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COMMERCIAL TRANSACTIONS

by

John Kraemer*

CONSISTENT with past *Annual Survey* Articles on Commercial Transactions, this year's *Annual Survey* concentrates on court opinions that interpret and apply the Uniform Commercial Code as adopted in Texas.¹ Because the current survey period spanned a legislative session,² pertinent legislative enactments have also been included throughout.

The number of reported cases during this survey period has remained about the same in most areas involving commercial transactions, but cases involving chapter 4 and chapter 5 banking law subjects have increased. Whether this increase is merely by chance or whether it reflects the beginning of a new trend can only be speculated upon at present.³ As a result of the growth in this area, chapter 4 and 5 cases have been separated from the Commercial Paper topic this year and accorded a Banking Law subdivision of their own.⁴

A useful feature incorporated in last year's Commercial Transactions survey by Professor Winship was the listing of new publications on commercial law.⁵ This practice has been continued by the present author, and new publications of interest to commercial lawyers have been collected in the accompanying footnote.⁶

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1. The Uniform Commercial Code first became effective in Texas on July 1, 1966. 1965 Tex. Gen. Laws, ch. 721, at 1-316. In 1967 it became part of the Texas Business & Commerce Code. As amended, the Texas version of the Uniform Commercial Code now conforms closely to the 1972 Official Text. In this Article, all references are to the Uniform Commercial Code as enacted in chapters one through eleven of the Texas Business and Commerce Code [hereinafter referred to as the Code]. TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Vernon 1968 & Supp. 1980).

2. The 1979 regular session of the legislature was convened Jan. 9, 1979, and adjourned May 28, 1979.

3. Recent approval of standby letters of credit by federal bank regulatory authorities may account for some of the increase in the area of letters of credit. See 12 C.F.R. § 7.1160 (1979) (Comptroller of the Currency); *id.* § 208.8(d) (Federal Reserve Board); *id.* § 337.2 (Federal Deposit Insurance Corporation).

4. See text accompanying notes 129-51 *infra*.

5. See Winship, *Commercial Transactions, Annual Survey of Texas Law*, 33 Sw. L.J. 203, 203 n.4 (1979).

6. The publications include W. HAWKLAND, *COMMERCIAL PAPER* (2d ed. 1979); R. RIEGART & R. BRAUCHER, *DOCUMENTS OF TITLE* (3d ed. 1978); and C. REITZ, *CONSUMER PROTECTION UNDER THE MAGNUSON-MOSS WARRANTY ACT* (1978). A second edition of J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* (1972) was published in February 1980.

I. SALES TRANSACTIONS

A. *Statute of Frauds*

Chapter 2 contains its own Statute of Frauds provision designed specifically to deal with some of the unique problems that can arise in alleged oral contracts for the sale of goods.⁷ A recent federal district court case has explored some of the exceptions and limitations of the chapter 2 Statute of Frauds.⁸ In *Rockland Industries, Inc. v. Frank Kasmir Associates*⁹ the buyer brought suit against the seller on a claimed oral contract under which the seller was to supply the buyer's requirement for specified patterns for a two-year term. The seller asserted section 2.201, the Statute of Frauds, as a bar to the enforcement of the alleged oral agreement. To avoid the effect of the Statute, the buyer advanced three theories: two exceptions to section 2.201 and one limitation. First, the buyer claimed that a letter that he sent to the seller in March 1977, referring to a claimed July 1976 agreement between the parties, operated to take the requirements contract out of section 2.201 as a "writing [sent between merchants] in confirmation of the contract."¹⁰ The court rejected this theory because the exception requires such a confirmation to be sent within a reasonable time.¹¹ Absent proof to the contrary by the buyer, the unexplained time lapse of eight months went well beyond the limit of a confirmation sent within a reasonable time.¹² The second exception urged by the buyer was that the seller had admitted the existence of the contract in court by offering in evidence various letters concerning the alleged contract, bringing the case within section 2.201(c)(2). The court held that the letters, at most, were merely descriptive of the buyer's legal position and did not constitute an admission that such legal position was sound.¹³ The third theory advanced by the buyer was that the doctrine of promissory estoppel operated to bar the seller from raising the Statute of Frauds as a defense. The court recognized that section 1.103 permits the principles of law and equity to supplement the Code and that there was authority applying the doctrine of promissory estoppel to the chapter 2 Statute of Frauds.¹⁴ The buyer contended that the doctrine could be invoked whenever a promise to perform induces detrimental reliance.¹⁵ The court, however, took a more limited position, supported by section 178 of the *Restatement (Second) of Contracts*, that promissory estoppel was applicable to preclude a Statute of Frauds defense only when a misrepresentation was made that a contract had been or would be reduced to writing. Because the buyer had made no

7. TEX. BUS. & COM. CODE ANN. § 2.201 (Vernon 1968).

8. *Rockland Indus., Inc. v. Frank Kasmir Assocs.*, 470 F. Supp. 1176 (N.D. Tex. 1979).

9. *Id.*

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

11. *Id.* Section 1.240(b) provides "[w]hat is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action."

12. 470 F. Supp. at 1178-79.

13. *Id.* at 1180-81.

14. *Id.* at 1179 (noting J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 59-60 (1972) and cases cited therein).

15. See RESTATEMENT (SECOND) OF CONTRACTS § 90 (1973).

such claim nor had shown any evidence of such misrepresentation, the promissory estoppel theory was rejected.¹⁶

B. Interpretation of Sales Contracts

One of the most significant problems arising after the formation of a contract is the problem of interpretation. The parties may recognize that they have a contract, but often will dispute its meaning. Because each party will favor an interpretation enhancing its own legal position, chapter 2 includes an elaborate system of rules that incorporate the conduct of the parties and established methods of dealing in their trade as further, and perhaps more objective, interpretive tools.¹⁷ Three cases during the survey period demonstrate the importance of these interpretive tools.¹⁸

Usage of Trade. In *Raney v. Uvalde Producers Wool & Mohair Co.*¹⁹ the primary contention raised by the seller-defendant on appeal was that a contract calling for the delivery of 25,000 mohair fleeces was satisfied by delivery of that number of fleeces. At trial, the buyer had been allowed to introduce evidence of an established trade usage in the mohair industry that the word "fleeces" meant fleeces of fixed average weight and that the seller's delivery of 41,000 pounds of mohair was 46,500 pounds below the amount required to fulfill the contract based on the "average weight per fleece" meaning in the industry. The San Antonio court of civil appeals held that the introduction of trade usage evidence was proper under the Code's parol evidence rule²⁰ and that, as a long-time producer of mohair, the seller could be expected to know of this usage as a "merchant" in the trade.²¹ The contract was, therefore, to be read in light of how parties in the mohair trade do business, and, on that basis, the seller was found to be in breach to the extent of the 46,500 pound shortage in delivery.

In *Salinas v. Flores*²² evidence of trade usage was determinative of whether, when watermelons were sold "by the patch" during the growing season, control of the melons remained with the seller or passed to the buyer. Relying upon what it termed "ample" and "overwhelming" evi-

16. 470 F. Supp. at 1180.

17. See TEX. BUS. & COM. CODE ANN. §§ 1.205, 2.202, .208 (Vernon 1968).

18. *Salinas v. Flores*, 583 S.W.2d 813 (Tex. Civ. App.—San Antonio 1979, no writ); *Krupp Organization v. Belin Communities, Inc.*, 582 S.W.2d 514 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ); *Raney v. Uvalde Producers Wool & Mohair Co.*, 571 S.W.2d 199 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.).

19. 571 S.W.2d 199 (Tex. Civ. App.—San Antonio 1978, writ ref'd n.r.e.).

20. TEX. BUS. & COM. CODE ANN. § 2.202 (Vernon 1968) provides:

Terms . . . set forth in writing intended by the parties as a final expression of their agreement . . . may not be contradicted by evidence of any prior agreement or of a contemporaneous oral agreement but may be explained or supplemented (1) by course of dealing or usage of trade (Section 1.205) or by course of performance (Section 2.208)

21. 571 S.W.2d at 200-01. That a person engaged in agricultural or livestock production can qualify as a "merchant" within the meaning of TEX. BUS. & COM. CODE ANN. § 2.104(a) (Vernon 1968) was established in *Nelson v. Union Equity Co-op. Exch.*, 548 S.W.2d 352 (Tex. 1977), noted in 31 Sw. L.J. 1150 (1977); 8 TEX. TECH. L. REV. 181 (1977).

22. 583 S.W.2d 813 (Tex. Civ. App.—San Antonio 1979, no writ).

dence, the court held that control over and responsibility for the care of the watermelons passed to the buyer when they were sold by the patch, provided that both parties were aware of this trade understanding.²³ Because of this practice in the trade, the court also held that under the Code provisions on risk of loss, the party in control of the goods, here, the buyer, bore the loss when the melons were destroyed by hail.²⁴ Section 2.613 dealing with casualty to identified goods was held inapplicable because, under its terms, it operated only when "the goods suffer casualty without fault of either party *before the risk of loss passes to the buyer . . .*"²⁵ It is worth noting that the risk of loss and casualty provisions of the Code came into play on the facts of this case only after the interpretation issue had been resolved by evidence of trade usage.

Course of Performance. The third case of the series dealt not with usage of trade but with what the particular contracting parties did during the course of a contract calling for repeated occasions of performance, *i.e.*, course of performance. In *Krupp Organization v. Belin Communities, Inc.*²⁶ the plaintiff-seller sought recovery for the loss of anticipated profits on an alleged contract to print and mail 250,000 advertising brochures. The buyer contended that the actual contract as finally agreed upon by the parties was for the printing and mailing of only 50,000 brochures and introduced evidence of the invoice charges made by the seller at various stages of the printing and mailing runs. The invoices showed the assessment of an additional charge during each stage, apparently reflecting the increased cost of smaller printing runs. On the basis of testimony linking the additional charge more directly to the cost of smaller printing runs, the trial court held that the course of performance evidence supported the buyer's contention that the actual agreement of the parties was for the reduced quantity of brochures. On appeal, the court noted with approval the use of evidence of course of performance to resolve conflicting oral and documentary evidence regarding the contract terms. "[T]he parties know best what they mean and . . . their actions under their agreement are the best indication of its meaning."²⁷

C. Warranties

Legislative Developments. Section 2.316 of the Code, dealing with the exclusion and modification of warranties, was amended during the 1979 legislative session to exclude all warranties of merchantability and fitness for a particular purpose in the "sale or barter of livestock or its unborn

23. *Id.* at 815.

24. *Id.* The provisions on risk of loss are contained in TEX. BUS. & COM. CODE ANN. §§ 2.509, .510 (Vernon 1968).

25. 583 S.W.2d at 815 (quoting TEX. BUS. & COM. CODE ANN. § 2.613 (Vernon 1968) (emphasis added)).

26. 582 S.W.2d 514 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ).

27. *Id.* at 519 (citing TEX. BUS. & COM. CODE ANN. §2.208, comment 1 (Vernon 1968), which is paraphrased by the court in the quoted portion of the opinion).

young."²⁸

Tort, Contract, or Deceptive Trade Practice. Last year's *Annual Survey* article dealt extensively with the continuing attempts by the courts to develop a rational line of distinction between tort theory and contract theory in those cases that seem to involve both.²⁹ Unfortunately, there have been no significant new case developments in the area since the decision in *Mid Continent Aircraft Corp. v. Curry County Spraying Service, Inc.*,³⁰ which was commented upon as a late inclusion in last year's *Survey*.³¹ As Professor Grant Gilmore has pointed out, the law on this subject seems to have progressed to the stage where traditional tort/contract distinctions have been abandoned, and we now have a cause of action which he calls a "contort."³² The boundaries in this area are still obscure, and no new cases have helped to clarify them during the last year.

