to accelerate and a notice of acceleration are required for proper acceleration and foreclosure).

4. See, e.g., *Ogden v. Gibraltar Sav. Ass'n*, 640 S.W.2d 232, 233 (Tex. 1982) (notices required but may be waived in note); *Cruce v. Eureka Life Ins. Co.*, 696 S.W.2d 656, 657 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (contractual waiver of notice requirements is valid); *Real Estate Exch., Inc. v. Bacchi*, 676 S.W.2d 440, 441 (Tex. App.—Houston [1st Dist.] 1984, no writ) (right to notice of acceleration waived).

5. 750 S.W.2d 814 (Tex. App.—Dallas 1988, writ dism'd).

the same transaction, contained an effective waiver of the right to receive the required notices. The most interesting part of the *Stricklin* decision is the language relied upon by the court to find that the debtor "expressly agreed to waive notice of intent to accelerate."<sup>6</sup> The relevant language quoted from the note provided, "Every principal, surety, guarantor and endorser of this note hereby severally waives demand, presentment for payment, notice of nonpayment, protest and notice of protest."<sup>7</sup> The language quoted from the deed of trust provided, "the said note, together with accrued interest thereon, and all other sums secured hereby, shall, at the option of Beneficiary, become at once due and payable without demand or notice, which are hereby expressly waived. . . ."<sup>8</sup> This language should give a cautious creditor some pause. A better drafting technique would be the addition of a direct statement that the debtor waives the rights to notice of intent to accelerate and notice of acceleration. Such a statement would leave no doubt about the rights that are being waived.<sup>9</sup>

## II. SALES TRANSACTIONS

### A. Enforceability of Sales Contracts

*Statute of Frauds.* Under section 2.201 of the Code,<sup>10</sup> a contract for the sale of goods for a price of five hundred dollars or more must either be evidenced by a properly signed writing or must be within one of the exceptions to the requirement of a signed writing.<sup>11</sup> Between merchants, a written con-

6. *Id.* at 815.

7. *Id.* (emphasis by court).

8. *Id.* (emphasis by court).

9. This suggestion of a more direct waiver statement is prompted by the decision of the Texas Supreme Court in *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987). In *Melody* the court created a new warranty of good and workmanlike repair or modification of tangible personal property and further held that the new warranty could not be waived or disclaimed. *Id.* at 354-55. In the process of reaching that decision, the court also overruled its earlier decision in *G-W-L, Inc. v. Robichaux*, 643 S.W.2d 392 (Tex. 1982). *Melody*, 741 S.W.2d at 355. *G-W-L* had posited that warranties of habitability and good workmanship in the construction of a residence could be disclaimed by language that was "clear and free from doubt." *G-W-L*, 643 S.W.2d at 393. In *Melody* the supreme court did not even discuss the possibility of establishing strict guidelines for the effectiveness of a disclaimer, but, instead, simply eliminated the ability to disclaim the warranty of good and workmanlike repair. *Melody*, 741 S.W.2d at 355.

While *Melody* is admittedly a decision in a different legal area, the result may indicate a general policy approach toward contract waivers affecting important rights. Careful drafters should guard against loose drafting that permits a court to implement a policy by the "back-door" of holding a clause insufficiently clear to waive a particular right. Without discussing the correctness or incorrectness of an "anti-waiver" policy, it at least seems appropriate for a drafter to close any loopholes that exist in the contract language and force a court to clearly state its position about the effectiveness of a waiver. It is not an idle exercise to compare the disclaimer of warranty language quoted in the *G-W-L* decision with the waiver language quoted in *Stricklin*. For an incisive policy analysis about the purpose of waivers and the defective nature of the waiver of acceleration involved in *Cruce*, see *Cruce v. Eureka Life Ins. Co.*, 696 S.W.2d 656, 657 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (Howell, J., dissenting). As for the interaction of disparate legal areas, see *infra* text accompanying note 278 (discussing *Halter v. Allied Merchants Bank*, 751 S.W.2d 286 (Tex. App.—Beaumont 1988, no writ)).

10. TEX. BUS. & COM. CODE ANN. § 2.201 (Tex. UCC) (Vernon 1968).

11. The exceptions include: (1) written confirmations between merchants; (2) specially

firmation of an oral agreement can sometimes serve as a substitute for a signed writing. In such cases, the Code requires that the confirmation be effective against the sender and be received by the other party within a reasonable time after the oral agreement was made.<sup>12</sup> If the party receiving the confirmation has reason to know its contents and does not give written objection within ten days after receipt, the confirmation will operate to satisfy the statute of frauds in an action against the recipient.<sup>13</sup>

In *Cox Engineering, Inc. v. Funston Machine & Supply Co.*<sup>14</sup> the court held that invoices from a manufacturer to an equipment broker referencing a ten percent downpayment on two oil rigs were sufficient confirmations to satisfy the statute in a suit against the broker.<sup>15</sup> The requirement of a proper "signing" was met by the inclusion of the manufacturer's name and address on the invoice letterhead.<sup>16</sup> The court noted that it was interpreting the Code to accomplish the goals of "simplification, clarification, and modernization of business practices"<sup>17</sup> as mandated by section 1.102 of the Code.<sup>18</sup>

In another decision<sup>19</sup> involving written confirmations the court decided that a farmer was not a merchant who fell within the written confirmation exception where the farmer had purchased cattle feed only twice within thirteen years and had never bought or sold the type of cattle feed that was the subject of the alleged transaction. The court took pains to explain the factual difference between this case and the decision by the Texas Supreme Court in *Nelson v. Union Equity Co-operative Exchange*,<sup>20</sup> where a wheat farmer was held to be a merchant based on his active dealings in the sale of wheat over a period of years. While the court was probably correct in its determination that *Nelson* was factually distinguishable on the "farmer as merchant" issue, the case is mystifying on another point. In the course of its opinion, the court specifically noted that the cattle feed was delivered to the farmer.<sup>21</sup> If the feed was delivered and accepted, another statutory exception would have been applicable to permit enforcement of the contract.<sup>22</sup> While it is possible that the feed was not accepted by the farmer upon delivery, the court mentions neither rejection nor refusal to take delivery and actually leaves an implication to the contrary.<sup>23</sup>

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manufactured goods; (3) admissions in pleadings, testimony or otherwise in court; (4) part payment; and (5) goods received and accepted. *Id.* § 2.201(b), (c).

12. *Id.* § 2.201(b).

13. *Id.*

14. 749 S.W.2d 508 (Tex. App.—Fort Worth 1988, no writ).

15. *Id.* at 510-11.

16. Under the Code, a writing can be "signed by" any symbol executed or adopted by a party with present intention to authenticate a writing." TEX. BUS. & COM. CODE ANN. § 1.201(39) (Tex. UCC) (Vernon 1968).

17. 749 S.W.2d at 511.

18. TEX. BUS. & COM. CODE ANN. § 1.102(b)(1) (Tex. UCC) (Vernon 1968).

19. *Chisolm v. Cleveland*, 741 S.W.2d 619 (Tex. App.—Fort Worth 1987, writ denied).

20. 548 S.W.2d 352 (Tex. 1977).

21. 741 S.W.2d at 620.

22. TEX. BUS. & COM. CODE ANN. § 2.201(c)(3) (Tex. UCC) (Vernon 1968).

23. The court described this part of the factual background in the following terms:

Cleveland sought to enforce an oral contract with Chisolm, a dairy farmer, for the purchase of one and one-half bags of green chop, which is a feed crop, for

In a third case<sup>24</sup> involving a written confirmation the court held that a writing sent from a seller to a buyer that required the buyer to sign and return the form could not operate as a confirmation, but only as an offer to be accepted by the act of signing the form.<sup>25</sup> In a significant further ruling, however, the court held that prior Texas decisions had allowed promissory estoppel to serve as the basis for enforcing an oral contract if the party seeking the protection of the statute of frauds had orally promised to provide a written contract satisfying the statute and had subsequently failed to furnish such a writing.<sup>26</sup> The court found the evidence sufficient to show that the buyer had agreed to buy the goods in question and had promised to sign a written contract for the purchase.<sup>27</sup> Because the court based recovery on promissory estoppel rather than on breach of contract, the court further held that the proper measure of damages to the seller was recovery for damages caused by reliance on the buyer's representation rather than expectation damages based on profits lost from the failure to perform the contract.<sup>28</sup> In what may become a significant part of the damage holding, the court also allowed the recovery of attorney's fees even though the theory of recovery was based on promissory estoppel instead of breach of contract.<sup>29</sup> The court noted that no prior decisions had addressed the issue of attorney's fee recovery in promissory estoppel cases.<sup>30</sup>

In a fourth case<sup>31</sup> a bank agreed to purchase printing equipment from a manufacturer and lease the equipment under a lease-purchase plan to a printing company. While the transaction was described in a signed writing executed by the bank as lessor and the printing company as lessee, there was no written contract between the bank and the manufacturer for the purchase of the equipment. After the manufacturer delivered the equipment to the lessee, a dispute arose between those parties about the quality of the equipment, and the bank refused to pay for the equipment. The court held that the uncontradicted testimony of the manufacturer that the bank had prom-

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the price of \$6,000.00 per bag. Chisolm wanted to purchase by weight, while Cleveland wanted to sell by volume (per bag). After the sale, Cleveland sent Chisolm a written confirmation of the contract, to which Chisolm did not respond within ten days. The terms stated by Cleveland called for price by volume. When the feed was delivered, Chisolm testified he understood the truck driver to say Cleveland had agreed to Chisolm's terms of sale by weight. Such was not the case and when Chisolm balked at paying per volume, this suit resulted.

741 S.W.2d at 620. There is no indication in the opinion of when Chisolm "balked" and what happened to the feed thereafter, a curious omission.

24. *Adams v. Petrade Int'l, Inc.*, 754 S.W.2d 696 (Tex. App.—Houston [1st Dist.] 1988, no writ).

25. *Id.* at 706-07. The court relied on the earlier decision of *Great W. Sugar Co. v. Lone Star Donut Co.*, 721 F.2d 510 (5th Cir. 1983) in reaching this result.

26. 754 S.W.2d at 706. This is the first Texas decision extending the promissory estoppel exception to the article 2 statute of frauds.

27. *Id.* at 708.

28. *Id.* at 709.

29. *Id.* at 720.

30. *Id.*

31. *Texas Am. Bank/Richardson v. A.B. Dick Prods. Co.*, 747 S.W.2d 412 (Tex. App.—Dallas 1988, writ denied).

ised to pay for the equipment conclusively established the manufacturer's right to recover the price of the equipment from the bank.<sup>32</sup>

### B. Warranties

*Restriction of the Parol Evidence Merger Doctrine.* Driven in part by the inclusion of breach of warranty as a separate violation of the Texas Deceptive Trade Practices Act (DTPA),<sup>33</sup> several warranty cases were reported during the Survey period. Perhaps the most important of these was the decision in *Alvarado v. Bolton*.<sup>34</sup> In *Alvarado* the Texas Supreme Court held that the parol evidence "doctrine of merger may not be applied to defeat a cause of action under the DTPA for breach of an express warranty made in an earnest money contract and breached by deed."<sup>35</sup> As in the case of *Melody Home Manufacturing Co. v. Barnes*,<sup>36</sup> this decision has the potential to cause immense change in existing Texas law.<sup>37</sup> While some earlier decisions<sup>38</sup> had

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32. *Id.* at 414. The bank could not raise the statute of frauds as a defense because the manufacturer brought the action on an account. *Id.* at 413. The delivery of the equipment to the lessee, the receipt by the bank of an invoice from the manufacturer, and the signed lease between the lessee and the bank with an accompanying purchase order signed by the lessee and running to the manufacturer prevented the bank from claiming the statute's protection. *Id.* at 414. All of this evidence probably led to the bank's inability to contradict the testimony of the manufacturer and would amount to an admission in court that a contract for the sale of the equipment had occurred. The case is interesting as an example of a "finance lease" under a proposed addition to the Code of a new article 2A governing lease transactions as promulgated by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. These two bodies were the source of the Official Text of the Uniform Commercial Code adopted in Texas. The case illustrates the interlocking nature of the existing article 2 on Sales and the proposed article 2A on leases in transactions where a financial institution is involved as the financing lessor. Article 2A also includes provisions incorporating several aspects of article 9 on secured transactions concerning the rights of lessors and lessees under the lease and the relationship of those rights vis-à-vis third parties. Article 2A may well be introduced in the 1989 session of the Texas Legislature for possible adoption and is currently under study by the Uniform Commercial Code Committee of the State Bar of Texas to determine the impact of the article on existing Texas law. Article 2A would probably not change the result of this case.

