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COMMERCIAL TRANSACTIONS

by

John Krahmer*

THIS Article summarizes developments during the 1986 Survey period in Texas commercial law and related subjects affecting commercial practice.¹ In general, 1986 was an active year in commercial law, especially in the area of banking litigation. For ease of reference, this Article follows the organization of the Uniform Commercial Code as adopted in Texas and codified in the Texas Business & Commerce Code (the Code).²

I. GENERAL PROVISIONS—ACCELERATION AND PREPAYMENT CLAUSES

A. Acceleration Must Be in Good Faith

Lack of Good Faith as a Defense. Under section 1.208 of the Code,³ a creditor may use a general insecurity clause to accelerate the balance due on an instrument. The only statutory restriction on the use of such a clause is that the acceleration must be made in good faith.⁴ In Jack M. Finley, Inc. v.

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³ TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1968 & Supp. 1987). The chapters in the Code are organized as follows: Chapter 1, General Provisions; Chapter 2, Sales; Chapter 3, Commercial Paper; Chapter 4, Bank Deposits and Collections; Chapter 5, Letters of Credit; Chapter 6, Bulk Sales; Chapter 7, Documents of Title; Chapter 8, Investment Securities; and Chapter 9, Secured Transactions.

⁴ Id.
Longview Bank & Trust Co. the court held that the creditor was entitled to summary judgment when the debtor failed to oppose the motion for summary judgment with any evidence of probative value. The mere statement of a general conclusion by the debtor that the creditor had not acted in good faith was not sufficient to carry the debtor's burden of proof.

Lack of Good Faith as a Claim. Although a lack of good faith may be raised as a defense to the acceleration of a note, a duty of good faith and fair dealing cannot be used as a claim against the accelerating creditor. In Cluck v. Frost National Bank the bank accelerated a note and deed of trust after a default in payments. After the foreclosure sale one of two joint debtors offered to pay the deficiency on condition that the creditor transfer the note and deed of trust to him. The creditor bank refused this offer on the ground that the bank had a policy against selling notes to individuals. The debtor then made a second offer by tendering full payment of the deficiency, including principal, interest, and attorney's fees. This tender was also refused, but on the ground that the note had already been sold, apparently to an individual. In an action by the bank to recover the remaining amount due on the note the debtor counterclaimed for breach of a duty of good faith and fair dealing. The court ruled that Texas has refused to recognize such a duty as the basis for a cause of action and held that the bank was not liable for refusing the offers of payment. The opinion is not clear on whether the debtor was only tendering payment of past due installments or was tendering payment of the entire note.


5. 705 S.W.2d 206 (Tex. App.—Texarkana 1986, writ ref’d n.r.e.).
6. Id. at 209.
8. 714 S.W.2d 408 (Tex. App.—San Antonio 1986, no writ).
9. Id. at 410.
10. Early in the opinion the court states, "On May 12, 1983, appellant offered to pay the deficiency on the condition that the bank transfer the note and lien to him." Id. at 409. In the next paragraph the court says, "[A]ppellant then unconditionally tendered full payment for all principal, interest, and attorney’s fees owing on the deficiency." Id. Because the bank had already accelerated the note, these comments sound as if the debtor was tendering payment of the entire note, although the language used by the court is not free from doubt. Toward the end of the opinion, however, the court says, "[T]he note became due upon acceleration and appellant lost the right to pay all delinquent payments and reinstate the original maturity date." Id. at 410. This passage is a clear statement of a more limited tender of payment, and it is followed a few sentences later by, "[T]he only issue is whether the bank had a right to refuse the maker's tender of full payment after default and sell the delinquent note to a third party." Id.

If the debtor was only tendering payment of past due installments, the court could have found some support for its position by analogy to Tex. Bus. & Comm. Code Ann. § 9.506 (Tex. UCC) (Vernon Supp. 1987), which provides: "At any time before the secured party has disposed of collateral or entered into a contract for its disposition . . . the debtor . . . may unless otherwise agreed in writing after default redeem the collateral by tendering fulfillment of all obligations secured by the collateral." (Emphasis added.) If the debtor was tendering full payment of the entire note, the court did not deal with the effect of id. § 3.604, which states:
II. SALES OF GOODS

A. Enforceability of Sales Contracts

Statute of Frauds. Section 2.201 of the Code requires that contracts for the sale of goods in the amount of $500 or more must be evidenced by a writing "sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought." The contract is not enforceable beyond the quantity of goods shown in the writing.

In Mel-Tex Valve, Inc. v. Rio Supply Co., the buyer introduced in evidence an unsigned purchase order that the buyer had generated internally but had never sent to the seller. The court held that the unsigned purchase order was insufficient to satisfy the writing requirement of the statute of frauds. The disappointed seller also attempted to fit the case into the specially manufactured goods exception. The court ruled, however, that there was no evidence to show that the goods were manufactured only for this particular buyer, especially since the seller had testified that the goods were suitable for resale to others. The buyer's motion for summary judgment was granted.

In Micromedia v. Automated Broadcast Controls the buyer, rather than the seller, ran afoul of the Code's statute of frauds. In Micromedia the seller

"Any party making tender of full payment to a holder when or after it is due is discharged to the extent of all subsequent liability for interest, costs and attorney's fees."

In addition to having an unclear statement of facts, the opinion is unsatisfactory on two substantive legal grounds. First, the court relies for its holding on earlier Texas cases that arose in quite distinguishable factual contexts, citing Exxon Corp. v. Atlantic Richfield Co., 678 S.W.2d 944, 947 (Tex. 1984), and English v. Fischer, 660 S.W.2d 521, 524 (Tex. App.-Houston [1st Dist.] 1986, no writ). Exxon involved an issue that was specifically covered in the contract itself. English concerned a Deceptive Trade Practices Act claim under TEX. BUS. & COM. CODE ANN. § 17.46(b)(12) (Vernon Supp. 1987) between attorneys who were both parties to a contract. Equal bargaining power was, therefore, not an issue. A concurring opinion in English noted this point and suggested that the majority opinion only covered this limited circumstance. 660 S.W.2d at 525 (Spears, J., concurring). Second, the Cluck opinion is unsatisfactory because the court refused to accept the argument that RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979) applied in the case. That section provides that: "[E]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Id. Although the court may have been correct in its rejection of the Restatement provision as an accurate statement of Texas law, the court failed to mention TEX. BUS. & COM. CODE ANN. § 1.203 (Tex. UCC) (Vernon 1968), which contains almost identical language and is a part of Texas law by legislative enactment. Because Cluck dealt with a note, a form of commercial paper covered by the Code, see TEX. BUS. & COM. CODE ANN. § 3.104(b)(4) (Tex. UCC) (Vernon 1968), § 1.203 was applicable to the case, and the court should have discussed it. The reason for the omission cannot be determined from the opinion.

11. TEX. BUS. & COM. CODE ANN. § 2.201 (Tex. UCC) (Vernon 1968).
12. Id. § 2.201(a).
13. Id.
15. Id. at 186.
16. This exception appears in TEX. BUS. & COM. CODE ANN. § 2.201(c)(1) (Tex. UCC) (Vernon 1968), which provides: "(c) A contract ... is enforceable (1) if the goods are to be specifically manufactured for the buyer and are not suitable for sale to others in the ordinary course of the seller's business . . . ."
17. 710 S.W.2d at 187.
18. Id.
19. 799 F.2d 230 (5th Cir. 1986).
of radio broadcasting equipment provided the buyer with a written price quotation for the type of equipment desired by the buyer. The court rejected this writing as insufficient to satisfy the statute of frauds because it was an offer for a future agreement, not a memorandum of an existing contract.\(^{20}\) According to the court, the statutory language requiring a writing that indicates "a contract for sale has been made"\(^{21}\) disqualified the price quotation as an adequate writing. The buyer also contended that the statute of frauds did not apply in this case because the seller had admitted the existence of a contract in the court proceedings. The court rejected this argument because the admission went only to the buyer's purchase of a different system and did not admit the existence of the primary contract underlying the buyer's claim.\(^{23}\)

### B. Warranties

**Warranties and the DTPA.** Both the Code and the Texas Deceptive Trade Practices Act (DTPA)\(^{24}\) permit actions founded on breach of warranty.\(^{25}\) In cases governed by Chapter 2 of the Code a property drafted waiver or disclaimer of warranties can effectively bar a warranty action under either the Code or the DTPA.\(^{26}\) In *Metro Ford Truck Sales, Inc. v. Davis*,\(^{27}\) however, the court held that an "as is" disclaimer of warranty is not effective to waive a separate cause of action for misrepresentation under the DTPA.\(^{28}\) The damages allowed by the court are a particularly interesting aspect of *Metro Ford*. Basing its decision on the earlier case of *Luna v. North Star Dodge Sales, Inc.*,\(^{29}\) the court granted recovery for the difference in value of the

\(^{20}\) Id. at 234.

