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## Property

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# PROPERTY

by

*Richard W. Hemingway\**

FROM the literally hundreds of decisions that have been handed down in the real property area by Texas courts in the past year, only the most significant are included in this survey. The decisions selected for discussion are representative of what the Texas courts have been doing in this field. Specific areas included are:

- I. Mechanics' and Materialmen's Liens
- II. Attorney's Fees as Claims for Labor Done and Materials Furnished
- III. Land Development and Contracts of Sale
- IV. Notes and Deeds of Trust
- V. Homestead
- VI. Usury

The cases are discussed in no particular order; however, within each area, supreme court cases generally appear first.

## I. MECHANICS' AND MATERIALMEN'S LIENS

Unquestionably, the most significant case in this area is *Hayek v. Western Steel Co.*,<sup>1</sup> a five-to-four decision with a vigorous dissent, handed down by the supreme court in March 1972. Although some twelve causes of action and different owners were involved, the facts may be simplified. In essence, it was a situation in which an owner of land desired to build an improvement, such as a house or apartment building on the land, and acted as his own general contractor and builder. The owner contracted for the concrete work for a foundation, which would cost some \$50,000. He paid the contractor, but did not pay the materialmen and suppliers who furnished the steel and concrete to the foundation contractor. Unpaid claims of such materialmen and suppliers amounted to some \$20,000. The issue was whether article 5469<sup>2</sup> required that the owner retain either (1) ten percent of the value of the total improvement being built, or (2) ten percent of a particular contract for specific work. In this case ten percent of the total value of the improvement being constructed would exceed the amount of the unpaid claims, but ten percent of the foundation contract, \$5,000, would fall far short of the amount of unpaid claims.

The court held that an owner must retain ten percent of the value of the entire improvement being constructed. There was no question of a lien being created upon the property, as the total amount of liability was covered by a deposit made into the registry of the court. The court noted that it was not the intent of the legislature, in passing the Hardeman Act,<sup>3</sup> to change the concept of the retainage fund as a protection for all claimants, although the Act changed the wording of the former statute concerning retainage from ten

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<sup>1</sup> 478 S.W.2d 786 (Tex. 1972).

<sup>2</sup> TEX. REV. CIV. STAT. ANN. art. 5469 (Supp. 1972).

<sup>3</sup> *Id.* arts. 5452-71, 5472c, 5472d.

percent of the contract price "of such building," to "of such work." The court stated:

The obvious purpose of this statute is to provide, with respect to the construction of any building, a single protective fund equal to ten per cent of the cost or value of the entire building, with *all* complying third party claimants having the right to share ratably in such fund and in a lien to such extent against the entire building. The general class to be protected by this ratable sharing of the fund and lien is comprised of *all* mechanics, artisans and materialmen . . . without regard to whether there be one or multiple original contracts or sub-contracts.<sup>4</sup>

*Hayek* has created obvious problems for an owner who acts as his own general contractor and executes multiple contracts. It appears that the owner must retain ten percent of the total improvement value for thirty days after the completion of the entire project, although this may be several months or years later than completion of any specific work, such as the foundation. But when the owner is retaining payments due to materialmen, what happens if, at the end of the job, payments due to artisans and mechanics have depleted the retained fund so that insufficient money is left for the materialmen? The case seems a misconstruction of the plain working of the statute. A reading of the dissent reveals further problems caused by the decision.

Another supreme court case in the area of mechanics' and materialmen's liens was *Fidelity Deposit Co. v. Felker*.<sup>5</sup> This case dealt with the claim of an electrical contractor involved in the construction of a shopping center. Although a general contractor had been designated, it was found that the electrical contractor had contracted directly with the owner. As this contract had not been abandoned, it was held that he was an original contractor under the Hardeman Act.<sup>6</sup> The general contractor had furnished a payment bond. When he did not receive payment, the electrical contractor made a claim against the surety. The court quoted from the statute<sup>7</sup> and the wording of the bond,<sup>8</sup> and held that the plaintiff could not recover because the bond ran only to sub-contractors and materialmen, not to original contractors. However, the court was careful to emphasize that it was not holding that the payment bond could not be written to cover original contractors. Although some elements of estoppel against the surety may have been present (in that the surety participated in the arrangement of the general contract and its fee was based, in part, on the bid for electrical work by the plaintiff), the estoppel question was not decided by the court, since it had not been pleaded.