One of the most significant issues underlying the increased use of leases was illustrated during the Survey period by *Potomac Leasing Co. v. Housing Auth.*, 743 S.W.2d 712 (Tex. App.—El Paso 1987, writ denied). In *Potomac* a lessee refused to continue making payments under a lease because of alleged defects in the leased equipment and asserted, inter alia, a claim for usury against the lessor. The court held that a true lease that is not intended as a disguised lending transaction is not usurious under Texas law. *Id.* at 713. Because the lessee had not claimed that the lease was really a disguised loan, the court determined that there was no usury violation and reversed a summary judgment in favor of the lessee on this issue. *Id.* at 713-14. Debate surrounding the possible adoption of article 2A will almost certainly include discussion about the economic function of leases and whether lease transactions should remain free of usury regulation.

33. TEX. BUS. & COM. CODE ANN. §§ 17.41-63 (Vernon 1987). Section 17.50(a)(2) provides that breach of warranty constitutes a distinct violation.

34. 749 S.W.2d 47 (Tex. 1988).

35. *Id.* at 48.

36. 741 S.W.2d 349 (Tex. 1987).

37. *Melody* had two holdings that may affect future Texas law. First, the supreme court held that any contract for the repair or modification of tangible property includes an implied warranty that the repair or modification would be done in a good and workmanlike manner, in actions brought under the DTPA. *Id.* at 354. Second, the court held that this warranty cannot be waived or disclaimed. *Id.* at 355. The court reaffirmed the first of these holdings during the last year in *Archibald v. Act III Arabians*, 755 S.W.2d 84 (Tex. 1988), by determining that

permitted the introduction of parol evidence in actions based on a misrepresentation under the DTPA "laundry list,"<sup>39</sup> breach of warranty claims were distinguished because the statutory violations were regarded as being akin to the fraud exception to the parol evidence rule.<sup>40</sup> The *Alvarado* court chose not to apply this distinction and held the parol evidence admissible in the warranty action without an accompanying allegation of misrepresentation under the DTPA.<sup>41</sup>

The difficult question *Alvarado* raises is how far the rationale of the decision will extend. If the case is narrowly limited to its facts, the rule will be applied only in real estate transactions when a deed fails to include an express warranty appearing in an earlier land purchase contract. Such a limitation appears highly artificial, however, since the merger doctrine may provide more benefits in the real property area, which requires clear rules establishing titles to land. The more significant erosion of the parol evidence rule and the merger doctrine has taken place in the law of contracts,<sup>42</sup> but the parol evidence rule certainly still exists.<sup>43</sup>

Abolition of the parol evidence rule in the area where it had been the most settled while leaving the rule in place in the area where it has been the most criticized would be curious jurisprudence indeed. The extension of *Alvarado*

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the service of training horses is within the scope of the implied warranty created by *Melody*. *Id.* at 86. It is important to note that the court in *Archibald* based its holding on the theory that horse training is a form of modification of goods (i.e., behavior modification) and did not base the holding on the theory that there is a warranty governing professional services. *Id.* Cases such as *Brooks, Tarlton, Gilbert, Douglas & Kressler v. U.S. Fire Ins. Co.*, 832 F.2d 1378 (5th Cir. 1988), holding that there is no implied warranty that professional services will be performed in a good and workmanlike manner, remain proper interpretations of *Melody* following the decision in *Archibald*. During the Survey period the court in *Walker v. Sears, Roebuck & Co.*, 853 F.2d 355, 358-59 (5th Cir. 1988), expanded *Melody* by holding that the implied warranty created by *Melody* was not limited to actions brought under the DTPA, but could be used as the basis of an ordinary breach of warranty claim. As such, the claim was cognizable under the longer four-year statute of limitations for contract actions instead of being barred by the two-year statute of limitations contained in the DTPA. *Id.* at 363 (citing TEX. BUS. & COM. CODE ANN. §§ 17.565, 17.43 (Tex. UCC) (Vernon Supp. 1988)). This possible expansion of *Melody* as well as other potential ramifications are discussed in greater detail in *Krahmer, Commercial Transactions, Annual Survey of Texas Law*, 42 Sw. L.J. 217, 222-25 (1988).

38. See, e.g., *Weitzel v. Barnes*, 691 S.W.2d 598 (Tex. 1985); *Anthony Indus., Inc. v. Ragsdale*, 643 S.W.2d 167 (Tex. App.—Fort Worth 1982, writ ref'd n.r.e.).

39. The DTPA contains a list of twenty-three deceptive acts or practices that can support a laundry list claim. See TEX. BUS. & COM. CODE ANN. § 17.46(b) (Vernon 19987).

40. In fact, the first opinion issued by the supreme court in *Alvarado* adopted this rationale. See *Alvarado v. Bolton*, 1987 WL 1816 (Tex. 1987). This opinion was denominated as "unpublished," and a second opinion was eventually substituted and released for publication. The second opinion appears at 749 S.W.2d 47 (Tex. 1988). The court followed a similar sequence in deciding *Melody*. See *Melody Home Mfg. Co. v. Barnes*, 30 Tex. Sup. Ct. J. 489 (June 17, 1987) (unpublished), *withdrawn and replaced by* *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987).

41. 749 S.W.2d at 48.

42. The movement from a strict, if not wooden, application of the parol evidence rule to a less rigid application has been traced in several treatises on contract law. See, e.g., A. FARNSWORTH, *CONTRACTS* 447-61 (1982); *J. Calamari & J. Perillo*, *Contracts* 103-11 (2d ed. 1977) and 3 A. CORBIN, *CORBON ON CONTRACTS* §§ 573-595 (1963).

43. The Code itself contains a statutory expression of the parol evidence rule. See TEX. BUS. & COM. CODE ANN. § 2.202 (Tex. UCC) (Vernon 1968).

to express warranties on personal property under the DTPA appears likely.<sup>44</sup> Extension to warranty actions brought outside the DTPA, such as actions brought under the Code, is more problematic. The court emphasized the legislative purpose of the DTPA in reaching its decision in *Alvarado*, possibly indicating that extension beyond the DTPA will not occur.<sup>45</sup> The parol evidence rule contained in the Code<sup>46</sup> also imposes a barrier to extending *Alvarado* to cases arising under the Code, although this would not be so for common law contract matters, such as contracts for services, lease agreements, or real property transactions.<sup>47</sup>

*Implied Warranty of Suitability in Commercial Leases.* In *Davidow v. Inwood North Professional Group-Phase I*<sup>48</sup> the Texas Supreme Court reviewed the reasons for imposing a warranty of habitability in residential leases<sup>49</sup> and concluded that many of these reasons were equally valid as arguments for extending a similar warranty to commercial leases.<sup>50</sup> The court therefore held that an implied warranty of suitability exists in commercial leases to ensure that the premises are suitable and can be used for "their intended commercial purpose."<sup>51</sup> A breach of this warranty by the landlord may permit the tenant to discontinue rent payments and, in an extreme situation, to justify the abandonment of the premises by the tenant.<sup>52</sup> Although the court

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44. Since the court has already held in *Weitzel v. Barnes*, 691 S.W.2d 598 (Tex. 1985) that the parol evidence rule will not prevent the admissibility of evidence of oral misrepresentations in DTPA actions, the exclusion of written misrepresentations would make no sense in such actions. The argument can still be made, however, that even an express written warranty on personal property should be capable of being superseded by a subsequent integrated agreement that expresses the entire understanding of the parties. To put the argument another way, a representation is not necessarily a misrepresentation.

45. In the course of its opinion, the court stated:

In 1980 we stated that "[t]he DTPA does not represent a codification of the common law" and a primary purpose of the Act was to provide consumers a cause of action for deceptive trade practices without the numerous defenses encountered in a common law fraud or breach of warranty suit.

*Alvarado v. Bolton*, 749 S.W.2d 47, 48 (Tex. 1988) (citing *Smith v. Baldwin*, 611 S.W.2d 611, 616 (Tex. 1980)).

46. TEX. BUS. & COM. CODE ANN. § 2.202 (Tex. UCC) (Vernon 1968).

47. For a further discussion of how DTPA decisions can grow beyond the scope of that statute, see *supra* note 36.

48. 747 S.W.2d 373 (Tex. 1988).

49. In *Kamarath v. Bennett*, 568 S.W.2d 658 (Tex. 1978), the supreme court adopted a rule creating an implied warranty of habitability in residential leases. The court discussed the policies underlying this decision at some length in the course of the *Davidow* opinion. *Kamarath*, 568 S.W.2d at 661.

50. 747 S.W.2d at 376-77.

51. *Id.* at 377. The court further elucidated the scope of this warranty in the following terms:

This warranty means that at the inception of the lease there are no latent defects in the facilities that are vital to the use of the premises for their intended commercial purpose and that these essential facilities will remain in a suitable condition. If, however, the parties to a lease expressly agree that the tenant will repair certain defects, then the provisions of the lease will control.

*Id.*

52. The court pointedly noted that whether a breach of the warranty of suitability occurs is

usually a fact question to be determined from the particular circumstances of



denied an award of damages in favor of the tenant because of failure to plead an affirmative cause of action,<sup>53</sup> such damages appear recoverable in a proper case. Moreover, the action would be cognizable under the DTPA as a breach of warranty claim.

*Warranty: Negligence or Contract?* One of the principal effects of interaction between the Code, the DTPA, and recent court decisions<sup>54</sup> has been a continued blurring of the lines between claims for breach of warranty, negligence, and contract.<sup>55</sup> Another example of this interaction was reported in *FDP Corp. v. Southwestern Bell Telephone Co.*<sup>56</sup> In *FDP* a yellow pages customer sued to recover for breach of contract, for negligent performance of contract, and for breach of express warranty under the DTPA when a telephone company failed to include an advertisement for the customer's business.<sup>57</sup> The court rejected the telephone company's argument that this was only a breach of contract action and that a limitation of liability clause prevented recovery for damages in excess of the price of the advertisement.<sup>58</sup> The court instead held that the case could be maintained either as a negligence claim or as a DTPA claim for breach of express warranty.<sup>59</sup> The

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each case. Among the factors to be considered when determining whether there has been a breach of this warranty are: the nature of the defect; its effect on the tenant's use of the premises; the length of time the defect persisted; the age of the structure; the amount of the rent; the area in which the premises are located; whether the tenant waived the defects; and whether the defect resulted from any unusual or abnormal use by the tenant.

*Id.*

In *Davidow* the materiality of the breach was clear. The premises had been rented for use as medical office space by Dr. Davidow. During the course of the lease, the air conditioning often failed; the roof leaked whenever it rained, causing stained tiles, mildew and rot; patients had to avoid the leaks when sitting in the waiting room; pests and rodents infested the office; the hallways were dark because lights were not replaced; the parking lot was filled with trash; hot water was not provided; the electricity was once shut down because of the landlord's failure to pay the electric bill; and there were several burglaries and acts of vandalism. The doctor moved out about fourteen months before the end of the five-year lease term.

53. 747 S.W.2d at 377.

