Commercial Transactions

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This Article discusses selected cases reported during the 1995 Survey period involving issues arising under the Uniform Commercial Code adopted in Texas as the Texas Business and Commerce Code. Possible revisions of Articles 3 and 4 dealing with Commercial Paper and Bank Deposits and Collections that may affect the decisions in cases reported during the Survey period have also been noted. A few provisions of the Bankruptcy Reform Act of 1994 are mentioned that bear on secured transactions issues, but an extensive discussion of bankruptcy goes beyond the scope of this Article.

I. GENERAL PROVISIONS

A. THE REQUIREMENT THAT A CONTRACT CLAUSE BE "CONSPICUOUS"

In *Dresser Industries, Inc. v. Page Petroleum, Inc.* the Texas Supreme Court announced that the Code definition of "conspicuous" in section 1.201(10) of the Code would henceforth be applied to both Code and non-Code cases to determine if a contract clause was or was not "conspicuous." *Dresser* was followed during the Survey period in *Allied Finance Co. v. Rodriguez,* a non-Code case, in which the court held that a clause requiring the purchase of insurance from either the lender or from a third party as part of a consumer credit transaction was not "conspicuous" under the Code definition. The failure to conspicuously disclose that insurance could be purchased elsewhere led the consumers to buy coverage from the lender even though they already had insurance that would

1. A Survey period generally runs from October 1 of a given year through September 30 of the following year. Because of differences in timing for the release of opinions for publication, motions for rehearing, and the like, a case may be included that was reported shortly before or shortly after those dates, but the vast majority of cases discussed are within that time frame.
3. See text at note 168, infra.
4. See notes 226 and 227, infra.
5. 853 S.W.2d 505 (Tex. 1993).
6. TEX. BUS. & COM. CODE ANN. § 1.201(10) (Tex. UCC) (Vernon 1994) defines "conspicuous" in the following terms: A term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: NON-NEGOTIABLE BILL OF LADING) is conspicuous. Language in the body of a form is "conspicuous" if it is in larger or other contrasting type or color. Whether a term or clause is "conspicuous" or not is for decision by the court.
7. 853 S.W.2d at 509.
8. 869 S.W.2d 567 (Tex. App.—Corpus Christi 1993, no writ).
9. Id. at 572. The clause in question appeared in a separate paragraph on the bottom one-third of the consumer credit contract, but it was not set out in capitals or other distinctive type so as to draw attention to it. The borrowers did separately initial this paragraph, but the court attached no special significance to the initialing. Id.
meet the loan requirements and this, in turn, resulted in a holding that the lender had violated the Texas Consumer Credit Code.10

B. ACCELERATION OF INSTRUMENTS

Texas law on the acceleration of instruments has involved three principal issues: (1) whether the proper method of acceleration outlined in the Texas caselaw was followed,11 (2) whether there was an effective waiver by the debtor of the right to insist that the creditor follow the rules established by such caselaw,12 and (3) whether the amount demanded upon acceleration was usurious.13 In McLemore v. Pacific Southwest Bank, FSB14 the court considered a situation that involved the first two of these

10. Id. The court affirmed a ruling by the lower court assessing a $2,000 penalty against the lender for the Credit Code violation as well as attorney’s fees and interest in the amount of $2,000. Because the transaction in question arose before various amendments to the Credit Code were enacted in 1993, the sections of the Credit Code involved in this decision were TEX. REV. CIV. STAT. ANN. arts. 5069-3.18(3) & -8.01(b) (Vernon 1987 & Supp. 1993), which provided for an automatic penalty of $2,000 for violations like the one in question. The penalty provisions in TEX. REV. CIV. STAT. ANN. art. 5069-8.01(b) were modified in the 1993 legislative session to provide for the recovery of (1) an amount not to exceed three times the amount of the actual economic loss (in Allied this would seem to be an amount not exceeding three times the cost of the excess insurance coverage for a total penalty of $161.03 × 3, or $483.09), or, alternatively, (2) an amount not in excess of two times the amount of all credit charges, but with a maximum limit of $2,000 or $4,000 depending upon the amount financed (the court did not specify the total amount of the credit charges in Allied, but the total loan amount was $3,382.26; at even a relatively modest interest rate, twice the amount of the credit charges would probably exceed three times the cost of the insurance). The revised art. 8.01(b) does not state whether the borrower, the lender, the court, or the jury is to make the election between the penalties stated in the section. In any event, the revised provision would result in the recovery of lesser penalties than those assessed under the earlier statutory language applied in Allied, but would not affect the holding that the conspicuousness of the insurance clause was to be measured against the Code standards.


12. In Shumway v. Horizon Credit Corp., 801 S.W.2d 890, 893 (Tex. 1991) the Texas Supreme Court held that “a waiver provision must state specifically and separately the rights surrendered.” A further discussion of Shumway and an example of a waiver clause appears in JOHN KRAHMER, KARL VANCIL & ROBERT WOOD, TEXAS COMMERCIAL LAW FOR BANK LAWYERS 298-300 (3d ed. 1994).

13. In Jim Walter Homes, Inc. v. Schueneman, 668 S.W.2d 324 (Tex. 1984) the Texas Supreme Court acknowledged this problem in the following terms: “In literally scores of cases, the courts of this state have been called upon to decide whether a contract is usurious because it contains an acceleration provision which allows the collection of unearned interest or finance charges.” Id. at 333 n.6. The court went on to suggest the use of savings clauses to disavow any usurious intent when a note is accelerated and excess interest is inadvertently demanded. Id. Such savings clauses have since been upheld in a variety of circumstances, See, e.g., Affiliated Capital Corp. v. Commercial Fed. Bank, 834 S.W.2d 521, 525-26 (Tex. App.—Austin 1992, no writ) (savings clause effectively disclaimed intent to charge usurious interest and permitted prepayment penalty to be upheld); First State Bank v. Dorst, 843 S.W.2d 790 (Tex. App.—Austin 1992, writ denied) (savings clause effective to cap interest rate at maximum lawful rate although escalation clause allowed theoretically unlimited interest); Myles v. RTC, 787 S.W.2d 616 (Tex. App.—San Antonio 1990, no writ) (plain English savings clause upheld in acceleration of note).

14. 872 S.W.2d 286 (Tex. App.—Texarkana 1994, writ dism’d by agr.).
three issues. Using a mix-and-match analysis, the court held that, while
the language used in a note was sufficient to waive the requirement of a
demand for payment and the requirement of a notice of intent to acceler-
ate, it was not sufficient to waive the separate requirement of a notice of
the acceleration itself. The court further held that three notice letters
sent to the debtor were merely notices of intent to accelerate, a notice
requirement that had already been waived, and did not give the debtor
proper notice of acceleration. Fortunately for the creditor, however,
the court ruled that notice of an intent to accelerate, followed by notice
of the date and time scheduled for the foreclosure sale and notice of the
completed sale of the property, was sufficient to constitute notice of the
actual acceleration.

The question of effective waiver took a new turn in Rey v. Acosta because of the amendment to the Texas Property Code in 1987 requiring
that, in a residential loan transaction, "[n]otwithstanding any agreement
to the contrary," the debtor be given notice of default and at least twenty
days to cure the default prior to acceleration. The issue before the
court was whether this amendment could be applied retroactively to
modify waivers contained in residential loan agreements entered into
before the effective date of the amendment. The court held that state
constitutional restrictions prohibiting retroactive application of new laws
and prohibiting the impairment of contracts applied only to vested rights
and not to the modification of a remedy. Because the amendment did
not abolish the right to accelerate, but merely imposed a requirement of
written notice and a prescribed grace period, the court viewed the revised
statute as remedial legislation rather than a constitutionally impermis-
sible impairment of any constitutionally protected substantive rights avail-
able to the creditor. Because the creditor failed to give a notice of
acceleration and a cure period that complied with the statutory require-
ments, the attempted acceleration was held to be improper and only the
missed installments could be recovered rather than the entire balance of
the loan.

15. Id. at 291.
16. Id.
17. Id. at 292. On this point the court noted that the Texas Supreme Court had de-
clined to decide this issue on the facts presented in Ogden v. Gibraltar Sav. Ass'n, 640
S.W.2d 232 (Tex. 1982), but believed it reasonable to infer that such a sequence of events
would constitute effective notice of acceleration. Id.
19. TEX. PROP. CODE ANN. § 51.002 (Vernon Supp. 1995) was amended by adding the
notice requirement and the 20-day cure period in a new subsection (d) during the 1987
legislative session.
20. 860 S.W.2d at 656. The amendment took effect on January 1, 1988. Id.
21. Id. at 657. The constitutional restrictions appear in TEX. CONST. art. I, § 16.
22. Id. at 658.
23. Id. at 658-59. The borrowers remained in possession of the property, but ceased
making any payments following receipt of the improper notice of acceleration which
demanded payment of the entire balance. The court noted that the creditor was entitled to
recover for all of the unpaid installments that had accumulated during the past 5 years plus
interest at the rate provided in the note. Id.
violated the Deceptive Trade Practices Act (DTPA)\(^\text{24}\) and the Debt Collection Practices Act\(^\text{25}\) as a matter of law. The case was remanded for entry of judgment on the creditor's claim in the amount of the past due installments and for the determination of damages on the borrowers' DTPA and debt collection practices counterclaims.\(^\text{26}\)

II. SALE OF GOODS

A. CONTRACT FORMATION AND INTERPRETATION

Section 2.207 of the Code is a statutory attempt to reject the common law "mirror image rule" in favor of a more pragmatic approach to the realities of contracting in a business environment.\(^\text{27}\) Although criticized as inadequate for the task,\(^\text{28}\) it does provide the courts with a degree of flexibility in dealing with cases where the parties have dealt with each other as if they have a contract despite the uncertainty that results when a later analysis of the forms, letters, or other communications leaves one in doubt as to exactly what the terms of the contract were supposed to be.\(^\text{29}\) In *Howell Crude Oil Co. v. Tana Oil & Gas Corp.*\(^\text{30}\) the parties disagreed about whether compulsory arbitration was required in a transaction involving the sale of natural gas. One party contended arbitration was required under a contract between the parties. The other argued that no contract had been formed because the documents they exchanged did not contain identical cancellation provisions. The court reviewed the various documents and determined that, despite differences in the cancellation provisions proposed by the two parties in their writings, they had dealt with each other as if they had a contract.\(^\text{31}\) Under these circumstances, the court held that a contract had been formed and that it included an arbitration clause on which the exchanged documents agreed and entered an order compelling arbitration.\(^\text{32}\)


\(^{26}\) 860 S.W.2d at 659. As to damages on the DTPA and Debt Collection Practices Act claims, the court noted that "[p]roof of any compensable damages may prove elusive" on the facts of the case since the debtors were not deprived of the property during the pendency of the litigation and made no payments for over years.


