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# Commercial Transactions

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# COMMERCIAL TRANSACTIONS

by

George E. Henderson\*

SINCE its adoption in 1966 the Uniform Commercial Code<sup>1</sup> has had an enormous impact upon business transactions in Texas. Although the Code was enacted to provide a degree of certainty and uniformity in the law governing commercial transactions, the Code's complexity has produced conflicting judicial decisions and interpretations. At the same time, significant sections of the Code have been virtually ignored by the courts. The purpose of this Article is to provide an over-view of recent significant decisions. In doing so, attention will be focused on those cases which relate to the more perplexing and misunderstood Code formulations.

The text of this Article has been classified under the headings of sales, negotiable instruments, secured transactions, creditor's remedies, and recent legislation. Although most of the analysis relates primarily to the Code, there are several areas where it is inapplicable. In those areas, the common law and recent statutory enactments must supply the answer.

## I. SALES

### A. *Contract Terms and Acceptance*

The UCC's treatment of uncertain contract terms was demonstrated in *Pacific Products, Inc. v. Great Western Plywood, Ltd.*<sup>2</sup> A purchase order was submitted by the buyer, Pacific, specifying the total amount and various grades of lumber to be delivered. However, the order was silent as to the desired amount of each particular grade.<sup>3</sup> A similar acknowledgment form was sent by the seller, Great Western.<sup>4</sup> Pursuant to the buyer's written instructions, the plywood was later shipped directly to Pacific's customer. Upon receipt of the shipment the customer notified Pacific that the plywood was not acceptable, as eighty-five percent of the shipment was of an inferior grade. Following Pacific's formal notice of rejection,<sup>5</sup> a reinspection was

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1. Uniform Commercial Code, 1972 Text with Comments, hereinafter referred to as "the Code." This statute became effective in Texas in 1966 and is found in the Texas Business and Commerce Code. Article 9 of the Code, dealing with secured transactions, was amended in large part in 1973. Ch. 400, [1973] Tex. Laws 999. Textual references will be to the Uniform Commercial Code; citations will be to the Texas Business and Commerce Code where appropriate.

2. 528 S.W.2d 286 (Tex. Civ. App.—Fort Worth 1975, no writ).

3. Pacific's order form stated that all purchases were made in accordance with certain trade association grading rules and practices unless otherwise stated. Pacific ordered one carload of plywood composed of AC, BC, and "shop" grades, with the quantity of shop grade to be no more than 5%. *Id.* at 288. The grading standards identified three qualities, AC being the best, BC an intermediate class, and shop the poorest. *Id.*

4. The written acknowledgment and the purchase order crossed in the mail. The acknowledgment form lacked the provision regarding association standards. *Id.* at 289.

5. This was done pursuant to § 2-602(1) of the Code. TEX. BUS. & COMM. CODE

conducted by a quality control firm at Great Western's request. The shipment was found to be in compliance with the standard agreed upon by the parties, since at least ninety-five percent of the plywood shipped was of the grades ordered. Nevertheless, Pacific refused to accept. Great Western then sued for damages after selling the shipment at a loss. The trial court found in favor of Great Western, holding that a valid contract existed and that Pacific's rejection was improper.

Pacific's principal contention on appeal was that since the exchange of forms failed to evidence an agreement on certain material terms, a contract sufficiently certain to be enforced never existed.<sup>6</sup> The court of civil appeals properly rejected this argument,<sup>7</sup> basing its decision on the text of sections 1-102, 1-205, 2-201, 2-202, 2-204, and 2-305 of the UCC.<sup>8</sup> The memoranda-order forms agreed on the quantity and type of goods sold,<sup>9</sup> and the absence of a fixed price term was not violative of section 2-201, the Code's Statute of Frauds provision,<sup>10</sup> nor would it prevent the creation of a contract.<sup>11</sup> In fact, the forms involved in this case rendered section 2-201 inapplicable—the vendor's form evidenced a contract for the sale of a specified quantity of goods, which was signed by both parties.<sup>12</sup> Circumventing the requirements of section 2-201(1) through the use of a written confirmation does not, however, establish an enforceable contract,<sup>13</sup> for the evidence, both written and oral, must still show that a contract was made.<sup>14</sup> The court in *Pacific Products* had little difficulty finding such a contract despite the dispute as to the grades of lumber. Under section 2-202 of the Code, parol evidence relating to course of dealing or usage of trade can supplement the terms of written documents.<sup>15</sup> Further, after section 2-

ANN. § 2.602(a) (1968). The shipment contained 85% of BC grade, but 5% or less of the plywood was of "shop" grade. 528 S.W.2d at 289. See note 3 *supra* and accompanying text.

6. Pacific argued that the number of units of each grade, the price for the total quantity of each grade, the total quantity of plywood, and the final total price could not be determined from the purchase order and acknowledgment. Therefore, the purported contract must fail due to the lack of expressed agreement as to certain material terms. 528 S.W.2d at 290.

7. *Id.* at 292-94.

8. TEX. BUS. & COMM. CODE ANN. §§ 1.102, 1.205, 2.201, 2.202, 2.204, 2.305 (1968).

9. The plaintiff sued on the basis of a thirty-unit car load shipment, thus avoiding a dispute under the last sentence of TEX. BUS. & COMM. CODE ANN. § 2.201(a) (1968) as to the quantity for which the agreement was enforceable. See notes 3, 4 *supra* and accompanying text.

10. TEX. BUS. & COMM. CODE ANN. § 2.201 (1968). The requisite writing need only afford a basis for believing that the offered oral evidence rests on a real transaction. UNIFORM COMMERCIAL CODE § 2-201, Comment 1.

11. Under § 2-305 the parties can create a contract for sale even though the price term is not settled. TEX. BUS. & COMM. CODE ANN. § 2.305 (1968).

12. A contract can be created by the conduct of the parties even though the writings are insufficient to evidence a contractual agreement. TEX. BUS. & COMM. CODE ANN. §§ 2.204(a), 2.207 (1968).

13. The only term which must appear in the writing is quantity, and recovery is limited to the amount stated. UNIFORM COMMERCIAL CODE §§ 2-201(1), (3)(b), Comment 1.

14. See, e.g., *Azevedo v. Minister*, 471 P.2d 661 (Nev. 1970).

15. Section 2-202 provides that course of dealing or usage of trade can explain or supplement the agreed terms of the parties. TEX. BUS. & COMM. CODE ANN. § 2.202 (1968).

201 has been satisfied, parol evidence is admissible to clarify and establish unsettled terms.<sup>16</sup> In *Pacific Products* the trial court had concluded that the written sales acknowledgment form signed by Pacific and returned to Great Western constituted a complete contract calling for an agreed upon quantity with unspecified percentages of different grades of plywood.<sup>17</sup> The evidence before the trial court did not show industry usage as to percentages of grades in the absence of specific agreement; nevertheless, the court of appeals held that the trial court had sufficient evidence to find a valid agreement despite these unexpressed percentages.<sup>18</sup> Under the Code, an agreement does not fail for indefiniteness provided the parties have intended a contract and there is a reasonably certain basis for giving an appropriate remedy.<sup>19</sup> Therefore, according to *Pacific Products*, where the evidence shows that persons in the industry order lumber without specifying the desired percentage of each particular grade, a contract will not fail for indefiniteness simply because the grade percentages are omitted from the writings.

In dictum the court examined Pacific's rejection of the goods. Great Western argued that Pacific, by directing the carrier to deliver the car to Pacific's customer promptly upon arrival, had waived any right to inspect and reject the goods. Further, Great Western urged that Pacific's instructions releasing the car to the customer amounted to an acceptance of the goods, since such conduct was inconsistent with Great Western's ownership.<sup>20</sup> In support of this argument Great Western relied on *Pittman-Harrison Co. v. Fox Bros.*,<sup>21</sup> a pre-Code case where the buyer had unloaded and stored nonconforming goods. The seller sued for conversion and the court held that even though unloaded, inspected, and stored, the shipment was still under the control of the seller. However, as the court properly pointed out, the decision in *Fox* did not support the position of Great Western.<sup>22</sup> In any event, the scope of section 2-606(1)(c),<sup>23</sup> relating to

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16. Under the general theory of § 2-201 the successful plaintiff recovers on an oral contract, not a written one. See J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 2.4 (1972) [hereinafter cited as WHITE & SUMMERS].

17. 528 S.W.2d at 291.

18. A contract existed for plywood of not more than 5% shop grade quality, the balance to be distributed between grades AC and BC without restriction. See note 3 *supra* and accompanying text.

19. TEX. BUS. & COMM. CODE ANN. § 2.204(c) (1968). A very similar result was reached in *Tracor, Inc. v. Austin Supply & Drywall Co.*, 484 S.W.2d 446 (Tex. Civ. App.—Austin 1972, writ ref'd n.r.e.), involving a dispute over an order of "one-inch sheetrock" where two types of "one-inch sheetrock" were available. That contract also withstood an attack based on indefiniteness, but § 2-204 was not cited. Similarly, *Tracor* was not cited in *Pacific*. The court in *Pacific* did not consider the possibility that Great Western's shipment and Pacific's acts with respect to the handling of the carload constituted conduct sufficient to show agreement under § 2-204(1). TEX. BUS. & COMM. CODE ANN. § 2.204(a) (1968).

20. Section 2-606 provides that acceptance of goods occurs when the buyer does any act inconsistent with the seller's ownership. *Id.* § 2.606(a)(3). Here the shipment arrived consigned to Great Western, and was apparently made on a "straight" bill of lading. 528 S.W.2d at 295. Had this been a documentary sale, Pacific's inspection rights would have been cut off. TEX. BUS. & COMM. CODE ANN. §§ 2.512, 2.513(c) (1968).

21. 228 S.W. 579 (Tex. Civ. App.—Texarkana 1921, no writ).

22. Not only was this a pre-Code decision but it was also directly contrary to Great Western's position. 528 S.W.2d at 296.

23. See note 20 *supra* and accompanying text.

acceptance by inconsistent acts, should be limited to the case in which the buyer has attempted to reject and then engaged in conduct inconsistent with the seller's ownership of the goods.<sup>24</sup> Viewed in this light, Pacific's directing delivery of the shipment before inspection raises no real issue as to acceptance or loss of inspection rights.

### B. Risk of Loss

The proper allocation of the risk of loss during sale and delivery was considered in *Caudle v. Sherrard Motor Co.*<sup>25</sup> Sherrard, the seller, brought suit against Caudle, who had stopped payment on a check given in partial payment for a house trailer. On the day the contract was made, but prior to delivery, the trailer was stolen from Sherrard's place of business. The jury found that, due to his failure to tender the balance of the purchase price, Caudle had breached the contract, but that Sherrard had not suffered any damage. However, a judgment *non obstante veredicto* was entered for the plaintiff in an amount approximately equal to the purchase price.

Applying section 2-509 of the Code, the Dallas court of civil appeals reversed, holding that since the trailer was stolen before the risk of loss had passed to Caudle, the contract failed for want of consideration.<sup>26</sup> However, the court did not invoke the reasoning process dictated by the Code. Under section 2-507 the buyer's duty to pay for goods is conditioned upon a proper tender of delivery.<sup>27</sup> Since Sherrard neither delivered the goods nor asserted its right to cure, Caudle was under no duty to make payment.<sup>28</sup> Hence, Sherrard would not have a claim against Caudle for non-payment.<sup>29</sup> Failure of the promised consideration is often said to give the promisee a right to rescind the contract. However, this right is frequently asserted, as in *Caudle*, as a defense to an action on the counter-promise.<sup>30</sup> Therefore, a more logical method of reaching the court's result would be to conclude that Sherrard, upon whom the risk of loss rested, breached the contract by failing to deliver the promised chattel, thereby relieving Caudle of any obligation for payment.

The seller contended that the risk of loss had passed to the buyer, since the seller, as bailee, had acknowledged the buyer's right to possession of the trailer.<sup>31</sup> The court's rejection of this argument cannot be faulted. Under section 2-509 a bailee is defined as one who issues a document of title and

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24. See WHITE & SUMMERS § 8.2.

25. 525 S.W.2d 238 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.).

26. *Id.* at 239.

27. TEX. BUS. & COMM. CODE ANN. § 2.507 (1968).

28. The right to cure an improper delivery is dependent upon reasonable notification by the seller of his intention to cure. *Id.* § 2.508.

29. Conversely, Caudle would have been able to recover any payment if the promised delivery did not follow.

30. See generally 4 A. CORBIN, CONTRACTS § 1223 (1951).

31. Under the terms of § 2-509(2)(b), upon acknowledgment by the bailee of the right to possess the goods, the risk of loss passes to the buyer where the goods are held by a bailee to be delivered without being moved. TEX. BUS. & COMM. CODE ANN. § 2.509(b)(2) (1968). If the risk of loss as to destroyed goods is placed on the buyer, he remains liable for the price under § 2-709. *Id.* § 2.709. Where the risk of loss remains with the seller, he is liable for the buyer's damage due to nondelivery unless he tenders a performance replacing the destroyed goods.

contracts to deliver the goods,<sup>32</sup> and an issuer of documents of title is one engaged in the business of transporting or delivering goods.<sup>33</sup> Further, section 2-509(3), which deals with merchants, tends to affirm the proposition that a seller in possession is not a bailee.<sup>34</sup> In fact, it has been suggested that except in unusual circumstances, a seller should not be regarded as a bailee.<sup>35</sup>

Turning to section 2-509(3), the court held that Sherrard was a merchant since it normally dealt in the sale of house trailers.<sup>36</sup> The risk of loss, therefore, remained with Sherrard until actual receipt by the buyer.<sup>37</sup> Consequently, since the risk of loss had not passed to the purchaser, his non-payment of the purchase price did not amount to a breach of the contract.

### C. Breach of Warranty and Damages

As is customary, the past year produced a number of decisions regarding the warranty sections of the Code, one of which was *Elanco Products Co. v. Akin-Tunnell*,<sup>38</sup> which returned for an encore.<sup>39</sup> The manufacturer of a weed control product was sued for negligence and breach of express warranty when the product failed to control weeds in a partnership's cotton crop.<sup>40</sup> Plaintiff-partnership had purchased the product after observing numerous advertisements concerning its qualities, but the partner making the purchase failed to read the manufacturer's warranty disclaimer on the container label. In addition, the aerial spraying service that applied the product failed to mix the chemical in the proportions suggested by the manufacturer, nor did it observe the wind velocity restrictions enumerated in a product brochure.<sup>41</sup>

The jury found that the manufacturer had made an affirmation of fact or promise that its product would control weeds, and that this became a part of the basis of the bargain between the parties. Although the jury determined that this warranty was conditioned on compliance with the manufacturer's instructions as to mixing and wind conditions, the failure to comply was *not* found to be a proximate cause of the alleged damages. Based on the findings as to proximate cause and other facts absolving the spraying service of negligence, judgment was entered denying any recovery against the spraying service and awarding judgment against the manufacturer for the damages sustained by the purchaser.

