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Commercial Transactions

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COMMERCIAL TRANSACTIONS

*John Kraher**

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AS usual in the even-numbered years between Texas legislative sessions, this Survey of Commercial Transactions is devoted primarily to case law developments and interpretations of the Uniform Commercial Code Chapters contained in the Texas Business and Commerce Code.¹ Very few cases decided during 1996 stand out as unique or surprising developments in the area of Commercial Transactions. A few cases, though, have added to the body of commercial law

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1. The Uniform Commercial Code comprises the first eleven chapters of the Texas Business and Commerce Code. The Uniform Commercial Code was originally adopted in Texas in the 1965 legislative session with an effective date of July 1, 1966. UNIFORM COMMERCIAL CODE, ch. 721, §§ 1-101 to 10-105, 1965 Tex. Gen. Laws 1-316. In 1967 it was reenacted as part of the new Texas Business and Commerce Code. Act of May 25, 1967, 60th Leg., R.S., ch. 785, §§ 1-6, 1967 Tex. Gen. Laws 2343-2782. In this Article all references are to the Uniform Commercial Code as enacted in chapters 1 through 11 of the Texas Business and Commerce Code, TEX. BUS. & COM. CODE ANN. §§ 1.101-11.108 (Tex. UCC) (Vernon 1987, 1991, 1994 & Supp. 1997) [hereinafter the Code].

available for Texas attorneys and a few others have contained indications of how recent amendments to the Business and Commerce Code might affect the future development of Texas commercial law.²

I. GENERAL PROVISIONS

A. TRUE LEASE OR DISGUISED SECURITY INTEREST?

Whether a transaction creates a true lease or a disguised security interest is an important determination under the Code. If the transaction creates a true lease, Chapter 2A governs the rights and liabilities of the parties.³ If the transaction is actually a disguised security interest, Chapter 9 controls.⁴ The definition of "security interest" in section 1.201 of the Code was amended in 1989 to make it clear that the economic attributes of the transaction play a predominate role in its classification.⁵ In *In re Rigg*,⁶ the classification issue arose in the context of a Chapter 13 bankruptcy proceeding. The debtors argued that they could retain various consumer goods they had acquired under rental-purchase agreements on the ground that the transactions created disguised security interests and made the rental company an undersecured creditor who could be paid under the terms of their proposed Chapter 13 plan.⁷ The rental company argued that the transaction created a true lease that required the bankruptcy debtors to either accept the lease and bring it current by payment of past due rent or reject the lease and return the goods.⁸ The court held that amendments to the Texas Credit Code⁹ and to section 1.201 of the Code¹⁰ made it clear that rental-purchase agreements had been designated by the legislature as a special form of lease contract and the right of the debtors to terminate the leases at any time made the transactions true

2. Significant amendments to the Code were enacted during the 1995 legislative session and became effective on January 1, 1996. The amendments included a new Chapter 3 covering Negotiable Instruments, Act of May 28, 1995, 74th Leg., R.S., ch. 921, §§ 1-2, 1995 Tex. Sess. Law Serv. 4282, 4582 (Vernon), a substantially revised Chapter 4 covering Bank Deposits and Collections, Act of May 28, 1995, 74th Leg., R.S., ch. 921, § 4, 1995 Tex. Sess. Law Serv. 4282, 4626 (Vernon), a new Chapter 8 covering Investment Securities, Act of May 27, 1995, 74th Leg., R.S., ch. 962, § 1, 1995 Tex. Sess. Law Serv. 4760, 4760 (Vernon), and conforming amendments to Chapter 9 on Secured Transactions, Act of May 27, 1995, 74th Leg., R.S., ch. 962, §§ 2-14, 1995 Tex. Sess. Law Serv. 4760, 4778 (Vernon).

3. TEX. BUS. & COM. CODE ANN. §§ 2A.101-.532 (Tex. UCC) (Vernon 1994).

4. TEX. BUS. & COM. CODE ANN. §§ 9.101-.507 (Tex. UCC) (Vernon 1991). If the transaction is actually a security interest instead of a lease, it may also be subject to various regulatory statutes as well, such as the Texas Credit Code, TEX. REV. CIV. STAT. ANN., art. 5069-6.01(f) (Vernon 1987 & Supp. 1997).

5. TEX. BUS. & COM. CODE ANN. § 1.201(37) (Tex. UCC) (Vernon 1994). The revised definition focuses on such matters as the relationship between the economic life of the goods and the rent payable by the lessee during the lease term, whether the lessee can terminate the lease during the lease term, whether the lessee can exercise an option to purchase the goods at the end of the lease term for nominal consideration, and whether the goods have a remaining economic life at the end of the lease.

6. 198 B.R. 681 (Bankr. N.D. Tex. 1996).

7. *Id.* at 683.

8. *Id.*

9. TEX. REV. CIV. STAT. ANN., art. 5069-6.01(f) (Vernon 1987 & Supp. 1997).

10. TEX. BUS. & COM. CODE ANN. § 1.201(37) (Tex. UCC) (Vernon 1994).

leases rather than security interests.¹¹ The court ordered the bankruptcy debtors to either assume or reject the leases.¹²

B. ACCELERATION OF NOTES

Acceleration of an instrument is specifically permitted by the Code.¹³ Much of the litigation surrounding acceleration clauses involves issues of wrongful acceleration or usury.¹⁴ Acceleration arose in a different context in *Communication Systems, Inc. v. Ironwood Corp.*,¹⁵ where the debtor contended that the exercise of an acceleration clause was the date on which a cause of action accrued for purposes of calculating the six-year limitations period for actions brought by the FDIC and its successors under the Federal Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).¹⁶ The plaintiff, a successor in interest to the FDIC, argued that the controlling date was the stated due date of the note and attempted to exclude evidence of the earlier acceleration under the *D'Oench, Duhme* doctrine.¹⁷ The court held that the exercise of an acceleration clause is not an unrecorded agreement subject to the *D'Oench, Duhme* doctrine and agreed with the debtor that the cause of action accrued when the acceleration took place.¹⁸ Because the cause of action accrued at the time of acceleration instead of at the due date, the six-year limitations period had expired by the time suit was brought and the debtors' motion for summary judgment was granted.¹⁹

The six-year limitations period also figured in *Cadle Co. v. 1007 Joint Venture*,²⁰ although in the context of a default and not in the context of an acceleration. In that case, the court held that a successor to the FDIC did not acquire the right to sue under the six-year limitations period unless

11. *Rigg*, 198 B.R. at 685.

12. *Id.*

13. TEX. BUS. & COM. CODE ANN. §§ 1.208 & 3.108 (Tex. UCC) (Vernon 1994 & Supp. 1997).

14. See, e.g., *Shumway v. Horizon Credit Corp.*, 801 S.W.2d 890 (Tex. 1991) (stating requirements for proper acceleration); *First State Bank v. Dorst*, 843 S.W.2d 790 (Tex. App.—Austin 1992, writ denied) (savings clause upheld to prevent usurious interest charge following acceleration); *Sumrall v. Navistar Fin. Corp.*, 818 S.W.2d 548 (Tex. App.—Beaumont 1991, writ denied) (claim for payment of interest when no interest was due constituted usury; repossession following acceleration was wrongful).

15. 930 F. Supp. 1162 (S.D. Tex. 1996).

16. *Id.* at 1164-65. The limitations period under FIRREA appears in 12 U.S.C. § 1821(d)(14) (1993 Supp. V).

