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Real Property

Wagner William Van R.

Holly H. Gotelli

Mark M. Sloan

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*William R. Van Wagner**
*Holly H. Gotelli***
*Mark M. Sloan****

THIS Article surveys developments in the area of Real Property, with discussion of related topics, from October 1, 1991 to September 30, 1992.[1] During the Survey period, Texas courts continued the trend of the last several years to enforce unambiguous contracts as written. The overriding contractual interpretation principle of the day is to enforce the intent of the parties as evidenced by the four corners of their contractual agreements.[2] The Survey cases further indicate that Texas courts (at least at the appellate level) and federal courts applying Texas and federal law will closely scrutinize lender liability claims and defenses that were so common during the 1980s[3] and, in some cases, chastise and admonish both borrowers asserting and trial courts upholding what appear to be dubious claims.[4] These decisions lead to the inescapable viewpoint that mortgage lenders' confidence in the enforceability of their clear contractual agreements should be as great as their wariness and fear of the wave of successful lender liability cases that occurred during the 1980s. Lenders are not invincible, however, as evidenced by several decisions that have imposed liability on or subjected a lender to the risk of liability where the lender has acted egregiously.[5] Nev-

* Shareholder, Thompson & Knight, P.C.; B.B.A., Western Michigan University, 1970; J.D., *cum laude*, Southern Methodist University, 1980.

** Associate, Thompson & Knight, P.C.; B.A., Texas Tech University, 1987; J.D., Texas Tech University, 1990.

*** Associate, Thompson & Knight, P.C., B.B.A., University of Iowa, 1985; J.D., *cum laude*, Southern Methodist University, 1990.

1. The sheer volume of cases has not permitted the authors to include all cases that affect the legal practice of all real estate practitioners. We have, however, addressed those cases that are most applicable to the "average" real estate practice. We have intentionally omitted zoning cases as they are more properly addressed in either a local government or administrative article. In addition, we have intentionally limited the scope of some sections. For example, we have not addressed all cases dealing with promissory notes, guaranties or cases arising under FIRREA, since many cases involving notes, guaranties and FIRREA have little effect on the real estate practitioner. Finally, we have made a conscious decision not to report on some real estate cases that reflect unremarkable fact situations and neither create new law nor provide new or otherwise worthy instruction on the application of existing law. Without making these decisions, we would have been deemed to have presumptuously decided that our writing and reporting ability is of such a magnitude that all readers would have the stamina and courage to traipse through the resulting forest.

2. *See infra* notes 154-66, 450, 486 and accompanying text.

3. *See, e.g.*, Lawrence J. Fossi et al., *Real Property, Annual Survey of Texas Law*, 45 SW. L.J. 2055 (1992).

4. *See, e.g.*, cases cited *infra* notes 302-22.

5. *See, e.g.*, Matthews v. AmWest Sav. Ass'n, 825 S.W.2d 552 (Tex. App.—Beaumont

ertheless, even egregious conduct may go unsanctioned if either the Federal Deposit Insurance Corporation (FDIC) or the Resolution Trust Corporation (RTC) becomes the receiver for or acquires the assets of the lender committing the egregious acts. In such cases, the debtor may be doomed by the *D'Oench, Duhme* doctrine[6] and/or its statutory companion (Section 1823(e))[7] created by the Financial Institutions Reform, Recovery and Enforcement Act of 1989[8] (commonly known as FIRREA), the federal holder in due course doctrine[9], the federal anti-punitive damages doctrine,[10] or dismissal under prudential grounds.[11] These strategic defenses can seem impenetrable to even the most damaged, inventive and adventuresome debtors and withstand, in most cases, the most potent nuclear lobs that could be thrown at a private lending institution.[12]

Aside from lender related matters, the Survey cases touched upon most areas of the real estate legal practice. Most courts made a valiant effort to enforce contracts as intended by the parties and, as to non-contractual matters, the courts generally applied sound reasoning. Although the authors disagree with several results and the reasoning in several cases,[13] the Survey cases generally apply the law appropriately and honor precedent.

I. MORTGAGES

A. FORECLOSURE AND DEFICIENCY

During the Survey period, the Texas courts addressed several cases involving deficiencies. Although the Texas legislature has enacted a deficiency collection statute[14] that would control the resolution of certain issues in several

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1992, writ denied) (lender who successfully argued that a claim for breach of oral contract was barred by statute of frauds was surprised by the court's holding that the debtor could recover the loss of the benefit of its bargain under its fraud claim, even though that measure of damages was the same as that which would have been recoverable under the barred claim for breach of oral contract); LaCoure v. LaCoure, 820 S.W.2d 228 (Tex. App.—El Paso 1991, writ denied) (mortgagee held liable for infliction of emotional distress resulting from wrongful foreclosure where it was shown that mortgagee foreclosed on the basis of a deed of trust and note that was backdated at the direction of the mortgagee and following foreclosure, mortgagee caused ex-daughter-in-law and child to be evicted on the belief that male friends were staying over); Fairfield Fin. Group, Inc. v. Gawerc, 814 S.W.2d 204 (Tex. App.—Houston [1st Dist.] 1991, no writ) (facts that mortgagee [i] over a ten month period, accepted payments at a time and in an amount different from written agreement; [ii] did not deny oral agreement regarding revised payment schedule; [iii] foreclosed on the basis that payments continued at a time and in an amount different from written agreement without giving the debtor a reasonable opportunity to redeem, established prima facie case that debtor would probably succeed in a wrongful foreclosure action against the mortgagee).

6. The *D'oench, Duhme* doctrine was enunciated by the Supreme Court in D'oench, Duhme & Co. v. Federal Deposit Ins. Corp., 315 U.S. 447 (1942) and has been interpreted and expanded by its progeny. *See generally infra* notes 86-153 and accompanying text.

7. 12 U.S.C. § 1823(e) (1989).

8. Pub. L. No. 101-73, 103 Stat. 183 (1989).

9. *See, e.g.*, Federal Deposit Ins. Corp. v. Wood, 758 F.2d 156 (6th Cir. 1985), *cert. denied*, 474 U.S. 944 (1985).

10. *See infra* notes 82, 85 and accompanying text.

11. *See infra* notes 31-34 and accompanying text.

12. *See infra* note 77.

13. *See, e.g., infra* notes 102, 129-30, 158, 347 and accompanying text.

14. TEX. PROP. CODE ANN. § 51.003 (Vernon 1984 & Supp. 1993) (allowing any person

of the cases decided during the Survey period, these cases are instructive in different respects. For example, in *Resolution Trust Corp. v. Westridge Court Joint Venture*[15] the RTC, as receiver of a failed savings association, appealed from the trial court's judgment that it was not entitled to a deficiency judgment against the guarantors of a loan made by the failed savings association.[16] The debtor apparently did not challenge the validity of the foreclosure sale, but argued (and the trial court agreed) that the RTC was not entitled to a deficiency judgment because the savings association had bid a grossly inadequate price at the foreclosure sale[17] and had breached a fiduciary duty and duty of good faith and fair dealing owed to the debtor and guarantors by failing to conduct a commercially reasonable foreclosure sale.[18]

On appeal, the Houston court of appeals (First District) concluded that the mortgagee only owed the guarantor the duty to conduct the foreclosure sale properly[19] and that this duty was fulfilled because the foreclosure sale was valid.[20] The validity of the sale, according to the court, was established because the defendant had not raised, as required by Texas law, a fact issue that would indicate that an irregularity occurred in the foreclosure sale process that resulted in a grossly inadequate sale price.[21]

Attempting to find a backdoor to avoid the deficiency claim, the guarantors argued that the foreclosure sale was an unconscionable transaction under Section 17.45(5) of the Texas Deceptive Trade Practices Act[22]

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against whom a deficiency judgment is sought to request the court to determine the fair market value of the property at the time of the foreclosure and, if the court determines that the property was purchased for less than its fair market value, the deficiency amount will be offset by the amount by which the fair market value, less the secured indebtedness not extinguished by the foreclosure, exceeds the sale price).

15. 815 S.W.2d 327 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

16. *Id.* at 328. It is not clear when the RTC succeeded to the rights of the failed Southwest Savings Association. Because no federal common law or statutory defenses were argued, this fact is not particularly relevant.

17. *Id.* at 330. The trial court determined that the fair market value of the property at the time of the foreclosure sale was at least $1,500,000, that the savings and loan had bid $957,600 and that the disparity resulted in a grossly inadequate bid price. *Id.*

18. *Id.*

19. *Id.* at 332.

20. *Id.* The court's reasoning that the sale was valid and therefore proper may not be correct. Specifically, as stated in Savings Ass'n of Houston v. Musick, 531 S.W.2d 581, 587 (Tex. 1975), an invalid foreclosure sale depends upon an irregularity in the foreclosure sale that causes or results in a gross insufficiency in the sale price. Accordingly, a mortgagee may logically argue that if it takes some action that chills the bidding process without resulting in a gross insufficiency in the sale price, the action should not invalidate the foreclosure sale. On the other hand, the debtor could logically argue that the chilling effect, although not affecting the validity of the sale, should constitute a defense to a deficiency action by the mortgagee. *See infra* notes 37-45 and accompanying text. Nevertheless, even assuming that the *Westridge* court erred in concluding that the sale was valid and therefore proper, the error should not be reversible because chilling was not argued by the guarantors.

21. *Westridge*, 815 S.W.2d at 330, 331 (relying on Savings Ass'n of Houston v. Musick, 531 S.W.2d 581, 587 (Tex. 1975)); *see also* Thompson v. Chrysler First Business Credit, 840 S.W.2d 25, 32 (Tex. App.—Dallas 1992, no writ) (a guarantor may not avoid a summary judgment on a deficiency claim by alleging inadequacy of consideration if there has been no irregularity in the foreclosure sale).

22. Tex. Bus. & Com. Code Ann. §§ 17.41-17.63 (Vernon 1987 & Supp. 1993).

(DTPA). Section 17.45(5) defines an unconscionable action to include a transaction that, to a person's detriment, results in a gross disparity between the value received and the consideration paid.[23] The trial court determined that the guarantors were not "consumers" under the DTPA and therefore were not entitled to pursue a DTPA action.[24] Reaching the right result for the wrong reason,[25] the Houston court upheld the trial court's determination that the guarantors did not have standing to assert a claim under the DTPA.[26]

McDonald v. Foster Mortgage Corp.[27] involved a defaulting mortgagor who went on the attack, only to be rebuffed and overrun by the RTC. In *McDonald*, the mortgagor had admittedly defaulted on the payment of a note secured by her residence. Apparently the mortgagor then located a potential purchaser who was interested in purchasing the residence for a price that would have eliminated any deficiency.[28] Subsequently, the mortgagee foreclosed on the residence and attempted to convince the mortgagor to pay a deficiency. Apparently perturbed by the mortgagee's request for payment of the deficiency, the mortgagor filed suit alleging that the mortgagee's refusal to accept or approve the proposed purchase breached a duty of good faith and fair dealing and resulted in a wrongful foreclosure. The RTC counterclaimed for the deficiency amount.[29] The trial court granted the

23. *Id.* § 17.45(5).

24. *Westridge*, 815 S.W.2d at 332.

25. The Houston court declined to decide whether the guarantors were consumers with regard to the loan transaction and instead, relying on Chastain v. Koonce, 700 S.W.2d 579, 581-83 (Tex. 1985), held that because the guarantors were not the purchasers at the foreclosure sale, they could not complain of the disparity between the value received and the consideration paid. *Westridge*, 815 S.W.2d at 332.

The Houston court, however, erred in its reading of *Chastain*. The *Chastain* court did not hold or infer that only a purchaser (whether or not a consumer) had the right to complain of the disparity between the value received and the consideration paid. Rather, the *Chastain* court specifically concluded that before examining the unconscionability issue, it had to first determine if the purchasers were consumers, for if they were not, the purchasers had no standing under the DTPA. *Chastain*, 700 S.W.2d at 580-81.

26. *Westridge*, 815 S.W.2d at 332. In at least two other Survey period cases, borrowers attempted to argue that the lender had acted unconscionably under the DTPA. In Federal Sav. & Loan Ass'n v. Kralj, 968 F.2d 500, 508 (5th Cir. 1992), the borrower argued that the mortgagee had purchased the property at its foreclosure sale for grossly inadequate consideration and that this conduct was unconscionable under the DTPA. The Fifth Circuit held that the borrower had no standing to assert this argument because the borrower was not a consumer under the DTPA. *Id.* at 508. In Affiliated Capital Corp. v. Commercial Fed. Bank, 834 S.W.2d 521 (Tex. App.—Austin 1992, no writ), the borrower attempted to prepay its note in order to avoid foreclosure of the lender's lien securing the note. The lender refused prepayment under a clause that prohibited prepayment and thereafter foreclosed its lien. The borrower argued that the lender's actions in preventing prepayment deprived the borrower of its investment in property and subsequent foreclosure resulted in a gross disparity covered by § 17.50(a)(3) of the DTPA. Consistent with *Kralj*, the court first concluded that the borrower was unable to allege a gross disparity DTPA claim with respect to the foreclosure because the borrower had not purchased the property from the bank. *Id.* at 528-29. The court went on to recognize, however, that a borrower could maintain a gross disparity claim under the DTPA if the borrower could show that it was prevented from using borrowed funds despite paying the costs of borrowing or that it had "sustained a similar inequity in its bargain." *Id.* at 529.

27. 834 S.W.2d 573 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

28. *See id.* at 575. The case does not reflect that the RTC admitted this fact.

29. Shortly after the mortgagor filed the suit, the mortgagee failed and the Federal Sav-

RTC summary judgment on all issues and the mortgagor appealed.[30]

Relying on the Texas Supreme Court's decision in *Federal Deposit Insurance Corp. v. Coleman*,[31] the court summarily rejected the mortgagor's assertion that a mortgagee owes a mortgagor an obligation of good faith and fair dealing.[32] Adding salt to the wound, the court concluded that even if the mortgagor was damaged by wrongful foreclosure, she could not maintain that action against the RTC because of the doctrine of prudential mootness,[33] which generally stands for the principle that if a party against whom judgment is sought has no assets and never will have any assets to satisfy the judgment sought, then dismissal is justified.[34]

With respect to the deficiency claim asserted by the RTC, the homeowner filed a general denial and then took the position that, as an element of its deficiency action, the RTC had the burden to show that the foreclosure sale was conducted in a commercially reasonable manner. The court disagreed, stating that commercial reasonableness is a defense that must be pled by the debtor and only after being pled, does the lender have the burden to prove commercial reasonableness.[35] Although not expressly so stating, the court's

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ings and Loan Insurance Corporation (FSLIC) was appointed receiver of the mortgagee. Thereafter, under FIRREA, the RTC succeeded as receiver.

30. *McDonald*, 834 S.W.2d at 575.

31. 725 S.W.2d 706 (Tex. 1990).

32. *McDonald*, 834 S.W.2d at 576. Because the mortgagor argued no other grounds for wrongful foreclosure, the court apparently determined that it was unnecessary to conclude whether the foreclosure was wrongful. In a somewhat curious effort to bootstrap its holding that the mortgagee breached no duty of good faith and fair dealing and although the case does not reflect that the mortgagor ever argued fraud or breach of fiduciary duty on the part of the mortgagee, the court pointed out that as a matter of law the RTC is protected from fraud and breach of fiduciary duty suits under the *D'oench, Duhme* doctrine. *Id.* Unfortunately this dicta is an overly broad statement of the protection afforded the RTC and FDIC by *D'oench, Duhme*. *See infra* notes 86-153 and accompanying text.

33. *Id.* (relying on 281-300 J.V. v. Onion, 938 F.2d 35 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 933 (1992)).

34. *Id.*; Sunbelt Sav., FSB v. Birch, 796 F. Supp. 991, 994 (N.D. Tex. 1992); Triland Holdings & Co. v. Sunbelt Serv. Corp., 884 F.2d 205 (5th Cir. 1989). Although dismissal on prudential grounds appears to be a strong argument in any case in which a judgment is sought against a failed institution whose secured obligations and deposit balances exceed its assets, the cases do not reflect that the argument has been made on a regular basis as has *D'Oench, Duhme* and other federal statutory or common law defenses. Perhaps this is due to the repugnancy of the prudential mootness theory as it applies to the FDIC, as aptly described by a district court in the Fifth Circuit:

> *D'Oench, Duhme* . . . already provide[s] the FDIC with an extraordinary arsenal to overcome defenses against enforcement of obligations to the FDIC and to defeat on the merits claims against it. No matter how dire the circumstances in which the FDIC finds itself, little need exists to give it another magic weapon with which to conquer all foes. To do so by acceding to the mootness theory may ease the FDIC's heavy burden, but at the same time would create bad law.

Federal Deposit Ins. Corp. v. Texas Country Living, 756 F. Supp. 984, 992 (E.D. Tex. 1990). Nevertheless, with the two existing rulings by the Fifth Circuit, prudential mootness should become an FDIC argument in avoiding judgments.

35. *McDonald*, 834 S.W.2d at 576. In support of its conclusion, the court cited to several cases decided under Article 9 of the Texas Uniform Commercial Code. The Dallas court of appeals has expressly held that because Article 9 does not apply to liens under real property mortgages, the commercial reasonableness standard under Article 9 does not apply to deficiencies resulting from a foreclosure of a real estate mortgage. Huddleston v. Texas Commerce Bank - Dallas, N.A., 756 S.W.2d 343, 347 (Tex. App.—Dallas 1988, no writ).

statements regarding commercial reasonableness could be interpreted to mean that a mortgagee seeking a deficiency action is under an obligation to prove the reasonableness of the foreclosure sale if commercial reasonableness is pled as a defense by the defendant. This is not the settled law in Texas with respect to real estate foreclosures and several courts have expressly so stated.[36]

In recent years, several Texas cases have specifically held that if a mortgagee acts in a manner that chills the bidding at a foreclosure sale, the mortgagor is entitled to either bring a damages action based on wrongful foreclosure[37] or utilize the chilling of the bid process as a defense to a deficiency action brought by the mortgagee.[38] One Survey case, *Resolution Trust Corp. v. Summers & Miller Gleneagles J.V.*,[39] addresses the burden that a defendant relying on a chilling argument bears in order to avoid a summary judgment motion by the mortgagee.[40] In *Gleneagles*, the lender foreclosed the lien of one deed of trust that covered two separate tracts and then sued for a deficiency. The defendants asserted that the lender was not entitled to a deficiency because the foreclosure notice did not correctly describe the two tracts of land,[41] thereby discouraging "prospective purchasers who would have otherwise participated in the sale."[42] The RTC moved for summary judgment.

The debtor argued that it was the jury's province to determine if an irregularity in the foreclosure sale resulted in a chilling of the bid process. The court disagreed and concluded that the debtor must present some evidence that would create a fact issue as to whether the irregularity caused a chilling of the bid process.[43] The sole evidence presented to the court was an affidavit by one of the venturers of the debtor opining that the bid price was materially less than the fair market value of the property at the time of the foreclosure. The court logically concluded that the venturer's opinion in no way supported the debtor's chilling argument.[44] Because the debtor failed to present any evidence that the error in the property descriptions resulted in a grossly inadequate sales price or otherwise chilled the bidding process, the

36. Thompson v. Chrysler First Business Credit Corp., 840 S.W.2d 25, 33 (Tex. App.—Dallas 1992, no writ); Pentad J.V. v. First Nat'l Bank, 797 S.W.2d 92, 97 (Tex. App.—Austin 1990, writ denied); *Huddleston*, 756 S.W.2d at 347.

37. Charter Nat'l Bank - Houston v. Stevens, 781 S.W.2d 368, 374 (Tex. App.—Houston [14th Dist.] 1989, writ denied).

38. Savers Fed. Sav. & Loan Ass'n v. Reetz, 888 F.2d 1497, 1503 (5th Cir. 1989); *Charter Nat'l Bank*, 781 S.W.2d at 371.

39. 791 F. Supp. 653 (N.D. Tex. 1992).

40. *Id.* at 654.

41. Apparently each property description contained a "save and except" clause and the clauses were inadvertently transposed, resulting in one tract being described to contain more land than was actually included in the tract and the other tract being described to contain less land than was actually included in the tract.

42. *Gleneagles*, 791 F. Supp. at 654.

43. *Id.* at 655. The court's conclusion is arguably contrary to *Charter Nat'l Bank*, wherein the court stated that whether the irregularity in fact caused a chilling of the bid price was an issue to be decided by the jury. *Charter Nat'l Bank*, 781 S.W.2d at 374.

44. *Gleneagles*, 791 F. Supp. at 655.

court granted the RTC's motion for summary judgment.[45]

B. WRAPAROUND MORTGAGES

In the 1989 decision of *Summers v. Consolidated Capital Trust*,[46] the Texas Supreme Court adopted the "outstanding balance" method of applying proceeds from a foreclosure sale involving a wraparound note and thereby rejected the "true balance" approach.[47] Under the outstanding balance method, the proceeds from a foreclosure sale are credited against the entire outstanding balance due under the wraparound note, while under the true balance approach, the proceeds from a foreclosure sale are credited against the difference between the wraparound note and the balance of the underlying note(s).[48] Although there can be little disagreement over the holding in *Summers*, the facts presented in *Beach v. Resolution Trust Corp.*[49] raise a scenario that probably was not contemplated by the *Summers* court. In *Beach*, the debtor defaulted under a $298,000 wraparound note, which included as part of its balance an existing note executed by the debtor in favor of a third party.[50] The lender foreclosed its lien and, as highest bidder, purchased the mortgaged property at the foreclosure sale for $220,000. At the time of the foreclosure, the balance of the wraparound note was approximately $257,000, approximately $111,000 of which was the balance of the underlying note executed by the debtor in favor of the third party. The debtor argued that because the lender had not paid any of the proceeds to the holder of the underlying note,[51] the deficiency should be measured by the true balance approach. The trial court disagreed and the debtor appealed.[52]

The majority of the Houston court of appeals (First District) summarily

45. *Id.* at 653-54 (relying on Savers Fed. Sav. & Loan Ass'n v. Reetz, 888 F.2d 1497 (5th Cir. 1989); *Charter Nat'l Bank*, 781 S.W.2d at 368).

46. 783 S.W.2d 580 (Tex. 1989).

47. *Id.* at 583.

48. *Id.*

49. 821 S.W.2d 241 (Tex. App.—Houston [1st Dist.] 1991, no writ). In the court's opinion, the primary issue was whether the RTC could assert *D'Oench, Duhme* defenses for the first time on appeal. The most pertinent cases addressing this issue are discussed, *infra*, in notes 90-105. In addition, one of the debtors assigned to the lender, as additional security for the lender's loan, a note payable to one of the debtors, and the lender was seeking a deficiency following foreclosure upon the note assigned to the lender. The collection of the deficiency on the assigned note is controlled by Article 9 of the Texas Uniform Commercial Code.

50. Apparently, the debtor had personal liability for payment of the underlying note, but this was not specifically argued by the debtor. *See Beach*, 821 S.W.2d at 243 n.1.

51. The lender apparently argued that it owned or held the underlying note, but the RTC conceded in oral argument that the lender neither held nor owned the underlying note and had foreclosed the mortgaged property subject to the second lien securing the underlying note. *See id.* at 243 n.1.

On the face of the case, there is no evidence that the lender took subject to the underlying note and lien other than the statement made by the RTC counsel during oral argument. One wonders why the holder of a first lien would take subject to a second lien that would be extinguished through the foreclosure of the first lien, especially in light of the fact that the foreclosing lender was not personally liable on the underlying debt. Perhaps, in this instance, the debtor's concern regarding non-payment was real, especially if the prudential doctrine would be applicable to any suit brought against the RTC for failure to pay.

52. *Beach*, 821 S.W.2d at 243.

rejected the debtor's argument.[53] In a footnote, however, the court stated that it had not considered certain factual differences between this case and the *Summers* case because the debtor neither relied on these differences nor contended that they called for a different result.[54] Perhaps the most important of these additional facts was that the debtor was liable for payment of the underlying note and the RTC did not own or hold the underlying note. As a result, the debtor was placed in the unenviable position of potentially paying the underlying note twice if the RTC failed to satisfy the underlying note. In a concurring opinion, Justice Mirabel acknowledged this concern,[55] but concluded he was compelled to follow *Summers* and apply the outstanding balance approach because, under *Summers*, the law implies a covenant to apply the foreclosure proceeds to the entire indebtedness included in the wraparound note.[56] In retrospect, the debtor in the *Beach* case should have emphasized the factual differences with the *Summers* case and argued that the lender had breached its implied covenant to apply the sales proceeds against the entire indebtedness of the wraparound note. Although these arguments probably would not have caused the *Beach* court to deviate from the holding in *Summers*, the debtor would have been in a good position to argue that the RTC was not entitled to a deficiency because of its breach of the implied covenant to satisfy the underlying debt to the extent of available proceeds.[57]

C. LENDER LIABILITY

As stated in the introductory paragraph of this Article, Texas courts are clearly disallowing lender liability claims against mortgagees, except in the most egregious circumstances. Accordingly, during the Survey period, the Texas and federal courts, applying Texas law, consistently rejected the argument that the mortgagee owes a duty of good faith or a fiduciary duty to a mortgagor,[58] and closely scrutinized claims of

53. *Id.*

54. *Id.* at 243 n.1.

55. *Id.* at 245.

56. *Id.*

57. Judge Mirabel also stated that if the proceeds, together with any deficiency collected, was not applied to the outstanding indebtedness, the debtor would have a cause of action against the lender. *Id.* at 245-46. Moreover, an argument exists that the trustee under the deed of trust could arguably have liability for proceeds received by it and not applied to the entire indebtedness.

58. *E.g.*, McDonald v. Foster Mortgage Corp., 834 S.W.2d 573, 576 (Tex. App.—Houston [1st Dist.] 1992, writ denied) (impossible for a mortgagee to breach implied duty of good faith obligation allegedly owed to mortgagor because Texas courts hold that no such implied duty of good faith arises out of lender/borrower or mortgagee/mortgagor relationship); Manufacturers Hanover Trust Co. v. Kingston Investors Corp., 819 S.W.2d 607, 610 (Tex. App.—Houston [1st Dist.] 1991, no writ) (lender does not owe an implied duty of good faith to borrower; therefore, lender did not have duty to disclose to borrower or guarantors financial condition of participant in borrower's project who had committed to provide development funds above the lender's commitment and who was another customer of the lender, even though lender allegedly had knowledge that participant would be unable to honor its financial commitment to borrower); Cockrell v. Republic Mortgage Ins. Co., 817 S.W.2d 106, 116 (Tex. App.—Dallas 1991, no writ) (lender did not breach a duty of good faith because Texas law does not recognize such an implied duty at law); Resolution Trust Corp. v. Westridge Court

fraud,[59] negligent misrepresentation,[60] duress,[61] and usury.[62] A number of cases involving lender liability are worthy of more than footnote mention and are discussed below.

Although *Rosas v. U.S. Small Business Administration*[63] creates no new law, it is illustrative of how today's courts will dismantle the throw in the kitchen sink approach to a lender liability action.[64] In *Rosas*, the debtor negotiated a commitment for a twenty year permanent loan, subject to the condition that the Small Business Administration (SBA) would provide an eighty percent guarantee. Prior to the funding of the permanent loan, the first lien loan was placed in default and the property was posted for foreclosure. At the closing of the loan, the SBA agreed to guaranty only a fifteen year loan and the lender accordingly prepared loan documents for a fifteen year loan. The borrower apparently complained of the fifteen year maturity and a representative of the lender allegedly agreed to modify its loan from a fifteen year loan to a twenty year loan at some time in the future. The borrower's agreement with the SBA, however, provided for a guaranty of a fifteen year loan instead of a twenty year loan. In addition, the lender advised (and, in the borrower's mind threatened) the borrower that if it did not ac-

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J.V., 815 S.W.2d 327, 332 (Tex. App.—Houston [1st Dist.] 1991, writ denied) (with respect to foreclosure sale, mortgagee owes but one duty to mortgagor; that is to conduct the foreclosure sale properly); Rosas v. U.S. Small Business Admin., 964 F.2d 351, 357 (5th Cir. 1992) (Texas courts do not recognize that a lender-borrower relationship creates a duty of good faith and fair dealing); Hall v. Resolution Trust Corp., 958 F.2d 75, 79 (5th Cir. 1991) (Texas courts have consistently refused to imply a duty of good faith and fair dealing in borrower-lender relationship; therefore lender had the right to refuse substitute collateral offer that did not conform with requirements of loan documents); Federal Deposit Ins. Corp. v. Claycomb, 945 F.2d 853, 859 n.17 (5th Cir. 1991) (borrower-lender relationship does not impose on lender either a fiduciary duty or obligation of good faith); Sunbelt Sav., FSB v. Birch, 796 F. Supp. 991 (lender does not owe duty of good faith to guarantor). *But cf.* Affiliated Capital Corp. v. Commercial Fed. Bank, 834 S.W.2d 521 (Tex. App.—Austin 1992, no writ) (court did not dispute allegation that lender owed borrower duty of good faith, but instead concluded that lender had not breached such duty).

59. *E.g.*, Rhima v. White, 829 S.W.2d 909, 911 (Tex. App.—Fort Worth 1992, writ denied) (where seller did not expressly disclose to purchaser the existence of recorded deed of trust and mortgagee had no dealings with purchaser until after the purchase, mortgagee was not liable to purchaser for fraud); *Kingston Investors Corp.*, 819 S.W.2d at 610 (borrowers are required to clearly demonstrate that mortgagee's acts constitute trickery, artifice or device in order to establish fraud in inducement claim against mortgagee). *Rosas*, 964 F.2d at 356 (where lender's representative made representation that he would restructure loan following execution of note, lender would not be liable for fraudulently inducing borrower to execute note unless borrower also showed that lender engaged in conduct calculated to deceive borrower into believing that alleged oral agreements would be honored on note).

60. *Rosas*, 964 F.2d at 355 (where debtor executed promissory note which contained clear and unambiguous terms, alleged negligent representation made by lender's representative was barred by parol evidence rule).

61. *Id.* at 356-57 (alleged threat by lender providing refinancing of loan in default that if borrower did not accept lender's terms, lender would not provide refinancing and holder of first lien would foreclose was not duress since statements were within lender's legal rights and therefore could not constitute duress).

62. *See infra* notes 235-41 and accompanying text. Although usury is a theory of lender liability, it is more appropriate to include the discussion of usury under the promissory note section.

63. 964 F.2d 351 (5th Cir. 1992).

64. The court also addressed several issues pertaining to the Small Business Administration (SBA), but which are not relevant to the subject matter of this article.

cept the lender's terms the lender would not make the loan and the first lien lender would foreclose its lien. As could be expected for a project already in trouble, the borrower ultimately defaulted on the permanent loan. The lender called on the SBA's guaranty and the SBA commenced foreclosure. The borrower sued the permanent lender for negligent misrepresentation, breach of duty of good faith, duress and breach of contract. The lender moved for and was granted summary judgment and the borrower appealed.[65]

The court of appeals disposed of all matters in favor of the lender. As to the negligent misrepresentation claim, the court concluded that the loan documents were clear and unambiguous and that the statement regarding the conversion of the fifteen year loan to a twenty year loan was inadmissible under the parol evidence rule.[66] The borrower argued that the misrepresentation resulted in fraudulent inducement and therefore was excepted from the parol evidence rule. Disagreeing, the court stated that to establish fraud in the inducement sufficiently to avoid the parol evidence rule, the complaining party must show trickery, artifice or device, in addition to the misrepresentation.[67]

The borrower further argued that the lender placed the borrower under duress to execute the loan documents since the lender "threatened" the borrower with statements that (i) the lender would not make the loan if the borrower didn't agree to the fifteen year term and other terms that had been negotiated, and (ii) if the lender didn't make the permanent loan, the first lien lender would continue with its foreclosure process.[68] The court summarily dismissed the duress argument by stating that the statements made by the lender were within the lender's legal rights and therefore could not possibly constitute duress.[69]

On appeal, the borrower apparently recharacterized its breach of good faith and fair dealing claim that was rejected by the trial court[70] as a breach of the implied promise by parties to an agreement to lend not to interfere or hinder each other's performance under their agreement. The borrower argued that the lender had breached this implied covenant because the lender

65. *Rosas*, 964 F.2d at 354-55.

66. *Id.* at 355.

67. *Id.* at 356. Somewhat shaking its finger at the borrower, the court stated that the borrower had executed the note with full knowledge of its contents and could not "now be heard to complain" that it was deceived. *Id.* To continue the scolding, the court stated that a contrary conclusion would permit a party to allege the existence of any collateral parol agreement to contradict a writing, thereby destroying the parol evidence rule. *Id.*

68. *Id.* at 356-57.

69. *Id.* at 357. The court chastised the borrower, stating that instead of attempting to address each element of a duress action, the borrower's argument focused only on the borrower's precarious financial condition at the time of the closing of the loan. *Id.* Accordingly, the court concluded that "there is no issue whatsoever, either legal or factual." *Id.*

70. The trial court rejected the good faith and fair dealing argument because Texas courts do not recognize this duty within the lender-borrower relationship. *Id.* Recognizing the futility of appealing that decision, the borrower relied on the theory that in every contract there is an implied covenant by each party not to interfere with or deter the other party's performance under the contract. *See* Texas Nat'l Bank v. Sandia Mortgage Corp., 872 F.2d 692 (5th Cir. 1989).

had violated SBA guidelines pertaining to disbursement of loan proceeds. The court concluded that the SBA's determination of the lender's compliance with the SBA guidelines was dispositive of this issue.[71] Although there was no direct testimony by the SBA as to the lender's compliance with the applicable guidelines, the court concluded that the SBA must have determined that the lender had complied with the guidelines because the SBA honored its guaranty.[72] Accordingly, the court rejected the borrower's claim.[73]

Federal Deposit Insurance Corp. v. Claycomb[74] reflects circumstances under which a defaulted borrower who has been sued by his lender may still wish that his lender would be his partner. In *Claycomb*, the lender made a loan to the borrower where the borrower's liability for repayment of the loan was limited to 50% of the balance outstanding from time to time. As part of the consideration for the loan, the borrower assigned to the lender 50% of the profits generated by the mortgaged property. The assignment of profits expressly disclaimed the existence of a partnership between the borrower and the lender, and further disclaimed any liability on the part of the lender for the debts, liabilities or obligations of the borrower. The borrower defaulted under the loan documents, resulting in a foreclosure of the lender's lien and a deficiency action against the borrower and guarantors. The borrower and guarantors defended and brought counterclaims on a number of grounds, including usury[75] and the breach of a fiduciary obligation arising out of a partnership allegedly existing between the borrower and the lender.[76] Such partnership, argued the borrower, was clearly evidenced by the assignment to the lender of the 50% interest in profits and the 50% limitation on the borrower's liability for repayment of the loan. The trial court granted summary judgment in favor of the lender and the borrower and guarantors appealed, arguing that there was a material fact issue as to the usury claim and the existence of a partnership between the lender and borrower.[77]

The Fifth Circuit disagreed and affirmed the judgment of the trial court.[78] As to the partnership claim, the court concluded that, under Texas law, one of the essential elements of a partnership agreement is an agreement to share

71. *Rosas*, 964 F.2d at 357.

72. *Id.* The court found it incongruous that the lender could have managed the loan in an inequitable manner and still complied with the SBA guidelines. *Id.*

73. *Id.*

74. 945 F.2d 853 (5th Cir. 1991), *cert. denied sub nom.*, SHWC, Inc. v. Federal Deposit Ins. Corp., 112 S. Ct. 2301 (1992).

75. *Id.* The opinion does not set forth the facts upon which the borrower based the usury claim.

76. *Id.*

77. *Id.* The FDIC cross-appealed and contended that it was unnecessary to reach the state law issues, as the usury claim and partnership claim were barred by *D'Oench, Duhme*. The court resolved the partnership issue on state law, and decided the usury issue on state law, as well as the federal common law theory that institutions created to serve the public interest are immune from punitive damages. *Id.* at 857-60.

78. *Id.* at 859-60.

losses.[79] Observing that the lender expressly disclaimed any liability for the losses, the court found specious the borrower's argument that the 50% cap on the borrower's liability constituted an agreement by the lender to share in the borrower's losses.[80] In view of Texas law, the lender's disclaimer as to sharing losses of the borrower, and each of the lender's and the borrower's disclaimer of the existence of a partnership, the court held there was no breach of fiduciary duty and could be no legal defense based on the existence of a partnership.[81]

Considering the usury claim, the court observed that Texas courts recognize the validity of usury savings clauses and that the objective intention of the parties as expressed in the written documents should be given effect.[82] According to the court, the pertinent loan documents, each of which contained a savings clause, evidenced the manifest intention of the parties to structure the transaction to avoid usurious interest.[83] Accordingly, the court held that the savings clauses used in the loan documents were sufficient to defeat any claim or defense of usury under existing law.[84] Although not necessary to its holding, the court went on to hold that, because of the punitive nature of usury under Texas law, the borrower's usury claim against the FDIC was barred under the federal common law rule that a claim for punitive damages cannot be asserted against an association created to serve the public interest.[85]

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79. *Id.* at 858 (citing Ayco Dev. Corp. v. G.E.T. Serv. Co., 616 S.W.2d 184, 186 (Tex. 1981); Coastal Plains Dev. Corp. v. Micrea, Inc., 572 S.W.2d 285, 287 (Tex. 1978)). Each of the Texas Supreme Court cases describe the essential elements of only a joint venture, not a partnership. Several Texas cases (some of which predate the Texas Uniform Partnership Act, TEX. REV. CIV. STAT. art. 6132b (Vernon 1979 & Supp. 1993)), have held that the definition of a partnership includes an obligation of the parties to bear some portion of the losses. *E.g.*, Conrad v. Judson, 465 S.W.2d 819, 825 (Tex. Civ. App.—Dallas 1971, writ ref'd n.r.e.), *cert. denied*, 405 U.S. 1041 (1972). However, even if sharing of losses is not an essential element to the creation of a partnership, it should be an element that indicates whether the parties intended to create a partnership. *See* Gutierrez v. Yancey, 650 S.W.2d 169 (Tex. App.—San Antonio 1983, no writ).

