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Commercial Transactions

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I. INTRODUCTION

IN 2010, the American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) approved several amendments to the Official Text of Article 9 of the Uniform Commercial Code on secured transactions.1 These amendments, with a few non-uniform changes, were adopted in Texas during the 2011 legislative session with an effective date of July 1, 2013.2 This article discusses...
several of these amendments as well as a number of cases decided during the Survey period.

II. SALE OF GOODS

A. CONTRACT FORMATION

Although Chapter 2 of the Texas Business and Commerce Code (the Code) contains a number of provisions directed specifically at contracts for the sale of goods, it is built on a common law framework. Section 2.204 on contract formation is one of the instances in which common law principles are used to supplement the Code. J.D. Fields & Co., Inc. v. United States Steel International, Inc. is a good example of the interaction

1617, and it was signed by the Governor on May 17, 2011. See Tex. S.B. 782, 82nd Leg., R.S. (2011), available at http://www.legis.state.tx.us/BillLookup/Text.aspx?LegSess=82R&Bill=SB782 (showing effective date of July 1, 2013); Uniform Law on Secured Transactions, 82nd Leg., R.S., ch. 67, §§ 1–20, 2011 Tex. Sess. Law. Serv. ch. 67 (West) (to be codified as an amendment to TEX. BUS. & COM. CODE ANN. ch. 9). The effective date of July 1, 2013 was deliberately chosen by ALI and NCCUSL as a uniform effective date to allow time for all states to consider legislative action on the amendments. The Texas version of the Uniform Commercial Code appears as the first eleven chapters in the Texas Business and Commerce Code (the Code). See TEX. BUS. & COM. CODE ANN. §§ 1.101–11.108 (West 2009). It should be noted that the Code became effective in Texas on July 1, 1966 as a separate statute. See Uniform Commercial Code, 59th Leg., R.S., Ch. 721, §§ 1.101–10.105, 1965 Tex. Gen. Laws 1. It was reenacted in 1967 as part of the Business & Commerce Code, the first of the codes promulgated under the Texas Codification Act. Uniform Commercial Code, 61st Leg., R.S., Ch. 785, §§ 1–6, 1967 Tex. Gen. Laws 2343. In that process, the designation of “Article” in the Official Text was changed to “Chapter,” subsections were designated by letters rather than numbers, and a period instead of a dash was used to designate sections. Thus, for example, § 2-204(1) in the Official Text became § 2.204(a) in the Texas codification. Revisions of the Code that have taken place since 1967 still substitute “Chapter” for “Article,” and a period instead of a dash was used to designate sections. Thus, for example, § 2-204(1) in the Official Text became § 2.204(a) in the Texas codification. Revisions of the Code that have taken place since 1967 still substitute “Chapter” for “Article,” and a period instead of a dash, but now use the Official Text system for designating subsections. See, e.g., Act of Jan. 1, 1996, 74th Leg., R.S., ch. 921, § 1, 1995 Tex. Sess. Law. Serv. ch. 921 (West) (codified at TEX. BUS. & COM. CODE ANN. §§ 3.101–805 (West 2011)). As currently enacted, Chapter 2 is the only chapter of the Code that retains the older non-uniform system to designate subsections. In the grand scheme of things, this is a minor point, but it can be confusing when doing Code research and in correlating the text of the Official Comments (which have not been adopted in Texas as part of the Code itself) to the statutory provisions. It can also affect searching on Westlaw and Lexis if the searcher is trying to track case interpretations of particular sections of the Code because of the variation in section and subsection designations over the years. Note 3, infra, contains an example of how this disparity can sometimes be confusing.

3. Several sections of Chapter 2 contain provisions directed specifically at transactions involving the sale of goods that differ from, or are inappropriate for, non-goods transactions. See, e.g., TEX. BUS. & COM. CODE ANN. §§ 2.207 (differing terms in offer and acceptance), 2.305 (open price terms), 2.307–308 (delivery terms), 2.314–315 (warranties of merchantability and fitness for particular purpose), 2.319–321 (shipment terms), 2.601–602 (right and manner of rejection), 2.705 (right to stop delivery in transit) (West 2009).

4. Section 2.204(a) provides, “A contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognizes the existence of such a contract.” The Official Comment to this section notes that “Subsection (1) continues without change the basic policy of recognizing any manner of expression of agreement, oral, written or otherwise. The legal effect of such an agreement is, of course, qualified by other provisions of this Article.” TEX. BUS. & COM. CODE ANN. § 2.204 (West 2009).
between the Code and the common law. In *Fields*, a seller of steel sent two separate price quotations to a prospective buyer. One of the quotations was sent in response to an inquiry from the prospective buyer and contained detailed information about the product, the quantity, the price, the payment terms, the manufacturing and delivery schedule, and an explicit statement that the terms would be valid for only fourteen days. The quotation did not, however, contain shipping terms, the method of shipping, or legal terms and conditions. Within five days, the prospective buyer sent a purchase order mirroring the terms of the quotation. The other price quotation contained similar terms, but the buyer did not respond to this quotation for more than fourteen days, and when the purchase order was finally sent, it stated a different quantity term. The seller did not acknowledge either purchase order and eventually notified the prospective buyer that it would not fill either of them.

The prospective buyer sued the seller for breach of contract. The principal issue turned on whether the prospective buyer was reasonable in believing the price quotations were offers that had been accepted by the purchase orders to form a contract. The seller moved for summary judgment and the district court ruled in favor of the seller on both claims. On appeal, the U.S. Court of Appeals for the Fifth Circuit discussed the interplay between the Code and the common law—citing Code provisions, the Restatement (Second) of Contracts, and several prior cases—in reaching a conclusion that a price quotation could constitute an offer if it was sufficiently detailed and did not limit the method of acceptance. The court held that the prospective buyer could have reasonably believed that the detailed price quotation was an offer that had been accepted by sending a purchase order within the specified time. It therefore reversed the determination as to the price quotation containing detailed terms to which the buyer had timely responded with a purchase order mirroring those terms, but affirmed summary judgment in favor of the seller on the other purchase order claim.

*Tricon Energy, Ltd. v. Vinmar International, Inc.* addressed the question of whether a proposed contract modification was effective to add an arbitration clause to a contract. The issue arose because an email sent by the seller proposing the modification contained signature blocks for both parties. The buyer responded with an assenting email, but neither the buyer nor the seller ever signed the signature blocks. The buyer argued that the modification never became effective because of the lack of

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7. *Id.* at 275–81.
8. *Id.* at 280.
9. *Id.* at 278, 280–81.
signature. The court disagreed.\textsuperscript{11} Citing, \textit{inter alia}, the \textit{Fields} case described above, the Federal District Court for the Southern District of Texas reasoned that the seller's email should be viewed as an offer that was accepted when the buyer returned an email agreeing to the modification.\textsuperscript{12} As to the lack of signatures, the court held that the terms of the sales contract indicated that the parties did not contemplate formal signing as a condition to contract formation because of industry practice and the language contained in the sales contract itself.\textsuperscript{13} The court also noted that section 1.201(b)(37) of the Code allows electronic “signing” of documents, and by typing their names at the bottom of the emails the parties had effectively signed the documents without the need to add a traditional written signature in the signature blocks.\textsuperscript{14} The court held that the proposed modification to add an arbitration clause had become a part of the contract.\textsuperscript{15}

While contracts for the sale of goods are often formed by an exchange of communications, an enforceable contract may also be formed by the acts of a party. In \textit{United Galvanizing, Inc. v. Imperial Zinc Corp.}, a buyer placed an order for zinc to be used in a galvanizing process.\textsuperscript{16} The seller made arrangements to supply the zinc through another company. Upon delivery, the buyer used one-half of the zinc in its galvanizing kettle and discovered that it contained too much aluminum to be suitable for galvanizing. The buyer then sued the seller for breach of contract and for damages caused to its galvanizing kettle. The seller counterclaimed for payment for the zinc that was used. The principal issues in the case turned on whether the seller had supplied zinc that conformed to the contract terms and whether the buyer’s use of part of the shipment constituted acceptance of the goods.