In another case dealing with the retainage statute,<sup>9</sup> a materialman brought suit against the landowner and a contractor seeking an accounting for materials furnished in the construction of additions to a lakehouse which was the homestead of the landowner. The contractor had entered into an oral contract with the owner for the improvements and had later defaulted. The

<sup>4</sup> 478 S.W.2d at 794.

<sup>5</sup> 469 S.W.2d 389 (Tex. 1971).

<sup>6</sup> TEX. REV. CIV. STAT. ANN. arts. 5452-71, 5472c, 5472d (Supp. 1972).

<sup>7</sup> 469 S.W.2d at 392.

<sup>8</sup> *Id.* at 393.

<sup>9</sup> *Langford v. Reeves*, 478 S.W.2d 259 (Tex. Civ. App.—Tyler 1972), *error ref. n.r.e.*

plaintiff materialman made no claim for a lien (which he obviously did not have), but claimed that the owner was personally liable because he did not retain ten percent of the contract price, as required by statute.<sup>10</sup> The court held that no personal liability existed; the existence of a valid lien is a condition precedent to the operation of the retainage statute. Since there had been no compliance with the provisions of the statute dealing with the creation of liens upon a homestead,<sup>11</sup> an action to impose personal liability on the owner could not be maintained.

*Fidelity & Deposit Co. v. Industrial Handling Engineers, Inc.*,<sup>12</sup> dealt with a case of first impression under the Hardeman Act. The case involved the question of when the time for notice of nonpayment to a subcontractor begins to run, where the materials at the time of original delivery by the subcontractor are not usable and do not become usable until a later date. The plaintiff, a subcontractor, furnished a platform lift as part of one of the buildings in a shopping center under construction. The lift was delivered to the job by plaintiff in September 1966, but was left in the crate and not installed until November 1966. The delay was due to the time necessary to obtain a transformer needed to make the lift operable. After installation, the prime contractor was billed by the plaintiff, but no payment was made. Notice was given on February 14, 1967, which was timely from the date of final installation, but which was not timely from the date of first delivery on the job site. Suit was brought against the surety on the payment bond. The plaintiff argued that the time for notice ran from the date indebtedness accrued under the statute,<sup>13</sup> *i.e.*, the tenth day of the month following the last month that labor was performed. The court held against the subcontractor; notice was late and not timely. It was stated that notice provisions under the Hardeman Act<sup>14</sup> were now similar to those of the McGregor Act.<sup>15</sup> Notice to the surety did not run from the time of accrual of indebtedness, but from the time of delivery of materials, *i.e.*, ninety days from the tenth day of the month next following each month that materials are delivered in whole or in part.

Another case dealing with the giving of notice<sup>16</sup> involved the McGregor Act. Notice was mailed by the subcontractor on the eighty-ninth day of the notice period and was received by the surety by the ninety-first day. The court stated that it was a case of first impression in this state, and held that notice was given when placed in a properly addressed and stamped envelope and deposited in the mails. The case seems correct, since the statute<sup>17</sup> provides for the mailing of notice, but does not spell out the effect of deposit in the mails. It may be noted that the Hardeman Act expressly provides for this result.<sup>18</sup>

Two relatively minor cases dealt with materialman claimants trying to reach

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<sup>10</sup> TEX. REV. CIV. STAT. ANN. art. 5469 (Supp. 1972).

<sup>11</sup> *Id.* art. 5460.

<sup>12</sup> 474 S.W.2d 584 (Tex. Civ. App.—Houston [14th Dist.] 1971).

<sup>13</sup> TEX. REV. CIV. STAT. ANN. art. 5467 (Supp. 1972).

<sup>14</sup> *Id.* art. 5453 (2) (b) (1).

<sup>15</sup> *Id.* arts. 5160, 5472a, 5472b, 5472b-1.

<sup>16</sup> *Johnson Serv. Co. v. Climate Control Contractors, Inc.*, 478 S.W.2d 643 (Tex. Civ. App.—Austin 1972).