80. *Claycomb*, 945 F.2d at 859.

81. *Id.* It is a little curious that the Fifth Circuit did not refer to their opinion in Federal Sav. & Loan Ins. Corp. v. Griffin, 935 F.2d 691 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 1163 (1992), which was decided approximately three months prior to the *Claycomb* case. In *Griffin*, a guarantor asserted a similar partnership/breach of fiduciary duty defense. The court recognized that the Texas Uniform Partnership Act provides that interest on a loan, even though it varies with the profits of the borrower's business, is not evidence to establish a partnership. *Id.* at 699 (relying on TEX. REV. CIV. STAT. ANN. art. 6132b, § 7(4)(d) (Vernon 1970 & Supp. 1993)). Because there was not an express agreement to share losses, there was a disclaimer as to partnership and the profits assignment could not be used as evidence of a partnership, the court held that no partnership relationship was established. *Id.* at 700.

82. *Claycomb*, 945 F.2d at 860.

83. *Id.* at 860-61.

84. *Id.* at 860. The curious matter about this case is that the facts establishing the usury claim are not set forth in the opinion. As a result, the value of the usury holding as precedent is uncertain.

85. *Id.* at 861. In support of its holding, the court pointed to several cases where the doctrine prohibiting penal damages against public institutions had been applied to receivers for federal courts. *See, e.g.*, Federal Deposit Ins. Corp. v. Southwest Motor Coach Corp, 780 F. Supp. 421, 423 (N. D. Tex. 1991) (FDIC, as an agency of the United States, is immune from usury penalties).

D. D'OENCH, DUHME AND FEDERAL DEFENSES

During the Survey period, the Fifth Circuit pronounced the "*D'Oench, Duhme* decision and its progeny . . . [to be] a well known, though sometimes misunderstood, federal common law doctrine"[86] that "confers a powerful litigation weapon by making . . . usually untimely arguments available to the FDIC."[87] Although the court recognizes that it has "been rather generous in treating *D'Oench Duhme*, perhaps not without controversy,"[88] the court also recognizes that "the FDIC's special role is not all empowering."[89] Perhaps the one issue that involves all of these Fifth Circuit observations is whether the FDIC[90] has the right to raise *D'Oench, Duhme* and Section 1823(e) for the first time on appeal. In *Resolution Trust Corp. v. McCrory*,[91] the Fifth Circuit, through its holding and explanation of several of its prior decisions, provided some clarification as to the current status of the law in the Fifth Circuit: (i) the FDIC is prohibited from raising *D'Oench, Duhme* and Section 1823(e) for the first time on appeal if the appeal is from a judgment against the failed lender and voids the asset transferred to the FDIC[92] and (ii) the FDIC may be permitted to raise *D'Oench, Duhme* and Section 1823(e) for the first time on appeal, if the appeal is from a judgment entered in favor of the failed lender and the FDIC did not have the opportunity to raise the doctrines at the trial level.[93]

The cases decided during the Survey period under the *D'Oench, Duhme* doctrine and its statutory companion, Section 1823(e), were, in more instances than not, decided in favor of the federal agency or bridge bank as-

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86. Resolution Trust Corp. v. Oaks Apartments J.V., 966 F.2d 995, 998 (5th Cir. 1992).

87. *In re* Meyerland Co., 960 F.2d 512, 519 (5th Cir.), *cert. denied*, 113 S. Ct. 967 (1992).

88. Texas Refrigeration Supply, Inc. v. Federal Deposit Ins. Corp., 953 F.2d 975, 980 (5th Cir. 1992).

89. Allied Elevator, Inc. v. East Texas State Bank, 965 F.2d 34, 38 (5th Cir. 1992) (citing *In re* Still, 963 F.2d 75, 78 (5th Cir. 1992)).

90. For purposes of the discussion regarding *D'Oench, Duhme* and Section 1823(e), any reference to the FDIC shall be deemed to include the RTC and a bridge bank who is entitled to rely on those doctrines.

91. 951 F.2d 68 (5th Cir. 1992), *cert. denied*, 113 S. Ct. 459 (1992).

92. *Id.* at 73-74 (citing Thurman v. Federal Deposit Ins. Corp., 889 F.2d 1441, 1442 (5th Cir. 1989); *Olney Sav. and Loan Ass'n v. Trinity Banc Sav. Ass'n*, 885 F.2d 266, 275 (5th Cir. 1989)).

93. *Id.* at 71 (relying on Union Fed. Bank v. Minyard, 919 F.2d 335, 336 (5th Cir. 1990); Baumann v. Federal Sav. & Loan Ass'n, 934 F.2d at 1506 (11th Cir. 1991)). *Accord*, *In re* 5300 Memorial Investors, Ltd., 973 F.2d at 1160, 1163-64 (5th Cir. 1992). None of the Survey cases expressly address the issue of whether the FDIC is entitled to raise *D'Oench, Duhme* and Section 1823(e) for the first time on appeal where the appeal is from a judgment entered against the failed lender in the trial court, but the judgment does not void the FDIC asset and the FDIC did not have the opportunity to raise the defense at the trial level. However, this is consistent with what appears to be the current law in the Fifth Circuit, a court should conclude that, under such facts, the FDIC should be permitted to raise *D'Oench, Duhme* and Section 1823(e) for the first time on appeal. *See* Larsen v. Federal Deposit Ins. Corp., 835 S.W.2d 66 (Tex. 1992) (holding that FIRREA may offer the FDIC the opportunity to raise *D'Oench, Duhme* or Section 1823(e) for the first time on appeal, unless the appeal is from a judgment against the failed lender and voids the asset).

serting the doctrine.[94] Two of these cases, *Resolution Trust Corp. v. Camp*[95] and *Resolution Trust Corp. v. McCrory*,[96] demonstrate that if a particular agreement is not barred on *D'Oench, Duhme* grounds, the FDIC may still successfully avoid the agreement under Section 1823(e).

In *Camp*, the lenders filed suit against their borrowers seeking payment on a promissory note. The borrowers asserted counterclaims and defended on the basis that its performance of the promissory note was conditional on resolution of another matter with the bank. In support of this claim, the borrowers produced a letter sent to the president of one of the lenders that arguably indicated that the borrower intended that its performance was conditional. Through various transactions, the RTC became the receiver of one of the lenders and a bridge bank acquired the assets of one of the other lenders. The new group of lenders filed a motion for summary judgment, which the district court granted. On appeal, the borrowers continued to argue that their performance under the note was conditional based on the letter sent to one of the lenders. The court noted that the record was void of any evidence that the letter was in the bank's loan files and even if the letter was in the bank's loan files, the court had serious questions as to whether the letter would have put bank examiners on notice of conditional performance under the note.[97] However, even assuming that the letter was in the bank's loan files and that the letter provided notice of conditional performance, the court concluded that the letter failed to meet the clear standards of Section 1823(e).[98] The borrowers did not argue that the letter used as their defense satisfied Section 1823(e). Instead, the borrowers argued that the current version of Section 1823(e) was not in effect when the letter was sent and the provisions of FIRREA, including Section 1823(e), were not intended to be

94. Federal Sav. & Loan Ins. Corp. v. Mackie, 962 F.2d 1144 (5th Cir. 1992) (*D'Oench, Duhme* barred fraud claim and defense to action on a note maintained by FSLIC because claims based on failed lender's oral commitment to make permanent loan); Texas Refrigeration Supply, Inc. v. Federal Deposit Ins. Corp., 953 F.2d 975 (5th Cir. 1991) (*D'Oench Duhme* barred breach of contract, negligence, breach of fiduciary duty, promissory estoppel, misrepresentation, breach of good faith and deceptive trade practice claims against FDIC and bridge bank because all claims based on failed lender's oral agreements); Federal Deposit Ins. Corp. v. Adam, 803 F. Supp. 1225 (S.D. Tex. 1992) (*D'Oench, Duhme* barred admission of alleged conspiratorial agreement between bank and other third party defendants where that "agreement" was not evidenced by a writing); Resolution Trust Corp. v. Toler, 791 F. Supp. 649 (N.D. Tex. 1991) (letter signed by failed lender allegedly agreeing to draw on letter of credit instead of seeking judgment on note barred under *D'Oench, Duhme* as a defense to action on the note maintained by RTC because letter was not part of failed lender's records regarding loan transaction); Federal Deposit Ins. Corp. v. Southwest Motor Coach Corp., 780 F. Supp. 421 (N.D. Tex. 1991) (oral evidence contravening recitation of consideration in guaranty of $1.00 and other valuable consideration would be barred by *D'Oench, Duhme*); Stiles v. Resolution Trust Corp., 831 S.W.2d 24 (Tex. App.—Dallas 1992, writ filed) (in action on note maintained by RTC, borrower had burden to prove that defenses based on payment, release, accord and satisfaction were not barred by *D'Oench, Duhme* and Section 1823(e), and borrower failed to meet that burden by not producing writing satisfying *D'Oench, Duhme* and Section 1823(e) [i.e., no written agreement in failed bank's records evidencing agreement to release, accord and satisfaction or payment on note]).

95. 965 F.2d 25 (5th Cir. 1992).

96. 951 F.2d 68 (5th Cir.), *cert. denied*, 113 S. Ct. 459 (1992).

97. *Camp*, 965 F.2d at 30.

98. *Id.* at 30-31.

retroactive.[99] Although the court noted that the Seventh and Eighth Circuits have held FIRREA to be retroactive,[100] the court found it unnecessary to apply Section 1823(e) retroactively because the Fifth Circuit had always viewed Section 1823(e) as a codification of the *D'Oench, Duhme* doctrine and both bar similar defenses.[101] Since the letter failed under Section 1823(e), the letter would, according to the court, also fail under the *D'Oench, Duhme* doctrine.[102]

In *Resolution Trust Corp. v. McCrory*,[103] the borrower's general partners defended against the RTC's action on a note on the basis of a letter agreement between the original lender of the loan evidenced by the note and the general partners that provided that the general partners' liability would be limited to their interest in the borrower. The letter agreement was not in the lender's files, but a copy of the letter agreement was in the file of the outside attorney who handled the closing of the loan for the original lender. The court concluded that the outside attorney's file was not an official record of the depository institution and therefore Section 1823(e) barred the borrower from using the side agreement as a defense to the RTC's action on the note.[104] The court further concluded that because Section 1823(e) provided a clear resolution of the issue, it was not necessary to determine the "thornier question" of whether *D'Oench, Duhme* would produce the same result.[105]

Notwithstanding the FDIC's and RTC's success under *D'Oench, Duhme* and Section 1823(e), (i) several cases, including the next three cases discussed, illustrate that *D'Oench, Duhme* and Section 1823(e) will not protect the FDIC or RTC from all sins of failed institutions[106] and (ii) one case,

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99. At the time the letter was written, Section 1823(e) applied to the FDIC only in its corporate capacity. *Id.* at 31.

100. *Id.*

101. *Id.*

102. *Id.* at 30-31. The court's analysis is somewhat inconsistent with its conclusion because the court considered the letter in light of Section 1823(e) while assuming two facts that arguably would have taken the letter out of *D'oench, Duhme*: (1) the letter was in the bank's main files; and (2) the letter was clear enough to place the FDIC on notice of an agreement by the bank to condition the borrower's performance of the note upon resolution of another matter. Moreover, in another Survey case, Resolution Trust Corp. v. McCrory, 951 F.2d 68, 72 (5th Cir.), *cert. denied*, 113 S. Ct. 459 (1992), the court recognized that Section 1823(e) and *D'Oench, Duhme* may not necessarily produce the same result, and in Federal Sav. & Loan Ins. Corp. v. Griffin, 935 F.2d 691, 698 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 1163 (1992), the court maintained that the common law doctrine of *D'Oench, Duhme* was not limited by Section 1823(e) and that those two doctrines were not identical in scope and nature. *See also* Jones v. Resolution Trust Corp., 828 S.W.2d 821, 823 (Tex. App.—Fort Worth 1991, no writ) (*D'Oench, Duhme* doctrine not preempted by Section 1823(e)).

103. *McCrory*, 951 F.2d 68.

104. *Id.* at 72. The court specifically declined to interpret the phrase "official record of depository institution," as used in Section 1823(e)(4). *Id.*

105. *Id.* The court noted that the defendants and the RTC disagreed over the correctness of the trial court's interpretation of *D'Oench, Duhme*, especially as to the existence of a scheme or arrangement that is likely to mislead the federal regulators. *Id.* Presumably, this disagreement represents the "thornier question" of whether *D'Oench, Duhme* would produce the same result as Section 1823(e).

106. *E.g.*, Federal Sav. & Loan Ins. Corp. v. Mackie, 962 F.2d 1144, 1150 (5th Cir. 1992) (in action on note brought by FSLIC, *D'Oench, Duhme* does not bar defenses based on failed lender's breach of loan agreement, so long as the defenses do not depend on any agreement not within bank's integral loan transaction files).

Resolution Trust Corp. v. 1601 Partners, Ltd.,[107] holds that the FDIC and RTC are not entitled to rely on *D'Oench, Duhme* to avoid contemporaneous agreements relating to a loan made by a private nonfinancial institution that is subsequently assigned to a federally insured financial institution.[108]

In *Texas Refrigeration Supply v. Federal Deposit Insurance Corp.*,[109] the borrower sued the lender for, among other things, wrongful acceleration and wrongful foreclosure. During the lawsuit the bank failed and the FDIC was appointed receiver. The FDIC then entered into a purchase and assumption agreement, pursuant to which the note was assigned to a bridge bank and the FDIC retained all obligations pertaining to the loan, and the FDIC and the bridge bank were substituted for the failed lender. The trial court granted summary judgment in favor of the FDIC and the bridge bank, holding that the borrower's claims and defenses were based on oral agreements and therefore barred by *D'Oench, Duhme*.[110] The Fifth Circuit concluded that the trial court applied *D'Oench, Duhme* too rigorously and held that wrongful acceleration and wrongful foreclosure claims based on the failed institution's breach of implied covenants that were part of the contract between the failed bank and the borrower were not barred by either *D'Oench, Duhme* or Section 1823(e).[111]

In *Allied Elevator, Inc. v. East Texas State Bank*,[112] the bank made the borrower a loan evidenced by a promissory note. The note was renewed five times. Apparently, in connection with the fifth renewal of the note, the bank and the borrower orally discussed whether the borrower wanted to acquire credit life insurance that would satisfy the bank's loan to the borrower in the event of the borrower's death.[113] The borrower decided to accept the credit life insurance and, when executing the fifth renewal note, initialed a request on the face of the note for the credit life insurance. Prior to the maturity of the fifth renewal note, the borrower died, thereby making the borrower's decision to acquire the credit life policy prudent, if not clairvoyant. After the bank made demands on the estate to pay the fifth renewal note, the trustees of the estate requested coverage under the credit life policy, but alas, the

107. 796 F. Supp. 238 (N.D. Tex. 1992).

108. *Id.* at 240. The court in *1601 Partners* reasoned that a contrary holding would allow payees to abrogate personal defenses to enforcement of a note by assigning the note to a failing financial institution, and thereby creating a windfall value. *Id.*

109. 953 F.2d 975 (5th Cir. 1992).

110. *Id.* at 978.

111. *Id.* at 981 (relying on Garrett v. Commonwealth Mortgage Corp., 938 F.2d 591, 595 (5th Cir. 1991)). The court concluded that all other claims of the borrower were barred by *D'Oench, Duhme* because they were based on oral promises. *Id.* The borrower made an interesting argument against the bridge bank, claiming that under a particular provision of the purchase assumption agreement, the bridge bank assumed the failed bank's lender liability claims and waived *D'Oench, Duhme* defenses. The particular provision provided that the bridge bank assumed the liabilities of the failed bank certified by the FDIC to be valid and enforceable obligations. The court thought the borrower's argument interesting, but not valid, pointing out that the assumed obligations were only those certified by the FDIC as valid and enforceable and the FDIC never certified any valid obligations. *Id.* at 983.

112. 965 F.2d 34 (5th Cir. 1992).

113. *See id.* at 38 (FDIC's assertion that the failed bank's agreement to provide credit life insurance was oral).

policy had never been issued. Clearly chagrined and feeling mistreated by the bank, the borrower's estate sued the bank claiming breach of contract for failing to provide the credit life insurance. The FDIC (as receiver for the bank, which had by this time joined many of its brethren in bank heaven) filed a counterclaim for payment of the note. The trial court granted summary judgment to the FDIC on all claims, apparently relying on the original note or a renewal note other than the fifth renewal note, none of which contained a request for the credit life policy.[114]

The trustees of the estate appealed to a higher authority for justice, with its first point of error being that the trial court erred in relying on notes prior to the fifth renewal note in establishing the borrower's indebtedness to the failed bank. The trustees argued that the parties had intended that each renewal note (including the fifth renewal note) was a novation of the prior notes, as evidenced by the bank's past due notice, which referenced only the fifth renewal note, and the stamp on the face of the original note and each of the first four renewal notes to the effect "CANCELLED BY RENEWAL."[115] The Fifth Circuit concluded that the trustee's evidence was sufficient to create a material issue of fact as to whether the parties intended that the prior notes be extinguished and accordingly, remanded the case to the district court.[116] The FDIC argued that remand was not necessary because *D'Oench, Duhme* barred the use of the failed bank's oral agreement to provide the credit life insurance. Perhaps somewhat taken back by the FDIC's assertion, the court informed the FDIC that the borrower's acceptance of the request for credit life insurance on the face of the fifth renewal was a writing within the failed bank's lending files and therefore was not barred by *D'Oench Duhme*.[117] Not embarrassed by making ridiculous arguments, the FDIC then asserted that remand was not necessary because the borrower and the bank orally agreed that the borrower did not want the credit life insurance. The Fifth Circuit viewed the FDIC's argument as an attempt to use *D'Oench, Duhme* to enforce the alleged oral side agreement, a novel proposition for which the FDIC could not provide support to the court.[118] Perhaps savoring an opportunity to humble the FDIC, the court observed that "contrary to the FDIC's belief, its special role is not all-empowering."[119]

Resolution Trust Corp. v. Oaks Apartments Joint Venture[120] should be read by every lawyer representing borrowers in loan transactions because the

114. *Id.* at 36.

115. *Id.* The borrower's argument was based on the settled law in Texas that a new note will extinguish a prior note if the parties intended that the old note be extinguished. Chapman v. Crichet, 95 S.W.2d 360, 363 (Tex. 1936). The trustee's success on this argument was crucial to its case, since only the fifth renewal note included the request for credit life insurance.

116. *Allied Elevator*, 965 F.2d at 37. The court noted that if on remand the district court determined that the FDIC could sue on the original note, the court was not considering whether the estate could still rely on the credit life provision in the fifth renewal note as a supplement to the original note. *Id.* at 39 n.3.

117. *Id.* at 38.

118. *Id.*

119. *Id.*

120. 966 F.2d 995 (5th Cir. 1992).

facts and results teach that thoughtful and complete drafting will not only achieve the borrower's intended results, but also may allow the borrower to overcome *D'Oench, Duhme* and Section 1823(e). In *Oaks Apartments*, the lender made a loan to a venture composed of five venturers. The borrower executed a recourse promissory note and the venturers executed a guaranty that limited the liability of the individual joint venturers to twenty percent of the outstanding indebtedness on the note. The note did not contain a similar limitation of liability clause, even though the individual venturers would, as a matter of law, have joint and several liability for payment of the note,[121] and did not refer to the guaranty. The borrower defaulted and the bank foreclosed its lien and then sued the borrower and its venturers for the deficiency resulting at the foreclosure sale. The case was tried on the pleadings and stipulated facts. The district court determined that the note and guaranty complied with the requirements of *D'Oench, Duhme*[122] and, on this basis, held that each venturer's liability under the note was limited to twenty percent of the outstanding balance.[123] The RTC (who had been appointed receiver of the bank prior to the issuance of the district court's summary judgment order) appealed to the Fifth Circuit arguing that the guaranty was a side agreement not referred to in the note and therefore any defenses or claims with respect to the note should be barred under *D'Oench, Duhme*.

In reviewing the record, the Fifth Circuit was unable to find any facts that supported what the district court described as the inescapable conclusion that the note and the guaranty were located in the same loan file.[124] Because the location of the guaranty was the critical element as to whether *D'Oench Duhme* applied, the Fifth Circuit concluded that no determination could be made regarding its application.[125] Accordingly, the Fifth Circuit vacated the applicable portion of the district court's summary judgment order and remanded the *D'Oench, Duhme* issue to the trial court to develop the facts needed to reach a determination as to whether *D'Oench, Duhme* was applicable.[126] In addition, the Fifth Circuit informed the district court that the

121. *See* Fincher v. B&D Air Conditioning and Heating Co., 816 S.W.2d 509, 512 (Tex. App.—Houston [1st Dist.] 1991, writ denied), *cert. denied*, 113 S. Ct. 77 (1992); Martin v. First Republic Bank, Fort Worth, N.S., 799 S.W.2d 482, 487 (Tex. App.—Fort Worth 1990, writ denied).

122. *Oaks Apartments*, 966 F.2d at 999.

123. *Id.* at 998-99.

124. *Id.* at 1000. In what can be described as a torpedo fired at the district court judge, the court observed that the record reflected that the district court judge "asked whether or not the [g]uaranty was in the file with the [n]ote and . . . was told that the stipulated facts simply do not indicate where or by whom the [g]uaranty was held." *Id.* Not satisfied with its first torpedo, the court fired a second at the district court by acknowledging that the "[c]ourt's factual inquiry on remand will undoubtedly uncover all necessary items needed for the application of *D'Oench Duhme*." *Id.* at 1001.

125. *Id.* The court also declined to address the applicability of Section 1823(e) until the district court reached a special finding as to the applicability of Section 1823(e) and fully developed the applicable *D'Oench, Duhme* facts. *Id.*

126. *Id.* Apparently lacking some confidence in the district court's ability to properly apply the *D'Oench, Duhme* doctrine, the court instructed the district court to apply *D'Oench, Duhme* if the facts showed that the guaranty was not contained within the loan transaction files and not to apply *D'Oench, Duhme* if the facts showed that the guaranty was within the bank's loan transaction file. *Id.* at 1000.

Fifth Circuit has recognized that *D'Oench, Duhme* does not bar a borrower from asserting claims or defenses based on a lender's failure to perform its obligations in an agreement with the borrower that imposes specific obligations both on the lender and the borrower, provided that the agreement is in the lender's written bank records.[127]

Bradford v. American Federal Bank, F.S.B.[128] deserves discussion because it is contrary to Fifth Circuit precedent in several respects. First, the *Bradford* court appears to conclude that *D'Oench, Duhme* will not apply to an oral side agreement between the borrower and lender if the borrower can prove that the FDIC has actual knowledge of such agreement.[129] This statement disregards precedent which establishes that *D'Oench, Duhme* absolutely bars all defenses and claims based on oral agreements, whether or not the FDIC has knowledge of such oral agreements.[130] The authors are not aware of any case so holding and, in fact, the courts have consistently held that *D'Oench, Duhme* bars defenses based on a written agreement that is not contained in the bank's transaction files for the loan to which the agreement applies.[131] Second, the case holds that the FDIC, as a receiver, is not protected from usury claims because state law governs when the FDIC is acting as a receiver.[132] Apparently the court ignored the many decisions that have applied *D'Oench, Duhme*, a federal common law doctrine, in cases involving the FDIC, FSLIC and RTC as a receiver.[133] Moreover, several months after

127. *Id.* Continuing its display of lack of confidence in the district court, the Fifth Circuit provided detailed instructions to the district court. Specifically, if the district court determined that the guaranty was not part of the bank's loan transaction files and therefore barred by *D'Oench, Duhme*, the district court should then determine if the liability limitation clause was a mutual contractual obligation of the bank, and if so, whether the obligation had been performed by the bank. If the obligation existed and had not been performed by the bank, the Fifth Circuit advised the district court that the *D'Oench, Duhme* doctrine would not bar the venturers' defense based on the language of the guaranty. *Id.* at 1001.

128. 783 F. Supp. 283 (N.D. Tex. 1991).

129. *Id.* at 285 (citing Federal Deposit Ins. Corp. v. Wood 758 F.2d 156, 162 (6th Cir. 1985), *cert. denied*, 474 U.S. 944 (1985)). The *Wood* case did not involve *D'Oench, Duhme* or Section 1823(e), but instead was a federal holder in due course case. The *Wood* case held that "when the FDIC in its corporate capacity, as part of a purchase and assumption transaction, acquires a note in good faith, for value, and without actual knowledge of any defense against the note, it takes the note free of all defenses that would not prevail against a holder in due course." *Wood*, 758 F.2d at 161. The issue of knowledge under the federal holder in due course rule simply has no effect on the prong of the *D'oench, Duhme* doctrine, which bars claims and defenses based on agreements other than a written agreement that is between the party asserting the defense or claim and the failed lender and that is located in the lender's loan transaction files. *Supra* note 7.

130. *E.g.*, Texas Refrigeration Supply, Inc. v. Federal Deposit Ins. Corp., 953 F.2d 975, 980 (5th Cir. 1992); *Oaks Apartments*, 966 F.2d at 995.

131. *E.g.*, *Oaks Apartments*, 966 F.2d at 998.

132. *Bradford*, 183 F. Supp. at 286 (citing Federal Deposit Ins. Corp. v. Renda, 692 F. Supp. 128, 134 (D. Kan. 1988)).

133. *E.g.*, Resolution Trust Corp. v. Ammons, 836 S.W.2d 705, 709-10 (Tex. App.—Houston [1st Dist.] 1992, no writ); Smith v. Federal Deposit Ins. Corp., 800 S.W.2d 648, 651 (Tex. App.—Houston [14th Dist.] 1990, writ dism'd). Campbell Leasing, Inc. v. Federal Deposit Ins. Corp., 901 F.2d 1244, 1249 (5th Cir. 1990); Federal Sav. & Loan Ins. Corp. v. Murray, 853 F.2d 1251, 1256 (5th Cir. 1988); Federal Deposit Ins. Corp. v. Wood 758 F.2d 156, 160 (6th Cir. 1985), *cert. denied*, 474 U.S. 944, 106 S. Ct. 308 (1985); *see also* Section 1823(e) (which applies to the FDIC in its corporate and receiver capacity).

the *Bradford* case, the Fifth Circuit specifically held that usury damages under Texas law are penal in nature and therefore, under federal law, cannot be asserted against the FDIC in its corporate or receiver capacity.[134]

Although not as sweeping as the *D'Oench, Duhme* doctrine, the federal common law holder in due course doctrine is nevertheless a potent weapon within the FDIC's arsenal of defenses to avoid a borrower's personal defenses in a suit on a promissory note. Subject to certain qualifications, the FDIC and RTC each have the right to assert the doctrine to avoid a maker's personal defenses on a promissory note acquired by the FDIC or RTC in a purchase and assumption transaction.[135] The entity asserting the doctrine is not required to meet the technical requirements of a holder in due course under state law,[136] but must take the note in good faith and without actual knowledge of the defense.[137] The Fifth Circuit recently held, however, that the entity acquiring the note is entitled to a presumption that it purchased the note without knowledge of any personal defenses and that the maker of the note is required to produce affirmative evidence to rebut this presumption.[138]

In *Sunbelt Savings, F.S.B. v. Montross,*[139] a Fifth Circuit panel held that the federal holder in due course doctrine did not protect the FDIC, RTC or their successors from personal defenses asserted by makers of non-negotiable instruments.[140] This holding had the potential of severely limiting the FDIC's and RTC's use of the doctrine because many of the promissory notes acquired by them in purchase and assumption transactions were arguably non-negotiable, including those many variable rate notes that had been executed since 1980.[141] Because of the exceptional importance of the issue, the

134. Federal Deposit Ins. Corp. v. Claycomb, 945 F.2d. 853, 861 (5th Cir. 1991), *supra* notes 74-85 and accompanying text. The Fifth Circuit recently extended its holding in *Claycomb* to the RTC where the RTC is the successor agency to the FDIC. First South Sav. Ass'n v. First Southern Partners II, 957 F.2d 174, 178 (5th Cir. 1992). *See also* Federal Deposit Ins. Corp. v. Royal Park No. 14, Ltd., 800 F. Supp. 477 (N.D. Tex. 1992) (United States and its agents are immune from claims of usury under doctrine of sovereign immunity).

135. *E.g., Oaks Apartments*, 966 F.2d at 995; Resolution Trust Corp. v. Montross, 944 F.2d 227 (5th Cir. 1991) (per curiam); *Campbell Leasing*, 901 F.2d 1244; *Murray*, 853 F.2d 1251; Federal Deposit Ins. Corp. v. Adam, 803 F. Supp. 1225 (S.D. Tex. 1992).

136. *E.g., Campbell Leasing*, 901 F.2d at 1249.

137. *Ammons*, 836 S.W.2d 605; Federal Sav. & Loan Ins. Corp. v. Mackie, 949 F.2d 818, 824 (5th Cir. 1992); *Wood*, 758 F.2d at 161.

138. *Mackie*, 949 F.2d at 825-26.

139. 923 F.2d 353 (5th Cir. 1991).

140. *Id.* at 358. The FDIC apparently argued that negotiability was merely a technical requirement under state law pertaining to holder in due course status, and therefore was not a requirement of the federal holder in due course doctrine. The court, however, concluded that negotiability was not a technical requirement of holder in due course status, but rather was the foundation underlying holder in due course status. *Montrose*, 949 F.2d at 356.

141. The FDIC and RTC also had to be concerned about those many promissory notes acquired by them that contained clauses recognizing that the note was not fully advanced at the time of execution. This concern was fully realized by the Fifth Circuit's decision in *Resolution Trust Corp. v. Oaks Apartments J.V.*, wherein the court held that a note which contains an obligation to pay a specific sum "or so much thereof as may be advanced" does not specify a sum certain to be paid and therefore is non-negotiable. *Oaks Apartments*, 966 F.2d at 1001-02.

Fifth Circuit agreed to a rehearing *en banc*,[142] thereby leaving the issue unsettled.[143] During early October of 1991, the Fifth Circuit delivered a major blow to the FDIC and RTC by reinstating the panel's original *Montross* opinion.[144] The court, however, left two significant doors open. First, the court made clear that the personal defenses could not be based on agreements barred under *D'Oench, Duhme* or Section 1823(e).[145] Second, the court stated that it was not taking a position on whether a variable interest rate note is a negotiable instrument under Texas law,[146] perhaps because the court had recently requested the Texas Supreme Court to answer that particular issue.[147]

In *Amberboy v. Societe de Banque Privee*,[148] the Texas Supreme Court answered the Fifth Circuit's question regarding the negotiability of a variable interest rate note. In a decision that could have only brought smiles and giddiness to the FDIC and the RTC, the Court concluded that a promissory note that provides for interest at a rate that can be determined only by reference to a bank's published prime rate does not violate the sum certain requirement of negotiability under the Texas Uniform Commercial Code and therefore is negotiable.[149] The court defined a bank's published prime rate as "only those rates which are public, either known to or readily ascertainable by any interested person."[150] The court stated, however, that it would

142. Sunbelt Savings, F.S.B. v. Montross, 932 F.2d 363 (5th Cir. 1991), *on suggestion for rehearing en banc*.

143. *See* Federal Sav. & Loan Ins. Corp. v. Griffin, 935 F.2d 691, 697 n.3 (5th Cir. 1991) (FDIC and RTC use of federal holder in due course doctrine is an open question in the Fifth Circuit).

144. Resolution Trust Corp. v. Montross, 944 F.2d 227 (5th Cir. 1991) (per curiam).

145. *Id.* at 228-29.

146. *Id.* at 228.

147. Ackerman v. Federal Deposit Ins. Corp., 930 F.2d 3 (5th Cir. 1991). The specific question certified to the Texas Supreme Court was:

> Is a promissory note requiring interest to be charged at a rate that can be determined only by reference to a bank's published prime rate a negotiable instrument as defined by the Texas Uniform Commercial Code?

Id. at 4.

148. 831 S.W.2d 793 (Tex. 1992).

149. *Id.* at 795. In a dissenting opinion, four justices disagreed with the court's conclusion, generally emphasizing that the vast majority of courts considering the issue have concluded that a variable interest rate note is non-negotiable, and that the majority's opinion was an inappropriate intrusion into the legislative process. *Id.* at 801-03. Not as instructive as this portion of the dissent, but more entertaining, was the dissent's very bold response to the Fifth Circuit's recent statements that the Texas Supreme Court was mysteriously reluctant to accept questions of first impression certified to it by the Fifth Circuit and that the time within which the Court answered certified questions had become frustratingly slow. *See* Jackson v. Freightliner Corp., No. 9-7092, slip op. 5171, 5174-75 (5th Cir. Aug. 7, 1991), *published as modified*, 938 F.2d 40 (5th Cir. 1991). The dissent came out swinging, providing a nearly three page response to the Fifth Circuit's assault before addressing the substantive issues presented by the certified question. *Amberboy*, 831 S.W.2d at 798-801. Not wanting to create an all out war with the Fifth Circuit, the majority opinion made clear to the Fifth Circuit that the majority of the court emphatically rejected any criticism of the Fifth Circuit and in no way presumed to instruct the Fifth Circuit on how to conduct its business. *Id.* at 798 n.10.

150. *Amberboy*, 831 S.W.2d at 797-98. In Federal Sav. & Loan Ins. Corp. v. Kralj, 968 F.2d 500, 508, the Fifth Circuit applied the holding in *Amberboy* to a promissory note that provided for interest at two percent over the rate per annum announced by Chase Manhattan Bank of New York at its principal office.

not specify or limit the manner in which the rate be published because the negotiability requirement of commercial certainty is satisfied "when the information is readily available to the public, regardless of the means utilized to make that information available."[151] The court recognized that its holding was contrary to the majority of other states that had addressed the issue,[152] but, in the court's opinion, the minority view adopted by the court was more in tune with the Uniform Commercial Code's stated purpose of clarifying and modernizing commercial law and current commercial practices involving the use of variable rate notes.[153]

E. MORTGAGES GENERALLY

Hall v. Resolution Trust Corp.[154] clearly demonstrates a lender's ability to derail a borrower's attempt to circumvent the language agreed upon in its loan documents. In *Hall*, the lender and borrower were parties to a security agreement that permitted (i) the lender to require the borrower to deliver additional collateral satisfactory to the lender, if the lender reasonably determined that its existing collateral (stock and notes) had declined or might decline in value and (ii) the borrower to obtain a release of certain notes that were part of the existing collateral by providing as substitute collateral approximately five million dollars of debenture promissory notes executed by the borrower or any affiliate of the borrower in form acceptable to the lender. Under the impression that the lender was in a generous mood (or perhaps believing that the lender could not interpret the clear language of its own loan documents), the borrower asked the lender to accept a debenture note in the amount of 6.45 million dollars in exchange for all of the existing collateral (stock and notes).[155] The lender rejected the borrower's request to substitute the debenture for the notes and the stock, and asked the borrower to post additional collateral pursuant to the insecurity clause due to the stock's declining value and the deteriorating financial condition of the makers of the pledged notes. Indignant, the borrower refused to deliver additional security, ceased making payments on the loan and sued the lender for breach of the insecurity clause and for unreasonably refusing to accept the borrower's offer of substitute collateral. Believing that it should be entitled to rely on the contractual language in its loan documents, the lender counterclaimed for acceleration of the note and moved for summary judgment on all issues. The trial court entered judgment for the lender and the borrower appealed, arguing that there was an issue of material fact as to whether the lender had acted reasonably in calling for additional collateral and accelerating the note.[156]

As to the lender's call for additional security, the borrower argued that

151. *Amberboy*, 831 S.W.2d at 798.
152. *Id.* at 794.
153. *Id.* at 796.
154. 958 F.2d 75 (5th Cir. 1992).
155. The court pointed out that the debenture notes were rejected by the lender because the lender had information that the debenture notes were delinquent. *Id.* at 77.
156. *Id.*

the security agreement required the lender to act reasonably and that the issue of reasonableness was fundamentally a jury question. The court of appeals disagreed, stating that there was undisputed evidence that the collateral was impaired and that the record clearly reflected that the lender had acted reasonably and consistently with the terms of the agreement.[157] In support of its conclusion, the Fifth Circuit stated that, "under Texas law, . . . undisputed evidence of significant impairment of the prospect of satisf[ying] a debt establishes, as a matter of law, the reasonableness of invoking [an] insecurity provision."[158]

With respect to the borrower's proposed substitution of collateral, the Fifth Circuit agreed with the trial court's determination that the proposed substitution was not in accordance with the security agreement provisions.[159] The court observed that the security agreement only permitted the borrower to substitute note debentures for the pledged notes that were a part of the collateral.[160] In comparison, the borrower's proposed substitution was for both the pledged notes and the stock. In the court's judgment, the fact that the pledged stock was essentially worthless at the time of the borrower's proposal was irrelevant.[161] The lender had the contractual right to retain the stock to secure its debt, regardless of the value thereof.[162] The borrower countered by arguing that the lender had an implied obligation of good faith and fair dealing and hence should have accepted its proposal.

