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PRESERVATION OF CLAIMS AND DEFENSES UNDER THE
TEXAS BUSINESS AND COMMERCE CODE AND
UNDER THE TEXAS CONSUMER
CREDIT CODE

JAMES G. BOYLE*

With the growth of consumer credit in recent years¹ has come an increased use of retail installment contracts that are discounted and immediately sold to a lending institution.² Unfortunately, on numerous occasions the seller of goods or services on credit has not lived up to his promises or has not complied with federal and state disclosure laws.³ Numerous cases of deception and explicit fraud have been documented in the sale of furniture, automobiles, carpeting, alarm systems, swimming pools, vacuum cleaners, hearing aids, health club memberships, and vocational school instruction.⁴ The natural reaction of a consumer who has been deceived or defrauded in such a situation is to default in the payment of the obligation owing under the retail installment contract.⁵ The lender-assignee will probably bring suit against the consumer and claim protection as a holder in due course of the contract against the consumer's claim as defense.⁶ If the consumer must pay on the contract, he may be unable to recover his loss by suing the seller, who may be insolvent or have absconded.⁷ The holder in due course doctrine has been used to deprive the consumer of any remedy in these situations.⁸

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1. Smyer, *A Review of Significant Legislation and Case Law Concerning Consumer Credit* (pt. 1), 6 ST. MARY'S L.J. 37 (1974).

2. Federal Trade Commission—Preservation of Consumers' Claims and Defenses: Final Regulations, Proposed Amendment and Statement of Basis and Purpose, 40 Fed. Reg. 53,506, 53,507 (1975) (to be codified at 16 C.F.R. § 433).

3. *See id.* at 53,510.

4. *Id.* at 53,510-14.

5. Note, *Consumer Financing, Negotiable Instruments, and the Uniform Commercial Code: A Solution to the Judicial Dilemma*, 55 CORNELL L. REV. 611, 611-12 (1970).

6. Comment, *Financing Consumer Goods Under the Uniform Commercial Code: Installment Buyers and Defaulting Sellers*, 37 U. CHI. L. REV. 513 (1970).

7. Countryman, *The Holder in Due Course and Other Anachronisms in Consumer Credit*, 52 TEXAS L. REV. 1, 2 (1973).

8. Federal Trade Commission—Preservation of Consumers' Claims and Defenses:

The Federal Trade Commission in adopting the Preservation of Consumers' Claims and Defenses Rule, which in effect destroyed the assignee's holder in due course status, was responding to the need to remove the burden of the consumer absorbing all of the loss occasioned by the seller's misconduct. The Commission felt that the lender was in a better position than the consumer to discourage fraudulent or deceptive conduct by the seller and, if a loss occurred, was in a better position to absorb the costs resulting from such conduct.⁹

The Rule was effective May 14, 1976.¹⁰ Two factors diminish the importance of the Rule: First, for some time to come most of the retail installment contracts to become involved in litigation will have been executed prior to May 14, 1976, and Texas lawyers will still have to be concerned about whether a claim or defense can be asserted based upon the law in existence prior to the effective date of the rule. Second, the Rule has no effect on business or commercial transactions.¹¹

CONSIDER NEGOTIABILITY FIRST

A holder in due course takes free of all personal defenses.¹² If a defense is shown to exist, then the assignee has the burden of proving that he has met all the prerequisites to establishing holder in due course status.¹³ A holder in due course is someone who takes an instrument for value, in good faith, and without notice that it has been dishonored or without notice of any defense against it.¹⁴ It is not difficult for the lender-assignee to establish "good faith" and lack of notice of a defense.¹⁵ Good faith is simply a subjective test of "honesty in fact,"¹⁶ and notice is actual or inferred knowledge, "from all the facts and circumstances," of the defense prior to negotiation of the instrument.¹⁷ Consumers have not generally been successful in defeating holder in due course status.¹⁸

Final Regulations, Proposed Amendment and Statement of Basis and Purpose, 40 Fed. Reg. 53,509-14 (1975) (to be codified at 16 C.F.R. § 433).

9. *Id.* at 53,522-23. See text accompanying notes 76-88 *infra*.

10. *Id.* at 53, 506.

11. *Id.* at 53, 506.

12. TEX. BUS. & COMM. CODE ANN. § 3.305 (Tex. UCC 1968).

13. *Id.* § 3.307(c).

14. *Id.* § 3.302(a).

15. Federal Trade Commission—Preservation of Consumers' Claims and Defenses: Final Regulations, Proposed Amendment and Statement of Basis and Purpose, 40 Fed. Reg. 53,506, 53,508 (1975) (to be codified at 16 C.F.R. § 433).

16. TEX. BUS. & COMM. CODE ANN. § 1.201(19) (Tex. UCC 1968).

17. See *id.* § 1.201(25).

18. See Countryman, *The Holder in Due Course and Other Anachronisms in Consumer Credit*, 52 TEXAS L. REV. 1, 3-4 (1973).

In representing the purchaser under a retail installment contract, it is important to avoid any kind of reflex action once the assignee has alleged he is a holder in due course. No attempt should be made to preserve a claim or defense by immediately trying to prove that the assignee did not purchase the contract in good faith or that he had knowledge of the claim or defense at the time he purchased the contract. A lawyer's first task in trying to preserve a claim or defense is to analyze the retail installment contract to see if it is negotiable. The odds are extremely good that the contract is nonnegotiable. If the contract is not negotiable, then the assignee, as explained below, cannot be a holder in due course and must take the agreement subject to the claims and defenses which might be asserted against it.¹⁹

In order to become a holder in due course the assignee must be a holder.²⁰ A holder is "a person who is in possession of a document of title or an instrument or an investment security drawn, issued, or indorsed to him or to his order or to bearer or in blank."²¹ Further, for the purpose of achieving holder in due course status, the assignee must be the holder of an instrument.²² An instrument means a negotiable instrument.²³

The modern day origin of the concept of negotiability is found in Lord Mansfield's opinion in *Miller v. Race*²⁴ written in 1758. A simple promise to pay a sum certain in money confers negotiability. This same basic concept of conferring negotiability to documents that involve little more than a simple promise to pay a sum certain in money is recognized in the Texas Business and Commerce Code when it mentions "draft," "checks," "certificates of deposit," and "notes" as examples of negotiable instruments.²⁵

In order to facilitate the use of negotiable instruments it is important to be able to tell at a glance whether the document is negotiable. There should be no penumbra between negotiable instruments and simple contracts.²⁶ For this reason the document must conform to the few prerequisites which establish negotiability and must not contain ad-

19. TEX. BUS. & COMM. CODE ANN. § 3.306 (Tex. UCC 1968).

20. *Id.* § 3.302(a).

