



---

January 1979

## Commercial Transactions

Peter Winship  
*Southern Methodist University, Dedman School of Law*

---

### Recommended Citation

Peter Winship, *Commercial Transactions*, 33 Sw L.J. 203 (1979)  
<https://scholar.smu.edu/smulr/vol33/iss1/8>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

# COMMERCIAL TRANSACTIONS

by

Peter Winship\*

THIS year's survey of commercial transactions again focuses on court opinions construing the Uniform Commercial Code as enacted in Texas.<sup>1</sup> This Article follows the scope and format adopted in the *Survey* articles of the past several years.<sup>2</sup> Although there are no Texas legislative developments to report, on the national scene the sponsors of the Code have published a 1978 Official Text of the Code, which incorporates amendments made in 1977 to the Code provisions dealing with investment securities.<sup>3</sup>

Court opinions construing the language of the Code grow not only in number but also in sophistication. In large measure this increased sophistication may be attributed to the growing number of useful publications interpreting Code provisions.<sup>4</sup> Fewer opinions appear to overlook the pos-

---

\* B.A., LL.B., Harvard University; LL.M., University of London. Associate Professor of Law, Southern Methodist University.

1. In this Article both textual and footnote citations are to the Texas Uniform Commercial Code [hereinafter referred to as the Code] as incorporated in the first eleven chapters of the Texas Business and Commerce Code. TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Vernon 1968 & Supp. 1978-79). The Code became effective in Texas on July 1, 1966, and in 1967 it became part of the Business and Commerce Code. The Code has been amended several times since 1967 and now generally conforms with the 1972 Official Text of the Uniform Commercial Code.

2. See Winship, *Commercial Transactions, Annual Survey of Texas Law*, 32 Sw. L.J. 181 (1978) [hereinafter cited as *1978 Annual Survey*]; Winship, *Commercial Transactions, Annual Survey of Texas Law*, 31 Sw. L.J. 165 (1977) [hereinafter cited as *1977 Annual Survey*].

3. ALI & NCCUSL, UNIFORM COMMERCIAL CODE, OFFICIAL TEXT—1978 (9TH ED. 1978). The appropriate committee of the State Bar of Texas is evaluating the revision of article 8. 16 TEX. ST. B. BULL. SECTION CORP., BANKING & BUS. L. No. 2, Dec. 1978, at 27. The state bar did not include any amendments to the Code in its legislative program for the 1979 legislative session. 42 TEX. B.J. 13 (1979). At the national level further amendments to the Official Text of the Code are being prepared. The Permanent Editorial Board for the Uniform Commercial Code has appointed a "348 Committee" to review the Code provisions on negotiable and investment instruments. An American Bar Association committee is revising article 6 (bulk transfers). See Hawkland, *The Trouble with Article 6 of the UCC: Some Thoughts About Section 6-103*, 82 COM. L.J. 113 (1977).

4. For recent publications, see R. BRAUCHER & R. RIEGERT, INTRODUCTION TO COMMERCIAL TRANSACTIONS (1977); W. DAVENPORT & D. MURRAY, SECURED TRANSACTIONS (1978); R. HENSON, HANDBOOK ON SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE (2d ed. 1979); T. QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST (1978); Professor Barclay Clark has prepared a text on secured transactions, organized on functional lines, which will be published in 1979. For publications more readily available in Texas, see W. DORSANEO, R. ANDERSON & P. WINSHIP, TEXAS LITIGATION GUIDE—COMMERCIAL LITIGATION (1978) [hereinafter cited as DORSANEO, ANDERSON &

sible applicability of the Code,<sup>5</sup> and an increasing number of courts are applying Code policy by analogy.<sup>6</sup>

## I. SALES TRANSACTIONS

### A. *Scope of Chapter 2 (Sales)*

*Sale of Goods or Rendering of Services.* Chapter 2 on sales covers "transactions in goods," with the primary focus on sales and contracts for sale.<sup>7</sup> In practice, however, commercial transactions may involve not only the sale of a product but also the rendering of services. The classic cases are hospitals that provide blood transfusions and hairdressers who apply hair products. Since the non-Code rules governing service contracts may differ from the Code rules, there are occasions when it becomes important to distinguish the sales from the service contract. Two recent Texas court opinions faced with this problem apply a mechanical test: is the "essence" of the transaction the rendering of services or the sale of goods? In *Potts v. W.Q. Richards Memorial Hospital*<sup>8</sup> the dispute was whether the two-year statute of limitations or the Code's four-year statute of limitations governed in a case where the plaintiff hospital supplied both goods and services.<sup>9</sup> The court held that the Code did not apply because "the essence of a hospital stay is the furnishing of the institution's healing services, which may include incidental sales of medicines and the like."<sup>10</sup> In *Freeman v. Shannon Construction, Inc.*<sup>11</sup> the dispute concerned the proper measure of

---

WINSHIP]; STATE BAR OF TEXAS, TEXAS COMMERCIAL LAW FOR GENERAL PRACTITIONERS (1977).

5. *But see* *Reece v. First State Bank*, 566 S.W.2d 296 (Tex. 1978), *discussed at* note 111 *infra*. In the area of damages for breach of sales contracts there is a disturbing tendency to avoid discussing the relevant Code sections and policies. *See* *Little Darling Corp. v. Ald, Inc.*, 566 S.W.2d 347 (Tex. Civ. App.—Dallas 1978, no writ); *Harper Bldg. Sys. v. Upjohn Co.*, 564 S.W.2d 123 (Tex. Civ. App.—Beaumont 1978, writ ref'd n.r.e.); *W.B. Dunavant & Co. v. Southmost Growers, Inc.*, 561 S.W.2d 578 (Tex. Civ. App.—Corpus Christi 1978, writ ref'd n.r.e.). These cases are discussed at notes 75-82 *infra* and accompanying text. This tendency is unfortunate because some of the most interesting academic literature is being published in this area. *See* *Clarkson, Miller & Muris, Liquidated Damages v. Penalties: Sense or Nonsense?*, 1978 WIS. L. REV. 351; Jackson, "Anticipatory Repudiation" and the Temporal Element of Contract Law: An Economic Inquiry into Contract Damages in Cases of Prospective Nonperformance, 31 STAN. L. REV. 69 (1978); Priest, *Breach and Remedy for the Tender of Nonconforming Goods Under the Uniform Commercial Code: An Economic Approach*, 91 HARV. L. REV. 960 (1978).

6. *Compare* *Graham v. United States*, 441 F. Supp. 741, 745-47 (N.D. Tex. 1977), *with* *MacDonald v. Mobley*, 555 S.W.2d 916, 919 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.). *See also* *Aycock v. Vantage Management Co.*, 554 S.W.2d 235 (Tex. Civ. App.—Dallas 1977, writ ref'd n.r.e.). Sometimes courts will apply Code provisions without questioning their applicability. *See* *Chaplin v. Milne*, 555 S.W.2d 161, 162 (Tex. Civ. App.—El Paso 1977, no writ) (§ 2.202 applied to promissory note despite judicial admission of oral agreement that the court found contradicted the printed note).

7. TEX. BUS. & COM. CODE ANN. § 2.102 (Vernon 1968). The terms "sale," "contract for sale," and "goods" are all defined by the Code. *Id.* §§ 2.105(a), .106(a).

8. 558 S.W.2d 939, 23 UCC Rep. Serv. 360 (Tex. Civ. App.—Amarillo 1977, no writ).

9. *Compare* TEX. REV. CIV. STAT. ANN. art. 5526 (Vernon 1958) *with* TEX. BUS. & COM. CODE ANN. § 2.725 (Vernon 1968).

10. 558 S.W.2d at 946.

11. 560 S.W.2d 732, 23 UCC Rep. Serv. 867 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.).

damages. A subcontractor for certain cement work on a construction project argued that section 2.713 of the Code provided the proper damage formula. The court, however, held that the "dominant factor" or "essence" of the transaction was the furnishing of services, and the Code therefore did not apply.<sup>12</sup>

Without questioning the results of these cases, one may suggest that it would be sounder to examine the policies underlying the relevant statutes to determine which would be more appropriate under the circumstances.<sup>13</sup> The need to examine these underlying policies is suggested by the Texas Supreme Court opinion in *Signal Oil & Gas Co. v. Universal Oil Products*.<sup>14</sup> In that case one of the defendants argued that the implied warranty provisions of the Code did not apply to it because it merely assembled and did not "sell" the isomax heater that failed. The court rejected this argument on the ground that the assembler was an essential link in the distribution chain: "The suitability of the finished product depends as much upon actions of the assembler as upon actions of the manufacturer of the component parts."<sup>15</sup> On a more formalistic level, the court also noted that the defendant purported to retain title until it had completed assembly of the unit. While the court does not relate its discussion of the role of the assembler to the policy underlying the implied warranty provision nor suggest what rule would apply if the Code did not, the court's realistic approach is a sounder implementation of the legislative policy embodied in the Code than is the mechanical "essence of the transaction" test.<sup>16</sup>

*Sale or Exchange.* Although the general scope provision of chapter 2 of the Code encompasses "transactions" in goods,<sup>17</sup> most of the particular sections in that chapter are limited to the "sale" or "contract for sale" of goods. A sale is defined as "the passing of title from the seller to the buyer for a price."<sup>18</sup> The price can be made payable in money or otherwise, including an exchange of property.<sup>19</sup> Pre-Code Texas law distinguished a "sale" from an "exchange" as follows: an exchange occurred when each party transferred property to the other without an agreed value being placed on the property, while a sale resulted if the parties agreed on the

---

12. 560 S.W.2d at 737-39. The court adopted a damage formula that awarded "the excess of the reasonable and necessary cost of completion over and above the unpaid portion of the contract price." *Id.* at 735-36.

13. See R. NORDSTROM, HANDBOOK OF THE LAW OF SALES 46-47 (1970); Comment, *Sales-Service Hybrid Transactions: A Policy Approach*, 28 Sw. L.J. 575 (1974).

14. 572 S.W.2d 320, 24 UCC Rep. Serv. 555 (Tex. 1978). For the court's discussion of the definition of "seller," see 572 S.W.2d at 329-31.

15. 572 S.W.2d at 330.

16. Although the court addressed only the question of the defendant's status as a "seller" under the Code, the court's policy reasoning presumably extends to strict liability under RESTATEMENT (SECOND) OF TORTS § 402A (1965), which also applies to "sellers."

17. TEX. BUS. & COM. CODE ANN. § 2.102 (Vernon 1968).

18. *Id.* § 2.106(a) (emphasis added).

19. *Id.* § 2.304(a).

value of the property.<sup>20</sup> The court in *Calloway v. Manion*<sup>21</sup> alluded to this pre-Code distinction, but did not decide whether it had been eliminated by the Code because the parties in that case had agreed on the value of the property; therefore, even under pre-Code law there was a sale. Given the language of the Code,<sup>22</sup> it is difficult to see how this pre-Code technical distinction survives, at least in the context of chapter 2 on sales.<sup>23</sup>

*Choice of Law.* Section 1.105 of the Code<sup>24</sup> adopts a general choice-of-law provision, permitting parties to select the law that will govern the transaction if that transaction bears a "reasonable relation" to the state or nation whose law is chosen. If the parties fail to select the governing law, then section 1.105 directs the court to apply the version of the Code in force in the state where the court sits as long as that state has an "appropriate relation" to the transaction. The Code provision appears to assume that the parties will choose the governing law at the time of contracting, but in *Calloway v. Manion*<sup>25</sup> the Fifth Circuit had little difficulty in enforcing the parties' stipulation as to the governing law even though it was entered into after a dispute had arisen between them. The court required only that the stipulated law bear a reasonable relation to the transaction.<sup>26</sup>

### B. Formation of Contracts

*Contract Formation.* Many Code provisions were designed to encourage the enforcement of the parties' "real" bargain, including section 2.207, which has received more than its share of academic commentary.<sup>27</sup> Difficult questions obviously arise when the parties do not set out their agreement in a single document. In *Harper Building Systems, Inc. v. Upjohn Co.*<sup>28</sup> the buyer apparently submitted an order form to the seller, which responded by sending the ordered goods together with a specification sheet containing instructions on the use of the goods. At the bottom of the specification sheet there was a clause limiting the buyer's exclusive remedy for breach of warranty to the purchase price of the goods. The majority opinion did not give effect to this clause on the ground that it was not part of an "expression of acceptance" because there was no evidence as to when the buyer received the specification sheet. The dissenting opinion argued that

20. *Griswold v. Tucker*, 216 S.W.2d 276 (Tex. Civ. App.—Fort Worth 1948, no writ).

21. 572 F.2d 1033, 23 UCC Rep. Serv. 1143 (5th Cir. 1978).

22. "If [the price] is payable in whole or in part in goods each party is a seller of the goods which he is to transfer." TEX. BUS. & COM. CODE ANN. § 2.304(a) (Vernon 1968).

23. *But see* *Weisbart & Co. v. First Nat'l Bank*, 568 F.2d 391, 23 UCC Rep. Serv. 797 (5th Cir. 1978). In *Weisbart* the court referred to the pre-Code "technical" distinction when construing § 9.306(b) of the Code, which specifically mentions both a sale and an exchange ("sale, exchange or other disposition"). 568 F.2d at 395.

24. TEX. BUS. & COM. CODE ANN. § 1.105 (Vernon Supp. 1978-79).

25. 572 F.2d 1033, 23 UCC Rep. Serv. 1143 (5th Cir. 1978).