\(^{29}\) One of the most extensive discussions in the Texas cases applying *Tex. Bus. & Com. Code Ann.* § 2.207 (Tex. UCC) (Vernon 1994) is Westech Eng’g, Inc. v. Clearwater Constructors, Inc., 835 S.W.2d 190 (Tex. App.—Austin 1992, no writ).

\(^{30}\) 860 S.W.2d 634 (Tex. App.—Corpus Christi 1993, no writ).

\(^{31}\) *Id.* at 637.

\(^{32}\) *Id.* at 639. *Tex. Bus. & Com. Code Ann.* § 2.207(c) (Tex. UCC) (Vernon 1994) provides:

Conduct by both parties which recognizes the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract. In such case the terms of the particular...
In *Axelson, Inc. v. McEvoy-Willis* the dispute centered on the cancellation term itself, with the seller insisting a contract had been formed that included a term limiting the right to cancel as contained in the seller’s quotation form, and with the buyer insisting it was free to cancel as per its own cancellation provision. Characterizing the case as one sounding “like the delight of a contracts professor, if no one else,” the court held that the buyer had accepted the offer contained in the seller’s quotation before sending its own proposed cancellation term. The court further held that a contract had been formed either on the seller’s terms or, if the exchanged writings did not create a contract, the conduct of the parties recognized the existence of a contract and, under the Code, the buyer’s attempted cancellation constituted a breach.

The court took a different approach to the issue of contract formation in *Gasmark, Ltd. v. Kimball Energy Corp.* In *Gasmark* both parties initialed a provision that their negotiations were subject to the “execution of a mutually agreed formal contract.” Discussion between the parties proceeded through conversations and the exchange of documents from late November to mid-February when one of the parties terminated the negotiations. Although the buyer purchased gas from the seller from December to February while negotiations proceeded, the court did not regard this as conduct recognizing the existence of a contract because of the agreement to be bound only upon execution of a formal contract. This agreement, according to the court, subjected the negotiations to the “common-law requirements of a formal offer and acceptance.” Since the parties never executed a formal agreement, the court held the negotiations remained preliminary and never resulted in the formation of a binding contract.

Rejection of the common law mirror image rule was not the only change made by the Code in attempting to reconcile the law of sales with business practice. Another innovation was the explicit approval of output and requirement contracts, issues which caused problems at common law because they are inherently indefinite.

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33. 7 F.3d 1230 (5th Cir. 1993).
34. 231.
35. 1233.
36. *Id.* The court cited *TEX. BUS. & COM. CODE ANN. §§ 2.703 & 2.708 (Tex. UCC)* (Vernon 1994) in support of the proposition that, absent a contractual right to cancel, the buyer’s refusal to accept and pay for the goods was a breach of the contract.
37. 868 S.W.2d 925 (Tex. App.—Fort Worth 1994, n.w.h.).
38. *Id.* at 927.
39. *Id.* at 928.
40. *Id.*
41. *Official Comment 2 to TEX. BUS. & COM. CODE ANN. § 2.306 (Tex. UCC)* (Vernon 1994) notes, “Under this Article, a contract for output or requirements is not too indefinite since it is held to mean the actual good faith output or requirements of the particular party.”
Lenape Resources Corp.\(^{42}\) the court determined that an agreement for the purchase and sale of natural gas was an output contract because the precise quantity was not specifically stated but varied in accordance with the seller's production and delivery capacity. A major issue in the case, however, was whether the seller had intentionally increased production to take undue advantage of the buyer under a "take or pay" clause in the contract.\(^{43}\) On this issue, the court reviewed the terms of the agreement in light of the provisions of section 2.306 of the Code\(^{44}\) and held that the seller could increase production only within the limits of reasonableness and good faith.\(^{45}\) In reaching this conclusion the court distinguished an earlier Texas Supreme Court decision\(^{46}\) holding that an implied obligation of good faith could not vary the terms of a written agreement.\(^{47}\) On this issue the court remanded the case for trial on whether the seller had merely expanded production reasonably and in good faith, or whether the seller had expanded production to take bad faith advantage of the take or pay clause.\(^{48}\)

**B. WARRANTIES**

An occasional case arises that permits a court to review multiple theories of liability based on a single set of facts and to write an opinion that resembles a legal mini-treatise. One such case is *Crosbyton Seed Co. v. Mechura Farms.*\(^{49}\) To obtain sorghum seed for the 1990 growing season, Mechura Farms, a family farming partnership, purchased a large quantity of seed through a seed broker. The seed itself was obtained through the Crosbyton Seed Company and, prior to delivery to Mechura Farms, it was treated with chemicals designed to protect the seed against the effects of herbicide. Soon after planting, the crop showed signs of poor germination and damaged plants. At the Mechuras' request, a number of persons inspected the crop in the field at various times during the growing season and, when the crop was finally harvested, the yield was below that for other seed varieties planted by the Mechuras on other acreage.

In an action against the three seed companies and the two chemical companies involved in the distribution chain, the Mechuras alleged a variety of claims: negligence, strict liability, breach of contract, breach of express warranty, breach of an implied warranty of fitness for a particular purpose, breach of an implied warranty of merchantability, and DTPA misrepresentations. The two chemical companies settled with the plaintiffs before trial and the case proceeded against the seed companies. In

\(^{42}\) 870 S.W.2d 286 (Tex. App.—San Antonio 1993, writ granted).

\(^{43}\) A "take or pay" clause is common in contracts for the sale and purchase of natural gas. Under such a clause a buyer must either take or pay for any gas the seller has available for delivery whether or not the buyer has any actual need for the gas at a given time.


\(^{45}\) Exxon Corp. v. Atlantic Richfield Co, 678 S.W.2d 944 (Tex. 1984).

\(^{46}\) Id. at 294.

\(^{47}\) Id. at 294.

\(^{48}\) Id.

\(^{49}\) 875 S.W.2d 353 (Tex. App.—Corpus Christi 1994, n.w.h.).
an instructive opinion, the court discussed the plaintiffs' interrelated theories on two levels: first, whether the theory of liability was valid under existing Texas law and, second, whether the evidence supported recovery under those theories determined to be valid.

As to the several theories of liability, the court made the following determinations:

1. **Negligence**

   Based on the decision in *Southwestern Bell Telephone Co. v. DeLaney*,\(^5\) a cause of action for negligence to recover for economic loss only would not lie because there was no showing that the defendants' conduct would give rise to liability independent of the contract; absent the contract, there was no separate common law duty owed by the defendants to the plaintiff.\(^5\)

2. **Strict Liability**

   Under existing Texas law, the theory of strict liability requires physical harm to persons or property; economic loss alone will not support recovery on a strict liability claim and the plaintiffs did not allege any physical harm caused by the seed or by the chemicals applied to it.\(^5\)

3. **Breach of Contract**

   There was no evidence to support a breach of contract claim because, although the yield was below that of other seed varieties, the seed did produce a yield that was above the average yield in the same county in 1990 and that was also above the ten-year average yield for Mechura Farms. The contract did not call for the seed to produce either a specific yield or a comparative yield.

4. **Express Warranty**

   As to express warranties, the court recognized some conflict in Texas law on the issue of whether privity of contract is required to enforce express warranties when only economic loss is involved.\(^5\) The bag tags on the seed purchased by the Mechuras claimed a germination rate of eighty-five percent and a purity of ninety-nine percent. Because all of the sellers in the distribution chain were aware that the Mechuras would be

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50. 809 S.W.2d 493 (Tex. 1991).
51. *Crosbyton Seed*, 875 S.W.2d at 360.
52. *Id.* at 361.
53. *Id.* at 361. The conflicting decisions noted by the court were Nat'l Bugmobiles, Inc. v. Jodi Properties, 773 S.W.2d 616 (Tex. App.—Corpus Christi 1989, writ denied) (privity not required where exterminator made a perpetual, transferable express written warranty knowing that house might eventually be sold); Texas Processed Plastics v. Gray Enter., Inc., 592 S.W.2d 412 (Tex. Civ. App.—Tyler 1979, no writ) (privity required to enforce an express warranty against a remote manufacturer); and Clarostat Mfg., Inc. v. Alcor Aviation, Inc., 544 S.W.2d 788 (Tex. App.—San Antonio 1976, writ ref'd n.r.e.) (privity not required where manufacturer made express warranties directly to buyer).
receiving at least part of the seed lot in question, the court held that the representations on the bag tags could constitute express warranties running to the ultimate purchasers whether or not the sellers were in direct privity with them. The seed broker through whom the seed was purchased was also alleged to have made representations that could be construed as express warranties of quality going beyond mere opinion or commendation. On the evidentiary level, there was some evidence showing a germination rate of less than eighty-five percent. There was no evidence, however, that the seed was less than ninety-nine percent pure. The court concluded that an express warranty claim would lie against all of the defendants for the representation of eighty-five percent germination and against the seed broker for his alleged representations, but there was no evidence to support a breach of express warranty as to the purity of the seed.

5. **Implied Warranty of Fitness for a Particular Purpose**

In a careful review of this often-misunderstood warranty, the court correctly noted that this warranty only arises when the buyer has a particular purpose for the use of the goods. Because there was no evidence that the buyer intended using the seed for anything other than its ordinary purpose of growing a grain sorghum crop, the court held that no implied warranty of fitness for a particular purpose arose on the facts of the case.

6. **Implied Warranty of Merchantability**

The court recognized that Texas law does not require privity of contract for the recovery of purely economic loss on a breach of implied warranty of merchantability theory. The court also acknowledged that, under Texas law, to prove that goods are not fit for their ordinary purpose the plaintiff must show the goods are defective because of the "lack of something necessary for adequacy." Because there was no disclaimer of this warranty by any of the defendants, and because there was some evidence tending to show that the seed was defective, the court held this was a viable theory of liability.