54. For representative decisions showing this interaction, see *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987) (contracts to repair or modify tangible goods or property include a warranty to make the repairs or modifications in a good and workmanlike manner; quality of repair measured by standards applied to persons skilled in the particular trade or occupation, not by a guarantee of results; concurrence argued creation of new warranty was unnecessary since case could be pursued in contract or for negligent performance of contract); *Rocha v. Merritt*, 734 S.W.2d 147 (Tex. App.—Houston [1st Dist.] 1987, no writ) (negligent performance of services could be "characterized as a claim in contract and/or tort"); *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); *Farina v. Southwestern Bell Media*, 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).

55. This subject is discussed at greater length in *Krahmer*, *supra* note 27, at 222-25.

56. 749 S.W.2d 569 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

57. Adding insult to injury, although the ad did not appear in the directory, the telephone company billed the customer for the ad and threatened to terminate phone service if the bill was not paid. The customer paid the charges for several months, although the telephone company eventually credited the customer's account for the erroneous charges.

58. *Id.* at 570.

59. The language used by the court in summarizing its characterization of the cause of

court deemed the limitation of liability clause ineffective because of section 17.42 of the DTPA.<sup>60</sup> The court determined that sufficient evidence existed for a jury to find both a breach of warranty and damage and remanded the case for a new trial.<sup>61</sup>

In *Dallas Power & Light v. Westinghouse Electric Corp.*<sup>62</sup> the buyer asserted claims for negligence, breach of express and implied warranties arising in the sales transaction, and breach of an implied warranty of good and workmanlike repair. The court held that the running of the statute of limitations barred the negligence claims because the injury occurred more than two years before the action was brought.<sup>63</sup> The claims based on breach of warranties in the sales transaction were also deemed barred by operation of a one-year limitation of the seller's liability contained in the sales contract, and none of the warranties extended to the future performance of the goods so as to avoid the one-year limitation.<sup>64</sup> The buyer also argued that the seller had breached the *Melody*<sup>65</sup> implied warranty of good and workmanlike repair. The court rejected this argument and distinguished *Melody* on the ground that the seller had never attempted to make repairs and had no contractual duty to do so.<sup>66</sup> The seller could not be liable, therefore, for failure to make repairs in a good and workmanlike manner when it had never tried to make any repairs.<sup>67</sup>

*Burdens of Proof in Warranty or DTPA Representation of Quality Actions.* Several cases decided during the Survey period dealt with the allocation of burdens of proof in warranty actions.<sup>68</sup> In *Kirby Forest Industries, Inc. v. Dobbs*<sup>69</sup> the court held that a buyer of timber seeking to recover under an express warranty of good title has the burden of proving that the

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action is instructive: "When, as here, an express warranty is made or a promised service is not performed in a good and workmanlike manner, a consumer can sue for breach of warranty under sec. 17.50." *Id.* This characterization could make any negligent performance of contractual duties into a DTPA warranty claim.

60. *Id.* TEX. BUS. & COM. CODE ANN. § 17.42 (Vernon 1987) provides, in relevant part, "Any waiver by a consumer of the provisions of this subchapter is contrary to public policy and is unenforceable and void." To the extent that a limitation of liability clause would avoid DTPA liability, the clause is ineffective. See *Martin v. Lou Poliquin Enter.*, 696 S.W.2d 180 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.).

61. 749 S.W.2d at 572. In the first trial, the jury found a breach of express warranty, but had also returned a finding of no damage. The trial court entered a take-nothing judgment against the customer. On appeal, the court believed the no damage finding was against the great weight of the evidence.

62. 855 F.2d 203 (5th Cir. 1988).

63. *Id.* at 206.

64. *Id.* at 207-08. Such limitations are expressly permitted by TEX. BUS. & COM. CODE ANN. § 2.725(a) (Tex. UCC) (Vernon 1968).

65. *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987). For additional discussion of *Melody*, see *supra* note 37.

66. 855 F.2d at 208.

67. *Id.*

68. See *Kennemore v. Bennett*, 755 S.W.2d 89 (Tex. 1988); *U.S. Steel Corp. v. Fiberex, Inc.*, 751 S.W.2d 628 (Tex. App.—Dallas 1988, writ granted); *Preston II Chrysler-Dodge, Inc. v. Donwerth*, 744 S.W.2d 142 (Tex. App.—Dallas 1988, writ granted); *Kirby Forest Indus., Inc. v. Dobbs*, 743 S.W.2d 348 (Tex. App.—Beaumont 1987, writ denied).

69. 743 S.W.2d 348 (Tex. App.—Beaumont 1987, writ denied).

warranty was part of the basis of the bargain between the parties.<sup>70</sup> Because no evidence was introduced on this point, the buyer could not recover on a theory of express warranty.<sup>71</sup> On a parallel claim for breach of an implied warranty, however, the court held that the seller had the burden of proving that the implied warranty of good title had been excluded when the contract was made.<sup>72</sup> The seller provided no pleading or proof on this issue, which entitled the buyer to judgment on the implied warranty theory.<sup>73</sup>

In *U.S. Steel Corp. v. Fiberex, Inc.*<sup>74</sup> the buyer sued under both the Code and the DTPA for breach of the implied warranties of merchantability and fitness for a particular purpose.<sup>75</sup> The buyer had purchased quantities of polyester resin to laminate fiberglass swimming pools. The resin failed to bond and the buyer argued that this sufficiently showed that the resin was not fit for its ordinary purpose. The buyer obtained a jury verdict in the trial court and the seller appealed, arguing that there was no evidence to prove that the resin was defective at the time it left the manufacturer.<sup>76</sup> The court held that, while the buyer did not have to directly prove that the resin had a defect, the buyer needed to prove more than a simple failure to bond.<sup>77</sup> The buyer had to show, at least circumstantially, that the resin failed to bond because of some act of the manufacturer before it left the manufacturer's possession and that the failure was not due to misapplication by the buyer or because of some other factor that affected the resin.<sup>78</sup> On this issue of proof of defect, the court distinguished the earlier decision in *Bernard v. Dresser Industries, Inc.*,<sup>79</sup> which held that proof of a defect was not required in a

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70. *Id.* at 355. Under TEX. BUS. & COM. CODE ANN. § 2.107(b) (Tex. UCC) (Vernon 1968), a contract for the sale of timber is covered by the provisions of chapter 2 of the Code even though it is part of the realty at the time of contracting. The court was probably incorrect in the allocation of this burden of proof since TEX. BUS. & COM. CODE ANN. § 2.313(a)(1) (Tex. UCC) (Vernon 1968) contemplates that affirmations of fact or promises made by a seller become part of the description of the goods. Official comment 3 to § 2.313(a)(1) provides, *inter alia*,

In actual practice affirmations of fact made by the seller about the goods during a bargain are regarded as part of the description of those goods; hence no particular reliance on such statements need be shown in order to weave them into the fabric of the agreement. *Rather, any fact which is to take such affirmations, once made, out of the agreement requires clear affirmative proof.*

*Id.* comment 3 (emphasis added).

71. 743 S.W.2d at 355.

72. *Id.* Under the Code, an implied warranty of good title is said to be "excluded" rather than "disclaimed" to make it clear that the transfer of good title is a normally expected incident of a sale and that specific language must be used if the seller does not intend to transfer good title. TEX. BUS. & COM. CODE ANN. § 2.312(b) (Tex. UCC) (Vernon 1968); *Id.* comment 6.

73. *Kirby*, 743 S.W.2d at 355.

74. 751 S.W.2d 628 (Tex. App.—Dallas 1988, writ granted).

75. The warranty of merchantability is implied in the sale of goods by TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1968) and the warranty of fitness for a particular purpose is implied by TEX. BUS. & COM. CODE ANN. § 2.315 (Tex. UCC) (Vernon 1968). The claim for breach of the warranty of fitness for a particular purpose was apparently dropped from the case prior to appeal.

76. 751 S.W.2d at 630.

77. *Id.* at 633.

78. *Id.* at 633-34.

79. 691 S.W.2d 734 (Tex. App.—Beaumont 1985, writ ref'd n.r.e.).

breach of warranty action.<sup>80</sup> The court noted that *Dresser* concerned the failure of a mechanical product under circumstances where no other explanation was possible and that the failure of the resin to bond could have resulted from a number of reasons other than a defect.<sup>81</sup>

The *U.S. Steel* court further held that the buyer had the burden of proving a causal connection between defects in the resin and the damages suffered by the buyer.<sup>82</sup> On this issue, the buyer faced substantial difficulties since it had manufactured a large number of pools during the time period in question and had kept no records about which pools were manufactured with the allegedly defective resin. Beyond this significant problem, the evidence at trial revealed that at least twelve different reasons could have accounted for the bonding failure and that only two of those were directly related to the manufacture of the resin. The court concluded that the jury finding was against the weight of the evidence on this issue.<sup>83</sup>

The seller also contended that a disclaimer printed on invoices sent to the buyer effectively avoided liability for breach of implied warranty and that the DTPA notice letter sent by the buyer was inadequate.<sup>84</sup> The court ruled against the seller on both of these issues.<sup>85</sup>

The Texas Supreme Court in *Kennemore v. Bennett*<sup>86</sup> held that the buyers of a new home had the burden of proving that the contractor "failed to construct the home in a manner generally considered proficient by those capable of judging such work"<sup>87</sup> to prove breach of an implied warranty that the home would be constructed in a good and workmanlike manner.<sup>88</sup> In

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80. *Id.* at 738.

81. *U.S. Steel*, 751 S.W.2d at 632-33.

82. *Id.* at 634-35.

83. *Id.* at 637.

84. *Id.* at 637-38.

85. *Id.* at 638. The issue of proper notice of a DTPA claim also arose in *Cielo Dorado Dev., Inc. v. Certainteed Corp.*, 744 S.W.2d 10 (Tex. 1988). In *Cielo* the only evidence showing that notice was given was a brief conclusory statement by the attorney for the plaintiff buyer. No issue on notice was requested or submitted, and the defendant seller did not object to the failure to request an issue. The court rendered judgment for the buyer. On appeal the supreme court held that the issue of notice was to be deemed found in support of the judgment under TEX. R. CIV. P. 279. 744 S.W.2d at 11. The most interesting part of the opinion, however, is the suggestion by the court that proof of proper notice may not be a part of the plaintiff's burden in DTPA cases. The suggestion occurs twice in the course of the opinion. In the first reference, the court stated: "Even if we assume *arguendo* that notice under [TEX. BUS. & COM. CODE ANN. § 17.50A (Vernon 1987)] was an element of Cielo Dorado's case, Cielo Dorado's attorney testified without objection that notice was given pursuant to the DTPA." 744 S.W.2d at 11. In the second reference, the court stated: "The testimony by Cielo Dorado's attorney was conclusory, but it came in without objection. We hold that constituted some evidence of proper notice under the DTPA. Again, *assuming* proper notice was Cielo Dorado's issue, Certainteed was required to object to its non-submission." *Id.* (emphasis in original). A dissenting opinion argued that: "Under the 1979 amendment to the Act, there is no question that this burden rests solely on the plaintiff once the issue of notice is joined. The majority's apparent attempt to open this question by the use of the word 'assuming' is not supportable under the facts of this case or prior case law." *Id.* at 11-12. (Gonzalez, J., dissenting) (citations omitted).

86. 755 S.W.2d 89 (Tex. 1988).

87. *Id.* at 91.

