



1967

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Recommended Citation

Lennart V. Larson, *Commercial Transactions*, 21 Sw L.J. 124 (1967)
<https://scholar.smu.edu/smulr/vol21/iss1/11>

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COMMERCIAL TRANSACTIONS

by

Lennart V. Larson*

THE Uniform Commercial Code became effective on July 1, 1966.¹ Hence one could not expect appellate cases in the Texas courts during the past year dealing with that legislation. However, a number of cases of interest in the field of negotiable instruments and sales were decided. Some of these made rulings which will endure; other cases will be treated differently under the Uniform Commercial Code.

I. NEGOTIABLE INSTRUMENTS

Exculpatory Provision in Stop Payment Order. The problem of a drawee bank's recovery of funds it paid over a stop-payment order, containing an exculpatory clause, was raised in a civil appeals case.² Walker gave Martin a check for \$350 and later on the same day executed a stop-payment order. The order contained a statement that the bank was not responsible "if such payment is made through inadvertence, accident or oversight."³ Three days later when Martin presented the check for payment, the stop-payment order was overlooked, and Martin received a cashier's check. The bank sued Martin, and the trial court gave judgment for the defendant. On appeal, the judgment was reversed and the case was remanded for a new trial. The court rejected Martin's argument that the bank could show no injury because of the exculpatory provision in the stop-payment order. It was recognized that the authorities were divided as to the validity of the exculpatory provision. The court, however, considered the better view to be that the provision was not supported by consideration and therefore was not binding on Walker. The bank could not have refused to stop payment "even though Walker refused to sign the particular stop-payment order which contained said provision, but instead merely instructed the bank by a written instrument or letter dated and signed and describing the item with certainty, to stop payment thereon."⁴

The Texas Banking Code prescribes that stop-payment orders be in writing and be renewed at sixty-day intervals.⁵ The court was of the

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¹ Texas Acts 1965, ch. 721.

² Central Nat'l Bank v. Martin, 396 S.W.2d 218 (Tex. Civ. App. 1965) *error dismissed*.

³ *Id.* at 220.

⁴ *Id.* at 221. A leading case is Reinhardt v. Passaic-Clifton Nat'l Bank & Trust Co., 16 N.J. Super. 430, 84 A.2d 741 (1951).

⁵ TEX. REV. CIV. STAT. ANN. art. 342-712 (Supp. 1966).

opinion that the bank was negligent as a matter of law and was liable to Walker. It followed that the bank had suffered injury in paying Martin. The payment to Martin was the result of inadvertence or mistake of fact, and the quasi-contractual principle is clear that such a payment can be recovered in order to prevent unjust enrichment if special circumstances do not exist justifying retention by the payee. The court remanded the case for a new trial to allow the bank to prove Martin's unjust enrichment and Martin, in turn, to show that he had changed his position and should be allowed to keep the proceeds of the cashier's check. It was pointed out that even if Martin had to repay the money, he had a cause of action against Walker if the latter had breached his contract in stopping payment on the check.

The court's view of the exculpatory clause seems sound. The remand to determine if Martin had been unjustly enriched or had changed his position can also be approved. The view that receipt of payment on a check is conclusive that the payee has changed his position is unduly rigid and does not, in some cases, square with the facts.

The Uniform Commercial Code now provides for six-month periods in renewing stop-payment orders,⁶ repeating the former provision of the Texas Banking Code.

Recovery of Payment on Forged Checks. The duty of a depositor to ascertain and report forgeries as a predicate to recovery from the drawee bank was considered in a civil appeals decision.⁷ The drawee bank paid forty checks on which the drawer's signature was forged. Within a year of payment of the earliest check, the drawer gave notice to the bank of the forgeries. The drawer sued the bank and recovered judgment, which was affirmed on appeal.

The bank contended that the drawer was negligent in failing to look at its cancelled checks and bank statements. The drawer's notice was given within the period allowed under the Texas Banking Code.⁸ The court said, "By the statute a depositor is given the period of one year, as a sort of statute of limitation. For that period, at least, a depositor is under no duty to examine the statements and cancelled checks and would not be negligent in failing to discover the forgeries."⁹

Certainly, a period should exist after which a depositor should not be heard to claim that his bank has paid a forged or unauthorized check. Does it follow that within the period the depositor cannot be guilty of contributory negligence, especially where a large number of forged checks are paid,

⁶ Texas Uniform Commercial Code, Vernon's Tex. Sess. Law Serv., ch. 721, pt. 4, § 4-403, and art. 10, § 10-102 (1965).