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32. *Id.* § 7.102(a)(1).

33. *Id.* §§ 1.201(6) (bill of lading), 1.201(45) (warehouse receipt).

34. WHITE & SUMMERS § 5.3 n.18.

35. *Id.*

36. A merchant is one who "deals in goods of the kind . . . involved in the transaction." TEX. BUS. & COMM. CODE ANN. § 2.104(a) (1968).

37. This rule is based on two theories: (1) control by the merchant over goods at his place of business, and (2) the likelihood of insurance coverage. UNIFORM COMMERCIAL CODE § 2-509, Comment 3.

38. 516 S.W.2d 726 (Tex. Civ. App.—Amarillo 1974, writ ref'd n.r.e.).

39. The prior decision, 474 S.W.2d 789 (Tex. Civ. App.—Amarillo 1971), remanded the case for new trial on issues of express warranty.

40. Further claims based on negligence were asserted against the party who had applied the product to the fields. 516 S.W.2d at 726.

41. *Id.* at 727-28.

The argument of the manufacturer on appeal was that the buyer's failure to comply with the manufacturer's instructions precluded recovery on the express warranty theory, notwithstanding jury findings as to causation. This contention required the Amarillo court of civil appeals to rewrite a rather murky portion of its earlier opinion in which the court's language implied that only those instructions which were part of the "bargain" need be satisfied in order to recover.<sup>42</sup> In its later decision the court adopted the position that compliance with all of the terms of an express warranty is essential to a plaintiff's recovery on a warranty theory.<sup>43</sup> Therefore, in reversing the lower court's judgment, the court held that the purchaser could not recover from the defendant.

The result in *Elanco* goes somewhat beyond that reached in other Texas decisions dealing with the necessity of compliance with conditions set out in an express warranty, but comports with the view, espoused in other cases, that a seller is the master of the terms of his offer. In *London v. Curlee*,<sup>44</sup> a pre-Code case, the court held that a purchaser's failure to comply with several express conditions precedent defeated recovery based on an express warranty theory. The plaintiff's failures in *London* were similar to those involved in *Elanco*. In *Veretto v. Eli Lilly Co.*,<sup>45</sup> directly supporting the result in *Elanco*, the jury found that the plaintiff had followed acceptable farming practices in applying the chemical. However, the trial court entered judgment for the defendant-manufacturer notwithstanding the jury verdict, since the general findings of the jury were not supported by any evidence that the plaintiff complied with the application requirements as specified in the instruction brochure.<sup>46</sup>

*Elanco* also contains an unusual twist with respect to the issue of whether the warranty instructions were part of the basis of the bargain. In *W.G. Tufts & Son v. Herider Farms, Inc.*<sup>47</sup> the jury found the purchaser's failure to read and heed label warnings was a proximate cause of the economic loss suffered. The court, however, held the label warnings were not a part of the basis of the bargain, since the purchaser had relied on the seller's representation that the product sold was identical to another product previously used.<sup>48</sup> By contrast, in *Elanco* strict compliance with the product's instructions was required by the court as a condition to warranty liability, despite the fact that they were not supplied to the partnership at the time of purchase. However, the instructions were known to the person hired by the partnership prior to the application of the chemical.<sup>49</sup> In effect, this result could be read to allow a seller to add qualifications to an express warranty

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42. 474 S.W.2d at 793.

43. 526 S.W.2d at 732.

44. 336 S.W.2d 836 (Tex. Civ. App.—San Antonio 1960, no writ).

45. 369 F. Supp. 1254 (N.D. Tex. 1974). For a discussion of the case see Larson, *Commercial Transactions, Annual Survey of Texas Law*, 29 Sw. L.J. 118, 133 (1975).

46. *Veretto* also refused to extend liability for consequential economic damages to the remote manufacturer. *Id.* at 1255. *Elanco* did not deal with this possible issue.

47. 485 S.W.2d 300 (Tex. Civ. App.—Tyler 1972, writ ref'd n.r.e.).

48. *Id.* at 303. For authority the court cited the earlier decision in *Elanco*, 474 S.W.2d 789 (Tex. Civ. App.—Amarillo 1971).

49. 516 S.W.2d at 728.

after sale but prior to use, similar to the expansion of a warranty by a vendor's assurances following a sale.<sup>50</sup>

In *Emmons v. Durable Mobile Homes, Inc.*<sup>51</sup> the purchaser of a mobile home claimed that the product was unfit for its intended use. In a suit against the dealer, manufacturer, and financing bank, the purchaser sought rescission and restitution. Plaintiff was denied recovery from the manufacturer on two grounds. First, in the absence of privity between the manufacturer and the plaintiff the contract theory seeking damages and rescission was improper. Second, since the manufacturer had given an express written warranty which negated any other express or implied warranty, including any implied warranty of merchantability or fitness, the purchaser could not rely upon breach of implied warranties.<sup>52</sup> Prior case law has supported this view.<sup>53</sup>

*Lanphier Construction Co. v. Fowco Construction Co.*<sup>54</sup> also involved an express warranty. Lanphier, the general contractor, sued its subcontractor, Fowco, for damages caused by defective asphalt paving. The subcontractor, in turn, impleaded Servtex, its supplier. With the defendant's approval, another type of asphalt paving had been substituted for that originally specified in the contract. Servtex had warranted that the substitution would meet certain highway specifications, but the new asphalt paving proved unsuitable and had to be relaid. The jury found that Servtex had breached express and implied warranties and the court entered judgment in favor of Lanphier and Fowco.

On appeal Servtex contended that its express warranty regarding conformity to the contract specifications excluded any implied warranty of fitness, and, therefore, the submission of issues relating to the existence of the implied warranty was erroneous.<sup>55</sup> The Code, however, contemplates that warranties shall, if possible, be construed as cumulative and not exclusive,<sup>56</sup> and in the usual sales situation a conspicuous written disclaimer is required to exclude an implied warranty of fitness for a particular purpose.<sup>57</sup> This was notably absent from Servtex's certificate. Further, the Code establishes a special rule of construction favoring the preservation of such implied warranties.<sup>58</sup> Thus, the court's rejection of this argument was clearly correct.

The court in *Lanphier* also considered the issue of whether an injured subcontractor is entitled to recover the costs of repaving, or whether he is limited to the usual breach of warranty measure, *i.e.*, the value as warranted less actual value. The court cited sections 2-714(2) and 2-715 in support of

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50. See UNIFORM COMMERCIAL CODE § 2-313, Comment 7.

51. 521 S.W.2d 153 (Tex. Civ. App.—Dallas 1974, no writ).

52. *Id.* at 154.

53. See, *e.g.*, *Lankford v. Rogers Ford Sales*, 478 S.W.2d 248 (Tex. Civ. App.—El Paso 1972, writ ref'd n.r.e.); *John Deere Co. v. Tenberg*, 445 S.W.2d 40 (Tex. Civ. App.—Beaumont 1969, no writ).

54. 523 S.W.2d 29 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.).

55. *Id.* at 40.

56. TEX. BUS. & COMM. CODE ANN. § 2.317 (1968).

57. *Id.* § 2.316(b).

58. Under the Code express warranties are said only to displace inconsistent implied warranties other than the implied warranty of fitness. *Id.* § 2.317(3).



a damage award based on the reasonable and necessary costs of repairing the defective pavement, which included removing and repaving the parking surface. The repair costs seem to fit within section 2-715(2)(a);<sup>59</sup> however, since the actual value of the substituted paving was zero, the calculation of damages could also be cast as warranty less actual value under section 2-714.<sup>60</sup>

Several non-Code contract cases should be briefly mentioned in connection with issues relating to damages. *Houston Chronicle Publishing Co. v. McNair Trucklease, Inc.*<sup>61</sup> involved the breach of a five-year contract for newspaper truck deliveries. McNair, the trucking concern, purchased new vehicles in order to fulfill its contract obligations. The trial court judgment allowed McNair to recover the capital outlay for the equipment, and this decision was affirmed on appeal on the ground that the purchase of a capital asset for the purpose of performing a contract is not a cost of performance saved by reason of the breach. Therefore, the item need not be set off against recovery of the contract revenues.

Although commentators have argued that a party cannot recover both the amount of expenditures incurred in part performance plus the profits he would have made if the contract had been fully performed, such a statement is inaccurate.<sup>62</sup> Profits, in any proper sense of the term, do not include expenditures. Thus, recovery of the full contract price, including a recovery of profits plus expenses, less the cost of completing the work to be done after breach is not a double recovery. A capital investment necessary to performance is not considered to be an expenditure in part performance except insofar as it will be exhausted in the course of such performance. It is only the depreciation, reasonably chargeable to the past performance actually rendered by the plaintiff, that is an unrecoverable expenditure.<sup>63</sup>

An unusual contract damage question was presented in *McCane Sondock Detective Agency v. Penland Distributors, Inc.*<sup>64</sup> where a burglar alarm system contract limited the agency's liability to twenty-five dollars for any loss resulting from the alarm's failure to operate. Plaintiff's system was connected to a "loop system" alarm which set off a flashing light when burglars cut the wires at plaintiff's business. Believing that the signal was caused by line trouble within the system, defendant failed to investigate. The court held that the system was "operating" when the trouble signal was given, thus precluding application of the damage limitation clause.

#### D. Miscellaneous

*Kiser v. Lemco Industries, Inc.*,<sup>65</sup> a venue case, held that under a contract

59. This section provides that consequential damage includes any loss resulting from general or particular requirements of which the seller at the time of contracting had reason to know. *Id.* § 2.715(b)(1).

60. Section 2-714(2) states this formula to be the measure of damages for breach of warranty unless special circumstances show proximate damages of a different amount. *Id.* § 2.714(b).

61. 519 S.W.2d 924 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ ref'd n.r.e.).

62. See 4 A. CORBIN, CONTRACTS § 1036 (1951).

63. *Id.*

64. 523 S.W.2d 62 (Tex. Civ. App.—Houston [14th Dist.] 1975, no writ).

65. 521 S.W.2d 142 (Tex. Civ. App.—Amarillo 1975, no writ).

calling for the purchase of grain at a specified price "F.O.B. Levelland, Texas," the defendant-seller had contracted to perform an obligation in Levelland. Therefore, the special venue rule of article 1995(5) applied, permitting suit in the county where performance was due.<sup>66</sup> The court's reasoning rested on section 2-319(1)(b) of the Code, which states the "F.O.B. destination" is a delivery term obligating the seller to deliver the goods, at his own expense and risk, to the stated destination.<sup>67</sup> Consequently, the defendant-seller's performance obligation was placed in Levelland, Hockley County, Texas.

Recently adopted article 1995(5)(b),<sup>68</sup> establishing venue for, among other things, extensions of credit for agricultural use in the county of the defendant's residence or in the county where the contract was signed, was construed in *Castleberry v. Acco Feeds, Division of Anderson-Clayton & Co.*<sup>69</sup> The buyer, who could be characterized as an "agri-businessman," was sued on an unpaid open account for feed sales. The delivery tickets specified payment at the seller's Abilene office. When suit was filed in Taylor County, the county of plaintiff's office, defendant filed a plea of privilege to be sued in Burnett County, the county of his residence and the county where he signed the delivery tickets. On appeal the court held that the defendant's plea of privilege should have been sustained by the district court, notwithstanding the plaintiff's argument that the stated venue provision was not intended to shelter the large agricultural businesses of the state. In support of plaintiff's theory, one commentator has suggested that consideration should be given to the mischief at which a statute was aimed and to the remedial objective which was sought in order to reach a fair interpretation.<sup>70</sup>

*Wade v. Austin*<sup>71</sup> held that a real estate exclusive brokerage contract was not unconscionable within the meaning of section 2-302 of the Code.<sup>72</sup> This novel attempt to incorporate the Code's unconscionability rules into this context prompted the court to review thoroughly the unconscionability doctrine.

A number of sworn account cases, which are contract cases in another guise, were heard on appeal during the past year. In *Big D Service Co. v. Climatrol Industries, Inc.*<sup>73</sup> the court held that the four-year statute of

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66. Article 1995(5) provides that, subject to the provisions of subsection (b), if a person has contracted in writing to perform an obligation in a particular county, suit may be brought against him in either that county or that of the defendant's domicile. TEX. REV. CIV. STAT. ANN. art. 1995(5) (Supp. 1975-76).

67. TEX. BUS. & COMM. CODE ANN. § 2.319 (1968).

68. Article 1995(5)(b) states that in an action arising out of a consumer transaction suit may be brought against the defendant either in the county in which the defendant signed the contract or in the county in which the defendant resides at the time of the commencement of the action. TEX. REV. CIV. STAT. ANN. art. 1995(5)(b) (Supp. 1975-76).

69. 525 S.W.2d 282 (Tex. Civ. App.—Eastland 1975, no writ).

70. See SUTHERLAND'S STATUTORY CONSTRUCTION § 48.03 (4th ed. C. Sands 1973).

71. 524 S.W.2d 79 (Tex. Civ. App.—Texarkana 1975, no writ).

72. Section 2-302 provides that the court can refuse to enforce a contract or any contract clause if it finds it unconscionable. In making this determination, evidence regarding the commercial setting, effect, and purpose can be presented. TEX. BUS. & COMM. CODE ANN. § 2.302 (1968).

73. 523 S.W.2d 236 (Tex. 1975), *refusing writ of error*, 514 S.W.2d 148 (Tex. Civ. App.—Texarkana 1974).

limitations provided in section 2-725 of the Code,<sup>74</sup> rather than the two-year statute of article 5526(6),<sup>75</sup> applied to sworn accounts based on breach of contract for the sale of goods. This decision follows the earlier, well-reasoned opinion in *Ideal Builders Hardware Co. v. Cross Construction Co.*<sup>76</sup>

The necessity of strict adherence to the sworn account rules for both plaintiffs and defendants was illustrated in several cases. In *Oliver Bass Lumber Co. v. Kay & Herring Butane Gas Co.*<sup>77</sup> the failure of a sworn denial to adhere strictly to the requisites of Texas Rule of Civil Procedure 93(k)<sup>78</sup> was held to preclude any dispute as to the account. However, in *Youngblood v. Central Soya Co.*<sup>79</sup> a deficient denial was held not to preclude summary judgment in a sworn account action where a cross-action and counterclaim were severed.