<sup>17</sup> TEX. REV. CIV. STAT. ANN. art. 5160 (1971).

<sup>18</sup> *Id.* art. 5456 (Supp. 1972).

retained funds on public works over \$2,000 that were covered by the McGregor Act. Under this Act, when the contract for improvements involves more than \$2,000, no claim may be made against the land or owner, but the claimant is restricted to rights against the surety on the bond.<sup>19</sup> In the first case<sup>20</sup> the claimant did not give the proper notices but attempted to claim an equitable lien against funds retained by the public authority. The claim was denied. In the second case<sup>21</sup> the materialman also tried to reach funds retained by the public authority, and again was unsuccessful. Here, the notices given to the surety were timely, but the court held they were not in the proper form. The case does not clearly state exactly what was wrong with the form of the notice, but it appears that it was not a sufficiently verified and itemized account. If this is correct, some difference may exist between the McGregor and Hardeman Acts as to the form of notice. In the Hardeman Act the form of notice has been liberalized over that required by the old statutes.<sup>22</sup> The second case also held that where no showing was made that the surety actually received the notice (however it may have been given), it is necessary to show that the notice was sent by registered or certified mail.<sup>23</sup>

In *General Electric Supply Co. v. EPCO Constructors, Inc.*,<sup>24</sup> a case brought in federal court, a dispute over funds retained in the hands of the prime contractor occurred between the materialman-supplier to a subcontractor working on construction of a public school addition and a bank which had taken an assignment of an account receivable from the subcontractor. Both claimants had properly secured their interests: the bank, by perfecting a security interest under the provisions of the Texas Business and Commerce Code; the supplier, under the provisions of the McGregor Act.<sup>25</sup> The court held for the supplier on the rationale that the retainage requirement is designed to protect first the person for whom the work is to be performed and then the performers themselves—laborers and materialmen. The court held that to the extent not specifically displaced by the Uniform Commercial Code, the well-established rule remains in effect—prior claims of laborers and materialmen take precedence over claims of an assignee money lender.

## II. ATTORNEY'S FEES AS CLAIMS FOR LABOR DONE AND MATERIALS FURNISHED

Although two supreme court cases<sup>26</sup> were decided which dealt with the awarding of attorney's fees within the scope of article 2226,<sup>27</sup> only one case

<sup>19</sup> *Id.* art. 5160 (1971).

<sup>20</sup> *Barfield v. Henderson*, 471 S.W.2d 633 (Tex. Civ. App.—Corpus Christi 1971), *error ref. n.r.e.*

<sup>21</sup> *Bunch Elec. Co. v. Tex-Craft Builders, Inc.*, 480 S.W.2d 42 (Tex. Civ. App.—Tyler 1972).

<sup>22</sup> See TEX. REV. CIV. STAT. ANN. art. 5455 (Supp. 1972). See also *United Benefit Fire Ins. Co. v. Metropolitan Plumbing Co.*, 363 S.W.2d 843 (Tex. Civ. App.—El Paso 1962).

<sup>23</sup> 480 S.W.2d at 46.

<sup>24</sup> 332 F. Supp. 112 (S.D. Tex. 1971).

<sup>25</sup> TEX. REV. CIV. STAT. ANN. art. 5160 (1971).

<sup>26</sup> *Pacific Coast Eng'r Co. v. Trinity Constr. Co.*, 481 S.W.2d 406 (Tex. 1972); *Tacker v. Phillips*, 473 S.W.2d 1 (Tex. 1971).

<sup>27</sup> TEX. REV. CIV. STAT. ANN. art. 2226 (Supp. 1972), provides as follows: "Any per-

will be discussed. In *Pacific Coast Engineering Co. v. Trinity Construction Co.*<sup>28</sup> the plaintiff was the fabricator of four large water control gates to be installed into Canyon Dam. He sued for payment on the contract and claimed reasonable attorney's fees, stating that the gates were "material furnished," within the meaning of the statute. The defendant argued that only raw materials came within this definition. The court held for the plaintiff on the basis that the test was whether the litigant furnished the final product or the parts of which the final product was composed. The former does not constitute materials furnished, but the latter does. The court stated that "the completed dam . . . is not 'material furnished.' But the mixed concrete, pipes, steel beams and gates furnished by a subcontractor are 'material furnished' for the completion of the dam."<sup>29</sup> The court further held that the value upon which the amount of attorney's fees are based is that of the item furnished by the subcontractor, not the value of the raw materials furnished to the subcontractor.