17. The *D'Oench, Duhme* doctrine originated in the much-cited case of *D'Oench, Duhme & Co., Inc. v. FDIC*, 315 U.S. 447 (1942), where the Supreme Court held that a bank customer was estopped from asserting a defense based on an unrecorded oral agreement with a failed bank in an action brought by the FDIC to collect a debt owed by the customer. The purpose of the doctrine was to prevent deception of bank regulators by unrecorded, secret agreements entered into by a failed bank. The doctrine has been expanded and codified in 12 U.S.C. § 1823(e) (1993 Supp. V).

18. *Communication Systems*, 930 F. Supp. at 1166-67. In reaching this decision, the court relied on the reasoning in the earlier case of *Texas Refrigeration Supply v. FDIC*, 953 F.2d 975 (5th Cir. 1992).

19. *Communication Systems*, 930 F. Supp. at 1167.

20. 82 F.3d 102 (5th Cir. 1996).

the default occurred before the FDIC acquired the instrument or while the FDIC held the instrument.²¹ Because the default on the note in question took place after a successor to the FDIC acquired it, the applicable limitations period was the state law two-year period for actions to recover deficiencies resulting from foreclosures on real property.²²

In *Travelers Insurance Co. v. Bosler*,²³ the guarantors of a note signed a continuing guaranty to secure a loan to a partnership. The loan was also secured by a deed of trust on real estate owned by the partnership. After the partnership defaulted, the note was accelerated and a foreclosure was conducted against the real estate. A successor to the Resolution Trust Corporation acquired the note and sued the guarantors for the deficiency that remained on the note after the foreclosure sale. The guarantors defended on the ground that they had been discharged because of a modification agreement renewing and extending the note. The court held that a non-recourse provision in the modification agreement applied only to the makers of the note and not to the guarantors.²⁴ The court further held that, under the terms of the continuing guaranty, the guarantors were bound by the renewal and extension of the note and were liable for the deficiency.²⁵

II. SALES OF GOODS

A. FORMATION AND TERMS OF SALES CONTRACTS

The statute of frauds governing contracts for the sale of goods is the subject of current debate ranging from how a contract can be "signed" when the parties communicate by facsimile or computer²⁶ to whether a statute of frauds is needed at all.²⁷ While the outcome of these debates

21. *Id.* at 105.

22. *Id.* at 104. The two-year limitations period appears in TEX. PROP. CODE ANN. § 51.003 (Vernon 1995). Mention should be made of the distinction that now exists between an action to collect a deficiency resulting from a real property foreclosure with its two-year limitations period and an action to collect the amount due on a negotiable note which now carries a six-year limitations period under the revised TEX. BUS. & COM. CODE ANN. § 3.118(a) (Tex. UCC) (Vernon 1994 & Supp. 1997) that became effective on January 1, 1996.

23. 906 S.W.2d 635 (Tex. App.—Fort Worth 1995, no writ).

24. *Id.* at 642-43.

25. *Id.* at 644.

26. See, e.g., Richard Allan Horning, *Has Hal Signed a Contract: The Statute of Frauds in Cyberspace*, 12 SANTA CLARA COMPUTER & HIGH TECH. L.J. 253 (1996).

27. Morris G. Shanker, *In Defense of the Sales Statute of Frauds and Parole Evidence Rule: A Fair Price of Admission to the Courts*, 100 COMM. L.J. 259 (1995). In regard to contracts for the sale of goods, the current proposed draft for revised UCC Article 2 provides:

SECTION 2-201. NO FORMAL REQUIREMENTS.

(a) A contract or modification thereof is enforceable, whether or not there is a record signed by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year after its making.

NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, UNIFORM COMMERCIAL CODE—REVISED ARTICLE 2 § 2.201(a) (Jan. 4, 1996, Draft). This revised Section 2-201 was originally approved by the Drafting Committee on March 6, 1993. A motion to

may well change the statute of frauds as now contained in section 2.201 of the Code, the present law still requires a contract signed by the party against whom enforcement is sought, a confirmation received by a merchant without objection, or some other indicator that the alleged contract rests on a real transaction.²⁸

Although, as between merchants, a confirmation received and not objected to within ten days can operate to satisfy the statute of frauds, the confirmation must be exactly that—a confirmation. It must not require the recipient to take action signifying acceptance of the contract. If it does require any such action, the “confirmation” is likely to be read as an offer and, until the offer is accepted, there will be no contract. In *International Meat Traders, Inc. v. H & M Food Systems*,²⁹ the seller learned this lesson to its dismay when the court found that several “confirmations” that asked the buyer to “Please sign and return the duplicate of this contract,” were actually offers.³⁰ Because the buyer never signed and returned the duplicates, the court held that the alleged oral agreements were unenforceable and affirmed a partial summary judgment in favor of the buyer.³¹

In *Crest Ridge Construction Group, Inc. v. Newcourt, Inc.*,³² the parties did exchange signed writings, but the issue was whether these writings operated to form a contract. A price quotation sent from the seller to the buyer contained the statement that it was “subject to credit department approval.”³³ The buyer sent a purchase order in response to this price quotation and the parties subsequently engaged in a five month discussion about the details of the order, including specifications for color, size, material samples, and the like. The seller ultimately demanded that the buyer pay in advance for the entire order of approximately \$760,000 and the buyer refused. At this juncture, the seller refused to deliver any of the goods. After obtaining substitute goods from another source, the buyer sued for the increased cost incurred by purchasing from another source. A majority of the court held that the phrase in the price quotation requiring “credit department approval” was a condition precedent to the obligation of the seller to perform, but not a condition precedent to

restore the statute of frauds was rejected by a voice vote of the Commissioners at the 1995 Annual Meeting of the Conference. Drafts of Uniform Commercial Code revisions proposed by the Conference are available on the internet at <http://www.kentlaw.edu/>.

28. See TEX. BUS. & COM. CODE ANN. § 2.201(a)-(c) (Tex. UCC) (Vernon 1994). Promissory estoppel is also available as a case-made exception to application of the Chapter 2 statute of frauds and this exception was deemed sufficiently established to be incorporated as a non-uniform amendment in TEX. BUS. & COM. CODE ANN. § 2A.201(d)(4) (Tex. UCC) (Vernon 1994) governing lease transactions, but it has not yet been added as a statutory exception to Chapter 2.

29. 70 F.3d 836 (5th Cir. 1995).

30. *Id.* at 839. The court noted that *Great W. Sugar Co. v. Lone Star Donut Co.*, 721 F.2d 510 (5th Cir. 1983), involved a very similar “sign and return” confirmation that was held to constitute an offer rather than a confirmation.

31. *Id.* at 840.

32. 78 F.3d 146 (5th Cir. 1996).

33. *Id.* at 148.

the formation of a contract.³⁴ Because the intent of the parties to form a contract was a question of fact, the court found there was sufficient evidence for the jury to find that a contract existed.³⁵ The court further ruled that the failure of the purchase order to specify the terms for payment did not vitiate the contract because section 2.204 of the Code allows parties to form a contract even though some of the terms are left open.³⁶ In this regard, the court noted that the Code supplies a payment term in section 3.310 requiring a buyer to make payment upon delivery rather than making payment in advance if the parties have been silent on the matter.³⁷ Judgment in favor of the buyer was upheld. A concurring opinion reached the same result, but reasoned that the purchase order, rather than the price quotation, constituted the offer and that it had been accepted by the seller's conduct.³⁸

Another gap-filling term supplied by the Code if the parties have been silent on the matter is section 2.306 on output and requirement contracts.³⁹ In such contracts, measurement of the output or requirements means "such actual output or requirements as may occur in good faith," but cannot include quantities that are "unreasonably disproportionate" to stated estimates or comparable prior output or requirements.⁴⁰

In *Lenape Resources Corp. v. Tennessee Gas Pipeline Co.*,⁴¹ the court held that an agreement for the purchase and sale of natural gas under a "take or pay" contract was not an output contract subject to section 2.306 of the Code because the quantity was stated in the contract and because the buyer could choose to forego taking any gas and simply make payment instead. The court noted that,

Section 2.306 fills in the quantity term only when a contract does not unambiguously specify the quantity of the output of the seller or the requirements of the buyer. It does not apply when the contract either specifies a numeric quantity or provides a standard for determining a specific quantity.⁴²

Lenape was a close case. A dissenting opinion joined by four of the Justices argued that the contract did not "unambiguously specify" the seller's output and that the output should be limited by the good faith requirement contained in section 2.306 of the Code.⁴³ The dissent con-

34. *Id.* at 150-51.

