Commercial Transactions

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BECAUSE 2008 was not a legislative year in Texas, developments in commercial law resulted exclusively from court decisions interpreting and applying the Texas Uniform Commercial Code.¹

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Cases discussed in this Survey are organized in the same order as the chapters in the Code.

I. GENERAL PROVISIONS

A. CONSPICUOUSNESS

Various provisions in the Code require that certain terms be "conspicuous" to be effective. In the seminal case of Dresser Industries, Inc. v. Page Petroleum, Inc., the Texas Supreme Court adopted and applied the Code standard for conspicuousness to all contracts whether or not arising under the Code. Since the decision in Dresser, the Code definition of "conspicuous" was amended to include a "safe harbor" for clauses that are displayed in larger type, font, or color, or set off by symbols or marks that call attention to the clause.

In Mickens v. Longhorn DFW Moving, Inc., household goods were destroyed by fire while being moved by a moving company. The contract contained a clause limiting the moving company's liability to sixty cents per pound for goods destroyed while in the company's possession. The owners contended the clause was ineffective because it was not conspicuous. The Dallas Court of Appeals disagreed. Citing Dresser and referring to the amended definition of "conspicuous," the court noted that the agreement had an outlined box containing the limitation of liability clause in capitalized letters and one of the property owner's signatures less than one inch below the capitalized clause. The court held that, as a matter of law, the clause was conspicuous.

The property owners also alleged their claim was for negligence and their recovery should not have been limited to contract damages. On this point, the court noted that whether a claim sounds in tort or contract depends on "the substance of the cause of action." Because the property owners' claim for mental anguish had not survived summary judgment,

2. See, e.g., TEX. BUS. & COM. CODE ANN. § 2.316(b) (Vernon 2009) (clause disclaiming warranties in contract for sale of goods must be conspicuous); TEX. BUS. & COM. CODE ANN. 2A.303(h) (Vernon 2009) (prohibition on transfer of interest in consumer lease ineffective unless conspicuous); TEX. BUS. & COM. CODE ANN. § 2A.214 (Vernon 2009) (disclaimer of warranties in lease must be conspicuous); TEX. BUS. & COM. CODE ANN. § 7-104(c) (Vernon 2002 & Supp. 2008) (legend that document of title is non-negotiable must be conspicuous); TEX. BUS. & COM. CODE ANN. § 8-204(1) (Vernon 2002) (restriction on right to transfer certificated security must be conspicuous).
3. 853 S.W.2d 505, 508-09 (Tex. 1993).
6. Id. at 877.
7. Id. at 879.
8. Id. at 879. This test for determining whether a claim sounds in tort or contract originated in Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617 (Tex. 1986), where the court also stated: "The acts of a party may breach duties in tort or contract alone or simultaneously in both. The nature of the injury most often determines which duty or duties are breached." Id. at 618.
the only remaining claim was for the loss of personal property that occurred while the property was being moved during performance of the contract. The court held this loss made the claim one for breach of contract and not one in tort. The limitation of liability clause was, therefore, effective.9

One of the most common instances in which the issue of conspicuousness can arise involves the disclaimer of implied warranties.10 In *Morgan Buildings and Spas, Inc. v. Humane Society of Southeast Texas*,11 the manufacturer of a portable steel building delivered a structure that varied considerably from the contract specifications regarding size, color, and frame. The purchaser sued for breach of warranty, breach of contract, Deceptive Trade Practices Act ("DTPA") violations, and fraud.12 Because deciding whether a clause is conspicuous is determined as a matter of law, the Beaumont Court of Appeals reviewed the disclaimer. It held that the disclaimer met the requirements of the Code because it was set off by a centered, bold print heading in uppercase letters and the clause itself was also in bold print, uppercase letters that included the word "merchantability."13 As to the DTPA and fraud claims, the court held the contract expressly disclaimed any reliance by the purchaser on any representations made by the seller outside the terms of the contract itself. The purchaser, therefore, could not recover for breach of warranty, DTPA violations, or fraud. The court further held, however, that the purchaser did have a valid claim for breach of contract because the delivered building did not conform to the contract specifications.14 The court pointed out that section 2.714 of the Code not only allows actions for breach of warranty, but also for "any failure of the seller to perform according to his obligations under the contract."15 The case was remanded for a new trial on the breach of contract claim.

The question of whether a disclaimer was conspicuous also arose in *Fieldtech Avionics & Instruments, Inc. v. Component Control.Com, Inc.*,16 this time in the context of a finance lease. Unlike an ordinary sale of goods between a seller and a buyer, or a direct lease between a lessor and a lessee, a finance lease involves three parties: a lessor, a lessee, and a supplier of the goods. In such leases, a finance lessor enters into a contract with a supplier to purchase the goods, but the goods are to be delivered directly to the lessee under a separate lease agreement between the

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9. 264 S.W.3d at 879.
10. Under both Chapters 2 and 2A governing the sale of goods and the lease of goods, respectively, disclaimers of implied warranties must be conspicuous. See *Tex. Bus. & Com. Code Ann. §§ 2.316(b), 2A.214(b) (Vernon 2009)*.
11. 249 S.W.3d 480 (Tex. App.—Beaumont 2008, no pet.).
13. 249 S.W.3d at 490. The requirement that an effective disclaimer include the word "merchantability" is stated in *Tex. Bus. & Com. Code Ann. § 2.316(b) (Vernon 2009)*.
14. 249 S.W.3d at 490-91.
16. 262 S.W.3d 813 (Tex. App.—Fort Worth 2008, no pet.).
lessee and the lessee. The advantage of a finance lease is that it effectively insulates the finance lessor from warranty claims arising from defects in the goods. Indeed, except for express warranties made by the lessor and implied warranties against interference and infringement, Chapter 2A does not imply any warranties regarding the quality of the goods between the lessor and the lessee. The sole remedy of a lessee for breach of an implied warranty of quality is against the supplier of the goods. In Fieldtech, the Fort Worth Court of Appeals recognized that the lessee's breach of warranty claims regarding the leasing and licensing of software would not lie against the finance lessor, with or without a conspicuous disclaimer by the lessor. Perhaps out of an abundance of caution (always a good idea in contract drafting), the finance lessor did include a conspicuous disclaimer of warranties in the lease agreement although such a disclaimer would not technically be required. The disclaimer appeared under a bold face, capitalized heading in capitalized type quoted in full in the opinion. The supplier, however, was not as careful with its disclaimer which appeared on the third page of a five page "clickwrap" agreement and was not distinguished by larger type or by a contrasting font or color. The disclaimer was, therefore, ineffective to disclaim implied warranties. As to express warranties, the court noted that while nothing in the Code requires disclaimers of express warranties to be conspicuous, any disclaimer of such warranties must be communicated before the sale is completed. Because there was no evidence that the lessee was aware that express warranties were being disclaimed until two months after the lease agreement had been signed, the attempted disclaimer of express warranties by the supplier was also ineffective. Summary judgment in favor of the finance lessor was affirmed, but summary judgment in favor of the supplier was reversed and remanded for trial on the claims against the supplier.

B. Security Interest or Lease?

A perennial issue faced by the courts is whether a transaction is a disguised security interest or a true lease. If the transaction is a disguised security interest, it is governed by Chapter 9 of the Code. If it is a lease, it is governed by Chapter 2A and the rights and responsibilities of the par-

18. 262 S.W.3d at 823.
19. Id. at 819–20.
20. Id. at 829. A "clickwrap" agreement is a term that has come into use to describe an agreement that appears on a computer screen when a purchaser downloads or installs software. The court noted that Texas recognizes the validity of clickwrap agreements. Id. at 818 n.1 (citing RealPage, Inc. v. EPS, Inc., 560 F. Supp. 2d 539 (E.D. Tex. 2007)).
21. 262 S.W.3d at 829 (citing Mercedes-Benz of N. Am., Inc. v. Dickenson, 720 S.W.2d 844, 852 (Tex. App.—Fort Worth 1986, no writ)).
22. 262 S.W.3d at 829-30.
ties are very different from those contained in Chapter 9. One of the most important results of deciding that a transaction is really a disguised security interest rather than a lease is the treatment each is accorded in bankruptcy. A security interest may be avoidable (with a consequent loss of secured status), while a true lease can only be affirmed or rejected.