88. *Id.*

reaching this decision, the court rejected a defense argument that the buyers had waived the right to maintain the action as a DTPA claim by taking possession of the home and paying the contractor for additional work on the home.<sup>89</sup> The court reasoned that in a DTPA claim traditional contract theories were not applicable to bar the action by the buyers.<sup>90</sup> The court also noted that proof of specific defects not only provided evidence of breach of warranty, but also provided some evidence of a misrepresentation of the standard, quality, or grade of the home.<sup>91</sup>

*Preston II Chrysler-Dodge v. Donwerth*<sup>92</sup> was a DTPA claim brought for an alleged misrepresentation rather than for breach of warranty.<sup>93</sup> When the car was purchased, one of the buyers commented to the salesman: "that there 'was something wrong with the brakes.'" <sup>94</sup> "The salesman responded that he had used this car as his 'personal car,' that this was a 'good car' and that there 'wasn't anything wrong with the brakes.'" <sup>95</sup> The brakes required a complete overhaul six months later, after the car had been driven some 3200 miles.<sup>96</sup> The buyers also asserted a misrepresentation of the mileage based on an incorrect odometer reading.<sup>97</sup> The court held there was no evidence to support the jury finding that the salesman had misrepresented the standard, quality, or grade of the brakes.<sup>98</sup> As to the mileage claim, the court noted that the only mileage representation made by the seller was that the odometer reading was the actual mileage on the car as far as the seller knew.<sup>99</sup> Without evidence showing actual knowledge of falsity on the seller's part, the court held that a DTPA claim would not lie for this representation.<sup>100</sup> Finding no evidence to support the buyers' claims, the court

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89. *Id.*

90. *Id.* at 90-91. The ability of a buyer to avoid traditional contract defenses in actions maintained under the DTPA has been noted in several decisions. *See, e.g.,* Weitzel v. Barnes, 691 S.W.2d 598 (Tex. 1985); Martin v. Lou Poliquin Enter., 696 S.W.2d 180 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.); Reliance Universal, Inc. v. Sparks Indus. Servs., Inc., 688 S.W.2d 890 (Tex. App.—Beaumont 1985, writ ref'd n.r.e.).

91. 755 S.W.2d at 92. The misrepresentation of standard, quality, or grade constitutes a separate cause of action under the DTPA. TEX. BUS. & COM. CODE ANN. § 17.46(b)(7) (Vernon 1987).

92. 744 S.W.2d 142 (Tex. App.—Dallas 1987, writ granted).

93. The claim was most likely brought on this single ground instead of following the more common practice of including a warranty claim as well because the Texas case law in the lower appellate courts has developed in the direction of denying the existence of implied warranties in the sale of used goods. *See, e.g.,* Southerland v. Northeast Datsun, 659 S.W.2d 889 (Tex. App.—El Paso 1983, no writ); Bunting v. Fodor, 586 S.W.2d 144 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ); Chaq Oil Co. v. Gardner Mach. Corp., 500 S.W.2d 877 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ). There is no indication of why an express warranty claim was not joined with the DTPA claim.

94. 744 S.W.2d at 144.

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.* The misrepresentation of standard, quality, or grade is made actionable by TEX. BUS. & COM. CODE ANN. § 17.46(b)(7) (Vernon 1987).

99. 744 S.W.2d at 144.

100. *Id.* at 145. In Pfeiffer v. Ebby Halliday Real Estate, 747 S.W.2d 887 (Tex. App.—Dallas 1988, no writ), another case decided during the Survey period, the court reached a similar result in a DTPA action brought under TEX. BUS. & COM. CODE ANN. §§ 17.46(b)(23), .50(a)(3) (Vernon 1987). According to the court: "one does not commit a decep-

ruled that the trial court had erred in disregarding jury findings that the claims had been brought in bad faith and for the purpose of harassment and that the seller was entitled to recover attorney's fees of \$7,000.00.<sup>101</sup> The court reversed the judgment of the trial court and rendered judgment in favor of the seller for recovery of the attorney's fees found by the jury.<sup>102</sup>

### C. Unconscionability

Both the Code and the DTPA contain provisions dealing with unconscionability.<sup>103</sup> The Code rules, however, allow the use of unconscionability only as a defense to enforcement of a contract while the DTPA allows unconscionability to be used as the basis of a claim for damages.<sup>104</sup> Little incentive exists, therefore, to use the Code instead of the DTPA when the unconscionability of a contract is in issue.

The DTPA contains two alternative definitions for an unconscionable action or course of action.<sup>105</sup> The first definition covers an act or practice that "takes advantage of the lack of knowledge, ability, experience, or capacity of a person to a grossly unfair degree."<sup>106</sup> The second definition provides that an act or practice is unconscionable if it "results in a gross disparity between the value received and consideration paid, in a transaction involving transfer of consideration."<sup>107</sup>

In *Brown v. Galleria Area Ford*<sup>108</sup> the Texas Supreme Court found the evidence sufficient under either definition to support a judgment for the adversely affected consumer.<sup>109</sup> The consumers were not told that a car dealership had significantly changed ownership and management operations between the time when the consumers brought their truck in for repairs and the time when the repairs were finally completed, albeit ineffectively, several weeks later. Under an internal agreement between the prior owner and the

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tive trade practice if he fails to disclose material facts of which he has no knowledge to the buyer. There is a distinction between misrepresentations and a failure to disclose information. One cannot be held liable under the Act for failure to disclose facts about which he does not know." 747 S.W.2d at 889-90 (citation omitted).

The case concerned problems with the settling of a house foundation. The jury had reached a verdict in favor of the buyers based on evidence of previous foundation repairs and repairs made inside the house, evidence of common knowledge among real estate companies in the area that the house had a history of foundation problems and a refusal by other companies to list the house, evidence that the listing agent was a friend of the previous owner and had visited in the house, and an inspection report prepared before the sale that reported "some foundation settling." *Id.* at 890. The trial court rendered a judgment notwithstanding the verdict in favor of the real estate company and this judgment was upheld on appeal on the ground that this evidence did not show actual knowledge of the defects on the part of the company. *Id.*

101. 744 S.W.2d at 145.

102. *Id.* at 146.

103. The principal Code provision on unconscionability appears in TEX. BUS. & COM. CODE ANN. § 2.302 (Tex. UCC) (Vernon 1968). The DTPA provision is contained in TEX. BUS. & COM. CODE ANN. § 17.45(5) (Vernon 1987).

104. *See id.*

105. *Id.* §§ 17.45(5)(A) & (B).

106. *Id.* § 17.45(5)(A).

107. *Id.* § 17.45(5)(B).

108. 752 S.W.2d 114 (Tex. 1988).

109. *Id.* at 116.

new owner, all DTPA claims were to be the responsibility of the prior owner, but the new owner had the responsibility for the actual operation of the dealership. When the truck was delivered to the consumers as "repaired," the brakes were found to be dangerously defective and the frame so damaged in the course of the repair work that it could not be fixed.<sup>110</sup> The change in ownership during the course of repairs surfaced as an attempt by each company to place the responsibility on the other for the defective repairs, and the consumers were unable to discern with whom they should be dealing. The court found the evidence sufficient to support a jury finding that the consumers had been grossly taken advantage of and that gross disparity existed between the value of the repairs received and the consideration paid.<sup>111</sup>

In *Sun Power v. Adams*<sup>112</sup> a buyer purchased a cash register and printer that the seller represented to be IBM compatible when in fact they were not. The seller also said that he would fully service the machines and if there were any problems that could not be corrected, the buyer could return the equipment for a full refund of the purchase price. After the machines were installed, the buyer endured three months of frustration caused by improper calculation of receipts and cash by the cash register, repeated printer breakdowns, and literally hundreds of extra hours of lost time spent reconciling accounting records by hand and attempting to reprogram the cash register. During this time, the seller worked on the equipment without noticeable success, but he finally told the buyer that any further repairs were no longer his problem and refused to refund the purchase price or pick up the machines.

Although the jury had found the seller's conduct to be unconscionable and awarded damages to the buyer, the trial court rendered judgment notwithstanding the verdict in favor of the seller.<sup>113</sup> On appeal, the court found the evidence sufficient to support the jury finding on either of the two tests for unconscionability and reinstated the jury verdict.<sup>114</sup>

In *Wyatt v. Petrila*<sup>115</sup> the court considered whether a disparity of fifty thousand dollars between the \$625,000.00 consideration paid for a house and the \$575,000.00 value that was found to have been received was a "gross disparity" within the meaning of the unconscionability definition.<sup>116</sup> In the court's view, prior decisions finding gross disparity involved situations where the value received was nothing or next to nothing.<sup>117</sup> Here, the purchasers had received a house of considerable value, although less than they had paid. The court ruled, as a matter of law, that the purchasers had not shown a

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110. *Id.*

111. *Id.* at 117.

112. 751 S.W.2d 689 (Tex. App.—Fort Worth 1988, no writ).

113. *Id.* at 691-92.

114. *Id.* at 695.

115. 752 S.W.2d 683 (Tex. App.—Corpus Christi 1988, no writ).

116. *Id.* at 686.

117. *Id.* at 686-87.

gross disparity.<sup>118</sup>

#### D. Good Faith Purchase

*Authority to Sell.* In *IFG Leasing Co. v. Ellis*<sup>119</sup> a buyer purchased a grain trailer from a company that represented itself as the owner's agent. The buyer paid the full price to the agent and received the trailer in exchange. Neither the agent nor the owner ever provided the buyer with a certificate of title. The agent subsequently filed for bankruptcy and the owner sued the buyer for return of the trailer contending that the agent had no authority to sell until the full purchase price was paid over to the owner, which had never taken place. The buyer counterclaimed under the DTPA for an order compelling the turnover of the certificate of title and for the recovery of attorney's fees. The court held there was adequate evidence to support findings that the agent had authority to sell the trailer without restriction and that the buyer qualified as a buyer in the ordinary course of business without knowledge that the sale was made in violation of the ownership rights of a third person.<sup>120</sup> The owner also contended that the sale was void under the Certificate of Title Act<sup>121</sup> because a certificate of title was not transferred when the sale was made. The court held that a sale made without complying with the act could be effective between the immediate parties even if it was ineffective against third parties.<sup>122</sup> The court held that the owner had violated the DTPA by misrepresenting the authority of the agent, since the owner had subsequently denied the authority of the agent to close the sale without restriction in a letter sent to the buyer after the sale had occurred.<sup>123</sup> The court affirmed an order in favor of the buyer requiring the turnover of the certificate of title and awarding attorney's fees to the buyer for the DTPA violation.<sup>124</sup>

*Secured Creditor as Good Faith Purchaser.* Under the Code, a secured creditor can qualify as a good faith purchaser capable of acquiring rights in personal property superior to those of a prior owner.<sup>125</sup> In *MBank Waco v. L & J, Inc.*<sup>126</sup> the court held that a bank with a perfected security interest in

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118. *Id.* at 686.

119. 748 S.W.2d 564 (Tex. App.—Houston [1st Dist.] 1988, no writ).

120. *Id.* at 566. Although not cited by the court in the course of its opinion, this is one of the good faith purchase standards contained in TEX. BUS. & COM. CODE ANN. § 2.403 (Tex. UCC) (Vernon 1968).

121. TEX. REV. CIV. STAT. ANN. art. 6687-1, §§ 33 & 53 (Vernon 1977).

122. 748 S.W.2d at 566. This is consistent with prior interpretations of the Certificate of Title Act. *See, e.g.,* Drake Ins. Co. v. King, 606 S.W.2d 812 (Tex. 1980); Everett v. U.S. Fire Ins. Co., 653 S.W.2d 948 (Tex. App.—Fort Worth 1983, no writ); Pfluger v. Colquitt, 620 S.W.2d 739 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.).

123. 748 S.W.2d at 567. TEX. BUS. & COM. CODE ANN. § 17.46(b)(14) (Vernon 1987) prohibits "misrepresenting the authority of a salesman, representative or agent to negotiate the final terms of a consumer transaction."

124. 748 S.W.2d at 568.

125. *See* TEX. BUS. & COM. CODE ANN. §§ 1.201(32), (33) & 2.403(a), (d) (Tex. UCC) (Vernon 1968). The complex relationship between these sections is carefully discussed at length in *In re Samuels & Co.*, 526 F.2d 1238 (5th Cir. 1976).

