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COMMERCIAL TRANSACTIONS

by

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THE 1989 Survey period was an active one in commercial litigation. This Article discusses cases decided during the Survey period under the Uniform Commercial Code adopted in Texas as the Texas Business and Commerce Code (the Code). For ease of reference, the Article follows the organization of the Code.

I. GENERAL PROVISIONS

A. Good Faith and Fair Dealing

Good Faith and Fair Dealing. Section 1.203 of the Code provides: "Every contract or duty within this title imposes an obligation of good faith in its performance or enforcement." The Second Restatement of Contracts has incorporated essentially the same standard by stating: "Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." Because of the similarity of standards, cases decided under the general law of contracts can be relevant to an understanding of good faith and fair dealing under the Code. In City of San Antonio v. Forgy, the court considered whether a contracting party breached the duty of good faith and fair dealing by failing to notify the other party that city engineers had recalculated the contract specifications for a well casing and concluded that the wall thickness might be inadequate to withstand anticipated pressures. The court analyzed the case in terms of the test suggested in Justice Spear's concurring opinion in English v. Fisher and concluded there was no element of trust and no imbalance of bargaining power to justify finding a special relationship between the parties as the basis for a duty

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2. As adopted in Texas, the Uniform Commercial Code was enacted as Tex. Bus. & Com. Code Ann. §§ 1.101-11.108 (Tex. UCC) (Vernon 1968 & Supp. 1990). The articles in the Code, renamed as chapters in the Texas version, 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.


5. 769 S.W.2d 293 (Tex. App.—San Antonio 1989, writ denied).

6. Id. at 296-97.

7. 660 S.W.2d 521, 524 (Tex. 1983).
of good faith and fair dealing. The case is of interest because it uses the test discussed in the Spears concurrence rather than the didactic pronouncement in the majority opinion and perhaps heralds a more analytical approach to the issue of good faith and fair dealing than has been true in some of the other cases decided under English v. Fisher.

B. Notices of Default and Acceleration

Notice of Acceleration. Under Texas law, acceleration requires both notice of intent to accelerate and notice of the actual acceleration. Both notice requirements can be waived. In Shumway v. Horizons Creditcorp the majority reaffirmed these propositions and found that language used in a note was adequate to waive the notice requirements. A strong dissenting opinion by Chief Justice Evans argued that acceleration is a "harsh remedy that deserves close scrutiny," and that the court should require express reference to notices of acceleration in any alleged waiver.

In Reynolds v. Wilder the court held that where the note required notice of default, the creditor had the burden of proving that such notice was given

8. 769 S.W.2d at 297-98.
9. In English v. Fisher, 660 S.W.2d 521 (Tex. 1983), the court used some hyperbole in its opinion that may have obscured analysis in some subsequent decisions. The court stated, inter alia:

This concept [of good faith and fair dealing] is contrary to our well-reasoned and long-established adversary system which has served us ably in Texas for almost 150 years . . . The novel concept advocated by the courts below would abolish our system of government according to settled rules of law and let each case be decided upon what might seem "fair and in good faith," by each fact finder. This we are unwilling to do.

Id. at 522.

This language was used by the courts in Cantu v. Western Fire & Casualty Ins. Co., 716 S.W.2d 737, 740 (Tex. App.—Corpus Christi 1986), writ ref'd n.r.e., per curiam, 723 S.W.2d 668 (Tex. 1987), and Cluck v. Frost Nat'l Bank, 714 S.W.2d 408, 410 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.), as a ground for decision in those cases. The supreme court itself seems to have recognized that the quoted language was a bit of an overstatement when it noted in its per curiam refusal of a writ of error in Cantu that the more recent case of Arnold v. Nat'l County Mutual Fire Ins. Co., 725 S.W.2d 165 (Tex. 1987), was the proper interpretation of English v. Fisher. See 723 S.W.2d at 668. In Adolph Coors Co. v. Rodriguez, 780 S.W.2d 477 (Tex. App.—Corpus Christi 1989, no writ), the court also used the more analytical approach described in the Spears's concurring opinion.

10. See, e.g., Williamson v. Dunlap, 693 S.W.2d 373, 374 (Tex. 1985) (no right to accelerate when no notice of intent to accelerate given); Baldazo v. Villa Oldsmobile, 695 S.W.2d 815, 817 (Tex. App.—Amarillo 1985, no writ) (both notice of intent to accelerate and notice of acceleration required for proper acceleration and foreclosure).


13. Id. at 388.
14. Id. at 389.
15. Id. at 390. The author has argued elsewhere that the standards for waiver of the notice requirements should be raised. See Krahmer, Commercial Transactions, Annual Survey of Texas Law, 40 Sw. L.J. 187, 188-90 (1986). Such a drafting requirement would hardly be an onerous one.

16. 768 S.W.2d 463 (Tex. App.—Tyler 1989, no writ).
II. Sales Transactions

A. Enforceability and Terms of Sales Contracts

Parol Evidence Admissible to Show Contract was Not Formed. It is fundamental hornbook law that no contract is formed if the parties lack contractual intent. In *King v. Fordice* the court held that adoption of the Code did not displace this general common law rule of contracts and that parol evidence was admissible to show that a contract for the sale of an airplane never came into existence. This conclusion is in accord with the view expressed by numerous commentators on the Code.

Calculation of Price. Section 2.305 of the Code allows a contract to be formed even if the parties have not agreed on a specific price so long as they intend to be bound by the contract. A fortiori, the parties can agree on a price to be fixed in terms of an agreed market, and this price will be enforceable if the market continues to operate. In *Tejas Grain Makers, Inc. v. Cactus Feeders, Inc.* the court held that a contract calling for the price of corn to be set by calculation of the monthly average of the daily midpoint of a specified market constituted a definite price enforceable by the buyer.

B. Warranties

Warranty of Title. Unless specifically disclaimed, a warranty of good title exists in every contract for the sale of goods. The warranty of title is breached, not only by an inability on the part of the seller to convey good title, but by a disturbance of the buyer's right to quiet possession of the
goods. According to the court in Saulny v. RDY, Inc., however, the warranty of good title was not breached by a seller’s failure to deliver a certificate of title to a boat where the buyer’s use of the boat was not affected by the nondelivery of the title. This result was reached even though the seller did not comply with the certificate of title provisions of the Texas Parks & Wildlife Code requiring a boat dealer to apply for a certificate of title within twenty days following sale. The court held that the statute did not render the sale void as between the parties.

Warranties of Quality. Most of the warranty litigation during the Survey period centered on alleged breaches of express or implied warranties of quality. In National Bugmobiles, Inc. v. Jobi Properties an extermination company treated a home for subterranean termites at the request of the original owner. After sale of the home to the plaintiff, an infestation of drywood termites was discovered, and the exterminator refused to honor a written warranty promising retreatment without charge if termites were discovered after the first treatment. The exterminator argued that the warranty did not extend to treating an infestation of a different type than that involved in the original work and that the plaintiff was not a “consumer” for purposes of the warranty under the Deceptive Trade Practices Act (DTPA) because the plaintiff did not directly seek the services of the defendant exterminator. The court held that the language of the warranty did not limit retreatment to particular types of termite infestation and that evidence of the transferability of the express warranty upon sale of the home made the plaintiff a consumer for purposes of the DTPA.

In Donwerth v. Preston II Chrysler-Dodge, Inc. the consumers purchased a used car after the salesman made representations that the brakes were in good condition. When the consumers later discovered that the odometer had been rolled back on the vehicle and that the brakes were seriously worn, they attempted to resolve the problems by negotiation with the dealer. When negotiations failed, they drove around the dealership on three consecutive Saturdays with a sign on their car reading “BOUGHT THIS CAR FROM PRESTON II. THE MILES WERE ROLLED BACK.” When the dealer brought an action for defamation, the consumers asserted counterclaims for misrepresentations of the quality of the goods under the Deceptive Trade Practices Act. The supreme court held that the salesman’s

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29. See Saenz Motors v. Big H. Auto Auction, Inc., 653 S.W.2d 521 (Tex. App.—Corpus Christi 1983) (seizure and retention of automobiles by Department of Public Safety breached warranty even without proof that the automobiles were stolen), aff’d, 665 S.W.2d 756 (Tex. 1984).
30. 760 S.W.2d 813 (Tex. App.—Corpus Christi 1988, no writ).
31. Id. at 815.
33. 760 S.W.2d at 815.
34. 773 S.W.2d 616 (Tex. App.—Corpus Christi 1989, writ denied).
35. TEX. BUS. & COM. CODE ANN. § 17.45(4) (Vernon 1987).
36. 773 S.W.2d at 621.
37. 773 S.W.2d 634 (Tex. 1989).
38. Id. at 636.
39. Id. TEX. BUS. & COM. CODE ANN. § 17.46(b)(7) (Vernon 1987) provides that mis-
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statements constituted some evidence to support a jury finding that the dealer had misrepresented the quality of the brakes.\textsuperscript{40} The more important part of the opinion, however, is the discussion of the holding by the court of appeals\textsuperscript{41} that the evidence did not support a DTPA claim and that the dealer was entitled to recover attorneys' fees because the action was groundless and brought in bad faith. On this issue, the supreme court held that the action was not groundless because some evidence did support the jury verdict.\textsuperscript{42} The court further noted, in dictum, that a DTPA action cannot be found to have been brought for "purposes of harassment" unless it was brought for the sole purpose of harassment.\textsuperscript{43} The court remanded the case for further proceedings.\textsuperscript{44}