The failure of the plaintiff to state with sufficient specificity the items sold, the dates of sale, and the reasonable charges in a sworn account petition proved fatal in two cases.<sup>80</sup> The court in *Hollingsworth v. Northwest National Insurance Co.*<sup>81</sup> held that an action to recover from an insurance agent the amounts of unpaid premiums due on policies sold to third parties could not be brought as a sworn account even though the defendant was liable under the agency contract. The court distinguished cases involving sworn account suits to recover premiums on policies sold to the defendant.<sup>82</sup> Finally, in *Evans Advertising Agency v. Morphew*<sup>83</sup> the court relied on earlier cases involving article 2226 in stating, though not clearly holding, that advertising services are not within the scope of sworn account suits under rule 185.<sup>84</sup> The court held that failure to introduce evidence of the actual performance of the advertisements defeated recovery.

## II. NEGOTIABLE INSTRUMENTS

### A. Acceleration of Notes

Several cases reported during the survey period involved controversies arising out of the acceleration of installment obligations and related foreclo-

74. Section 2-725 states that an action for breach of contract for sale must be commenced within four years after the cause of action has accrued. A cause of action accrues when the breach occurs regardless of the aggrieved party's lack of knowledge of the breach. TEX. BUS. & COMM. CODE ANN. § 2.725 (1968).

75. Article 5526(5) provides that in actions upon stated or open accounts a two-year statute of limitation is applicable. TEX. REV. CIV. STAT. ANN. art. 5526(5) (1958).

76. 491 S.W.2d 228 (Tex. Civ. App.—Houston [1st Dist.] 1972, no writ).

77. 524 S.W.2d 600 (Tex. Civ. App.—Tyler 1975, no writ).

78. This rule states that a pleading which states that an account which is the foundation of the plaintiff's action is unjust must be supported by an affidavit. TEX. R. CIV. P. 93(k).

79. 522 S.W.2d 277 (Tex. Civ. App.—Fort Worth 1975, writ ref'd n.r.e.).

80. *Hassler v. Texas Gypsum Co.*, 525 S.W.2d 53 (Tex. Civ. App.—Dallas 1975, no writ); *Unit Inc. v. Ten Eyck-Shaw, Inc.*, 524 S.W.2d 330 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.).

81. 522 S.W.2d 242 (Tex. Civ. App.—Texarkana 1975, no writ).

82. *Id.* at 245.

83. 525 S.W.2d 56 (Tex. Civ. App.—Tyler 1975, no writ).

84. Article 2226 states that in actions on sworn accounts attorney fees can be recov-

sure proceedings. In *Allen Sales & Servicecenter, Inc. v. Ryan*<sup>85</sup> the maturity of a five-year installment note for \$10,000 was accelerated four days after the initial payment was missed. However, the payee failed to demand payment of the overdue installment before accelerating. The Texas Supreme Court, reversing the Fort Worth court of civil appeals,<sup>86</sup> held that section 3-501<sup>87</sup> did not abolish the presentment for payment as a prerequisite to the exercise of an optional acceleration clause in a promissory note,<sup>88</sup> despite the absence of such a requirement in the Code.<sup>89</sup> Recognizing that acceleration was an extremely harsh remedy, the court held that equity demanded notice of an intent to accelerate in the absence of clear legislative intent to abolish the rule.<sup>90</sup>

In *Vaughan v. Crown Plumbing & Service, Inc.*<sup>91</sup> an examination of the equities of an attempted acceleration and foreclosure led the Houston court of civil appeals to affirm a temporary injunction against foreclosure. The court determined that since the creditor had exercised an acceleration remedy, not to protect the collateral or the debt, but instead to coerce the debtor into payment or forfeiture, a court of equity could properly intervene to protect the debtor.<sup>92</sup> In addition, the creditor's conduct as to previous delinquencies was, in the court's view, a waiver of his right to accelerate for similar defaults in the future, absent either a provision in the note that no such waiver would result or a notice that future strict compliance would be required.<sup>93</sup> Therefore, the trial court was well within its discretion in applying its equity powers to protect the defaulting debtor from the operation of the acceleration clause.<sup>94</sup>

Similarly, in *Stevens v. Bowie National Bank*<sup>95</sup> a creditor was found to have waived prior delinquencies in payment. The court held that a bank which had purchased a note and deed of trust with full knowledge that late payments had been accepted was not a holder in due course,<sup>96</sup> and, thus,

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ered. TEX. REV. CIV. STAT. ANN. art. 2226 (Supp. 1975-76).

85. 525 S.W.2d 863 (Tex. 1975), *rev'g* 517 S.W.2d 700 (Tex. Civ. App.—Fort Worth 1974).

86. *Allen Sales & Servicecenter, Inc. v. Ryan*, 517 S.W.2d 700 (Tex. Civ. App.—Fort Worth 1974), *rev'd*, 525 S.W.2d 863 (Tex. 1975).

87. Section 3-501 provides that, unless excused, presentment is necessary to charge secondary parties. TEX. BUS. & COMM. CODE ANN. § 3.501 (1968). Presentment is defined as "a demand for acceptance or payment." *Id.* § 3.504(2).

88. Ch. 123, § 70, [1919] Tex. Laws 198. Texas courts under the Negotiable Instruments Act held strictly to the view that presentment was a prerequisite to acceleration of maturity. However, it was possible to avoid the application of the presentment provision by a carefully drafted waiver providing acceleration without presentment. *See, e.g.*, *Faulk v. Futch*, 147 Tex. 253, 214 S.W.2d 614 (1948). Since section 3.511 of the Texas Business and Commerce Code carries forward in more elaborate terms the waiver provisions of the Negotiable Instruments Act, one would expect a similar result in a case involving an appropriate waiver under the Code. *Compare* ch. 123, § 82, [1919] Tex. Laws 200 with TEX. BUS. & COMM. CODE ANN. § 3.511(b)(1) (1968). The note in *Allen Sales* contained no such waiver clause.

89. 525 S.W.2d at 866; *see* note 87 *supra*.

90. *Id.*

91. 523 S.W.2d 72 (Tex. Civ. App.—Houston [1st Dist.] 1975, writ *ref'd n.r.e.*).

92. *Id.* at 76.

93. *Id.* at 75.

94. *Id.* at 77.

95. 517 S.W.2d 686 (Tex. Civ. App.—Fort Worth 1974, no writ). [Editor's Note: The Texas Supreme Court reversed this case. 532 S.W.2d 67 (Tex. 1975).]

96. TEX. BUS. & COMM. CODE ANN. §§ 3.302, 3.304(c), (d) (1968).

took the instrument subject to all defenses, including estoppel to accelerate.<sup>97</sup> This defect in the bank's suit led to the cancellation of the trustee's foreclosure deed.<sup>98</sup>

### B. Accommodation Parties

The definition of "accommodation party" under section 3-415 of the Code<sup>99</sup> was interpreted in *Jones v. San Angelo National Bank*.<sup>100</sup> Jones and Vetterlein executed a promissory note for \$100,000, and used the proceeds to finance a construction corporation of which they were the sole stockholders. After Vetterlein's death, his executor paid the balance of the note and brought suit against Jones for contribution. Jones asserted that he was an accommodation party and sought indemnification from the corporation for his liability on the note as principal obligor. The court, however, held that the absence of the corporation as a named party to the note excluded Jones from the literal definition of "accommodation party" set out in section 3-415(1).<sup>101</sup> By adopting a literal reading of section 3-415(1), the court clearly followed the more reasoned course. In addition, the court noted that even if section 3-415(1) had been read so as not to require the name of the accommodated party to appear on the instrument, Jones could not have qualified as an accommodation party under the circumstances of this case. Relying on earlier Texas cases,<sup>102</sup> the court concluded that even if the proceeds were paid into the jointly-owned corporation, Jones could not be an accommodation maker because, as a fifty percent shareholder of the corporation, he benefited from the underlying consideration for the note.<sup>103</sup>

### C. Guaranty and Suretyship Obligations

*Consideration. Whitten v. Alling & Cory Co.*<sup>104</sup> considered the sufficiency of consideration for a guaranty of payment and the applicability of the Statute of Frauds<sup>105</sup> to an oral agreement not reduced to writing until after the beneficiary of the guaranty had suspended sales to the principal debtor. The Tyler court of civil appeals determined that the beneficiary's sales, in reliance on the promised guaranty, constituted sufficient consideration for the

97. 517 S.W.2d at 688; see TEX. BUS. & COMM. CODE ANN. § 3.306(2) (1968).

98. 517 S.W.2d at 689.

99. TEX. BUS. & COMM. CODE ANN. § 3.415(a) (1968) states: "An accommodation party is one who signs the instrument in any capacity for the purpose of lending his name to another party to it." (Emphasis added.) The language of § 3.415(a), and the problems of a literal reading of it, are discussed in Peters, *Suretyship Under Article 3 of the Uniform Commercial Code*, 77 YALE L.J. 833 (1968).

100. 518 S.W.2d 622 (Tex. Civ. App.—Beaumont 1974, writ ref'd n.r.e.).

101. *Id.* at 624.

102. Of the cases cited by the court, *Motor & Indus. Fin. Corp. v. Hughes*, 157 Tex. 276, 302 S.W.2d 386 (1957), and *Otto v. Republic Nat'l Co.*, 173 S.W.2d 235 (Tex. Civ. App.—Dallas 1943, writ ref'd), are the most persuasive. See also *Wohlhuter v. St. Charles Lumber & Fuel Co.*, 16 UCC REP. SERV. 792 (Ill. App. 1975).

103. 518 S.W.2d at 624. Section 3-415(1) does not carry forward the concept that an accommodation party sign "without receiving value therefore." UNIFORM COMMERCIAL CODE § 3-415(1), Comment 2. Compare UNIFORM NEGOTIABLE INSTRUMENTS LAW § 29 with UNIFORM COMMERCIAL CODE § 3-415(1).

104. 526 S.W.2d 245 (Tex. Civ. App.—Tyler 1975, writ ref'd).

105. TEX. BUS. & COMM. CODE ANN. § 26.01(b)(2) (1968) provides that a promise to stand good for the debts of another must be in writing.

written guaranty. Although a guaranty given for a pre-existing debt must be supported by new consideration, if the guarantor's oral promise was given as an inducement to the advance of credit, the promise will be supported by the beneficiary's action in reliance upon the assurances of a guaranty, even though only later reduced to writing.<sup>106</sup> The subsequent execution of a written guaranty to satisfy the Statute of Frauds does not invalidate the earlier consideration supporting the guaranty.

*Cobb v. Texas Distributors, Inc.*<sup>107</sup> dealt with another aspect of consideration. Defendant, an officer and shareholder of a corporation, signed a guaranty agreement form supplied by a credit rating agency which provided, *inter alia*, that the agency could rely on the guaranty in making credit reports, and could furnish copies of the guaranty to persons requesting information regarding the company. Plaintiff, who had extended a line of credit to the corporation prior to the execution of the guaranty, subsequently learned of the guaranty and, in reliance thereon, continued to sell to the corporation on credit. Based on this evidence, the court held that there was sufficient consideration for the guaranty; therefore, the defendant guarantor was liable for the unpaid balance on such sales.<sup>108</sup> The court rejected defendant guarantor's argument that he should be liable only to the extent the balance owed plaintiff exceeded the amount outstanding at the time plaintiff learned of the guaranty. Since plaintiff had no continuing obligation to sell on credit, the court ruled that the damages sustained by plaintiff should be measured by unpaid amounts due on sales made after plaintiff began to rely on the guaranty.<sup>109</sup>

The character of a maker as an accommodation party was raised in *Peterson v. Caylor*.<sup>110</sup> Peterson executed a note, guaranteed by plaintiffs, to borrow money to pay a debt owed plaintiffs. On appeal from a judgment for plaintiffs, who had paid the note as guarantors and then had sued Peterson as maker, Peterson asserted he was not liable "as an accommodation maker." The court properly rejected this contention, stating that even if Peterson were an accommodation maker, he signed the note personally and was thereby liable as a maker;<sup>111</sup> the argument that liability cannot be imposed *simply because* of accommodation status is erroneous.

*Independent Liability of Sureties.* *Bohart v. Universal Metals & Machinery, Inc.*<sup>112</sup> illustrated the continued uncertainty regarding the relationship between suretyship and negotiable instruments law, and the Code's effect on that relationship.<sup>113</sup> Plaintiff, Universal Metals, had sold machinery to a

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106. 526 S.W.2d at 248; *accord*, 1 A. CORBIN, CONTRACTS § 213, at 286 n.26 (1963).

107. 524 S.W.2d 342 (Tex. Civ. App.—Dallas 1975, no writ).

108. The court also stated that because of the unconditional nature of the guaranty no notice to the defendant was necessary. 524 S.W.2d at 345.

109. The court held notice of acceptance of the guaranty was not required, the sale of goods being sufficient. 524 S.W.2d at 345.

110. 515 S.W.2d 375 (Tex. Civ. App.—Waco 1974, no writ).

111. TEX. BUS. & COMM. CODE ANN. § 3.415(b) (1968); *see* Peters, *supra* note 99, at 838.

112. 523 S.W.2d 279 (Tex. Civ. App.—Dallas 1975, writ granted).

113. For a discussion of the uncertainty on this point, see WHITE & SUMMERS § 13-12 n.98.

Mexican company, taking a promissory note. The signature of the Mexican company on the promissory note was a forgery, and plaintiff successfully sued defendant guarantors on the guaranty. The question presented on appeal was whether the guarantors, who had signed an absolute guaranty of payment as primary obligors, were liable to plaintiff despite the forgery. A majority of the Dallas court of civil appeals answered in the negative, reasoning that the terms "guarantor" and "primary obligor" as employed in the written guaranty were mutually exclusive, thereby creating an ambiguity in the document as to the scope of the defendant's undertaking.