21. *Id.* § 1.201(20).

22. *Id.* § 3.302(a).

23. *Id.* § 3.102(a)(5).

24. 97 Eng. Rep. 398 (K.B. 1758).

25. TEX. BUS. & COMM. CODE ANN. § 3.104(c) (Tex. UCC 1968).

26. Chafee, *Acceleration Provisions in Time Paper*, 32 HARV. L. REV. 747, 750 (1919).

ditional promises, powers, or obligations which are not essential to negotiability. A negotiable instrument is a "courier without luggage."²⁷ Under the Uniform Commercial Code as adopted in Texas, the courier now may carry at least a few handbags.²⁸ These handbags may travel with the document once the prerequisites of negotiability under section 3.104 of the Texas Business and Commerce Code have been satisfied. These prerequisites of a writing are:

- (1) be signed by the maker or drawer; and
- (2) contain an unconditional promise or order to pay a sum certain in money and no other promise, order, obligation or power given by the maker or drawer except as authorized by this chapter; and
- (3) be payable on demand or at a definite time; and
- (4) be payable to order or to bearer.²⁹

Although a negotiable instrument ostensibly may not contain any other promise, order, obligation, or power other than a promise to pay a sum certain in money, the Code does permit other promises or powers where authorized by law. Although section 3.112 does permit additional baggage, the language of this section should be narrowly construed in order to permit the rapid identification of negotiable instruments.³⁰ Any doubt as to the negotiability of a document should be resolved in favor of nonnegotiability.³¹

Several recent cases have indicated that retail installment contracts do not qualify as negotiable instruments.³² These cases have declared such contracts nonnegotiable despite the language contained in section 3.112. There are no reported Texas cases involving retail installment contracts after the enactment of the Code that have declared the contracts to be nonnegotiable. This is not because the contracts are nego-

27. *Lane Co. v. Crum*, 291 S.W. 1084, 1085 (Tex. Comm'n App. 1927, jdgmt adopted).

28. TEX. BUS. & COMM. CODE ANN. § 3.112 (Tex. UCC 1968).

29. *Id.* § 3.104(a).

30. *See Discount Purchasing Co. v. Porch*, 12 UCC REP. SERV. 600, 608 (Tenn. Ct. App. 1973).

31. *Geiger Fin. Co. v. Graham*, 182 S.E.2d 521, 525 (Ga. Ct. App. 1971); *Pacific Fin. Loans v. Goodwin*, 324 N.E.2d 578, 580 (Ohio Ct. App. 1974); TEX. BUS. & COMM. CODE ANN. § 3.104, Comment 5 (Tex. UCC 1968).

32. *E.g.*, *Jefferson v. Mitchell Select Furniture Co., Inc.*, 321 So. 2d 216, 221 (Ala. Civ. App. 1975); *Geiger Fin. Co. v. Graham*, 182 S.E.2d 521, 525 (Ga. Ct. App. 1971); *Chrysler Credit Corp. v. Friendly Ford, Inc.*, 535 S.W.2d 110, 114 (Mo. Ct. App. 1976); *Pacific Fin. Loans v. Goodwin*, 324 N.E.2d 578, 580 (Ohio Ct. App. 1974); *Discount Purchasing Co. v. Porch*, 12 UCC REP. SERV. 600, 608-09 (Tenn. Ct. App. 1973); *see* 4 R. ANDERSON, UNIFORM COMMERCIAL CODE § 9-101:3, at 7 (2d ed. 1971).

liable, but probably results from the failure of Texas lawyers to analyze the contracts to see if they meet the standards of negotiability. Because of the absence of Texas decisions, the opinions of the courts of other states in this matter should be accorded great weight. One of the major objectives of the Code is to make the law uniform among the various jurisdictions,³³ and for that reason, the reported decisions by the courts of other states should influence the interpretations of the Code made by Texas courts.

A typical retail installment contract for the purchase of a mobile home is included in an appendix to this article. Contracts similar to this one are in wide use in Texas. This contract does not meet the standards of negotiability. The analysis which follows is not exhaustive, but is offered solely to present a glimpse into the reason such contracts should be considered nonnegotiable.

CLAUSES WHICH DESTROY NEGOTIABILITY

The reverse side of the "RETAIL INSTALLMENT CONTRACT-MOBILE HOME & SECURITY AGREEMENT"³⁴ executed between Mr. and Mrs. Moe Bill Buyer and Camel Lot Mobile Homes contains numerous powers, promises, and obligations beyond a simple promise to pay money to order of bearer by a definite date. In determining whether these powers, promises, and obligations destroy negotiability a lawyer's attention should be primarily focused on subsections 3.112(a)(2) and (3) of the Texas Business and Commerce Code, which provide that:

- (a) The negotiability of an instrument is not affected by
-
- (2) a statement that collateral has been given to secure obligations either on the instrument or otherwise of an obligor on the instrument or that in case of default on those obligations the holder may realize on or dispose of the collateral; or
- (3) a promise or power to maintain or protect collateral or to give additional collateral.³⁵

There is some confusion over the word "statement" in subsection 3.112(a)(2). It could be argued that this word permits only the nam-

33. TEX. BUS. & COMM. CODE ANN. § 1.102(b)(3) (Tex. UCC 1968).

34. For the purpose of this article this retail installment contract is referred to as the "CONTRACT." The text of the contract is reproduced pp. 694-95 *infra*.