In In re Ecco Drilling co., Ltd., the bankruptcy court determined that a lease of drilling rigs allowing the lessee to purchase the rigs for at least fifteen percent of their value at the end of the lease term should be recharacterized as a security interest instead of a lease. In reaching this decision, the court applied New York law as required by the terms of the agreement, but noted that Texas law would be the same so far as application of the "economic realities" test was concerned. Using this test, the court held that exercise of the purchase option was so likely in view of the nominal amount required and the amount already spent by the lessee in procuring and adapting the rigs, it was not credible to believe the lessee would fail to exercise the option. Judgment was rendered in favor of the lessee who sought to have the transaction characterized as a security interest rather than a lease.

C. Choice of Law and Forum Selection

With a few exceptions, section 1.301 of the Code allows the parties to agree that the law of any state or nation that has a reasonable relation to the transaction shall govern their rights and responsibilities. Not infrequently, a choice of law clause is joined with a forum selection clause; after all, if the parties have chosen the law of a given state to govern their transaction, it would make sense to have a court in that state hear disputes applying that state's law. The enforceability of conjoined choice of law and forum selection clauses was addressed in Ramsay v. Texas Trading Co., Inc. In Ramsay, an investor challenged enforceability on the grounds that it was a venue selection clause rather than a forum selection clause and the language of the clause made it permissive rather than

24. See, e.g., Tex. Bus. & Com. Code Ann. § 9.602 (Vernon 2002) which contains a list of several rights that cannot be waived by a debtor under Chapter 9. Chapter 2A has no similar list and some of the rights that cannot be waived under Chapter 9 are fully waivable by a lessee under Chapter 2A.


27. See 390 B.R. at 226. The economic realities test focuses on whether it is reasonable to expect that a lessee will not exercise an option to purchase at the end of the lease term and identifies four main factors: (1) is the term of the lease equal to or greater than the remaining economic life of the goods?; (2) is the lessee bound to renew the lease at the end of their economic life or to become the owner of the goods?; (3) does the lessee have an option to renew the lease for nominal or no consideration at the end of the original lease term?; and (4) does the lessee have the option to purchase the goods for nominal or no consideration at the end of the lease term? Id. at 227-28.

28. Id. at 232.

29. Id.


mandatory. The Texarkana Court of Appeals rejected the former argument because the clause merely allowed the action to be filed in any court in Illinois in accord with any applicable Illinois venue rules.\textsuperscript{32} As to the latter argument, the court was not persuaded that allowing the defendant broker to exercise discretion about whether to bring an action in Illinois instead of Texas made the clause unenforceable. Pointing out that it was required to enforce the contract as written, the court found no authority holding that allowing a party discretion about whether to bring the suit in one state rather than another rendered the clause invalid or unenforceable.\textsuperscript{33}

In \textit{In re Lyon Financial Services, Inc.},\textsuperscript{34} the dispute centered on whether a forum selection clause allowed an unjust result because the plaintiff would be unable to assert usury claims under Pennsylvania law and whether this was inconsistent with Texas public policy. Furthermore, the clause was allegedly the result of overreaching and fraudulent representations that would result in increased costs of litigation for the plaintiff.\textsuperscript{35} Reviewing each of these objections, the supreme court held the clause did not violate Texas public policy because there was no Texas statute requiring suit to be brought in Texas and the plaintiff made no showing that a Pennsylvania court would not apply Texas law in determining the rights of the parties.\textsuperscript{36} The supreme court also held that mere allegations of disparity in bargaining power were not sufficient to invalidate the forum selection.\textsuperscript{37} Nor were allegations of increased costs—without evidence of what those costs would be—enough to make the clause unenforceable.\textsuperscript{38} The trial court was directed to enter an order granting the defendant's motion to dismiss.\textsuperscript{39}

In \textit{Delaney v. Gulf Stream Coach, Inc.},\textsuperscript{40} the plaintiffs purchased a motor home from a local dealer in Texas. The manufacturer of the home was located in Indiana. After delivery, the plaintiffs discovered mold and water damage in the motor home and the dealer told them to bring the home back to the dealership for repairs. Attempts by both the dealer and the manufacturer to correct the problems were ineffective. The plaintiffs sued for breach of warranty and DTPA violations. The defendant asserted that a forum selection clause in a limited warranty agreement allegedly signed by one of the plaintiffs at the time of purchase required suit in Indiana.

The U.S. District Court for the Southern District of Texas found there was insufficient evidence to show that either plaintiff signed the limited

\begin{itemize}
  \item \textsuperscript{32} \textit{Id.} at 626.
  \item \textsuperscript{33} \textit{Id.} at 631.
  \item \textsuperscript{34} 257 S.W.3d 228 (Tex. 2008).
  \item \textsuperscript{35} \textit{Id.} at 231.
  \item \textsuperscript{36} \textit{Id.} at 234-35.
  \item \textsuperscript{37} \textit{Id.} at 233.
  \item \textsuperscript{38} \textit{Id.} at 233-34.
  \item \textsuperscript{39} \textit{Id.} at 235.
  \item \textsuperscript{40} No. H-08-2018, 2008 WL 5114955, at *1 (S.D. Tex., Dec. 3, 2008).
\end{itemize}
warranty document when the motor home was purchased. The question before the court, therefore, was whether the plaintiffs could be bound by the forum selection clause as nonsignatories. On this issue, the court applied the same tests used to determine if nonsignatories could be bound by an arbitration clause. The defendant argued only that the plaintiffs should be bound to the forum selection clause by equitable estoppel. The court held that estoppel did not apply because the plaintiffs' claims were based on implied warranties that arose independently from the sale of the motor home itself and not as part of the limited warranty document. Furthermore, the defendant could not avail itself of the federal law provisions allowing a change of venue because neither the private factors that might favor a venue change, such as availability of witnesses, nor the public factors, such as administrative difficulties in conducting the litigation, would be served by transferring the case to Indiana.

II. SALE OF GOODS

A. Modification of Sales Contracts

Section 2.209 of the Code abolishes the common law rule requiring consideration for contract modifications. In Graybar Electric Co., Inc. v. LEM & Associates, L.L.C., the Houston Court of Appeals (14th District) ruled that the trial court had erred by applying the common law rule to the modification of a purchase order for electrical equipment. Because the contract was for the sale of goods, the court held the contract was clearly covered by section 2.209 and the buyer was entitled to a price reduction of approximately $2.6 million under the terms of the change order. The court also rejected the trial court's determination that the change order was void as a result of fraudulent inducement or duress.

41. Id. at *2.
42. Id.
43. Id. The court listed six theories that could be used to bind non-signatories: (1) incorporation of a clause by reference in another document; (2) assumption of a contract containing the relevant clause; (3) agency; (4) veil-piercing or alter ego; (5) estoppel; and (6) third-party beneficiary theory. Id.
44. Id. at *3.
45. Id. at *4. Even without a forum selection clause, venue may be transferred between federal courts if the interests of justice would be served. See 28 U.S.C. § 1404(a) (2006).
46. TEX. BUS. & COM. CODE ANN. § 2.209(a) (Vernon 2009). At common law, a modification unsupported by separate or changed consideration is ineffective under the preexisting duty rule. See § 2209 cmt. 1. Even at common law, inroads have been made on the consideration requirement by allowing a modification to be enforceable if the modification induces a material change in the position of the party relying on the modification. See RESTATEMENT (SECOND) OF CONTRACTS § 89(c) (1981).
47. 252 S.W.3d 536 (Tex. App.—Houston [14th Dist.] 2008, no pet.).
48. Id. at 545-47.
49. Id. at 546-47.
B. DAMAGES RECOVERABLE FOR BREACH OF WARRANTY

The same facts often give rise to an action asserting claims for breach of warranty, DTPA violations, and negligence or strict liability in tort. Two significant cases decided during the Survey period explored some of the ramifications of the overlap between these theories.