⁷ Hillcrest State Bank v. Evis-Southwest Inc., 402 S.W.2d 276 (Tex. Civ. App. 1966).

⁸ TEX. REV. CIV. STAT. ANN. art. 342-711 (Supp. 1966).

⁹ 402 S.W.2d at 278.

which would defeat his claim? The affirmative answer in the instant case affords a clear-cut rule. But one may wonder whether a depositor should not occasionally look at his cancelled checks and accompanying statements.

The customer's duty to discover and report unauthorized signatures and alterations is dealt with in detail in the Uniform Commercial Code, and the earlier statute is repealed.¹⁰ A duty of reasonable care and prompt examination is imposed on the customer, violation of which excuses the bank from liability for subsequent items forged or altered by the same wrongdoer. A one-year period of limitation is declared with respect to unauthorized signatures and alterations and a three-year period is declared as to unauthorized indorsements.

The court also held that amounts from which plaintiff received the benefits despite the forgery were not recoverable from the bank.

Suretyship. The right of contribution among guarantors of payment was dealt with in a civil appeals case.¹¹ In the absence of express agreement otherwise, their obligations are equal. If one pays all or more than his proportionate part of the main obligation, he can sue each of the other guarantors for contribution, although the latter cannot be held beyond his proportionate share.¹² In the instant case plaintiff paid the entire main obligation and sued one of his two co-guarantors for a forty per cent contribution. Plaintiff's claim was based on the fact that defendant owned forty per cent of the stock of the principal debtor. The court held that in the absence of a provision limiting the liability of the guarantors as among themselves, the normal rule operated and the plaintiff's recovery was limited to one-third of the main obligation.

The vital difference between a surety's right of reimbursement from his principal and a surety's right of indemnity under an express indemnity contract is illustrated in a civil appeals decision.¹³ Aetna executed performance and payment bonds for Sinton Plumbing in favor of general contractors on three construction projects. A contract of indemnity in favor of Aetna was executed by Sinton Plumbing and three individual indemnitors. Sinton Plumbing became bankrupt, and eventually Aetna paid out \$138,000 to finish up Sinton Plumbing's contracts. Aetna sued the individual indemnitors and a judgment of recovery was affirmed.

Contention was made that the indemnity contract was contrary to public policy in allowing Aetna to determine conclusively whether claims should be paid; in making vouchers and affidavits prima facie evidence of losses sustained; in authorizing Aetna to alter and modify obligations without

¹⁰ Texas Uniform Commercial Code, Vernon's Tex. Sess. Law Serv., ch. 721, art. 4, pt. 4, § 4-406, and art. 10, § 10-102 (1965).

¹¹ Miller v. Miles, 400 S.W.2d 4 (Tex. Civ. App. 1966) error ref. n.r.e.

¹² SIMPSON, SURETYSHIP § 49 (1950).

¹³ Ford v. Aetna Ins. Co., 394 S.W.2d 693 (Tex. Civ. App. 1965) error ref. n.r.e.

notice to the indemnitors; in authorizing Aetna to obtain releases and to charge their expense to the indemnitors; and in allowing Aetna to cancel its surety undertaking on ten days' notice. The court rejected the contention, stating that an indemnity contract creates rights broader than the reimbursement rights of a common law surety. Ordinarily, a surety can obtain reimbursement only for payment of legal obligations of the principal debtor. An indemnitee's right is broader, and is determined by the terms of the contract of indemnity. Although payments made in bad faith cannot be recovered by an indemnitee, negligence is not equivalent to bad faith.

A civil appeals case¹⁴ held that a surety's right of subrogation is superior to a garnishment writ sued out by a creditor of the principal debtor. Trinity was surety for Marble in the performance of a contract for the construction of a building for a cooperative. Nine months after the surety contract was entered into, Marble became financially unable to continue the construction work. Marble assigned to Trinity all its rights to payments from the cooperative. Trinity took over the contract and finished the building. Marble continued to manage the work, an arrangement permitted by Trinity in order to avoid publicizing Marble's financial difficulties. Marble issued checks, which were covered by Trinity. On completion of the building, the cooperative owed \$25,000 to Marble. Bellmead State Bank obtained judgment against Marble and caused a writ of garnishment to be served on the cooperative. The trial court held that the bank had a superior right over Trinity to the \$25,000 owed by the cooperative. The court of appeals reversed and awarded the money to Trinity.