35. TEX. BUS. & COMM. CODE ANN. § 3.112(a)(2), (3) (Tex. UCC 1968).

ing of what collateral serves the contract and not the language that creates a security interest.³⁶ A more liberal connotation of (a)(2) would allow a statement which constitutes a "security agreement,"³⁷ but only in the most abbreviated terms.³⁸

Cross-collateral clauses are permitted by allowing the statement to mention that the collateral serves obligations arising under the instrument and "otherwise."³⁹ On default the holder may "realize on or dispose of" the collateral.⁴⁰ This clause authorizes a provision that gives the holder the right to sell or dispose of the collateral.⁴¹ One court has held that the right to dispose of or sell the collateral does not mean that the contract may provide for repossession without judicial process.⁴² Such a provision would destroy negotiability.

Subsection 3.112(a)(3) permits a clause containing a promise or power to maintain or protect collateral or to give additional collateral. A promise by the buyer to insure the collateral against loss may fall within that subsection. A narrow construction of this provision would only allow the use of a promise by the buyer that he will not waste or destroy the collateral and will keep it in good order and repair. A long list of provisions which relate to the protection of the collateral is outside the scope of what is permitted by subsection 3.112(a)(3).⁴³ To permit such a list would destroy the idea of being able to readily determine whether the document is negotiable or not.

Keeping in mind subsections 3.112(a)(2) and (a)(3), an examination of several of the paragraphs on the reverse side of the CONTRACT executed between Camel Lot Mobile Homes and Mr. and Mrs. Moe Bill Buyer should point to the fact that the CONTRACT is not negotiable.

Paragraph 8 grants the seller the power to receive all money paid for any loss or damage to the mobile home, the power to execute

36. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 14-4, at 462 (1972).

37. TEX. BUS. & COMM. CODE ANN. § 9.105(a)(12) (Tex. UCC Supp. 1976).

38. J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 14-4, at 463 (1972). If an "instrument" as defined by § 9.105(a)(9) of the Texas Business & Commerce Code may not of itself be a security agreement, then the better position is that the contract may indicate what the security is and may not contain language creating the security interest.

39. TEX. BUS. & COMM. CODE ANN. § 3.112, Comment 1 (Tex. UCC 1968).

40. *Id.* § 3.112(a)(2).

41. *Id.* § 3.112, Comment 1.

42. Pacific Fin. Loans v. Goodwin, 324 N.E.2d 578, 580 (Ohio Ct. App. 1974).

43. See J. WHITE & R. SUMMERS, HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE § 14-4, at 463 (1972).

drafts and releases, and the authority to apply such money to the indebtedness:

8. BUYER hereby directs any insurance company or any other person liable for loss or damage to MOBILE HOME to make payments directly to SELLER and BUYER hereby appoints SELLER as attorney in fact to endorse any draft or to execute any proofs or releases in the name of BUYER in connection with any insurance loss or claim. All payments so received by SELLER shall be applied on the indebtedness secured by this Contract until same is fully paid and the balance, if any, shall be delivered to BUYER.

The money received by the seller under this paragraph may be used solely for the purpose of reducing the indebtedness. The power given by this paragraph is not for the protection and maintenance of the mobile home. Since the power given by this paragraph is not authorized by section 3.112 the CONTRACT is not negotiable.

Paragraph 6 provides that any future indebtedness owed to the seller would be paid according to the terms and provisions of the CONTRACT:

6. Payment—BUYER will pay the Total of Payments secured by this Contract and any renewal or extension thereof and any other indebtedness hereby secured in accordance with the terms and provisions thereof and will repay immediately all sums expended by SELLER in accordance with the terms and provisions of this Contract.

The promise to pay future indebtedness according to the terms and conditions of the CONTRACT is "another promise" beyond the scope of sections 3.104 and 3.112.⁴⁴

Paragraph 5 requires the buyer to notify the seller of any change in location of the mobile home or any change in location of his chief place of business or his residence:

5. Change of Residence or Place of Business—BUYER will promptly notify SELLER in writing of any change in the place where MOBILE HOME is to be kept, or BUYER'S chief place of business or BUYER'S residence.

The promise to notify of a change of address is "another promise" which destroys negotiability.⁴⁵ This promise is but one of many which

44. See *Geiger Fin. Co. v. Graham*, 182 S.E.2d 521, 524 (Ga. Ct. App. 1971). See also 6C BENDER'S UNIFORM COMMERCIAL CODE SERVICE, U.C.C. REPORTER-DIGEST § 3-104, at 2-718.12 (1975).

45. *Hudiburg Imported Cars, Inc. v. Hart*, 383 P.2d 650, 652 (Okla. 1963).

an assignee of the CONTRACT might argue has some relevance in trying to protect or maintain the collateral. To conclude that subsection 3.112(a)(3) permits this promise, after the buyer has already promised to keep the collateral insured and in good repair and to keep the taxes paid, would depart from the simplicity with which negotiability should be recognized.

Not only do retail installment contracts generally fail to meet the "no other promise" test of negotiability, the contracts very often do not meet the "sum certain" requirement.⁴⁶ Paragraph 7(d) of the CONTRACT provides that if the required physical damage insurance purchased by buyer is cancelled, then the seller shall furnish equivalent coverage and add the additional cost incurred to the sum owing under the CONTRACT:

7(d). If during the existence of this Contract the insurance company to which application is made for an insurance policy required by this Contract, or, if after the issuance of a policy required by this Contract and during the term of this Contract, a policy required by this Contract is cancelled, BUYER shall, prior to said cancellation, furnish an equivalent policy issued by another company, or if BUYER so fails to furnish said equivalent policy, SELLER shall procure an equivalent policy and all unearned portions of the premium of the insurance cancelled shall be applied upon the premium for said equivalent policy, and BUYER shall pay the balance, if any, of the premium for said equivalent policy.