157. *Id.* at 78. The court noted that the lender based its call for additional security on information supplied to it by the borrower, which reflected that the regulatory capital and the net income of the issuer of the pledged stock had decreased dramatically during the year in which the borrower made the request to substitute collateral. *Id.*

158. *Id.* (citing Finley, Inc. v. Longview Bank & Trust Co., 705 S.W.2d 206, 208-09 (Tex. App.—Texarkana 1985, writ ref'd n.r.e.); Sparkman v. Peoples Nat'l Bank, 580 S.W.2d 868, 869 (Tex. Civ. App.—Texarkana 1979, writ ref'd n.r.e.)). Although the court's statement of Texas law is probably correct, both *Finley* and *Sparkman* address the issue of whether the lender acted in good faith in accelerating a loan containing an insecurity or acceleration-at-will provision and not whether a lender had reasonably determined if its collateral was sufficient or had declined in value. In *Hall*, the lender was not only under a contractual obligation to have reasonably determined that the collateral had become insufficient or had declined in value, but was also under a statutory obligation to accelerate only if it had a good faith belief that the prospect of payment of its debt or performance of the additional collateral clause was impaired. *See* TEX. BUS. & COM. CODE ANN. § 1.208 (Vernon 1987), which generally provides that a term in an agreement stating that one party may accelerate payment or performance at will or when he deems himself insecure shall be construed to mean that the party shall have the right to accelerate only if "he in good faith believes that the prospect of payment or performance is impaired." The debtor in *Hall* apparently did not make the § 1.208 argument, perhaps in the belief that if the lender won the reasonableness argument, it would logically follow that the lender acted in good faith. The Fifth Circuit identified two Texas cases that it thought arguably contrary to the *Finley* and *Sparkman* cases: American Bank v. Waco Airmotive, 818 S.W.2d 163, 172 (Tex. App.—Waco 1991, writ denied); Ford Motor Credit Co. v. Powers , 613 S.W.2d 30, 34 (Tex. App.—Corpus Christi 1981, no writ). *Hall*, 958 F.2d at 78. Apparently, the concept in both of these cases that disturbed the court was that good faith must be determined by the trier of fact. However, neither *Waco Automotive* nor *Powers* addressed the issue of whether good faith could be determined as a matter of law based on summary judgment proof and therefore should not be viewed as contrary to *Finley* or *Sparkman*.

159. *Hall*, 958 F.2d at 78.

160. *Id.*

161. *Id.*

162. *Id.* at 79.

The court summarily rejected this contention, recognizing that Texas courts have not imposed a duty of good faith upon a lender in a borrower-lender relationship.[163] The borrower finally argued that it had substantially complied with the requirement for substituting collateral.[164] The court rejected this argument, stating that the borrower's substitution proposal was materially different than that contemplated by the security agreement.[165] Moreover, the borrower cited no case in which a Texas court had applied the substantial compliance doctrine to loan and security agreements and the court was not inclined to set precedent.[166]

The result in *In re Davis Chevrolet, Inc.*[167] is proof positive that the debtor who bites the hand of a generous lender may lose even in the most benevolent debtor forum, a federal court presided over by a bankruptcy judge. In this case, the debtor failed to make payment on a note on the date it became finally due and payable (May 16, 1987). Nearly four years later, the forgiving (or perhaps dilatory) lender commenced foreclosure proceedings against the property that secured the note. The lender appointed its first substitute trustee on March 5, 1991 and the appointment was acknowledged on March 11, 1991. On March 7, 1991, the first substitute trustee signed a notice of trustee's sale that did not include the amount owed on the note. On March 11, 1991, the lender replaced the first substitute trustee with a second substitute trustee; curiously this appointment was acknowledged on March 5, 1991.[168] On March 12, 1991, the second substitute trustee posted the notice prepared and executed by the first substitute trustee. On April 2, 1991, the second substitute trustee conducted the foreclosure sale. However, pursuant to a written agreement entered into on the date of the foreclosure sale, the altruistic and reasonable lender permitted the debtor to continue to occupy the property for a period of 10 days, during which time the lender agreed not to sue the debtor and further agreed to accept $200,000 in consideration for which the lender would release the property in favor of the debtor. Apparently the 60-day possession agreement did not expressly toll the statute of

163. *Id.* (citing Cockrell v. Republic Mortgage Ins. Co., 817 S.W.2d 106, 116 (Tex. App.—Dallas 1991, no writ); Georgetown Assoc., Ltd. v. Home Fed. Sav. & Loan Ass'n., 795 S.W.2d 252, 255 (Tex. App.—Houston [14th Dist.] 1991, writ dism'd w.o.j.); Victoria Bank & Trust Co. v. Brady, 779 S.W.2d 893, 902 (Tex. App. —Corpus Christi 1989), *rev'd on other grounds*, 811 S.W.2d 931 (Tex. 1991)).

164. The borrower relied on Telles v. Vasconcelos, 417 S.W.2d 491, 494 (Tex. Civ. App.—El Paso 1967, writ ref'd n.r.e.) ("[I]n all domains of the law, unless it is otherwise provided, either expressly or by necessary implication, a substantial compliance with the specified requirements [of a contract] is the legal equivalent of compliance." (quoting Christy v. Williams, 292 S.W.2d 348, 352 (Tex. Civ. App.—Galveston 1956, writ dism'd w.o.j))).

165. *Hall*, 958 F.2d at 79.

166. *Id.*

167. 135 B.R. 29 (Bankr. N.D. Tex. 1992).

168. Perhaps "curiously" is the wrong word. A good bet is that the notary was given both appointments on the same date and acknowledged them in the wrong order (i.e. the notice dated the 5th was shown acknowledged on the 11th and the appointment dated the 11th was shown acknowledged on the 5th). If this was the case, hopefully the notary complied with the provisions of TEX. GOV'T CODE ANN. § 406.14 (Vernon 1988) and TEX. CIV. PRAC. & REM. CODE ANN. § 121 (Vernon 1986 & Supp. 1993), which set forth the procedures for a proper acknowledgment.

limitations with respect to collection of the deficiency or otherwise.[169] Prior to the end of the 60-day period, the debtor filed for bankruptcy protection and then bit the hand of the lender by bringing an adversary proceeding to invalidate the foreclosure on four grounds: (1) the debtor received no notice of the amount payable to avoid foreclosure;[170] (2) the notice of trustee's sale was filed and posted less than 21 days prior to the foreclosure; (3) the notice of trustee's sale was improperly signed by the substitute trustees; and (4) the statute of limitations was not tolled by the 60 day agreement.[171]

The debtor first argued that it had not received a notice setting forth the amount payable in order to avoid a foreclosure. In the court's judgment, such a notice is not required under Texas law because neither the Texas statute governing non-judicial foreclosure sales[172] nor the Texas Uniform Commercial Code section governing demands for payment[173] requires that a debtor receive notice of the amount due in order to avoid foreclosure.[174] Even if Texas law requires such a notice, the court concluded that Texas law permits presentment of demand to be waived by a clear and unequivocal writing and that the loan documents executed by the debtor contained such a clear and unequivocal waiver.[175]

The debtor next argued that the 21-day posting and mailing period specified in Section 51.002 of the Texas Property Code[176] requires that the period commencing with (and including) the date of posting and ending on (and including) the date of foreclosure may not be less than 21 days. The court concluded that the debtor's method for calculating the 21-day period was incorrect.[177] Texas law, the court observed, does not require that both the day of posting and the date of foreclosure be excluded in calculating the twenty-one day notice period.[178]

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169. *Davis Chevrolet*, 135 B.R. at 31.

170. The facts indicate that the notice of trustee's sale did not include the amount owed on the note.

171. *Id.* at 30-31.

172. TEX. PROP. CODE ANN. § 51.002 (Vernon 1984 & Supp. 1993).

173. TEX. BUS. & COM. CODE ANN. § 3.501 (Vernon 1987 & Supp. 1993).

174. *Davis Chevrolet*, 135 B.R. at 32.

175. *Id.* (citing TEX. BUS. & COM. CODE ANN. § 3.511(b)(1) (Vernon 1987 & Supp. 1993); Shumway v. Horizon Credit Corp., 801 S.W.2d 890, 893 n.6 (Tex. 1991); Sydnor v. Gascgoigne, 11 Tex. 449, 456 (1854)).

176. TEX. PROP. CODE ANN. § 51.002 (Vernon 1984 & Supp. 1993).

177. *Davis Chevrolet*, 135 B.R. at 33.

178. *Id.* (relying on Newman v. Woodhaven Nat'l Bank, 762 S.W.2d 374 (Tex. App.—Fort Worth 1988, no writ); Huston v. Sadler, 501 S.W.2d 728 (Tex. Civ. App.—Tyler 1973, no writ)). The bankruptcy court read *Woodhaven Nat'l Bank* to say that the 21-day period under § 51.002 could include either the day of posting or the day of foreclosure sale, but not both. *Davis Chevrolet*, 135 B.R. at 33. Perhaps a more accurate reading of *Woodhaven Nat'l Bank* is that the court recognized that no Texas case had held that both the day of posting and the day of sale must be excluded in the calculation of the 21-day notice period while several cases have held that the date of sale is excluded from the 21-day period but the day of posting is included. *See Huston*, 501 S.W.2d at 730; Hausmann v. Texas Sav. & Loan Ass'n, 585 S.W.2d 796, 800 (Tex. Civ. App.—El Paso 1979, writ ref'd n.r.e.). Although it is not clear, the *Woodhaven Nat'l Bank* court apparently included the day of posting. In a recent federal district court case, Federal Deposit Ins. Corp. v. Royal Park No. 14, Ltd., 800 F. Supp. 477 (N.D. Tex. 1992), the court cited *Woodhaven Nat'l Bank* for the principle that Texas courts follow the

The debtor also claimed that the authority of the substitute trustees was ineffective because their appointments were not acknowledged on the same day they were signed. The court concluded that the validity date of an appointment of a trustee or successor is controlled by the deed of trust.[179] The deed of trust in this case permitted the holder of the note to appoint a substitute trustee or a successor trustee to act in place of the named trustee "without other formality than the designation in writing of a substitute or successor trustee."[180] No requirement of acknowledgement was set forth in the deed of trust and the court cited ancient Texas precedent for the proposition that appointments are valid between the parties and those with notice when validity is not dependent on a proper acknowledgement.[181] Accordingly, the court concluded that the appointments of the trustees were valid and became effective on the date their respective written appointments were executed.[182]

As to whether the second substitute trustee had authority to post the notice of foreclosure prepared by the first substitute trustee, the court cited Texas cases that held that a substitute trustee may foreclose pursuant to a valid notice of sale posted by a prior trustee.[183] From this principle, the court logically concluded that because the notice of foreclosure was prepared by the first substitute trustee pursuant to the deed of trust during the effective period of the first substitute trustee's appointment, there was no need for the second substitute trustee to prepare another notice of sale.[184]

With respect to the debtor's argument regarding the statute of limitations,[185] the court simply would not permit the debtor to avoid its contrac-

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rule that only the date of sale is excluded in calculating the 21 day notice period under § 51-002. *Id.* at 481.

179. *Davis Chevrolet*, 135 B.R. at 33.

180. *Id.*

181. *Id.* at 33 (citing Palmer v. Texas Tram & Lumber Co., 23 S.W. 38 (Tex. Civ. App. 1893, no writ)). The *Palmer* case dealt with an irregular acknowledgement on a deed and at best inferentially supports the broad statement by the court. Perhaps the court would have been better advised to simply emphasize that the deed of trust did not require the appointment to be acknowledged and that the court discovered no Texas law requiring that the appointment be acknowledged. Absent any deed of trust or legal requirement of acknowledgement, the acknowledgements were irrelevant.

182. *Id.*

183. *Id.* at 34 (citing Tarrant Sav. Ass'n v. Lucky Homes, Inc., 390 S.W.2d 473 (Tex. 1965); Loomis Land & Cattle Co. v. Diversified Mortgage Investors, 533 S.W.2d 420 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.)).

184. *Id.*

185. The statute of limitations issue in this case is somewhat confusing. The facts of the case indicate that the statute of limitations would not have run on the note until May 16, 1991, that the foreclosure sale occurred on April 2, 1991, that the debtor remained in possession of the foreclosed property pursuant to a written agreement entered into on the date of the foreclosure sale and pursuant to which he had a limited right to reacquire the property, that the trustee's deed was recorded on April 9, 1991 and that the debtor filed for bankruptcy on May 20, 1991. *Id.* at 31, 34. Obviously, the sale and the recording of the trustee's deed took place before the expiration of the four year statute of limitations period and prior to the bankruptcy. The debtor only remained in possession of the property (without any apparent claim of ownership of the property) pursuant to a written agreement. On these facts, it appears that the foreclosure sale was completed prior to the expiration of the limitations period (without regard to tolling). The tolling issue would, however, remain important to the creditor if it intended to collect the payments the debtor agreed to make pursuant to the possession agreement.

tual obligations by asserting an "I got you" argument. The court observed that Texas law estops a party from asserting limitations if that party's conduct induces the other party to not bring its action within the limitations period.[186] The court concluded that the terms and conditions contained in the 60-day possession agreement entered into between the debtor and the lender on the date of the foreclosure sale induced the lender to not bring suit within the limitations period.[187] Accordingly, the court turned the borrower's argument on its ear, concluding that the limitations period was extended for the 60-day period within which the lender had previously agreed not to bring suit.[188]

In three cases decided during the Survey period, a party sued a mortgagee in order to have a portion of the mortgagee's collateral released from its lien. One of the three is noted below,[189] while the other two deserve discussion. In the first case, *Groschke v. Gabriel*,[190] the mortgagor sued the mortgagee for release of a six acre tract from the mortgagee's lien. The mortgagor purchased the six acre tract, as well as 289 acres of other land, from the mortgagee, and executed a wraparound note, which wrapped around a note executed by the mortgagee, payable to a third party.[191] The mortgagee secured payment of the wraparound note by a second lien deed of trust, which contained a release provision entitling the mortgagor to obtain a partial release of the six acres from the second lien deed of trust so long as (i) the wraparound note was not in default, (ii) the wrapped note was paid in full, and (iii) the first lien securing the payment of the wrapped note was fully and finally released.[192] The mortgagor defaulted on the first principal payment due on the wraparound note and the mortgagee posted the property for foreclosure. Thereafter, the mortgagor and mortgagee reached an agreement pursuant to which the mortgagee agreed to accept the missed principal payment one year after the original due date and to forbear from foreclosing on the property.[193] Approximately three weeks before the deferred principal payment was to become due, the mortgagor purchased the wrapped note and

186. *Id.* at 35 (citing Zimmerman v. First Am. Title Ins. Co., 790 S.W.2d 690 (Tex. App.—Tyler 1990, writ denied)).

187. *Id.* The court had to stretch somewhat to reach a conclusion that the lender was induced not to bring suit within the limitations period. Clearly, the lender could have saved itself several headaches and enabled the court to avoid unnecessarily expending its energy by including a specific tolling provision in its agreement with the debtor.

188. *Id.* The court further held that the limitations period would be extended to the extent permitted under the Federal Bankruptcy Code.

189. Lindsey v. Federal Deposit Ins. Corp., 960 F.2d 567 (5th Cir. 1992) (where mortgagor entered into letter agreement to lift automatic stay to permit mortgagee to foreclose lien and security interest and at the same time announced its intention to retain ownership of peanut allotment covering land to be foreclosed upon, such oral reservation was insufficient to bind mortgagee to agreement to release its interest in peanut allotment in favor of mortgagor without evidence that mortgagee agreed to release its lien against peanut allotment).

190. 824 S.W.2d 607 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

191. *Id.* at 608.

192. *Id.* at 608-09 n.2.

193. Apparently, the mortgagee expressly agreed to reserve its right to foreclose its lien in the event that the mortgagor failed to timely pay the deferred principal payment. *See id.* at 611.

the first lien securing its payment. The original holder of the wrapped note delivered to the mortgagor both a release of the first lien (which was not recorded) and an assignment of the first lien.[194] The mortgagor then apparently offered the wrapped note to the mortgagee[195] and demanded that the mortgagee release its lien against the six acre tract, but the mortgagee refused.[196] Not surprisingly, the mortgagor failed to make the principal payment and shortly thereafter sued the mortgagee for failing to release the six acre tract.[197] Both parties moved for summary judgment. The trial court granted the mortgagee's motion, and the mortgagor appealed.[198]

On appeal, the mortgagor's argument revealed an interesting strategy that was perhaps too slick for the appeals court. The mortgagor argued that at the time it requested the release of the six acre tract, the mortgagor was not in default under the wraparound note, the wrapped note had been satisfied, and the wrap deed of trust had been released. Accordingly, all conditions precedent to the release had been satisfied and the mortgagee had breached its obligation to release the six acres. The mortgagor attempted to convince the court that the mortgagor was not in default on the wraparound note at the time of the demand for the release of the six acres because the deferred principal payment was not due for approximately another three weeks. The court hemmed and hawed, and, without citing case law to support its position, concluded that the extension agreement regarding the initial principal default did not negate that default.[199] This conclusion was reached by the court despite the fact that the mortgagee had agreed to permit the mortgagor to defer the payment for up to one year. In addition, having the benefit of not particularly relevant hindsight, the court placed some importance on the mortgagor's default on the deferred principal payment three weeks after the demand for the release of the six acres.[200] These two defaults, according to the court, made it clear that the first condition precedent to the release of the six acres was not satisfied.[201]

As to the issue of satisfaction of the wrapped note, the court observed that

194. Obtaining the release was obviously an effort by the mortgagor to satisfy one of the conditions precedent to the release of the six acre tract, specifically that the first lien be fully and finally released.

195. *See Groschke*, 824 S.W.2d at 612. The case is not clear as to when this offer was made to the mortgagee, but it appears to have been made shortly before the written demand for the release of the six acres.

196. *Id.*

197. The mortgagor sought and obtained a temporary injunction prohibiting the mortgagee from foreclosing its lien against the six acres. The mortgagee proceeded with foreclosure against the remaining 289 acres covered by the deed of trust without objection by the mortgagor. *Id.*

198. *Id.* It is somewhat curious that the trial court granted the mortgagee's motion for summary judgment in light of the trial court's issuance of the temporary injunction prohibiting the mortgagee from foreclosing its lien, which would have required the trial court to reach a determination that the mortgagor had a probable right of recovery in a trial on the merits.

199. *Id.*

200. *Id.*

201. *Id.* If this had been the sole condition that had not been satisfied, the court's conclusion that the default had not been waived was open to challenge on appeal because the extension agreement allowed the mortgagor to defer the payment for a one-year period and the default on the deferred payment which did not occur until after the demand for the release,

the mortgagor admitted that the wrapped note was not paid in full by testifying that she expected to either obtain the six acres through an exchange for the wrapped note or receive the $89,000 she had invested in the purchase of the wrapped note.[202] This testimony, according to the court, clearly established that the note had not been paid in full because the mortgagee still owed $89,000, no matter who owned the note.[203] While the court was busy fine-tuning its tunnel vision, it failed to recognize that if the wrapped note was delivered to the mortgagee in exchange for the release of the six acres, the mortgagee's unpaid obligation would have been owing to himself and therefore tantamount to being paid in full.[204]

As to the third condition precedent, the court was not impressed by the fact that the mortgagor had a signed release in its hands because the release had not been recorded and would not be recorded until the release of the lien securing the wraparound note on the six acres had been signed.[205] Although this is a technically correct conclusion, the court could just as easily have deemed the condition of release satisfied if the exchange of the releases was to occur simultaneously, a common occurrence in commercial transactions.

Resolution Trust Corp. v. Kemp is susceptible to several interpretations.[206] To some, it may demonstrate that the law can produce an inequitable result, but to others, it illustrates the Fifth Circuit's efforts to uphold the "integrity of the public records system of Texas."[207] In *Kemp*, a developer obtained a loan from a lender to finance the development of residential subdivision lots. The initial loan funds proved insufficient and the developer obtained additional financing from a second lender. Pursuant to a subordination agreement executed by the two lenders, the original lender subordinated its lien to the lien of the second lender and agreed to release its lien as to individual

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was, based on the facts presented in the case, irrelevant. Certainly, when reading this case, one can sense that the court simply did not approve of the mortgagor's strategy.

202. *Id.* at 613.

203. *Id.*

204. If the wrapped note did not contain an anti-merger clause, there certainly exists an argument that upon assignment of the wrapped note to the mortgagee, the mortgagee's obligation to pay would have merged with its right to collect, thereby extinguishing the debt. The court further supported its conclusion by pointing out that the mortgagee was not required to accept the wrapped note in lieu of the deferred principal payment ($53,000). *Id.* at 612. Although this observation is correct, the facts indicate that the wrapped note was being offered in exchange for the six acres and not for satisfaction of the deferred payment. The court also observed that the mortgagee had four more years to pay the wrapped note and during that time had the right to receive approximately $400,000 under the wraparound note. *Id.* This right, according to the court, would be lost if the mortgagee accepted the wrapped note. *Id.* Either the court failed to include relevant facts in its opinion or the court simply reached a wrong conclusion. The facts indicate that the mortgagor requested the mortgagee to accept the wrapped note in exchange for the release of the six acres, not in satisfaction of all of the debt or for the release of any other acreage covered by the deed of trust.

205. *Id.* at 614.

206. 951 F.2d 657 (5th Cir. 1992).

207. *Id.* at 659. In its conclusion the court stated:

> We refuse to allow the . . . [lot owners] to manipulate the system by using the recordation of the Subordination Agreements as a subterfuge for ignoring the properly recorded . . . [l]iens. Such a construction of this case would annihilate the effective operation of the recording system in Texas.

Id. at 665.

lots upon receiving notice from the second lien lender that there was a pending sale. The subordination agreement was recorded in the appropriate county records. The original lender was taken over by the RTC and its assets were transferred to another lending entity. That entity filed a lawsuit against the second lender, challenging the enforceability of the subordination agreement and asserting the priority of its lien.[208] The first lender also filed a notice of lis pendens referencing the lawsuit. Subsequently, the developer defaulted on the loan and the original lender commenced foreclosure proceedings. Prior to the commencement of the foreclosure proceedings, several individuals purchased and then constructed homes on subdivision lots, without having obtained a specific release of the original lender's lien. This suit was then brought by the lot purchasers to prohibit the foreclosure as to their lots, claiming entitlement to the partial release provisions in the recorded subordination agreement. The district court dismissed the purchasers' suit against the original lender and realigned the parties, whereupon the original lender sued for judicial foreclosure of its lien and the individual homeowners counterclaimed for the value of the improvements they had constructed on the lots.[209] The trial court granted the original lender's motion for summary judgment and ordered the lender's lien to be foreclosed, leaving the homeowners with reduced cookie jar reserves, as they were to receive nothing for their improvements.[210]

On appeal, the Fifth Circuit affirmed the trial court's judgment.[211] The lot owners argued that the original lender's lien should be deemed released for two reasons. First, the release provisions that were recorded at the time the lot owners purchased their lots caused the original lender's lien to be automatically released when it received notice of the sale as contemplated in the subordination agreement. In the court's judgment, the lot owners were attempting to have their cake and eat it too, in that they were relying on the recordation statute while wholly disregarding the fact that under the same statute they had notice of the original lender's lien, and no release of that lien was of record.[212] The recordation statutes, the court opined, are a time honored mechanism that permit "one who seeks to purchase [land to] safely judge the validity of title."[213] Here, the lot owners failed to take full advantage of the safety offered by the recordation statute when they failed to verify whether the original lender had released its lien as to their lots.[214]

208. The assignee was the actual party to file the lawsuit and notice of lis pendens. *Id.* at 659-60 n.2.

209. *Id.* at 660.

210. *Id.*

211. *Id.*

212. The lot owners relied on two Texas cases: Moran v. Wheeler, 27 S.W. 54 (Tex. 1894) and Cook v. Leslie, 59 S.W.2d 302 (Tex. Civ. App.—San Antonio 1933, no writ). The court distinguished both cases from the facts before it. *Moran* involved the effect of a release of lien that had been properly recorded, and not, as in this case, a recorded agreement to release a lien. In *Cook*, the purchasers not only had notice of an agreement by the lender to release provisions which affected their lots, but the deed from the mortgagee to the mortgagor bound the mortgagee to its release provisions. *Kemp*, 951 F.2d at 662.

213. *Kemp*, 951 F.2d at 662 (citing *Moran*, 27 S.W. at 55).

214. In the court's judgment, the issue was not whether the lot owners had notice of the

In the court's judgment, if the lot owners were to prevail, they had to show that they were entitled to the benefit of the original lender's contractual agreement to release its lien upon receiving notice of the purchase of their lots.[215] Since the lot owners were not parties to the subordination agreement, they had to prove that they had third party beneficiary status.[216] Recognizing that Texas law requires a party claiming third party beneficiary status to show that from the terms of the contract the parties intended to benefit the third party,[217] the court concluded that the lot owners failed to meet this burden.[218] The trial court found and the Fifth Circuit agreed that the subordination agreements did not mention the lot owners or otherwise indicate that the two lenders intended that the lot owners benefit from the release provisions.[219] Accordingly, the Fifth Circuit concluded that the lot owners were not third-party beneficiaries to the subordination agreement.[220]

In what may have been their last chance to salvage a substantial portion of their investment in their homes,[221] the lot owners argued that they were good faith improvers under Texas law and therefore entitled to compensation for their improvements to their lots.[222] The court found that under Texas law a purchaser who makes improvements to property while under a good faith belief that it has good title to the property is entitled to compensation for those improvements.[223] On the facts before it, the court concluded that the lot owners were not entitled to compensation for the improvements because at the time the improvements were made the lot owners had constructive knowledge of the original lender's lien.[224]

Vista Development Joint Venture II v. Pacific Mutual Life Insurance Co.[225] shows that, in today's environment, a mortgagee may be able to overcome both drafting inconsistencies in its loan documents and its own failure to act

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release provisions, but whether they could claim the benefits of the release provisions. *Id.* Your authors agree with the court's identification of the ultimate issue as benefit and not notice. However, the court failed to recognize that the right to rely on notice under the recordation statutes may result in the right to claim a benefit.

215. *Id.*

216. *Id.* (citing Old Stone Bank v. Fidelity Bank, 749 F. Supp. 147, 152 (N.D. Tex. 1990)).

217. *Id.* (citing Talman Home Fed. Sav. & Loan Ass'n of Ill. v. Am. Bankers Ins., 924 F.2d 1347, 1351 (5th Cir. 1991); Hellenic Inv. Inc. v. Kroger Co., 766 S.W.2d 861, 864 (Tex. App.—Houston [1st Dist.] 1989, no writ); Cunningham v. Healthco, Inc., 824 F.2d 1448, 1455 (5th Cir. 1987); (quoting Corpus Christi Bank and Trust v. Smith, 525 S.W.2d 501, 503 (Tex. 1975)).

218. *Id.*

219. *Id.*

220. *Id.* The lot owners also argued that the district court erred by not abating the foreclosure proceedings pending the disposition of the lawsuit between the two lenders regarding the superiority of the original lender's lien and the enforceability of the subordination agreement. The court concluded that whatever the outcome of the litigation between the lenders, the result was only as between the parties to the lawsuit and that the interest of the original lender would remain superior to the interest of the lot owners. *Id.*

221. Perhaps this was not the lot owners' last chance because there was at least one title company that was a party to the action. There is no mention in the case, however, of the liability, if any, asserted against the title company.

222. *Kemp*, 951 F.2d at 665.

223. *Id.*

224. *Id.*

225. 822 S.W.2d 305 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

prudently in protecting its secured indebtedness. In *Vista*, the loan to the mortgagor was non-recourse, with the exception of certain items for which the mortgagor had personal liability. The note contained a carveout provision, which provided that the mortgagee, after the occurrence of an event of default, had the right to recover from the mortgagor ad valorem taxes that were due but not paid by the mortgagor. The deed of trust also contained a carveout provision relating to ad valorem taxes, but its language varied from the note in that the mortgagee's right to recover ad valorem taxes arose only after the occurrence of an event of default and during the pendency of the default. The mortgagor defaulted under the note by failing to pay the last installment and failing to pay the property taxes then due for the current and prior year. The mortgagee foreclosed its lien, shortly after foreclosure paid the past due ad valorem taxes, and then sued for the amount of the taxes. The trial court granted summary judgment for the mortgagee and the mortgagor appealed.[226]

On appeal, the mortgagor argued, somewhat weakly, that its liability for the taxes was extinguished because, under *Smart v. Tower Land & Investments Co.*,[227] the taxes became a part of the nonrecourse debt when they were paid by the mortgagee. The court agreed that the debt became part of the overall indebtedness secured by the deed of trust, but disagreed with the mortgagor's reliance on *Smart*, stating that the court in *Smart* restricted its holding to cases where there is no contractual language permitting the mortgagee to also enforce its right to reimbursement as a personal debt.[228] In overruling the mortgagor's first point of error, the court concluded that, unlike the contracts in *Smart*, the contracts before it expressed the parties' intent to impose personal liability on the mortgagor for the payment of the ad valorem taxes.[229]

The mortgagor next argued that the mortgagor-mortgagee relationship created by the deed of trust had terminated prior to the time the mortgagee paid the taxes, thereby conveniently relieving the mortgagor from any liability for payment of the taxes.[230] Although this argument was more appealing than the first argument, the court was not moved. The court acknowledged that under the deed of trust the trustee was permitted to seek reimbursement for only the taxes paid during the pendency of the default, and that at the time the taxes were paid the foreclosure had already occurred.[231] The court, however, recognized that the note also permitted the mortgagee to seek reimbursement for taxes that, after a default, were due but not paid, without limitation as to time of recovery. Construing the deed of trust and note as one instrument, the court resolved the internal conflict by concluding that the note and deed of trust provisions provided alternative means of recov-

226. *Id.* at 306.
227. 597 S.W.2d 333 (Tex. 1980).
228. *Vista*, 822 S.W.2d at 307-08 (citing *Smart*, 597 S.W.2d at 337).
229. *Id.*
230. The mortgagor argued that the mortgagor-mortgagee relationship terminated upon the foreclosure of the deed of trust.
231. *Vista*, 822 S.W.2d at 308.

ery.[232] Therefore, the court concluded that the mortgagee was not paying the taxes pursuant to the mortgagor-mortgagee relationship under the deed of trust, but rather pursuant to its contractual right under the note.[233] Apparently under the impression that the mortgagee was unable to fend for itself, the court went beyond the mortgagee's arguments and concluded that by paying the taxes, the mortgagee became subrogated to the lien of the taxing authority, thereby securing the mortgagor's recourse reimbursement obligation.[234] Although the mortgagee emerged from this litigation relatively unscathed and perhaps protected beyond what it anticipated, the mortgagee would have been much more prudent to have satisfied the taxes prior to the foreclosure of its lien, thereby nullifying the mortgagor's second argument.

II. USURY

A. GENERALLY

In addition to the usury issues pertaining to *D'Oench, Duhme* and other related federal defenses discussed previously,[235] Texas courts were presented with a number of other usury-related issues during the Survey period. In addressing those issues, the courts recognized that the spreading doctrine is alive and well,[236] the mere act of charging interest on past due interest is not usury,[237] equitable defenses are available to defeat a claim of usury (including claims that a debtor originates by setting up a lender to commit a technical violation and those that take on the characteristics of small or trifling matters),[238] the interest rate applicable to a loan transaction need not be in writing and may be established by a course of conduct,[239] and a net profits assignment, although the proper subject of a usury claim, may be saved by a properly drafted savings clause[240] and a guarantor may not deny the en-

232. *Id.* at 307-08.

233. *Id.* at 308. Somewhat surprisingly the court, on appeal from a summary judgment, was able to conclude without trouble or equivocation that there was not a material fact issue created by the differing carve-out language in the deed of trust and the note.

234. *Id.* at 308-09 (relying on *Smart*, 597 S.W.2d at 338, wherein the Texas Supreme Court recognized that "[u]nder various circumstances[,] . . . [a mortgagee discharging taxes] may be subrogated to the taxing authority's lien to the extent necessary for his own equitable protection.").

235. *See supra* notes 86-153 and accompanying text.

236. Affiliated Capital Corp. v. Commercial Fed. Bank, 834 S.W.2d 521, 526 (Tex. App.—Austin 1992, no writ) (prepayment penalty payable on the acceleration of loan to be spread over the entire period the loan was outstanding for purpose of determining if the loan was usurious).

237. Shoberg v. Shoberg, 830 S.W.2d 149, 153 (Tex. App.—Houston [14th Dist.] 1992, no writ).

238. HSAM Inc. v. Gatter, 814 S.W.2d 887, 890-92 (Tex. App.—San Antonio 1991, writ dism'd by agr.).

239. Matter of Worldwide Trucks, Inc., 948 F.2d 976, 980 (5th Cir. 1991).

240. Federal Sav. & Loan Ins. Corp. v. Mackie, 962 F.2d 1144, 1151 (5th Cir. 1992). *Mackie* is not a case of first impression in the Fifth Circuit. In *In re* Casbeer, 793 F.2d 1436 (5th Cir. 1986), the Fifth Circuit concluded that the profits assignment at issue was not usurious because the assignment contained a savings clause that provided that the assignment, together with other interest on the loan, would not exceed the maximum allowable interest rate. *Id.* at 1447 n.30. However, in Federal Sav. and Loan Ins. Corp. v. Locke, 718 F. Supp 573

forcement of its guaranty on the basis that the guaranteed obligation is usurious.[241]

B. DID A CHARGING OF USURIOUS INTEREST OCCUR?

During the Survey period, several Texas courts addressed the issue of what constitutes a charging of interest under the statutory definition of interest.[242] In the one Texas case worthy of text discussion, *George A. Fuller Co. v. Carpet Services, Inc.*,[243] the Texas Supreme Court formed the beginnings of the principle that a claim of usury may not accrue solely out of the judicial process. *Carpet Services* involved a subcontractor who performed work pursuant to a subcontract with a general contractor. Under the subcontract, the general contractor was not obligated to pay the subcontractor until the general contractor received payment from the owner. If the general contractor failed to pay the subcontractor after receiving payment from the owner, the subcontractor was entitled to interest. After completing its work, the subcontractor was not paid for its work and sued the general contractor for payment, together with prejudgment interest for a period that commenced prior to the owner's payment to the general contractor. The general contractor claimed that the subcontractor's claim for interest constituted usury since no interest was due for the period preceding the contractor's receipt of funds from the owner. The trial court agreed with the general contractor and ordered that the subcontractor forfeit both the payment due and all interest.[244] The subcontractor appealed and the court of appeals reversed, holding that a demand for usurious interest in a pleading was not a usurious charge of interest.[245] The general contractor appealed to the Texas Supreme Court.

The central issue identified by the Texas Supreme Court was whether the pleading in which the subcontractor claimed interest was a "charge" for interest under the Texas usury statute.[246] The court noted that the statute

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(W.D. Tex. 1989), the district court relied on *In re Casbeer* in holding that a net profits assignment could not form the basis of a usury claim. *Id.* at 584. In *Mackie*, the Fifth Circuit removed any confusion created by *Locke* by stating that the *Locke* court had mischaracterized the holding of *In re Casbeer*. *Mackie*, 962 F.2d at 1151.

241. Federal Sav. & Loan Ins. Corp. v. Griffin, 935 F.2d 691 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 1163 (1992); Sunbelt Sav., FSB v. Birch, 796 F. Supp. 991 (N.D. Tex. 1992).

242. *E.g.*, McKenna Inv. v. Atlas Energy Corp., 832 S.W.2d 651, 655 (Tex. App.—Fort Worth 1992, no writ) (trial court did not commit reversible error by finding that letter sent to borrower following foreclosure demanding unpaid principal and interest due under non-recourse promissory note was not a charging of interest); Shoberg v. Shoberg, 830 S.W.2d 149, 153 (Tex. App.—Houston [1st Dist.] 1992, no writ) (estranged wife argued that a charging of usurious interest occurred when she did not seek increased child support from her ex-husband because of ex-husband's threat to foreclose lien against her residence, but court could not fathom how estranged wife's forbearance from seeking child support could constitute a charge within the meaning of Texas usury statute); *HSAM*, 814 S.W.2d at 890 (mortgagee's payoff quote, which included a late charge that was not actually due, constituted a charging under Texas usury statute).

243. 823 S.W.2d 603 (Tex. 1992).

244. *Id.* at 604.