A conversation that took place between the seller and the buyer prior to placement of the buyer’s order indicated that they discussed variations in the grade of “Prime Western” zinc and “remelt” zinc and the relationship of these types of zinc to the standards of the American Society of Testing Materials (ASTM) for zinc to be used in a galvanizing process. When the buyer eventually placed its order by email, it did not specify that the zinc was to be “Prime Western” zinc conforming to the ASTM B 6 standard. A confirming email sent by the seller referred to the zinc as

\begin{footnotesize}
\begin{enumerate}
\item 11. \textit{Id.} at *8-10.
\item 12. \textit{Id.} at *8. In the buyer’s email response, it stated that the seller’s proposal was accepted except for a proposal to change the time period for demurrage charges. The court viewed this response as “assent to the un-objected to additional terms in the sales contract.” \textit{Id.} at *9.
\item 13. \textit{Id.} at *10.
\item 14. \textit{Id.} at *11. \textit{Tex. Bus. \\& Com. Code § 1.201(b)(37)} allows parties to sign a document by “using any symbol executed or adopted with present intention to adopt or accept a writing.” \textit{Tex. Bus. \\& Com. Code Ann. § 1.201(b)(37)} (West 2009). The court reasoned that by typing their names in the emails, the parties showed an intent to adopt the modification. \textit{Id.}
\item 15. \textit{Tricon Energy, Ltd.}, 2011 WL 4424802, at *12.
\end{enumerate}
\end{footnotesize}
“remelt” zinc and did not represent that it conformed to the ASTM B 6 standard. The bill of lading also referred to the delivered zinc as “remelt” zinc. Based on the exchange of emails, and on the buyer’s use of the zinc despite the lack of any indication that it conformed to the ASTM standard, the court held that a contract had been formed. Furthermore, the emails and the buyer’s use of the zinc created a contract that satisfied the Code’s Statute of Frauds. The buyer argued that even though it had not rejected the goods upon delivery, it was entitled to revoke acceptance because of nonconformity. The Federal District Court for the Southern District of Texas rejected this argument on the ground that the goods did conform to the contract terms since none of the contract documents required the zinc to meet the ASTM B 6 standard. The court concluded that the seller was not liable for any damages suffered by the buyer and that the buyer was required to pay for the zinc that had been used.

B. WARRANTIES

Facts giving rise to a breach of warranty claim under the Code often give rise to other claims as well, such as negligence, fraud, strict liability in tort, and violation of the Texas Deceptive Trade Practices Act (DTPA). Woodhouse v. Sanofi-Aventis U.S. LLC is one example of such a case. In Woodhouse, the plaintiff sought help in treating her insomnia. Her physician gave her a sample box of Ambien, a medication available by prescription for conditions of insomnia. The plaintiff alleged that the medication caused her to "sleepwalk" and, in that condition, she drove and wrecked her car and was injured. She sued the manufacturer for negligence, strict liability, breach of implied and express warranties, fraud, and violation of the DTPA. Of particular interest for purposes of the breach of warranty claims, the court pointed out that claims for breach of an implied warranty of merchantability require the sale or lease of a product to a purchaser. In this case, the plaintiff did not purchase or lease the medication, but instead she was given a sample of the product. Thus, the plaintiff failed to plead all of the necessary elements for a

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17. Id. at *10–12.
18. Id. The Code Statute of Frauds appears in Section 2.201 of Texas Business and Commerce Code. TEX. BUS. & COM. CODE ANN. § 2.201 (West 2009). In addition to the usual provisions dealing with contracts signed by the party against whom enforcement is sought, a separate provision provides that the Statute may be satisfied when goods have been "received and accepted." See TEX. BUS. & COM. CODE ANN. § 2.201(c)(3) (West 2009).
20. Id. at *12.
21. Numerous cases can be found in which some combination of these claims have been asserted. An overview of the relationship between these claims may be found in John Krahmer, 12 TEXAS PRACTICE: METHODS OF PRACTICE § 25.51 (3d ed. 2005 & Supp. 2011). Claims under the Texas Deceptive Trade Practices Act (DTPA) are frequently asserted because that Act includes a provision allowing DTPA actions for breach of warranty. See TEX. BUS. & COM. CODE ANN. § 17.50(a)(2) (West 2011).
23. Id. at *4.
claim of breach of implied warranty.\textsuperscript{24} As to the breach of express warranty claim, the court reached a similar result because one of the elements of that claim requires the plaintiff to be a buyer of the product.\textsuperscript{25} Here, again, the plaintiff was not a buyer because the medication had been given to her.\textsuperscript{26} The claim brought for a violation of the DTPA was also dismissed, but the grounds were slightly different because the DTPA requires only that the plaintiff be a “consumer” who “seeks or acquires by purchase or lease, any goods or services.”\textsuperscript{27} In her petition, the plaintiff neither sought nor acquired the medication by purchase or lease. The Federal District Court for the Western District of Texas granted the defendant’s motion to dismiss all claims.\textsuperscript{28}

Unless disclaimed, the Code provides that every sale of goods by a merchant includes an implied warranty of merchantability.\textsuperscript{29} An issue not addressed by the Code is whether used goods, as well as new goods, can include a warranty of merchantability when they are sold by a merchant seller. In \textit{Shows v. Man Engines \& Components, Inc.}, a buyer purchased a yacht from an engine manufacturer’s subsidiary with knowledge that both the yacht and its engines were used.\textsuperscript{30} A major engine failure occurred and the buyer sued the manufacturer.\textsuperscript{31} Several Texas courts of appeals cases have held that the Code implies no warranty of merchantability in the sale of used goods.\textsuperscript{32} The plaintiff argued that this rule should no longer apply as shown by Texas Supreme Court decisions dealing with actions for breach of implied warranties of habitability and the assignability of claims under the DTPA.\textsuperscript{33} The Houston Court of Appeals rejected this argument on the ground that those cases did not address the issue of merchantability under the Code and referred, instead,

\begin{itemize}
\item \textsuperscript{24} Id.
\item \textsuperscript{25} Id. at *6-7.
\item \textsuperscript{26} Id.
\item \textsuperscript{27} Id. at *6; \textsc{Tex. Bus. \& Com. Code Ann.} § 17.45(4) (West 2011).
\item \textsuperscript{28} \textsc{Woodhouse}, 2011 WL 3666595, at *7. The negligence, strict liability, and fraud claims were dismissed on various grounds dealing with tort law that go beyond the scope of this article.
\item \textsuperscript{29} \textsc{Tex. Bus. \& Com. Code Ann.} §2.314 (West 2009). Although this section defines the elements of “merchantability” in some detail, it is sufficient to note that the term generally requires that goods be of fair, average quality and such that they would pass without objection in the trade.
\item \textsuperscript{30} \textsc{Shows v. Man Engines \& Components, Inc.}, No. 14-09-00895-CV, 2011 WL 4793764, at *1 (Tex. App.—Houston [14th Dist.] Oct. 11, 2011); \textit{reh’g granted}, 364 S.W.3d 348 (Tex. App.—Houston [14th Dist.] 2012, no pet.).
\item \textsuperscript{31} Id. The yacht itself was a 1988 model. The engines had been replaced in 2000. The sale of the yacht with the replaced engines took place in 2002. Thus, both the yacht and the engines were “used” at the time plaintiff purchased the yacht.
\item \textsuperscript{32} See, e.g., \textsc{Bren-Tex. Tractor Co., Inc. v. Massey-Ferguson, Inc.}, 97 S.W.3d 155, 159 n.8 (Tex. App.—Houston [14th Dist.] 2002, no pet.); \textsc{Bunting v. Fodor}, 586 S.W.2d 144, 145-46 (Tex. Civ. App.—Houston [1st Dist.] 1979, no writ); \textsc{Chaq Oil Co. v. Gardner Mach. Corp.}, 500 S.W.2d 877, 878 (Tex. Civ. App.—Houston [14th Dist.] 1973, no writ.).
\item \textsuperscript{33} \textsc{Shows}, 2011 WL 4793764, at *3. The cases cited by the plaintiff were \textsc{Gupta v. Ritter Homes, Inc.}, 646 S.W.2d 168, 168-69 (Tex. 1983) (warranty of habitability would extend from builder to both the original purchaser and to a subsequent purchaser of a home) and \textsc{PPG Indus., Inc. v. JMB/Houston Ctrs. Partners Ltd. P’ship}, 146 S.W.3d 79 (Tex. 2004) (distinguishing warranties on homes from warranties on goods).
\end{itemize}
to the earlier line of cases decided in the courts of appeals. The court held that it was bound by these authorities unless they were abrogated by a supreme court decision or by an en banc ruling by the deciding court. The lower court judgment granting a take-nothing judgment against the plaintiff was affirmed.

C. REVOCATION OF ACCEPTANCE

In Hull v. South Coast Catamarans, L.P., the buyer of a boat discovered cracks, dents, and small holes in the fiberglass. The buyer notified the seller about the defects and had the boat examined by a fiberglass technician. The technician estimated that it would cost three to four thousand dollars just to determine the extent of the problems with the fiberglass. The seller offered to make repairs or to replace the boat, but the buyer refused this offer and demanded a full refund and reimbursement for costs incurred in connection with the boat. The seller refused and the buyer sued. After a fairly convoluted series of motions, discovery issues, and an assignment to a visiting judge, summary judgment was granted in favor of the seller. On appeal, the principal Code issue was whether the plaintiff had given effective notice of revocation to avoid the bar rule in section 2.607(c)(1) of the Code. After reviewing the summary judgment record, the Houston First Court of Appeals held that the buyer had given proper notice to the seller and that issues of material fact existed as to whether the buyer provided an opportunity for the seller to cure the defects. The court added that, even if notice had not been given as required by the Code, this would only bar the plaintiff from recovering on his Code claims and would not bar claims for negligence, negligent misrepresentation, breach of contract, and non-warranty claims based on violations of the DTPA because these claims sought remedies

34. Shows, 2011 WL 4793764, at *3.
35. Id.
36. Id. at *5. The author has noted elsewhere that the issue of whether a warranty of merchantability should be implied in the sale of used goods should be re-examined because Chaq Oil Co. v. Gardner Mach. Corp., the seminal case on this issue, merely relied on pre-Code cases as controlling precedent without analyzing the provisions of Tex. Bus. & Com. Code § 2.314 or its Official Comment, and subsequent decisions have uncritically followed the lead of Chaq Oil. See John Krahmer, Commercial Transactions, 37 S.W. L.J. 145, 150–52 (1983). One would hope that a supreme court case or an en banc decision would revisit this issue for an analytical determination of whether implied warranties might appropriately be imposed in at least some sales of used goods. As noted more than one hundred years ago by Justice Holmes, "It is revolting to have no better reason for a rule of law than that so it was laid down in the time of Henry IV. It is still more revolting if the grounds upon which it was laid down have vanished long since, and the rule simply persists from blind imitation of the past." Oliver Wendell Holmes, The Path of the Law, 10 HARV. L. REV. 457, 469 (1897).
38. Id. at 44. Tex. Bus. & Com. Code § 2.607(c)(1) provides that a “buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy.” TEX. BUS. & COM. CODE ANN. § 2.607(c)(1) (West 2009).
39. Hull, 365 S.W.3d at 45.
outside of the Code. The summary judgment was reversed and the case remanded for trial.