### III. LAND DEVELOPMENT AND CONTRACTS OF SALE

An interesting case concerning land development and the Securities Act of 1933<sup>30</sup> is *SEC v. Lake Havasu Estates*.<sup>31</sup> Lake Havasu Estates had sold to investors in excess of \$3,500,000 worth of investment contracts without registration of the offerings with the SEC, despite repeated warnings. The SEC finally filed suit seeking both preliminary and permanent injunctions against the selling of such contracts. Lake Havasu argued that the sales to investors did not involve "investment contracts" as that term is defined in the 1933 Act, and, therefore, were not subject to registration; that the SEC could not show irreparable harm to the public; that return under the investment contracts was not dependent upon the profitability of the business; and finally, that the defendant could stay in business only for some thirty to sixty days if the injunctions were granted.

The court supported the Commission in finding that the contracts constituted securities under the 1933 Act and were subject to registration. Although a return under the contract was not dependent upon the profitability of the business, the court emphasized that the investment of money was in a common enterprise, and the investors were led to expect profits solely from the efforts of promoters or a third party. It was further pointed out that the investors relied solely upon Lake Havasu Estates for (a) selection of land, (b) selection of a purchaser, (c) selection of a specific contract to be sold to the investor, (d) collection agency services, (e) guarantee of monthly payments, (f) guarantee of replacement of land contracts upon default, and (g) transfers and recording. The court found irreparable harm to the public in that some \$3,500,000 of contracts were sold without the protection of the 1933 Act,

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son, corporation, partnership, or other legal entity having a valid claim against a person or corporation for services rendered, labor done, material furnished . . . may, if represented by an attorney, also recover, in addition to his claim and costs, a reasonable amount as attorney's fees."

<sup>28</sup> 481 S.W.2d 406 (Tex. 1972).

<sup>29</sup> *Id.* at 408.

<sup>30</sup> 15 U.S.C. §§ 77a-aa (1970).

<sup>31</sup> 340 F. Supp. 1318 (D. Minn. 1972).

which harm more than offset the hardship to Lake Havasu an injunction might cause.

Attention should be drawn to *Carter v. Barclay*<sup>32</sup> for an example of bad closing technique. Simplifying the facts, closing was made and the purchaser (*P*) gave the seller (*S*) his check. The check represented proceeds from a bank loan, but the note had not been delivered to the bank. *P* and *S* were to meet at the bank the next day. Through a mixup, they did not meet and *S* immediately presented the check for payment, which was refused. *S*, apparently deciding he never wanted to sell the land in question, moved on the land, plowed it up, and removed some improvements which *P* had made. In a suit by *P*, the court found that the deed had been delivered by *S* to *P* and that all provisions in the contract dealing with payment of consideration as conditions precedent to delivery had been merged in the deed, although the contract contained a non-merger clause. The court also found that the tender of *P* was sufficient and *S* had acted fraudulently and with malice toward *P*. As to merger, the case appears to state the Texas rule that the parties have a duty to have the prior contract provisions incorporated in the deed and that failure to do so is sufficient to prevent the contention that the agreement was not merged. Texas does not follow a rule based on the intent of the parties; agreements will be merged unless left out due to a collateral agreement or mistake of the parties.<sup>33</sup> It should be noted that the later problems could have been avoided if all papers had been escrowed until the consideration was paid by the purchaser.

In another case<sup>34</sup> the contract of sale was conditioned upon time being of the essence. It was held that the seller could retain all payments as liquidated damages. The payments made did not exceed a fair rental value of the premises and hence did not exceed the injury suffered by the seller. No pleading or showing was made that the provisions in the contract constituted a penalty.

