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COMMERCIAL TRANSACTIONS

by

Peter Winship*

AS in previous years, this year's survey of commercial transactions focuses on the Uniform Commercial Code as enacted in Texas.¹ While Texas court decisions construing the Code continue to proliferate, most published opinions do not break new ground. The major court decisions this year, for example, are decisions on appeal which were discussed in last year's *Survey*.² Other decisions, however, provide useful illustrations of the operation of specific Code provisions. At the same time there appear to be fewer instances in which application of the Code is overlooked.³

Given this focus on the Texas Code, two general caveats must be stressed. First, Texas attorneys faced with Code problems should not ignore general Code commentaries and out-of-state court decisions construing the Code.⁴ The Code itself instructs courts to construe the Code liberally to promote the underlying purposes, one of which is "to make uniform the law among the various jurisdictions."⁵ In construing the Code, Texas courts

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1. In this Article both textual and footnote citations are to the Texas Uniform Commercial Code [hereinafter referred to as "the Code"] as incorporated in the first eleven chapters of the Texas Business and Commerce Code, TEX. BUS. & COMM. CODE ANN. §§ 1.101-11.108 (Vernon 1968 & Supp. 1978). The Code became effective in Texas on July 1, 1966. 1965 Tex. Gen. Laws ch. 721, at 1-316. In 1967 the Code became part of the Business and Commerce Code, and since that date its provisions have been amended several times. The Code's provisions now generally conform with the 1972 Official Text of the Uniform Commercial Code. The Code was amended most recently by the Texas Legislature in 1977. For a discussion of these amendments see notes 9-18 *infra* and accompanying text.

2. *Kimbell Foods, Inc. v. Republic Nat'l Bank*, 557 F.2d 491 (5th Cir. 1977), *rev'g* 401 F. Supp. 316 (N.D. Tex. 1975) (*discussed in notes 173-75, 185-86 infra* and accompanying text); *Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977), *aff'g* 539 S.W.2d 190 (Tex. Civ. App.—Beaumont 1976) (*discussed in notes 65-70 infra* and accompanying text); *Nelson v. Union Equity Coop. Exch.*, 548 S.W.2d 352 (Tex. 1977), *aff'g* 536 S.W.2d 635 (Tex. Civ. App.—Fort Worth 1976) (*discussed in notes 24-30 infra* and accompanying text). The lower court opinions in these cases are discussed in Winship, *Commercial Transactions, Annual Survey of Texas Law*, 31 Sw. L.J. 165 (1977) [hereinafter cited as *1977 Annual Survey*].

3. Compare the number of cases listed in last year's *Survey* article in which the relevance of the Code was not considered. *1977 Annual Survey, supra* note 2, at 165 n.3. For a case involving a lease of real property in which the Code did not apply see *Aycock v. Vantage Management Co.*, 554 S.W.2d 235, 237 (Tex. Civ. App.—Dallas 1977, writ ref'd n.r.e.). The court in *Aycock* properly cited the Code as representative of legislative policy rather than as controlling law.

4. A useful summary of research aids for Code problems is set out in R. BRAUCHER & R. RIEGERT, INTRODUCTION TO COMMERCIAL TRANSACTIONS 40-48 (1977). Texts of Code decisions are published in the *UCC Reporting Service*. Digests of Code cases appear in the *Commercial Law Journal*, the *UCC Law Letter*, and the *UCC Law Journal*. An annual survey of Code cases from all jurisdictions is published each year in *The Business Lawyer*. See, e.g., *Uniform Commercial Code Annual Survey*, 32 BUS. LAW. 1065-1164 (1977). Relevant sections of the State Bar of Texas publish periodicals which survey current developments. The Texas Association of Bank Counsel began publication of *The Texas Bank Lawyer* in June 1977 on a monthly basis with digests of current cases.

5. TEX. BUS. & COMM. CODE ANN. § 1.102(a), (b)(3) (Vernon 1968). For a recent study which suggests that uniformity is not being achieved see Minahan, *The Eroding Uniformity of the Uniform Commercial Code*, 65 KY. L.J. 799 (1977). A good general statement of the Code's

should give these resources considerable weight in the absence of Texas amendments to the Code or definitive Texas court decisions.⁶ A second caveat relates to the continuing need of an attorney dealing with commercial matters to be aware of statutes and the common law outside the framework of the Code. Section 1.103 of the Code provides that principles of law and equity supplement the Code unless displaced by the Code provisions.⁷ In addition, important commercial topics such as arbitration, conversion, and guaranty agreements remain unregulated or imperfectly regulated by the Code. As in the past, an attempt is made in this Article to call attention to recent developments in some of these extra-Code areas.⁸

With minor amendments the scope and format of this Article follow that of last year. Brief sections on legislative developments and miscellaneous Code decisions have been added. As was done last year, Texas developments with respect to creditors' rights are dealt with in a separate *Survey* article.

I. TEXAS LEGISLATIVE DEVELOPMENTS

The Sixty-fifth Legislature's forays into the domain of private commercial law were modest. Only two laws amending the Code were enacted. The first of these laws comprises amendments to chapter 9 as proposed by the State Bar of Texas.⁹ The Act makes relatively minor non-uniform amendments to the filing provisions and to provisions regulating who must be given notice after default.¹⁰ Before these amendments sections 9.504(c) and 9.505(b) required a secured party who wished either to dispose of repossessed collateral or to retain the collateral in satisfaction of the underlying obligation to notify "any other secured party who has duly filed a financing statement indexed in the name of the debtor in this state" as well as any other secured party who gives written notice of his claim.¹¹ This requirement has now been modified so that notice must be given "to any other secured party who has a security interest *in the same collateral* and who has duly

policy encouraging uniformity appears in Comment, *Uniformity of the Commercial Code*, 8 B.C. INDUS. & COM. L. REV. 568 (1967).

6. See generally Note, *How Appellate Opinions Should Justify Decisions Made Under the U.C.C.*, 29 STAN. L. REV. 1245 (1977).

7. TEX. BUS. & COMM. CODE ANN. § 1.103 (Vernon 1968). See Hillman, *Construction of the Uniform Commercial Code: UCC Section 1-103 and "Code" Methodology*, 18 B.C. INDUS. & COM. L. REV. 655 (1977).

8. The most important of these extra-Code commercial decisions are often discussed in student case notes. See, for example, the case note discussions of *Classified Parking Sys. v. Dansereau*, 535 S.W.2d 14 (Tex. Civ. App.—Houston [14th Dist.] 1976, no writ) (bailment "fire and theft" exception); Note, *Rejection of the Fire and Theft Exceptions in Texas Bailment Law: Classified Parking Systems v. Dansereau*, 29 BAYLOR L. REV. 403 (1977); Note, *Bailments—Evidence—Proof of Theft of Bailed Goods Does Not of Itself Rebut Presumption of Bailee's Negligence*, 8 ST. MARY'S L. REV. 359 (1976); Note, *Bare Facts of Fire or Theft No Longer Rebut the Presumption of a Bailee's Negligence*, 8 TEX. TECH L. REV. 387 (1976). The *Classified Parking* case is also briefly noted in *1977 Annual Survey*, *supra* note 2, at 199.

9. 1977 Tex. Gen. Laws ch. 163, §§ 1-7, at 333-35 (codified in scattered sections of ch. 9, TEX. BUS. & COMM. CODE ANN.). For a commentary on the State Bar's proposal, see Mehl, *Proposed Legislation Involving Chapter 9 of the Texas Business and Commerce Code (Texas Uniform Commercial Code)*, 40 TEX. B.J. 63, 63-64 (1977).

10. TEX. BUS. & COMM. CODE ANN. §§ 9.402(d), .403(a), (b), .504(c), .505(b) (Vernon Supp. 1978).

11. 1973 Tex. Gen. Laws ch. 400, § 5, at 999.

filed, *in the office of the Secretary of State or the county clerk* in the proper county in this state, a financing statement indexed in the name of the debtor."¹² Despite this amendment to the Code the notice requirement in these provisions remains more stringent than the 1972 Official Text of the Uniform Commercial Code.¹³

A second amendment to the Code appears in the Artists' Consignment Act.¹⁴ This piece of special legislation protects a work of art delivered to an art dealer¹⁵ for exhibition or sale, and any proceeds thereof, from the claims of the dealer's creditors. Section 2.326(c) of the Code has been amended to call attention to this exception to the general Code rule which subjects goods on consignment to the claims of consignee's creditors.¹⁶ When special advantages are given to such groups as artists and farmers, it is no doubt good practice to call attention to these privileges by non-uniform amendment to the Code as was done in this Act.¹⁷ Failure to amend the Code may mislead the practitioner who is not familiar with a particular trade. Unfortunately, proponents of special legislation have no interest in a general review of Code provisions. The whole question of the Code's regulation of consignments, for example, should be reviewed.¹⁸

Other recent state legislation of general interest to the practitioner of commercial law includes amendments to usury laws¹⁹ and revision of the Texas Deceptive Trade Practices—Consumer Protection Act.²⁰ More specialized legislation is of interest to attorneys dealing with problems in particular trades or industries.²¹

12. TEX. BUS. & COMM. CODE ANN. §§ 9.504(c), .505(b) (Vernon Supp. 1978) (emphasis added).

13. The 1972 Official Text of the Uniform Commercial Code only requires notice to be given to any secured party who has given timely written notice of his claim to the first secured party. U.C.C. §§ 9-504(3), -505(2) (1972 version). The State Bar committee on the Uniform Commercial Code balked at adopting the uniform text. See Mehl, *supra* note 9, at 64.

14. TEX. REV. CIV. STAT. ANN. art. 9018 (Vernon Supp. 1978); TEX. BUS. & COMM. CODE ANN. § 2.326(c) (Vernon Supp. 1978).

15. The Act apparently does not require that the work of art be delivered to an art dealer by an artist. An original draft may have intended to limit the Act because the short title of the Act is "Artists' Consignment Act." TEX. REV. CIV. STAT. ANN. art. 9018, §§ 1,2(2) (Vernon Supp. 1978).

16. TEX. BUS. & COMM. CODE ANN. §§ 2.326(a)-(c) (Vernon 1968 & Supp. 1978).

17. *Cf. id.* § 1.104 (Vernon 1968) (construction against implicit repeal of Code provisions by subsequent legislation). Special legislation to reverse adverse judicial opinions is not uncommon. Following ultimate defeat in the *In re Samuels* case, *Stowers v. Mahon*, 526 F.2d 1238 (5th Cir.), *cert. denied*, 429 U.S. 834 (1976), farmers obtained both state and federal legislation. See Pub. L. No. 94-410, 90 Stat. 1249 (1976) (codified in scattered sections of 7 U.S.C.); TEX. REV. CIV. STAT. ANN. art. 6910b (Vernon Supp. 1978).

18. See generally Winship, *The "True" Consignment Under the Uniform Commercial Code, and Related Peccadilloes*, 29 Sw. L.J. 825 (1975), reprinted in 2 CORPORATE COUNSEL'S ANNUAL—1977, at 885 (H. Friedman, J. O'Brien & H. Schlagman eds. 1977).

19. TEX. REV. CIV. STAT. ANN. arts. 5069—1.01 to —51.19 (Vernon 1971 & Supp. 1978).

20. TEX. BUS. & COMM. CODE ANN. §§ 17.41-.63 (Vernon Supp. 1978).

21. See generally STATE BAR OF TEXAS, TEXAS LEGISLATIVE HIGHLIGHTS 1977 (1977). Note, for example, the revision of the Texas Mobile Homes Standards Act. TEX. REV. CIV. STAT. ANN. art. 5221f (Vernon Supp. 1978). Mobile home sales and financing give rise to so many legal problems that an entire course on commercial law could be taught using only the court decisions dealing with mobile homes. See, e.g., *Nobility Homes of Texas, Inc. v. Shivers*, 557 S.W.2d 77 (Tex. 1977), *aff'g* 539 S.W.2d 190 (Tex. Civ. App.—Beaumont 1976) (discussed in notes 65-70 *infra* and accompanying text).

II. SALES TRANSACTIONS

A. *Who is a "Merchant"?*

Article 2 of the Code applies to all contracts for the sale of personal property, except where a specific Code provision limits the application of its rule to a transaction with a "merchant" or "between merchants." Section 2.104 of the Code defines these terms and the comments to that section further elaborate on the scope and policy underlying the special provisions applicable to mercantile transactions.²²

Whether farmers are "merchants" under Article 2 has been a question raised in a growing number of cases in recent years.²³ The answer is inconclusive because state supreme courts have resolved the question both ways. In *Nelson v. Union Equity Co-operative Exchange*²⁴ the Texas Supreme Court, over a strong dissent by four justices, affirmed a decision which had found the defendant farmer in that case to be a merchant for the purposes of an exception to the Code's statute of frauds.²⁵ This exception is that "between merchants" the requirement of the statute of frauds is met by a written confirmation. The majority opinion in *Nelson* found that on the undisputed facts the farmer met three distinct tests for being a merchant within the definition of section 2.104(a): (1) he "dealt" in goods of the kind; (2) by his occupation he held himself out as having knowledge or skill peculiar to the *practices* involved in the transaction; and (3) by his occupation he held himself out as having knowledge or skill peculiar to the *goods* involved in the transaction.²⁶ By selling his annual crop the defendant "trafficked" in or "transacted business" in wheat and therefore fell within the dictionary definition of "dealing" in goods of the kind. Furthermore, the defendant not only raised but also sold wheat. The court ruled that a person who sells a commodity such as wheat, at least to the extent shown to be true of the defendant, necessarily represents that he has knowledge of both the goods and practices of selling wheat. The court noted that an experienced farmer like the defendant would be expected to know the attributes of wheat, such as grades and qualities, which are peculiar to the goods. The majority opinion, quoting from the comment to section 2.104, also pointed out that the trade practice in *Nelson* was the non-specialized business

22. See generally Dolan, *The Merchant Class of Article 2: Farmers, Doctors, and Others*, 1977 WASH. U.L.Q. 1. For a comment on the importance of the "merchant" provisions to the assumptions underlying the drafting of article 2 see Winship, *Jurisprudence and the Uniform Commercial Code: A "Commote"*, 31 Sw. L.J. 843 (1977). It should be stressed that the fact that one is a "merchant" for the purposes of the Code does not mean one is a "merchant" under other statutes. *But see* Trial v. McCoy, 553 S.W.2d 199, 201 (Tex. Civ. App.—El Paso 1977, no writ). See note 64 *infra*.

23. See generally Squillante, *Is He or Isn't He a Merchant?—The Farmer* (pts. 1-3), 82 COM L.J. 155, 367, 430 (1977); Note, *Uniform Commercial Code—Is the Farmer a "Merchant"*, 28 BAYLOR L. REV. 715 (1976); Note, *The Farmer as a Merchant Under the UCC*, 53 N.D.L. REV. 587 (1977); Note, *Lish v. Compton—Is a Farmer a Merchant Under the UCC*, 1976 UTAH L. REV. 558. See also UCC L. LETTER, Sept. 1977, at 3-4.

24. 548 S.W.2d 352 (Tex. 1977), *aff'g* 536 S.W.2d 635 (Tex. Civ. App.—Fort Worth 1976). The opinion of the court of civil appeals is commented on in 1977 *Annual Survey*, *supra* note 2, at 168-70.

25. TEX. BUS. & COMM. CODE ANN. § 2.201(b) (Vernon 1968).

26. 548 S.W.2d at 355.

practice of answering mail.²⁷ The majority's approach, an expansive reading of the merchant definition, was based on the broad language of section 2.104(a) and the fact that under the circumstances of the case the burden on the defendant was not onerous.