D. Remedies

Section 2.709 of the Code is titled "Action for the Price." This title can engender some confusion because it sounds as if it were a generic remedy for any breach of contract by a buyer. In fact, the remedy is quite limited. It applies only when risk of loss has passed to the buyer, when the buyer has accepted the goods, or when the goods cannot be resold. Two examples will explain both the limitation and the operation of this section. Suppose Buyer orders a case of copy paper from Seller, a paper distributor. Seller has hundreds of cases of this paper available. Before the case of paper is sent to Buyer, Buyer calls Seller and cancels the order. Because the case of paper could be resold to other buyers and the risk of loss had not passed to Buyer in the course of shipping the paper, Seller would not be entitled to sue Buyer for the price of the paper, but would instead be limited to recovering the difference between the contract price and the going market price for this paper (probably zero) or, alternatively, the profit lost by Seller on this contract, i.e., the difference between the price Seller paid for the paper and the price charged to Buyer (probably only a few cents or, at most, only a few dollars for one case of paper).

Contrast this case with one in which Buyer orders 1000 menus for Buyer's restaurant from Seller, a printing company. Seller prints the 1000 menus, using a case of paper in the process. Before the menus are delivered to Buyer, Buyer cancels the order. In this situation, it is unlikely that the menus can be sold to another buyer because they are uniquely suitable for Buyer's restaurant (unless Buyer's restaurant has a remarkably limited menu selection). In this case, Seller could hold the goods for the buyer and maintain an action for the price. Between these extremes, a situation may be more complex if a buyer has ordered goods that are specially manufactured for the buyer (like the restaurant menus) and, after the seller has begun the manufacturing process but before it has been completed, the buyer cancels the order. The Code provides for this situation by allowing the seller, using reasonable commercial judgment, to stop manufacture and sell the partially finished goods for scrap or salvage, to complete the process and resell the goods, or treat the goods as a product that is suitable only for this buyer and maintain an action for the price. Part of the seller's decision may be based on whether the seller has already entered into contracts with third parties that would expose the seller to liability if the seller were to cancel those contracts as a result

40. Id. at 45.
41. Id. at 45.
42. TEX. BUS. & COM. CODE ANN. § 2.709 (West 2009).
43. See id. at Official Comment 2.
44. See id. § 2.708.
45. See id. § 2.704.
of the buyer's cancellation. This could occur if, for example, the menus ordered by Buyer were to be printed on special paper that Seller had ordered before learning of Buyer's cancellation. If Seller could not cancel the paper order without liability, this would be a factor to consider in making a decision to stop or to continue manufacture.

This situation arose in Barrington Group, Limited, Inc. v. Classic Cruise Holdings S DE RL, where a buyer ordered several lots of gifts and promotional items to be distributed to cruise ship passengers. The buyer eventually cancelled two of the orders, but the seller completed the orders and sued the buyer for the price. The trial court held that the seller's decision was commercially reasonable. On appeal, the U.S. Court of Appeals for the Fifth Circuit agreed, noting that the seller had become obligated to third parties for the purchase of various articles to be used in manufacturing the items, and it was clear that the products would not be suitable for sale to others, particularly because they would have little or no value after the scheduled cruise ships sailed. The court rejected an argument by the buyer that the seller's evidence failed to adequately show that the seller was obligated to the third parties. Judgment in favor of the seller was affirmed.

Under the Code, if a seller breaches a contract for the sale of goods, the buyer is, of course, entitled to recover for the breach. Unless the action is one for specific performance, the critical question then becomes one of calculating a dollar amount that will compensate the buyer for the seller's breach. As a general rule, the Code permits a buyer to recover any damages resulting directly from the breach, e.g., the difference between the contract price and the market price or the amount the buyer had to pay to obtain comparable goods. If the action is one for breach of warranty, the buyer's recovery is based on the difference in value between the goods accepted and the value the goods should have had if they had been as warranted. Under any of these formulations, the buyer may also be entitled to recover incidental or consequential damages resulting from the breach. It is not uncommon, however, for a seller to insist upon a contractual limitation of liability to prevent recovery of con-

46. Barrington Group, Ltd., Inc. v. Classic Cruise Holdings S DE RL, 435 F. App'x 382, 383 (5th Cir. 2011). An earlier decision in this case involving application of the statute of frauds was discussed in the 2011 Survey. See John Krahmer, supra note 5, at 158-59.
47. Barrington Group, Ltd., Inc., 435 F. App'x at 383.
48. Id. at 385-86.
49. Id.
50. Id. at 386.
52. Id. § 2.713 (containing the provisions dealing with recovery of the contract/market difference). Id. § 2.712 (stating the rules to be applied when the buyer purchases comparable goods to "cover" for the seller's breach).
53. See id. § 2.714.
54. See id. § 2.715. Incidental damages include such miscellaneous items as expenses incurred in the inspection, receipt, care and custody of rejected goods, costs of obtaining cover, and other reasonable expenses associated with the breach. Consequential damages include losses "resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be
sequential damages where such damages may greatly exceed the value of the goods themselves. If a contract excludes or limits recovery of consequential damages, a determination must then be made of which damages are damages directly resulting from the breach and which damages are consequential damages. This was the issue addressed by the Houston First Court of Appeals in Powell Electrical Systems, Inc. v. Hewlett Packard Company. In Powell Electrical, an electrical contractor was hired to repair a transformer at a manufacturing plant. The contract excluded recovery of consequential damages. During the repair process, breaker cables connected to the transformer were removed and unintentionally crossed when they were reconnected. The crossing of the breaker cables caused damage to one of the two transformers in the factory resulting in costs to the manufacturer for repair of the damaged transformer and for a temporary replacement transformer. The manufacturer sued to recover all of these costs. At trial, the jury found in favor of the manufacturer on its breach of contract and breach of warranty claims and the trial court granted judgment on the verdict after allowing for an offset and interest. On appeal, the repair company contended that all of the damages were consequential damages for which recovery was barred under the contract.

After reviewing earlier decisions discussing the difference between direct damages and consequential damages, the court of appeals reasoned that damages that are “conclusively presumed to have been foreseen or contemplated” are direct damages, while damages that “result naturally, but not necessarily, from the breach” are consequential damages. Applying this standard to the case at bar, the court reasoned that it could have been conclusively foreseen that crossing the breakers when the transformer was reconnected would cause damage to the transformer. These damages were, therefore, direct damages resulting from the defendant's breach. According to the court, however, the cost of renting a replacement transformer was not a cost that could have been conclusively foreseen because the factory could operate for a period of time with only prevented by cover or otherwise . . . ." Consequential damages also include “injury to person or property proximately resulting from any breach of warranty.”

55. Limitations of liability are permitted in Section 2.719 of Texas Business and Commerce Code. Id. § 2.719. Consequential damages may be limited or excluded under this section unless the limitation or exclusion is unconscionable. If the contract is one for the sale of consumer goods, limitation of consequential damages is prima facie unconscionable. See id.


59. Id. at 120.
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one transformer.\textsuperscript{60} In fact, the parties had anticipated such operation because the contract itself contemplated continued operation of the factory with one transformer while repair work progressed on the other transformer.\textsuperscript{61} The need for a temporary replacement, therefore, may have been a natural, but not a necessary result, of the breach.\textsuperscript{62} As such, the cost of the temporary replacement was a consequential damage that was not recoverable under the terms of the contract.\textsuperscript{63}

Another part of the decision dealt with the recovery of attorney's fees by the manufacturer. After concluding that the amount of attorney's fees had not been adequately proven, the court affirmed the judgment of the trial court after subtracting the cost of renting and installing a replacement transformer and remanded the case for trial on the issue of recoverable attorney's fees.\textsuperscript{64}

It is of particular note that the Texas Supreme Court may provide additional guidance on the distinction between direct damages and consequential damages since a petition for review has been granted in \textit{Wolf Hollow I, L.P. v. El Paso Marketing, L.P.},\textsuperscript{65} another case decided by the Houston Court of Appeals on this point, but not cited or discussed in \textit{Powell Electrical}.