35. *Id.*

36. *Id.* If some of the terms of a sales contract are left open by the parties, Chapter 2 supplements the contract with appropriate terms. These implied terms are sometimes called "gap-fillers." See 1 JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE: PRACTITIONER TREATISE SERIES 125-35 (4th ed. 1995).

37. TEX. BUS. & COM. CODE ANN. § 3.310(1) (Tex. UCC) (Vernon 1994).

38. *Crest Ridge*, 78 F.3d at 153.

39. TEX. BUS. & COM. CODE ANN. § 2.306 (Tex. UCC) (Vernon 1994).

40. *Id.* § 2.306(a).

41. 925 S.W.2d 565 (Tex. 1996).

42. *Id.* at 570.

43. *Id.* at 580-81.

cluded that it would affirm the judgment of the court of appeals.⁴⁴

B. WARRANTIES

Under Texas law, claims for breach of warranty may be asserted as a cause of action arising under the Code and as a cause of action under the Deceptive Trade Practices Act (DTPA).⁴⁵ Because the DTPA allows the possible recovery of damages in an amount up to three times that of the actual damage suffered, it is common to find both breach of warranty and DTPA claims asserted in the same case.⁴⁶ Any warranty on which a DTPA claim is brought must be found, however, outside the DTPA itself and this requires proof that a warranty existed and was breached.⁴⁷

In *Fredericksburg Industries, Inc. v. Franklin International, Inc.*,⁴⁸ the glue used by the buyer in the manufacture of furniture failed to bond the laminated plywood components of the furniture. The trial court excluded evidence offered by the buyer showing that the supplier of the glue was aware of similar problems encountered by other furniture manufacturers. On appeal, the court held that evidence of similar occurrences was relevant to show a breach of warranty and should have been admitted.⁴⁹ The court further noted that, despite some differences between the other occurrences and the problems encountered by the buyer in the case at bar, the evidence would not be prejudicial and the jury could weigh such differences along with the evidence of prior occurrences to determine if a warranty had been breached.⁵⁰

In *Miles v. Ford Motor Co.*,⁵¹ the plaintiffs sued on theories of negli-

44. *Id.* at 585. That *Lenape* was a close case is further indicated by the fact that the decision of the court of appeals reported *sub nom.* *Tennessee Gas Pipeline Co. v. Lenape Resources Corp.*, 870 S.W.2d 286 (Tex. App.—San Antonio 1993), had been affirmed previously by the Supreme Court in an opinion that was withdrawn by this case. The withdrawn opinion, not reported in S.W.2d may be found at 1995 WL 453266, No. 94-0278 (Tex. 1995).

45. Warranties under the Code can be either express or implied. TEX. BUS. & COM. CODE ANN. §§ 2.313-316 (Tex. UCC) (Vernon 1994). Damages for breach of warranty under the Code include the difference in value between the goods accepted and the value they would have had if they had been as warranted, along with foreseeable consequential damages. TEX. BUS. & COM. CODE ANN. §§ 2.714-715 (Tex. UCC) (Vernon 1994). A breach of an express or implied warranty is also actionable under the Deceptive Trade Practices Act, TEX. BUS. & COM. CODE ANN. § 17.50(a)(2) (Tex. UCC) (Vernon 1987 & Supp. 1997).

46. See, e.g., *Plas-Tex, Inc. v. United States Steel Corp.*, 772 S.W.2d 442 (Tex. 1989) (implied warranty of merchantability and DTPA); *North Star Dodge Sales, Inc. v. Luna*, 667 S.W.2d 115 (Tex. 1984) (combining claims for breach of express warranty, unconscionability, and DTPA violation); *Big H Auto Auction v. Saenz Motors*, 665 S.W.2d 756 (Tex. 1984) (warranty of good title and DTPA). The ability to recover enhanced damages under the DTPA was restricted, but not eliminated, by amendments passed during the 1995 legislative session. TEX. BUS. & COM. CODE ANN. § 17.50(b) (Tex. UCC) (Vernon 1987 & Supp. 1997), amended by Act of May 19, 1995, 74th Leg., R.S., ch. 414, § 1, Tex. Sess. Law Serv. 2988, 2988 (Vernon).

47. *La Sara Grain Co. v. First Nat'l Bank*, 673 S.W.2d 558, 565 (Tex. 1984).

48. 911 S.W.2d 518 (Tex. App.—San Antonio 1996, writ denied).

49. *Id.* at 523.

50. *Id.* at 524.

51. 922 S.W.2d 572 (Tex. App.—Texarkana 1996, no writ).

gence, product defect, and breach of warranty for injuries suffered in an automobile accident because of an alleged failure of the seat belt restraints. On the warranty issue, the plaintiffs asserted a breach of the implied warranty of fitness for a particular purpose, namely that of carrying passengers in the vehicle.⁵² The court of appeals correctly reasoned that carrying passengers in a vehicle is an ordinary use for a vehicle and not a unique or special use that would invoke a warranty of fitness for a particular purpose.⁵³ Because carrying passengers was an ordinary use, the plaintiffs should have asserted a claim for breach of the implied warranty of merchantability.⁵⁴ While the lower court should have directed a verdict for the defendant manufacturer on this issue, the court held that this was harmless error because the award of damages could have been based on the plaintiffs' other causes of action.⁵⁵

In another case involving seat belts, the plaintiffs asserted claims for economic loss on the ground that the seat belt system was designed in such a way that persons were discouraged from using the restraints.⁵⁶ The court correctly held that no cause of action would lie for the recovery of economic loss on theories of strict liability or negligence.⁵⁷ Economic loss was recoverable, however, on a theory of breach of warranty, but the defendant argued that the plaintiff failed to give notice of the breach of warranty.⁵⁸ On this point, the court agreed that notice of breach is required, but held that a general allegation in the plaintiffs' petition that all conditions precedent had been performed, the failure of the defendant to file a verified denial, and the failure to offer evidence that notice had not been given, were sufficient for the plaintiffs to avoid summary judg-

52. The warranty of fitness for a particular purpose is implied in contracts for the sale of goods by TEX. BUS. & COM. CODE ANN. § 2.315 (Tex. UCC) (Vernon 1994).

53. *Miles*, 922 S.W.2d at 587. In reaching this conclusion, the court cited several earlier Texas cases in which the seller was aware that the buyer had a special use for the goods being purchased. The court, however, did not cite or discuss *Lester v. Logan*, 893 S.W.2d 570 (Tex. App.—Corpus Christi 1994), *writ denied per curiam*, 907 S.W.2d 452 (Tex. 1995), where the court upheld a jury determination that hay supplied by a seller was merchantable, but was not fit for the particular purpose of feeding cattle. In *Lester*, the court did not explain how it concluded feeding hay to cattle was a "particular purpose" and the court seems to have incorrectly decided that issue. It is unfortunate that the court in *Miles* did not discuss *Lester*, because this seems to leave Texas with two different lines of authority on the scope of the warranty of fitness for a particular purpose. *Miles* is the better-reasoned case and it may be eventually recognized as such in subsequent warranty litigation.