26. 572 F.2d at 1036.

27. TEX. BUS. & COM. CODE ANN. § 2.207 (Vernon 1968). *See, e.g.*, Murray, *Section 2-207 of the Uniform Commercial Code: Another Word About Incipient Unconscionability*, 39 U. PITT. L. REV. 597 (1978).

28. 564 S.W.2d 123 (Tex. Civ. App.—Beaumont 1978, writ ref'd n.r.e.).

the buyer's use of the specification sheet was an expression of his acceptance and he had failed to object to its terms. The result reached by the majority is the better one. Even if one concludes that the contemporaneous sending of the goods and the form was the seller's expression of acceptance, without regard to when the buyer received the goods and the form, one would not give effect to the clause under section 2.207(b)(2) because it would materially alter the buyer's original offer as set forth in his order form.<sup>29</sup>

*Contract Terms—Parol Evidence.* Section 2.202 of the Code restates the parol evidence rule for all transactions in goods.<sup>30</sup> This restatement refines the rule and liberalizes the introduction of parol evidence, especially with respect to evidence of course of dealing and usage of trade. Unfortunately, in *Hobbs Trailers v. J.T. Arnett Grain Co.*<sup>31</sup> the Texas Supreme Court ignored many of these statutory refinements. In that case the lessee of a tractor trailer sought to introduce evidence that it had an oral agreement with the lessor's authorized salesman that it could purchase the equipment on the payment of one dollar at the end of the lease term. The "equipment lease" contract form stated that the lessee did not acquire any right, title, or interest in the equipment and that the instrument was the entire agreement between the parties. The lessee argued that the proffered evidence of the purchase option was evidence of a consistent additional term that supplemented the written instrument. The trial court admitted the lessee's evidence, and the jury findings supported the lessee's theory. The trial court, however, disregarded the jury findings on the ground that the evidence violated the parol evidence rule. The court of civil appeals reversed the trial court, but the Texas Supreme Court reversed the court of civil appeals and affirmed the trial court's judgment.

In a majority opinion that grossly oversimplified the statutory language, the supreme court held that the evidence was not admissible because the evidence "varied and contradicted the clear and exclusive terms of the written contract."<sup>32</sup> A careful reading of the Code suggests that the result

---

29. "The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: . . . (2) they materially alter it; . . ." TEX. BUS. & COM. CODE ANN. § 2.207 (b)(2) (Vernon 1968). Note that the seller could have accepted the buyer's order by shipping the ordered goods without any further communication between the parties. *Id.* § 2.206(a)(2).

30. *Id.* § 2.202. See generally J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 68-81 (1972). Several non-Code cases decided in this survey period illustrate well-established exceptions to the common law parol evidence rule. *Wright v. Gernandt*, 559 S.W.2d 864, 868 (Tex. Civ. App.—Corpus Christi 1978, no writ) (reformation); *Neuhaus v. Kain*, 557 S.W.2d 125, 132 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.) (fraud). Although these exceptions are not included in the Code's restatement of the parol evidence rule, presumably they continue to apply to commercial transactions by virtue of § 1.103, which states that the general principles of law and equity supplement the Code except where displaced. TEX. BUS. & COM. CODE ANN. § 1.103 (Vernon 1968).

31. 560 S.W.2d 85 (Tex. 1977), *rev'g* 540 S.W.2d 441 (Tex. Civ. App.—Waco 1976).

32. 560 S.W.2d at 86. The court's one reference to the Code merely states: "Article 2.202 of the Uniform Commercial Code prohibits the contradiction of final written expres-

reached in the majority opinion could have been supported by specific reference to at least two distinct parts of section 2.202(2). First, the court found that the proffered evidence was of an *inconsistent* additional term. Second, the court found that the parties had intended the writing to be a complete and exclusive statement of the terms of the agreement because they had included a merger clause in the contract. It is unfortunate that the court did not take the opportunity to refer to the specific language of the Code or to discuss the policy underlying the Code provision.<sup>33</sup>

### C. Warranties

*Tort or Contract.* Practical legal consequences depend on the determination of whether a remedy for a particular grievance about a defective product falls within the ambit of "contract," which would activate Code warranties, or "tort," which would involve a suit based on negligence or strict liability. Privity, for example, is often required under a contract theory but not under a tort theory; notice of a breach of a warranty may have to be given under a contract theory, while notice may not be required to recover on a tort theory; and different statutes of limitation may apply to the different causes of action. Academic discussion of the policies underlying the two different routes for resolving grievances, such as optimal "risk allocation," has eroded strict conceptual distinctions between contract and tort forms of action. As a result, many courts now re-examine traditional distinctions in the light of these policy considerations.

A trio of recent Texas Supreme Court cases have explored the distinctions between contract and tort theories. In *Nobility Homes, Inc. v. Shivers*,<sup>34</sup> commented on in last year's *Survey*,<sup>35</sup> the court held that economic losses could be recovered only in a warranty action under the Code, but that the traditional contract requirement of privity is no longer necessary. Subsequently, the court concluded in *Mid Continent Aircraft Corp. v. Curry County Spraying Service, Inc.*<sup>36</sup> that an accident in which only the good

---

sions by evidence of a prior or contemporaneous agreement." *Id.* at 87. One might argue that the Code did not apply because a lease rather than a sale of goods was involved. One answer to this argument lies in the broad scope of ch. 2 (transactions in goods) and the absence of "contract for sale" language in the Code statement of the parol evidence rule. TEX. BUS. & COM. CODE ANN. §§ 2.102, .202 (Vernon 1968).

33. The parol evidence problem with respect to purchase options in what purports to be a lease transaction has given rise to considerable case law and some commentary, none of which was mentioned by the Texas court. See generally 1 B P. COOGAN, W. HOGAN & D. VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 29A.06[1][a] (1977) [hereinafter cited as COOGAN, HOGAN & VAGTS]. One potentially fruitful line of attack on these cases is to seek to introduce evidence of course of dealing, usage of trade, or course of performance. See TEX. BUS. & COM. CODE ANN. §§ 1.205, 2.202(1), .208 (Vernon 1968).

34. 557 S.W.2d 77, 22 UCC Rep. Serv. 621 (Tex. 1977), noted in 15 HOUS. L. REV. 435 (1978) and 19 S. TEX. L.J. 319 (1978).

35. 1978 *Annual Survey*, *supra* note 2, at 190-91. See also Comment, *What Price Nobility? The Recovery of Economic Loss in Texas after Nobility Homes v. Shivers*, 19 S. TEX. L.J. 292 (1978).

36. 572 S.W.2d 308, 24 UCC Rep. Serv. 574 (Tex. 1978), *rev'g* 553 S.W.2d 935, 21 UCC Rep. Serv. 1273 (Tex. Civ. App.—Amarillo 1977). The supreme court opinion is noted in 44 J. AIR L. & COM. 207 (1978). For a discussion of the opinion of the court of appeals, see

that was purchased under a sales contract was damaged resulted in an economic loss subject to the Code rules governing warranties, but did not give rise to a right to recover in strict liability. An accident, however, that damaged not only the purchased good but also other property would give rise to a right to recover not only in warranty but also in tort, as exemplified by *Signal Oil & Gas Co. v. Universal Oil Products*.<sup>37</sup>

These court decisions establish several important propositions. First, the Code, strict liability, and negligence theories apparently are the exclusive sources of recovery in products liability cases. It is no longer possible to resort to the concept of "a warranty implied as a matter of public policy" now that Texas has adopted both the Uniform Commercial Code and section 402A of the *Restatement (Second) of Torts*.<sup>38</sup> Each theory is, in effect, a "form of action" with its own elements that must be proved. A party may determine which form of action is available in his or her case by examining the type of loss that has occurred. Economic losses may be recovered only in warranty, but damages to persons or property may be recovered under any of the forms of action if the party otherwise proves each element of his theory. A party must be careful to submit jury issues on each element of all of his theories.<sup>39</sup>

In addition, defenses available in tort suits may not be available in contract actions. The *Signal Oil* opinion, for example, indicates that contributory negligence—a tort concept—is not a bar to recovery under an implied warranty theory; any consequential damages proximately resulting from a breach of warranty may be recovered. If the contributory negligence of the buyer is one of several concurring proximate causes of a loss, the jury must determine the respective percentages by which the concurring causes contributed to the consequential damages.<sup>40</sup> Similarly, a contract defense may not be effective in tort. The court in *Mid Continent*, for example, held that an "as is" contract clause is an effective disclaimer in warranty but suggested that greater proof of the parties' intent to allocate the risk of loss might be necessary when a seller attempts to disclaim potential damages in

---

1978 Annual Survey, *supra* note 2, at 192-93. See also 19 S. TEX. L.J. 337 (1978); 9 TEX. TECH. L. REV. 733 (1978).

37. 572 S.W.2d 320, 24 UCC Rep. Serv. 555 (Tex. 1978), *aff'g in part & rev'g in part* 545 S.W.2d 907, 21 UCC Rep. Serv. 470 (Tex. Civ. App.—Beaumont 1977). For further discussion of this case, see notes 14-16 *supra* and accompanying text.

38. The court stated this proposition in both the *Nobility Homes* and the *Signal Oil* opinions. 557 S.W.2d at 78; 572 S.W.2d at 326-27. The court had suggested that there was an "implied warranty as a matter of public policy" in its landmark decision of *Jacob E. Decker & Sons v. Capp*, 139 Tex. 609, 164 S.W.2d 828 (1942). The court later adopted RESTATEMENT (SECOND) OF TORTS § 402A (1965) in *McKisson v. Sales Affiliates, Inc.*, 416 S.W.2d 787 (Tex. 1967).

39. Jury issues relevant to one theory may not be interchangeable. The court in *Signal Oil* indicated that issues as to "proximate cause" must be submitted on a negligence or a warranty theory but that "producing cause" is the proper issue on a strict liability theory. Jury findings as to one form of causation could not be used to support the other theory. 572 S.W.2d at 326.

40. This formula differs from the Texas comparative negligence statute, TEX. REV. CIV. STAT. ANN. art. 2212a (Vernon Supp. 1978-79), in that a buyer is entitled to recover even if his percentage of negligence is found to be greater than the seller's. 572 S.W.2d at 329.



negligence or strict liability.<sup>41</sup>

*Express Warranties.* Express warranties usually relate to the seller's affirmation or promise as to the quality of the goods sold.<sup>42</sup> Although it is sometimes difficult to distinguish a breach of a warranty from a breach of a nonwarranty promise, it is necessary to make this distinction in suits brought under the Deceptive Trade Practices—Consumer Protection Act (DTPA)<sup>43</sup> because the DTPA provides for recovery of treble damages for breach of a warranty but not for other breaches of contracts in consumer transactions.<sup>44</sup>

*Allen v. Parsons*<sup>45</sup> illustrates how difficult it may be to make this distinction. In *Allen* the seller agreed to sell a truck to the buyer. The seller also promised to affix an inspection sticker on the truck if the buyer would do the necessary work to enable the truck to pass inspection. The buyer did the work, but the seller refused to affix the sticker; instead, he repossessed the truck. The buyer prevailed in his DTPA suit, and the court of civil appeals affirmed on the ground that the breach of the promise to affix the sticker was a breach of an express Code warranty. The court noted that the truck was useless to the buyer without the sticker and drew an analogy to a promise by the seller "to repair a vehicle or to place a part or an accessory on a vehicle."<sup>46</sup> The Texas Supreme Court has granted a writ of error.<sup>47</sup>

What makes the *Allen* case so difficult to grasp is that the buyer had obtained possession of the truck before the promise to affix the sticker could be performed. If the seller had kept possession and had promised to deliver a truck that could be used on the road, his failure to tender delivery, by his inaction with respect to the sticker, would be considered a contract breach, giving rise to the general remedies of Code sections 2.711-2.713.<sup>48</sup> The inaction would not be a breach of a warranty but rather a breach of the seller's general obligation "to transfer and deliver."<sup>49</sup> It is difficult to see how this analysis would change merely because the buyer took possession before the seller's obligation to deliver a truck that could be used on the highway arose. The earlier transfer of possession of the equipment was for repairs rather than for tender of delivery of the truck.

*Notice of Breach as Prerequisite to Remedy.* If a buyer accepts and retains a nonconforming good, he must notify the seller of the nonconformity within a reasonable time after discovery of the breach or else be barred

---

41. 572 S.W.2d at 310-11, 313.

42. TEX. BUS. & COM. CODE ANN. § 2.313 (Vernon 1968).

43. *Id.* §§ 17.41-.63 (Vernon Supp. 1978-79).

44. *Id.* § 17.50(a)(2).

45. 555 S.W.2d 522 (Tex. Civ. App.—Texarkana 1977, writ granted).

46. *Id.* at 524.

47. 21 Tex. Sup. Ct. J. 178-79 (Feb. 4, 1978).

48. TEX. BUS. & COM. CODE ANN. §§ 2.711-.713 (Vernon 1968).

49. *Id.* § 2.301.

from any remedy under the Code.<sup>50</sup> The buyer's notice does not have to be formal, but it should be sufficient "to let the seller know that the transaction is still troublesome."<sup>51</sup> A Code draftsman's comment suggests that the reason for the notice is to encourage negotiations leading to informal settlement.<sup>52</sup> The court in *Import Motors, Inc. v. Matthews*,<sup>53</sup> however, suggested that the notice is necessary in order to allow the seller an opportunity to cure the defect. In this respect the court went beyond the language and policy of the Code. In that case the buyer already had notified the seller of an oil leak, and the seller already had attempted unsuccessfully to cure the problem. The seller, therefore, knew that the transaction was still troublesome, and there would seem to be no need to require that the buyer notify the seller of the reoccurrence of the leak. Moreover, unless the parties' contract so provided, and the court did not set forth the contract language, the seller did not have a right to cure the defect under section 2.508 of the Code.<sup>54</sup> Nevertheless, the court held that the buyer was barred from recovering on the basis of a breach of warranty because of its failure to notify the seller of the reoccurrence of the leak.