In Medical City Dallas, Ltd. v. Carlisle Corp.,\(^5^0\) a building owner sued a manufacturer of roofing material for breach of an express warranty. As part of its claim, the owner sought recovery of attorney’s fees. The manufacturer argued that attorney’s fees were recoverable only in contract actions and not in actions for breach of express warranty.\(^5^1\) This argument was based on lower court decisions in JHC Ventures, L.P. v. Fast Trucking, Inc.\(^5^2\) and Harris Packaging Corp. v. Baker Concrete Const. Co.,\(^5^3\) where the courts of appeal held that actions for “breach of contract and breach of warranty are not the same cause of action.”\(^5^4\) The quoted language first appeared in Southwestern Bell Co. v. FDP Corp.\(^5^5\) and the unfortunate phrasing introduced an additional complexity into breach of warranty actions under Texas law.\(^5^6\) In Medical City, the Texas Supreme Court reviewed the relationship between tort and warranty claims as it has developed in Texas law. The supreme court reasoned that while the defendant manufacturer was correct in stating that breach of contract and breach of warranty are distinct causes of action, the appropriate test is whether the plaintiff is seeking economic damages based on a failure to perform according to contract terms or whether the plaintiff is seeking non-economic damages that are more appropriately recoverable in tort.\(^5^7\) The supreme court concluded that actions for breach of express warranty seeking recovery for economic loss are actions founded on contract and permit recovery of attorney’s fees under Texas law.\(^5^8\) The supreme court specifically disapproved the decisions in JHC and Harris to the extent they were inconsistent with the holding in Medical City.\(^5^9\)

In JCW Electronics, Inc. v. Garza,\(^6^0\) the supreme court rendered another significant decision affecting warranty litigation in Texas. In JCW, an electronics company installed telephones for inmate use in a city jail. Following an arrest for public intoxication, an inmate committed suicide by hanging himself with the telephone cord provided by the electronics

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\(^5^0\) 251 S.W.3d 55 (Tex. 2008).
\(^5^1\) Id. at 58. TEX. CIV. PRAC. & REM. CODE § 38.001(8) (Vernon 2008) (allowing the recovery of attorney’s fees in actions founded on an oral or written contract).
\(^5^2\) 94 S.W.3d 762 (Tex. App.—San Antonio 2002, no pet.).
\(^5^4\) JHC Ventures, 94 S.W.3d at 769.
\(^5^5\) 811 S.W.2d 572, 576 (Tex. 1991).
\(^5^6\) The author has previously noted this phrase was taken out of context and seems to have misled the lower courts in JHC and Harris to reach a doubtful result. See John Krahmer, Commercial Transactions, 56 SMU L. REV. 1255, 1261 (2003).
\(^5^7\) Medical City Dallas, 251 S.W.3d at 60-61.
\(^5^8\) Id. at 61-62.
\(^5^9\) Id. at 62.
\(^6^0\) 257 S.W.3d 701 (Tex. 2008).
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62. 257 S.W.3d at 703. Liability is apportioned among those responsible for a loss in "any action based on tort." Tex. Civ. Prac. & Rem. Code § 33.002(a)(1) (Vernon 2008). If a claimant's percentage of responsibility is greater than fifty percent, the claimant is barred from any recovery under § 33.001. If a claim involves death, the term "claimant" includes not only the party seeking damages, but also the decedent. Id. § 33.011(1)(A-B).

63. 257 S.W.3d at 705.

64. Id. at 705.

65. Id. at 707-08. In Diamond H. Recognition LP v. King of Fans, Inc., 589 F. Supp. 2d 772 (N.D. Tex. 2008), the court relied on JCW to conclude that the proportionate responsibility rules of Chapter 33 applied to the case at bar. In Diamond H., however, the court also had to determine if Tex. Civ. Prac. & Rem. Code § 82.003(a)(7) (Vernon 2005) applied to permit the immediate seller of a heater to designate a Chinese manufacturer as a responsible third party and have the jury apportion responsibility between the retailer and the manufacturer. 589 F. Supp. 2d at 774. Expressing some misgivings about the effect such designation might have on the litigation, the court nonetheless granted leave to designate. Id. at 776. The court noted, however, that the plaintiff could move to strike the designation if the Chinese company was beyond the jurisdiction of the court. Id. at 777.

66. See Tex. Bus. & Com. Code Ann. § 2.403(a) (Vernon 2009) (providing in part, "A purchaser of goods acquires all title which his transferor had or had power to transfer except that a purchaser of a limited interest acquires rights only to the extent of the interest purchased. A person with voidable title has power to transfer good title to a good faith purchaser for value.").

67. 271 S.W.3d 856 (Tex. App.—Amarillo 2008, no pet.).
cattle. At that time, however, the seller (an order buyer of cattle) did not own the cattle. On January 16, 2005, the seller purchased enough cattle to cover the buyer's purchase, but the check issued by the seller was dishonored on or about January 26, 2005. Since the original owner of the cattle had not been paid, the owner sued the remote buyer for conversion. The dispute centered on whether the remote buyer was a good faith purchaser under section 2.403.

Based on evidence that it was not customary in the cattle business for a buyer to pay in full before delivery, the Amarillo Court of Appeals decided the remote buyer did not qualify as a good faith purchaser under a definition of good faith requiring "honesty in fact and the observance of reasonable commercial standards of fair dealing."68 Judgment in favor of the original owner of the cattle was affirmed.

D. NOTICE OF BREACH

The non-uniform Texas version of section 2.318 of the Code provides that the courts have discretion to determine whether privity between a seller and anyone other than an immediate buyer is required in breach of warranty actions.69 Several years ago, in Nobility Homes of Texas, Inc. v. Shivers,70 the supreme court ruled that privity was not required in implied warranty actions brought by a buyer against a remote manufacturer.71 Under section 2.607(c) of the Code, however, notice of a breach of warranty must be given by the buyer or the buyer will "be barred from any remedy."72 This requirement gives rise to two related questions. First, to whom must notice of breach be given? Second, who must give the notice? The first question has never been answered authoritatively by the Texas Supreme Court and lower court decisions are split on the issue.73 The second question was addressed in Alvarado v. Conmed Corp.74 In Alvarado, a patient was injured during the course of a surgical procedure. She

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68. Id. at 860 (quoting TEX. BUS. & COM. CODE ANN. § 1.201(b)(20) (Vernon 2009)).

69. TEX. BUS. & COM. CODE ANN. § 2.318 (Vernon 2009) ("This chapter does not provide whether anyone other than a buyer may take advantage of an express or implied warranty of quality made to the buyer or whether the buyer or anyone entitled to take advantage of a warranty made to the buyer may sue a third party other than the immediate seller for deficiencies in the quality of the goods. These matters are left to the courts for their determination.").

70. 557 S.W.2d 77 (Tex. 1977).

71. Id. at 81.

72. See TEX. BUS. & COM. CODE ANN. § 2.607(c)(1) (Vernon 2009).

73. Compare Vintage Homes, Inc. v. Coldiron, 585 S.W.2d 886, 887-88 (Tex. Civ. App.—El Paso 1979, no writ) (not requiring notice to remote manufacturer) with Wilcox v. Hillcrest Mem'l Park, 696 S.W.2d 423 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (requiring notice to remote manufacturer). In a per curiam opinion affirming Wilcox, the Supreme Court noted the split of authority, but did not find it necessary to resolve the issue in the case before it. See Wilcox v. Hillcrest Mem'l Park, 701 S.W.2d 842 (Tex. 1986) (per curiam). More recently in U.S. Tire Tech, Inc. v. Boeran, 110 S.W.3d 194 (Tex. App.—Houston [1st Dist.] 2003, pet. denied), the court reviewed the conflicting decisions and concluded that the general approach of the Supreme Court regarding notice in other contexts required a buyer to give notice to a remote manufacturer.

subsequently sued on theories of strict liability, negligence, and breach of implied warranties. The plaintiff failed to prove her injuries were caused by use of a defective surgical instrument and all of her claims were dismissed. Nonetheless, the U.S. District Court for the Western District of Texas addressed the notice issue. Based on comment five to section 2.607, the court opined that a person who is directly benefited by a product must give notice of breach even if that person is not a buyer of the product.\(^7\)

III. LEASES OF GOODS

A. UNCONSCIONABILITY

In *Oden v. Vanguard Car Rental, USA, Inc.*,\(^7\) a lessee rented a car. When she returned the car with less than a full tank of gas, the lessor charged her $4.95 per gallon to fill the tank. Although this was the amount specified in the lease agreement, the plaintiff alleged this amounted to an unenforceable and unconscionable penalty under sections 2A.108 and 2A.504.\(^7\) The U.S. District Court for the Eastern District of Texas rejected this argument, pointing out that both sections are couched in terms that make them available only as affirmative defenses and not as claims.\(^8\) The action was dismissed with leave to amend if the plaintiff was able to state a valid claim under Texas law.