Adding to the difficulty of making rational distinctions is the continued inclusion of breach of warranty claims in the Texas Deceptive Trade Practices Act (DTPA).³³ Although the DTPA was amended during the last legislative session to eliminate the automatic trebling of actual damages,³⁴ the theoretical basis for treating a warranty breach as a deceptive trade practice is still unexplained.³⁵ In the warranty and deceptive trade practices area, the point was made in last year's *Annual Survey* article that

28. 1979 Tex. Gen. Laws, ch. 99, § 1, at 190.

29. Winship, *supra* note 5, at 208-10.

30. 572 S.W.2d 308 (Tex. 1978).

31. Winship, *supra* note 5, at 208-09.

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

33. TEX. BUS. & COM. CODE ANN. §§ 17.41-63 (Vernon Supp. 1980). See also Dor-saneo, *Creditor and Consumer Rights*, p. 253 *infra*; Lynn, *Of White Knights and Black Knights: An Analysis of the 1979 Amendments to the Texas Trade Practices Act*, 33 Sw. L.J. 941 (1980).

34. 1979 Tex. Gen. Laws, ch. 603, § 4, at 1330.

35. As originally enacted, § 17.50(a)(2) provided that "A consumer may maintain an action if he has been adversely affected by . . . (2) a failure by any person to comply with an express or implied warranty." 1973 Tex. Gen. Laws, ch. 143, § 17.50(a)(2), at 326 (emphasis added). An amendment in 1977 changed the italicized language to "breach of" an express or implied warranty, 1977 Tex. Gen. Laws, ch. 216, § 5, at 603; and the 1979 amendments (1979 Tex. Gen. Laws, ch. 603, § 4, at 1329) did not further modify the phrase.

Chapter 2's concept of a warranty breach clearly contemplates that the breach normally occurs upon tender of delivery. TEX. BUS. & COM. CODE ANN. § 2.725 (Vernon 1968). While express warranties might be distinguished because they come into existence by representations of the seller, it seems unduly harsh to impose treble damages for the breach of an implied warranty when that breach occurs instantly upon tender of delivery. The former language of the statute between 1973 and 1977 made more sense because it could be said that a seller who "failed to comply" with the terms of a warranty (*e.g.*, refused to remedy or repair the discovered defect) had, acting with knowledge that a breach had taken place, engaged in a voluntary act (refusal to remedy) that might fairly be treated as a deceptive trade practice. The existence of a punitive deceptive trade practices remedy, at least for simple breach of implied warranties, does not seem logically justified, but such a remedy does seem proper for *refusals to comply* with warranty terms once the fact of breach is known. Some procedural safeguards have been added to the DTPA that help to limit its otherwise harsh remedies. See TEX. BUS. & COM. CODE ANN. §§ 17.50A, .50B (Vernon Supp. 1980) ("opportunity to cure" defense). These safeguards, however, are not directly responsive to the question of whether breach of implied warranty is properly the subject of deceptive trade practice regulation.

"actions by 'consumers' for breach of Code warranties should now routinely include a reference to the DTPA as well as the relevant Code provisions."³⁶ The validity of this point is well-illustrated by the case of *Valley Datsun v. Martinez*.³⁷ In *Valley Datsun* the buyer brought suit on theories of unconscionability, breach of implied warranty, and breach of express warranty, all under the damage umbrella of the DTPA. Lack of evidence precluded recovery on the unconscionability theory. The implied warranty theory (a marriage of section 2.314 of the Code and section 17.50(a)(2) of the DTPA) failed because the buyer knew that the goods were used, a fact that precluded the creation of an implied warranty.³⁸ The assertion by a salesman that the goods were in "excellent condition," however, was held not to be "mere 'dealer's talk'" but an affirmation of fact creating a section 2.313 express warranty, the breach of which brought the multiple damage remedy of DTPA section 17.50(a)(2) into play.³⁹ The disappointed buyer recovered treble damages.⁴⁰ Although treble damages are no longer mandatory, and procedural limits have been imposed by sections 17.50A and 17.50B, the "consumer" plaintiff should still include a DTPA count in warranty actions as a standard practice.⁴¹ The plaintiff, however, should be certain to comply with the procedures of sections 17.50A and 17.50B before filing such an action.⁴²

Warranty of Title. Section 2.312 of the Code provides, in effect, that unless specifically excluded or modified, the seller warrants title to any goods conveyed under a contract of sale.⁴³ In a case involving a reverse twist on the usual alignment of seller and buyer in such litigation, *Gunderland*

36. Winship, *supra* note 5, at 212.

37. 578 S.W.2d 485 (Tex. Civ. App.—Corpus Christi 1979, no writ).

38. Although comment 3 to § 2.314 suggests that an implied warranty might arise in the sale of used goods, TEX. BUS. & COM. CODE ANN. § 2.314, comment 3 (Vernon 1968), that possibility has not met with judicial favor. See *Chaq Oil Co. v. Gardner Mach. Corp.*, 500 S.W.2d 877, 878 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ).

39. 578 S.W.2d at 490. With regard to the type of evidence needed to establish an express warranty, an interesting contrast to *Valley Datsun* is *Hodge Boats & Motors v. King*, 578 S.W.2d 890 (Tex. Civ. App.—Beaumont 1979, writ ref'd n.r.e.) (delivery of the manufacturer's warranty to the purchaser by the dealer does not make the dealer a party to the instrument).

40. 578 S.W.2d at 491.

41. The mandatory treble damages provision in § 17.50(b)(1), 1973 Tex. Gen. Laws, ch. 143, 1, at 326, was changed to permit the award of treble damages only when the trier of fact finds that the conduct of the defendant was committed "knowingly." 1979 Tex. Gen. Laws, ch. 603, § 4, at 1330 (codified at TEX. BUS. & COM. CODE ANN. § 17.50(b)(1) (Vernon Supp. 1980)).

Quotation marks have been included around the word "consumer" in the text because, under the very broad definition in TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon Supp. 1980), anyone can qualify as a "consumer." Cf. *W.R. Weaver Co. v. Burroughs Corp.*, 580 S.W.2d 76 (Tex. Civ. App.—El Paso 1979, writ ref'd n.r.e.) (lessee of computer considered "consumer" in action for alleged breach of express and implied warranties). For a discussion of *Weaver* see notes 52-60 *infra* and accompanying text.

42. TEX. BUS. & COM. CODE § 17.50A (Vernon Supp. 1980) establishes special procedural requirements, including a 30-day prelitigation notice, that must be met before a deceptive trade practices claim may be properly maintained.

43. TEX. BUS. & COM. CODE ANN. § 2.312 (Vernon 1968).

Marine Supply, Inc. v. Bray,⁴⁴ the Corpus Christi court of civil appeals held that a person who traded in a used boat to a boat dealer as part of the purchase price of a new boat impliedly warranted that he had good title to the trade-in property.⁴⁵ The warranty of good title was implied despite evidence showing the relative professional status of the buyer vis-a-vis the amateur status of the seller. The court noted that amendments to the Texas Parks and Wildlife Code regarding the issuance of certificates of title on boats had been passed subsequent to the facts in the case so that only the provisions of section 2.312 were controlling.⁴⁶ The court had no difficulty in concluding that the trade-in was a "sale" within the terms of chapter 2.⁴⁷

Notice of Breach. An important element in preserving a breach of warranty claim is giving the seller notice of the breach.⁴⁸ Proof that such notice was given is of equal importance. While this should be elementary commercial law, cases still arise that indicate that the Code's notice requirements can be a trap for the unwary. In *Cox v. Mesa Petroleum Co.*⁴⁹ the buyer failed to show that notice of breach had been given within a reasonable time after he discovered or should have discovered the claimed breach. His failure to submit these issues to the trier of fact barred any recovery. The seller's failure to deny under oath the receipt of any notice did not cause the fact of notice to be deemed admitted under rule 93 of the Texas Rules of Civil Procedure.⁵⁰ Proof of notice was part of the buyer's case, and the court held that rule 93 is inapplicable to contracts that do not prescribe a time limit within which notice must be given as a prerequisite to suit.⁵¹

Exclusion of Warranties. Of all the warranty cases reported this year, *W.R.*

44. 570 S.W.2d 542 (Tex. Civ. App.—Corpus Christi 1978, writ ref'd n.r.e.).

45. *Id.* at 546.

46. *Id.* The legislation referred to by the court is TEX. PARKS & WILD. CODE ANN. § 31.045 (Vernon Supp. 1980). Further amendments regarding the issuance of certificates of title on boats were passed in the 1979 legislative session and are discussed at note 175 *infra* and accompanying text. The amateur/professional distinction asserted by the seller can come into play if certificates of title are used. See TEX. BUS. & COM. CODE ANN. § 9.103(b)(4) & comment 4(e) (Vernon Supp. 1980).

47. 570 S.W.2d at 545. TEX. BUS. & COM. CODE ANN. § 2.304(a) (Vernon 1968) provides that "[t]he price can be made payable in whole or in part in money or otherwise. If it is payable in whole or in part in goods each party is a seller of the goods which he is to transfer." The holding in *Gunderland Marine* is consistent with the proposition advanced in last year's *Survey*. See Winship, *supra* note 5, at 205-06.

48. TEX. BUS. & COM. CODE ANN. § 2.607(c)(1) (Vernon 1968).

49. 572 S.W.2d 110 (Tex. Civ. App.—Amarillo 1978, writ ref'd n.r.e.).

50. *Id.* at 113. TEX. R. CIV. P. 93(m) states that

[a] pleading setting up any of the following matters, unless the truth of such matters appear of record, shall be verified by affidavit.

(m) That notice and proof of loss or claim for damage has not been given, as alleged. Unless such plea is filed such notice and proof shall be presumed and no evidence to the contrary shall be admitted. A denial of such notice or such proof shall be made specifically and with particularity.

51. 572 S.W.2d at 113.

*Weaver Co. v. Burroughs Corp.*⁵² is the most interesting, and, if litigation in the case continues, it has the potential to become a landmark decision affecting contracts for computer software. In 1971 the Weaver Company entered into a transaction with the Burroughs Corporation to lease a computer from Burroughs, to purchase a "software package" of computer accounting programs from Burroughs, and to have Burroughs systems personnel work with Weaver to "tailor" the accounting programs to Weaver's particular requirements. The Burroughs sales contract contained conspicuous large print warranty disclaimer clauses to satisfy section 2.316,⁵³ and these same clauses had been held to be effective disclaimers in other litigation involving Burroughs.⁵⁴ The lease agreement contained substantially similar disclaimers, but these clauses were printed only in uncapitalized regular type. In addition to the contract and lease, however, Weaver demanded assurances about the overall operation of the total system. In response, Burroughs supplied a "Statement of Installation Conditions," a separate document that provided for the assistance of Burroughs personnel in tailoring the system and committed Burroughs to provide software that would "be operable prior to installation." No disclaimers of any kind were contained in this additional "statement."

There were lengthy delays by Burroughs in providing several of the programs called for in the software contract, and some of the programs were never delivered. Finally, in late 1972 or early 1973, Weaver cancelled the lease agreement and sales contract. On December 21, 1976, Weaver filed suit against Burroughs, seeking incidental and consequential damages on theories of breach of express and implied warranties of merchantability and fitness, strict liability, and violation of the DTPA. Burroughs answered by pleading, *inter alia*, statute of limitations, disclaimer of warranties, and limitations on damages. The trial court granted Burroughs' motion for summary judgement.

On appeal, the primary issue was whether there were any genuine issues of material fact as to one or more of the essential elements of Weaver's claim. The appellate court held that genuine issues of fact were presented on: (1) the statute of limitations question because it was not clear when the alleged breach of warranty occurred;⁵⁵ (2) the disclaimer of warranties issue because, while the sales contract and lease agreement disclaimers were effective,⁵⁶ the "Statement Installation Conditions" might factually have been intended as an express warranty that would survive the inconsistent

52. 580 S.W.2d 76 (Tex. Civ. App.—El Paso 1979, writ ref'd n.r.e.).