*Exclusion of Warranties.* Section 2.316 of the Code validates agreements that exclude or modify warranties.<sup>55</sup> With careful attention to the wording of the Code, one can construct boilerplate language disclaiming all implied warranties, and many form contracts now include such boilerplate provisions as a matter of course. The court in *MacDonald v. Mobley*<sup>56</sup> gave an interesting twist to the Code requirements that should not be overlooked. The court in that case construed section 2.316 to require "as is" language to be conspicuous in order to disclaim implied warranties effectively. This conclusion was reached by reading the subparagraph (b) requirement of section 2.316, which requires that a written modification of the implied warranties of merchantability and fitness be conspicuous, into subparagraph (c)(1), which states that an expression such as "as is" excludes all implied warranties. This construction of section 2.316 was apparently not suggested by the plaintiffs in *Mid Continent Aircraft Corp. v. Curry County Spraying Service, Inc.*,<sup>57</sup> in which the court upheld an "as is" disclaimer.

---

50. *Id.* § 2.607(c)(1).

51. *Id.* § 2.607, comment 4.

52. *Id.*

53. 557 S.W.2d 807, 23 UCC Rep. Serv. 83 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

54. TEX. BUS. & COM. CODE ANN. § 2.508 (Vernon 1968) (seller can only cure prior to expiration of time for performance, or if seller had reasonable grounds to believe tender would be acceptable, within a reasonable time after the time for performance). The opinion in *Import Motors* suggested that the implied warranty that was breached was a warranty of good workmanship in repairing the oil leak. 557 S.W.2d at 809. If so, a warranty arising from a contract for sale was not involved and the Code provisions might not have been directly applicable. This does not mean that the policies underlying the notice and cure provisions should not have been applied by analogy.

55. TEX. BUS. & COM. CODE ANN. § 2.316 (Vernon 1968).

56. 555 S.W.2d 916, 23 UCC Rep. Serv. 65 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

57. 572 S.W.2d 308, 313, 24 UCC Rep. Serv. 574 (Tex. 1978).

As a result, we do not have a definitive statement by the Texas Supreme Court as to the Code's requirements on this point. Other reported Texas decisions also indicate that sellers must make "as is" language conspicuous<sup>58</sup> and caution certainly suggests adopting this practice. Nevertheless, the Code language deserves a closer analysis than was given in the *MacDonald* opinion.<sup>59</sup>

*Code Warranties and Consumer Legislation.* A plaintiff who brings a successful action under the DTPA may recover three times the amount of his "actual damages" plus court costs and attorneys' fees.<sup>60</sup> A consumer who has been adversely affected by a "breach of an express or implied warranty"<sup>61</sup> is expressly authorized to bring suit under the DTPA. As a result, actions by "consumers" for breach of Code warranties should now routinely include a reference to the DTPA as well as the relevant Code provisions.<sup>62</sup>

#### D. Performance

*Tender of Delivery.* The seller of goods has a general obligation "to transfer and deliver."<sup>63</sup> In carrying out this obligation the seller normally must give the buyer any notification reasonably necessary to enable the buyer to take delivery.<sup>64</sup> The parties, however, may vary these Code provisions,<sup>65</sup> and a buyer may agree to notify the seller when he is ready to take delivery. The seller in *Jon-T Farms, Inc. v. Perryton Equity Exchange*<sup>66</sup> sought to excuse its failure to tender delivery on the ground that the parties agreed that the buyer would give the notice, which the buyer had failed to do. The court agreed, citing section 2.311(c)<sup>67</sup> of the Code as the source of the seller's right to consider the buyer's noncooperation as a breach of their contract.

*Rejection and Revocation of Acceptance.* A buyer who is tendered or receives nonconforming goods has two opportunities to call the contract off.

58. *E.g.*, *Henderson v. Ford Motor Co.*, 547 S.W.2d 663, 20 UCC Rep. Serv. 1158 (Tex. Civ. App.—Amarillo 1977, no writ), *discussed in 1978 Annual Survey, supra* note 2, at 192.

59. For a good discussion of the issue, see *Fairchild Indus. v. Maritime Air Serv., Ltd.*, 274 Md. 181, 333 A.2d 313 (1975).

60. TEX. BUS. & COM. CODE ANN. § 17.50 (Vernon Supp. 1978-79).

61. *Id.* § 17.50(a)(2).

62. The reported decisions for this survey period suggest that the DTPA is routinely pleaded in warranty cases. *See, e.g.*, *Ford Motor Co. v. Tidwell*, 563 S.W.2d 831 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.); *Dallas Heating Co. v. Pardee*, 561 S.W.2d 16 (Tex. Civ. App.—Dallas 1977, writ ref'd n.r.e.); *MacDonald v. Mobley*, 555 S.W.2d 916 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.); *Allen v. Parsons*, 555 S.W.2d 522 (Tex. Civ. App.—Texarkana 1977, writ granted).

63. TEX. BUS. & COM. CODE ANN. § 2.301 (Vernon 1968).

64. *Id.* § 2.503(a).

65. *Id.* § 1.102(c).

66. 567 S.W.2d 560, 23 UCC Rep. Serv. 1136 (Tex. Civ. App.—Amarillo 1978, no writ).

67. TEX. BUS. & COM. CODE ANN. § 2.311(c) (Vernon 1968) (when cooperation of one party is necessary to agreed performance of the other, and cooperation is not seasonably forthcoming, the other party may, after time for a material part of his performance has passed, treat the failure to cooperate as a breach).

The buyer may "reject" goods delivered or tendered under the contract if they fail "in any respect" to conform to the contract.<sup>68</sup> Once the buyer accepts the goods he no longer may reject them, but may "revoke his acceptance" if the nonconformity "substantially impairs [their] value to him."<sup>69</sup> Although "rejection" and "revocation of acceptance" are theoretically distinct, sometimes the same facts will justify a finding of both. This is illustrated by *Don's Marine, Inc. v. Haldeman*,<sup>70</sup> in which the appellate court upheld the trial court's judgment for the buyer on either the theory of rejection under section 2.601 or revocation of acceptance under section 2.608 of the Code.

#### E. Remedies

*Cancellation or Termination.* The Code distinguishes between "cancellation" and "termination." On breach of contract by the other party, the nonbreaching party may "cancel" the contract and recover damages.<sup>71</sup> "Termination," on the other hand, "occurs when either party pursuant to a power created by agreement or law puts an end to the contract otherwise than for its breach."<sup>72</sup> The distinction is illustrated by *Frigiking, Inc. v. Century Tire & Sales Co.*<sup>73</sup> In that case the contract provided for a termination procedure, which apparently was not followed by the seller upon the buyer's breach. The court held that the seller did not have to follow the termination procedure set out in the contract because the seller was exercising the cancellation power granted him by the Code, and the Code does not prescribe a specific procedure.

*Seller's Recovery of Lost Profits.* When a buyer does not accept conforming goods or when he repudiates the sales contract, the Code provides a seller with several different damage formulas for putting himself in the position he would have been in if the contract had been performed. The most important of these formulas is found in section 2.708(b), which awards "the profit (including reasonable overhead) which the seller would have made from full performance by the buyer, together with any incidental damages . . . , due allowance for costs reasonably incurred and due credit for payments or proceeds of resale."<sup>74</sup> Pre-Code case law recognized a similar lost profit formula and required the seller to establish his damages with whatever degree of certainty reasonably could be expected under the circumstances of the particular case. Given that the Code now authorizes enforcement of contracts that contain some open terms, courts are sometimes faced with difficulties when forced to determine damages

---

68. *Id.* § 2.601.

69. *Id.* § 2.608.

70. 557 S.W.2d 826, 23 UCC Rep. Serv. 78 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.).

71. TEX. BUS. & COM. CODE ANN. §§ 2.106(d), .703(6), .711 (Vernon 1968).

72. *Id.* § 2.106(c).

73. 452 F. Supp. 935, 24 UCC Rep. Serv. 896 (N.D. Tex. 1978).

74. TEX. BUS. & COM. CODE ANN. § 2.708(b) (Vernon 1968). See Goetz & Scott, *Measuring Sellers' Damages: The Lost-Profit Puzzle*, 31 STAN. L. REV. 323 (1979).

with any degree of certainty. One such case is *Little Darling Corp. v. Ald, Inc.*,<sup>75</sup> in which car wash units were to be delivered over a five-year period on a "cost plus 25%" basis. The buyer had the right to order from four types of units with different prices, and the seller had the right to redetermine the initial cost price every six months. The seller brought suit due to the buyer's failure to accept the number of units that it was obligated to take. The trial court entered judgment for the plaintiff, but the court of appeals found insufficient evidence in the record to support jury findings on the damage issue and remanded the case for a new trial.<sup>76</sup> The court did not cite or discuss the relevant Code provisions or policies.

*Recovery of Damages by the Buyer.* When the seller breaches a sales contract by not delivering the goods, the buyer may either "cover" by buying substitute goods and recover the difference between the cover price and the contract price or recover the difference between the market price and the contract price.<sup>77</sup> The operation of these provisions is illustrated by *W.B. Dunavant & Co. v. Southmost Growers, Inc.*<sup>78</sup> In that case an agent for the seller-cooperative was found to lack authority to sell on behalf of one member, and the seller therefore was unable to deliver that member's cotton to the buyer as promised. The buyer then bought the cotton directly from the member at a price that reflected the market price at the time of harvest and sued the seller for the damages caused by its failure to deliver. In calculating the buyer's damages, the court cited section 2.712(a), which is the measure of damages applicable when the buyer covers, but applied the market-contract differential formula found in section 2.713. Since the jury found that the "reasonable price" of the cotton at the time of cover was the same as the cover price, there was no harm in the court's failure to focus on the appropriate Code provision.

*Consequential Damages.* Following the seller's breach of a sales contract, the buyer may recover as consequential damages "any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise."<sup>79</sup> This Code formula allows for the recovery of lost profits that the buyer can show resulted from the breach. Although the formula was a familiar one in pre-Code law, the Code directs courts to administer this and other remedies liberally.<sup>80</sup> The majority opinion in *Harper Building Systems, Inc. v. Upjohn Co.*<sup>81</sup> examined evi-

---

75. 566 S.W.2d 346 (Tex. Civ. App.—Dallas 1978, no writ).

76. Due to the nature of the contract, the court believed that the plaintiff's cost per unit had to be shown with reasonable certainty. The testimony of the plaintiff's vice president merely alleged a profit figure to be multiplied by the number of units not accepted, which the court found to be insufficient. *Id.* at 349.

77. TEX. BUS. & COM. CODE ANN. §§ 2.712, .713 (Vernon 1968).

78. 561 S.W.2d 578 (Tex. Civ. App.—Corpus Christi 1978, writ ref'd n.r.e.).

79. TEX. BUS. & COM. CODE ANN. § 2.715(b)(1) (Vernon 1968).

80. *Id.* § 1.106. See also *id.* § 2.715, Comment 4.

81. 564 S.W.2d 123 (Tex. Civ. App.—Beaumont 1978, writ ref'd n.r.e.).

dence of the lost profits of a buyer and held that the trial court had acted improperly in setting aside a jury award of lost profits. The opinion stressed that the newly formed buyer firm already had made some profit and had entered specific contracts with ultimate consumers that could not be performed due to the seller's breach. The dissenting opinion found the evidence of lost profits too speculative. Neither opinion cited the relevant Code provisions or discussed Code policy. Although many of the considerations set out in the decisions cited by the *Harper* court continue to be relevant under the Code, Code rules and policies should not be overlooked.<sup>82</sup>

#### F. *Miscellaneous Sales Transactions*

*Entrusting Automobiles.* Disputes arising from the sale of an automobile frequently may be resolved only after analyzing not only the Uniform Commercial Code but also a certificate of title act. Since the states have not universally adopted a uniform certificate of title act, court decisions resolving conflicting claims to motor vehicles are not consonant.<sup>83</sup> In *Boswell v. Connell*<sup>84</sup> a Texas court had to resolve conflicting claims to a pickup truck between an unpaid dealer and a purchaser from the dealer's original customer. The dealer had retained the certificate of title and argued that the subsequent sale was void under the Texas Certificate of Title Act.<sup>85</sup> The ultimate buyer argued that the dealer had entrusted the truck to the buyer's seller and that the buyer therefore took full title by virtue of section 2.403 of the Code.<sup>86</sup> The court concluded that the Certificate of Title Act applied, rendering the subsequent sale void; the dealer, therefore, was entitled to recover possession of the truck. The court further stated that there was no conflict between the Code and the Act under the facts before the court. This conclusion is questionable, and the result is more properly supported by the maxim that the more specific rule of the Act takes precedence over the general rule in the Code.<sup>87</sup>

## II. COMMERCIAL PAPER AND BANK TRANSACTIONS

### A. *Liability of Parties*

*Liability of Co-Makers.* Unless a note specifies otherwise, co-makers are

82. A Code comment suggests that a seller may recover lost profits even if the seller cannot show a history of earnings. TEX. BUS. & COM. CODE ANN. § 2.708, comment 2 (last sentence).