B. EFFECT OF CANCELLATION

In *Frank's International, Inc. v. Smith International, Inc.*,\(^7\) the parties entered into a lease of oilfield equipment. The lessee withheld a portion of the rental payments for the payment of taxes to a foreign government in the belief that the tax liability was that of the lessor and not that of the lessee. The lessor disagreed, contending that any tax liability was the responsibility of the lessee. After this dispute arose, the parties cancelled a provision in the original lease that dealt with tax withholding by the lessee and substituted a new provision concerning tax liability that ex-

\(^{75}\) Id. at *9. The relevant part of Tex. Bus. & Com. Code Ann. § 2.607 cmt. 5 (Vernon 2009) states,

[T]he reason of this section does extend to requiring the beneficiary to notify the seller that an injury has occurred. What is said above, with regard to the extended time for reasonable notification from the lay consumer after the injury is also applicable here; but even a beneficiary can be properly held to the use of good faith in notifying, once he has had time to become aware of the legal situation.


\(^{77}\) Id. at *2 (quoting Tex. Bus. & Com. Code Ann. §§ 2A.108 & .504 (Vernon 2009)).

\(^{78}\) Id. at *3. The plaintiff did not assert a cause of action under the DTPA which does permit unconscionability to be used as a claim. See Tex. Bus. & Com. Code Ann. § 17.50(a)(3) (Vernon 2008).

\(^{79}\) 249 S.W.3d 557, 560-61 (Tex. App.—Houston [1st Dist.] 2008, no pet.).
pressly superseded the earlier provision. However, the new provision did not specify which party had responsibility for the past taxes. The lessor sued to recover the amounts that had been withheld under the original lease agreement.\textsuperscript{80}

The lessee asserted that the cancellation agreement amounted to a discharge of any liability the lessee might have had under the original lease. The Houston Court of Appeals (1st District) pointed out that under section 2A.505, unless the agreement to cancel clearly shows an intent to discharge claims arising prior to cancellation, the aggrieved party, in this case the lessor, has the right to recover for prior defaults.\textsuperscript{81} A summary judgment entered by the trial court in favor of the lessee was reversed and the case was remanded for trial.

C. Waiver of Defenses

In \textit{IFC Credit Corp. v. Specialty Optical Systems, Inc.},\textsuperscript{82} an assignee took an assignment of leases from a company that provided telecommunication services and equipment to customers. The assignor required customers to purchase “matrix boxes” which purportedly enabled the assignor to provide low cost services. The lease contained a waiver of defenses clause stating that a customer could not assert any claims against the assignee that the customer might have against the assignor.\textsuperscript{83} The lease also provided that customers were responsible for making payments once the matrix box was delivered even if telecommunications services were never provided.\textsuperscript{84} One of the lessees who received the matrix box and signed for delivery refused to make payments and sued to have the lease declared unenforceable.\textsuperscript{85}

The Dallas Court of Appeals reasoned that the assignee’s knowledge of a high rate of default and numerous customer complaints about a lack of service put the assignee on notice of claims and defenses.\textsuperscript{86} The court also held the assignee had not acted in good faith because it participated in developing a “script” used by the assignor to deceive customers about the services they would receive under the lease.\textsuperscript{87} Because the assignee did

\textsuperscript{80} \textit{Id.} at 561.
\textsuperscript{81} \textit{Id.} at 565 (citing \textit{TEX. BUS. & COM. CODE ANN.} § 2A.505 (Vernon 2009)).
\textsuperscript{82} 252 S.W.3d 761, 763-66 (Tex. App.—Dallas 2008, pet. denied).
\textsuperscript{83} \textit{Id.} at 766; \textit{TEX. BUS. & COM. CODE ANN.} § 9.403(b) (Vernon 2002) (providing that assignment of a contract containing a waiver of defenses clause in a transaction other than a consumer transaction gives the assignee rights parallel to those of a holder in due course if the assignee takes the contract for value, in good faith, and with notice of a claim or defense).
\textsuperscript{84} \textit{Id.} A clause of this kind is the hallmark of a finance lease. It makes the obligation of a lessee irrevocable and independent upon the lessee’s acceptance of the goods regardless of any claims, defenses, or setoffs the lessee might otherwise have against the supplier of the goods. See \textit{TEX. BUS. & COM. CODE ANN.} § 2A.407(a) (Vernon 2009). Such a clause is generally called a “hell or high water clause,” meaning that the lessee must make lease payments “come hell or high water.” See \textit{id.} at cmt. 6.
\textsuperscript{85} \textit{IFC Credit Corp.}, 252 S.W.3d at 766.
\textsuperscript{86} \textit{Id.} at 768.
\textsuperscript{87} \textit{Id.} at 768-69.
not qualify for holder in due course protection under section 9.403, the
customer was entitled to assert a defense of fraudulent inducement ren-
dering the lease unenforceable. The court did, however, vacate a por-
tion of the trial court's judgment imposing additional sanctions on the
assignee.

IV. NEGOTIABLE INSTRUMENTS

A. LIABILITY OF MAKERS AND DRAWERS

Although a negotiable note carries with it a number of special charac-
teristics associated with the concept of "negotiability," it remains, at
heart, a specialized form of contract subject to many of the rules of ordi-
nary contract law, including the parol evidence rule. The Houston
Court of Appeals reaffirmed this principle in DeClaire v. G & B McIn-
tosh Family Limited Partnership, where the payee of a note attempted
to enforce a prior oral agreement with the maker. According to the
payee, the parties had orally agreed that if the collateral securing the note
was insufficient to pay the note in full, the maker would be liable for the
deficiency. The note itself, however, contained a clause stating that the
collateral was to be the sole source for repayment of the note. The trial
court allowed the payee to introduce evidence of the oral agreement and
entered judgment in favor of the payee based on that agreement. On ap-
peal, the court held that the terms of the note were clear and parol evi-
dence could not be used to change the terms.

The payee also claimed that the fraud exception to the parol evidence
rule permitted proof of the oral agreement. On this issue, the court ruled
that the payee failed to introduce sufficient evidence of reliance on any
alleged misrepresentations to satisfy the fraud exception.