An elaborate dissent read the statutory definition of merchant in the light of what the dissent characterized as its "clear, ordinary meaning," which stresses professionalism. Reviewing the facts mentioned in the majority opinion, the dissent concluded that the facts did not indicate that the defendant knew of the practice of sending a confirmatory memorandum.

While approving the result in *Nelson*, this reviewer does not find the majority opinion helpful. The conclusion that the defendant "dealt" in wheat because he "transacted business" in wheat suggests, as the minority opinion pointed out, that virtually everyone who at some time buys or sells a good, such as a used car, would be a merchant under the Code. Fortunately, the majority opinion suggested, albeit obliquely, two possible limitations to this broad reading of section 2.104. First, the facts of each case, it was suggested, should be examined to evaluate the experience and scope of a defendant's activities.²⁸ The opinion, however, did not indicate which facts are to be given greater weight. Secondly, the opinion stressed the relatively light burden imposed on the defendant by section 2.201(b). This suggests that a farmer need not be a merchant within the meaning of all of the Code's merchant provisions, thereby avoiding the higher obligations imposed on merchants.²⁹ This approach followed from the implication in comment 2 to section 2.104 and was consistent with the general approach of the Code to extend or contract the scope of a Code provision in the light of its purpose or "reason."³⁰

The danger of misreading the scope of the *Nelson* opinion was realized in *Gray v. Kirkland*.³¹ In *Gray* the Corpus Christi court of civil appeals stated that the Code applied to the transaction before it because the Code applies to farmers, citing *Nelson*.³² The Code, however, applies to transactions in goods, especially sales of goods, not to classes of persons.³³ The Code applied to the transaction in *Gray* because an alleged sale of cotton seed, a "good" under the Code, was involved.³⁴ The opinion in *Nelson* is irrelevant to the question of whether or not the Code applies to a particular transaction.

27. TEX. BUS. & COMM. CODE ANN. § 2.201(b), comment 2 (Vernon 1968).

28. 548 S.W.2d at 355-56 ("He annually sold that crop himself; and in the five years preceding the trial of this case, his sales were to a milling company."); *id.* at 356 ("A person whose occupation includes the selling of a commodity, at least to the extent shown of *Nelson* . . ."). The dissenting opinion conveniently listed all the facts mentioned in the majority opinion. *Id.* at 358.

29. For example, a merchant is held to a higher standard of "good faith." TEX. BUS. & COMM. CODE ANN. §§ 1.201(19), .203, 2.103(a)(2) (Vernon 1968).

30. *Id.* § 1.102, comment 1.

31. 550 S.W.2d 410 (Tex. Civ. App.—Corpus Christi 1977, writ ref'd n.r.e.).

32. *Id.* at 412.

33. TEX. BUS. & COMM. CODE ANN. § 2.102 (Vernon 1968).

34. *Id.* § 2.105(a).

B. Formation of Contracts

Statute of Frauds. Section 2.201 of the Code states that a contract for the sale of goods at a price of \$500 or more is unenforceable "unless there is some writing sufficient to indicate that a contract for sale has been made between the parties and signed by the party against whom enforcement is sought."³⁵ The Code provides several exceptions to this formal requirement. One exception has already been mentioned in connection with the discussion of the *Nelson* case.³⁶ Between merchants a written confirmation of an oral agreement satisfies the Statute of Frauds unless the person receiving the confirmation makes a timely written objection to its contents.³⁷ In *Nelson* the Texas Supreme Court held that the defendant farmer, who had failed to object to a written confirmation, was a "merchant" within this exception. Even if a defendant is a merchant within this exception, a plaintiff still has the burden of showing that a contract was entered into by the parties.³⁸

A second exception to the formal requirement of section 2.201 exists where the parties enter into a valid agreement which is unenforceable because of the Statute of Frauds, but which has been partially performed.³⁹ Physical receipt and acceptance of goods, for example, is considered an unambiguous admission by both parties that a contract exists and is, therefore, a substitute for a writing. The party seeking to enforce the contract has the burden of showing receipt and acceptance, which will usually be questions of fact. This exception is illustrated by *Wilson v. Remmel Cattle Co.*⁴⁰ In this case the plaintiffs sought to establish an oral contract for the purchase of cattle. The jury found that there had been an oral contract but made no findings with respect to the receipt and acceptance of the cattle by the buyer. The trial court rendered judgment n.o.v. for the defendant on the ground that the oral contract was "violative" of the Statute of Frauds. Noting that a judgment n.o.v. is equivalent to a finding that there is no evidence to raise an issue for the jury, the appellate court reversed because the facts as to receipt and acceptance were in dispute. In order to enforce the agreement the seller, in effect, had to establish both that there had been an oral contract and that the buyer had received and accepted the cattle.⁴¹

Parties occasionally argue that there are non-Code exceptions to the Statute of Frauds which permit an oral contract to be enforced. In *H. Molsen & Co. v. Hicks*⁴² a cotton buyer sought to recover damages from

35. *Id.* § 2.201(a).

36. See notes 24-30 *supra* and accompanying text.

37. TEX. BUS. & COMM. CODE ANN. § 2.201(b) (Vernon 1968). See Note, *Promissory Estoppel and Farmer as a Merchant: The 1973 Grain Cases and the UCC Statute of Frauds*, 1977 UTAH L. REV. 59.

38. See TEX. BUS. & COMM. CODE ANN. § 2.201, comment 3 (Vernon 1968). In *Nelson* the trial court had determined that the parties had entered into an oral agreement. 548 S.W.2d at 354.

39. TEX. BUS. & COMM. CODE ANN. § 2.201(c)(3) (Vernon 1968). See also *id.* § 2.201, comment 2.

40. 542 S.W.2d 938 (Tex. Civ. App.—Amarillo 1976, writ ref'd n.r.e.).

41. *Id.* at 941.

42. 550 S.W.2d 354, 21 UCC Rep. Serv. 294 (Tex. Civ. App.—El Paso 1977, writ ref'd n.r.e.).

farmers who allegedly had agreed orally to sell their cotton to plaintiff. To avoid the Statute of Frauds the plaintiff buyer alleged that the defendants had promised to sign a written agreement but had failed to do so. The plaintiff argued that the defendants, therefore, were estopped from raising the Statute of Frauds because of the doctrine of promissory estoppel. The appellate court, however, found that there was evidence the parties had not reached agreement on the final terms of a contract, and, therefore, that real property cases such as "*Moore*" *Burger, Inc. v. Phillips Petroleum Co.* were distinguishable.⁴³ The court apparently assumed that when an agreement can be shown the doctrine of promissory estoppel will apply notwithstanding the terms of section 2.201. While this writer approves the result on the general ground that the Statute of Frauds does more harm than good, in a proper case a more elaborate analysis should be undertaken.⁴⁴

Contract Formation. The Uniform Commercial Code rendered obsolete a number of pre-Code limitations on contract formation. Section 2.204(c), for example, provides that even an "indefinite" contract is enforceable "if the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy."⁴⁵ When a term has been left open, the Code may supply the term.⁴⁶ If the parties exchange correspondence during contract negotiations, then the Code encourages the finding of an enforceable contract by abrogating the rule that offers and acceptances must be mirror-images.⁴⁷

The legal effect of an exchange of correspondence was at issue in *Tylan Corp. v. Texas Materials Laboratories, Inc.*⁴⁸ The defendant submitted to the plaintiff a written purchase order for a reactor to be built by plaintiff. The plaintiff replied with a letter setting out its understanding of the transaction, including a price. Having received no answer to its letter, the plaintiff commenced work, but was soon informed that the defendant would not accept the reactor. The plaintiff sought to recover the amount it had already spent in developing the reactor. The jury found that the defendant had agreed to purchase the reactor but that the parties had not agreed on a price. The lower court rendered judgment that the plaintiff take nothing, and the appellate court affirmed after reviewing the facts but not the law. The appellate court stated there was some evidence that the defendant did not agree to the terms of the plaintiff's letter.

In *Tylan* the plaintiff should have recovered at least some amount on two different theories. Given the jury finding of an agreement to purchase, the court should have enforced the contract under section 2.207(c) and supplied

43. 492 S.W.2d 934 (Tex. 1972). See Comment, *Promissory Estoppel Marches On—Moore-burger*, 28 BAYLOR L. REV. 703 (1976).

44. See J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE 59-60 (1972). See also *Robert Johnson Grain Co. v. Chemical Interchange Co.*, 541 F.2d 207 (5th Cir. 1976) (alternate theories of "promissory estoppel" and estoppel to raise Statute of Frauds not free from difficulty under state law).

45. TEX. BUS. & COMM. CODE ANN. § 2.204(c) (Vernon 1968). See also *id.* § 2.207(c).

46. See, e.g., *id.* §§ 2.305-325.

47. *Id.* § 2.207.

48. 548 S.W.2d 811 (Tex. Civ. App.—Waco 1977, no writ).

the price term using section 2.305. The plaintiff could then have recovered on the contract for the repudiation by the defendant.⁴⁹ Alternatively, the plaintiff should have sought to recover on the theory of promissory estoppel. Damages recoverable on this theory might have been limited to reliance damages.⁵⁰

Contract Terms—Parol Evidence. The Code restates the parol evidence rule in section 2.202. While the statutory text does not make drastic changes to the rule, the comments to the section state that the text “definitely rejects” certain assumptions frequently made in pre-Code case law. For example, the comment states that contract language does not have to be found ambiguous before evidence of course of dealing or usage of trade can be admitted to explain or supplement an agreement.⁵¹ Courts, however, have not always been careful in distinguishing such evidence from other types of evidence which continue to be subject to stricter standards of admissibility under the parol evidence rule. In *Monesson v. Champion International Corp., Del-Mar Division*,⁵² for example, the appellate court held that because contract language was ambiguous “therefore” extrinsic evidence was admissible to show the intent of the parties, course of dealing, and usage of trade.⁵³

Contract Terms—Output Contracts. Although the Code leaves the parties to shape their own contract, when the parties have failed to supply a term, the Code fills in the term under its supplementary provisions.⁵⁴ One such provision is section 2.306, which regulates output and requirements contracts. This provision validates such contracts with the limitation that they cover only “such actual output or requirements as may occur in good faith.”⁵⁵ The application of section 2.306 was discussed in *Tennell v. Esteve Cotton Co.*⁵⁶ The contract for the sale of a cotton grower’s “entire production” included an estimate of the number of bales to be produced. Actual production was far higher than the estimate, and the seller argued that he was not required to supply more than an amount reasonably proportionate to the contract estimate of his output. The court, however, concluded that section 2.306 was not applicable because production was not to be measured

49. TEX. BUS. & COMM. CODE ANN. §§ 2.610, .703, .704(b), .706, .708 (Vernon 1968).

50. Plaintiff in the *Tylan* case may have been seeking damages based on promissory estoppel because plaintiff sought to recover only its expenses up to the time defendant informed plaintiff that it would not take the reactor. See generally J. MURRAY, MURRAY ON CONTRACTS §§ 91-93 (2d rev. ed. 1974). Section 90 of the *Restatement of Contracts* has been revised to provide that “[t]he remedy granted for breach may be limited as justice requires.” RESTATEMENT (SECOND) OF CONTRACTS § 90 (1973).

51. TEX. BUS. & COMM. CODE ANN. § 2.202, comment 1(c) (Vernon 1968). See *id.* §§ 1.205, 2.202, .208. See generally Kirst, *Usage of Trade and Course of Dealing: Subversion of the UCC Theory*, 1977 U. ILL. L. F. 811.

52. 546 S.W.2d 631 (Tex. Civ. App.—Tyler 1976, writ ref’d n.r.e.).

53. *Id.* at 637.

54. See generally J. WHITE & R. SUMMERS, *supra* note 44, at 88-102.

55. TEX. BUS. & COMM. CODE ANN. § 2.306(a) (Vernon 1968). See generally Weistart, *Requirements and Output Contracts: Quantity Variations Under the UCC*, 1973 DUKE L.J. 599.

56. 546 S.W.2d 346, 21 UCC Rep. Serv. 978 (Tex. Civ. App.—Amarillo 1976, writ ref’d n.r.e.).

by the requirements of the buyer.⁵⁷ This disposition did not answer the contention that the contract was an "output" contract. Perhaps the court meant that this contract for the sale of one crop did not call for the continuing production, demands, and tenders which characterize most output or requirement contracts. Nevertheless, the policy underlying section 2.306, which places good faith limitations on the party who has control over the quantity produced under the contract, would appear to apply to the *Tennell* contract in which the cotton grower controlled the amount produced. In any case the court's decision gave the seller the benefit of all production over the estimate in a rising market. To the extent farmers can control production, the decision removed the farmer's incentive to increase production in a rising market and may lead to even higher prices for the consumer.

C. Warranties

Four types of warranties are provided for in the Code: a warranty of title, an express warranty, an implied warranty of merchantability, and an implied warranty of fitness for a particular purpose.⁵⁸ In addition, the Code regulates the disclaimer of warranties and the limitation of remedies for breach of warranties.⁵⁹ The Code delegates to the courts the development of doctrines regarding vertical and horizontal privity between parties.⁶⁰ These "contract" warranties have traditionally had attributes which distinguish them from "tort" remedies under negligence or strict liability theories. Privity, for example, is often required under a contract theory but not under a tort theory; notice may have to be given of breach of a contract warranty while notice is not required to recover on a tort theory; and different statutes of limitations may apply to the different causes of action. Although courts still struggle with the traditional forms of action, many courts now make functional distinctions on the basis of who the parties are and the nature of the damage.⁶¹ Several recent Texas cases discussed below illustrate these general principles.

57. 546 S.W.2d at 358.

58. TEX. BUS. & COMM. CODE ANN. §§ 2.312-.315 (Vernon 1968). Courts occasionally confuse the different warranties. One recent Texas court confused the implied warranty of merchantability (§ 2.314) with the implied warranty of fitness for a particular purpose (§ 2.315). *Signal Oil & Gas Co. v. Universal Oil Prods.*, 545 S.W.2d 907, 21 UCC Rep. Serv. 470 (Tex. Civ. App.—Beaumont 1977, writ granted). There is an implied warranty of merchantability that the goods are "fit for the ordinary purposes for which such goods are used" when the seller is a merchant with respect to goods of the kind sold. TEX. BUS. & COMM. CODE ANN. §§ 2.314(a), (b)(3) (Vernon 1968). For this implied warranty of merchantability to apply it is unnecessary to show that seller knew of a particular purpose for which buyer required the goods or that buyer relied on seller's skill or judgment. A showing that seller knew of buyer's particular purpose and that buyer relied on seller's skill or judgment is necessary when an implied warranty of fitness for a particular purpose is relied on. *Id.* § 2.315.

59. *Id.* §§ 2.316, .719.

60. *Id.* § 2.318. This writer deplors this abdication of legislative responsibility. Why courts should be better equipped to resolve the conflicting economic interests is difficult to understand. Moreover, as the official comments to the Code indicate, the existence of a legislative rule does not necessarily mean the end of further case law development. *Id.* § 2.313, comment 2. For an incisive criticism that the Code as a whole represents an abdication of legislative responsibility see Danzig, *A Comment on the Jurisprudence of the Uniform Commercial Code*, 27 STAN. L. REV. 621 (1975).

61. For a useful discussion of the different policies underlying the contract warranty and tort theories see *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 553 S.W.2d 935, 938-40, 21 UCC Rep. Serv. 1273 (Tex. Civ. App.—Amarillo 1977, no writ).

