



January 1983

Commercial Transactions

John Krahrmer

Recommended Citation

John Krahrmer, *Commercial Transactions*, 37 Sw L.J. 145 (1983)
<https://scholar.smu.edu/smulr/vol37/iss1/7>

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

COMMERCIAL TRANSACTIONS

by
*John Krahmer**

THIS Article discusses case developments in the Texas law of commercial transactions that were reported during the 1982 survey period. In addition, for the convenience of those who regularly practice in the area of commercial law, recent publications of special interest are collected in the accompanying footnote.¹ 1982 produced no legislative developments to report in this Article. The organization of this Article follows the topical outline of the Uniform Commercial Code.²

I. GENERAL PROVISIONS

A. *Accord and Satisfaction*

A recurring situation in the law of commercial transactions is the debtor who sends to a creditor a check marked "payment in full." The creditor then indorses and cashes the check, sometimes crossing out the "payment in full" language and marking it "accepted under protest." The legal issue is simple to state: Has there been a valid accord and satisfaction between the parties? The solution is not so simple. Common law recognized a valid accord and satisfaction on these facts and provided the debtor with an affirmative defense if the creditor should later sue for an alleged remaining balance due.³ Texas, as well as a majority of American jurisdic-

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

1. W. HAWKLAND, *UNIFORM COMMERCIAL CODE SERIES* (1982) (projected nine-volume treatise on the Uniform Commercial Code); 3 W. NORTON, *BANKRUPTCY LAW AND PRACTICE* (1981) (good reference work for research under the new Bankruptcy Code); SHEPHARD'S *UNIFORM COMMERCIAL CODE CITATIONS* (1982) (useful addition to Shephard's series permitting statute-to-case research on Uniform Commercial Code subjects); STATE BAR OF TEXAS, *CREDITORS' RIGHTS IN TEXAS* (2d ed. 1981) (two-volume treatment of the major Texas commercial, lien, and lending statutes).

2. The Uniform Commercial Code first became effective in Texas on July 1, 1966. 1965 Tex. Gen. Laws, ch. 721, §§ 1-101 to 10-105, at 1-182. In 1967 it became part of the Texas Business and Commerce Code. 1967 Tex. Gen. Laws, ch. 785, §§ 1-6, at 2343-2621. 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 1 through 11 of the Texas Business and Commerce Code [hereinafter referred to as the Code]. TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1968 & Supp. 1982-1983).

3. *Hudson v. Yonkers Fruit Co.*, 258 N.Y. 168, 172, 179 N.E. 373, 375 (1932); see Gold, *Accord and Satisfaction by Estoppel*, 27 IOWA L. REV. 31 (1941-1942) (common law rules and copious citation of authority on accord and satisfaction in check situation).

tions, adopted this general rule.⁴

The Uniform Commercial Code casts doubt on the continuing vitality of the common law accord and satisfaction rule. Section 1.207 of the Code provides that "[a] party who with explicit reservation of rights . . . assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved."⁵ The interpretation of this language has been extremely divergent. Some courts hold that this provision does not explicitly displace the common law rule, and that the pre-Code accord and satisfaction doctrine still controls.⁶ Other courts read the section as a legislative reversal of the pre-Code law and hold that a creditor can accept a "payment in full" check under protest and later sue for any balance due without facing an accord and satisfaction defense.⁷

In *Hixson v. Cox*⁸ the Dallas court of appeals held that the pre-Code accord and satisfaction rule continued to apply in Texas, at least in cases involving payment by check for services rendered.⁹ The court left open the possibility of a different result in cases involving the sale of goods, because such sales are within the scope of the Code.¹⁰ The court failed to note, however, that any payment by check is within the scope of the Code, regardless of whether it is for goods or services.¹¹ While the rationale of *Hixson* is not entirely satisfactory, the case does address the effect of the Code on the common law doctrine of accord and satisfaction and represents an advance over the earlier decision in *Roylex, Inc. v. S. & B. Engineers, Inc.*,¹² which merely applied pre-Code law without consideration of possible Code modifications.¹³

II. SALES TRANSACTIONS

A. Enforceability of Sales Contracts

Statute of Frauds—Signed Writing. The statute of frauds requirements for the sale of goods are found in section 2.201 of the Code.¹⁴ The basic rule states that in contracts for the sale of goods for a price of \$500 or more the contract is not enforceable unless there is a writing to evidence the sale

4. *First State Bank v. Knapp*, 3 S.W.2d 468 (Tex. Civ. App.—Amarillo 1928, no writ); see Gold, *supra* note 3, at 31.

5. TEX. BUS. & COM. CODE ANN. § 1.207 (Tex. UCC) (Vernon 1968).

6. See, e.g., *Connecticut Printers, Inc. v. Gus Kroesen, Inc.*, 134 Cal. App. 3d 54, 61, 184 Cal. Rptr. 436, 439 (1982); *Eder v. Yvette B. Gervy Interiors, Inc.*, 407 So. 2d 312, 314 (Fla. 1981).

7. See, e.g., *Aguiar v. Harper & Row Publishers, Inc.*, 452 N.Y.S.2d 519, 522, 114 Misc.2d 828 (N.Y. City Civ. Ct. 1982); *Scholl v. Tallman*, 247 N.W.2d 490, 492 (S.D. 1976).

8. 633 S.W.2d 330 (Tex. Ct. App.—Dallas 1982, writ ref'd n.r.e.).

9. *Id.* at 331.

10. *Id.*; see also TEX. BUS. & COM. CODE ANN. § 1.207 comment 1 (Tex. UCC) (Vernon 1968).

11. 633 S.W.2d at 330.

12. 592 S.W.2d 59 (Tex. Civ. App.—Texarkana 1979, no writ).

13. See *id.*; see also Krahmer, *Commercial Transactions, Annual Survey of Texas Law*, 35 Sw. L.J. 191, 193-94 (1981) (discussion of *Roylex*).

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

signed by the party against whom enforcement is sought.¹⁵ Applying this rule, the court in *Martco, Inc. v. Doran Chevrolet, Inc.*¹⁶ held that a signed bid worksheet submitted to a buyer for preliminary consideration could not be used as evidence that a sale had occurred, but could only be used to show that the parties contemplated a future transaction.¹⁷ The court recognized that this was a case of first impression in Texas,¹⁸ but cited numerous cases from other jurisdictions to support its conclusion that writings in confirmation of a contract must look backward, not forward, in time.¹⁹ The decision in *Martco* is a sensible interpretation of the basic rule of section 2.201.

Statute of Frauds—Goods Received and Accepted. In addition to the basic “signed writing” rule, section 2.201 permits enforcement of a contract for the sale of goods without a writing when one or more exceptional circumstances occur.²⁰ One such circumstance is the receipt and acceptance of goods by a buyer.²¹ The Code waives the writing requirement in this instance because there is other objective evidence to show that a real transaction occurred between the parties. In *Stone v. Metro Restaurant Supply, Inc.*²² the court properly applied the “received and accepted” exception to hold a buyer who had received and retained commercial kitchen equipment liable for the purchase price of the equipment despite the lack of a signed writing.²³

Statute of Frauds—Formation—Remedies. The most comprehensive sales decision reported during the survey period is *Dura-Wood Treating Co. v. Century Forest Industries, Inc.*²⁴ In *Dura-Wood* a merchant-buyer orally agreed to purchase railroad ties from a merchant-seller. The buyer confirmed the agreement by a letter to the seller, which read: “Confirming our conversation, please enter our order of 20,000 6 x 8— 8’6” No. 3 hardwood ties at \$8.60 each. These are to be treated with creosote coal-tar solution. We will advise instructions just as soon as we get some releases on the job.”²⁵ The seller, who was aware that the buyer had a contract to resell the ties to a third party, never signed any letter or other document evidencing the agreement. A few months later the seller cancelled the buyer’s

15. *Id.* § 2.201(a).