The CONTRACT, paragraph 6, provides that any future indebtedness will be repaid according to the terms and conditions of the CONTRACT. By granting the seller the power to purchase insurance and add the cost of such insurance to the balance, the sum payable becomes uncertain.⁴⁷ There have been courts which have held that

46. The sum certain requirement of § 3.104 is qualified by the provisions of § 3.106. Section 3.106 *Sum Certain*

(a) The sum payable is a sum certain even though it is to be paid
 (1) with stated interest or by stated installments; or
 (2) with stated different rates of interest before and after default or a specific date;
 or
 (3) with a stated discount or addition if paid before or after the date fixed for payment; or
 (4) with exchange or less exchange, whether at a fixed rate or at the current rate;
 or
 (5) with costs of collection or an attorney's fee or both upon default.

(b) Nothing in this section shall validate any term which is otherwise illegal. TEX. BUS. & COMM. CODE ANN. § 3.106 (Tex. UCC 1968).

47. 2 R. ANDERSON, UNIFORM COMMERCIAL CODE § 3-106:10, at 638 (1971).

where the obligor promises to pay taxes and insurance, the document⁴⁸ is not rendered nonnegotiable.⁴⁹ On the other hand, where the obligee is given the authority to purchase and add the cost of such insurance to the unpaid balance, the contract is nonnegotiable.⁵⁰

Even from this brief analysis of the CONTRACT it is easy to see why a retail installment contract containing numerous obligations between buyer and seller cannot meet the standards of negotiability. It may be possible to draft a retail installment contract that is negotiable. The safest way for a retail installment contract to pass the test of negotiability is to draft it as though it were a simple promissory note that makes reference to a separate document, which is the security agreement.

A RETAIL INSTALLMENT CONTRACT AND A SECURITY AGREEMENT AS A SINGLE DOCUMENT CAN NOT BE NEGOTIABLE

A retail installment contract that contains a security agreement is governed by the provisions of article 9 of the UCC.⁵¹ Section 9.318 provides that an assignee is subject to any claim or defense arising from the contract between the assignor and the account debtor,⁵² unless the account debtor has made an enforceable agreement not to assert claims or defenses arising out of the sale as provided in section 9.206.⁵³

48. "Document" for the purpose of this article means a writing which consists of either a note, contract, or security agreement.

49. *Hunter v. Clarke*, 56 N.E. 297, 298-99 (Ill. 1900); *Wilson v. Campbell*, 68 N.W. 278, 280 (Mich. 1896).

50. *Johnstown Bank v. American Sur. Co.*, 174 N.Y.S.2d 385, 388 (Sup. Ct. 1958); *Anderson v. Hoard*, 387 P.2d 73, 75 (Wash. 1963); Opinion of the Attorney General of Iowa, 3 UCC REP. SERV. 183, 189 (1965).

51. *Jefferson v. Mitchell Select Furniture Co., Inc.*, 321 So. 2d 216, 220 (Ala. Civ. App. 1975); *Geiger Fin. Co. v. Graham*, 182 S.E.2d 521, 525 (Ga. Ct. App. 1971). In the Texas Business and Commerce Code, article 9 of the UCC is referred to as chapter 9. Chapter 9, § 9.102(b) applies to security interests created by conditional sales contracts. Chapter 3 is also subject to the provisions of chapter 9. TEX. BUS. & COMM. CODE ANN. § 3.103(b) (Tex. UCC 1968).

52. TEX. BUS. & COMM. CODE ANN. § 9.318(a)(1) (Tex. UCC 1968). Someone who is obligated on chattel paper is an "account debtor." *Id.* "Chattel paper" includes conditional sales contracts. *Id.* § 9.105, Comment 4.

53. TEX. BUS. & COMM. CODE ANN. § 9.206(a) (Tex. UCC Supp. 1976-1977) provides that:

Subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods, an agreement by a buyer or lessee that he will not assert against an assignee any claim or defense which he may have against the seller or lessor is enforceable by an assignee who takes his assignment for value, in good faith and without notice of a claim or defense, except as to defenses of a type which may be asserted against a holder in due course of a negotiable instrument under the chapter on Commercial Paper (Chapter 3). A buyer who as part of one transaction signs both a negotiable instrument and a security agreement makes such an agreement.

An enforceable agreement not to assert claims and defenses may result from the situation where a buyer signs both a negotiable instrument and a security agreement as part of one transaction. In order to qualify as an "instrument" under chapter 9 of the Texas Business and Commerce Code the contract may not itself be a security agreement.⁵⁴ The CONTRACT between Mr. and Mrs. Buyer and Camel Lot Mobile Homes cannot be a negotiable instrument for purposes of chapter 9. The CONTRACT cannot be an instrument since it also contains a security agreement. The retail installment contract and the security agreement would have to be two separate writings in order for the contract to be considered an instrument.⁵⁵

WAIVER OF DEFENSES

A clause waiving claims or defenses against the assignee is enforceable subject to any statute or decision that establishes a different rule for buyers or lessees of consumer goods.⁵⁶ As far as motor vehicle installment sales contracts are concerned in Texas, no such contract can "provide that the buyer agrees not to assert against the seller or holder of any claim or defense arising out of the sale."⁵⁷ This prohibition applies to the purchase of motor vehicles on credit whether the purchase is for business use or for personal, family, or household use.⁵⁸ A holder for the purpose of motor vehicle installment sales under chapter 7 of the Texas Credit Code is a seller or assignee of the retail installment contract.⁵⁹

All retail installment sales, other than chapter 7 motor vehicle sales, that are subject to finance charge limitations are governed by the provisions of chapter 6 of the Texas Credit Code. Chapter 6 transactions, unlike chapter 7 transactions, are limited to purchases of goods⁶⁰

54. *Id.* § 9.105(a)(9).

55. *See* Van Norden v. Auto Credit Co., 135 S.E.2d 477, 479 & n.1 (Ga. Ct. App. 1964). From the definition of instrument in chapter 9 it can be inferred that when § 9.206 refers to the buyer signing both a negotiable instrument and a security agreement it is making reference to the signing of two separate documents. *See* TEX. BUS. & COMM. CODE ANN. § 9.105(a)(9) (Tex. UCC Supp. 1976-1977).