\textit{Michael Smith Custom Clothier, Inc. v. Constantini} also concerned a limitation of liability.\textsuperscript{66} This case arose out of a transaction in which a customer placed an order for custom-made shirts with a clothing company. When the shirts were delivered, they fit improperly and the customer called the store about the problem approximately sixty days after the order was placed. Neither this call, nor a series of subsequent phone conversations with sales personnel at the store and with a representative at company headquarters, resolved the dispute. The customer ultimately returned the shirts and asked for a refund which the store denied. The customer prevailed at trial on claims for breach of warranty, violation of the DTPA, and negligence.\textsuperscript{67}

On appeal, the issue revolved around interpretation of the limitation of liability provisions in the contract. A guarantee provided by the company stated, in part, that "[c]lothing made to your measurements and styling, is non-refundable . . . If you have issues with your order, they need to be addressed within 120 days of when the order was placed."\textsuperscript{68} The same guarantee also appeared on a receipt given to the customer at the time.

\textsuperscript{60} Id.
\textsuperscript{61} Id.
\textsuperscript{62} Id.
\textsuperscript{63} Id.
\textsuperscript{64} Id. at 122. The court was able to precisely determine the costs of renting and installing a temporary transformer because the jury had returned a verdict on special issues specifying each element of damage claimed by the manufacturer. See id. at 116.
\textsuperscript{65} \textit{Wolf Hollow I, L.P.}, 329 S.W.3d at 628. \textit{Wolf Hollow} was discussed in the 2011 Survey. See Krahmer, supra note 5, at 162–64.
\textsuperscript{67} Id. at *1.
\textsuperscript{68} Id. at *4–5.
the order was placed. The company asserted that it was not liable to the customer on any of the claims. Although the Houston Court of Appeals agreed that section 2.719 of the Code permits limitations of liability, the court also noted that the contract terms themselves were the best indication of the parties' intent in defining the scope of any limitation.69 Applying the language in the contract to the evidence presented at trial, the court held that the clothing had not been made to the customer's measurements.70 The company also argued that the one phone call made by the customer within 120 days after the order was placed was not sufficient to "address" the problem as required by the contract terms. The court disagreed with this narrow interpretation of the word address and held that the phone call gave the store adequate notice that a problem existed.71 Judgment was affirmed in favor of the customer.72

III. LEASES OF GOODS

A. LEASE OR SALE?

An interesting statute of limitations case was litigated in Prestige Ford Limited Partnership v. Morales, where a consumer signed a five-year lease contract for a car but allegedly did so in the belief that she was buying the car rather than leasing it.73 At the end of the lease term, she was unable to pay for or finance the purchase of the vehicle and returned it to the dealer. The car was later sold at auction and the consumer sued for breach of contract. In an attempt to avoid the statute of limitations, she argued that she was unaware that the contract she had signed was a lease contract and not a sales contract until one month before the end of the lease term. She alleged that this lack of knowledge on her part was caused by the dealer's fraudulent concealment of the nature of the transaction, and she asked for a return of the payments she had made on a theory of promissory estoppel because the dealer had represented the transaction as a sale. The jury found in favor of the plaintiff on the promissory estoppel claim, and the trial court entered judgment on the verdict after allowing the dealer a credit for amounts owed by the consumer for excessive use of the vehicle.74

On appeal by the dealer, the Dallas Court of Appeals held that a promissory estoppel claim begins to run when a promise is breached and not

69. Id. at *4.
70. Id. at *5.
71. Id. at *5-6. The court characterized the store's interpretation of "address" as imposing a duty on the customer to take further action with respect to the problems with the shirts. On this point, the court stated, "The policy itself, however, only requires that any issues 'be addressed' within 120 days; it does not expressly or implicitly require that all issues be resolved or even that significant progress be made toward resolution. Accordingly, the trial court did not err in concluding that [the customer] complied with store policy by notifying [the store] of the problem with the shirts within 120 days." Id.
72. Id. at *8.
74. Id. at 835.
when the promisee learns of the breach.\textsuperscript{75} In this case, the dealer promised to sell the consumer a car in August of 1999, but had her sign a lease instead of a sales contract. Under section 2A.103(10) of the Code, the signed lease gave the consumer a right to possession and use of the vehicle for a five-year period, but it did not transfer title to her.\textsuperscript{76} The breach of the promise to sell, therefore, took place in 1999 and not in 2004 when the consumer learned that she had not purchased the car, but had leased it instead.\textsuperscript{77} When suit was filed in 2006, the claim fell well beyond the four-year limitation period and was, therefore, time-barred.\textsuperscript{78} The court held that the dealer was entitled to judgment as a matter of law and reversed the decision of the trial court.\textsuperscript{79}

IV. NEGOTIABLE INSTRUMENTS

A. NEGOTIABLE OR NON-NEGOTIABLE?

Section 3.104 of the Code states the formal requirements needed to make an instrument a negotiable instrument under Chapter 3.\textsuperscript{80} Unless the instrument meets these requirements, it is non-negotiable and falls outside the scope of Chapter 3.\textsuperscript{81} In \textit{Guniganti v. Kalvakuntla}, a determination of negotiability was critical to the outcome.\textsuperscript{82} If the note was negotiable, it would be governed by the six-year limitations period in section 3.118; if non-negotiable, it would be governed by the four-year

\textsuperscript{75} \textit{Id.} at 837.
\textsuperscript{76} \textit{Id.} at 838–39. The Texas Business and Commerce Code provides, in part, "'Lease' means a transfer of the right to possession and use of goods for a term in return for consideration . . . ." \textit{TEX. BUS. & COM. CODE ANN.} § 2A.103(10) (West 2009).
\textsuperscript{77} \textit{Prestige Ford}, 336 S.W.3d at 839.
\textsuperscript{78} \textit{Id.}
\textsuperscript{79} \textit{Id.}
\textsuperscript{80} \textit{TEX. BUS. & COM. CODE ANN.} § 3.104 (West Supp. 2011). Although the statutory language in § 3.104 is quite detailed, the basic requirements are: (1) the instrument must be payable to order or to bearer; (2) the instrument must be payable on demand or at a definite time; and (3) the instrument must not contain any promises except a promise or an order to pay a fixed amount of money unless an additional promise is one of those listed in § 3.104(a)(3).
\textsuperscript{81} Chapter 3 does not, itself, state what law should govern if an instrument is found to be non-negotiable. The Official Comment to Section 3.104 of the Texas Business and Commerce Code does, however, offer some guidance by stating:

An order or promise that is excluded from Article 3 because of the requirements of Section 3-104(a) may nevertheless be similar to a negotiable instrument in many respects. Although such a writing cannot be made a negotiable instrument within Article 3 by contract or conduct of its parties, nothing in Section 3-104 or in Section 3-102 is intended to mean that in a particular case involving such a writing a court could not arrive at a result similar to the result that would follow if the writing were a negotiable instrument. . . . [I]t may be appropriate, consistent with the principles stated in Section 1-102(2), for a court to apply one or more provisions of Article 3 to the writing by analogy, taking into account the expectations of the parties and the differences between the writing and an instrument governed by Article 3. Whether such application is appropriate depends upon the facts of each case.

\textit{TEX. BUS. & COM. CODE ANN.} § 3.104 (West Supp. 2011).
\textsuperscript{82} \textit{Guniganti v. Kalvakuntla}, 346 S.W.3d 242 (Tex. App.—Houston [14th Dist.] 2011, no pet.).
period stated in the Texas Civil Practice and Remedies Code for actions on a debt.\textsuperscript{83} The note provided that additional advances could be made on the note "in accordance with the terms and conditions of the Loan Agreement, reference to same being here made for all purposes."\textsuperscript{84} The Houston Court of Appeals held that this language made the promise to pay one that was conditioned by the terms of the loan agreement and, therefore, the instrument was non-negotiable and subject to the four-year limitations period.\textsuperscript{85} Because suit was brought more than four years after issuance, an action to recover on the note was barred.\textsuperscript{86} A declaratory judgment entered by the trial court in favor of the guarantors who had intervened in the action to assert the statutory limitations defense was affirmed.\textsuperscript{87}

B. Transfer and Enforcement of Instruments

In \textit{Rosero v. Fuentes},\textsuperscript{88} a note was made payable in the form, "Pay . . . to the order of [A or B or C] (collectively 'Payee') . . . "\textsuperscript{89} In an action brought against the maker by one of the payees, the maker contended that all of the payees were necessary parties, and without their joinder the action could not proceed. Referring to section 3.110 of the Code and to the decision in \textit{Allied Capital Partners v. Bank One},\textsuperscript{90} the Federal District Court for the Southern District of Texas held that a note payable in this form was payable in the alternative and could be transferred or enforced by any one of the payees.\textsuperscript{91} Joinder of all payees was, therefore, not required. The court also pointed out that the parenthetical reference stating, "(collectively 'Payee')," was ambiguous and would not change the result under the provisions of section 3.110.\textsuperscript{92}

The defendant maker also contended that the parties had a contemporaneous oral agreement that the note was payable only if one of the

\textsuperscript{83} See \textit{TEX. Bus. \& COM. CODE ANN.} § 3.104(a) (West Supp. 2011); \textit{TEX. CIV. PRAC. \& REM. CODE} § 16.004(a)(3) (West 2002).