16. 632 S.W.2d 927 (Tex. Ct. App.—Dallas 1982, no writ).

17. *Id.* at 929.

18. *Id.* at 928.

19. *Id.* at 929.

20. TEX. BUS. & COM. CODE ANN. § 2.201(c)(1)-(3) (Tex. UCC) (Vernon 1968). The rule does not apply if: (1) the contract is for goods specially manufactured for the buyer, *id.* § 2.201(c)(1); (2) the party against whom enforcement is sought admits to the contract in pleadings, testimony, or otherwise in court, *id.* § 2.201(c)(2); or (3) the buyer pays for the goods and seller accepts payment, *id.* § 2.201(c)(3); and (4) the buyer receives and accepts the goods, *id.*

21. *Id.* § 2.201(c)(3).

22. 629 S.W.2d 254 (Tex. Ct. App.—Fort Worth 1982, writ ref’d n.r.e.).

23. *Id.* at 257.

24. 675 F.2d 745 (5th Cir. 1982).

25. *Id.* at 747.

order because of cost increases. From July through December of 1978 the buyer urged the seller to retract its cancellation, but to no avail. Shipments to the third party were to begin in February of 1979 and, in order to meet this obligation, the buyer decided to manufacture the ties in its own facility as a means of cover. The buyer fulfilled its third-party contract during February through June of 1979 and then sued the defaulting seller for breach of the original sales contract. The buyer claimed damages for three items: (1) the costs incurred in effecting cover;²⁶ (2) the profits lost by diverting the buyer's manufacturing plant to processing ties for the resale contract instead of manufacturing goods for other sales;²⁷ (3) the profits lost on the resale contract itself because of the higher cost of the ties used as cover.²⁸

In a carefully reasoned opinion the court held that a seller could not successfully raise a statute of frauds defense in the face of a confirming letter sent by a buyer.²⁹ The court pointed out that section 2.201(b) of the Code makes an oral contract between merchants enforceable against the recipient of a signed confirmation if the confirmation is sent within a reasonable time, and no objection is made to it within ten days after receipt.³⁰ Furthermore, the court noted that, although a confirmation might satisfy the statute of frauds, the Code required a further inquiry to determine whether an oral contract existed and, if so, what the terms of the agreement were.³¹ Although the seller vigorously contested the sufficiency of the evidence, the court concluded that an oral agreement had been made and that the terms were sufficiently definite to permit enforcement.³²

A second issue the defendant raised was the legal propriety of the buyer's various damage claims. On the claim for cover damages the court held that, although section 2.712 speaks in terms of obtaining cover by the purchase of substitute goods,³³ a buyer could obtain cover by means of internal manufacture.³⁴ On the facts of the *Dura-Wood* case, the court

26. The remedy of cover is provided for in TEX. BUS. & COM. CODE ANN. § 2.712 (Tex. UCC) (Vernon 1968). The essence of this remedy is to permit a disappointed buyer to purchase substitute goods and recover from the defaulting seller the difference between the cost of cover and the contract price. *Id.*

27. Profits lost because of a seller's breach are recoverable within the limits stated by TEX. BUS. & COM. CODE ANN. § 2.715 (Tex. UCC) (Vernon 1968).

28. *See id.*

29. 675 F.2d at 749.

30. *Id.* at 748-49; *see* TEX. BUS. & COM. CODE ANN. § 2.201(b) (Tex. UCC) (Vernon 1968):

Between merchants if within a reasonable time a writing in confirmation of the contract and sufficient against the sender is received and the party receiving it has reason to know its contents, it satisfies the requirements of Subsection (a) against such party unless written notice of objection to its contents is given within ten days after it is received.

31. 675 F.2d at 749.

32. *Id.* at 750-52.

33. *See* TEX. BUS. & COM. CODE ANN. § 2.712 (Tex. UCC) (Vernon 1968).

34. 675 F.2d at 754. On this point the court said: "It would defy reason and the Tex. Bus. & Com. Code's purposes of flexibility and adaptation to reasonable commercial practice to require a buyer to increase losses by covering through the purchase of goods from another seller, if it could produce the goods itself at a lower price." *Id.*

found that the buyer had acted reasonably and in good faith when it decided to manufacture the necessary ties to cover its resale contract.³⁵ On the claim for lost manufacturing profits, however, the court concluded that the lost profits could have been avoided had the buyer covered by purchasing substitute goods.³⁶ Such a purchase would have left the buyer's manufacturing facility in a position to accept other contracts and minimize the damages resulting from the seller's breach. The court, therefore, denied recovery for lost manufacturing profits.³⁷ The court also denied the plaintiff's claim for lost resale profits.³⁸ The court properly concluded that an award of such profits would amount to a double recovery because the buyer had already received contract/cover damages to put it in the position it would have been in had the contract been fully performed.³⁹

Dura-Wood is worth close reading because of its careful analysis of several Code provisions. If there is a flaw in the opinion, it is in the somewhat inadequate explanation of how the buyer could act reasonably in electing to manufacture goods for cover, but act unreasonably by the same act in incurring a loss of manufacturing profits. Reasonableness can, of course, vary in interpretation, depending on the subject of the inquiry, but a better explanation of the court's reasoning could have provided useful guidance to future buyers trying to choose the most effective means of cover.⁴⁰ *Dura-Wood* teaches that a buyer should consider not only contract/cover differentials, but also lost manufacturing profits when deciding whether to buy or to manufacture substitute goods.

B. Performance Disputes

Unconscionability. An interesting fact situation involving the international sale of natural gas by an American seller to a Mexican buyer provided the Fifth Circuit with an opportunity to consider the doctrine of unconscionability in a commercial context.⁴¹ In 1968 the parties in *Compania de Gas de Nuevo Laredo, S.A. v. Entex, Inc.*⁴² amended a 1944 long-term export contract to permit the automatic pass through of price increases or decreases the suppliers charged to the American seller. No one objected to this amendment until the buyer filed suit years later. The seller made sales under the amended contract for several years charging pass through price increases to the buyer from time to time. The price increases caused ar-

35. *Id.*

36. *Id.* at 755.

37. *Id.*

38. *Id.*

39. *Id.*

40. A very similar situation involving the problem of effecting cover in a manner that permits the recovery of consequential damages is thoroughly discussed in J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* § 6-7, at 196-206 (1972).

41. See *Compania De Gas De Nuevo Laredo, S.A. v. Entex, Inc.*, 686 F.2d 322 (5th Cir. 1982). In addition to the commercial issues, the case discussed issues of collateral estoppel and the application of the act of state doctrine. Discussion of these issues has been omitted because they did not bear on the resolution of the commercial matters.

42. 686 F.2d 322, 324 (5th Cir. 1982).

rearrage to accumulate against the buyer. Ultimately, the seller threatened to suspend deliveries unless the buyer paid the entire arrearage. At this point the buyer filed suit in the U.S. federal court to enjoin the seller from suspending deliveries and to challenge the validity of the pass through charges. The buyer argued that the seller had unconscionably used the pass through clause as a blank check for price increases. Under section 2.302 of the Code the issue of whether a contract clause is unconscionable is an issue of law for the court.⁴³ Unconscionability is, therefore, reviewable on appeal.