In \textit{Sidco Products Marketing, Inc. v. Gulf Oil Corp.}\textsuperscript{45} a disappointed buyer of "Middle Layer Emulsion," or "MLE," described as "a mixture of oil, water and particulate matter,"\textsuperscript{46} sued for breach of express warranties, implied warranties and associated DTPA claims. The court found that no express warranties were given by the seller and that no implied warranties were breached when the oil was found to be environmentally hazardous because the oil was never described as "ordinary slop oil."\textsuperscript{47} The court also found there was no basis for the DTPA claims because the seller made no inaccurate representations about the qualities of the goods.\textsuperscript{48}

In \textit{Glockzin v. Rhea}\textsuperscript{49} the court found neither a breach of warranty nor a DTPA misrepresentation when a truck repair company refused to repair a truck under an alleged oral warranty because of the owner's failure to pay for prior repair work, including repairs purportedly covered by the warranty.\textsuperscript{50} The court noted evidence introduced by the repair company that it was customary in the trade to refuse repairs when prior work had not been paid for by the customer and held there was no breach or misrepresentation of the repair warranty.\textsuperscript{51} A dissenting opinion argued that the various repair contracts were severable and that the failure of the customer to pay the entire account for all repairs should not preclude recovery for any collateral representation of standard, quality, or grade constitutes a deceptive trade practice. The opinion does not indicate why an express warranty claim was not joined with the DTPA claim; in actions involving express representations of quality, no essential difference exists in the two claims.

\begin{itemize}
\item \textsuperscript{40} 775 S.W.2d at 636. The odometer claim was not pursued because the rollback apparently occurred when the car was in the hands of a prior owner, and the car dealer did not know this at the time of sale.
\item \textsuperscript{41} Preston II Chrysler-Dodge v. Donwerth, 744 S.W.2d 142 (Tex. App.—Dallas 1987), rev'd, 775 S.W.2d 634 (Tex. 1989).
\item \textsuperscript{42} 775 S.W.2d at 637.
\item \textsuperscript{43} \textit{Id.} at 638.
\item \textsuperscript{44} \textit{Id.} at 639.
\item \textsuperscript{45} 858 F.2d 1095 (5th Cir. 1988).
\item \textsuperscript{46} \textit{Id.} at 1097.
\item \textsuperscript{47} \textit{Id.} at 1099. Ordinary slop oil can be processed by ordinary refining processes while MLE requires special handling and treatment.
\item \textsuperscript{48} \textit{Id.}
\item \textsuperscript{49} 760 S.W.2d 665 (Tex. App.—Houston [1st Dist.] 1988, writ denied).
\item \textsuperscript{50} \textit{Id.} at 668.
\item \textsuperscript{51} \textit{Id.}
\end{itemize}
warranty claims. Oddly enough, neither the majority nor the dissenting opinions mentioned *Melody Home Manufacturing Co. v. Barnes* and the implied warranty of good and workmanlike service for the repair or modification of tangible property created by that decision.  

**Implied Warranties.** Implied warranties arise in transactions for the sale of goods under sections 2.314 and 2.315 of the Code. Texas case law has also created implied warranties in other types of transactions. Several recent cases dealt with the scope of these warranties and how burdens of proof should be allocated in proving breach. In *Doe v. Cutter Laboratories* and *Easterly v. HSP of Texas, Inc.* the courts considered arguments that products used in the rendition of medical services are covered by the implied warranty provisions of the Code. In *Doe* the products were cryoprecipitate and lyophilized plasma derived from blood and blood plasma. The court cited the provisions contained in section 2.316 of the Texas Code, which exclude blood, blood plasma or other human tissues from implied warranty coverage and concluded that products derived from blood and blood plasma were subject to the same exclusion because they were inherent parts of a medical service rather than commodities offered for sale. In *Easterly* the court similarly concluded that a catheter that broke off in a mother’s spine during childbirth related to the rendition of a medical service and not to the sale of a good. Because the primary relationship between the parties was based on a service rather than the sale of a product, no implied warranties attached to the transaction.

In the rather bizarre case of *Haney v. Purcell Co., Inc.* the purchasers of a home discovered that their backyard had once been a cemetery. The supreme court ruled that simply because the area had been abandoned as a

52. *Id.* at 669 (Hoyt, J., dissenting).

53. 741 S.W.2d 349 (Tex. 1987).

54. *Id.* at 354. In *Melody Home* the court also held that the implied warranty could not be waived or disclaimer. *Id.* at 355. It is unfortunate that the court did not address the question of whether the failure to pay for repairs is a valid defense under *Melody Home* in light of the antiwaiver policy.

55. TEX. BUS. & COM. CODE ANN. § 2.314-.315 (Tex. UCC) (Vernon 1968).

56. See, e.g., Davidow v. Inwood N. Professional Group-Phase I, 747 S.W.2d 373 (Tex. 1988) (implied warranty of suitability in commercial leases); *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987) (implied warranty that repairs or modifications of tangible personal property will be done in a good and workmanlike manner); *Kamarath v. Bennett*, 568 S.W.2d 658 (Tex. 1978) (implied warranty of habitability in residential leasing); *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968) (implied warranty of habitability in sale of dwelling).


58. 772 S.W.2d 211 (Tex. App.—Dallas 1989, no writ).

59. TEX. BUS. & COM. CODE ANN. § 2.316(e) (Tex. UCC) (Vernon 1968) provides:

The implied warranties of merchantability and fitness shall not be applicable to the furnishing of human blood, blood plasma, or other human tissues or organs from a blood bank or reservoir of such other tissues or organs. Such blood, blood plasma or tissue or organs shall not for the purpose of this Title be considered commodities subject to sale or barter, but shall be considered as medical services.

60. 703 F. Supp. at 574.

61. 772 S.W.2d at 214.

62. *Id.*

63. 770 S.W.2d 566 (Tex. 1989).
cemetery at some time in the past, the purchasers’ claims for negligence, fraud, breach of express warranty, breach of implied warranty and DTPA violations were not moot. The court remanded the case for consideration of the other issues raised.

In *Melody Home Manufacturing Co. v. Barnes* the supreme court held that an implied warranty of good and workmanlike service attached to the repair or modification of tangible property. The court also held that this warranty could not be waived or disclaimed. In *Archibald v. Act III Arabians* the court of appeals held that the inability to waive or disclaim this warranty also meant that the provider of services could not utilize the defenses of assumption of risk or indemnity from the consumer to avoid the warranty. *Archibald* is the first case to deal with the substantive meaning of the waiver aspect of the *Melody Home* opinion.

The most important warranty decision rendered during the Survey period was *Plas-Tex, Inc. v. United States Steel Corp.* In *Plas-Tex* the supreme court held that the purchaser of goods who asserted breach of the implied warranty of merchantability had to prove that the goods were defective at the time they left the manufacturer’s or seller’s possession. The court defined “defect” as meaning “a condition of the goods that renders them unfit for the ordinary purposes for which they are used because of a lack of something necessary for adequacy.” The difficulty of proving a defect under this test is somewhat ameliorated by the suggestion of the court that circumstantial evidence may be used to prove a defect where the plaintiff can show proper use of the goods together with a malfunction.

Disclaimers and Statute of Limitations. Disclaimers of warranty are regulated by section 2.316 of the Code. The most fundamental rule stated in that section is the requirement that a disclaimer must be conspicuous.

In *Cate v. Dover Corp.* the court determined that one paragraph in a five-paragraph advertisement bearing the prominent title “WARRANTY” was conspicuous and constituted an adequate disclaimer of all implied warranties. The dissent disagreed that the single paragraph, which was not set out from the rest of the text in boldface or other distinguishable type, was conspicuous. The advertisement itself is reprinted in the text of the opin-

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64. Id. at 567.
65. Id. The court of appeals, in an unpublished opinion, had not reached the other issues because it regarded them as mooted by the abandonment of the property as a cemetery.
66. 741 S.W.2d 349 (Tex. 1987); see supra note 54.
67. 741 S.W.2d at 354.
68. Id. at 355.
69. 768 S.W.2d 827 (Tex. App.—Houston [14th Dist.] 1989, writ denied).
70. Id. at 828.
71. 772 S.W.2d 442 (Tex. 1989).
72. Id. at 444.
73. Id. n.4.
74. Id. at 444-45.
75. TEX. BUS. & COM. CODE ANN. § 2.316 (Tex. UCC) (Vernon 1968).
76. Id. § 2.316(b).
77. 776 S.W.2d 680 (Tex. App.—Texarkana 1989, writ requested).
78. Id. at 682.
79. Id. at 685 (Grant, J., dissenting).
ion and provides an interesting way for lawyers to test themselves in judging whether a disclaimer is conspicuous.\textsuperscript{80} Apparently, no DTPA misrepresentation claim was alleged as a cause of action in the case.