\textsuperscript{84} Guniganti, 346 S.W.3d at 249.

\textsuperscript{85} Id. at 249–50.

\textsuperscript{86} See id. at 247–51.

\textsuperscript{87} Id. at 253. Pursuant to \textit{TEX. CIV. PRAC. \& REM. CODE} § 37.004, the trial court also allowed recovery of attorney's fees by the guarantors as part of its ruling on their motion for a declaratory judgment. This ruling was also affirmed by the appellate court. See id.


\textsuperscript{89} See id. at *3.

\textsuperscript{90} Id. at *3. See \textit{TEX. BUS. \& COM. CODE ANN.} § 3.110(d) (West 2002); \textit{Allied Capital Partners, L.P. v. Bank One, Texas, N.A.}, 68 S.W.3d 51, 53 (Tex. App—Dallas 2001, no pet.) (an instrument payable to multiple payees separated by 'or' is payable to the payees alternatively). Although not cited by the court, \textit{New Wave Technologies, Inc. v. Legacy Bank of Texas}, also addressed the question of ambiguity in naming the payees to an instrument. \textit{New Wave Technologies, Inc. v. Legacy Bank of Texas}, 281 S.W.3d 99, 102–03 (Tex. App.—El Paso 2008, pet. denied). In \textit{New Wave}, a check was made payable to A and/or B. The court held that the check had been properly negotiated by the indorsement of only one of the designated payees. \textit{Id}. The case is discussed in more detail in John Krahmer's article. John Krahmer, \textit{Commercial Transactions}, 62 SMU L. REV. 995, 1011–12 (2009).

\textsuperscript{91} Rosero, 2011 WL 4017871, at *3.

\textsuperscript{92} Id.
named payees died before the stated date of payment. Citing numerous earlier Texas cases, the court held that Texas law routinely applies the parol evidence rule to notes.93 Because the note was an integrated agreement and the alleged oral agreement would vary its express terms, proof of the agreement was excluded by the parol evidence rule.94

Since the economic downturn that began in 2008, mortgage defaults have risen exponentially in the United States.95 This has led, in turn, to a nationwide increase in the number of mortgage foreclosures and in the number of court cases addressing various aspects of the foreclosure process.96 The legal issues involved in a foreclosure proceeding often involve an interplay between state real property law, foreclosure procedures, and the Code. This interplay caused the Permanent Editorial Board for the Uniform Commercial Code to issue a report on the "Application of the Uniform Commercial Code to Selected Issues Relating to Mortgage Notes."97 The news release announcing the availability of the report states that it addresses four questions:

To whom is the obligation to pay a mortgage note owed?
What steps must be taken for the owner of a mortgage note to transfer ownership of the note to another person or use the note as collateral for an obligation?

... ...

What actions may a person to whom an interest in a mortgage note has been transferred, but who has not taken a recordable assignment

97. The introduction to this report states:
The Permanent Editorial Board for the Uniform Commercial Code has prepared this Report in order to further the understanding of this statutory background by identifying and explaining several key rules in the UCC that govern the transfer and enforcement of notes secured by a mortgage on real property. The UCC, of course, does not resolve all issues in this field. Most particularly, as to both substance and procedure, the enforcement of real estate mortgages by foreclosure is primarily the province of a state's real property law (although determinations made pursuant to the UCC are typically relevant under that law). Accordingly, this Report should be understood as providing guidance only as to the issues the Report addresses. (footnotes omitted).

of the mortgage, take in order to become the assignee of record of the mortgage securing the note? 

One of the issues that must be determined in a foreclosure proceeding is whether the foreclosing party is the person entitled to foreclose. This determination will depend, in part, on whether the foreclosure is a judicial foreclosure or a non-judicial foreclosure. In a judicial foreclosure, proof that the foreclosing party is a holder or owner of the note will be necessary. \(^9\) Sections 3.301 and 3.309 provide the rules for deciding this issue. \(^10\) In the case of a non-judicial foreclosure, proof of holding or ownership is not required under Texas law, but may become an issue if the foreclosure is challenged. \(^11\) In *Falk v. Wells Fargo Bank* \(^12\) and *Wells v. BAC Home Loans Servicing, L.P.* \(^13\) the mortgagors sued in state court to contest the non-judicial foreclosures of their homes. The cases were removed to federal court. In both cases, the federal district courts held that the foreclosing parties were entitled to foreclose as assignees of rights under the deeds of trust and were not required to be holders of the note to foreclose their liens. \(^14\) The opinion in *Wells* contains a particularly helpful discussion of the reasons why production of the note is not required for the non-judicial foreclosure of a lien. \(^15\)

In *DeFrancheschi v. Wells Fargo Bank,  N.A.* \(^16\) and *Bittinger v. Wells Fargo Bank, N.A.*, \(^17\) the homeowners also challenged non-judicial foreclosures on their homes. In *DeFrancheschi*, the Federal District Court for the Northern District of Texas held that the foreclosing party was the holder of the note and the assignee of the deed of trust and was therefore entitled to foreclose. \(^18\) In *Bittinger*, the Federal District Court for the Southern District of Texas discussed sections 3.301 and 3.309 of the Code

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99. The Texas Business and Commerce Code provides that three classes of persons are entitled to enforce an instrument: (1) the holder of the instrument, (2) a nonholder who has the rights of a holder and who has possession of the instrument, and (3) a person not in possession who is entitled to enforce the instrument under §§ 3.309 or 3.418(d). *Tex. Bus. & Com. Code Ann.* § 3.301 (West 2002). Section 3.309 deals with situations in which a person seeks to enforce an instrument that has been lost or stolen. *Id.* § 3.309 (West Supp. 2011). The Texas Business and Commerce Code Section 3.418 involves recovery of payments by a payor or acceptor and would not generally apply to foreclosures. *Id.* § 3.418(d) (West 2002).

100. *Id.* §§ 3.301, 3.309, 3.418.


at some length and concluded that the foreclosure could be conducted under the provisions of section 3.301 because the foreclosing parties could proceed as either the holder or owner of the note. A somewhat different situation arose in *Norwood v. Chase Home Finance LLC*, where the homeowner challenged a foreclosure by a loan servicer. The servicer moved for summary judgment and argued that it was “exempt” from showing possession of the note. The case was referred to a magistrate judge in the Western District of Texas who recommended that summary judgment be denied because the servicer failed to show who possessed the note or an assignment of the right to foreclose by the possessor of the note.

These cases, which illustrate the interplay between Texas property law, foreclosure procedure, and the Code, are only the tip of the iceberg in terms of the complexity and costs involved in effecting a foreclosure. One author has suggested that the development of a secondary mortgage market and the securitization of mortgages has rendered the concept of negotiability obsolete and that a different legal framework should be established to facilitate a more efficient way of proving ownership to avoid the costs inherent in the present foreclosure system. Whether such a framework will eventually be established remains to be seen, but in the meantime, disputes about “robo-signing” and inadequate documentation about the transfer of notes and mortgages in the secondary mortgage market continue with economic consequences for both individuals and for the economy as a whole.

### C. Conversion of Instruments

In *Jones v. Wells Fargo Bank, N.A.*, the authorized agent of a bank customer asked the bank to issue a cashier’s check payable to four named individuals. Later that same day, the agent returned to the bank and deposited the check into an unrelated corporate account that had been established by the agent and on which the agent was the only signatory. None of the payees had ever obtained possession of the check nor had

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111. *Id.* at *2.
112. *Id.* at *4–5.
any of them indorsed the check. When the bank customer learned about
the agent's actions, the customer sued the bank for conversion and
breach of contract.

The Federal District Court for the Northern District of Texas reasoned
that the agent was not a person "entitled to enforce" the cashier's check
under section 3.301 of the Code but was, instead, a "remitter" as defined
in section 3.103(a)(11).116 Because the check was payable to the named
payees and not to the agent, the bank's failure to obtain the payees' in-
dorsements rendered the bank liable for conversion under section
3.420.117 On this point, the court noted that proper banking practice re-
quired the bank to cancel the cashier's check and issue a new cashier's
check payable to the corporation into whose account the check was to be
deposited.118 The court rejected expert testimony that the bank's failure
to proceed in this manner was a "minor oversight" or a "clerical er-
ror".119 The court also rejected an argument that, as a remitter, the
plaintiff had given up ownership of the check by the action of its agent in
depositing the check into an account controlled by the agent because this
action was adverse to the interests of the principal and should not be
imputed to the principal.120

Because the court had determined that the plaintiff was entitled to re-
cover as a matter of law on its conversion claim, it was unnecessary to
address the contract claim.121 Determining that the contract claim was
moot, however, also meant that the plaintiff was not entitled to recover
attorney's fees under the Texas Civil Practice and Remedies Code.122

D. Payment by Mistake

In Manley v. Wachovia Small Business Capital, a bank sued the maker
of a note to recover the unpaid balance.123 At trial, the maker testified
that he had paid the bank by delivering $375,000 in cash to one of its
branches. At that time, the maker allegedly asked for a receipt and was
told that one would be mailed to him. The maker never received a re-
cipient, but he did receive the original note. The note had been stamped,
"PAID" on October 18, 2006. The original note, as stamped and re-

116. Id. at *3.
117. Id. at *4.
118. Id. at *5.
119. The court characterized the bank's actions as a "critical omission" because,"[s]imply depositing the cashier's check into [an account] while skipping that vital step was
unacceptable, commercially unreasonable, and amounted to conversion under the UCC.
[The bank] was unable to produce any bank policies or procedures that authorized its
deposit of the cashier's check into the [corporate] account without first requiring a proper
indorsement from the named payees." Id. at *5.
120. Id. at *6.
121. Id.
122. Id. Texas Civil Practice and Remedies Code allows recovery of attorney's fees in
any action founded on contract. TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (West
2008).
2011, pet. denied).
turned, was admitted into evidence. The bank introduced evidence that it had an audit procedure which it followed when a note was paid and there was no record of this procedure in the loan file. One of the bank’s assistant vice presidents testified that he had no idea how the note had been stamped “PAID” and sent to the maker.