245. *Id.*

246. TEX. REV. CIV. STAT. ANN. art. 5069-1.06 (1), (2) (Vernon 1987 & Vernon Supp. 1993), which generally provides for penalties in the event a person "contracts for, charges or receives interest which is" greater than the lawful amount.

does not provide guidance as to what constitutes a charging of interest, but found helpful the legislature's declaration that in enacting the interest legislation, it intended to protect Texas citizens from abusive and deceptive practices by unscrupulous operators, lenders and vendors in consumer transactions.[247] The court concluded that the wrongs that the legislature sought to eradicate are not present in a pleading that makes a demand for prejudgment interest.[248] Moreover, recognizing that the usury statutes are not intended to be a "trap for the unwary pleader in a court proceeding," the court concluded that claims for excessive interest in a pleading are best dealt with in the action of which the pleading is a part rather than through usury laws.[249] Accordingly, the court held that the demand for usurious interest in the pleading filed with the court was not a charging of usurious interest under the Texas usury statute.[250]

Although not necessary to the court's holding, the court expressly disapproved of a 1979 court of appeals decision, *Hagar v. Williams*,[251] which held

247. *Carpet Services*, 823 S.W.2d at 604 (citing Act of May 23, 1967, 60th Leg., R.S., ch. 24, § 1, 1967 Tex. Gen. Laws 609).

248. *Id.* at 606.

249. *Id.* Sumrall v. Navistar Fin. Corp., 818 S.W.2d 548 (Tex. App.—Beaumont 1991, writ denied), was decided by the Beaumont court of appeals several months before *Carpet Services* and raises an interesting issue since the Texas Supreme Court denied writ of error. In *Sumrall*, the borrower obtained a loan to purchase certain vehicles from time to time. The borrower ran into financial difficulty and filed for protection under Chapter 11 of the Federal Bankruptcy Act. In the bankruptcy proceeding, the borrower and lender agreed to certain stipulations, two of which were the amount of principal owed to the lender and the per diem interest accruing on the unpaid principal. Both stipulations were based on information provided by the lender. The principal set forth in the stipulation was greater than the amount of principal actually outstanding and therefore the per diem interest was excessive. The borrower was dismissed from bankruptcy and again defaulted under the lender's note. The lender repossessed the vehicles and the borrower sued, alleging, among other things, usury based on the stipulations submitted in the bankruptcy proceeding. The trial court concluded that, as a matter of law, the bankruptcy stipulations constituted a charging of interest that was usurious on its face. *Id.* at 559.

On appeal, the lender argued that the bankruptcy pleadings could not constitute a charging of interest, relying on the Dallas court of appeals' decision in *Carpet Services*. The Beaumont court determined that the Dallas court's decision in *Carpet Services* was based on that court's determination that when a pleader makes a claim for interest in filing a suit, the pleader's claim is against the court and not the debtor. *Id.* at 553. The Beaumont court rejected this reasoning, concluding that a court is only a procedural medium by which a lender can make a claim for interest against its borrower. *Id.* Clearly, the Dallas court's rationale, as identified by the Beaumont court, was not the basis for the Texas Supreme Court's decision in *Carpet Services*, so perhaps the Beaumont court would reach a different conclusion if again presented with a similar fact situation. Although the Texas Supreme Court denied the lender's writ of error application, the denial of writ by the Texas Supreme Court does not validate the Beaumont court of appeals' holding that the bankruptcy stipulations constituted a charging of usury. First, the lender's writ of error not place this issue squarely in front of the supreme court. Secondly, the facts submitted to the supreme court make it clear that the bankruptcy stipulations were not in the true nature of a judicial pleading. Rather, the lender and bankrupt borrower had agreed upon a modification of the loan documents and sought the bankruptcy court's approval of those modifications in accordance with applicable bankruptcy law. Under such facts, the issue of usury is more properly controlled by the written modification agreement, as opposed to treating the request for the approval of the documents by the bankruptcy court as a pleading which, under *Carpet Services*, does not result in a charging of interest.

250. *Carpet Services*, 823 S.W.2d at 603.

251. 593 S.W.2d 783 (Tex. Civ. App.—Amarillo 1979, no writ).

that a charge, as used in the usury statute, means "unilaterally placing on an account an amount due as interest."[252] The court went on to hold that, in addition to placing interest on an account, the placement must be communicated to the debtor to constitute a charge under the usury statute.[253] Lenders may find this holding to be a significant defense to usury claims.

Two recent Fifth Circuit cases have expanded the holding in *Carpet Services* regarding usurious interest claimed in judicial pleadings. In *First South Savings Association v. First Southern Partners, II*,[254] two individuals executed separate guaranty agreements covering a promissory note executed by a partnership, the general partners of which were the individual guarantors. Each guaranty agreement expressly limited the guarantor's liability under the note to fifty percent of the unpaid principal balance.[255] The partnership ultimately defaulted under the note and the FSLIC (which had succeeded to the rights of the original lender) sued the borrower and the guarantors for the outstanding principal balance of the note. The guarantors counterclaimed, alleging the charging of usurious interest through several letters and through claims contained in the original complaint, each of which demanded that the guarantors pay the entire unpaid principal balance of the note and interest on the note, notwithstanding the provisions of the guaranty agreements limiting each guarantor's liability to only fifty percent of the unpaid principal balance of the note.[256] The guarantors argued that the demand for the amount of interest and principal for which the guarantors were not liable constituted a usurious charging of interest. The trial court granted summary judgment in favor of the lender and the guarantors appealed.[257]

The Fifth Circuit recognized that the demand letters and the claims made in the original complaint for interest and all principal under the note were erroneous.[258] Merely being erroneous, however, did not, according to the court, constitute a charge for usurious interest.[259] First, the court concluded that the Texas Supreme Court's holding in *Carpet Services*[260] disposed of the guarantors' contention that charging of usurious interest can occur in pleadings.[261] Although the specific holding of *Carpet Services* was not necessarily

252. *Carpet Services*, 823 S.W.2d at 605 (citing *Hagar*, 593 S.W.2d at 788).

253. *Id.* One justice dissented with the majority's overruling of *Hagar*, stating that the court was "acting in the dark, without the benefit of an adversarial presentation, and without considering the manifold implications of its ruling." *Id.* at 607 (Mauzy, J., concurring in part). The dissenter also concluded that the court's rejection of *Hagar* necessarily resulted in a rejection of a similar holding in *Williams v. Back*, 624 S.W.2d 272, 275 (Tex. App.—Austin 1981, no writ). The supposed implicit rejection of *Back* gave the dissenter particular heartburn since in *Back* the lender had mailed a notice containing the alleged usurious charge, but the debtor had not received it.

254. 957 F.2d 174 (5th Cir. 1992).

255. The note and each guaranty also contained a savings clause.

256. The counterclaim was actually brought against the RTC (which had succeeded to the rights of the FSLIC) and a newly formed federal savings association, which had acquired the assets of the original lender, including the note and guaranties sued upon.

257. *First South*, 957 F.2d at 174.

258. *Id.* at 176. The court of appeals described the trial court's judgment as cryptic. *Id.*

259. *Id.* at 177.

260. 823 S.W.2d 603 (Tex. 1992).

261. *First South*, 957 F.2d at 177. A subsequent Fifth Circuit case concluded under similar

dispositive of the guarantors' claim, it appears that the Fifth Circuit's application of *Carpet Services* to defeat the guarantors' claim that the complaint constituted a charging of usurious interest was correct in light of the rationale of *Carpet Services*.[262]

As to the demand letters, the court observed that Texas law defines interest as compensation for the use, detention or forbearance of money.[263] Here, the demand letters demanded that the guarantors pay sums owed under the promissory note that was the subject of the guaranty and, according to the court, did not constitute a demand for interest because the borrower, not the guarantor, received the use, forbearance and detention of money under the note.[264] The guarantors argued that under the Texas Supreme Court's decision in *Houston Sash & Door Co., Inc. v. Heaner*[265] a claim for usury could be made under a guaranty.[266] The Fifth Circuit agreed that the guarantors in *Houston Sash & Door* were permitted to assert a claim of usury under the guaranty, but pointed out that the guaranty contained a separate provision providing for interest if the guarantor failed to pay certain sums by a specified date. It was this provision that gave rise to the claim of usury under the *Houston Sash* guaranty.[267] By pointing out *Houston Sash*, the guarantors shot themselves in the foot, as the court relied on the guarantors' cited case to reach a conclusion that the guarantors sought to avoid: that an erroneous claim under a guaranty that does not contain a separate interest provision is simply an erroneous claim and not a charging of interest under the Texas usury statute.[268]

Remaining consistent with the reasoning of *Carpet Services* and *First South*, but going beyond the holding in each of those cases, the Fifth Circuit, in *Federal Savings & Loan Insurance Corp. v. Kralj*,[269] held that neither pleadings that make a claim for usurious interest nor interrogatory answers that demand an amount of usurious interest constitute an unlawful charge of interest under Texas usury laws.[270] In *Kralj*, the borrower defaulted under a promissory note that was arguably usurious on its face.[271] The borrower

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facts that a pleading would not constitute a charging under the usury statue. Resolution Trust Corp. v. Oaks Apartments J.V., 966 F.2d 995, 1002 (5th Cir. 1992).

262. The Fifth Circuit confirmed this reasoning in Federal Sav. & Loan Ins. v. Kralj, 968 F.2d 500, 503-04 (5th Cir. 1992).

263. *First South*, 957 F.2d at 177 (citing TEX. REV. CIV. STAT. ANN. art. 5069-1.01(a) (Vernon 1987)).

264. *Id.*

265. 577 S.W.2d 217 (Tex. 1979).

266. *First South*, 957 F.2d at 177.

267. *Id.*

268. *Id.* In Resolution Trust Corp. v. Oaks Apartments J.V., 966 F.2d 995 (5th Cir. 1992), the Fifth Circuit, without discussion, concluded that a demand letter sent under a similar fact situation did not constitute a charging under the usury statute. *Id.* at 1002.

269. 968 F.2d 500 (5th Cir. 1992).

270. *Id.* at 505.

271. See discussion of the facts in *Kralj*, *infra* note 278 and accompanying text. The original lender failed, the FSLIC was appointed the receiver, and thereafter entered into an acquisition agreement with another lender pursuant to which that lender would acquire the assets of the failed lender, including the note sued upon. The FSLIC removed the case from state court to federal court and the new lender intervened.

presented interrogatories to the lender to verify the method of calculation of interest under the note, and the lender used 18% per annum calculated over a 360-day year. The borrower then filed a counterclaim against the lender, alleging that the demand in the complaint and the response to the interrogatories constituted a charging of usurious interest. Recognizing that it had stubbed its toe, the lender hurriedly amended its complaint and the interrogatories to demand only a lawful amount of interest. The lender then filed a motion for summary judgment, which the district court granted, and the borrower appealed.[272]

Relying on the holding and rationale of *Carpet Services* and other cases,[273] the court concluded that if the underlying documents are not usurious, the purpose of the usury laws would not be served by imposing usury penalties where a lender demands interest in excess of that permitted by the underlying agreements in pleadings and related interrogatories.[274] Accordingly, the court held that neither the lender's pleadings nor its answers to interrogatories could support a claim for a charge of usurious interest.[275]

C. SAVINGS CLAUSES

Although properly drafted savings clauses have long been held to defeat most usury claims,[276] savings clauses have not been an unsinkable life pre-

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272. *Kralj*, 968 F.2d at 503.

273. *Id.* (relying on *e.g.*, *First South*, 957 F.2d at 176-77; Gibraltar Sav. v. L.D. Brinkman Corp., 860 F.2d 1275, 1296 n.26 (5th Cir. 1988), *cert. denied*, 109 S. Ct. 2432 (1989)).

274. *Id.* at 504. The court placed some importance on the fact that, after receiving the borrower's counterclaim, the lender promptly amended its complaint and written answers to the interrogatories to provide for a lawful rate of interest. Although not neatly tied together, the importance of the amendments assumed by the court is in keeping with the rationale of a district court opinion relied on by the court:

> [C]onstruing a claim asserted only in a pleading filed in a law suit as an interest charge triggering the draconian penalties of usury would do little to serve any reasonable purpose of the statute. There is little risk of overreaching or coercion because the sum claimed would never be payable absent judicial approval. . . . [T]his proffered construction would exalt form over substance and attach a heavy penalty to a pleading error contrary to the policy of both state and federal rules of procedure that amendments ought to be freely allowed to avoid injustice.

Id. at 504 n.10 (emphasis added) (citing Fibergate Corp. v. Research-Cottrell, Inc., 481 F. Supp. 570 (N.D. Tex. 1979). *But cf.* Sumrall v. Navistar Fin. Corp., 818 S.W.2d 548, 553 (Tex. App. —Beaumont 1991, writ denied) ("To permit a creditor, upon being faced with claims by a debtor that excessive charges in violation of usury statutes were made, to escape liability by reducing usurious charges to within statutory limits would totally negate the intent and render ineffective our usury statutes.").

275. *Kralj*, 968 F.2d at 505.

276. *E.g.*, Tanner Dev. Co. v. Ferguson, 561 S.W.2d 777 (Tex. 1977). During the Survey period, the courts concluded that savings clauses would defeat a usury defense under a variety of circumstances. *E.g.*, *First South*, 957 F.2d at 178 (erroneous statements in demand letters remedied by virtue of savings clause); Nevels v. Harris, 102 S.W.2d 1046 (1937); Federal Deposit Ins. Corp. v. Claycomb, 945 F.2d 853, 860-861 (5th Cir. 1991), *cert. denied*, SHWC, Inc. v. Federal Deposit Ins. Corp., 112 S. Ct. 2301 (1992) (savings clause set forth in loan documents, including a profits assignment, defeated usury defense under Texas law); Affiliated Capital Corp. v. Commercial Fed. Bank, 834 S.W.2d 521, 525 (Tex. App.—Austin 1992, no writ) (savings clause which provided for rebate of interest in excess of maximum legal rate defeated usury claim based on requirement that prepayment penalty would be due if note was accelerated).

server for loan transactions that are usurious on their face.[277] Two cases decided during the Survey period, however, give some indication that certain transactions that may be usurious on their face will nevertheless avoid a usury claim if the loan documents contain a properly drafted savings clause. In *Federal Savings and Loan Insurance Corp. v. Kralj*,[278] the clauses at issue (i) provided for stated interest equal to the lesser of the maximum rate permitted by applicable law or two percent (2%) above an agreed upon prime rate, (ii) provided that past due installments would bear interest at the maximum legal rate or if no maximum legal rate was established, then at a rate of five percent (5%) above the prime rate and (iii) provided that the amount of interest payable would be calculated on the basis of a daily rate equal to 1/360th of the annual percentage rate. Following the borrower's default, the lender demanded an amount of interest that was based on 18% per annum (the then existing maximum legal rate), calculated, however, on a 360-day year as contemplated by the note. By using a 360-day year, the actual per annum rate used in the calculation was 18.25%, which exceeded the then existing maximum legal rate. The lender sued the borrower and the borrower defended claiming, among other things, that the note was facially usurious due to the 360-day calculation clause. The lender argued that although one clause in the note charged excessive interest, the savings clause defeated a construction of the contract that would violate usury laws. The trial court agreed with the lender, concluding on motion for summary judgment that the note was not usurious on its face, and the borrower appealed.[279]

On appeal, the Fifth Circuit recognized that under Texas law the mere existence of a savings clause will not defeat a usury claim in a transaction that is usurious on its face.[280] Moreover, the court concluded that Texas law required the court to construe the terms of the savings clause as a whole and in light of the circumstances surrounding the transaction.[281] Apparently not convinced that the note at issue was usurious on its face, the Fifth Circuit concluded that the applicable documents and the facts and circumstances surrounding them did not establish that the lender intended to charge or had a practice of charging usurious interest.[282] Accordingly, the Fifth Circuit held that the savings clause remedied "any problem with the clause in the note containing reference to calculations regarding the 360-day year."[283]

277. *E.g.*, Smart v. Tower Land & Inv. Co., 597 S.W.2d 333, 341 (Tex. 1980); Woodcrest Assoc., Ltd. v. Commonwealth Mortgage Corp., 775 S.W.2d 434, 438 (Tex. App.—Dallas 1989, writ denied) ("The mere presence of such a [savings] clause, however, will not rescue a transaction that is necessarily usurious by its explicit terms."); Terry v. Teachworth, 431 S.W.2d 918, 926 (Tex. Civ. App.—Houston [14th Dist.] 1968, writ ref'd n.r.e.) Mack v. Newton, 737 F.2d 1343, 1371 (5th Cir. 1984).

278. 968 F.2d 500 (5th Cir. 1992).

279. *Id.* at 503.

280. *Id.* at 506 (citing *Woodcrest*, 775 S.W.2d at 438).

281. *Id.*

282. *Id.*

283. *Id.* The borrower argued that the lender had a practice of charging pre-default and post-default interest at a usurious rate. To establish this practice, the borrower presented no evidence other than a computer printout produced by the lender's employee who calculated the amount of the interest claimed by the lender. The court was unimpressed, concluding that

Lawyers relying on the *Kralj* holding to defeat claims of usury based on the effect of a 360-day interest calculation clause should proceed with the utmost caution. Although the *Kralj* holding is somewhat broad, the facts of the case are extremely important to the outcome. First, the note at issue expressly capped stated interest at the maximum rate permitted under applicable law and limited delinquent interest to the maximum rate permitted under applicable law; therefore, the 360-day clause arguably did not apply to either the stated interest clause or the delinquent interest clause. Second, as the court noted,[284] the 360-day calculation provision was in the paragraph that defined the prime rate of interest; therefore, the 360-day calculation provision arguably applied only to the calculation of the prime rate of interest, and not to the calculation of interest at the maximum rate permitted by applicable law. In conclusion, *Kralj* is consistent with existing Texas law[285] and in no way vitiates *Nevels v. Harris*,[286] where the Texas Supreme Court recognized that "a person may [not] exact from a borrower a contract that is usurious under its terms, and then relieve himself of the pains and penalties visited by law . . . by merely writing into the contract a disclaimer of any intention to do that which under his contract he has plainly done."[287]

In *Affiliated Capital Corp. v. Commercial Federal Bank*,[288] the borrower executed a note that required him to pay a penalty in the event the principal was paid prior to maturity or in the event the balance of the note became due prior to maturity. The amount of the penalty was equal to that amount that would compensate the lender for interest that would not be paid in the future due to the prepayment. The note also contained a savings clause that generally provided that in no event would the amount of interest required to be paid or actually paid ever exceed the maximum interest permitted under applicable law. Following the borrower's default under the note, the lender

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the computer printout was not sufficient to establish a genuine issue of material fact regarding the lender's practice of charging usurious interest. *Id.*

284. *Id.* at 505.

285. The Fifth Circuit acknowledged the Texas Supreme Court's decision in Lawler v. Lomas & Nettleton Mortgage Investors, 691 S.W.2d 593, 596 (Tex. 1985), wherein the court held that a note that provided for an interest rate at the maximum rate permitted under applicable law and that calculated interest on the basis of a 360-day year was usurious. This holding was reached notwithstanding the existence of a savings clause in the note at issue. However, the facts in *Lawler* are significantly different than the facts in *Kralj*. First, there was no indication in *Lawler* that the stated interest was capped to the lesser of the maximum rate permitted by applicable law or the stated rate. Second, the 360-day calculation provision in the note was clearly applicable to the calculation of the amount of interest that was due at the stated rate. Under these facts, the Fifth Circuit would not have reached a conclusion different than that reached in *Lawler*.

286. 102 S.W.2d 1046 (Tex. 1937).

287. *Id.* at 1050. The language quoted from *Nevels* is significantly different from the language from *Woodcrest* relied on by the Fifth Circuit. The "mere presence" language from *Woodcrest* seems to indicate that some further analysis is required in facially usurious transactions, while the language from *Nevels* may dictate a conclusion that the savings clause is ineffective with respect to the facially usurious clauses. However, if the savings clause goes beyond negating the intention to charge usurious interest by providing that all agreements for interest are deemed limited to the maximum rate permitted by law and/or further provide for the return of any usurious interest actually collected, perhaps the quoted language in *Nevels* is avoided.

288. 834 S.W.2d 521 (Tex. App.—Austin 1992, no writ).

accelerated the note, demanded payment of principal, interest and the prepayment penalty and then foreclosed its lien securing payment of the note. The borrower sued the lender, claiming, among other things, that the lender had charged and contracted for usurious interest.

The borrower argued that the note was usurious on its face and therefore could not be protected by the savings clause. The borrower based its argument on a hypothetical failure by the borrower to qualify for its first advance under the loan. If such failure had occurred, the prepayment provision would have been triggered and the borrower would have been required to pay the prepayment penalty, an amount far in excess of the amount of interest which would have been permitted under applicable law. The court simply concluded that the borrower's understanding of the law was inaccurate and, relying on *Nevels*, concluded that a savings clause requiring the reduction of the interest payable to a legal amount saves a contract from being usurious on its face.[289] Although the result reached by the *Affiliated Capital* court was correct and *Nevels* was properly applied to the facts of *Affiliated Capital*,[290] *Nevels* does not stand for the broader principle that a savings clause prevents an otherwise clearly usurious contract from being usurious on its face.[291] A contrary conclusion would appear to emasculate substantially that portion of *Nevels* that recognized that a lender will not be saved from the penalties of usury by writing into a clearly usurious contract a provision that disclaims to do that which it has plainly done.[292]

The borrower in *Affiliated Capital* also argued that the lender charged usurious interest by requiring the prepayment penalty on the accelerated debt as a separate and new contract. Therefore, the borrower argued, the amount of the prepayment penalty should have been viewed as one day's interest and usurious and neither the savings clause nor the doctrine of spreading should be applied to prevent the usury claim. The court found no law directly on point, but considered three cases cited by the borrower, two of which were distinguished by the court with little difficulty.[293] The court was forced to give some thought to an ancient Texas Supreme Court deci-

289. *See id.* at 526.

290. The authors do not believe that the note in *Affiliated Capital* was usurious on its face and that the court therefore properly applied the savings clause. Perhaps the real issue created by the *Nevels* case is what constitutes a note that is usurious on its face. *See, e.g.*, Smart v. Tower & Land Inv. Co., 597 S.W.2d 333, 340-41 (Tex. 1980).

291. Perhaps the limitation recognized in *Nevels* most clearly applies to a note that contracts for interest at an obviously usurious rate (i.e., 30% per annum on a non-residential loan) and then attempts to limit that clause by a savings clause. One could logically argue, however, that a properly drafted savings clause (i.e. one that expressly limits the amount of any interest payable under the note to the maximum amount permitted by applicable law) modifies the express interest provision to a legal rate. Although this is a logical argument, we must then wonder what is left of the limitation set forth in *Nevels*.

292. *See supra* note 287 and accompanying text.

293. 834 S.W.2d at 525 (distinguishing General Motors Corp v. Uresti, 553 S.W.2d 660 (Tex. Civ. App.—Tyler 1977, writ ref'd n.r.e.) (consumer credit case involving refund of time-price differential in case of a voluntary prepayment); Moore v. Sabine Nat'l Bank, 527 S.W.2d 209 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.) (time price differential case involving charging and collection of unearned time price differential)).

sion, *Crider v. San Antonio Real Estate Building & Loan Association*,[294] wherein the Texas Supreme Court held that upon acceleration of a note, the unpaid principal balance together with all accrued interest constituted a single, new obligation, upon which interest could be charged.[295] In the present case, the court observed that the prepayment penalty was designed to be a one-time charge to compensate the lender for the interest not received due to the prepayment and not a charging of post-acceleration interest on the matured debt, which was expressly covered by another provision in the note analogous to the provision at issue in *Crider*.[296] These facts, in the court's judgment, were sufficient to distinguish *Crider* and support a finding that the amount of the prepayment charge was covered by the savings clause and the doctrine of spreading.[297]

III. GUARANTIES

The law concerning guaranties is far broader than the scope of this article. Several Survey period cases concerning guaranties, however, are of particular relevance to the real estate practitioner and are therefore appropriate for discussion.

In *Barr v. Resolution Trust Corp., ex rel. Sunbelt Federal Savings*,[298] the Texas Supreme Court adopted the transactional approach to res judicata, holding that a "subsequent suit will be barred if it arises out of the same subject matter of a previous suit and which through the exercise of diligence, could have been litigated in a prior suit."[299] Although the holding of *Barr* is generally applicable to res judicata, the facts of *Barr* show how the rule will apply to a lender's claims against a guarantor who is also a partner of the

294. 35 S.W. 1047 (Tex. 1896).

295. *Id.* at 1048.

296. *Affiliated Capital*, 834 S.W.2d at 525.

297. *Id.* at 525-26. In support of its holding, the court analogized Dixon v. Brooks, 678 S.W.2d 728, 731 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.), wherein the court combined a one-time late charge and interest on principal to determine if the amount collected was usurious. The borrower in *Affiliated Capital* pointed to another late charge case, Fisher v. Westinghouse Credit Corp., 760 S.W.2d 802 (Tex. App.—Dallas 1988, no writ), but this case was inapposite since the late charge was a percentage charge assessed on a daily basis until the late payment was made. The *Affiliated Capital* case did not note this difference, but was able to successfully distinguish *Fisher* on other grounds. *See Affiliated Capital*, 834 S.W.2d at 526.

298. 837 S.W.2d 627 (Tex. 1992).

299. *Id.* at 631. The court recognized that in Foster v. Wells, 4 Tex. 101, 104 (1849), it had adopted a transactional approach to res judicata by holding that res judicata barred not only the claims litigated but also claims that could have been litigated in the original action. Due to the broad nature of this holding, the court, in subsequent decisions, restricted the transactional approach of *Foster* by adopting a number of theories and tests. The *Barr* court admitted the confusion that its prior holdings had created and sought to clarify res judicata by reaffirming the transactional approach and overruling the test adopted in one of its prior cases, Griffin v. Holiday Inns of Am., 496 S.W.2d 535 (Tex. 1973). Although the *Barr* court specifically overruled only *Griffin*, *Barr* probably has the effect of overruling the policy analysis of res judicata used in Westinghouse Credit Corp. v. Kownslar, 496 S.W.2d 531 (Tex. 1973). *Barr*, 827 S.W.2d at 631. Although the court appears to adopt the transactional approach set forth in the Restatement of Judgments § 24(1), the rule announced by the court is somewhat more limiting because of its requirement in *Barr* that the claim sought to barred could have been, through the exercise of diligence, litigated in a prior suit. *Barr*, 837 S.W.2d at 629-30.

borrowing entity. In *Barr*, the lender sued the borrowing entity on the note and the partner/guarantor on his guaranty. When the partner/guarantor was awarded summary judgment in the action on the guaranty, the lender joined the partner/guarantor to the action on the note, asserting liability against the partner/guarantor in its capacity as a partner of the borrowing entity.[300] Applying the transactional rule of res judicata to the facts, the *Barr* court concluded that the action under the note brought against the partner/guarantor was barred by res judicata.[301] *Barr* makes clear that lenders bringing suits on their debt must strongly consider joining all liable parties in every capacity that such liability may be created. Similarly, if a lender in a suit on a debt should fail or elect not to sue a particular party in all capacities, the defending party should strongly consider the ramification of failing to raise all defenses it may have on the debt under any capacity.

In *Resolution Trust Corp. v. Northpark Joint Venture*[302], the guarantors of a note appealed from a district court's order imposing liability on the guarantors for a portion of a deficiency judgment entered against the maker of a non-recourse note obligation. On appeal, the guarantors directed the court's attention to language in the guaranty that provided that the guarantors were required to pay "the indebtedness or other liability . . . which . . . [the borrower] may now or at any time hereafter owe [the lender]."[303] This language, the guarantors argued, limited their liability to the amount of the deficiency that the borrower was required to pay the lender. If the guarantors' argument was correct, the guarantors would have no liability for the deficiency since that amount was non-recourse to the borrower. Although this is an interesting technical argument, the Fifth Circuit concluded that the guarantors misunderstood the meaning of their guaranty.[304] The court concluded that the fact that the borrower's debt was non-recourse had no bearing on whether the note was an indebtedness owed by the borrower to the lender.[305] Indebtedness, according to the court, is the state of being in debt, and the borrower incurred a debt when it signed the note.[306] Refusing to elevate form over substance, the court concluded that the guaranty unambiguously obligated the guarantors for the deficiency.[307]

The guarantors also argued that under Texas law the liability of the guarantor is equal to that of its principal.[308] The court acknowledged the general

300. *Barr*, 837 S.W.2d at 628.
301. *Id.* at 631.
302. 958 F.2d 1313 (5th Cir. 1992).
303. *Id.* at 1320.
304. The court recognized that if a guaranty contract is ambiguous, the court must give the contract the construction that is most favorable to the guarantor. *Id.* (citing Coker v. Coker, 650 S.W.2d 391, 393 (Tex. 1983)). However, if the contract is unambiguous, the court is required to construe the guaranty contract as a matter of law in determining the intent of the parties. *Id.*
305. *Id.*
306. *Id.*
307. *Id.* at 1320-21.
308. The guarantors cited Technical Consultant Serv., Inc. v. Lakewood Pipe of Texas, Inc., 861 F.2d 1357, 1363 (5th Cir. 1988) (interpreting Texas law), in support of their argument. *Northpark*, 958 F.2d at 1321.

rule proffered by the guarantors, but directed the guarantors' attention to an exception to that rule that permits the guaranty to impose on the guarantor liability greater than that of its principal.[309] By agreeing to pay not only the borrower's liability to the lender, but also the borrower's indebtedness to the lender, the guarantors, in the court's judgment, agreed to greater liability than that imposed on the borrower.[310] Not to be deterred by the court's calm and logical rejection of their arguments, the guarantors further argued that they did not intend to agree to any liability greater than that of the borrower. Suggesting that the guarantors' argument was somewhat ludicrous, the court reminded the guarantors of a provision in the note that in fact placed greater liability on the guarantors than the borrower by specifically excluding the guaranty from the provision that made the note nonrecourse to the borrower.[311]

While *In re Corland Corp.*[312] involves a fact situation not likely to reoccur on a regular basis, the Fifth Circuit's holding and reasoning should strengthen certain guaranties in bankruptcy situations. In *Corland*, the bank renewed a loan to a borrower and the borrower delivered its renewal note to the bank. On the same date, the borrower renewed a loan to a third party to whom the borrower had lent a portion of its original loan from the bank. The third party gave its renewal note to the borrower and personally guaranteed the bank's loan to the borrower. The third party/guarantor and borrower intended that the third party's payments to the borrower would be used by the borrower to make payments on the borrower's debt to the bank. This procedure was followed until the borrower filed for bankruptcy, at which time the third party/guarantor began making payments directly to the bank and the bank credited all such payments to the borrower's note. The bank apparently never presented a demand to the third party/guarantor to make the periodic payments under the borrower's note to the bank, but a demand was made for the guarantor to make (and the guarantor made) the balloon payment that eventually became due under the borrower's note. Following (and perhaps waiting for) the balloon payment, the trustee in the borrower's bankruptcy proceeding filed an action against the third party/guarantor seeking to set aside the payments made by the third party/guarantor to the bank. The third party/guarantor and the bank argued that the payments were made pursuant to the guaranty and not pursuant to the third party/guarantor's note to the bankrupt borrower. Concluding that the third party/guarantor's payments were constructive payments on its note to the borrower, the bankruptcy court held that the

309. *Northpark*, 958 F.2d at 1321 (citing Western Bank-Downtown v. Carline, 757 S.W.2d 111, 114 n.7 (Tex. App.—Houston [1st Dist.] 1988, writ denied); Simpson v. Mbank Dallas, N.A., 724 S.W.2d 102, 110 (Tex. App.—Dallas 1987, writ ref'd n.r.e.)).

310. *Id.*

311. *Id.* Perhaps to counteract an argument presented by the guarantors, the court noted that where a guaranty is absolute and unconditional, all of the terms of the note covered by the guaranty are deemed incorporated into the guaranty. *Id.* at 1321 n.13. Because the guarantor's liability under the guaranty was not subject to a condition precedent, the guaranty was absolute and unconditional, thereby incorporating all of the terms of the note. *Id.*

312. 967 F.2d 1069 (5th Cir. 1992).

trustee could avoid the third party/guarantor's payments to the bank.[313] The district court affirmed the bankruptcy court and the third party/guarantor appealed.[314]

Much to the bank's and the third party/guarantor's delight, the Fifth Circuit reversed the bankruptcy court and district courts, holding that the third party/guarantor's payments to the bank were payments made pursuant to the third party/guarantor's guaranty.[315] Finding fault with the bankruptcy court and district court for concluding that the payments were constructive payments under the third party/guarantor's note without considering the effect of the guaranty,[316] the Fifth Circuit concluded that upon the borrower's default in payment of its note to the bank, the third party/guarantor, irrespective of the lack of notice from the bank, became liable on the note.[317] The Fifth Circuit then addressed the issue of whether the third party's payments were made pursuant to its note or its guaranty. In support of its position, the trustee made four arguments, none of which the Fifth Circuit found particularly appealing.[318] Additionally, the court observed that the third party/guarantor would have acted irrationally if it had paid on the note instead of the guaranty because it would have exposed itself to additional liability.[319] Under this circumstance, the court thought it could reach no conclusion other than that the payments had been made pursuant to the guaranty and not the note.[320]

The trustee finally argued that the payments by the third party/guarantor were post-petition transfers of property of the estate barred by the bankruptcy code. The court summarily rejected this contention, stating that the funds were not property of the estate because they came from the third party/guarantor, not the borrower.[321] To hold otherwise, the court concluded, would render guaranties worthless in bankruptcies.[322]

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313. *Id.* at 1073.
314. *Id.*
315. *Id.* at 1075.
316. *Id.* at 1073.
317. *Id.* at 1073-74 (relying on United States v. Select Meat Co., 275 F. Supp. 38, 45 (W.D. Tex. 1967)); TEX. BUS. & COM. CODE ANN. §§ 3.416 (a), (e) (Vernon 1968).
318. *Corland*, 967 F.2d at 1074-75. The one non-procedural argument made by the trustee concerned language in the third party/guarantor's note that gave the third party/guarantor the right to make payments on the borrower's note and receive corresponding credits under its note. The trustee argued that enforcement of the guaranty would make the credit language redundant and meaningless. The court quickly disposed of the trustee's argument by concluding that the bank received benefit under the guaranty, not under the credit language in the note. *Id.* at 1075.
319. *Id.*
320. *Id.*
321. *Id.* at 1076.
322. *Id.* The third party/guarantor also argued for a right to offset the payments made pursuant to the guaranty against its note to the borrower. Although the third party/guarantor failed to seek a lifting of the automatic stay to assert an offset under § 553(a) of the bankruptcy code, this omission was not fatal to its claim of offset. The trustee filed a turnover action under § 542 (b) of the bankruptcy code, which permits a right to offset debts that are mutual and pre-petition. *Id.* at 1077. Mutuality existed because of the third party/guarantor's note to the borrower and the third party's subrogation right under the borrower's note to the bank arising from the third party's payments under the guaranty. The issue of whether the third party/guarantor's claim for reimbursement arose pre-petition was less clear. The court, how-

IV. CHOICE OF LAW

Several important choice of law cases were decided during the Survey period.[323] In *Resolution Trust Corp. v. Northpark Joint Venture*,[324] a Texas corporation made a loan to a Texas joint venture evidenced by a note and secured by a deed of trust lien placed against real property located in Mississippi and guaranties executed by the venturers of the borrower. The note and the deed of trust each contained a choice of law clause, the note providing for the application of Texas law, and the deed of trust providing for the application of Mississippi law. The borrower defaulted on the note, and the lender foreclosed its lien and sued the guarantors for payment of the deficiency. Applying Texas law to the deficiency claim, the district court ordered summary judgment in favor of the lender.[325]

On appeal, the guarantors argued that the district court should have applied Mississippi law to the deficiency action.[326] Pointing to language in the deed of trust that provided that the grantee would remain liable for any deficiency following foreclosure, the guarantors asserted that the deed of trust created the right to a deficiency judgment and the deficiency action should therefore be controlled by the deed of trust choice of law clause. Ignoring the deed of trust and instead relying on several Texas cases,[327] the Fifth Circuit disagreed with the guarantors, stating that a deficiency action is an action involving enforcement of the underlying debt and does not arise out of the foreclosure action.[328] Having disposed of the choice of law clause in the deed of trust, the court concluded that the guarantors had ratified the choice of law clause contained in the note through their respective guaran-

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ever, found its way through the fog and held that the reimbursement claim was pre-petition since the third party/guarantor, as the holder of the subrogation right, stood in the shoes of the bank and the bank's right to payment clearly arose pre-petition. *Id.* at 1078.

323. In addition to two Fifth Circuit cases, a district court opinion, Pennsylvania House, Inc. v. Juneau's Pennsylvania House, Inc., 791 F. Supp. 160 (E.D. Tex. 1992), discussed this issue. This case is not particularly noteworthy, especially in light of the fact that neither the court nor the litigants chose to recognize the contractual choice of law rules announced by the Texas Supreme Court in DeSantis v. Wackenhut Corp., 793 S.W.2d 670 (Tex. 1990). However, the case addressed an argument the authors have heard in their legal practice, and is noteworthy at least in that respect. In *Pennsylvania House*, the holder of a security interest, following foreclosure of that interest, sued for recovery of a deficiency. The applicable security documents each contained a choice of law provision that generally provided that the loan documents would be construed under and in accordance with the laws of Pennsylvania. The debtor argued that in determining whether the holder properly foreclosed its interest, the parties were not bound to the choice of law provisions because they addressed the construction of the documents and not the enforcement of remedies. The court summarily rejected the borrower's position as a mere semantical argument and refused to "recognize the artificial distinction between construction of the agreement and enforcing legal remedies . . ." *Pennsylvania House*, 791 F. Supp. at 161.