\(^{21}\) Id. (construing TEX. BUS. & COM. CODE ANN. § 2.201(a) (Tex. UCC) (Vernon 1968) (emphasis by the court)).

\(^{22}\) Id.

\(^{23}\) Id. at 235.

\(^{24}\) See Singleton v. LaCoure, 712 S.W.2d 757, 760 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.) (disclaimers of implied warranties requiring buyer's acknowledgment effective to bar both Code and DTPA claims); Ellmer v. Delaware Mini-Computer Sys., Inc., 665 S.W.2d 158, 160-61 (Tex. App.—Dallas 1983, no writ) (same result); see also McCrea v. Cubilla Condominium Corp., 685 S.W.2d 755, 758 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.) (disclaimer of implied warranty effective to bar DTPA claim when Code not applied).

In contrast to a disclaimer that prevents the creation of a warranty, a limitation of remedies clause or a limitation of liabilities clause recognizes a warranty but limits the relief available for the warranty's breach under TEX. BUS. & COM. CODE ANN. § 2.719 (Tex. UCC) (Vernon 1968). A limitation of remedies clause or a limitation of liabilities clause will not, however, limit the relief available under a DTPA claim. *Id.* § 17.42 (Vernon Supp. 1987). See *Martin v. Lou Poliquin Enters., Inc.*, 696 S.W.2d 180 (Tex. App.—Houston [14th Dist.] 1985, writ ref'd n.r.e.).

\(^{25}\) Id. § 17.50(a)(2) (Vernon Supp. 1987) (Texas DTPA).

\(^{26}\) See 709 S.W.2d 785 (Tex. App.—Fort Worth), aff'd on rehearing, 711 S.W.2d 145 (Tex. App.—Fort Worth 1986, no writ).

\(^{27}\) 709 S.W.2d at 790. This holding is similar to that of the court in Reliance Universal, Inc. v. Sparks Indus. Servs., Inc., 688 S.W.2d 890, 892-93 (Tex. App.—Beaumont 1985, writ ref'd n.r.e.).

\(^{28}\) 667 S.W.2d 115 (Tex. 1984).
goods as delivered and as represented, the loss of use of the goods following repossession, lost earnings, mental anguish, lost credit, and additional punitive damages under the treble damage provision of the DTPA.\textsuperscript{30} A judgment for the buyer in the total amount of $534,016 was affirmed.\textsuperscript{31}

An issue related to the contractual waiver of warranties is the existence of a statutory procedure limiting the buyer's right immediately to bring a breach of warranty action. Under the Texas Manufactured Housing Standards Act,\textsuperscript{32} a buyer may not maintain an action for breach of warranty provisions contained in the Act until the seller has been given an opportunity to cure defects and the buyer has exhausted the administrative remedies available within the Department of Labor and Standards.\textsuperscript{33} This limitation is significant because failure to comply with the warranty provisions of the Act or with any implied warranties expressly violates the DTPA.\textsuperscript{34} In \textit{Holder v. Wood}\textsuperscript{35} a disappointed married couple who had purchased a mobile home sought recovery for breach of express and implied warranties without exhausting their administrative remedies under the act. The lower court granted a plea in abatement to prevent the buyers from maintaining their action until the administrative procedures were satisfied.\textsuperscript{36} The supreme court held that the abatement was proper so far as the express warranty claim was concerned,\textsuperscript{37} but further held that the Manufactured Housing Standards Act only required the purchaser to follow the administrative procedure for claims based on express warranties.\textsuperscript{38} The purchaser could still maintain claims based on implied warranties or misrepresentation without regard to the administrative procedure.\textsuperscript{39} The lower court was instructed to lift the abatement order on the implied warranty claims not covered by the Act.\textsuperscript{40}

\textit{Notice of Warranty Breach}. Section 2.607 of the Code\textsuperscript{41} requires a buyer to notify the seller of an alleged breach of warranty within a reasonable time or suffer the loss of any remedy for the breach. In \textit{Wilcox v. Hillcrest Memorial.

\textsuperscript{30} 709 S.W.2d at 790-95. As an aside to the \textit{Metro Ford} case, the decision in Sierra Switchboard Co. v. Westinghouse Elec. Corp., 789 F.2d 705 (9th Cir. 1986), is worth noting. In \textit{Sierra}, a bankruptcy action, the Ninth Circuit Court of Appeals held that a debtor's claim for emotional distress was property of the debtor's estate, regardless of whether such a claim was transferrable or assignable under state law. \textit{Id.} at 708-09. If this decision is followed in the Fifth Circuit, a bankruptcy trustee can probably recover damages for mental anguish in DTPA cases for the benefit of the estate of a bankrupt plaintiff.

\textsuperscript{31} 709 S.W.2d at 795.


\textsuperscript{33} \textit{Id.} art. 5221f, § 17(d).

\textsuperscript{34} \textit{Id.}

\textsuperscript{35} 714 S.W.2d 318 (Tex. 1986).

\textsuperscript{36} \textit{Id.} at 319.

\textsuperscript{37} \textit{Id.}

\textsuperscript{38} \textit{Id.}

\textsuperscript{39} \textit{Id.}

\textsuperscript{40} \textit{Id.}

\textsuperscript{41} \textit{Tex. Bus. & Com. Code Ann.} § 2.607(c)(1) (Tex. UCC) (Vernon 1968) provides: "(c) Where a tender has been accepted (1) the buyer must within a reasonable time after he discovers or should have discovered any breach notify the seller of breach or be barred from any remedy . . . ."
Park, the Texas Supreme Court acknowledged a conflict between the lower Texas courts on the question of whether a buyer is required to notify only his or her immediate seller of an alleged breach of warranty to preserve a claim against a remote seller or manufacturer, or whether a buyer must also notify each remote seller or manufacturer in order to preserve a claim for breach of warranty against it. In an opinion denying an application for writ of error the Supreme Court held that it did not need to resolve the conflict because, on the facts before it, the buyer did not prove a breach of warranty. Pending resolution of this conflict between the courts of appeals, the only safe course for a buyer is to notify every seller or manufacturer in the chain of distribution to insure that a later warranty claim is not barred by a procedural defect in the giving of notice.

Liability of Dealer for Manufacturer's Warranty. In Doran Chevrolet-Peugeot, Inc. v. Ganschow the court held that a car dealer was not liable under a warranty running from the manufacturer to the buyer when the dealer acted only as the agent of the manufacturer for the purpose of determining whether repairs were covered under the manufacturer's warranty. The dealer was apparently not the dealer that sold the car.

Warranties of Future Performance. Some years ago the Fifth Circuit Court of Appeals addressed the question of whether under Texas law an implied warranty of merchantability extends to the future performance of goods. Finding no Texas cases on the subject, the court conjectured that Texas would probably follow the rule adopted in other jurisdictions that an implied warranty does not extend to future performance because the Code requires a warranty of future performance explicitly to extend the warranty coverage and, by its very nature, "an implied warranty . . . cannot 'explicitly extend to future performance' . . ." In Safeway Stores, Inc. v. Certainteed Corp. the Texas Supreme Court confirmed the Fifth Circuit's "best guess" and adopted the majority rule that implied warranties do not extend to the future performance of goods. The Texas Supreme Court also held that whether an express warranty given by the seller was an explicit warranty of future performance was a question of fact when the goods concerned, roofing materials, were described as being "bondable up to 20 years." The issue of

42. 701 S.W.2d 842 (Tex. 1986).
44. See Wilcox v. Hillcrest Memorial Park, 696 S.W.2d 423, 424-25 (Tex. App.—Dallas 1985, writ ref'd n.r.e. per curiam), 701 S.W.2d 842 (Tex. 1986).
45. Id. at 261.
46. Id. at 260 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).
47. Id. at 261.
49. Id.
50. 710 S.W.2d 544 (Tex. 1986).
52. 710 S.W.2d at 548.
warranty coverage arose because the defects were discovered nine years after the sale, a time well beyond the four-year limitations period for the sale of goods under the Code.53

C. Performance Disputes

Acceptance and Revocation of Acceptance. The Code establishes an elaborate scheme for the tender, rejection, and revocation of acceptance of goods.54 In general, if the buyer revokes his acceptance he must prove a greater nonconformity in the goods than the buyer has to prove if the buyer rejects the goods. At the acceptance stage the buyer can reject the goods if the tender “fail[s] in any respect to conform to the contract,”55 and the buyer is entitled to a reasonable opportunity to inspect the goods before accepting them.56 To revoke acceptance, the buyer must show, among other things, a substantial impairment of the value of the goods.57 In Tri-Continental Leasing Corp. v. Law Office of Richard W. Burns58 the court applied the rejection standards of the Code by analogy to a lease transaction and held that the lessee of a copying machine was entitled to a reasonable opportunity to inspect the goods before acceptance would be effective.59 The buyer’s mere signing of a delivery and acceptance receipt purporting to acknowledge full inspection and good working condition was not binding without an actual opportunity to inspect.60 The court also held that warranty disclaimers contained in the lease were unconscionable when the buyer did not know how to operate the goods and when the value of the goods and the consideration paid were grossly disparate.61