In \textit{American Alloy Steel v. Armco, Inc.}\textsuperscript{81} a buyer notified a steel seller that certain steel plate purchased from the seller was defective. The defect was one that could not be discovered until a buyer attempted to burn and mill the plate (that is, the defect could not be discovered by a seller who merely held the plate in inventory without attempting to use it). The seller replaced the plate and sued the manufacturer for reimbursement. The court held there was no express indemnity agreement between the manufacturer and the seller and no indemnity liability should be implied.\textsuperscript{82} The court further held that any warranty claim by the seller against the manufacturer was barred by the four-year statute of limitations in section 2.725 of the Code\textsuperscript{83} because more than four years had passed from the time of sale by the manufacturer to the seller.\textsuperscript{84}

\section*{C. Good Faith Purchase}

Right of Buyers to Avoid Third-Party Claims. Two sections of the Code deal with the right of a buyer of goods to avoid third-party claims of ownership or other interests in the goods that are the subject of the transaction.\textsuperscript{85} In \textit{La Hacienda Savings Association v. Houston-Gulf Investment Corp.}\textsuperscript{86} the buyer of a repossessed aircraft from a leasing company argued that it was either a buyer in the ordinary course of business or a bona fide purchaser who took the aircraft free of the outstanding security interest of a third party that had financed the purchase of the plane by the leasing company. The court held that the buyer did not qualify as a buyer in the ordinary course of business because it did not purchase the aircraft from a seller who was in the business of selling goods of that kind.\textsuperscript{87} The court also held that the evidence was in dispute as to whether the buyer had knowledge of the claim of the secured party and thus would not support summary judgment in favor of the buyer.\textsuperscript{88} The court remanded the case for trial.\textsuperscript{89}

In \textit{Thompson v. Apollo Paint & Body Shop}\textsuperscript{90} the buyer of a used automobile fared better against the claim of a repair shop that it had a mechanic's lien on the automobile. The seller had possession of both the automobile and a certificate of title disclosing only a security interest in favor of a bank;

\begin{itemize}
  \item \textsuperscript{80} \textit{Id.} at 684. If the majority is correct, the author of this Article flunks the test because the disclaimer hardly seems conspicuous in his view.
  \item \textsuperscript{81} 777 S.W.2d 173 (Tex. App.—Houston [14th Dist.] 1989, no writ).
  \item \textsuperscript{82} \textit{Id.} at 176.
  \item \textsuperscript{84} 777 S.W.2d at 176.
  \item \textsuperscript{86} 759 S.W.2d 195 (Tex. App.—San Antonio 1988, no writ).
  \item \textsuperscript{88} 759 S.W.2d at 198.
  \item \textsuperscript{89} \textit{Id.}
  \item \textsuperscript{90} 768 S.W.2d 373 (Tex. App.—Houston [14th Dist.] 1989, writ denied).
\end{itemize}
nothing in the documentation or in the circumstances showed that a mechanic's lien existed. The court held that possession by the repair shop was essential to foreclosure of a mechanic's lien and that, by giving up possession, the repair shop ran the risk that the automobile would be sold to a good faith purchaser. The court awarded the buyer title and possession of the automobile as a matter of law.

D. Performance Disputes

Revocation of Acceptance. In Green Tree Acceptance, Inc. v. Pierce the Tyler court of appeals carefully analyzed the relationship between the DTPA, the Federal Trade Commission Holder in Due Course Rule, and the right of a buyer to revoke acceptance of goods under the Code. The court stated three principal conclusions: First, the buyers of a mobile home were entitled to revoke acceptance of the home because of numerous defects substantially impairing its value to them; second, the right to revoke acceptance was equivalent to the right of rescission allowed under the DTPA, and a pleading that sought to revoke acceptance was adequate as a prayer for rescission under the DTPA; and third, the holder of a consumer credit contract under the FTC Holder in Due Course Rule was subject to the remedy of rescission and the buyers did not need to prove an amount of actual damage to obtain cancellation of the contract in the hands of the holder. The court also held that the buyers were entitled to the recovery of attorney's fees on its rescission claim, but the holder of the contract was entitled to an offset for the fair rental value of the home during the time it was in use by the buyers.

Excused Performance. Under the Code, performance under a contract of sale may be excused if performance "has made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made." The parties to a contract are free to modify the Code test if they so desire or to adopt other standards for the determination of a valid excuse for nonperformance. In Atlantic Richfield Co. v. ANR Pipeline Co., the parties included a force majeure clause in their contract that excused performance by a buyer of gas in response to "any laws, orders, rules, regulations, acts or restraints of any government or

91. Id. at 376.
92. Id. at 377.
93. 768 S.W.2d 416 (Tex. App.—Tyler 1989, no writ).
96. TEX. BUS. & COM. CODE ANN. § 2.608 (Tex. UCC) (Vernon 1968).
97. 768 S.W.2d at 424. The test of substantial impairment is contained in TEX. BUS. & COM. CODE ANN. § 2.608 (Tex. UCC) (Vernon 1968).
98. 768 S.W.2d at 424.
99. Id. at 420.
100. Id. at 425.
102. Id. § 2.615(2).
103. 768 S.W.2d 777 (Tex. App.—Houston [14th Dist.] 1989, no writ).
governmental body or authority, civil or military. Because of a change in rate structure under Federal Energy Regulatory Commission Order No. 380, the buyer substantially reduced its gas purchases. The court held that the force majeure clause was sufficient to excuse the buyer's performance. In Texas City Refining, Inc. v. Conoco, Inc. the jury found that a delay in the seller's delivery of crude oil (during which the price fell by approximately fifty percent) had been caused by bad weather, an event excused by the force majeure clause. Because the seller's delay was excused under the terms of the contract, the buyer was not relieved from the obligation to accept delivery when the goods finally arrived.

E. Remedies

Difference Between Contract Price and Market Price. Under section 2.708 of the Code, the measure of damages for nonacceptance by a buyer is the difference between the market price at the time and place for tender and the unpaid contract price. In Everspring Enterprises v. Bunge Edible Oil the court held that proof of the difference in value of crude soybean oil was not relevant to prove the difference in value of a finished product manufactured in part from the crude oil. Because of the failure to plead and prove the proper measure of damages, the seller was denied recovery for the buyer's failure to take delivery.

Buyer's Security Interest in Delivered Goods. Section 2.711 of the Code gives the buyer a right to cancel if goods are nonconforming and also creates a security interest in goods in the possession of the buyer to the extent of any payments made on their price and for expenses incurred in the care and custody of the goods. The secured buyer is entitled to sell the goods in an attempt to realize on its security interest. In Aztec Corp. v. Tubular Steel, Inc. and Oil Country Specialists, Ltd. v. Phillip Bros. buyers of oil field pipe attempted to use this security interest to secure payments made against the price. In Aztec the attempt was successful even though the buyer was unable to sell the goods in realization of its security interest. The court held that a buyer who was unsuccessful in selling the goods could not be charged with the value of the goods as an offset to the recovery of damages against the seller. In Oil Country Specialists the court of appeals held that
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The failure to make a good faith rejection prevented the buyer from cancelling under the terms of section 2.711.119 The court also found, however, that the seller had breached the contract by delivering defective pipe; this breach terminated any liability of the buyer to pay restocking fees.120 The buyer had previously obtained a standby letter of credit in favor of the seller as beneficiary to pay the restocking fees if the buyer defaulted in making such payment, and the court of appeals enjoined the seller from making a presentment under the credit because of the seller's breach.121 The Texas Supreme Court reversed the court of appeals on the letter of credit issue, noting that a letter of credit is an independent contract between the issuing bank and the beneficiary.122 The court held that a breach of contract by the beneficiary was not equivalent to the fraud in the transaction required to justify an injunction against honor of a letter of credit.123

Damages for Breach of Warranty. The usual, but not exclusive, measure of damages for a breach of warranty is the difference between the value of the goods as represented and the value of the goods as actually delivered.124 In Pontiac v. Elliott125 the court determined that the evidence was insufficient to prove that the goods as delivered were completely worthless.126 There was some evidence, however, tending to show a difference between the value of the goods as delivered and the value of the goods as represented.127 The court remanded the case for a new trial.128 In Ortiz v. Flintkote Co.129 the court held that cost of repair was a proper alternative measure of damages where a contractor had incorporated the goods into the construction of houses.130 The court approved this measure even though the contractor had already sold the houses and any money judgment awarded on this basis would not actually be used to make repairs.131

118. 762 S.W.2d at 179.
119. Id.
120. Id.
121. Id.
123. Id. TEX. BUS. & COM. CODE ANN. § 5.114 (Tex. UCC) (Vernon 1968 & Supp. 1990) allows an injunction against honor if there is fraud in the underlying transaction between the beneficiary and the account party.
124. TEX. BUS. & COM. CODE ANN. § 2.714 (Tex. UCC) (Vernon 1968); see also W.O. Bankston Nissan, Inc. v. Walters, 754 S.W.2d 127, 128 (Tex. 1988) (common law measure of actual damage for breach of contract is difference between value of goods as represented and that of goods delivered).
125. 775 S.W.2d 395 (Tex. App.—Houston [1st Dist.] 1989, writ denied).
126. Id. at 400.
127. Id.
128. Id. at 401.
129. 761 S.W.2d 531 (Tex. App.—Corpus Christi 1988, writ denied).
130. Id. at 536. In Ludt v. McCollum, 762 S.W.2d 575, 576 (Tex. 1988), the court noted that cost of repair could be combined with an amount allowed for the permanent reduction in market value of a residence after repair; special issues must be submitted on both cost of repair and reduction in value after repairs are made.
131. 761 S.W.2d at 536.
Limitation of Liability Clause. A limitation of liability clause was upheld in Transcontinental Gas Pipe Line Corp. v. American National Petroleum Co.\textsuperscript{132} under section 2.719 of the Code\textsuperscript{133} in a commercial context involving the sale of natural gas.\textsuperscript{134} Although the court was willing to hold an implied covenant of good faith and fair dealing governed performance of the contract, the court also held that a breach of this covenant would be contractual only and, absent a finding of an independent tort with accompanying actual damage, exemplary damages could not be awarded.\textsuperscript{135} In Southwestern Bell Telephone v. Delanney\textsuperscript{136} the majority refused to enforce a limitation of liability clause where the action was based on the theory of negligent performance of contract rather than on simple breach of contract.\textsuperscript{137} In addition to the majority opinion, both a concurrence and a dissent appear in Delanney.\textsuperscript{138} Between the three opinions, the case contains a comprehensive discussion of the theory of negligent performance of contract.