126. 754 S.W.2d 245 (Tex. App.—Waco 1988, writ denied).



after-acquired collateral obtained title to the collateral and its proceeds superior to that of an owner who had left the property in the hands of the debtor under circumstances that made it appear the debtor was the owner.<sup>127</sup>

### E. Remedies for Breach

*Breach of Installment Contract and Recovery of Lost Profits.* In *USX Corp. v. Union Pacific Resources Co.*<sup>128</sup> the seller and buyer entered into a four-year installment contract calling for the delivery of between 75 million and 125 million pounds of cumene per year.<sup>129</sup> The open price term payments called for payment according to "the prevailing price in cents per pound, FOB Gulf Coast."<sup>130</sup> At about the time for the first delivery under the contract, the buyer began complaining about the price and did not take delivery of the first installment as originally planned. Discussions between the parties resulted in some adjustment in the price and a revised agreement on the quantity of the first installment. The buyer subsequently failed to take any delivery of cumene under the revised agreement and also failed to respond to the seller's demand for an assurance of due performance.<sup>131</sup> Following these events, the seller cancelled the contract and sued for recovery of lost profits.<sup>132</sup> The court determined that the special issues adequately instructed the jury with respect to the standards for the recovery of lost profits and that the buyer had sufficient notice that the seller was seeking recovery on this theory.<sup>133</sup> The buyer contended that the seller did not have adequate grounds to cancel the contract. On this issue, the court found that the seller was justified in cancelling because of substantial impairment of the whole contract<sup>134</sup> as well as the failure of the buyer to provide an adequate assurance of due performance.<sup>135</sup>

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127. *Id.* at 251-52. The collateral consisted of cattle left in the possession of the debtor and marked, with the owner's knowledge and consent, with the debtor's registered brand. The owner admitted that one could assume the cattle marked with the brand were owned by the debtor, thereby making it impossible to tell from looking at the cattle that the owner had an interest in them. *Id.* at 251. In addition, the owner had nothing on file to indicate an interest in the cattle. *Id.*

128. 753 S.W.2d 845 (Tex. App.—Fort Worth 1988, no writ).

129. *Id.* at 847. Cumene is a chemical compound manufactured by combining benzene and propylene.

130. *Id.*

131. *Id.* at 848. TEX. BUS. & COM. CODE ANN. § 2.609 (Tex. UCC) (Vernon 1968) permits a party who has become insecure about the likelihood of the other party's performance to demand an assurance of due performance. A failure to respond to the demand within a reasonable time not exceeding thirty days constitutes a repudiation of the contract. *Id.*

132. The recovery of lost profits is one of the remedies available to a seller who loses sale volume because of the buyer's breach or who stops the manufacture of incomplete goods upon learning of a breach. *Id.* § 2.708(b).

133. 753 S.W.2d at 849-50. The same court had previously discussed in detail the special issue requirements for the recovery of lost profits in *Malone v. Carl Kisabeth Co.*, 726 S.W.2d 188 (Tex. App.—Fort Worth 1987, writ ref'd n.r.e.). Although the special issues in *USX* did not precisely track the wording suggested in *Kisabeth*, they were deemed adequate to bring the seller within TEX. BUS. & COM. CODE ANN. § 2.708(b) (Tex. UCC) (Vernon 1968).

134. 753 S.W.2d at 851. This is the standard for cancellation in the case of installment contracts stated in TEX. BUS. & COM. CODE ANN. § 2.612 (Tex. UCC) (Vernon 1968).

135. 753 S.W.2d at 851. This independent ground for cancellation appears in TEX. BUS. & COM. CODE ANN. §§ 2.609 & 2.703 (Tex. UCC) (Vernon 1968).

*Recovery of Amount Paid as Damage.* In *Vogelsang v. Reece Import Autos*<sup>136</sup> the buyer had contracted for the repainting of a car. The buyer was dissatisfied with the completed job and sued under the DTPA for recovery of the price paid for the work. The court determined the evidence sufficient for a jury to find that the work was worthless and that delivery of a worthless performance in exchange for a price could constitute adequate proof of damage under the DTPA.<sup>137</sup> A take-nothing judgment was reversed and the case was remanded for trial.<sup>138</sup>

#### F. Miscellaneous

*Recovery Under Different Theories for Same Acts Not Allowed.* In *American Baler Co. v. SRS Systems, Inc.*<sup>139</sup> the buyer recovered damages based on theories of DTPA violations, fraud, negligent misrepresentation, and breach of contract. The court held that allowing damages separately under the DTPA, fraud, and misrepresentation theories would amount to double recovery for actual damages under different theories for the same acts.<sup>140</sup> The court therefore awarded only the highest amount of damage allowed under a single theory.<sup>141</sup> Separate damages for breach of contract were not contested.<sup>142</sup>

*Recorded Notice No Defense to DTPA Claim.* In *Ojeda de Toca v. Wise*<sup>143</sup> the Texas Supreme Court held that a recorded notice of a demolition order would not bar an action by the buyer of a house against a real estate company that knew about the order but sold the house without disclosing its existence.<sup>144</sup> The court ruled that imputed notice by operation of the recording acts will not bar a DTPA claim for failure to disclose material information.<sup>145</sup>

### III. COMMERCIAL PAPER

#### A. Holding in Due Course

*Acquisition of Holder in Due Course Status.* A holder in due course takes an instrument free from personal defenses of a party with whom the holder has not dealt.<sup>146</sup> Until evidence is introduced showing that a defense exists, a holder is presumed to be a holder in due course thereby entitling him to

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136. 745 S.W.2d 47 (Tex. App.—Dallas 1987, no writ).

137. *Id.* at 49.

138. *Id.* The opinion does not indicate the theory on which the case was brought, but breach of warranty, unconscionability, or violation of a laundry list provision all appear possible given the delivery of a worthless performance. *Id.*

139. 748 S.W.2d 243 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

140. *Id.* at 246.

141. *Id.* The highest amount awarded was under the DTPA.

142. *Id.*

143. 748 S.W.2d 449 (Tex. 1988).

144. *Id.* at 451.

145. *Id.*

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

recover on the instrument.<sup>147</sup> In *Shenandoah Associates v. J & K Properties, Inc.*<sup>148</sup> the court found the evidence insufficient to deprive the holder of the benefit of the presumption.<sup>149</sup> In *Jones v. Missouri Savings Association*<sup>150</sup> a statement that a decorator's allowance had been allowed to the purchaser of condominiums did not constitute notice of a defense to a note so as to deprive the holder of holder in due course status.<sup>151</sup>

In contrast, if the court finds the evidence sufficient to establish a defense, the holder must show that he or she is qualified in all respects as a holder in due course.<sup>152</sup> In *Bohmfolk v. Linwood*<sup>153</sup> the holder of a check allegedly won the instrument in a crap game, thus failing to satisfy the value requirement of holding in due course if the allegation was true. The court held that it was error to exclude deposition testimony by an officer of the bank on which the check was drawn to the effect that the holder had admitted winning the check at craps.<sup>154</sup> The court considered the offered testimony both as an admission against interest within the exception to the hearsay rule and as an impeachment of the holder's testimony.<sup>155</sup> The court remanded the case for a new trial.<sup>156</sup> The court did not note, however, that even if the holder did not qualify as a holder in due course by taking the check in payment of a gambling debt, this alone would not constitute a defense to payment by the drawer since the gambling transaction was between the payee and the holder and did not involve the drawer.<sup>157</sup> The Code does not permit the claims of third persons, such as that of the payee in *Bohmfolk*, to be used as a defense by a maker or drawer unless the third person himself defends the action on behalf of the maker or drawer.<sup>158</sup>

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147. *Id.* § 3.307(c); see *Jonwilco, Inc. v. C.I.T. Fin. Servs.*, 662 S.W.2d 664, 666 (Tex. App.—Houston [14th Dist.] 1983, no writ) (holder is presumed to be a holder in due course until a defense is shown to exist); *Favors v. Yaffe*, 605 S.W.2d 342, 344 (Tex. Civ. App.—Houston [14th Dist.] 1980, writ ref'd n.r.e.) (holder need not prove holder in due course status unless a defense is shown).

148. 741 S.W.2d 470 (Tex. App.—Dallas 1987, writ denied).

149. *Id.* at 483. The jury found that the holder had no knowledge of and had not participated in any misrepresentation or other wrongdoing concerning the instrument. *Id.*

150. 756 S.W.2d 423 (Tex. App.—Dallas 1988, no writ).

151. *Id.* at 425. There was a failure to show that the holder had even seen the documents in which the statement about the allowance was contained. The court noted that, even without this failure of proof, "we fail to see how the statement about a decorator's allowance would put MSA or any other holder on notice that it is part of the down payment." *Id.*

152. The requirements to qualify as a holder in due course are specified in TEX. BUS. & COM. CODE ANN. § 3.202 (Tex. UCC) (Vernon 1968). To be a holder in due course, the instrument must be taken for value, in good faith and without notice that the instrument is overdue or that a defense against it exists. *Id.*

153. 742 S.W.2d 518 (Tex. App.—Dallas 1987, no writ).

154. *Id.* at 521.

155. *Id.* at 521-22.

156. *Id.* at 522.

157. *Id.* at 520.

158. This limitation on the ability of a maker or drawer to raise *jus tertii* defenses appears in TEX. BUS. & COM. CODE ANN. § 3.306(4) (Tex. UCC) (Vernon 1968). Section 3.306(4) of the Code was discussed and correctly applied in *Davis v. Watson Bros. Plumbing*, 615 S.W.2d 844 (Tex. Civ. App.—Dallas 1981, no writ). The court in *Bohmfolk* believed that simply proving that the holder was not a holder in due course would prevent recovery. This reasoning by the court is an incorrect view of the *jus tertii* under § 3.306(4) of the Code.

In another gambling case, *Ryno v. Tyra*, 752 S.W.2d 148 (Tex. App.—Fort Worth 1988, no

Another part of qualifying as a holder in due course is that the purchaser of an instrument must be a "holder."<sup>159</sup> A purchaser becomes a holder by proper negotiation. If the instrument is bearer paper, negotiation is by delivery; if the instrument is order paper, negotiation is by delivery together with a proper indorsement.<sup>160</sup> An indorsement must be written on the instrument or on a paper firmly affixed to the instrument.<sup>161</sup> In *Crossland Savings Bank FSB v. Constant*<sup>162</sup> the indorsement was put on a separate piece of paper and stapled to the instruments. The court held that the writing on the separate paper did not constitute an effective indorsement to make the transferee a holder and, hence, a holder in due course, for two reasons. The court reasoned that stapling did not adequately affix the separate paper to the instruments and the instruments themselves provided sufficient room for the indorsement.<sup>163</sup> The transferee remained subject to any personal defenses available to prior parties.<sup>164</sup>

### B. Liability of Parties

*Signatures by Representatives.* Under section 3.401 of the Code: "No person is liable on an instrument unless his name appears thereon."<sup>165</sup> An agent may sign an instrument on behalf of a principal and, if the signature shows that the agent has signed only in a representative capacity, the agent is not personally liable on the instrument.<sup>166</sup> What happens if an agent signs an instrument that shows he or she signed in a representative capacity, but the instrument does not name the principal for whom the agent is acting?

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writ), the loser of a coin flip, a car dealer, turned over the keys, a German document of title, and a \$125,000.00 BMW to the winner. The car was later loaned back to the dealer for a car show, and the dealer refused to return the car when the show was over and later sold it to a third party. The aggrieved winner sued the dealer for conversion. The court held that although the transaction would have been initially void as a gambling transaction, the dealer had voluntarily and gratuitously parted with the car and indicia of ownership thus making a completed gift of the vehicle. *Id.* at 150. As a gift, the car could then be the subject of conversion and a conversion action would properly lie. *Id.* Perhaps the lesson of these cases for gamblers is: "Take cars, not checks."

159. TEX. BUS. & COM. CODE ANN. § 3.302 (Tex. UCC) (Vernon 1968).

160. *Id.* § 3.202(a).

161. *Id.* § 3.202(b). An indorsement written on a separate, but attached paper is called an "allonge."