Warranty of Title. Section 2.312 of the Code states that seller warrants to the buyer that "the title conveyed shall be good."⁶² The scope of this warranty was considered in *Trial v. McCoy*.⁶³ The buyer showed that the antique gun he had purchased had been taken from him by police officers on their information that the gun had been stolen. The gun was not returned to the buyer, he sued the seller, and the trial court granted summary judgment for the buyer. The appellate court held that disturbance of quiet possession was sufficient to show a breach of the warranty of title and that the buyer, therefore, did not have to prove that the gun in fact had been stolen. Citing comment 1 to section 2.312 and cases from other jurisdictions in support of its decision, the court held that the buyer was entitled to recover his actual damages (the purchase price).⁶⁴

Privity. In an important decision the Texas Supreme Court in *Nobility Homes of Texas, Inc. v. Shivers*⁶⁵ held that "a manufacturer can be responsible, without regard to privity, for the economic loss which results from its breach of the Uniform Commercial Code's implied warranty of merchantability."⁶⁶ The plaintiff consumer purchased from an independent dealer a mobile home manufactured by defendant. The trial court found, *inter alia*, that the mobile home was defectively constructed and not fit for the purposes for which it was sold. The trial court rendered judgment for the plaintiff for the difference between the reasonable market value of the mobile home at the time of the plaintiff's purchase and the original contract price.⁶⁷ The Beaumont court of civil appeals affirmed over a vigorous dissent. The Texas Supreme Court affirmed with an elaborate opinion, carefully reviewing the bases of its decision.

The supreme court's opinion stressed a number of points: (a) it would be unfair to distinguish physical and economic loss when economic loss can be

62. TEX. BUS. & COMM. CODE ANN. § 2.312(a)(1) (Vernon 1968).

63. 553 S.W.2d 199, 22 UCC Rep. Serv. 48 (Tex. Civ. App.—El Paso 1977, no writ).

64. The court went on to consider whether the buyer was entitled as a "consumer" to treble damages under the Deceptive Trade Practices—Consumer Protection Act, TEX. BUS. & COMM. CODE ANN. § 17.50 (Vernon Supp. 1978). The court held that there was a disputed fact question and remanded the case for a trial on the merits of this question. Although the court cited § 2.104 of the Code (definition of "merchant") this section is irrelevant because the Deceptive Trade Practices—Consumer Protection Act has its own definition. *Id.* § 17.45. Nor did the court discuss the Act's substantive provision which a breach of warranty of title violates. *See id.* § 17.46. As noted in note 20 *supra*, the Deceptive Trade Practices—Consumer Protection Act recently was amended extensively.

65. 557 S.W.2d 77, 22 UCC Rep. Serv. 621 (Tex. 1977), *aff'g* 539 S.W.2d 190, 20 UCC Rep. Serv. 15 (Tex. Civ. App.—Beaumont 1976). For a discussion of the opinion of the court of civil appeals see 1977 *Annual Survey*, *supra* note 2, at 172-74. *See also* 8 ST. MARY'S L.J. 865 (1977).

66. 557 S.W.2d at 81. The supreme court's opinion in effect overrules the opinion of the Amarillo court of civil appeals in *Henderson v. Ford Motor Co.*, 547 S.W.2d 663, 667, 20 UCC Rep. Serv. 1158 (Tex. Civ. App.—Amarillo 1977, no writ). The supreme court's opinion was consistent with and went even further than the federal district court in *Roberts v. General Dynamics, Convair Corp.*, 425 F. Supp. 688, 690-91, 21 UCC Rep. Serv. 565 (S.D. Tex. 1977) (privity not required when breach of implied warranty causes personal rather than economic injury).

67. For a suggestion that the proper measure of damages should be based on the value of the mobile home at the time it left the hands of the manufacturer and not the value at the time plaintiff purchased it, see 1977 *Annual Survey*, *supra* note 2, at 174 n.48. The reason given was that the manufacturer should not bear the risk of depreciation in the hands of an independent dealer. *Id.* An appellate court may now remand on the damage issue alone. TEX. R. CIV. P. 503.

just as disastrous for an individual consumer; (b) a contrary holding would encourage manufacturers to limit their liability by marketing their products through thinly capitalized entities; (c) the court's decision was consistent with the idea that the law of contract should govern economic damages and the law of tort should govern physical damages; and (d) the decision would avoid wasteful litigation because the manufacturer would be ultimately liable anyway. The court also reasoned that the Code permitted the manufacturer to protect itself from unlimited and unforeseeable liability.⁶⁸

Although the result and opinion in *Nobility* are consistent with the position urged in last year's *Survey*,⁶⁹ several limitations on the potential breadth of the opinion arise from the facts before the court in that case. First, while no attempt was made by the manufacturer to disclaim warranties or to limit remedies, the court specifically recognized this practice as valid. A predictable result of *Nobility* will be concentrated attempts at boilerplate protection when a manufacturer sells to an independent dealer. Secondly, the plaintiff consumer in *Nobility* did not seek consequential economic losses, such as lost profits. Not having dealt with the ultimate consumer, the manufacturer is usually in no position to calculate these consequential economic losses into his costs. On the other hand, the manufacturer will be in a better position to calculate the difference between the value of its good with a defect and the value of the same good without a defect, even if these values are retail rather than wholesale values. Thirdly, the point that the defective product in *Nobility* could have caused the consumer "to lose his entire life savings" was stressed.⁷⁰ Thus, *Nobility* may be distinguished in future cases when merchants are involved or the defective good is less costly and important to the consumer.

A manufacturer may give an express warranty to the ultimate consumer even if the manufacturer and consumer are not in privity.⁷¹ An interesting variation on this point arose in *Clarostat Manufacturing, Inc. v. Alcor Aviation, Inc.*⁷² The defendant manufacturer expressly warranted the quality of components that were sold directly to the plaintiff for use in an aviation instrument. The plaintiff also indirectly purchased the defendant's components from a subcontractor who had assembled the defendant's components into instruments sold to the plaintiff. The court held that the plaintiff could recover from the defendant as to these indirectly acquired components because privity was not essential where the defendant made express warranties directly to the plaintiff. The court also noted that the defendant knew of the arrangement between the plaintiff and the plaintiff's subcontractor.⁷³

68. The court of civil appeals stressed broader points of equity and justice not emphasized by the supreme court. 539 S.W.2d 190, 193-95 (Tex. Civ. App.—Beaumont 1976). See 1977 *Annual Survey*, *supra* note 2, at 173.

69. 1977 *Annual Survey*, *supra* note 2, at 174.

70. 557 S.W.2d at 81.

71. See *Henderson v. Ford Motor Co.*, 547 S.W.2d 663, 20 UCC Rep. Serv. 1158 (Tex. Civ. App.—Amarillo 1977, no writ). The court in *Henderson* apparently required privity to permit recovery for economic loss resulting from a breach of an implied warranty, but recognized that the manufacturer might be liable on an express warranty directed to the ultimate consumer. See note 66 *supra*.

72. 544 S.W.2d 788 (Tex. Civ. App.—San Antonio 1976, writ ref'd n.r.e.).

73. *Id.* at 791.

Exclusion or Modification of Warranties. Section 2.316 of the Code validates agreements which exclude or modify warranties.⁷⁴ With careful attention to the wording of the Code, boilerplate language disclaiming all implied warranties may be constructed. Many form contracts now include such boilerplate disclaimers as a matter of course. The contracts in *Henderson v. Ford Motor Co.*⁷⁵ illustrate the effectiveness of this language. The court examined the language of the manufacturer's new car limited warranty ("this warranty is expressly IN LIEU OF any other express or implied warranty . . . including any implied WARRANTY OF MERCHANTABILITY OR FITNESS") and the Motor Vehicle Contract between dealer and consumer ("the described vehicle is purchased AS IS."). The court held that the language of the Motor Vehicle Contract effectively excluded implied warranties under section 2.316(c)(1).⁷⁶ The plaintiff also argued that the limited express warranty had failed in its essential purpose, and, therefore, the plaintiff had the benefit of all the remedy provisions of the Code.⁷⁷ The court dismissed this argument because the plaintiff had not pled and submitted evidence showing a failure of the limitation's essential purpose.⁷⁸

Another successful exclusion of implied warranties by the use of the phrase "as is" arose in *Mid Continent Aircraft Corp. v. Curry County Spraying Service, Inc.*⁷⁹ The court further considered whether this same contract language also effectively excluded liability under a strict liability theory. The seller had sold a used aircraft "as is" to buyer. Soon after the purchase the plane's engine failed while the plane was in flight and the plane was damaged in the crash landing. The buyer sought to recover on strict liability, negligence, and breach of implied warranties theories. The court found the contract language had effectively excluded implied warranties. After a lengthy review of the different functions served by the Code's warranty rules and the strict liability rules developed at common law, the court held that the rule of strict liability applied when a defect in the produce rendered it unreasonably dangerous, even if the product was a used good and the damage was only to the product itself. While conceding that two business entities of equal bargaining power could waive or disclaim potential liability imposed on a seller by the strict liability rule, the court held that an "as is" clause with no reference to potential tort liability was not such a

74. TEX. BUS. & COMM. CODE ANN. § 2.316 (Vernon 1968).

75. 547 S.W.2d 663, 20 UCC Rep. Serv. 1158 (Tex. Civ. App.—Amarillo 1977, no writ).

76. The trial court had concluded that there were no implied warranties between manufacturer and consumer because there was no privity between the parties. The appellate court, therefore, did not consider the effectiveness of the exclusionary language in the manufacturer's warranty document. *Id.* at 667. Presumably the contract clause would be effective because it both mentions "merchantability" and is conspicuous. TEX. BUS. & COMM. CODE ANN. §§ 1.201(10), 2.316(b) (Vernon 1968).

77. 547 S.W.2d at 669; TEX. BUS. & COMM. CODE ANN. § 2.719(b) (Vernon 1968). See generally Anderson, *Failure of Essential Purpose and Essential Failure on Purpose: A Look at Section 2-719 of the Uniform Commercial Code*, 31 Sw. L.J. 759 (1977); Eddy, *On the "Essential" Purposes of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*, 65 CALIF. L. REV. 28 (1977).

78. 547 S.W.2d at 669.

79. 553 S.W.2d 935, 21 UCC Rep. Serv. 1273 (Tex. Civ. App.—Amarillo 1977, writ granted). See 21 Tex. Sup. Ct. J. 144 (Jan. 14, 1978). See also *Keystone Aeronautics Corp. v. R.J. Enstrom Corp.*, 499 F.2d 146 (3d Cir. 1974).

waiver or disclaimer. One judge dissented on the ground that strict liability should not extend to damage to the defective product. The dissenting opinion characterized this loss as a loss from unfulfilled commercial expectations which is better governed by the provisions of the Code.⁸⁰ The scope of the majority's opinion is limited, however, by the nature of the product; a defect in an airplane's engine renders it unreasonably dangerous to the consumer or to his property.⁸¹

Notice of Breach as Prerequisite to Remedy. Section 2.607(c)(1) of the Code requires the buyer who has accepted a good to notify the seller within a reasonable time after he discovers the breach or should have discovered the breach. Failure to notify the seller bars the buyer from any remedy. The notice need not be formal, but should be sufficient "to let the seller know that the transaction is still troublesome."⁸² In effect, the buyer must plead and prove that this notice was given or his action will fail. This requirement was illustrated in *Clarostat Manufacturing, Inc. v. Alcor Aviation, Inc.*⁸³ The plaintiff brought suit to recover damages from the seller for breach of express and implied warranties with respect to component parts used by the plaintiff in an assembled aviation instrument. At trial neither party requested the submission of special issues inquiring whether the plaintiff gave the defendant timely notice of the alleged breach of contract. The appellate court held that the plaintiff had the burden of alleging and proving proper notice and that the defendant had sufficiently called the issue to the attention of the trial court by requesting a determination of when the plaintiff learned of the alleged breach. The court, therefore, reversed judgment for the plaintiff and remanded for a new trial.

Code Warranties and Consumer Legislation. As draftsmen have become more adept at disclaiming warranties and limiting remedies under the Code, pressure from consumer groups for remedial legislation has increased. At the federal level the Magnuson-Moss Act⁸⁴ and the rules issued under it by the Federal Trade Commission regulate the use of warranties.⁸⁵ At the state level there have been a growing number of consumer protection acts adopted. Texas has the Deceptive Trade Practices—Consumer Protection Act which is incorporated into the Business and Commerce Code.⁸⁶ The combination of federal and state regulations can be "explosive"⁸⁷ although the

80. 553 S.W.2d at 942.

81. On motion for rehearing the majority stressed that essential to its holding was the fact that the defect rendered the product unreasonably dangerous to the user or to the consumer or his property. 553 S.W.2d at 943. The court cites RESTATEMENT (SECOND) OF TORTS § 402A (1965) as a codification of the strict liability rule adopted in Texas.

82. TEX. BUS. & COMM. CODE ANN. § 2.607, comment 4 (Vernon 1968).

83. 544 S.W.2d 788 (Tex. Civ. App.—San Antonio 1976, writ ref'd n.r.e.); see note 72 *supra* and accompanying text.

84. 15 U.S.C. §§ 2301-2312 (Supp. V 1975).

85. Commentaries on the federal legislation have proliferated. For a good review of the changes made by the legislation, see Eddy, *Effects of the Magnuson-Moss Act upon Consumer Product Warranties*, 55 N.C.L. REV. 835 (1977).

86. TEX. BUS. & COMM. CODE ANN. §§ 17.41-.63 (Vernon Supp. 1978).

87. See Comment, *Texas Deceptive Trade Practices Act and Magnuson-Moss: An Explosive Combination*, 29 BAYLOR L. REV. 559 (1977).

recent legislative session limited somewhat the effectiveness of the Texas Act. The Texas Act now gives a consumer a statutory remedy for "breach of an express or implied warranty."⁸⁸ Relief includes three times the amount of actual damages plus court costs and reasonable attorney fees,⁸⁹ unless "the defendant proves that he was not given a reasonable opportunity to cure the defects or malfunctions before suit was filed," in which case relief is limited to actual damages plus costs and fees.⁹⁰

Several warranty cases have been brought under the Texas statute. In *Volkswagen of America, Inc. v. Licht*⁹¹ the plaintiff buyer sought to recover under the statute from the importer for breach of an express warranty and from the dealer for breach of its implied warranty. The plaintiff had bought a Volkswagen from the dealer and had received an owner's manual and warranty pamphlet. The car's engine caught fire three weeks later, and the plaintiff brought suit under the statute. On rehearing the appellate court noted that because liability was based on the statute the plaintiff did not have to show that a defect existed at the time the car left the control of the importer. The court affirmed judgment for the buyer against the importer.⁹²

In *Trial v. McCoy*⁹³ the appellate court assumed without specific citation to the Deceptive Trade Practices—Consumer Protection Act that a breach of a warranty of title provided by section 2.312 of the Code would also be a violation of the Act.

D. Remedies

Rejection and Revocation of Acceptance. A number of changes to pre-Code law made by the Uniform Commercial Code are directed at terminology rather than underlying concepts. The Code's provisions on "rejection" and "revocation of acceptance" are good examples of this point.⁹⁴ A buyer may "reject" a good delivered or tendered under the contract if it fails "in any respect" to conform to the contract.⁹⁵ Once a buyer accepts the goods⁹⁶

88. TEX. BUS. & COMM. CODE ANN. § 17.50(a)(2) (Vernon Supp. 1978). The definition of "consumer" presumably includes a "merchant" as defined by the Uniform Commercial Code. *Id.* §§ 2.104, 17.45(4) (Vernon 1968). The *Trial* case casts a doubt on this interpretation. *Trial v. McCoy*, 553 S.W.2d 199, 201-02 (Tex. Civ. App.—El Paso 1977, no writ). See note 64 *supra*. The definition of "merchant" (anyone who is not a consumer) in § 17.45 was deleted by the 1977 amendments.