54. *Crosbyton Seed*, 875 S.W.2d at 361-62.
55. *Id.* at 362. The Mechuras were, of course, in direct privity with the seed broker so there was no privity issue in regard to these alleged representations.
56. On this point the court correctly noted, "This is the stuff of which a claim for breach of the implied warranty of merchantability is made...." 875 S.W.2d at 365 n.10.
57. *Id.* at 363 (citing Nobility Homes of Texas, Inc. v. Shivers, 557 S.W.2d 77, 80-82 (1977)).
58. 875 S.W.2d at 363 (citing Plas-Tex, Inc. v. United States Steel Corp., 772 S.W.2d 442, 443 (Tex. 1989) in which this requirement was announced).
59. *Crosbyton Seed*, 875 S.W.2d at 363.
7. **DTPA Claims**

Curiously enough, in asserting their DTPA claims, the plaintiffs did not allege a DTPA violation based on breach of warranty, but chose, instead, to limit these claims to misrepresentations about the seed.\(^{60}\) In a lengthy review of the evidence on the DTPA claims, the court concluded that, while the theory was potentially valid, there was insufficient evidence to support a verdict in favor of the plaintiffs based on alleged misrepresentations concerning chemical application and germination.\(^{61}\)

The net result of the court’s analysis resulted in judgments against the plaintiffs on the theories of negligence, strict liability, breach of contract, breach of an express warranty of purity, breach of an implied warranty of fitness for a particular purpose and DTPA claims for misrepresentation.\(^{62}\) A new trial was ordered, however, on the theories of an express warranty of the germination rate and on any express warranties made by the seed broker, on the claim for breach of an implied warranty of merchantability, and on the DTPA claim based on the germination rate representation.\(^{63}\) The court also reversed and remanded an associated counterclaim by the defendants to recover the balance due on the price of the seed because of erroneous jury instructions regarding the deduction of such recovery on the counterclaim from any damages found in favor of the plaintiff.\(^{64}\)

C. **Remedies**

Another warranty case involving claims of negligence and breach of implied warranty was *Hininger v. Case Corp.*\(^{65}\), where the plaintiff sued a component supplier for lost profits resulting from the failure of four combines to work properly due to apparent defects in the drive wheels manufactured by the component supplier.\(^{66}\) Reviewing the same principal cases discussed in *Crosbyton Seed*,\(^{67}\) the court reached an identical conclusion that damages for economic loss alone could not be recovered

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60. Id. at 365. Recovery under the DTPA can be based on claims for misrepresentation or for breach of warranty claims. As to these claims, see Tex. Bus. & Com. Code Ann. §§ 17.50(a)(1) & (a)(2) (Vernon 1987 & Supp. 1995), respectively.

61. 875 S.W.2d at 367-71. In its review of the evidence, the court placed great reliance on Texas Department of Agriculture testing and regulations indicating that the germination rate had not been misrepresented by the defendants. Id. at 370-71.

62. Id. at 372.

63. Id. at 372-73.

64. Id. Because several of the issues had to be retried, proper treatment of any recovery on the counterclaim had to await determination of the plaintiffs’ right to recover on the various theories of liability, including the possible recovery of attorney’s fees on the DTPA claim.


66. Id. The other defendants originally included the combine manufacturer, the selling dealer, and the lender who had financed the purchase. All of these parties settled and only the component supplier remained in the litigation as a party defendant.

67. Crosbyton Seed Co. v. Mechura Farms, 875 S.W.2d 353 (Tex. App.—Corpus Christi 1994, n.w.h.), discussed in text at note 49, supra. The principal cases discussed in both opinions were Southwestern Bell Tel. Co. v. DeLanney, 809 S.W.2d 493 (Tex. 1991) and Nobility Homes of Texas, Inc. v. Shivers, 557 S.W.2d 77 (Tex. 1977).
under Texas law on a theory of negligence against either the combine manufacturer or the component supplier. On the implied warranty issue, the court recognized that a lack of privity is not a bar to the recovery of economic loss because of a breach of warranty asserted by a purchaser against a remote manufacturer. In this case, however, the purchaser was attempting to assert liability against a component supplier who had supplied parts to the actual manufacturer of the finished goods. The court found no Texas authority directly in point on whether an implied warranty claim for economic loss would lie against the manufacturer of a component part. Lacking direct authority, the court reasoned that the policy underlying the rejection of a privity requirement in Texas was because a manufacturer could always restrict liability for economic loss by making appropriate disclaimers of warranty or limitations of remedy. At the same time, however, the court noted that Texas law disallows the recovery of economic loss on a theory of strict liability to protect manufacturers from "unlimited and unforeseeable liability." Applying these underlying policies to the facts of the case before it, the court believed that component suppliers would not be able to effectively disclaim warranties because their components simply become part of another product and any disclaimer may never be communicated to the ultimate purchaser of the finished product. The court concluded, therefore, that Texas "would distinguish between the manufacturer of the finished product and the component supplier because of the component supplier's inability to disclaim its warranty liability effectively" and denied recovery on the implied warranty theory because of a lack of privity.

While the court's rationale seems facially persuasive, it is not an entirely satisfactory explanation of why a lack of privity should deny the ultimate purchaser a direct claim against a component supplier. An excellent example illustrating the problems with the court's reasoning occurred in November of 1994 when it was announced that approximately two million of the first Pentium computer chips manufactured by Intel Corp. and delivered to computer manufacturers had a defective floating point calculating unit (a specialized mathematics processing part of the chip). Because of this defect, certain computations generate incorrect results. Intel Corp. acknowledged the defect, but also reported that the errors might result in only approximately one in nine billion division calculations. A reported example of the error, however, might lead one to believe that the frequency is somewhat higher. According to one article, an example of the error was generated by using the Microsoft "Excel" spreadsheet software: Taking the number 4195835 and first multiplying it

68. 23 F.3d at 127.
69. Id. at 128.
70. Id.
71. Id.
72. Id.
73. 23 F.3d at 129.
74. Id.
by 3145727, then dividing it by the same number, gave a result of 4195579 instead of the expected correct result of 4195835.\textsuperscript{75} The correct result was obtained using the same Excel software on a computer that used an 80486 chip that was also manufactured by Intel Corp. instead of a Pentium chip.\textsuperscript{76}

From a legal standpoint, there are at least three intriguing aspects about this example. First, Intel Corp. had previously engaged in an extensive advertising campaign to promote the use by computer manufacturers of a stylized logo consisting of a circle with the words “Intel Inside” written inside the circle and encouraging purchasers to look for this logo when making computer purchases. In this instance, Intel Corp. was hardly an unknown component supplier, but an aggressive marketer intentionally seeking to promote the use of its brand of computer chip to computer manufacturers and end users. This certainly differs from the component supplier who cannot effectively communicate a warranty disclaimer to the ultimate purchaser. Second, if a purchaser sues a computer manufacturer for breach of warranty, the manufacturer may have a claim over against Intel Corp. under section 2.607 of the Code.\textsuperscript{77} Is it legally sound to deny the purchaser the right to proceed directly against the manufacturer of the faulty computer chip? Considered in this light, the court's rationale seems incorrect even in the case of an unknown component supplier. Third, there is some indication that Intel Corp. was aware of the defect in the chip as early as July of 1994. Although the defect was apparently corrected at about that time, Intel Corp. did not acknowledge the defect until it was generally reported from other sources in November of 1994.\textsuperscript{78} Some purchasers may have DTPA claims because of this delay in making information about the error available.\textsuperscript{79}

As a Fifth Circuit case attempting to predict Texas law in the absence of direct authority, \textit{Hininger v. Case Corp.}\textsuperscript{80} should not be accepted too literally, but should be critically examined to see if its reasoning is a proper analysis of the Texas caselaw on implied warranties, privity, and economic loss.

One of the difficulties facing a disappointed buyer when the seller fails to deliver the goods called for under a contract of sale is the need to prove market price if the buyer sues under the standard damage formula allowing recovery of the difference between the contract price and the market price.\textsuperscript{81} The remedy of “cover” in section 2.712 of the Code pro-

\textsuperscript{75} \textsc{Infoworld}, Vol. 16, No. 48 at 1, 18 (Nov. 28, 1994).
\textsuperscript{76} \textit{Id}.
\textsuperscript{77} \textsc{Tex. Bus. & Com. Code Ann.} § 2.607(e) (Tex. UCC) (Vernon 1994).
\textsuperscript{78} A separate article in the same issue of Infoworld reports this scenario. \textsc{Infoworld}, Vol. 16, No. 48 at 130 (Nov. 28, 1994).
\textsuperscript{79} The claims could be based on either breach of warranty claims or on laundry list violations under \textsc{Tex. Bus. & Com. Code Ann.} §§ 17.46 & 17.50 (Tex. UCC) (Vernon 1994).
\textsuperscript{80} 23 F.3d 124 (5th Cir. 1994), \textit{cert. denied}, 1995 U.S. LEXIS 131 (Jan. 9, 1995).
\textsuperscript{81} Calculating expectation damages based on the contract/market differential is a standard common law remedy as well as one of the remedies provided under the Code.
vides a buyer with a useful alternative to the difficulties of proving mar-
ket price. This remedy allows a buyer to purchase goods in substitution 
for the goods the buyer failed to receive under the contract and sue for 
difference between the contract price and the cover price. To avoid 
abuse of this remedy, the Code requires the cover purchase to be made in 
good faith and without unreasonable delay. In Mueller v. McGill the 
court correctly held that the good faith and reasonableness of a buyer's 
cover purchase were questions of fact raising a "classic jury issue." The 
court reached this conclusion even though the substitute purchase was for a 1986 model Porsche and the original contract was for a 1985 model. The court noted that the Code allows reasonable substitution 
when identical goods are not available and that the evidence showed great difficulty, if not impossibility, in finding a 1985 model as a substitute.

D. Limitation of Actions

The statute of limitations for breach of a sales contract is four years 
from the time the cause of action accrues. A cause of action for breach 
of warranty accrues upon tender of delivery of the goods unless the war-

ranty explicitly extends to the future performance of the goods. According to the Texas Supreme Court, in construing a warranty to 
determine if it extends to future performance so as to extend the limita-
tions period, emphasis must be placed on the word "explicitly." This 
rule of construction was followed in Kline v. U.S. Marine Corp., where 
the court held that a warranty on a boat motor covering "failures by de-
fects in material and workmanship" for twelve months after the date of sale did not explicitly extend to the future performance of the goods themselves, but only stated the buyer's remedy if the goods suffered a failure due to defects in material or workmanship during the first year following the purchase.

The buyer in Kline also alleged a breach of the common law implied 

warranty of good and workmanlike repair that was judicially adopted in

83. Id. § 2.712(a).
84. 870 S.W.2d 673 (Tex. App.—Houston [1st Dist.] 1994, writ denied).
85. Id. at 676 (quoting from American Carpet Mills, Etc. v. Gunny Corp., 649 F.2d 
1056 (5th Cir. 1981)).
86. Id.
88. Id. § 2.725(b).
89. Safeway Stores, Inc. v. Certainteed Corp., 710 S.W.2d 544, 548 (Tex. 1986) (ques-
tion of fact presented whether express warranty that roofing material was "bondable up to 
20 years" was an explicit reference to future performance).
90. 882 S.W.2d 597 (Tex. App.—Houston [1st Dist.] 1994, writ denied).
91. Id. at 600.
Melody Home Manufacturing Co. v. Barnes. On this issue, the court properly held that the focus of the warranty is not on the result of the repairs that are done, but on the manner in which the repairs are done. The work in question was done by the dealer which had originally sold the motor to the buyer, by other dealers, and by the manufacturer itself. The attempts to repair extended over a substantial period of time and much of the work was done without charge even though the original twelve-month warranty covering parts and labor had expired. There was no expert testimony challenging the manner in which the work was done, and even the buyer testified that he had come to believe "that the problem exists with the motor itself, not with the services that are being performed on the motor." Because the evidence failed to show that the repairs were not done in a good and workmanlike manner, the court rendered judgment against the buyer on this alleged breach of the Melody Home warranty.