III. COMMERCIAL PAPER

A. Burdens of Proof

Evidence of Defense Required to Avoid Summary Judgment. Under section 3.307 of the Code, production of an instrument entitles the holder to recover on it unless the defendant establishes a defense.\textsuperscript{139} Mere conclusory allegations are insufficient to establish a defense; the defendant must support each element of an alleged defense by evidence that would be admissible at trial to show the existence of a genuine issue of material fact.\textsuperscript{140} Under some circumstances a defense may appear in the record as a matter of law, as when a prepayment penalty has been assessed when a note has been accelerated.\textsuperscript{141} In such cases the appellate court can rule on the issue directly.\textsuperscript{142} In other circumstances the court must determine if an alleged defense has been properly supported by admissible evidence.\textsuperscript{143}

The failure to support an alleged defense with admissible evidence can be hazardous for a defendant. In two cases Texas courts assessed damage awards against the defendants for taking nonmeritorious appeals from adverse rulings on summary judgment motions where evidence did not support the alleged defenses.\textsuperscript{144}

\begin{footnotes}
\item[132] 763 S.W.2d 809 (Tex. App.—Texarkana 1988, writ granted).
\item[134] 763 S.W.2d at 817.
\item[135] Id. at 820.
\item[136] 762 S.W.2d 772 (Tex. App.—Texarkana 1988, writ granted).
\item[137] Id. at 775.
\item[138] Id. at 777. (Cornelius, C.J., concurring); Id. at 777-81 (Grant, J., dissenting).
\item[140] Hooper v. Mercantile Bank & Trust, 762 S.W.2d 383, 386 (Tex. App.—San Antonio 1988, no writ).
\item[141] Texas Airfinance Corp. v. Lesikar, 777 S.W.2d 559, 563 (Tex. App.—Houston [14th Dist.] 1989, no writ).
\item[142] Id.
\item[143] Id. at 563-64.
\item[144] Hill v. Thompson & Knight, 756 S.W.2d 824, 826 (Tex. App.—Dallas 1988, no writ) (damages of $1,500 awarded on appeal); Trans-Continental Finance Corp. v. Summit Nat'l
\end{footnotes}
Federal law also requires that a person who might be liable on an instrument raise a genuine issue of material fact to avoid an adverse ruling on a motion to enforce the instrument by summary judgment. In litigation involving the FDIC, this requirement can be an even greater burden than under state law because some defenses that might be available against a state-law noteholder are cut off by the rights of the FDIC in its receivership or in its corporate capacities. Such defenses include failure of consideration, fraud in the inducement, and misrepresentation. If a defendant can establish, however, that the alleged defense appeared in the minutes of the board of directors of an insolvent bank, or if the defense amounts to fraud in the factum, a motion for summary judgment in favor of the FDIC may be avoided.

**B. Liability of Parties**

**Liability of Guarantors.** In *Ford v. Darwin* the guarantors under a non-negotiable "Promissory Note Agreement" argued that the plaintiff was required either to join the principal obligor or to prove that the obligor was actually or notoriously insolvent. The court noted that the word "guarantee," used without qualification, is a guaranty of payment and not merely a guaranty of collection under section 3.416 of the Code. In this case, though, the agreement was entirely outside the Code rules governing instruments because the agreement included a promise by the borrower to sell stock to the lender. The court did not regard this circumstance as con-
trolling, however, and held that a guarantor of payment on a non-Code instrument has the same obligations as the guarantor of payment on a Code instrument.154

**Liability of Assignees.** The question of whether the assignee of a credit contract may be vicariously liable to the debtor because the assignee and assignor are “inextricably intertwined” has been the subject of considerable litigation in Texas.155 In *Qantel Business System v. Custom Controls Co.*156 the supreme court seems to have settled the issue of vicarious liability by holding that the inextricably intertwined doctrine does not create a new theory of liability and that an assignee must have committed an independent wrong to be held liable to the debtor.157 Proof that an assignee is intertwined with an assignor is only relevant to show that the debtor qualifies as a “consumer” with respect to the assignee for purposes of possible Deceptive Trade Practices Act liability; it does not dispense with the need to show the commission of a deceptive act by the assignee.158 The court reached the same result in *Briercroft Service Corp. v. De Los Santos*,159 a case involving the Federal Trade Commission “holder in due course rule.”160 The court also noted that, under the FTC rule, the assignee was not liable to the debtor beyond the amount paid under the contract; because nothing had been paid under the contract, the assignee would not be liable in any event even if a violation by the assignor had occurred.161

**Liability of Issuer of Travelers’ Checks.** In *Thomas C. Cook, Inc. v.*

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154. 767 S.W.2d at 855. On this point, the Court said: “We are persuaded that section 3.416(a) of the Texas UCC correctly reflects the present law regarding guaranties of payment of both UCC and non-UCC instruments. Regardless of the UCC or non-UCC nature of the underlying instrument, a guarantor performs the identical function and should assume the identical obligations. We find no rational basis for the argument that a guarantor of payment of a non-UCC instrument has different rights and liabilities than a guarantor of payment of a UCC instrument.”


156. 761 S.W.2d 302 (Tex. 1988).

157. Id. at 305.

158. Id.

159. 776 S.W.2d 198 (Tex. App.—San Antonio 1988, writ denied).

160. The Federal Trade Commission “holder in due course rule” requires that a consumer credit contract contain a conspicuous notice that any holder of the contract is subject to all claims and defenses that the debtor could raise against the original assignor. 16 C.F.R. §§ 433.1-3 (1989).

161. 776 S.W.2d at 205. The Texas Supreme Court had previously held that an assignee was liable only to the extent of payments made under a contract containing the FTC notice. *Home Sav. Ass’n v. Guerra*, 733 S.W.2d 134, 136 (Tex. 1987).
Rowhanian, the El Paso court of appeals again considered the liability of an issuer to the owner of lost travelers’ checks. In a careful analysis of the Code rules as applied to travelers’ checks, the court concluded that such checks are negotiable instruments under the Code. A purchaser of travelers’ checks could also be a “consumer” of services for purposes of the Deceptive Trade Practices Act because the issuer guarantees replacement of lost checks. In Rowhanian, however, the owner testified that the checks, when lost, already contained the signature and countersignature of the original purchaser. Because the checks had already been countersigned, the owner was merely the holder of bearer instruments and not a consumer vis-à-vis the issuer. Under these circumstances, the court said it would be “unreasonable to require replacement.” The issuer had nevertheless agreed to replace the checks if the holder would sign an indemnity agreement to cover the lost checks if they should ever be presented for payment. The court allowed recovery for the face amount of the instruments and partial prejudgment interest.

IV. BANK TRANSACTIONS

A. Payment of Instruments

Liability of Payor Banks for Payment Over a Forged Indorsement. According to section 3.419 of the Code, an instrument is converted when it is paid on a forged indorsement. In Interfirst Bank v. Pioneer Concrete the court considered whether a payor bank that pays an instrument on a forged indorsement is entitled to utilize the defense that it acted in good faith and in accordance with reasonable commercial standards in making the payment and no longer has funds represented by the instrument remaining in its hands. The court termed this an issue of first impression in Texas and noted that only one other case in the United States had addressed the question. The court correctly held that a payor bank stands in a different

163. The court had previously addressed this issue in Thomas C. Cook, Inc. v. Rowhanian, 700 S.W.2d 672, 674 (Tex. App.—El Paso 1985, writ ref’d n.r.e.), where it reversed and remanded for a new trial.
164. 774 S.W.2d at 682.
165. Id. at 683.
166. Id.
167. Id.
168. Compare Tex. Bus. & Com. Code Ann. § 3.804 (Tex. UCC) (Vernon 1968) allowing recovery on lost instruments upon indemnity against loss by reason of further claims on the instruments. Failing agreement with the issuer, the owner could have asserted rights under this section as an alternative to the indemnity agreement.
169. 774 S.W.2d at 686. Only partial prejudgment interest was allowed because of the failure of the owner to file suit on the correct legal theory in the first trial and appeal. Interest was suspended from the time of the first filing until judgment in the first appeal.
171. 761 S.W.2d 857 (Tex. App.—Dallas 1988, no writ).
174. 761 S.W.2d at 858.
relationship to the owner of an item than does a collecting bank since a payor is not an agent of the owner, but rather is acting on behalf of the depositor who drew the check.\textsuperscript{175} It would make little sense for the statute to impose liability on a payor for payment of a check over a forged indorsement and to then excuse that liability if the payor no longer has the funds represented by the check. This would, in effect, excuse virtually every payment on a forged indorsement and make conversion liability meaningless. The court properly rejected the defense asserted in this case,\textsuperscript{176} which simply misconstrued the payment structure of articles 3 and 4 of the Code.