89. TEX. BUS. & COMM. CODE ANN. § 17.50(b)(1) (Vernon Supp. 1978). The Texas Supreme Court recently held that treble damages under this section are mandatory. *Woods v. Littleton*, 554 S.W.2d 662, 668-69 (Tex. 1977), noted in 15 HOUS. L. REV. 212 (1977).

90. TEX. BUS. & COMM. CODE ANN. § 17.50A (Vernon Supp. 1978).

91. 544 S.W.2d 442 (Tex. Civ. App.—El Paso 1976, no writ). The statutory recovery by buyer was in addition to the reimbursement buyer received from his automobile insurance carrier for the cost of repairs. *Id.* at 444.

92. The court also concluded that, in the absence of a statutory provision or a finding of negligence on the part of the importer, the importer would not be ordered to indemnify the dealer. For a new statutory provision on indemnification see TEX. BUS. & COMM. CODE ANN. § 17.55A (Vernon Supp. 1978).

93. 553 S.W.2d 199, 22 UCC Rep. Serv. 48 (Tex. Civ. App.—El Paso 1977, no writ); see notes 63-64, 87 *supra* and accompanying text.

94. See generally Whaley, *Tender, Acceptance, Rejection and Revocation—The UCC's "TARR"-Baby*, 24 DRAKE L. REV. 52 (1974); Comment, *Substantial Performance: The Real Alternative to Perfect Tender Under the U.C.C.*, 12 HOUS. L. REV. 437 (1975).

95. TEX. BUS. & COMM. CODE ANN. § 2.601 (Vernon 1968).

96. *Id.* § 2.606.

he may "revoke his acceptance" only if the non-conformity "substantially impairs its value to him."⁹⁷ The Code avoids using the term "rescission" which caused confusion in pre-Code law.⁹⁸

While few changes have been made in pre-Code law in the area of rejection and revocation of acceptance, failure to use Code language in litigation frequently leads to confusion. In *Explorers Motor Home Corp. v. Aldridge*⁹⁹ the plaintiff buyers of a mobile home sought restitution from the seller and the manufacturer on the ground that the mobile home was unfit for the purpose for which it was designed and sold. The plaintiffs had used the home for almost two years, and they did not tender return of the home to the defendants. The trial court quashed the citation against the seller, but rendered judgment for plaintiffs against the manufacturer. On appeal the Beaumont court disregarded the objection that there was no privity between the parties¹⁰⁰ and focused on the relief sought. In the context of distinction in contract law between restitution and damages, the court examined the relevant Code provisions. The court found that as a matter of law¹⁰¹ the plaintiffs had accepted the mobile home by using the home for almost two years and failing to give notice of rejection within a reasonable time after taking delivery of the home.¹⁰² Without discussing the possibility that the plaintiffs might still have revoked their acceptance,¹⁰³ the court then examined the rules on recovery of damages and held that because the buyer was entitled to recover the purchase price there must be a reduction in this amount by the value of any benefit derived by the buyer from the good. Since the evidence did not support a finding that the plaintiffs derived no benefit at all, the court remanded the case for further consideration of this point. The court also noted that the trial court had failed to consider the unjust enrichment which would result from allowing the plaintiffs to retain the mobile home while receiving the return of the purchase price.¹⁰⁴

It is difficult to place the court's opinion in *Explorers Motor Home* within the framework of Code remedies. Under the Code a plaintiff has a choice between revoking acceptance and recovering the price paid plus damages,¹⁰⁵ or keeping the motor home and collecting damages.¹⁰⁶ To revoke acceptance, however, a plaintiff must comply with all the prerequisites of section 2.608, which include the plaintiff's showing that the non-conformity sub-

97. *Id.* § 2.608.

98. *Id.* § 2.608, comment 1.

99. 541 S.W.2d 851, 20 UCC Rep. Serv. 87 (Tex. Civ. App.—Beaumont 1976, writ ref'd n.r.e.).

100. The court cited its decision in *Nobility Homes* on this point. The Texas Supreme Court has since affirmed the decision of the Beaumont court in *Nobility*. See notes 65-72 *supra* and accompanying text.

101. Although the question of whether notice of rejection was given within a reasonable time is normally a question of fact, on the facts in this case the court found that reasonable minds could not differ. 541 S.W.2d at 854.

102. TEX. BUS. & COMM. CODE ANN. § 2.602(a) (Vernon 1968). The court does not cite or discuss § 2.606 which sets out the acts which constitute acceptance under the Code. *Id.* § 2.606.

103. *Id.* § 2.608.

104. In a colorful dissent Justice Keith agreed that the majority's exposition of the Code was correct, but he argued that the record before the court conclusively established that plaintiffs could not recover. 541 S.W.2d at 855.

105. TEX. BUS. & COMM. CODE ANN. §§ 2.608, .711(a) (Vernon 1968).

106. *Id.* §§ 2.714, .715.

stantially impaired its value to him, that revocation was timely, and that notice of revocation was given. Unless the motor home is worthless, the plaintiff must tender the home back to the defendants.¹⁰⁷ If a plaintiff wishes to keep the home, he could recover the difference between the value of the home as accepted and its value as warranted, plus any incidental or consequential damages.

Anticipatory Repudiation. Before a contract has been performed, one of the parties may indicate that he will not carry out his contractual duties. While section 2.610 of the Code governs this "anticipatory repudiation" generally,¹⁰⁸ several questions are left unresolved. For example, the Code does not define what acts constitute repudiation;¹⁰⁹ furthermore, the time when damages for repudiation are to be measured remains problematic under the present Code language.¹¹⁰

Several recent Texas cases considered the problem of anticipatory repudiation. In *Jon-T-Farms, Inc. v. Goodpasture, Inc.*¹¹¹ the plaintiff sought to recover damages for the defendant's breach of a contract to sell grain to plaintiff. At the end of the period for delivery specified in the contract the defendant had delivered less than half the grain agreed upon. Pursuant to the contract terms the plaintiff extended the time for delivery. In a letter sent soon after the original time period elapsed, the defendant announced that the original contract had expired and offered to extend the contract at slightly more than a twenty percent "upcharge." The appellate court upheld a jury finding that the letter constituted a repudiation under section 2.610 of the Code.¹¹² The court further found that the plaintiff's actions, including the acceptance of several late car loads of grain and the suspension of payment, did not constitute a waiver of repudiation because the acts were authorized by section 2.610.¹¹³ Failure to reserve formally rights under section 1.207 of the Code was not relevant because the court held that this statutory provision is permissive rather than mandatory.

The time when damages are to be measured in cases of anticipatory repudiation by the buyer was at issue in *Harris v. Gunner*.¹¹⁴ The sellers in that case sought to recover damages from the buyer for the anticipatory repudiation of a contract to purchase two heifers a year, for three years.

107. *Id.* § 2.608(b). See also *id.* § 2.608, comment 6.

108. *Id.* § 2.610.

109. *But see id.* § 2.609(d) (failure to provide adequate assurance of performance constitutes repudiation).

110. See Comment, *Anticipatory Repudiation Under the Uniform Commercial Code: Interpretation, Analysis, and Problems*, 30 Sw. L.J. 601 (1976).

111. 554 S.W.2d 743, 21 UCC Rep. Serv. 1309 (Tex. Civ. App.—Amarillo 1977, no writ).

112. The appellate court approved the submission of the following special issue as within the discretion of the trial court: "Did Jon-T Farms, Inc., breach and/or repudiate Contract No. 16,811 (\$2.70)? (Answer 'Yes' or 'No')." *Id.* at 750. Compare this special issue with the special issues in *Harris v. Gunner*, 545 S.W.2d 856, 859-60, 21 UCC Rep. Serv. 1055 (Tex. Civ. App.—Fort Worth 1976, no writ).

113. Throughout the opinion the court relied heavily on the comments to the Code. The court, for example, rejected the applicability of § 2.612(c). The court cited comment 6 to § 2.612 to show that plaintiff had not reinstated the "installment contract." 554 S.W. 2d at 746.

114. 545 S.W.2d 856, 21 UCC Rep. Serv. 1055 (Tex. Civ. App.—Fort Worth 1976, no writ).

After taking the first two heifers the buyer repudiated the contract.¹¹⁵ The appellate court noted that the pre-Code measure of damages for anticipatory repudiation was the difference between the contract price and the market value of the good at the time of the breach. The court concluded that section 2.708 of the Code did not necessarily foreclose use of this former measure of damages, but in any case the Code granted a seller the option to await performance and measure damages at that later time.¹¹⁶ The appellate court thus affirmed the judgment for the plaintiffs based on this Code formula.

In *Tennell v. Esteve Cotton Co.*¹¹⁷ the defendant cotton grower argued that as a matter of law failure of the original buyer to give the defendant notice of the assignment of the contract was a repudiation by the buyer which entitled the defendant to suspend performance. The appellate court held that there was no repudiation because the defendant had failed to demand assurance from the assignee.¹¹⁸

Recovery of Damages by Buyer. Section 2.711 of the Code summarizes the buyer's remedies for specific forms of contract breach in situations in which the buyer ends up without the goods. In addition to the power to cancel and to recover any part of the price already paid, a buyer may recover damages under two separate damage measures: cover less contract price or market price less contract price.¹¹⁹ If a buyer has accepted the goods but the seller has breached a warranty, then the buyer may recover damages measured by the difference between the value of the goods accepted and their value had they been as warranted, as well as any incidental and consequential damages.¹²⁰

Although the text of the Code does not so state, an Official Comment to section 2.713 suggests that the market less contract price damage formula "applies only when and to the extent that the buyer has not covered."¹²¹ Several recent Texas cases examined the relation between the two damage formulas. In *Jon-T-Farms, Inc. v. Goodpasture, Inc.*¹²² the defendant ar-

115. The bulk of the appellate court's opinion dealt with the consequences of plaintiffs' failure to submit the complete "cluster of ideas" necessary to prove anticipatory repudiation. *Id.* at 859-61. The statement of facts is ambiguous in several respects. It is unclear, for example, whether or not seller made a written demand for assurances which would comply with § 2.609 of the Code.

116. *Id.* at 858-59; see TEX. BUS. & COMM. CODE ANN. § 2.723(a) (Vernon 1968) (rule for determining market price where action for anticipatory repudiation brought before time for performance).

117. 546 S.W.2d 346, 21 UCC Rep. Serv. 978 (Tex. Civ. App.—Amarillo 1976, writ ref'd n.r.e.).

118. *Id.* at 354 n.4. TEX. BUS. & COMM. CODE ANN. §§ 2.210(e), .609(a), .609(d), .610 (Vernon 1968).

119. TEX. BUS. & COMM. CODE ANN. §§ 2.711-.713 (Vernon 1968). Trial courts occasionally render judgment based on jury findings which do not conform with the Code formulas. The appellate court in *Wilson v. Hays*, 544 S.W.2d 833, 21 UCC Rep. Serv. 522 (Tex. Civ. App.—Waco 1976, writ ref'd n.r.e.), for example, had to recalculate plaintiff's recovery in light of the buyer remedy provisions of the Code.

120. TEX. BUS. & COMM. CODE ANN. § 2.714 (Vernon 1968).

121. *Id.* § 2.713, comment 5; cf. *id.* § 2.703, comment 1 (rejection of doctrine of election of remedies with respect to seller). Imprecise pleading or argument may further confuse the picture in a particular case. See *Cooper v. Kruse-Reed, Inc.*, 554 S.W.2d 45, 48, 22 UCC Rep. Serv. 683 (Tex. Civ. App.—Amarillo 1977, no writ). The *Cooper* case also suggests the difficulty of determining whether a purchase is a proper substitute to constitute "cover." 554 S.W.2d at 48-49.

122. 554 S.W.2d 743, 21 UCC Rep. Serv. 1309 (Tex. Civ. App.—Amarillo 1977, no writ).

gued that the plaintiff had covered in accordance with section 2.712 and, therefore, was precluded from recovering under the damage measure of section 2.713, the difference between market and contract price, on which the plaintiff and the trial court had relied. The appellate court held that on the seller's breach the buyer was free to choose the measure of damages. The court further found that there was no evidence of specific purchases by the plaintiff as a cover for the defendant's breach. By implication the court suggested that if there had been evidence of a specific purchase to cover, such cover would have constituted an election to recover under section 2.712. The seller's burden to produce evidence of cover by the buyer would have been very heavy because the subject matter of the contract was grain, a fungible commodity, and the needs of the buyer presumably remained the same whether or not the seller breached. The court apparently would have required the seller to show a contract made by the buyer soon after breach for exactly the same amount that remained undelivered by the seller or some other equally unequivocal evidence of cover.¹²³

Noting that pleadings which referred to both cover and market price were not a model of correctness with respect to damages, the appellate court in *Tennell v. Esteve Cotton Co.*¹²⁴ held that the plaintiff was not required to allege the applicable measure of damages and that evidence was properly admitted in the absence of any objections by defendant. The court, therefore, affirmed judgment for damages based on the market price on the date the plaintiff learned that the defendant would not perform. In effect the court held that the plaintiff could have recovered under either section 2.712 or section 2.713, whether or not the plaintiff-buyer had actually covered.

Whether the buyer was precluded from recovering damages for breach of warranty because of the buyer's contributory negligence was at issue in *Signal Oil & Gas Co. v. Universal Oil Products.*¹²⁵ The plaintiff sought to recover for damages caused by the rupture of a heater in an isomax unit in an oil refinery. The buyer brought causes of action against the supplier of the unit and its subcontractors based on negligence, strict liability, and warranty theories. Regarding the warranty claim the jury found the units were not reasonably suited for their intended use and that the unsuitability was a proximate cause of the rupture. The jury failed to find, however, that the defective condition of the unit was a producing cause of the tube rupture which had led to the property damage for which the plaintiff sought recovery. The appellate court ruled that because the plaintiff failed to heed the warnings by the defendants of the risks of continuing to use the unit, there

123. The court in *Jon-T-Farms* also held that defendant should bear the extra expenses incurred when plaintiff had to transport grain in its own trucks because railroad cars were in short supply. The contract provided "FOB West Texas TEP Area." The court found that the extra expenses would not have occurred had defendant performed, and that defendant, under the contract, would have had to bear the expense of transporting the grain from its elevator to a railhead for loading. *Id.* at 751-52.

124. 546 S.W.2d 346, 21 UCC Rep. Serv. 978 (Tex. Civ. App.—Amarillo 1976, writ ref'd n.r.e.).

125. 545 S.W.2d 907, 21 UCC Rep. Serv. 470 (Tex. Civ. App.—Beaumont 1977, writ granted).

could be no proximate cause of the consequential damages as required by section 2.715 of the Code.

Remedies Outside the Code Framework. Attorneys faced with sales transactions should not overlook possible remedies available under general legal or equitable principles which apply to commercial transactions by virtue of section 1.103 of the Code.¹²⁶ Common examples include rescission for misrepresentation or mutual mistake of a material fact. In *Plains Cotton Cooperative Association v. Wolf*,¹²⁷ for example, the plaintiff-sellers of cotton sought rescission of contracts on the ground of mutual mistake. Agents of the defendant¹²⁸ stated that the plaintiffs were contractually bound by the oral negotiations and that the plaintiffs could withdraw from the contract by giving written notice at least thirty days before harvesting. Relying on these representations, the plaintiffs signed written agreements without reading them. When the plaintiffs later tried to withdraw the defendant insisted on delivery, and the plaintiffs brought suit to rescind. The appellate court held that the plaintiffs' negligence, if any, would not bar equitable relief in a suit for rescission based on a mutual mistake theory or in a suit in which the plaintiffs had executed a contract in reliance on a false representation made by the defendant.