#### IV. NOTES AND DEEDS OF TRUST

*Bradford v. Thompson*,<sup>35</sup> another case of first impression in this state, was a surprising decision to many who are in the business of loaning money. In this case *O* purchased a home, assuming a second lien note secured by a deed of trust. The note required payments of \$10 per month, and it expressly provided that the payments could be made "on or before" a certain day of each month. After *O* had paid some \$700 on the note, he requested that he be allowed to pay in full. The note holder refused to allow him to do so. As *O* was then some \$420 in advance, *O* stopped all payments. The noteholder foreclosed, bought the property in at the trustee's sale, and later brought suit in trespass to try title. After winning in both the trial court and the court of appeals, the noteholder lost in the supreme court, where it was held that the note was not in default at the time of foreclosure. The plaintiff argued that

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<sup>32</sup> 476 S.W.2d 909 (Tex. Civ. App.—Amarillo 1972).

<sup>33</sup> *Guardian Dev. Co. v. Jones*, 86 S.W.2d 466 (Tex. Civ. App.—Dallas 1935), error dismissed.

<sup>34</sup> *Grant v. Sherwood Shores, Inc.*, 477 S.W.2d 667 (Tex. Civ. App.—Austin 1972).

<sup>35</sup> 470 S.W.2d 633 (Tex. 1971).

under the terms of the note the excess payments were to be credited on principal and did not relieve the defendant from making the regular monthly payments to cover the interest. The supreme court disagreed, stating that excess payments made on an "on or before" note in one month may be applied to satisfy required payments in subsequent months. The question remains of what to do with the excess payments in subsequent months. Apparently when an excess exists for each month in which no payment is made, the outstanding principal must be increased by the amount of interest payable in that month, and the interest for that month is considered paid.

Two minor cases dealt with voidable sales under a deed of trust. In one case<sup>36</sup> notice of acceleration upon default was held not to have been properly made when the mortgagor could not be found, but mail was apparently deliverable at all times even if sent to his old address. Notice by mailing had not been properly attempted. The other case<sup>37</sup> concerned a conflict between the note and the deed of trust as to the amount of attorney's fees payable upon default. It was held that attorney's fees are part of the obligation and are controlled by the terms of the note.

In another case of first impression in Texas<sup>38</sup> the apportionment of a condemnation award between the mortgagor and mortgagee was questioned. The mortgagee held a vendor's lien, which, as is usual, contained no provisions concerning condemnation. The court held that where the condemnation did not impair the security of the mortgagee, under the rule of *Carroll v. Edmondson*<sup>39</sup> the mortgagee had no right to the award. Texas follows the lien theory of mortgages,<sup>40</sup> in that they only constitute a lien on the property, and the mortgagee generally has no right to possession until after foreclosure and sale. However, in Texas, according to *Edmondson* the mortgagee may recover for damages to his security where the acts complained of reduce the value of the property below the amount then due and owing on the debt. This rule has been criticized, since, as a practical matter, the security is impaired when the initial loan ratio has not been maintained. In defining impairment of security for the purpose of sharing in the condemnation award, the court indicated it would take the original loan ratio into account in determining whether security has in fact been impaired. Unfortunately, the supreme court refused to review this case.

## V. HOMESTEAD

A significant decision dealing with the marital homestead was handed down by the supreme court in *Burk Royalty Co. v. Riley*.<sup>41</sup> Blackacre was the homestead of *H* and *W*. A judgment was obtained against *H* and placed on record. *H* and *W* were divorced, and *W* was awarded an undivided one-half interest

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<sup>36</sup> *Lookwood v. Lisby*, 476 S.W.2d 871 (Tex. Civ. App.—Fort Worth 1972), *error ref. n.r.e.*

<sup>37</sup> *Lasater v. Franklin Life Ins. Co.*, 471 S.W.2d 99 (Tex. Civ. App.—El Paso 1971).

<sup>38</sup> *Buell Realty Note Collection Trust v. Central Oak Inv. Co.*, 483 S.W.2d 14 (Tex. Civ. App.—Dallas 1972), *error ref. n.r.e.*

<sup>39</sup> 41 S.W.2d 64 (Tex. Comm'n App. 1931), *judgment adopted*.