83. See generally 1B COOGAN, HOGAN & VAGTS, *supra* note 33, §§ 30A.01-.07; 1 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY §§ 20.1-.8 (1965).

84. 556 S.W.2d 624 (Tex. Civ. App.—Beaumont 1977, writ ref'd n.r.e.).

85. TEX. REV. CIV. STAT. ANN. art. 6687—1, §§ 51, 53 (Vernon 1977) (violation of Act to sell motor vehicle without having certificate of title; sales made in violation of Act are void).

86. TEX. BUS. & COM. CODE ANN. § 2.403 (Vernon 1968) (person with voidable title has power to transfer good title to good faith purchaser for value).

87. *But see* TEX. REV. CIV. STAT. ANN. art. 6687—1, § 65 (Vernon 1977) (in case of conflict between the Act and the Code, the Code controls).

jointly and severally liable on the note.<sup>88</sup> A holder therefore may recover the full amount of a note from any one of the co-makers.<sup>89</sup> The co-maker who pays the holder, however, may recover contribution from each other co-maker in the amount of his *aliquot* share, which is presumed to be an equal share unless the party seeking contribution shows that the co-makers shared unequally in the consideration received.<sup>90</sup> The action for contribution is based on an implied promise, *assumpsit*, and the cause of action will be barred by the two-year statute of limitations for unwritten agreements.<sup>91</sup> A party who signed a note as an accommodation party, however, may step into the shoes of the holder by paying the amount of the note, and he then may sue the accommodated party on the note rather than in *assumpsit*.<sup>92</sup> In this case the four-year statute of limitations will apply.<sup>93</sup>

*Negligence Contributing to Alteration.* Section 3.406 of the Code provides that a drawer of a check whose negligence substantially contributes to a material alteration will be estopped from raising that alteration against a drawee who pays the check in good faith and in accordance with reasonable commercial standards.<sup>94</sup> In *Ray v. Farmers State Bank*<sup>95</sup> a man gained entry into the home of the plaintiff, an elderly woman, by posing as an electric utility serviceman. After examining several wall outlets, he helped the plaintiff to write a check for the \$1.50 "service charge." The man left considerable space between the dollar sign and the numerals, but the plaintiff nevertheless signed the check. Prior to cashing the check, the man inserted "185" before the "1.50" and completed the check by writing "Eighteen Hundred Fifty-One and 50/100." The defendant-bank cashed the check after asking for identification and before receiving a stop payment order from the plaintiff. The plaintiff brought suit to have the bank recredit her account with the amount of the check. The trial court found that the bank had acted in good faith and in accordance with reasonable commercial standards but that the plaintiff's acts did not amount to negligence substantially contributing to the loss within the meaning of section 3.406 of the Code. The court of civil appeals reversed the judgment for the plaintiff and held that, as a matter of law, the plaintiff had "substantially contributed" to the material alteration by her negligence. She therefore was precluded by section 3.406 from asserting the alteration against the

---

88. TEX. BUS. & COM. CODE ANN. § 3.118(5) (Vernon 1968).

89. *Dittberner v. Bell*, 558 S.W.2d 527, 23 UCC Rep. Serv. 369 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.).

90. *See Caldwell v. Stevenson*, 567 S.W.2d 278 (Tex. Civ. App.—Austin 1978, no writ).

91. TEX. REV. CIV. STAT. ANN. art. 5526(4) (Vernon 1958). *See Caldwell v. Stevens*, 567 S.W.2d 278, 280 (Tex. Civ. App.—Austin 1978, no writ).

92. TEX. BUS. & COM. CODE ANN. §§ 3.415(e), .603(b) (Vernon 1968). *See also id.* § 34.04.

93. TEX. REV. CIV. STAT. ANN. art. 5527(1) (Vernon 1958).

94. TEX. BUS. & COM. CODE ANN. §§ 3.406, .407(a) (Vernon 1968). *See also id.* § 4.401(b).

95. 22 Tex. Sup. Ct. J. 190, 25 UCC Rep. Serv. 779 (Jan. 20, 1979), *rev'g* 565 S.W.2d 103, 23 UCC Rep. Serv. 959 (Tex. Civ. App.—Amarillo 1978).

bank, notwithstanding contrary pre-Code case law.<sup>96</sup> The appellate court buttressed its holding by noting that "the ultimate loss should fall upon the person who first dealt directly with the wrongdoer and was careless in so dealing, thereby providing the wrongdoer with the means of carrying out the offense."<sup>97</sup> On appeal, the Texas Supreme Court reversed after concluding that the court of civil appeals erred in finding the plaintiff negligent as a matter of law.<sup>98</sup>

*Extent of Liability—Acceleration.* With respect to acceleration clauses in instruments, the Code merely provides that such clause does not make the instrument payable at an indefinite time,<sup>99</sup> which would render it non-negotiable. The courts, however, have circumscribed the right to accelerate payment.<sup>100</sup> In *Purnell v. Follett*<sup>101</sup> the court required evidence that there was both a formal demand for payment and notice of intent to accelerate before the right to accelerate could be exercised. The court held that the language in the note and deed of trust was not a clear and unambiguous waiver of notice of intent to accelerate.<sup>102</sup> Moreover, the court cited with apparent approval a court of civil appeals decision requiring the creditor to give the obligor an opportunity to pay the past due portion of the note before the note could be accelerated.<sup>103</sup>

The court in *Shepler v. Kubena*<sup>104</sup> also stressed the need for a clear and unambiguous exercise of the option to accelerate. In that case the court found that a declaration of intent to accelerate not followed by any affirmative action to enforce the declared intention was ineffective to mature the note.<sup>105</sup>

### B. Enforcement of Commercial Paper<sup>106</sup>

As a general matter the Code does not deal in detail with procedural and evidentiary rules. Section 3.307 of the Code does, however, set out

96. See *Lockwood Nat'l Bank v. Jennings*, 381 S.W.2d 682 (Tex. Civ. App.—Houston 1964, writ ref'd n.r.e.).

97. 565 S.W.2d at 105.

98. The court held that if conflicting evidence regarding negligence is introduced at trial, the trial court's finding is binding on the court of civil appeals. 22 Tex. Sup. Ct. J. at 192. Compare *Ray with Williams v. Montana Nat'l Bank*, 534 P.2d 1247 (Mont. 1975) (husband of drawer found negligent, absolving bank of liability for loss).

99. TEX. BUS. & COM. CODE ANN. § 3.109(a)(3) (Vernon 1968).

100. See *Allen Sales & Servicenter, Inc. v. Ryan*, 525 S.W.2d 863 (Tex. 1975); *Sylvester v. Watkins*, 538 S.W.2d 827 (Tex. Civ. App.—Amarillo 1976, writ ref'd n.r.e.), discussed in *1977 Annual Survey, supra* note 2, at 184.

101. 555 S.W.2d 761 (Tex. Civ. App.—Houston [14th Dist.] 1977, no writ).

102. The note provided: "All makers, sureties and indorsers . . . waive grace, protest, notice, demand, diligence, presentation and time of commencement of suit. . . ." *Id.* at 765. The deed of trust stated that upon default the holder "shall have the option to declare all of the indebtedness immediately due and payable and without demand upon, or notice to, the Grantors, to foreclose the lien." *Id.*

103. *Id.* at 764; see *Joy Corp. v. Nob Hill Properties, Ltd.*, 543 S.W.2d 691, 694 (Tex. Civ. App.—Tyler 1976, no writ).

104. 563 S.W.2d 382 (Tex. Civ. App.—Austin 1978, no writ).

105. *Id.* at 385.

106. See generally 10 DORSANEQ, ANDERSON & WINSHIP, *supra* note 4, §§ 230.01-.203;



some basic rules governing pleading and burden of persuasion in the enforcement of commercial paper. These rules are not fully coordinated with the Texas Rules of Civil Procedure, and judging from the continuing flow of reported decisions, both courts and attorneys frequently overlook the Code's applicability.

Section 3.307 of the Code provides that the "holder" of an instrument may recover on it by merely producing the instrument unless (1) the effectiveness of the defendant's signature on the instrument is put in issue, or (2) the defendant establishes a defense.<sup>107</sup> A person is a holder if he is "in possession of . . . an instrument . . . drawn, issued or indorsed to him or to his order or to bearer or in blank."<sup>108</sup> The court in *Taylor v. Fred Clark Felt Co.*<sup>109</sup> held that a person may satisfy the possession requirement by the possession of his agent, who may, for example, be an attorney in whose hands the instrument has been placed for collection.

As to the issue of the defendant's signature, the Code states that no person is liable on an instrument unless his or her signature appears on it.<sup>110</sup> The signature may be made by an authorized representative, however, and even an unauthorized signature may be ratified.<sup>111</sup> Section 3.307 provides that the genuineness of a signature is admitted "[u]nless specifically denied in the pleadings."<sup>112</sup> The Texas Rules of Civil Procedure add the requirement that a plea denying execution of the instrument or the genuineness of an indorsement must be verified by affidavit.<sup>113</sup> If the validity of the signature is put in issue by the pleadings, there is an initial presumption that

Kinyon, *Actions on Commercial Paper: Holder's Procedural Advantages Under Article Three*, 65 MICH. L. REV. 1441 (1967).

107. TEX. BUS. & COM. CODE ANN. § 3.307 (Vernon 1968).

108. *Id.* § 1.201(20).

109. 567 S.W.2d 863, 866 (Tex. Civ. App.—Houston [14th Dist.] 1978, writ ref'd n.r.e.). See also *Lazidis v. Goidl*, 564 S.W.2d 453, 455 (Tex. Civ. App.—Dallas 1978, no writ) (constructive possession by owner of note when it was in possession of owner's son, who managed owner's affairs).

110. TEX. BUS. & COM. CODE ANN. § 3.401(a) (Vernon 1968).

111. *Id.* §§ 1.201(35), (43), 3.403, .404. See Littlefield, *Corporate Signatures on Negotiable Instruments*, 55 DENVER L.J. 61 (1978). The Texas Supreme Court cited none of these provisions in its opinion in *Reece v. First State Bank*, 566 S.W.2d 296, 24 UCC Rep. Serv. 194 (Tex. 1978), *aff'g* 555 S.W.2d 929 (Tex. Civ. App.—Fort Worth 1977). In *Reece* the court held the guarantor liable for a corporate debt that the court found enforceable because the corporation had ratified the forged signature of its vice president by knowingly accepting the proceeds of the note.

112. TEX. BUS. & COM. CODE ANN. § 3.307(a) (Vernon 1968).

113. TEX. R. CIV. P. 93(h), (i). See *Walker v. Republic Nat'l Bank*, 559 S.W.2d 438 (Tex. Civ. App.—Tyler 1977, no writ) (affidavit stating no recollection of executing note defective because it did not recite that it was made on the personal knowledge of the affiant; compare with rule 93(i) with respect to affidavits denying the genuineness of indorsement); *Gonzales v. American Gen. Leasing & Financing Corp.*, 555 S.W.2d 197 (Tex. Civ. App.—Waco 1977, no writ) (general denial did not raise issue of genuineness of indorsement; court cited rule 93(i) but not the Code). The language of the Texas Rules of Civil Procedure is not fully coordinated with that of the Code. For example, when it refers to "genuineness," rule 93(i) may refer only to forged indorsements rather than to other forms of unauthorized indorsements, while Code § 1.201(43) applies to both forgeries and indorsements made without authority. TEX. BUS. & COM. CODE ANN. § 1.201(43) (Vernon 1968). See also *Cowhouse Dairy, Inc. v. Agristor Credit Corp.*, 566 S.W.2d 339 (Tex. Civ. App.—Waco 1978, no writ) (general denial ineffective to raise issue of prior indorser's authority to indorse note).

the signature is genuine or authorized. The ultimate burden of establishing the effectiveness of the signature, however, is on the party claiming under it.<sup>114</sup>

If the authenticity of the signature is admitted or established, the defendant may still set up defenses to the obligation set out in the instrument. Although the Code distinguishes "real" defenses<sup>115</sup> from "personal" defenses,<sup>116</sup> it does not indicate which defenses must be verified or pled affirmatively. As a result, the Texas Rules of Civil Procedure control these further pleading requirements.<sup>117</sup> The Code does, however, provide that the defendant has the burden of establishing his defenses,<sup>118</sup> and in a summary judgment proceeding he must show that there are disputed fact issues.<sup>119</sup>

Even if the defendant establishes a personal defense to the obligation in the instrument, the holder may still recover on the instrument if he carries the burden of establishing his status as either a holder in due course or a transferee from a holder in due course.<sup>120</sup> In the original petition the holder need not plead his status as a holder in due course. If the defendant raises a defense that a holder in due course can cut off, however, the plaintiff should amend his petition to allege holder in due course status.<sup>121</sup> A holder who is not a holder in due course may, of course, recover on the instrument if the defendant does not establish a defense.

The above results follow if the holder of the instrument "produces" the instrument.<sup>122</sup> Some of the most important decisions in this survey period concerned the problems of introducing an instrument into evidence, especially for the purposes of a summary judgment proceeding. In *Town North National Bank v. Broadus*<sup>123</sup> and *Life Insurance Co. v. Gar-Dal, Inc.*<sup>124</sup> the Texas Supreme Court held that an unverified copy of an instrument is a sworn copy within the ambit of rule 166-A(e)<sup>125</sup> if attached to an affida-

---

114. TEX. BUS. & COM. CODE ANN. § 3.307(a) (Vernon 1968). See also *id.* § 1.201(8) (definition of "burden of establishing").