53. TEX. BUS. & COM. CODE ANN. § 2.316 (Vernon 1968) contains a "how to do it" statement of the proper method to use in disclaiming express warranties and the implied warranties of title, merchantability, and fitness. Boilerplate disclaimers can be readily located. See, e.g., 1 TEX. CODE FORMS ANN. § 2.316 (Vernon 1968 & Supp. 1980).

54. *Investors Premium Corp. v. Burroughs Corp.*, 389 F. Supp. 39 (D.S.C. 1974); *Westfield Chem. Corp. v. Burroughs Corp.*, 21 UCC Rep. Serv. 1293 (Mass. Super. Ct. 1977); *Bakal v. Burroughs Corp.*, 74 Misc. 2d 202, 343 N.Y.S.2d 541 (Sup. Ct. 1972).

55. 580 S.W.2d at 80.

56. *Id.* at 81 (citing the cases collected in note 54 *supra*).

disclaimers under the operation of section 2.316;⁵⁷ and (3) the limitation of remedy issue because of the uncertain factual impact of the "Statement of Installation Conditions." On the strict liability issue, Weaver conceded that the Texas Supreme Court holding in *Nobility Homes, Inc. v. Shivers*⁵⁸ precluded recovery of purely economic loss. The DTPA was not discussed. The summary judgment of the lower court was reversed and the case remanded for trial.

The potential importance of *Weaver* lies in the application of Code warranty theory to computer software installation contracts, an increasingly important area of business activity.⁵⁹ As computers grow rapidly in sophistication and complexity, the design of software systems to adapt computing capability to the needs of particular businesses becomes more and more important—and more risky.⁶⁰ The *Weaver* case does not so much involve new law as it does the application of old law to a new technology that is being extended to more businesses (and individuals) every day. A prediction can be made that, in the future, the courts will be faced with an increasing number of cases raising difficult issues about how well the old law fits the new technology, what reshaping of the law needs to be done, and how far the parties have gone, or can go, in contractually defining their rights and remedies. If *Weaver* appears again in the appellate reports, some of these questions may be addressed.

D. Performance Disputes

Substantial Compliance. The doctrine of substantial compliance is a well-accepted doctrine of general contract law.⁶¹ The law of sales is not, however, general contract law, and an equally long-standing doctrine of sales law is that "[t]here is no room in commercial contracts for the doctrine of substantial performance."⁶² The "perfect tender rule" of sales law is carried forward into section 2.601 of the Code, which allows the buyer to reject goods whenever "goods or the tender of delivery fail in any respect to conform to the contract."⁶³ There are, however, exceptions to the per-

57. *Id.* at 81-82.

58. 557 S.W.2d 77 (Tex. 1977), noted in 15 Hous. L. Rev. 435 (1978); 19 S. Tex. L.J. 319 (1978).

59. The subject of computers and the law, in addition to various one volume references, is now the subject of a ten-volume reporter published by Callaghan & Co. entitled COMPUTER LAW SERVICE (1972). The service is updated in much the same way as the UNIFORM COMMERCIAL CODE REPORTING SERVICE.

60. See, e.g., *IBM v. Catamore Enterprises, Inc.*, 548 F.2d 1065 (1st Cir. 1976), cert. denied, 431 U.S. 960 (1977) (plaintiff alleged eighteen million dollars actual damages suffered due to failure of computerized accounting and production control system).

61. See 3A A. CORBIN, CONTRACTS §§ 700-12 (1960). The classic illustration is *Jacob & Youngs, Inc. v. Kent*, 230 N.Y. 239, 129 N.E. 889, 175 N.Y.S. 281 (1921). (When identical quality "Cohoes" pipe was inadvertently substituted by builder instead of specified "Reading" pipe, the court held that the builder had substantially complied.)

62. *Mitsubishi Goshi Kaisha v. J. Aron & Co.*, 16 F.2d 185, 186 (2d Cir. 1926). The reasons for the divergence between sales law and general contract law are discussed in R. NORDSTROM, HANDBOOK OF THE LAW OF SALES § 102 (1970).

63. TEX. BUS. & COM. CODE ANN. § 2.601 (Vernon 1968).

fect tender rule.⁶⁴ Consequently, the burden of proof rests upon the seller to show either that full performance has occurred or that the case falls within an exception to the rule.⁶⁵

In *Del Monte Corp. v. Martin*⁶⁶ a farmer entered into a written contract with a canner to grow, harvest, and deliver hybrid "fancy grade" spinach. Upon tender by the farmer, the canner rejected the crop, and the farmer then sued for breach. At trial, the court submitted the case to the jury with instructions to determine if the plaintiff had "substantially complied with the terms of the contract."⁶⁷ The court refused to submit the defendant's special issues designed to determine specifically if the spinach tendered by the plaintiff was of "fancy grade." The jury returned a verdict in favor of the plaintiff for actual damages and punitive damages for willful and malicious rejection. On appeal, the court of civil appeals approved the use of the substantial compliance standard without discussion or analysis of the differences between that doctrine and the perfect tender rule applicable to sales contracts.⁶⁸ The punitive damage award was reversed because there was no evidence to support a finding of willful or malicious rejection.

Although the decision may be correct on its facts, and the same result might have been reached under an analysis of the perfect tender rule and its exceptions, the use of the substantial compliance standard should be deplored because it obscures analysis of sales law principles and introduces an element of uncertainty to the framework of chapter 2.

Excused Performance. In contrast to the failure of the *Del Monte* court to apply sales law to a sales case, *Robberson Steel, Inc. v. J.D. Abrams, Inc.*⁶⁹ is a carefully reasoned opinion analyzing and applying the appropriate theories of chapter 2 to a claim of excused performance by reason of the failure of presupposed conditions under section 2.615. In *Robberson* the buyer sued for damages caused by a six-month delay in the delivery of fabricated steel to be used in the construction of bridges. The seller claimed that the delay was excused because of its inability to obtain fabricating steel from the steel mills. The test for applying such excuse in section 2.615(1) is whether "performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." There was undisputed evidence that the seller checked with two steel mills about supplies before entering into the fabrication contract, and that, having

64. For example, TEX. BUS. & COM. CODE ANN. § 2.508 (Vernon 1968) allows the seller to cure a defective delivery in certain circumstances. Other exceptions are discussed in R. NORDSTROM, *supra* note 62, §§ 103-05.

65. R. NORDSTROM, *supra* note 62, at § 102.

66. 574 S.W.2d 597 (Tex. Civ. App.—San Antonio 1978, no writ).

67. *Id.* at 598.

68. The court did not address whether the Code was applicable to the case, and, consequently, the relevant provisions of the Code were not discussed. The applicable scope provisions are found at TEX. BUS. & COM. CODE ANN. §§ 2.102, .103, .105, .106 (Vernon 1968), § 2.107 (Vernon Supp. 1980). See generally R. NORDSTROM, *supra* note 62, §§ 20-22.

69. 582 S.W.2d 558 (Tex. Civ. App.—El Paso 1979, no writ).

received assurances, he failed to include a contract clause excusing performance in the event of a failure of supply. In a lengthy and carefully researched opinion, the court of appeals concluded that "[t]he evidence established that the contingency which developed was one which the parties could reasonably have foreseen and it was one of that variety of risks which the parties tacitly assigned to the promisor by their failure to provide for it explicitly."⁷⁰ The judgment of the trial court rejecting the claimed defense was affirmed.

E. Remedies

Seller's Resale and Damages for Nonacceptance. In *Wirth, Ltd. v. Panhandle Pipe & Steel, Inc.*⁷¹ a buyer refused to accept delivery of steel, and the seller, in an attempt to utilize section 2.706 of the Code, resold the steel and sued for the difference between the contract price and the resale price. The trial court held that the seller had failed to resell the steel in a commercially reasonable manner as required by section 2.706 and, further, that the seller had offered no evidence of market price to justify recovery on a contract/market difference theory under section 2.708. These findings were affirmed on appeal. The opinion does not discuss exactly why the resale failed to meet the test of commercial reasonableness. This is unfortunate because the standard of "commercially reasonable" resale is also used in chapter 9 for the resale of collateral and has been frequently litigated, while the 2.706 standard has been raised only sporadically.⁷² It would be beneficial for the courts to develop the chapter 2 standard further to assist contracting parties in knowing whether the two standards are not only verbally but also legally identical or whether the different contexts of sales and secured transactions may cause functional differences in the application of the standards.⁷³

II. COMMERCIAL PAPER

A. Form of Negotiable Instruments—Incomplete Instruments

Chapter 3 is the most formalistic of all the chapters in the Code. Any writing, to be a negotiable instrument under chapter 3, must: (1) be signed

70. *Id.* at 564.

71. 580 S.W.2d 58 (Tex. Civ. App.—Tyler 1979, no writ).

72. Resale of collateral under ch. 9 is governed by TEX. BUS. & COM. CODE ANN. § 9.504 (Vernon Supp. 1980). Even a brief comparison of the annotations collected for *id.* § 2.706 (Vernon 1968 and Supp. 1980) with those collected for *id.* § 9.504 (Vernon Supp. 1980) shows the remarkable disparity in frequency of litigation. The annotations in the UNIFORM COMMERCIAL CODE CASE DIGEST (John W. Willis ed. 1976) for the respective sections shows a similar disparity on the national level.

73. One theoretical difference, for example, might be that resale of collateral under TEX. BUS. & COM. CODE ANN. § 9.504 (Vernon Supp. 1980) operates to deprive a debtor of a current equity ownership in the collateral being resold while a sale under *id.* § 2.706 (Vernon 1968) does not deprive a buyer of such an ownership interest. The ch. 2 standard of commercial reasonableness might, therefore, be somewhat less stringent than the ch. 9 standard.

by the maker or drawer; (2) contain an unconditional order or promise to pay a sum certain; (3) be payable on demand or at a definite time; and (4) be payable to order or bearer.⁷⁴ In *Hoss v. Fabacher*⁷⁵ the plaintiff brought suit on an instrument in which the payee's name had been omitted and the sum certain had not been stated. Citing sections 3.104, 3.111,⁷⁶ and 3.115,⁷⁷ the court held that the writing was not a negotiable instrument but an incomplete instrument.⁷⁸ The plaintiff therefore had the burden of proving all matters essential to the claim, including ownership and the amount allegedly due. The "note" did not operate to supply prima facie proof of the plaintiff's claim when it was incomplete. Because the plaintiff failed to introduce any evidence other than the incomplete instrument to prove the amount due or to show any other basis for recovery, the take nothing judgment of the trial court was affirmed. It is interesting to note that comment 2 to section 3.111 analyzes an example precisely like that of the instrument sued on in *Hoss* and that the indicated result is the same.⁷⁹

B. *Liability of Parties*

Liability of Co-Makers. In *Hooper v. Ryan*⁸⁰ the payees on an installment note brought suit against the two co-makers after default in payment occurred. After the suit was filed, the payees reached a settlement with one of the co-makers and released him from further liability in the action without making an express reservation of rights. The single remaining defendant urged that the release of the co-maker operated to discharge him from liability on the instrument under section 3.606.⁸¹ The trial court apparently accepted this argument and rendered a take nothing judgment against the plaintiff. On appeal, this decision was reversed and rendered on the ground that section 3.606 is applicable only to sureties and not to co-makers. For authority, the court relied exclusively upon *Wohlhuter v. St. Charles Lumber & Fuel Co.*,⁸² an Illinois case, and *Hallowell v. Turner*,⁸³ an Idaho case. While both cases represent a line of respectable au-

74. *Id.* §§ 3.104(a)(1)-(4) (Vernon 1968).