The bank argued that the assignment from Marble to Trinity was invalid for failure to record under the Assignment of Accounts Receivable Act.¹⁵ The court answered that Trinity's rights were not dependent on the express assignment and the statute had no application. "It is . . . well settled in our law that the surety whose funds go to discharge contractor's obligations is thereby subrogated to the rights of the owner to apply the contract balances to the completion of the project and payment of bills incurred in that connection."¹⁶ The right of subrogation "is founded solely upon the equitable principle of having paid, pursuant to a bound obligation so to do, what in equity should have been paid by the contractor."¹⁷ "The contractor in this case obviously had no right to the contract funds retained by it, and

¹⁴ Trinity Universal Ins. Co. v. Bellmead State Bank, 396 S.W.2d 163 (Tex. Civ. App. 1965) error ref. n.r.e.

¹⁵ TEX. REV. CIV. STAT. ANN. art. 260-1 (1959): This statute is now repealed, and article 9 of the Uniform Commercial Code deals comprehensively with this and other types of secured transactions.

¹⁶ 396 S.W.2d at 168.

¹⁷ *Ibid.*

the bank . . . as its garnishment creditor, could acquire no greater rights into said fund."¹⁸

The law has a tender regard for sureties. It would be surprising if a general creditor could gain a superior right over a surety by garnishing monies which became due on a contract only because the surety has performed the contract.

Unfair Advantage and Oppression. Damages recoverable for a finance company's fraudulent collection of funds from the borrower was involved in *Dennis v. Dial Fin. & Thrift Co.*¹⁹ *H* and *W* borrowed money secured by a chattel mortgage on their furniture. Four months later the couple was divorced, and *H* settled the debt by paying \$550. Later, the lender's agent telephoned *W*, asserted that \$100 was still due, and threatened to take her furniture. *W* paid \$68.58 but subsequently sued for this sum plus exemplary damages. The trial court awarded *W* a judgment for \$68.58 plus \$3,250. The court of civil appeals modified the judgment by eliminating the item for \$3,250. The Texas Supreme Court reversed and remanded, and the ultimate action of the court of civil appeals was to affirm the judgment below on the filing of a remittitur reducing exemplary damages to \$1,000.

The supreme court distinguished *Ware v. Paxton*,²⁰ a case involving unreasonable collection efforts, from the present case which was one for money obtained by fraud. "It is generally recognized that exemplary damages may properly be awarded when the plaintiff has suffered actual damage as the result of fraud intentionally committed for the purposes of injuring him."²¹ The facts were said to support the jury finding of deliberate and flagrant fraud.

The completely different problem of calculating interest on prepayment of an entire note was raised in *Community Sav. & Loan Ass'n v. Fisher*.²² The plaintiffs obtained a \$7,200 five per cent discount loan from the defendant association. The principal and interest were to be paid over a ten-year period. The plaintiffs signed a note for \$10,800 (\$7,200 plus \$360 yearly interest for ten years), payable in 120 monthly installments of \$90. The note stated that if there was prepayment of the entire balance before maturity, the holder agreed to credit to the note all unearned interest.

Plaintiffs exercised their prepayment privilege and by the end of the fifty-first month had paid \$8,584.93. They then tendered \$145.07 as payment in full (total \$8,730). They calculated that they owed at this time \$7,200 plus fifty-one months of interest at \$30 a month. Defendant dis-

¹⁸ 396 S.W.2d at 169.

¹⁹ 401 S.W.2d 803 (Tex.), further proceedings, 403 S.W.2d 847 (Tex. Civ. App. 1966).

²⁰ 359 S.W.2d 897 (Tex. 1962).

²¹ 401 S.W.2d at 805.