<sup>40</sup> *Duty v. Graham*, 12 Tex. 427 (1854).

<sup>41</sup> 475 S.W.2d 566 (Tex. 1972).

in the homestead tract in the divorce decree. *W* later remarried. *W* and her new husband never occupied the old homestead property. For some seven years prior to trial, *W* and her second husband moved around in connection with his Air Force employment. The first husband, *H*, and *W* joined in this litigation to remove the cloud of the judgment against *H* from the old homestead property. On the theory of abandonment, the trial court found against the continued existence of homestead rights in the property after divorce. On appeal it was held that the finding of abandonment was against the preponderance of the evidence and the case was remanded. However, the supreme court reversed the holding of the court of appeals, and the trial court holding was affirmed. The supreme court reasoned that the homestead exemption for the property was lost when *W* moved from the premises, and was not based upon the theory of abandonment.

In deciding the case the court distinguished between the continuing homestead right of a widow and those of a divorced person. Under the Texas Constitution<sup>48</sup> the widow has the right to a homestead exemption for life, a right which will survive remarriage. The court stated that loss of such homestead right may come about through abandonment, but that a mere showing of time away from the property will not be sufficient in itself. If a widow is involved, the burden is on the creditor or other claimant to show abandonment, since the constitution raises a presumption of a continuing homestead right in the widow. The court contrasted the right of the divorced person to a homestead exemption, noting that the homestead rights of the divorced person would last as long as the person remained the head of a family, but not for life. Therefore, when *W* remarried the new husband had the right to designate the homestead, and the intent of *W* became immaterial. Contrary to the rule governing the loss of homestead rights by a widow, mere nonuse after remarriage by a divorced person is sufficient, and abandonment need not be shown. When *W* moved from the old property and no longer used it as the homestead of the new marital unit, the homestead rights of *W* were lost. The court, however, did not expressly indicate what the result would have been if *W* and her second husband had actually occupied the property as their homestead.

## VI. USURY

The case of *Imperial Corporation of America v. Frenchman's Creek Corp.*<sup>49</sup> dealt with (1) whether (a) costs, expenses, and legal fees, or (b) loan or commitment fees constituted front end interest which violated the usury laws of the state, and (2) the effect of a savings clause in the event the sums to be paid were usurious. Simplifying the facts to a great extent, *D* was the builder and owner of a dormitory to be built near the University of Texas campus. The loan agreement provided that *D* would reimburse the lender for costs, expenses, and legal fees not to exceed \$22,500 and to pay a loan or commit-

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<sup>48</sup> TEX. CONST. art. XVI, § 52.

<sup>49</sup> 453 F.2d 1338 (5th Cir. 1972).

ment fee of \$67,500. The deed of trust for the interim financing contained the following savings clause:

No provision of this instrument or of the Notes shall require the payment or permit the collection of interest in excess of the maximum permitted by law. If any excess of interest in such respect is herein or in the notes provided for . . . the provisions of this paragraph shall govern, and . . . the Mortgagors . . . shall not be obligated to pay the amount of such interest to the extent that it is in excess of the amount permitted by law.<sup>44</sup>

When the initial advance was made by the lender both sums were deducted from the amount advanced. Upon later default by *D* and suit by the lender, the defense of usury was asserted. The Fifth Circuit held that the evidence amply supported the finding that the \$22,500 sum for legal fees, expenses of the loan, and other expenses represented bona fide fees for services of the lender's special agents and, therefore, did not constitute interest.

On the other hand, the commitment fee was held to be front end interest, which was usurious but for the fact that the court spread it over the length of the loan due to the presence of the savings clause:

Since the commitment fee is interest by operation of law and not because the parties in their dealings with each other treated it as such, the agreements here do not specify the period for which this interest is considered to be 'payment for the use of money.' If, as in this case, there is a savings clause, Texas courts will give effect to it by spreading over the life of the loan the impact of the judicially determined interest.<sup>45</sup>

Therefore, the only amount in excess of the statutory rate of interest as spread over the life of the loan was considered usurious, a sum of \$3,835.88.

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<sup>44</sup> *Id.* at 1341.

<sup>45</sup> *Id.* at 1343.