75. 578 S.W.2d 454 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ).

76. TEX. BUS. & COM. CODE ANN. § 3.111 (Vernon 1968) provides that an instrument is payable to bearer only when one of three alternative entries (bearer, specific person or bearer, cash) is made in the payee space. *See also id.* comment 2 (the section is worded to remove any possible implication that "Pay to the order of _____" makes the instrument payable to bearer; it is an incomplete order instrument and falls under § 3.115).

77. TEX. BUS. & COM. CODE ANN. § 3.115 (Vernon 1968) provides that when an instrument is signed while it is incomplete it may not be enforced.

78. 578 S.W.2d at 455-56.

79. *See note 76 supra.*

80. 581 S.W.2d 237 (Tex. Civ. App.—Waco 1979, no writ).

81. In part, TEX. BUS. & COM. CODE ANN. § 3.606 (Vernon 1968) provides: "(a) The holder discharges *any party* to the instrument to the extent that without such party's consent the holder (1) without express reservation of rights releases . . . *any person* against whom the party has to the knowledge of the holder a right of recourse . . ." (emphasis added).

82. 62 Ill. 2d 16, 338 N.E.2d 179 (1975).

83. 95 Idaho 392, 509 P.2d 1313 (1973) (dictum).

thority,⁸⁴ there is an equally respectable line of authority to the contrary.⁸⁵ The court made no attempt to explain why it chose one line rather than the other.⁸⁶ Nevertheless, the precedent is now established despite the failure of the court to provide any rationale for its decision.

Liability of Commercial Paper Guarantors. Under section 3.416, a guarantee of payment operates to make the liability of a guarantor indistinguishable from that of a co-maker and constitutes an undertaking by the guarantor that "if the instrument is not paid when due he will pay it according to its tenor without resort by the holder to any other party."⁸⁷ Due to this "individual" liability, the holder may recover in an action against the guarantor without joining any other parties, *e.g.*, the maker, as co-defendants.⁸⁸ In *Ferguson v. McCarrell*⁸⁹ an action on a note was brought against the corporate maker and the defendant guarantors. Subsequently, the corporate maker filed a chapter X reorganization petition and as to it the action on the note was severed and abated.⁹⁰ On appeal from an adverse judgment, the guarantors urged that they could not be adjudged liable on the note in the absence of the maker, without pleading and proof that the corporation was insolvent.⁹¹ Concluding that the guarantors were primary and not secondary obligors, the court rejected the argument.⁹² The decision is consistent with prior law as developed by the Texas Supreme Court.⁹³

In *Metze v. Entman*⁹⁴ a guarantor contended that, as a surety, he was released from liability when the plaintiff consented to an agreement, in which the defendant also participated, that dissolved the corporate maker. The court correctly pointed out that the consent of a surety to an act or

84. Similar cases include *Peoples Bank v. Pied Piper Retreat, Inc.*, 209 S.E.2d 573 (W. Va. 1974), and *Oregon Bank v. Baardson*, 256 Or. 454, 473 P.2d 1015 (1970).

85. See *Langeveld v. L.R.Z.H. Corp.*, 74 N.J. 45, 376 A.2d 931 (1977); *Indianapolis Morris Plan Corp. v. Karlen*, 28 N.Y.2d 30, 268 N.E.2d 632, 319 N.Y.S.2d 831 (1971) (dictum). The dictum in *Karlen* was subsequently followed in *Beneficial Fin. Co. v. Husner*, 82 Misc. 2d 550, 369 N.Y.S.2d 975 (Sup. Ct. 1975).

86. For discussion of the interpretation of the 1962 Official Text version of § 3-606 (which is identical to TEX. BUS. & COM. CODE ANN. § 3.606 (Vernon 1968)), see J. WHITE & R. SUMMERS, *supra* note 14, at 432-38. See also Murray, *Secured Transactions—Defenses of Impairment and Improper Care of Collateral*, 79 COMM. L.J. 265 (1974).

87. TEX. BUS. & COM. CODE ANN. § 3.416(a) (Vernon 1968).

88. See, *e.g.*, *Reece v. First State Bank*, 566 S.W.2d 296 (Tex. 1978); *Universal Metals & Mach., Inc. v. Bohart*, 539 S.W.2d 874 (Tex. 1976).

89. 582 S.W.2d 539 (Tex. Civ. App.—Austin 1979, writ ref'd n.r.e.).

90. The reorganization was filed under 11 U.S.C. § 526 (1976) as it existed prior to the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, which became effective on Oct. 1, 1979. Reorganizations and arrangements (former ch. X and ch. XI proceedings respectively) have been merged into a single ch. 11, which has been codified as 11 U.S.C. § § 1101-74 (Supp. 1979).

91. See TEX. REV. CIV. STAT. ANN. arts. 1986, 2088 (Vernon 1964) (no judgment may be had against secondary parties unless judgment is also had as to primary obligor except in certain circumstances; *e.g.*, insolvency of primary obligor).

92. 582 S.W.2d at 541.

93. See *Reece v. First State Bank*, 566 S.W.2d 296 (Tex. 1978); *Universal Metals & Mach., Inc. v. Bohart*, 539 S.W.2d 874 (Tex. 1976).

94. 584 S.W.2d 512 (Tex. Civ. App.—Houston [14th Dist.] 1979, no writ).

agreement discharging the maker prevents the discharge of the surety. The court, however, cited only case authority⁹⁵ for this proposition, much of it pre-Code, and did not mention that the same rule has been carried forward into section 3.606.⁹⁶

Liability for Contractually Specified Attorney's Fees on Commercial Paper. In *F.R. Hernandez Construction & Supply Co. v. National Bank of Commerce*⁹⁷ the supreme court held that the holder of a promissory note is not automatically entitled to the contractual percentage for attorney's fees provided in the note, even when the holder has agreed to pay the attorney at the specified rate. Instead, the holder is subject to an affirmative defense by the obligor that the specified fee is unreasonable on the facts of the particular case. The court noted that the defense of unreasonable attorney's fees is comprised of two elements, on both of which the obligor has the burden of proof: (1) that the contractual fee is unreasonable; and (2) that a lesser fee is reasonable under the circumstances of the case. In the *Hernandez* case the court held that the defendant maker had met its burden of proof on both elements and was entitled to a reduction of attorney's fees from the contractual rate of fifteen percent of the balance due (\$15,887.51) to the lesser proven amount of a reasonable fee of \$10,000.⁹⁸

C. Enforcement of Commercial Paper

Retail Installment Contracts Do Not Qualify as Commercial Paper. In *Insurance Agency Managers v. Gonzales*⁹⁹ the assignee of a retail installment contract providing for the purchase of various home improvements argued that the assignment of the contract qualified as a "negotiation," not under chapter 3, but under article 5069—6.07 in the Texas Consumer Credit Code,¹⁰⁰ and that compliance with that provision operated to preclude the defendant from asserting any claims or defenses. While the argument was at least ingenious, the court of civil appeals held that "[t]he provisions of Article 5069—6.07 do not create a new classification of negotiable instruments, but merely impose restrictions upon the ability of a holder of a retail installment contract to cut off actions or defenses by negotiation of the instrument."¹⁰¹ Because the court further held that the contract did

95. *Old Colony Ins. Co. v. City of Quitman*, 163 Tex. 144, 352 S.W.2d 452 (1961); *Whitten v. Metro Bank*, 556 S.W.2d 383 (Tex. Civ. App.—Waco 1977, no writ).

96. TEX. BUS. & COM. CODE ANN. § 3.606(a)(1) (Vernon 1968).

97. 578 S.W.2d 675 (Tex. 1979).

98. *Id.* at 678-79.

99. 578 S.W.2d 803 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ).

100. TEX. REV. CIV. STAT. ANN. art. 5069—6.07 (Vernon 1971) provides:

No right of action or defense of a buyer arising out of a retail installment transaction *which would be cut off by negotiation*, shall be cut off by negotiation . . . to any third party unless such holder acquires the contract relying in good faith upon a certificate of completion . . . and . . . gives notice of the negotiation to the buyer as provided in this Article, and within thirty days of the mailing of such notice receives no written notice from the buyer of any facts giving rise to any claim or defense of the buyer.

(Emphasis added).

101. 578 S.W.2d at 805.

not qualify as a negotiable instrument under chapter 3, the claimed defenses were not precluded by article 5069—6.07 and could be properly asserted.¹⁰²

Failure of Consideration as a Defense. The importance of becoming a holder in due course of a negotiable instrument is demonstrated by the case of *Worthey v. First State Bank*.¹⁰³ In *Worthey* the plaintiff bank sued to recover the face amount of a defaulted promissory note from J.D. Worthey, who had signed the note as maker. As a defense, Worthey contended that he had never received the \$8,000 loan amount from the bank. Instead, he argued that a J.D. Edwards had later signed the note as a co-maker without Worthey's knowledge and had delivered the instrument to the bank in exchange for the money. The defendant did not contend that the bank did not give value, that it had notice of Edwards' activity, or that it had failed to act in good faith.¹⁰⁴ On motion for summary judgment by the bank, the trial court held that no issues of material fact existed concerning the bank's status as a holder in due course and that the claimed defense was, therefore, cut off under section 3.305.¹⁰⁵ This decision by the trial court was affirmed.¹⁰⁶

Illegality as a Defense. Not all defenses to commercial paper are cut off by section 3.305. The usual dividing line depends on a classification of those defenses that are cut off as "personal defenses" and those defenses that continue as "real defenses."¹⁰⁷ In the latter category are defenses challenging the legality of the transaction that gave rise to the instrument. In *International Aircraft Sales, Inc. v. Betancourt*¹⁰⁸ the knowing participation of the plaintiff holders in a transaction that involved the smuggling of electronic devices into Mexico by the defendant makers in violation of Mexican law conclusively established a valid defense of illegality. It made no difference to the result that the note taken by the holder-payees was not the original instrument, but was instead a substitute for worthless checks that

102. *Id.* Article 5069—6.07 makes it clear that its provisions apply only to cases in which the buyer's defenses may be cut off by negotiation, which, of course, presupposes that the contract is a negotiable instrument. Thus the court here first examined whether the assigned contract was negotiable.

103. 573 S.W.2d 279 (Tex. Civ. App.—Waco 1978, no writ).

104. See TEX. BUS. & COM. CODE ANN. § 3.302(a) (Vernon 1968): "A holder in due course is a holder who takes the instrument (1) for value; and (2) in good faith; and (3) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person."

105. *Id.* § 3.305. This section allows a holder in due course to take free of "all defenses of any party to the instrument with whom the holder has not dealt" (emphasis added). Arguably, in *Worthey*, the bank "dealt with" the defendant maker. See J. WHITE & R. SUMMERS, *supra* note 14, at 478-79, 487. The issue, however, was not raised in the case.

106. 573 S.W.2d at 281. The judgment of the trial court was, however, reversed and remanded on the issue of the reasonableness of the attorney's fees claimed by the plaintiff. See F.R. Hernandez Constr. & Supply Co. v. National Bank of Commerce, 578 S.W.2d 675 (Tex. 1979); note 97 *supra* and accompanying text.