²² 409 S.W.2d 546 (Tex. 1966).

agreed and asserted that plaintiffs still owed \$874.09. Defendant used the "sum of digits method" in computing what interest was still owed when a prepayment was made. This method involved using a table of interest not earned and refiguring the balance owed (with five per cent interest); to be paid in \$90 monthly installments.

Plaintiffs sued for a declaratory judgment that they had paid their obligation in full. Judgment was rendered for plaintiffs, affirmed by the court of civil appeals²³ and reversed by the Texas Supreme Court. The opinion of the supreme court was based on the fact that the note showed on its face that \$10,800 was to be paid over a ten-year period for a \$7,200 loan and no rate of interest was stated. Thus, the "time interest rate" had to be determined by calculation.

It is that percentage which, when applied to each monthly balance of the principal, will, upon crediting the payments in accordance with the rule stated above, result in complete amortization of the \$7200.00 principal advance and the \$3600.00 interest charge in 120 monthly payments of \$90.00 each as agreed by the parties.²⁴

*Usury. East Dallas Clinic v. Stacks*²⁵ was a case in which a victim of usury dealt with three parties and failed in his suit for double interest because the party sued received no part of the interest. Plaintiff owed defendant clinic a bill, and the clinic had an arrangement with a credit association to have the bill paid off by X bank. Plaintiff executed a note for the amount due, payable to X bank in monthly installments. In addition, he made checks out to the clinic which amounted to payments of usurious interest. The checks were collected by the clinic, which remitted a check for their amount to the credit association. The note for the principal was indorsed by the clinic and transmitted to X bank through the credit association. X bank sent its cashier's check to the clinic for the amount due on the note. The credit association paid X bank five per cent on monies paid out under this arrangement. Eventually, plaintiff defaulted on the note, and X bank returned it to the clinic, charging the latter with the balance. The clinic collected the balance. Thereafter plaintiff sued the clinic for twice the amount of usurious interest. Plaintiff won in the district court, but the judgment was reversed in the court of civil appeals. The Texas Supreme Court affirmed in a five-to-four decision.

The majority of the court stated that the determination of the case depended on construction of the Texas usury statute. A person paying usurious interest may "recover double the amount of such interest from the person, firm or corporation receiving same."²⁶ The court was of the opinion

²³ 400 S.W.2d 927 (Tex. Civ. App. 1966).

²⁴ 409 S.W.2d 546, 550 (Tex. 1966).

²⁵ 409 S.W.2d 842 (Tex. 1966), *affirming* 397 S.W.2d 558 (Tex. Civ. App. 1965).

²⁶ TEX. REV. CIV. STAT. ANN. art. 5073 (1948).

that defendant clinic had not received the benefit of the usurious interest. "The only benefit the Clinic received was the collection of its account from Stacks. A 'benefit' from the interest refers to a direct benefit from the receipt and retention of the interest itself, and not to something so incidental as the collection of an account receivable, admitted due, as in this case."²⁷

The dissenting opinion noted that plaintiff paid usurious interest to his immediate creditor and had no contact with the credit association. The dissent expressed the fear that the opinion of the majority opened up a new way to avoid the usury statute.

Waiver of Defense of Want of Consideration. In a civil appeals case P sued M on a note, and the latter set up the defense of lack of consideration. The evidence showed that the note was in renewal of earlier notes, to which the same defense could have been set up. P obtained judgment, which was affirmed on the ground that "one who executes a renewal not knowing there was no consideration for the original, waives the defense of want of consideration."²⁸ The court emphasized that M knew every fact relevant to his defense when he executed the renewal note that he now knew.

Application of Payments on Notes. In a civil appeals case defendants were accommodation makers on a \$15,000 note.²⁹ A year later a \$26,000 note was executed in renewal and extension of the \$15,000 note and for additional advances. Defendants did not sign as accommodation makers on the new note. The maker made payments to the payee bank, which were applied to the \$26,000 note, reducing the amount due to \$18,000. The \$15,000 note was assigned to plaintiff bank, and admittedly \$3,500 had been paid on it. Plaintiff received judgment for \$11,500 against defendants, and this was affirmed on appeal.

The court first disposed of defendants' contention that the acceptance of the \$26,000 note was a novation discharging liabilities on the \$15,000 note. The court cited *Schwab v. Schlumberger Well Surveying Corp.*³⁰ for the proposition that the burden of proof was on defendants to show that the \$26,000 note was accepted as a complete discharge of the \$15,000 note. In the absence of such proof the obligation on the \$15,000 note continued.