115. *Id.* § 3.305.

116. *Id.* § 3.306.

117. TEX. R. CIV. P. 93-95.

118. TEX. BUS. & COM. CODE ANN. § 3.307(b) (Vernon 1968); see *Thigpen v. Thigpen*, 563 S.W.2d 868 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.) (did not cite Code).

119. See *Taylor v. Fred Clark Felt Co.*, 567 S.W.2d 863, 866-67 (Tex. Civ. App.—Houston [14th Dist.] 1978, writ ref'd n.r.e.); *Braselton v. Nicolas & Morris*, 557 S.W.2d 187, 188 (Tex. Civ. App.—Corpus Christi 1977, no writ).

120. TEX. BUS. & COM. CODE ANN. §§ 3.302, .307(c) (Vernon 1968).

121. See *Hackett v. Broadway Nat'l Bank*, 570 S.W.2d 184 (Tex. Civ. App.—Waco 1978, no writ) (plaintiff bank moved for summary judgment with affidavit claiming status as holder in due course; defendant had answered with general denial, but apparently argued failure of consideration; court ignored rule 94 which requires defense of failure of consideration to be raised affirmatively; court also bogged down on question of plaintiff-bank's giving of value, apparently overlooking the possible applicability of Code § 4.208(b)).

122. TEX. BUS. & COM. CODE ANN. § 3.307(b) (Vernon 1968).

123. 569 S.W.2d 489, 24 UCC Rep. Serv. 924 (Tex. 1978), *rev'g* 558 S.W.2d 909, 23 UCC Rep. Serv. 371 (Tex. Civ. App.—Tyler 1977).

124. 570 S.W.2d 378 (Tex. 1978), *rev'g* 557 S.W.2d 565 (Tex. Civ. App.—Beaumont 1977).

125. TEX. R. CIV. P. 166-A(e).

vit in which the affiant swears the copy is a true and correct copy of the original instrument.<sup>126</sup> Other cases in this period held that a defendant may waive his objection to an instrument,<sup>127</sup> that an instrument is properly before the court if the defendant attaches the instrument to an affidavit in opposition to a motion for summary judgment,<sup>128</sup> and that the validity of an instrument may be admitted by failing to respond to a request for admission concerning the genuineness of the document.<sup>129</sup>

### C. Bank Collection

*Duties of Collecting Banks.* In *Gulf Coast State Bank v. Emenhiser*<sup>130</sup> a buyer purchased Mr. and Mrs. J.C. Emenhiser's rice crop. To pay for the rice, the buyer drew drafts on itself payable "through" a Louisiana bank. One draft was payable to "Gulf Coast State Bank a/c J.C. Emenhiser."<sup>131</sup> Gulf Coast, without the indorsements of the defendant-sellers, issued cashier's checks in the amount of the draft to the manager of the agricultural cooperative handling the sale for the defendants. Gulf Coast then treated the draft as a cash item for collection purposes, but the draft was subsequently dishonored because of the drawer-buyer's insolvency. Gulf Coast then sought to recover the amount of the cashier's checks from the Emenhisers and their landlord. The court of civil appeals affirmed judgment for the defendants on the ground that the bank had not proved that the cooperative manager was the defendants' agent when he cashed the sight draft. The Texas Supreme Court, citing section 4.201(a),<sup>132</sup> ruled that the manager's agency was not an indispensable element of the bank's cause of action and held that the trial court had misstated the law in its jury instructions.<sup>133</sup> The court of civil appeals was reversed and the case

126. 569 S.W.2d at 490; 570 S.W.2d at 380.

127. *Hackett v. Broadway Nat'l Bank*, 570 S.W.2d 184, 187 (Tex. Civ. App.—Waco 1978, no writ) (plaintiff's affiant failed to allege that copy of checking account attached to affidavit in support of summary judgment motion was true and correct copy; defect of form waived by defendant because not brought to attention of trial court prior to rendering of summary judgment).

128. *Barclay v. Waxahachie Bank & Trust Co.*, 568 S.W.2d 721, 723 (Tex. Civ. App.—Waco 1978, no writ).

129. *Packer v. First Tex. Sav. Ass'n*, 567 S.W.2d 574, 575 (Tex. Civ. App.—Eastland 1978, writ ref'd n.r.e.).

130. 562 S.W.2d 449, 23 UCC Rep. Serv. 1259 (Tex. 1978), *rev'g* 544 S.W.2d 722 (Tex. Civ. App.—Tyler 1976). The opinion in the court of civil appeals is noted in *1978 Annual Survey*, *supra* note 2, at 205. Note that the *Survey* Article stated incorrectly that the draft was drawn by the defendant-sellers rather than by the buyer.

131. 562 S.W.2d at 450.

132. TEX. BUS. & COM. CODE ANN. § 4.201(a) (Vernon 1968) provides that the collecting bank, here Gulf Coast, is the agent of the owner of an item, here J.C. Emenhiser, until the settlement given by the collecting bank for the item becomes final, and prior to that time any settlement given for the item is provisional. *Id.* § 4.212 gives a collecting bank that makes a provisional settlement a right of refund from its customer if the item subsequently is dishonored. Under *id.* § 4.211(c)(3) settlement becomes final if the bank fails to seasonably forward the item for collection before the bank's "midnight deadline," which is defined in *id.* § 4.104(a)(8) (*see* note 134 *infra*).

133. In addition to the misstatement of the law, there was also some question as to whether the instruction constituted an illegal comment on the weight of the evidence. Since the petitioner failed to raise this point in the court of civil appeals, the supreme court held

was remanded to the trial court for a new trial.

The supreme court found that one special instruction gave the impression that Gulf Coast was required to present the draft to the Louisiana bank before midnight on the next banking day, and another implied that the bank was required to mail the draft directly to the Louisiana bank. Since neither of these requirements is mandated by the Code, the court found the instructions to be erroneous. The court concluded that the Code only requires that the draft be forwarded for collection before the depository bank's midnight deadline<sup>134</sup> and allows the bank to use any "reasonably prompt method" of collection under the circumstances.<sup>135</sup>

Section 4.211(c) appears to be inapposite when the plaintiff depository bank is forwarding an item for collection and has not yet received any remittance from the drawee. Section 4.202(b) should be the controlling provision, and it gives the bank the same midnight deadline with the possibility of extension for a "reasonably longer time" if the bank establishes that this longer time is "seasonable."<sup>136</sup> Moreover, the measure of damages if the bank is found not to have exercised care is limited to "the amount of the item reduced by an amount which could not have been realized by the use of ordinary care."<sup>137</sup> Thus, no damages will be awarded if the collecting bank can show that the drawee would not have paid the item even if it had been presented promptly.

*Collection of Documentary Drafts.*<sup>138</sup> In *New Ulm State Bank v. Brown*<sup>139</sup> a seller of livestock entered into a course of dealing with a buyer whereby the seller would draw a "bill of sale draft" for the agreed sale price, naming itself as the payee and both the buyer and his bank as drawees. The seller would place the draft with its bank for collection, and the seller's bank would then forward the draft with a collection letter to the buyer's bank.<sup>140</sup> The buyer customarily paid his bank for the draft with a check drawn against his account at the bank, and the bank would then issue to the seller's bank a cashier's check for the amount of the draft. The buyer's bank, however, learned that the buyer was experiencing financial difficulties. After keeping the drafts that were the subject matter of this subsequent litigation for from four to ten days after presentment, the buyer's

---

that the ground of error had been waived. The court cautioned, however, that it did not approve either the form or the content of the instructions. 562 S.W.2d at 452-53.

134. TEX. BUS. & COM. CODE ANN. § 4.211(c)(3) (Vernon 1968). See also *id.* § 4.104(a)(8) (defining "midnight deadline" as midnight on the next banking day following the banking day on which the bank receives the relevant item).

135. *Id.* § 4.204(a). See generally *id.* § 4.202(a)(1) (bank must use ordinary care in sending item for presentment).

136. *Id.* § 4.202(b).

137. *Id.* § 4.103(e).

138. "Documentary draft" is defined at *id.* § 4.104(a)(6) as "any negotiable or non-negotiable draft with accompanying documents, securities or other papers to be delivered against honor of the draft."

139. 558 S.W.2d 20, 23 UCC Rep. Serv. 389 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ).

140. Copies of the "bill of sale draft" and collection letter are set out in the court's opinion. 558 S.W.2d at 23-24.

bank returned the drafts unpaid. The seller sued the buyer's bank and recovered both the amount of the unpaid drafts and an additional sum of \$5,000 based on a jury finding that the bank had acted in bad faith in failing to either pay or return the drafts within the time provided by law.<sup>141</sup>

The appellate court affirmed the trial court's judgment on two different theories. First, the court held that the buyer's bank had converted the drafts within the meaning of section 3.419(a)(2) of the Code.<sup>142</sup> Since the collection letter contained the command "[d]o not hold after maturity or for convenience of payer,"<sup>143</sup> the appellate court noted that the trial court could have concluded that a demand had been made for the return of the draft at the time of delivery. The intentional failure by the defendant bank to return the instrument following the demand constituted conversion. Second, the appellate court concluded that the judgment for the seller could be sustained on the theory that the buyer's bank was liable as a "payor bank" for the late return of the draft.<sup>144</sup> Unfortunately, the court's reasoning on this second theory is not clear. Despite the language of section 4.302(b) which sets forth the liability of a payor bank that does not accept, pay, or return an item within the specified time, and which is worded broadly enough to encompass documentary drafts, the court apparently relied on the comment to that section,<sup>145</sup> which suggests that the section is limited to cases covered by section 4.301, a section that does not apply to documentary drafts. The court then concluded that sections 4.501 and 4.202 establish the bank's midnight deadline as the time within which the defendant bank had to act, despite the difficulty in fitting a payor bank within the language of section 4.501.<sup>146</sup>

#### D. *Bank-Customer Relationship*

*Bank-Customer Contract.* The relationship between a bank and a person

---

141. The trial court also decreed that the seller's bank was entitled to a preferential lien on the judgment rendered in favor of the seller and that the buyer's bank was entitled to judgment against the buyer. *Id.* at 23. The court granted a lien to the seller's bank because it had given the seller immediate credit for the draft. *Id.* at 21; see TEX. BUS. & COM. CODE ANN. § 4.212 (Vernon 1968) (setting forth the conditions under which a collecting bank that has made a provisional settlement with its customer for an item may revoke its settlement and charge the customer's account for the amount previously credited on the item).

142. TEX. BUS. & COM. CODE ANN. § 3.419(a)(2) (Vernon 1968). The court did not refer to any specific subsection of Code § 3.419, but subsection (a)(2) is the only relevant one. Under that subsection, an instrument is converted when any person to whom it is delivered for payment refuses on demand either to pay or to return it. The court stressed the language of the official comment to § 3.419, which states that a demand may be implied under the circumstances or understood as a matter of custom. *Id.* § 3.419, comment 2.

143. 558 S.W.2d at 24.

144. *Id.* at 24-25; see TEX. BUS. & COM. CODE ANN. § 4.105(2) (Vernon 1968) (defining payor bank as a bank by which an item is payable as drawn or accepted).

145. TEX. BUS. & COM. CODE ANN. § 4.302 (Vernon 1968).

146. *Id.* § 4.501 requires a bank that takes a documentary draft for collection to present the draft, and upon learning that the draft has not been paid or accepted in due course, to "seasonably" notify its customer of that fact. *Id.* § 4.202(b) states that a collecting bank acts seasonably if it takes action before its midnight deadline, or within a reasonably longer time if the bank establishes that its action was seasonable.

who has established an account with the bank is contractual in nature.<sup>147</sup> The terms of the contract are usually set out in a document prepared by the bank and signed by the customer when he opens his account<sup>148</sup> although some terms of the contractual relationship may be supplied by implication.<sup>149</sup> The Code also contains some provisions regulating the relationship. The Code, for example, determines when a bank is authorized to charge a customer's account and when it is liable to the customer for wrongful dishonor.<sup>150</sup> The Code's provisions, however, are not comprehensive, as illustrated by the recent decision in *Groos National Bank v. Shaw's, Inc.*<sup>151</sup> The court upheld the refusal of the bank to accept the tender by a third party of a deposit to the checking account of one of the bank's customers.<sup>152</sup> The customer had given the third party a check drawn on insufficient funds, and the third party sought to reduce its loss by withdrawing the amount in the customer's account. To do this the third party tendered for deposit the difference between the amount in the account and the amount of the check. The appellate court held that the bank was under no duty to accept the tender on the ground that some situations exist under which the customer might not want to accept a gratuitous deposit.<sup>153</sup>

*Right of Set-Off.* Unless there is a special deposit, a bank's relation to its customer is that of a debtor to a creditor. The bank may set off against its debt to its customer any indebtedness that the customer owes to it. In *Sears v. Continental Bank & Trust Co.*<sup>154</sup> a customer sued the bank to recover the amount that he claimed the bank had wrongfully withdrawn from his account in order to pay a note. The bank did not offer evidence in the trial court that the amount withdrawn was owed to the bank by the customer. The supreme court held that a directed verdict for the bank was improper because the bank had the burden of pleading and proving the indebtedness that justified its set-off against the customer's account. The court rejected, however, the customer's theory that the bank must assert the customer's indebtedness as a counterclaim.