Under the doctrine of *strictissimi juris* such ambiguity was resolved in the favor of defendant guarantors: the absence of a binding obligation on the part of the principal relieved the guarantors of any liability.<sup>114</sup> Justice Guittard disagreed with the reasoning of the majority. Finding the assumption of guarantor status to be consistent with an intention to assume a primary obligation, he would have held defendants liable as primary obligors despite the forgery.<sup>115</sup> An analysis of prior Texas decisions, cases in other jurisdictions, and the language of the Code itself suggests that the reasoning of Justice Guittard is correct. In *Wood v. Canfield Paper Co.*<sup>116</sup> the commission of appeals analyzed a number of Texas cases dealing with the nature of guarantor's obligations under statutes and rules<sup>117</sup> which regulate the enforcement of claims against sureties and guarantors. The commission of appeals in *Wood* held that the guarantor was entitled to the benefit of the statutes governing suits against sureties, reasoning that the agreements before the courts in those cases where a "guarantor" had been denied the benefits of the protective statutes had actually imposed independent liability on the guarantor, thus removing the "guarantor" from the statutes.<sup>118</sup> The same logic would appear to be equally applicable in *Bohart* and would support the dissent's view that the terms of the guaranty may be reconciled.<sup>119</sup> Thus, the "guarantor" may, under the terms of any given agreement, be liable to the creditor independent of any obligation on the part of the maker.<sup>120</sup>

Decisions in other jurisdictions indicate that an absolute guarantor may still be liable notwithstanding the fact that the principal's signature is forged. *Veazie v. Willis*<sup>121</sup> involved a guaranty of payment which was not indorsed on the note itself. The maker's signature and that of one indorser had been forged; two other indorsements were genuine. The Massachusetts Supreme

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114. 523 S.W.2d at 281.

115. *Id.* at 287.

116. 117 Tex. 399, 5 S.W.2d 748 (1928).

117. See TEX. REV. CIV. STAT. ANN. arts. 1986-87 (1964); TEX. BUS. & COMM. CODE ANN. §§ 34.01-.03 (1968); TEX. R. CIV. P. 30-31.

118. 117 Tex. at 408, 5 S.W.2d at 751-52.

119. 523 S.W.2d at 288; see, e.g., *Simon v. Landau*, 27 Misc. 2d 269, 208 N.Y.S.2d 120 (Sup. Ct. 1960) (a reference to "primary obligors" in a guaranty of a corporate debt held consistent with the concept of guaranty).

120. L. SIMPSON, SURETYSHIP (1950) was cited by both the majority and dissenting opinions. The majority relied upon it for the proposition that the forgery of the principal's signature is a risk borne by the creditor who deals with the principal. *Id.* § 54. The dissent pointed to *id.* § 55 for the proposition that a surety can undertake a greater obligation than that of the principal. The phrase "primary obligor(s)" could well be interpreted as showing an undertaking that was not tied exclusively to the principal debt.

121. 72 Mass. (6 Gray) 90 (1856).

Court held that the payment of the note had been guaranteed regardless of the forgery.<sup>122</sup> *Veazie* did, however, concern a note in which at least some indorsements were genuine, and, therefore, "the paper was not . . . a wholly fictitious paper . . ."<sup>123</sup> *Newark Finance Corp. v. Acocella*<sup>124</sup> involved an absolute guaranty indorsed on the note itself and a forged maker's signature. Although the holding in *Acocella* did rest in part upon indorsement liability,<sup>125</sup> the court stated an alternative holding that the forgery of the maker's signature did not relieve the accommodation indorser-guarantor of liability.<sup>126</sup>

Finally, the language of the Code itself would appear to support the reasoning of the *Bohart* dissent. First, the comment to section 3-416 of the UCC indicates that one who signs a note as an accommodation indorser and guarantees payment has a liability "indistinguishable from that of a co-maker."<sup>127</sup> The position taken by the Code regarding the liability of the indorser-guarantor indicates that this obligation should survive the forgery of the maker's signature and supports the view that guarantors under agreements such as that involved in *Bohart* incur primary and independent liability. Second, "under the Code, the word 'surety' includes all 'guarantors' and 'accommodation parties.'<sup>128</sup> Although the Code does not explicitly state the effect of the treatment of guarantors as sureties,<sup>129</sup> the distinction under the Code between the guarantor of payment, whose undertaking it is to perform "without resort to any other party,"<sup>130</sup> and the traditional surety<sup>131</sup> is diminishing<sup>132</sup> and is, therefore, subject to criticism. Third, although the point was not discussed in *Bohart*, the plaintiff appeared to have qualified as a holder in due course.<sup>133</sup> At least one commentator has suggested that in a situation such as that presented in *Bohart* the interests of the remote holders in due course should take precedence over a surety centrally involved in the negotiation of the note.<sup>134</sup> The argument is persuasive and suggests quite strongly that the dissent in *Bohart* was correct.<sup>135</sup>

122. *Id.* at 94.

123. *Id.*

124. 115 N.J.L. 388, 180 A. 862 (1935).

125. Compare UNIFORM NEGOTIABLE INSTRUMENTS LAW § 66 with UNIFORM COMMERCIAL CODE § 3-417(2).

126. 180 A. at 864. Other cases which contain language to the effect that an absolute guarantor is liable, regardless of forgery of the maker's signature, may be more accurately classified as resting on the warranty liability of an indorser-guarantor. *See, e.g.,* *Holm v. Jamieson*, 173 Ill. 295, 50 N.E. 702 (1898); *First Nat'l Bank v. Bair*, 315 Pa. 463, 173 A. 329 (1934).

127. UNIFORM COMMERCIAL CODE § 3-416, Comment.

128. *Id.* § 3-415, Comment 1. *See also* TEX. BUS. & COMM. CODE ANN. § 1.201 (40) (1968).

129. Since § 1.201(40) states "'Surety' includes 'guarantor,'" it is possible that under the Code either (a) guarantors are a subset of sureties, all of which have primary liability, or (b) "surety" is used for both direct and collateral undertakings.

130. TEX. BUS. & COMM. CODE ANN. § 3.416(a) (1968).

131. The surety's liability is frequently called "immediate and direct," as distinguished from the guarantor's "contingent liability." *See* A. STEARNS, *THE LAW OF SURETYSHIP* § 6 (1902).

132. *See* Peters, *supra* note 99, at 841.

133. TEX. BUS. & COMM. CODE ANN. § 3.302(b) (1968).

134. *See* Peters, *supra* note 99, at 863.

135. The case is admittedly a close one and the phrase "principal obligor(s)" must



An ancillary issue in *Bohart* involved defendant guarantor's claim that he was free from liability because the promissory note charged a usurious rate of interest. Although this issue was not resolved in *Bohart*, it raises questions of interpretation of the Texas corporate borrowing statute and its exclusions from the usury laws.<sup>136</sup> In *Sud v. Morris*<sup>137</sup> the Beaumont court of civil appeals held that when an individual and a corporation execute a "joint and several" note as co-makers, the individual has a cause of action for usury which may be pursued without joinder of the corporate party. *Sud*, however, did not address the question of whether the individual co-maker was an accommodation party under section 3-415 of the Code. It has been held elsewhere that an accommodation co-maker may not assert usury as a defense where the principal maker is barred from raising the defense.<sup>138</sup> The corporate borrowing statute itself excludes "such corporation, its successors, guarantors, assigns or anyone on its behalf" from asserting the defense of usury.<sup>139</sup>

The proper resolution of this problem was suggested by the decision in *E'Town Shopping Center, Inc. v. Lexington Finance Co.*,<sup>140</sup> which also involved a guaranty agreement. The court in *E'Town* accepted the proposition stated in the comment to section 3-416 that "the liability of a guarantor [of payment] is made the same as that of a co-maker [but] it does not follow that he is in fact a co-maker . . . . [Under section 3-416] one who is technically a 'guarantor' is in the same position as a surety with respect to the enforceability of the obligation without first proceeding against the principal."<sup>141</sup> The language of article 1302-2.09 should be construed to facilitate, rather than impede, the flow of capital to corporate borrowers. Therefore, the term "guarantor" should be interpreted to include the defendants in *Bohart* even though the guaranty provides for independent liability.

*Discharge.* Two cases during the survey period dealt with novel aspects of guaranty law. *Diamond Paint Co. v. Embry*<sup>142</sup> arose on complicated facts which may be summarized as follows: Embry funded a loan to Diamond Manufacturing, one of several corporations closely linked and dominated by Shepherd, a businessman active in many business and promotional activities. The loan in question was guaranteed by Shepherd and two of his corporations, Diamond Industries and Diamond Paint. In addition, Embry obtained "take-out commitments" from plaintiffs, Ladin and SBIC. When Diamond Manufacturing defaulted on the note, Ladin and SBIC were called upon by Embry to perform their obligations under the take-out agreements. After paying Embry the principal amount of the note, Ladin and SBIC sued

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carry the laboring oar in the dispute. However, the phrase should have some meaning in the guaranty, and it is suggested that the dissent sets out the better position. See 523 S.W.2d at 287 (Guittard, J., dissenting).

136. TEX. REV. CIV. STAT. ANN. art. 1302-2.09 (Supp. 1975-76).

137. 492 S.W.2d 335 (Tex. Civ. App.—Beaumont 1973, no writ).

138. See, e.g., *Raby v. Commercial Banking Corp.*, 208 Pa. Super. 52, 220 A.2d 659 (1966).

139. TEX. REV. CIV. STAT. ANN. art. 1302-2.09 (Supp. 1975-76).

140. 436 S.W.2d 267 (Ky. Ct. App. 1969).

141. *Id.* at 269 (emphasis added).

142. 525 S.W.2d 529 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd n.r.e.).

Diamond Manufacturing on the note and Diamond Paint on its guaranty. Embry also sued for the difference between the principal amount received and the full value of the note. Defendants argued that Ladin and SBIC were "guarantors." Consequently, the settlement between Embry, the principal creditor, and Ladin and SBIC released the defendants from their guaranty obligations.<sup>143</sup>

The court disagreed with the defendants, holding that the take-out commitment, although "functionally additional security," was not a guaranty of payment.<sup>144</sup> On these facts<sup>145</sup> this result seems correct and preferable to a situation in which the parties receiving the benefit of the money are free from all liability. Furthermore, a holding that a take-out commitment letter constituted a guaranty could have significant impact on lending practices if guaranty law were incorporated wholesale into financing arrangements.

Diamond Paint also contended that its guaranty was unenforceable because it violated article 1302-2.06 of the Texas Miscellaneous Corporations Act.<sup>146</sup> In deciding this question the court relied on section B of article 1302-2.06, which permits corporate guaranties of obligations of subsidiary parent, or affiliated corporations.<sup>147</sup> The court held that the guaranty was legal since it was authorized by statute and did not contravene any public policy.<sup>148</sup>

*Tomlin v. Ceres Corp.*<sup>149</sup> also involved a guarantor's claim of discharge. Defendant Neuman guaranteed partial payment of a note given by Ceres Ranches, a limited partnership, to plaintiff, a trustee for a number of its creditors. Defendant Mitchell T. Curtis & Co. also guaranteed partial payment and executed an indemnity in favor of Neuman. When Ceres Ranches failed to make the note payments, an extension agreement was entered into between Mitchell T. Curtis & Co. (the co-guarantor) and plaintiff (the payee of the note). When sued on the debt Neuman argued that this agreement effected a discharge by altering the guaranty obligations. Disagreeing, the court stated that the agreement was merely between one co-

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143. See *Miller v. Miles*, 400 S.W.2d 4 (Tex. Civ. App.—Tyler 1966, writ ref'd n.r.e.), for a discussion of the measure of a guarantor's contribution claim. If the settling guarantor pays less than the full amount of the claim, the contribution liabilities should be decreased pro rata.

144. 525 S.W.2d at 532. Under the "take-out" agreement, Ladin and SBIC were obligated to purchase the note should the maker default. Following purchase of the note, they stood in the shoes of the payee with his rights against the maker and the collateral securing the note including the right to proceed against the guarantors on the note. Therefore, these take-out commitments should not be classified as guaranties.

145. Ladin and SBIC had originally been approached as lenders by Diamond Paint. This fact would indicate that these parties were involved in some capacity other than as guarantors.

146. The court based its decision on the statute that was in effect when the guaranty was given. Ch. 469, § 3, [1963] Tex. Laws 1184, as amended by ch. 285, § 1, [1973] Tex. Laws 676.

147. TEX. REV. CIV. STAT. ANN. art. 1302-2.06B (Supp. 1975-76).

148. Of particular note was the court's interpretation of the 1973 amendment to article 1302-2.06, which provides that corporate guaranties are permissible where they directly or indirectly benefit the corporation, as indicative of the trend of public policy toward the approval of such guaranties and the ease of restrictions on their use. Ch. 285, § 1, [1973] Tex. Laws 676, amending ch. 469, § 3, [1963] Tex. Laws 1184; 525 S.W.2d at 636.

149. 507 F.2d 642 (5th Cir. 1975).

guarantor and the payee rather than between the payee and the principal debtor, and, therefore, the guarantor's position under the original agreement had not been affected.<sup>150</sup>

*Guarantor's Liability for Attorney's Fees.* Three cases decided during the survey period dealt with a guarantor's liability for attorney's fees. In *Ganda Inc. v. All Plastics Molding, Inc.*<sup>151</sup> the court, following prior Texas decisions,<sup>152</sup> held that a guarantor was not liable for attorney's fees absent an express liability provision in the guaranty.<sup>153</sup> The court in *Woods Exploration and Producing Co., Inc. v. Arkla Equipment Co.*<sup>154</sup> held that where a guaranty provided for reasonable attorney's fees based on a percentage of the outstanding debt, a fact issue as to the reasonableness of the attorney's fees precluded summary judgment on that portion of the suit.<sup>155</sup>

In *Coward v. Gateway National Bank*<sup>156</sup> plaintiffs brought suit on a promissory note which included a provision for reasonable attorney's fees. At trial, plaintiffs obtained a summary judgment, and consequently, attorney's fees were granted in accord with plaintiff's affidavit. The court of civil appeals, utilizing the 1971 amendment to article 2226,<sup>157</sup> took judicial notice of the state bar minimum fee schedule and suggested a remittitur to conform with the schedule. The Texas Supreme Court held that the summary judgment procedure was improper in that the 1971 amendment to article 2226 applied only to suits within the scope of article 2226.<sup>158</sup> In what must be considered dictum, the court expressed the view that the 1971 amendment was limited to non-jury trials.<sup>159</sup> The court stated that it would continue to apply a strict standard of summary judgment proof regarding reasonable attorney's fees. Since plaintiff's affidavit was not conclusive, the fee issue was remanded to the district court.<sup>160</sup>

#### D. Usury

A number of significant usury decisions were rendered during the survey period. In *Southwestern Investment Co. v. Hockley County Seed & Delinting, Inc.*<sup>161</sup> the terms of a loan provided for more than the statutory

150. *Id.* at 648. The court in *Tomlin* noted that the guarantor's right to pursue the primary debtor would be inconsistent with the extension between the other guarantor and the creditor.

151. 521 S.W.2d 940 (Tex. Civ. App.—Waco 1975, writ ref'd n.r.e.).

152. *See, e.g.*, *Blume v. Nat'l Homes Corp.*, 441 S.W.2d 176 (Tex. 1969).

153. 521 S.W.2d at 944.