Another contention on the part of defendants was that the payments which had reduced the amount due on the \$26,000 note should have been applied to the \$15,000 note. The court recognized the general rule that where neither debtor nor creditor specifies how a payment is to be applied, it is applied to the oldest portion of a running account. But where a debtor is liable alone on a part of a debt and jointly with others on another part, payment is applied to that part of the debt on which the debtor is alone

²⁷ 409 S.W.2d at 845.

²⁸ *Kemper v. Branch*, 394 S.W.2d 819 (Tex. Civ. App. 1965).

²⁹ *Smith v. First Pasadena State Bank*, 401 S.W.2d 123 (Tex. Civ. App. 1966).

³⁰ 145 Tex. 379, 198 S.W.2d 79 (1946).

liable. It appeared that the payee bank had properly directed application of the payments in the absence of prior contrary instruction by the principal obligor.

II. SALES

Oral Contracts of Sale. In a civil appeals case the plaintiff sued and recovered damages from defendants for breaching an oral contract to purchase an airplane.³¹ Delivery of the airplane, procurement of insurance by the buyers, conduct of the parties and other circumstances were held sufficient evidence to support a finding that an oral sale had been accomplished. The court stated that the execution of a Federal Aviation Agency bill of sale was not necessary in order to pass title.

The Uniform Commercial Code now denies enforceability of a contract for the sale of goods for the price of \$500 or more unless a sufficient writing has been signed by the party against whom enforcement is sought.³² Part performance (concerning goods for which payment has been made and accepted or which have been received and accepted), however, makes an oral contract enforceable.

Warranties. In a civil appeals case a buyer was allowed damages against a seller because a string of used oilfield pipe had not been "drifted."³³ The seller honestly believed the pipe had been drifted and represented accordingly. "Drifted" pipe is that which has been milled so that it has uniform interior dimensions and will admit a swabbing tool. Because of the seller's representations as to the "drifted" pipe he was held liable on a theory of express warranty. The seller knew that the buyer needed the pipe for carrying on swabbing operations, and for this reason an implied warranty of fitness for a specific purpose was also made out.

In a court of appeals case two parents sued sellers for breach of express warranty that the casket for their deceased child was air and watertight.³⁴ Seventy-five days after burial the casket was disinterred and found to contain water. Recovery of damages was denied, the court saying that the warranty related to the time of sale and not to future defects. The decision seems to be based on the idea that the leaking which occurred could have resulted from causes not within the sellers' control or contemplation and that proof was lacking that at the time of the sale the casket was not as warranted. The court recognized that a warranty may by agreement of the parties be extended into the future, or its continuance may be implied from the subject matter of the contract.

³¹ Peters v. Norris, 402 S.W.2d 216 (Tex. Civ. App. 1966).

³² Texas Uniform Commercial Code, Vernon's Tex. Sess. Law Serv., ch. 721, art. 2, pt. 2, § 2-201 (1965).

³³ Marshall v. Rife, 397 S.W.2d 915 (Tex. Civ. App. 1965) error ref. n.r.e.

³⁴ Colwell v. Ware, 395 S.W.2d 394 (Tex. Civ. App. 1965) error ref. n.r.e.

Express warranties and the warranty of fitness for a particular use are dealt with in the Uniform Commercial Code.³⁵

Right To Rescind Purchase. An express right to rescind a contract of purchase was enforced in a civil appeals case even though the buyer was unable to return a large part of the goods he had received.³⁶ The contract to purchase a hog ranch and equipment and to take an assignment of a garbage collection contract with the federal government expressly reserved the right to rescind if the government contract could not be assigned within a certain period. The buyer exercised this right of rescission when the Government cancelled the contract, and sued the seller for the \$34,000 paid on the purchase contract. The buyer recovered this sum less the fair value (\$22,000) of hogs received which had been sold. The right to rescind carries the burden of restoring everything received under a contract, but in the instant case the burden was converted to money's worth. At the time the buyer paid the seller the Government had not decided whether the assignment should be permitted; thus buyer had no right to rescind and could not waive a right he did not then have.