Bank of Texas v. VR Electric, Inc. is an interesting decision about the
balance of fault provisions in the Texas version of section 3.406 of the
Code. The plaintiff wrote a check on its account at the drawee bank, but

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88. Id. at 771.
89. Id. at 772-73.
90. See, e.g., Simmons v. Compania Financiera Libano, S.A., 830 S.W.2d 789 (Tex.
App.—Houston [1st Dist.] 1992, writ denied); Litton v. Hanley, 823 S.W.2d 428 (Tex.
App.—Houston [1st Dist.] 1992, no writ); Mfrs. Hanover Trust Co. v. Kingston Investors
Corp., 819 S.W.2d 607 (Tex. App.—Houston [1st Dist.] 1991, no writ); Bailey v. Gulfway
Nat'l Bank, 626 S.W.3d 70 (Tex. App.—Corpus Christi 1981, writ ref'd n.r.e.).
91. 260 S.W.3d 34, 38-41 (Tex. App.—Houston [1st Dist.] 2008, no pet.).
92. Id. at 45-46.
93. Id. at 47.
94. 276 S.W.3d 671 (Tex. App.—Houston [1st Dist.] 2008, no pet.).
95. TEX. BUS. & COM. CODE ANN. § 3.406(b) (Vernon 2002) differs from the Official
Text by changing the burden of proof for a party who pays an instrument or takes it for
value or for collection. The change was effected by leaving the word "substantially" in
subsection (a) but deleting it in subsection (b) as shown in the following text of the section:
(a) A person whose failure to exercise ordinary care substantially contrib-
utes to an alteration of an instrument or to the making of a forged signature
on an instrument is precluded from asserting the alteration or the forgery
left the signature line blank. The drawer's bookkeeper put the unsigned check on a counter in an area accessible to the public. A contractor's employee who was working with the plaintiff stole the check, forged the drawer's name, and negotiated the check to a used car dealer. Although the drawer discovered the check was missing before it reached the drawee bank, the drawer believed the check had been lost somewhere in the drawer's offices and did not issue a stop order on the check. Because the check was in an amount well below the drawee bank's alert amount, it was processed and paid by the bank's automated payment system. When the forgery was discovered, the drawer promptly notified the bank, but the bank refused to recredit the drawer's account on the ground that the drawer had been negligent in handling the check.

In an action by the drawer against the bank and the car dealer, the jury found the drawer and the bank each fifteen percent responsible for the loss and the car dealer seventy percent responsible for the loss. The trial court held that while the evidence supported a finding of breach of contract on the part of the bank, the evidence also supported a finding of negligence by the plaintiff that "substantially contributed" to the forgery as required by section 3.406(a) and entered judgment against the bank for eighty-five percent of the loss by aggregating the liability of the bank and the car dealer. The bank appealed.

In reviewing evidence that the bank had failed to exercise ordinary care that contributed to the loss under section 3.406(b), the Houston Court of Appeals (1st District) found that there was inconsistency in the testimony by the bank's Vice President of Operations about when checks would be manually examined and when they would be processed solely by automated means. Her testimony ranged from stating that the bank had a verbal policy for manual review of checks over $100,000, to stating that manual review of checks only applied to checks greater than $250,000, to not being sure of what the bank's verbal policy was. She also testified that the bank had no written policy on the matter and that the average amount of checks processed by the bank was "just over

against a person who, in good faith, pays the instrument or takes it for value or for collection. (emphasis added.)
(b) Under Subsection (a), if the person asserting the preclusion fails to exercise ordinary care in paying or taking the instrument and that failure [substantially] contributes to loss, the loss is allocated between the person precluded and the person asserting the preclusion according to the extent to which the failure of each to exercise ordinary care contributed to the loss.

As a result of this change, in the case of a check, a drawee bank has the burden of proving the negligence of the drawer substantially contributed to an alteration or forgery, but the drawer has the burden of proving only that the action of the bank contributed to the loss. The State Bar Committee Comments explain this change was made "in the interest of maintaining a more appropriate balance between banks and their customers." See the State Bar Committee Comments to TEX. BUS. & COM. CODE ANN. § 3.404 (Vernon 2002).

96. 276 S.W.3d at 675-76.
97. Id.
98. Id. at 682.
99. Id.
$1,000."\textsuperscript{100} Other employees generally testified to the same effect about the bank's verbal policy. The court held that this evidence and the lack of a written policy were sufficient to support the jury finding that the bank failed to exercise ordinary care that contributed to the loss.\textsuperscript{101}

As to the aggregation of damages, the bank argued that the proportionate responsibility provisions of Chapter 33 in the Texas Civil Practice and Remedies Code prohibited the aggregation resulting from adding the fifteen percent attributed to the bank to the seventy percent attributed to the car dealer.\textsuperscript{102} Without aggregation, the bank would be liable for only fifteen percent of the damages and not for the eighty-five percent assessed by the trial court. On this point, the court held that Chapter 33 did not apply and that section 3.406 creates its own "discrete fault scheme, specifically allocating responsibility among parties to a banking relationship."\textsuperscript{103} Because the bank only asserted that the case was governed by Chapter 33, and did not challenge the apportionment of damages under section 3.406, the court held it was not required to reach the issue of proper apportionment under that section.\textsuperscript{104} The judgment of the trial court was affirmed.\textsuperscript{105}

\textbf{B. Holding in Due Course}

In \textit{Max Duncan Family Investments, Ltd. v. NTFN Inc.},\textsuperscript{106} the president of a corporation entered into an agreement to personally purchase some real estate for $1.5 million. The purchaser funded most of this purchase with personal financing. However, he used corporate property as collateral to secure his promissory note for the $320,000 balance. The seller of the property, a limited liability investment company, did not request documentation from the corporation to confirm whether the purchaser had authority to pledge the corporation's property. After the purchaser defaulted, the corporation sought an injunction to prevent foreclosure of its property, claiming the transaction was invalid under the interested director doctrine.\textsuperscript{107} The seller contended that the deal was proper and that it was a holder in due course although it was the payee listed on the note and not a transferee. The trial court held the lien was void and unenforce-

\begin{itemize}
  \item \textsuperscript{100} Id.
  \item \textsuperscript{101} Id. at 683.
  \item \textsuperscript{102} \textsc{Tex. Civ. Prac. \\& Rem. Code} § 33.013 (Vernon 2008) (limiting the liability of a defendant to the percentage found by the trier of fact unless the defendant's liability is found to be more than fifty percent or if the claim involves personal injury, property damage, death, or environmental hazard).
  \item \textsuperscript{103} 276 S.W.3d at 683. In support of its ruling, the court cited \textit{Sw. Bank v. Info. Support Concepts, Inc.}, 149 S.W.3d 104, 105 (Tex. 2004) (holding that application of Chapter 33 to conversion actions under § 3.420 could disrupt the discrete fault scheme of the Code).
  \item \textsuperscript{104} Id. at 684.
  \item \textsuperscript{105} Id. at 686.
  \item \textsuperscript{106} 267 S.W.3d 447, 449-50 (Tex. App.—Dallas 2008, pet. denied).
  \item \textsuperscript{107} Under \textsc{Tex. Bus. Corp. Act Ann.} art. 2.35-1 (Vernon 2003), transactions between a director and a corporation for which the director acts are void unless specific criteria are met to avoid harm to the corporation.
\end{itemize}
able. The seller appealed.

On appeal, the Dallas Court of Appeals reasoned that the president was not purchasing from the corporation for which he was a director and the purchaser was not a director or officer of the seller so the interested director doctrine did not apply. On the holder in due course issue, the court referred to section 3.302 of the Code defining a holder in due course as one who takes an instrument for (1) value (2) in good faith, and (3) without notice of any claim or defense to the instrument. The court noted that while the holder in due course doctrine most often involves a transferee, a payee can sometime be a holder in due course. In this case, however, the court found there was evidence that the seller knew the purchaser was a fiduciary of the corporation and yet failed to request confirmation that the purchaser had authority to bind the corporation. The evidence also established that the seller had notice of the purchaser’s breach of duty to the corporation. As a result, the seller did not qualify as a holder in due course and trial court’s judgment was affirmed.

In *Austin v. Countrywide Home Loans*, a debtor executed a thirty-year promissory note secured by a deed of trust to purchase real property. The note was reassigned multiple times and ended up in the hands of a mortgage company as the holder of the note. After the debtor stopped making payments, he began filing instruments in the real property records purporting to amend or revoke the deed of trust. The debtor eventually sued the holder for fraud, breach of contract, and breach of fiduciary duty. The holder counterclaimed for foreclosure, recovery of the outstanding balance on the note, a declaration that the instruments filed in the property records constituted forbidden “clouds on the title,” and dismissal of the debtor’s claims. The trial court granted summary judgment in favor of the holder.