162. 737 S.W.2d 19 (Tex. App.—Corpus Christi 1987, no writ).

163. *Id.* at 21. The earlier case of *Estrada v. River Oaks Bank & Trust Co.*, 550 S.W.2d 719, 725 (Tex. Civ. App.—Houston [14th Dist.] 1977, writ ref'd n.r.e.) had stated the requirement that an allonge is proper only if there is no more room on an instrument for indorsements.

164. 737 S.W.2d at 22. Another part of the case is also of interest in connection with the relationship between the law of commercial paper and the DTPA. The court further held that, for purposes of this appeal only, a waiver of defenses clause was invalid as a waiver of rights under § 17.42 of the DTPA. *Id.* at 20-21; TEX. BUS. & COM. CODE ANN. § 17.42 (Vernon 1987). The same argument might be raised against any instrument in negotiable form since it carries with it the possibility of cutting off claims and defenses. Compare TEX. BUS. & COM. CODE ANN. §§ 3.302, .305 (Tex. UCC) (Vernon 1968) with TEX. BUS. & COM. CODE ANN. § 9.206 (Tex. UCC) (Vernon Supp. 1989).

165. *Id.* § 3.401(b).

166. *Id.* § 3.403.

According to the court in *Bradford v. McElroy*<sup>167</sup> neither the principal nor the agent is necessarily liable on the instrument! Although the court termed the result an anomaly,<sup>168</sup> the result follows from the application of section 3.403 as it relates to unnamed principals and actions between immediate parties to an instrument.<sup>169</sup> The court remanded the case for a determination of the understanding of the parties when the instrument was issued.<sup>170</sup>

In *F.D.I.C. v. K-D Leasing Co.*<sup>171</sup> the court held that the word "By" preceding a signature was sufficient to show a signing in a representative capacity.<sup>172</sup> In a third signing case<sup>173</sup> the court held that the defendant had waived the right to raise the issue of a signature made in a representative capacity by allowing a default judgment to be entered against him when he was sued on the note in question.<sup>174</sup> The failure to raise this matter as an affirmative defense before the court entered a default precluded raising the defense.<sup>175</sup>

#### IV. BANK TRANSACTIONS

##### A. Stop Payment Orders

*When Payment May Be Stopped.* In two similar cases<sup>176</sup> different courts of appeal reached diametrically opposite conclusions on the issue of whether an "official check" and a "teller's check" issued by savings and loan associations are analogous to cashier's checks and whether payment may be stopped on such instruments. The first opinion by the Dallas court involved a scheme that left two Dallas men none the poorer after three hours of high rolling and a Las Vegas casino holding an "official check" for \$900,000 on which payment had been stopped by the issuing savings and loan.<sup>177</sup> The second opinion involved a gasoline sales contract and a "teller's check" for over \$2,000,000 on which payment was stopped five days after the check was issued.<sup>178</sup> Both courts referred to the seminal Texas case on the issuance

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167. 746 S.W.2d 294, 296-97 (Tex. App.—Austin 1988, no writ).

168. *Id.* at 297-98.

169. The operative language is as follows: "An authorized representative who signs his own name to an instrument . . . (2) *except as otherwise established between the immediate parties*, is personally obligated if the instrument . . . does not name the person represented but does show that the representative signed in a representative capacity." TEX. BUS. & COM. CODE ANN. § 3.403(b)(2) (Tex. UCC) (Vernon 1968) (emphasis added).

170. 746 S.W.2d at 297-98.

171. 743 S.W.2d 774 (Tex. App.—El Paso 1988, no writ). This decision parallels the examples shown in the official comments to TEX. BUS. & COM. CODE ANN. § 3.403 (Tex. UCC) (Vernon 1968).

172. 743 S.W.2d at 776.

173. *Simon v. BancTexas Quorum*, 754 S.W.2d 283 (Tex. App.—Dallas 1988, no writ).

174. *Id.* at 285-86.

175. *Id.* at 286.

176. *Guaranty Fed. Sav. & Loan Ass'n v. Horseshoe Operating Co.*, 748 S.W.2d 519 (Tex. App.—Dallas 1988, writ granted); *University Sav. Ass'n v. Intercontinental Consol. Co.*, 751 S.W.2d 657 (Tex. App.—Houston [1st Dist.] 1988, writ granted). The author gratefully acknowledges the assistance of Mr. Dwight Moody in preparing the description of these cases.

177. *Guaranty Fed. Sav. & Loan Ass'n v. Horseshoe Operating Co.*, 748 S.W.2d 519 (Tex. App.—Dallas 1988, writ granted).

178. 751 S.W.2d 657 (Tex. App.—Houston [1st Dist.] 1988, writ granted).

and acceptance of a cashier's check, *Wertz v. Richardson Heights Bank & Trust*,<sup>179</sup> and both agreed that a bank may not stop payment on a cashier's check. At that point, the courts diverged.

The Dallas court, finding no Texas cases on point, extensively reviewed opinions from other states, particularly from New York and New Jersey, and found two major approaches.<sup>180</sup> The New York approach treats a bank draft bought and paid for as an executed sale of credit not subject to rescission and countermand.<sup>181</sup> The New Jersey approach turns on the fact that the drawer and drawee are separate, as in both cases here, and permits the drawer to issue a stop payment to the drawee.<sup>182</sup> The Dallas court adopted the New York approach based on findings that the issuing savings and loan treated its "official check" as analogous to a cashier's check, repeatedly referred to it as a cashier's check and a bank money order in testimony, and delivered it as the equivalent of cash.<sup>183</sup> Consequently, the court held the stop payment order was ineffective and the casino as holder was entitled to recover from the drawer savings and loan.<sup>184</sup> The court held the defense of lack of consideration inapplicable against the casino.<sup>185</sup>

The Houston court analogized the "teller's check," which is indistinguishable from the description in the case from an "official check," to a "bank draft" drawn by a bank on an account it maintains in another bank or financial institution.<sup>186</sup> The court specifically rejected the analogy to a cashier's check since the savings and loan was the drawer, but not the drawee.<sup>187</sup> The court found support from a different set of New York cases than those cited by the Dallas court and from a Georgia case very similar to the case before the court.<sup>188</sup> The court held that the savings and loan was not prohibited from stopping payment on the teller's check and remanded the case for trial on holder in due course and failure of consideration issues.<sup>189</sup>

*Liability of Bank for Failure to Stop Payment.* In *Benjamin Franklin Savings Association v. Kotrla*<sup>190</sup> a husband and wife sought to stop payment on a check they had written on their checking account. The stop order correctly

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179. 495 S.W.2d 572 (Tex. 1973).

180. 748 S.W.2d at 524.

181. *Id.* at 524-25.

182. *Id.* at 525.

183. *Id.*

184. *Id.* at 529.

185. *Id.* Although the court assumed for purposes of its decision that the casino was not a holder in due course, it nonetheless invoked the rule that a holder is entitled to recover on an instrument upon its production unless the defendant establishes a defense. *Id.* at 526, 528. See *supra* text accompanying note 158. The "official check" was issued in exchange for a check that was later dishonored, and the court accepted the truth of the lack of consideration defense, simply labeling the defense as "inapplicable." *Id.* at 529. Apparently a misunderstanding of the Code sections 3.306 and 3.307 exists.

186. *University Sav. Ass'n v. Intercontinental Consol. Co.*, 751 S.W.2d 657, 659-60 (Tex. App.—Houston [1st Dist.] 1988, writ granted).

187. *Id.* at 659.

188. *Id.*

189. *Id.*

190. 751 S.W.2d 218 (Tex. App.—Houston [14th Dist.] 1988, no writ).

described the check except for identifying it as Check # 398 instead of Check # 399. At the same time, the customers transferred \$7,800.00 from their checking account into a money market account at the bank. The bank entered the stop order in their stop payment log. Later that same day, Check # 399 was presented for payment. Instead of stopping payment, the bank changed the account number shown on the check, paid it out of the money market account, and sent an insufficient funds notice to the customers stating that the check had been returned unpaid. The bank also debited a \$20.00 charge against the customers' account for the insufficient funds notice. The customers discovered the check had been paid some three weeks later when they received their bank statement. The customers sued for breach of contract, negligence, and gross negligence on the part of the bank.<sup>191</sup> The court of appeals upheld an award in the amount of \$8,000.00 actual damages, representing the amount of the check, \$28,000.00 in punitive damages and \$10,000.00 in attorney's fees.<sup>192</sup>

### B. Presentment of Instruments

*Breach of Presentment Warranties.* Upon presentment, each customer or collecting bank warrants that it has good title to the instrument being presented for payment.<sup>193</sup> While the warranty of good title certainly encompasses a warranty against forged indorsements, it can also include a warranty against missing indorsements. The case of *Longview Bank & Trust Co. v. First National Bank*<sup>194</sup> illustrates this point. In *Longview* only one of two joint payees had indorsed a check and sent it through the collection process for payment. After an extensive review of cases from other jurisdictions, as well as secondary authorities, the court correctly held that a missing indorsement was equivalent to a forged indorsement so far as a breach of warranty on presentment is concerned.<sup>195</sup>

## V. LETTERS OF CREDIT

### A. Form of Credit

*Letter of Credit or Guaranty?* One of the primary purposes of a letter of credit is to separate the function of payment from the function of performance of the underlying transaction. An instrument that not only provides for payment against documents but also requires that the beneficiary comply with the terms of the underlying contract before payment constitutes a guaranty, rather than a true letter of credit.<sup>196</sup> In *Gunn-Olson-Stordahl Joint*

191. *Id.* at 220.

192. *Id.* at 221-22. The court noted in the course of its opinion that the "acts of alteration and payment constituted a breach of contract *and* negligence on the part of BFS [the bank]." *Id.* at 222 (emphasis by court). See *supra* note 54 and accompanying text (concerning blending of contract and tort liability under recent Texas law).

193. TEX. BUS. & COM. CODE ANN. § 4.201(a)(1) (Tex. UCC) (Vernon 1968).

194. 750 S.W.2d 297 (Tex. App.—Fort Worth 1988, no writ).

195. *Id.* at 301.

196. Republic Nat'l Bank v. Northwest Nat'l Bank, 578 S.W.2d 109 (Tex. 1978).

*Venture v. Early Bank*<sup>197</sup> the court held that a condition stated in a letter of credit requiring factual performance of the underlying contract made the purported credit a guaranty instead of a credit.<sup>198</sup>

In contrast, a statement in a letter of credit specifying that payment will be made against a document or statement certifying default in performance or payment is an acceptable condition because it does not entangle the issuer in the policing of the underlying transaction.<sup>199</sup> In *Kerr Construction Co. v. Plains National Bank*<sup>200</sup> the court held that requiring a signed statement of default by a contractor was proper to authorize the beneficiary to draw under the credit. The court further held that an inconsistency in the date of the letter of credit and a date stated in another paragraph in the credit should be resolved by reference to ordinary rules of contract interpretation.<sup>201</sup> The court ruled that the date first stated in the credit controlled over a later date that appeared in the last paragraph of the credit.<sup>202</sup>

### B. Injunction Against Honor

*Fraud in the Transaction.* Fraud in the transaction provides one of the three exceptions to the rule of absolute payment under a letter of credit.<sup>203</sup> The usual type of fraud in the transaction that justifies an injunction against honor is a breach of the underlying transaction that is so serious as to vitiate the entire transaction.<sup>204</sup> In *Alamo Savings Association v. Forward Construction Co.*<sup>205</sup> the claim of fraud went to the actions of the beneficiary who, allegedly with the knowledge of the issuer, fraudulently induced a contractor to obtain a letter of credit with the intent of using it as collateral for the beneficiary's own loan from the issuer instead of using it to obtain a waiver of the requirement of a payment and performance bond for the contractor. The court affirmed the trial court's grant of a temporary injunction against honor pending the outcome of trial<sup>206</sup> and concluded that, if proven, this fraud would be such as would vitiate the transaction.<sup>207</sup>

### C. Payment of Proceeds Under a Credit

*Strict Compliance Required for Payment.* In *First Bank v. Paris Savings & Loan Association*<sup>208</sup> the court held that additional identifying language writ-

197. 748 S.W.2d 316 (Tex. App.—Eastland 1988, writ denied).