III. COMMERCIAL PAPER

A. Introductory Note

Prior to 1990, the Official Text of Article 3 of the Code was entitled "Commercial Paper" and covered issues associated with checks, drafts, notes, and other forms of paper used to evidence debts or to make payments. In 1990, the National Conference of Commissioners on Uniform State Laws and the American Law Institute approved a new Official Text for Article 3 and retitled the article as "Negotiable Instruments." The general coverage remained the same. At the same time, extensive revisions were also approved in the Official Text of Article 4 of the Code covering issues arising in the bank collection and payment process, but the title of Article 4, "Bank Deposits and Collections," was not changed.

The pre-1990 Official Text of Articles 3 and 4 was adopted in Texas in 1966 with very few modifications and became Chapters 3 and 4 in the Texas Business and Commerce Code. During the period covered by this Survey, the pre-1990 Official Text was in effect for the cases discussed in this article, but the reader should be alert to the distinct possibility that the 1990 Official Text will be adopted during the 1995 Texas legislative session and may affect the precedential value of cases decided under the prior version of Articles 3 and 4 of the Code. This article will occasion-

92. 741 S.W.2d 349 (Tex. 1987). In Melody the court held that contracts to repair or modify tangible goods or property carry with them an implied warranty that the repair or modification will be done in a good and workmanlike manner.
93. Kline, 882 S.W.2d at 600.
94. Id. at 601.
95. Id.
ally refer to the 1990 Official Text as it bears on the issues raised in the cases discussed.

B. FORM AND ENFORCEABILITY OF INSTRUMENTS

One of the essential elements of negotiability is that an instrument must state a “sum certain in money.” 98 Under the pre-1990 Official Text of the Code, there was a serious question whether this requirement was met if the instrument contained a variable interest rate. 99 In Cartwright v. MBank Corpus Christi 100 the court held that a variable rate note was negotiable where it called for the payment of interest at the rate of two percent above the published prime rate of Corpus Christi National Bank. 101 This result was consistent with the rule announced by the Texas Supreme Court in answering a certified question from the Fifth Circuit in Amberboy v. Societe de Banque Privee, 102 where the court reasoned that modernization of commercial law was a stated purpose of the existing Code and that it was consistent with both the purpose and language of the current Code to look to the Revised Official Text for guidance on whether variable rate notes were negotiable. 103 Finding that the Revised Text expressly provides that variable rate notes are negotiable, 104 the court ruled that such notes would be treated as negotiable under the existing Code as well so long as the stated rate was publicly available to interested persons. 105

Another interest rate issue addressed during the Survey period was determination of the proper rate to be substituted for the rate charged by a failed bank. In FDIC v. Massingill 106 the court allowed the substitution of the prime rate of an assuming bank in place of the “base rate” of the failed bank which had originally made the loan. 107

Even if it wasn’t the most significant case reported during the Survey period, Carnival Leisure Industries, Ltd. v. Aubin, 108 was easily the most entertaining one. To finance what proved to be a disastrous run of gambling luck, the defendant issued drafts totaling $25,000 to a casino in the

98. See TEX. BUS. & COM. CODE ANN. § 3.104(a)(2) (Tex. UCC) (Vernon 1994). The revised Code retains this requirement, but changes the phrasing to “a fixed amount of money” instead of a “sum certain.” Rev. U.C.C. § 3-104(a) (1990).
99. The uncertainty surrounding this requirement is discussed in Ackerman v. FDIC, 930 F.2d 3 (5th Cir. 1991), where the court certified this question to the Texas Supreme Court for determination under Texas law.
100. 865 S.W.2d 546 (Tex. App.—Corpus Christi 1993, writ denied).
101. Id. at 549.
102. 831 S.W.2d 793, 797 (Tex. 1992).
103. Id. at 796. TEX. BUS. & COM. CODE ANN. § 1.102 (Tex. UCC) (Vernon 1994) states that it is the policy of the Code to “simplify, clarify and modernize the law governing commercial transactions.” Id. at § 1.102(2)(a).
105. 831 S.W.2d at 796-97.
106. 24 F.3d 768 (5th Cir. 1994). Massingill also involved a significant statute of limitations issue. That aspect of the case is discussed in the text at note 146, infra.
107. Id. at 780-81.
Bahamas to pay for chips. The chips were treated as the equivalent of cash at the casino and could be used to pay for room charges, food, drink, or entertainment, as well as being used for gambling. After losing the entire $25,000 in less than two days of gambling, the defendant returned to Texas. The casino attempted to obtain payment of the drafts directly from the defendant before presenting them to the defendant's bank for payment. The defendant refused to pay the drafts and also notified his bank to stop payment on them. When the drafts were finally presented, the bank dishonored them and notified the casino that payment had been stopped. The casino sued for the amount of the drafts.

Following a decision by the Fifth Circuit that Texas public policy barred enforcement of gambling debts, the case was remanded to the district court, resulting in a decision that reads as much like a short story as a legal opinion. After first describing how the court believed the appellate court had failed to properly analyze the enforceability of the drafts, the district court noted, however, that it was bound by the law of the case and that the drafts could not be enforced against the defendant. The casino, however, had amended its pleading to allege fraud and equitable estoppel and this change of theory gave the district court an opening to find that the debt was enforceable on the independent ground of fraud because the defendant had made a promise to pay by issuing negotiable drafts while harboring a secret intention not to perform. Finding the Texas public policy against fraud to outweigh the public policy against gambling, the court entered judgment against the defendant.

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109. This decision is reported as Carnival Leisure Indus., Ltd. v. Aubin, 938 F.2d 624 (5th Cir. 1991).
110. 830 F. Supp. at 371. A few lines from this portion of the decision give the flavor of the court's opinion.

[The rule that gambling debts are unenforceable] persists in the face of a public policy that allows churches, charities, and the state itself to operate gambling establishments . . . . Asserting a sweeping public policy against gambling is anachronistic. If there really was a policy, it is totally defunct.

. . . . .

If two people are shooting craps, and one goes $100 into the hole, that debt is not enforceable at law. [but] negotiating a draft does not create a debt. The consideration is the medium of exchange received for the draft, whether it is dollars, Deutsche marks, sea shells, or poker chips.

. . . . .

When cash is given for a check and the cash is gambled and lost, the check is not tainted by gambling.

. . . . .

Courts that twist the facts or warp the public policy are not persuasive.

. . . . .

[The defendant] did not gamble on credit, and his drafts were not payment for money he already lost. Under the law of the case doctrine, however, the taint assigned by the court of appeals to [the defendant's] debt is indelible.

830 F. Supp. at 374-76.
111. Id.
112. Id. at 377.
113. Id. In its conclusion, the court stated, "An anachronistic public policy and misguided case law that forbid legal casinos from lawfully collecting commercial instruments and the debts arising from them will eventually force collection efforts underground. While it may save moralistic posturing, it may cost knee-caps." Id. The doubt cast in this
In the *Carnival* case,\(^{114}\) there was no doubt about whether the defendant had signed the drafts in question; the critical issue was whether he could be held liable on some other theory for the amount of the debt represented by the drafts. In *626 Joint Venture v. Spinks*\(^{115}\) it was clear that the named defendants had not signed the note in question, but it was equally clear that they were partners in a joint venture formed for the purpose of purchasing land. Although the defendants could not be held liable on the note because their signatures did not appear on the instrument, they could be held liable on the underlying obligation arising from the agreement of the joint venture partners to purchase the land.\(^{116}\)

In *FDIC v. Trans Pacific Industries, Inc.*\(^{117}\) the question was whether a person had signed two notes in the capacity of a comaker, thus making him personally liable on the instruments, or whether he had signed only in a representative capacity, thus avoiding any personal liability at all. The only name appearing in an identification block in the top left corner of each note listed the borrower as Trans Pacific Industries. The signature block in the lower right hand corner, however, contained three preprinted lines with the printed word “Borrower” appearing at the end of each line. The lines in the signature block had been filled in with the typed corporate name on the first line and with the typed name of the individual on the second line. There were no words appearing before or after the name of the individual to identify him as an agent or other representative. Applying the standard rule of construction that a contract must be interpreted as a whole, and reading the notes in the light of business expectations, the court held that it was “abundantly clear” that the individual had signed only in a representative capacity and did not incur personal liability on the notes.\(^{118}\)

In *In re Appel*\(^{119}\) the court considered a different issue of enforceability by addressing the question: When is a cashier’s check not a cashier’s decision about the validity of a continuing policy against gambling was subsequently echoed in *Ysleta Del Sur Pueblo v. State of Texas*, 852 F. Supp. 587 (W.D. Tex. 1993).


\(^{115}\) 873 S.W.2d 73 (Tex. App.-Austin 1993, no writ).

\(^{116}\) *Id.* at 76. **TEX. BUS. & COM. CODE ANN.** § 3.401 (Tex. UCC) (Vernon 1994) provides, “No person is liable on an instrument unless his signature appears thereon.” Official Comment 1 to this section states, in part, that “The party who does not sign may still be liable on the original obligation for which the instrument was given.” *Id.* § 3.401 cmt. 1. Rev. U.C.C. § 3-401(a) (1990) provides a similar rule, but the Official Comment to the revised section does not mention the possible liability of a party on the underlying obligation.

\(^{117}\) 14 F.3d 10 (5th Cir. 1994).

\(^{118}\) *Id.* at 12. In reaching this result, the court applied **TEX. BUS. & COM. CODE ANN.** § 3.403 (Tex. UCC) (Vernon 1994) to interpret the name appearing in the identification block in relation to the names appearing on the signature lines. The result may have been different if the instrument had been a check instead. See *Griffin v. Ellinger*, 538 S.W.2d 97 (Tex. 1976), where the preprinted check form identified the person represented, but the court nonetheless held the representative signer personally liable for failing to identify his representative capacity on the signature line. Rev. U.C.C. § 3-402(c) (1990) changes this result in the check cases and Official Comment 3 to that section specifically notes that it is intended to overrule *Griffin* and similar cases.

\(^{119}\) 166 B.R. 624 (Bankr. S.D. Tex. 1994).
check? At the request of a bankruptcy trustee, a bank prepared four cashier's checks to transfer funds from the bankruptcy debtor's bank accounts to the bankruptcy estate. Before the checks were delivered to the trustee, however, the bank's attorney advised the bank that its common law right of setoff was dependent on the continued possession of the funds. Acting on this sound advice, the bank refused to deliver the cashier's checks to the trustee. The trustee argued that under Texas law a bank may not dishonor or stop payment on a cashier's check. While the court agreed with this proposition, it pointed out that the rule does not apply when the cashier's check has never been issued. The court entered an order allowing the bank to exercise its common law right of setoff, thus answering the question posed above by stating, in effect: A cashier's check is not a cashier's check when it has never been issued.