**Liability for Failure to Verify Drawer’s Signature.** A payor bank that pays items over the forged signature of its customer is generally required to recredit its customer’s account unless the payor can establish that the customer failed to act with reasonable promptness to notify the payor of forgeries on the account.\textsuperscript{177} The customer may avoid this duty, however, if it can be shown that the bank itself failed to exercise ordinary care in paying the items.\textsuperscript{178} While the issue of ordinary care is usually an issue of fact, extreme circumstances may permit the court to treat it as a matter of law. Such circumstances occurred in *McDowell v. Dallas Teachers Credit Union*,\textsuperscript{179} where witnesses for the payor testified that it had no procedure for the verification of signatures on share drafts drawn on accounts maintained at the payor credit union and that this was standard practice in the credit union industry. One witness testified that general industry usage did not even require that share drafts be signed before they were paid. Faced with this rather remarkable testimony,\textsuperscript{180} the court held that, as a matter of law, the failure to have any procedure to verify signatures was “unreasonable, arbitrary, and unfair.”\textsuperscript{181} Despite a delay by the customers in giving notice of forgeries on their account, the payor was held liable for the amount of the forgeries because of its failure to exercise ordinary care.\textsuperscript{182}

**Time Allowed for Payment or Return of Items.** One of the underlying policies of article 4 of the Code is to promote speed in the check collection process. This is accomplished in large part by the imposition of strict time limits for the collection and payment of items by collecting and payor

\begin{enumerate}
  \item Id. at 859.
  \item Id.
  \item TEX. BUS. & COM. CODE ANN. § 4.406 (Tex. UCC) (Vernon 1968).
  \item Id. To similar effect, see id. § 3.406, but under this section the payor has the burden of proving ordinary care.
  \item 772 S.W.2d 183 (Tex. App.—Dallas 1989, no writ).
  \item The court stated:
    After an exhaustive search, we have found no cases directly on point nor have the parties cited any cases directly on point. Of the published opinions that deal with similar issues, each case involves a situation where the bank employed some method of signature verification on some of the checks passing through the bank. . . . In the instant case, there was no evidence that any process was used to verify signatures on any of the share drafts.
    \textit{Id.} at 189-90 (footnote omitted; emphasis in original).
  \item Id. at 189.
  \item Id. at 193.
\end{enumerate}
In the case of a payor bank, a decision to pay or return must be made by midnight of the day following the day of receipt of an item, a time period referred to as the "midnight deadline."184 In *Pulaski Bank & Trust v. Texas American Bank*,185 the issue was whether an item was returned by the midnight deadline where the presenting bank and the payor bank were both owned by the same holding company and where both banks cleared checks through a data processing center that was also owned by the holding company. After a careful review of the collection and payment rules of article 4, the court held that each bank was entitled to be regarded as a separate corporate entity for purposes of determining the time for the processing of checks. Based on the separate status of each bank, the court held that the payor bank had made a timely return of the check through the data processing center to the presenting bank and was not liable for a late return.186 The presenting bank, however, breached its duty of ordinary care in returning the item by misrouting it, thereby delaying receipt of notice of dishonor by the depositary bank that had initiated the collection.187 The measure of damages for breach of the duty of ordinary care by a collecting bank is the face amount of the item reduced by an amount that could not have been realized by the use of ordinary care.188 The court found that the depositary bank could have mitigated its damages by freezing its depositor’s account instead of allowing further withdrawals when it belatedly learned of the dishonor and could thus have avoided all but some $8,202.14 in damages.189

The *Pulaski* case is important for its careful application of article 4 to modern check clearings through jointly owned data processing centers and settles critical issues of timing for purposes of check payment. Although the court carefully noted that no evidence indicated that the banks engaged in a fraudulent or sham arrangement designed to extend the time for processing checks or to avoid liability for late returns, the court did suggest that such evidence would represent a limit on the use of joint processing centers by affiliated banks.190

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183. The time limit for collecting banks is midnight of the day following the day an item is received. *Tex. Bus. & Com. Code Ann.* § 4.202(b) (Tex. UCC) (Vernon 1968). The time limit for payor banks is midnight of the day of receipt for settlement, *Tex. Bus. & Com. Code Ann.* § 4.301(a), and midnight of the day following the day of receipt for payment, *id.* §§ 4.301(a), 4.302(1).

184. *Id.* § 4.104(a)(8).

185. 759 S.W.2d 723 (Tex. App.—Dallas 1988, writ denied).

186. 759 S.W.2d at 731; see *Tex. Bus. & Com. Code Ann.* § 4.106 (Tex. UCC) (Vernon 1968) (branch banks to be treated as separate banks for clearing purposes).


188. 759 S.W.2d at 734.


190. 759 S.W.2d at 736.

191. *Id.* at 732.
B. Setoffs

Setoffs and the Duty of Good Faith. In *Plaza National Bank v. Walker* the court upheld both lack of good faith and Deceptive Trade Practice claims against a bank for the exercise of a wrongful setoff. The court awarded actual damages of $300 and $100 dollars to each of two savings account depositors and exemplary damages of $20,000, remitted to $10,000 on appeal. The opinion contains little discussion of rationale, but the court states two holdings of potential importance. First, citing *Arnold v. National County Mutual Fire Insurance Co.*, the court ruled that a relationship between a bank and a depositor is a "special relationship" creating a duty of good faith and fair dealing that was breached by the bank. The opinion, however, does not discuss precisely how the bank breached this duty. Second, citing *Riverside National Bank v. Lewis*, the court held that a depositor who maintains a savings account with a bank seeks more than an extension of credit; the depositor also seeks services associated with the account, and thus qualifies as a "consumer" under the DTPA. Here again, however, the opinion does not explain how the bank violated the DTPA. The opinion offers virtually no guidance about the particular acts by the bank that resulted in a determination of liability, yet the holding expands both the duty of good faith and fair dealing and the concept of consumer under the DTPA.

In contrast to *Plaza National Bank*, the court in *Pennzoil Co. v. Southwest Bank of San Angelo* held that a bank properly exercised a right of setoff where a third party deposited funds in a customer's general account without any instruction by the customer to hold them in trust. Because of a failure to prove that the bank knew or should have known that the funds were to be held in trust, the setoff was proper and the bank was entitled to judgment as a matter of law.

V. LETTERS OF CREDIT

Issues of Interpretation. The ordinary rules of contract interpretation are applicable to letters of credit, and the question of interpretation is a question of law for the court. Thus, in case of ambiguity, a letter of credit is construed against the drafter, and an interpretation that renders perform-
performance possible is preferred to one that makes performance impossible. In Universal Savings Association v. Killeen Savings & Loan the court applied these principles to determine that a reference in a letter of credit to the underlying contract was a general reference only and did not create conditions precedent to the issuer's liability on the credit. In the view of the court, more than a general reference to the underlying contract should have been included in the credit if the issuer intended to condition its liability; lacking express conditions, the court preferred an interpretation that made performance possible under the terms of the credit.

In a case involving a different type of interpretation issue, the Texas Supreme Court declined to answer a certified question by the Fifth Circuit Court of Appeals concerning the proper interpretation of Texas law as applied to a letter of credit that contained an October 31, 1981, date for presentation of documents, but also stated that it covered a contract to be performed between September and December 1981. Due to the lack of Texas Supreme Court guidance, the Fifth Circuit interpreted previous state appellate court cases to conclude that the date in the letter of credit controls over the expiration date. In Kerr Construction Co. v. Plains National Bank the Amarillo court of appeals had addressed a similar issue and had concluded there was an irreconcilable conflict between the stated expiry date and the date for contract performance. In Kerr the court held that the contract date was the most important provision in the letter of credit and that the beneficiary could draw against the credit under the longer performance date even though it extended beyond the expiry date. Professing itself "unable to determine" whether Kerr correctly states Texas law because of the interaction between rule 90 and rule 133 of the Texas Rules of Appellate Procedure, the Fifth Circuit certified the question to the Texas Supreme Court.

The confusion as to whether Kerr correctly states Texas law arose because of the denial of a writ of error in Kerr, at that time an unpublished decision, and the subsequent publication of Kerr, not by the Texas Supreme Court as part of its writ denial, but by the Amarillo court of appeals. This sequence of events led the Fifth Circuit to note, "it is not clear whether or not

204. Id.; Temple-Eastex, Inc. v. Addison Bank, 672 S.W.2d 793, 798 (Tex. 1984).
205. 757 S.W.2d 72 (Tex. App.—Houston [1st Dist.] 1988, no writ).
206. Id. at 76.
207. Id.
208. Exxon Co. v. Banque De Paris et des Pays—Bas, 867 F.2d 1524, ques. certified, 874 F.2d 234 (5th Cir. 1989), answer to question certified and conformed, 889 F.2d 674 (5th Cir. 1989).
209. 889 F.2d 674, 675 (5th Cir. 1989).
210. 753 S.W.2d 181 (Tex. App.—Amarillo 1987, writ denied).
211. Id. at 184.
212. Id.
213. 867 F.2d at 1526. TEX. R. APP. P. 133 describes the effect of a "writ refused" designation (connoting that the lower court opinion is correct) and the effect of a "writ denied" designation (connoting an error of law in the lower court opinion, but not one so serious as to require reversal). TEX. R. APP. P. 90 provides, in part, that unpublished opinions cannot be cited as authority by the courts or by counsel.
214. 867 F.2d at 1526.
the Texas Supreme Court would consider Kerr a proper elaboration of Texas law on letters of credit."215 The refusal by the Texas Supreme court to accept certification of the question prompted the Fifth Circuit to follow Kerr as precedential authority.216

In yet another variation on the interpretation theme, the court found itself unable even to read some of the critical documents presented by an advising bank under a letter of credit because they were written in Chinese.217 Although the facts indicated that the advising bank had taken a draft drawn under the letter of credit in good faith and without notice that an accompanying purchase order had been forged, two "certificates of negotiation" constituted the only proof that value had been given for the draft. Despite the forgery, the advising bank could not qualify as a holder in due course of the draft entitled to payment under the credit without proof of value.218 The trial court had excluded proof of the contents of the Chinese documents by an oral translation because no written translation was offered. The court of appeals permitted oral translation, particularly since the primary use was to explain the meaning of arabic numbers contained in the documents and these were the relevant portions of the documents to prove the giving of value.219

Issues of Presentment. Upon presentment of documents under a letter of credit, the beneficiary warrants that the documents comply with the credit and meet the necessary conditions to draw under the credit.220 In Artoc Bank & Trust v. Sun Marine Terminals, Inc.221 the court held that the beneficiary breached this warranty by presenting an invoice purporting to cover services already rendered to the account party by the beneficiary when such services had not actually been performed.222 The court rejected an argument by the beneficiary that it was entitled to payment because the invoiced amount represented part of the accelerated balance due under a lease agreement following default by the account party.223