On appeal by the debtor, the Houston Court of Appeals affirmed the summary judgment. The court noted that: (1) an obligee may recover on a negotiable instrument by making a showing that the obligee is the legal holder of the note; (2) the debtor executed the note; and (3) an unpaid balance exists on the instrument. The court concluded that the holder was the legal holder of the note by proper transfer and met the other requirements for holding in due course. The court also held that since the debtor admitted the debt in a prior bankruptcy case, he was barred by res judicata from relitigating the ownership issue or the exis-

108. 267 S.W.3d at 450.
109. *Id.* at 451.
111. 267 S.W.3d at 453.
112. *Id.*
113. *Id.* at 454.
114. 261 S.W.3d 68, 71 (Tex. App.—Houston [1st Dist.] 2008, no pet.).
115. *Id.*
116. *Id.* at 76.
117. *Id.* at 72-73.
118. *Id.*
C. ISSUES REGARDING ENDORSEMENTS

Learning is hard, and sometimes slow. Fourteen years have passed since Texas adopted revised Article 3. One of the changes made in the revision was reversal of the rule dealing with ambiguity in instruments payable to multiple payees. Under the former version of section 3.116, if an instrument was made payable to "A and/or B," it was deemed to be payable jointly and both A and B had to indorse the instrument. Revised section 3.110 now provides that an instrument payable to "A and/or B" is payable in the alternative and can be indorsed by either of them.

The El Paso Court of Appeals recently addressed this issue in New Wave Technologies, Inc. v. Legacy Bank of Texas, where a check stated on its face that it was payable to "Maxim Solutions Group/New Wave Techn." A legend on the back of the check stated that "Each Payee Must Indorse Exactly as Drawn." Maxim Solutions indorsed the check by putting its account number on the back and depositing the check in its account at a depositary bank. New Wave Technologies did not indorse the check. Maxim used the funds to pay withholding taxes owed to the IRS for Maxim employees. New Wave Technologies sued the bank for conversion under section 3.420 of the Code.

Although the court found no Texas cases addressing the effect of a virgule ("/") on the proper form of indorsement, it did find several cases from other jurisdictions holding that use of a virgule commonly means "or." In reference to the legend on the back of the check, the court reasoned that the statement only increased ambiguity because the face of the check indicated either payee could indorse while the back of the check required indorsement by both payees. The court concluded indorsement by only one payee was required. The bank, therefore, had acted properly in taking the check with only one indorsement and sum-

119. Id. at 73.
121. TEX. BUS. & COM. CODE ANN. § 3.110(d) (Vernon 1968) (amended 2002) (current version at TEX. BUS. & COM. CODE ANN. § 3.110(d) (Vernon 2002).
122. TEX. BUS. & COM. CODE ANN. § 3.110(d).
124. Id. at 100.
125. Id. Note that this statement spells "endorse" with an "e" instead of using the Code convention of spelling the word with an "i." Despite the statutory usage, banks continue to stamp checks as "P.E.G.," standing for "Prior endorsements guaranteed." Perini Corp. v. First Nat'l Bank of Habersham, 553 F.2d 398, 401 at n. 1 (5th Cir. 1977), mentioned that "[T]his practice could be attributed to the bankers' understandable reluctance to stamp "Pay any Bank PIG" on the backs of the checks they handle." Id.
126. TEX. BUS. & COM. CODE ANN. § 3.420 (Vernon 2002); id.
127. 281 S.W.3d at 101.
128. Id. at 102.
129. Id.
mary judgment in favor of the bank on the conversion claim was affirmed.\textsuperscript{130}

In \textit{Citibank Texas v. Progressive Casualty Insurance Co.},\textsuperscript{131} the Fifth Circuit Court of Appeals held the surety on a financial institution bond was not collaterally estopped from relitigating the issue of whether indorsements on a series of checks had been forged within the definition of "unauthorized" signatures or indorsements contained in the bond. This case first arose in a state court action for conversion brought by an unhappy employer against a bank when the employer discovered that an employee had indorsed a series of checks made payable to the company and deposited the checks in the employee's personal account.\textsuperscript{132} The bank sought to have the surety join in the defense of the state action, but the surety declined to do so. The bank was ultimately held liable for conversion in the state court action.\textsuperscript{133}

At this point, the drama shifted to federal court in an action by the bank against the surety on the theory that the surety was liable under the bond because the indorsements were unauthorized.\textsuperscript{134} The district court reasoned that the surety was collaterally estopped from litigating the validity of the indorsements because it had chosen not to participate in the defense of the state court action.\textsuperscript{135} Alternatively, the district court further held that if the issue were relitigated, the same result would be reached, that is, the indorsements were unauthorized under the terms of the bond.

On appeal to the Fifth Circuit, the court initially agreed that the surety was collaterally estopped but, upon panel rehearing, reversed itself and held that the terms of the bond did not cover indorsements made by a person who had some authority to indorse checks, but who exceeded the scope of his authority.\textsuperscript{136} According to the court, the issue was not whether the indorsements were unauthorized within the meaning of section 1.201(b)(41) of the Code, but whether they were unauthorized within the meaning of the definition contained in the bond.\textsuperscript{137} Because the terms of the bond also provided that participation in the defense would render the surety liable for any loss, whether or not the loss was otherwise covered by the bond, the court held that "the language of [the bond] expressly prevented [the surety] from exercising its option to defend [the

\textsuperscript{130} \textit{Id.} at 103.

\textsuperscript{131} 522 F.3d 591 (5th Cir. 2008). This decision replaced a prior decision by the court reaching a different result. \textit{See} Citibank Tex., N.A. v. Progressive Cas. Ins. Co., 508 F.3d 779 (5th Cir. 2007).

\textsuperscript{132} 522 F.3d at 592.

\textsuperscript{133} \textit{Id.}

\textsuperscript{134} \textit{Id.} at 593.


\textsuperscript{136} 522 F.3d at 594-95.

\textsuperscript{137} \textit{Id.} at 595. The bond defined the term as "an endorsement not reflected on the appropriate signature card or named in the Insured's records for the account or accounts in question." \textit{Id.}
bank] in state court without waiving its rights. It would be inequitable, then, for us to prevent [the surety] from having any opportunity to contest its liability for [the bank's] loss in court.\footnote{138} The surety, therefore, was not bound by the state court determination that the indorsements were unauthorized. Judgment was rendered in favor of the surety.\footnote{139}

D. Statute of Limitations

In Burney v. Citigroup Global Markets Realty Corp.,\footnote{140} the Dallas Court of Appeals held that a cause of action for foreclosure accrued when the maker of a note received a clear and unequivocal notice of intent to accelerate and notice of acceleration. Because an application for foreclosure was not filed until more than four years later, the foreclosure action was barred by limitations.\footnote{141}

V. Bank Deposits and Collections

A. Relationship Between a Bank and Its Customer

In Orix Capital Markets, LLC v. Washington Mutual Bank,\footnote{142} a mortgage-backed securities business deposited mutual funds with a bank. The deposit agreement stated that the depositor would "maintain" money market deposit accounts at the bank, and the bank would pay a monthly incentive fee based on the average daily balance for the previous month. The contract stated that either party could terminate the arrangement upon giving three months notice. The arrangement continued satisfactorily with both parties performing until the depositor sold the deposit balances to a third party. At that point, the bank stopped paying the incentive fees. The depositor sued for breach of contract and recovery of the fees.\footnote{143} The bank alleged it did not breach the contract because the depositor did not continue to own and control the accounts after it sold them. The trial court entered judgment in favor of the bank.\footnote{144}

On appeal by the depositor, the Dallas Court of Appeals held that the bank had breached its agreement to pay incentive fees.\footnote{145} The court rea-