324. 958 F.2d 1313 (5th Cir. 1992). This case also involved guaranty issues discussed in Section III above.

325. *Id.* at 1315, 1318.

326. The RTC conceded that if Mississippi law governed the substantive issues in the deficiency action, summary judgment was inappropriate.

327. *Northpark*, 958 F.2d at 1318 (citing Resource Sav. Ass'n v. Neary, 782 S.W.2d 897, 902 (Tex. App.—Dallas 1989, writ denied); First Commerce Realty Investors v. K-F Land Co., 617 S.W.2d 806, 809 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.)).

328. *Id.*

ties of the payment of the note,[329] and held that the choice of law clause in the note controlled the substantive issues of the case.[330] The procedural value of this portion of the court's holding is questionable in light of the court's failure to analyze the effectiveness of the choice of law clause contained in the note under Section 187 of the Restatement (Second) of Conflict of Laws (Section 187),[331] as required by *DeSantis v. Wackenhut Corp.*[332]

Perhaps not wholly comfortable with its holding regarding the choice of law clause contained in the note, the court assumed that the parties had not chosen Texas law and proceeded to determine which state had the most significant relationship with the transaction,[333] as required by Section 188 of the Restatement (Second) of Conflict of Laws (Section 188), which generally provides that, in the absence of an effective choice of law clause, the law of the state that has the most significant relationship with the transaction will control.[334] The court had no difficulty concluding that Texas had the most significant relationship with the transaction, observing that the note and guaranties were negotiated in Texas, the parties were all either residents or domiciles of Texas, and the note and guaranties, by their terms, were wholly performable in Texas.[335] In assessing the relative importance of these factors, the court concluded that Texas had a great interest, while Mississippi had no interest, in resolving the central issue of whether the Texas debtors were liable under guaranties delivered to and held by the Texas creditors.[336]

In a second choice of law decision, *Chase Manhattan v. Greenbriar North Section II*,[337] the Houston court of appeals (First District), unlike the Fifth Circuit in *NorthPark*, analyzed the applicable choice of law clause under Section 187.[338] The facts show that the borrower negotiated and executed a note in New York and that the note was secured by a guaranty executed in New York and by a deed of trust executed in Texas.[339] The note and the guaranty each contained a choice of law clause that provided that the appli-

329. *Id.* at 1319. Certainly the court's determination was consistent with prior Texas cases holding that when the borrower of a guaranteed obligation defaults in payment, the guarantor becomes liable on the guaranteed obligation according to its terms. *See* Matter of Corland Corp., 967 F.2d 1069, 1074 (5th Cir. 1992) (citations omitted).

330. *Northpark*, 958 F.2d at 1320.

331. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971).

332. 793 S.W.2d 670, 677-78 (Tex. 1990). The court's failure to analyze the choice of law provision under § 187 of the Restatement is somewhat curious in light of the court's recognition of the requirements of § 187 and its specific statement that it was not addressing the § 187 analysis. *Northpark*, 958 F.2d at 1318 n.6. Moreover, the court could have concluded under § 187 that the choice of law clause was effective.

333. *Northpark*, 958 F.2d at 1319.

334. RESTATEMENT (SECOND) CONFLICT OF LAWS § 188 (1971). Section 188 was adopted by the Texas Supreme Court in *DeSantis*, 793 S.W.2d at 678.

335. *Northpark*, 958 F.2d at 1319. Section 188 provides that the factors to be considered by the court, as well as others, that are to be considered in determining which state has the most significant relationship to the transaction.

336. *Id.* Section 188 provides that the contacts described in § 188 are to be considered according to their relative importance with respect to the particular issue.

337. 835 S.W.2d 720 (Tex. App.—Houston [1st Dist.] 1992, no writ).

338. *Id.* at 723-28.

339. The facts did not indicate where the parties negotiated the guaranty or the deed of trust.

cable instrument would be governed by and construed in accordance with New York law. The deed of trust provided for remedies that conformed to Texas law and further provided that the maximum permitted interest rate on the note would be controlled by New York law. The original lender was ultimately acquired by another lender (Chase Manhattan), who succeeded to all of the rights of the original lender under the various documents. Thereafter, the borrower, while in Texas, executed a renewal note containing a choice of law clause similar to that contained in the original note. In connection with the renewal note, the deed of trust was modified and the guarantors executed a new guaranty covering the renewal note.[340]

The borrower subsequently defaulted on the renewal note, the lender foreclosed its lien, and, without following a New York requirement that the lender obtain an order confirming the sale of the property within 90 days after the foreclosure and a judicial determination of the fair market value of the property, sought a deficiency judgment against the borrower and the guarantors. The borrower and guarantors asserted that the parties had chosen New York law to control the issue of deficiency and because the lender had failed to follow New York law in that regard, the borrower and guarantors were relieved of any liability for the deficiency.[341] To the bank's chagrin, the district court agreed with the borrowers and guarantors and entered summary judgement in their favor.[342]

On appeal, the lender argued that the district court should have applied Texas law to the deficiency issue and the court, in accordance with *DeSantis*, proceeded to analyze the effectiveness of the contractual choice of law provisions under Section 187.[343] Under Section 187(1), a choice of law clause is to be applied to an issue if that issue could have been resolved by placing an explicit provision in the documents.[344] The court concluded that the parties could have placed a specific provision in the contract documents to provide for a deficiency and accordingly held that the choice of New York law was therefore enforceable.[345] The court found support for its holding under comment c to Section 187, which provides that the court shall apply the chosen law to rules of contract law relating to, among other things, conditions precedent.[346] According to the court, the New York requirement to obtain a judicial confirmation of sale and fair market value prior to obtaining a deficiency judgment were conditions precedent of the nature covered by

340. The facts do not indicate in which state the renewal note and the deed of trust modification were executed or in which state those instruments or the renewal note were negotiated.

341. The lender did not dispute that it had not complied with deficiency procedures under New York law, which generally prohibit a deficiency judgment unless the lender obtains an order confirming sale of the property within 90 days of the consummation of the sale.

342. *Greenbriar*, 835 S.W.2d at 723.

343. *Id.* at 723-28.

344. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(l) (1971).

345. *Greenbriar*, 835 S.W.2d at 724. *Cf. Northpark J.V.*, 958 F.2d 1313 (5th Cir. 1992), wherein the court generally ignored a provision regarding a deficiency contained in the deed of trust and instead concluded that the issue of deficiency was a matter of state law. *See supra* notes 324-28.

346. *Id.*; RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. c (1988).

comment c.[347] The court recognized that in *DeSantis*, the Texas Supreme Court reached a conclusion that the enforceability of a non-competition agreement was not an issue that the parties could have resolved by explicit agreement.[348] The appeals court had no disagreement with *DeSantis*, but the issue before the appeals court was not one of enforceability, but rather one of conditions precedent to obtaining a deficiency judgment.[349]

Perhaps as a reflection of the court's confidence in its holding that the New York statutory preconditions to a deficiency judgment were of the nature that could have been resolved in the parties' contract, the court assumed the inaccuracy of its own holding and proceeded to analyze the effectiveness of the contractual choice of law clauses under Section 187(2).[350] Section 187(2) generally provides that even if the issue does not pass muster under 187(1), the choice of law provision will be enforced unless (a) the chosen state has no substantial relationship to the transaction and there is no reasonable basis for the parties' choice or (b) the law of the chosen state would be contrary to a fundamental policy of a state having a materially greater interest in the particular issue and that, in the absence of a choice of law clause, would be the state with the most significant relationship to the transaction under Section 188.[351]

In determining whether New York had a substantial relationship to the transaction as contemplated under Section 187(2)(a), the court noted that the renewal note was payable in New York, the lender's principal place of business was in New York, the deed of trust modification provided that the maximum permissible interest rate would be determined according to New York law, and that the renewal note and related guaranty each provided that they would be construed and enforced in accordance with New York law.[352] These facts, according to the court, were sufficient to establish a substantial relationship between New York and the transaction.[353]

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347. *Greenbriar*, 835 S.W.2d at 724. Although the New York pre-deficiency requirements are indeed in the nature of conditions precedent, the authors are not as confident as the court that the New York requirements "are precisely the type cited by comment c as an example of an issue that could have been resolved by the parties via an explicit provision in their agreement." *Id.* Comment c deals with rules of contract law while the court was dealing with a statutory provision regarding liability. Comment c provides that "[a]s to all such matters", meaning rules of contract law designed to fill gaps pertaining to conditions precedent, the forum will apply the provisions of the chosen law. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. c (1988). However, in *Northpark*, the court looked to comment c to create a condition precedent, as opposed to filling a gap regarding a condition precedent.

348. *Greenbriar*, 835 S.W.2d at 724.

349. *Id.* at 724-25. The court may have oversimplified its analysis in that the whole process of obtaining a deficiency judgment was at issue as opposed to mere contractual conditions precedent.

350. *Id.* at 725-28.

351. RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187(2) (1971).

352. *Greenbriar*, 835 S.W.2d at 725. The court also considered certain facts pertaining to the original lender and the original note, guaranty and deed of trust. *Id.* These facts appear irrelevant, especially in light of the fact that a lender other than the original lender entered into renewal documents that contained new choice of law provisions relating to the renewal transaction between the new lender, the borrower and the guarantors.

353. *Id.* The court heavily relied on First Commerce Realty Investors v. K-F Land Co., 617 S.W.2d 806 (Tex. Civ. App.—Houston [14th Dist.] 1981, writ ref'd n.r.e.), which under

With regard to its analysis under Section 187(2)(b), the court recognized that it must make three determinations: (1) whether Texas had a more significant relationship to the transaction and the parties than did New York; (2) whether Texas had a materially greater interest in the resolution of the issue than did New York; and (3) whether the application of New York law would offend a fundamental policy of Texas.[354] In determining the first prong of this test, the court applied the significant relationship factors set forth in Section 188.[355] On the Texas side of the equation, the court noted that the renewal note and modification of the deed of trust were executed in Texas, the property securing the note was located in Texas, and the borrowers and guarantors were located in Texas.[356] On the New York side of the equation, the court noted that the renewal note was payable in New York, the lender was located in New York, the original note and deed of trust were executed in New York, and the original note was negotiated in New York.[357] These facts, the court concluded, were insufficient to establish that Texas had a more significant relationship to the transaction and the parties than did New York.[358]

As to the second prong, the court concluded that Texas did not have a materially greater interest in the determination of whether New York's conditions to obtaining a deficiency judgment should be applicable to the deficiency action brought by the lender.[359] Without in any way discussing why Texas had or did not have a materially greater interest in the determination of the factors that were relevant to a deficiency action, the court simply stated that the action before it involved the payment of a debt and not foreclosure on the property, an issue in which Texas might have a materially greater interest.[360]

As to the fundamental policy issue, the court concluded that no Texas fundamental policy of Texas would be implicated, much less offended, by applying the New York deficiency rules to the deficiency action brought by the lender.[361] In reaching its conclusion, the court looked to Section 187 and found some sage wisdom in comment g, which suggests that the focus

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similar facts held that Louisiana had a reasonable relationship to the transaction. *Id.* at 807. However, the test for reasonable relationship is probably not as rigorous as the test for determining whether a state has a substantial relationship with a transaction; therefore, *Greenbriar's* reliance on *K-F Land* may be somewhat misplaced.

354. *Greenbriar*, 835 S.W.2d at 725.

355. *Id.* at 725-26. Generally, § 188 provides that the following contacts are relevant to determining which state has the most significant relationship to the transaction and parties: (i) place of contracting; (ii) place of negotiation; (iii) place of performance; (iv) location of the subject matter of the contract; and (v) the domicile, residence, nationality, place of incorporation and place of business of the parties. RESTATEMENT (SECOND) CONFLICT OF LAWS § 188 (1971).

356. *Greenbriar*, 835 S.W.2d at 726.

357. *Id.*

358. *Id.* While the authors agree with the court's determination, the factors pertaining to the original note, guaranty and deed of trust are probably irrelevant for the reasons stated in *supra* note 352.

359. *Id.*

360. *Id.*

361. *Id.*

should be on whether the law in question is part of a state policy so fundamental that the courts of that state will refuse to enforce an agreement contrary to that law, regardless of the parties' original intention and regardless of the fact that the agreement would be enforceable in another state connected with the transaction.[362] Although the deficiency laws in Texas and New York were clearly different, the court simply concluded that the deficiency laws in Texas were not such a fundamental state policy that the Texas courts would refuse to enforce an agreement contrary to those rules, despite the parties' intentions.[363]

V. HOMESTEAD

The constitutional and statutory homestead rights accorded to Texas residents are continually guarded by the judiciary. Indeed, one court has stated that "we must uphold and enforce the Texas homestead laws even though in so doing we might unwittingly assist a dishonest debtor in wrongfully defeating his creditor."[364] Accordingly, it should surprise no one that transactions designed to avoid homestead rights are closely scrutinized and rarely prevail. Consistent with these principles, several cases decided during the Survey period make clear that sham sales of homesteads to avoid the prohibition of liens on homesteads, other than liens for purchase money, taxes and home improvements, will not be tolerated or upheld by Texas courts.[365] Similarly, Texas courts have developed, and Survey cases continued to condone, a paternalistic policy that upholds, even in the face of a representation by an owner that the mortgaged property is not the owner's homestead, an owner's claim that any lien, other than a constitutionally permitted lien, is invalid against the owner's homestead,[366] unless (i) the owner does not occupy the property or uses it in a fashion that makes its status dubious at the time the mortgage is executed,[367] or (ii) the lien is created in connection with a simu-

362. *Id.* (citing DeSantis v. Wackenhut Corp., 793 S.W.2d 670, 680 (Tex. 1990)); RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 cmt. g (1988).

363. *Greenbriar*, 835 S.W.2d at 726. While it lamented the fact that neither § 187 nor the cases following that section, including *DeSantis*, defined "fundamental policy", the court stated that it could not conceive of a definition that would include the right of a creditor to obtain a deficiency judgment without first satisfying requirements similar to the New York requirements. *Id.*

364. *In re* Bradley, 960 F.2d 502, 507 (1992) (quoting in part from Cocke v. Conquest, 120 Tex. 43, 35 S.W.2d 673, 678 (1931)).

365. *See, e.g.*, Orozco v. Sander, 824 S.W.2d 555 (Tex. 1992); Firstbank v. Pope, 141 B.R. 115 (Bankr. E.D. Tex. 1992).

366. *See, e.g.*, Exocet Inc. v. W.W. Cordes, 815 S.W.2d 350 (Tex. App.—Austin 1991, no writ) (judicial admission by homestead owner that a judgment lien was perfected against his property did not estop the homestead owner from claiming that such property was his homestead); *In re* Bradley, 960 F.2d 502 (5th Cir. 1992) (where owner made representation to lender that mortgaged property was not owner's homestead, but owner in fact occupied a residence on the mortgaged property and utilized the entire mortgaged property for homestead purposes, owner was not estopped from denying validity of the lien on the basis that mortgaged property was owner's homestead).

367. *E.g.*, Gregory v. Sunbelt Sav. F.S.B., 835 S.W.2d 155 (Tex. App.—Dallas 1992, writ denied) (where owner represented to lender that mortgaged property was not owner's residential homestead, owner did not occupy the mortgaged property at the time of execution of the mortgage and lender loaned funds in reliance on the owner's representation, owner was es-

lated transaction that has the outward appearance of a sale, but that is in fact a mortgage,[368] or (iii) the owner also represents that the secured notes are valid mechanic's lien notes for improvements, secured by the lien of a properly executed mechanic's lien contract.[369] These exceptions to the general rule may be rigorously applied by the courts to avoid borrower abuses.

For example, in *In re Smith*,[370] the homestead owner executed a mechanic's lien secured by a properly executed mechanic's lien contract and then used the funds advanced by the lender to pay taxes. The lender was subsequently taken over by the FDIC and the note was thereafter acquired by another bank. In holding that the homestead owner was estopped from denying the validity of the lien, the court noted that the policy behind the mechanic's lien note exception was to protect lenders who had been induced to advance funds on the belief that those funds would be secured by the mechanic's lien.[371] Applying this policy, the court concluded that the FDIC and the bank that ultimately acquired the failed lender's note had advanced funds in reliance on the validity of the mechanic's lien and, accordingly, the homestead owner was estopped from denying the validity of the mechanic's lien.[372] The homestead owner argued that estoppel should not apply because the original lender was fully aware of the owner's actual use of the funds prior to funding. Although the court recognized that the original lender probably would have been denied the use of the estoppel argument because it had prior actual knowledge regarding the use of the loan proceeds, the court refused to impute that knowledge to the FDIC or the purchaser of the failed institution's note.[373]

Texas courts have long held that a court may require a partition of the homestead in connection with a divorce proceeding.[374] In addition, Texas law permits a court to order in a divorce proceeding that one spouse be entitled to the homestead estate even if title to the property is held by the other spouse.[375] However, prior to *Laster v. First Huntsville Properties*

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topped from denying validity of the mortgage on grounds that mortgaged property was owner's residential homestead); *In re* Nelson, 134 B.R. 838 (Bankr. N.D. Tex. 1991) (where owner disclaimed mortgaged property as being a business or residential homestead and claimed another property to be his residential homestead and the lender advanced funds in reliance on representations, owner was estopped from denying validity of lien on grounds that the mortgaged property was owner's business homestead).

368. *But see supra* note 365 and accompanying text regarding the courts' close scrutiny of sales which are in fact disguised mortgages.

369. *In re* Smith, 966 F.2d 973, 976-77 (5th Cir. 1992).

370. *Id.* at 973.

371. *Id.* at 977.

372. *Id.* at 977-78.

373. *Id.* at 978; *see supra* note 366. If the original lender was not entitled to the estoppel argument, arguably the lien was void at the time of assignment to the FDIC. If so, the court's holding is incorrect.

374. *E.g.*, Kirkwood v. Kirkwood, 80 Tex. 645, 16 S.W. 428, 429 (1891); Hedtke v. Hedtke, 112 Tex. 404, 408, 411, 248 S.W. 21, 22-23 (1923). The Texas Family Code also provides that the trial court in a divorce proceeding has the right to order a "just and right" division of a divorcing couple's estate, including the right to order the sale of the homestead and a partition of the proceeds. TEX. FAM. CODE ANN. § 3.63 (Vernon 1993).

375. *E.g.*, *Hedtke*, 248 S.W. at 23; *see* TEX. FAM. CODE ANN. § 3.63.

Co.,[376] the Texas Supreme Court had not squarely addressed the issue of whether "one ex-spouse who, pursuant to a consent decree of divorce, holds a future interest in property subject to the homestead right of the other ex-spouse, can mortgage that [future] interest."[377] In *Laster*, a husband and wife were divorced and agreed to a decree that awarded the wife a 73.83% interest in the family residence, the husband a 26.17% interest and the wife and children the right to use and occupy the residence for an agreed upon period of time.[378] Several years after the divorce, the husband mortgaged his future interest in the residence to secure the payment of a promissory note. The husband subsequently defaulted on the note, the mortgagee foreclosed its deed of trust and then sold the husband's interest in the residence to a third party. When the wife's and childrens' right to use and occupy the residence expired, the holder of the husband's interest filed a suit to partition the residence and the wife answered, claiming that the mortgage was void because the residence was her homestead at the time the husband executed the deed of trust and at the time the suit was filed. The trial court denied the purchaser's writ of partition and held that the purchaser's interest in the residence was subject to the wife's ongoing homestead right, thereby protecting the wife's continuing homestead right from forced foreclosure.[379] The court of appeals reversed and the wife appealed to the Texas Supreme Court to protect her homestead by declaring the mortgage void because it created a lien against the homestead to secure general indebtedness.[380] Although the wife found some support from a minority of the court,[381] a strong majority concluded that the husband's mortgage was not a lien against a homestead and therefore was not void under Texas homestead laws.[382] The court concluded that through the division of property provisions in the divorce decree, the husband and wife became joint owners of the residence,[383] with the

376. 826 S.W.2d 125 (Tex. 1991).

377. *Id.* at 127.

378. *Id.*

379. *Id.* at 128.

380. *Id.* The supreme court noted that the trial court, in its findings of fact and conclusions of law, stated that the purchaser of the husband's interest did so subject to the wife's right of occupancy. *Id.* Although the court did not indicate the significance of this portion of the trial court's findings and conclusions, it appears that the court was noting some contradiction between the trial court's conclusion that the purchaser's interest in the residence was subordinate to the wife's ongoing homestead right.

381. Justices Gammage and Mauzy wrote a dissenting opinion, chiding the majority for (i) "trouncing the family homestead rights" granted to the wife, (ii) relying on lower court cases that had not been reviewed by the supreme court and in any event that did not support the majority's opinion, and (iii) aiding a creditor even though it had ample notice of the wife's homestead rights. *Id.* at 134, 136. Notwithstanding the dissenters' chastising comments, the dissenting opinion was not nearly as persuasive or logical as the majority opinion.

382. *Id.* at 130.

383. *Id.* at 129. The court of appeals had concluded that, through the divorce decree, the husband and wife had become cotenants of the residence. First Huntsville Prop. Co. v. Laster, 797 S.W.2d 151, 152 (Tex. App.—Houston [14th Dist.] 1991, writ granted). The supreme court disagreed with this portion of the court of appeals opinion, concluding that the husband and wife could not have become cotenants since the wife enjoyed possession of the residence to the exclusion of the husband. *Laster*, 826 S.W.2d at 129 (relying on Reed v. Turner, 489 S.W.2d 373, 381 (Tex Civ. App.—Tyler 1972, writ ref'd n.r.e.); LeBus v. LeBus, 269 S.W.2d 506, 510 (Tex. Civ. App.—Fort Worth 1954, writ ref'd n.r.e)).

wife's homestead interest in the residence being akin to a life estate and the husband's interest being akin to a future interest held by a remainderman in the fee simple estate.[384] The court further concluded that Texas law permits the holder of a future interest in property to mortgage that interest free of homestead constraints, unless the interest is impressed with the homestead character. Such an interest may be impressed with the homestead character only if the holder has the present right to possess the property.[385] From these principles, the court concluded that because the husband held no present right to possess the residence, the husband's future interest was not impressed with the homestead character, thereby entitling the husband to mortgage his future interest in the residence free of homestead constraints.[386]

The court next considered whether the wife's homestead interest invalidated the mortgage executed by the husband. According to the court, Texas law generally provides that a party's homestead rights with respect to property will not protect a non-possessory future interest in that property held by another party.[387] Accordingly, the court concluded that the homestead rights exclusively retained by the wife could not invalidate the mortgage created by the husband against his future estate in the residence.[388]

The court then turned to the question of whether the wife's remaining homestead rights in the property prevented the forced sale and partition of the residence sought by the purchaser of the husband's interest. The court noted that long established Texas case law permits a court to order a just and right division of a divorcing couple's estate, which includes the ability to order the sale of the homestead and to partition the resulting proceeds.[389] Although this judicial right was not exercised at the time of the decree, the court concluded that under the decree the husband and wife merely postponed the partition of the homestead for an agreed-upon period of time.[390] The court held that with the expiration of the agreed-upon period of the wife's occupancy, the residence became subject to an order of forced sale and partition of proceeds just as if that order had been issued at the time of the divorce.[391] The court concluded that prohibiting the partition and sale of

384. *Laster*, 826 S.W.2d at 129.

385. *Id.* at 130. The court also observed that if a remainderman holds a present right to possession of the property sufficient to establish a homestead interest and continues so to occupy the property, the homestead character will be impressed upon the property when the remainderman receives fee simple title and the homestead character will relate back to the date the remainderman began occupying the property as a homestead. *Id.* 130 at n.2 (citing W.R. Thompson & Sons Lumber Co. v. Clifton, 132 Tex. 366, 124 S.W.2d 106, 107 (1939)).

386. *Id.*

387. *Id.* (relying on Johnson v. Prosper State Bank, 125 S.W.2d 707 (Tex. Civ. App.—Dallas 1939), *aff'd*, 134 Tex. 677, 138 S.W.2d 1117 (1940)).

388. *Id.*

389. *Id.* at 131; *see* cases cited *supra* notes 374 and 375.

390. *Laster*, 826 S.W.2d at 131. Although the court does not provide specific reference to evidence of the husband's and wife's agreement, the facts reflect that the divorce decree provided that upon termination of the agreed upon period of the wife's occupancy, the husband's and wife's interests in the residence would be determined in accordance with their interests set forth in the decree.

391. *Id.* at 132.

the residence merely because the partition would take place after the expiration of the agreed upon occupancy period as opposed to the time of the divorce would be manifestly unjust to the husband's rights in the residence.[392] Moreover, the court concluded that its decision to permit the partition and sale of the residence would not in any way divest the wife of her homestead rights because those rights would carry over to the partition proceeds, thereby according the partition proceeds the same protections against forced sale as would be accorded the proceeds of any other type of sale of her homestead interest.[393]

The Texas constitution generally protects the homestead of a family or single adult from forced sale for the payment of debts, except to satisfy liens securing purchase money, certain tax debts or properly documented and created home improvement debts.[394] This constitutional right is aggressively guarded by the courts, even in the muddled arena of division of property in divorce proceedings. For example, in *Heggen v. Pemelton*,[395] the Texas Supreme Court addressed a trial court's ability to impose an equitable lien in favor of one divorcing party against the separate property homestead of the other divorcing party. In *Heggen*, the husband was granted a divorce, the wife was awarded her separate property homestead and the husband was awarded $150,000 for his interest in the homestead and the right to reimbursement for his share of any community funds used to improve the homestead.[396] In addition, the trial court imposed an equitable lien on the homestead in favor of the husband in order to ensure its just and right division of the marital estate.[397] The wife appealed, seeking to remove the equitable lien on the grounds that it was an invalid lien against the homestead under the Texas constitution. The appeals court upheld the trial court and the wife appealed to the Texas Supreme Court.[398]

The supreme court had little difficulty reversing both the trial court and the appeals court.[399] Recognizing the general prohibition against forced sale of a homestead to satisfy debts other than liens for purchase money, certain taxes and properly documented home improvements, the court concluded that the validity of the equitable lien depended on whether the lien fit into

392. *Id.* at 131.

393. *Id.* at 132. Presumably the court was referring to the protection afforded by TEX. PROP. CODE ANN. § 41.001(c) (Vernon Supp. 1993), which generally provides that the proceeds from the sale of a homestead are protected from seizure by creditors for a period of six months. *See infra* notes 413-418.

394. TEX. CONST. art. XVI, § 50.

395. 836 S.W.2d 145 (Tex. 1992).

396. *Id.* at 146.

397. *Id.* Regarding a court's broad discretionary right to make a just and right division of marital property in a divorce proceeding, see TEX. FAM. CODE ANN. § 3.63 (Vernon 1993) and *supra* note 374.

398. *Heggen*, 836 S.W.2d at 145-46.

399. In addition to denying the lien on homestead grounds, the court also concluded that the lien was improper because a trial court may not impose a lien on a divorcing party's separate real property merely to ensure a "just and right division" of the marital estate. *Id.* at 148 (relying on, *e.g.*, Dakan v. Dakan, 125 Tex. 305, 83 S.W.2d 620, 627 (1935); Eggemeyer v. Eggemeyer, 623 S.W.2d 462, 466 (Tex. Civ. App.—Waco 1981, writ dism'd w.o.j.)).

one of the permitted categories.[400] Based on the record, however, the court was unable to determine whether the equitable lien fit into any of the permitted lien categories, and therefore remanded the case to the trial court to further develop the facts and make that determination.

Justices Cornyn and Cook concurred in the judgment, but not the opinion. Relying on *Laster v. First Huntsville Properties Co.*[401] and other cases, the concurring justices opined that the homestead right of a divorcing party should yield to a trial court's power to partition community property in a divorce proceeding.[402] Moreover, the concurring justices felt that the majority opinion was problematic in that it failed to consider the effect of a divorce on a homestead, resulting in an unnecessarily overbroad opinion.[403] The authors also see some logical inconsistency between *Laster* and *Heggen*. For example, is it logical that a divorcing party be exposed to a different risk merely because the court awards a divorcing party dollars from the other divorcing party for his/her interest in the community homestead as opposed to ordering a sale of the homestead and a partition of the proceeds? The authors think not, yet the risk is clearly different since the proceeds resulting from a sale are readily obtainable while recovery of a judgment against a divorcing party who fails to pay its monetary obligations is far more problematic.

During the Survey period several cases concerning the business homestead arose, and one case is particularly worthy of discussion. In *In re Webb*,[404] the Fifth Circuit reviewed a district court's decision to overturn a bankruptcy court determination that a non-contiguous lot used in the operation of the debtor's business was not part of the debtor's business homestead because the non-contiguous lot was not "essential to and necessary for" the debtor's business.[405] The not "essential to and necessary for" standard arises out of the Texas Supreme Court's decision in *Ford v. Aetna Insurance Co.*,[406] where the court held that the business homestead exemption could extend to two non-contiguous lots if those lots are used for the operation of

400. *Id.* Interestingly, the court's opinion does not discuss or cite Magill v. Magill, 816 S.W.2d 530 (Tex. App.—Houston [1st Dist.] 1991, writ denied), where the court permitted a lien to be placed against a divorcing party's separate property homestead in order to secure the other divorcing party's right of reimbursement for the value and nature of improvements that enhanced the value of the home, even though there was evidence that the improvements were made by the divorcing parties through their own efforts as opposed to being performed pursuant to a written contract signed by both the husband and wife and otherwise complying with the constitutional requirements. Presumably, *Magill* would not pass muster under *Heggen*, which specifically states that an equitable lien may be imposed on a homestead in favor of a divorcing party to secure only a reimbursement claim that satisfies the constitutional strictures pertaining to homesteads, including the requirement that any lien for work and materials relating to home improvements must be contracted for in writing, with the consent of both spouses. *Heggen*, 836 S.W.2d at 148. *See also* Falor v. Falor, 840 S.W.2d 683 (Tex. App.—San Antonio 1992, no writ).

401. 826 S.W.2d 125 (Tex. 1991).

402. *Heggen*, 836 S.W.2d at 149-50.

403. *Id.* at 150-51.

404. 954 F.2d 1102 (5th Cir. 1992).

405. *Id.* at 1104.

406. 424 S.W.2d 612 (Tex. 1968).

the business of a head of a family and both lots are necessary to and essential for such business, as opposed to merely being used as an aid to the business.[407] The *Webb* court applied the standard announced in *Ford* and concluded that the bankruptcy court's determination was correct.[408] In so holding, the *Webb* court approvingly cited one commentator's conclusion that the *Ford* standard should not require a showing that the business would perish without the non-contiguous lot.[409] Rather, the test focuses on two elements: purpose and space.[410] Accordingly, "purpose" should be satisfied "if the activity conducted on the lot is required to carry out the purpose of the business", and "space" should be satisfied unless the activity "could as well be conducted on one lot as two."[411]

The commentator's conclusions are, with one exception, consistent with *Ford*. A close reading of *Ford* reflects that the court focused on whether the activity on the non-contiguous lot in question was necessary to the operation of the business and whether both lots were actually used in the operation of the business.[412] While space needs may be one relevant fact as to whether the lot at issue is necessary, the issue of space should not be considered a separate prong of the *Ford* test. In addition, it appears that the issue of space should not be static in nature. Consider, for example, a situation where an owner uses, and due to lack of available storage space needs, a non-contiguous lot to store his business inventory, but due to temporary declining business conditions, the inventory on that lot could, until an upswing in business conditions occurs, be stored on the primary business homestead lot. Under these circumstances and analysis, *Ford* does not require a conclusion that the owner should be denied the right to claim the non-contiguous lot as part of its business homestead merely because of the temporary interruption in the space requirements of an essential element of the owner's business.

Section 41.001(c) of the Texas Property Code[413] generally provides that proceeds from the sale of a homestead are not subject to seizure for a creditor' claim for the six month period following the date of sale. During the Survey period, several homestead owners attempted to argue that Section 41.001(c) provided a separate and distinct exemption for the proceeds from the sale of a homestead. In *In re Evans*,[414] the homestead owner sold his rural homestead and reinvested a portion of those proceeds in a new urban homestead. Following the purchase of the urban homestead and within six months after the sale of the rural homestead, the owner filed for bankruptcy

407. *Id.* at 616.
408. *Webb*, 954 F.2d at 1108.
409. *Id.*
410. *Id.* (quoting *Recent Decisions, Business Homestead—Non-Contiguous Lots*, 22 SW. L.J. 694, 695-96 (1968)).
411. *Id.*
412. *See Ford*, 424 S.W.2d at 614 ("[the business owner] testified that both lots were necessary . . . for use in the exercise of his . . . business, and that both were actually used in such business"); *Id.* at 616 ("since the [business owner] adduced evidence . . . to support [his] contention that both lots were actually and necessarily used as a place for the operation of the . . . business, no abuse of discretion by the trial court was shown").
413. TEX. PROP. CODE ANN. § 41.001(c) (Vernon Supp. 1993).
414. 135 B.R. 261 (Bankr. S.D. Tex. 1991).

protection and claimed that Section 41.001(c) protected from the claims of creditors the portion of the proceeds from the sale of the rural homestead that was not used to purchase the urban homestead. The court concluded that the purpose of Section 41.001(c) was to allow a homestead claimant six months within which to purchase a new homestead[415] and that the proceeds had the homestead character of the rural homestead which was abandoned upon the sale thereof.[416] The court further concluded that because under Texas law there can be but one homestead,[417] the acquisition of the urban homestead constituted an abandonment of all right in the remaining proceeds from the sale of the rural homestead.[418]

In a similar case, *In re England*,[419] the homestead owners sold their residential homestead for cash and a sizable note, moved to another property owned by them and then designated that property as their new homestead. Within six months after the sale of the residential homestead, the debtors filed for bankruptcy protection and sought to protect the note received in connection with the sale under the provisions of Section 41.001(c). Rejecting the owner's argument, the court held that, following the designation of the new homestead, Section 41.001(c) no longer protected the note received as part of the proceeds from the sale of the residential homestead.[420] Concluding that the purpose of Section 41.001(c) was to provide a homestead owner a reasonable period of time to acquire a new homestead with the proceeds from the sale of a prior homestead, the court held that the six-month protection period could not be claimed by a party who, at the same time, claimed homestead rights in another property pursuant to Section 41.002.[421]

Texas law places the burden on the homestead claimant to establish the

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415. Although the court provided no authority for its conclusion, at least one Texas case substantiates the court's conclusion. Taylor v. Mosty Bros. Nursery, Inc., 777 S.W.2d 568 (Tex. App.—San Antonio 1989, no writ) ("The six-month provision was enacted in order that the proceeds might be reinvested in another homestead."). However, it should be noted that the *Taylor* case relied on Ingram v. Summers, 29 S.W.2d 447 (Tex. Civ. App.—El Paso 1930, writ dism'd), which when addressing a predecessor statute to § 41.001(c), stated that "[t]he Legislature evidently realized that conditions might and probably would arise when . . . the homestead should be sold, and if the proceeds of such a sale was [sic] in no way protected, then the beneficent provisions of our Constitution would be . . . lost." This statement obviously does not go as far as the statement made by the *Taylor* court.

416. *Evans*, 135 B.R. at 264. The court's conclusion is consistent with the Texas Supreme Court's holding in Laster v. First Huntsville Properties Co., 826 S.W.2d 125, 132 (Tex. 1991), that upon the sale of the homestead, the owner's homestead rights carry over to the proceeds of the sale.

417. *Evans*, 135 B.R. at 264 (citing *e.g.*, Silvers v. Welch, 127 Tex. 58, 91 S.W.2d 686 (1936); Rockett v. Williams, 78 S.W.2d 1077 (Tex. Civ. App.—Dallas 1935, writ dism'd w.o.j.)).

418. *Id.* at 263. The court concluded that to hold otherwise would "not only . . . further the generous provisions of the Texas homestead laws but also . . . [would] create windfalls for debtors who reinvest sale proceeds into homesteads of lesser value." *Id.*

419. 141 B.R. 495 (Bankr. N.D. Tex. 1991).

420. *Id.* at 498-99.

421. *Id.* at 498. The court actually concluded that an exemption could not be claimed, at the same time, under both subsections (a) and (c) of § 41.001 of the Texas Property Code. The author's believe that the reference to § 41.001(a) was in error and that the court actually meant to refer to TEX. PROP. CODE ANN. § 41.002(b) (Vernon Supp. 1993), which is the section

homestead character of the property,[422] which generally requires a combination of overt acts of homestead use and intent on the part of the owner to claim the property as a homestead.[423] However, investigation of intention is not necessary and the requisite intent will be presumed when the homestead claimant displays that the property is actually put to homestead use.[424] The Fifth Circuit, in *In re Bradley*,[425] applied each of these principles to uphold the debtor's claim for homestead property. In *Bradley*, the homestead claimants acquired property from a partnership of which they were partners. During the period that the partnership owned the property, the homestead claimants occupied 15 acres of the 129 acres for homestead purposes and the remainder of the acreage was to be developed in accordance with the partnership agreement. None of the acreage was developed and immediately following the homestead claimants' acquisition of the entire property, the homestead claimants began and continued to use the entire property as their home and ranch. Thereafter, the homestead claimants borrowed a substantial sum of money and granted a deed of trust lien against approximately 124 acres of the property to secure repayment of the loan. Several years later the homestead claimants filed for bankruptcy protection and claimed that the lien against the 124 acres was invalid as that property constituted a part of their rural homestead. The bankruptcy court rejected the claim for homestead, reasoning that the 114 acre portion of the property was vacant and that the claimants had executed a disclaimer in which they represented to the lender that the 114 acres were not part of their rural homestead.[426]

On appeal, the Fifth Circuit reversed the trial court, holding that, notwithstanding the existence of the homestead disclaimer, the claimants' evidence of occupancy of the residence and farming and ranching of the remainder of the property was sufficient to establish as a matter of law the homestead character of the entire property.[427] As to the bankruptcy court's

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under which the owners claimed the homestead exemption as to the property to which they relocated. *See England*, 141 B.R. at 496.