198. *Id.* at 320.

199. *Republic Nat'l Bank*, 578 S.W.2d at 115.

200. 753 S.W.2d 181, 184 (Tex. App.—Amarillo 1987, writ denied).

201. *Id.* The court cited the leading case of *Temple-Eastex Inc. v. Addison Bank*, 672 S.W.2d 793, 798 (Tex. 1984) in support of this proposition.

202. 753 S.W.2d at 184.

203. The three exceptions are set out in TEX. BUS. & COM. CODE ANN. § 5.114(b) (Tex. UCC) (Vernon 1968).

204. *See, e.g., Phillipp Bros., Inc. v. Oil Country Specialists*, 709 S.W.2d 262 (Tex. App.—Houston [1st Dist.] 1986, writ dismissed) (rejection rates ranging from 12 percent to 100 percent on goods delivered under contract justified injunction against honor).

205. 746 S.W.2d 897 (Tex. App.—Corpus Christi 1988, writ dismissed w.o.j.).

206. *Id.* at 902.

207. *Id.* at 901.

208. 756 S.W.2d 329 (Tex. App.—Dallas 1988, writ denied).



ten on a draft drawn under a letter of credit was mere surplusage that did not invalidate presentment under the credit.<sup>209</sup> The court further held that the beneficiary was not required to include a statement describing modifications or renewals of the underlying indebtedness when no modifications or renewals had occurred.<sup>210</sup>

*Proceeds as a Subject of Conversion.* In *Intermarkets U.S.A. v. C-E Natco*<sup>211</sup> one company had assigned to another company the right to payment of proceeds under a letter of credit. The issuer paid the funds to the original beneficiary, but the beneficiary never paid the funds over to the assignee. In an action for conversion by the assignee to recover the funds, the court held the proceeds paid under the letter of credit constituted a specified, identifiable sum of money that the beneficiary had retained and converted for its own use.<sup>212</sup> The court held the conversion action was proper and allowed the assignee to recover.<sup>213</sup>

## VI. SECURED TRANSACTIONS

### A. Validity of Security Agreement

*Relationship to Consumer Credit Code.* In *Gonzalez v. Gainan's Chevrolet City*<sup>214</sup> the Texas Supreme Court held "there is no reason to presume the legality of terms and provisions of a contract which are required or prohibited by the Consumer Credit Code and which are not relevant to a finding of usury."<sup>215</sup> This holding left in place the doctrine of "presumed legality" in cases involving usury,<sup>216</sup> but eliminated the doctrine in nonusury contexts.<sup>217</sup> In *McCarty v. Citicorp Acceptance Co.*<sup>218</sup> the court considered the legality of a repossession clause that stated: "On any default, we will have all the remedies of a secured party under the Uniform Commercial Code."<sup>219</sup> While recognizing the application of *Gainan* to a clause of this type, the court ruled that as a matter of law, the clause did not violate the Consumer Credit Code.<sup>220</sup>

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209. *Id.* at 331.

210. *Id.* at 331-32.

211. 749 S.W.2d 603 (Tex. App.—Houston [1st Dist.] 1988, no writ).

212. *Id.* at 604.

213. *Id.* at 606.

214. 690 S.W.2d 885 (Tex. 1985).

215. *Id.* at 887.

216. The doctrine of presumed legality permitted an ambiguous contract term to be construed as complying with the law if the term was reasonably susceptible of such an interpretation. See *Jim Walter Homes, Inc. v. Schuenemann*, 668 S.W.2d 324, 332 (Tex. 1984).

217. *Gainan's* concerned the validity of a repossession clause providing that upon default "seller or any sheriff or other officer of the law may take immediate possession of said [secured] property without demand, including any equipment or accessories thereto; and for this purpose seller may enter upon the premises where said property may be and remove same." 690 S.W.2d at 888 (emphasis by court). The court held that, without applying the doctrine of presumed legality, this clause could be read as authorizing a trespass in violation of the Consumer Credit Code in TEX. REV. CIV. STAT. ANN. art. 5069-7.07(3) (Vernon Supp. 1989). *Id.* at 888-89.

218. 752 S.W.2d 206 (Tex. App.—Houston [1st Dist.] 1988, writ denied).

219. *Id.* at 207.

220. *Id.* at 207-08. The court also noted that TEX. REV. CIV. STAT. ANN. art. 5069-

In *Ballin v. Poston Home Care Center Co.*<sup>221</sup> the San Antonio court of appeals considered a usury case under the doctrine of presumed legality.<sup>222</sup> The borrowers argued that the documents in question provided for acceleration of the entire balance upon default, resulting in a usurious interest charge. Based on a construction of all the documents executed as part of the transaction, including several clauses that specifically excluded unearned interest from the accelerated balance, the court held the contract was not usurious.<sup>223</sup>

*Validity as Against Third Parties.* In *Modern Living, Inc. v. Niederhofer*<sup>224</sup> the seller of a mobile home ran into difficulties in repossessing the home after the buyers defaulted because of the refusal of a mobile home park operator to relinquish possession of the home while he was still owed money for past due rents and utility charges. The parties negotiated from January to May, and the secured creditor finally paid \$900.00 to the park operator and obtained possession of the home. The secured creditor then sued for interference with the right to possession and for conversion of some of the contents of the home. The trial court entered a take nothing judgment against the creditor.<sup>225</sup> The court of appeals upheld the judgment on the conversion action, but reversed and remanded on the action for interference with the right to possession stating: "A commercial business should not be expected to step to the line of forcible confrontation before they can claim intentional interference with possession of chattels."<sup>226</sup>

In *Bruner v. Exxon Co., U.S.A.*<sup>227</sup> the court considered the right of a party holding an assignment of rentals under a lease to recover from the lessor and

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7.07(3) (Vernon Supp. 1989) had been amended in 1979 to prohibit entry in violation of chapter 9 of the Business and Commerce Code rather than prohibiting unlawful entry as under the earlier version considered in *Gainan's*, 752 S.W.2d at 207. This change further clarifies the notion that a clause of the type before the court did not authorize an unlawful remedy although the same result should have obtained even under the earlier statutory language.

221. 749 S.W.2d 164 (Tex. App.—San Antonio 1988, writ denied).

222. *Id.* at 167.

223. *Id.* at 169. One of the clauses in the Retail Installment Contract executed by the borrowers tracked the language suggested by the supreme court in *Jim Walter Homes, Inc. v. Schuenemann*, 668 S.W.2d 324, 332 (Tex. 1984). The *Ballin* court quoted the *Schuenemann* court that stated: "[W]e fail to understand why acceleration clauses are drafted which do not include a sentence expressly disavowing any intention to collect excessive unearned interest or finance charges in the event the obligation is accelerated. . . ." 749 S.W.2d at 168 (quoting *Schuenemann*, 668 S.W.2d at 333 n.6). The clause provided:

Secured Party (Seller) has no intent to contract for, receive or charge a time-price differential in excess of that permitted under the laws of the State of Texas, and in the event that any charge hereunder or under any instruments or documents associated herewith should result in a time-price differential in excess of that permitted by law, any and all such excess shall not be payable by Buyer. . . .

*Id.* at 166.

224. 751 S.W.2d 243 (Tex. App.—Beaumont 1988, writ denied).

225. *Id.* at 244.

226. *Id.* at 245-46. In a letter dated April 15, 1983, the park operator had stated "It will be needless for you to send anyone to pick up a mobile home out of my park without the rent being paid." *Id.* at 245.

227. 752 S.W.2d 679 (Tex. App.—Dallas 1988, writ denied).

lessee for an alleged wrongful cancellation of the lease.<sup>228</sup> The court held that the lease could be terminated by the lessor and lessee without violating the right of the assignee who was "merely an incidental beneficiary: a casual assignee."<sup>229</sup> The court also noted that the assignee had drafted the assignment and negotiated the lease and could have included terms in the documents to continue rental payments in the event of termination.<sup>230</sup> Although this case did not arise under article 9, the resolution by the court is similar to the result that would obtain under section 9.318 of the Code<sup>231</sup> and is seemingly carried over into the proposed article 2A of the Uniform Commercial Code on Leases of Personal Property.<sup>232</sup>

In a case<sup>233</sup> concerning the assignment of rights under a security agreement the court held that the assignee acquired the rights of the assignor under the agreement, including any rights of subrogation resulting from payment of the secured debt by the assignor.<sup>234</sup> The assignee was entitled to maintain an action to collect the secured debt that had been assigned.<sup>235</sup> In *MBank Grand Prairie v. State*<sup>236</sup> the court considered the rights of an unperfected secured creditor to obtain relief from forfeiture of a vehicle to the state under the Controlled Substances Act.<sup>237</sup> The court held that an unperfected security interest was a bona fide security interest notwithstanding the lack of perfection and was protected against forfeiture under the terms of the statute.<sup>238</sup>

#### B. Priorities

*Priority Against Statutory Liens.* In *FDIC v. Sears, Roebuck & Co.*<sup>239</sup> a priority conflict arose between a perfected security interest in inventory and a statutory landlord's lien. The court stated:

[The landlord's lien statute] has been interpreted to provide a preference lien to a landlord for rent that is due and for rent that is to become due during the current twelve-month period succeeding the date of the beginning of the lease or an anniversary of that date. . . . Each year of the contract is viewed separately. At the beginning of each contract year, if a UCC financing statement has been filed during the previous

228. *Id.* at 681.

229. *Id.* at 683.

230. *Id.* The assignee had received the assignment of part of the rents in consideration of his services in arranging for the rental of the property.

231. TEX. BUS. & COM. CODE ANN. § 9.318(b) (Tex. UCC) (Vernon Supp. 1989).

232. UNIFORM COMMERCIAL CODE § 2A-303 (1987). The official comments to this section make reference to § 9-318 and contemplate the continued operation of that section in the context of lease transactions.

233. *State Fidelity Mortgage Co. v. Varner*, 740 S.W.2d 477 (Tex. App.—Houston [1st Dist.] 1987, writ denied).

234. *Id.* at 480-81. The assignor had pledged property as collateral for the debt of another person and this property was used to pay part of the debt.

235. *Id.* at 481.

236. 737 S.W.2d 424 (Tex. App.—Fort Worth 1987, no writ).

237. The pertinent section of the act appears in TEX. REV. CIV. STAT. ANN. art. 4476-15, § 5.03(c) (Vernon 1976).

238. 737 S.W.2d at 427.

239. 743 S.W.2d 772 (Tex. App.—El Paso 1988, no writ).

year, it then becomes superior to the landlord's lien.<sup>240</sup>  
Judgment was rendered in favor of the secured party.<sup>241</sup>

*Loss of Purchase Money Protection.* The Fourteenth District Court of Appeals in Houston addressed the interesting question of when the twenty-day time period for purchase money priority begins to run for purposes of the special protection given to purchase money transactions under the Code.<sup>242</sup> The purchase money creditor had sold goods to a debtor on open account for some time. During this time period, a bank loaned money to the same debtor and took a non-purchase-money security interest in collateral then-owned and thereafter acquired. When the seller became concerned about the ability of the debtor to pay for the goods that were being delivered, a security agreement was signed in favor of the seller and a financing statement was filed within twenty days of the signing of this agreement, but well after the bank had already filed a financing statement covering its non-purchase-money interest.