In Vista Chevrolet, Inc. v. Lewis62 the buyer successfully met the greater proof requirements for revocation of acceptance even though twenty months had passed from the time of sale. The buyer showed that revocation was delayed because of the seller’s repeated promises to cure the defects in the buyer’s automobile when, in fact, repeated attempts at repair failed to cure

54. See id. §§ 2.601-.602, .608.
55. Id. § 2.601. The application of this provision of the Code is discussed in Printing Center of Texas, Inc. v. Supermind Publishing Co., 669 S.W.2d 779, 783-84 (Tex. App.—Houston [14th Dist.] 1984, no writ), and Texas Imports v. Allday, 649 S.W.2d 730, 737-38 (Tex. App.—Tyler 1983, writ ref’d n.r.e.).
57. Id. § 2.608(a) provides:
(a) The buyer may revoke his acceptance of a lot or commercial unit whose non-conformity substantially impairs its value to him if he has accepted it
(1) on the reasonable assumption that its nonconformity would be cured and it has not been seasonably cured; or
(2) without discovery of such non-conformity if his acceptance was reasonably induced either by the difficulty of discovery before acceptance or by the seller’s assurances.
58. 710 S.W.2d 604 (Tex. App.—Houston [1st Dist.] 1986, no writ).
59. Id. at 608.
60. Id.
61. Id. at 607.
62. 704 S.W.2d 363 (Tex. App.—Corpus Christi), aff’d in part, rev’d in part, per curiam, 709 S.W.2d 176 (Tex. 1986).
the defects. The continued use of the car by the buyer after revocation did not bar revocation when the buyer was willing to pay for such use at a reasonable rate.63 The Vista Chevrolet case contains a careful analysis of the standards for revocation of acceptance and is, therefore, a helpful case on that subject.

D. Consignments

Secured Creditors Can Sometimes Lose to Consignors. One of the primary risks for a consignor of goods is that a secured creditor will take priority over the consignor in goods delivered to a debtor-consignee.64 While section 2.326 of the Code65 does provide some exceptions to this usual outcome,66 consignors do not generally fare well in contests with secured parties.67 The case of Brashear v. D Cross B, Inc.,68 however, is an example of a very lucky consignor. In Brashear the jury found that the consignee had proven that the consignee was generally known by his creditors to be engaged in selling the goods of others.69 In a rather opaque opinion the court held that because of this jury finding the consigner’s claim prevailed over the claim of a secured creditor.70

E. Statute of Limitations

Statute of Limitations Begins to Run When Sale Occurs. Despite some earlier confusion introduced by Garcia v. Texas Instruments71 concerning the time when the statute of limitations starts to run in warranty actions involving contracts for the sale of goods,72 the lower Texas courts have made it

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63. 709 S.W.2d at 176. In its per curiam opinion the supreme court upheld the revocation of acceptance, but reversed and rendered judgment against the plaintiff on a DTPA claim because the buyer failed to satisfy his burden of proof on that issue. Id.
65. TEX. BUS. & COM. CODE ANN. § 2.326(c) (Tex. UCC) (Vernon 1968).
66. Id. The exceptions are: (1) compliance with an applicable sign law allowing the interest of the consignor to be evidenced by a sign; (2) proof that the person conducting the business is generally known to his creditors to be substantially engaged in selling consigned goods; and (3) compliance with the filing provisions of chapter 9 of the Code (TEX. BUS. & COM. CODE ANN. §§ 9.114, .408 (Tex. UCC) (Vernon Supp. 1987)). Id. § 2.32(c)(1)-(3).
68. 711 S.W.2d 749 (Tex. App.—Fort Worth 1986, no writ).
69. Id. at 751.
70. Id.
71. 610 S.W.2d 456 (Tex. 1980).
72. TEX. BUS. & COM. CODE ANN. § 2.725(b) (Tex. UCC) (Vernon 1968) provides that the statute of limitations begins to run on a warranty claim when tender of delivery is made. Garcia contained some language suggesting that in an action for personal injury the limitations period would begin when the injury occurred. 610 S.W.2d at 465. This dictum may have led to erroneous decisions in Garvie v. Duo-Fast Corp., 711 F.2d 47, 48 (5th Cir. 1983) (statute of limitations period began to run when injury occurred) and Cleveland v. Square-D Co., 613 S.W.2d 790, 791 (Tex. Civ. App.—Houston [14th Dist.] 1981, no writ) (same).
plain that they agree in their interpretation of section 2.725 of the Code that tender of delivery is the triggering event for the Code's four-year limitations period. Two recent cases support this reading of the Code.

III. COMMERCIAL PAPER

A. Form of Instruments

Incomplete Instruments. According to the court in Thomas C. Cook, Inc. v. Rowhanian traveler's checks do not become instruments until the identification signature is placed upon them and, until then, no claim can arise on the checks. In Cook the plaintiff had purchased $20,100 worth of travelers' checks from a street broker in Iran. The checks were subsequently stolen, and the plaintiff sought to recover their value from the issuer, Thomas Cook, Inc., under the contract of sale. The plaintiff testified that the identification signature was not on the checks. On these facts the court held that the plaintiff could not qualify as the owner of a lost instrument under section 3.804 of the Code.

A second and more common risk associated with incomplete instruments is illustrated in FDIC v. McClanahan. Defendant McClanahan had signed a blank note and left it with one Orrin Shaid, "a 'charismatic 300-pound east Texan,'" who represented himself as the owner of the Ranchlander Bank. The note was signed with the understanding that it would later be completed to represent the amount of a loan McClanahan had requested from the bank. Shaid subsequently told McClanahan that the loan application had been denied. McClanahan, inexplicably, did not request return of the incomplete note. The temptation to make personal use of McClanahan's signed, blank note was apparently too much for Shaid, who had, to the knowledge of McClanahan, once been convicted of bank fraud. Shaid completed the note in the amount of $62,500, to reflect a loan from Ranchlander to McClanahan and took the money for himself. An accomplice subsequently turned Shaid in to the FBI, the bank was declared insolvent, and Shaid's dealings with the note came to light. By this time, the FDIC had acquired the note as receiver of the failed bank and asserted a right to recover against McClanahan. The court noted that this was apparently the first decision in the Fifth Circuit

73. TEX. BUS. & COM. CODE ANN. § 2.725(b) (Tex. UCC) (Vernon 1968).
74. See, e.g., Cooper v. RepublicBank, 696 S.W.2d 629, 633 (Tex. App.—Dallas 1985, no writ) (statute of limitations begins to run when tender is made); Weeks v. J.I. Case Co., 694 S.W.2d 634, 635-36 (Tex. App.—Texarkana 1985, no writ) (statute of limitations began to run upon delivery of farm equipment); Fitzgerald v. Caterpillar Tractor Co., 683 S.W.2d 162, 165 (Tex. App.—Fort Worth 1985, writ ref'd n.r.e.) (statute of limitations period began when employer received forklift).
75. Madden v. J.I. Case Co., 712 S.W.2d 181, 182 (Tex. App.—Houston [14th Dist.] 1986, no writ) (statute of limitations period began on date of delivery); Wyatt v. General Motors Corp., 703 S.W.2d 708, 709 (Tex. App.—Corpus Christ 1985, no writ) (statute of limitations period began on date of purchase and delivery).
76. 700 S.W.2d 672 (Tex. App.—El Paso 1985, writ ref'd n.r.e.).
77. Id. at 674.
78. Id. (construing TEX. BUS. & COM. CODE ANN. § 3.804 (Tex. UCC) (Vernon 1968)).
79. 795 F.2d 512 (5th Cir. 1986).
80. Id. at 513.
raising the question of whether the estoppel rule of *D'Oench, Duhme & Co. v. FDIC* 81 applied "to a maker who signed a blank promissory note with the understanding that it would later be filled in to reflect the terms of a loan that he in fact never received." 82 Noting that a rule 83 similar to that of *D'Oench, Duhme* has been applied in other cases to estop makers of incomplete instruments from raising the defense of fraud in the inducement, 84 the court held that the estoppel rule should operate against McClanahan since his conduct was at least reckless and he, instead of the bank's uninsured creditors or depositors, should bear any loss in the transaction. 85

**B. Liability of Parties**

*Signatures of Representatives.* Numerous Texas cases have involved the issue of whether a party has signed a negotiable instrument of guaranty as a principal or only as an agent. 86 In the recent case of *Gulf & Basco Co. v. Buchanan* 87 the court held that where a corporate officer's capacity in signing a guaranty is ambiguous, then parol evidence between immediate parties to the transaction showing that a corporate officer had guaranteed payment of a corporate debt only in his corporate capacity is admissible. 88