The court did not hesitate to apply section 2.302 to this case. It correctly stated the basic test for unconscionability to be "whether, in light of the general commercial background and the commercial needs of the particular trade or case, the clause involved is so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract."⁴⁴ Applying this test, the court concluded that the pass through clause was not unconscionable and had not been used by the seller in an unconscionable manner.⁴⁵

C. Warranties

Proof of Warranty Breach. The question of express and implied warranties was discussed during this survey period in *Bormaster v. Henderson*.⁴⁶ The *Bormaster* court held that, while both express and implied warranties had arisen in the sale of a rare cockatoo, the purchaser failed to show that a breach of warranty occurred.⁴⁷ The court correctly stated that the buyer had the burden of showing by a preponderance of the evidence that a breach occurred at the time of sale in order to recover on either an express or implied warranty theory.⁴⁸

No Implied Warranty in Sale of Used Home. Section 2.314 of the Code creates an implied warranty of merchantability for the sale of goods.⁴⁹ While the Code is not applicable to the sale of realty, Texas has adopted an implied warranty theory for the sale of homes on the ground that buy-

43. TEX. BUS. & COM. CODE ANN. § 2.302 (Tex. UCC) (Vernon 1968) states:

(a) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(b) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.

44. 686 F.2d at 328.

45. *Id.* The court concluded that the clause did not result in gross disparity between the consideration and the amount paid. On the contrary, the court found that the pass through charges brought the amount paid in line with the fair market value of the gas. *Id.*

46. 624 S.W.2d 655 (Tex. Ct. App.—Houston [14th Dist.] 1981, no writ).

47. *Id.* at 661.

48. *Id.* at 660-61.

49. TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1968).

ers of houses, like buyers of goods, are entitled to minimum quality protections.⁵⁰ Unfortunately for the buyers of both goods and houses, the lower Texas courts have consistently refused to extend warranty protection to the purchasers of used goods or used homes.⁵¹

The comments to section 2.314, while indicating a need for warranties on used goods, clearly recognize that implied warranties for used goods should be more limited than those for new goods.⁵² The Texas decisions, however, have taken the view that no implied warranties should exist on used goods.⁵³ These decisions appear to be unduly restrictive⁵⁴ and might be wrong.⁵⁵ The case of *Gupta v. Ritter Homes, Inc.*⁵⁶ illustrates the theo-

50. See *Humber v. Morton*, 426 S.W.2d 554, 557 (Tex. 1968). Implied warranties of habitability were subsequently extended to the lessees of apartments or other dwellings. See *Kamarath v. Bennett*, 568 S.W.2d 658, 660 (Tex. 1978).

51. See, e.g., *Thornton Homes, Inc. v. Greiner*, 619 S.W.2d 8 (Tex. Ct. App.—Eastland 1981, no writ); *Cheney v. Parks*, 605 S.W.2d 640 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.); *Bunting v. Fodor*, 586 S.W.2d 144 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ); *Chaq Oil Co. v. Gardner Mach. Corp.*, 500 S.W.2d 877 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ).

52. TEX. BUS. & COM. CODE ANN. § 2.314 comment 3 (Tex. UCC) (Vernon 1968) provides: "A contract for the sale of second-hand goods, however, involves only such obligation as is appropriate to such goods for that is their contract description." *Id.*

53. See, e.g., *Bunting v. Fodor*, 586 S.W.2d 144 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ); *Chaq Oil Co. v. Gardner Mach. Corp.*, 500 S.W.2d 877 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ).

54. It is difficult to understand why the mere fact of a first sale should completely erase the possibility of any implied warranty when the goods are sold a second time by a professional seller. Subsequent sales sometimes occur while goods are still, for all practical purposes, new goods. Implied warranties only attach when goods are sold by a professional in the trade, and not when they are sold by a casual seller. TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1968). Comment 3 to section 2.314 of the Code states: "A person making an isolated sale of goods is not a 'merchant' within the meaning of the full scope of this section and, thus, no warranty of merchantability would apply." *Id.* comment 3. If the owner of an apartment is held to an implied warranty of habitability upon the reletting of an apartment on the ground that a landlord is in a better position than a tenant to know of latent defects because of greater knowledge and experience, see *Kamarath v. Bennett*, 568 S.W.2d 658, 660 (Tex. 1978), then a merchant who claims professional knowledge of the goods being sold should also be in a better position to know of latent defects than a buyer of the goods. Of the jurisdictions that have addressed the issue, only Texas holds that no warranty of merchantability of any kind arises on the sale of used goods. See the cases collected in 2A UNIFORM COMMERCIAL CODE CASE DIGEST § 2314.12(3) (1982 & Supp. 1982).

55. *Chaq Oil Co. v. Gardner Mach. Corp.*, 500 S.W.2d 877 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ), was the seminal case asserting that no implied warranties exist in the sale of used goods under the Texas Code. *Chaq Oil* referred to section 2.314 of the Texas Business and Commerce Code and the comments thereto, but the court did not analyze the statute to determine its meaning. Instead, the court adopted the position that pre-Code law was still controlling, citing *American Soda Found. Co. v. Palace Drug Store*, 245 S.W. 1032 (Tex. Civ. App.—Austin 1922, no writ), and *Norvell-Wilder Supply Co. v. Richardson*, 300 S.W.2d 773 (Tex. Civ. App.—El Paso 1957, writ ref'd n.r.e.). Subsequent decisions merely cite *Chaq Oil* as controlling. See cases cited *supra* note 51. No Texas case has discussed the underlying policy question of whether warranties of merchantability should exist on the sale of used goods, nor has one directly addressed the plain language of section 2.314(a) of the Texas Code, which states, "a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind." TEX. BUS. & COM. CODE ANN. § 2.314(a) (Tex. UCC) (Vernon 1968) (emphasis added). This language is certainly susceptible to the interpretation that the Code imposes an implied warranty on the sale of goods whether new or used and that pre-Code law is no longer control-

retical thicket into which the lower courts have wandered by following the shibboleth of no implied warranties on used goods or on used homes.

In *Gupta* the second owner of a used home brought suit against the original homebuilder on theories of implied warranty and negligence. The trial court granted summary judgment for the homebuilder on both theories. On appeal the court cited two earlier civil appeals decisions holding that no implied warranties exist in the sale of used homes⁵⁷ and concluded that the instant case fell within the same rule.⁵⁸ The appeals court affirmed the summary judgment on the implied warranty issue.⁵⁹

On the negligence theory the court decided that privity was not required between the second buyer and the homebuilder and that a negligence claim might lie.⁶⁰ The court, therefore, remanded the case for trial on the negligence issue.⁶¹ In support of this ruling the court cited *Nobility Homes of Texas, Inc. v. Shivers*,⁶² an implied warranty case, for the proposition that privity was not necessary in negligence actions. The interplay between theories of negligence, implied warranty, and strict liability in tort is well documented in the sale of goods arena,⁶³ and, if *Gupta* is any indication, the same interplay is beginning to operate in cases involving the sale of homes. Rather than simply denying that implied warranties can ever exist in the sale of used goods or used homes, a better jurisprudential approach would be to recognize that implied warranties can exist in such sales and focus judicial consideration on whether particular defects should fall within the scope of such an implied warranty.⁶⁴

ling. See, e.g., *Brown v. Hall*, 221 So. 2d 454 (Fla. App. 1969) (purchaser of used dump truck relied on seller's skill and judgment in selection; implied warranty arose); *Perry v. Lawson Ford Tractor Co.*, 613 P.2d 458 (Okla. 1980) (pre-purchase examination of used combine could not have revealed defects; warranty implied); *Testo v. Russ Dunmire Oldsmobile, Inc.*, 16 Wash. App. 39, 554 P.2d 349 (1976) (buyer's inspection of used auto, though specially equipped, did not raise suspicion of its use as a race car and did not waive implied warranty).