154. 525 S.W.2d 50 (Tex. Civ. App.—Houston [14th Dist.] 1974), *aff'd*, 528 S.W.2d 568 (Tex. 1975).

155. 525 S.W.2d at 52.

156. 525 S.W.2d 857 (Tex. 1975), *rev'g* 515 S.W.2d 129 (Tex. Civ. App.—Beaumont 1974).

157. TEX. REV. CIV. STAT. ANN. art. 226 (Supp. 1975-76) provides for the recovery of attorney's fees in certain cases, and as amended in 1971 further states that the state bar minimum fee schedule shall be prima facie evidence of a reasonable fee.

158. 525 S.W.2d at 859.

159. *Id.*

160. *Id.* at 860.

161. 511 S.W.2d 724 (Tex. Civ. App.—Amarillo), *writ ref'd n.r.e.*, 516 S.W.2d 136 (Tex. 1974) (per curiam).

maximum ten percent annual interest in the early years of the loan, which would be offset by lower rates in later years. The trial court found that during the first year, and for the first six months of the second and third years, the loan was usurious, since the borrower had to pay in excess of ten percent interest.<sup>162</sup> The lender contended on appeal that the loan was not usurious, since the total amount of interest, spread over the life of the loan, was less than the total amount that would have resulted if a straight ten percent had been charged each year. The court of appeals, citing as authority *Commerce Trust Co. v. Ramp*,<sup>163</sup> adhered to the traditional rule that "a loan contract is considered usurious if for the first year or first few years it requires the payment of interest in excess of the lawful rate, even though the interest calculated over the entire loan period does not exceed the statutory limit."<sup>164</sup> Thus, in light of the per curiam refusal of error by the supreme court, the opinion of the court of civil appeals and the acceptance by some jurisdictions of the practice of spreading the interest over the term of the loan,<sup>165</sup> it appears that such practice is still subject to question in Texas.

*Wall v. East Texas Teachers Credit Union*<sup>166</sup> involved the interpretation of a note in a usury context. The promissory note recited the principal amount as "Nineteen hundred eight hundred ninety-six and 01/100 Dollars"; the note showed the face amount to be "\$19,896.01." The court held the written expression to be ambiguous in the context of the note<sup>167</sup> and, under section 3-118(c) of the Code,<sup>168</sup> the amount clearly expressed in figures established the correct amount of the note. However, the note, even as so interpreted, called for the payment of usurious interest.<sup>169</sup> The borrower argued that, due to the usurious character of the note, he was entitled to a credit of an amount equal to twice the interest, despite the fact that usury had not been specifically pleaded as an affirmative claim for the statutory penalty.<sup>170</sup> The court held that the 1967 amendments to the usury laws,

162. The corporate exception statute, TEX. REV. CIV. STAT. ANN. art. 1302-2.09 (Supp. 1975-76), was inapplicable because the loan was executed prior to adoption of the new statute which was not retroactive. See *Hockley County Seed & Delinting, Inc. v. Southwestern Inv. Co.*, 476 S.W.2d 38 (Tex. Civ. App.—Amarillo 1971, writ ref'd n.r.e.). This decision is discussed in Lebowitz, *Corporations, Annual Survey of Texas Law*, 27 Sw. L.J. 85, 120 (1973), and in Larson, *Commercial Transactions, Annual Survey of Texas Law*, 27 Sw. L.J. 67, 75-76 (1973).

163. 135 Tex. 84, 138 S.W.2d 531 (1940).

164. 511 S.W.2d at 732.

165. See Comment, *Usury Implications of Front-End Interest and Interest in Advance*, 29 Sw. L.J. 748, 754 and nn.44-48 (1975), for an analysis of decisions in other jurisdictions.

166. 526 S.W.2d 148 (Tex. Civ. App.—Texarkana 1975, writ granted).

167. *Id.* at 150.

168. TEX. BUS. & COMM. CODE ANN. § 3.118(3) (1968) states: "Words control figures except that if the words are ambiguous figures control." See *Mees v. Canino*, 31 Colo. App. 514, 503 P.2d 1036, 11 UCC REP. SERV. 1212 (1972); *Guthrie v. National Homes Corp.*, 394 S.W.2d 494 (Tex. 1965).

169. On a loan of \$19,896.01, repaid over four months in installments, the lender received \$20,803.48, or something in excess of 1% *per month* (as stated on the note) on the original balance.

170. The defendant had pleaded that the note represented an "illegal" and "unenforceable" loan. 526 S.W.2d at 151-52.

which changed the dual penalty<sup>171</sup> rule to a forfeiture concept,<sup>172</sup> allowed the borrower to recover the penalty by means of a credit *without* a specific counterclaim or similar affirmative defensive pleading.<sup>173</sup> Further, under rule 93,<sup>174</sup> the defendant's pleading, which was viewed as raising the issue of usury, was not required to be verified because "simple mathematical calculation" demonstrated the note to be usurious.<sup>175</sup>

In *Johns v. Jaeb*<sup>176</sup> plaintiff and defendant had entered into a limited partnership agreement wherein defendant ostensibly "contributed" \$5000 as capital. Simultaneously plaintiff had agreed to purchase defendant's interest in the partnership, executing a promissory note for \$6500. When business declined and plaintiff was unable to repay the note, he brought suit alleging that the purchase was, in reality, a loan with usurious interest. The court considered two issues of usury law. The first issue was whether the partnership agreement was actually a loan for which usurious interest had been charged.<sup>177</sup> Following established precedent, the court held that when money is advanced with the understanding that the advance plus an added amount are to be returned, there is a loan which must conform to statutory interest limitations.<sup>178</sup> The nature of defendant's investment illustrated that he had not placed his money at risk in an enterprise but had merely assumed the role of a creditor.

The second issue concerned the applicability of article 5069-1.06 which provides that any person "who *contracts for*, charges or receives" usurious interest shall be subject to penalties.<sup>179</sup> In *Johns* \$1500 was "contracted for" as interest for the use of \$5000 for a period of six months, an amount far in excess of the permitted rates. As was determined in *Lafferty v. A.E.M. Developers & Builders Co.*,<sup>180</sup> the forfeiture of principal under article 5069-1.06(2) includes both paid and unpaid amounts. However, in *Lafferty* the entire balance had been discharged before suit was brought;

171. Former art. 5071 provided that usurious contracts were void as to the interest, but principal could be recovered; this was a purely defensive remedy. Ch. 6, § 1, [1892] Tex. Laws 4, 10 H. GAMMEL, LAWS OF TEXAS 368 (1898), *repealed by* ch. 274, § 5, [1967] Tex. Laws 659. Former art. 5073 allowed recovery by an "action for debt" of twice the usurious interest "received and collected." Ch. 143, § 1, [1907] Tex. Laws 277, *repealed by* ch. 274, § 5, [1967] Tex. Laws 659.

172. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (1971) provides in essence that a lender charging usurious interest forfeits twice the charged interest plus the principal.

173. 526 S.W.2d at 151-52.

174. TEX. R. CIV. P. 93 requires certain pleas, including usury, to be verified, unless the "truth of such matters appear of record."

175. *Southwestern Inv. Co. v. Hockley County Seed & Delinting, Inc.*, 511 S.W.2d 724, 732-33 (Tex. Civ. App.—Amarillo), *writ ref'd n.r.e.*, 516 S.W.2d 136 (Tex. 1974) (*per curiam*).

176. 518 S.W.2d 857 (Tex. Civ. App.—Dallas 1974, no writ).

177. The limited partnership documents included: (1) a limited partnership certificate showing the defendant as limited partner and the plaintiff as general partner, with defendant's contribution being \$5,000 and his share of profits at 99%; (2) a side agreement for plaintiff to "purchase" the partnership assets for \$6,500; (3) a \$6,500 promissory note payable to defendant in six monthly installments. *Id.* at 859.

178. *Id.* For a discussion of the relevant law, see generally Comment, *Lender Participation in Borrower's Venture: A Scheme To Receive Usurious Interest*, 8 HOUS. L. REV. 546 (1971).

179. Prior Texas law limited the penalties to those cases where usurious interest had been "received or collected." Ch. 143, § 1, [1907] Tex. Laws 277, *repealed by* ch. 274, § 5, [1967] Tex. Laws 659.

180. 483 S.W.2d 279 (Tex. Civ. App.—San Antonio 1972, *writ ref'd n.r.e.*).

here, the plaintiff had paid only one-third (\$2166.66) of the face amount of the note.

In computing the penalty, the court did not allocate the payments made between interest and principal, since article 5069-1.06(1) applies to interest "contracted for, charged or received." Thus the lender was assessed \$3000 as the double interest penalty. In addition, under article 5069-1.06(2) the lender forfeited "as an additional penalty all principal as well as interest." Plaintiff was not entitled to recover the whole sum of the principal since he had made only two payments. The court therefore subtracted the outstanding balance of \$4333.34 from the total judgment of \$8000 and awarded plaintiff a net judgment of \$3666.66 plus reasonable attorney's fees. This recovery put the parties in the same position as if plaintiff had paid the entire note and then recovered twice the interest charged plus the principal.

*Corporate Borrowing Exemptions.* Two recent decisions, both from the Dallas court of civil appeals, dealt with the availability and use of the corporate borrowing exemption.<sup>181</sup> In *Skeen v. Glenn Justice Mortgage Co.*<sup>182</sup> the borrower urged that he had incorporated at the insistence of the lender in order to enable the latter to charge interest at a rate in excess of ten percent per annum by utilizing the corporate exemption. In dictum<sup>183</sup> the court approved the view expressed in other jurisdictions<sup>184</sup> that the mere fact that the corporation was formed in order to obtain the loan does not render the transaction void or illegal.<sup>185</sup>

In *American Century Mortgage Investors v. Regional Center, Ltd.*<sup>186</sup> the issue was more subtle than the coerced incorporation argument asserted in *Skeen*. Here the borrower argued that the loan was usurious, since the actual borrower was not the corporation which had signed the note and deed of trust, but rather a limited partnership for whose benefit the corporation was acting.<sup>187</sup>

The limited partnership had originally secured the commitment from a mortgage company. However, on the mortgage company's advice, the original commitment was modified to change the borrowing entity to a related corporation.<sup>188</sup> Corporate documents, not revealed to the lender,

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181. By statute, corporations can agree to any interest rate not exceeding 1½% per month on any bond, note, debt, contract, or other obligation so long as the principal amount is five thousand dollars or more. TEX. REV. CIV. STAT. ANN. art. 1302-2.09 (Supp. 1975-76).

182. 526 S.W.2d 252 (Tex. Civ. App.—Dallas 1975, no writ), noted in 29 Sw. L.J. 959 (1975).

183. The court held that the trustee's affidavit failed to set out the facts necessary to sustain the summary judgment. 526 S.W.2d at 255. Therefore, the court's discussion of the incorporation issue was unnecessary to the disposition of the case.

184. See, e.g., *Tel Serv. Co. v. General Capital Corp.*, 227 So. 2d 667 (Fla. 1969); *Jenkins v. Moyses*, 254 N.Y. 319, 172 N.E. 521 (1930). The literature on incorporation and usury law is extensive. See, e.g., *Loiseaux, Some Usury Problems in Commercial Lending*, 49 TEXAS L. REV. 419 (1971); Comment, *Using a "Dummy" Corporate Borrower Creates Usury and Tax Difficulties*, 28 Sw. L.J. 437 (1974).

185. 526 S.W.2d at 256.

186. 529 S.W.2d 578 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.).

187. *Id.* at 582.

188. The corporation was a functioning corporate vehicle used by Campbell, the organizer of the limited partnership, in his real estate activities and had been incorporated

showed that the corporation was taking title as trustee for the partnership, and a deed conveying the land from the corporation to the partnership was placed in escrow with the corporation's attorney. The plaintiff-partnership alleged that it was not only the equitable owner of the land, but was also the actual beneficiary-obligor of the loan. The plaintiff's primary argument was that the lender's failure to investigate the circumstances of the transaction amounted to the making of a usurious loan. The court held that the plaintiff, whose own evidence showed an intent to deceive the lender and whose agents participated in concealing the partnership's interests, could not obtain the advantages of the usury laws on the theory that the party deceived should have discovered the facts being concealed.

### III. SECURED TRANSACTIONS

#### A. Priorities

The Fifth Circuit, on remand in the case of *In re Samuels & Co.*,<sup>189</sup> held that under article 2 the reclamation rights of unpaid cash sellers, who reserve title to goods sold to a bankrupt shortly before bankruptcy, have priority over the claims of both a perfected inventory financier of the bankrupt and the bankruptcy trustee armed with the status of a hypothetical lien creditor. The facts of *Samuels* are no doubt familiar to aficionados of Code litigation.<sup>190</sup> Several sellers delivered cattle to Samuels, a meat processor, under agreements reserving title. After processing, the sale price was determined on the basis of the "grade and yield." Samuels' payment checks were dishonored due to the refusal of C.I.T. Corporation, a secured inventory financier of Samuels, to advance the additional funds needed to cover the checks. Samuels immediately filed for bankruptcy. The sellers and C.I.T. each asserted rights to the proceeds of the cattle.

The court first considered the sellers' claims to priority over the secured creditor under sections 2-507 and 2-511.<sup>191</sup> The court concluded that under these facts the transaction was a "cash sale" and not a credit sale which would have been governed by section 2-702.<sup>192</sup> The court, relying on the comment to section 2-507,<sup>193</sup> found that an unpaid cash seller had a right of reclamation as against the buyer under the Code.<sup>194</sup> The critical

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in 1970. The court was willing to assume that the requirement of a corporate borrower was imposed by the lender. *Id.* at 580-81.

189. 510 F.2d 139 (5th Cir. 1975) (rehearing en banc granted, May 19, 1975).

190. The prior appeals are reported at 483 F.2d 557 (5th Cir. 1973), *rev'd sub nom.* Mahon v. Stowers, 416 U.S. 100 (1974).

191. Section 2-507(2) provides that where payment is due and demanded on the delivery to the buyer of goods his right as against the seller to retain or dispose of them is conditioned upon his making the payment due. TEX. BUS. & COMM. CODE ANN. § 2.507(b) (1968). Section 2-511(3) states that payment by check is conditional and is defeated as between the parties by dishonor of the check upon due presentment. *Id.* § 2.511(c).

192. Under § 2-702(3) the reclaiming credit seller's right of reclamation is subject to the rights of a "good faith purchaser or lien creditor." *Id.* § 2.702(c).

193. The comment provides that an unpaid seller may reclaim goods delivered on credit to an insolvent buyer. UNIFORM COMMERCIAL CODE § 2-507, Comment 3.