107. The two classifications of defenses are discussed in J. WHITE & R. SUMMERS, *supra* note 14, at 486-91.

108. 582 S.W.2d 632 (Tex. Civ. App.—Corpus Christi 1979, writ ref'd n.r.e.).

had initially been given to the payees by the defendants. On this point the court said, "[w]e think a mere change in the evidence of obligation does not validate that which is invalid."¹⁰⁹

Fraud as a Defense. Misrepresentations that induce another to sign a negotiable instrument create a defense of fraud that is cut off by negotiation of the instrument to a holder in due course.¹¹⁰ If the note is not negotiated and the instrument remains in the hands of a holder who dealt directly with the maker, however, the defense of fraudulent inducement can still be raised.¹¹¹ Claims of fraud may, of course, be asserted either defensively as a means of avoiding payment, or offensively as the basis of a suit for affirmative relief, as in the case of *Bodovsky v. Texoma National Bank*.¹¹² In *Bodovsky* the plaintiff bank brought suit on several promissory notes issued to the bank by the defendant makers in exchange for bank loans. The notes included various renewal notes that had been signed by the defendants over a three- to four-year period. The defendants asserted that bank officers had made material and false representations to them about the worth and resale value of certain restaurant equipment on which the bank held a lien, and that those misrepresentations were made to induce the defendants to purchase the equipment and sign the notes as part of the purchase transaction. This claim of fraud was raised both as an affirmative defense to reduce the bank's attempted recovery on the notes and as a counterclaim. While the jury held that the evidence supported the allegations of fraudulent misrepresentations and that the defendants did not discover the falsity until late in 1972, the trial court disregarded these findings and awarded the plaintiff judgment on the notes. The counterclaim was held to be barred by the statute of limitations.

The Dallas court of civil appeals held that the unchallenged jury findings supported the use of the fraud defense as a recoupment to reduce the plaintiff's recovery.¹¹³ Although the applicable statute of limitations¹¹⁴ would not bar the use of fraud as a defense, it would operate to prevent the assertion of a counterclaim based on the misrepresentations.¹¹⁵ In a well researched and comprehensive opinion, Chief Justice Guittard provided a useful research reference on commercial paper matters involving a defense or claim of fraud.

Prior Waiver of Holder's Rights as a Defense. The purchaser of a note who

109. *Id.* at 636.

110. TEX. BUS. & COM. CODE ANN. § 3.305 (Vernon 1968). *But see id.* § 3.305(2)(c), which provides that "such misrepresentation as has induced a party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or essential terms" may be asserted as a defense against a holder in due course. *See id.* comment 7 (the common example is of a maker tricked into signing a note in the belief it is a receipt or other document).

111. *Id.*; *see note 105 supra.*

112. 584 S.W.2d 868 (Tex. Civ. App.—Dallas 1979, writ ref'd n.r.e.).

113. *Id.* at 876.

114. TEX. REV. CIV. STAT. ANN. art. 5526 (Vernon 1958).

115. 584 S.W.2d at 875.

has knowledge that the note is in default does not qualify as a holder in due course.¹¹⁶ He takes the note subject to any defenses the makers may have, including any waiver of rights that may have been granted to the makers by the prior holder.¹¹⁷

Discharge by Agreement as a Defense. Section 3.601(b) operates to discharge a party from liability on an instrument to another party by any act or agreement that would discharge a simple contract for the payment of money.¹¹⁸ In *Bank of North America v. Bluewater Maintenance, Inc.*¹¹⁹ the jury found that the maker and payee entered into an oral novation agreement, supported by new consideration, by which a new note was substituted for an earlier note left in the holder's possession. On appeal, the court held that the novation was a valid defense to an action by the holder to enforce the unpaid balance on the earlier note, despite the fact the first note remained in the holder's possession.¹²⁰ Leaving the earlier note with the holder is not good practice. Under chapter 3 a defense of discharge is a personal defense that can be cut off by negotiation of the "paid" instrument to a person who qualifies as a holder in due course.¹²¹

Notice of Alteration as a Claim? Against a Holder—in Due Course? Occasionally a case is reported that seems somehow inexplicable—not in the sense that a court adopts a rule that seems wrong or in the sense that a holding is extremely vague, but in the sense that it is impossible to tell exactly what a party is asking the court to do. *New Hampshire Insurance Co. v. Bank of the Southwest*¹²² is such a case. The plaintiff insurance company sued the defendant bank, which had "cashed" an altered check and had collected the proceeds therefrom. The check bore obvious indications of alteration, and a teller at the defendant bank had exercised the precaution of calling the drawer about the correctness of the check before cashing it. Unfortunately, the teller took the advice of the person cashing the check to ask for "Cathy" or "Jan" when making the call to the drawer and ended up speaking to "Cathy," a participant in the alteration scheme. Upon being assured that the check was good, the teller turned over cash for the item. While the evidence tended to raise a valid fact question under section 3.304¹²³ as to the holder's notice of a claim or defense because of the "visible evidence of . . . alteration," the plaintiff failed to state any theory of recovery explaining why the defendant bank was liable to it. At

116. TEX. BUS. & COM. CODE ANN. § 3.302(a)(3) (Vernon 1968).

117. *In re Marriage of Rutherford*, 573 S.W.2d 299 (Tex. Civ. App.—Amarillo 1978, no writ) (when original holder waived right to foreclose as to past defaults by regular acceptance of late payments and failure to give notice that future defaults will provide basis for foreclosure, purchaser with notice of prior defaults is subject to maker's defense of waiver); TEX. BUS. & COM. CODE ANN. § 3.305 (Vernon 1968).

118. TEX. BUS. & COM. CODE ANN. § 3.601(b) (Vernon 1968).

119. 578 S.W.2d 841 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.).

120. *Id.* at 842. The court made no reference to any Code section.

121. TEX. BUS. & COM. CODE ANN. § 3.602 (Vernon 1968).

122. 584 S.W.2d 560 (Tex. Civ. App.—Amarillo 1979, no writ).

123. TEX. BUS. & COM. CODE ANN. § 3.304 (Vernon 1968).

most, the evidence may have defeated the bank's status as holder in due course, but, as the court pointed out, the status was immaterial because, "[a]bsent an assignment of error bringing forward a recognized theory of recovery, this court can grant no relief to the insurance company."¹²⁴ The court went on to mention various theories that the plaintiff could have asserted, but did not. In fact, some of them were expressly disclaimed. The judgment of the trial court in favor of the defendant was affirmed.

Evidence in Summary Judgment Commercial Paper Cases. In *Dallas County State Bank v. Thiess*¹²⁵ the maker of a note pledged certain certificates of deposit to the holder as collateral. The bank executed against the certificates when the note became overdue, offsetting some of the maker's indebtedness. In a suit to collect the balance due on the note, the bank moved for summary judgment, but failed to attach to its motion certified copies of the pledge agreement or the certificates of deposit. The trial court granted the motion, and the Texas Supreme Court, in a per curiam opinion, affirmed.¹²⁶ The pledge agreement and offset were not elements of the plaintiff's case, but instead an affirmative defense upon which the defendant bears the burden of pleading and proof.¹²⁷ "While it is no doubt preferable that all documents be attached, in a case such as this where the missing documents do not pertain to an element of the movant's suit, . . . Rule 166-A(e) of the Texas Rules of Civil Procedure will not require a reversal when the movant fails to attach them."¹²⁸

III. BANK TRANSACTIONS

A. *Payments and Collections*

Checks Made Payable in a Foreign Currency. The controversy in *Lakeway Co. v. Bravo*¹²⁹ arose when the purchasers under a real estate sales contract made what they believed was the final payment on August 18, 1976, for the purchase of a lot in Travis County, Texas. The contract stipulated the total price as "U.S. \$25,820.00 (MEX. \$322,750.00)." The downpayment was described as "U.S. \$5,000.00 (MEX. \$62,500.00)." The purchasers, citizens of Mexico, made the down-payment with a check made payable in pesos. The vendor accepted the check without objection, and it cleared the United States-Mexico banking and exchange system without difficulty. For the final payment of the balance due, the purchasers again issued a check made payable in pesos, which was received by the vendor without objection and deposited in the vendor's United States bank on Monday, August 20, 1976. The check for 260,250 pesos was paid by the Banco Nacional de Mexico on August 30, 1976. One day later the Mexican Government devalued the peso and, instead of yielding 20,820.00 United

124. 584 S.W.2d at 562.

125. 575 S.W.2d 20 (Tex. 1978).

126. *Id.*

127. *See* TEX. R. CIV. P. 94.

128. 575 S.W.2d at 21.

129. 576 S.W.2d 926 (Tex. Civ. App.—Tyler 1979, writ ref'd n.r.e.).

States dollars, the check for 260,250 pesos yielded only \$12,631.55 (United States), some \$8,188.45 less than the original United States dollar amount of the final payment. The vendor kept the funds but refused to deliver title to the property, claiming that the purchasers still owed the \$8,188.45 difference. In the purchasers' suit for specific performance of the contract, the court held that the payment of the check in due course by the Mexican bank on August 30, 1976, related back to the date when the check was delivered and, under section 3.802(a)(2),¹³⁰ and the payment of the check operated to discharge the obligors on the instrument and also on the underlying obligation.¹³¹ Specific performance was decreed.

Accountability of Payor Banks for Late Return of Items. Two cases reported during the survey period involved suits by payees against payor banks for allegedly excessive bank delays in returning items or sending notice of dishonor. In *Continental National Bank v. Sanders*¹³² a payor bank held a check for eight days without sending notice of dishonor. While this time period was substantially longer than the "midnight deadline" of section 4.302,¹³³ the payor argued that it had incurred no liability to the payee because of the payee's waiver of the strict midnight deadline standard. The waiver, it was claimed, arose by a resubmission of the check for a second time by the collecting bank. Although the payee had no knowledge of either the original dishonor or of the resubmission, the payor bank contended that the collecting bank, as an agent of the payee, could effectively waive the need for notice of dishonor under section 3.511(b)(1). The court firmly rejected this argument, noting that a waiver traditionally involves the knowing relinquishment of a right, and that the payee never knew about the late return or the resubmission.¹³⁴ The court also pointed out that the waiver of notice of dishonor under section 3.511(b)(1) refers to the waiver of notice by "the party to be charged" and that this was simply not applicable to the facts of the case. In addition, the court noted that the agency of the collecting bank was for a limited purpose that did not include the purpose of waiving any rights the payee might have against the payor bank. Judgment in favor of the payee under the strict liability rule

130. "Unless otherwise agreed where an instrument is taken for an underlying obligation . . . discharge of the underlying obligor on the instrument also discharges him on the obligation." TEX. BUS. & COM. CODE ANN. § 3.802 (Vernon 1968).

131. 576 S.W.2d at 929. For a specific discussion of foreign currency problems under the Code, see Kraemer, *Foreign Currency Instruments and the UCC*, TEX. BANK LAW., Mar. 1980, at 1. See generally TEX. BUS. & COM. CODE ANN. §§ 1.201(24), 3.107, 4.212(f) (Vernon 1968); 3 R. ANDERSON, UNIFORM COMMERCIAL CODE §§ 3-107, 4-212 (2d ed. 1971); J. CLARKE, H. BAILEY & R. YOUNG, BANK DEPOSITS AND COLLECTIONS 98-99 (4th ed. 1972); *id.* at 101-02 (3d ed. 1963); [1965] 6 BENDER'S UNIFORM COMMERCIAL CODE SERVICE 1-363 to -365; 1956 N.Y. LAW. REV. COMM. STUDY OF THE UNIFORM COMMERCIAL CODE 456; 1955 N.Y. LAW. REV. COMM. STUDY OF THE UNIFORM COMMERCIAL CODE 1368-69.

132. 581 S.W.2d 293 (Tex. Civ. App.—El Paso 1979, no writ).

133. The "midnight deadline" is defined as "midnight on [a bank's] next banking day following the banking day on which it receives the relevant item." TEX. BUS. & COM. CODE ANN. § 4.104(a)(8) (Vernon 1968).

134. 581 S.W.2d at 296.

of section 4.302 was affirmed. The collecting bank was not a party to the suit and its possible liability under section 4.202¹³⁵ was not discussed.