The Texas Supreme Court may agree that used goods should carry warranties appropriately limited in scope. See *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308, 313 (Tex. 1978). For further discussion, see Krahmer, *supra* note 13, at 198-99.

56. 633 S.W.2d 626 (Tex. Ct. App.—Houston [14th Dist.] 1982, writ granted).

57. The court cited *Thornton Homes, Inc. v. Greiner*, 619 S.W.2d 8 (Tex. Ct. App.—Eastland 1981, no writ), and *Cheney v. Parks*, 605 S.W.2d 640 (Tex. Civ. App.—Houston [1st Dist.] 1980, writ ref'd n.r.e.). 633 S.W.2d at 627.

58. 633 S.W.2d at 627-28.

59. *Id.* at 626.

60. *Id.* at 628.

61. *Id.*

62. 557 S.W.2d 77 (Tex. 1977).

63. See, e.g., *Signal Oil & Gas Co. v. Universal Oil Prods.*, 572 S.W.2d 320 (Tex. 1978); *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308 (Tex. 1978) (both discussing the historical interaction of these theories). Professor Grant Gilmore has suggested that the law on this subject has progressed to the point at which traditional tort/contract distinctions have been abandoned, and we now have a cause of action that he calls a "contort." G. GILMORE, *THE DEATH OF CONTRACT* 90 (1974).

64. This is the approach taken by courts in other jurisdictions. See, e.g., *Richards v. Goerg Boat & Motors, Inc.*, 384 N.E.2d 1084 (Ind. App. 1979) (no implied warranty extended to observable cracks in gel coat); *Tracy v. Vinton Motors, Inc.*, 130 Vt. 512, 296 A.2d 269 (1972) (implied warranty on used automobile must be on operative qualities not aes-

D. Remedies

Breach of Warranty—Pleading and Proof of Damages. In *Simmons v. Simpson*⁶⁵ a plaintiff-buyer brought suit on theories of breach of express and implied warranties. The plaintiff introduced proof as to the cost of repairs made to the goods in order to bring them up to the standard required under the contract. The jury rendered a verdict and the court entered a judgment in favor of the buyer. On appeal the court held that a fatal variance existed between the pleading and proof because the proper measure of damage for breach of warranty is not the cost of repair, but the difference in market value between the goods delivered and the goods as represented.⁶⁶ Because the pleadings did not seek damages for the cost of repairs and because no evidence had been introduced to prove market value of the goods, the appeals court reversed the judgment for the plaintiff and rendered a new judgment in favor of the defendant/seller.⁶⁷

Breach of Warranty of Title—Constructive Trust. The buyer in *Powell, Inc. v. Abney*⁶⁸ recovered a judgment against the seller for breach of warranty of title and sought to avoid the discharge of a constructive trust lien on the seller's homestead. In the district court the buyer obtained a judgment for \$115,000 for the seller's knowing breach of an implied warranty of title. The judgment traced \$27,000 of the price paid for the goods into the seller's homestead and the district court imposed an equitable lien on the homestead to secure it. After entry of the judgment the defendant moved to discharge the lien by paying \$27,000 into court and the court granted the motion.⁶⁹ On appeal the buyer argued that the equitable lien should not have been discharged in light of the wrongful conduct of the defendant. The Fifth Circuit agreed, saying "[t]he discharge of the lien rewards [the seller] for the disposal—in a manner successfully frustrating tracing—of the monies he acquired from [the buyer] He who comes into the court seeking equity, must do so with clean hands and in turn must be prepared to do equity. [The seller] has done neither."⁷⁰ The court refused to order the discharge of the lien.⁷¹

thetic items); *Testo v. Russ Dunmire Oldsmobile, Inc.*, 16 Wash. App. 39, 554 P.2d 349 (1976) (implied warranty in used goods directed to operative essentials).

65. 626 S.W.2d 315 (Tex. Civ. App.—El Paso 1980, no writ).

66. *Id.* at 317. The leading case on pleading and proof of damages for breach of warranty is *Kissman v. Bendix Home Systems, Inc.*, 587 S.W.2d 675 (Tex. 1979). A fatal variance between pleading and proof in regard to repair costs was found to exist in *Kissman*. *Id.* at 677.

67. 626 S.W.2d at 317.

68. 669 F.2d 348 (5th Cir. 1982).

69. *Id.*

70. *Id.* at 350.

71. *Id.*

III. COMMERCIAL PAPER

A. Form of Negotiable Instruments

Instruments Payable Jointly to More than One Payee. In *Johnson v. Cox*⁷² Cox obtained a default judgment against the maker of a note payable to the order of Paul Cox and Dan M. Bates for one-half the face amount of the note. Bates was not a party to the suit. On appeal from the default judgment the court of appeals referred to section 3.116 of the Code⁷³ and held that Bates was an indispensable party to the suit because the note was payable jointly and not in the alternative.⁷⁴ The court of appeals stated that it was fundamental error for the trial court to have proceeded without the joinder of Bates,⁷⁵ citing the earlier section 3.116 decision of *Hinojosa v. Love*.⁷⁶ The court reversed the judgment and remanded the case.⁷⁷

On appeal the Texas Supreme Court refused to grant writ of error, but stated that the doctrine of fundamental or unassigned error was a discredited and very limited doctrine that was not applicable to this case.⁷⁸ The supreme court held that failure to join Bates was not fundamental error because his absence would not deprive the court of jurisdiction to adjudicate the merits of the controversy.⁷⁹ Thus, the supreme court expressly disapproved the court of appeals decisions in *Johnson* and *Hinojosa*.⁸⁰ The high court affirmed the judgment of the court of appeals granting a new trial, however, because the maker had raised other meritorious defenses in his appeal.⁸¹ The supreme court did not explain how the trial court was to proceed under a statutory standard that says an instrument payable jointly to two or more persons can be "enforced only by all of them."⁸²

B. Liability of Parties

Signatures in Representative Capacity. Section 3.403 of the Code presumes a signature to be in a representative capacity when the name of an organization is preceded or followed by the name and office of an authorized individual.⁸³ This presumption arose in *Barclay v. Epic Associates XXIV*⁸⁴ when a party signed a note "De Cra Homes /s/ Maurice L. Barclay; Mau-

72. 630 S.W.2d 492 (Tex. Ct. App.—Corpus Christi 1982), writ *ref'd n.r.e. per curiam*, 638 S.W.2d 867 (Tex. 1982).

73. TEX. BUS. & COM. CODE ANN. § 3.116 (Tex. UCC) (Vernon 1968) states: "An instrument payable to the order of two or more persons . . . (2) if not in the alternative is payable to all of them and may be negotiated, discharged or enforced only by all of them."

74. 630 S.W.2d at 493.

75. *Id.*

76. 496 S.W.2d 224 (Tex. Civ. App.—Corpus Christi 1973, no writ).