The jury was given an instruction tracking the language of section 3.604 and found that the maker had not paid any money to the bank and remained liable on the note. The maker appealed on the ground that stamping the note “PAID” discharged his liability as a matter of law. The Dallas Court of Appeals disagreed, holding that section 3.604 of the Code clearly requires discharge to be by an intentional, voluntary act. Because there was sufficient evidence in the record to support the jury’s determination that payment had not been paid, the mistaken stamping of the note did not discharge the maker’s liability.

The maker also made an ingenious argument that the bank was not the holder of the note because he, not the bank, had physical possession of the note, and the note had been neither lost nor stolen. The bank, therefore, was not a “person entitled to enforce” the note as defined in section 3.301. Although nothing in the Code directly addressed this peculiar situation, the court rejected the maker’s argument and held that the Code could be supplemented by the common law of mistake to avoid an inequitable result.

V. SECURED TRANSACTIONS

A. Scope of Chapter 9

The primary focus of Chapter 9 is on consensual security interests created in personal property and fixtures. “Fixtures” are defined as

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124. Id. Section 3.604 of Texas Business and Commerce Code provides:
   (a) A person entitled to enforce an instrument, with or without consideration, may discharge the obligation of a party to pay the instrument:
      (1) by an intentional voluntary act, such as surrender of the instrument to the party, destruction, mutilation, or cancellation of the instrument, cancellation or striking out of the party's signature, or the addition of words to the instrument indicating discharge; or
      (2) by agreeing not to sue or otherwise renouncing rights against the party by a signed record.
   TEX. BUS. & COM. CODE ANN. § 3.604 (West Supp. 2011).

125. Manley, 349 S.W.3d at 238.

126. Id.

127. TEX. BUS. & COM. CODE ANN. § 3.301 (West 2002) is described supra note 99.


129. See TEX. BUS. & COM. CODE ANN. § 9.109(a) (West Supp. 2011). Chapter 9 also applies to other transactions that may be difficult to distinguish from a security interest or
"goods that have become so related to particular real property that an interest in them arises under the real property law of the state in which the real property is situated." The difficulty in applying this definition was nicely illustrated in 21st Mortgage Corp. v. Stovall, where the collateral was variously described by the parties as a "modular home" or as a "manufactured home." Regardless of the terminology used, the Dallas Court of Appeals held that the critical issue was whether, after affixation to the real property, the collateral retained its character as personal property that would allow the secured party to repossess the collateral after default. The court ruled that the trial court had erred in granting summary judgment to the landowners because genuine issues of material fact existed as to whether the home had lost its character as personal property.

One scope issue that has apparently been concluded with a whimper instead of a bang is the extent to which a secured party can assert a purchase money security interest when funds are advanced to pay off a debtor's "negative equity" in a used vehicle when that vehicle is traded in on the purchase of a new vehicle. The issue arises because of an ambiguity that exists in the "hanging paragraph" appearing in section 1325(a) of the Bankruptcy Code. After a number of lower courts reached differing results about the interpretation and application of the provision, the issue seemed to be moot when eight federal circuit courts agreed that negative equity should be included as part of the value given by a secured party in financing the purchase of a new vehicle. However, after a

where public filing is helpful in documenting transactions to alert third parties to the existence of another person's claim to personal property. See TEX. BUS. & COM. CODE ANN. § 9.109(a)(2)-(5) (West Supp. 2011) (extending the scope of Chapter 9 to agricultural liens, sales of accounts, chattel paper, payment intangibles, promissory notes, consignments, and non-consensual security interests arising under other chapters of the Code).


132. Id. at *5.

133. Id. at *7. The secured party asserted that four fact issues existed that precluded summary judgment: (1) the home was easily removable; (2) the home was a trade fixture; (3) the lease under which the debtor-tenant had acquired the home allowed removal; and (4) recording with the county clerk and filing a UCC financing statement gave the secured party a right to recover the home or enforce a lien against the realty. Id. at *3.


135. See Nuvell Credit Corp. v. Westfall (In re Westfall), 599 F.3d 498 (6th Cir. 2010); In re Howard, 597 F.3d 852 (7th Cir. 2010); Peaslee v. GMAC (In re Peaslee), LLC, 585 F.3d 53 (2d Cir. 2009); In re Price, 562 F.3d 618 (4th Cir. 2009); Ford Motor Credit Co. v. Dale, 582 F.3d 568 (5th Cir. 2009); Ford Motor Credit Co. v. Mierkowski (In re Mierkowski), 580 F.3d 740 (8th Cir. 2009); Nuvell Credit Co., LLC v. Callicott (In re Dale), 580 F.3d 753 (8th Cir. 2009); Ford v. Ford Motor Credit Corp. (In re Ford), 574 F.3d 1279 (10th Cir. 2009); Graupner v. Nuvell Credit Corp. (In re Graupner), 537 F.3d 1295 (11th Cir. 2008).
contrary result reached by the Ninth Circuit Court of Appeals in *In re Penrod* created a split between the circuits, the issue appeared to be headed toward final resolution by the United States Supreme Court. Surprisingly, the Supreme Court declined to hear the case and the split among the circuits remains unresolved.

B. Perfection of Security Interests

"Perfection" is necessary to give a security interest priority against the claims of a variety of third parties. The term means that the secured party has taken any necessary steps to protect the security interest against third party claims. The general rule contained in section 9.310 of the Code requires the filing of a financing statement as a means of perfection. This rule, however, is subject to a number of exceptions.

In *In re Willis*, a secured party took a security interest in an annuity policy as part of the collateral for a loan. No financing statement was filed to perfect the security interest, but the secured party did send a notice to the issuer of the annuity that the security interest had been assigned as collateral and, after the debtor defaulted, sent a letter to the issuer demanding possession of the annuity. Ninety days later, the debtor filed for bankruptcy. The trustee in bankruptcy sought to avoid the security interest as a preferential transfer. The issue before the court was whether the secured party had perfected its security interest before the ninety-day preference period began.

The secured party resisted avoidance on the ground that its interest in the annuity was perfected by sending a letter demanding possession of the collateral prior to the beginning of the ninety-day preference period. The Federal District Court for the Eastern District of Texas held that the annuity was a payment intangible in which a security interest could be perfected by filing a financing statement.

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136. AmeriCredit Fin. Servs., Inc. v. Penrod (In re Penrod), 611 F.3d 1158 (9th Cir. 2010), reh’g en banc denied, 636 F.3d 1175 (9th Cir. 2011), cert. denied sub nom., AmeriCredit Fin. Servs., Inc. v. Penrod, 132 S. Ct. 108 (2011).
137. *In re Penrod*, 132 S. Ct. at 108.
138. Absent perfection, a security interest will lose priority against various third party claimants. See TEX. BUS. & COM. CODE ANN. § 9.317 (West Supp. 2011) (listing a number of situations in which third party claims will have priority over an unperfected security interest).
139. See id. § 9.308(a) (West 2011).
140. Id. § 9.310(a).
141. See id. § 9.310(b). The exceptions include such things as possession by the secured party, control of accounts, attachment of a security interest to a purchase money security interest in consumer goods, compliance with a treaty or other statute providing for a different method of perfection, and continued perfection of a security interest in proceeds of collateral. Id.
143. Id. at *1–2.
144. Id. at *2.
145. Id. at *2–3. 11 U.S.C. § 547(b) allows avoidance of transfers made within ninety days prior to a bankruptcy filing. 11 U.S.C. § 547(b) (2006). A "transfer" includes perfection of a security interest made more than thirty days after it has attached. See 11 U.S.C. § 547(e)(1)(B) (2006).
statement as required by section 9.310(a) or which could be perfected automatically under section 9.309(2) if the assignment did not constitute an assignment of a "significant part" of the debtor's payment intangibles. Because the secured party had not filed a financing statement and had introduced no evidence about the value of the annuity in relation to the debtor's other payment intangibles, the record did not support a conclusion that the interest had been perfected outside the ninety-day preference period. The secured party also argued that payment of the proceeds of the annuity by the issuer following entry of final judgment in a state court action that the secured party had brought against the debtor either perfected the security interest or, alternatively, divested the debtor of any rights in the annuity and therefore no rights in the annuity passed to the trustee as part of the debtor's bankruptcy estate. As to this argument, the court pointed out that payment by an account debtor (in this case, the issuer of the annuity) pursuant to section 9.406 of the Code does not operate to perfect a security interest. Furthermore, in the state court action, the court did not consider the issue of perfection because, as between the debtor and secured party, perfection was not required to enforce the security interest against the debtor. Because further proceedings were required to determine if the security interest had been automatically perfected under section 9.309(2), the secured party's motion for summary judgment was denied.