56. TEX. BUS. & COMM. CODE ANN. § 9.206(a) (Tex. UCC Supp. 1976-1977).

57. TEX. REV. CIV. STAT. ANN. art. 5069-7.07(6) (1971).

58. This prohibition would not apply to the purchase of a motor vehicle on credit which is being purchased for resale. *See id.* art. 5069-7.01(b).

59. *Id.* art. 5069-7.01(j).

60. Goods are defined as:

all tangible personal property when purchased primarily for personal, family or household use and not for commercial or business use including such property which is furnished or used at the time of sale or subsequently, in the modernization, rehabilitation, repair, alteration, improvement or construction of real property

or services⁶¹ solely for personal, family, or household use.⁶²

Chapter 6 prohibits the use of a clause in which the buyer would waive a claim or defense that he might have against the seller.⁶³ There is no prohibition against waiving claims and defenses which might be asserted by the buyer in an action brought by the assignee. There is no logical reason for chapter 6 not to contain such a prohibition when chapter 7 forbids the waiving of claims and defenses.⁶⁴ Public policy prohibiting such a waiver should be just as strong in chapter 6 transactions since it relates exclusively to transactions affecting consumers.⁶⁵ It is likely that the failure to include "holder" in article 5069-6.05(6) was simply an oversight.

There is good reason to argue, even without a specific prohibition, that a waiver of defense clause in a chapter 6 transaction is unenforceable. The effect of enforcing a waiver of defense clause is to make a nonnegotiable document negotiable by stipulation. Negotiability by stipulation is not sanctioned by the Texas Business and Commerce Code.⁶⁶ To enforce such clauses in valid consumer transactions is contrary to public policy.⁶⁷ One of the purposes in enacting the Texas Credit Code was to protect consumers from sellers "engaged in many abusive and deceptive practices in the conduct of their businesses."⁶⁸ Enforcement of a waiver of defense clause would be contrary to that

so as to become a part thereof whether or not severable therefrom. The term also includes, but is not limited to, any boat, boat-trailer, motor scooter, motorcycle, camper-type trailer, horse trailer, any vehicle propelled or drawn exclusively by muscular power, and merchandise certificates or coupons, issued by a retail seller, not redeemable in cash and to be used in their face amount in lieu of cash, in exchange for goods or services sold by such seller.

Id. art. 5069-6.01(a).

61. Services are defined as:

work, labor, or services of any kind when purchased primarily for personal, family or household use and not for commercial or business use, but does not include (i) the services of a professional person licensed by the State; or (ii) services for which the cost is by law fixed or approved by, or filed with or subject to approval or disapproval by the United States or the State of Texas, or any agency, instrumentality or subdivision thereof; or (iii) educational services provided by an accredited college or university or a primary or secondary school providing education required by the State of Texas or services of a kindergarten or nursery school.

Id. art. 5069-6.01(b).

62. *See id.* art. 5069-7.01(d).

63. *Id.* art. 5069-6.05(6).

64. *Id.* art. 5069-7.07(6).

65. *Id.* art. 5069-6.01(e).

66. TEX. BUS. & COMM. CODE ANN. § 3.104, Comment 2 (Tex. UCC 1968), provides that a writing cannot be made a negotiable instrument by contract or "by the mere insertion of a clause agreeing that it shall be one."

67. *Fairfield Credit Corp. v. Donnelly*, 264 A.2d 547, 551 (Conn. 1969); *Unico v. Owen*, 232 A.2d 405, 418 (N.J. 1967).

68. Tex. Laws 1967, ch. 274, § 1(4), at 608.

purpose. The purchaser of a retail installment contract is in a far better position to know the true character of the seller and the nature of his business.⁶⁹ An attempt to evade the clear prerequisites of negotiability by use of technical language, the significance of which is difficult for the ordinary consumer to appreciate, is contrary to the policy of the Texas Business and Commerce Code, which provides that one not a holder in due course takes subject to all the claims and defenses which could have been asserted against the assignor.⁷⁰

THIRTY-DAY NOTICE

No claim or defense can be cut off by assignment of a chapter 6 or chapter 7 retail installment contract without giving the appropriate statutory "notice to buyer."⁷¹ From the date the notice is mailed the buyer is given thirty days to notify the assignee of any claim or defense which he has against the seller.⁷²

Even though the proper notice is sent to the buyer, claims and defenses will not be cut off even if the buyer does not respond within the thirty-day period.⁷³ "No right of action or defense . . . which would be cut off by negotiation, shall be cut off by negotiation" unless the notice to buyer is given.⁷⁴ Only claims and defenses which could have been cut off by negotiation shall be cut off after the "notice to buyer" has been given. The assignee is still required to purchase a negotiable instrument before claims and defenses are cut off. To allow the "notice to buyer" provision to operate to deprive consumers of the right to assert a claim or defense against an assignee who is a purchaser of a nonnegotiable contract would be unjust. The "notice to buyer" does not tell the buyer that he cannot assert claims or defenses if he does not register his complaint within thirty days. Before a "notice to buyer" statement should be allowed to cut off claims and defenses the "notice" should indicate to the buyer what the consequences of his failure to act are. Even if the "notice" informed the buyer of the consequences of his failure to respond, the chances are good that the un-

69. *Discount Purchasing Co. v. Porch*, 12 UCC REP. SERV. 600, 611 (Tenn. Ct. App. 1973).

70. TEX. BUS. & COMM. CODE ANN. § 3.306 (Tex. UCC 1968).

71. TEX. REV. CIV. STAT. ANN. art. 5069-6.07, and art. 5069-7.08(4) (1971); see *Commercial Credit Corp. v. Nichols*, 529 S.W.2d 588, 590 (Tex. Civ. App.—Amarillo 1975, no writ).

72. TEX. REV. CIV. STAT. ANN. art. 5069-7.08(4), and art. 5069-6.07 (1971).

73. *Id.* art. 5069-6.07, and art. 5069-7.08(4).