77. 630 S.W.2d at 493.

78. 638 S.W.2d at 868.

79. *Id.*

80. *Id.*

81. *Id.*

82. TEX. BUS. & COM. CODE ANN. § 3.116(2) (Tex. UCC) (Vernon 1968). The text of this section is set out *supra* note 73.

83. TEX. BUS. & COM. CODE ANN. § 3.403(c) (Tex. UCC) (Vernon 1968).

84. 631 S.W.2d 544 (Tex. Ct. App.—El Paso 1982, no writ).

rice L. Barclay, President." The court of appeals held that the note itself, when read in light of section 3.403, showed that Barclay signed in a representative capacity, absent proof overcoming the statutory presumption.⁸⁵

Liability for Attorneys' Fees. The appeals courts decided a pair of cases⁸⁶ during the survey period on the issue of attorneys' fees assessed as part of the cost of collecting overdue notes. In *Spring Branch Bank v. Mengden*⁸⁷ the maker of a note paid the entire balance demanded on an overdue note to avoid foreclosure on certain oil and gas properties. The amount included \$61,000 in attorneys' fees, an amount calculated as ten percent of the balance due under the terms of the note. The maker subsequently filed suit to recover allegedly unreasonable attorneys' fees. The case would have been a rather simple one had the maker resisted making the payment initially and challenged the reasonableness of the fees immediately.⁸⁸ Because this was not done, and the plaintiff questioned the reasonableness of the fees after he had paid them, the court of appeals attempted to develop rules to govern such post-payment challenges. The court essentially created a four-step procedure for such a post-payment challenge to attorneys' fees collected pursuant to the terms of a promissory note.⁸⁹

The plaintiff must first plead and prove that he paid the fee involuntarily or, alternatively, that he did not, by paying, intend to waive his claim that the fees were unreasonable.⁹⁰ Secondly, he must show that the attorneys' fees he paid were unreasonable, and, thirdly, he must prove the amount that would have been reasonable under the circumstances.⁹¹ The court's fourth rule requires the plaintiff to plead and prove duress, fraud, or compulsion if he fails to prove that he paid the fee involuntarily or that he did not intend to waive his claim.⁹² The court held that a demand for payment of attorneys' fees in the percentage specified in the note, while perhaps unreasonable, was not illegal or wrongful.⁹³ In such circumstances the court concluded that duress did not exist as a matter of law.⁹⁴

In another decision the Corpus Christi court of appeals held that an attorney who conducted foreclosure proceedings on behalf of the holder of a real estate lien note was not in privity with the obligors on the note.⁹⁵ Because privity did not exist, the obligors could not recover against the attorney for alleged unreasonable attorneys' fees charged in the foreclo-

85. *Id.* at 545.

86. *Graham v. Turcotte*, 628 S.W.2d 182 (Tex. Ct. App.—Corpus Christi 1982, no writ); *Spring Branch Bank v. Mengden*, 628 S.W.2d 130 (Tex. Ct. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

87. 628 S.W.2d 130 (Tex. Ct. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.).

88. *Id.* at 134.

89. *Id.* at 137.

90. *Id.*

91. *Id.*

92. *Id.*

93. *Id.* at 135.

94. *Id.*

95. *Graham v. Turcotte*, 628 S.W.2d 182, 184 (Tex. Ct. App.—Corpus Christi 1982, no writ).

sure proceedings.⁹⁶

C. Enforcement and Defenses

Reformation of Instruments. Parol evidence is not ordinarily admissible to vary the terms of a note unless there is a showing that the transferee, by some trickery, artifice, or device, fraudulently induced the transferor to sign the instrument.⁹⁷ A mere representation that the transferor will not be liable on the instrument is not sufficient to show fraud in the inducement.⁹⁸ According to the court in *First National Bank v. Jones*,⁹⁹ however, the ordinary rule excluding parol evidence is not applicable when the transferor seeks to reform an instrument to reflect the actual intent of the parties.¹⁰⁰

In *Jones* the defendant-transferor indorsed three notes to the plaintiff bank as a representative of his insurance agency. The defendant alleged that he had also been asked to sign his name a second time on the notes "for the purpose of identifying himself with his agency."¹⁰¹ The defendant asked that the notes be reformed on the ground of mutual mistake. He maintained that the parties' true agreement was that he would not be personally liable on the instruments. Alternatively, the defendant urged the court to admit parol evidence because of the fraud or inequitable conduct of the bank. The court agreed with the defendant on both grounds and ruled that the trial court properly admitted the parol evidence.¹⁰² The bank contended that it was a holder in due course of the notes and, as such, entitled to judgment on the notes as a matter of law.¹⁰³ On this point the court correctly ruled that, even if the bank did qualify as a holder in due course, it would still be subject to the transferee's defenses because of the dealings between the parties.¹⁰⁴

Discharge by Cancellation of Instrument. Under section 3.605 the holder of an instrument can discharge a party by intentionally cancelling the instrument or by returning the instrument to the party being discharged.¹⁰⁵ *Gi-*

96. *Id.* at 183-84.

97. *Town N. Nat'l Bank v. Broaddus*, 569 S.W.2d 489 (Tex. 1978). The appeals court applied the ordinary parol evidence rule during the survey period in *Bailey v. Gulfway Nat'l Bank*, 626 S.W.2d 70 (Tex. Ct. App.—Corpus Christi 1981, writ ref'd n.r.e.).

98. *Town N. Nat'l Bank v. Broaddus*, 569 S.W.2d 489 (Tex. Ct. App.—Corpus Christi 1981, writ ref'd n.r.e.).

99. 635 S.W.2d 950 (Tex. Ct. App.—Eastland 1982, writ ref'd n.r.e.).

100. *Id.* at 951.

101. *Id.*

102. *Id.* at 953.

103. *Id.*

104. *Id.*; see TEX. BUS. & COM. CODE ANN. § 3.305(b) (Tex. UCC) (Vernon 1968): "To the extent that a holder is a holder in due course he takes the instrument free from . . . (b) all defenses of any party to the instrument *with whom the holder has not dealt.*" (emphasis added).

105. TEX. BUS. & COM. CODE ANN. § 3.605 (Tex. UCC) (Vernon 1968) provides:

(a) The holder of an instrument may even without consideration discharge any party

(1) in any manner apparent on the face of the instrument or the indorsement, as by intentionally cancelling the instrument or the party's sig-

*bralter Savings Association v. Watson*¹⁰⁶ illustrates the application of these discharge rules. In *Watson* the payee mistakenly credited \$9100 to the makers' account. This error caused the balance due on the note to be \$9100 too low. The makers paid the amount the note showed to be the balance due and the payee marked the note paid, delivering it to the makers. After discovering the error the payee demanded payment of the deficiency, but the demands were unsatisfied. Litigation followed.