Some cases never seem to die. The last Survey, in discussing the case of In re Moye, pointed out that, when cars are held by a dealership as inventory a financing statement must be filed to perfect a security interest in the inventory. After a car has been sold, the proper method of perfection is by notation on the certificate of title. In In re Moye, the Fifth Circuit affirmed the decision of the lower court and reiterated these rules governing perfection of security interests in cars. This ruling did not, however, end the litigation surrounding the dealership's bankruptcy. In two other consolidated cases arising out of the same bankruptcy, the Federal District Court for the Southern District of Texas again discussed and applied the rules governing the perfection of security interests in the inventory of a car dealer. As before, the court held that the physical

147. Id. at *4.
148. Id. at *4.
149. Id.
150. Id. at *4–5.
152. See Krahmer, supra note 5, at 168. The rule requiring filing of a financing statement on a car dealer's inventory appears in Texas Business and Commerce Code. TEX. BUS. & COM. CODE ANN. § 9.311(d) (West 2011).
153. See TEX. BUS. & COM. CODE ANN. § 9.311(a)(2) (West 2011). See also Krahmer, supra note 5, at 168.
possession of car titles by the secured parties did not perfect a security interest in the cars, but did find in favor of one of the secured parties who had filed a financing statement. This decision was still not the end of the saga of Moye. In Moye v. Cage, the trustee moved for sanctions against the attorneys who had represented one of the secured parties in earlier proceedings for filing a proof of claim based on the allegedly perfected security interest. The bankruptcy court granted the motion, and the attorneys took an interlocutory appeal to the District Court for the Southern District of Texas. The trustee moved to dismiss the appeal for lack of subject matter jurisdiction and the motion was granted.

While much of the opinion discusses the jurisdictional issue, it is worthy to note that, in dicta, the court opined that even if the appeal were granted, it would fail on the merits because there was no basis on which the secured parties could assert that the security interests claimed in the vehicles were perfected by possession or assignment of the certificates of title.

C. PRIORITIES

When Texas adopted the revision of Chapter 9 in 1999, section 9.406 of the Code contained a provision allowing the assignment of security interests in accounts even if assignment was otherwise prohibited by another law. In Texas Lottery Commission v. First State Bank of DeQueen, the Texas Supreme Court held that this provision allowed the assignment of lottery winnings despite a conflict with the Texas Lottery Act prohibiting assignment of lottery winnings. In Great-West Life & Annuity Insurance Co. v. Texas Attorney General Child Support Division, the Austin Court of Appeals, applying the reasoning of the Texas Supreme Court in DeQueen, held that section 9.406 allowed the assignment of lottery winnings despite a prohibition on the assignment of winnings when

156. Id. at *7–10.
158. Id. at *2–3.
159. Id. at *5.
160. Id. at *4. The lesson in this decision seems clear. A secured party's attorney runs the risk of sanctions for filing a proof of claim when the Code rules are clear and leave no room for even a colorable argument about whether a security interest was or was not properly perfected. See id.
161. See TEX. BUS. & COM. CODE ANN. § 9.406(f) (West Supp. 2011) (providing that accounts are assignable despite the existence of a “rule of law, statute, or regulation that prohibits, restricts, or requires the consent of the government, governmental body or official.”). Texas Business and Commerce Code provides that “accounts” include “winnings in a lottery or other game of chance operated or sponsored by a state, governmental unit of a state, or person licensed or authorized to operate the game by a state or governmental unit of a state.” TEX. BUS. & COM. CODE ANN. § 9.102(a)(vi) (West 2011).
162. Tex. Lottery Comm'n v. First State Bank of DeQueen, 325 S.W.3d 628 (Tex. 2010).
the winner was subject to an order of child support. The Lottery Act has since been amended to make section 9.406 subject to the child support provisions of the Lottery Act.

D. ENFORCEMENT OF SECURITY INTERESTS FOLLOWING DEFAULT

After a default has occurred, Chapter 9 gives a variety of remedies to a secured party. These remedies include repossession, acceptance of the collateral in full or partial satisfaction of the debt, sale of the collateral, and a right to sue for any deficiency. All of these remedies include a number of procedural safeguards to protect the rights of a debtor after a default. The first issue to consider, however, is whether these rights and remedies have been triggered by a default. In SLT Dealer Group, Ltd. v. AmeriCredit Financial Services, a secured party financed the operation of a car dealer. The financing agreement required the dealer to perfect security interests in any vehicles sold by the dealer before assigning the retail installment sales contracts to the secured party. The dealer sold a vehicle without complying with this requirement. The vehicle was subsequently damaged in an accident, and a mechanic’s lien was placed on the vehicle to secure the cost of repairs. The secured party demanded that the dealer repurchase this contract because of the dealer’s

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165. Id. at 899.
166. See Act of May 23, 2011, 82nd Leg., R.S., ch. 403, § 5, 2011 Tex. Sess. Law. Serv. 403 (West) (current version at TEX. GOV’T. CODE ANN. § 466.410 (West Supp. 2011)). Unfortunately, this amendment may not entirely resolve the statutory conflict because, in the same legislative session, Section 9.406 of Texas Business and Commerce Code was also amended to provide,

[a]n assignment under this section is subject to Section 466.410, Government Code, except to the extent that Section 466.410(a), Government Code, prohibits the assignment of installment prize payments due within the final two years of the prize payment schedule, in which case this section shall prevail over Section 466.410 solely to the extent necessary to permit such assignment.


169. SLT Dealer Grp., Ltd. v. AmeriCredit Fin. Servs., 336 S.W.3d 822 (Tex. App.—Houston [1st Dist.] 2011, no pet.).

failure to perfect a security interest in the vehicle, and the dealer refused. The secured party also discovered that the dealer had sold three other vehicles without perfecting security interests in them before assignment of the sales contracts. The secured party sued for breach of contract.\footnote{171} The dealer defended on the theory that the secured party had failed to comply with the duty to dispose of collateral in a commercially reasonable manner when it failed to repossess and resell the vehicles. The Houston First Court of Appeals disagreed, holding that the dealer's own actions prevented the secured party from perfecting security interests in the vehicles.\footnote{172} Under these circumstances, the duty of the secured party to repossess the vehicles was never triggered and there was therefore no obligation on the part of the secured party to dispose of collateral that had never been repossessed.\footnote{173} The judgment of the trial court in favor of the secured party for breach of contract was affirmed.\footnote{174}

In \textit{People's United Equipment Finance Corp. v. Halls}, the secured party did repossess and resell collateral consisting of equipment financed by a loan from the secured party.\footnote{175} After the debtor filed for bankruptcy, the secured party sued four guarantors for the resulting deficiency. The guarantors contested the commercial reasonableness of the resale. The secured party introduced expert testimony showing that it had given proper notice of disposition and had conducted the sale in a manner conforming with a commercially reasonable disposition of collateral of this kind.\footnote{176} The Federal District Court for the Southern District of Texas held that the guarantors were liable under their guaranty agreements and that the sale of the collateral was commercially reasonable.\footnote{177}

In \textit{Morales v. JP Morgan Chase Bank},\footnote{178} the debtor sued for a deficiency following the repossession and resale of a motor vehicle. In this case, however, in response to the secured party's motion for summary judgment, the debtor alleged that he did not recall receiving a notice of disposition from the secured party. The Houston First District Court of Appeals held that this allegation was not sufficient to place the issue of commercially reasonable disposition in issue and would not defeat the motion for summary judgment.\footnote{179}
In *Captran/Tanglewood LLC v. Thomas N. Thurlow & Associates*, the dispute centered on whether the secured party could recover attorney's fees under section 38.001 of the Texas Civil Practice and Remedies Code following the assignment of accounts to the secured party in an action seeking recovery from the account debtor on unpaid accounts. The Federal District Court for the Southern District of Texas held that the secured party's action was not a claim founded on contract as required by section 38.001, but was instead an action governed by the Code. Under these circumstances, the court held it was clear that section 9.607 of the Code requires a secured party to deduct attorney's fees instead of adding them to the proceeds recovered from the account debtor.