A common issue in letter of credit litigation is whether the beneficiary has strictly complied with the terms of the credit in making a presentment for payment under the credit.224 Resolution of this issue often depends on the construction of terms used in the letter of credit, and Employers Mutual Casualty v. Tascosa National Bank225 is no exception. The letter of credit in

215. Id.
216. 889 F.2d at 674.
218. A holder in due course of a draft drawn under a letter of credit is entitled to receive payment from the issuer even though a required document is forged. TEX. BUS. & COM. CODE ANN. § 5.114(b)(1) (Tex. UCC) (Vernon 1968 & Supp. 1990).
219. 767 S.W.2d at 261.
220. TEX. BUS. & COM. CODE ANN. § 5.111(a) (Tex. UCC) (Vernon 1968).
221. 760 S.W.2d 311 (Tex. App.—Texarkana 1988, writ granted).
222. Id. at 314.
223. Id.
225. 767 S.W.2d 279 (Tex. App.—Amarillo 1989, writ denied).
dispute required the beneficiary to provide a "written certification" of certain events as part of the presentment. The beneficiary provided a written statement describing the events, but did not use the word "certify" or "certification" in the statement. The issuer refused to pay on the ground that the documents did not strictly comply with the terms of the credit. The court held it would be a redundancy for a written document asserting the existence of a fact to be required to denominate itself as a written certification of that fact when the meaning of the term "certify" means to authenticate in writing. The court was unwilling to find that such redundancy was intended absent a clear expression of that intent by the issuer who had drafted the document.

VI. INVESTMENT SECURITIES

Perfection of Security Interest in Stock Certificates. In FDIC v. W. Hugh Meyer & Associates, Inc. stock pledged to a bank and subsequently acquired by the FDIC did not give the FDIC a secured claim to a separate stock dividend certificate where the bank never received the dividend certificate and where neither the bank nor the FDIC ever registered the holding of the originally pledged stock nor timely filed a stop transfer form. Because possession is essential to obtain a security interest in a certificated security, a law firm holding the stock dividend certificate as security for a legal retainer had priority in the dividend certificate up to the amount of its retainer.

Enforcement of Judgments Against Securities. Article 8 of the Code strongly distinguishes between certificated and uncertificated securities. A critical difference between the two types of securities is that the certificated security requires a creditor to obtain effective physical control of the security to enforce a judgment, while an uncertificated security requires only a proper court order directed to the issuer. A primary reason for this difference in treatment is the need to protect possible subsequent bona fide purchasers; if the certificated security cannot be brought within the control of the court, a bona fide purchaser may buy the certificate without knowing that a prior court order affected ownership rights. In Detox Industries, Inc. v. Gullett this concern led the court to conclude properly that it could not enter an order against the issuer of a certificated security to cancel the old certificate and issue a new one when a possibility existed that the holder of the certificated security, who did not appear before the court, might subsequently transfer the certificate to a bona fide purchaser.
VII. SECURED TRANSACTIONS

A. Creation and Attachment of a Security Interest

Form of Security Agreement. To create a valid security interest under article 9, (1) a written security agreement signed by the debtor must exist or the secured party must have possession of the collateral, (2) the secured party must give value, and (3) the debtor must have rights in the collateral. When all three of these elements occur, the security interest attaches to the collateral. While it is often easy to determine if the debtor has signed a written security agreement, the inquiry is sometimes more complex. In In re Maddox the court applied the composite document rule to find that, even though no single writing constituted a security agreement, the existence of a filed financing statement along with other written documents constituted sufficient evidence to show that a security agreement existed between the parties. In reaching this decision, the court distinguished the case of Mosley v. Dallas Entertainment Co., in which the court held that a financing statement did not sufficiently qualify as a security agreement. In Mosley the financing statement did not contain any language granting a security interest and there were no other supporting documents to evidence an agreement to create a security interest.

In In re Hardage the court found that a sales slip stating, “I agree that Sears retains a security interest under the Uniform Commercial Code in the merchandise purchased until fully paid” was sufficient to create a security interest in the goods sold and identified on the sales slip. In a carefully reasoned opinion, however, the court also found that the secured party had failed to introduce any evidence of the terms for repayment of the indebtedness. The secured party could not, therefore, enforce the security interest in the claimed amount without proof that payment of the outstanding balance was due.

Rights in the Collateral. An important issue affecting the creation of a valid security interest is whether the debtor has sufficient rights in the collateral to permit attachment of a security interest. In Crocker National Bank v. Ideco Division of Dresser Industries the debtor received a shipment of goods from a seller with delivery being made to an inventory storage facility used jointly by the debtor and an affiliate. Prior to the delivery, the debtor and the affiliate made a contract for sale of the goods to the affiliate, but the

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236. Id.
238. Id. at 713.
239. Id. at 711.
241. Id. at 240.
243. Id. at 739.
244. Id. at 742.
245. Id.
246. Id.
247. 889 F.2d 1452 (5th Cir. 1989).
affiliate never actually received use of the goods. The seller, who had not been paid, later accepted return of the goods for full credit on the price, thereby cancelling the debt. A secured creditor holding a perfected security interest in the debtor’s after-acquired inventory sued the seller for conversion, claiming priority in the goods over the unpaid seller. The debtor subsequently filed for reorganization under chapter 11 of the Bankruptcy Code and intervened in the conversion action seeking redelivery of the goods from the seller. The district court held that the debtor never acquired sufficient rights in the goods to permit attachment of the security interest because they had been delivered to a facility used jointly by the debtor and its affiliate and the affiliate, under the sales contract with the debtor, was the entity that had rights in the goods. The court of appeals disagreed, holding that the sales contract between the debtor and its affiliate did not effectively pass title to the goods to the affiliate where the affiliate never made a payment nor used the goods. The court regarded the return of the goods by the debtor as important evidence that no sale had actually occurred and that the debtor still retained title to the goods. The possessory interest of the debtor permitted attachment of the security interest, thereby allowing entry of a judgment in favor of the secured party on its conversion claim against the seller.

The issue of rights in the collateral can also become entangled with questions of the authority of an agent to pledge certain collateral under a security agreement. In *Tripp Village Joint Venture v. MBank Lincoln Centre* a joint venture agreement specifically vested authority in the manager of a joint venture to sign documents on behalf of the joint venture. Documents executed by the manager in favor of a third party created “conclusive evidence” that the document was authorized. The manager, who was also part-owner of a real estate management firm, borrowed money for his firm by pledging a certificate of deposit owned by the joint venture as collateral for the loan. The court held that the joint venture agreement gave the manager power to use property owned by the joint venture as collateral for a loan made to the manager’s firm. The court also rejected parol evidence offered to avoid the security agreement on the principal theory that the joint venture agreement represented conclusive evidence of the authority of the manager to enter into agreements using collateral owned by the joint venture.

A third question that can arise in determining whether a debtor’s rights in the collateral will permit attachment of a security interest is whether the

250. 889 F.2d at 1453.
251. Id. at 1454.
252. 774 S.W.2d 746 (Tex. App.—Dallas 1989, writ denied).
253. Id. at 748.
254. Id. at 751.
255. Id. at 749, 750, 751.
transaction is within the scope of article 9. In Matter of Nix the court held that a bankruptcy debtor's Keogh retirement plan was a general intangible in which a valid security interest could be created. Although article 9 excludes security interests in deposit accounts from its scope, the court distinguished a Keogh plan from a deposit account because of the limitations on the ability of the owner to withdraw funds under the plan prior to retirement.

Security Interest of a Collecting Bank. While most secured transactions are created under article 9, in a few instances security interests can arise by operation of law under another article of the Code. One such instance is the security interest of a collecting bank in an item and accompanying documents when the collecting bank has advanced funds against the item while it is still in the process of collection. In In re C.M. Turtur Investments, Inc. a collecting bank advanced funds to its customer against a sight draft deposited with it for collection. The bank's customer, a car dealer, was engaged in a "dealer trade" of designated automobiles with another car dealer. The draft, drawn by the customer, named the other dealer as drawee and was accompanied by several manufacturer's statements of origin and related certificates of title indorsed in favor of the drawee. The dealer trade fell through and the drawee refused to pay the sight draft. The collecting bank asserted a security interest in the draft and in the accompanying statements of origin and certificates of title. The court held that the security interest of a collecting bank in "documents" under section 4.208 of the Code is limited to a security interest in "documents of title," such as bills of lading and warehouse receipts, and does not extend to statements of origin and certificates of title. The court also held that the bank could not qualify as a holder in due course of the certificates of title because the certificates had already been indorsed over to the purchasing car dealer. Judgment was entered in favor of another secured creditor holding a perfected security interest in the customer's inventory. In dictum, the court rejected the theory advanced by the bankruptcy court that the intent of the parties was

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256. Article 9 excludes certain types of transactions. Tex. Bus. & Com. Code Ann. § 9.104 (Tex. UCC) (Vernon 1968 & Supp. 1990). The reasons for exclusion range from federal preemption (e.g., rights in copyrights or patents), to areas traditionally regulated by other law (e.g., real estate or landlord's liens), to collateral that is not generally commercial in nature (e.g., insurance claims or judgments).

257. 864 F.2d 1209 (5th Cir. 1989).

258. Id. at 1212.


262. Id. § 4.208(a).

263. 883 F.2d 35 (5th Cir. 1989).


265. 883 F.2d at 38.