54. *Miles*, 922 S.W.2d at 587. The implied warranty of merchantability includes a warranty that goods are fit for their ordinary purposes. TEX. BUS. & COM. CODE ANN. § 2.314 (Tex. UCC) (Vernon 1994).

55. *Id.*

56. *Brewer v. General Motors Corp.*, 926 S.W.2d 774 (Tex. App.—Texarkana 1996, no writ). A preliminary issue in the case was whether federal law preempted state claims arising from the design of seat belt systems. On this issue, the court held that the federal Motor Vehicle Safety Act, 49 U.S.C. §§ 30101-33101 (1995 & Supp. 1996) and the associated regulations, 49 C.F.R. § 571.208 (1997), did not preempt state claims that did not conflict with the purposes of federal law. *Brewer*, 926 S.W.2d at 779-80.

57. *Brewer*, 926 S.W.2d at 780.

58. *Id.* at 781. TEX. BUS. & COM. CODE ANN. § 2.607(c) (Tex. UCC) (Vernon 1994) requires a buyer to notify the seller that a breach of warranty has occurred or be barred from any remedy.

ment.⁵⁹ The case was remanded for trial on the warranty issue.⁶⁰

While failure to give notice of a breach of warranty is one possible bar to a warranty action, another bar is the statute of limitations contained in section 2.725 of the Code.⁶¹ In *Allgood v. R.J. Reynolds Tobacco Co.*,⁶² the court held that various cigarette advertisements by tobacco companies did not create warranties that explicitly extended to the future performance of the goods.⁶³ Because the warranties did not extend to future performance, the usual statutory four year limitations period applied and the plaintiffs' claims based on sales more than four years earlier were barred.⁶⁴ As to sales that took place during the four years prior to suit, the court held that the risks associated with cigarette smoking were within the common knowledge of the public and that no warranty claims would lie for risks that were known at the time of sale.⁶⁵

Although brought only as a DTPA action for misrepresentation, and not for breach of warranty, *Amstadt v. United States Brass Corp.*,⁶⁶ should be noted because of its parallels to the warranty decision in *Hininger v. Case Corp.*⁶⁷ In both cases, end purchasers of goods sought recovery against a manufacturer who had supplied components that were incorporated into the final product.⁶⁸ In *Amstadt*, the court held that a DTPA claim would not lie against the component supplier because any misrepresentations by the component manufacturer were made to those who incorporated the components into the final product and not to the end purchasers.⁶⁹ In *Hininger*, the court held that the implied warranty of merchantability did not run from a remote component manufacturer to the end purchaser.⁷⁰ In both cases, the end purchasers also asserted claims based on the negligence of the component manufacturer. In *Amstadt*, recovery was allowed on this theory where the plaintiffs sought recovery for property damage and mental anguish.⁷¹ In *Hininger*, recovery based on negligence was denied because the only damages sought were for economic loss.⁷² These two cases provide an interesting microcosmic

59. *Brewer*, 926 S.W.2d at 781.

60. *Miles*, 922 S.W.2d at 587.

61. TEX. BUS. & COM. CODE ANN. § 2.725 (Tex. UCC) (Vernon 1994).

62. 80 F.3d 168 (5th Cir. 1996).

63. *Id.* at 171.

64. *Id.*

65. *Id.* at 172.

66. 919 S.W.2d 644 (Tex. 1996).

67. 23 F.3d 124 (5th Cir.), *rehearing denied*, 32 F.3d 568 (5th Cir. 1994), *cert. denied*, 115 S.Ct. 728 (1995).

68. In *Amstadt*, the finished products sold to the end users were homes built by developers and the component in question was a plumbing system made of flexible plastic pipe connected with plastic and brass fittings. The plumbing system eventually developed cracks and leaks in several of the homes. In *Hininger*, the component was a drive wheel incorporated into the manufacture of farm equipment. Failure of the drive wheel caused the equipment to become inoperable.

69. *Amstadt*, 919 S.W.2d at 649.

70. *Hininger*, 23 F.3d at 129.

71. *Amstadt*, 919 S.W.2d at 648.

72. *Hininger*, 23 F.3d at 127.

comparison and contrast on the current Texas law of warranty, deceptive trade practices, and negligence. Perhaps the most important point about the parallels between these two cases is that they represent two currents of thought arising out of different legal theories, but tending in the same direction—a revival of the privity doctrine that appeared dead after the decision in *Nobility Homes of Texas, Inc. v. Shivers*.⁷³ The cases also illustrate the complex and confusing nature of the fine distinctions that have developed as the law of contract and tort (with a deceptive trade practice overlay) have gradually merged into Professor Gilmore's theory of legal "contorts."⁷⁴

C. GOOD FAITH PURCHASE

In addition to his writing on the gradual merger of contract and tort, Professor Gilmore was intrigued by the concept of good faith purchase.⁷⁵ One of the difficult legal problems that arises in this area occurs when innocent party A transfers goods to B, who turns out to be a wrongdoer of some kind, and B, in turn, sells the goods to C, who is also an innocent party. When A and C learn that B's activities were something less than honest (and that B is judgment proof, has filed for bankruptcy, or has simply disappeared), the legal issue becomes one of allocating the loss to one of the more-or-less innocent parties.⁷⁶ Section 2.403 of the Code is the Chapter 2 attempt to allocate loss between two innocent parties who have both dealt with the same wrongdoer in regard to the same goods.

In *Bruckner Truck Sales, Inc. v. Farm Credit Leasing Services Corp.*,⁷⁷ and in *Gallas v. Car Biz, Inc.*,⁷⁸ the courts were concerned with the rights of the purchasers who bought motor vehicles without receiving certificates of title in conjunction with their purchases. Certificate of title cases have presented a continuing source of uneasy reconciliation between the Code and the Texas Certificate of Title Act because, while the Code only requires transfer of the goods, the Certificate of Title Act sometimes requires delivery of the certificate of title as well.⁷⁹ In *Bruckner*, the court

73. 557 S.W.2d 77 (Tex. 1977).

74. GRANT GILMORE, *THE DEATH OF CONTRACT* 90 (1974).

75. See, generally, Grant Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 *YALE L.J.* 1057 (1954).

76. In this vein, and while more appropriate to possible criminal implications of B's activities, a couplet attributed to Daniel Drew, one of the 19th century "robber barons" (who also gave us the term "watered stock"), is of interest:

He who sells what isn't his'n
Must buy it back or go to pris'n.

MATTHEW JOSEPHSON, *THE ROBBER BARONS* 70 (Harcourt, Brace & World ed. 1962).

77. 909 S.W.2d 75 (Tex. App.—Amarillo 1995, no writ).

78. 914 S.W.2d 592 (Tex. App.—Dallas 1995, no writ).