*Consideration to the Obligor Supports Obligation of a Surety.* It is elementary commercial law that a surety need not receive any independent consideration to be bound on the surety obligation. 89 It is equally elementary that the holder of an instrument may proceed against the surety without first resorting to the principal unless the parties agree to the contrary. 90 In *Duke v.*

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81. 315 U.S. 447 (1942).
82. 795 F.2d at 516. In *D'Oench, Duhme* the court held that a maker of a note may not raise the defense of fraud if the note would tend to have the effect of deceiving creditors. 315 U.S. at 460-61.
83. 12 U.S.C. § 1823(e) (1982). This statutory estoppel rule is applicable to suits brought by the FDIC in its corporate capacity.
84. See, e.g., FDIC v. Langley, 792 F.2d 541, 545 (5th Cir. 1986) (12 U.S.C. § 1823(e) (1982) estoppel rules barred defense based on maker's side agreements with banks); FDIC v. Hatmaker, 756 F.2d 34, 38 (6th Cir. 1985) (maker could not raise defense of fraud when he left bank with signed notes and allowed bank to fill in terms); FDIC v. Powers, 576 F. Supp. 1167, 1171-72 (N.D. Ill. 1983) (both § 1823(e) and *D'Oench* common law estoppel rules applied to bar maker's defense of fraud), aff'd, 753 F.2d 1076 (7th Cir. 1984).
85. 795 F.2d at 516.
86. See, e.g., Griffin v. Ellinger, 538 S.W.2d 97, 100-01 (Tex. 1976) (president of corporation held personally liable); Seale v. Nichols, 505 S.W.2d 251, 255 (Tex. 1974) (signer of promissory note who did not reveal his representative capacity to the party receiving the note held personally liable); Byrd v. Southwest Multi-Copy, Inc., 693 S.W.2d 704, 707 (Tex. App.—Houston [14th Dist.] 1985, no writ) (summary judgment entered against signer for failure to overcome presumption of individual liability); A. Duda & Sons, Inc. v. Madera, 687 S.W.2d 83-85 (Tex. App.—Houston [1st Dist.] 1985, no writ) (failure to support allegation of representative capacity at trial resulted in personal judgment against signer).
87. 707 S.W.2d 655 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).
88. Id. at 658.
90. Compare *Tex. Bus. & Com. Code Ann.* § 3.416(a) (Tex. UCC) (Vernon 1968) (guaranty of payment) *with id.* § 3.416(b) (guaranty of collection). Under these provisions a guaranty of payment can be enforced without resort to any other party while a guaranty of collection first requires an attempt to collect from the maker. If the words of guaranty do not
First Nat'l Bank the court applied these basic principles without difficulty to hold the defendant liable on his guaranty.

Statute of Limitations on Promissory Notes. In Siegler v. France the court held that the general four-year statute of limitations for actions founded on contracts applies to notes and begins to run on the day of maturity stated in the note. If the note also permits a demand for payment at an earlier time, the statute begins to run when the demand is made.

Liability of Acceptors. Section 3.409 of the Code clearly states that a drawee is not liable on a draft until he accepts it. That same section, however, leaves open the possibility that a drawee may be obligated to the holder or to another person in contract, tort, or otherwise for representations made about the drafting arrangement. In First National Bank v. Anderson Ford-Lincoln-Mercury, Inc. a bank gave oral drafting instructions to a car dealer indicating that the bank would approve a draft of $13,000 to finance a truck purchase by one of the car dealer's customers. Based on this representation, the truck was sold. On the following day the bank told the dealer that a mistake had occurred and that the bank would not finance the purchase. In an action by the dealer the court applied the provisions of section 3.409 to find the bank liable in negligence, based upon the representations made by the bank. According to the court, this was a case of first impression in Texas. The court's decision is, therefore, of particular interest.

Another type of acceptance that has been recognized by the Texas courts is the issuance of a cashier's check. In such cases, the bank is deemed to have accepted the instrument when it is issued and cannot stop payment after the acceptance has occurred. The rule of thumb is simply: payment cannot be stopped on a cashier's check. The court had no difficulty in applying this rule in University State Bank v. Allied Conroe Bank.

otherwise specify, they are taken to be a guaranty of payment. Id. § 3.416(c) (Tex. UCC) (Vernon 1968).
91. 698 S.W.2d 230 (Tex. App.—Beaumont 1985, no writ).
92. Id. at 233.
93. 704 S.W.2d 429 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e.).
94. Id. at 430; see TEX. REV. CIV. STAT. ANN. art. 5527, § 1 (repealed 1985), reenacted as TEX. CIV. PRAC. & REM. CODE ANN. § 16.004 (Vernon 1986).
95. 704 S.W.2d at 430. It should be mentioned that if a note is a simple demand note that does not contain a maturity date, the statute of limitations begins to run upon the note's stated date or upon its date of issue. TEX. BUS. & COM. CODE ANN. § 3.122(a)(2) (Tex. UCC) (Vernon 1968).
96. TEX. BUS. & COM. CODE ANN. § 3.409 (Tex. UCC) (Vernon 1968).
97. Id. § 3.409(a).
98. Id. § 3.409(b). The full text of that section provides: "Nothing in this section shall affect any liability in contract, tort or otherwise arising from any letter of credit or other obligation or representation which is not an acceptance." Id.
99. 704 S.W.2d 83 (Tex. App.—Dallas 1985, writ ref'd n.r.e.).
100. Id. at 85.
101. Id. at 84.
102. See Wertz v. Richardson Heights Bank & Trust Co., 495 S.W.2d 572, 574 (Tex. 1973).
103. Id.
104. 712 S.W.2d 193 (Tex. App.—Houston [14th Dist.] 1986, no writ).
State Bank the court entered judgment against the issuing bank, holding that no distinction exists between a bank's dishonoring a cashier's check and stopping payment on a cashier's check.\(^{105}\)

IV. BANK TRANSACTIONS

A. DTPA Claims Against Banks

Bank Liability for Misrepresenting Account Status. In First Federal Savings & Loan Association v. Ritenour\(^{106}\) a bank had advised one of its depositors that the bank could place a "hold" on a joint account, thus requiring both parties to the account to authorize a withdrawal of funds from it. The depositors, husband and wife, asked that the bank place such a hold on their account. After execution of the hold the depositor's wife withdrew more than $11,000 from the account on her signature alone. The depositor sued the bank under the DTPA. The court carefully considered earlier Texas cases\(^{107}\) on the question of whether a bank depositor could qualify as a consumer for DTPA purposes.\(^{108}\) On this issue the court concluded that the evidence supported the depositor's theory that he had sought and received services from the bank, thereby qualifying as a consumer under the DTPA.\(^{109}\) A dissenting opinion took the position that the case was indistinguishable from earlier case law disallowing bank customers' DTPA claims;\(^{110}\) in the dissent's view the depositor therefore was not a consumer for DTPA purposes.\(^{111}\)

Injunctive Relief Will Not Support the Recovery of Punitive Damages. In Nabours v. Longview Savings & Loan Association,\(^{112}\) another DTPA case brought against a bank, the customers successfully proved that the bank had made false statements in connection with a foreclosure proceeding and had effectively waived its right to foreclose on a deed of trust. The customers, however, failed to prove that they had suffered any actual damage. The jury nevertheless awarded $126,000 in punitive damages, and the trial court upheld this award as well as the grant of a permanent injunction against foreclosure. The court of appeals reversed the award of damages, but affirmed

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105. Id. at 194.
106. 704 S.W.2d 895 (Tex. App.—Corpus Christi 1986, writ ref'd n.r.e.).
107. The cases reviewed by the court included Riverside Nat'l Bank v. Lewis, 603 S.W.2d 169, 176 (Tex. 1980) (filing loan application does not qualify party as a consumer for DTPA purposes); First State Bank v. Chesshir, 613 S.W.2d 611, 612-13 (Tex. Civ. App.—Amarillo), rev'd on other grounds, 620 S.W.2d 101 (Tex. 1981), on remand, 634 S.W.2d 742 (Tex. App.—Amarillo 1982, writ ref'd n.r.e.) (bank customer's purchase of certificate of deposit did not qualify customer as a consumer for DTPA purposes).
108. TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon Supp. 1987) (defines a consumer as "an individual... who seeks or acquires by purchase or lease, any goods or services...")
109. 704 S.W.2d at 900.
111. 704 S.W.2d at 902 (Seerden, J., dissenting).
112. 700 S.W.2d 901 (Tex. 1986).
the injunctive relief.\textsuperscript{113}