Measure of Damages for Breach of Contract by Buyer. In *Rector v. De Arana*³⁷ a buyer totally breached a contract to purchase timber f.o.b. La Mesa Hurucan (in Mexico). The seller recovered damages in the district court, but the court of civil appeals ruled that the findings were contrary to the great weight of evidence, and required remittitur. The court of appeals went on to calculate the remittitur on the basis of what the seller had actually received for the timber subtracted from the contract price. The supreme court remanded with instructions that the court of appeals should determine the excess damages allowed by the district court because of the excessively low value put on the timber in Mexico. The court said that the remittitur should be any excess over the difference between the contract price and a figure representing fair market value found by the court to be supported by the evidence. If no market value could be shown at La Mesa, the place of delivery, "then the fair market value at the nearest market, less reasonable transportation costs from La Mesa to such market, will determine the figure to be deducted from the contract price to arrive at seller's damages."³⁸

The supreme court's statement of the measure of damages when a buyer breaches a contract to purchase is essentially the same as that set forth in the Uniform Commercial Code.³⁹ If a fair market price cannot be deter-

³⁵ Texas Uniform Commercial Code, Vernon's Tex. Sess. Law Serv., ch. 721, art. 2, pt. 3, §§ 2-313, 2-315 (1965).

³⁶ *Mauldin v. Sparks*, 396 S.W.2d 514 (Tex. Civ. App. 1965).

³⁷ 398 S.W.2d 911 (Tex. 1966).

³⁸ *Id.* at 914.

³⁹ Texas Uniform Commercial Code, Vernon's Tex. Sess. Law Serv., ch. 721, art. 2, pt. 7, §§ 2-708, 2-723 (1965).

mined at the time and place for performance, a reasonable substitute may be used, allowance being made for the cost of transporting the goods.

Violation of Bulk Sales Act. In a civil appeals case⁴⁰ a buyer of goods in bulk who violated the Bulk Sales Act⁴¹ was held liable for the value of the goods when they were sold by order of the court rather than for the much larger value they had when he purchased them. Plaintiffs got judgments for varying amounts against *D1* for goods sold. Two or three years before, *D1* had sold goods to *D2* without compliance with the Bulk Sales Act. Plaintiffs sought to hold *D2* for the full value of the goods he had bought. The trial court ordered an inventory of the goods still retained by *D2*, and these goods were ultimately sold for \$3,640. Determination was also made that *D2* had previously sold merchandise received from *D1* for \$794. A total of \$4,434 was paid into court, and the decree was that the plaintiffs should share proportionally (37.15 per cent of the claims were paid). Plaintiffs appealed and sought full judgment against *D2*. But the judgment was affirmed.

The court of appeals explained that under the Bulk Sales Act *D2* was a receiver of goods for the benefit of all of *D1*'s creditors. *D2* was liable only for the goods he still had and for the proceeds of the goods he had disposed of. Plaintiffs were wrong in claiming that *D2* had converted or that he was liable to the extent of the value of the goods when he first received them.

One may well argue that a buyer not complying with the Bulk Sales Act suffers a sufficient penalty in paying for the goods and then having to yield them up to pay the seller's creditors. The buyer has paid a price which, in the seller's hands, has been subject to the claims of creditors. ~~There is no justification or authority for imposing a greater liability on the noncomplying buyer.~~⁴²

The new Bulk Sales Article of the Uniform Commercial Code sets up new requirements and procedures for a buyer in bulk.⁴³ But the liability of a noncomplying buyer probably continues as it was under the old law.⁴⁴

⁴⁰ *General Trimming Prods., Inc. v. S.C. Nelson & Co.*, 398 S.W.2d 775 (Tex. Civ. App. 1966) error ref. n.r.e.

⁴¹ TEX. REV. CIV. STAT. ANN. arts. 4001-03 (1966).

⁴² See Larson, *Bulk Sales: Texas Law and the Uniform Commercial Code*, 6 SW. L.J. 417 (1952), revised and updated in STATE BAR OF TEXAS, CREDITORS RIGHTS IN TEXAS 180 (1963).

⁴³ See Larson, *Article 6 of the Uniform Commercial Code: Bulk Transfers*, 44 TEXAS L. REV. 661 (1966).

⁴⁴ *Id.* at 666, 667, discussing § 6-104.