Under section 9.620 of the Code, a secured party may elect to retain collateral in full or partial satisfaction of the secured debt. In *Smith v. Community National Bank*, following the bankruptcy of the principal debtor, a secured party and the guarantor of the secured debt entered into an agreed order allowing assignment to the secured party of the collateral and the proceeds of an insurance claim for damage to the collateral. The secured party sold the collateral and also sued the guarantor for a deficiency. The trial court entered judgment against the guarantor. The guarantor appealed on the ground that the assignment of the collateral to the secured party was an acceptance in full or partial satisfaction of the debt. The secured party argued that the guarantor had waived any defenses relating to the disposition of collateral under the terms of the guaranty agreement. On this issue, however, the Eastland Court of Appeals disagreed with the secured party because section 9.602 of the Code prohibits such waivers. Because the waiver was ineffective, the guarantor was entitled to raise the issue of whether the collateral had been accepted in full or partial satisfaction of the debt. Although the guarantor could raise this issue, the effort ultimately proved unavailing because, in reviewing the procedural requirements surrounding accept-

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181. Id. at *1-2.
182. Id. at *2-3.
183. Id. at *4 (referring to and applying TEX. BUS. & COM. CODE ANN. § 9.607(c)).
186. Id. at 563.
187. Id. at 568 (citing and applying TEX. BUS. & COM. CODE § 9.602(10) and referring to the rules stated in TEX. BUS. & COM. CODE §§ 9.620–9.622 which provide protection to debtors and secondary obligors).
188. Id. at 568–69.
ance of collateral in satisfaction of a debt, the court held that the agreed order contained nothing to indicate the collateral had been assigned to the secured party to satisfy the debt, nor had the actions of the secured party amounted to a strict foreclosure of the collateral. The judgment of the trial court was affirmed on the substantive issues of waiver and acceptance in satisfaction of the debt, but reversed and remanded for recalculation of the damages to credit the guarantor with the amounts received by the secured party in the form of insurance proceeds resulting from damage to the collateral and for the amount received by the secured party from sale of the collateral.

E. The 2011 Legislative Amendments of Chapter 9

Sixteen sections of Chapter 9 were amended during the 2011 Texas legislative session. Many of the amendments represent clarifications or minor changes, but a few of them deserve particular comment.

Section 9.102(a) was amended by adding a definition of the term "Public Organic Record." This change was required because of the extensive amendment of section 9.503 dealing with naming the debtor on a

189. Id. at 568-69, 572-74. On the latter point, the court noted that Texas Business and Commerce Code Section 9.620 was intended to abolish the doctrine of constructive strict foreclosure. Id. at 572-73.

190. Id. at 575.

191. The following sections of the Code were amended by Uniform Law on Secured Transactions, 82nd Leg., R.S., ch. 67, §§ 1-20, 2011 Tex. Sess. Law. Serv. ch. 67 (West) (to be codified as an amendment to Tex. Bus. & Com. Code ch. 9) (eff. July 1, 2013):
§ 9.102 Definitions of “Authenticate,” “Certificate of Title,” “Jurisdiction of Organization,” and “Registered Organization” were amended in §§ (7), (10), (50) and (71), respectively and a definition of “Public Organic Record” was added as § 9.102(a)(68-a);
§ 9.105 Control of Electronic Chattel Paper;
§ 9.307 Location of Debtor;
§ 9.311 Perfection of Security Interests in Property Subject to Certain Statutes, Regulations, and Treaties;
§ 9.316 Effect of Change in Governing Law;
§ 9.317 Interests that Take Priority Over or Take Free of Security Interest or Agricultural Lien;
§ 9.326 Priority of Security Interests Created by New Debtor;
§ 9.406 Discharge of Account Debtor; Notification of Assignment; Identification and Proof of Assignment; Restrictions on Assignment of Accounts, Chattel Paper, Payment Intangibles, and Promissory Notes Ineffective;
§ 9.408 Restrictions on Assignment of Promissory Notes, Health-Care-Insurance Receivables, and Certain General Intangibles Ineffective;
§ 9.502 Contents of Financing Statement; Record of Mortgage as Financing Statement; Time of Filing Financing Statement;
§ 9.503 Name of Debtor and Secured Party;
§ 9.507 Effect of Certain Events on Effectiveness of Financing Statement;
§ 9.515 Duration and Effectiveness of Financing Statement; Effect of Lapsed Financing Statement;
§ 9.516 What Constitutes Filing; Effectiveness of Filing;
§ 9.518 Claim Concerning Inaccurate or Wrongfully Filed Record; and
§ 9.607 Collection and Enforcement by Secured Party;
In addition to these amendments, §§ 9.801-.809 were added to the Code as transition provisions. Id. § 18.

192. Id. § 1.
financing statement.\(^{193}\) As amended, section 9.503 will require that in the case of registered organizations, the name of the debtor be shown on the public organic record in the state in which the debtor is organized.\(^{194}\) This change is intended to make it clear that a specific record must be used to determine the names of debtors established as registered organizations and that other public records, such as certificates of good standing or assumed name filings, will not suffice as the name of the debtor on a financing statement.\(^{195}\) The definition includes trusts that are formed as registered organizations, such as business trusts.\(^{196}\) Section 9.503 was also amended to provide "safe harbors" for use in filing financing statements against individuals, a subject that has caused considerable difficulty under the existing version of the Code.\(^{197}\) The amended version of section 9.503 parallels a non-uniform change made to this section in 2007 concerning the use of a debtor's name appearing on a driver's license as a safe harbor for filing a financing statement.\(^{198}\)

The definition of "certificate of title" in section 9.102(a)(10) was amended to accommodate developing systems that provide for electronic issuance and notation of liens on certificates of title.\(^{199}\)

Section 9.105 was amended to accommodate technological changes in the control of electronic chattel paper. The current version of this section contains a six-factor test for control.\(^{200}\) The amended version retains this test, but also allows use of any system that provides a reliable method of control that would not satisfy the stated test.\(^{201}\)

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193. See id. at § 12.

194. See id.

195. This change will not, of course, solve the problem if a secured party files a financing statement that fails to properly state the name of a debtor as shown in the public organic record. See, e.g., In re Jim Ross Tires, Inc., 379 B.R. 670, 673–78 (Bankr. S.D. Tex. 2007) (where one of the filings in question added a dba name to the name of debtor and the other filing in question failed to include the letter "s" in the word "Tires."). The court held that neither filing correctly provided the name of the debtor as required by Section 9.503 of the Texas Business and Commerce Code. Id. at 680.


197. See id. For examples of this difficulty, see Clark v. Deere and Co. (In re Kinderknecht), 308 B.R. 71, 76 (B.A.P. 10th Cir. 2004) (using nickname "Terry Kinderknecht" incorrect where debtor's name was "Terrance Kinderknecht"); Parks v. Berry (In re Berry), No. 05-14423, Adv. No. 05-5755, 2006 WL 3499682, at *1 (Bankr. D. Kan. 2006) (filing in name "Mike Berry" not effective where correct name was "Michael Berry"); Nazar v. Bucklin Nat'l Bank (In re Erwin), 50 U.C.C. Rep. Serv. 2d (West) 933, 933 (Bankr. D. Kan. 2003) (using name "Mike Erwin" ineffective where name should have been "Michael Erwin").


Section 9.307 was amended to clarify the location of a debtor organized under the laws of the United States. This change was needed because federal statutes are not consistent in terminology, e.g., sometimes referring to "main office" or "home office" as the location of a debtor.\textsuperscript{202}

Section 9.316 was amended to provide that a security interest will attach and be perfected in new collateral acquired by a debtor after a change of the debtor's location from one state to another state.\textsuperscript{203} This perfection will continue for four months after the change in location.\textsuperscript{204} This change will give greater protection to secured parties than the current section 9.316, which only continues perfection for collateral acquired before the change in location.\textsuperscript{205}

This change in section 9.316 also required amendment of section 9.326 to make a security interest perfected under section 9.316 subordinate to a security interest created by a new debtor.\textsuperscript{206}

Section 9.518 was amended to allow debtors and secured parties the right to file an "information statement" if the party believes that a filed record is inaccurate or was wrongfully filed.\textsuperscript{207} This change in terminology makes it clear that an information statement does not correct a filed record, but only provides information to a searcher that additional inquiry is needed to determine rights that may exist in collateral.

Sections 9.801 through 9.809 were added as transition provisions to continue perfection by filings made under current law and to provide rules governing the filing of continuation statements and amendments following July 1, 2013, when the amendments become effective.\textsuperscript{208} As was the case when Chapter 9 was revised in 1999, a five-year transition period was designated to conform with the five-year effectiveness of filed financing statements.\textsuperscript{209}

\section*{VI. CONCLUSION}

Although several interesting cases were reported during this Survey period, there is no doubt that the amendments to Chapter 9 will have a significant impact on secured lending when they become effective on July 1, 2013. Prior to that time, attorneys practicing in the area of commercial law should become familiar with the amendments and with the need to file continuation statements within the time limits provided in amended section 9.805 in order to continue perfection of security interest perfected

\begin{thebibliography}{9}
\bibitem{202} See id. § 3.
\bibitem{203} See id. § 6.
\bibitem{204} See id.
\bibitem{205} See \textit{TEX. BUS. \& COM. CODE ANN.} § 9.316 (West Supp. 2011).
\bibitem{207} See id. § 16.
\bibitem{208} See id. § 18.
\bibitem{209} See id. § 18; \textit{TEX. BUS. \& COM. CODE ANN.} § 9.515(a) (West 2011).
\end{thebibliography}
by filing under the current version of the Code.\textsuperscript{210}