194. This right of reclamation is apparently subject to the 10-day rule of § 2-702. In this case, however, the court found that the "underlying purpose" of the 10-day rule had been satisfied by the action of C.I.T., the competing secured creditor, even though

issue concerned the relationship between the sellers' right of reclamation and the perfected inventory financier's rights as a secured creditor under article 9. The court was willing to concede that, since the cattle were in Samuels' possession, the security interest of C.I.T. had attached under section 9-204, which requires, *inter alia*, that the debtor have "rights in the collateral."<sup>195</sup> The court, however, held that C.I.T.'s rights in the collateral as a secured creditor are derived from, and are no greater than, the rights of the debtor.<sup>196</sup>

Although this position has been accepted elsewhere,<sup>197</sup> it is based upon an erroneous reading of the Code. The key to this issue is found in section 2-403, which recognizes that one with "voidable title" can transfer good title to a "good faith purchaser for value" even though the initial transaction was a "cash sale" and payment was not made.<sup>198</sup> The secured creditor who has given "value"<sup>199</sup> and who acts in "good faith"<sup>200</sup> should qualify as a "purchaser"<sup>201</sup> entitled to protection under section 2-403. Since C.I.T. had given value by financing Samuels' operations and had, therefore, come within the scope of the purchaser requirement, the only question remaining was whether C.I.T. had met the Code "good faith" requirement. Section 1-201(19) of the Code defines "good faith" as honesty-in-fact in the conduct or transaction concerned.<sup>202</sup> The majority of the court found that C.I.T.'s knowledge of Samuels' business and the likely effect which its refusal to advance additional funds would have upon its debtor barred C.I.T. from claiming that it had acted in "good faith." Although the majority would not require a creditor to continue financing a sinking business, its interpretation of the "good faith" concept seems erroneous in light of the business realities of secured lending. If mere knowledge of a third-party claim is sufficient to defeat good faith purchaser status, then the use of section 2-403 by the inventory financier as a means of cutting off the claims of suppliers will be frustrated.

The rights of C.I.T. should have been held superior under section 2-403 to those of the sellers, even though, *as between Samuels and the sellers*, the sellers had superior rights. Though the mandate of section 2-403 may have dictated a harsh result against the sellers in this particular instance, a better reading of the "good faith" purchaser requirement would have upheld the status of the inventory financier, C.I.T., as a good faith purchaser.

Finally, the court's treatment of the seller's reservation of title deserves

the sellers had not even come close to complying with that requirement. *But see* 510 F.2d at 157 (Godbold, J., dissenting).

195. Ch. 785, § 1, [1967] Tex. Laws 2343. This concept is now expressed, in identical language, in TEX. BUS. & COMM. CODE ANN. § 9.203(a)(3) (Supp. 1975-76).

196. 510 F.2d at 150.

197. *See, e.g.*, International Harvester Credit Corp. v. American Nat'l Bank, 296 So. 2d 32 (Fla. 1974).

198. TEX. BUS. & COMM. CODE ANN. § 2.403 (1968).

199. The requirements for value are set out in § 1-201(44). *Id.* § 1.201(44).

200. Good faith means honesty in fact in the conduct or transaction concerned. *Id.* § 1.201(19).

201. To be a purchaser, one must take by sale, discount negotiation, mortgage, pledge, lien, issue, or gift. *Id.* § 1.201(32).

202. *Id.* § 1.201(19).



comment. Section 2-401(1)<sup>203</sup> classifies title retention devices as security interests. The majority found that the cash sale in this case did not "fit" the fact pattern in which a seller could be expected to perfect a security interest, even though a purchase money security interest could always obtain undisputed priority over earlier perfected security interests. Again, the court stretched the Code to achieve a result not provided therein. On rehearing the court would do well to adopt the analysis of the dissenting opinion in *Samuels* which adhered to a stricter interpretation of the Code.<sup>204</sup>

The conflicting rights of a pledgee and a lien creditor without knowledge of a security interest were involved in *Meadows v. Bierschwale*.<sup>205</sup> Bierschwale sold an apartment project to Oakes and received in exchange fifty-nine promissory notes. Oakes later conveyed the same project to Goldman and received in exchange notes executed by Goldman. When the fifty-nine notes given by Oakes to Bierschwale in the first sale became worthless, Bierschwale filed suit to rescind the sale and impress a constructive trust on the proceeds of the Goldman notes. After this action had been commenced, Oakes, in securing a prior debt unrelated to the land transaction, pledged a portion of the Goldman notes to Smith. The court, upon hearing Bierschwale's allegation of fraud and request for rescission, ordered Goldman to place all payments on the pledged notes into the registry of the court pending the outcome of the litigation. Oakes then defaulted on the unrelated obligation secured by the pledge. Smith, the pledgee-secured creditor, appealed from the award to Bierschwale, who had been deemed a lien creditor as to the proceeds of the sale to Goldman by reason of a constructive trust.

The security agreement between Oakes and Smith covering the pledged notes contained the following provision: "[M]utation of collateral notes by . . . acceptance of payment . . . shall inure to the benefit of . . . [Smith] and a security interest in the same shall arise . . . in favor of . . . [Smith]."<sup>206</sup> This security agreement was filed as a financing statement in Harris County, but not with the secretary of state. The court conceded that the above language in the security agreement provided for a security interest in the notes' proceeds,<sup>207</sup> but held that the security interest was unperfected since a filing with the secretary of state was required under section 9-401(1)(c).<sup>208</sup> Section 9-306(1) of the Code also provided that: "The

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203. Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to the reservation of a security interest. *Id.* § 2.401(a).

204. 510 F.2d at 157 (Godbold, J., dissenting).

205. 516 S.W.2d 125 (Tex. 1974), *rev'g* 497 S.W.2d 506 (Tex. Civ. App.—Houston [1st Dist.] 1973).

206. 516 S.W.2d at 133.

207. Prior to the 1973 amendments, §§ 9.203(a)(2) and 9.306(b) of the Texas Business and Commerce Code were inconsistent as to whether proceeds were automatically covered by a security interest. The 1973 amendments provided for an automatic interest in proceeds and eliminated the requirement that the creditor check "proceeds" on the financing statement. See TEX. BUS. & COMM. CODE ANN. §§ 9.203(a)(2), 9.306(b) (Supp. 1975-76), *amending* ch. 785, § 1, [1967] Tex. Laws 2343.

208. Section 9.401(a)(3) of the Texas Business and Commerce Code, cited by the court, is a catch-all provision indicating that filings should be made with the secretary of state in all cases not covered by subsections (a)(1) and (a)(2). The provisions of this subsection were left unchanged by the 1973 amendments. TEX. BUS. & COMM. CODE ANN. § 9.401(a)(3) (Supp. 1975-76).

security interest in proceeds is a continuously perfected security interest if the interest in the original collateral was perfected but it . . . becomes unperfected ten days after receipt of the proceeds by the debtor unless (1) a filed financing statement covering the original collateral also covers proceeds . . . ."<sup>209</sup> The court combined sections 9-306(1), 9-401(1)(c) and 9-401(2) and concluded that the failure to file a financing statement with the secretary of state made Smith's security interest unperfected as to the proceeds in the registry of the court. Therefore, his rights were inferior to the claims of Bierschwale. Bierschwale, by reason of the constructive trust imposed on the sale proceeds, was a lien creditor, and consequently, he was entitled to priority under section 9-301.<sup>210</sup>

This result, while not necessarily incorrect, is considerably outside the normal commercial expectations of the business community. The court mentioned that although Smith, as pledgee, was a "holder in due course" of the notes,<sup>211</sup> he did not take free of Bierschwale's claims arising under the constructive trust. This result logically follows from the terms of the security agreement permitting Oakes, the debtor-pledgor, to receive payments until default on his obligation to Smith.<sup>212</sup> Also, under the rationale of this decision, the careful creditor will now need to file a financing statement with the office of the secretary of state in order to perfect a security interest in "identifiable cash proceeds"<sup>213</sup> of collateral in which a security interest has been perfected by possession.<sup>214</sup> This may seem awkward initially, but it may well be a prudent step.

*Corpus Christi Bank & Trust Co. v. Smith*<sup>215</sup> considered the relative priorities between unpaid materialmen and subcontractors, and a bank which had a security interest in contract rights<sup>216</sup> and accounts receivable of the contractor. Manson Industries contracted with the city of Corpus Christi to repair damage to the municipal airport. Prior to the contract in question,

209. The 1973 amendments substantially revised § 9.306 of the Texas Business and Commerce Code. Section 9.306(c)(2) now states that "a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds." Money and checks are included as "cash proceeds." TEX. BUS. & COMM. CODE ANN. § 9.306(c)(2) (Supp. 1975-76), *amending* ch. 785, § 1, [1967] Tex. Laws 2343.

210. Under § 9-301 an unperfected security interest is subordinate to the rights of a person who becomes a lien creditor without knowledge of the security interest and before it is perfected. TEX. BUS. & COMM. CODE ANN. § 9.301 (Supp. 1975-76).

211. "Holder in due course" is defined in § 3-302. Under § 3-303(b) one takes "for value" if the note is taken as "security for an antecedent claim." TEX. BUS. & COMM. CODE ANN. § 3.303(2) (1968).

212. Section 9-502(1) provides for similar rights between the secured creditor and debtor unless otherwise agreed. TEX. BUS. & COMM. CODE ANN. § 9.502(a) (Supp. 1975-76).

213. The security interest in proceeds is a continuously perfected interest if the interest in the original collateral was perfected. But it ceases to be perfected 10 days after receipt of the proceeds by the debtor unless a filed financing statement covers the original collateral and the proceeds are identifiable cash proceeds. *Id.* § 9.306(c)(2).

214. Section 9-304 and 9-305 state the perfection mechanisms for a security interest. *Id.* §§ 9.304-305.

215. 525 S.W.2d 501 (Tex. 1975).

216. Section 9.106 of the Texas Business and Commerce Code during the period covered by the instant case differentiated between "accounts" and "contract rights." The two definitions were combined as "accounts" in the 1973 amendments. See TEX. BUS. & COMM. CODE ANN. § 9.106 (Supp. 1975-76), *amending* ch. 785, § 1, [1967] Tex. Laws 2343.

Manson Industries granted Corpus Christi Bank & Trust a security interest in all accounts receivable then owed by Manson or thereafter acquired. The security interest of the bank was duly perfected by a timely filing with the secretary of state prior to award of the contract. Upon completion of the project and certification of the work by the city, unpaid materialmen and subcontractors asserted claims to the retainage of funds held by the city of Corpus Christi, in which the bank had a security interest. Of the unpaid claims, only one of the claimants had complied with article 5160<sup>217</sup> so as to perfect a claim under the payment bond against the surety. That claimant was not involved in the appeal. However, the materialmen and subcontractors claimed priority as third-party beneficiaries under the contract between the city and the contractor, Manson Industries.

The court first considered the contention of the claimants that they were third party beneficiaries of the prime contract by reason of the clause requiring proof of payment of subcontractors prior to payment by the city. The claimants argued<sup>218</sup> that prior decisions<sup>219</sup> denying third party beneficiary status to subcontractors all involved private contracts, in which similar provisions could foreseeably benefit the owner by minimizing the risk of liens against the property. However, in a public contract situation this benefit to the owner is absent because the property of the municipality is not subject to any such lien and the city itself is not liable for such claims.<sup>220</sup> Therefore, the subcontractors argued that the proof of payment clause was intended for their benefit. The court, finding no evidence of an intent to protect claimants who had not perfected their liens under article 5160, followed the private contract precedents and held that the contract, even with the proof of payment provision, did not clearly evidence an intent to create third party rights in favor of unpaid subcontractors.<sup>221</sup>

The cases cited<sup>222</sup> by the court demonstrate the position of the Texas courts that a contract will not be construed as giving rise to third party beneficiary rights unless the intent of the parties is clear.<sup>223</sup> The language of the contract and public works bond indicated an intent to benefit those subcontractors *who complied with* article 5160, and, therefore, the absence of sufficient evidence to show a clear intent to benefit the subcontractors defeated the third party beneficiary claim.<sup>224</sup> The court also rejected the claimants' contention that compliance by the contractor with the proof of payment clause was a necessary condition to the contractor's right to

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217. Article 5160 relating to performance bonds and bonds for materials and labor, applies to public contracts over \$2,000. TEX. REV. CIV. STAT. ANN. art. 5160 (1971). Article 5472a provides an "informal" lien procedure for public contracts of less than \$2,000. *Id.* art. 5472a.

218. They prevailed below on this theory. *See* 512 S.W.2d 761 (Tex. Civ. App.—Corpus Christi 1974), *aff'd in part, rev'd in part*, 525 S.W.2d 501 (Tex. 1975).

219. *See, e.g.*, General Elec. Supply Co. v. Epco Constructors, Inc., 332 F. Supp. 112 (S.D. Tex. 1971).

220. 512 S.W.2d at 764.

221. 525 S.W.2d at 506.

222. *See, e.g.*, Republic Nat'l Bank v. Nat'l Bankers Life Ins. Co., 427 S.W.2d 76, 79 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.).

223. 525 S.W.2d at 505.

224. *Id.* at 505-06.

retainage.<sup>225</sup> Consequently, since Manson had no rights in the retained funds, the bank did not have a perfected security interest. However, as the court pointed out, Manson did have rights in the retainage. The retained funds were "accounts" (in the pre-1974 sense), having been earned, and were subject to the perfected security interest of the bank.<sup>226</sup>

In *Associates Financial Services of Texas, Inc. v. Solomon*<sup>227</sup> the relative priorities between a landlord's lien for rent and a secured creditor's unperfected security interest in collateral left on the leased premises by a defaulting tenant were presented. The disputed collateral was purchased by the tenant with funds advanced by plaintiff, who took a security interest in the goods under the security agreement executed between the parties. Though the financing statement was timely filed, the collateral in question was not listed. The goods were placed on the leased premises and, some months later, following a default in the payment of rent, the landlord took possession. The landlord promptly filed an affidavit under the landlord's lien statutes<sup>228</sup> before the plaintiff had corrected its error by filing a proper financing statement with respect to the goods. Both the landlord and secured creditor claimed liens in the goods that were on the leased premises. Article 9 of the UCC expressly excludes landlords' liens from the operation of the statute.<sup>229</sup> Finding no guidance in the Code, the court looked to pre-Code law and noted that a landlord's lien had always been superior to any unrecorded chattel mortgage, even though the mortgage might pre-date the landlord's lien. Since plaintiff's security interest was unperfected at the time the landlord's lien attached, the court concluded that the landlord's lien had priority.<sup>230</sup>

*Gulf Coast State Bank v. Nelms*<sup>231</sup> dealt with the priority of a claim partially excluded under the Code: the possessory lien of the mechanic who repairs a chattel.<sup>232</sup> Buchanan furnished goods and services in repairing an automobile subject to a bank's perfected security interest. Upon failure of the debtor to pay for the repairs, Buchanan retained the automobile. When the bank attempted to repossess the vehicle for delinquent payments, Buchanan refused to release the car. The sole question presented was whether Buchanan's possessory lien under articles 5503 and 5506<sup>233</sup> was entitled to priority over the bank's interest.