*Wrongful Dishonor.* A bank is liable to its customer for damages proximately caused by the wrongful dishonor of an item. A customer, however,

---

147. *Frost Nat'l Bank v. Nicholas & Barrera*, 534 S.W.2d 927, 933 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.).

148. TEX. BUS. & COM. CODE ANN. § 4.103(a) (Vernon 1968).

149. See *id.* §§ 4.103(b), (c).

150. *Id.* §§ 4.401, .402.

151. 555 S.W.2d 492 (Tex. Civ. App.—San Antonio 1977, writ ref'd n.r.e.).

152. The tender was in the form of a check to the customer, and the court noted that the bank had no authority to indorse the check for her. *Id.* at 494. Cf. TEX. BUS. & COM. CODE ANN. § 4.205(a) (Vernon 1968) (depository bank may supply any indorsement of the customer that is necessary to title unless the item specifies otherwise).

153. The court gave as an example the situation where receipt of funds by the customer would constitute an illegal act. 555 S.W.2d at 494.

154. 562 S.W.2d 843 (Tex. 1977), *rev'g* 553 S.W.2d 394 (Tex. Civ. App.—Houston [1st Dist.] 1977).

may recover only actual damages if the bank dishonored the item by mistake.<sup>155</sup> In *First National Bank v. Hubbs*<sup>156</sup> the defendant bank received a letter from a third party drawer of checks that alleged that the plaintiff, a customer of the bank, was indorsing the checks without authority. The bank subsequently removed over \$3,500 from the plaintiff's account and placed it in the form of a cashier's check payable to the plaintiff with the notation "Funds held pending outcome of dispute."<sup>157</sup> Due to this removal a check issued by the plaintiff to the Internal Revenue Service was dishonored for insufficient funds. Plaintiff brought an action against the bank on alternate grounds of wrongful dishonor and conversion, although the case was apparently submitted to the jury only on the theory of conversion. The appellate court reversed the judgment for the plaintiff and remanded for another trial. Money may be the subject of a conversion action only if the money can be described as a specific chattel. The court held that money deposited with a bank ordinarily becomes a general deposit, thereby losing its characterization as an identifiable chattel. The court therefore held that the plaintiff was unable to recover on a conversion theory. The court also held that the plaintiff could not recover for wrongful dishonor because he had not pled and proved that there was sufficient money in his account to pay the check when it was presented for payment.

### III. SECURED TRANSACTIONS

#### A. *Applicability of the Code*

*Pre-Code Law—The Concept of "Title."* The concept of "title" played an important role in pre-Code security law. In the conditional sale transaction, for example, the seller retained title to the goods sold until the buyer made the final payment, and if the buyer defaulted, the seller could reclaim "his" goods. Chapter 9 of the Code specifically disclaims reliance on "title"; each of that chapter's provisions governing rights, obligations, and remedies apply whether title to the collateral is in the secured party or in the debtor.<sup>158</sup> Other rules of law, however, may require the courts to determine who has title, and for this purpose pre-Code case law continues to have some vitality. An example is the recent case of *Goetz v. Goetz*,<sup>159</sup> in which the Dallas court of civil appeals looked to pre-Code case law governing pledges to determine whether the pledgor continued to hold title to pledged bonds so that the bonds could properly be included in a court-ordered division of marital property. These pre-Code cases, the court noted, "remain viable to the extent they are necessary to determine the

---

155. TEX. BUS. & COM. CODE ANN. § 4.402 (Vernon 1968). See generally J. WHITE & R. SUMMERS, *supra* note 30, at 566-74; Holland, *An Analysis of the Legal Problems Resulting from Wrongful Dishonor*, 42 MO. L. REV. 507 (1977).

156. 566 S.W.2d 375 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ).

157. *Id.* at 377.

158. TEX. BUS. & COM. CODE ANN. § 9.202 (Vernon Supp. 1978-79).

159. 567 S.W.2d 892, 24 UCC Rep. Serv. 1029 (Tex. Civ. App.—Dallas 1978, no writ).

location of title, which is unanswered by the Code."<sup>160</sup> Given that a debtor's "rights" in collateral may be involuntarily transferred by judicial process,<sup>161</sup> it is not clear why the court's reference to the transfer of "title" was necessary.

*Unenforceable Security Agreements—Limited Partner.* A limited partner in a limited partnership formed in a jurisdiction that has adopted the Uniform Limited Partnership Act may not only make a capital contribution to the partnership, but may also lend money to the partnership or otherwise deal with the partnership as if it were an independent third party.<sup>162</sup> Section 13(1)(a) of that Act, however, states that a limited partner may not "[r]eceive or hold as collateral security any partnership property," and section 13(2) makes contravention of this limitation a fraud on the creditors of the partnership.<sup>163</sup> In *Kramer v. McDonald's System, Inc.*<sup>164</sup> a general partner purported to grant to a limited partner a security interest in partnership property to secure repayment on a loan made by the limited partner to the partnership. The limited partnership was established in Illinois to carry on a restaurant business in Texas, where most of the partnership property was located. A proper financing statement was filed with both the Texas secretary of state and the county recorder of deeds. The restaurant lost money and was forced to close, causing the limited partnership to default on several notes. Another secured party repossessed the collateral that secured the limited partner's loan, and the limited partner brought a conversion action against it. The Illinois court held that under section 13 of the Uniform Limited Partnership Act as adopted in Illinois the limited partner had no security interest in the partnership property. The limited partner, therefore, had no right to immediate possession of that property, a requirement that had to be met in order to maintain an action for conversion.

### B. *Validity of Security Agreement*

*Security Agreement—Disclosures and Regulation Z.* Court opinions construing the disclosure requirements of regulation Z,<sup>165</sup> which sets forth the truth-in-lending rules, continue to proliferate. Two Texas cases decided in this survey period are of particular importance for the disclosure of a creditor's security interest.<sup>166</sup> Section 226.8(b)(5) requires the creditor to disclose "a description or identification of the type of any security interest held . . . and clear identification of the property to which the security in-

160. 567 S.W.2d at 895 n.2.

161. TEX. BUS. & COM. CODE ANN. § 9.311 (Vernon Supp. 1978-79).

162. UNIFORM LIMITED PARTNERSHIP ACT § 13.

163. *Id.* §§ 13(1)(a), (2).

164. 61 Ill. App. 3d 947, 378 N.E.2d 522 (1978).

165. 12 C.F.R. §§ 226.1-1503 & app. (1978). See generally R. CLONTZ, TRUTH-IN-LENDING MANUAL (4th ed. 1976 & Supp. 1978).

166. See notes 169-72 *infra* and accompanying text. See also *Martinez v. Tropical Sav. & Loan Ass'n*, 572 F.2d 1030, 1031 (5th Cir. 1978).



terest relates."<sup>167</sup> The same provision requires an after-acquired property clause to be "clearly set forth *in conjunction with* the description or identification of the type of security interest."<sup>168</sup> In *Casillas v. Government Employees Credit Union*<sup>169</sup> the disclosure form included the following statement: "The Security Agreement will secure future or other indebtedness and will cover after acquired property." The form did not inform the debtor of the limitations on after-acquired property rights in consumer goods set out in section 9.204(b) of the Code<sup>170</sup> and did not inform the debtor of the type of security interest retained. The court upheld the debtor's counterclaim based on these violations. In *Garza v. Allied Finance Co.*<sup>171</sup> the appellate court found that the creditor contravened the same section of regulation Z for two reasons. First, the reference to after-acquired property did not explain the limitations set forth in section 9.204(b), and second, the clause was at the bottom of the page rather than "in conjunction with" the description of the type of security interest retained.<sup>172</sup>

*"Floating Secured Parties."* A potential creditor who searches the public files to discover financing statements filed in the name of the potential debtor will find the standard financing statement contains only the name and address of the creditor, who may or may not have entered into a security agreement with the debtor, and the types of collateral covered.<sup>173</sup> There is no indication of the amount of indebtedness, and the "types" of collateral may be very general.<sup>174</sup> If the potential creditor wants additional information, it will make further inquiries informally or through the indirect formal procedure set out in section 9.208 of the Code.<sup>175</sup> Given the validity of after-acquired property clauses and future advance clauses, the subsequent creditor with a security interest in the same collateral as that included within the purview of these clauses takes a calculated risk. In an opinion that should be read for its outrageous puns if for no other reason, Judge Brown of the Fifth Circuit declared in *In re E.A. Fretz Co.*<sup>176</sup> that a subsequent creditor did not have to take the additional risk of "floating secured parties." In that case Revlon and Fretz signed a secur-

---

167. 12 C.F.R. § 226.8(b)(5) (1978).

168. *Id.* (emphasis added).

169. 570 S.W.2d 57 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.).

170. TEX. BUS. & COM. CODE ANN. § 9.204(b) (Vernon Supp. 1978-79) (security interest does not attach to consumer goods under an after-acquired property clause unless debtor acquires rights in the goods within ten days after the secured party gives value).

171. 566 S.W.2d 57, 24 UCC Rep. Serv. 469 (Tex. Civ. App.—Corpus Christi 1978, no writ).

172. 566 S.W.2d at 64-65.

173. TEX. BUS. & COM. CODE ANN. § 9.402(a), (c) (Vernon Supp. 1978-79).

174. *See, e.g., Borg-Warner Acceptance Corp. v. Wolfe City Nat'l Bank*, 544 S.W.2d 947, 21 UCC Rep. Serv. 631 (Tex. Civ. App.—Dallas 1976, no writ) (the words "all inventory" gives sufficient notice).

175. TEX. BUS. & COM. CODE ANN. § 9.208 (Vernon Supp. 1978-79) (debtor may send a statement to secured party listing the aggregate amount of his unpaid indebtedness as of a specific date and identifying the collateral covered by the security agreement; within two weeks secured party must send correction or approval).

176. 565 F.2d 366, 23 UCC Rep. Serv. 1 (5th Cir. 1978), *noted in* 31 VAND. L. REV. 716 (1978).

ity agreement that purported to secure not only Fretz's debts to Revlon but also Fretz's present and future debts to Revlon's subsidiaries. Revlon properly filed a financing statement, listing only itself as a secured party. The subsidiaries entered into separate security agreements, but did not file financing statements. On Fretz's bankruptcy Revlon applied for payment of its claim for both Fretz's debt to it and Fretz's debt to its subsidiaries. The subsidiaries had formally assigned their claims against Fretz to Revlon after the bankruptcy petition had been filed. The court held, however, that a second creditor would have priority over the claims of the subsidiaries. If Revlon had carried on business with divisions that were not separately incorporated, presumably it would have recovered its full claim. The moral is clear: a separately incorporated subsidiary should enter into and perfect its own security interests.

### C. Attachment and Perfection

*Classification of Collateral.* A creditor who takes a security interest in a consumer good has the advantage of automatic perfection without the need to file a financing statement.<sup>177</sup> If, however, the creditor is worried that the debtor will sell the good to another consumer, who will take free of the security interest, the creditor may protect himself by filing a financing statement in the county clerk's office in the county of the debtor's residence.<sup>178</sup> The Code defines "consumer goods" as goods "used or bought for use primarily for personal, family or household purposes."<sup>179</sup> In *McGehee v. Exchange Bank & Trust Co.*<sup>180</sup> the court attempted to clarify this definition. In that case a secured party filed a financing statement pertaining to a boat in the office of the county clerk. The original debtor sold the boat to a buyer who had no actual knowledge of the outstanding security interest. On default by the original debtor, the secured party brought suit against the buyer of the boat, alleging conversion of his security interest. The jury found that the boat had been used by the original buyer primarily for service and not for personal and family use, apparently relying on the fact that the boat had been registered in the auxiliary coast guard. The trial court disregarded this finding because it was not supported by the evidence, and the appellate court affirmed. The court concluded that the boat was a consumer good within the meaning of the Code and that the filing with the county clerk perfected the secured party's interest. Under section 9.307(b) the buyer of the boat took subject to the secured party's security interest.<sup>181</sup>

The appellate court ruled that the intent of the debtor at the time the security interest attaches determines whether the collateral is a consumer good, and "no creditor is required to monitor the use of collateral in order

---

177. TEX. BUS. & COM. CODE ANN. § 9.302(a)(4) (Vernon Supp. 1978-79).

178. *Id.* §§ 9.307(b), .401(a).

179. *Id.* § 9.109(a). See also *id.* § 9.105(a)(8) (definition of "goods").

180. 561 S.W.2d 926, 23 UCC Rep. Serv. 816 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.).

181. TEX. BUS. & COM. CODE ANN. §§ 9.306(b), .307(b) (Vernon Supp. 1978-79).

to ascertain its proper classification."<sup>182</sup> The court referred to the debtor's intent at the time of "attachment," which under the facts of this case was the time of the original sale of the boat. The court, however, also spoke of the actual use of the boat while in the possession of the debtor, which would seem to be irrelevant. The court might have been referring to the use of the collateral at the time of perfection, which would be more consistent with the language of section 9.401(c). In most cases, as in *McGehee* where only six days separated the time of attachment and the time of perfection, this distinction will make no difference.