In a carefully reasoned opinion the *Watson* court held that a discharge under section 3.605 would occur only when the payee acted intentionally.¹⁰⁷ The mistake in calculation obviated any intention to discharge the makers and, despite the marking and returning of the note, the makers remained liable for the \$9100 balance due on the instrument.¹⁰⁸ This decision is consistent with the language of section 3.605 and with decisions under that section in other jurisdictions.¹⁰⁹

Discharge by Tender of Payment. Section 3.604 discharges a party to an instrument from subsequent liability for interest, costs, and attorneys' fees if he tenders full payment to the holder.¹¹⁰ The holder's refusal to accept such tender wholly discharges any party who has a right of recourse against the party making the tender.¹¹¹ The Texas Supreme Court applied section 3.604 in *Guaranty Bank v. Thompson*.¹¹² The court determined that the maker of a note and a party with a right of recourse against the maker had a meritorious discharge defense in an action by the holder of the note because of the holder's refusal of a tender of full payment.¹¹³ The court reached the same decision in a companion case consolidated for appeal.¹¹⁴

Agreement Permitting Release of Collateral. Section 3.606 of the Code discharges from liability a party with a right of recourse on an instrument if collateral is released without the party's consent.¹¹⁵ The official comments to section 3.606 point out that a party may consent to the release of collateral in advance, and the consent may be incorporated into the instru-

nature by destruction or mutilation, or by striking out the party's signature; or

(2) by renouncing his rights by a writing signed and delivered or by surrender of the instrument to the party to be discharged.

(b) Neither cancellation nor renunciation without surrender of the instrument affects the title thereto.

106. 624 S.W.2d 650 (Tex. Ct. App.—Houston [14th Dist.] 1981, no writ).

107. *Id.* at 652; see TEX. BUS. & COM. CODE ANN. § 3.605 (Tex. UCC) (Vernon 1968).

108. 624 S.W.2d at 654.

109. See, e.g., *First Galesburg Nat'l Bank & Trust Co. v. Martin*, 58 Ill. App. 3d 113, 373 N.E.2d 1075 (1978); *Peoples Bank v. Robinson*, 272 S.C. 155, 249 S.E.2d 784 (1978); *Reid v. Cramer*, 24 Wash. App. 742, 603 P.2d 851 (1979).

110. TEX. BUS. & COM. CODE ANN. § 3.604(a) (Tex. UCC) (Vernon 1968).

111. *Id.* § 3.604(b).

112. 632 S.W.2d 338 (Tex. 1982).

113. *Id.* at 340.

114. *Guaranty Bank v. O'Dowd*, 632 S.W.2d 338 (Tex. 1982).

115. TEX. BUS. & COM. CODE ANN. § 3.606 (Tex. UCC) (Vernon 1968).

ment.¹¹⁶ The Tyler court of appeals construed section 3.606 in *Lawyers Title Insurance Corp. v. Northeast Texas Development Co.*¹¹⁷ In that case a guarantee clause stated: "This guarantee shall be a continuing guarantee, and the liability of the guarantors hereunder shall in no way be affected, modified or diminished . . . by reason of any substitution or release of security, whether or not notice thereof is given to the guarantors."¹¹⁸ Based on this language the court held that the release of a deed of trust securing a note did not discharge the guarantors.¹¹⁹ The guarantee clause amounted to an effective consent to the release of collateral under section 3.606.

IV. BANK DEPOSITS AND COLLECTIONS

A. Payor Banks

Bank's Right to Recover Funds Paid by Mistake. Section 4.403 of the Code gives a bank customer the right to stop payment on a check by giving appropriate notice to the drawee bank.¹²⁰ If the bank mistakenly pays a check over a stop order the bank has three subrogation rights under section 4.407 to prevent unjust enrichment and to avoid loss to the bank.¹²¹ In addition to the subrogation rights stated in the Code, a bank has the common law remedy of restitution for money paid by mistake against the person who received payment.¹²² The most difficult question is the determination of the scope of the bank's common law right of restitution. In *Bryan v. Citizens National Bank*¹²³ the Texas Supreme Court answered

116. *Id.* comment 2.

117. 635 S.W.2d 897 (Tex. Ct. App.—Tyler 1982, no writ).

118. *Id.* at 899.

119. *Id.*

120. TEX. BUS. & COM. CODE ANN. § 4.403 (Tex. UCC) (Vernon 1968).

121. *Id.* § 4.407. The three subrogation rights are outlined in the following terms:

If a payor bank has paid an item over the stop payment order of the drawer or maker or otherwise under circumstances giving a basis for objection by the drawer or maker, to prevent unjust enrichment and only to the extent necessary to prevent loss to the bank by reason of its payment of the item, the payor bank shall be subrogated to the rights

- (1) of any holder in due course on the item against the drawer or maker; and
- (2) of the payee or any other holder of the item against the drawer or maker either on the item or under the transaction out of which the item arose; and
- (3) of the drawer or maker against the payee or any other holder of the item with respect to the transaction out of which the item arose.

Id.

122. *Id.* comment 5. Comment 5 following § 4.407 provides:

The spelling out of the affirmative rights of the bank in this section does not destroy other existing rights (Section 1—103). Among others these may include the defense of a payor bank that by conduct in recognizing the payment a customer has ratified the bank's action in paying in disregard of a stop payment order or rights to recover money paid under a mistake.

Id. (emphasis added).

123. 628 S.W.2d 761 (Tex. 1982).

that question and, in so doing, considerably narrowed the bank's restitutionary right as it existed in pre-Code Texas law.

In *Bryan* the court held that a bank may assert a claim for restitution against a holder who receives a mistaken payment only if the bank introduces evidence to show that its customer had a defense against payment of the check.¹²⁴ Once it is shown that a defense exists the holder has the burden of proving holder in due course status.¹²⁵ Unless it can be shown that a defense exists the holder is presumed to be a holder in due course¹²⁶ and is protected against recovery of the mistaken payment by the final payment rule of section 3.418.¹²⁷ Under the pre-Code Texas rule a showing that the bank made a mistaken payment immediately shifted the burden to the holder to prove that he was a holder in due course.¹²⁸ The supreme court in *Bryan* specifically abandoned this pre-Code rule and overruled the cases on which it was based.¹²⁹ The court reversed the decision of the court of appeals in *Bryan*,¹³⁰ which the appeals court had based on the pre-Code rule, and remanded the case for a new trial.¹³¹

Accountability of Payor Bank for Late Return of Item. In *Union Bank v. First National Bank*¹³² the Fifth Circuit held a payor bank accountable for violating the midnight deadline rule of section 4.302¹³³ by failing to timely return several dishonored checks.¹³⁴ In a subsequent appeal of the same case the Fifth Circuit held the payor bank liable for prejudgment interest

124. *Id.* at 762.

125. *Id.* at 763-64.

126. *Id.* at 763.

127. *Id.* Section 3.418 of the Texas Code provides:

Except for recovery of bank payments as provided in the chapter on Bank Deposits and Collections (Chapter 4) and except for liability for breach of warranty on presentment under the preceding section, payment or acceptance of any instrument is final in favor of a holder in due course, or a person who has in good faith changed his position in reliance on the payment.

TEX. BUS. & COM. CODE ANN. § 3.418 (Tex. UCC) (Vernon 1968).

128. *Central Nat'l Bank v. Martin*, 396 S.W.2d 218 (Tex. Civ. App.—Houston 1965, writ dismissed w.o.j.); *First-Wichita Nat'l Bank v. Steed*, 374 S.W.2d 932 (Tex. Civ. App.—Fort Worth 1964, no writ); *Capital Nat'l Bank v. Wootton*, 369 S.W.2d 475 (Tex. Civ. App.—Austin 1963, writ dismissed w.o.j.).

129. 628 S.W.2d at 762. In its opinion the court stated:

These three cases, [cited *supra* note 128] along with the opinion of the court of civil appeals in the present case, appear to be the only decisions in any state which allow a bank to recover on the mere showing of mistaken payment and place the burden upon the payee to show he was a holder in due course.

id.