74. *Id.* art. 5069-6.07, and art. 5069-7.08(4).

sophisticated and poorly educated consumer still would not respond within the very short complaint period. The result of a cut-off in this situation would diminish the effectiveness of many consumer protection laws.⁷⁵

FTC HOLDER IN DUE COURSE RULE

On May 14, 1976, the Federal Trade Commission's Rule concerning the "Preservation of Consumers' Claims and Defenses" went into effect.⁷⁶ The HDC Rule makes it an unfair or deceptive practice for a seller not to include the following provision in a consumer credit contract:⁷⁷

NOTICE

ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.⁷⁸

The notice requirement also applies to "purchase money loans"⁷⁹ as well as to retail installment contracts. For the purpose of this article attention is focused solely on the effect of the HDC Rule on retail installment contracts.

The HDC Rule destroys the negotiability of consumer credit contracts by imposing an additional "obligation" or "power" not permitted under article three of the UCC.⁸⁰ The failure to include the

75. The Deceptive Trade Practices-Consumer Protection Act is one act that might be diminished in its effectiveness. TEX. BUS. & COMM. CODE ANN. § 17.41-.63 (Supp. 1976-1977). Another such act concerns Home Solicitation Transactions. TEX. REV. CIV. STAT. ANN. arts. 5069-13.01 to .06 (Supp. 1976-1977).

76. 40 Fed. Reg. 53,506 (1975) (to be codified at 16 C.F.R. § 433.1, .2) [hereinafter referred to as the HDC Rule].

77. *Id.* at 53,506 defines a "contract" as "[a]ny oral or written agreement . . . between a creditor and a seller, which contemplates or provides for cooperative or concentrated activity in connection with the sale of goods or services to consumers or the financing thereof."

78. *Id.* at 53,506 (must be in at least ten point, bold face type).

79. *Id.* at 53,506 defines a "purchase money loan:"

A cash advance which is received by a consumer in return for a 'Finance Charge' within the meaning of the Truth-in-Lending Act and Regulation Z, which is applied, in whole or substantial part, to a purchase of goods or services from a seller who (1) refers consumers to the creditor or (2) is affiliated with the creditor by common control, contract, or business arrangement.

See 41 Fed. Reg. 34,594-97 (1976) for explanation of HDC Rule's definition of "purchase money loan."

80. TEX. BUS. & COMM. CODE ANN. § 3.104(a)(2) (Tex. UCC 1968).

notice in the contract would also destroy negotiability since such failure would give rise to a claim for engaging in an unfair or deceptive trade practice.

As discussed earlier, a retail installment contract which contains a security agreement is subject to the provisions of chapter 9 of the Texas Business and Commerce Code.⁸¹ If the assignee is not the owner of a negotiable retail installment contract, then under section 9.318(a)(1) the "*rights of an assignee are subject to all the terms of the contract between the account debtor and assignor and any defense or claim arising therefrom . . .*"⁸² This provision does not permit affirmative recovery but only the assertion of claims and defenses up to a complete set-off of "rights" acquired by the assignee.⁸³

The major change in assignee liability brought about by the HDC Rule is that an assignee may be liable to the consumer for an affirmative recovery up to the amount paid under the contract.

The limitations on affirmative recovery against the assignee under section 9.318 or the HDC Rule should not be construed as limiting the consumer's right to affirmative recovery under any other law which may subject the assignee to liability.⁸⁴ Affirmative recovery against an assignee may be had for debt collecting harassment,⁸⁵ Truth-in-Lending violations,⁸⁶ certain Credit Code disclosure violations,⁸⁷ and excessive charging of interest or time-price differential.⁸⁸

CONCLUSION

For years to come it will still be necessary for Texas lawyers to analyze retail installment contracts to see if they are negotiable or not. The chances are good that most retail installment contracts in use today are not negotiable. If the contract is nonnegotiable, the con-

81. See note 51 *supra*.

82. TEX. BUS. & COMM. ANN. § 9.318(a)(1) (Tex. UCC 1968) (emphasis added).

83. The "rights" of the assignee being subject to any claim or defense is a limitation on affirmative recovery. The claim or defense may be asserted only to the extent of the "rights" acquired by the assignee. See *Hudson Supply & Equip. Co. v. Home Factors Corp.*, 210 A.2d 837 (D.C. Ct. App. 1965); *Pendarvis v. General Motors Corp.*, 6 UCC REP. SERV. 457 (N.Y. Sup. Ct. 1969).

84. Guidelines on Trade Regulation Rule Concerning Preservation of Claims and Defenses, 41 Fed. Reg. 20,022 (1976).

85. TEX. REV. CIV. STAT. ANN. arts. 5069-11.01 to .11 (Supp. 1976-1977).

86. 15 U.S.C. § 1614 (Supp. 1976).

87. TEX. REV. CIV. STAT. ANN. arts. 5069-6.04, and 5069-7.06 (1971).

88. *Moore v. Sabine Nat'l Bank*, 527 S.W.2d 209, 211 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.).

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sumer may assert his claims and defenses. The Texas Credit Code was meant to protect the buyer and not deprive him of his claims and defenses; with this idea in mind the "notice to buyer" statutory notices will not operate to cut off his claims and defenses.

RETAIL INSTALLMENT CONTRACT - MOBILE HOME & SECURITY AGREEMENT
Consecutive & Substantially Equal Monthly Installments
Truth In Lending Disclosure

DATE JULY 19 1973

IN ACCORDANCE with the terms and provisions of this combined retail installment contract, security agreement and Truth in Lending Disclosure (hereinafter referred to as CONTRACT) SELLER hereby sells on the date above shown and BUYER (jointly and severally) hereby purchases from SELLER the following described MOBILE HOME and all extra equipment checked below, hereinafter referred to as MOBILE HOME, for the consideration herein provided.