225. *Id.* at 506.

226. *Id.*

227. 523 S.W.2d 722 (Tex. Civ. App.—Waco 1975, no writ).

228. TEX. REV. CIV. STAT. ANN. art. 5238 (1962) prescribes the filing of a sworn statement of the landlord to "secure" a lien for more than six months' rent. *Id.* art. 5222 provides for the lien itself.

229. Section 9-104(b) expressly excludes landlord's liens from the scope of art. 9. TEX. BUS. & COMM. CODE ANN. § 9.104(2) (Supp. 1975-76).

230. 523 S.W.2d at 724.

231. 525 S.W.2d 866 (Tex. 1975), *aff'g* 516 S.W.2d 421 (Tex. Civ. App.—Houston [1st Dist.] 1974).

232. Section 9-104(c) excludes from the operation of art. 9 "a lien given by statute or other rule of law for services or materials except as provided in Section 9.310 . . . ." TEX. BUS. & COMM. CODE ANN. § 9.104(3) (Supp. 1975-76). Section 9-310 provides that a possessory lien for services or materials is prior to a perfected security interest "unless the lien is statutory and the statute expressly provides otherwise." *Id.* § 9.310.

233. See TEX. REV. CIV. STAT. ANN. art. 5503 (Supp. 1975-76); *id.* art. 5506 (1958).

Section 9-310 of the Code provides that a possessory lien for services and materials is entitled to priority over a perfected security interest "unless the lien is statutory and the statute expressly provides otherwise."<sup>234</sup> The supreme court interpreted the reference in section 9-310 to "the statute" which must expressly provide for subordination of the mechanic's lien as meaning *only* the mechanic's lien statute and not including the Certificate of Title Act.<sup>235</sup> The language in article 5506<sup>236</sup> that a mechanic's possessory lien shall not "affect or impair" other liens was held not to amount to an "express" provision required by section 9-310 for subordination of the mechanic's lien.<sup>237</sup> Therefore, the mechanic's possessory lien under articles 5503 and 5506 was held superior to the previously perfected security interest.<sup>238</sup>

### B. Notice Requirements Following Default

The right of a secured creditor to recover a deficiency judgment following a foreclosure sale was considered in two cases involving the creditor's failure to give the notice of sale prescribed by the Code.<sup>239</sup> In *United States v. Whitehouse Plastics*<sup>240</sup> the Small Business Administration sought to collect from two guarantors of a loan to a corporation the deficiency which resulted from a public auction of collateral. The court assumed that the guarantors were "debtors" for purposes of the notice requirements of section 9-504(3)<sup>241</sup> and that there was insufficient evidence to support a jury finding that reasonable notice had been received.

234. TEX. BUS. & COMM. CODE ANN. § 9.310 (Supp. 1975-76).

235. TEX. REV. CIV. STAT. ANN. art. 6687-1 (Supp. 1975-76). The repeal in 1971 of §§ 43 and 46 of the original Certificate of Title Act, art. 1436-1 of the Penal Code (now found as TEX. REV. CIV. STAT. ANN. art. 6687-1 (Supp. 1975-76)), amended by ch. 123, § 7, [1971] Tex. Laws 896, lend support to the court's interpretation of these statutes. 525 S.W.2d at 868-69. The court cited Comment 2 to § 9-310 in support of its conclusion that Texas Business and Commerce Code § 9.310 requires that the language of the statute *creating* the lien, arts. 5503 and 5506, be consulted to determine whether the artisan's lien shall have priority. UNIFORM COMMERCIAL CODE § 9-310, Comment 2, cited at 525 S.W.2d at 869.

236. TEX. REV. CIV. STAT. ANN. art. 5506 (1958).

237. On this point the court cited its decision in *First Nat'l Bank v. Whirlpool Corp.*, 517 S.W.2d 262 (Tex. 1974), which held that the priority of a mechanic's and materialman's lien over a deed of trust lien, as to removables, did not violate the language of TEX. REV. CIV. STAT. ANN. art. 5459 (Supp. 1975-76), to the effect that the mechanic's lien shall not affect a previously recorded deed of trust. 525 S.W.2d at 870. For a discussion of *Whirlpool* see Wallenstein, *Property, Annual Survey of Texas Law*, 29 Sw. L.J. 29, 48-49 (1975).

238. 525 S.W.2d at 870.

239. Section 9-504(2), as amended, provides that, in transactions other than sales of accounts, the debtor is liable for any deficiency. Section 9-504(3), as enacted and amended in Texas, calls for notice of a foreclosure sale to be sent (1) to the debtor, (2) to any other secured party with a financing statement on file "in this state" with respect to the debtor, and (3) to any other secured party giving notice of a claim to the collateral. TEX. BUS. & COMM. CODE ANN. §§ 9.504(b), (c) (Supp. 1975-76), amending ch. 785, § 1, [1967] Tex. Laws 2343.

240. 501 F.2d 692 (5th Cir. 1974).

241. The version of § 9.504(c) of the Texas Business and Commerce Code in force at the time of the disposition of the collateral, and, therefore, applied by the court, provided that reasonable notice of public or private sale be sent by the secured party to the debtor, and except in the case of consumer goods to any other person who has perfected his security interest in the collateral by filing, or who is known by the creditor to have a security interest in the collateral. TEX. BUS. & COMM. CODE ANN. § 9.504(c)

The court was directly presented with the question of whether the failure to comply with the notice requirements of section 9-504(3) precluded recovery of the deficiency. The court adopted (and predicted that state courts in Texas would adopt) the position that the failure to give notice does not bar recovery of a deficiency but rather gives rise to a rebuttable presumption that the value of the collateral equalled the debt, placing the burden on the secured party to prove that the value (and not just the amount bid at the sale) was less than the debt.<sup>242</sup> The court reasoned that section 9-507,<sup>243</sup> which specifically deals with remedies available in the event a creditor fails to comply with the default provisions of the Code, was intended to be the sole source of remedies in this situation.<sup>244</sup> The evidence presented to the court, which was not limited to proof of the auction bids, supported the conclusion that the fair market value of the collateral did not exceed the amount realized on the sale. Therefore, the deficiency judgment against the guarantors was sustained.

The second case, *First State Bank v. Northrop*,<sup>245</sup> may lend support to the view, rejected in *Whitehouse Plastics*, that failure to give reasonable notice bars recovery of a deficiency judgment. Northrop had co-signed a note secured by a lien. Following default, the secured creditor foreclosed by private sale without giving any prior notice to Northrop. A deficiency letter was sent three days later to Northrop, demanding payment of the balance due on the note. The court affirmed a take-nothing judgment as to Northrop, holding that there was probative evidence sufficient to support the trial court's finding that reasonable notice had not been given *before* sale, and that post-sale notice did not constitute reasonable notice under section 9-504.

Whether such lack of notice *per se* barred a recovery and whether evidence of the value of the collateral was admissible to establish the amount of a deficiency were not expressly discussed on appeal. The opinion can, however, be read as requiring reasonable *pre-sale* notice as a condition to recovery of a deficiency. The trial court's take-nothing judgment was characterized as being "expressly based . . . upon the conclusion that [the] Bank failed to give . . . [reasonable] notice"<sup>246</sup> under section 9-504(3). The most likely interpretation of this statement is that the trial court was of the view that failure to give notice automatically barred a deficiency

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(1968). This section was amended in 1973 to require notice to persons other than the debtor only if such persons had notified the secured party in writing of their claims of an interest in the collateral before notification was sent to the debtor or before the debtor's renunciation of his rights. Ch. 400, § 5, [1973] Tex. Laws 999, *amending* TEX. BUS. & COMM. CODE ANN. § 9.504(c) (1968).

242. The court collected numerous cases on both sides of this issue. 501 F.2d at 695 nn.3, 4. On deficiency rights and other foreclosure problems see Siegel, *The Commercially Reasonable Disposition of Collateral*, 80 COMM. L.J. 67 (1975).

243. TEX. BUS. & COMM. CODE ANN. § 9.507 (Supp. 1975-76). The 1973 Texas revision of art. 9 made no changes in this section.

244. 501 F.2d at 696. One of the principal architects of art. 9 has reached a contrary conclusion. See 2 G. GILMORE, *SECURITY INTERESTS IN PERSONAL PROPERTY* § 44.9.4 (1965).

245. 519 S.W.2d 161 (Tex. Civ. App.—Waco 1975, no writ).

246. 519 S.W.2d at 162.

recovery. The affirmance of the trial court judgment and the absence of any discussion of the effect of the failure to give proper notice is a difficult combination to analyze fruitfully, but the potential for a per se rule growing out of *Northrop* should be recognized.

#### IV. CREDITORS' REMEDIES

During the survey period constitutional challenges of Texas creditors' remedies had a significant effect upon Texas law. Self-help repossession under the Uniform Commercial Code<sup>247</sup> survived constitutional attack in *Calderon v. United Furniture Co.*,<sup>248</sup> a per curiam opinion issued by the United States Court of Appeals for the Fifth Circuit. In *Calderon* the plaintiff brought suit for an allegedly wrongful repossession. Relying upon its opinion in *James v. Pinnix*,<sup>249</sup> the court affirmed the district court's dismissal of the action for lack of subject matter jurisdiction.<sup>250</sup> In *James* the buyer of a used car had sued to restrain repossession of a car by the dealer and to have the Mississippi self-help statute<sup>251</sup> declared unconstitutional. The district court granted the requested relief but the Fifth Circuit reversed, holding that self-help repossession did not involve sufficient state action to warrant due process scrutiny.<sup>252</sup> Both *Calderon* and *James* distinguish *Hall v. Garson*<sup>253</sup> in which the court found sufficient state action when, pursuant to a landlord lien provision, a landlady entered an apartment and seized the tenant's possessions to satisfy a past due rent liability.<sup>254</sup> In *Calderon* the court distinguished *Hall* by pointing out that the statute challenged<sup>255</sup> in that case allowed a landlord to seize property unconnected to the rental debt, while self-help repossession under the Uniform Commercial Code involves property in which the creditor has a security interest.<sup>256</sup> Since a state officer did not take part in the dispossession of goods in either case, a determination of state action appears to have been dependent upon whether a lien was created statutorily or contractually.

247. UNIFORM COMMERCIAL CODE §§ 9-503, -504. These two provisions are codified in Texas as TEX. BUS. & COMM. CODE ANN. §§ 9.503, .504 (1968).

248. 505 F.2d 950 (5th Cir. 1975).

249. 495 F.2d 206 (5th Cir. 1974).

250. The district court opinion is set out at 371 F. Supp. 572 (S.D. Tex. 1974).

251. MISS. CODE ANN. § 75-9-503 (1972).

252. 495 F.2d at 207. See also *Brantley v. Union Bank & Trust Co.*, 498 F.2d 365 (5th Cir. 1974); *Adams v. Southern Cal. First Nat'l Bank*, 492 F.2d 324 (9th Cir. 1973). For a discussion of the self-help issue see Note, *Self-Help Repossession Under the UCC: Presence or Absence of State Action?*, 28 Sw. L.J. 796 (1974). For an opinion which finds the requisite state action in self-help repossession see *Boland v. Essex County Bank & Trust Co.*, 361 F. Supp. 917 (D. Mass. 1973).

253. 430 F.2d 430 (5th Cir. 1970).

254. *Calderon*, *Hall*, and *James* were appeals from the lower courts' rulings concerning subject matter jurisdiction. All three plaintiffs had brought their actions under 42 U.S.C. § 1983 (1970) and the fourteenth amendment. *Calderon* and *James* held there was not sufficient state action to confer jurisdiction under 42 U.S.C. § 1983 (1970) or the fourteenth amendment, while *Hall* held the requisite state action was present and remanded for further proceedings. In a later appeal of the *Hall* case the court reached the merits of the due process challenge. See note 262 *infra* and accompanying text.

255. Ch. 686, [1969] Tex. Laws 2008, as amended, TEX. REV. CIV. STAT. ANN. art. 5236d (Supp. 1975-76).

256. 505 F.2d at 951. The court in *James* found the same dissimilarity. 459 F.2d at 208.

Unlike self-help repossession under the Uniform Commercial Code, Texas landlord lien provisions have not survived constitutional challenge. As indicated above, the Fifth Circuit in *Hall v. Garson*<sup>257</sup> found sufficient state action in the Texas landlord lien statute<sup>258</sup> to allow federal court jurisdiction under a fourteenth amendment challenge.<sup>259</sup> Although the seizure was not conducted by an officer of the state, the court found that the act of seizure under the statute possessed the characteristics of an act of the state since the execution of a lien has traditionally been carried out in Texas by a state official.<sup>260</sup> After remand and upon a subsequent appeal from a denial by the district court of the requested relief,<sup>261</sup> the Fifth Circuit held the statute unconstitutional for failing to grant the tenant notice and hearing before his goods were seized.<sup>262</sup> The court based its holding on the then recently handed down *Fuentes v. Shevin*.<sup>263</sup> The Texas Legislature subsequently repealed<sup>264</sup> the statute held unconstitutional in *Hall*, replacing it with article 5236d.<sup>265</sup> The new statute restricts a landlord's right to dispossess a tenant of his property for unpaid rent to those situations where the rental agreement clearly displays the contractual lien "underlined or printed in conspicuous bold print."<sup>266</sup> However, in *Fancher v. Cronan*<sup>267</sup> a federal district court found the new statute involved state action and was unconstitutional due to the act's failure to provide for notice and a hearing. Since the lien under article 5236d is created by contract rather than by statute, the *Fancher* holding appears to be unsound under the holdings in *Calderon* and *James*.<sup>268</sup>

The Texas distress warrant statute<sup>269</sup> also has not fared well. In *Stevenson v. Cullen Center, Inc.*,<sup>270</sup> the plaintiff had rented office space from the defendant. When a dispute arose as to the rent due plaintiff refused to make further payments. The defendant filed an affidavit under

257. 430 F.2d 430 (5th Cir. 1970).