422. *E.g*, Lifemark Corp. v. Merritt, 655 S.W.2d 310, 314 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e).

423. Gregory v. Sunbelt Sav. F.S.B. 835 S.W.2d 155, 158 (Tex. App.—Dallas 1992, writ denied) (citing Burk Royalty Co. v. Riley, 475 S.W.2d 566, 568 (Tex. 1972); Sims v. Beeson, 545 S.W.2d 262, 263 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.)).

424. *See* Youngblood v. Youngblood, 124 Tex. 184, 76 S.W.2d 759, 761 (1934); Lifemark Corp. v. Merritt, 655 S.W.2d 310, 315 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e.). *But see infra* note 428, which discusses a limited situation in which the question of intent should not be presumed, notwithstanding the owner's established usage of the property for homestead purposes.

425. 960 F.2d 502 (5th Cir. 1992).

426. *Id.* at 508.

427. *Id.* The court observed that Texas courts have routinely held that farming and ranching purposes, coupled with occupancy of the property, is sufficient to establish the rural homestead character of the property. *Id.* (citing Fajkus v. First Nat'l Bank, 735 S.W.2d 882, 884 (Tex. App.—Austin 1987, writ denied); Clark v. Salinas, 626 S.W.2d 118, 120 (Tex. App.—Corpus Christi 1981, writ ref'd n.r.e.)). In a subsequent decision, *In re* Kennard, 970 F.2d 1455, 1458-59 (5th Cir. 1992), the Fifth Circuit reached a similar result, concluding that an improper designation of homestead knowingly made by the owner did not estop the owner from claiming that another tract of land was the owner's actual homestead where, at the time of the improper designation, the house on the land originally designated by the owner as his

supporting reasoning that the property was vacant and the existence of the non-homestead affidavit, the court concluded that these matters were irrelevant because they addressed the issue of intent, which became presumed upon the claimant's showing of the homestead character of the property.[428]

The issue of whether a claimed homestead is rural or urban can be significant in some cases, since a family's rural homestead may be up to 200 acres of land,[429] while an urban homestead is limited to one acre of land.[430] For example, in *Bradley*, the 129 acres of home and ranch land that the owners sought to protect as their rural homestead was located within the city limits of Southlake, Texas, but was not served by water or any other municipal utility at the time that the owners began using the property as a homestead. The lienholder claimed that because the property was located within the limits of a city, the owners should be permitted to claim only an urban homestead. The Fifth Circuit disagreed,[431] relying on Section 41.002(c) of the Texas Property Code,[432] which generally provides that a homestead is to be considered rural if the homestead is not served by municipal utilities and fire and police protection at the time the homestead designation is made.[433] Based on the facts in the record, the court concluded that the claimed rural homestead satisfied the requirements of Section 41.002(c).[434]

An interesting feature of *Bradley* appears in footnote 18 of the opinion, where the court recognized that at least one commentator has suggested that Section 41.002(c) may be unconstitutional because the homestead exemption under the Texas constitution provides that a rural homestead is one not located in a *city, town or village,*[435] and Section 41.002(c) contains no such

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homestead was neither owned nor occupied by the owner and the owner actually and openly occupied the non-designated tract as his homestead.

428. *Bradley*, 960 F.2d at 508. *See also, Kennard*, 970 F.2d 1455 ("investigation of intention need not be made when the land is actually put to homestead uses") (quoting Lifemark Corp. v. Merritt, 655 S.W.2d 310, 314 (Tex. App.—Houston [14th Dist.] 1983, writ ref'd n.r.e)). The *Bradley* court noted that under certain circumstances evidence of objective intent may be required notwithstanding the owner's showing of homestead usage. 960 F.2d at 508. The court provided several examples. First, if an owner owns several two hundred acre tracts of land and uses them all for homestead purposes, the owner would be required to produce evidence of which two hundred tract of land the owner intended to be a homestead. Second, if a claimant owned a tract of land in excess of two hundred acres and used the entire tract for homestead purposes, the claimant would be required to produce evidence of which two hundred acres within the tract that the owner intended to be a homestead. *Id.* at n.9.

429. TEX. CONST. art. XVI, § 51; TEX. PROP. CODE ANN. § 41.002(b) (Vernon Supp. 1993).

430. TEX. CONST. art. XVI, § 51; TEX. PROP. CODE ANN. § 41.002(a) (Vernon Supp. 1993).

431. 960 F.2d at 511.

432. TEX. PROP. CODE ANN. § 41.002(c) (Vernon Supp. 1993).

433. The Fifth Circuit notes that § 41.002(c) may not displace (and the authors believe that § 41.002(c) should not displace) the traditional common law approach as to the nature and characteristics of a rural homestead. *Bradley*, 960 F.2d at 511, 512 n.18. TEX. PROP. CODE ANN. § 41.002(c) (Vernon Supp. 1993) provides that "[a] homestead is to be considered rural, if . . ." it meets the requirements of that section, but in no way indicates that a homestead will be considered a homestead only if it meets the requirements of that section. See the discussion concerning the common law character of a rural homestead in *In re* Mitchell, 132 B.R. 553, 557 (Bankr. W.D. Tex. 1991).

434. *Bradley*, 960 F.2d at 511-12.

435. TEX. CONST. art. XVI, § 51 (emphasis added).

requirement.[436] The commentator argues that Section 41.002(c) constitutes a definition of rural homestead contrary to that provided in the Texas constitution, thereby resulting in a possible abuse of authority by the Texas legislature.[437] The court quickly dismissed the commentator's concern,[438] observing that the terms city, town and village are not defined in the Texas Constitution and in such a case the legislature is permitted to provide a definition that constitutes a reasonable interpretation of the constitutional language and does not do violence to the plain meaning and intent of the constitution.[439] In the Fifth Circuit's opinion, Section 41.002(c) is a reasonable interpretation of the constitution and does not do violence to the plain meaning and intent of the constitution and accordingly is a proper exercise of authority by the legislature.[440]

The homestead exemption provided under the Texas constitution runs in favor of a family and a single adult person.[441] The constitution does not, however, provide a definition for family. In applying the homestead exemption, Texas courts hold that the family relation is one of status and that status will be attained if the head of the family is legally or morally obligated to support at least one other family member and such other family member must depend on this support.[442] Moreover, Texas courts have expressly recognized that a family may exist even if the head of household is an unmarried person.[443] The single adult person (other than an unmarried head of

436. *Bradley*, 960 F.2d 511 n.18 (citing McSwain, *The Texas Business Homestead in 1990*, 42 BAYLOR L. REV. 657, 661 (1990)). At least one court has recognized this concern and accordingly treats § 41.002(c) as a rebuttable presumption. *In re* Mitchell, 132 B.R. 553, 568 (Bankr. W.D. Tex. 1991).

437. McSwain, *supra* note 436, at 661.

438. *Bradley*, 960 F.2d at 511.

439. *Id.* at 511, n.18 (citing Swearingen v. City of Texarkana, 596 S.W.2d 157, 160 n.1 (Tex. Civ. App.—Texarkana 1979, writ ref'd n.r.e.)). *Swearingen* relied on San Antonio Conservation Society, Inc. v. City of San Antonio, 455 S.W.2d 743 (Tex. 1970), but this case provides no inferential support for the cited principle since it does not involve any issue of constitutionality.

440. *Bradley*, 960 F.2d at 511. The authors agree with the Fifth Circuit's conclusion that § 41.002(c) is constitutional. As stated by the Fifth Circuit, the constitution does not define a city, town or village, thereby leaving the courts in a position of having to provide an interpretation of the intent of the constitutional provision. *Id.* at 512. Texas cases have held that where a rural homestead is brought within a city's boundaries through an extension of the city's corporate lines, the mere fact that the rural homestead is within the city's boundaries will not cause the homestead to lose its rural character. Laucheimer v. Saunders, 97 Tex. 137, 76 S.W. 750 (1903); Wilder v. McConnell, 91 Tex. 600, 45 S.W. 145 (1898). In addition, several courts have expressly recognized that a rural homestead may be located within the corporate limits of a city, town or village and that an urban homestead may located outside the corporate limits of a city, town or village. Jones v. First Nat'l Bank of McAllen, 259 S.W. 157 (Tex. Comm'n App. 1924, opinion adopted); Commerce Farm Credit Co. v. Sales, 288 S.W. 802 (Tex. Comm'n App. 1926, holding approved); Aetna Ins. Co. v. Ford, 417 S.W.2d 448 (Tex. Civ. App.—Eastland 1967), *rev'd on other grounds*, 424 S.W.2d 612 (Tex. 1968); *In re* Moody , 77 B.R. 580, 592 (Bankr. S.D. Tex. 1987). The addition of § 41.002(c) appears in keeping with the foregoing judicial determinations concerning the character of rural homesteads.

441. TEX. CONST. art. XVI, § 50.

442. *E.g.*, Roco v. Green, 50 Tex. 483 (1878); Henry S. Miller Co. v. Shoaf, 434 S.W.2d 243, 244 (Tex. Civ. App.—Eastland 1969, writ ref'd n.r.e.).

443. *E.g.*, Renaldo v. Bank of San Antonio, 630 S.W.2d 638, 689-40 (Tex. 1982); Woods v. Alvarado State Bank, 118 Tex. 586, 19 S.W.2d 35 (Tex. 1929).

household) was not entitled to a homestead exemption until 1973, when both the Texas constitution and the Texas Property Code were amended to provide the homestead exemption to single adults. Section 41.002(b) of the Texas Property Code, which implemented the homestead protection for single adult persons, limits a single adult person's rural homestead to 100 acres, unless that person is not otherwise entitled to a homestead exemption.[444] In *In re Hill*,[445] the creditor in a bankruptcy proceeding argued that the addition of the single adult person as a proper homestead claimant changed the definition of family recognized by the courts to exclude a family unit in which the head of household was an unmarried person. On this basis, the creditor argued that Section 41.002(b) limited the rural homestead that could be claimed by the debtor, an unmarried head of household, to 100 acres. The bankruptcy court disagreed, the district court affirmed and the creditor appealed to the Fifth Circuit.[446] The Fifth Circuit agreed with the bankruptcy court and district court, holding that Section 41.002(b) in no way changed the judicial definition of family that had been consistently applied for many years by the Texas courts.[447] According to the court, the plain language of Section 41.002(b), which applies the 100 acre limitation to "a single adult person, *not otherwise entitled to a homestead*,[448] is clear evidence of the legislature's intent to preserve the judicial definition of family.[449]

VI. LANDLORD AND TENANT

Several landlord-tenant cases decided during the Survey period serve as thoughtful reminders that a lease instrument, unless ambiguous, will be interpreted in accordance with the intention of the parties as expressed within the four corners of the lease.[450] Some other cases also serve as a reminder of the need to draft contractual documents clearly, concisely and unambiguously, failing which at least one party will likely be unhappy with the result. For example, in *Towers of Texas, Inc. v. J & J Systems*,[451] a ground lease provided that the lessee would have the exclusive use of the mountain top

444. TEX. PROP. CODE ANN. § 41.002(b) (Vernon Supp. 1993).
445. 972 F.2d 116 (5th Cir. 1992).
446. *Id.* at 118.
447. *Id.* at 120.
448. *Id.* (citing TEX. PROP. CODE ANN. § 41.002(c) (Vernon Supp. 1993)).
449. *Id.*
450. *E.g.*, Duracon v. Price, 817 S.W.2d 147, 149 (Tex. App.—El Paso 1991, writ denied) (where lease obligated tenant and each assignee to pay for rents and ad valorem taxes, but also provided that neither the tenant nor any assignee of the lessee's interest would have personal liability under the lease, lease unambiguously relieved tenant and any assignee of tenant from any personal liability for payment of rents and taxes); Wadsworth Properties v. ITT Employment and Training Systems, Inc., 816 S.W.2d 819, 822 (Tex. App.—Houston [1st Dist.] 1991, writ denied) (where landlord believed that lease was intended to give tenant right to terminate the lease if, during a specific period of time, a third-party funding commitment to tenant was terminated, but lease [without reference to a period of time] expressly gave tenant right to terminate the lease upon termination of the third-party funding commitment, court concluded that lease unambiguously gave tenant right to terminate the lease if, at any time during the term of the lease, the third-party funding commitment was terminated).
451. 834 S.W.2d 1 (Tex. 1992).

space described in the lease in order to construct and operate a radio transmission tower and prohibited the ground lessor from leasing any space on top of the mountain for any purpose. The lease described the mountain top space by geographical coordinates; however, the actual location of the geographical coordinates was a single point that was located on an inaccessible area on the side of the mountain and that was not a feasible site for construction of a transmission tower. Apparently not understanding the specific mountain area described in the lease and believing that it had the exclusive right to construct and operate a transmission tower on the mountain top area owned by the ground lessor, the ground lessee constructed a radio tower on top of the mountain and not on the specific mountain space described in the ground lease. Thereafter, the ground lessee assigned its interest under the lease to a third party, who apparently failed to have the geographical coordinates specifically located and accepted the assignment on the belief that the ground lease granted the ground lessee the exclusive right to construct and operate a transmission tower on the top of the mountain. However, much to the surprise of the assignee, the ground lessor erected and began to operate a transmission tower very near to the location of the assignee's transmission tower. Understandably chagrined (but perhaps being somewhat embarrassed for failing to verify the location of the geographical coordinates set forth in the ground lease), the assignee brought suit for damages and breach of lease and asserted that the ground lease gave the lessee the exclusive right to use the mountain top to operate a transmission tower.

The trial court found the lease ambiguous but resolved the ambiguity in favor of the assignee.[452] The appellate court reversed, concluding that the reference in the lease to space on top of the mountain violated the statute of frauds, thereby leaving an unambiguous description of the leased space established by the geographical coordinates.[453] On appeal, much to the satisfaction of the assignee, the Texas Supreme Court summarily reversed the appellate court, holding that the lease was ambiguous because the geographical coordinates described a single, inaccessible point on the side of the mountain, while the purpose of the lease was to grant an accessible and appropriately sized area on top of the mountain for the purpose of constructing and operating a radio transmission tower.[454]

Several cases were decided during the Survey period concerning a commercial landlord's liability for personal injury occurring on the leased premises.[455] In *Brownsville Navigation Dist. v. Izaguirre*,[456] the Texas Supreme Court considered whether ground, which becomes soft and muddy due to

452. *Id.* at 2.

453. *Id.* One wonders if, following the appellate court's determination, the assignees became somewhat concerned about whether they had ownership of their transmission tower since, according to the appellate court, the tower was not located on land covered by the lease.

454. *Id.*

455. *E.g.*, Hernandez v. Kasco Ventures, Inc., 832 S.W.2d 629, 632 (Tex. App.—El Paso 1992, no writ) (a landlord who relinquishes control of the leased premises is not liable for personal injuries to tenant's employees caused by defects in leased premises, unless the defect arises out of landlord's failure to make repairs as required by the lease).

456. 829 S.W.2d 159 (Tex. 1992).

rain, could constitute a dangerous condition for which a landlord could be liable under Texas law. In *Izaguirre*, the support legs of a trailer that was to be loaded were lowered on a wooden board because the ground had become soft and muddy due to a rainfall. An employee of the lessee, a company that operated a warehouse business on the leased property, was working inside the trailer when the wooden board beneath the support legs broke, the trailer fell to one side and the cargo shifted, crushing and killing the employee. The employee's estate sued Brownsville Navigation District, the owner of the property upon which the accident occurred, alleging that the owner was liable for the employee's death because the owner (but not the lessee) knew of a dangerous natural condition on the leased premises, and failed to disclose that condition to the lessee. The trial court found in favor of the employee, the appeals court affirmed and the owner appealed to the Texas Supreme Court.[457]

The supreme court recognized the general rule that a lessor of land does not have liability to his lessee or others for injury arising out of a dangerous condition on the leased premises that existed at the time the lessee took possession of the leased premises.[458] However, the court of appeals upheld the judgment against the owner based upon an exception to the general rule that generally provides that if (i) a lessor of land knows of or has reason to know of, and hides or fails to disclose to his lessee, any condition on the leased premises that involves unreasonable risk of physical harm, (ii) the lessor has reason to believe that the lessee would not realize or discover the condition or risk posed by such condition, and (iii) the lessee does not know and does not have reason to know of the condition or the risk, then the lessor is liable to the lessee and his invitees and guests for any physical injury incurred by them as a result of the condition.[459]

Applying these rules to the facts, the supreme court reversed the appeals court, concluding that the ground, in its soft and muddy condition, was like any other ordinary wet dirt and could not constitute a condition that involves unreasonable risk of physical harm or a condition of which the lessee would not have known.[460]

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457. *Id.* at 160.

458. *Id.* (citing RESTATEMENT (SECOND) OF TORTS § 356 (1965)).

459. *Id.* at 160-61 (citing RESTATEMENT (SECOND) OF TORTS § 358(1) (1965)). The appeals court also concluded that the owner incurred liability as a result of failing to advise the deceased or his employer of a prior, similar accident which occurred on the property. According to the supreme court, the court of appeals imposed liability based on the testimony of an employee of the owner who stated that if he had known of the prior accident, he would have disclosed same to the employer. *Id.* The owner's employee further testified that his testimony was his personal opinion and not the policy of his employer. The supreme court concluded that the owner's employee's testimony was merely a personal opinion that did not impose a duty on the employer or a basis for imposing liability on the owner for failure to warn. *Id.*

460. *Id.* Justices Doggett, Mauzy and Gammage dissented, with Justice Doggett writing the dissenting opinion. *Id.* at 161-63. The dissent ridiculed the majority for "dazzling" the dissent with the court's agricultural knowledge, exhibited by the majority's conclusion that the ground was "plain dirt" and just like any other "ordinary dirt" when it became wet. *Id.* at 162. This astute statement, according to the dissent, failed to recognize the many different kinds of soils within the State of Texas and the varying characteristics of each kind of soil. *Id.* at 163. The dissent also complained that the majority failed to properly apply RESTATEMENT

The plaintiffs also asserted that the owner had liability under Sections 360 and 361 of the RESTATEMENT (SECOND) OF TORTS[461] because the owner had retained control over the leased property pursuant to provisions in the lease.[462] The court disagreed, concluding that no provision in the lease gave the owner the right to control the lessee's operations conducted on the property.[463]

Texas courts have followed the rule that a purchaser or assignee of a lessee's entire interest under a lease becomes obligated under the lease for the remaining term thereof, whether or not the assignee expressly assumes the obligations of the tenant under the lease, even when the assignee thereafter assigns its interest under the lease to a third party.[464] In a concurring opinion written over fifty years ago in *Stark v. American National Bank*,[465] an appeals court justice urged the Texas Supreme Court to re-examine the Texas rule regarding the liability of an assignee of a leasehold estate and consider adopting a "rule of decision promulgated in keeping with the great weight of authority and which it is believed is more consistent with the principles of justice."[466] The authors are not aware of any Texas Supreme Court decision that re-examines the rule of law recognized in *Stark*. However, in the Survey case *Armstrong Forest Products v. Redempco, Inc.*,[467] the Texarkana appeals court either nimbly avoided or elected to walk over the rule recognized in *Stark*.

In *Redempco*, the owner of property entered into a ground lease with a third party. The lessee then assigned the leasehold estate to another party. In connection with the assignment, the original lessee sold certain personal property and took back a promissory note secured by a deed of trust executed by the assignee and covering the leasehold estate. The first assignee

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OF TORTS § 358(1) (1965) by concentrating on the condition and not whether the deceased or his employer were aware of the risk that was involved. *Id.* The dissenters' opinion begs the question, since the inquiry under § 358(1) first requires the existence of a condition which involves an unreasonable risk of physical harm and this was found by the majority not to have existed.

461. RESTATEMENT (SECOND) OF TORTS §§ 360-61 (1965), which generally provide that a landlord who leases part of his property and retains control over any other part that his lessee is entitled to use or that is necessary to the safe use of the leased property is subject to liability to his lessee and others upon the land with the consent of the lessee or sublessee for physical harm caused by conditions upon the property under the landlord's control, if the landlord could have discovered the condition by the exercise of reasonable care and could have made the condition safe.

462. The plaintiff also argued that the owner retained control over the property because the owner, a governmental authority, had the regulatory authority to enact ordinances governing the property and its uses. The court agreed that it was possible for the owner to regulate the lessee's operations, but concluded that the owner was immune from liability for its discretionary exercise of its regulatory power under § 101.021 of the Texas Civil Practices and Remedies Code. *Izaguirre*, 829 S.W.2d at 161.

463. *Id.*

464. *E.g.*, Carter v. Stovall 291 S.W.2d 411, 413 (Tex Civ. App.—Amarillo 1956, writ ref'd n.r.e); Waggoner v. Edwards, 83 S.W.2d 386, 388 (Tex. Civ. App.—Amarillo 1935, writ ref'd). *But see*, Armstrong Forest Products v. Redempco, Inc., 818 S.W.2d 446 (Tex. App.—Texarkana 1991, writ denied).

465. 100 S.W.2d 208 (Tex. Civ. App.—Beaumont 1937, writ ref'd).

466. *Id.* at 212-13.

467. 818 S.W.2d 446 (Tex. App.—Texarkana 1991, writ denied).

then assigned the leasehold estate (and the personal property) to another party, who took subject to the existing note and deed of trust and who also executed a deed of trust covering the leasehold estate to secure payment of the prior promissory note. The second assignee defaulted on the note, the second deed of trust was foreclosed and the defendant purchased the leasehold estate at the foreclosure sale without expressly assuming the obligations of the lessee under the lease. Subsequently, the defendant purchaser sold and assigned the leasehold estate to a third party and in connection therewith took back a note secured by a deed of trust lien against the leasehold estate. Thereafter, the assignee defaulted and the defendant foreclosed against the leasehold estate. Subsequently, the defendant again assigned the leasehold estate to yet another party, and in connection therewith received a note, secured by a deed of trust against the leasehold estate.[468] Several years later, the lessor under the lease declared the lease to be in default, terminated the lease on account of the default and then brought suit against the defendant and others seeking payment of rentals which had accrued, but which were not paid, after the defendant had sold the leasehold estate.

The trial court found that the defendant had not assumed any obligations under the lease and that the defendant had not become an assignee of the lease by purchase of the leasehold estate at the foreclosure sale.[469] The lessor appealed, but without success. Without citing any precedential support or the rule recognized in *Stark*, the appeals court upheld the judgment of the trial court, stating that the defendant had not executed a document assuming the obligations of the lessee under the lease and that certain answers made by the lessor in requests for admissions were probative evidence supporting the trial court's conclusion that the defendant had not assumed the obligations of the lessee under the lease.[470] The lessor argued that under *Amco Trust, Inc. v. Naylor*,[471] the defendant, as a matter of law, was an assignee under the lease and therefore liable for the payment of all rents accruing from and after the date of assignment.[472] In *Naylor*, the Texas Supreme Court concluded that a mortgagee, who as a mortgagee in possession, took possession of property covered by a lease that had been assigned to the mortgagee as additional collateral, did not become an assignee of the lease and therefore was not liable to the lessor for rentals due thereunder.[473] In so concluding, the court specifically noted that the mortgagee did not possess the property by reason of the foreclosure of its lien or by acquiring the entire leasehold interest in any other manner.[474] The defendant argued

468. Several subsequent assignments occurred, but are not relevant to the issues of the case.
469. *Redempco*, 818 S.W.2d at 449.
470. *Id.* at 449-50. The facts show that the lessor had answered certain requests for admissions to the effect that the lessor did not have a document in its possession pursuant to which the defendant purchaser assumed the lease obligations, that the purchaser had not orally assumed the lease and that the lessor had permitted the purchaser to possess the premises without requiring the purchaser to execute an assumption agreement.
471. 159 Tex. 146, 317 S.W.2d 47 (1958).
472. *Redempco*, 818 S.W.2d at 450.
473. *Naylor*, 317 S.W.2d at 51.
474. *Id.*

that by negative inference, the Texas Supreme Court had stated that if the mortgagee had foreclosed its lien, the mortgagee would have become the assignee of the lease and liable for the payment of rent thereunder.[475] Without agreeing or disagreeing with the defendant's argument, the appeals court noted that the original deed of trust lien against the leasehold estate remained outstanding and that the defendant therefore had not acquired the entire interest of the leasehold estate.[476] The authors have some difficulty with the court's conclusion that the prior deed of trust constituted a reservation of a portion of the leasehold estate that destroys the ability to have an assignment of the lease. If the court's conclusion is correct, logic dictates that a holder of a leasehold estate who burdens that estate with a third party lien is also barred from making an effective assignment of the leasehold estate to a third party. This is not the law in Texas.

Several other landlord-tenant cases were decided during the Survey period, none of which are significant, but some of which serve as helpful reminders. For example, the courts continue to hold that although clauses that prohibit assignment of a lease are generally enforceable in Texas, those clauses may not be enforceable in a bankruptcy proceeding,[477] that a waiver between a landlord and tenant as to insured claims effectively destroys an insurer's subrogation claim,[478] that if a tenant holds over beyond the term of its lease and such holdover is prohibited under the terms of the lease, the landlord is entitled to the reasonable value of the use of the premises for the holdover period,[479] and that a lease contract must state its duration or provide a certain time for expiration, failing which any person occupying premises covered by the lease is merely a tenant at will.[480]

VII. CONVEYANCING

Several cases decided during the Survey period affirmed time honored

475. *Redempco*, 818 S.W.2d at 450.

476. *Id.*

477. *E.g.*, *In re* Office Products of America, Inc., 140 B.R. 407, 409 (Bankr. W.D. Tex. 1992).

478. *E.g.*, Interstate Fire Ins. Co. v. First Tape, Inc., 817 S.W.2d 142, 145 (Tex. App.—Houston [1st Dist.] 1991, writ denied) (general rule is that release between insured and offending party prior to loss destroys insurance company's rights to subrogation). In *First Tape*, the original lessee had assigned its leasehold interest to a third party, but the original lessee, pursuant to the terms of the lease, remained liable for the performance thereof. Following the assignment, the building was substantially damaged by fire and the insurance company sought to collect from the original lessee, claiming that the current lessee under the lease, but not the original lessee, could take advantage of the release of claims caused by casualty. The appeals court disagreed, concluding that since the original lessee was still liable under the lease, the original lessee should be entitled to the benefits as well. *Id.*

479. *E.g.*, Winters v. Arm Refining Co., Inc., 830 S.W.2d 737, 739 (Tex. App.—Corpus Christi 1991, writ denied) (citing Stewart v. Breese, 367 S.W.2d 72, 74 (Tex. Civ. App.—Dallas 1963, writ dism'd w.o.j.)).

480. *E.g.*, Virani v. Syal, 836 S.W.2d 749 (Tex. App.—Houston [1st Dist.] 1992, writ denied) (citing Holcombe v. Lorino, 124 Tex. 446, 79 S.W.2d 307, 310 (1935)). *But cf.*, Atlas Petroleum Corp. v. Galveston, H. & S.A. R. Co., 5 S.W.2d 215, 219 (Tex. Civ. App.—El Paso 1928, writ ref'd) (where the court held that if a lease is for a term not stated, the implied term will be one year). Although *Atlas Petroleum* has not been expressly overruled, the Texas Supreme Court's decision in *Holcombe* should control.

principles relating to deeds.[481] For instance, Survey cases confirmed that in Texas the recording of a deed is not essential to an effective conveyance,[482] for effective delivery of a deed, the deed must be placed in the control (but not necessarily physical possession) of the grantee with the intent that the deed become operative as a conveyance,[483] a forged deed will not convey title, even to an innocent purchaser who obtains a deed for value and without knowledge of the fraud,[484] a correction deed relates back to the date of the agreement that it purports to express more accurately,[485] and a deed, if unambiguous, will be governed by the intent of the grantor and grantee as evidenced within the four corners of the deed.[486]

Although not a significant case, *Buccaneer's Cove, Inc. v. Mainland Bank*,[487] demonstrates several points: first, a correction deed is probably a misnomer because it may create an ambiguity as opposed to correcting a mistake, and secondly, the need for careful drafting on the part of the practitioner. In *Buccaneer's Point*, a mortgagee foreclosed its deed of trust lien. At the time of the foreclosure, the unpaid debt secured by the mortgage was approximately $925,578. However, the substitute trustee's deed to the lender reflected a bid price of approximately $1,133,409. When the borrower discovered the bid price, the borrower filed suit seeking payment of the difference between the consideration recited in the deed and the outstanding debt. Understandably in a panic, the substitute trustee shortly thereafter executed a correction deed reflecting a bid price of the unpaid debt. Both parties filed a motion for summary judgment and much to the relief of the substitute trustee, the trial court granted the lender's motion.[488]

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481. Specific discussion of cases concerning mineral deeds and mineral reservations have been omitted, as those cases are more appropriately addressed in the article entitled *Oil, Gas and Mineral Law* in this Survey edition. For the reader's convenience, however, we note two significant mineral deed interpretation cases that were decided by the Texas Supreme Court during the Survey period. Luckel v. White, 819 S.W.2d 459 (Tex. 1991) (rejecting a prior rule of interpretation announced in Alford v. Krum, 671 S.W.2d 870 (Tex. 1984), wherein the court had held that where the granting clause conflicted with the future interest clause, the granting clause controlled because it was a key expression of intent, while the future interest clause was a mere redundancy of other provisions in the mineral deed); Jupiter Oil Co. v. Snow, 819 S.W.2d 466 (Tex. 1991).

482. *E.g.*, Rogers v. Shelton, 832 S.W.2d 709, 711 (Tex. App.—Eastland 1992, writ denied) (where a valid deed was delivered to grantee in 1951, but recording was delayed until 1985, the delay in recording did not affect effectiveness of conveyance).

483. *E.g.*, Bellaire Kirkpatrick J.V. v. Loots, 826 S.W.2d 205, 213 (Tex. App.—Fort Worth 1992, writ denied) (where grantor delivered deed to grantee with the express intention of not conveying the property, the deed was not an effective conveyance); Cecil v. Smith, 821 S.W.2d 375, 378 (Tex. App.—Tyler 1991, no writ) (where deed was never placed within the control of the grantee, the deed was not delivered and therefore not an effective conveyance).

484. *E.g.*, *Bellaire Kirkpatrick*, 826 S.W.2d at 210 (where party was conveyed property pursuant to a forged deed, the deed did not convey effective title, even though the grantee paid value for the property without knowledge of the forgery).

485. *E.g.*, Buccaneer's Cove, Inc. v. Mainland Bank, 831 S.W.2d 582, 584 (Tex. App.—Corpus Christi 1992, no writ).

486. *E.g.*, Luckel v. White, 819 S.W.2d 459, 461 (Tex. 1991); State v. Brazos River Harbor Navigation Dist., 831 S.W.2d 539, 542 (Tex. App.—Corpus Christi 1992, writ denied); White v. White, 830 S.W.2d 767, 769 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

487. 831 S.W.2d 582 (Tex. App.—Corpus Christi 1992, no writ).

488. *Id.* at 583.

The substitute trustee's elation and relief were short lived, however, as the appellate court reversed the trial court, concluding that the existence of the original trustee's deed and the correction deed resulted in two deeds reflecting contradictory evidence and a factual dispute, thereby making summary judgment inappropriate.[489] The court accordingly remanded the matter to the trial court for determination by the trier of fact.[490]

Although the Texas Property Code provides, and Texas law has long recognized, that liens and conveyances that are not acknowledged, sworn to or proved and filed for record as required by Texas law will be void as to subsequent purchasers of the property for value and without notice of the preexisting conveyance or lien, several Survey cases show that section of the Texas Property Code does not provide a safe haven for all subsequent purchasers who purchase property for value and without notice of the preexisting lien or conveyance.[491] For example, in *Bellaire Kirkpatrick Joint Venture v. Loots*,[492] the owners of a parcel of property engaged a representative to aid them in selling the parcel. The representative in turn enlisted the services of another party who was familiar with the Texas real estate market. At the suggestion of this third party, the representative requested the owners to convey the property to the representative for the purpose of facilitating a sale to a third party and not with the intent of conveying the property to the representative. The broker engaged by the representative promptly located a purchaser, which must have caused the representative to be pleasantly pleased with himself for making such an astute broker selection. Any pleasure realized by the representative quickly dissapated, however, because the broker forged a deed in the name of the representative, conveyed the property to a company controlled by the broker, caused that company to sell the property to the prospective purchaser and absconded with the proceeds of sale. In an attempt to preserve what it thought to be title to the property, the purchaser brought a trespass to try title action.[493] The trial court ruled that even though the plaintiff was a bona fide purchaser for value and without knowledge of the owners' claim to title of the property, the purchaser did not obtain title to the property because the deed from the representative to the company controlled by the broker was a forgery.[494]

On appeal, the court agreed with the judgment of the trial court, but disagreed with the trial court's determination that the plaintiff was a bona fide

489. *Id.* at 584.

490. *Id.*

491. TEX. PROP. CODE ANN. § 13.001(a) (Vernon Supp. 1993). *See* Hawley v. Bullock, 29 Tex. 216 (1867); Watson v. Chalk, 11 Tex. 89 (1853).

492. 826 S.W.2d 205 (Tex. App.—Fort Worth 1992, writ denied).

493. In a trespass to try title action where the defendant has possession of the property, the plaintiff must show title superior to the defendant's through (i) adverse possession, (ii) title originating from the sovereign and, through a chain of title, resting with the plaintiff, and (iii) a superior title in himself emanating from the same source from which the defendant obtained title. Land v. Turner, 377 S.W.2d 181, 182 (Tex. 1964); Robbins v. Amoco Prod. Co., 952 F.2d 901, 905 (5th Cir. 1992).

494. *Bellaire Kirkpatrick*, 826 S.W.2d at 209. Under Texas law, a forged deed is void, *ab initio*. *See* Pure Oil Co. v. Swindall, 58 S.W.2d 7, 10 (Tex. Comm'n App. 1933, holding approved).

purchaser. The appellate court held that because a forged deed is void and conveys no title, the plaintiff did not purchase the property and therefore could not qualify as a bona fide purchaser.[495]

In the second bona fide purchaser case, *Park Central Bank of Dallas v. JHJ Investments Co. of Little Elm*,[496] an individual purchased several parcels of property and shortly thereafter formed a partnership.[497] The partnership requested its attorney to prepare a deed to transfer the parcels to the partnership. Apparently the deed was never prepared, but the partnership, believing that it had been transferred the property, paid from funds maintained in a partnership bank account the mortgage, real estate taxes and maintenance expenses incurred in connection with the ownership of the property. In addition, each partner of the partnership was assessed their pro rata share of the property expenses and, for federal tax purposes, reported its ownership interest in and income generated by the partnership. Approximately ten years after the formation of the partnership, a lender obtained a judgment against the individual who originally purchased the property, and filed an abstract of judgment and notice of sheriff's sale. When the individual received the notice of sale, he checked the real property records and found that the property had never been transferred to the partnership as requested ten years earlier. To correct the supposed error, the individual executed a deed in favor of the partnership and recorded the deed in the appropriate real property records. Thereafter, the bank foreclosed its judgment lien against the property and the partnership brought suit claiming superior title to the property.[498] The trial court found that the bank had no right, title or interest in the property and ordered the bank to execute a deed conveying the property to the partnership.[499]

The bank appealed, claiming that it was a creditor entitled to protection under the bona fide purchaser provisions set forth in Section 13.001(a) of the Texas Property Code,[500] and that the partnership did not acquire equitable title to the property.[501] The appellate court agreed that the bank was a creditor under Section 13.001(a), but held that the bank was not entitled to rely on the protection of Section 13.001(a) because the section applies only to an

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495. *Bellaire Kirkpatrick*, 826 S.W.2d at 209.

496. 835 S.W.2d 813 (Tex. App.—Fort Worth 1992, no writ).

497. The facts do not indicate who the partners of the partnership were. Presumably the individual was one of the partners since the partnership bore his individual initials.

498. There were several events that occurred prior to the bank's foreclosure, but none are important to the outcome of the case.

499. *JHJ Investments*, 835 S.W.2d at 813.

500. TEX. PROP. CODE ANN. § 13.001(a) (Vernon Supp. 1993), which provides:

> A conveyance of real property or an interest in real property or a mortgage or deed of trust is void as to a creditor or to a subsequent purchaser for a valuable consideration without notice unless the instrument has been acknowledged, sworn to, or proved and filed for record as required by law.