On appeal, the Texas Supreme Court held that the grant of a permanent injunction would not support an award of punitive damages.\textsuperscript{114} The court noted that its decision should not be read to mean that other forms of equitable relief would not support an award of punitive damages, for example, in the case of an order entered to rescind deeds or to return property.\textsuperscript{115} A strong dissenting opinion argued that the majority overturned long-standing Texas law in reaching its decision.\textsuperscript{116} The majority also noted that it need not reach the issue of whether the plaintiffs qualified as consumers under the DTPA since they failed to recover damages under the Act.\textsuperscript{117}

\textit{Threats of Criminal Action to Collect Debt.} The Texas Debt Collection Act\textsuperscript{118} prohibits a variety of debt collection practices including fraud, threats, and coercion. A violation of the Debt Collection Act is defined as a violation of the DTPA, and the remedies of the DTPA are made available.\textsuperscript{119} In \textit{Brown v. Oaklawn Bank} \textsuperscript{120} a bank customer went to his bank to close his savings account. The teller told the customer his account balance was some $9,000. The customer said that the amount was too high by several thousand dollars. The teller checked with a supervising officer and confirmed the $9,000 amount. That amount was then paid to the customer and he deposited the sum in accounts he had at a credit union. Later that day, the bank discovered that it had overstated the depositor’s balance because of an error in its bookkeeping entries, contacted the customer, and demanded return of $7,500. The customer refused, saying that he thought everything had been taken care of earlier and that he would ask his attorney to handle the matter. Not content with this answer, the bank proceeded to send letters to the customer threatening criminal prosecution.\textsuperscript{121}

The bank brought a civil action to collect the overpayment, and the debtor counterclaimed for alleged violations of the Debt Collections Practices Act. The bank defended on the statutory ground that a violation of the Act occurs only when “in fact the debtor has not violated any criminal laws.”\textsuperscript{122} The trial court made a finding of fact that the debtor had violated criminal laws, and that the bank had, therefore, stated a good defense. The Texas Supreme Court held that the bank had not established a defense because the trial court could not find the debtor guilty of criminal violations absent an

\textsuperscript{113} 673 \textit{S.W.2d} 357-362 (Tex. App.—Texarkana 1984), \textit{aff’d}, 700 \textit{S.W.2d} 901 (Tex. 1986).

\textsuperscript{114} 700 \textit{S.W.2d} 901, 905 (Tex. 1986).

\textsuperscript{115} \textit{Id.} at 904.

\textsuperscript{116} \textit{Id.} at 905 (Kilgarlin, J., dissenting).

\textsuperscript{117} 700 \textit{S.W.2d} at 905. Because of the failure to recover damages, the plaintiffs were also unable to recover attorney’s fees. \textit{Id.}

\textsuperscript{118} \textit{TEX. REV. CIV. STAT. ANN.} art. 5069, §§ 11.01-.11 (Vernon Pam. Supp. 1987).

\textsuperscript{119} \textit{Id.} § 11.11.

\textsuperscript{120} 718 \textit{S.W.2d} 678 (Tex. 1986).

\textsuperscript{121} One of the bank directors was the local prosecuting attorney.

\textsuperscript{122} \textit{Id.} at 680 (citing \textit{TEX. REV. CIV. STAT. ANN.} art. 5069, § 11.02(f) (Vernon Pam. Supp. 1987)).
underlying criminal proceeding. In its opinion the court stated: "We decline to accept a standard giving the creditor the power and authority to determine the guilt or innocence of an individual debtor. Similarly, a trial court cannot assume that responsibility in a civil proceeding to enforce the debt." The standard announced by the court imposes such a high burden of proof on the creditor that creditors should simply avoid threats of criminal prosecution to collect debts.

B. Actions in Response to Court Orders

Default by Bank in Garnishment Proceeding. As a debtor to its depositors, a bank is frequently the subject of garnishment proceedings. Since the garnishing creditor rarely knows the exact amount of a depositor's bank account, it is incumbent upon the bank to answer the writ of garnishment. One of the risks a bank incurs for failing to answer a writ is illustrated in First National Bank v. Peterson. The trial court entered a default judgment for $48,831.77 against a bank on a writ of garnishment even though the bank only had a $312.68 balance in the debtor's deposit account. Three bank officers read the writ, but the only action taken was to freeze the account. None of the bank's officers notified an attorney about the writ; nor did the bank advise the issuing court that it had frozen the account. The bank moved to reopen the judgment claiming accident or mistake in failing to answer the writ. The court denied this motion on the ground that the facts indicated that the bank had acted intentionally or with conscious indifference rather than through accident or mistake when it failed to answer the writ.

Negligence in Transferring Funds Between Accounts. In American National Bank v. Sneed's Shipbuliding, Inc. the bankruptcy judge issued a written order to place a bankrupt debtor's funds in an interest bearing account. The order required the signatures of both the judge and the debtor's president for withdrawals from the account. The judge later orally ordered the bank to transfer the funds to a noninterest bearing checking account. While the bank questioned the judge about the transfer order, it did not notify the debtor of the order or the transfer. When the debtor learned about the transfer almost one year later it had already lost a significant amount of interest income. The court held the bank liable to the debtor for the lost interest because of its failure to notify the debtor about the order and the transfer. The court took pains to make it clear that its finding of negligence was not based on the bank's compliance with the court order, but on the bank's failure to notify the bankrupt debtor about the order as the other

123. 718 S.W.2d at 680.
124. Id.
125. 709 S.W.2d 276 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.).
126. Id. at 280.
127. 703 S.W.2d 336 (Tex. App.—Beaumont 1985, no writ).
128. Id. at 339.
signatory on the account.129

C. Suits Against Customers

 Recovery of Overpayments. If a bank erroneously overcredits a customer’s account and the customer subsequently withdraws the money, elementary jurisprudence seems to dictate that the bank should have some cause of action to recover the overpayment. Equally elementary jurisprudence seems to dictate that conversion is the proper cause of action for detention of the bank's funds. This elementary approach is incorrect according to the court in Vickory v. Summit National Bank.130 According to the court, the cause of action is not conversion, but an action for debt because the relationship between a bank and a depositor is one of debtor and creditor and an erroneous overpayment simply makes the depositor the debtor rather than the other way around.131 The heart of the dispute in Vickory was whether the two-year statute of limitations for conversion132 or the four-year statute of limitations for debt133 applied to the bank's claim. The court's decision that the bank brought an action for debt134 allowed the bank to benefit from the longer statute of limitations period.

 Interpleaders and Conflicts of Laws. In Duncan v. Cessna Aircraft Co.,135 the supreme court abandoned the rule that the law of the place of the making of a contract governs the contract. Instead, the court adopted the more modern approach that the law of the place with the most significant relationship to the contract should govern.136 The court in Ossorio v. Leon137 applied this newer rule when a bank interpled claimants to a joint account after the death of one party to the account because of conflicting claims to the decedent's share of the account. All of the claimants were citizens of Mexico, and the only contact that Texas had with the dispute was the deposit of funds in a Texas bank. The court held that the law of Mexico should apply to determine the rights of the respective claimants since Mexico had the most significant relationship to the transaction.138

 D. Setoffs

 Setoffs as Against Depositors. In Texas National Bank v. Karnes139 a bank repossessed a car purchased by the depositors' son under a loan guaranteed

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129. Id.
130. 702 S.W.2d 324 (Tex. App.—Fort Worth 1986, writ ref'd n.r.e.).
131. Id. at 325.
132. TEX. CIV. PRACT. & REM. CODE ANN. § 16.003(a) (Vernon 1986).
133. TEX. REV. CIV. STAT. ANN. art. 5527, § 1 (repealed 1985), reenacted as TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a) (Vernon 1986).
134. 702 S.W.2d at 325.
135. 665 S.W.2d 414 (Tex. 1984).
136. Id. at 421.
137. 705 S.W.2d 219 (Tex. App.—San Antonio 1986, no writ).
138. Id. at 223.
139. 711 S.W.2d 389 (Tex. App.—Beaumont), aff'd in part, rev'd & vac'd in part, 717 S.W.2d 901 (Tex. 1986) (court vacated only award of attorneys' fees and punitive damages).
by his mother. The bank failed to dispose of the car in the manner required by section 9.504 of the Code. Under the rule of Tanenbaum v. Economics Laboratory, Inc.141 the bank was not entitled to a deficiency.142 Nonetheless, the bank set off an alleged deficiency of some $3,000 against the savings account of the depositors without notifying them. The court of appeals allowed the depositors to recover the amount of the setoff143 and also awarded punitive damages on the ground that the bank had acted tortiously.144 The Texas Supreme Court disagreed, however, because the only jury finding was that the bank had failed to act in a commercially reasonable manner in the disposition of the collateral.145 According to the court, the obligation to dispose of repossessed collateral in a commercially reasonable manner "is an implied covenant in all contracts governed by Article 9 . . . . [T]he bank's breach of this covenant gave rise to a cause of action which sounds in contract."146 Because the jury found damages only for violation of the implied covenant and not damages in tort, the plaintiffs were entitled to recover for the amount of the improper setoff, but could not recover punitive damages.147