258. Ch. 686, [1969] Tex. Laws 2008, *as amended*, TEX. REV. CIV. STAT. ANN. art. 5236d (Supp. 1975-76).

259. 430 F.2d at 439.

260. *Id.*

261. The district court denied the requested injunctive relief in an unreported memorandum opinion.

262. *Hall v. Garson*, 468 F.2d 845 (5th Cir. 1972).

263. 407 U.S. 67 (1972).

264. Ch. 441, § 5, [1973] Tex. Laws 1228.

265. TEX. REV. CIV. STAT. ANN. art. 5236d (Supp. 1975-76).

266. *Id.* § 4.

267. Civil No. 75-H179 (S.D. Tex. 1975) (order withdrawn), *noted in* 7 ST. MARY'S L.J. 613 (1975).

268. See notes 253-56 *supra* and accompanying text. See also *Barrera v. Security Bldg. & Inv. Corp.*, 519 F.2d 1166 (5th Cir. 1975), where the court upheld TEX. REV. CIV. STAT. ANN. art. 3810 (Supp. 1975-76), the Texas statute which regulates the private foreclosure process of deeds of trust. The court found that there was not "a sufficiently close nexus between the State and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself." *Id.* at 1171, citing *Jackson v. Metropolitan Edison*, 419 U.S. 345 (1974). See also *Armenta v. Nussbaum*, 519 S.W.2d 673 (Tex. Civ. App.—Corpus Christi 1975, writ ref'd n.r.e.).

269. TEX. REV. CIV. STAT. ANN. art. 5239 (1962). See also TEX. R. CIV. P. 610-20. The statute in conjunction with its procedural rules provides that upon a bond and an affidavit stating that rent is overdue and there is danger the landlord will be defrauded, the sheriff may impound the tenant's property.

270. 525 S.W.2d 731 (Tex. Civ. App.—Houston [14th Dist.] 1975, no writ).



the provisions of the distress warrant statute, and the constable subsequently dispossessed plaintiff of his property by changing the locks on the office doors. The district court denied plaintiff's request for a temporary injunction, but the court of appeals reversed, holding the distress warrant statute unconstitutional for failure to meet due process standards.<sup>271</sup> The court utilized a recent United States Supreme Court holding<sup>272</sup> to lay down a three-pronged test<sup>273</sup> to examine the constitutionality of the statute. The test requires that: (1) a judge participate in the issuing process; (2) the affidavit contain specific allegations; (3) a hearing be available immediately after seizure to determine the validity of the claims. The court found that a distress warrant could only be issued by a justice of the peace under the Texas statute.<sup>274</sup> However, the court also determined that the rules accompanying the statute<sup>275</sup> permitted issuance of the warrant upon mere conclusory allegations and that the statute failed to provide for an immediate post-seizure hearing.<sup>276</sup> Hence, the court adjudged due process protection to be lacking and declared the statute unconstitutional.

A test similar to that used in *Stevenson* had been employed earlier by a United States District Court in *Garcia v. Krause*,<sup>277</sup> in which the Texas sequestration statute<sup>278</sup> was held unconstitutional. The Texas Legislature has recently amended the sequestration statute<sup>279</sup> so as to conform with the constitutional requirements set out in *Garcia*.<sup>280</sup> The amended statute requires issuance of the writ by a judicial officer,<sup>281</sup> the allegation of specific facts upon which the judicial officer may draw a reasonable conclusion that the issuance of the writ is justified,<sup>282</sup> and the opportunity for an immediate post-seizure hearing to take place not later than ten days after a debtor's motion for dissolution.<sup>283</sup> Since the amended statute is extremely similar to the Louisiana statute<sup>284</sup> upheld by the United States Supreme Court in *Mitchell v. W.T. Grant Co.*,<sup>285</sup> there should not be great doubt as to its

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271. *Id.* at 735.

272. *North Georgia Finishing, Inc. v. Di-Chem, Inc.*, 419 U.S. 601 (1975), noted in 29 Sw. L.J. 660 (1975). The court also made reference to three earlier cases: *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974); *Fuentes v. Shevin*, 407 U.S. 67 (1972); *Southwestern Warehouse Corp. v. Wee Tote, Inc.*, 504 S.W.2d 592 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ). For a discussion of the above cases see Comment, *Constitutional Dimensions of the Amended Texas Sequestration Statute*. 29 Sw. L.J. 884 (1975).

273. 525 S.W.2d at 734.

274. *Id.*

275. TEX. R. CIV. P. 610-20.

276. *Id.* at 734-35.

277. 380 F. Supp. 1254 (S.D. Tex. 1974). For a discussion of the court's holding see Note, *Pre-Judgment Seizures and the Due Process Clause: North Georgia Finishing, Inc. v. Di-Chem, Inc.*, 29 Sw. L.J. 660, 666 n.55 (1975).

278. Ch. 44, [1887] Tex. Laws 30, 9 H. GAMMEL, LAWS OF TEXAS 828 (1898), as amended, TEX. REV. CIV. STAT. ANN. art. 6840 (Supp. 1975-76).

279. TEX. REV. CIV. STAT. ANN. art. 6840 (Supp. 1975-76). For an in-depth discussion of the amended sequestration statute see Comment, *supra* note 272.

280. The requirements set by *Garcia* are substantially the same as those set out in *Mitchell v. W.T. Grant Co.*, 416 U.S. 600 (1974).

281. TEX. REV. CIV. STAT. ANN. art. 6840, § 1 (Supp. 1975-76).

282. *Id.* §§ 1, 2.

283. *Id.* § 3.

284. LA. CODE CIV. PRO. ANN. art. 3571 (West 1961).

285. 416 U.S. 600 (1974).

constitutionality.<sup>286</sup>

The upcoming survey year also promises to be significant for Texas creditors' remedies. The Texas garnishment statute<sup>287</sup> was recently held unconstitutional in *Southwestern Warehouse Corp. v. Wee Tote, Inc.*<sup>288</sup> on grounds similar to those employed in *Garcia*.<sup>289</sup> Since the United States Supreme Court in *North Georgia Finishing, Inc., v. Di-Chem, Inc.*<sup>290</sup> has recently affirmed the due process requirements found to be constitutional requisites in *Wee Tote*, one may expect that the garnishment statute will soon be revised to meet those requirements.<sup>291</sup> One also hopes that the Fifth Circuit will review the *Fancher* holding so as to clarify the constitutional status of self-help in Texas creditors' remedies.

## V. LEGISLATION

The last session of the Texas Legislature saw the enactment of numerous new statutes which will affect commercial transactions within the state. Some of the more significant of these are summarized below.

*Interest—Real Estate Loans Secured by Lien.* The 64th Legislature adopted a new act,<sup>292</sup> article 5069-1.07, governing interest charged on real estate loans. Article 5069-1.07(a) provides for the "spreading" of interest payments on loans "secured, in whole or in part, by a lien, mortgage, security interest, or other interest in or with respect to any interest in real property."<sup>293</sup> The second portion of the new statute permits "any person" to pay "the same rate of interest as corporations (other than non-profit corporations)" for loans in principal amounts of \$500,000 or more for the purpose of interim construction financing on real property or for the purpose of "financing or refinancing of improved real property."<sup>294</sup>

The relevant statute governing corporate interest rates<sup>295</sup> does not specify a rate for "corporations (*other than non-profit corporations*)." It does, however, prohibit the defense of usury by a corporation (except "charitable or religious" corporations) where the aggregate obligation exceeds \$5,000 and the rate of interest does not exceed one-and-one-half percent per month.<sup>296</sup> The legislature's intent as to the permissible rate should be clear enough to guide a court to the proper statute. There are, however, other

286. If there is an obvious flaw in the statute it may be that the burden is upon the debtor to come forward and request a post-seizure hearing. *See, e.g.,* LA. CODE CIV. PRO. ANN. art. 3506 (West 1961). For one writer's view that the amended statute is still unconstitutional see Comment, *supra* note 272.

287. TEX. REV. CIV. STAT. ANN. art. 4076 (1966).

288. 504 S.W.2d 592 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ). *See also* Texas Commerce Bank Nat'l Ass'n v. Tripp, 516 S.W.2d 256 (Tex. Civ. App.—Fort Worth 1974, writ granted).

289. 350 F. Supp. at 1259.

290. 419 U.S. 601 (1975), *noted in* 29 Sw. L.J. 660 (1975).

291. TEX. REV. CIV. STAT. ANN. art. 275 (1966), the Texas attachment statute, may require revision for the same reasons. For a discussion of the constitutionality of the Texas attachment and garnishment provisions see Comment, *supra* note 272, at 899-903.

292. TEX. REV. CIV. STAT. ANN. art. 5069-1.07 (Supp. 1975-76).

293. *Id.* art. 5069-1.07(a).

294. *Id.* art. 5069-1.07(b).

295. *Id.* art. 1302-2.09.

296. *Id.*

questions presented by the text of the new act which should be recognized.

First, the use of the phrase "other than non-profit corporation" should be taken simply as identifying the applicable rate and should not be read as restricting or modifying the statement that "any person" may borrow at the higher rates on appropriate loans. "Any person" means "any person" and not "any person other than non-profit corporations." Second, the use of the phrase "non-profit corporations" in the new statute raises a question as to what the legislature originally meant in article 1302-2.09 by the phrase "charitable or religious" corporation. One can conceive of religious or charitable corporations that operate *for* a profit, as well as non-profit corporations that are *not* charitable or religious. The most clear-cut way to resolve this issue would be to amend article 1302-2.09 to refer to "non-profit corporation." Third, the scope of the statute is made somewhat unclear by reason of the phrases "interim construction financing" and "improved real property." Each is capable of varying interpretations and will likely give rise to future litigation.

*Interest—Judgments.* Article 5069-1.05 was amended to increase the interest rate of judgments from six percent to nine percent, or such higher rate, if any, agreed upon in the underlying contract.<sup>297</sup> This statute was effective September 1, 1975.

*Sales Under Deed of Trust—Advertising.* Article 3810,<sup>298</sup> governing the process of foreclosure under deeds of trust, was amended by the legislature.<sup>299</sup> Notice of the sale must now be given by posting a written notice at least twenty-one days preceding the date of sale, at the door of the courthouse in the county(ies) specified in the act. In addition, at least twenty-one days preceding the date of sale, written notice must be mailed to each debtor by certified mail addressed to the last address shown on the creditor's records for each such debtor. By its terms, this statute becomes effective on January 1, 1976, and governs sales only after that date.

*Judgment Liens—Discharge After Bankruptcy.* Article 5449(a)<sup>300</sup> was added by the legislature to provide a means of clearing records of judgments and abstracts of judgments affecting bankrupts. One year after a discharge is granted, the bankrupt, debtor, other specified persons, or "any other interested person" may apply for the discharge and cancellation of any judgment, and of any abstract of judgment, relating to discharged obligations. The application should be filed with the court that rendered the judgment in question. Provision is also made in certain cases for limiting the effect of judgment liens based on undischarged obligations or liens affecting property "abandoned during the course of the proceeding."

*Secured Transactions—Revisions.* Certain provisions of chapter 9 of the Texas Business & Commerce Code were amended in minor respects by the

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297. *Id.* art. 5069-1.05.

298. *Id.* art. 3810 (1966).

299. Ch. 723, § 1, [1975] Tex. Laws 2354.

300. TEX. REV. CIV. STAT. ANN. art. 5449(a) (Supp. 1975-76).

legislature.<sup>301</sup> The amendments were made for clarification and to correct some slight inconsistencies with other statutes.<sup>302</sup>

*Livestock—Purchase for Slaughter.* In an apparent response to *In re Samuels & Co.*<sup>303</sup> the legislature enacted a statute providing special protection for persons selling livestock for slaughter. The new act<sup>304</sup> regulates the payment procedures<sup>305</sup> to be followed by "meat processors," as defined by the act,<sup>306</sup> provides for twelve percent damages in the event the statutory procedures or agreed methods of payment are not satisfied,<sup>307</sup> and grants a lien on the livestock sold, the carcasses and products, and all proceeds thereof.<sup>308</sup> This lien is given priority over any conflicting liens or security interests.<sup>309</sup>

*Banks—Branch Banks—Connecting Facilities.* The provisions of the Texas Banking Code<sup>310</sup> regulating the operation of "connected" office facilities and drive-in facilities were amended.<sup>311</sup> Closed-circuit television systems were added to the permissible methods of "connecting" facilities to the central bank building. The county population limitations on distant<sup>312</sup> automobile drive-in facilities were removed,<sup>313</sup> but the definition of "automobile drive-in facility" precludes the use of a walk-up window as part of the drive-in facility.<sup>314</sup>

*Escheat—Depositories—Dormant Deposits and Inactive Accounts.* A new statute amends the statutes regulating the escheat of deposits and accounts.<sup>315</sup> The financial institutions reporting under the statute will be required to remit to the state treasurer the total amount of funds in the dormant accounts and will not be able to retain accounts in excess of \$25.00 if the institution feels further efforts should be made to locate the owner.

301. Ch. 353, §§ 1-9, [1975] Tex. Laws 940-43, amending TEX. BUS. & COMM. CODE ANN. §§ 9.110, 9.402(c), (e), (f), 9.403(e)-(g), 9.404(c), 9.405(a), (d), 9.406, 9.504(c), 9.505(b) (1968).

302. TEX. REV. CIV. STAT. ANN. arts. 6626, 6627, 6630 (1969), as amended, ch. 353, §§ 13-15, [1975] Tex. Laws 944-45.

303. 510 F.2d 139 (5th Cir. 1975) (rehearing en banc granted, May 19, 1975); see notes 189-204 *supra* and accompanying text.

304. TEX. REV. CIV. STAT. ANN. art. 6910b (Supp. 1975-76).

305. *Id.* § 2.

306. *Id.* § 1(b).

307. *Id.* § 3. The same section authorizes the collection of interest and attorneys' fees.

308. *Id.* § 4.

309. *Id.* § 7.

310. *Id.* arts. 41-101 to -951 (1973).

311. *Id.* art. 342-903 (1973), as amended, ch. 215, § 1, [1975] Tex. Laws 531.

312. Automatic drive-in facilities may now be located between 500 and 2000 feet from the bank building, an increase from the 500- to 1850-foot rule previously in effect. TEX. REV. CIV. STAT. ANN. art. 342-903 (Supp. 1975-76).

313. The former provision limited the availability of drive-in facilities to banks in counties of over 350,000 population.

314. The drive-in facilities permitted under the new act are defined to mean facilities "offering banking services solely to persons who arrive at such facility in an automobile and remain during the transaction of business with the bank."

315. TEX. REV. CIV. STAT. ANN. art. 3272b, §§ 4, 5 (Supp. 1975-76).