\footnotesize{\footnote{138. Id.} \footnote{139. Id. at 597.} \footnote{140. 244 S.W.3d 900, 903-04 (Tex. App.—Dallas 2008, no pet.).} \footnote{141. Id. at 904. Although TEX. BUS. & COM. CODE ANN. § 3.118(b) (Vernon 2002) provides that a six year limitations period applies to actions on notes, a non-uniform Texas amendment in § 3.118(h) provides that the four year limitations period in §§ 16.035 & .036 of the Civil Practice and Remedies Code applies to the foreclosure of liens on real property. In Holy Cross Church of God in Christ v. Wolf, 44 S.W.3d 562 (Tex. 2001), the Texas Supreme Court held that a lender need only give notice of intent to accelerate and notice of acceleration to trigger the four year limitations period; there was no requirement that a lender take steps to initiate foreclosure. Id. at 562. The court in Burney relied on Wolf in reaching its decision. 244 S.W.3d at 904. The same rule was applied in Rabo Agrifinance, Inc. v. Terra XXI Ltd., 257 F. App'x 732 (5th Cir. 2007), which also cited Wolf but, in this case, the foreclosure was commenced within the four year limitations period. Id. at 734-35.} \footnote{142. 260 S.W.3d 620, 622 (Tex. App.—Dallas 2008, no pet.).} \footnote{143. Id.} \footnote{144. Id.} \footnote{145. Id. at 625.}}
soned that the depositor had always held the funds as a custodian, not as an owner, and the bank was aware that third parties typically owned deposits from servicing companies. Further, the contract required the depositor to maintain the funds, not own and control them. The court interpreted the plain meaning of "maintain" as "to retain." The depositor did not close the account or withdraw funds. The language of the contract did not indicate that the bank's incentive to enter into the contract was contingent on the depositor's ability to control the funds. The funds remained in an account with the bank for the entire period in question and the relationship between the depositor and the bank did not change after the sale. The depositor was on record as the account holder and its employees were the only authorized signatories on the accounts. The bank had no duty to determine ownership of the funds. The bank's regulations, incorporated by reference into the contract, protected it from claims of ownership by third parties. The court rendered judgment in favor of the depositor, but remanded the issues of attorney's fees and interest to the trial court.

In Security Service Federal Credit Union v. Sanders, several account holders asserted DTPA claims against a credit union for wrongfully dishonoring checks, miscalculating loans balances, making unauthorized funds transfers, and selling credit insurance. The credit union moved to compel arbitration under separate clauses contained in the account holders' member agreements and loan agreements. The trial court denied the motion and the credit union appealed.

On appeal, the account holders argued the arbitration clauses were unconscionable because both arbitration clauses allowed assessment of attorney's fees in a manner inconsistent with that stated in the DTPA. Under the member agreement, attorney's fees could be awarded against the account holders without a finding that their claims were groundless. Under the loan agreement, fees were to be borne by each party without regard to which party prevailed. The San Antonio Court of Appeals agreed with the account holders that these changes in how attorney's fees were to be awarded violated the public policy underlying the DTPA and were substantively unconscionable. The court further noted, however, that Texas law permits severance of an unconscionable provision and enforcement of the remainder of a contract. Reviewing the clauses in the loan agreements and in the member agreements separately, the court pointed out that the clause in the loan agreements expressly prohibited

146. Id. at 624-25.
147. Id. at 625-26.
149. Id. at 297.
150. Id. at 297-98. Under the Texas DTPA, attorney's fees can be awarded to a prevailing consumer or, if the claim is determined to be groundless, to the defendant. See Tex. Bus. & Com. Code Ann. § 17.50(c-d) (Vernon 2002 & Supp. 2008).
151. 264 S.W.3d at 299-300.
152. Id. at 300-01.
severance, but the clause in the member agreements did not.\textsuperscript{153} Under these circumstances, the court ruled that the trial court was correct in refusing to enforce arbitration under the loan agreements.\textsuperscript{154} This determination did not end the case, however, because the court also had to explore the issue of whether the arbitration clause in the member agreements was procedurally unconscionable.\textsuperscript{155} On this issue, the court held that a capitalized heading and description of the arbitration clause in the member agreements was sufficient to bring it to the attention of account holders and the clause, therefore, was not procedurally unconscionable.\textsuperscript{156} Thus, while the trial court was correct in refusing to compel arbitration under the loan agreements, it erred in failing to compel arbitration under the member agreements. A writ of mandamus was conditionally issued for the trial court to vacate its order and grant the credit union's motion to arbitrate.\textsuperscript{157}

**VI. SECURED TRANSACTIONS**

**A. CREATING A SECURITY INTEREST**

As noted in the last Survey, there has been considerable disagreement about the effect of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") amendments on purchase money security interests in motor vehicles.\textsuperscript{158} This disagreement continues with divergent results reached in two recent Texas bankruptcy cases decided by different judges in the Southern District of Texas. In *In re Brodowski*,\textsuperscript{159} the bankruptcy court held that it would apply the "dual status" rule to bifurcate a loan into purchase money and non-purchase money claims. Under this approach, funds advanced for the purchase price of a new vehicle are treated as secured, but funds advanced to pay off any negative equity in a trade-in vehicle are unsecured. This result means a Chapter 13 debtor must pay the secured debt in full, but the unsecured debt can be paid on a pro-rata basis.\textsuperscript{160}

In *In re Dale*,\textsuperscript{161} decided by the district court on appeal from a decision

\textsuperscript{153} Id.
\textsuperscript{154} Id.
\textsuperscript{155} Id. at 301-02.
\textsuperscript{156} Id.
\textsuperscript{157} Id. at 302.
\textsuperscript{158} See John Krahmer, *Commercial Transactions*, 61 SMU L. REV. 673-74 (2008). The basic issue is whether a purchase money security interest should include both the amount needed to finance the purchase price of a vehicle and the amount needed to pay off any negative equity on a vehicle traded in by the debtor as part of the transaction. The courts are deeply divided on whether the security interest should be bifurcated into secured and unsecured claims or whether the entire amount of the loan should be treated as secured. The issue arises because of a lack of clarity in the unnumbered "hanging paragraph" added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005) to the end of 11 U.S.C. § 1325(a). Id.
\textsuperscript{159} 391 B.R. 393, 401-02 (Bankr. S.D. Tex. 2008).
\textsuperscript{160} Id. at 403.
of the bankruptcy court, the court disagreed with the result in *Brodowski* and held the secured party’s claim should not be bifurcated but, instead, should include the amount advanced to pay negative equity and treated as fully secured. The bankruptcy court’s decision was reversed.

**B. Perfecting a Security Interest**

Once a security interest is created, it must be perfected to protect it against the claims of other creditors, including trustees in bankruptcy.

While the most common method of perfection is the filing of a financing statement giving public notice that a security interest exists in the described collateral, section 9.311 of the Code contains an important exception for security interests in motor vehicles covered by a certificate of title. To perfect a security interest in titled vehicles, other than vehicles held as inventory by a dealer, a secured party must comply with the requirements of any relevant certificate of title act.

When a vehicle is not part of a dealer’s inventory, perfection under the Texas certificate of title act requires a secured party to record its interest on the certificate of title. Mere possession of a certificate of title does not perfect a security interest absent notation on the title. This point was driven home in *In re Moye*, where the secured party took physical possession of several certificates of title covering vehicles in the inventory of a car dealer, but neither recorded its security interest on the titles nor filed a financing statement covering the dealer’s inventory. Another secured party claimed a priority interest in the inventory by virtue of its filed financing statement. The court had no difficulty in deciding that possession of the titles did not perfect a security interest in the individual vehicles and failure to file a financing statement rendered the claim to the inventory unperfected. The court ordered the trustee to deliver the vehicles to the second secured party as the creditor holding the superior claim.