79. See, e.g., *Associates Discount Corp. v. Rattan Chevrolet, Inc.*, 462 S.W.2d 546 (Tex. 1970); *Morey v. Page*, 802 S.W.2d 779, 783-84 (Tex. App.—Dallas 1990, no writ); and *Pfluger v. Colquitt*, 620 S.W.2d 739, 741-42 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.). In the 1995 legislative session, the Texas Certificate of Title Act, formerly cited as *TEX. REV. CIV. STAT. ANN.* art. 6687-1 (Vernon Supp. 1995), became part of the Texas Transportation Code and is now properly cited as *TEX. TRANSP. CODE ANN.* §§ 501.001-.157 (Vernon 1996).

held that the Certificate of Title Act does not require the first purchaser of a new motor vehicle from a dealer to obtain a certificate of title as part of the transaction and that section 2.403 therefore governed the transaction.⁸⁰ In contrast, where the purchaser was not the first purchaser of the vehicle but was, instead, the purchaser of a used vehicle, the court in *Gallas* held that the Certificate of Title Act governed the transaction and the failure to obtain a certificate of title as part of the transaction rendered the sale void.⁸¹ Returning to the hypothetical A to B to C transaction, the net result of these two transactions is to allocate the loss to A in the first case and to C in the second case. The underlying question in both cases, of course, is whether C, in either case, really understood that he or she might be required to obtain a certificate of title as part of the transaction and that C's right to the vehicle might depend on whether C was or was not the "first purchaser" under the Certificate of Title Act and the Uniform Commercial Code. Questions like this have led to the formation of an American Bar Association Task Force on Certificate of Title laws to reconcile the provisions of the Code with the varying Certificate of Title Acts of the several states.⁸²

In comparison to the reconciliation of disparate statutes, the case of *Rogers v. Ricane Enterprises, Inc.*,⁸³ is a straight-forward decision under section 2.403. In *Rogers* the owners of an interest in the production of oil from a group of oil properties entered into a series of contracts and leases which eventually came into the hands of a company engaged in the production and sale of oil at the wellhead. After tracing a convoluted series of deeds, leases, and prior litigation in the case as background to its decision, the court focused on whether a purchaser of oil from a merchant who dealt in goods of that kind was liable in conversion to owners who had acquiesced in sales of the oil by the production company.⁸⁴ The court reasoned that "entrustment" to a merchant could include either a direct transfer of possession to a merchant or an acquiescence in continued possession by a merchant and, under the facts of this case, a purchaser without actual knowledge of competing claims could qualify as a good faith purchaser of the goods.⁸⁵ As a good faith purchaser, the buyer of oil produced from the various properties acquired a good title to the oil that was superior to the ownership claims of those who had done the entrust-

80. *Bruckner*, 909 S.W.2d at 81.

81. *Gallas*, 914 S.W.2d at 595.

82. The task force was formed in 1994 and is in the process of completing a survey of the certificate of title acts in the several states. The task force chair is Professor Alvin Harrell and he may be contacted at the Oklahoma City University School of Law, 2501 N. Blackwelder, Oklahoma City, Oklahoma 73106 for information about the task force survey and any proposed legislation for certificates of title. A discussion of the wide variation in current certificate of title statutes may be found in John Kraemer, *Cars, Boats, and Security Interests: Certificates of Title and the Uniform Commercial Code*, 48 CONSUMER FIN. L.Q. REP. 149 (1994).

83. 930 S.W.2d 157 (Tex. App.—Amarillo 1996, writ denied).

84. *Id.* at 162-70.

85. *Id.* at 172.

ing.⁸⁶ On this point, the court correctly noted that oil, once severed from the ground, becomes goods subject to Chapter 2 of the Code.⁸⁷

III. LEASES OF GOODS

A. LIABILITIES OF LESSORS UNDER CHAPTER 2A

Chapter 2A was added to the Texas Business and Commerce Code in 1993 to govern leases of personal property.⁸⁸ As with Chapter 2 on Sales, cases under Chapter 2A will inevitably overlap with the DTPA because that act covers transactions in which a consumer "seeks or acquires by purchase or lease, any goods or services."⁸⁹ *Innovative Office Systems, Inc. v. Johnson*⁹⁰ is the first reported Texas case involving the overlap between Chapter 2A and the DTPA.

In *Innovative*, a lessee acquired a combination computer and copying system to produce high quality color graphics for the lessee's computer graphics service bureau.⁹¹ Before entering into a lease for the system, the then-prospective lessee provided the prospective lessor with a list of requirements that the system had to meet. After receiving assurances from the prospective lessor that the system would meet the requirements, the lessee signed a lease for the system.⁹² The lessor then purchased the system and the necessary software and delivered the entire "package" to the lessee. From the first day of installation, the system never worked properly, with problems ranging from complete inoperability to continuing problems with software incompatibility and low quality output. Neither the lessor nor the lessee were able to correct the problems and the lessee testified that, after spending "hundreds of hours" over a three month period to make the system work, he "threw in the towel."⁹³ The lessee sued on several grounds, but limited his claims by the time of trial to breach of warranty, DTPA violations, and breach of contract.⁹⁴ The lessee prevailed on all three theories and the court of appeals affirmed. The court held that the actions of the lessor were unconscionable under the DTPA

86. *Id.* at 175.

87. *Id.* at 171.

88. TEX. BUS. & COM. CODE ANN. §§ 2A.101-.532 (Tex. UCC) (Vernon 1994).

89. TEX. BUS. & COM. CODE ANN. § 17.45(4) (Tex. UCC) (Vernon 1987 & Supp. 1997).

90. 906 S.W.2d 940 (Tex. App.—Tyler 1995, no writ).

91. *Id.* at 944. A computer graphics service bureau is a specialty company that produces high quality art work for advertising agencies or companies for use in color advertising, brochures, and the like.

92. The discussions between the parties extended over a period of approximately two to two and one-half months and it was clear that the lessee had definite requirements and that the lessor was informed of those requirements. A curious aspect about the case is that, while the lessee signed the lease, it was never signed by the lessor, but both parties dealt with each other as if the lease were fully effective. The lack of signing by the lessor did not prevent recovery by the lessee on either the DTPA or warranty theories, but it did give the court a basis for denying a counterclaim by the lessor for breach of the lease. *See id.* at 953.

93. *Id.* at 946. Anyone who has much experience with computer problems can sympathize with the lessee about this kind of experience.

94. *Id.* at 944.

because of the lessor's admitted knowledge that some of the representations were misleading, including representations about compatibility.⁹⁵ The court further held that the lessor breached both express and implied warranties under both Chapters 2 and 2A of the Code as well as committing common law fraud.⁹⁶ The court upheld an award of actual damages to the lessee, including lost profits and mental anguish damages, plus statutory damages for the knowing misconduct of the lessor, as well as attorney's fees.

A special point to note about this case is that the lessor supplied the goods directly to the lessee and dealt with the lessee in attempting to make the system work. The case might have come out quite differently if this had been a "finance lease" as defined in section 2A.103.⁹⁷ The lessor in *Innovative* could not qualify as a finance lessor because it supplied the goods.

IV. NEGOTIABLE INSTRUMENTS

A. LIABILITY OF PARTIES

It is a basic tenet of Chapter 3 that no person is liable on a negotiable instrument unless he or she has signed it, either personally or through a representative.⁹⁸ In *Love v. L K & P, Ltd.*,⁹⁹ the payees on a note transferred it to a bank but never indorsed it; the transfer was made, instead, under a collateral transfer agreement. The bank failed and the note was eventually acquired by assignment from the FDIC. When the assignee later sued the payees on the note, they defended on the ground that they had never signed the note as indorsers and, therefore, they were not liable on the instrument.¹⁰⁰ The assignee argued that it had the specifically enforceable right to have the unqualified indorsements of the payees, but the payees pointed out, and the court agreed, that the right to obtain the indorsements was subject to any contrary agreement between the payees and the bank.¹⁰¹ In this case, because the note had been transferred to

95. *Id.* at 948. Some of the admittedly misleading representations were actually on the box containing the software.

96. *Id.* at 949. The provisions cited by the court were TEX. BUS. & COM. CODE ANN. §§ 2.313-315, 2A.210, 2A.212, 2A.213 & 2A.315 (Tex. UCC) (Vernon 1994). These sections govern express warranties and the implied warranties of merchantability and fitness for a particular purpose in the respective chapters of the Code. It is not clear from the opinion why the court referred to the Chapter 2 sales provisions when the warranty claims arose out of a lease transaction.