*Financing Statement—Description.* The Code requires a financing statement to include "a statement indicating the types, or describing the items, of collateral."<sup>183</sup> In *McGehee v. Exchange Bank & Trust Co.*<sup>184</sup> the court found that factual errors in the financing statement as to the model year and the engine numbers of the boat, were minor in nature and would not mislead anyone. Citing section 9.110,<sup>185</sup> the court apparently adopted the standard that "it is not essential that the description be so specific that the property may be identified by it alone, if such description suggests inquiries or means of identification, which, if pursued, will disclose the property covered by the mortgage."<sup>186</sup>

#### D. Priorities

*Continuation of Security Interest after Sale.* Should a debtor sell collateral, section 9.306(b) of the Code<sup>187</sup> gives the secured party both a security interest in the identifiable proceeds and the right to trace the collateral into the hands of the purchaser unless the secured party has authorized the sale or the Code provides otherwise. Several cases construing the Texas Code examined this general rule during the survey period.<sup>188</sup>

The most important of these decisions is *Weisbart & Co. v. First National Bank*.<sup>189</sup> In that case a secured party repossessed cattle from the debtor following the debtor's default. A purchaser of the cattle from the debtor, who had not yet taken delivery because the debtor had agreed to raise the cattle for him, sued the secured party. The time for the debtor's performance under the contract of sale had been extended following negotiations

182. 561 S.W.2d at 930. The court also cited TEX. BUS. & COM. CODE ANN. § 9.401(c) (Vernon Supp. 1978-79) (filing made in the proper place continues effective for four months after the location of the collateral or its use is changed).

183. TEX. BUS. & COM. CODE ANN. § 9.402(a) (Vernon Supp. 1978-79).

184. 561 S.W.2d 926, 23 UCC Rep. Serv. 816 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.).

185. TEX. BUS. & COM. CODE ANN. § 9.110 (Vernon Supp. 1978-79) (description of personal property or real estate is sufficient if it reasonably identifies what is described).

186. 561 S.W.2d at 932.

187. TEX. BUS. & COM. CODE ANN. § 9.306(b) (Vernon Supp. 1978-79).

188. See also *McGehee v. Exchange Bank & Trust Co.*, 561 S.W.2d 926, 23 UCC Rep. Serv. 816 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.) (security interest continues in consumer goods and is not cut off by § 9.307(b)). The *McGehee* case is discussed at notes 180-82 *supra* and accompanying text.

189. 568 F.2d 391, 23 UCC Rep. Serv. 797 (5th Cir. 1978).

in which the secured party had participated, and the buyer claimed that the secured party had thereby authorized the sale. The jury found that the secured party had consented and acquiesced in the extension, but that it did not intend thereby to subordinate its security interest to the buyer's interest. The appellate court affirmed the judgment for the secured party on the ground that there had been no "sale, exchange or other disposition" of the collateral so as to trigger the operation of section 9.306(b). The court then indicated that even though section 9.306(b) did not cover the situation, the buyer still might succeed under the principles of common law waiver, which are preserved by section 1.103.<sup>190</sup> The court, however, found that waiver in Texas requires *intentional* relinquishment of a right. Under the facts of the case, the jury found that the secured party had not intended to subordinate its claim, and the buyer therefore was subordinate to the secured party.<sup>191</sup>

In *Montgomery v. Fuquay-Mouser, Inc.*<sup>192</sup> the court of civil appeals found sufficient evidence in the record to affirm the trial court's finding that the secured party had not waived its security interest in a tractor sold by the original debtor. The buyer of the tractor from the debtor therefore held the tractor subject to the original secured party's security interest.

*Proceeds—Insurance.* Prior to 1972 the Code defined proceeds to include "whatever is received when collateral or proceeds is sold, exchanged, collected or otherwise disposed of."<sup>193</sup> Since no specific reference was made to insurance payable on destruction of the collateral, courts and commentators were divided on whether insurance payments were proceeds within the meaning of chapter 9.<sup>194</sup> The 1972 amendments to the Code, which came into effect in Texas on January 1, 1974, resolved this question by adding the following sentence: "Insurance payable by reason of loss or damage to the collateral is proceeds, except to the extent that it is payable to a person other than a party to the security agreement."<sup>195</sup> Faced with an insured loss that occurred in Texas fourteen days before the 1972 amendment went into effect, the federal district court in *Aetna Insurance Co. v. Texas Thermal Industries*<sup>196</sup> concluded that, in the absence of a contrary state court decision, the federal court could rely on the draftsmen's original intention to include insurance payments within the definition of "proceeds." The court found this original intention manifested in the 1972 amendment itself and in the accompanying comment, which stated that the new sentence was added to overrule various cases that had held that insurance payments were not proceeds. The court believed that the

190. TEX. BUS. & COM. CODE ANN. § 1.103 (Vernon 1968) (unless displaced by particular provisions of the UCC, the principles of law and equity supplement its provisions).

191. See *id.* § 1.201(37) (Vernon Supp. 1978-79) (special property interest of buyer on identification of goods to contract of sale is not a security interest).

192. 567 S.W.2d 268, 24 UCC Rep. Serv. 756 (Tex. Civ. App.—Amarillo 1978, no writ).

193. 1967 Tex. Gen. Laws ch. 785, § 1, at 2343.

194. I COOGAN, HOGAN & VAGTS, *supra* note 33, § 3A.03(c).

195. TEX. BUS. & COM. CODE ANN. § 9.306(a) (Vernon Supp. 1978-79).

196. 436 F. Supp. 371, 22 UCC Rep. Serv. 1228 (E.D. Tex. 1977).

amendment was persuasive evidence of the effect which section 9.306 was originally intended to have.<sup>197</sup>

*Priorities: Secured Party vs. Federal Tax Lien.* In *Aetna Insurance Co. v. Texas Thermal Industries*<sup>198</sup> the court also had to determine whether a federal tax lien or a state-created security interest had priority to the insurance proceeds upon the destruction of the collateral. Notice of the federal tax lien against the debtor was filed on December 17, 1973. The secured party perfected its security interest in the inventory, accounts receivable, machinery, and equipment of the debtor by filing financing statements pursuant to state law on January 15, 1973, and June 21, 1973. The inventory was destroyed by fire on December 18, 1973. The court concluded that when the state security interest has priority over a federal tax lien as to the original collateral, the priority also applies to the proceeds.<sup>199</sup> Any other result, the court noted, would penalize the secured party, who often is the one responsible for the insurance fund in the first place.

*Priorities: Secured Party vs. Unpaid Seller.* The unpaid seller who delivers goods to the buyer is an unsecured creditor and has limited rights to recover the goods.<sup>200</sup> If the seller purports to retain "title" to the goods sold, the Code states that the seller retains only a security interest that must be perfected under chapter 9 of the Code in order to prevail against most other claimants.<sup>201</sup> In spite of these provisions, the unpaid seller in *Peerless Equipment Co. v. Azle State Bank*<sup>202</sup> claimed that its retention of title meant that the buyer did not have "rights" in the collateral to which the secured party's security interest could attach.<sup>203</sup> The court upheld the secured party's security interest, citing section 2.403(a)(3) to the effect that a party who has received a good in a "cash sale" may transfer good title to a good faith purchaser for value, which would include a person who purchases a security interest.<sup>204</sup>

197. See also TEX. BUS. & COM. CODE ANN. § 11.108 (Vernon Supp. 1978-79) (unless a change in law has clearly been made, provisions of new UCC are declaratory of the meaning of the old UCC).

198. 436 F. Supp. 371, 22 UCC Rep. Serv. 1228 (E.D. Tex. 1977).

199. The court cited *PPG Indus., Inc. v. Hartford Fire Ins. Co.*, 384 F. Supp. 91 (S.D.N.Y. 1974), *aff'd*, 531 F.2d 58 (2d Cir. 1976). See also Treas. Reg. § 301.6323(c)-1(d) (1976).

200. See TEX. BUS. & COM. CODE ANN. § 2.702 (Vernon Supp. 1978-79) (seller may reclaim goods if buyer has received goods on credit while insolvent). Section 2.702 is now limited by the Bankruptcy Act of 1978. 11 U.S.C.A. § 546(c) (1979).

201. TEX. BUS. & COM. CODE ANN. §§ 1.201(37), 2.401(a), 9.113 (Vernon 1968 & Supp. 1978-79).

202. 559 S.W.2d 114, 23 UCC Rep. Serv. 611 (Tex. Civ. App.—Fort Worth 1977, no writ).

203. See TEX. BUS. & COM. CODE ANN. § 9.203(a)(3) (Vernon Supp. 1978-79) (security interest not enforceable unless the debtor has rights in the collateral).

204. See also *id.* § 2.401(b) ("Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest. . .").

E. *Default*

*Judicial Foreclosure.* In *Garza v. Allied Finance Co.*<sup>205</sup> the secured party sued to recover the balance due on an installment promissory note following the debtors' default. The plaintiff's petition did not specifically plead or pray for foreclosure of his security interest. Nevertheless, the trial court ordered foreclosure. The court of civil appeals noted that the creditor could have proceeded by nonjudicial foreclosure but had the option to enforce the debt by judicial proceedings. The court held that judicial foreclosure must be specifically requested and that a general prayer does not fulfill this requirement.<sup>206</sup> Presumably, even without a court order, the secured party could still proceed against the property by self-help.<sup>207</sup>

*Wrongful Repossession.* On default by the debtor a secured party has the right under the Code to take possession of the collateral.<sup>208</sup> A person who does not have a security interest in the particular collateral does not have the right to repossess, and if the person does take possession, he will be liable as a converter. In *Steakley Brothers Chevrolet, Inc. v. Westbrook*<sup>209</sup> a dealer that had assigned the security agreement to a bank repossessed the debtor's motorcycle by picking it up at the debtor's place of employment. The debtor had taken possession of the motorcycle only thirty-four days before, had paid a substantial downpayment, and was not delinquent on any installment. The appellate court affirmed the judgment for the debtor, awarding both actual and exemplary damages for wrongful repossession. The court affirmed the award of exemplary damages on the theory that "ill will" may be implied from a knowing conversion of the debtor's property when the dealer knew or should have known that it did not have a legal right to repossess.

A secured party's right to repossess without judicial process is limited by the Code's injunction against proceeding by self-help if so proceeding would necessitate a breach of the peace. In *Robertson v. Union Planters National Bank*<sup>210</sup> an agent of the secured party took the debtor's locked car from her driveway in the middle of the night without her knowledge. Under the circumstances the court concluded that there was "neither force nor fraud nor breach of the peace."<sup>211</sup> The court further indicated that even if there had been a breach of the peace, the defendant national bank had not voluntarily and intentionally waived its statutory privilege to be sued in Tennessee.<sup>212</sup>

---

205. 566 S.W.2d 57, 24 UCC Rep. Serv. 469 (Tex. Civ. App.—Corpus Christi 1978, no writ).

206. TEX. R. CIV. P. 301 (judgment of the court must conform to the pleadings).

207. See TEX. BUS. & COM. CODE ANN. § 9.501(a) (Vernon Supp. 1978-79) ("The rights and remedies referred to in this subsection are cumulative.").

208. *Id.* § 9.503.

209. 558 S.W.2d 544 (Tex. Civ. App.—Waco 1977, writ ref'd n.r.e.).

210. 561 S.W.2d 901 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.).

211. *Id.* at 904.

212. 12 U.S.C. § 94 (1976); see 561 S.W.2d at 903-04.

*Notice of Sale of Repossessed Collateral.* After default by the debtor, the secured party may dispose of the collateral and apply the proceeds to satisfy the indebtedness.<sup>213</sup> Disposition by the secured party is subject to the general principle that "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable."<sup>214</sup> The Code also requires the secured party to give the debtor notice of the disposition.<sup>215</sup> Over the years a number of cases have explored the consequences that follow when the secured party fails to give proper notice.<sup>216</sup>

In *Bundrick v. First National Bank*<sup>217</sup> the debtors sought to recover the penalty provided by section 9.507(a) of the Code.<sup>218</sup> The secured party failed to give the debtor notice of the sale by auction of the repossessed car. The secured party sued for the deficiency and produced some evidence that the sale price represented the cash market value of the car and that the car was sold in the regular course by an established used car auction dealer. In holding that the debtors' claim under section 9.507(a) was not well founded, the court stressed that the debtors did not produce evidence that they had sustained any loss and had not shown that the car was a "consumer good." The court further suggested that even as to consumer goods the debtor must show some loss or damage before he will be allowed to recover under section 9.507(a). The court's reading reduces the formula in that section to one facilitating the establishment of the amount of damage rather than one assessing a statutory penalty for not complying with the Code provisions on default.

In *Aetna Finance Co. v. Ables*<sup>219</sup> the secured party sold repossessed collateral without notice to the debtor. The secured party then sued the debtor for the deficiency, but did not produce evidence showing the market value of the collateral at the time of the repossession or sale. Further, there was no evidence regarding how the sales were conducted. The appellate court affirmed a take-nothing judgment on the ground that the trial court could have found that the original purchase price was the market price at the time of the sale of the repossessed collateral. The court reached this conclusion by an ingenious reading of the Code: section 9.504(a) states that a sale of repossessed goods is governed by chapter 2,<sup>220</sup> and section 2.723(b) allows the use of a reasonable substitute price when the market price "at the times or places described in [chapter 2]" is not

---

213. TEX. BUS. & COM. CODE ANN. § 9.504(a) (Vernon Supp. 1978-79).

214. *Id.* § 9.504(c).

215. *Id.*

216. See 1977 *Annual Survey*, *supra* note 2, at 190-92. A leading case examining the Texas law is *United States v. Whitehouse Plastics*, 501 F.2d 692 (5th Cir. 1974).

217. 570 S.W.2d 12 (Tex. Civ. App.—Tyler 1978, writ ref'd n.r.e.).