New or Used N Year 7 No. 4yl Make CHIEF Trade Name Length & Width 60x24 Number of Bedrooms 3 Manufacturer's Serial No. 3597FE1LND6014263858

FURNISHINGS AND EQUIPMENT FINANCED AS PART OF THE MOBILE HOME: (THIS INFORMATION MUST BE FURNISHED TO THE LENDER)

I. Appliances	Make	Serial #	II. Furniture	# Items	# Items
Refrigerator			Dinette Table		Bed(s)
Stove			Dinette Chair(s)		Dresser(s)
Dishwasher			Sofa		
Disposal			Occa. Chair(s)		III. General
Washer			End Table(s)		Decorator Kit
Dryer			Coffee Table(s)		General Decor
Hot Water Heater			Lamp(s)		Carpet
Air Conditioner			Drapes		Wheels
Central Heating			Description of Trade		Axles
Freezer					

Mobile Home shall be kept at _____

Total of payments shown on line 7 of Disclosure Column is payable to SELLER, or order, at SELLER'S address, or any other place in the State of Texas, designated in writing by the owner and holder of this Contract in 144 monthly installments of \$ 150.83 each, commencing SEPTEMBER 1973, and on the same day of each month thereafter with the remaining unpaid balance being due _____, 19____.

BUYER may prepay any unpaid balance at any time, without penalty, and any unearned FINANCE CHARGE will be refunded in accordance with the sum of the digits method (less acquisition charge of \$25). If any installment or portion thereof continues unpaid for more than ten days following the date such payment is due, including Sundays and holidays, SELLER shall have the right, at SELLER'S option, to collect additional interest for default in an amount not to exceed 5% of each installment or FIVE DOLLARS, whichever is less, and said charge shall be paid not later than 30 days after said default; accelerate the maturity of installments, repossess and sell MOBILE HOME, and BUYER shall pay all reasonable attorneys' fees, court costs, disbursements and interest after maturity at the highest lawful contract rate, subject to and governed by the applicable provision of the Uniform Commercial Code of Texas and the Consumer Credit Code of Texas. BUYER and SELLER hereby acknowledge that this Contract contains the entire agreement of the parties and no promise has been made by SELLER as inducement to the BUYER to become a party to this Contract and no promises have been made to compensate BUYER for referring customers or prospective customers.

Credit life, accident, health or loss of income insurance coverage is voluntary and not required for this credit. For term of credit, Credit life, at \$ 300.00, Credit life, accident and health at \$ _____, _____ at \$ _____ is available. I desire the insurance coverage checked, _____, 19____.

I do not desire insurance coverage.

MOE BILL BUYER
(Signature of BUYER)

All insurance listed in this paragraph and checked is required by this contract and shall be for a term of at least 60 months and shall be based upon actual value of MOBILE HOME at time of loss, not to exceed limits of liability set forth in policy and shall be payable to BUYER, SELLER or SELLER'S assigns, as interest may appear and if obtained through SELLER at the premium shown: Fire and Theft Premium \$ _____, Comprehensive Coverage \$ 757.00, Deductible Col. \$ _____.

ON THE INSURANCE COVERAGE REQUIRED BY THIS CONTRACT AS SHOWN ABOVE, BUYER SHALL HAVE THE OPTION OF FURNISHING SAID INSURANCE EITHER THROUGH EXISTING POLICIES OWNED OR CONTROLLED BY BUYER OR OF PROCURING AND FURNISHING EQUIVALENT COVERAGE THROUGH ANY INSURANCE COMPANY AUTHORIZED TO TRANSACT BUSINESS IN TEXAS. Above required insurance coverage to be furnished by SELLER BUYER. LIABILITY INSURANCE COVERAGE FOR BODILY INJURY AND PROPERTY DAMAGE CAUSED TO OTHERS IS NOT INCLUDED HEREIN.

Insurance furnished under this contract is/is not of manual rates.

BUYER hereby acknowledges delivery and acceptance of MOBILE HOME in its present condition, and hereby grants to SELLER a security interest in MOBILE HOME and all after acquired personal property to secure the payment of Total of Payments and all existing and future liabilities, of whatever type, of BUYER to SELLER.

Notice to the BUYER - Do not sign this Contract before you read it or if it contains any blank spaces. You are entitled to a copy of the Contract you sign. Under the law you have the right to pay off in advance the full amount due and under certain conditions may obtain a partial refund on the FINANCE CHARGE. Keep this Contract to protect your legal rights.

NOTICE: See other side for important information. The warranties, covenants, terms, and agreements on the reverse side are incorporated herein and made a part hereof for all intents and purposes. SELLER and BUYER, as used in this contract, include the heirs, executors, and administrators, successors, or assigns of those parties.

BUYER hereby acknowledges that this combined Retail Installment Contract and Security Agreement with Truth In Lending Disclosure was completed as to all essential provisions and disclosures before it was signed by BUYER and a copy thereof was delivered to BUYER at the time this Contract was signed.

MOE BILL BUYER
(Signature of Buyer)

MRS. MOE BILL BUYER
(Signature of Co-Signer)

MR. AND MRS. MOE BILL BUYER, 1234 NOWHERE AVE., NOWHERE, TEXAS
(Type Name and Address of Buyer)

CAMEL LOT MOBILE HOMES, 4567 MAIN STREET, NOWHERE, TEXAS
(Signature and Address of Seller)

TRIPlicate

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BUYER WARRANTIES, COVENANTS AND AGREES:

- 1. Certificate of Title - BUYER will execute all necessary instruments deemed necessary by SELLER to perfect the security interest herein granted and will pay the cost of filing same.
2. Protection of MOBILE HOME - BUYER will keep MOBILE HOME in good order and repair and will not waste or destroy MOBILE HOME or any part thereof. BUYER will not use the MOBILE HOME in violation of any statute or ordinance and SELLER will have the right to examine and inspect MOBILE HOME at any reasonable time.
3. Taxes - BUYER will pay promptly when due all taxes and assessments upon the MOBILE HOME or for its use and operation.
4. Additional Security Interest - BUYER hereby grants to SELLER, a security interest in and to all proceeds, substitutions, replacements, additions, accessions to the MOBILE HOME. BUYER hereby agrees that all equipment, accessories, repairs, and parts placed upon MOBILE HOME during the existence of the security interest hereby granted shall become a part of MOBILE HOME and shall be subject to the terms and provisions of this Contract.
5. Change of Residence or Place of Business - BUYER will promptly notify SELLER in writing of any change in the place where MOBILE HOME is to be kept, or BUYER'S chief place of business or BUYER'S residence.
6. Payment - BUYER will pay the Total of Payments secured by this Contract and any renewal or extension thereof and any other indebtedness hereby secured in accordance with the terms and provisions thereof and will repay immediately all sums expended by SELLER in accordance with the terms and provisions of this Contract.
7. Insurance - On all insurance policies required under this Contract as provided on front side hereon, BUYER hereby agrees as follows:
a. On all policies furnished or procured by SELLER, BUYER shall pay all premiums on said policy or policies promptly and perform all other acts necessary to keep said policy or policies in full force and effect during the existence of this Contract.
b. On all policies required by this Contract and furnished by BUYER, BUYER shall pay all premiums due on said policy and otherwise perform all necessary acts to keep said policy in full force and effect during the existence of this Contract and a copy of said policy shall be promptly furnished SELLER.
c. All proceeds from required physical damage insurance, by whomsoever procured, shall be applied toward replacement or repair of MOBILE HOME or repayment of Total of Payments, at the option of SELLER.
d. If during the existence of this Contract the insurance company to which application is made for an insurance policy required by this Contract, or if after the issuance of a policy required by this Contract and during the term of this Contract, a policy required by this Contract is cancelled, BUYER shall, prior to said cancellation, furnish an equivalent policy issued by another company, or if BUYER so fails to furnish said equivalent policy, SELLER shall procure an equivalent policy and all unearned portions of the premium of the insurance cancelled shall be applied upon the premium for said equivalent policy, and BUYER shall pay the balance, if any, of the premium for said equivalent policy.
8. BUYER hereby directs any insurance company or any other person liable for loss or damage to MOBILE HOME to make payments directly to SELLER and BUYER hereby appoints SELLER as attorney in fact to endorse any draft or to execute any proofs or releases in the name of BUYER in connection with any insurance loss or claim. All payments so received by SELLER shall be applied on the indebtedness secured by this Contract until same is fully paid and the balance, if any, shall be delivered to BUYER.
9. If any provision of this Contract is prohibited by law, the remaining portion of this Contract shall remain in full force and effect and shall not be affected by said invalid portion or provision.
10. Time-Waiver - BUYER agrees that in performing any act under this Contract and the payment of Total of Payments secured thereby that time shall be of the essence and that SELLER'S acceptance of partial or delinquent payments, or failure of SELLER to exercise any right or remedy shall not be a waiver of any obligation of BUYER to right of SELLER or constitute waiver of any other similar default subsequently occurring.
11. Default - BUYER shall be in default under this Contract upon the happening of any of the following events or conditions:
a. Default in the payment or performance of any obligation, covenant or liability contained or referred to herein;
b. Any time SELLER in good faith believes that the prospect of payment of Total of Payments secured hereby or the performance of this Contract is impaired.
12. Remedies - Upon the occurrence of any such event of default, or any time thereafter, SELLER may declare the Total of Payments secured hereby immediately due and payable and may proceed to enforce payment of the same and exercise all the rights and remedies provided by the Uniform Commercial Code as well as all rights and remedies possessed by SELLER; provided, however, that SELLER shall not have any rights or remedies under the Uniform Commercial Code which are denied or prohibited by the Consumer Credit Code of Texas (House Bill 452, 60th Legislature, Regular Session, 1967) and the warranties, covenants, and agreements herein contained shall not constitute waiver of any rights accruing to BUYER under the Consumer Credit Code of Texas. Said warranties, covenants, and agreements shall not be construed to authorize the SELLER or any person acting on the SELLER'S behalf to enter upon the BUYER'S premises unlawfully or to commit any breach of the peace in the repossession of MOBILE HOME. SELLER may require BUYER to make MOBILE HOME available to SELLER at any place to be designated by SELLER which is reasonably convenient to both parties. Unless MOBILE HOME threatens to decline speedily in value or is a type customarily sold in a recognized market, SELLER will give BUYER reasonable notice of the time and place of any public sale thereof or of the time after which any private sale or any other intended disposition thereof is to be made. The requirements of reasonable notice shall be met as such notice is mailed, postage prepaid, to the address of BUYER shown at the beginning of this Contract at least five days before the time of sale or disposition.
13. Warranties - No warranties, expressed or implied, representations or promises, have been made by SELLER to BUYER with respect to the merchantability, suitability, fitness for purpose or otherwise of MOBILE HOME unless same is endorsed hereon in writing or is contained in a separate instrument duly executed.

ASSIGNMENT

For value received, SELLER assigns the Total of Payments due under the above RETAIL INSTALLMENT CONTRACT - MOBILE HOME and all rights, title and interest in said RETAIL INSTALLMENT CONTRACT to FRIENDLY FINANCE COMPANY with recourse

DATED this the 19th day of July, 1973

CAMEL LOT MOBILE HOMES

Signature of Seller

JOHN CAMEL

By

FULL REPURCHASE

PARTIAL REPURCHASE

Undersigned agrees to repurchase the Mobile Home from Assignee should Assignee at any time repossess or come into possession of it, and tender delivery of the same to undersigned. Undersigned agrees to pay, in cash therefor, upon demand, an amount equal to the unpaid balance owing on the Contract relating thereto, regardless of the need of repair or condition of said Mobile Home. Undersigned waives notice of the acceptance of this Agreement.

The terms and obligations of the foregoing Full Repurchase agreement (which are incorporated herein by reference) are hereby assumed by the undersigned to Assignee with the understanding, however, that in lieu of purchasing said Mobile Home, undersigned may discharge such obligation by payment of \$_____ to Assignee upon demand.

Dated this the ___ day of _____, 19__

Dated this the ___ day of _____, 19__

Seller

Seller

By _____

By _____