In In re Williams148 a depositor sued a bank for wrongful setoff. The depositor failed to recover because the court held that the bank could hold the depositor’s funds subject to a right of setoff based on the depositor’s indebtedness to the bank.149 The more difficult issue was whether the bank could impose an administrative freeze on the account pending determination of its substantive rights in the depositor’s bankruptcy proceeding. Under the facts before the court, the bank account was cash collateral under section 363 of the Bankruptcy Code150 and the court faced a conflict in decisions on this issue. Some cases had permitted banks to apply administrative freezes under section 542 of the Bankruptcy Code151 as a necessary self-help method of preventing dissipation of the cash collateral before the bank had an opportunity to have its setoff claim heard in bankruptcy court.152 Other cases had regarded the administrative freeze as a violation of the automatic stay of post-petition setoffs.153

140. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon Supp. 1987) (repossession had occurred in 1979, and the vehicle was not sold until 1984).
141. 628 S.W.2d 769 (Tex. 1982).
142. Id. at 772 (creditor may not retain collateral and sue for deficiency without compliance with notice requirement of TEX. BUS. & COM. CODE ANN. § 9.504(c) (Vernon Supp. 1987)).
143. 711 S.W.2d at 397.
144. Id.
145. 717 S.W.2d at 903.
146. Id.
147. Id.
149. Id. at 574.
152. See, e.g., In re Edgins, 36 Bankr. 480, 484 (Bankr. 9th Cir. 1984); Stann v. Mid American Credit Union, 39 Bankr. 246, 248 (D. Kan. 1984); Kenney’s Franchise Corp. v. Central Fidelity Bank, 22 Bankr. 747, 750 (W.D. Va. 1982).
153. See, e.g., In re Wildcat Constr. Co., 57 Bankr. 981, 986 (Bankr. D. Vt. 1986); In re
The court reasoned that sections 542 and 362 could be reconciled by the rule of statutory construction that the specific language in section 542 controls the general language in section 362. In the court's view section 542 specifically refers to the use of an administrative freeze, while section 362 refers generally to post-petition setoffs. The bank, therefore, acted properly in imposing a freeze on the depositor's account pending a hearing on the validity of the bank's right of setoff. The court noted that a bank is liable for actual and punitive damages if it does not have a valid right of setoff and this risk of liability is sufficient to prevent banks from taking improper advantage of the right to impose an administrative freeze.

Setoffs as Against Third Parties Claiming an Interest in an Account. Since a depositor can assign his or her interest in a bank account to a third party, the right of setoff can sometimes become entangled with an issue of the priority of claims between the bank and the third party assignee. In Texas Bank & Trust Co. v. Spur Security Bank the assignee of a nonnegotiable certificate of deposit was notified that the issuing bank had placed an administrative freeze on the account because it might have a claim to the underlying deposit. On appeal from a summary judgment for the assignee bank the appellate court ruled that a fact issue existed as to whether the hold had occurred before the assignee had given notice of the assignment. The resolution of that issue required trial on the merits to determine the priorities in the account and the validity of an attempted setoff.

In a second case involving the assignee of a nonnegotiable certificate of deposit, Citibank v. Interfirst Bank, the court explored the Texas equitable setoff rule. The court concluded that the bank could not validly set off the amount of its claim against the equitable interest of an assignee when the bank was unable to show a change in its position in reliance on the depositor's continued ownership of the funds. The Texas Supreme Court adopted the equitable setoff rule in National Indemnity Co. v. Spring Branch State Bank, and Texas courts continue to follow that rule.

The rule has two parts. First, a bank cannot validly set off funds if it has actual or constructive knowledge that the funds are held for the benefit of a third party. Second, even if a bank has no notice or knowledge of a third party...
party's interest in the funds, the bank may not set off and retain the funds unless it has detrimentally changed its position in reasonable reliance on the depositor's continued ownership of the funds. In applying this rule the court in Citibank found that even if the bank did not have notice of the claim of the third-party assignee, the bank had not changed its position in reasonable reliance on the depositor's ownership of the funds. This case is of particular interest because, according to the court, its decision was only the second decision in the United States to consider whether the equitable rule applied to a priority dispute between a secured creditor under the Code and a bank attempting to exercise its right of setoff. Attorneys, when dealing with banks, sometimes seem to overlook the second portion of the equitable rule, and the Citibank case is helpful in developing a better understanding of the rule.

E. Unauthorized Signatures

Negligence Contributing to Unauthorized Signatures. Under section 3.406 of the Code any person whose negligence contributes to the making of an unauthorized signature is precluded from asserting the lack of authorization against a holder or payor who pays the instrument in good faith and in accordance with reasonable commercial standards. In First City National Bank v. FDIC a bank acted as a collecting bank for some checks and as a payor bank for other checks. The court held that the bank could not assert the negligence of the payee as a defense to its own liability when the bank failed to introduce any evidence showing that it had acted according to reasonable commercial standards.

Another aspect of the potential liability of collecting banks for dealing with checks bearing forged endorsements is the question of whether the code rules on conversion of instruments have displaced other remedies available at common law. In Peerless Insurance Co. v. Texas Commerce Bank the court held that the rightful owner of checks could maintain a common law action for money had and received against a collecting bank that had collected the funds under forged endorsements. The underlying issue in Peerless was whether the two-year statute of limitations for conversion

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165. Continental, 606 S.W.2d at 348.
166. 784 F.2d at 622.
167. Id. The other decision is First Wis. Nat'l Bank v. Midland Nat'l Bank, 76 Wis. 2d 662, 251 N.W.2d 829, 831-32 (1977) (bank precluded from exercising setoff against assignee's funds). Interestingly enough, another decision invoking the equitable setoff rule was handed down by the Fifth Circuit at almost the same time as Citibank. See Energetics, Inc. v. Allied Bank, 784 F.2d 1300, 1302 (5th Cir. 1986).
169. 782 F.2d 1344 (5th Cir. 1986).
170. Id. at 1349.
171. TEX. BUS. & COM. CODE ANN. § 3.419 (Tex. UCC) (Vernon 1968).
172. See 791 F.2d 1177 (5th Cir. 1986).
173. Id. at 1180.
claims or the four-year statute of limitations for actions for money had and received controlled. The decision allowed the plaintiff to go forward on the claim under the longer limitations period.

F. Wire Transfer Problems

Forged Wire Transfer Orders. In *Bradford Trust Co. v. Texas American Bank* the Fifth Circuit determined that the Code rules allocating loss between parties affected by forgeries in commercial paper cases should be applied by analogy to wire transfers. Bradford Trust Company of Boston, the party in the position of the drawee bank, had received a forged order directing it to initiate a wire transfer of $800,000 from the account of one of its customers to an account at Texas American Bank in Houston purportedly held by the same customer. In fact, while the name of the customer was correct, the account number listed for the bank in Houston was for another customer. Bradford Trust followed the instructions on the forged order and Texas American, without checking to see if the name and account number matched, deposited the funds in accordance with the account number. The funds were then effectively used by the con artists who had forged the order to buy rare coins and gold bullion from a coin dealer in Houston.

When Bradford Trust discovered the scheme it demanded that Texas American and the coin dealer reimburse them. Both refused. In the action by Bradford Trust to recover the funds on the ground of negligence by Texas American by its incorrect deposit of the funds, the district court found both banks negligent and applied the Texas comparative negligence statute to divide the loss equally between the banks. On appeal the court acknowledged an "equitable tug" to reach the same result, but noted that the comparative negligence statute applied to "damages for negligence resulting in death or injury to persons or property." Because the court doubted that Texas courts would apply the comparative negligence provisions to cases of commercial loss, the court decided instead to use the Uniform Commercial Code as guidance for a rule of decision.

175. *Id.* § 16.004.
176. 791 F.2d at 1181.
177. 790 F.2d 407 (5th Cir. 1986).
178. *Id.* at 409.
179. The ingenious part of the scheme lay in this deliberate use of the customer's real name and a misstated account number. Unless Bradford Trust took steps to confirm the transaction with its customer or unless the receiving bank checked the name against the account number, the funds would end up in the wrong account and be available for withdrawal or use by the wrongdoers. Oddly enough, Bradford Trust had been tricked by a similar scheme in 1980 and the company had instituted internal security procedures to prevent a recurrence. The company, however, did not follow those procedures in this transaction.
180. Bradford Trust had settled the claim against the coin dealer; thus, the dealer was not involved in the litigation.
182. *Id.*
In applying the Code the court identified two factors as underlying the Code loss allocation scheme: "1) which party was in the best position to avoid the loss; and 2) which solution promotes the policy of finality in commercial transactions?" According to the court, both factors pointed toward placing the entire loss upon Bradford Trust since it was the party who dealt with the wrongdoer and also made the final payment under the forged transfer order.