501. The bank also argued that it had no notice of the partnership's claim to ownership before the bank's lien attached to the property. The court summarily dismissed this argument, stating that the bank's knowledge (or lack thereof) of the partnership's claim was irrelevant to the disposition of the case. *JHJ Investments*, 835 S.W.2d at 814.

instrument that conveys an interest in writing.[502] The court reasoned that through its payments in respect of the property the partnership held equitable title to the property as opposed to an interest conveyed by a writing.[503] Moreover, because of the bank's status as a judgment lien creditor, the court did not view the result of the case as unfair, noting that if a judgment lien creditor's lien fails to attach, he loses nothing because his judgment continues to exist without impairment.[504] Several aspects of this case are worthy of discussion. First, if the partnership had received a deed prior to the time the judgment lien attached and had failed to file the deed of record, the lender probably would have prevailed under Section 41.003(a).[505] Second, the holding of this case, as well as cases upon which it relies, addresses claims made by judgment lien creditors as opposed to the rights of an innocent mortgagee or purchaser of land for value without notice of a claim of equitable title being held by a party other than the mortgagor or grantor. The rights of such a purchaser or mortgagee should prevail under the common law.[506]

The doctrine surrounding strips and gores has been a fruitful source of litigation in past years. During the Survey period, one strip and gore case, *State v. Brazos River Harbor Navigation Dist.*,[507] was decided. In this case, the State and a navigation district butted heads over which of them owned a narrow strip of land adjacent to a patent granted by the State many years

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502. *Id.* (citing Texas American Bank/Levelland v. Resendez, 706 S.W.2d 343, 345 (Tex. App.—Amarillo 1986, no writ)).

503. *Id.*

504. *Id.* at 815 (citing *Resendez*, 706 S.W.2d at 346). Certainly the lender may have had different feelings about this observation, if the individual, without the property in which the partnership held equitable title, had few assets with which to satisfy the judgment.

505. *See* TPEA No. 5 Credit Union v. Solis, 605 S.W.2d 381 (Tex. Civ. App.—Waco 1980, no writ) (judgment creditor prevailed over buyer who, at the time of payment of purchase price, received a deed but failed to record same prior to attachment of the judgment creditor's lien).

506. *See, e.g.*, Johnson v. Darr, 114 Tex. 516, 272 S.W. 1098, 1101 (1925) (bona fide purchasers for value are protected against equitable title by doctrine of estoppel, not registration statutes); Federal Life Ins. Co. v. Martin, 157 S.W.2d 149, 152 (Tex. Civ. App.—Texarkana 1941, writ ref'd) (rights of holder of equitable title to real property became inferior to rights of an innocent purchaser or mortgagee for value without notice by allowing naked legal title to remain in another).

507. 831 S.W.2d 539 (Tex. App.—Corpus Christi 1992, writ denied). *Brazos River* also involved the issue of whether a call in a deed constituted a meander line or a true boundary line. If the call constitutes a meander line, the natural object or monument (i.e., a river or stream) will control over specific calls and distances. *Id.* at 542 (citing Howland v. Hough, 570 S.W.2d 876, 882 (Tex. 1978)). Thus, the meander lines that follow the natural object are not to be considered boundaries, but they are to follow the general course of the natural object, which will constitute the real boundary. *Id.* (citing Stover v. Gilbert, 112 Tex. 429, 247 S.W. 841 (Tex. Comm'n App. 1923, opinion adopted)). A call in the deed at issue in *Brazos River* provided in part "[i]n the County of Brazoria on the Gulf Coast . . . [b]eginning at a Cedar post . . . to a post marked 'GM' on the West side and 'B' on the East side about 30 ys. from tide water." *Id.* at 544. The grantee argued that the reference to the Gulf Coast placed the property on the shoreline of the Gulf of Mexico and that the call of 30 ys. from tide water was therefore a meander line. The appellate court disagreed that the term "Gulf Coast" as generally used in Texas refers to a large geographical region of the State generally along or near the Gulf of Mexico. *Id.* The court therefore concluded that it could not infer a border along the shore or that the call parallel to the shore was a meander line. *Id.*

before. The trial court found in favor of the navigation district and the State appealed. On appeal, the navigation district argued that the strip of land, if not specifically conveyed by the patent,[508] constituted a strip and gore that should be included in the grant of patent under the strip and gore doctrine. Although the court recognized that the strip and gore doctrine presumes that, absent an express reservation, a grantor does not intend to reserve a fee in a strip of land adjoining land conveyed by him if the strip ceases to be of use to him,[509] the court concluded that the strip and gore doctrine was not applicable to the case before it because the strip of land adjoined other state-owned beaches and submerged land.[510]

VIII. EASEMENTS AND LATERAL SUPPORT

Easements may be created in a number of ways, including by specific instrument, prescription, implication, necessity, dedication, or statute. Cases decided during the Survey period touch upon most every way to create an easement and therefore constitute a good summary of the laws relating to creation of easements.

In *Johnson v. Dale*,[511] a property owner encumbered its property with an oil and gas lease and in connection therewith granted the lessee the right to use a road that crossed an adjoining property owner's land for the purpose of accessing oil wells on the lessor's land.[512] The adjoining landowner objected to the ongoing use of the road by the lessor and blocked access to the road. Apparently, the lessee and at least one other party who was the owner of real property in the vicinity of, but not adjacent to, the land upon which the road was located filed a declaratory action seeking a determination that they had an easement right to use the road.[513] The easement claimants argued that they were entitled to an easement over the road by reason of an easement granted under a deed to the lessor's predecessor in title. They further argued that they were entitled to an easement under alternate grounds of prescription, implication and necessity. The trial court agreed with the easement claimants in all respects and the owner of the land upon which the road was

508. *See supra* note 507, describing the navigation district's argument that the true boundary line was the shoreline and therefore the strip of land was specifically included in the grant of patent.

509. *Brazos River*, 831 S.W.2d at 544 (citing Strayhorn v. Jones, 157 Tex. 136, 300 S.W.2d 623 (1957)).

510. *Brazos River*, 831 S.W.2d at 544. Practioners interested in the Texas Open Beaches Act, TEX. NAT. RES. CODE ANN. § 1.012 (Vernon 1978) may want to refer to the decision in Hirtz v. State of Texas, 773 F. Supp. 6 (S.D. Tex. 1991), *vacated*, 974 F.2d 663 (5th Cir. 1992). The authors, however, find the case somewhat confusing and the holdings elusive.

511. 835 S.W.2d 216 (Tex. App.—Waco 1992, no writ).

512. Thus, the oil & gas operator's right to use the road was dependent on the lessor's right to use the road on the adjacent property. The lessor's purported right to use the road originated from a deed executed in 1956 by the adjoining landowner's predecessor in title to the lessor's predecessor in title.

513. The facts are not clear from the appellate court opinion, but are reasonably inferable from the synopsis provided by the publisher. It is possible, however, that the owner against whom the easement was claimed filed the declaratory action seeking a determination that the parties claiming the easement were not entitled to same.

located appealed.[514]

The appellate court reversed the trial court's judgment that the easement claimants were entitled to an easement granted under a prior deed.[515] Although the deed granted an easement, the specific location of the easement was not the road or even located on the land upon which the road was located.[516] The easement claimants argued that the description of the deed was in error and could not possibly have been correct because the easement, as described in the deed, could not be extended by a straight line over the lessor's property to the highway to which the easement was to attach. The court, however, determined that the easement description in the deed was unambiguous and therefore the court could not consider extrinsic evidence to contradict the description.[517] Accordingly, the court reversed the trial court's determination that the deed granted the parties a right-of-way easement over the road located on the appellant's land.[518]

Although the appellant won the battle regarding easement by deed, he lost the war. The appeals court concluded that the lessor had an easement by prescription, implication and necessity and that the other landowner whose land was not adjacent to the appellant's land had an easement by prescription.[519] As to easement by prescription, the court noted that under Texas law, a person acquiring an easement by prescription must show open, notorious, continuous, exclusive, and adverse use of the land for the easement purpose for ten years.[520] The court observed that although the evidence did not establish the date that the lessor or other landowners began using the road, the lessor and adjoining landowners each testified that they, their families and others had continuously used the road for over fifty years.[521] In addition, a forty-plus-year-old aerial photograph showed that the road was on the ground, and a thirty-plus-year-old aerial photograph showed that the road connected the lessor's property to a public highway by a county road. The court concluded that these facts "raised a rebuttable presumption that the use [of the road] was non-permissive, under a claim of right, and thus adverse."[522] Observing that the trial court impliedly concluded that the appellant had not rebutted the presumption,[523] the court upheld the trial court's determination that the lessor and other landowner acquired an ease-

514. *Johnson*, 835 S.W.2d at 218.

515. *Id.*

516. The location of the easement described by the deed was actually on another adjoining landowner's property who was not a party to this litigation.

517. *Id.* (citing Smith v. Sorelle, 126 Tex. 353, 87 S.W.2d 703, 705 (1935); Coffee v. Manly, 166 S.W.2d 377, 380-81 (Tex. Civ. App.—Eastland 1942, writ ref'd)). *Cf. supra* note 451, a case in which a lease discussed a specific locatable point by geographical coordinates, but was found to be ambiguous by the Texas Supreme Court because the location would frustrate the purpose of the lease.

518. *Johnson*, 835 S.W.2d at 218.

519. *Id.* at 220.

520. *Id.* at 218 (citing Brooks v. Jones, 578 S.W.2d 669, 673 (Tex. 1979)).

521. *Id.*

522. *Id.* at 219 (relying on Schultz v. Shatto, 150 Tex. 130, 237 S.W.2d 609, 613 (1951)).

523. *See id.*

ment to use the road by prescription.[524]

As to the implied easement, the court stated that an implied easement will exist if the use of the claimed easement is (i) apparent and exists at the time of the severance of the dominant estate (in this case, the lessor's land) from the servient estate (in this case, the land upon which the road was located), (ii) continuous enough to show that the parties intended the easement to pass to the dominant estate, and (iii) reasonably necessary to the comfortable use of the dominant estate.[525] The court concluded that it was clear from the evidence that the lessor's land was conveyed to his predecessors as part of an overall tract, which included the land upon which the road was located, and that at the time of that conveyance the road existed and was the only practicable means of access to the lessor's and the other owner's land.[526] Accordingly, the court upheld the trial court's determination that an implied easement existed in favor of the lessor.[527]

In *Boland v. Natural Gas Pipeline Co.*,[528] a landowner had granted an easement to a pipeline company to construct over her land an initial pipeline and any additional pipelines along routes selected by the company. Pursuant to the easement agreement, the pipeline company constructed an initial pipeline and two subsequent pipelines in different locations on the easement tract. The company wanted to construct a fourth pipeline in another location on the easement tract, but the landowner refused to allow the company to enter the land. The pipeline company sought and was granted injunctive relief and the landowner counterclaimed, requesting injunctive relief and damages. The trial court found that the easement granted a multiple line,

524. *Id.*

525. *Id.* (relying on Drye v. Eagle Rock Ranch, Inc., 364 S.W.2d 196, 207 (Tex. 1962)). The court's requirement that the easement be reasonably necessary for the comfortable use of the dominant estate is contrary to *Drye* and the Texas Supreme Court's opinion in Mitchell v. Castellaw, 151 Tex. 56, 246 S.W.2d 163, 168 (1952), wherein the court adopted a strict necessity standard as to implied easements. The *Mitchell* court noted, however, that even the strict necessity standard is not "hopelessly inelastic for sensible application to varying sets of facts." *Id.*

526. *Johnson*, 835 S.W.2d at 219. As to the necessity issue, the court did not disregard the fact that there was an alternative route over which the lessor and other landowners could access their respective properties from a public road. *Id.* However, the court also noted that the other route of access did not exist at the time the dominant estate was severed from the servient estate and there was no evidence of alternative means of access at that time. *Id.* The court also noted that the alternative means of access was not used under a claim of right and depended on the permission of the owners of the property over which the alternative route was located. *Id.* Given these facts, the *Johnson* court's determination of necessity was probably correct, even under the proper standard of strict necessity adopted by the Texas Supreme Court in *Mitchell*, 151 Tex. 56, 246 S.W.2d 163, 168 (1952).

527. *Johnson*, 835 S.W.2d at 219. On the basis of its findings regarding necessity, *supra* note 526, and relying on Koonce v. Brite Estate, 663 S.W.2d 451, 452 (Tex. 1984), the *Johnson* court also concluded that the lessor was entitled to an easement by necessity. *Johnson*, 835 S.W.2d at 220. The court specifically found that the other landowner was not entitled to an implied easement because there was no evidence that his land was ever in unity of title with the land upon which the road was located. *Id.* (relying on Estate of Waggoner v. Gleghorn, 378 S.W.2d 47, 48 (Tex. 1964); Ulbricht v. Friedsam, 159 Tex. 607, 325 S.W.2d 669, 676 (1959)). The court did not specifically state whether the other owner was entitled to an easement by necessity, but its disposition of the case seems to indicate that it concluded that the other landowner was not so entitled. *See id.* at 220.

528. 816 S.W.2d 843 (Tex. App.—Fort Worth 1991, no writ).

perpetual right-of-way easement in favor of the grantee and the landowner appealed.[529] On appeal, the landowner cited *Houston Pipe Line Co. v. Dwyer*,[530] for the proposition that the location where the company could lay additional lines became fixed and certain at the time the initial line was installed.[531] The Fort Worth court of appeals disagreed, distinguishing *Dwyer* on the basis that the easement grant at issue in *Dwyer* was limited to one pipeline, while the easement before the court permitted multiple pipelines over routes selected by the company.[532] Concluding that the contract was unambiguous, the court determined that as a matter of law the clear intention of the parties as expressed by the contract permitted the construction of multiple pipelines over the areas on the easement tract designated by the company.[533] This case should serve as a reminder to practitioners to explain to their clients the ramifications of granting blanket easements with no express limitations on usage.

At times an express unambiguous easement granted by a written instrument may grant more rights than apparent on its face. For example, in *Grimes v. Corpus Christi Transmission Co.*[534] the landowner granted to the State of Texas an easement for the purposes of "opening, constructing, and maintaining a permanent road."[535] The defendant, a natural gas transmission company, recognized by at least one state agency as an intrastate gas utility,[536] laid a high pressure gas line beneath the road constructed by the state on the easement area granted by the landowner. The landowner filed suit against the pipeline company for trespass, or in the alternative, an unconstitutional taking, claiming that the express purpose of the easement was for a road and that all other purposes were outside the grant. The utility company argued that, as a company transporting gas for public consumption, it had the statutory authority to lay its lines along all public highways.[537] The trial court found in favor of the transmission company and the landowner appealed.[538]

Although the appellate court agreed with the landowner's theory that the scope of an express purpose easement may not be expanded beyond the express purpose,[539] the court found that the scope of the express purpose of the easement was not expanded by permitting the installation of the gas pipe-

529. *Id.* at 844.
530. 374 S.W.2d 662 (Tex. 1964).
531. *Id.* at 666.
532. *Boland*, 816 S.W.2d at 845.
533. *Id.*
534. 829 S.W.2d 335 (Tex. App.—Corpus Christi 1992, writ denied).
535. *Id.* at 336.
536. *Id.* at 339. The company was designated as a "gas utility" by the Railroad Commission of Texas, was granted a permit to lay gas lines and, according to the Railroad Commission's legal division, was an intrastate gas utility pursuant to TEX. REV. CIV. STAT. ANN. arts. 1446e and 6050 (Vernon 1962).
537. The utility company relied on TEX. REV. CIV. STAT. ANN. art. 1436b § 1 (Vernon 1980).
538. *Grimes*, 829 S.W.2d at 336.
539. *Id.* at 337 (citing Coleman v. Forister, 514 S.W.2d 899, 903 (Tex. 1974), *appeal after remand*, 538 S.W.2d 14 (Tex. Civ. App.—Austin 1976, writ ref'd n.r.e.)).

line.[540] The court stated that Texas law recognizes that easements in city streets include the rights necessary to allow the municipality to do those activities incident to maintaining those streets, including laying sewer, gas and water pipelines.[541] In addition, observed the court, the phrase "street purposes" as used in an easement includes the laying of gas lines.[542] These attendant rights, according to the court, are identical whether the municipality owns the fee estate or an easement obtained by condemnation, deed, dedication or prescription.[543]

Phillips Natural Gas Co. v. Cardiff[544] is an interesting case involving the scope and terms of an easement granted by a written instrument and a public utility's ability to enlarge the scope of an easement granted by written instrument. In *Cardiff*, a landowner granted a pipeline company an easement for the purpose of constructing, maintaining and operating a pipeline solely for the purpose of transporting crude oil. The easement holder constructed the pipeline and subsequently sold its easement right and the pipeline to a public gas utility. Following the purchase, the purchaser attempted to negotiate an amendment to the easement with the landowner in order to permit the use of the easement to operate a pipeline to transport gas. The landowner refused to amend the easement, so the utility filed a condemnation action to acquire the right to transport natural gas through the pipeline constructed in the easement area. The trial court signed a condemnation order and writ of possession granting the utility the immediate right to commence using the pipeline to transport natural gas.[545] Subsequently, the trial court granted the landowner's motion for partial summary judgment, ruling that under the terms of the easement agreement, the utility abandoned the easement on or prior to the date it obtained the condemnation order, that the pipeline constructed on the easement area had been forfeited to the landowner and that the utility's condemnation of only the right to transport gas through the pipeline was an improper taking.[546] Not surprisingly, the landowners promptly amended their complaint, alleging trespass, and a jury trial resulted in a substantial award to the landowners.[547] The utility appealed.

On appeal, the utility argued that the easement had not been abandoned under the terms of the easement instrument.[548] The court looked to the

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540. *Id.*

541. *Id.* (relying on Hill Farm, Inc. v. Hill County, 436 S.W.2d 320, 323 (Tex. 1969)).

542. *Id.* (relying on Harris County Flood Control Dist. v. Shell PipeLine Corp., 591 S.W.2d 798, 799 (Tex. 1979)).

543. *Id.* (relying on City of San Antonio v. United Gas Pipe Line Co., 388 S.W.2d 231, 232 (Tex. Civ. App.—San Antonio 1965, writ ref'd n.r.e.); City of Houston v. Fox, 429 S.W.2d 201, 203 (Tex. Civ. App.—Houston [1st Dist.] 1968), *rev'd on other grounds*, 444 S.W.2d 591 (Tex. 1969)). With the court's conclusion that the grant of the easement included the right to lay the pipeline, the issue of whether the installation of the pipeline constituted an unconstitutional taking became moot.

544. 823 S.W.2d 314 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

545. *Id.* at 316.

546. *Id.* The utility promptly amended its original petition in condemnation to obtain the pipeline and the right to use the pipeline to transport natural gas. *Id.*

547. *Id.*

548. *Id.* The landowner argued (and the trial court had agreed) that under the common law a change in the permitted use of the express easement resulted in an abandonment of the

express terms of the easement instrument and concluded that the easement would be deemed abandoned if the pipeline was not operated for the express purpose stated in the instrument for twenty-four consecutive months.[549] The undisputed facts showed that the maximum number of consecutive months that the pipeline had not been operated before the issuance of the condemnation order was seven. Accordingly, the court concluded that at the time the condemnation order was issued the easement had not been abandoned.[550] The court then also noted that the condemnation order did not attempt to abandon the easement, but only enlarged the scope of the easement by permitting the transportation of natural gas through the pipeline. Citing case law for the principle that, under Texas law, the scope of an easement may be increased through condemnation proceedings[551] and that such a condemnation action does not result in an abandonment of the easement,[552] the court reversed the trial court's finding that the easement had been abandoned and that the condemnation of only the right to use the pipeline was an improper condemnation.[553]

IX. LANDOWNER'S RIGHT TO LATERAL AND SUBJACENT SUPPORT

In Texas, an owner of land has the absolute right to lateral and subjacent support of adjoining land.[554] There were several lateral support cases decided during the Survey period, one of which is noted below[555] and another of which is *Vecchio v. Pinkus*.[556] In *Vecchio*, the court addressed the issue of whether an owner could be held liable for a prior owner's excavations that removed the lateral support for adjacent land and caused the adjacent land to slide and collapse.[557] The *Vecchio* court stated that it was unable to locate any Texas cases addressing the specific issue, but observed that several other jurisdictions had addressed the issue and concluded that an owner could not be held liable for a prior owner's acts causing the removal of lateral or subja-

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easement. *Id.* at 317. The appellate court quickly disposed of that argument by concluding that the easement instrument contained terms regarding abandonment and therefore, under Texas law, controlled over the common law. *Id.* (relying on Kothe v. Harris County Flood Control Dist., 306 S.W.2d 390, 393 (Tex. Civ. App.—Houston 1957, no writ)). Although the *Kothe* case does not properly support the court's statement, the case of Harris v. Windover, 294 S.W.2d 798, 800 (Tex. 1956) does provide proper support.

549. *Phillips*, 823 S.W.2d at 318.

550. *Id.*

551. *Id.* (citing, *e.g.*, Brazos River Conservation & Reclamation Dist. v. Allen, 171 S.W.2d 842, 846 (Tex. 1943)).

552. *Id.* at 317-18 (citing City of San Antonio v. Ruble, 453 S.W.2d 280, 283 (Tex. 1970)).

553. *Id.* at 318-19. The court also concluded that the landowner's condemnation damages should date from the date of the issuance of the condemnation order and remanded the case to the trial court for a determination of the condemnation damages. *Id.* at 318.

554. Carpentier v. Ellis, 489 S.W.2d 388, 389 (Tex. Civ. App.—Beaumont 1972, writ ref'd n.r.e.); Whitehead v. Zeiller, 265 S.W.2d 689, 691 (Tex. Civ. App.—Fort Worth 1954, no writ).

555. Corley v. Exxon Pipeline Co., 821 S.W.2d 435 (Tex. App.—Houston [14th Dist.] 1991, writ denied) (an easement holder is entitled to the same right to naturally necessary lateral and subjacent support as is accorded to a fee owner).

556. 833 S.W.2d 300 (Tex. App.—Fort Worth 1992, writ denied).

557. *Id.* at 302.

cent support to adjoining land.[558] The court elected to follow these jurisdictions and accordingly affirmed the trial court's granting of summary judgment in favor of the subsequent landowner.[559]

X. COVENANTS RUNNING WITH THE LAND

Under Texas law, a covenant will run with the land if (i) the covenant touches and concerns the land, (ii) the covenant is related to a thing in existence or specifically binds the parties and their assigns, (iii) the parties to the covenant intend that the covenant run with the land, and (iv) the successor to the burden of the covenant has notice thereof.[560] During the Survey period, courts were twice presented with the issue of whether a particular agreement constituted a covenant running with the land. One of these cases is noted below[561] and the other case is *Wimberly v. Lone Star Gas Co.*[562] In *Wimberly*, the owner of a tract of land entered into an agreement with a public utility pursuant to which the utility could, so long as it operated a specific compressor station, use water from the landowner's water well in connection with that compressor station.[563] The owner of the land then sold the property, and the evidence showed that the purchasers read the water contract and supplied water for twenty-four years to the utility, at which time the purchasers terminated the water contract. The utility sued to enforce the contract, and the trial court granted the utility's motion for summary judgment, permanently enjoining the landowners from stopping the flow of water from the property for the utility's use.[564]

On appeal, apparently not embarrassed by the fact that they had honored the water contract for nearly twenty-five years, the landowners asserted that the water agreement was personal in nature, did not run with the land, and accordingly, was not binding upon them. First, the landowners contended that the water agreement did not confer a benefit to their land. The court summarily stated that the definition of a covenant running with the land does not include such a requirement, but does require that the covenant touch the land.[565] Clearly, the court stated, the requirement that water be

558. *Id.* (citing Keck v. Longoria, 771 S.W.2d 808, 810 (Ark. Ct. App. 1989); Platts v. Sacramento N. Ry., 253 Cal. Rptr. 269, 272 (Cal. Ct. App. 1988); Lee v. Takao Bldg. Dev. Co., 220 Cal. Rptr. 782, 783 (Cal. Ct. App. 1985); Spoo v. Garvin, 32 S.W.2d 715, 716 (Ky. 1930)).

559. *Id.* One justice dissented, stating that he would hold that the duty of lateral support to adjoining land runs with the ownership of the land, reasoning that a purchaser has the ability to inspect the property for defects prior to purchase and therefore should assume the risk of those defects. *Id.*

560. Inwood N. Homeowner's Ass'n v. Harris, 736 S.W.2d 632, 635 (Tex. 1987).

561. Dryden v. Calk, 771 F. Supp. 181 (S.D. Tex. 1991). Dryden is not a good example of a covenant running with the land case as it was more appropriately decided on other grounds.

562. 818 S.W.2d 868 (Tex. App.—Fort Worth 1991, writ denied).

563. Subsequently, the public utility drilled a second water well on the landowner's property and the water agreement was amended to permit the utility to use the water from the second well.

564. *Wimberly*, 818 S.W.2d at 869.

565. *Id.* at 871.

supplied from the land touched the land.[566] Secondly, the landowners argued that the parties could not have credibly intended that the water agreement continue for an indefinite period of time with the price to remain fixed. The court disagreed, stating that the clear terms of the contract provided that it would be binding on the parties' successors and assigns.[567] Accordingly, the court concluded that the water agreement constituted a covenant running with the land and was enforceable against the landowners.[568]

XI. MECHANICS' LIENS

The relation-back doctrine applicable to mechanics' liens has been a fruitful source of litigation over the years. The Survey period contained one interesting relation-back doctrine case. In *Valdez v. Diamond Shamrock Refining and Marketing Co.*,[569] the owner of a 7.9 acre tract of land contracted with a general contractor to construct improvements on 7.1 acres of that land. Shortly thereafter, the contractor entered into a subcontract with a subcontractor to perform work on the 7.1 acres. Following commencement of work by the subcontractor, the owner filed a replat of its land, showing one 7.1 acre tract and one .8 acre tract. Within several months after replatting the property, the owner sold the .8 acre tract to a third party. The subcontractor performed no work on the .8 acre tract and at the time of purchase by the third party, the .8 acre tract was unimproved. Approximately five weeks after the purchase, the subcontractor filed a lien against the property and forwarded all proper notices to the owner of the 7.1 acre tract and the contractor. Subsequently, the subcontractor filed suit against the contractor and the owner of the 7.1 acre tract. The subcontractor was awarded a lien against the entire 7.9 acres, and then sought to foreclose its lien against the .8 acre tract. The trial court ordered judgment in favor of the owner of the .8 acre tract and the subcontractor appealed.[570]

On appeal, the subcontractor argued that the relation-back doctrine entitled the subcontractor to a lien against the .8 acre tract because it was part of the 7.9 acre parcel when the subcontractor commenced its work. Accordingly, under the subcontractor's argument, the subdivision of the 7.9 acre tract and the subsequent sale of the .8 acre tract were irrelevant under the relation-back doctrine.

The appellate court agreed that, under the relation-back theory, the date of perfection of a properly perfected mechanic's lien relates back to the in-

566. *Id.*

567. *Id.* The court acknowledged that the landowners could have argued as a defense that the contract was unconscionable, but provided the court with no authority that would require the utility to plead that the contract was not unconscionable. *Id.*

568. *Id.* The landowners attempted to argue that the utility was in breach of the covenant because it was using some of the water for a residence located near the compressor station. The court recognized, however, evidence that established that the residence was used in connection with and necessary to the operation of the compressor station and was therefore permissible under the terms of the water agreement. *Id.* at 871-72.

569. 820 S.W.2d 955 (Tex. App.—Fort Worth 1991, writ granted).

570. *Valdez*, 820 S.W.2d at 956.

ception of the lien.[571] The court concluded, however, that under the applicable provisions of the Texas Property Code, a subcontractor is required to give written notice of its lien claim to the owner of the property against which the lien is claimed,[572] and in this case the subcontractor had not delivered the statutory notice to the owner of the .8 acre tract.[573] The subcontractor directed the court's attention to several cases that, according to the subcontractor, stood for the proposition that the statutory notice is not required to be given to a subsequent purchaser of the land against which the lien is claimed.[574] The court regarded the cases cited by the subcontractor as inapplicable to the instant case, as in each of those cases there had been sufficient construction on the purchased property to give the purchaser constructive notice of potential lien claims, while under the facts before it, the .8 acre tract was vacant and all work had been confined to the 7.1 acre tract.[575] On this basis, the court concluded that the purchaser of the .8 acre tract was a good faith purchaser for value and without notice of the subcontractor's right to file a mechanic's lien and, accordingly, took the property free and clear of the subcontractor's lien claim.[576]

Despite the court's dismissal of the constructive notice cases, those cases are not, in fact, quite so easily distinguishable. At the time of the sale of the .8 acre tract, the buyer was aware of substantial construction being conducted on the adjoining 7.1 acres and probably knew or at least should have known that the .8 acre tract was separated from the 7.1 acre tract less than two months prior to the sale. Because the lien of a subcontractor not only attaches to the improvements but also to each lot necessarily connected to the improvements,[577] the purchaser of the .8 acre tract would have been prudent to assure itself that no liens could attach to the .8 acre tract. Moreover, the buyer had enough constructive notice to make it aware of the po-

571. *Id.* at 956-57 (citing Diversified Mortgage Inv., Inc. v. Lloyd D. Blaylock Gen. Contractor, Inc., 576 S.W.2d 794, 800 (Tex. 1978)).

572. *Id.* at 957 (citing TEX. PROP. CODE ANN. § 53.056(b) (Vernon 1984 & Supp. 1991)). The current version of § 53.056 requires the notice to go to the owner or the "reputed owner" of the property against which the lien is claimed. TEX. PROP. CODE ANN. § 53.056(b) (emphasis added). The "reputed owner" language did not become effective until September 1, 1989 and therefore was not applicable to the issue in *Valdez*. Presumably, if the "reputed owner" language had been applicable to the issue in *Valdez*, the outcome of the case would have been different.

573. *Valdez*, 820 S.W.2d at 957.

574. *Id.* The following cases were cited by the subcontractor: Inman v. Clark, 485 S.W.2d 372 (Tex. Civ. App.—Houston [1st Dist.] 1972, no writ) (contractor's failure to send notice of lien to subsequent purchaser of newly constructed improvements was not fatal because newly constructed improvements provided constructive notice of contractor's right to file lien affidavits); Contract Sales Co. v. Skaggs, 612 S.W.2d 652 (Tex. Civ. App.—Dallas 1981, no writ) (where subcontractor commenced work on improvements prior to sale to purchaser, evidence precluded the possibility that the owner purchased the property without notice of the subcontractor's potential rights); Wood v. Barnes, 420 S.W.2d 425 (Tex. Civ. App.—Dallas 1967, writ ref'd n.r.e.) (where buyer purchased new improvements before expiration of mechanic's lien filing period, purchaser took property with constructive notice of mechanics lienholders' rights to file liens).

575. *Valdez*, 820 S.W.2d at 957.

576. *Id.*

577. TEX. PROP. CODE ANN. § 53.022(a) (Vernon 1984).

tential for lien claims to be filed. The Texas Supreme Court has granted the subcontractor's application for writ of error, and will likely address the issues raised here, and perhaps others as well.[578]

Unless an owner obtains a bond to pay liens or claims in conformance with the applicable requirements of Subchapter I of Chapter 53 of the Texas Property Code,[579] the owner is required to withhold from the original contractor, until 30 days after the completion of the work, 10% of the cost of the work to the owner for the protection of mechanic's lien claimants.[580] Section 53.106(e) of the Texas Property Code makes it clear that completion of the work means actual completion of the work under the contract, including extras or change orders required or contemplated under the original contract, exclusive, however, of repairs and warranty work.[581] If the owner fails to withhold the required retainage, then the claimants, at least to the extent of the required retainage, have a lien against the improvements and lot or lots necessarily connected thereto.[582]

In *TDIndustries, Inc. v. NCNB Texas National Bank*,[583] the court was asked to determine if "actual completion of the work required under the contract" as used in Section 53.106(e) meant actual completion of all of the work required by the original contract.[584] The facts show that the owner engaged a general contractor to perform certain renovation work. At the time the contractor requested final payment, the owner's architect certified that 100% of the work required by the contract was complete, despite knowing that a pocket door that was required by the original contract had not been installed. Several months thereafter the pocket door was installed by a subcontractor and, within 30 days after the installation of the door, the subcontractor filed a claim against the retainage that the owner was required to withhold from the contractor. The retainage, however, had been previously distributed to the contractor on the 30th day following the architect's certification of completion. The subcontractor filed suit to foreclose its mechanic's lien and the owner countered that the claim was invalid because it had not been timely filed. The trial court agreed with the owner, and the subcontractor appealed.[585]

On appeal, the owner argued that completion of the work, as used in Section 53.106(e), really means substantial completion, because under Texas law substantial completion means full performance by the contractor.[586]

578. 35 Tex. Sup. Ct. J. 642 (April 22, 1992). Since the writing of this article, the Texas Supreme Court has rendered its opinion and has reversed the judgment of the court of appeals. 842 S.W.2d 273 (Tex. 1992). The Texas Supreme Court found for the subcontractor, holding that the subcontractor's lien related back to the entire 7.9 acres. As this decision is after the Survey period, it will be covered more fully in next year's article.

579. TEX. PROP. CODE ANN. §§ 53.202-53.203 (Vernon 1984 & Supp. 1993).

580. *Id.* § 53.101.

581. *Id.* § 53.106(e).

582. *Id.* § 53.105(a).

583. 837 S.W.2d 270 (Tex. App.—Eastland 1992, no writ).

584. TEX. PROP. CODE ANN. § 53.106(e) (Vernon Supp. 1993).

585. *TDIndustries*, 837 S.W.2d at 271.

586. The owner relied on cases that generally hold that if the contractor has substantially completed the work under the contract, the contractor has completed performance under the

The court summarily rejected the owner's position, stating that the cases cited by the owner did not concern the legislative definition of completion of work under Section 53.106(e).[587] Not surprisingly, the court stated that completion of the work means completion of all work except warranty and repair work that is specifically excluded under the statute.[588] The court found no evidence indicating that the installation of the pocket door was repair or warranty work,[589] and accordingly held that the owner failed to hold the required retainage for 30 days after completion of the work required by the contract.[590]

In *Roland v. General Brick Sales, Inc.*,[591] a supplier supplied bricks to an owner of a residential development. The developer used the bricks on various homes within the development, but never paid the supplier. The developer sold several of the homes and thereafter the supplier sought to foreclose its liens against the purchasers of the residences[592] and recover attorneys' fees under Section 53.156 of the Texas Property Code.[593] The trial court entered judgment in favor of the supplier, allowing foreclosure of the lien and holding all lot owners jointly and severally liable for payment of the attorneys' fees.[594] The owners appealed as to the issue of attorneys' fees and collection costs. On appeal, the lot purchasers argued that, because they were not owners at the time the bricks were supplied, they were not in privity of contract with the supplier and therefore could not be liable for the supplier's attorneys' fees. The court summarily rejected the lot purchasers' argument, stating that Section 53.156 clearly provides for the recovery of collection costs and attorneys' fees if the lien is not satisfied within a specific period of time.[595] Relying on a 1988 Dallas court of appeals decision,[596] the court concluded that the statute permitted the collection of attorneys' fees against the owner of the land against which the lien was properly filed and

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contract. The cases relied on were Transamerica Ins. Co. v. Housing Auth. of the City of Victoria, 669 S.W.2d 818, 823 (Tex. App.—Corpus Christi 1984, writ ref'd n.r.e.); Weissberger v. Brown-Bellows-Smith, 289 S.W.2d 813, 816 (Tex. Civ. App.—Galveston 1956, writ ref'd n.r.e.). The owner, however, may under such circumstances recover from the contractor the difference between the value of the work as completed and the value of the work as if it had been fully completed in accordance with the contract. *See* Mancorp, Inc. v. Culpepper, 802 S.W.2d 226, 231 (Tex. 1990); Vance v. My Apartment Steak House of San Antonio, Inc., 677 S.W.2d 480, 482 (Tex. 1984).

587. *TDIndustries*, 837 S.W.2d at 272.

588. *Id.*

589. *Id.* The facts clearly indicate that installation of the pocket door was work required by the original contract and the installation did not occur until after the disbursement of the retainage.

590. *Id.*

591. 818 S.W.2d 896 (Tex. App.—Fort Worth 1991, no writ).

592. The facts do not make clear whether the supplier filed its lien prior to or after the sale of the residences to the individual purchasers.

593. TEX. PROP. CODE ANN. § 53.156 (Vernon Supp. 1993) was amended in 1989, to be effective September 1, 1989. The *Roland* court applied the 1984 version since the contract was executed prior to September 1, 1989. *Roland*, 818 S.W.2d at 897 n.1.

594. *Roland*, 818 S.W.2d at 896-97.

595. *Id.* at 897.