97. TEX. BUS. & COM. CODE ANN. § 2A.103(a)(7) (Tex. UCC) (Vernon 1994). The principal characteristic of a finance lease is that the lessor is insulated from claims based on defects in the leased goods. To qualify as a finance lessor, however, the lessor must not select, manufacture, or supply the goods and delivery must be made directly from the manufacturer or other supplier. See TEX. BUS. & COM. CODE ANN. § 2A.103 cmt. g (Tex. UCC) (Vernon 1994).

98. TEX. BUS. & COM. CODE ANN. § 3.401 (Tex. UCC) (Vernon Supp. 1997).

99. 920 S.W.2d 474 (Tex. App.—Waco 1996, no writ).

100. *Id.* at 477.

101. *Id.* TEX. BUS. & COM. CODE ANN. § 3.203(c) (Tex. UCC) (Vernon Supp. 1997) provides, in part, "Unless otherwise agreed, if an instrument is transferred for value . . . the transferee has a specifically enforceable right to the unqualified indorsement of the trans-

the bank by means of a collateral transfer agreement as security for a loan from the bank, there was no right to compel an indorsement by the payees.¹⁰² Because the payees never indorsed the note, the court would neither presume nor compel an indorsement, and the payees, therefore, had no liability on it.¹⁰³

B. LOST, DESTROYED, OR STOLEN INSTRUMENTS

Everyone loses something at one time or another. When the thing that is lost is a negotiable instrument, Chapter 3 provides some relief by permitting a person to show that he or she had possession of the instrument, that the loss of possession was not by means of a transfer, and that the instrument has been lost, destroyed, or is otherwise unavailable.¹⁰⁴ If these conditions are satisfied, recovery on the instrument may be allowed despite the inability to produce the instrument itself.¹⁰⁵ In *Priesmeyer v. Pacific Southwest Bank, F.S.B.*,¹⁰⁶ a bank obtained the assets of a failed savings bank under a transfer and assignment agreement from the FSLIC. When the maker of one of the notes acquired by the bank defaulted, the bank foreclosed on the real property securing the note and sued for the deficiency. There was one problem, however. The note could not be found. The bank attempted to prove ownership by testimony of one of its senior vice presidents, but she could not testify from personal knowledge that the note was among the assets acquired under the transfer and assignment agreement.¹⁰⁷ Summary judgment in favor of the bank was reversed because the bank failed to meet its burden of showing its ownership of the missing note or to account for its absence.¹⁰⁸

Another bank that could not find a note faced a double problem in *Western National Bank v. Rives*,¹⁰⁹ which involved an interesting combination of a missing signature like that in *Love* and a missing note like that in *Priesmeyer*.¹¹⁰ In *Western*, the bank alleged that it had acquired the missing note by indorsement from the payee and sought recovery against the payee on his indorsement contract. Without the note, however, the bank had to prove not only that it had possessed the note, but also that it

feror" The same rule previously appeared in TEX. BUS. & COM. CODE ANN. § 3.201(c) (Tex. UCC) (Vernon 1994). The court noted the existence of the amendment, but the facts in the case had arisen prior to the amendment and the court cited the 1994 Code "for simplicity." *Love*, 920 S.W.2d at 477 n.4.

102. *Love*, 920 S.W.2d at 478.

103. *Id.* at 479.

104. TEX. BUS. & COM. CODE ANN. § 3.309 (Tex. UCC) (Vernon Supp. 1997). This section carries forward the rule that previously appeared in TEX. BUS. & COM. CODE ANN. § 3.804 (Tex. UCC) (Vernon 1994).

105. TEX. BUS. & COM. CODE ANN. § 3.309(b) (Tex. UCC) (Vernon Supp. 1997).

106. 917 S.W.2d 937 (Tex. App.—Austin 1996, no writ).

107. *Id.* at 940.

108. *Id.*

109. 927 S.W.2d 681 (Tex. App.—Amarillo 1996, no writ).

110. *Love v. L K & P, Ltd.*, 920 S.W.2d 474 (Tex. App.—Waco 1996, no writ) and *Priesmeyer v. Pacific Southwest Bank, F.S.B.*, 917 S.W.2d 937 (Tex. App.—Austin 1996, no writ) are discussed *supra*, in the text accompanying notes 99 and 106, respectively.

had been indorsed by the payee. In an ingenious attempt to resolve this problem, the bank sought to prove its ownership of the missing note and then to compel the payee's indorsement.¹¹¹ In an opinion that carefully analyzes both the old and the new versions of Chapter 3, the court concluded that the bank had to prove its status as a holder of the note to compel an indorsement and that proof of such status required proof that the bank had, at some time, been in possession of the note. Based on the evidence submitted on the cross-motions for summary judgment, the court concluded "that the bank failed to obtain possession of the note before it was lost, [and] given the absence of both present and prior possession," summary judgment was properly entered against the bank.¹¹²

In *Starcrest Trust v. Berry*,¹¹³ another lost instrument case, the alleged owner of a note fared better. Evidence adduced at trial showed that the note had, in fact, been in the possession of the owner and that the maker of the note had bragged about destroying it.¹¹⁴ Additional evidence showed the existence of the original loan and payment of the loan proceeds to third parties.¹¹⁵ In the court's view, the evidence "more than met" the proof required to show that a note had been lost or destroyed.¹¹⁶ Judgment in favor of the owner was affirmed.¹¹⁷

C. HOLDING IN DUE COURSE

Under both the old and the new versions of Chapter 3, a holder in due course may enforce an instrument despite the existence of various defenses asserted by the maker.¹¹⁸ While the new version of Chapter 3 states the requirements for becoming a holder in due course in somewhat more elaborate form than the prior Chapter 3, the basic requirements of value, good faith, and lack of notice of defenses remain the same.¹¹⁹ In *Insurance Co. of North America v. Morris*,¹²⁰ a plaintiff claiming to be the holder in due course of notes issued by the defendants failed to satisfy the requirements for holding in due course on several grounds. First, the plaintiff took the notes by assignment and not by indorsement.¹²¹ Sec-

111. *Western*, 927 S.W.2d at 683. Note that this reasoning combines the use of TEX. BUS. & COM. CODE ANN. § 3.203(c) and § 3.309(a) (Tex. UCC) (Vernon Supp. 1997), the provisions that were involved separately in *Love* and *Priemeyer*, respectively, *supra*.

112. *Western*, 927 S.W.2d at 686.

113. 926 S.W.2d 343 (Tex. App.—Austin 1996, no writ).

114. Although the testimony about destruction of the note was hearsay, the court noted there was no objection lodged against the testimony at trial and that even inadmissible hearsay could be given probative value. *Id.* at 350 n.4.

115. *Id.* at 350.

116. *Id.*

117. *Id.* at 356.

118. TEX. BUS. & COM. CODE ANN. § 3.305 (Tex. UCC) (Vernon 1994 & Supp. 1997). Under both versions of Chapter 3, a holder in due course takes an instrument free from "personal defenses," but remains subject to "real defenses." See TEX. BUS. & COM. CODE ANN. § 3.305 cmts. 1 & 2 (Tex. UCC) (Vernon Supp. 1997).

119. Compare TEX. BUS. & COM. CODE ANN. § 3.302 (Tex. UCC) (Vernon 1994) with TEX. BUS. & COM. CODE ANN. § 3.302 (Tex. UCC) (Vernon Supp. 1997).

120. 928 S.W.2d 133 (Tex. App.—Houston [14th Dist.] 1996, no writ).