In *Western Air & Refrigeration, Inc. v. Metro Bank*¹³⁶ the payee also sued under section 4.302. In this case, however, the court held that the payee had reached an agreement with the payor bank that the payor was to hold the item "for collection" for a period of time, awaiting the availability of funds in the drawer's account to pay the check. The effect of this agreement, which was documented by a "hold for collection" receipt given to the payee, was to change the act of leaving the check with the payor from a "presentment for payment" under section 3.504, which would trigger section 4.302, into an agreement for the payor to hold the check for a period of time beyond the midnight deadline in hopes that the drawer's account would be credited with funds from which payment could be made. As a necessary incident to its disposition of the case, the court stated that parties may, by agreement, vary the time requirements of section 4.302.¹³⁷

An important feature distinguishing these two cases is that in *Continental* the payee never knew about the situation surrounding the delay and resubmission of the check; in *Western Air* the payee was fully aware of the lack of funds in the drawer's account and directly negotiated the "hold for collection" agreement with the payor. The lessons for bank counsel that emerge from the cases are: (1) do not cross the midnight deadline without consultation with the owner of the item, preferably documented; and (2) do not rely on the authority of a collecting bank to reach an agreement waiving section 4.302.

B. Letters of Credit

Dishonor of Drafts Drawn Under a Credit. Under chapter 5 of the Code, the issuer of a letter of credit is generally required to honor any draft or demand for payment that complies with the terms of the credit.¹³⁸ The requirement of honor is absolute if the demand for payment is made by one who qualifies as a holder in due course and the draft and any required documents comply *on their face* with the terms of the credit.¹³⁹ The issuer may choose to dishonor only if the demand for payment is not made by a holder in due course and the issuer is aware of defects that are not apparent on the face of the documents, such as forgery or fraud.¹⁴⁰ Even in this situation, as against its customer, the issuer may choose to honor demands under the credit despite knowledge of forgery, fraud, or the like unless a court enjoins such honor.¹⁴¹ These rules lie at the heart of letter of credit

135. TEX. BUS. & COM. CODE ANN. § 4.202 (Vernon 1968) sets forth the standard of care a collecting bank must exercise.

136. 599 F.2d 83 (5th Cir. 1979).

137. See TEX. BUS. & COM. CODE ANN. § 4.103(a) (Vernon 1968). See generally J. WHITE & R. SUMMERS, *supra* note 14, at 556.

138. TEX. BUS. & COM. CODE ANN. § 5.114(a) (Vernon 1968).

139. *Id.* § 5.114(b)(1).

140. *Id.* § 5.114(b)(2).

141. *Id.*

transactions, because it is the strong legal compulsion in favor of honoring the terms of a credit that give such credits their value. A breach of the duty to honor gives the person affected an automatic right to recover the face amount of the demand without the need to prove any damages.¹⁴²

These primary rules regarding letters of credit were all involved in reported litigation during the current survey period. The case of *East Girard Savings Association v. Citizens National Bank & Trust Co.*¹⁴³ was decided under the general duty to honor rule and the measure of damages principle. *Siderius, Inc. v. Wallace Co.*¹⁴⁴ involved the application of the limited exception permitting dishonor and the concept of injunction against honor.

In *East Girard Savings* the Citizens National Bank (Citizens) issued a standby letter of credit to East Girard Savings (Girard) to guaranty the credit of a general contractor and to induce Girard to provide financing for an apartment project that the contractor was building. Girard advanced funds to the contractor during construction, but, upon demand for payment under the credit, Citizens refused honor, claiming that Girard had failed to comply with the terms of the letter of credit requiring evidence that some obligation of the contractor was in default. Girard sued under the general rule requiring honor on the ground that the letter of credit was ambiguous as to whether evidence of default was needed and that the ambiguity should be resolved against Citizens as the drafter of the credit. The United States District Court for the Southern District of Texas agreed with Girard and entered judgment against Citizens for the face amount of the credit. On appeal, the Fifth Circuit affirmed. The court noted that:

[an issuing] bank must use the utmost care in drafting its letters of credit Banks are presumed to be cognizant of prevailing commercial practices in transacting their business When a bank eschews those practices, it does so at its own peril. If Citizens desired that it be liable only upon La Vista's default, it should have made default an express condition of the letter of credit.¹⁴⁵

The court also noted that recovery for the face amount of the credit was the proper measure of damage.¹⁴⁶

In *Siderius* both the beneficiary under the credit and the customer who had procured the issuance of the credit sued the issuing bank. The beneficiary sought to compel honor after the bank had refused payment because of fraud on the part of the beneficiary. The customer, in a separate action, sought an injunction to prevent honor by the bank. The two actions were consolidated for trial and the bank's refusal to honor the credit was held to

142. *Id.* § 5.115(a).

143. 593 F.2d 598 (5th Cir. 1979).

144. 583 S.W.2d 852 (Tex. Civ. App.—Tyler 1979, no writ).

145. 593 F.2d at 602-03. Unfortunately for Citizens, it attempted to draft a guaranty letter of credit on a form designed for a letter of credit involving a sale of merchandise. The use of the wrong form made the attempt to specify the required accompanying documents meaningless. Although the parties clearly intended that notice of default was to be a precondition to Citizens' liability as an issuer, "[a]n issuer's liability on a letter of credit is controlled solely by the terms of that letter." *Id.* at 602.

146. *Id.* at 603.

be proper under the limited exception to section 5.114(b)(2) discussed above.¹⁴⁷ The trial court's decision was upheld.

C. Texas Banking Code

Confidentiality of Banking Department Records. In *Stewart v. McCain*¹⁴⁸ the Texas Supreme Court held that article 342—210 of the Texas Banking Code¹⁴⁹ establishes an absolute privilege on the part of the Banking Department to refuse to divulge information concerning the confidential section of a bank examination report. The court noted that an earlier opinion of the attorney general had concluded that the Texas Open Records Act¹⁵⁰ did not apply to financial information compiled under article 342—210.¹⁵¹

IV. INVESTMENT SECURITIES

In *Reed v. White, Weld & Co.*¹⁵² the plaintiff brought a conversion action against a broker for the wrongful sale of securities. The securities had been part of an estate and were sold by the broker under instructions by one of three executors who did not have authority to order the sale. The broker, however, had accounted to the estate for the full market value of the shares and the plaintiffs, who were beneficiaries under the estate, sought damages only for the interest the shares would have earned during their lifetimes had they not been sold. The court held that the conversion action would not lie for the future earnings because the plaintiffs had already been fully compensated and could simply purchase the same securities on the market to earn the future interest.¹⁵³ The plaintiffs did not allege any special damage or any fraud on the part of the broker. Although not discussed, the provisions of section 8.318 of the Code may be usefully compared with the decision in *Reed*.¹⁵⁴

V. SECURED TRANSACTIONS

A. Validity of Security Agreement

Retail Installment Sales and Chapter 9. While a commercial transaction may validly include a waiver of defenses clause under the terms of section 9.206, that section is expressly made "[s]ubject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods."¹⁵⁵

One such statute is article 5069—7.07(6) of the Texas Consumer Credit

147. See text at note 140 *supra*.

148. 575 S.W.2d 509 (Tex. 1978).

149. TEX. REV. CIV. STAT. ANN. art. 342—210 (Vernon 1973).

150. *Id.* art. 6252—17a (Vernon Supp. 1980).

151. TEX. ATT'Y GEN. ORD-147 (1976).

152. 571 S.W.2d 395 (Tex. Civ. App.—Texarkana 1978, no writ).

153. *Id.* at 397.

154. TEX. BUS. & COM. CODE ANN. § 8.318 (Vernon 1968) provides that an agent who sells securities in good faith according to the instructions of his principal is not liable for conversion although the principal had no right to dispose of them.

155. *Id.* § 9.206(a) (Vernon Supp. 1980).

Code,¹⁵⁶ which prohibits the use of waiver of defense clauses in consumer motor vehicle transactions. In *Horn v. Nationwide Financial Corp.*¹⁵⁷ it was held that the inclusion of such a clause in violation of article 5069—7.07(6) permitted the consumer-buyers to recover the automatic penalty amounts specified by the Consumer Credit Code¹⁵⁸ and that both the seller and the assignee were liable for the violation.

In *Martens v. General Motors Acceptance Corp.*¹⁵⁹ the plaintiffs also alleged a violation of the Consumer Credit Code. The retail installment contract used by GMAC contained a clause that provided, *inter alia*, that in the event of a default the seller could “take immediate possession of said [secured] property without demand . . . and for this purpose seller may enter upon the premises where said property may be and remove same.” The contract also authorized the secured party to take possession of any other property contained in the secured motor vehicle at the time of repossession “and hold same for buyer at buyer’s risk without liability on the part of seller.” The plaintiff buyers contended that this clause purported to waive the buyers’ right to sue the secured party for breaches of the peace and other illegal acts committed in the repossession of the secured motor vehicle. The plaintiffs alleged that this waiver of rights violated article 5069—7.07(4),¹⁶⁰ which prohibits the use of a clause waiving the buyer’s rights of action against the seller or assignee for any illegal acts committed in the repossession of goods. The court held that the clause in question, although subject to the interpretation that it operated as a waiver in violation of the Consumer Credit Code, did not contain express language of waiver and could be “more reasonably construed to comply with the Code.”¹⁶¹ The court distinguished *Southwestern Investment Co. v. Man-nix*¹⁶² and *Ford Motor Credit Co. v. Cole*,¹⁶³ but the distinctions are not persuasive. Caution should be exercised in relying on *Martens* as a precedent.

Truth In Lending Disclosures in Security Agreement. In *Chapman v. Miller*¹⁶⁴ the failure of a seller to put the required description of a retained security interest on the same side of a retail installment contract as the space for the buyer’s signature was held to violate section 226.8(a)(1) of regulation Z.¹⁶⁵ The transaction was not saved by an interpretive ruling of

156. The statute was amended in 1979, but subsection (6) was not changed. Compare TEX. REV. CIV. STAT. ANN. art. 5069—7.07(6) (Vernon 1977) with *id.* art. 5069—7.07(6) (Vernon Supp. 1980).

157. 574 S.W.2d 218 (Tex. Civ. App.—San Antonio 1978, writ ref’d n.r.e.).

158. The penalties for a violation of the Consumer Credit Code are contained in TEX. REV. CIV. STAT. ANN. art. 5069—8.01 (Vernon Supp. 1980).

159. 584 S.W.2d 941 (Tex. Civ. App.—Dallas 1979, no writ).

160. See note 156 *supra*. The current version of § 4 remains the same. TEX. REV. CIV. STAT. ANN. art. 5069—7.07(4) (Vernon Supp. 1980).

161. 584 S.W.2d at 944.

162. 557 S.W.2d 755 (Tex. 1977).

163. 503 S.W.2d 853 (Tex. Civ. App.—Fort Worth 1973, writ dismissed).

164. 575 S.W.2d 581 (Tex. Civ. App.—Beaumont 1978, writ ref’d n.r.e.).