A similar certificate of title issue was addressed in *In re Clark Contracting Services, Inc.*, this time, however, in the context of an assign-
ment of a security interest. In 2005, a debtor granted a security interest to a creditor to obtain a loan for the purchase of construction equipment.\textsuperscript{172} The creditor filed a financing statement and, as various items of equipment were purchased, the creditor also applied for and obtained certificates of title recording its security interest in the equipment. In 2007, another creditor purchased all of the first creditor's interests in the equipment and took physical possession of the certificates of title. It did not, however, apply for and receive new certificates of title recording its security interest. The debtor eventually filed a Chapter 11 bankruptcy and, as a debtor in possession, sought to avoid the security interest under the "strong-arm" powers of the Bankruptcy Code.\textsuperscript{173} After a careful review of the Texas Certificate of Title Act, the court held the assignee's failure to record its name on the titles following the assignment rendered the assignee's security interest unperfected and subject to avoidance by the debtor in possession.\textsuperscript{174}

C. RIGHTS OF THIRD PARTIES

In \textit{THPD, Inc. v. Continental Imports, Inc.},\textsuperscript{175} a car dealer opened a dealership specializing in used "muscle cars."\textsuperscript{176} A lender perfected a security interest in the dealer's inventory. Through a series of fraudulent actions, the first dealer obtained loans from other lenders by using the same cars as collateral. The dealer routinely bought and sold cars with other dealers, including some covered by the inventory lender's security interest. Some of these transactions were in the form of trades or payments of debt in lieu of cash sales. The dealer's fraud was eventually discovered and the inventory lender sued one of the other dealers for conversion of four cars.\textsuperscript{177}

The Austin Court of Appeals held the inventory lender's security interest continued in three of the four cars because the sales were neither authorized nor did the second dealer qualify as a buyer in the ordinary course of business.\textsuperscript{178} As to the fourth car, however, the court held that

\textsuperscript{172} \textit{Id.} at 792-93.
\textsuperscript{174} \textit{399 B.R.} at 804.
\textsuperscript{175} \textit{260 S.W.3d} 593 (Tex. App.—Austin 2008, no pet.).
\textsuperscript{176} \textit{Id.} at 597. "Muscle cars" are vehicles designed with eye-catching styling and high engine performance without regard to fuel economy. The production of muscle cars ceased as gasoline prices rose and they are now generally available only as used vehicles. The four cars that were principally involved in this case were a 1965 Chevrolet Corvette, a 1965 Mustang, a 1982 Ferrari, and a 1992 Chevrolet Corvette. \textit{Id.} at 600.
\textsuperscript{177} \textit{Id.} at 608. The lender had also asserted other claims against the second dealer, but failed to obtain jury findings supporting these claims.
\textsuperscript{178} \textit{Id.} at 614-15. Under \textsc{Tex. Bus. \& Com. Code Ann.} § 9.615(a) (Vernon 2002), a security interest continues in collateral unless the sale of the collateral is authorized or unless Chapter 9 otherwise provides. One of the most important provisions in Chapter 9 that "otherwise provides" is \textsc{Tex. Bus. \& Com. Code Ann.} § 9.320(a) (Vernon 2002) allowing a buyer in ordinary course of business to take free of a security interest created by
the evidence was insufficient to show that the inventory lender's security interest attached to this vehicle. Absent attachment, there was no conversion. The judgment of the trial court was affirmed as to three of the four cars and reversed as to the fourth vehicle.

One of the most difficult issues arising under Chapter 9 is the relationship between section 9.406 and other rules, statutes, or regulations restricting or prohibiting assignments or the creation of security interests in accounts or chattel paper when a governmental entity is the account debtor. In Texas Lottery Commission v. First State Bank of DeQueen, a lottery winner entered into a composition agreement with his creditors to assign funds payable to him from lottery payments due in 2013 and 2014. In a declaratory judgment action filed by the assignees, the Texas Lottery Commission contended that Texas law prohibited assignment of lottery winnings except by the procedure provided in the Texas Government Code.

Addressing the conflict between section 9.406 and the Government Code, the Austin Court of Appeals reasoned that the legislature could have included language in the Government Code expressly preempting section 9.406, but had chosen not to do so. Viewing the Uniform Commercial Code ("UCC") as an integrated codification of an entire field of law, the court believed that implied repeal of a UCC provision should not be lightly assumed. Absent an explicit statement in the Government Code to the contrary, the court held that section 9.406 was controlling and assignment of the lottery winnings was effective.

D. Disposition of Collateral

In Tex Star Motors, Inc. v. Regal Finance Co., Ltd., a factor entered into an agreement with a car dealer to purchase installment sales contracts resulting from the sale of cars by the dealer. The agreement in-
cluded a repurchase clause and a "holdback reserve" clause allowing the factor to retain $750 of the price of each contract it purchased to reimburse the factor for repossession expenses and debts owed to the factor by the dealer. Three years later, the factor stopped buying contracts from the dealer and the dealer refused to repurchase any more defaulted contracts or make any further deposits into the reserve fund. The factor subsequently repossessed and sold some nine hundred cars after buyers defaulted, resulting in an alleged eight million dollar deficiency. The factor sued the dealer to recover the deficiency. The dealer counterclaimed to recover unfunded reserve funds and statutory damages. The jury returned a verdict in favor of the factor.

On appeal by the dealer, the Houston Court of Appeals (14th District) held that the factor failed to prove it sold the collateral in accordance with reasonable commercial standards as defined in the jury instructions. The court further held that the trial court erred in denying the dealer recovery on its claim for money it had received by virtue of its deposits into the reserve account. A take nothing judgment was rendered against the factor and in favor of the dealer on its claim to recover the reserve funds.

In Chapa v. Traciers & Associates, a borrower obtained a loan from a finance company to purchase a vehicle. After the borrower defaulted, the finance company hired a collection agency to repossess the vehicle. The finance company told the collection agency that the vehicle would be located at a certain address. The address given to the finance company, however, was the address of the borrower's brother, who had purchased a vehicle identical to the one the borrower had purchased. When the collection agency's employee went to the address, he saw a vehicle of the right kind parked on the street. This vehicle, however, belonged to the borrower's brother; something the collection agency's employee didn't know. The employee hooked the vehicle to his tow truck and drove away. After driving for a couple of blocks, the employee noticed that the vehicle's engine was running. Upon further inspection, the employee discovered there were children inside the vehicle. The employee realized that a mistake had been made and quickly returned the vehicle. The borrower's brother and his wife sued the finance company and the collection agency for breach of the peace in violation of section 9-609 of the Code. The plaintiffs also asserted claims based on the Restatement (Second) of Torts and a claim for bystander liability. The trial court granted summary

188. Id.
189. Id.
190. Id. at 752. Under TEX. BUS. & COM. CODE ANN. § 9.610(b) (Vernon 2002) a sale of collateral must be done in a commercially reasonable manner.
191. 246 S.W.3d at 754.
192. Id. at 755-56.
194. Id. at 390.
195. Id. The tort claims were asserted under RESTATEMENT (SECOND) OF TORTS §§ 424 & 427 (1965). Section 424 deals with precautionary action required by a person by a statute
judgment in favor of the defendants on all of the claims.\textsuperscript{196}

On appeal, the Houston Court of Appeals (14th District) reasoned that a claim for breach of the peace required the borrower's brother to show conduct that would probably result in a loss of public order.\textsuperscript{197} After reviewing the facts and several other breach of the peace cases, the court concluded that repossessing a vehicle on a public street, absent any contemporaneous objection or confrontation, was not a breach of the peace under section 9.609.\textsuperscript{198} The court also denied recovery on the claims asserted under the Restatement (Second) of Torts and for bystander liability.\textsuperscript{199} Summary judgment in favor of the defendants was affirmed.\textsuperscript{200}

\section*{VII. CONCLUSION}

Two of the cases decided during the Survey period stand out because they authoritatively resolve issues arising under the Code that were previously debatable.\textsuperscript{201} A few other decisions, however, addressed issues that are likely to be the subject of further litigation, either in other cases or as the subject of further appeal. These include, in particular, \textit{Bank of Texas v. VR Electric, Inc.},\textsuperscript{202} \textit{IFC Credit Corp. v. Specialty Optical System, Inc.},\textsuperscript{203} \textit{New Wave Technologies, Inc. v. Legacy Bank of Texas},\textsuperscript{204} and \textit{In re Clark Contracting Services, Inc.}\textsuperscript{205} Although 2008 was not a legislative year, cases decided during the year have provided useful guidance in reaffirming past interpretations of the Code or, in some instances, raising new issues to be considered.