596. Gill Sav. Ass'n v. International Supply Co., 759 S.W.2d 697, 702 (Tex. App.—Dallas 1988, writ denied).

claimed, regardless of whether the owner was a party to the original contract.[597]

As to the issue of joint and several liability, the purchasers argued that the supplier should be obligated to segregate the attorneys' fees and collection costs as to each owner and that each owner should be liable for only their respective segregated portion of attorneys' fees and collection costs. The court disagreed, holding that joint and several liability for attorneys' fees and collection costs is appropriate where "the claims arise out of the same transaction and are so interrelated that their prosecution or defense entails proof or denial of essentially the same facts."[598]

Under Texas law, a subcontractor performing work on or supplying materials for a public building is prohibited from asserting a mechanic's lien against the building.[599] Though this prohibition can lead to results that seem inequitable, it is well established. For example, in *Heldenfels Brothers, Inc. v. City of Corpus Christi*,[600] the city engaged a general contractor to construct a building on city land and, in connection with that engagement, the city required the general contractor to provide a statutory payment bond as required by article 5160 of the Revised Texas Civil Statutes.[601] The general contractor delivered to the city bonds that facially appeared to comply with the statutory requirements, but it was subsequently discovered that the bonds were fraudulent. The general contractor ultimately abandoned the project, leaving the subcontractor unpaid and no statutory bond to look to for payment. The subcontractor sued the city, alleging that the city had liability for failing to obtain a proper bond as required by article 5160. The Texas Supreme Court agreed that article 5160 required the city to obtain the bond from the general contractor for the benefit and protection of subcontractors, but concluded that the subcontractor could not recover against the city for breach of that obligation because the statute did not provide for recovery.[602]

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597. *Roland*, 818 S.W.2d at 897. The court spent far too much time resolving this issue. Simply stated, Section 53.156 would be non-sensical if it did not permit the collection of attorneys' fees against the owner of the property against which a lien is properly filed, because the attorneys' fees are incurred in foreclosing a lien against that owner's property, not the property of the prior owner. Perhaps a bit more interesting issue is whether Section 53.156 permits the mechanic's lienholder to seek recovery of fees against the original owner, to the extent those fees are attributable to the foreclosure of subsequently sold lots. Under that portion of the *Roland* court's decision that resolves the issue of joint and several liability for payment of attorneys' fees and collection costs, if the attorneys' fees and collection costs related to the claims of the subcontractor against the various owners are so interrelated that their prosecution or defense involve essentially the same facts, the prior owner could be exposed to liability for the fees.

598. *Roland*, 818 S.W.2d at 898 (quoting *Gill*, 759 S.W.2d at 705-06).

599. *E.g.*, City of Corpus Christi v. Acme Mechanical Contractors, Inc., 736 S.W.2d 894, 897 (Tex. App.—Corpus Christi 1987, writ denied).

600. 832 S.W.2d 39 (Tex. 1992).

601. TEX. REV. CIV. STAT. ANN. art. 5160 (Vernon 1987). The current version of article 5160 became effective September 1, 1991. Accordingly, the court used the version of article 5160 that became effective September 1, 1989.

602. *Heldenfels*, 832 S.W.2d at 42. The current version of article 5160 became effective September 1, 1991 and addresses the inequity created under facts similar to those in *Heldenfels*, by adding a provision that provides that if a governmental authority fails to obtain

Although the legislature has resolved the inequity posed by *Heldenfels*,[603] additional inequities may be experienced because of a subcontractor's inability to file a lien against a public project. For example, in *City of LaPorte v. Taylor*,[604] a subcontractor was engaged by a general contractor to perform work on a city-owned swimming pool, and the general contractor provided the city with the statutory payment bond required by article 5160. The general contractor ultimately defaulted and went into bankruptcy without paying the subcontractor any amounts due him. The subcontractor provided notice to the city and the surety who had issued the required statutory payment bond, and the city withheld funds from the general contractor sufficient to pay the subcontractor's claim. A number of months passed, during which the subcontractor received only a small partial payment from the surety. Apparently feeling ignored, the subcontractor filed suit against the city and the surety. However, several months after the filing of the suit, the surety was placed into receivership, leaving the subcontractor without its most likely source of payment and the city with an uncompleted project and without sufficient funds (including the retained funds) to complete the project. Thereafter, the trial court entered a judgment in favor of the subcontractor, holding the city, the surety and the general contractor jointly and severally liable to the subcontractor for the amount of its lien and attorneys' fees.[605] The city and surety appealed.

According to a majority of the court, the subcontractor's claim against the city was based on an equitable lien against the project funds in an amount necessary to pay the subcontractor's lien claim.[606] The subcontractor claimed it had a better right to the retained funds than did the city, since it had placed its claim on the funds prior to the time the surety went bankrupt. Although an interesting argument, the court totally rejected the subcontractor's theory, relying on *Heldenfels*.[607] The court reasoned that if the city could not be sued for failing to obtain the required bond from the general contractor, it surely could not be liable merely because the surety became insolvent.[608]

XII. TITLE INSURANCE

The world of title insurance and escrow responsibilities covers a broad range of law that is beyond the scope of this article. However, we note that several cases were decided during the Survey period dealing with scope of

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from the contractor the required bond on projects in excess of $25,000, then the authority is liable to the same extent as the surety would have been under a properly issued bond and the claimant is entitled to a lien on the contract funds in the manner as if the contract was a public works contract under $25,000 as described in Subchapter J of § 53.231 of the Texas Property Code.

603. *See supra* note 602.

604. 836 S.W.2d 829 (Tex. App.—Houston [1st Dist.] 1992, no writ).

605. *Id.* at 831.

606. *Id.* at 832. One concurring justice disagreed with the court's statement of the subcontractor's theory of liability. *Id.* at 832-33 (Wilson, J., concurring).

607. *Id.* at 832.

608. *Id.*

coverage,[609] liability of the title insurance underwriter for the acts of the title insurance agent,[610] and the responsibilities of a title insurance agent generally and as an escrow agent.[611]

XIII. EMINENT DOMAIN

There were many decisions during the Survey period concerning a broad range of topics in the area of eminent domain, including (i) the provisions of Section 21.002 of the Texas Property Code,[612] which require a condemnation proceeding pending in a county court to be transferred to a district court if an issue of title is raised,[613] (ii) the admissibility of factors bearing on the valuation decision in a condemnation proceeding,[614] (iii) the period of

609. First Am. Title Ins. Co. v. Adams, 829 S.W.2d 356 (Tex. App.—Corpus Christi 1992, writ denied) (whether an easement that had been granted affected the insured land); Daca, Inc. v. Commonwealth Land Title Ins. Co., 822 S.W.2d 360 (Tex. App.—Houston [1st Dist.] 1992, writ denied) (whether the title insurance coverage required the title insurer to defend a particular defendant).

610. Cameron County Sav. Ass'n v. Stewart Title Guar. Co., 819 S.W.2d 600 (Tex. App.—Corpus Christi 1991, writ denied).

611. *Id.*; Bell v. Safeco Title Ins. Co., 830 S.W.2d 157 (Tex. App.—Dallas 1992, writ denied). *See also* Pack v. First Fed. Sav. & Loan Ass'n of Tyler, 828 S.W.2d 60 (Tex. App.—Tyler 1991, no writ) (discussing general responsibility of an escrow agent).

612. TEX. PROP. CODE ANN. § 21.002 (Vernon 1984).

613. Christian v. City of Ennis, 830 S.W.2d 326 (Tex. App.—Waco 1992, no writ) (under Section 21.002 of the Texas Property Code, if an issue of title is raised in a condemnation proceeding pending in county court, then that proceeding must be transferred to district court; therefore, where an intervening party claimed ownership of an interest in an air easement above land being condemned and county court did not transfer the proceeding to district court, county court committed reversible error).

614. *E.g.*, Wegner v. State, 829 S.W.2d 922 (Tex. App.—Tyler 1992, writ denied) (a jury, though not bound by testimony of expert witnesses, may not leap entirely outside of the evidence presented to them; therefore, court reversed jury award of $30,000 when the two testifying expert witnesses opined values of $97,894 and $99,000, respectively); State v. Tigner, 827 S.W.2d 611 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (notwithstanding existence of restrictive covenants that limited use of condemned property for residential purposes, condemnee's valuation expert was allowed to give his opinion that there existed a reasonable probability that the current residential use of the condemned property would be allowed to change to commercial use in the near future); State v. Resolution Trust Corp., 827 S.W.2d 106 (Tex. App.—Austin 1992, writ denied) (condemnee's expert opinion as to value of whole property and value of remainder based partially on unaccepted offer to purchase the whole property was admissible, even though unaccepted offer would not have been admissible as separately presented evidence); State v. Munday Enters., 824 S.W.2d 643 (Tex. App.—Austin 1992, writ requested) (in condemnation case involving raising of traffic lanes of highway abutting landowner's business, landowner permitted to show reduction of market value of remainder by evidence that [1] access would become more difficult to remainder, [2] visibility of remainder from the road would be substantially decreased and [3] duration of construction activities on the highway project would be a period of years and would interfere with the use of the remainder); Stinson v. Arkla Energy Resources, 823 S.W.2d 770 (Tex. App.—Texarkana 1992, no writ) (in a proceeding involving the condemnation of a natural gas pipeline right-of-way and the diminution as to the remainder, [1] condemnee not permitted to introduce evidence of 200 pipeline failures because condemnee failed to show fear in the minds of buying public and [2] condemnee not permitted to introduce evidence of any pipeline failure unless the failures concerned pipelines having characteristics similar to the characteristics of the pipeline to be installed in the condemned right-of-way); All Am. Pipeline Co. v. Ammerman, 814 S.W.2d 249 (Tex. App.—Austin 1991, no writ) (in a proceeding involving crude oil pipeline right-of-way, evidence that 27 oil spills could be expected along the pipeline to be installed across the condemnee's property and other properties was admissible because it showed either an actual danger that forms the basis of fear or a type of fear that is reasonable).

time within which a condemnee must object to a special commissioner's award under Section 21.018(a) of the Texas Property Code,[615] (iv) the requirement under Section 21.012(a) of the Texas Property Code[616] that a condemning authority may file a condemnation proceeding only if it is unable to agree with the owner of the property on the amount of damages,[617] and (v) the distinction between actions of a governmental entity that constitute a taking versus negligence.[618] The Texas Supreme Court was especially busy,

615. John v. State, 826 S.W.2d 138 (Tex. 1992) (the time within which a condemnee must object under § 21.018(b) of the Texas Property Code is tolled until the clerk of the commissioner's court sends the notice required by § 21.049 of the Texas Property Code); TEX. PROP. CODE ANN. § 21.018 (Vernon 1984).

616. TEX. PROP. CODE ANN. § 21.012(a) (Vernon 1984).

617. State v. Hipp, 832 S.W.2d 71 (Tex. App.—Austin 1992, writ denied) ([1] trial judge should determine as a threshold matter, and regardless of whether the determination includes an issue of fact, whether the condemnor has satisfied the pre-requisite to bringing a suit that the parties were unable to agree, [2] in showing that it was unable to agree with the property owner, condemnor is not required to show that it bargained with the owner, but only that the condemnor made a bona fide, good faith attempt to agree with the owner, which standard is satisfied if the condemnor makes a single bona-fide offer to the property owner setting forth the condemnor's good faith belief of the compensation due the property owner, and which standard does not require the condemnor to divulge the basis of its offer, [3] where evidence showed that condemnor instructed appraiser to disregard any diminution in value in direct contravention of condemnor's internal guidelines, the evidence was sufficient to support a finding that condemnor's offer was not a bona-fide offer of its good faith belief of the compensation due the owner), and [4] where evidence showed that the condemnor made a single offer of compensation to property owners, the value determined by the condemnor's appraiser was based on the property being residential and not commercial, the property was zoned residential, several attempts to rezone the property as commercial had failed, and that other residential property owners vigorously protested rezoning the area as commercial, the condemnor's offer was a bona fide offer setting forth the condemnor's good faith belief of the compensation due the property owners); Texas-New Mexico Power Co. v. Hogan, 824 S.W.2d 252 (Tex. App.—Waco 1992, writ denied) (when several persons own interests in the condemned property, the unable to agree requirement is satisfied if the condemnor is unable to agree with any one of the property owners).

618. County of Burleson v. General Elec. Capital Corp., 831 S.W.2d 54 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (where taxing authority seized a mobile home pursuant to §§ 33.21-33.25 of the Texas Tax Code and conducted a summary sale without making an attempt to notify the mortgagee holding a perfected and recorded lien, such action constituted a taking of the mortgagee's interest without compensation, and not negligence); Smith v. Harrison County, 824 S.W.2d 788 (Tex. App.—Texarkana 1992, no writ) (deed fraudulently obtained from an owner by governmental authority could constitute inverse condemnation); Hale v. Colorado River Mun. Water Dist., 818 S.W.2d 537 (Tex. App.—Austin 1991, no writ) (where governmental authority made conscious decision to release quantities of chloride-laden water into a river from which property owner obtained water to irrigate fields, and the property owner was no longer able to use the river water to irrigate its crops because it had become chloride-ladened, an issue of material fact existed as to whether the governmental authority's action constituted a taking, without compensation, of the property owner's riparian right to irrigate its fields with the river water); Shade v. City of Dallas, 819 S.W.2d 578 (Tex. App.—Dallas 1991, no writ) (where evidence showed that [1] property owner's home was significantly damaged due to sewer backups, [2] city found a significant level of grease in the city sewer line, and [3] city did not contend in its motion that any damage caused by the city arose out of its negligence or that the act which was claimed to constitute a taking was not an intentional taking of property for public use, property owner pled facts sufficient to support a cause of action for inverse condemnation and city's motion for summary judgment was improperly granted); Hues v. Warren Petroleum Co., 814 S.W.2d 526 (Tex. App.—Houston [14th Dist.] 1991, writ denied) (a decrease in fair market value of owner's property allegedly resulting from gas leaks and disposal of brine on or nearby the owner's property could not constitute an inverse condemnation of the property).

issuing five opinions, one of which is noted below[619] and three of which are discussed in this section.

Under the Texas Constitution, a landowner is entitled to just compensation for a taking of his property.[620] Generally, just compensation for a partial condemnation is the sum of the value of the condemned portion of the property (including the improvements constructed thereon) and the damage to the remainder caused by the partial condemnation.[621] The Texas Supreme Court has refined these rules by holding that a landowner can agree to waive his claim for damage to the remainder and proceed to trial seeking the value of only the portion taken.[622] In such a case, the trial court should exclude from evidence any enhancement of value to the remainder[623] and, if the property taken has a higher value than the remainder at the time of condemnation, the fair market value of the property taken may not be calculated by averaging the unit value of the entire tract.[624] An appellate court decision recognizes that the market value of the portion taken may be determined without reference to the remainder if the portion taken constitutes a separate economic unit.[625]

Using the foregoing rules and perhaps going beyond them, the Texas Supreme Court decided *State v. Windham*.[626] In *Windham*, a state governmental agency condemned an approximately 110 foot strip of land lying immediately adjacent to a state highway. The strip constituted approximately two acres out of a nineteen acre tract. The special panel of commissioners appointed pursuant to Section 21.014 of the Texas Property Code[627] made an award with which the property owner was displeased. The property owner appealed to the county court, and prior to the trial filed a motion in limine that stipulated to the state's right to condemn the two acre tract, waived his right for damages to the remainder, unilaterally designated a larger strip of land as the economic unit upon which he contended that the value should be based, and sought to exclude evidence of the value of the nineteen acre tract as a whole and the value of the taken portion as a percentage of the whole. The property owner claimed a right to designate the larger tract as an economic unit and the right to exclude the averaging method of determining the market value because the tract condemned by the state was not an economic unit, while the larger designated tract was an economic unit with a highest and best use for commercial development. The

619. City of San Antonio v. Fourth Court of Appeals, 820 S.W.2d 762 (Tex. 1991). This case primarily addresses the sufficiency of a condemnation notice under the notice provisions of the Open Meetings Act, TEX. REV. CIV. STAT. ANN. art. 6252-17, § 3A (Vernon Supp. 1993).

620. TEX. CONST. art. I, § 17.

621. State v. Carpenter, 89 S.W.2d 194, 197 (Tex. 1936).

622. State v. Meyer, 403 S.W.2d 366, 374 (Tex. 1966).

623. *Id.* at 374.

624. *Id.* at 375.

625. *See* City of Tyler v. Brogan, 437 S.W.2d 609, 613 (Tex. Civ. App.—Tyler 1969, no writ). This case and the rule stated in the accompanying text was cited favorably by the Texas Supreme Court in State v. Windham, 837 S.W.2d 73, 76 (Tex. 1992).

626. 837 S.W.2d 73 (Tex. 1992).

627. TEX. PROP. CODE ANN. § 21.014 (Vernon 1984).

trial court granted the landowner's motion and excluded any evidence by the state to support its contention that the economic unit should consist of the entire nineteen acre tract, which, in the state's judgment, had a highest and best use for investment purposes.[628] The trial court entered judgment in accordance with the jury verdict in favor of the property owner and the state appealed.[629] The appellate court affirmed the trial court and the state then appealed to the Texas Supreme Court.[630]

On appeal to the Texas Supreme Court, the state argued that the appellate court erred in holding that the property owner had the unilateral right to designate the appropriate economic unit and that the trial court improperly excluded the state's evidence as to the highest and best use of the nineteen acre tract. In agreeing with the state, the court stated that the jury, in making their determination of market value,[631] should be able to consider all uses to which the property is reasonably adaptable and to which the property is or will, in reasonable probability, be put.[632] In keeping with the definition of fair market value, the court concluded that the jury should be able to consider those uses argued by the condemnor as well as the condemnee, and then accept or reject those positions in making the market value determination.[633] The property owner argued that the state's position was contrary to *Southwestern Bell Telephone Co. v. Ramsey*,[634] wherein the court held that the trial court did not err by permitting the condemnee to designate a larger tract than that which was condemned (but not the entire remainder) for the purpose of obtaining remainder damages.[635] The supreme court distinguished *Ramsey*, however, on the basis that the property owner before it sought to limit the jury's consideration to what he believed to be the economic unit and thereby gain the right to cause the market value of the economic unit to be determined without reference to the remainder, while the property owner in *Ramsey* did not seek to unilaterally designate an economic unit, but rather sought damages for the condemned portion and remainder damages for less than all of the remainder.[636] Without expressly so stating, the Texas Supreme Court appears to be saying that a landowner cannot unilaterally add adjacent land to the condemned portion to create an independent economic unit and thereby take advantage of the rule that permits the value of a condemned portion that is an independent economic unit

628. *Windham*, 837 S.W.2d at 74.

629. *Id.* at 75.

630. *Id.*

631. The court recognized that market value "is the price which the property would bring when it is offered for sale by one who desires, but is not obligated to sell, and is bought by one who is under no necessity of buying it." *Id.* (citing State v. Carpenter, 89 S.W.2d 194, 202 (Tex. 1936)).

632. *Id.* at 77.

633. *Id.*

634. 542 S.W.2d 466 (Tex. Civ. App.—Tyler 1976, writ ref'd n.r.e.).

635. *Id.* at 472.

636. *Windham*, 837 S.W.2d at 77-78. Justice Mauzy dissented, arguing that the method chosen by the landowner in this case was essentially the same as that chosen in the Ramsey case. *Id.* at 79.

to be determined without regard to the remainder.[637]

The *Ramsey* case was again at issue in *State v. Oak Hill Joint Venture*.[638] In *Oak Hill*, the state condemned a strip of the owner's land for the purpose of expanding a state highway that abutted the condemned property. The owner disputed the award made by the special commissioners and appealed to the probate court in which the condemnation proceeding had been instituted. For the purpose of determining damages to the remainder, the owner sought to designate only a portion of the remaining property and exclude all evidence of its ownership of property abutting the designated remainder. The trial court excluded the owner's ownership of the property abutting the designated remainder from the evidence and entered judgment in favor of the owner. The state appealed, arguing that the trial court improperly excluded this evidence.

The appeals court agreed with the state, concluding that evidence of the existence of the non-designated remainder may not be excluded when its existence and potential use are probative of the damages sustained by the designated remainder.[639] The property owner argued that the state's position was contrary to *Ramsey*, wherein the owner was permitted to designate a remainder less than the whole and exclude evidence relating to the portion of the remainder not included in the designated remainder.[640] The court, however, distinguished *Ramsey*, pointing out that the remainder designated by the owner in that case had a higher and best use different from the undesignated portion of the remainder, thereby making any evidence pertaining to the undesignated portion irrelevant as to the designated portion.[641] On the other hand, under the facts before the *Oak Hill* court, the highest and best use for the designated remainder was no different than the undesignated portion of the remainder. In such a case, according to the *Oak Hill* court, the existence of the non-designated remainder could be highly relevant to the damages suffered by the designated remainder.[642]

In *Brown v. United States*,[643] a condemnation case resulting from the

637. *See supra* notes 622-25, 636 and accompanying text.

638. 815 S.W.2d 827 (Tex. App.—Austin 1991, no writ).

639. *Id.* at 832.

640. *Ramsey*, 542 S.W.2d at 472.

641. *Oak Hill*, 815 S.W.2d at 831. The court appears to limit the scope of the *Ramsey* holding by interpreting the case to permit a landowner who designates a remainder less than the whole to exclude evidence relating to the landowner's ownership and the potential uses of the undesignated remainder if the undesignated remainder "lacks any probative value as to the amount of damages sustained by the designated remainder." *See id.*

642. *Id.* The court in *Oak Hill* also reached a determination that the use to which the remainder is ultimately put has no bearing on the pre-condemnation market value of the part taken. *Id.* at 832. This holding appears somewhat contradictory to several statements made by the *Windham* court. First, the *Windham* court stated that the uses to which the "property is reasonably adaptable and for which it is, or in all reasonable probability will become, available in the foreseeable future" are relevant to the issue of market value. *Windham*, 837 S.W.2d at 77. Secondly, the *Windham* court concluded that the condemnor should be allowed to present evidence of the highest and best use as to the entire property if the condemnee seeks to present evidence of market value by using the highest and best use of a tract larger than that taken. *Id.*

643. 263 U.S. 78 (1923).

flooding of a town caused by the construction of a reservoir, the United States Supreme Court reached a holding that is generally known as the substitute facilities doctrine. Specifically, the Court held that because of the peculiar circumstances before it, a "method of compensation by substitution would seem to be the best means of making the parties whole."[644] In two subsequent cases, *United States v. 564.54 Acres*[645] and *United States v. 50 Acres of Land*,[646] however, the Court either obliterated or substantially reduced the availability of the substitute facilities doctrine, at least in federal condemnation cases. In *564.54 Acres*, the Court concluded that there was no reason to treat the condemnees, three non-profit summer camps whose property was being condemned, any "differently from the many private homeowners and other noncommercial property owners who neither derive earnings from their property nor hold it for investment purposes."[647] In *50 Acres*, the Court held that "[n]othing in *Brown* implies that the Federal Government has a duty to provide the city with anything more than the fair market value of the condemned property."[648]

Notwithstanding *564.54 Acres* and *50 Acres*, a private catholic school for girls recently attempted to breath life into the dying substitute facilities doctrine by requesting the Texas Supreme Court to continue recognizing the doctrine in Texas. In *Religious of the Sacred Heart of Texas v. City of Houston*,[649] the City of Houston commenced condemnation proceedings on approximately 1.5 acres of land owned by a private school for girls for the purpose of extending a public street. The condemned 1.5 acres included a parking lot, playground, and building. The condemnation also separated an approximately .7 acre tract from the remaining acreage of approximately 12.7 acres. The school contended that at least one other building would be perilously close to the road and that the remainder of the campus would suffer other damages including noise and air pollution. Following the award of the special commissioners,[650] both the school and the city appealed to the county court. At trial, the city argued that the campus could achieve pre-condemnation utility by the relocation and reconstruction of the buildings on the remaining land within the campus.[651] Arguing that the court should follow the substitute facilities doctrine, the school claimed that, in addition to the award of the special commissioners, the city should be required to pay the school an amount necessary to acquire an adjacent 7.9 acre tract because the remaining land within the campus was not sufficient to achieve pre-condemnation utility.[652] The court followed the school's theory and the jury

644. *Id.* at 82-83.
645. 441 U.S. 506 (1979).
646. 469 U.S. 24 (1984).
647. *564.54 Acres*, 441 U.S. at 514.
648. *50 Acres*, 469 U.S. at 33.
649. 836 S.W.2d 606 (Tex. 1992).
650. *Id.* at 607. The award was a substantial amount, $7,250,000.
651. The city claimed that the cost to perform the relocation and reconstruction would be $4,400,000.
652. The adjoining tract included an apartment complex that would have to be torn down in order to accommodate the relocation of the school facilities. The cost to acquire the apart-

awarded the school nearly the amount the school sought to recover.[653] The city appealed, arguing that the trial court should not have permitted the use of the substitute facilities doctrine. The court of appeals agreed with the city, holding that the substitute facilities doctrine does not apply to private schools.[654] The school, hoping to maintain the utility of its pre-condemnation campus, appealed to the Texas Supreme Court.

On appeal, the school presented two main arguments: first, that the limitations placed on *Brown* in *564.54 Acres* and *50 Acres* were not applicable because in each of those cases there was evidence that the remainder had market value; second, that the court should apply the substitute facilities doctrine as required by the *City of San Antonio v. Congregation of Sisters of Charity*,[655] where the Eastland court of appeals stated that if special damages are suffered by a private school as a result of a condemnation (i.e., fair market value would not be fair and adequate compensation under the existing circumstances), the private school is entitled to the same measure of damages as a public school.[656] The court summarily rejected the school's first argument, stating that it was simply incorrect[657] and that there was no language in either *564.54 Acres* or *50 Acres* that supported such an application of the substitute facilities doctrine.[658] The court further stated that language quoted from the *50 Acres* case "sounds the death knell for the application of the substitute facilities doctrine to private property."[659]

As to the school's argument that *Sisters of Charity* should be followed by the court, the court opined that the case "floats alone in a sea of contrary authority."[660] The court simply was not prepared to apply a doctrine that, by the dictates of the United States Supreme Court, has little vitality.[661]

In *Westgate, Ltd. v. State of Texas*,[662] the majority, according to a dissent-

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ment complex was approximately $12,000,000, bringing the cost to comply with the school's proposal to nearly $20,000,000.

653. *Religious of the Sacred Heart*, 836 S.W.2d at 607.

654. *Id.* at 608.

655. 404 S.W.2d 333 (Tex. Civ. App.—Eastland 1966, no writ).

656. *Id.* at 337.

657. *Religious of the Sacred Heart*, 836 S.W.2d at 609. The court cited language from *564.54 Acres* that reflected that there were 11 recent sales of comparable facilities to establish market value. *Id.* at 610 (citing *564.54 Acres*, 441 U.S. at 513). The court also noted language from *50 Acres* reflecting that there was testimony of comparable sales. *Id.* (citing *50 Acres*, 469 U.S. at 30).

658. *Id.* at 609.

659. *Id.* at 610.

660. *Id.* at 611. The court further noted that the case was decided without citation to authority and had not been affirmatively relied on by any other court. *Id.*

661. A concurring opinion was delivered by Justice Cornyn, who was not prepared to say that there could be no instance where the substitute facilities doctrine should be applied to the taking of private property. *Id.* at 618. Justice Gonzalez wrote a lengthy, critical dissent in which Justice Cook joined. *Id* at 619. Justice Gonzalez thought the case was a simple condemnation case made complex and confusing by the majority. *Id.* The dissent is well reasoned and argued and brings up points that suggest that the majority may have read too narrowly the *564.54 Acres* and *50 Acres* cases. *See id.* at 624-26.

662. 35 Tex. Sup. Ct. J. 1042 (July 4, 1992). Since the writing of this article, the Texas Supreme Court withdrew its original opinion and substituted a new opinion. 843 S.W.2d 448 (Tex. 1992). The Texas Supreme Court affirmed the judgment of the court of appeals on the statutory condemnation claim and inverse condemnation claim, but remanded the case on the

ing justice, warmly embraces bureaucratic bungling that causes millions of dollars of damages to Texas landowners.[663] In *Westgate*, a developer gained city and highway department approval to construct a shopping center. The developer completed construction in the spring of 1985, at which time the developer was made aware that the state and the City of Austin intended to construct a highway extension, a portion of which would cross the shopping center. The general partner of the developer contacted the state highway department, seeking to have this worrisome rumor confirmed or denied. The highway department promptly responded to the developer, confirming that not only would the highway extension pass over a part of the shopping center, but that it would also go through one of the newly constructed buildings. After being overwhelmed by this shocking revelation, the general partner nearly had cardiac arrest when he was also advised that the highway department and the city were both aware of the proposed highway extension and its location when each had approved the detailed plans for the shopping center. Notwithstanding the fact that the shopping center tenants would have the benefit of extremely close access to a newly constructed highway extension, the developer was not deluged with potential tenants for the shopping center, who, it seemed, were concerned about the possible adverse effect that could be created by the construction of the extremely convenient highway extension and the potential loss of their newly leased space to accommodate the highway extension.

By July 1986, the developer had become concerned about the highway department delaying the condemnation process for a considerable length of time and, accordingly, requested an expedited condemnation process because of the financial hardship being caused by the lack of tenants. Acting with the speed of a 500 pound tortoise, the government approved the developer's application for the expedited process in November of 1986 and made its first offer to the developer in June of 1987. The developer rejected the offer and the government continued its break-neck pace with reckless abandon, commencing condemnation proceedings in September 1988. The special commissioners issued their award and the developer appealed to the trial court, claiming inverse condemnation and seeking lost profits for the period from the announcement of the highway extension until the date of acquisition, which was January of 1989. The developer argued and the jury agreed that the government was negligent for failing to warn the developer of the proposed highway when the government approved the developer's plans and that the government unreasonably delayed the acquisition of the property.[664] The trial court entered judgment in accordance with the jury's award, which

issue of damages because of the trial court's failure to submit the damages question to the jury in broad form. This decision will be discussed more fully in next year's Survey Article.

663. *Id.* at 1048. Justice Mauzy, in one of two dissenting opinions, states that the government should be expected to act reasonably, which, in his opinion, it did not do in this case in light of the delay between the announcement of the condemnation and the actual condemnation. *Id.* In Justice Mauzy's opinion, the government's conduct should be reviewed under an objective reasonableness standard, as opposed to the subjective bad faith standard that the majority opinion imposed. *Id.* at 1049. *See infra* note 674 and accompanying text.

664. *Westgate*, 35 Tex. Sup. Ct. J. at 1043.

set damages in the amount of $633,000 for inverse condemnation and $2,734,000 on the developer's statutory claim for condemnation.[665] The government appealed and the court of appeals reversed the trial court on the inverse condemnation claim, concluding that the failure to notify and undue delay did not rise to a level of interference with access to and use of the developer's property to warrant an inverse condemnation award.[666] In addition, the court of appeals concluded that the trial court's submission of two separate questions regarding the measure of damages for the developer's statutory claim was not proper,[667] and that the trial court should have submitted one issue requesting the difference in value between the value of the entire tract without considering the highway project and the value of the developer's remaining property following the condemnation.[668] The developer appealed to the Texas Supreme Court.

The supreme court recognized that an inverse condemnation may occur where the government, without paying adequate compensation, takes or invades property for public use or when it unreasonably interferes with the use or access to the owner's property.[669] The supreme court identified the issue before it as whether an owner could recover for inverse condemnation if "the government has not directly restricted use of the landowner's property."[670] The court defined direct restriction as "an actual physical or legal restriction on the property's use, such as a blocking of access or denial of a permit for development."[671] The supreme court analyzed various Texas appellate court cases and concluded that the appellate courts had never held that a landowner may collect economic damages, such as a reduction in fair market value, where the government has not imposed a direct restriction on the use of the property.[672] The court elected not to deviate from the appellate court cases, and although the supreme court's holding is less than clear, it appears

665. *Id.*

666. *Id.* Curiously, the court of appeals did not reject the inverse condemnation award on the basis that the government was negligent in not informing the property owner of the condemnation. Instead, the court noted that even if the charges of negligence and undue delay were true, there was no inverse condemnation because the city did not physically restrict access or impose any barriers to the property. In addition, although the Texas Supreme Court addressed the negligence issue, the court did not deny the inverse condemnation claim on the basis of negligence, but instead concluded that "the failure to warn, absent any showing of bad faith, was not a taking or damaging of property, since it resulted in no restriction on the property's use." *Id.* at 1047.

667. *Id.* at 1043; *see infra* note 677.

668. *Westgate*, 35 Tex. Sup. Ct. J. at 1047.

669. *Id.* at 1043 (citing, *e.g.*, City of Austin v. Teague, 570 S.W.2d 389 (Tex. 1978)).

670. *Id.* at 1043-44.

671. *Id.*

672. *Id.* (analyzing, *e.g.*, Allen v. City of Texas City, 775 S.W.2d 863 (Tex. App.—Houston [1st Dist.] 1989, writ denied) (where city constructed levee that made owner's property more susceptible to flooding and existence of levy caused market value of owner's property to decrease by 50%, owner was not entitled to damages for inverse condemnation because owner failed to show present interference with the use of the property); City of Houston v. Biggers, 380 S.W.2d 700 (Tex. Civ. App.—Houston 1964, writ ref'd n.r.e.), *cert. denied*, 380 U.S. 962 (1965) (mere passage of ordinance authorizing construction of civic center on owner's property did not constitute a taking because the ordinance did not restrict the owner's use of the property); State v. Vaughan, 319 S.W.2d 349 (Tex. Civ. App.—Austin 1958, no writ) (mere fact that tenant vacated leased premises after becoming aware that leased property was slated for

that by affirmatively answering the issue identified by the supreme court, the court held that if the government has not directly restricted the use of the landowner's property, the landowner cannot maintain an action.[673]

The developer argued that even if most of the government's pre-condemnation actions did not constitute a taking, the government's unreasonable delay in actually acquiring the condemned parcel should constitute a taking. The supreme court disagreed, holding that in the absence of clear constitutional or statutory authority, the court would not interfere with the government's ability to make prudent and well thought out decisions by imposing time constraints on the government.[674] The court reasoned that if the government was subject to liability for unreasonable delay, the government might hasten its review and thereby skew the review process.[675] The court did, however, leave one small opening by reserving the issue of whether a landowner could claim inverse condemnation where the government's bad faith results in economic damage to the landowner, even though the government did not directly restrict the use of the owner's property.[676]

As to the issue regarding the submission of the measure of damages to the jury, the supreme court held that both the trial court and the appellate court erred.[677] The court referred the trial court and the appellate court to the supreme court's decisions in *State v. Carpenter*[678] and *Callejo v. Brazos Electric Power Cooperative, Inc.*[679] In *Carpenter*, the supreme court suggested that three questions regarding market value should be submitted to the jury: (i) the market value of the condemned portion, (ii) the market value of the remainder before the partial taking, and (iii) the market value of the remainder after the partial taking.[680] The court then interpreted its later opinion in *Callejo*, for the proposition that "in the interest of broad-form submission", the three questions raised in *Carpenter* should be reduced to two issues: (i) the market value of the condemned portion, and (ii) the damage to the re-

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condemnation did not constitute taking since the state had not taken nor physically invaded the owner's property)).

673. *Westgate*, 35 Tex. Sup. Ct. J. at 1043-46. *See also* Bell v. City of Waco, 835 S.W.2d 211 (Tex. App.—Waco 1992, no writ) (decrease in market value of land caused by potential restrictive neighborhood conservation did not constitute a present taking and merely constituted noncompensable damages, the risk of which is born by every owner of land).

674. *Westgate*, 35 Tex. Sup. Ct. J. at 1045.

675. *Id.*

676. *Id.* at 1046. Justice Doggett wrote a dissent arguing that the developer had pled bad faith and even if it had not pled bad faith, the court should remand to the trial court to permit the developer to amend its pleadings. *Id.* at 1050-52. The majority concluded that the developer had not pled bad faith and that the court did not elect to exercise its remand authority to permit the developer to amend its pleadings. *Id.* at 1046-47.

677. *Id.* at 1047; *see supra* note 667 and accompanying text. The trial court submitted two questions to the jury, one of which inquired into the pre-taking market value of the entire tract of land, and the other of which inquired into the post-taking market value of the entire tract of land, without any distinction between the condemned portion and the remainder. The court of appeals, on the other hand, held that only one question as to the damages should have been submitted to the jury.

678. 89 S.W.2d 194 (Tex. 1936).

679. 755 S.W.2d 73 (Tex. 1988).

680. *Westgate*, 35 Tex. Sup. Ct. J. at 1047 (citing *Carpenter*, 89 S.W.2d 194, 195-96 (Tex. 1936)).

mainder portion, accompanied by a jury instruction that the damage to the remainder is to be determined by the difference in the pre-taking market value of the remainder tract and its post-taking market value.[681] The court stated that *Callejo* did not change the measure of damages in partial-taking cases.[682] In effect, *Callejo* combined the second and third issues of the *Carpenter* measure of damages to the remainder into a single broad form question to the jury, with an instruction to the jury that it could consider the pre-taking and post-taking market values of the remainder.[683] In the present case, the trial court committed reversible error by not only failing to submit the jury question in broad form by presenting specific questions as to the pre-taking and post-taking market value of the land, but also by failing to identify the correct measure of damages.[684] The court of appeals, on the other hand, incorrectly concluded that only a single question should have been submitted to the jury.[685]

681. *Id.* at 1048.
682. *Id.*
683. *Id.*
684. *Id.*; *see supra* notes 667-73, 677. The trial court's questions failed to separately determine the damages to the condemned tract and the remainder tract, thus resulting in an incorrect measure of damages according to the supreme court's holdings in *Carpenter* and *Callejo*.
685. *Westgate*, 35 Tex. Sup. Ct. J. at 1048; *see supra* notes 667-73, 677. The court of appeals held that a single question as to the difference in the pre-taking market value and post-taking market value of the entire tract should have been submitted. This question, like that of the trial court's, did not separately identify the damages to the condemned tract and the remainder tract.