E. Miscellaneous Sales Transactions

Consignment Sales. Tucked in the interstices of Articles 2 and 9 are rules regulating the consignment transaction.¹²⁹ Several Texas cases last year considered the application of these provisions. The appellate court in *Bufkor, Inc. v. Star Jewelry Co.*¹³⁰ had to resolve competing claims between a consignor and a creditor of the consignee to jewelry in the hands of the consignee. The creditor had levied execution on the jewelry, and the consignor brought an action to try the creditor's right to the property.¹³¹ The court held that the consignment was a "sale or return" governed by section 2.326 of the Code so that the consignor did not have title or right to possession. The court held that the consignor, having no title to or right of possession in the jewelry, was not entitled to proceed under the procedure for the trial of right to property. On the merits the decision is consistent with the substantive rule that "goods held on sale or return are subject to such claims [of the consignee's creditors] while in the buyer's possession."¹³² The Code says nothing, however, about who has title or who has the right to possession in a consignment arrangement, although traditionally the consignment transac-

126. For commentaries on § 1.103 of the Code, see articles cited in note 7 *supra*.

127. 553 S.W.2d 800 (Tex. Civ. App.—Amarillo 1977, no writ).

128. The issue of the authority of defendants' agents to make these representations was resolved in favor of plaintiffs. The agents believed the representations; thus, there was a "mutual" mistake as to the present legal effect of the parties' relationship. *Id.* at 804-06.

129. See generally Winship, *supra* note 18.

130. 552 S.W.2d 522, 22 UCC Rep. Serv. 388 (Tex. Civ. App.—Beaumont 1977, writ ref'd n.r.e.). See also *Ada Oil Co. v. Dunlop Tire & Rubber Corp.*, 550 S.W.2d 129, 132 (Tex. Civ. App.—Eastland 1977, no writ) (consignee bears risk of loss when received delivery of goods on consignment).

131. TEX. R. CIV. P. 717-736.

132. TEX. BUS. & COMM. CODE ANN. § 2.326(b) (Vernon 1968).

tion has been a principal-agent relationship in which the consignor retained title. If the consignor cannot proceed to try the question of the right to property, it is difficult to see how the consignor's interests may be protected in a proper case. For example, the consignor should be protected where the consignee is "generally known by his creditors to be substantially engaged in selling the goods of others."¹³³

III. NEGOTIABLE INSTRUMENTS

A. *Rights of a Holder*

All transferees of negotiable instruments want the status of holders in due course who take an instrument free from virtually all defenses of any party to the instrument. To reach this status the transferee must be a "holder" by having the instrument transferred to him by "negotiation." Several permutations on this basic theme were discussed in *Estrada v. River Oaks Bank & Trust Co.*¹³⁴ In this case the bank made a loan to the debtor and took his note secured by a collateral assignment of four unindorsed promissory notes executed by the maker payable to the order of the debtor. On default by the debtor¹³⁵ the bank sued on the debtor's note and on the maker's notes. The maker denied the bank's status as a holder in due course and asserted a complete offset by virtue of an unsatisfied judgment which the maker had against the debtor. The trial court granted the bank's motion for summary judgment against the maker, and the maker appealed. The appellate court held that the bank was not a holder in due course because the notes had not been indorsed to the bank by the debtor-payee. Indorsement was necessary because an instrument payable to order is negotiated by delivery along with any necessary indorsement; without a proper negotiation the bank could not qualify as a holder of the instrument. The court rejected the bank's argument that the collateral assignment was an effective indorsement under section 3.202(b) of the Code because there was only one assignment for the four notes transferred. Nor did the court accept the suggestion that the indorsement was incorporated by reference from the attached collateral assignment under section 3.119 of the Code. Citing out-of-state decisions, the court noted that reference to collateral instruments in order to determine proper indorsements would impede the use of negotiable instruments as a medium of exchange in commerce. The court held that, unless the bank could show that the debtor-payee was a holder in due course,¹³⁶ the bank

133. *Id.* § 2.326(c)(2) (Vernon Supp. 1978). Note also that the consignor may protect his interest in the goods by filing under art. 9. *Id.* §§ 2.326(c)(3), 9.114, .408.

134. 550 S.W.2d 719, 22 UCC Rep. Serv 83 (Tex. Civ. App.—Houston [14th Dist.] 1977, writ ref'd n.r.e.). For a student case note on this decision see Note, *Commercial Paper—Negotiable Instruments—Signature on Single Collateral Assignment Does Not Serve as Indorsement on Series of Promissory Notes*, 9 ST. MARY'S L. J. 323 (1977). See also UCC L. LETTER, Feb. 1978, at 4-5.

135. The court remarked that the debtor's original note had been renewed but made no mention of whether the renewal released the security. See *Bank of Austin v. Barnett*, 549 S.W.2d 428 (Tex. Civ. App.—Austin 1977, no writ), discussed in note 153 *infra* and accompanying text.

136. A payee may be a holder in due course under the Code. TEX. BUS. & COMM. CODE ANN. § 3.302(b) (Vernon 1968).

could proceed only as an assignee of the notes subject to all defenses and equities to which the notes were subject in the hands of the debtor-payee. The appellate court, therefore, remanded the case for further proceedings.¹³⁷

The defenses available against a holder in due course were the subject of *Lucas v. Whitely*.¹³⁸ The plaintiffs, holders of a note, sought to enforce the note against the estate of a co-maker who was found by the jury to have been mentally incompetent at the time his name was signed on the note pursuant to a special power of attorney. Although the plaintiffs had acted in good faith and had given valuable consideration in exchange for the note, the appellate court reversed a judgment in their favor. The court found conclusive the two jury findings that the decedent had been mentally incompetent at the time he signed the special power of attorney, and that the plaintiffs had "dealt" with the decedent through his agent. Having dealt with the decedent, the plaintiffs, even if holders in due course, did not take the note free from the defense of incapacity under section 3.305(b) of the Code.¹³⁹ The note was, therefore, voidable at the election of the decedent or his representative. The court also noted that article 5561a of the Texas Revised Civil Statutes¹⁴⁰ did not apply because the decedent had not received the consideration advanced by the plaintiffs and therefore had nothing to restore to them.

B. *Liability of Parties*

Accommodation Parties. After the excitement of the *Bohart*¹⁴¹ decision in last year's survey period, this year has been relatively calm, although the *Bohart* decision has had continuing impact. In *V.I.P. Commercial Contractors v. Alkas*¹⁴² an individual co-signatory of a note, which provided on its face for interest of twelve percent per annum, raised for the first time on appeal the question of whether summary judgment was proper on the note which was allegedly usurious on its face. The court of civil appeals assumed as true appellee's undenied sworn statement that the appellant co-maker had acted as a surety or guarantor of the note on an obligation owed by his corporation. Citing the language of article 1302—2.09 of the Texas Miscel-

137. The court also held that the offset claimed by the maker of the note was not sufficiently proved, leaving a material fact issue in dispute. The claimed offset was based on a judgment for the maker against debtor-payee. The court suggested that the maker might not have been an accommodation party to the notes on which the maker recovered judgment and that the plaintiff bank in *Estrada* should have been permitted to inquire into this matter. 550 S.W.2d at 729. Because the maker had already obtained a judgment against the debtor-payee, it is difficult to see how the bank could defeat this judgment.

138. 550 S.W.2d 767, 22 UCC Rep. Serv. 95 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.), noted in UCC L. LETTER, Feb. 1978, at 5-6.

139. Because plaintiffs had dealt with the decedent, the court mentioned but did not decide whether the defense of incapacity was cut off under § 3.305 of the Code. 550 S.W.2d at 769. Since under pre-Code law incapacity made the note voidable rather than void, the defense of incapacity should be ineffective against a holder in due course who has not dealt with the incapacitated party. See TEX. BUS. & COMM. CODE ANN. § 3.305(b)(2) (Vernon 1968).

140. TEX. REV. CIV. STAT. ANN. art. 5561a (Vernon Supp. 1978).

141. *Universal Metals & Mach., Inc. v. Bohart*, 539 S.W.2d 874 (Tex. 1976). See 1977 *Annual Survey*, *supra* note 2, at 179-82.

142. 553 S.W.2d 656 (Tex. Civ. App.—San Antonio 1977, no writ).

laneous Corporations Act¹⁴³ and the recent *Bohart* decision, the court held that as a guarantor or accommodation maker the appellant could not assert the defense of usury even though he was an individual and was primarily liable on the note.

In *Willmon v. Sigma Steel Inc.*¹⁴⁴ the guarantor of a note sought to enforce it against an accommodation maker. After the co-makers had defaulted on the note, the guarantor paid the note and had it transferred to him. Working without a statement of facts indicating the nature of the guaranty agreement, the appellate court affirmed a judgment for the guarantor for the full amount of the note, ruling that the doctrine of contribution did not apply between a guarantor of an obligation for which a note is given and an accommodation co-maker of the note.

Conversion. In *Allen v. Alison Mortgage Investment Trust*¹⁴⁵ a check issued to two corporate payees jointly had been endorsed with the typed names of both corporations and the signature of the president of the second payee. The check had been deposited in the second payee's bank account and immediately withdrawn by the president for his personal benefit. The two payees brought suit for conversion against the president, the depository bank, and the drawer of the check. The appellate court reviewed the lower court's decision overruling the president's plea of privilege. The court held that there was adequate evidence that both the president and the bank had converted the check under sections 3.116(2) and 3.419(a)(3) of the Code. The court, therefore, ruled that venue was proper in the county of the defendant bank's residence under subdivisions 4 and 9 of article 1995.¹⁴⁶

Impostor Rule. In *Fair Park National Bank v. Southwestern Investment Co.*¹⁴⁷ the drawer of a draft delivered it to a person posing as one of the two payees. A third person presented the draft to a collecting bank with the purported endorsements in blank of both payees. After forwarding the draft for payment, the collecting bank delivered a cashier's check drawn on itself to the person presenting the draft. The drawer sued the collecting bank, among others, for breach of warranty and negligence. With respect to the alleged breach of warranty the court found that the indorsements were effective under the impostor rule of section 3.405(a)(1) of the Code.¹⁴⁸ The drawer claimed that the impostor rule did not apply because there were two payees, and only one impostor had induced it to transfer the draft. The court held that there was sufficient evidence to support the jury's finding that there had been two impostors, and that the rule applied even though the second impostor had not met the drawer face to face. The court went on to

143. TEX. REV. CIV. STAT. ANN. art. 1302—2.09 (Vernon Supp. 1978).

144. 551 S.W.2d 142 (Tex. Civ. App.—Fort Worth 1977, no writ).

145. 548 S.W.2d 783 (Tex. Civ. App.—San Antonio 1977, no writ).

146. TEX. REV. CIV. STAT. ANN. arts. 1995(4), (9) (Vernon 1964).

147. 541 S.W.2d 266, 20 UCC Rep. Serv. 454 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.).

148. This section provides that an indorsement by an imposter of a named payee is effective if the imposter has induced the maker or drawer to issue the instrument to him or his confederate in the name of the payee. TEX. BUS. & COMM. CODE ANN. § 3.405(a)(1) (Vernon 1968).

indicate, however, that even if the second payee, who had not approached the drawer, had been legitimate, the indorsements would still have been effective under section 3.405(a)(1): "We interpret this language to mean that if an instrument is payable to A and B, and X, by impersonating A, induces the drawer to deliver the instrument to him, then X, or anyone else, can make effective endorsements in the names of both A and B."¹⁴⁹ The court stressed that its interpretation is consistent with the policy of the imposter rule which is to throw the loss on the person who first dealt with the impostor and who presumably had the best opportunity to detect the fraud.

As to the claim of negligence against the collecting bank in *Fair Park*, the court rejected the drawer's contention on two grounds. First, section 3.405(a)(1) makes all indorsements in the name of the payee effective so that acceptance and payment of the draft is final under section 3.418 of the Code. The collecting bank can have no more liability for negligence than for breach of warranty.¹⁵⁰ The court also noted that section 3.405 does not impose liability for failure to use ordinary care whereas closely related sections, particularly sections 3.406 and 4.406, do explicitly impose liability for negligence. The court concluded from the absence of this language in section 3.405 that negligence on the part of the collecting bank was irrelevant.¹⁵¹

Unauthorized Completion. Section 3.115 of the Code states that if an instrument is incomplete in any necessary respect it cannot be enforced until completed, but when it is completed in accordance with authority given it is effective as completed. The burden of establishing that completion was unauthorized is on the party so asserting. In *Antrim v. McMurrey*¹⁵² the co-makers of a note defended an action brought to enforce the note with the argument that the note was incomplete when signed and completed without authority. The court held that although the Code did not specifically authorize a transferee to complete an incomplete instrument, the same result was reached by placing the burden of proof on the party asserting that completion was unauthorized. The court concluded that the co-makers had not produced evidence that the payee lacked authorization to complete the blanks and reversed a judgment for the co-makers.

C. Discharge

The holder of an instrument may discharge any party to the instrument by cancellation. Frequently a holder will cancel an instrument when renewing or consolidating obligations which will be represented by a new instrument. In *Bank of Austin v. Barnett*¹⁵³ the debtor argued that a cancellation which had taken place under such circumstances discharged him under section 3.605 of the Code and therefore released the personal property securing the

149. 541 S.W.2d at 269.

150. *Id.* at 270.

151. *Id.* at 270-71.

152. 549 S.W.2d 463, 21 UCC Rep. Serv. 1091 (Tex. Civ. App.—Austin 1977, no writ), *noted in* UCC L. LETTER, Dec. 1977, at 2-3; *cf.* First Nat'l Bank v. Walker, 544 S.W.2d 778, 784-85. (Tex. Civ. App.—Dallas 1976, no writ) (completion of incomplete non-negotiable instrument).

153. 549 S.W.2d 428, 21 UCC Rep. Serv. 1127 (Tex. Civ. App.—Austin 1977, no writ).

indebtedness. The secured party had financed the debtor's purchase of paintings over a number of years. The debtor signed notes and granted the bank security interests in the pictures. In a complicated series of transactions the notes were renewed and combined, and the cancelled notes were returned to the debtor. A new security agreement was not always signed on renewal although a description of the collateral was listed in or attached to the renewal note. The debtor argued that the return of the cancelled notes had released the original indebtedness and the collateral securing that indebtedness. The court held that section 3.605 of the Code did not alter the rule that the renewal note merely evidenced a new promise with respect to the original indebtedness. The original collateral would, therefore, continue to secure the indebtedness unless the parties intended to release the collateral. The court found insufficient the evidence that the bank intended to release the security, and judgment for the debtor was reversed.

Unless the parties otherwise agree, a party who accepts an instrument as payment for an underlying obligation has the obligation suspended until the instrument is due. If the instrument is dishonored, the holder may then maintain an action on either the instrument or on the "revived" underlying obligation.¹⁵⁴ Several recent cases considered this basic principle. In *Stone Fort National Bank v. Elliott Electric Supply Co.*¹⁵⁵ the court considered whether the receipt of a note made by third parties reduced the amount owed by the transferor of the note to the transferee. The court held that the mere transfer of the note did not constitute absolute payment in the absence of any evidence that the parties had agreed otherwise, and evidence that the transferee had brought an action to enforce the note implied that it had been dishonored. On dishonor the underlying obligation had revived under section 3.802, and until the amount of the note was actually collected in the action against the maker the underlying obligation was still outstanding.