130. *See Bryan v. Citizens Nat'l Bank*, 621 S.W.2d 761, 816 (Tex. Civ. App.—Eastland 1981).

131. 628 S.W.2d at 764.

132. 621 F.2d 790 (5th Cir. 1980).

133. *See* TEX. BUS. & COM. CODE ANN. § 4.302 (Tex. UCC) (Vernon 1968). Section 4.302 holds a bank accountable for the amount of any demand item when the item is retained beyond midnight on the same banking day or does not pay, return, or notify of dishonor until after the midnight deadline or any other properly payable item unless it is accepted, paid, or returned within the time allowable for acceptance or payment of that item.

134. 621 F.2d 790 at 796. The case is discussed in Krahmer, *supra* note 13, at 213.

from the time that the bank became accountable for the amount of the delayed items until the date of judgment.¹³⁵

Duty of Customer to Examine Returned Items. Section 4.406 requires a customer to examine his statement and returned checks and report any forgeries or alterations within fourteen days after the statement and items are made available to the customer.¹³⁶ If a customer fails to report forgeries or alterations within the fourteen-day period the customer is precluded from asserting subsequent forgeries or alterations by the same wrongdoer against the payor bank.¹³⁷ In *Ju-Nel Homes v. White Rock Bank*¹³⁸ the Dallas court of appeals precluded a customer, who failed to examine statements or report forgeries for a period of almost one year, from asserting any forgeries by the same wrongdoer occurring after the initial fourteen-day period.¹³⁹ The failure to examine and report forgeries resulted in a loss to the customer of over \$12,000.

V. SECURED TRANSACTIONS

A. Validity of Security Agreement

Waiver of Defenses Clauses Invalid. Section 9.206 of the Code permits a debtor to waive the right to assert any claims or defenses that he might have against the assignee of a security agreement.¹⁴⁰ The section expressly provides that its provisions are "[s]ubject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods."¹⁴¹ In *Knight v. International Harvester Credit Corp.*,¹⁴² a case of first impression, the Texas Supreme Court ruled "that article 5069-7.07(6) [of the Consumer Credit Code] forbids the waiver of *any* claim or defense a buyer might have against a seller or a holder."¹⁴³ In effect, Texas now has an adjudicated statute that reverses the effect of section 9.206 in consumer cases.

B. Priorities

Airplanes and Buyers in the Ordinary Course of Business. Airplanes and other forms of aircraft present special problems in the law of secured transactions. A security interest in an airplane is perfected by recording the

135. 677 F.2d 1074, 1079-80 (5th Cir. 1982).

136. TEX. BUS. & COM. CODE ANN. § 4.406(a)-(i) (Tex. UCC) (Vernon 1968).

137. *Id.* § 4.406(b).

138. 632 S.W.2d 648 (Tex. Ct. App.—Dallas 1982, no writ).

139. *Id.* at 650.

140. TEX. BUS. & COM. CODE ANN. § 9.206 (Tex. UCC) (Vernon Supp. 1982-1983).

141. *Id.* § 9.206(a).

142. 627 S.W.2d 382 (Tex. 1982).

143. 627 S.W.2d at 388 (emphasis in original); see TEX. REV. CIV. STAT. ANN. art. 5069—7.07(6) (Vernon Supp. 1982-1983). The case also raised issues under art. 5069, ch. 14 of the Texas Revised Civil Statutes, which was repealed by 1979 Tex. Gen. Laws, ch. 672, § 51, at 1595, and under the Texas Deceptive Trade Practices Act, codified at TEX. BUS. & COM. CODE ANN. §§ 17.41-.63 (Vernon Supp. 1982-1983). 627 S.W.2d at 384. Discussion of these issues is beyond the scope of this Article.

security agreement with the Federal Aviation Administration,¹⁴⁴ not by filing a financing statement under the Code.¹⁴⁵ The federal statute, however, does not explicitly state any priority rules and the courts are split on whether federal law implicitly governs priority disputes by establishing a recording system or, in the absence of express priority rules, state law should be used to determine priority disputes.¹⁴⁶

In *Gary Aircraft Corp. v. General Dynamics Corp.*¹⁴⁷ the Fifth Circuit faced, for the first time, the question of whether state or federal law should govern the priority of security interests in airplanes. In *Gary* the secured creditor, General Dynamics, properly perfected a security interest in several airplanes owned by its debtor by filing with the Federal Aviation Administration. A clause in the security agreement authorized the debtor to sell the airplanes unless the debtor defaulted on its obligations to General Dynamics. The debtor defaulted, contrary to the terms of the security agreement, and sold four of the secured airplanes to Arthur Stewart, who did not check the federal records before buying the planes. Stewart, President of Gary Aircraft Corp., subsequently learned of the pre-existing security interest but, despite this knowledge, transferred two of the airplanes to Gary Aircraft Corp., apparently without consideration. Gary Aircraft Corp. subsequently filed for chapter XI reorganization under the Bankruptcy Act. The priority dispute before the circuit court arose between Gary and General Dynamics in the bankruptcy proceedings.

After reviewing numerous cases¹⁴⁸ and considering the legislative history and policies underlying the federal registration system, the Fifth Circuit adopted the view that federal law governs only the recordation of security interests and that state law governs questions of priority.¹⁴⁹ This conclusion did not entirely resolve the case because General Dynamics claimed that under Texas law¹⁵⁰ it had priority over the ostensible owner of the airplanes, Gary Aircraft. The court held that Stewart, the first purchaser of the planes, qualified as a buyer in the ordinary course of business under section 9.307¹⁵¹ and took the planes free of the General Dynamics security interest.¹⁵² The court further held that Stewart had no duty to check for recorded security interests in the planes because the relevant test

144. 49 U.S.C. § 1403 (1976).

145. See TEX. BUS. & COM. CODE ANN. § 9.302(c) (Tex. UCC) (Vernon Supp. 1982-1983): "The filing of a financing statement . . . is not necessary or effective to perfect a security interest in property subject to (1) a statute or treaty of the United States"

146. Compare *Dowell v. Beech Acceptance Corp.*, 3 Cal. 3d 544, 476 P.2d 401, 91 Cal. Rptr. 1 (1970), cert. denied, 404 U.S. 823 (1971) (federal law governs priorities), with *Sanders v. M.D. Aircraft Sales, Inc.*, 575 F.2d 1086 (3d Cir. 1978) (state law governs priority disputes). The cases on both sides of this interpretive split are collected in Annot., 22 A.L.R.3d 1273 (1968 & Supp. 1982).

147. 681 F.2d 365 (5th Cir. 1982).

148. The court cited cases at *supra* note 146.

149. 681 F.2d at 372.

150. The relevant law was TEX. BUS. & COM. CODE ANN. §§ 9.101-507 (Tex. UCC) (Vernon Supp. 1982-1983).

151. *Id.* § 9.307.