165. 12 C.F.R. § 226.1-1503 (1979).

the Federal Reserve Board allowing disclosures to be made on both sides of a document that combines an installment sales contract with a security agreement.¹⁶⁶ That ruling requires the space for the buyer's signature to be located at the end of the document; the signature space in *Chapman* was at the bottom of the face side and not at the end on the reverse side. An attempted incorporation by reference to the disclosures on the reverse side of the agreement was also ineffective because the incorporating language appeared *below* the buyer's signature line on the face side. The decision in *Chapman* should be read in light of the later Texas Supreme Court opinion in *General Electric Credit Corp. v. Smail*.¹⁶⁷

B. *Perfection and Attachment—Legislative Developments*

Purchase Money Security Interests. Since the original enactment of the Uniform Commercial Code in Texas in 1966, sections 9.301(b) and 9.312(d) have provided for a ten-day grace period for the perfection of purchase money security interests. The grace period allows the "relation-back" of delayed filings made within the ten-day period against intervening parties claiming an interest in the same collateral.¹⁶⁸

An amendment during the last legislative session extended the purchase money grace period from ten days to twenty days in both section 9.301(b) and section 9.312(d).¹⁶⁹ In the opinion of the author, the extension of this time period for delayed filings should be approached with great caution and should be used only in cases of necessity when filing within ten days is simply impossible. Reliance on the increased time period should not become habitual. The reason for this rather emphatic caveat is that the new Federal Bankruptcy Code,¹⁷⁰ which became effective October 1, 1979, permits only a ten-day grace period for the delayed filing of security interests.¹⁷¹ A delay of more than ten days will permit the trustee in bankruptcy to assert that the claimed security interest is void as a preference under the extensively revised and strengthened preference section of the Bankruptcy Code.¹⁷² Because the gift of prescience is not common

166. *Id.* § 226.801. The regulations and rulings are promulgated under the authority of the Federal Truth in Lending Act, 15 U.S.C. §§ 1601-67e (1976).

167. 584 S.W.2d 690 (Tex. 1979). In *General Electric* the Texas Supreme Court carefully distinguished Federal Reserve Board regulations pursuant to the Truth in Lending Act from Federal Reserve Board interpretations of regulation Z. The latter are entitled to deference on the part of the courts, while the former are, in effect, "legislative rules." The court held that the interpretive ruling argued in *Chapman v. Miller*, see note 164 *supra* and accompanying text, had a very limited application to forms designed for electrical processing and did not apply to the facts of the case. In its discussion of § 226.8(a) of regulation Z the court concluded that all of the required disclosures of § 226.8(b) were on the face of the agreement above the buyer's signature. Since the interpretive ruling did not apply, the fact that the buyer's signature was not below the full content of the agreement was immaterial. *Id.* at 693-97. The court also raised, but did not decide, the propriety of a defense of substantial compliance to a charge of a violation of the Truth in Lending Act. *Id.*

168. J. WHITE & R. SUMMERS, *supra* note 14, at 918-20.

169. 1979 Tex. Gen. Laws, ch. 318, §§ 1-2, at 723.

170. 11 U.S.C. §§ 101-1501 (Supp. 1979).

171. *Id.* § 547(e)(2).

172. *Id.* § 547.

among secured creditors, a debtor's future bankruptcy should always be considered a potential risk, and filing within ten instead of twenty days is a virtually cost free means of avoiding a substantial part of that risk. In sum, ignore the section 9.301(b) and 9.312(d) amendments and file quickly.

Security Interests in Boats and Motors. Section 9.302 of the Code provides for the perfection of security interests in property covered by certificate of title statutes to be by notation on the certificate rather than by filing of a financing statement.¹⁷³ Since 1977 the Parks and Wildlife Code has provided for the issuance of certificates of title on motorboats and outboard motors.¹⁷⁴ By amendments added during the last legislative session, such certificates of title may now be issued, and liens noted thereon, by county tax assessors and collectors as well as by the Parks and Wildlife Department.¹⁷⁵

In *Olson v. Holmes*,¹⁷⁶ another truth in lending case, the seller described the retained security interest on the face of the security agreement above the space for the buyer's signature; on the reverse side, however, the seller listed the remedies available to him as a secured seller. The Austin court of civil appeals held that, under federal court interpretations of regulation Z, this listing was unnecessary because the description on the face was an adequate disclosure.¹⁷⁷ The existence of this unnecessary listing did not, therefore, violate the Truth in Lending Act or regulation Z. On appeal, the Texas Supreme Court held that the court of civil appeals had properly referred to federal rather than state case law to interpret the Truth in Lending Act.¹⁷⁸ The earlier opinion by another court of civil appeals in *McDonald v. Savoy*¹⁷⁹ was disapproved to the extent that it conflicted with the federal interpretation of the Truth in Lending Act applied in *Olson*.¹⁸⁰

Assignment as Sale or for Security. In *Berman, Fichtner & Mitchell, Inc. v. Kahn*¹⁸¹ the Eastland court of civil appeals refused to permit an assignee to show by parol evidence that an assignment of an interest in collateral was intended for security only and not as a discharge of a debt, when the assignment agreement described the assignment as being for the purpose of discharging an obligation for attorney's fees. The court squarely rejected the "argument that an assignee may always show by parol evidence that an assignment, absolute on its face, was intended only as security for a debt."¹⁸²

173. TEX. BUS. & COM. CODE ANN. § 9.302(c)(2) (Vernon Supp. 1980).

174. TEX. PARKS & WILD. CODE §§ 31.045-.055 (Vernon Supp. 1980).

175. 1979 Tex. Gen. Laws, ch. 607, §§ 1-5, at 1352-53.

176. 571 S.W.2d 211 (Tex. Civ. App.—Austin 1978), writ *ref'd n.r.e. per curiam*, 587 S.W.2d 678 (Tex. 1979).

177. The court cited the leading case of *Grant v. Imperial Motors*, 539 F.2d 506 (5th Cir. 1976), in support of its decision.

178. *Holmes v. Olson*, 587 S.W.2d 678 (Tex. 1979) (*per curiam*).

179. 501 S.W.2d 400 (Tex. Civ. App.—San Antonio 1973, no writ).

180. 587 S.W.2d at 679.

181. 573 S.W.2d 869 (Tex. Civ. App.—Eastland 1978, no writ).

182. *Id.* at 871.

C. *Priorities*

Priorities in Cases Involving Federal Agencies. A continuing problem of some importance has been the determination of what law applies to a commercial transaction when one of the parties to the transaction is an agency of the federal government. Since the decision in *Clearfield Trust Co. v. United States*,¹⁸³ the United States Supreme Court has consistently held that federal law is to be applied to determine the rights of the United States when it is a party to a commercial dispute. While the decisions have been consistent regarding the choice of a *source* of law, however, there has been great inconsistency in determining the *content* of the law.¹⁸⁴

A recent decision by the United States Supreme Court in *United States v. Kimbell Foods, Inc.*¹⁸⁵ has remedied much of the inconsistency with a determination that, in cases involving the application of state laws that do not discriminate between federal agencies and private lenders, *e.g.*, the Uniform Commercial Code, the content of the federal law is to be found by incorporation of the state law. An example is the priority rules of the Texas Business and Commerce Code that were involved in the *Kimbell* case.¹⁸⁶ The Court explicitly limited its holding to voluntary agency loan activities in order to prevent the application of the *Kimbell* doctrine to federal tax lien situations, which would present problems of special federal interest because of the involuntary nature of government tax lien claims.¹⁸⁷

In *Aetna Insurance Co. v. Texas Thermal Industries, Inc.*¹⁸⁸ the Court of Appeals for the Fifth Circuit had occasion to consider the relative priority of a federal tax lien vis-a-vis a properly perfected chapter 9 security interest. While *Aetna* was reported shortly before *Kimbell* was handed down, *Aetna* is consistent with the Supreme Court decision. In *Aetna* the court held that the Small Business Administration, the holder of a security interest properly perfected by filing, had priority over a federal tax lien filed some months later.¹⁸⁹ The court reasoned that the Federal Tax Lien Act of 1966¹⁹⁰ had made the "choateness doctrine"¹⁹¹ inapplicable to cases covered by the Act. Subsections 6323(a) and (h)(1) explicitly provide that

183. 318 U.S. 363 (1943).

184. Compare *United States v. Hext*, 444 F.2d 804 (5th Cir. 1971) (content determined by reference to model uniform act), with *United States v. Oswald & Hess Co.*, 345 F.2d 886 (3d Cir. 1965) (content determined by reference to federal common law).

185. 440 U.S. 715 (1979).

186. TEX. BUS. & COM. CODE ANN. §§ 9.312, .314 (Vernon 1968 & Supp. 1980), cited in *Kimbell Foods, Inc. v. Republic Nat'l Bank*, 557 F.2d 491, 497-98 (5th Cir. 1977).

187. 440 U.S. at 729.

188. 591 F.2d 1035 (5th Cir. 1979).

189. *Id.* at 1039.

190. 26 U.S.C. §§ 6321-6323 (1976).

191. The choateness doctrine is a principle of federal common law governing priority conflicts between nonfederal liens or obligations and federal claims for the collection of debts owing the United States. Prior to 1966 the United States Supreme Court had held that in order for a nonfederal lien to prevail over a later filed federal tax lien, "the identity of the lienor, the property subject to the lien, and the amount of the lien," must be established as of the date of filing of notice of the tax lien. *United States v. New Britain*, 347 U.S. 81, 84 (1953). See generally Kennedy, *The Relative Priority of the Federal Government: The Pernicious Career of the Inchoate and General Lien*, 63 YALE L.J. 905 (1954).

perfected security interests have priority over later federal tax liens. Because the collateral originally claimed by the secured party had been destroyed by fire and the parties were seeking recovery against insurance proceeds, the court also needed to determine whether insurance proceeds were "proceeds" of collateral within the meaning of that term in section 9.306. Looking to state law, the court found no decisions directly on point under the 1966 version of the Code.¹⁹² It was persuaded, however, by the amendment of section 9.306 in 1973¹⁹³ that the original intent underlying the earlier version was to include insurance within the scope of "proceeds."¹⁹⁴

Secured Party as Chapter 2 "Good Faith Purchaser." It is important to recognize that one of the secured party's principal rights is contained, not in chapter 9, but in section 2.403 of chapter 2. In pertinent part, that section provides, "A person with voidable title has power to transfer a good title to a good faith purchaser for value."¹⁹⁵ A secured party can qualify as a good faith purchaser for value under the Code definitions.¹⁹⁶ A classic fact situation illustrating the operation of section 2.403 was presented in *Leif Johnson Ford, Inc. v. Chase National Bank*.¹⁹⁷ In that case, the seller sold two trucks to buyer, who paid by check and obtained "clean" certificates of title to the vehicles three days later. On the basis of these certificates, buyer then obtained a loan from the bank, which took a security interest in the trucks and promptly filed an application with the Texas Highway Department to have the certificates amended to reflect the bank's lien. Shortly thereafter, the seller learned that the buyer's check had failed to clear due to insufficient funds and sought to file its own amendment on the certificates to claim a lien in its own favor. When the seller and the bank learned of their competing claims to the trucks, litigation commenced. The trial court awarded the plaintiff bank partial summary judgment that its lien had priority. On appeal, the court held that section 2.403 gave the bank the rights of a good faith purchaser for value with priority over the claim of the unpaid seller.¹⁹⁸

Continuation of Security Interest in Sold Collateral. Section 9.306(b) provides in effect that a security interest continues in collateral, notwithstanding sale, exchange, or other disposition, unless: (1) chapter 9 itself contains a rule effecting a "cut-off" of the security interest upon disposition;¹⁹⁹ or (2) the secured party authorizes disposition in the security agreement or otherwise.²⁰⁰

192. 1966 Tex. Gen. Laws, ch. 785, § 1, at 2534-36.

193. 1973 Tex. Gen. Laws, ch. 400, § 5, at 1012-14.

194. 591 F.2d at 1039.

195. TEX. BUS. & COM. CODE ANN. § 2.403(a) (Vernon 1968).

196. *Id.* §§ 1.201(19), (32), (33), (44).

197. 578 S.W.2d 792 (Tex. Civ. App.—Beaumont 1979, no writ).

198. *Id.* at 794.

199. *See, e.g.*, TEX. BUS. & COM. CODE ANN. §§ 9.307-.309 (Vernon Supp. 1980).