In *Kaiser v. Northwest Shopping Center, Inc.*¹⁵⁶ the defendant argued that his obligation to pay rent had been discharged by the landlord's retention of the rent checks for an unreasonable period of time before presenting them for payment. The Dallas court of civil appeals held that under sections 3.601 and 3.802 of the Code retention of the check did not discharge either the check or the underlying obligation. The court distinguished cases which held that when the payee retains a check tendered in full payment of a disputed claim the payee is deemed to have "accepted" the amount in settlement and is barred from recovering the alleged balance due. The court suggested that acceptance as used in those cases means the creditor treats the check as cash. The court went on to indicate that although instruments should be presented for payment within the time limits set out in section 3.503, that section does not provide for a discharge if presentment is delayed. An unexcused delay will discharge the drawer of the instrument only if the drawee has become insolvent in the interim.

154. TEX. BUS. & COMM. CODE ANN. § 3.802(a)(2) (Vernon 1968).

155. 548 S.W.2d 441 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.).

156. 544 S.W.2d 785, 21 UCC Rep. Serv. 180 (Tex. Civ. App.—Dallas 1976, no writ).

D. *Miscellaneous Decisions*

Banking Cases. In *Gulf Coast State Bank v. Emenhiser*¹⁵⁷ a sight draft had been presented to the plaintiff bank for collection by an alleged agent of the defendants. The bank advanced funds but the draft was subsequently dishonored because of the insolvency of the drawee. The plaintiff then sought to hold the defendant drawers on the draft, but the defendants denied that the purported agent had any authority. After a trial by jury the trial court rendered a take nothing judgment against the plaintiff bank. The appellate court affirmed, and the supreme court has granted a writ of error. The plaintiff alleged on appeal that the trial court erred when it refused to allow the plaintiff to introduce evidence showing that the plaintiff had acted in compliance with the local custom of advancing cash on sight drafts. The plaintiff argued that the defendants, whether or not they knew of the custom, must be held to have agreed to be governed by the custom. The appellate court held that the plaintiff's pleadings were inadequate because there was no allegation that the plaintiff's custom was to treat all sight drafts in the same manner as defendants' draft had been treated, and there was no allegation that the defendants had known of the custom. The court also held that the plaintiff had failed to carry its burden of proving the authority of the agent.

The bank's right of set off was the subject of *Sears v. Continental Bank & Trust Co.*¹⁵⁸ The plaintiff sued his bank to recover money from his general account after the bank had set off against this account a note on which he was a co-maker. The court of civil appeals commented that the note was not in evidence and held that there was no evidence produced or offered which would show that the plaintiff suffered damage because of the bank's actions. The Supreme Court reversed in an unpublished opinion.

In *South Central Livestock Dealers, Inc. v. Security State Bank*¹⁵⁹ the creditor bank did not fare so well. The appellant cattle investors appealed a directed verdict for the appellee bank in an action against the bank for wrongful offset and tortious interference with contractual relations. The Fifth Circuit reversed and remanded, finding some evidence that the investors had been in a principal-agent relationship with the feedlot which was the customer of the defendant bank, and some evidence that the bank had known the feedlot's bank account equitably belonged to third parties even though the parties had not established a "special account."¹⁶⁰ The court found Texas precedent for the proposition that if a bank knows that a depositor holds funds in a fiduciary capacity in an account in his own name, then the bank may not offset these funds against the individual indebtedness of the depositor. The court also found some evidence that the feedlot was solvent when the defendant bank acted, mandating a reconsideration of the

157. 544 S.W.2d 722 (Tex. Civ. App.—Tyler 1976, writ granted).

158. 553 S.W.2d 394 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ).

159. 551 F.2d 1346, 21 UCC Rep. Serv. 834 (5th Cir. 1977).

160. To establish a special account the bank must agree to hold and distribute funds according to the agreement between the parties. Defendant bank in the *South Central Livestock Dealers* case did not so agree. *Id.* at 1349.

claim that the bank's action tortiously interfered with the feedlot's relations with its customers.

Instruments Payable to Two or More Persons. Section 3.116 of the Code sets out a rule for negotiation, discharge, or enforcement of an instrument payable to the order of two or more persons. The interplay of this rule with a bank's authority under section 4.205 of the Code to supply the missing indorsement of a customer is illustrated by the recent case of *Leinert v. Sabine National Bank*.¹⁶¹ In the *Leinert* case a cashier's check was issued to "Defendant Bank and A or B." The check was deposited in an account with the defendant bank on which A or C were authorized to make withdrawals. The check was indorsed before deposit in the account with only the regular stamped indorsement of the defendant bank. C then withdrew the amount of the cashier's check and deposited the sum in another account. The executor of A's estate brought an action against the defendant bank for loss of the proceeds. The Beaumont court of civil appeals concluded that the defendant bank had acted legally, if not commendably, when it deposited the check and allowed a joint owner of the account to withdraw the deposit. The check could be negotiated either by "Defendant Bank and A" or by "B."¹⁶² The defendant bank indorsed the check and it could supply the indorsement of its customer, A.¹⁶³ Withdrawal from the account by a joint owner (C) is also authorized.¹⁶⁴ The net result is no liability for the defendant bank.

Statute of Limitations. In *Allied Chemical Corp. v. Koonce*¹⁶⁵ the assignee of a demand note sought to enforce it against the maker. The petition showed on its face that more than four years had run before suit was brought and the maker pleaded the four-year statute of limitations.¹⁶⁶ The plaintiff produced correspondence signed by the maker and addressed to the plaintiff which acknowledged the existence of a debt and a promise to pay. The plaintiff argued alternatively that the correspondence represented a waiver of the statute of limitations, or it estopped defendant from asserting the statute. The plaintiff, in other words, did not argue that its action was on a new promise but relied on the old one represented by the note. The court held that the claim should have been based on the new promise. Furthermore, there was no allegation that the plaintiff was the owner of the debt at the time of the correspondence. The appellate court held that for an acknowledgement to be effective it must be made to or for the benefit of the party to whom the debt is then due.

In *Bacher v. Maddux*¹⁶⁷ the maker of an installment note defended an action to enforce the note by raising the defense of the statute of limitations.

161. 541 S.W.2d 872, 20 UCC Rep. Serv. 414 (Tex. Civ. App.—Beaumont 1976, writ ref'd n.r.e.). An editorial note to the report in the UCC Reporting Service suggests the Beaumont court's construction of 3.116 of the Code is unreasonable. 20 UCC Rep. Serv. at 415.

162. TEX. BUS. & COMM. CODE ANN. § 3.116 (Vernon 1968).

163. *Id.* § 4.205(a).

164. TEX. REV. CIV. STAT. ANN. art. 342-706 (Vernon 1973).

165. 548 S.W.2d 80 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ).

166. TEX. REV. CIV. STAT. ANN. art. 5527 (Vernon 1958).

167. 550 S.W.2d 405 (Tex. Civ. App.—Dallas 1977, no writ).

The defendant had made substantial prepayments but made no payments after July 1, 1971, at which time \$1,450 of principal remained unpaid. Suit was brought on August 31, 1976. The defendant argued that the cause of action arose when he failed to make the January 1 and July 1, 1972, payments. The court held, however, that because of the prepayments, which were to be applied to the installments first arising, nothing was actually due in 1972 and the cause of action did not arise until 1974.

Stop Payment. In *Bank of El Paso v. Powell*¹⁶⁸ a customer purchased a money order from his bank and before payment of the order requested the bank to stop payment. The bank agreed to do so after the customer agreed to hold the bank harmless for the costs and expenses it would incur by refusing payment. On refusal by the bank to pay the order, the payee brought suit against the bank. The customer and a third party intervened. After extended litigation the court awarded judgment for the bank against the intervenors for attorney's fees and the interest the bank had been required to pay on the payee's judgment against the bank. The court, however, offset against this sum the interest earned by the bank prior to judgment on the amount paid for the money order. The court construed the hold harmless clause to mean that only actual losses would be paid by the customer and not that the customer would discharge the bank's liability. The trial court, therefore, properly took into account the bank's benefit in the form of the interest it had earned on the purchase money for the money order pending final settlement of the litigation between the parties.

IV. SECURED TRANSACTIONS

A. *Scope of Article 9*

Relation of the Code to Federal Law. Two important Fifth Circuit opinions in this survey period considered the interaction of federal and state law in the enforcement of secured notes assigned to the Small Business Administration pursuant to the SBA's loan guaranty program. In both cases the governing documents, signed by the original parties, included a clause stating that the terms of the security agreements were to be construed according to the law of Texas. On default by the debtors the secured notes were transferred to the Small Business Administration. In one case the law governing the rights of the SBA and the debtor was at issue, while in the other case the law governing priority when the SBA is competing for priority with a third party claimant to the same collateral was at issue.

In *United States v. Terrey*¹⁶⁹ the question before the court was what standard governed the conduct of the SBA when it sought to realize on repossessed collateral when there was no competing third party claimant. The court held that federal law governed the transaction because the SBA acted pursuant to federal constitutional and statutory authority. Since Congress had not imposed any particular standard of care regarding disposi-

168. 550 S.W.2d 383 (Tex. Civ. App.—El Paso 1977, no writ).

169. 554 F.2d 685, 21 UCC Rep. Serv. 1488 (5th Cir. 1977).

tion of collateral by the SBA, the court was obligated to fashion a standard. The court determined that when all the relevant documents were construed together the SBA had contracted for the application of Texas law and therefore applied the Code as the federal law of decision.¹⁷⁰ The court specifically noted that it did not have to decide what the federal law of decision would be in the absence of contractual provisions, but it did note that the Uniform Commercial Code had been widely adopted and that its rules did not threaten the SBA's voluntary loan guaranty program.¹⁷¹ In effect the court held that the SBA may waive its right to have federal law apply to a transaction, at least with respect to the other parties to an SBA agreement.¹⁷²

The Fifth Circuit came to the same conclusion in *Kimbell Foods, Inc. v. Republic National Bank*¹⁷³ in deciding whether a similar choice-of-law clause in a security agreement had waived the SBA's right to have federal law applied in evaluating the priority of its security interest in the same collateral claimed by another secured party. In a thorough, well-reasoned opinion the court held that there had been no waiver and that the federal common law rule of "first in time, first in right" was the relevant rule of decision. The court's construction of the relevant federal rule will have far-reaching consequences with respect to non-tax federal liens. First, it rejected the lower court's extension of the "choateness" doctrine to the SBA's lien.¹⁷⁴ Secondly, the case concerned collateral which secured inventory sales made on open account, and the court suggested that in a proper case it would adopt the Uniform Commercial Code rule with respect to priority when such future advances are involved. In the case before it the court ruled that the other secured party had priority under both the Code rule and the stricter "actual notice" rule¹⁷⁵ so that the court did not have to define federal common law more closely. In effect, the court's opinion suggests the considerable influence that the Code has in shaping federal common law developing around the commercial activities of the federal government.

Lease or Security Interest. Regardless of the form of the transaction the Code applies if the parties intended to create a security interest in personal

170. *Id.* at 692-93.

171. The court felt that local banks might be more willing to participate in the program if their agreements were governed by local laws with which they regularly dealt. This would not force the government to face disparate responsibilities in different states, however, because the UCC governs commercial transactions in forty-nine states. *Id.* at 693 n.8.

172. The choice-of-law regulation governing SBA contracts requires that they be "construed and enforced in accordance with applicable Federal law." 13 C.F.R. § 101.1(d)(2) (1977).

173. 557 F.2d 491 (5th Cir. 1977), *rev'g* 401 F. Supp. 316 (N.D. Tex. 1975). For a discussion of the district court opinion, see *1977 Annual Survey, supra* note 2, at 194-95. See also Burke, *Secured Transactions, Uniform Commercial Code Annual Survey*, 31 BUS. LAW. 1583, 1586-87, 1590-91 (1976).

174. 31 U.S.C. § 191 (1970). This section requires that in settling the affairs of certain insolvents "the debts due to the United States shall be first satisfied." Under the choateness doctrine this priority defers only to specific and perfected (choate) liens which are prior in time. 557 F.2d at 498-502.

175. At the time the advances in question were made the secured party did not have actual notice of the federal lien which had arisen, and, hence, he was able to retain his priority. 557 F.2d at 502-05.

property,¹⁷⁶ but the Code gives more specific guidelines for distinguishing a true lease from a disguised security agreement. If the lessee has the option to become the owner of the leased property for a nominal consideration, for example, the lease is presumed to be intended for security and therefore subject to article 9 of the Code.¹⁷⁷ In *Robinson v. Granite Equipment Leasing Corp.*¹⁷⁸ the defendant had leased an ice machine under a detailed lease agreement. After the machine broke down the lessee placed it in storage, requested lessor to take it back, and stopped payment of the monthly rental. Although notices of sale were sent to the defendant, the lessor did not sell or rent the machine. On appeal from an adverse judgment in an action brought to collect unpaid rent, the defendant lessee argued that the lease agreement was really a security agreement subject to the provisions in sections 9.504 and 9.505 of the Code that allow a secured party to dispose of the collateral on default while crediting the debtor with the proceeds in excess of the reasonable expenses of disposition. After reviewing the terms of the agreement and the record, however, the appellate court found that there was some evidence to support an implied finding by the trial court that the instrument was a straight lease not subject to article 9 of the Code.

B. *Creation and Scope of Security Interest*

Incomplete Security Agreement. Section 9.203(a)(1) of the Code requires that the creditor, in order to obtain an enforceable security interest in a debtor's property, either take possession of the debtor's property or sign a security agreement that contains a description of the collateral. In *Means v. United Fidelity Life Insurance Co.*¹⁷⁹ the debtor sought a declaration that two security agreements were invalid because they had been signed without a description of the collateral, the description having been completed later by a bank employee. The jury found that the bank employee had authority from the husband, but not the wife, to complete the security agreement. The appellate court held that authorization from the husband was sufficient and that, by analogy to the applicable rule governing negotiable instruments,¹⁸⁰ the agreement should be enforced to the extent authorized.

Validity of "Dagnet" Clause. In the course of its opinion in *Kimbell Foods, Inc. v. Republic National Bank*¹⁸¹ the federal circuit court con-

176. TEX. BUS. & COMM. CODE ANN. § 9.102 (Vernon Supp. 1978). It should be noted, however, that a lease of goods may be chattel paper. The Code governs both security interests in chattel paper and the sale of chattel paper. TEX. BUS. & COMM. CODE ANN. §§ 9.102(a), .105(a)(2) (Vernon Supp. 1978). See *Hillcrest State Bank v. Bankers Leasing Corp.*, 544 S.W.2d 727, 20 UCC Rep. Serv. 1330 (Tex. Civ. App.—Dallas 1976, writ ref'd n.r.e.) (court may treat absolute assignment as an assignment for security only).

177. TEX. BUS. & COMM. CODE ANN. § 1.201(37) (Vernon Supp. 1978).

178. 553 S.W.2d 633 (Tex. Civ. App.—Houston [1st Dist.] 1977, writ ref'd n.r.e.).

179. 550 S.W.2d 302, 21 UCC Rep. Serv. 1177 (Tex. Civ. App.—El Paso 1977, writ ref'd n.r.e.), noted in UCC L. LETTER, Dec. 1977, at 3-4. *Contra*, *Dane County Farmco Coop v. Paskin (In re Hein)*, 20 UCC Rep. Serv. 745 (W.D. Wis. 1976) (security interests were invalid since both husband and wife failed to complete the collateral provision prior to their signing the documents).