218. TEX. BUS. & COM. CODE ANN. § 9.507(a) (Vernon Supp. 1978-79) (if secured party violates provisions on disposition of collateral and collateral is consumer goods, debtor is entitled to recover a penalty).

219. 559 S.W.2d 139 (Tex. Civ. App.—Fort Worth 1977, no writ). Note that the debtor appeared *pro se*.

220. TEX. BUS. & COM. CODE ANN. § 9.504 (Vernon Supp. 1978-79).

readily available.<sup>221</sup> The court viewed the original purchase price as a potentially reasonable substitute for the market value, in which case there would be no deficiency on resale. In doing this, the court ignored the possibility that there were reasonable expenses connected with the repossession of the collateral. The court also overlooked the statutory penalty that the debtor can recover when consumer goods are involved and a secured party fails to follow the Code procedures. A sounder way to reach the result would be to place the burden on the secured party to show the amount of the deficiency and, when the Code is not complied with, to show the deficiency that would exist if the Code had been complied with. Since this latter figure must be shown by the evidence of the market price at the time of the sale, the plaintiff secured party in the *Aetna* case failed to show the amount of the deficiency, that is, it failed to prove that it was entitled to recover anything.

#### IV. MISCELLANEOUS DECISIONS

##### A. *Standby Letters of Credit (Chapter 5)*

The letter of credit was created as a payment device to avoid the insecurity involved in the sale of goods across national boundaries.<sup>222</sup> The Code codified the commercial practices governing the letter of credit, but explicitly provided for its continuing evolution.<sup>223</sup> Since the drafting of the Code, use of the standby letter of credit has become much more prevalent. In the standby letter of credit transaction the issuer of the credit agrees to pay the beneficiary if the issuer's customer defaults on an obligation running from the customer to the beneficiary. The federal bank regulatory authorities recognize the standby letter of credit.<sup>224</sup>

Under traditional rules governing banking operations a bank did not have the authority to enter into guaranty agreements because the business of suretyship was *ultra vires*.<sup>225</sup> While general incorporation statutes have carefully circumscribed the doctrine of *ultra vires*,<sup>226</sup> the doctrine continues to have vitality as to bank activities. In *Republic National Bank v. Northwest National Bank*<sup>227</sup> the Texas Supreme Court held that a standby letter of credit was a true letter of credit and therefore it was not *ultra vires* for a national banking association to issue such a letter. The court distinguished the standby transaction from a guaranty agreement by reasoning that the issuer of a letter of credit has a primary obligation dependent

221. *Id.* § 2.723(b) (Vernon 1968).

222. *See generally* H. HARFIELD, *BANK CREDITS AND ACCEPTANCES* (5th ed. 1974).

223. *TEX. BUS. & COM. CODE ANN.* § 5.102(c) (Vernon 1968). *See also id.* § 5.102, comment 2.

224. 12 C.F.R. § 7.1160 (1978) (Comptroller of the Currency); *id.* § 208.8(d) (Federal Reserve Board); *id.* § 337.2 (Federal Deposit Insurance Corp.).

225. *E.g.*, *First State Bank v. Sanford*, 255 S.W. 644, 648 (Tex. Civ. App.—Dallas 1923, no writ).

226. *See TEX. BUS. CORP. ACT ANN.* art. 2.04 (Vernon 1956).

227. 578 S.W.2d 109, 25 UCC Rep. Serv. 832 (Tex. 1978), *rev'g* 566 S.W.2d 358, 24 UCC Rep. Serv. 939 (Tex. Civ. App.—Fort Worth 1978).



solely on presentation of the documents required by the letter, while a guarantor has a secondary obligation that turns on the rights and obligations of the parties to the underlying contract.

### B. *Bulk Transfers (Chapter 6)*

Chapter 6 of the Code regulates the transfer in bulk of a major part of the inventory of any enterprise principally engaged in the sale of merchandise from stock.<sup>228</sup> Under section 6.106 of the Texas Business and Commerce Code a transferee of a bulk transfer must make sure that the transferor's creditors are paid.<sup>229</sup> In *Petereit v. Mid-West Marko, Inc.*<sup>230</sup> the court held that a creditor could not recover from the transferee because it had failed to show either that it was on the list of creditors furnished by the transferor or that it had filed a written claim within thirty days after receiving notice of the transfer.<sup>231</sup>

### C. *Documents of Title (Chapter 7)*

Chapter 7 of the Code regulates documents of title, including those documents issued by warehousemen and carriers.<sup>232</sup> The chapter assumes that a document has been issued. Section 7.206(a), for example, sets out rules governing the termination of storage at the option of the warehouseman, and the rules are framed in terms of whether or not the document fixes the storage period.<sup>233</sup> Section 7.206(a), in other words, does not govern directly when the warehouseman has not issued any document of title. In *American Transfer & Storage Co. v. Reichley*<sup>234</sup> the parties orally agreed on a fixed storage period, but the defendant warehouseman nevertheless sold the goods before the end of the period. The court held that section 7.206 does not apply to oral agreements and after a cryptic reference to section 1.102(c),<sup>235</sup> the court affirmed the lower court's finding for the plaintiff, holding that the lack of a document does not give the warehouseman the option to terminate the storage at will and sell the stored goods.

---

228. TEX. BUS. & COM. CODE ANN. § 6.102 (Vernon 1968). An American Bar Association committee is revising chapter 6. See Hawkland, *The Trouble with Article 6 of the UCC: Some Thoughts About Section 6-103*, 82 COM. L.J. 113, 113 (1977).

229. TEX. BUS. & COM. CODE ANN. § 6.106(1) (Vernon 1968). The official text of the Code designates this section as "Optional."

230. 564 S.W.2d 442, 23 UCC Rep. Serv. 727 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ).

231. TEX. BUS. & COM. CODE ANN. § 6.102 (Vernon 1968) requires the transferee of a bulk transfer to assure that those creditors who fulfill one of these two requirements are paid.

232. See generally R. RIEGERT & R. BRAUCHER, DOCUMENTS OF TITLE (3d ed. 1978).

233. TEX. BUS. & COM. CODE ANN. § 7.206(a) (Vernon 1968).

234. 560 S.W.2d 196, 23 UCC Rep. Serv. 144 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.). For an earlier appeal in the same case, see 543 S.W.2d 162 (Tex. Civ. App.—Amarillo 1976, no writ).

235. TEX. BUS. & COM. CODE ANN. § 1.102(c) (Vernon 1968) (obligations of good faith, diligence, reasonableness, and care prescribed by UCC may not be disclaimed by agreement).

### D. Guaranty Agreements

*Continuing Guaranty.* In *Houston Furniture Distributors, Inc. v. Bank of Woodlake, N.A.*<sup>236</sup> the defendant guarantor argued that the plaintiff beneficiary of the guaranty agreement had the burden of offering affirmative proof that the continuing guaranty agreement was in effect on the date on which the defaulted note was signed. The court stated that a continuing guaranty agreement remains in effect until revoked and is thus presumed to be in effect unless the guarantor proves otherwise.

*Guarantor's Liability for Attorneys' Fees.* A guarantor may expand or restrict his liability for the principal's obligation by an express provision in the guaranty agreement. If the guaranty agreement is silent, the guarantor ordinarily will be liable in accordance with the terms of the obligation guaranteed. A guarantor liable for "payment of said note, plus interest," for example, must pay attorneys' fees if the note guaranteed provides for payment of attorneys' fees on default.<sup>237</sup> Where a guarantor guarantees payment of the costs of collection "including reasonable attorneys' fees," the beneficiary must produce evidence of reasonable attorneys' fees, and a court may not enter judgment against a guarantor for the amount of the attorneys' fees provided in the note in the absence of evidence that the amount specified was reasonable.<sup>238</sup> If the guarantors sign either the note guaranteed or a renewal and extension agreement, they will be liable for the attorneys' fees provided in the note or the extension agreement. If the guarantors claim that the fees provided in the note are unreasonable, they must raise the matter as an affirmative defense and obtain an explicit finding on the issue of reasonableness.<sup>239</sup>

### E. Liquidated Damages Versus Penalty

Parties entering into a long-term contract, such as a lease of personal property, may include in their contract a provision for liquidated damages. The draftsman of a liquidated damage clause must consider the possibility that the clause may later be declared unenforceable as a penalty.<sup>240</sup> The difficulties facing the draftsman are illustrated by two cases in this survey period<sup>241</sup> in which the courts held liquidated damage clauses to be unen-

236. 562 S.W.2d 880 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ).

237. *Barclay v. Waxahachie Bank & Trust Co.*, 568 S.W.2d 721, 724-25 (Tex. Civ. App.—Waco 1978, no writ).

238. *Houston Furniture Distributors, Inc. v. Bank of Woodlake, N.A.*, 562 S.W.2d 880, 884 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ).

239. *National Bank of Commerce v. F.R. Hernandez Constr. & Supply Co.*, 564 S.W.2d 499, 501 (Tex. Civ. App.—Corpus Christi 1978, writ granted).

240. For a discussion of the policies underlying the liquidated damage versus penalty debate, see Clarkson, Miller & Muris, *Liquidated Damages v. Penalties: Sense or Nonsense?*, 1978 WIS. L. REV. 351; Comment, *Liquidated Damages and Penalties Under the Uniform Commercial Code and the Common Law: An Economic Analysis of Contract Damages*, 72 NW. U.L. REV. 1055 (1978). See TEX. BUS. & COM. CODE ANN. § 2.718(a) (Vernon 1968).

241. *Servisco v. Tramco, Inc.*, 568 S.W.2d 434 (Tex. Civ. App.—Texarkana 1978, writ ref'd n.r.e.); *United States Leasing Corp. v. Smith*, 555 S.W.2d 766 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.).

forceable because the clauses could be invoked for very minor breaches of the contract, resulting in damages that were "unreasonable and a violation of the principle of just compensation."<sup>242</sup> The plaintiffs in those cases, however, were permitted to plead and prove actual damages in the alternative.<sup>243</sup> The court in one of the cases distinguished earlier opinions enforcing liquidated damage clauses by noting that those cases involved clauses that could only be invoked for failure to pay rentals, rather than for lesser breaches.<sup>244</sup>

#### F. *Sunday Sales*

The Texas "Sunday Sale" statute,<sup>245</sup> which prohibits the sale of certain items on specified days, survived yet another attack in this survey period. In *Gibson Distributing Co. v. Downtown Development Association*<sup>246</sup> the Texas Supreme Court refused to reconsider its earlier decision holding that the statute was constitutional and did not violate the due process and equal protection clauses of the fourteenth amendment.<sup>247</sup> The court also considered and rejected the argument that federal antitrust law pre-empted the field. The court held that state regulation of commerce in exercise of the state's police power was exempted from the Sherman Act under the Supreme Court's decision in *Parker v. Brown*.<sup>248</sup>

#### G. *Third-Party Creditor Beneficiary*

Short-term lenders continue in their struggle to hold long-term lenders to commitment letters issued to a common borrower. In *Texas Bank & Trust Co. v. Lone Star Life Insurance Co.*<sup>249</sup> the short-term lender added a new twist to previous arguments. Conceding that precedent did not permit it to enforce the commitment letter as a third-party beneficiary,<sup>250</sup> the short-term lender argued that since it had been assigned the borrowers' rights under the commitment letter, it was an "assignee for collateral pur-

242. *Stewart v. Basey*, 150 Tex. 666, 672, 245 S.W.2d 484, 487 (1952). The courts in both *Smith* and *Servisco* relied heavily on the *Stewart* case.

243. In the *Smith* case the plaintiff did not plead either damages for anticipatory repudiation or for past due rentals. 555 S.W.2d at 771. The plaintiff in the *Servisco* case did plead actual damages, and the appellate court reversed the lower court's ruling that damages for breach of the requirements contract were too speculative. The appellate court ruled that the plaintiff did not have to prove a perfect measure of damages, and the plaintiff therefore was able to base his damages on his past requirements. 568 S.W.2d at 436.

244. *United States Leasing Corp. v. Smith*, 555 S.W.2d 766, 770 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.).

245. TEX. REV. CIV. STAT. ANN. art. 9001 (Vernon Supp. 1978-79).

246. 572 S.W.2d 334 (Tex. 1978).

247. *Gibson Prod. Co. v. State*, 545 S.W.2d 128 (Tex. 1976), *cert. denied*, 431 U.S. 955 (1977). See also *S.S. Kresge Co. v. State*, 546 S.W.2d 928 (Tex. Civ. App.—Dallas 1977, writ ref'd n.r.e.), *discussed in 1978 Annual Survey, supra* note 2, at 219.

248. 317 U.S. 341 (1943).

249. 565 S.W.2d 353 (Tex. Civ. App.—Tyler 1978, no writ).

250. See, e.g., *Exchange Bank & Trust Co. v. Lone Star Life Ins. Co.*, 546 S.W.2d 948 (Tex. Civ. App.—Dallas 1977, no writ), *discussed in 1978 Annual Survey, supra* note 2, at 220.

poses” rather than a third-party beneficiary.<sup>251</sup>

The appellate court summarily rejected the argument, holding that the undisputed facts showed the lender to be a third-party beneficiary. The court also rejected the short-term lender’s argument that the long-term lender had waived the clause prohibiting assignment of the commitment letter or was estopped from relying on the clause.

---

251. 565 S.W.2d at 357. The court did not spell out the appellant’s argument that it was an “assignee for collateral purposes.”