Overpayments by Wire Order from Drawer's Account. In another wire transfer case, Walker v. Texas Commerce Bank, the payor bank erroneously transferred $25,000 more than its customer had orally requested. While holding that the Code does not cover wire transfer orders and that common law principles governed the transaction unless displaced by provisions of the Code, the court nonetheless found the Code rules consistent with common law duties of good faith and ordinary care imposed on a bank to govern relations with its customer. The bank was held liable for the erroneous overpayment.

V. LETTERS OF CREDIT

A. Letter of Credit or Guaranty?

While a bank most commonly issues a letter of credit and clearly denominates it as such, any person may issue a letter of credit if it meets certain standards set out in section 5.102 of the Code. The critical language states,

(a) This chapter applies . . . (2) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and (3) to a credit issued by a bank or other person if the credit . . . conspicuously states that it is a letter of credit or is conspicuously so entitled.

In BA Commercial Corp v. Hynutek, Inc. a corporation had issued a document entitled Standby Guarantee of Payment, which purported to guarantee the debts of another company up to $320,000. The guarantee was valid until December 31, 1983. The guarantee required certified written notice in a specified form for demands for payment under the guarantee, but did not require documents of title. After the principal debtor had defaulted the creditor made a series of demands for payment under the guarantee, the last demand dated January 31, 1984. The corporate guarantor argued that its guarantee was a letter of credit and the creditor had failed to comply strictly with the conditions in the credit agreement, including a failure to

183. Id.
184. Id. at 410.
186. Id. at 682.
187. Id. at 685.
188. TEX. BUS. & COM. CODE ANN. § 5.102 (Tex. UCC) (Vernon 1968).
189. Id.
190. 705 S.W.2d 713 (Tex. App.—Dallas 1986, no writ).
make a proper demand before the credit expired. The court held, however, that the document issued by the corporation did not meet any of the relevant definitions in section 5.102 and that it should be classed as a contract of guaranty rather than a letter of credit. As a contract of guaranty there was no rule of strict compliance and no rule that the creditor demand payment before expiration. The only requirement was that a covered indebtedness must arise before the expiration date. The corporation was held liable up to the stated limit of liability.

In another case involving a guaranty, *Campbell v. Fort Worth Bank & Trust*, the guarantor claimed that an agreement with the corporation and the other guarantors released him from liability for the corporation's debts. There was no evidence, however, that the guarantor had ever notified the creditor bank of the release or of revocation of the guaranty. The guarantor was held liable for a continuing guaranty.

**B. Dishonor Under a Credit**

*What Constitutes “Fraud in the Transaction?”* The most significant aspect of a letter of credit is the obligation of the issuer to make payment without regard to any underlying contractual disputes between the customer and the beneficiary if the required documents conform to the credit. The primary exception to the issuer's obligation occurs when fraud underlies the transaction. In such cases, unless a draft drawn under the credit has been negotiated to a good faith purchaser, the customer may seek injunction against the issuer to prevent payment under the credit.

In *Philipp Brothers, Inc. v. Oil Country Specialists, Ltd.* the customer bought oil field casing pipe. The pipe delivered by the seller was of substantially lower quality than called for by the contract. The customer cancelled the deal and refused to pay a ten percent restocking fee specified in the contract. The seller then attempted to draw against a standby letter of credit that the buyer had supplied as part of the original transaction. The buyer sought to enjoin payment of the draft by the issuing bank on the ground that the quality of the pipe was so low that the seller was guilty of fraud in the underlying transaction within the terms of section 5.114 of the Code. The court held that evidence of rejection rates for the pipe ranging from twelve percent to one hundred percent for various lots of the pipe went beyond a simple breach of warranty claim and "were pervasive enough to render the

191. *Id.* at 716.
192. *Id.* at 715.
193. *Id.* at 716.
194. *Id.* at 717.
195. 705 S.W.2d 400 (Tex. App.—Fort Worth 1986, no writ).
196. *Id.* at 402-03. The parties did not raise the issue of whether the guarantee should be construed as a letter of credit.
197. See J. WHITE & R. SUMMERS, supra note 89, § 18-1, at 706-07.
198. See *id.*, § 18-6, at 734.
201. TEX. BUS. & COM. CODE ANN. § 5.114(b) (Tex. UCC) (Vernon Supp. 1987).
entire inventory virtually worthless, thus destroying the legitimate purposes of the letter of credit."\textsuperscript{202} An order granting a temporary injunction against honor was affirmed.\textsuperscript{203}

Even if a customer has not sought to enjoin an issuer from honoring documents drawn under a letter of credit, the issuer may choose to dishonor the documents if fraud in the transaction is present, but the fraud must be of the same kind as would support an injunction against honor.\textsuperscript{204} A good faith belief that such fraud has occurred is not an adequate ground for dishonor; the issuer must have proof of the fraud before dishonoring.\textsuperscript{205}

VI. DOCUMENTS OF TITLE

A. Duties of Carriers

Duties of Carrier in C.O.D. Shipments. In \textit{American Airlines, Inc. v. Swest, Inc.}\textsuperscript{206} the Texas Supreme Court resolved a conflict between the lower appellate courts on the scope of a carrier's duty in collecting payment on C.O.D. shipment contracts.\textsuperscript{207} In \textit{American Airlines} the airline delivered goods under a C.O.D. contract in exchange for a certified check that was actually a forgery. The Dallas court of appeals ruled that the carrier had an absolute duty to attempt to verify the certified check.\textsuperscript{208} Since the airline had taken no steps to verify the check, it was held liable to the shipper for the value of the goods.\textsuperscript{209} At almost the same time that the court of appeals decided \textit{American Airlines} the San Antonio court of appeals decided the case of \textit{Duderstadt Surveyors Supply, Inc. v. Alamo Express, Inc.}\textsuperscript{210} and adopted a rule that a carrier has a duty to use reasonable care and skill in making collections on C.O.D. shipments.\textsuperscript{211} Furthermore, the carrier's exercise of reasonable care does not necessarily include a duty to verify a cashier's check.\textsuperscript{212} In \textit{American Airlines} the Texas Supreme Court rejected the absolute duty approach of the court of appeals and adopted a reasonable care standard consistent with \textit{Duderstadt}.\textsuperscript{213} Since the shipments in question had arrived after business hours and the shipper had insisted on prompt delivery, the airline had no opportunity to verify the certified checks with the certifying bank. On this basis the court held that the airline had acted with reason-
able care. The court noted that a shipper could always contract for a greater duty of care in the original shipping agreement.

VII. SECURED TRANSACTIONS

A. Validity of Security Agreement

Dragnet Clauses. While chapter 9 of the Code simplifies much of the law of secured transactions and gives a secured party considerable freedom from technical rules in obtaining and perfecting a valid security interest, it does not purport to give the secured party a completely free hand in asserting claims to collateral. In Hannigan v. First State Bank the secured creditor attempted to use collateral given to secure loans made to joint owners of stock as collateral for other, earlier loans made to only one of the owners. The court had little difficulty in finding that the security interest in the stock extended only to secure the joint loan and did not secure the separate liabilities of one of the owners. The court based its decision primarily on the intent of the parties as shown in the security agreement in which the joint owners were defined collectively as the debtor. Other documents in the transaction were consistent with the court’s interpretation that the parties intended the security agreement to cover only joint loans.

B. Description of Collateral

Adequacy of Description in a Financing Statement. In contrast to earlier statutes governing security interests in personal property, the Code adopts a theory of notice filing instead of transaction filing. The parties are not required to place their entire arrangement in the public record, nor are they required to identify the collateral covered by their arrangement in terms that match the accuracy of a real property description. It is sufficient if they file a financing statement with a description that reasonably identifies the collateral covered by the agreement. The purpose of such a filing is simply to put third parties on such notice that a reasonable person would inquire further before making a loan to or purchase from the debtor.

The court in Marine Drilling Co. v. Hobbs Trailers applied this standard of notice filing to find that a financing statement that inaccurately described property held as collateral reasonably identified the collateral and

214. Id. at 547.
215. Id.
217. 700 S.W.2d 7 (Tex. App.—Dallas 1985, writ ref’d n.r.e.).
218. Id. at 9.
219. Id. at 8.
220. Id.
222. See id.
223. Id. § 9.110 provides: “[F]or the purposes of this chapter] any description of personal property or real estate is sufficient . . . whether or not it is specific if it reasonably identifies what is described.”
224. 697 S.W.2d 831 (Tex. App.—Corpus Christi 1985, writ ref’d n.r.e.).
was not seriously misleading. The statement identified the property as a "1976 Ford Forklift s/n 45614," even though it may have been a 1975 model and the serial number was actually 452614. The court held that the secured creditor's financing statement was sufficient to put a reasonably prudent buyer on notice of a possible security interest in the forklift. Evidence introduced at trial showed that the buyer did not conduct a search for the financing statement and that whether the equipment was a 1975 or 1976 model was unclear. This decision is consistent with the general trend of financing statement description cases around the country.