152. 681 F.2d at 373-74.

was whether Stewart acted in good faith.¹⁵³ Only if Stewart had actual knowledge of facts or circumstances that amounted to bad faith would he lose the status of a buyer in the ordinary course of business and no such facts were shown.¹⁵⁴ Because Gary Aircraft traced its title through Stewart, who had taken free of the security interest, Gary was likewise free of General Dynamics' claim.¹⁵⁵ This result obtained even though Gary paid no consideration for the airplane.¹⁵⁶

Continuation of Perfection and Priorities in Sold Collateral. In *In re McBee*¹⁵⁷ the Bankruptcy Court for the Western District of Texas decided several issues of interest in the secured transactions area. First, the court determined that a filed financing statement bearing only the trade name of a debtor was not effective to perfect a security interest.¹⁵⁸ Secondly, the court decided that a secured creditor need not file an amended financing statement within four months after the transfer of a debtor's inventory as section 9.402 normally requires.¹⁵⁹ The court reached this conclusion because section 6.111 permits a creditor to avoid a bulk transfer for up to six months after the transfer occurs.¹⁶⁰ The court reasoned that bulk transfers represented an exception to the four-month rule of section 9.402.¹⁶¹ Finally, the bankruptcy court resolved a priority conflict between two secured parties holding perfected security interests in the inventory and account of a bulk transferee by referring to the first to file under section 9.312(e).¹⁶² The *McBee* case merits careful reading, particularly on the section 9.402 point. No other Texas cases construe the statutory language the court interprets in the *McBee* decision, and the case, therefore, may be a useful precedent for the commercial law attorney.

C. Proceedings After Default

No Election of Remedies Doctrine Under the Code. In *Bennett v. State National Bank*¹⁶³ the court held that section 9.501¹⁶⁴ permits a secured party

153. *Id.* at 375-76.

154. *Id.* at 376.

155. *Id.* at 377.

156. *Id.* On this point the court said: "We cannot imagine applying any rule other than that a donee takes the title that his donor had." *Id.*

157. 20 Bankr. 361 (Bankr. W.D. Tex. 1982).

158. *Id.* at 363-64.

159. *Id.* at 364-67; see TEX. BUS. & COM. CODE ANN. § 9.402(g) (Tex. UCC) (Vernon Supp. 1982-1983).

160. TEX. BUS. & COM. CODE ANN. § 6.111 (Tex. UCC) (Vernon 1968). Chapter 6 of the Code deals with bulk transfers and the rights of creditors of the transferee. *Id.* §§ 6.101-.111.

161. 20 Bankr. at 365-66; TEX. BUS. & COM. CODE ANN. § 9.402(g) (Tex. UCC) (Vernon Supp. 1982-1983).

162. 20 Bankr. at 368; TEX. BUS. & COM. CODE ANN. § 9.312(e) (Tex. UCC) (Vernon Supp. 1982-1983) (provides that conflicting security interests are ranked according to priority in time of filing or perfection).

163. 623 S.W.2d 719 (Tex. Civ. App.—Houston [1st Dist.] 1981, no writ).

164. TEX. BUS. & COM. CODE ANN. § 9.501 (Tex. UCC) (Vernon Supp. 1982-1983).

to sue on an outstanding debt without first foreclosing on collateral.¹⁶⁵ The secured party may pursue any remedy or combination of remedies that may be legally available to him.¹⁶⁶ The Code does not require a party to elect between several possible remedies.¹⁶⁷

Repossession and Venue—National Banks. *University National Bank v. McFarland*¹⁶⁸ presented the question of self-help repossession. The court held that a self-help repossession by a national bank did not waive the bank's right to be sued in the county where it was located rather than in the county where the repossession occurred.¹⁶⁹ The decision is consistent with earlier Texas cases on the same issue.¹⁷⁰

Improper Resale Bars Recovery of Deficiency. Section 9.504 of the Code establishes two basic standards to govern the resale of collateral: (1) Notice of the sale must be given to the debtor; and (2) the sale must be conducted in a commercially reasonable manner.¹⁷¹ In *Tanenbaum v. Economics Laboratory, Inc.*¹⁷² the Texas Supreme Court held that this section bars a secured party who failed to comply with either or both of these basic standards from recovering any deficiency that remained on the debt after completing the sale of collateral.¹⁷³ The decision is an important one because it reverses several lower court decisions that had adopted a different rule.¹⁷⁴ Every commercial lawyer should read *Tanenbaum*. The court in *Gentry v. Highlands State Bank*¹⁷⁵ applied the *Tanenbaum* rule. In *Gentry* the Houston [14th District] court of appeals held that a secured creditor must establish that notice of the sale was given before the creditor can recover a deficiency in a summary judgment proceeding.¹⁷⁶

Conversion Action Lies for Wrongful Repossession. Section 9.507 provides a debtor with remedies for injunctive relief or damages if a secured credi-

165. 623 S.W.2d at 721.

166. *Id.*

167. *Id.*

168. 635 S.W.2d 200 (Tex. Ct. App.—San Antonio 1982, no writ).

169. *Id.* at 202. The right of a bank to be sued in the county of its location is established by the National Bank Act, 12 U.S.C. § 94 (1945). The venue provisions have been substantially amended by the Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 406, 96 Stat. 1469 (Oct. 15, 1982).

170. See *Robertson v. Union Planters Nat'l Bank*, 561 S.W.2d 901 (Tex. Civ. App.—El Paso 1978, writ ref'd n.r.e.); *Rivera v. Austin Nat'l Bank*, 547 S.W.2d 735 (Tex. Civ. App.—Corpus Christi 1977, no writ).

171. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1982-1983).

172. 628 S.W.2d 769 (Tex. 1982).

173. *Id.* at 772.

174. *Id.*; see *Roylex, Inc. v. E.F. Johnson Co.*, 617 S.W.2d 760 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ); *Ward v. First State Bank*, 605 S.W.2d 404 (Tex. Civ. App.—Amarillo 1980), writ ref'd n.r.e. per curiam, 24 Tex. Sup. Ct. J. 170 (Dec. 31, 1980); *Tackett v. Mid-Continent Refrigerator Co.*, 579 S.W.2d 545 (Tex. Civ. App.—Fort Worth 1979, writ ref'd n.r.e.); *O'Neil v. Mack Trucks, Inc.*, 533 S.W.2d 832 (Tex. Civ. App.—El Paso 1975), rev'd on other grounds, 551 S.W.2d 32 (Tex. 1977).

175. 633 S.W.2d 590 (Tex. Ct. App.—Houston [14th Dist.] 1982, writ ref'd).

176. *Id.* at 592.

tor fails to properly proceed with the repossession or disposition of collateral.¹⁷⁷ The Code does not, however, prohibit an action for common law conversion.¹⁷⁸ In *Wilson v. First National Bank*¹⁷⁹ a debtor successfully sued a secured creditor for the conversion of a tractor. The court calculated the damages as the value of the goods at the time of the wrongful repossession less the amount the secured party credited on the debtor's account from the proceeds of resale.¹⁸⁰ The Waco court also allowed exemplary damages.¹⁸¹

177. TEX. BUS. & COM. CODE ANN. § 9.507(a) (Tex. UCC) (Vernon Supp. 1982-1983) provides:

If it is established that the secured party is not proceeding in accordance with the provisions of this subchapter disposition may be ordered or restrained on appropriate terms and conditions. If the disposition has occurred the debtor or any person entitled to notification or whose security interest has been made known to the secured party prior to the disposition has a right to recover from the secured party any loss caused by a failure to comply with the provisions of the subchapter. If the collateral is consumer goods, the debtor has a right to recover in any event an amount not less than the credit service charge plus ten per cent of the principal amount of the debt or the time price differential plus ten per cent of the cash price.

178. *See id.* § 9.505(a) (specifically mentions action for conversion as a possible remedy).

179. 635 S.W.2d 887 (Tex. Ct. App.—Waco 1982, no writ).

180. *Id.* at 890.

181. *Id.*