C. HOLDERS IN (AND NOT IN) DUE COURSE

The rights of a holder in due course are dramatically greater than those of a holder who is not in due course. A holder in due course holds an instrument free from a wide variety of common defenses while a holder who is not in due course remains subject to these defenses. Four cases decided during the Survey period nicely illustrate the difference.

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120. Id. As to the rule preventing a bank from stopping payment on cashier's checks, see Wertz v. Richardson Heights Bank & Trust Co., 495 S.W.2d 572 (Tex. 1973). A bank may stop payment, however, when it draws a check against an account maintained at another financial situation instead of on itself. See the combined cases of Guaranty Fed. Sav. & Loan Ass'n v. Horseshoe Operating Co. and University Sav. Ass'n v. Internat'l Consol. Co., 793 S.W.2d 652 (Tex. 1990) (bank allowed to stop payment on teller's checks).

121. 166 B.R. at 625. TEX. BUS. & COM. CODE ANN. § 3.102(a)(1) (Tex. UCC) (Vernon 1994) defines "issue" as "the first delivery of an instrument to a holder or remitter." The 1990 revision broadens the definition providing for delivery to "a holder or nonholder" instead of using the term "remitter," but the effect of the rule remains the same. See UCC Official Text § 3-105(a) (1990).

122. 166 B.R. at 626. Rev. U.C.C. § 3-105(a) (1990) (UCC) seems to treat this question somewhat differently by stating that "An unissued instrument . . . is binding on the maker or drawer, but nonissuance is a defense." Under the revised Code, a cashier's check may be a cashier's check as soon as it is written, even though it may have been written in error and destroyed immediately thereafter. While the nonissuance can be raised as a defense, this is not the same as determining whether payment can be stopped on the instrument.

123. Compare TEX. BUS. & COM. CODE ANN. § 3.305 (Tex. UCC) (Vernon 1968) on the rights of a holder in due course with TEX. BUS. & COM. CODE ANN. § 3.306 (Tex. UCC) (Vernon 1994) on the rights of a holder who is not in due course. The revised Code continues this dichotomy. See Rev. U.C.C. Official Text § 3-305(a) & (b) (1990) which restates the respective rights in a single section, but does not change the substance. Examples of defenses which may be asserted against a holder who is not in due course, but which are cut off by a holder in due course, include failure of consideration, breach of contract, fraud in the inducement, and non-performance of conditions precedent. Certain defenses of public concern or of an egregious nature remain good even against a holder in due course. Examples of these defenses include infancy of the obligor, duress, lack of legal capacity, or illegality of the transaction.

In *Burns v. RTC* the Resolution Trust Corporation acquired several notes from a failed bank. The defendant maker asserted breach of contract defenses arising from his failure to receive notice of sale when the bank foreclosed on the notes and conducted a sale of the collateral securing the notes. The court held that, in the RTC's capacity as a holder in due course of the notes, these defenses were unavailing. The court further held, however, that the RTC itself had the burden of proving the amount of the debt, the sale price of the collateral, and the resulting deficiency. Having the status of a holder in due course does not relieve a holder from complying with his or her own obligations in regard to an instrument; it merely allows freedom from claims and defenses arising before the holder's acquisition of the instrument. Failure to establish the amount of the deficiency prevented the RTC from recovering on the notes.

In *Cadle Co. v. Bankston & Lobingier* the holder not only failed to show that it was a holder in due course, but also breached a separate agreement with the maker entered into after the holder had acquired the note. Under these circumstances, the holder remained subject to the maker's defenses of setoff and tender of payment to a prior holder, thus preventing recovery on the note. In addition, because of the failure to fulfill its own agreement with the maker to withdraw an adverse credit report the holder had filed with a credit reporting agency, the court held the maker was entitled to recover damages for injury to his credit and credit reputation.

In *Trueheart v. Braselton* the holder also failed to qualify as a holder in due course and was subject to a defense of setoff and a defense of failure of an oral condition precedent arising out of the maker's dealings with a prior holder. In *Hou-Tex Printers, Inc. v. Marbach* the plaintiff purchasers of a note failed to establish that they rose to the status of a holder, much less to the status of a holder in due course, because of their

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125. 880 S.W.2d 149 (Tex. App.—Houston [14th Dist.] 1994, n.w.h.).
126. Id. at 154. The RTC had qualified as a holder in due course under the federal holder in due course doctrine which permits the FDIC and the RTC to acquire holder in due course status without meeting the technical requirements of state law. See FDIC v. Payne, 973 F.2d 403, 407 (5th Cir. 1992). The rights of a holder in due course under this doctrine parallel those existing under the Code except for the manner of acquisition.
127. Id.
129. 880 S.W.2d 149 at 156.
130. 868 S.W.2d 918 (Tex. App.—Fort Worth 1994, writ denied).
131. Id. at 922.
132. Id. at 924.
133. 875 S.W.2d 412 (Tex. App.—Corpus Christi 1994, n.w.h.).
134. Id. at 415.
135. 862 S.W.2d 188 (Tex. App.—Houston [14th Dist.] 1993, no writ).
failure to establish proof of ownership.\textsuperscript{136} Summary judgment in favor of the plaintiffs was reversed.\textsuperscript{137}

D. Statutes of Limitation

In \textit{Lyco Acquisition 1984 v. First National Bank of Amarillo}\textsuperscript{138} an oil royalty interest owner sued a well operator for failure to make royalty payments. During the course of this litigation, the interest owner learned that the well operator had in fact issued twenty-five checks naming the interest owner as payee, but the payee's name had been forged on all of the checks before they were delivered to the payee and the funds had been paid by the drawee bank to persons who converted the money to their own use. The checks had been paid on March 10, 1986, but the payee did not learn of the conversion until April 30, 1991. A few days later, the payee sued the drawee bank for conversion.

The bank asserted two defenses. First, that the conversion claim was barred by a two-year limitations period and, second, that the payee could not maintain a cause of action for conversion because the checks had never been delivered to the payee. The court held that, absent fraudulent concealment by the bank, a conversion claim based on a forged indorsement accrues when the instrument is paid.\textsuperscript{139} Because the payee failed to commence an action against the bank by March 10, 1988, and because there was no evidence of fraudulent concealment, the court held the conversion claim was barred.\textsuperscript{140} This holding made it unnecessary for the court to reach the second defense raised by the bank that the checks had never been delivered to the payee.\textsuperscript{141}

A different limitations issue arose in \textit{Cadle Co. v. Matheson},\textsuperscript{142} where the court withdrew its previous decision holding that a transferee from

\textsuperscript{136} \textit{Id.} at 191-92. Proof of ownership may be established by offering either the original of the note showing a proper sequence of indorsements or by offering a sworn copy of a note together with an affidavit of ownership. \textit{Zarges v. Bevan}, 652 S.W.2d 368, 369 (Tex. 1983). The plaintiffs in \textit{Hou-Tex} did neither.

\textsuperscript{137} 862 S.W.2d at 191.

\textsuperscript{138} 860 S.W.2d 117 (Tex. App.—Amarillo 1993, writ denied).

\textsuperscript{139} \textit{Id.} at 119.

\textsuperscript{140} \textit{Id.} The court applied the 2-year limitations period found in \textit{Tex. Civ. Prac. & Rem. Code Ann.} § 16.003 (Vernon 1986).

\textsuperscript{141} 860 S.W.2d at 119. The current version of Article 3 in Texas does not state a limitations period for conversion actions and \textit{Tex. Bus. & Com. Code Ann.} § 3.419 (Tex. UCC) (Vernon 1994) is silent on the question of whether non-delivery is a defense to a payee's action for conversion. The revised Article 3 states a three-year limitations period in \textit{Rev. U.C.C.} § 3-118(a) (1990) and, noting a split of authority on the non-delivery issue, specifically provides that "An action for conversion of an instrument may not be brought by . . . a payee or indorsee who did not receive delivery of the instrument either directly or through delivery to an agent or a co-payee." \textit{Rev. U.C.C.} § 3-420(c) & cmt. 1 (1990). There appear to be no Texas cases in point on the non-delivery issue under the Code but, with this lack of caselaw and the failure of the existing Code to address the issue, the revised Code may well be a persuasive interpretive source if this issue is litigated in another case prior to adoption of the revision. See the reasoning of the Texas Supreme Court in \textit{Amberboy v. Societe de Banque Privee}, 831 S.W.2d 793, 797 (Tex. 1992), discussed in the text at note 102, supra.

\textsuperscript{142} 870 S.W.2d 548 (Tex. App.—Houston [1st Dist.] 1994, writ denied).
the federal agency appointed as receiver of a failed bank was limited to the four-year state limitations period. On rehearing, the court applied the holding of the Texas Supreme Court in Jackson v. Thweatt, that the transferee from a federal banking receiver obtains the benefit of the six-year federal limitations period.

In FDIC v. Massingill there was no doubt that the federal limitations period applied because the action was brought by the FDIC. The critical question, however, was whether an invalid attempt to accelerate a note triggered the beginning of the six-year period. If it did, the FDIC action was time-barred; if it did not, the action was still timely. On two separate grounds, the court concluded that the action was not barred.

First, contrary to Texas law, the creditor failed to give notice of an intent to accelerate and only gave a notice of acceleration instead. Although the note signed by the debtor contained a provision waiving "notice," the court held the waiver was not effective because it did not specify the notices being waived as required under Texas law. Since the attempt to accelerate was ineffective, no cause of action accrued to the creditor that would commence the running of the statute of limitations. The inquiry did not end here, however, because there was a serious conflict of law issue as to whether Texas law or New Mexico law applied to the case. Under the law of New Mexico, the attempt to accelerate appeared to be proper and a cause of action may have accrued. Because of this possibility the court discussed another basis for holding the action was not time-barred.

This second basis turned on the creditor's failure to pursue any legal rights it may have had even if the acceleration had been proper under the laws of both Texas and New Mexico. After the attempted acceleration, one of the two notes in question was renewed and no action was pursued to enforce any claim based on the purported acceleration of the other note. The court characterized this as "the lack of affirmative action necessary for a valid acceleration pursuant to Texas law" and as an "aban-

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143. The four-year limitations period is stated in TEX. CIV. PRAC. & REM. CODE ANN. § 16.004 (Vernon 1986).
146. 24 F.3d 768 (5th Cir. 1994).
147. Unless waived, Texas law requires a notice of intent to accelerate followed by a notice of the acceleration itself. Ogden v. Gibraltar Sav. Ass'n, 640 S.W.2d 232, 234 (Tex. 1982). Rights to receive these notices can be waived by a debtor if the waiver clearly and separately states the rights being waived. Shumway v. Horizon Credit Corp., 801 S.W.2d 890, 893 (Tex. 1991).
148. 24 F.3d at 776-77. The waiver standards are those stated in Shumway v. Horizon Credit Corp. cited in the preceding footnote.
149. Id. at 777-78.
150. Id. at 776.
donment or waiver” under the law likely to be applied in New Mexico.\footnote{152}

E. Contracts of Guaranty

Contracts of guaranty may arise as part of the obligation of a party who has signed an instrument as a guarantor under the Code or as separate contracts between a guarantor and a creditor outside the Code. Guaranty contracts created by the form of an indorsement under Article 3 of the Code fall into two categories: guaranties of collection and guaranties of payment.\footnote{153} The contracts are created simply by adding the words “Collection guaranteed” or “Payment guaranteed” to an indorsement.\footnote{154} The terms of such “short-form” guaranties are, in effect, provided by statute instead of being stated in a more elaborate agreement between the parties. Guaranty contracts created outside the Code not only contain words of guaranty, but also frequently contain provisions waiving presentment and notices of default and acceleration, terms specifying the amount or the scope of the guarantor’s obligation, and limitations on the discharge of a guarantor arising from the release of other parties or from the impairment of collateral.