121. *Id.* at 153.

ond, the plaintiff took the notes after default.¹²² Third, the plaintiff had notice of the defendants' security fraud defense.¹²³ Fourth, the plaintiff was a party to the securities fraud.¹²⁴ In addition to its inability to qualify as a holder in due course and cut off defenses, the participation of the plaintiff in the securities fraud allowed the defendants to recover a judgment against the plaintiff on a deceptive trade practices counterclaim for \$435,000 plus attorney's fees of \$400,000.¹²⁵

V. INVESTMENT SECURITIES

As noted in the discussion of cases decided under Chapter 2, the National Conference of Commissioners on Uniform State Laws proposes to abolish the statute of frauds requirement for the sale of goods.¹²⁶ The new Chapter 8 adopted in Texas during the 1995 legislative session has already abolished a writing requirement for contracts involving the sale of securities.¹²⁷ In *GNG Gas Systems, Inc. v. Dean*,¹²⁸ the court held that the statute of frauds was not available as a defense where the defendants were unable to show that the contract was one for the sale of securities. Although the facts in this case arose prior to adoption of the new Chapter 8, and the court necessarily applied the prior law, the opinion noted that the statute of frauds had been eliminated.¹²⁹ Because the statute of frauds was not available as a defense, the net result on this issue was the same as it would be under the new Chapter 8.

VI. SECURED TRANSACTIONS

A. SECURITY INTERESTS IN PROCEEDS

Under section 9.306 of the Code, a perfected security interest in collateral continues in any proceeds received by the debtor in exchange for the collateral, provided the secured party takes any steps that may be necessary to continue the perfected status of the security interest.¹³⁰ In *In re Texas State Optical, Inc.*,¹³¹ the court agreed that a security interest continued in the proceeds received by the debtor, but held that the secured party had failed to continue the perfected status of its security interest because the proceeds consisted of negotiable notes, and the creditor had

122. *Id.*

123. *Id.* at 154.

124. *Id.*

125. *Id.* at 157.

126. *See supra* note 27.

127. TEX. BUS. & COM. CODE ANN. § 8.113 (Tex. UCC) (Vernon Supp. 1997) provides: A contract or modification of a contract for the sale or purchase of a security is enforceable whether or not there is a writing signed or record authenticated by a party against whom enforcement is sought, even if the contract or modification is not capable of performance within one year of its making.

128. 921 S.W.2d 421 (Tex. App.—Amarillo 1996, no writ).

129. *Id.* at 428 n.5. The statute of frauds appeared in the prior Chapter 8 as TEX. BUS. & COM. CODE ANN. § 8.319 (Tex. UCC) (Vernon 1991).

130. TEX. BUS. & COM. CODE ANN. § 9.306(b) & (c) (Tex. UCC) (Vernon 1991).

131. 188 B.R. 552 (Bankr. E.D. Tex. 1995).

not perfected its interest in the notes within ten days after the debtor received them.¹³² Because the only way to perfect a security interest in instruments is by possession, the failure of the creditor to obtain possession of the notes rendered the security interest unperfected.¹³³

B. SECURITY INTERESTS IN FARM PRODUCTS

Under the federal Food Security Act of 1985, a buyer in the ordinary course of business takes free of a perfected security interest in farm products purchased from a farmer unless: (1) prior to the sale, the buyer has received written notice that a secured party claims a security interest in the farm products; or (2) the secured party has made a filing in a central filing office approved by the United States Department of Agriculture.¹³⁴ Because Texas has never established an approved central filing office, the only option available to a secured creditor in Texas is written notice to prospective buyers. In *Nelson v. American National Bank*,¹³⁵ a bank asserted a security interest in cattle that had been sold to a buyer. The bank failed to prove that it had given the requisite notice to the buyer and the court held that this failure prevented the bank from claiming a right to the cattle under section 9.307 of the Code.¹³⁶ The court further held, however, that if the buyer did not qualify as a buyer in the ordinary course of business, the buyer would remain subject to the bank's security interest and the case was remanded for a factual determination of this issue.¹³⁷

C. LIENS ARISING BY OPERATION OF LAW

Although the *Thoroughbred Horsemen's Association of Texas, Inc. v. Dyer*,¹³⁸ did not arise under Chapter 9, the decision has a bearing on the application of section 9.310 of the Code.¹³⁹ In *Thoroughbred*, the owner of two registered thoroughbreds attempted to sell them through an auction conducted by the Association. As part of the auction process the owner provided the Association with the registration certificates for the horses. The bids did not reach the reserve price specified by the owner and the horses were placed with the plaintiff for boarding, but the Associ-

132. *Id.* at 555.

133. TEX. BUS. & COM. CODE ANN. § 9.304(a) (Tex. UCC) (Vernon 1991) requires the secured party to take possession of money or instruments to perfect a security interest unless the security interest is perfected by another provision in Chapter 9, such as the ten day automatic perfection allowed by TEX. BUS. & COM. CODE ANN. § 9.306(c) (Tex. UCC) (Vernon 1991).

134. 7 U.S.C. § 1631(d) & (e) (1988).

135. 921 S.W.2d 411 (Tex. App.—Corpus Christi 1996, no writ).

136. *Id.* at 417. TEX. BUS. & COM. CODE ANN. § 9.307 (Tex. UCC) (Vernon 1991).

137. *Nelson*, 921 S.W.2d at 417. Under TEX. BUS. & COM. CODE ANN. § 9.306(b) (Tex. UCC) (Vernon 1991) a security interest continues in collateral notwithstanding sale or exchange unless Chapter 9 otherwise provides or unless the disposition of the collateral was authorized by the secured party.

138. 905 S.W.2d 752 (Tex. App.—Houston [14th Dist.] 1995, no writ).

139. TEX. BUS. & COM. CODE ANN. § 9.310 (Tex. UCC) (Vernon 1991).

ation retained the certificates pending payment by the owner of the fees for conducting the auction.

The owner failed to pay the boarding expenses and, after a year, the plaintiff made written demand for payment and sold the horses according to the procedures required by the Texas Property Code.¹⁴⁰ The plaintiff himself bought the horses at the sale and asked the Association to deliver the registration certificates to him. When the Association refused to do so, the plaintiff sued to obtain the certificates.

In an interesting historical review dating back to 1840, the court found that Texas law had not previously addressed the existence of a common law auctioneer's lien and, noting that the common law as "declared by the courts of the different states of the United States" was the applicable source of law, the court determined that an auctioneer's lien was a recognized common law lien.¹⁴¹ While the Texas Property Code gave the plaintiff the right to satisfy the boarding charges from the sale of the property entrusted to him, he never had possession of the certificates. The court, therefore, held that the auctioneer's lien for boarding the horses extended only to the horses themselves and not to the registration certificates.¹⁴²

*Dob's Tire & Auto Center v. Safeway Insurance Agency*¹⁴³ was a case of first impression applying some of the worker's liens provisions in the Texas Property Code.¹⁴⁴ The court reasoned that a mechanic who repossesses a car to assert a worker's lien is required to give notice of the repossession within ten days after the repossession occurs and to give a second notice demanding payment after the mechanic has retained possession for thirty days.¹⁴⁵ If the repair bill is not then paid before the thirty-first day after this notice is sent (a total of sixty-one days from the time the mechanic repossessed the car), the mechanic may sell the vehicle.¹⁴⁶ Although the mechanic sent the required ten day notice, no second notice was sent and the car was sold before the sixty-first day. A judgment was affirmed against the mechanic for both actual and punitive damages for failure to comply with the notice and sale requirements.¹⁴⁷

D. PERFECTION OF SECURITY INTERESTS

While the Code system of notice filing has streamlined the procedure for the perfection of security interests, one downside of the system that has recently emerged is the ease with which fraudulent financing state-

140. TEX. PROP. CODE ANN. § 70.003 (Vernon 1995).

141. *Thoroughbred*, 905 S.W.2d at 754-55.

142. *Id.* at 755.

143. 923 S.W.2d 715 (Tex. App.—Houston [1st Dist.] 1996, no writ).