200. Disposition might be authorized by explicit statement in the security agreement as,

Two cases were decided during the survey period involving the continuation of a security interest in collateral despite sale of that collateral by the debtor. In *Fisher v. First National Bank*²⁰¹ the sale of cattle by a farmer to a purchaser did not operate to cut off a security interest in the cattle. The purchaser argued that the secured party had "authorized" the sale by a prior course of conduct of permitting the farmer to sell cattle without objection, despite the existence of a "no-sale without consent" clause in the security agreement. On this point, the court discussed the case of *Clovis National Bank v. Thomas*,²⁰² which squarely supported the purchaser's position, but noted several contrary decisions from other jurisdictions.²⁰³ After an analysis of the competing arguments, the court expressly declined to follow the rule of *Thomas* and held that no authorization of the sale had occurred.²⁰⁴ Judgment was rendered in favor of the secured party.

In *Ford Motor Credit Co. v. Uresti*²⁰⁵ the court held that the security interest of a secured party continued in a tractor despite sale of the tractor by the debtor to a third party. The secured party was allowed recovery against the third party purchaser, subject to a claim by the debtor and purchaser that the security agreement contained provisions violating the Federal Truth in Lending Act and the State Consumer Credit Code. The case was remanded for trial on these issues.

D. Default, Repossession, and Resale of Collateral

Default and Acceleration. It has been widely recognized that default is "whatever the security agreement says it is."²⁰⁶ The only Code limitation on this concept is the doctrine of good faith.²⁰⁷ Likewise, when a default triggers an acceleration clause, the only limitation on the ability to accelerate is that of good faith.²⁰⁸ The burden of proving a lack of good faith is on the debtor.²⁰⁹

In *Sparkman v. Peoples National Bank*²¹⁰ the debtor sued the secured party for conversion of the collateral covered by the security agreement, alleging that no default had occurred and that the secured debt had been accelerated in bad faith. A second count for slander was also alleged in the petition. The court recognized that the burden of proof on the issues of default and lack of good faith were on the debtor and held that this burden

for example, when the collateral is inventory and resale is expected; it might also be authorized by independent action or agreement outside of the original security agreement.

201. 584 S.W.2d 515 (Tex. Civ. App.—Amarillo 1979, no writ).

202. 77 N.M. 554, 425 P.2d 726 (1967).

203. *Wabasso State Bank v. Caldwell Packing Co.*, 308 Minn. 349, 251 N.W.2d 321 (1976); *Garden City Prod. Credit Ass'n v. Lannan*, 186 Neb. 668, 186 N.W.2d 99, 108 (1971).

204. 584 S.W.2d at 519.

205. 581 S.W.2d 298 (Tex. Civ. App.—Waco 1979, no writ).

206. J. WHITE & R. SUMMMERS, *supra* note 14, at 956 (quoting 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY 1193 (1965)).

207. TEX. BUS. & COM. CODE ANN. § 1.203 (Vernon 1968).

208. *Id.* § 1.208.

209. *Id.*

210. 580 S.W.2d 868 (Tex. Civ. App.—Texarkana 1979, writ ref'd n.r.e.), *former appeal reported*, 501 S.W.2d 739 (Tex. Civ. App.—Tyler 1973, writ ref'd n.r.e.).

had not been met. The issue of whether a slander had occurred was remanded for trial.

Reasonableness of Notice and Resale of Collateral. Section 9.504(c) of the Code requires that a secured party send reasonable notice of the time and place for the resale of collateral after repossession. In *Byrd v. General Motors Acceptance Corp.*²¹¹ it was held that the mailing of notices to the joint debtors by both regular and certified mail more than ten days before the sale was conducted satisfied the statutory requirement that notice be "sent."²¹² The evidence showed that the letters sent by regular mail were never returned to the sender and that a return receipt for one of the certified letters was signed by one of the joint debtors and returned to the secured party. The certified letter sent to the other debtor was returned unclaimed after the post office had twice notified him that the letter was being held. The return of this letter was held not to vitiate the notice under the circumstances of the case.

In *Siboney Corp. v. Chicago Pneumatic Tool Co.*²¹³ it was held that the omission of the words "Houston, Texas" after a street address in a notice that contained several other references to "Houston" presented a fact issue on which a jury could conclude that the notice was reasonable. An issue was also raised as to whether the sale itself was conducted in a commercially reasonable manner. In an opinion detailing the manner of resale, the court held that the resale was commercially reasonable.²¹⁴ The court found that evidence supporting the commercial reasonableness included the following elements: a depressed market, notice to the debtor, newspaper publicity of the sale, adequate opportunity for inspection, acceptance of the highest bid, and minimal sale expenses.²¹⁵

Failure to Resell in a Commercially Reasonable Manner. If it is established that a secured party has failed to resell collateral in a commercially reasonable manner, a presumption arises that the value of the collateral was equal to the amount of the debt; the burden of going forward with evidence to overcome the presumption is on the secured party.²¹⁶ This rule was adopted in *Tackett v. Mid-Continent Refrigerator Co.*,²¹⁷ in which the secured party converted collateral to its own use and failed to offer any evidence of the fair market value of the collateral on the date of conversion. A take nothing judgment was rendered against the secured party.

The latest chapter in the saga of *Maxey v. Texas Commerce Bank*²¹⁸ was

211. 581 S.W.2d 198 (Tex. Civ. App.—Waco 1979, no writ).

212. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Vernon Supp. 1980).

213. 572 S.W.2d 4 (Tex. Civ. App.—Houston [1st Dist.] 1978, writ ref'd n.r.e.).

214. *Id.* at 7-8.

215. *Id.* at 7 (citing *Pruske v. National Bank of Commerce*, 533 S.W.2d 931, 937 (Tex. Civ. App.—San Antonio 1976, no writ)).

216. *O'Neil v. Mack Trucks, Inc.*, 533 S.W.2d 832 (Tex. Civ. App.—El Paso 1974), *rev'd on other grounds*, 551 S.W.2d 32 (Tex. 1977), *noted in* 8 TEX. TECH L. REV. 560 (1977).

217. 579 S.W.2d 545 (Tex. Civ. App.—Fort Worth 1979, writ ref'd n.r.e.).

218. 571 S.W.2d 39 (Tex. Civ. App.—Armarillo 1978), *writ ref'd n.r.e. per curiam*, 580 S.W.2d 340 (Tex. 1979). This judgment is the latest in the tortuous history of a case that was

reported during the survey period. The Amarillo court of civil appeals had held that the debtor had introduced ample evidence to support jury findings that the defendant secured party had not conducted a commercially reasonable resale and had acted with a lack of good faith in the resale proceedings. The jury findings on the issue of damages, however, were against the great weight of the evidence, and the trial judge erred in substituting his own findings on the damage issues. The case was once again remanded for another trial. An appeal to the Texas Supreme Court was refused, the court stating that it did not "have jurisdiction to pass upon the fact question of the great weight and preponderance of the evidence."²¹⁹

Motor Vehicle Possessory Liens—Legislative Developments. Section 9.310 of the Code grants a priority to the holder of a possessory mechanic's lien on secured property.²²⁰ The Certificate of Title Act²²¹ and the motor vehicle possessory lien statutes²²² have been amended to provide a new method of enforcement by holders of possessory liens on motor vehicles. Such liens generally cover the cost of repair charges.²²³

Under the new sale procedure, when the motor vehicle has remained in the possession of the lien holder for thirty days and the charges remain unpaid, in order to sell the vehicle, the lien holder must give written notice of the accumulated charges and a demand for payment to the owner and to all lienholders, *i.e.*, secured parties whose liens are noted on the certificate of title.²²⁴ If the charges are not paid within thirty days from the date the notice was mailed, the vehicle may be sold at public sale and the proceeds applied to the debt.²²⁵ A new certificate of title may be issued to the purchaser upon the affidavit of the lienholder that the required notice was given and the sale conducted in accordance with the statutes.²²⁶

VI. MISCELLANEOUS

Guaranty Agreements. In *Prather v. Citizens National Bank*²²⁷ the guarantor and the creditor bank allegedly reached an agreement that the bank would release the guarantor from further indebtedness if a payment of

first tried in 1970, reversed and remanded for insufficient evidence in *Citizens Nat'l Bank v. Maxey*, 461 S.W.2d 138 (Tex. Civ. App.—Amarillo 1970, writ ref'd n.r.e.). At retrial, summary judgment was granted to the bank, which was upheld in *Maxey v. Citizens Nat'l Bank*, 489 S.W.2d 697 (Tex. Civ. App.—Amarillo 1972). The Texas Supreme Court reversed the second appellate decision, and remanded for a new trial in *Maxey v. Citizens Nat'l Bank*, 507 S.W.2d 722 (Tex. 1974). The decisions reported here result from appeals from the third trial of the case.

219. *Maxey v. Texas Commerce Bank*, 580 S.W.2d 340, 340 (Tex. 1979) (per curiam).

220. TEX. BUS. & COM. CODE ANN. § 9.310 (Vernon Supp. 1980). The priority of the mechanic over the secured party under § 9.310 was discussed and applied in *Gulf Coast State Bank v. Nelms*, 525 S.W.2d 866 (Tex. 1975).

221. TEX. REV. CIV. STAT. ANN. art. 6687—1, §§ 1-65 (Vernon 1977).

222. *Id.* arts. 5502-04 (Vernon 1958 & Supp. 1980).

223. 1979 Tex. Gen. Laws, ch. 490, §§ 2—3, at 1059-60.

224. *Id.* § 2, at 1060.

225. *Id.*

226. *Id.* § 3, at 1060.

227. 582 S.W.2d 903 (Tex. Civ. App.—Waco 1979, writ ref'd n.r.e.).

\$28,000 was made on a \$140,000 debt. Although the evidence on whether such an agreement had been made was conflicting, the court held there was no need to resolve the evidentiary conflict because, under any view of the facts, there was no consideration to support the alleged accord and satisfaction.²²⁸ In *First National Bank v. Love*²²⁹ it was held that parol evidence could not be introduced to contradict or vary the clear terms of a guaranty agreement creating an unconditional obligation to pay.

In *Thompson v. Preston State Bank*,²³⁰ in which a credit card account was under an absolute and unlimited guaranty agreement, the Dallas court of civil appeals held that the guarantor of the account was not relieved of liability by actions of the bank administering the credit card account when the bank both increased the credit limit on the account without notice to the guarantor and negligently allowed the cardholder to make purchases beyond the credit limit. The court, however, held that by its own terms the guaranty was limited to "purchases" and did not extend to "finance charges." Therefore, the guarantor was liable only for interest at the legal rate from the date of default and not for interest at the credit card contract rate.²³¹

Liquidated Damages Clauses. In *Krenek v. Wang Laboratories, Inc.*²³² and *Mayfield v. Hicks*²³³ liquidated damages clauses contained in equipment lease agreements were held void as penalty provisions because the clauses could be invoked for any default, no matter how minor. The courts reasoned that there was, therefore, no reasonable relation between the amounts specified as liquidated damages and the amount of actual damages resulting from a default.

Statute of Limitations—Legislative Developments. The statute of limitations on actions for debts not evidenced by a writing and for stated and open accounts has been extended from two to four years.²³⁴ This amendment conforms articles 5526 and 5527 of the Texas Revised Civil Statutes to the four-year time period for contract actions involving goods stated in section 2.725 of the Business and Commerce Code.

228. *Id.* at 907.

229. 584 S.W.2d 345 (Tex. Civ. App.—Eastland 1979, writ *dism'd*).

230. 575 S.W.2d 312 (Tex. Civ. App.—Dallas 1978, writ *ref'd n.r.e.*).

231. *Id.* at 315.

232. 583 S.W.2d 454 (Tex. Civ. App.—Waco 1979, no writ).

233. 575 S.W.2d 571 (Tex. Civ. App.—Dallas 1978, writ *ref'd n.r.e.*).

234. 1979 Tex. Gen. Laws, ch. 716, § 2, at 1769 (codified at TEX. REV. CIV. STAT ANN. art. 5527 (Vernon Supp. 1980)).