Terms contained in separate guaranty agreements figured in four cases decided during the Survey period.\footnote{155} In Sonne v. FDIC\footnote{156} and in Marshall v. Ford Motor Co.\footnote{157} the issue concerned the scope of the guaranty. In Sonne the court held that the guaranty was a continuing guaranty.

\begin{footnotes}
\footnote{151} Id. at 778.
\footnote{152} The court found no New Mexico cases directly addressing the abandonment or waiver issue and interpolated this as the likely result in New Mexico based on the “dominant trend” among the states to allow abandonment or waiver of claims based on an acceleration. 24 F.3d at 778.
\footnote{153} See TEX. BUS. \& COM. CODE ANN. §§ 3.415 \& 3.416 (Tex. UCC) (Vernon 1994). The revised Code combines these provisions into a single section and makes a significant substantive change by eliminating the category of guaranties of payment. Rev. U.C.C. § 3-419 (1990). A Commentary by the Uniform Commercial Code Permanent Editorial Board notes the change, but offers no explanation for it: PEB Commentary No. 11, 6-7 (1994). The same section in the revised Code also omits the prior rule in TEX. BUS. \& COM. CODE ANN. § 3.416(e) (Tex. UCC) (Vernon 1994) that words of guaranty waive presentment, notice of dishonor, and protest. It is uncertain whether these changes would overturn the result in such cases as Ferguson v. McCarrell, 588 S.W.2d 895 (Tex. 1979) (liability of guarantor of payment indistinguishable from that of a maker) and Universal Metals \& Machinery, Inc. v. Bohart, 539 S.W.2d 874 (Tex. 1976) (guarantors of payment are primary obligors and waive the requirement that the holder first proceed against the maker as a condition precedent to liability) or merely cause the rules surrounding guaranties of payment to become a matter of common law outside the Code, since such guaranties are not prohibited by Rev. U.C.C. § 3-420 (1990); they are simply not provided for.
\footnote{154} See TEX. BUS. \& COM. CODE ANN. § 3.416(a) \& (b) (Tex. UCC) (Vernon 1994). If only the word “Guaranteed” is used, or if the words do not otherwise specify, the guaranty is a guaranty of payment. TEX. BUS. \& COM. CODE ANN. § 3.416(c) (Tex. UCC) (Vernon 1994).
\footnote{156} 881 S.W.2d 789 (Tex. App.—Houston [14th Dist.] 1994, wrrt requested).
\footnote{157} 878 S.W.2d 629 (Tex. App.—Dallas 1994, n.w.h.).
\end{footnotes}
that made the guarantors liable for additional amounts loaned to the principal obligor after the original guaranty contracts were signed.\textsuperscript{158} The court rejected an argument that a handwritten change in the amount of the note evidencing the guaranteed debt was a material alteration that discharged the guarantors, because the guarantors had consented to payment of any increased obligations incurred by the principal debtor regardless of how the creditor and the debtor may have agreed on such amounts.\textsuperscript{159} In \textit{Marshall v. Ford Motor Co.}\textsuperscript{160} the guarantors were more fortunate. The guaranty in question guaranteed payment for goods sold by Ford Marketing Corporation to the principal debtor. After the guaranty was signed, Ford Marketing Corporation was merged into Ford Motor Company and subsequent sales of goods took place through Ford Motor Company. The court held that the guarantors were not liable for such sales because the guaranty did not specify it covered sales by any entity other than Ford Marketing Corporation and the guarantors were entitled to insist that the terms of their guaranty be strictly followed.\textsuperscript{161}

In \textit{Peoples State Bank of Clyde v. Andrews}\textsuperscript{162} and in \textit{Wiman v. Tomaszewicz}\textsuperscript{163} the issue concerned the ability of a guarantor to assert claims or defenses of the principal obligor against the obligee. In \textit{Peoples State Bank} the guarantor argued that a demand letter sent to him by the obligee made him an obligor and permitted him to recover usury penalties against the obligee. The court held that the right to recover penalties for usury is personal to the principal debtor and, since the guarantor was not an immediate party to the loan transaction, he was not entitled to a penalty award.\textsuperscript{164} In \textit{Wiman} the guarantor contended that the statute of limitations began to run against him when the creditor made a demand for payment on the principal debtor. The court held that the guaranty was a guaranty of payment allowing the creditor to proceed directly against the guarantor without first resorting to the principal debtor.\textsuperscript{165} However, the guaranty conditioned any claim against the guarantor upon a written demand for payment from the creditor directed to the guarantor. The court reasoned that, under such a guaranty, the limitations period begins to run against the guarantor only when demand is made to the guarantor for payment of the debt.\textsuperscript{166} Since a demand was not directed to the guarantor until some three weeks after demand for payment was made on the principal debtor, an action against the guarantor that was brought one

\begin{itemize}
\item \textsuperscript{158} 881 S.W.2d at 793.
\item \textsuperscript{159} \textit{Id.} at 792.
\item \textsuperscript{160} 878 S.W.2d 629 (Tex. App.--Dallas 1994, n.w.h.).
\item \textsuperscript{161} \textit{Id.} at 631. In reaching this result, the court cited FDIC v. Attayi, 745 S.W.2d 939, 944 (Tex. App.--Houston [1st Dist.] 1988, no writ), for the proposition that contracts of guaranty are to be strictly construed.
\item \textsuperscript{162} 881 S.W.2d 520 (Tex. App.--Eastland 1994, n.w.h.).
\item \textsuperscript{163} 877 S.W.2d 1 (Tex. App.--Dallas 1994, n.w.h.).
\item \textsuperscript{164} 881 S.W.2d at 522. The court noted that the Texas Supreme Court had previously held that usury is a personal defense of the debtor in \textit{Houston Sash and Door Co. v. Heaner}, 577 S.W.2d 217, 222 (Tex. 1979).
\item \textsuperscript{165} 877 S.W.2d at 6.
\item \textsuperscript{166} \textit{Id.}
\end{itemize}
day short of the four-year limitations period was not time-barred, even though an action against the principal debtor would have been barred by that same date.\textsuperscript{167}

IV. BANK DEPOSITS AND COLLECTIONS

A. RELATIONSHIP BETWEEN A PAYOR BANK AND ITS CUSTOMER

Perhaps the most important case decided during the Survey period was \textit{First Bank v. Tony's Tortilla Factory, Inc.}\textsuperscript{168} In that case the Texas Supreme Court held, as a matter of law, that service fees charged by a bank for the payment of overdrafts are not interest and, therefore, cannot be the grounds for a usury claim.\textsuperscript{169} Between April and December of 1984, Tony's Tortilla Factory wrote 2,165 checks creating overdrafts in its checking accounts. The bank charged a total of $47,600.00 in service fees for paying these overdrafts and the customers sued the bank on a variety of claims, including a claim for alleged usury resulting from the charges assessed for paying the overdrafts. The court of appeals held there was sufficient evidence on the usury claim to go to the jury on the question of whether the overcharge fees constituted interest on the amounts paid out by the bank on the overdrafts.\textsuperscript{170} On appeal by the bank, the supreme court reversed and rendered judgment against the plaintiffs on their claim of usury, noting the overdraft charges were processing fees assessed for handling the insufficient fund checks.\textsuperscript{171} Because the bank had the authority to pay the checks even if they created overdrafts under section 4.401 of the Code, the consideration for such payment was the implied promise by the customer to repay the amount of such overdrafts.\textsuperscript{172} Because this was a separate consideration from the consideration paid for processing the insufficient fund checks, the court ruled the fees could not be usurious.\textsuperscript{173}

Section 4.406 of the Code allows a customer one year to report a forgery drawn against the customer's account.\textsuperscript{174} This time limit may be va-
ried by agreement under section 4.103 of the Code so long as the agreement does not disclaim the bank's responsibility to act in good faith or its failure to exercise ordinary care. In *Tumlinson v. First Victoria National Bank* some forty-five checks ranging from five hundred to one thousand dollars were forged against the customers' account during the course of a one-year period. When the forgeries came to light, the bank asserted a sixty-day limitation period contained in the deposit agreement. The court held that claims for any forged checks paid by the bank more than sixty days before the customers received their bank statement and notified the bank of such forgeries were barred by the agreement between the customers and the bank. Claims for forgeries occurring within the sixty-day time period might be valid under section 4.406 of the Code if the customers could show that the bank failed to exercise ordinary care in paying the forged items.

**B. Joint Accounts**

Joint bank accounts have been a continuing source of litigation in Texas. To remedy some of the confusion surrounding such accounts, and to protect financial institutions from allegations that an account was not properly established by a signature card or other deposit agreement, the legislature added a statutory account form to the Texas Probate Code in 1993. Accounts that came into existence prior to the adoption of the statutory form and which have not been updated by having the customers complete a new form will continue to generate interpretive difficulties as