**Adequacy of Description in a Security Agreement.** In Unicut, Inc. v. Texas Commerce Bank, the court applied the same standard of reasonable identification to determine that a description of collateral in a security agreement was sufficient. The court quoted with approval the following statement from the Official Comment to section 9.110 of the Code: "The test of sufficiency of a description laid down by this section is that the description do the job assigned to it—that it make possible the identification of the thing described." The debtor's objection to a writ of sequestration on this ground was denied.

The debtor also objected to the issuance of the writ on the basis that the creditor had prayed for foreclosure and the court had, instead, allowed the secured party to take possession of the collateral after seizure. According to the debtor, a prayer for foreclosure is tantamount to an exclusive request for judicial sale. The court properly held that unless the secured party has specifically asked for a judicial sale, the option to pursue a private sale continues as an available remedy. This holding is consistent with section 9.501 of the Code.

**C. Resale of Collateral**

**Notice of Intended Resale.** To effect a commercially reasonable resale under

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225. Id. at 833-34.
226. Id. at 834.
227. See, e.g., In re Vintage Press, Inc., 552 F.2d 1145, 1147 (5th Cir. 1977) (error in serial number did not vitiate description when it was otherwise sufficient); In re Delta Molded Prods., Inc., 416 F. Supp. 938, 941-42 (N.D. Ala. 1976) (description that included model number, type of machine, factory modifications, and a listing of auxiliary equipment held adequate even though serial number was incorrect); In re Simplified Data Processing Sys., 55 Bankr. 77, 78 (Bankr. E.D.N.Y. 1985) (description of collateral as a Prime 550 and Prime 650 computer sufficient even though serial numbers not listed when debtor owned only one computer of each type); McGehee v. Exchange Bank & Trust Co., 561 S.W.2d 926, 931-32 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.) (description of boat was sufficient even though the model year and engine number were incorrect).
228. 704 S.W.2d 442 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.).
229. Id. at 444.
230. Id. (citing TEX. BUS. & COM. CODE ANN. § 9.110 (comment) (Tex. UCC) (Vernon Supp. 1987)).
231. Id. at 445.
232. Id. at 445-46.
section 9.504 of the Code\textsuperscript{234} the creditor must give notice of the intended sale of collateral to the debtor.\textsuperscript{235} Under the rule of Tanenbaum v. Economics Laboratory, Inc.\textsuperscript{236} a failure to give reasonable notice to the debtor will bar the secured party from recovering a deficiency.\textsuperscript{237} An issue that is not entirely settled in Texas law concerns the persons entitled to receive notice, but the case law seems to be moving in the direction of resolving this issue.

In Peck v. Mack Trucks, Inc.\textsuperscript{238} the court held that the term "debtor" includes any guarantors of the secured obligation and that such guarantors are entitled to receive notice of the intended sale of any collateral securing the debt.\textsuperscript{239} According to the court, failure to give notice to the guarantors barred the secured party from recovering a deficiency judgment against them under the Tanenbaum rule.\textsuperscript{240} The court also held that debtors, including guarantors, cannot waive their rights to notice of sale, except as provided in sections 9.501 and 9.504 of the Code,\textsuperscript{241} which only permits waivers of notice after default.\textsuperscript{242}

The case of MBank Dallas v. Sunbelt Manufacturing, Inc.\textsuperscript{243} also required the secured party to notify the guarantor before selling collateral, but the primary issue in the case was whether written notice is required or whether oral notice will suffice. The court did not find any prior Texas cases on this precise point and recognized a split of authority in cases from other jurisdictions.\textsuperscript{244} Based primarily on the definitions of "notice" and "send" in section 1.201 of the Code\textsuperscript{245} and the lack of any explicit requirement of written notice in section 9.504 of the Code,\textsuperscript{246} the court concluded that oral notice could suffice as proper notice of sale.\textsuperscript{247} The court reasoned that the purpose of the Code rules on notification is to require reasonable "notice sufficient to enable the debtor to protect his interest in the collateral."\textsuperscript{248} In the view of the court oral notice could meet this test.\textsuperscript{249}

In a third case involving the right of a guarantor to receive notice, Bexar County National Bank v. Hernandez,\textsuperscript{250} the Texas Supreme Court agreed that guarantors are entitled to notice when the secured party intends to sell, but held that no notice is required when the collateral is merely transferred.

\textsuperscript{234} Id. § 9.504(c).
\textsuperscript{235} Id.
\textsuperscript{236} 628 S.W.2d 769 (Tex. 1982).
\textsuperscript{237} Id. at 772.
\textsuperscript{238} 704 S.W.2d 583 (Tex. App.—Austin 1986, no writ).
\textsuperscript{239} Id. at 585.
\textsuperscript{240} Id.
\textsuperscript{241} TEX. BUS. & COM. CODE ANN. §§ 9.501(c), .504(c) (Tex. UCC) (Vernon Supp. 1987).
\textsuperscript{242} 704 S.W.2d at 586.
\textsuperscript{243} 710 S.W.2d 633 (Tex. App.—Dallas 1986, writ ref’d n.r.e.).
\textsuperscript{244} Id. at 635.
\textsuperscript{245} TEX. BUS. & COM. CODE ANN. § 1.201(26), (38) (Tex. UCC) (Vernon 1968).
\textsuperscript{246} Id. § 9.540(c) (Tex. UCC) (Vernon Supp. 1987).
\textsuperscript{247} 710 S.W.2d at 635-36.
\textsuperscript{248} Id.
\textsuperscript{249} Id.
\textsuperscript{250} 716 S.W.2d 938 (Tex. 1986) (per curiam).
Burden of Proving Commercially Reasonable Resale. Another issue that Texas courts have not completely resolved is whether the secured party or the debtor has the burden of proving that a sale was or was not conducted in a commercially reasonable manner. In *Sunjet, Inc. v. Ford Motor Credit Co.*,253 the court exhaustively collected cases from other states and concluded that the "vast majority of other jurisdictions hold that the secured party must prove the commercial reasonableness of his disposition of the collateral when he seeks to collect a deficiency judgment."254 The court adopted the majority rule and held that the secured party had failed to meet the burden of proving commercial reasonableness.255 An earlier decision by the same court of appeals had assumed, without deciding, that the burden of proof was on the secured party.256

Because the law is an evolutionary process, a single case can sometimes be the genesis of major changes in legal rules. From the standpoint of secured creditors, the case of *Lee v. Sabine Bank*257 is a possible source of major change in the law governing secured creditors. In *Lee* the court dealt with the foreclosure of a maritime mortgage. The debtor raised an issue about the fair market valuation of the foreclosed vessel as compared to the price paid for the vessel in the judicial sale. In considering this question the court reviewed a case258 decided under the federal Ship Mortgage Act,259 a case that was not binding precedent for the case at bar. The court concluded that a significant proven disparity between the judicial sale price and the appraisal value of a vessel should give the debtor a deficiency offset measured by the fair market value of the vessel as opposed to the foreclosure sale price when the secured party is the successful bidder at the sale.260 In dictum the court said:

We are persuaded that the rule [described above] is fair and reasonable,
and should be applied in Texas law. But we know of no reason why it should be restricted to ships. A lender who has secured collateral, whether personalty or reality is under a trust arrangement with the borrower, in the event of foreclosure, to make an honest effort to reduce the loan as much as possible by securing a fair price for the collateral. The court held that "when a lender or its surrogate purchases collateral to secure a loan given by a borrower, and where there is a probable significant disparity between the sales price of the property and its fair market value, the borrower may contest the sale and present evidence contending such." 

The danger to secured creditors in the Lee decision is the approach taken to decide the fair market value issue. The secured creditor has some protection under section 9.507 of the Code which provides that "[T]he fact that a better price could have been obtained by a sale at a different time or in a different method from that selected by the secured party is not of itself sufficient to establish that the sale was not made in a commercially reasonable manner." Under the Lee approach a debtor can easily argue that although a significant proven disparity in price does not make a sale commercially unreasonable, the debtor should, nonetheless, be entitled to an offset for the amount of disparity that is proven. If accepted, this argument could sometimes result in a considerable reduction in the amount of recoverable deficiency judgments. For mortgage lenders the risk may be even greater because no statute parallels section 9.507 of the Code. It is too early to tell whether the Lee dictum will make its way into the general Texas law, but secured lenders should be aware of its implications.

261. Id.
262. Id. at 585.