266. Id. at 39.

267. Id.
controlling on the issue of whether a security interest was created.\textsuperscript{268}

\section*{B. Security Interests in Proceeds}

\textbf{PIK Payments as Proceeds of Collateral.} In \textit{Sweetwater Production Credit Association v. O'Briant}\textsuperscript{269} the Texas supreme court held that "Payments In Kind" (PIK payments) are proceeds of crops and that a perfected security interest in crops will also cover PIK payments received by a farmer.\textsuperscript{270} Whether the decision is correct is less important than that the issue is now settled under Texas law.\textsuperscript{271}

\section*{C. Priorities}

\textbf{Security Interests v. Mechanics' Liens.} Article 9 does not attempt to deal with mechanics' liens except to the limited extent of giving such liens priority so long as the mechanic retains possession unless another statute expressly provides otherwise.\textsuperscript{272} The relative rights of a secured party when dealing with a mechanics' lien may be affected, however, by agreement between the parties. Thus, in \textit{Cranetex, Inc. v. Precision Crane & Rigging}\textsuperscript{273} a secured party who agreed to pay the cost of repairing construction equipment was liable to the mechanic for the cost of repair and the mechanic's claim was enforceable by means of a sale of the equipment under the mechanic's lien and recovery of a deficiency judgment against the secured party.\textsuperscript{274} In \textit{Collision Center Paint & Body, Inc. v. Campbell}\textsuperscript{275} the court held that tender by a secured party of the full amount claimed by a mechanic in a statutory notice of mechanics' lien discharged the lien and the subsequent retention of possession by the mechanic constituted conversion.\textsuperscript{276} The secured party was held entitled to recover possession of the goods.\textsuperscript{277}

\textbf{Security Interests Versus Subrogees.} The relative priority between an article 9 secured party and a surety who acquires subrogation rights in retained construction funds has been litigated in several jurisdictions,\textsuperscript{278} but until the

\begin{footnotesize}
\textsuperscript{268} \textit{Id.} The bankruptcy court had reached the same result as the court of appeals, but on the theory of intent rather than on a consideration of whether certificates of title were documents covered by \textit{TEX. BUS. & COM. CODE ANN.} \textsection{4.208(a)} (\textit{TEX. UCC}) (Vernon 1968). \textit{In re C.M. Turtur Inv., Inc.}, 93 \textit{Bankr.} 526 (Bankr. S.D. Tex. 1988).

\textsuperscript{269} 764 S.W.2d 230 (Tex. 1988).

\textsuperscript{270} \textit{Id.} at 232.

\textsuperscript{271} The case law is widely split on whether PIK payments and similar government agricultural program payments are proceeds, general intangibles or accounts. See, e.g., \textit{In re Sunberg}, 725 F.2d 561 (8th Cir. 1984) (PIK payments are general intangibles); \textit{In re Lions Farms, Inc.}, 4 \textit{U.C.C. Rep. Serv.} 2d 1213 (D. Kan. 1987) (PIK payments are accounts because they are made in exchange for the service of conservation management of unplanted land); \textit{United States v. Carolina B. Chem. Co.}, 638 F. Supp. 521 (D.S.C. 1986) (PIK payments cannot be proceeds since they are paid for not growing a crop); \textit{Osterooes v. Norwest Bank Minot}, 604 F. Supp. 848 (D.N.D. 1984) (PIK payments are proceeds).

\textsuperscript{272} \textit{TEX. BUS. & COM. CODE ANN.} \textsection{9.310} (\textit{TEX. UCC}) (Vernon 1968 & Supp. 1990).

\textsuperscript{273} 760 S.W.2d 298 (Tex. App.—Texarkana 1988, writ denied).

\textsuperscript{274} \textit{Id.} at 305.

\textsuperscript{275} 773 S.W.2d 354 (Tex. App.—Dallas 1989, no writ).

\textsuperscript{276} \textit{Id.} at 357.

\textsuperscript{277} \textit{Id.} at 358.

\textsuperscript{278} See, e.g., \textit{In re Pacific Marine Dredging & Constr.}, 79 Bankr. 924, 928 (Bankr. D. Or.)
\end{footnotesize}
decision in Interfirst Bank v. Pioneer Concrete the issue had not been addressed in Texas. In Interfirst, the Dallas court of appeals followed the majority rule that a surety who pays off laborers and material suppliers following a default by a contractor is entitled to priority in any retainage over the claim of a competing secured creditor. The court reached this result on the theory of equitable subrogation of the surety to the rights of the laborers and material suppliers whose liens it pays, whether or not those liens were perfected.

In another subrogation case the Austin court of appeals held that an insurer who paid the proceeds of a fire insurance policy to the holder of a note and deed of trust was subrogated to the rights of the holder against the guarantors of the note. The court regarded an act of the holder discharging the guarantors' liability after payment by the insurer to constitute nothing more than a question of fact as to the holder's authority to discharge the obligation after the subrogation rights had already attached. The court reversed judgment in favor of the guarantors and remanded the case.

D. Assignment of Claims

Right of Assignee to Retain Funds Paid by Account Debtor. The assignment of contract rights or accounts is a common article 9 financing device. Section 9.318 of the Code states some of the respective rights of the assignee and the account debtor. In Irrigation Association v. First National Bank the court distinguished between the right of an account debtor to resist an action by the assignee to collect on the debt in the face of a defense arising from the underlying contract and the right of an account debtor to seek an affirmative recovery against the assignee based on a claim arising from the same contract. The court refused to apply section 9.318 in the latter case, and held that the general law of restitution determined the rights of the parties where an account debtor asserted a claim for recovery of a down payment made jointly to the assignor and assignee. The court denied recovery against


279. 761 S.W.2d 857 (Tex. App.—Dallas 1988, no writ).
280. Id. at 858.
281. Id. at 859.
283. Id. at 687.
284. Id. at 688.
285. Id. at 689.
287. 773 S.W.2d 346 (Tex. App.—Dallas 1989, writ denied).
288. Id. at 350.
289. Id. This result is consistent with the limited number of other cases addressing the issue. See, e.g., Michelin Tires (Canada) Ltd. v. First Nat'l Bank, 666 F.2d 673, 680 (1st Cir.
the assignee under the general law of restitution.290

Rights and Liabilities of Successors. Although not exclusively within the area of assignments, two situations litigated during the Survey period deserve special mention because of the scope of their impact in a commercial context. The first situation involved the purchase of one bank by another bank, including an assignment of all contracts and other property owned by the purchased bank. In United States v. Central National Bank291 the court held that in this situation of a complete purchase, the successor institution remained liable for criminal violations of the Currency Transactions Reporting Act292 committed by the purchased predecessor bank.293 The second situation involved the sale of bank trust departments as an asset of failed banks to other banking institutions. In two cases, one arising from the sale of a failed state bank,294 and the other arising from the sale of a failed national bank,295 the court held that provisions of the Texas Trust Code requiring court approval for the appointment of successor trustees296 did not limit the power of the FDIC to sell the trust departments of failed banks to solvent institutions.297 The court further held that this result obtains only if

1981 (neither § 9-318 nor pre-Code law allowed affirmative recovery against assignee); Phil Greer & Assoc., Inc. v. Continental Bank, 614 F. Supp. 423, 426 (E.D. Pa. 1985) (account debtor with notice of assignment cannot assert affirmative claims against the assignee); Lydig Constr., Inc. v. Rainier Nat'l Bank, 40 Wash. App. 141, 697 P.2d 1019, 1022 (1985) (use of the term “subject to” in section UCC § 9-318 does not create affirmative rights for recovery against assignee; account debtor is limited to defensive use of claims);

290. 773 S.W.2d at 351. Rather than holding that Tex. Bus. & Com. Code Ann. § 9.318 (Tex. UCC) (Vernon 1988 & Supp. 1990) was not applicable to the case, a better approach might have been to hold that use of the term “subject to” in the section limits the account debtor to using a claim defensively to reduce recovery by an assignee. See Lydig Constr., Inc. v. Rainier Nat’l Bank, 40 Wash. App. 141, 697 P.2d 1019, 1022 (1985). This approach would prevent the assertion of claims under the general law that might appear more meritorious than the restitution theory used in the case at bar.


293. 880 F.2d at 830.


In NCNB Texas Nat’l Bank v. Cowden, 712 F. Supp. 1249 (W.D. Tex. 1989), the court held that where the failed bank is a national bank, the supremacy clause of the U.S. Const. art. VI, cl. 2, and the powers granted to the FDIC to enter into purchase and assumption agreements under 12 U.S.C. § 1823(c)(2)(A) (1988), preempt the Texas Trust Code to the extent it is inconsistent with federal law providing for the transfer of banking business to a successor institution. 712 F. Supp. at 1253-55.

Further litigation on this subject is quite possible. The court noted in Cowden that the affected:

fiduciary positions include approximately 1,000 appointments as executor, administrator, or guardian of estates involved in proceedings pending in 96 Texas Courts, over 9,000 corporate and employee benefit trusts, and more than 17,000 other trusts. . . The assets of the trusts are valued at approximately $50 billion
the individual trust instruments contain no provisions to the contrary.298

E. Repossession and Resale of Collateral

Right of Secured Party to Foreclose. In a very interesting decision299 the Fifth Circuit Court of Appeals held that a secured transaction includes an implied promise by the debtor not to interfere with the right of the secured party to foreclose and sell the collateral.300 The court reached this result by reasoning that section 9.503 of the Code301 specifically gives the secured party the right to possession of the collateral and that every contract includes an implied promise that a party will refrain from doing anything that will hinder or delay performance of the contract by the other party.302 The debtor, therefore, was under an implied obligation to refrain from interfering with the right to foreclose given to the secured party under the Code. By refusing to permit the release of collateral to the secured party, the debtor breached this obligation and became liable for attorney’s fees incurred by the secured party in seeking to enforce its foreclosure rights.303

The Fifth Circuit emphasized that the imposition of an implied obligation to refrain from interfering with foreclosure fell “far short” of implying a covenant of good faith and fair dealing.304 In Coleman v. FDIC305 the El Paso court of appeals did not so restrict its ruling and found that a material issue of fact existed as to whether the FDIC breached a duty of good faith and fair dealing in delaying a real estate foreclosure for several months during a period of apparently declining real estate values in the area.306 The decision in Coleman conflicts with the decision in Lovell v. Western National Life Insurance Co.,307 in which the court held no “special relationship” existed between a mortgagee-mortgagor to justify the imposition of a duty of good faith and fair dealing.308

Commercial Reasonableness and the Disposition of Collateral. The most active area in secured transactions litigation during the Survey period revolved around issues of whether the disposition of collateral was commercially reasonable. Under Texas law, this issue is particular important because the failure to dispose of collateral in a commercially reasonable manner bars the creditor from obtaining a deficiency judgment.309 Some courts disposed of

and produce a revenue stream for the fiduciary institution of nearly $100 million a year.