176. 865 S.W.2d 176 (Tex. App.—Corpus Christi 1993, no writ).
177. Uncontroverted testimony by a bank officer showed that bank statements of account were mailed to all customers on a monthly basis. *Id.* at 178.
178. *Id.* at 178.
179. *Id.*. *Tex. Bus. & Com. Code Ann.* § 4.406(c) (Tex. UCC) (Vernon 1994) does not preclude a customer from asserting a claim for improper payment of a forged item by the same wrongdoer if the customer is able to show that the bank failed to exercise ordinary care in paying the item. Curiously enough, the court never mentions whether the 45 forgeries were by the same person. Under the present Code, the bank may have been able to assert a 14-day limit if the forgeries had been by the same wrongdoer, but this time limit did not figure in the case. The revised Code changes the 14-day time limit to 30 days on forgeries by the same wrongdoer. Rev. U.C.C. § 4-406(d)(2) (1990). This is a strange case that seems to leave several loose ends.
180. See, e.g., *Stauffer v. Henderson*, 801 S.W.2d 858 (Tex. 1990) (language in signature card held insufficient to create right of survivorship); *Cecil v. Smith*, 821 S.W.2d 375 (Tex. App.—Tyler 1991, no writ) (dispute regarding ownership of funds evidenced by a certificate of deposit); *Dickerson v. Brooks*, 727 S.W.2d 652 (Tex. App.—Houston [1st Dist.] 1987, writ ref'd n.r.e.) (statement on signature card that account was held by parties as joint tenants with right of survivorship held insufficient); *Chopin v. InterFirst Bank Dallas*, 694 S.W.2d 79 (Tex. App.—Dallas 1985, writ ref'd n.r.e.) (to vest ownership in surviving party a joint account must state that the account is held by the parties as joint tenants with right of survivorship); *Leinert v. Sabine Nat'l Bank*, 541 S.W.2d 872 (Tex. Civ. App.—Beaumont 1976, writ ref'd n.r.e.) (right of parties to control funds in joint account held in the names of "A or B" as contrasted to the control of funds held in the names of "A and B").
evidenced by *McNeme v. Estate of Hart*\(^{182}\) and *Banks v. Browning*.\(^{183}\) Accounts at two different banks were involved in *McNeme*. The court initially held that the account at one bank had used appropriate language on the signature card to create a joint tenancy with right of survivorship, but the account at the other bank failed to create a survivorship right because there was only a signature card bearing the depositors’ initials and no signed agreement creating such a right.\(^ {184}\) On rehearing, however, the court reversed its decision in regard to the initialed signature card because the signature card incorporated by reference a deposit agreement that did contain language creating a right of survivorship.\(^ {185}\) The court held that the signature card and the deposit agreement, taken together, were sufficient to satisfy the requirement of a written agreement creating a right of survivorship in a joint account.\(^ {186}\) In *Banks* the court held that the decedent’s signature on an account form containing a typewritten “X” in a box located beside a paragraph designating the account as a joint account with a right of survivorship was sufficient to create a right of survivorship.\(^ {187}\) The court rejected an argument that proof was required to show that the typewritten “X” was placed on the card with the knowledge and consent of the decedent.\(^ {188}\)

In *Regency Financial Corp. v. Kidder, Peabody & Co.*\(^ {189}\) the dispute centered on whether funds were improperly disbursed from a bank account by means of a check signed by only one of the two account holders. Although this issue involved the disbursement of funds from a bank account rather than the right of joint payees to enforce an instrument, the court was persuaded that the designation of payees as “A and B” or “A or B” was equally applicable to an account.\(^ {190}\) Because the defendant joint owner failed to show whether the account was an “and” account or an “or” account, summary judgment in favor of the defendant was reversed and the case was remanded for determination of this fact issue.\(^ {191}\)

### C. Setoff

The right of setoff gives a bank some special protection to recover funds owed by a debtor but, at the same time, it can involve some special risks. This duality means that a bank must be constantly on the alert to factors that may invalidate a setoff or that may expose it to greater liability than the setoff is worth. One of the basic requirements of a proper setoff is that the funds used for the setoff actually belong to the debtor. In

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\(^{182}\) 860 S.W.2d 536 (Tex. App.—El Paso 1993, no writ).

\(^{183}\) 873 S.W.2d 763 (Tex. App.—Fort Worth 1994, writ denied).

\(^{184}\) 860 S.W.2d 536 at 539.

\(^{185}\) *Id.* at 540.

\(^{186}\) *Id.* at 541.

\(^{187}\) 873 S.W.2d 763 at 765.

\(^{188}\) *Id.*

\(^{189}\) 879 S.W.2d 178 (Tex. App.—Houston [14th Dist.] 1994, writ ref’d).

\(^{190}\) *Id.* at 183-84.

\(^{191}\) *Id.* at 184.
Soto v. First Gibraltar Bank\textsuperscript{192} the bank guessed correctly that an account denominated as a trust account was actually a revocable gift that remained under the control of the settlors, and were general funds available to the settlors at their discretion and subject to a right of setoff for debts owing from the settlors to the bank.\textsuperscript{193} In contrast to Soto, the bank guessed wrongly in Mauriceville Nat. Bank v. Zernial,\textsuperscript{194} where the court determined that the evidence clearly showed that a bank had sufficient information to know that the funds in an account were held by a general contractor in the nature of a trust to pay subcontractors and materialmen, and that a setoff against these funds was wrongful.\textsuperscript{195} The bank was not only held liable for the amount of twelve thousand dollars in actual damages resulting from the setoff, but also for punitive damages of two hundred thousand dollars.\textsuperscript{196} In reaching its decision about punitive damages, the court noted that the bank had chosen to "Razoo" the account, meaning to " 'grab all you can, as quick as you can.' "\textsuperscript{197}

A proper setoff also requires that the debt owing from the debtor must be in default. The events of default may be defined in the loan documents, but a default there must be. In Boyd v. American Bank of Commerce at Wolfforth,\textsuperscript{198} a bank setoff the amount of a loan against its customer's checking account, causing several checks written by the customer to be dishonored. In an action against the bank for wrongful dishonor and for wrongful setoff, the bank defended on the ground that the notes signed by the customer waived any claims against the bank arising from a setoff. The court held that, while the waiver might be effective

\footnotesize{\textsuperscript{192} 868 S.W.2d 400 (Tex. App.—San Antonio 1993, writ denied).  
\textsuperscript{193} Id. at 404.  
\textsuperscript{194} 880 S.W.2d 282 (Tex. App.—Beaumont 1994, writ requested).  
\textsuperscript{195} Id. at 287-88.  
\textsuperscript{196} Id. at 292.  
\textsuperscript{197} Id. at 291, n. 1. In the footnote, the court described the word, "Razoo" in the following terms:  
"Razoo" is a "real" word meaning: with influence of razzle-dazzle ... WEBSTER'S NEW INTERNATIONAL DICTIONARY 2069 (2nd ed. 1936). "Razoo" was also used colloquially, meaning, "grab all you can, as quick as you can." The word was commonly used by marble playing youngsters in the 1940's and 50's. During this era, playing the game of marbles "for keeps" was morally unacceptable, for such constituted a form of gambling or gaming. To be caught playing marbles "for keeps" on school campus, subjected the catchee or catchees to corporal punishment. Nevertheless, certain youngsters, from time to time, would run the risk of punishment by indulging in this morally improper activity. In so doing, a virtually fail-safe warning system was devised. One or more youngsters were designated "lookouts," whose sole function was to sound the alert should a teacher or principal approach the area. Rather than yelling, "the teacher/principal is coming," the "lookout" would simply yell, "Razoo" thus, was born the "Razoo Rule." The word "Razoo," immediately triggered an unwritten legal concept known as "absolute and unquestioned ownership" of all the marbles which could be grabbed by any of the players. The fairness of the "Razoo Rule" was derived from the fact that all players "agreed" to the rule.  
Whether the "Razoo Rule" was recognized nationally, the writer knoweth not, however, the rule was of common understanding at Pine Grove Elementary School, Newton County, Texas.  
\textsuperscript{198} 872 S.W.2d 29 (Tex. App.—Amarillo 1994, writ dism’d by agr.).}
against claims arising from a proper setoff, nothing in the notes purported to waive the need for a default before a setoff was exercised.\textsuperscript{199} As stated by the court, "[W]ithout an authorized offset, [the plaintiff's] waiver of the bank's liability for the offset is of no moment at this stage of the proceedings."\textsuperscript{200} Summary judgment in favor of the bank was reversed.\textsuperscript{201}

Even if a setoff is exercised after a debt has matured against funds in an account that are not denominated as trust funds or the like, the creditor may be required to return the funds upon learning that the funds were actually being held for the benefit of another person. This rule is generally termed the "equitable setoff" or "federal setoff" rule and was adopted in Texas in the case of \textit{National Indemnity Co. v. Spring Branch State Bank}.\textsuperscript{202} The rule was most recently applied in \textit{FDIC v. Golden Imports, Inc.}\textsuperscript{203} where a bank holding a perfected security interest in inventory, proceeds of inventory, and deposit accounts "setoff" a defaulted loan against the funds in the debtor's business account. After exercising the setoff, the bank learned that some of the funds in the account had been received from a customer to pay for an automobile purchased by the customer in a "brokerage transaction" and were to be remitted to the seller of the automobile.\textsuperscript{204} The bank refused to return any of the funds and the debtor sued for conversion. Applying the equitable setoff rule, the court held that, even though the setoff may have been innocent at the time it was exercised, the bank had a duty to return the affected funds when it learned they were being held for the benefit of another person.\textsuperscript{205} An award of punitive damages was reversed, however, because the FDIC had intervened in the action following the failure of the lending bank and punitive damages are not recoverable against the FDIC.\textsuperscript{206}

Although presently only a lower court opinion with minimal precedential weight, the decision in \textit{FDIC v. Perry Bros.}\textsuperscript{207} makes fascinating reading and may influence future decisions about the procedure to be followed by a bank in exercising a right of setoff. After reviewing and discussing a complex set of facts and multiple legal claims arising out of a long-term lending arrangement between the debtor, a failed bank, the FDIC, and an assuming bank, the court concluded that the assuming bank had improperly setoff against the debtor's account and, more importantly, had this to say about the setoff procedure generally:

\begin{itemize}
  \item \textsuperscript{199} \textit{Id.} at 32.
  \item \textsuperscript{200} \textit{Id.}
  \item \textsuperscript{201} \textit{Id.}
  \item \textsuperscript{202} 348 S.W.2d 528, 531 (Tex. 1961).
  \item \textsuperscript{203} 859 S.W.2d 635 (Tex. App.-Houston [1st Dist.] 1993, no writ).
  \item \textsuperscript{204} Under the terms of the security agreement with the bank, brokered cars were not treated as part of the debtor's inventory. The debtor's only function in regard to these cars was to receive orders from prospective purchasers, to locate a car that met the purchaser's requirements, and to make arrangements for delivery and payment between the purchaser and the seller. \textit{Id.} at 643.
  \item \textsuperscript{205} \textit{Id.} at 641.
  \item \textsuperscript{206} \textit{Id.} at 648.
  \item \textsuperscript{207} 854 F. Supp. 1248 (E.D. Tex. 1993).
\end{itemize}
The Court's review of authorities reveals that beyond the debt maturity requirement, several procedural steps are necessary to the proper exercise of the bank's self-help setoff right: (a) the decision by the bank to exercise the right; (b) some action that accomplishes the setoff; (c) some record which evidences that the right of setoff has been exercised; and (d) in light of the essentially governmental (judicial) nature of a bank's setoff action, it is clear that at least contemporaneous notice of such a setoff to the depositor is necessary in order for the bank to avoid violating the depositor's rights under due process and/or the federal common law.\footnote{208}

The court went on to explain that the notice need not be extensive or formal, but that a bank must make at least a good faith attempt to contemporaneously advise the debtor that a setoff was being exercised.\footnote{209} Placing a right to notice on a constitutional or federal common law due process ground adds yet another element to the difficulties a bank faces in exercising what began as a "simple" process to obtain payment of a debt.