The problem arose because the Code specifies that the twenty-day time period begins to run when the debtor "receives possession of the collateral."<sup>243</sup> The seller argued that the goods did not become collateral until the security agreement was signed; prior to that time, the debtor had only possessed "goods." The court correctly pointed out that this reading of the Code seriously undermines the purpose of the filing system when property is left in the possession of a debtor and there is nothing on record to show that other parties have a claim to the property.<sup>244</sup> The court held that the seller was not entitled to the special purchase money priority rule<sup>245</sup> and that under the first to file rule<sup>246</sup> the seller occupied a second priority position.<sup>247</sup>

*Circular Priorities.* One of the most difficult priority problems that can arise under any statute containing a priority scheme is the conundrum of circular priorities.<sup>248</sup> A circular priority generally occurs in the form of "A has pri-

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240. *Id.* at 773.

241. *Id.* at 774.

242. *Mark Prods. U.S. v. Interfirst Bank Houston*, 737 S.W.2d 389 (Tex. App.—Houston [14th Dist.] 1987, writ denied).

243. TEX. BUS. & COM. CODE ANN. § 9.312(d) (Tex. UCC) (Vernon Supp. 1989).

244. 737 S.W.2d at 392. This is one of the issues that may arise in consideration of the proposed article 2A on Lease Transactions because that proposal does not require any notice filing to show that property in the possession of a debtor is subject to a lease. The pros and cons of required filing are discussed in Mooney, *The Mystery and Myth of "Ostensible Ownership" and Article 9 Filing: A Critique of Proposals to Extend Filing Requirements to Leases*, 39 ALA. L. REV. 683 (1988) and Kripke, *Some Dissonant Notes About Article 2A*, 39 ALA. L. REV. 791 (1988).

245. TEX. BUS. & COM. CODE ANN. § 9.312(d) (Tex. UCC) (Vernon Supp. 1989).

246. *Id.* § 9.312(e).

247. 737 S.W.2d at 394.

248. Gilmore once wrote in regard to circular priority problems: "A judge who finds himself face to face with a circular priority system typically reacts in the manner of a bull who has been goaded by the picadors: he paws the ground and roars with rage. The spectator can only sympathize with judge and bull." G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* § 39.1, at 1020-21 (1965).

ority over B, who has priority over C, who has priority over A."<sup>249</sup> In *ITT Diversified Credit Corp. v. First City Capital Corp.*<sup>250</sup> the Texas Supreme Court considered a circular priority that arose because of a subordination agreement between the holder of the first priority position and the holder of the third priority position.<sup>251</sup> The court adopted the following formula to resolve the circularity:

1. Set aside from the fund the amount of "A" 's claim.
2. Out of the money set aside, pay "C" the amount of its claim, pay "A" to the extent of any balance remaining after "C" 's claim is satisfied.
3. Pay "B" the amount of the fund remaining after "A" 's claim has been set aside.
4. If any balance remains in the fund after "A" 's claim has been set aside and "B" 's claim has been satisfied, distribute the balance to "C" and "A".<sup>252</sup>

### C. Proceedings After Default

*Burden of Proving Commercially Reasonable Disposition.* The most active single area of commercial law during the time period covered by this Article concerned proceedings after default.<sup>253</sup> The rule requiring the secured party to prove that a sale or other disposition of collateral was reasonable<sup>254</sup> is becoming increasingly well-established<sup>255</sup> although the Texas Supreme Court has not provided a definitive opinion.<sup>256</sup>

249. *Id.*

250. 737 S.W.2d 803 (Tex. 1987).

251. *Id.* at 804.

252. *Id.* (citing G. GILMORE, *supra* note 248, § 39.1, at 1021). This solution sometimes referred to as the "New York Rule" apparently originated in *Bacon v. Van Schoonhoven*, 19 Hvn. 158 (1879), *aff'd*, 87 N.Y. 446 (1882).

253. The rights and remedies of parties following default are the subject of TEX. BUS. & COM. CODE ANN. chapter 9, subchapter E (Tex. UCC) (Vernon Supp. 1989).

254. The rule putting the burden of proving commercial reasonableness on the secured party was first adopted in Texas by *Sunjet, Inc. v. Ford Motor Credit Co.*, 703 S.W.2d 285, 287 (Tex. App.—Dallas 1985, no writ).

255. The *Sunjet* rule was applied in the following cases during the time period covered by this article: *Daniell v. Citizens Bank*, 754 S.W.2d 407, 409-10 (Tex. App.—Corpus Christi 1988, no writ) (better reasoned view puts burden of proving notice and commercially reasonable disposition on secured party); *Boles v. Texas Nat'l Bank*, 750 S.W.2d 879, 880-81 (Tex. App.—Waco 1988, no writ) (burden of pleading and proving a commercially reasonable disposition of collateral is on secured party); *Whirlybirds Leasing Co. v. Aerospatiale Helicopter Corp.*, 749 S.W.2d 915, 918 (Tex. App.—Dallas 1988, no writ) (secured creditor has burden of proving commercial reasonableness including proving that notice of intended disposition of collateral was given); *Hall v. Crocker Equip. Leasing*, 737 S.W.2d 1, 3 (Tex. App.—Houston [14th Dist.] 1987, writ denied) (burden of proving commercially reasonable resale and burden of proving that repairs made to goods before resale were reasonable is on secured party); *FDIC v. Attayi*, 745 S.W.2d 939, 948 (Tex. App.—Houston [1st Dist.] 1988, no writ) (proving notice of sale is an element of secured party's case in action for a deficiency against a guarantor). *But see* *Folkes v. Del Rio Bank & Trust Co.*, 747 S.W.2d 443, 445 (Tex. App.—San Antonio 1988, no writ) (failure to dispose of collateral in commercially reasonable manner is an affirmative defense).

256. Although the supreme court has not directly spoken on the issue of burden of proof, the court has held that the duty to dispose of collateral in a commercially reasonable manner constitutes an implied covenant in all contracts under TEX. BUS. & COM. CODE ANN. § 9.504

*Right to Recover a Deficiency.* The Texas Supreme Court in *Tanenbaum v. Economics Laboratory*<sup>257</sup> adopted a rule denying the recovery of a deficiency if the disposition of collateral was not conducted in a commercially reasonable manner.<sup>258</sup> The peculiar facts in *Tanenbaum* left open questions about the scope of the rule announced by the court.<sup>259</sup> Recent cases have addressed some of these questions. The court in *Adams v. Waldrop*<sup>260</sup> held that the rule denying a deficiency extended to a guarantor and that a failure to conduct a sale in a commercially reasonable manner discharged the liability of the guarantor.<sup>261</sup> In *Wright v. Interfirst Bank Tyler*<sup>262</sup> a notice of public sale of collateral did not constitute reasonable notification of the day, place, and time of the private sale that ensued.<sup>263</sup> The failure to give proper notice was held to bar recovery of a deficiency.<sup>264</sup> In *Beltran v. Groos Bank*<sup>265</sup> the court held an oral notice of disposition of collateral sufficient to satisfy the notice requirements of the Code. The court further concluded that the creditor met the burden of proving that the disposition was commercially reasonable.<sup>266</sup>

*Purchase of Collateral by Secured Party.* Under the Code, a secured party may purchase collateral after default only under very limited circumstances.<sup>267</sup> In *Mercantile Bank & Trust v. Cunov*<sup>268</sup> the secured party purchased stock at a private sale following default. Because the stock was not the subject of standard price quotations nor sold in a recognized market, and because the sale was a private sale, the court held the secured party liable to the debtor in an amount equal to the fair market value of the stock, less the amount of the debt.<sup>269</sup> In another case<sup>270</sup> involving the purchase of collateral by a secured creditor, the court discussed the requirements of a proper foreclosure and disposition of a vessel under the Ship Mortgage Act

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(Tex. UCC) (Vernon Supp. 1989) and that breach of this covenant sounds in contract rather than tort. *International Bank v. Morales*, 736 S.W.2d 662, 624 (Tex. 1987). Punitive damages are not recoverable for breach of this covenant unless an independent tort is found. *Id.* This raises the question, of course, of how the theory of negligent performance of contract fits into the disposition of collateral under article 9.

257. 628 S.W.2d 769 (Tex. 1982).

258. *Id.* at 771-72.

259. *Tanenbaum* arose in the context of a retention of collateral instead of a sale, thereby leaving open some issues about notice and the parties protected by the rule.

260. 740 S.W.2d 32 (Tex. App.—El Paso 1987, no writ).

261. *Id.* at 33.

262. 746 S.W.2d 874 (Tex. App.—Tyler 1988, no writ).

263. *Id.* at 877.

264. *Id.* at 878.

265. 755 S.W.2d 944 (Tex. App.—San Antonio 1988, no writ).

266. *Id.* at 946-48.

267. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1989) allows a secured party to purchase collateral only when it is of a type sold in a commonly recognized market or is the subject of widely distributed standard price quotations or if it is purchased at a public sale. *Id.*

268. 749 S.W.2d 545 (Tex. App.—San Antonio 1988, writ denied).

269. *Id.* at 549.

270. *Register v. Ford Motor Credit Co.*, 744 S.W.2d 301 (Tex. App.—Houston [1st Dist.] 1987, writ granted).

of 1920.<sup>271</sup> The court noted that ship foreclosures were excluded from the coverage of the Code<sup>272</sup> and held that the trial court had correctly applied the rule<sup>273</sup> of *Walter E. Heller & Co. v. O/S Sonny V.*<sup>274</sup> The rule requires credit for the fair market value of a vessel to be credited against the debt whenever a secured creditor bought the vessel at a foreclosure sale.<sup>275</sup> The court acknowledged that the creditor had met its burden of proving that the foreclosure was conducted in a commercially reasonable manner.<sup>276</sup> Texas courts first addressed the issue of crediting fair market value of collateral against debt in *Lee v. Sabine Bank*<sup>277</sup> where the court cited *Walter E. Heller* as authority for a general rule applicable to all foreclosures, including foreclosure under the maritime mortgage before the court.<sup>278</sup> The issue arose again during the time period covered by this article in *Halter v. Allied Merchants Bank*.<sup>279</sup> The *Halter* court, in dictum, noted the previous decision in *Lee* and suggested that it would follow that decision but for a failure of the debtor to raise the issue on summary judgment that the bank or its agent had purchased the property at the foreclosure sale. In contrast to *Lee*, the *Halter* case involved real property. It seems only a matter of time until *Lee* and *Walter E. Heller* float into the law of article 9.<sup>280</sup>

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271. 46 U.S.C. §§ 911-984 (1975).

272. 744 S.W.2d at 305. The official comment to TEX. BUS. & COM. CODE ANN. § 9.104 (Tex. UCC) (Vernon Supp. 1989) specifically mentions the Ship Mortgage Act as an example of federal law that governs the rights of secured creditors outside of article 9.

273. 744 S.W.2d at 305.

274. 595 F.2d 968, 971 (5th Cir. 1979).

275. *Id.*

276. 744 S.W.2d at 306.

277. 708 S.W.2d 582 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.).

278. *Id.* at 584. In *Lee* the court ruled that a significant proven disparity between the judicial sale price of the vessel and the appraisal value should give the debtor a deficiency offset measured by the fair market value of the vessel as opposed to the foreclosure sale price when the secured party is the successful bidder. In expansive dictum the court added:

We are persuaded that the rule [described above] is fair and reasonable and should be applied in Texas law. But we know of no reason why it should be restricted to ships. A lender who has secured collateral, whether personalty or realty is under a trust arrangement with the borrower, in the event of foreclosure, to make an honest effort to reduce the loan as much as possible by securing a fair price for the collateral.

*Id.*

279. 751 S.W.2d 286, 287-88 (Tex. App.—Beaumont 1988, no writ).

280. The possible expansion of *Lee v. Sabine Bank*, 780 S.W.2d 582 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.), will no doubt meet with resistance as evidenced by the decision in *Huddleston v. Texas Commerce Bank*, 756 S.W.2d 343, 347 (Tex. App.—Dallas 1988, writ denied), where the court refused to extend the article 9 rules on personal property foreclosures to real property foreclosures and require the lender to prove that it had disposed of the real property in a commercially reasonable manner.