180. TEX. BUS. & COMM. CODE ANN. § 3.115 (Vernon 1968).

181. 557 F.2d 491 (5th Cir. 1977), rev'g 401 F. Supp. 316 (N.D. Tex. 1975). See notes 173-75 *supra* and accompanying text.

sidered the validity under Texas law of the future advance clause on which the state law claimant relied. The competing parties claimed the proceeds of the bulk sales of fixtures, equipment, and inventory owned by a bankrupt supermarket chain. Kimbell's claim was based on sales on open account to the supermarket chain. Kimbell alleged that payment was secured by agreements entered into by the parties in 1966 and 1968 securing the repayment of two promissory notes and "the payment of all other indebtedness at any time hereafter owing by Debtor to Secured Party."¹⁸² The Small Business Administration claimed the proceeds of the bulk sales as successor to the Republic National Bank whose claim arose from the default by the bankrupt on a loan guaranteed by the SBA. The federal district judge had held that the Code had adopted pre-Code Texas case law which limited broad future advance clauses to future indebtedness that was clearly contemplated by the parties at the time of making the original agreement and was of the same nature as the original indebtedness. The appellate court reversed. It agreed with the district court that Texas courts would uphold the validity of a future advance clause with respect to a further extension of credit by the secured party only if reasonably contemplated by the parties when they executed the agreement containing the clause. The court noted that Texas courts in analogous circumstances had upheld these clauses. It then examined the circumstances under which the security agreements were signed and concluded that freeing current cash flow for the purchase of inventory by financing the purchase of fixtures was not "unrelated" to the sales of inventory on open account.¹⁸³ Hence, the future advance clause fulfilled the prerequisites established by Texas law.

C. Priorities

Competing Secured Parties. In *Borg-Warner Acceptance Corp. v. Wolfe City National Bank*¹⁸⁴ two secured parties claimed priority in collateral held by a sole proprietor. Borg-Warner had entered into a security agreement with the debtor covering the debtor's inventory to secure repayment of certain loans. Borg-Warner had filed a financing statement covering "all inventory" and also had notified other known creditors. Subsequently, Wolfe City National Bank advanced funds to the debtor for the purchase of inventory and took a security interest in the goods. The bank filed financing statements with the county clerk but not with the secretary of state. On default by the debtor under the agreements with both secured parties, the bank repossessed the inventory and sold it over Borg-Warner's request for its return. At a trial to determine the priority to the proceeds of the sale of the collateral, the bank argued that Borg-Warner's financing statement had not given notice of its claim to the "after-acquired property." The court of civil appeals held that the financing statement's reference to "all inventory" gave sufficient notice to other creditors of Borg-Warner's claim to after-

182. 557 F.2d at 493.

183. *Id.* at 494-97.

184. 544 S.W.2d 947, 21 UCC Rep. Serv. 631 (Tex. Civ. App.—Dallas 1976, no writ).

acquired inventory. The court further found that filing with the secretary of state was necessary to perfect the bank's security interest and that Borg-Warner's knowledge of the contents of the bank's improperly filed financing statement did not affect its prior perfected security interest. The court also noted that Borg-Warner's financing statement had been filed under the name of the sole proprietor and rejected a suggestion that section 9.402(g) required a new filing when the sole proprietor changed the name of his business. The court remanded the case for determination of damages.

Although not discussed by the court in *Borg-Warner*, the bank in that case would not only have to file with the secretary of state to perfect its interest in the debtor's inventory, but it would also have to comply with the provisions of section 9.312(c) of the Code in order to gain priority over Borg-Warner.

The Fifth Circuit's opinion in *Kimbell Foods, Inc. v. Republic National Bank*¹⁸⁵ also discussed the priority of two secured parties under state law. Having found that Kimbell had an enforceable security interest in the proceeds of the collateral, the court held that Kimbell had priority over the SBA, as assignee of Republic, under state law. The record showed that the bankrupt had used some of the funds borrowed from Republic for the purchase of inventory, but Republic had not followed the notice procedures set forth in section 9.312(c) in order to gain priority over Kimbell. Moreover, the record did not show that any of the Republic loan had been used for the purchase of collateral other than inventory; thus Republic and the SBA were unable to claim priority under section 9.312(d) of the Code which would only have required that the security interest be perfected at the time the bankrupt received possession of the collateral or within ten days thereafter. Finally, the court held that even though Kimbell extended credit to the bankrupt after the filing of a financing statement by Republic, this future advance related back to the original filing, giving Kimbell priority under the first-to-file rule of section 9.312(e)(1).¹⁸⁶

Secured Party vs. Landlord. Section 9.104(2) of the Code explicitly excludes the landlord's lien from the coverage of article 9; the scope of the landlord's lien is determined elsewhere. Occasionally, however, the landlord's lien is competing with a secured party claiming a perfected security interest under article 9. In *Bank of North America v. Kruger*¹⁸⁷ a landlord and a secured party both claimed priority in the personal property of the lessee of the premises. The lease agreement granted the landlord a lien on all of the lessee's personal property, but the landlord did not file a financing statement. The bank subsequently made a loan to the lessee, secured by equipment, motors, and other personal property, and immediately filed the

185. 557 F.2d 491 (5th Cir. 1977), *rev'g* 401 F. Supp. 316 (N.D. Tex. 1975); *see* notes 173-75, 181-83 *supra* and accompanying text.

186. 557 F.2d at 497-98. The court noted that the 1972 amendments to the Code, which were adopted in Texas in 1973, explicitly adopted the rule that gives future advances priority from the date of the original filing. TEX. BUS. & COMM. CODE ANN. § 9.312(g) (Vernon Supp. 1978).

187. 551 S.W.2d 63, 21 UCC Rep. Serv. 1446 (Tex. Civ. App.—Houston [1st Dist.] 1977, writ *ref'd n.r.e.*).

necessary financing statements. On default the bank brought suit to foreclose, and the sheriff levied on the debtor-lessee's personal property. The landlord then sued the lessee and also sued the bank for conversion. The appellate court reversed a judgment for the landlord. The court first examined the lien allegedly arising under the lease agreement and held that this contractual lien had to be filed to be perfected, citing pre-Code authority.¹⁸⁸ Section 9.104(2) of the Code, it stated, excluded only statutory landlords' liens from the coverage of article 9. The landlord's interest in the lease agreement was therefore unperfected because there had been no filing. As a result, the bank's perfected security interest was held to have priority over the landlord's unperfected interest. The appellate court also found that the bank's actual knowledge of the prior unperfected security interest did not indicate that the bank lacked good faith so as to necessitate subordinating its security interest to that of the landlord. The court, however, left open the possibility that if lack of good faith were established by additional facts, it might subordinate the perfected security interest otherwise legally entitled to priority. The court also examined the landlord's rights to a statutory lien.¹⁸⁹ The court construed the statute as giving the landlord priority over the article 9 secured party only during the first year of the lease contract.¹⁹⁰ The court found that a full year had elapsed and the landlord's lien had become subordinate.

Secured Party vs. "Owner." In *Poteet v. Winter Garden Production Credit Association*¹⁹¹ both a secured party and an "owner" claimed cattle held by the debtor. The debtor operated a feed lot, and Poteet claimed that the debtor acted as his agent in the purchase and care of the cattle. The secured party claimed the cattle under a security agreement which extended to "all livestock hereafter acquired by Debtor."¹⁹² The appellate court noted the absence of findings of fact which would indicate whether or not the debtor had ever acquired rights in the cattle so as to allow the secured party's after-acquired property interest to attach. In the absence of findings of fact which would resolve this issue, the court presumed that the debtor had purchased the cattle for himself and later had resold them to Poteet. The court then assumed without argument that the attached security interest would prevail over the owner¹⁹³ and affirmed the lower court's judgment in favor of the secured party.

188. *Shwiff v. City of Dallas*, 327 S.W.2d 598 (Tex. Civ. App.—Dallas 1959, writ ref'd n.r.e.).

189. TEX. REV. CIV. STAT. ANN. art. 5238 (Vernon 1962).

190. As authority for this construction the court cited *Radford v. Bacon Sec. Co.*, 18 S.W.2d 848 (Tex. Civ. App.—Eastland 1929, no writ).

191. 546 S.W.2d 650, 21 UCC Rep. Serv. 645 (Tex. Civ. App.—El Paso 1977, writ ref'd n.r.e.).

192. *Id.* at 652.

193. In the usual case the court would have to consider the possibility that Poteet was a "buyer in the ordinary course" who took free of the security interest. TEX. BUS. & COMM. CODE ANN. §§ 1.201(9), 9.307(a) (Vernon Supp. 1978). This case, however, probably falls within the "farm" exception to that rule. The cattle are "farm products" and a cattle feed lot operator is probably "engaged in farming operations." *Id.* §§ 9.109(3), .307(a) (Vernon Supp. 1978).

Secured Party vs. Mechanic. In *Miller & Freeman Ford, Inc. v. Greater Houston Bank*¹⁹⁴ both a bank, which had financed the purchase of a pickup truck, and a dealer, which had repaired the pickup, claimed the proceeds arising from a judicial sale of the truck. The bank claimed it had secured its purchase money security interest prior to the repairs and moved for summary judgment. The dealer also filed a motion for summary judgment along with an affidavit averring that the repairs were authorized by the debtor's husband. The Texas Supreme Court held that, although the dealer's affidavit was insufficient to sustain its motion for summary judgment, it did raise a fact issue concerning the existence of a statutory lien¹⁹⁵ which precluded the court from granting the bank's motion.

D. *The Rights of Parties After Default*

When a debtor is in default under a security agreement, the secured party has the rights and remedies provided in part 5 of article 9, including a number of mandatory provisions which cannot be disclaimed by the parties.¹⁹⁶ One such provision is section 9.504 which requires that every aspect of the disposition of repossessed collateral must be commercially reasonable. What constitutes commercially reasonable disposition was recently considered by the Fifth Circuit in *United States v. Terrey*.¹⁹⁷ Having concluded that the Small Business Administration had agreed that Texas law would govern its conduct when repossessing and disposing of the debtor's business, the court reviewed the record to determine if the SBA had complied with the standard set out in section 9.504. The court questioned the weight given to some factors by the trial court and suggested a number of facts in the case on which a jury could rely to find the sale commercially unreasonable: the SBA decided to auction the assets of the debtor only two days after the assets had been turned over to the SBA; the SBA did not negotiate the private sale of partially completed products; the SBA refused to postpone a public auction in order to allow further negotiations for the sale of the business as a unit; the SBA placed unreasonable limitations on negotiations with third parties interested in purchasing the business; and the amount realized at the public auction was substantially less than the alleged market value of the semi-finished inventory or of the business as a whole.¹⁹⁸ The appellate court reversed the trial court's judgment for the SBA and remanded the case for a new trial.

194. 544 S.W.2d 925 (Tex. 1976).

195. TEX. REV. CIV. STAT. ANN. art. 5503 (Vernon Supp. 1978).

196. TEX. BUS. & COMM. CODE ANN. §§ 1.102(c) (Vernon 1968), 9.501(c) (Vernon 1968 & Supp. 1978). In addition to the *Terrey* decision discussed in the text see *Anterbury v. American Bank & Trust Co.*, 553 S.W.2d 943, 949 (Tex. Civ. App.—Texarkana 1977, no writ).

197. 554 F.2d 685, 21 UCC Rep. Serv. 1488 (5th Cir. 1977); see notes 169-72 *supra* and accompanying text.

198. For an "excellent picture of a reasonably commercial disposition of collateral" the court cited *Old Colony Trust Co. v. Penrose Indus. Corp.*, 280 F. Supp. 698 (E.D. Pa.), *aff'd*, 398 F.2d 310 (3d Cir. 1968), 554 F.2d at 694 n.9; see TEX. BUS. & COMM. CODE ANN. §§ 9.504(c), .507(b) (Vernon Supp. 1978).

E. Miscellaneous Decisions

Assignment of Security Agreement. In *John Deere Co. v. Neal*¹⁹⁹ the assignee of chattel paper arising from the sale of a tractor brought suit against the buyer to enforce the note signed by the buyer. The buyer defended by arguing that he was authorized under section 9.318(c) of the Code to make payments on the note to the assignor until notified that payment was to be made to the assignee. The plaintiff sought to rely on the negotiable instrument provisions of article 3, and argued that section 9.104(6) should be read broadly to exclude all non-financing sales. The court, however, found no reason to give an expansive reading to the enumerated limitations on the scope of article 9 set out in section 9.104. The court then reviewed the requirements of a notice of assignment under section 9.318 and found that due to the defendant's lack of experience in secured transactions, his knowledge of facts from which he should have concluded that the assignee had a right to collect payments on the note fell short of the requirement of section 9.318(c).²⁰⁰

Consignments. The Fifth Circuit in *Looney v. Nuss*²⁰¹ reversed a turnover order with respect to the return to the trustee in bankruptcy of art works consigned by the bankrupt for sale at an art gallery. The consignment arose in an attempt prior to bankruptcy to satisfy a creditor. The art works were irrevocably consigned to the art gallery, the consignor retained control over the sales prices, and the proceeds were assigned to the creditor who agreed to suspend suit on the debt. The art gallery was informed of this arrangement by a letter from the bankrupt. The trial court had found that the documents, when read together, gave the creditor a security interest in the proceeds of sale rather than in the art works. The appellate court disagreed and found that the bankrupt had granted his creditor a security interest in the art works themselves. The security interest was perfected under sections 9.304(c) and 9.305 by the letter to the art gallery, the bailee of the art works.²⁰² Perfection occurred before the filing of the petition in bankruptcy, and, thus, the secured party had priority over the interest of the trustee in bankruptcy.

199. 544 S.W.2d 514, 20 UCC Rep. Serv. 1332 (Tex. Civ. App.—Texarkana 1976, no writ).

200. The court did not cite or discuss the definitions of "notice" and "receives a notice" which appear in article 1 of the Code. TEX. BUS. & COMM. CODE ANN. § 1.201(25), (26) (Vernon 1968).

201. 545 F.2d 916 (5th Cir.), *cert denied*, 97 S. Ct. 1687 (1977). For recent legislation giving the consignor of art works in effect a perfected security interest, see the Artists' Consignment Act discussed in notes 14-18 *supra* and accompanying text.

202. In an interesting footnote the court noted that since there was a written security agreement there was no need to decide whether notice to a bailee of the secured party's interest would satisfy the statute of frauds provision in § 9.203(a)(1). That section concerns the attachment of security interests and requires either possession by the secured party or a written agreement signed by the debtor. The court said it was unnecessary to decide whether the possession by the bailee together with the notice of the assignment would suffice for attachment as well as perfection of the security interest. 545 F.2d at 919 n.6.

Field Warehouse. In *Utica National Bank & Trust Co. v. Happy Wheat Growers, Inc.*²⁰³ a secured party brought an action against a field warehouseman for delivering cattle held in the warehouse to a buyer without promptly forwarding confirmations of delivery. The court held that the requirement that the confirmation of delivery be sent was an independent covenant and not a condition. Being a covenant, the secured party's action was for breach of contract; thus, in order to prevail, it had to prove that any damages were foreseeable. The trial court's rejection of a special verdict on causation of damages was reversible error, and the case was remanded for a new trial limited to the issues of the existence, type, and amount of damages.