V. SECURED TRANSACTIONS

A. perfection of security interests

Article 9 of the Code draws a sharp distinction between the rights accorded to an unperfected security interest and a perfected security interest.\footnote{210} Section 9.302 describes the proper method for initially perfecting a security interest in various types of collateral.\footnote{211} Although a security interest may have been properly perfected in the first instance, it may lose that status by a change in the nature of the collateral,\footnote{212} or by interstate movement of the collateral,\footnote{213} or even by the mere passage of time.\footnote{214}

A novel question regarding the continuation of perfection arose in Giese v. NCNB Tex. Forney Banking Center.\footnote{215} In what the court denominated a "case of first impression,"\footnote{216} an individual purchased a double-wide mobile home and obtained a "clean" certificate of title to the

\footnote{208} Id. at 1269.
\footnote{209} Id. at 1272.
\footnote{210} TEX. Bus. & COM. CODE ANN. § 9.301 (Tex. UCC) (Vernon 1991) provides that an unperfected security interest is subordinate to a number of other claimants listed in § 9.301(a)(1)-(4). In contrast, a perfected security interest has priority over those same claimants.
\footnote{212} For example, the original collateral may be sold and the proceeds used to purchase a type of collateral not described in the original financing statement used to perfect the security interest. See TEX. Bus. & COM. CODE ANN. § 9.306(a)(1) (Tex. UCC) (Vernon 1991).
\footnote{213} TEX. Bus. & COM. CODE ANN. § 9.103 (Tex. UCC) (Vernon 1991) states a variety of circumstances in which a security interest properly perfected in one state loses perfected status after the collateral is moved to another state.
\footnote{214} The simplest example of such loss of perfected status is the rule stated in TEX. Bus. & COM. CODE ANN. § 9.403(b) (Tex. UCC) (Vernon 1991) that a filed financing statement ceases to be effective after 5 years unless a continuation statement is filed.
\footnote{215} 881 S.W.2d 776 (Tex. App.—Dallas 1994, n.w.h.).
\footnote{216} Id. at 778.
home. She permanently affixed it to a lot she already owned and added various improvements such as a porch, a deck, and plumbing and electrical systems. Three years later she sold the home and lot to a husband and wife and financed the sale herself. To secure the loan she filed a deed of trust and a financing statement in the county real estate records. She also delivered the “clean” certificate of title to the purchasers. The purchasers subsequently borrowed money from a bank and used the mobile home as collateral. The bank’s security interest was noted on the certificate of title. Following a default by the purchasers on both loans, the bank foreclosed on the mobile home and the financing seller claimed a superior interest.

The court ruled that the seller’s attempt to perfect a lien in the mobile home by filing in the real estate records was ineffective so long as a certificate of title on the home was outstanding. According to the court, the proper method to perfect a security interest in a mobile home when a certificate of title exists that covers the home is by notation on the certificate, whether or not the mobile home is affixed to realty. Recording in the real property records is the proper method of perfection only if the certificate of title is surrendered and canceled by the issuing authority. The court held that the Bank had the only perfected interest and was entitled to priority in the mobile home.

The issue in *White v. FDIC* centered on whether the relative priority rights of claimants to an interpleader fund are frozen in the position they had when the interpleader was commenced or whether subsequent events could change the respective rights of the various claimants. This question can arise in different contexts, but the basic issue remains the same. For example, the claim of one party may be based on a security interest that is perfected when the interpleader is filed, but the security interest becomes unperfected while the interpleader is still pending. Alternatively, one claimant may take steps after an interpleader is filed that gives that claimant greater rights than the claimant had when the interpleader was filed. In *White* the court noted that the Second Circuit had previously decided a case arising on the former set of facts, but the case before it concerned

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218. Id. at 781.

219. Id.

220. Id. The court noted: “When perfection is attempted in the manner described in this case, there is an original certificate of title outstanding that does not reflect any liens against the property. . . Had the title been canceled, the Bank would have been put on notice that it needed to investigate further.” Id. at 781.

221. 881 S.W.2d at 781.

222. 19 F.3d 249 (5th Cir. 1994).
the latter situation.\textsuperscript{223} Despite the factual difference between the two cases, the court held that the rationale used by the Second Circuit was "clearly applicable."\textsuperscript{224} The court reasoned that once an interpleader is filed, the property passes into the custody of the court and "absent extraordinary circumstances," the court should determine the rights of the parties as they existed when the interpleader was filed.\textsuperscript{225} The Bankruptcy Reform Act of 1994 eliminated one difficulty facing holders of purchase money security interests by changing the time period allowed under the Bankruptcy Code for the perfection of purchase money interests from ten days to twenty days.\textsuperscript{226} This change avoids an inconsistency between federal law, which allowed a ten-day time period to perfect such interests, and state law, which allowed a twenty-day time period.\textsuperscript{227} This change overrules the decision in \textit{In re Hamilton},\textsuperscript{228} which held that a bankruptcy trustee could avoid a purchase money security interest as a preferential transfer when that interest was perfected more than ten days after it attached because the ten-day period stated in the Bankruptcy Code preempted the twenty-day period allowed by state law.\textsuperscript{229} Other courts disagreed with the preemption doctrine as applied in \textit{Hamilton}, but this disagreement has been obviated by the amendment of the Bankruptcy Code.\textsuperscript{230}

\textsuperscript{223} Id. at 251-52 The prior decision was Avant Petroleum, Inc. v. Banque Paribas, 853 F.2d 140 (2d Cir. 1988).

\textsuperscript{224} 19 F.3d at 252.

\textsuperscript{225} Id. at 253. A similar issue arises when a debtor files a petition in bankruptcy and a security interest that was perfected at the commencement of the bankruptcy becomes unperfected during the course of the insolvency proceedings. Tex. Bus. & Com. Code Ann. § 9.403(b) (Tex. UCC) (Vernon 1991) addresses this situation if the security interest was originally perfected by a filing that lapses during the bankruptcy, but it does not cover cases where the security interest is perfected by some other method, such as the four-month period of perfection provided in Tex. Bus. & Com. Code Ann. § 9.103(a)(4)(i) (Tex. UCC) (Vernon 1991). A secured party is well-advised to make any necessary filing to continue perfection for security interests not protected by Tex. Bus. & Com. Code Ann. § 9.403(b) (Tex. UCC) (Vernon 1991). The Bankruptcy Reform Act of 1994 recognized the need to provide secured parties with this ability by allowing continuation statements and similar filings to be made during the pendency of a bankruptcy proceeding without violating the automatic stay. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 204, 108 Stat. 4106 (1994) (amending 11 U.S.C. § 362(b)(3)).


\textsuperscript{228} 892 F.2d 1230 (5th Cir. 1990).

\textsuperscript{229} The security interest in \textit{In re Hamilton} was perfected by notation on a certificate of title eleven days after attachment, thus missing the 10 day period allowed by the Bankruptcy Code by a single day.

\textsuperscript{230} Cases rejecting application of the preemption doctrine to the perfection of purchase money security interests include \textit{In re Hesser}, 984 F.2d 345 (10th Cir. 1993) (Bankruptcy Code incorporates effective date of perfection under state law) and \textit{In re Busenlehner}, 918 F.2d 928 (11th Cir. 1990) (Bankruptcy Code allows perfection within time permitted by state law), cert. denied sub nom. Moister v. General Motors Acceptance Corp., 500 U.S. 949 (1991)).
Once a default occurs under a security agreement, a secured party is entitled to take possession and dispose of the collateral and seek a recovery against the debtor for any deficiency.\textsuperscript{231} One of the most common difficulties faced by secured creditors is the disposition of collateral in a commercially reasonable manner as required in section 9.504 of the Code, including giving notice of any sale of collateral to the debtor.\textsuperscript{232} One way to avoid this difficulty is by obtaining a waiver from the debtor, but the right to a commercially reasonable disposition cannot be waived,\textsuperscript{233} and a waiver of the right to notice of a sale of collateral is effective only if it is signed by the debtor after default.\textsuperscript{234} In Steinberg v. Cinema N' Drafthouse Systems, Inc.,\textsuperscript{235} the court addressed the question of whether the limitation on the ability of a debtor to waive rights to a commercially reasonable disposition of collateral extended to guarantors as well as debtors. The court noted that "[n]o Texas case has answered this precise question,"\textsuperscript{236} but its review of Texas authority on related issues convinced the court that the Texas Supreme Court would hold that the prohibition on waiver would not be applied to guarantors.\textsuperscript{237}

If the collateral consists of accounts, chattel paper, or instruments, a secured party does not face the same restrictions in dealing with the collateral after default. Section 9.502 of the Code permits a secured party with a security interest in such collateral to make direct collections from the persons obligated on the collateral (the "account debtors") without notice to the debtor.\textsuperscript{238} In Bray v. Cadle Co.,\textsuperscript{239} the court applied section 9.502 to hold that a secured creditor was entitled to collect the amount owed on a note pledged as security for a loan from the account debtor.\textsuperscript{240} The court reached this result even though the original note had apparently been lost and could not be produced by the secured party. On the evidence in the record, the court concluded that ownership of the note was sufficiently established to permit collection by the secured party despite the absence of the original.\textsuperscript{241}

The problems confronting a secured party who is unable to avoid the strictures of section 9.504 were illustrated in Gordon & Assoc. v. Cullen Bank/Citywest\textsuperscript{242} which contains a litany of the ways in which a secured party failed to carry the burden of proving that it disposed of collateral in

\begin{itemize}
\item \textsuperscript{235} 28 F.3d 23 (5th Cir. 1994).
\item \textsuperscript{236} Id. at 25.
\item \textsuperscript{237} Id.
\item \textsuperscript{239} 880 S.W.2d 813 (Tex. App.—Houston [14th Dist.] 1994, writ denied).
\item \textsuperscript{240} Id. at 816.
\item \textsuperscript{241} Id. at 818.
\item \textsuperscript{242} 880 S.W.2d 93 (Tex. App.—Corpus Christi 1994, n.w.h.).
\end{itemize}
a commercially reasonable manner. The defects noted by the court included a failure to show proper advertising of the sale when the record indicated the sale had been advertised as a private sale, but the collateral was subsequently sold at public sale; a failure to account for and explain the expenses allegedly associated with the sale; a failure to account to the debtor for the proceeds of the sale; and a failure to show that the purported sale was not actually a retention of the collateral by the creditor in full satisfaction of the debt. The court held the secured party was not entitled to a summary judgment in its deficiency action and remanded the case to the trial court.

244. 880 S.W.2d at 97.
245. Id. at 97-98.
246. Id. at 98.
247. Id. The court noted that an election to retain collateral in satisfaction of a debt may result from the actions of the secured party and bar the recovery of a deficiency under Tex. Bus. & Com. Code Ann. § 9.505 (Tex. UCC) (Vernon 1991).
248. 880 S.W.2d at 98.