Id. at 1250 n.2.
300. Id. at 698.
302. 872 F.2d at 698 (citing Keener v. Sizzler Family Steak Houses, 424 F. Supp. 482, 484 (N.D. Tex. 1977), aff’d on this point, 597 F.2d 453 (5th Cir. 1979)).
303. Id. at 701.
304. Id. at 699.
306. Id. at 244.
308. Id. at 302.
309. The rule barring the recovery of a deficiency judgment if the disposition of collateral is
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cases on procedural grounds. One case considered whether the exercise of voting rights in stock by a secured party following a default amounted to a disposition of collateral barring recovery of a deficiency judgement. The court ruled that this issue presented a question of fact for the jury in light of the language in the security agreement and the pending foreclosure suit. Another case determined that a secured party who refused to release the certificate of title to an automobile after a loan had been fully paid was liable in conversion for $2,000 in actual damages and $75,000 in punitive damages. The court reached this conclusion based on jury findings that the creditor "had breached its guaranty agreement, had altered a security agreement, had misrepresented the guaranty agreement, had engaged in an unconscionable course of action, had committed fraud, had committed conversion and did not have a security interest" as claimed.

The remaining cases dealing with commercial reasonableness fall into two categories: the first concerns the allocation of the burden of proving that a sale of collateral was commercially reasonable or unreasonable; the second is whether the price realized on the sale of collateral must be a fair and reasonable price to permit the recovery of a deficiency. In the first category of proving the commercial reasonableness of a sale of collateral, the most comprehensive discussion is contained in Chase Commercial Corp. v. Datapoint Corp.

In Chase, the Dallas court of appeals held, first, that an assignor is a debtor entitled to notice of disposition of collateral and second, that the

 commercially unreasonable was first adopted in Texas in Tanenbaum v. Economics Laboratory, Inc., 628 S.W.2d 769, 772 (Tex. 1982).

310. Allied Bank v. Eshaghian, 700 F. Supp. 206, 207 (S.D.N.Y. 1988) (motion for summary judgment granted in favor of secured party where guarantors failed to raise questions of material fact regarding the commercial reasonableness of the disposition of collateral under Texas law); Shearer v. Allied Live Oak Bank, 758 S.W.2d 940, 943-44 (Tex. App.—Corpus Christi 1988, writ denied) (debtors' failure to plead or prove conversion or wrongful disposition of collateral at trial level waived right to raise issue for first time on appeal); Martinez v. Corpus Christi Area Teachers Credit Union, 758 S.W.2d 946, 952 (Tex. App.—Corpus Christi 1988, writ denied) (debtors' claims for improper preparation of note form and for wrongful disposition of collateral barred by statute of limitations; usury claim mooted by bona fide error doctrine).


312. Id. at 393.

313. Id.


315. Id. at 853.


318. 774 S.W.2d 359 (Tex. App.—Dallas 1989, no writ).

319. The court analogized the position of an assignor under a repurchase agreement to that of a guarantor and reasoned that there was "no reason why a seller of chattel paper who owes
secured creditor has the burden of pleading and proving the commercial reasonableness of the disposition as part of the creditor's principal case in chief without need for the debtor to raise the issue by specifically pleading an affirmative defense on this issue. The court left little room for doubt about the meaning of its decision by stating, "We hold that notice and the disposition of collateral in a commercially reasonable manner are essential elements of a creditor's suit to recover a deficiency, and the creditor bears the burden to plead and prove notice and disposition of the collateral in a commercially reasonable manner." The other cases reached similar decisions, but without the extensive discussion contained in Chase.

The cases dealing with the price realized from the sale of collateral are perhaps the most interesting of the secured transactions cases litigated during the Survey period. In Olney Savings & Loan Association v. Farmers Market of Odessa, Inc., the creditor bid in the property at foreclosure for $150,000 and sold it eight days later for $200,000, the previously appraised value. The court adopted the "rule" suggested in Lee v. Sabine Bank that a creditor is under a trust arrangement with a borrower to make an honest effort to realize the best possible price from a sale of collateral.

The court held that the evidence of price disparity sufficiently raised a question for the jury whether the foreclosure price was "fair and reasonable" and, if not, what a fair and reasonable price would be. The defendants in Savers Federal Savings & Loan Association v. Reetz subsequently cited Olney.

Other performance by way of repurchase of paper from its assignee should not likewise be held to be a 'debtor' under the Code. Id. at 363.

320. Id. at 364. Prior Texas case law, without authoritative guidance from the Texas Supreme Court, had almost reached this point by requiring the secured party to go forward with proof of commercial reasonableness when the debtor raised the issue by denying that a sale had been conducted in a commercially reasonable manner. See, e.g., Schultz v. General Motors Acceptance Corp., 704 S.W.2d 797, 798 (Tex. App.—Dallas 1986, no writ), overruled, Chase Commercial Corp. v. Datapoint Corp., 774 S.W.2d 359 (Tex. App.—Dallas 1989, no writ); M.P. Crum Co. v. First Sw. Sav. & Loan Ass'n, 704 S.W.2d 925, 926 (Tex. App.—Tyler 1986, no writ); Sunjet, Inc. v. Ford Motor Credit Co., 703 S.W.2d 285, 288 (Tex. App.—Dallas 1985, no writ), overruled, Chase Commercial Corp. v. Datapoint Corp., 774 S.W.2d 359 (Tex. App.—Dallas 1989, no writ).

321. 774 S.W.2d at 364.

322. See Molyneaux v. MBank Corpus Christi, N.A., 776 S.W.2d 744, 746 (Tex. App.—Corpus Christi 1989, no writ) (notice of sale and commercial reasonableness of sale are elements of the secured party's cause of action); Plato v. Alvin State Bank, 775 S.W.2d 861, 862 (Tex. App.—Houston [1st Dist.] 1989, no writ) (commercial reasonableness of sale is element of secured party's cause of action).


324. Id. at 871.

325. 708 S.W.2d 582 (Tex. App.—Beaumont 1986, writ ref'd n.r.e.).

326. Id. at 584. In Lee the court said that a proven significant disparity between the sale price of collateral and the appraisal value should give the debtor a deficiency offset measured by the fair market value of the collateral instead of the foreclosure sale price when the creditor is the successful bidder. In Olney, however, the lack of evidence of the fair market value resulted in the court's being unable to apply the rule that it announced. The further statements in Lee about a trust arrangement with the borrower are entirely dicta. Subsequently, in Halter v. Allied Merchants Bank, 751 S.W.2d 286 (Tex.App.—Beaumont 1988, writ denied), the court referred to Lee with approval, but once again in dicta. 751 S.W.2d at 287.

327. 764 S.W.2d at 871.

328. 888 F.2d 1497 (5th Cir. 1989).
ney as authority for the use of fair market value as the proper amount to
offset against a deficiency judgment.329 In a lengthy analysis of the origins of
the fair market value formula, the Fifth Circuit left no doubt about its strong
disagreement with Lee v. Sabine Bank330 and its progeny, including Olney,
and refused to apply what it regarded as an aberrational development in the
Texas law on the disposition of collateral.331 Commercial lawyers will be
interested in seeing the effect of this severe criticism of the Lee rule.

329. Id. at 1505-06.
330. 708 S.W.2d 582 (Tex. App.—Beaumont 1986, writ ref’d n.r.e.).
331. At the end of its analysis, the court stated:
In this diversity case we are bound to apply Texas law, whether or not we
“agree” with it. But it is settled Texas law that a Texas Court of Appeals must,
in civil cases, follow the law as established by the Texas Supreme Court. The
dicta in Lee, Halter, and Olney, relied on by appellants, is contrary to the Texas
Supreme Court’s holding in Tarrant Savings Ass’n. Moreover, the Texas
Supreme Court’s holdings in Maupin and Musick taken together likewise de-
mand rejection of this dicta.

888 F.2d at 1506.
The cases referred to by the court in the quoted paragraph are: Lee v. Sabine Bank, 708
S.W.2d 582 (Tex. App.—Beaumont 1986, writ ref’d n.r.e.); Halter v. Allied Merchants Bank,
751 S.W.2d 286, 287 (Tex. App.—Beaumont 1988, writ denied); Olney Sav. & Loan v. Farm-
ers Market of Odessa Inc., Inc., 764 S.W.2d 869 (Tex. App.—El Paso 1989, writ requested);
Tarrant Savings Ass’n v. Lucky Homes, Inc., 390 S.W.2d 473, 475 (Tex. 1965); Maupin v.
Chaney, 139 Tex. 426, 163 S.W.2d 380, 382-84 (1942); and American Sav. & Loan Ass’n v.
Musick, 531 S.W.2d 581, 587 (Tex. 1975).