144. TEX. PROP. CODE ANN. §§ 70.004 & 70.006 (Vernon 1995).

145. *Dob's*, 923 S.W.2d at 719-20. Under TEX. PROP. CODE ANN. § 70.001(b) (Vernon 1995), if a mechanic releases a car to the owner of a vehicle who pays for the repairs with a check drawn on insufficient funds, the mechanic can repossess the vehicle in accordance with the terms of TEX. BUS. & COM. CODE ANN. § 9.503 (Tex. UCC) (Vernon 1991).

146. *Id.* at 720.

147. *Id.*

ments can be filed.¹⁴⁸ Because there is no independent verification of the accuracy of the information, including verification of the debtor's signature, it is a simple matter for someone to fill out a financing statement and present it, along with the required fee, to a filing officer.¹⁴⁹ The filing officer has no discretion under the Code to determine if the financing statement is or is not valid or if it represents a real transaction; the function of the filing officer is entirely ministerial. The result of a fraudulent filing can have severe consequences for the person named in the financing statement as the debtor because subsequent record searches will show what appears to be a perfected security interest covering some or all of the person's assets and this can have an adverse impact on that person's ability to obtain credit. In an attempt to deal with this problem, the Texas Legislature added section 9.412 to the Code during the 1995 legislative session.¹⁵⁰ Under that provision, an owner of property covered by a fraudulent financing statement can maintain an action against the person who made a fraudulent filing to have the fraudulent financing statement released from the record and to recover the greater of \$5,000 or the owner's actual damages, court costs, and attorney's fees.¹⁵¹ This provision was not effective in time, however, to benefit the owners of collateral covered by a fraudulent financing statement in *U.S. v. Greenstreet*.¹⁵² Therefore, the case was brought on behalf of the owners by the United States instead of being brought as a private claim. The fraudulent financing statements in question were filed in apparent retribution against employees of the Farmers Home Administration who handled the foreclosure of real estate owned by the defendants. There was no evidence at all to show that the financing statements were based on a real transaction and the statements themselves were not signed by the alleged debtors.¹⁵³ The defense offered by the defendant who filed the financing statements was based on the law of the Republic of Texas and alleged a mish-mash of claims ranging from lack of jurisdiction to the unconstitutionality of United States coinage.¹⁵⁴ Characterizing the defendant's position as "irrational," the court entered a judgment to remove the financing statements from the public record.¹⁵⁵

148. "Notice filing" allows a secured party to file a simplified form containing relatively few formal requirements. See TEX. BUS. & COM. CODE ANN. § 9.402 cmt. 2 (Tex. UCC) (Vernon 1991).

149. Presentation for filing and tender of the required fee constitutes filing under TEX. BUS. & COM. CODE ANN. § 9.403(a) (Tex. UCC) (Vernon 1991).

150. TEX. BUS. & COM. CODE ANN. § 9.412 (Tex. UCC) (Vernon Supp. 1997).

151. TEX. BUS. & COM. CODE ANN. § 9.412(a) & (d) (Tex. UCC) (Vernon Supp. 1997). This section also makes a fraudulent filing a criminal offense. See TEX. BUS. & COM. CODE ANN. § 9.412(c) (Tex. UCC) (Vernon Supp. 1997).

152. 912 F. Supp. 224 (N.D. Tex. 1996).

153. *Id.* at 227. The court characterized the signing as "a crude compliance attempt at best and a forgery at worst." *Id.*

154. *Greenstreet*, 912 F. Supp. at 226.

155. *Id.* at 229-230.

E. DISPOSITION OF COLLATERAL AFTER DEFAULT

Section 9.504 of the Code requires a secured party to dispose of collateral in a commercially reasonable manner.¹⁵⁶ As applied in Texas, a failure to do so bars a secured party from recovering a deficiency.¹⁵⁷ In *Schmid v. Texas Commerce Bank-Fort Worth, N.A.*,¹⁵⁸ the debtor contended that a secured party who had taken possession of stock certificates as collateral for a loan was required to sell the stock before suing for payment of the balance due under a note secured by the stock. The court properly held that the Code does not require a secured party to sell collateral before seeking a judgment on the debt, but merely authorizes the sale of collateral by a secured party.¹⁵⁹ Judgment in favor of the secured party was affirmed.¹⁶⁰

In *Acuff v. Lamesa National Bank*,¹⁶¹ the debtor claimed that a secured party failed to properly dispose of collateral because he did not receive notice of sale of the collateral before its disposition. While this is a good argument in the abstract, the court held that it failed on the facts of this particular case because a co-maker on the note owned the collateral and sold it to the secured party in partial satisfaction of the debt; the collateral had not been sold by the secured party. Because the owner and not the secured party was the one who sold the collateral, no notice of the sale was required.¹⁶²

Lack of notice of the disposition of collateral, this time to a guarantor, was also raised in *Bishop v. National Loan Investors, L.P.*,¹⁶³ as a defense to recovery of a deficiency after a foreclosure on real estate. The court noted, however, that the rule requiring notice of disposition to guarantors applies only to the disposition of personal property under the Code and does not apply to foreclosures on real property.¹⁶⁴ The lack of notice, therefore, did not preclude the creditor from recovering a deficiency.¹⁶⁵

Perhaps the most interesting recent decision involving the disposition of collateral under Chapter 9 is *Havins v. First National Bank*.¹⁶⁶ In *Havins*, a bank repossessed cattle and farm equipment and sold some of

156. TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1991).

157. The rule barring recovery of a deficiency when the secured party fails to dispose of collateral in a commercially reasonable manner was first adopted in Texas in *Tannenbaum v. Economics Lab., Inc.*, 628 S.W.2d 769 (Tex. 1982).

158. 912 S.W.2d 845 (Tex. App.—Fort Worth 1995, no writ).

159. *Id.* at 846, citing TEX. BUS. & COM. CODE ANN. §§ 9.501(a) & 9.504 (Tex. UCC) (Vernon 1991).

160. *Schmid*, 912 S.W.2d at 848.

161. 919 S.W.2d 154 (Tex. App.—Eastland 1996, no writ).

162. *Id.* at 157.

163. 915 S.W.2d 241 (Tex. App.—Fort Worth 1995, no writ).

164. *Id.* at 245. In reaching this conclusion, the court cited *Long v. NCNB-Tex. Nat'l Bank*, 882 S.W.2d 861, 866 (Tex. App.—Corpus Christi 1994, no writ). *Long* contains an extensive review of the Texas cases and statutes involving the issue of notice to guarantors and is a valuable reference source in situations involving such notice. *Long* is discussed in John Kraemer, *Commercial Transactions, Annual Survey of Texas Law*, 49 SMU L. REV. 803-04 (1996).

165. *Bishop*, 915 S.W.2d at 245.

166. 919 S.W.2d 177 (Tex. App.—Amarillo 1996, no writ).

the cattle through a livestock auction barn. No notice of the sale was given to the debtor. In a scholarly and well-reasoned opinion that discusses much of the prior Texas case law on notice of sale and commercially reasonable disposition of collateral, the court held that the sale of cattle at a livestock auction might be treated as a sale in a recognized market that does not require prior notice.¹⁶⁷ In the case before it, however, the court found the record inadequate to show that the livestock auction qualified as a recognized market.¹⁶⁸ Absent proof of prior notice and commercially reasonable disposition, or proof of sale in a recognized market, the bank was not entitled to recover a deficiency.¹⁶⁹ The case was remanded for a new trial on these issues.¹⁷⁰

167. *Id.* at 183. If collateral is sold in a recognized market TEX. BUS. & COM. CODE ANN. § 9.504(c) (Tex. UCC) (Vernon 1991) does not require notice of sale.

168. *Havins*, 919 S.W.2d at 184.

169. *Id.*

170. *Id.* at 185.