Impairment of Collateral. In *Commercial Credit Equipment Corp. v. Hutton*²⁰⁴ a federal district court held that a surety, who had informed the assignee of a security agreement that the collateral, an airplane, was being used for commercial purposes in violation of the security agreement, was not discharged from his suretyship liability by the assignee's failure to repossess. The court found that the surety was not discharged under either section 3.606 or section 34.02 of the Texas Business and Commerce Code.²⁰⁵ As to section 3.606(a)(1)²⁰⁶ the court ruled that the failure to repossess the airplane was not an agreement to suspend the right to enforce the instrument against the debtor, and in any case, the surety had waived the protection of this provision by a waiver clause in his agreement with the secured party. The court further held that discharge under section 3.606(a)(2) for impairment of collateral required the secured party to be in possession, a circumstance not present here. The court supported this holding by reference to Code comments, pre-Code Texas case law, and the practical difficulties to which an opposite rule would lead by forcing a secured party to investigate every allegation of impairment of collateral by the debtor. The court noted that the surety could protect himself by paying the indebtedness and proceeding in the shoes of the secured party against the debtor: "Let the one who complains of the cold fetch in the firewood."²⁰⁷ The court found section 34.02 inapplicable because the surety had not requested the secured party to sue on the contract. Even if the request to repossess could be so construed, the court found that the secured party had satisfied section 34.02 by proceeding within a reasonable time.

203. 558 F.2d 279 (5th Cir. 1977).

204. 429 F. Supp. 997, 22 UCC Rep. Serv. 118 (N.D. Tex. 1977).

205. Under § 34.02, if a cause of action has accrued on a contract, a surety by written notice may require the obligee to sue on the contract. If the obligee fails to initiate suit during the first term of court after receiving the notice, then the surety is discharged from all liability under the contract. TEX. BUS. & COMM. CODE ANN. § 34.02 (Vernon 1968).

206. Section 3.606(a)(1) provides that the holder of a negotiable instrument discharges a party if without the party's consent the holder releases a person against whom the party has a right of recourse or agrees to suspend the right to enforce the instrument against such person. *Id.* § 3.606(a)(1).

207. 429 F. Supp. at 1001.

V. MISCELLANEOUS DECISIONS

A. Article 7 Cases

Article 7 of the Uniform Commercial Code governs the storage and carriage of goods. Perhaps because professionals are involved in storage and carriage and these professional bailees are regulated by state and federal regulatory legislation, there is relatively little litigation construing article 7 provisions. Nevertheless, a handful of Texas cases arose during this survey period.

Cotton farmers and the Amarillo court seem to go together in the Texas reports. In *R.E. Huntley Cotton Co. v. Fields*²⁰⁸ the plaintiff cotton farmers brought an action to recover warehouse receipts and to enjoin the defendants from removing the cotton from the warehouses. The plaintiffs had transferred the warehouse receipts to a broker and had received checks in payment which were later dishonored because of insufficient funds. The warehouse receipts stated that upon return of the receipt the cotton "will be delivered to the above named depositor or its order, or bearer."²⁰⁹ The broker sold the receipts to defendant cotton companies. The trial court granted a temporary injunction, but the appellate court held that this was an abuse of discretion due to the existence of an adequate remedy at law. The court further held that the plaintiffs had not shown they had a right to recover. Noting both "order" and "bearer" language in the receipt, the court held that under section 7.104(a)(1) it was a bearer receipt which did not require indorsement, and, thus, could be negotiated by delivery alone under section 7.501(b)(1). The court noted that its conclusion was consistent with practice in the cotton business and prior case law. It also found no evidence that the defendants had acted in bad faith and, as a result, held that the receipts had been duly negotiated as defined by section 7.501(d).

In *Elizabeth-Perkins, Inc. v. Morgan Express, Inc.*²¹⁰ the plaintiff consignee sought to recover the value of lost dresses from the carrier. The carrier admitted losing the dresses but claimed that a tariff of its rates which it had filed with the Railroad Commission limited its liability to \$50 unless a greater value was declared by the consignor. Here no value had been declared, and the court held that the consignee could only recover \$50. It rejected the consignee's argument that section 7.309(b)²¹¹ required the carrier to show that it had expressly called the liability limitation to the attention of the consignor. When a tariff has been filed, the court noted, the carrier need only afford the consignor a chance to declare a higher value.

In *Mitsui & Co. (U.S.A.), Inc. v. Ramsey Truck Lines, Inc.*²¹² a foreign seller sued an American common carrier for damaging goods in transit.

208. 551 S.W.2d 472, 21 UCC Rep. Serv. 1157 (Tex. Civ. App.—Amarillo 1977, writ ref'd n.r.e.).

209. *Id.* at 474.

210. 554 S.W.2d 216, 22 UCC Rep. Serv. 771 (Tex. Civ. App.—Dallas 1977, no writ).

211. This section allows a carrier to limit his liability, but only if the carrier's rates are dependent upon value and the consignor is afforded an opportunity to declare value higher than the limit. TEX. BUS. & COMM. CODE ANN. § 7.309(b) (Vernon 1968).

212. 554 S.W.2d 738 (Tex. Civ. App.—Houston [14th Dist.] 1977, no writ).

Some damage to the goods had been discovered before delivery to the defendant carrier, but the seller alleged that the defendant caused further damages. The appellate court upheld judgment for the defendant. The court held that where a plaintiff had failed to prove that the shipment was in good condition when delivered to the defendant there was no presumption that the defendant common carrier caused the damage. The court noted that there was conclusive evidence that the goods were materially damaged before the common carrier accepted them.

Following a flimflam which fooled everyone and left a bank \$13,000 out of pocket, the bank in *Purolater Service, Inc. v. Citizens National Bank*²¹³ sought to recover its losses from the armored car service for misdelivering the money. A jury found the bank negligent in failing to check the authenticity of the flimflam man and in failing to indicate clearly to the armored car service where and to whom the money was to be delivered. The jury also found that this negligence proximately caused the loss. The bank argued, however, that misdelivery was a conversion and that contributory negligence, therefore, was not a defense. Without discussing the possible relevance of the Code, the appellate court disagreed and held the bailee-carrier not liable for the loss proximately caused by the bailor-bank.

B. Arbitration

Whether an arbitration award is enforceable under Texas law was at issue in *L.H. Lacy Co. v. City of Lubbock*.²¹⁴ The parties had entered into a construction contract for the improvement of the runway and taxiway at the Lubbock Regional Airport. The contract included an arbitration provision drafted by the defendant which stated in part:

The decision of the arbiters upon any question submitted to arbitration under this contract shall be a condition precedent to any right of legal action. The decision of the arbiter or arbiters may be filed in court to carry it into effect.²¹⁵

After completing construction the plaintiff sought arbitration of disputes between the parties. The defendant city objected from the beginning on the ground that the Texas General Arbitration Act did not apply, but continued to participate in the proceedings until a final award was granted. Although the Texas General Arbitration Act specifically excludes arbitration of construction contracts from its scope,²¹⁶ the Texas Supreme Court reaffirmed the continuing applicability of common law arbitration principles as an alternative to the statute. Applying these common law rules, the court concluded that an enforceable award had been made because the defendant had not met the burden of proving that it had unequivocally withdrawn from the arbitration proceedings before the award was made. The court dismissed the defendant's jurisdictional objections on the ground that they referred to

213. 546 S.W.2d 935 (Tex. Civ. App.—Waco 1977, no writ).

214. 21 Tex. Sup. Ct. J. 72 (Nov. 26, 1977), *rev'g* 546 S.W.2d 373 (Tex. Civ. App.—Amarillo 1976).

215. *Id.* at 73.

216. TEX. REV. CIV. STAT. ANN. art. 224 (Vernon 1973).

the inapplicability of the statutory arbitration provisions, which in fact indicated defendant's awareness that common law arbitration was involved. If it had wished to revoke the executory arbitration agreement, defendant should have refused to participate in the arbitration proceedings from the outset.²¹⁷

More important than the holding in the *Lacy* case, however, was the court's restatement of public policy with respect to arbitration and its conclusion that: "While it is unnecessary in this case to alter common law arbitration rules, the policy of refusing specific enforcement to executory arbitration agreements is not justifiable when the case fits within the common mold."²¹⁸ The court noted that the common law rule refusing specific enforcement of an agreement to arbitrate future disputes had arisen at a time when court congestion was not a problem as it is today. The court also stressed the flexibility, efficiency, and privacy provided by commercial arbitration. In sum, "in modern times a policy encouraging agreements to arbitrate is preferable."²¹⁹ In the proper case the supreme court might be willing to enforce an executory arbitration agreement under judicial common law when the statute is not applicable. This would bring the common law rule in line with the policy underlying the statutory rule.

C. Guaranty Agreements

Compared with last year there are relatively few court decisions in this survey period concerned with guaranty agreements and the rights and obligations of guarantors.²²⁰ Cases continue to reflect confusion because of the overlap of a number of different concepts and statutes: accommodation parties and guarantors on negotiable instruments,²²¹ traditional suretyship concepts,²²² and usury legislation.²²³

217. The court of civil appeals had held that the original contractual provision was void and that defendant had never agreed to arbitrate after the dispute arose. The court had, therefore, distinguished cases which discussed whether there was revocation of an enforceable agreement. 546 S.W.2d at 377. In effect, the Texas Supreme Court held that there was a *voidable*, but not void, arbitration agreement which was never avoided ("revoked").

218. 21 Tex. Sup. Ct. J. at 74.

219. *Id.*

220. See also *Hopkins v. First Nat'l Bank*, 546 S.W.2d 84 (Tex. Civ. App.—Corpus Christi, 1976), writ *ref'd n.r.e. per curiam*, 551 S.W.2d 343 (Tex. 1977) (if a guaranty contract does not specify where the agreement may be enforced, but the note secured by the guaranty agreement does specify a particular county, then the defendant guarantor may be sued in the county in which the principal obligor is sued); *Gubitosi v. Buddy Schoellkopf Prods., Inc.*, 545 S.W.2d 528, 534-35 (Tex. Civ. App.—Tyler 1976, no writ).

221. TEX. BUS. & COMM. CODE ANN. §§ 3.415, .416 (Vernon 1968). See generally *Peters, Suretyship Under Article 3 of the Uniform Commercial Code*, 77 YALE L.J. 833 (1968). For an example of the failure to examine closely the underlying concepts see *Knick v. Green*, 545 S.W.2d 269, 272 (Tex. Civ. App.—Waco 1977, writ *ref'd n.r.e.*). The guarantor in *Knick* apparently signed a separate guaranty agreement rather than the negotiable instrument, but the court relies on § 3.416 of the Code for the proposition that an "unqualified" guarantor becomes liable as the original guarantor, overlooking the traditional rights of the guarantor-surety. See note 222 *infra*. See also *Cleburne Nat'l Bank v. Kenedco, Inc.*, 547 S.W.2d 67 (Tex. Civ. App.—Waco 1977, writ *ref'd n.r.e.*) (guarantor who signs guaranty agreement but is not party to note apparently relies on § 3.606 of the Code with respect to discharge of "party to the instrument" where collateral impaired).

222. TEX. BUS. & COMM. CODE ANN. §§ 34.01-.05 (Vernon 1968); TEX. REV. CIV. STAT. ANN. arts. 1986, 1987 (Vernon 1964); TEX. R. CIV. P. 31.

223. TEX. REV. CIV. STAT. ANN. arts. 1302—2.09, 5069—1.01 to —14.28 (Vernon 1971 & Supp. 1978).

In *Maykus v. Texas Bank & Trust Co.*²²⁴ the defendant argued that there was no consideration for the written guaranty agreement. To demonstrate this he produced evidence showing that the guaranty agreement had been signed after the note was signed. The court held that the statutory presumption²²⁵ that written contracts are supported by consideration applied not only to the note but also to the guaranty agreement. The mere showing that the guaranty agreement was signed after the note did not rebut this statutory presumption.

The scope of a guarantor's right to be subrogated to the creditor's rights against the principal debtor and co-guarantors is illustrated in *Highland Cable Television, Inc. v. Wong*.²²⁶ In this case one guarantor paid the underlying obligation and the creditor endorsed the note and assigned the guaranty agreements to the guarantor. The guarantor then recovered judgment against the co-guarantors for their proportionate share of the guaranty obligation plus attorney's fees. The co-guarantors argued on appeal that they were liable only in an action in contribution, which would not allow for the recovery of attorney's fees. The appellate court held, however, that the guarantor who paid the debt was subrogated to the creditor's rights, including rights to security.²²⁷ In the absence of pleading that the attorney's fees had not been agreed to or that the fees were unreasonable, the court stated that the amount for fees provided in the note would be enforceable by the guarantor who was transferee of the note.

D. Sunday Sales

A case brought under the "Sunday Sale" statute,²²⁸ which prohibits the sale of certain items on specified days, survived an attack on the constitutional ground of discriminatory enforcement in *S.S. Kresge Co. v. State*.²²⁹ The action for a permanent injunction had been initiated on the complaint of the Dallas Retail Merchants Association. The court found no showing that there had been clearly intentional discrimination on the part of the district attorney. The court distinguished the recent New York case of *People v. Acme Markets, Inc.*²³⁰ in which the New York court found that enforcement of the statute had been delegated to private parties. The court found the New York and Texas statutes distinguishable in that private parties in Texas are authorized to file for injunctive relief, but enforcement is not limited to private parties.

224. 550 S.W.2d 396 (Tex. Civ. App.—Dallas 1977, no writ).

225. TEX. REV. CIV. STAT. ANN. art. 27 (Vernon 1969).

226. 547 S.W.2d 324 (Tex. Civ. App.—Austin 1977, writ ref'd n.r.e.).

227. 547 S.W.2d at 326. The court cites both the Code and case law as authority for its conclusion as to subrogation. TEX. BUS. & COMM. CODE ANN. §§ 3.201, .603(b) (Vernon 1968). *Fox v. Kroeger*, 119 Tex. 511, 35 S.W.2d 679 (1931); *Seale v. Hudgens*, 538 S.W.2d 459 (Tex. Civ. App.—San Antonio 1976, writ dism'd).

228. TEX. REV. CIV. STAT art. 9001 (Vernon Supp. 1978).

229. 546 S.W.2d 928 (Tex. Civ. App.—Dallas 1977, writ ref'd n.r.e.). The court summarily rejected the argument that art. 9001 violated the due process and equal protection clauses of the United States and Texas Constitutions, citing *Gibson Prods. Co. v. State*, 545 S.W.2d 128 (Tex. 1976), cert. denied, 97 S. Ct. 2677 (1977). 546 S.W.2d at 929.

230. 37 N.Y.2d 326, 334 N.E.2d 555, 372 N.Y.S.2d 590 (1975).

E. *Third-Party Creditor Beneficiary*

An attempt to distinguish previous cases which had held that a short-term lender was not a third-party creditor beneficiary of a long-term commitment failed in *Exchange Bank & Trust Co. v. Lone Star Life Insurance Co.*²³¹ The court found that the commitment letter could not be interpreted as obligating the long-term lender to purchase the short-term note, even though the letter contained references to the short-term lender. Nor did the court find that the long-term lender had made a direct promise to the short-term lender to purchase its loan.

231. 546 S.W.2d 948 (Tex. Civ. App.—Dallas 1977, no writ). The cases which plaintiff sought to distinguish were *Briercroft Sav. & Loan Ass'n v. Foster Fin. Corp.*, 533 S.W.2d 898 (Tex. Civ. App.—Eastland 1976, writ ref'd n.r.e.), and *Republic Nat'l Bank v. National Bankers Life Ins. Co.*, 427 S.W.2d 76 (Tex. Civ. App.—Dallas 1968, writ ref'd n.r.e.).