1970

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PROPERTY

by

Joe A. Stalcup* and J. McDonald Williams**

I. FINANCING OF REAL ESTATE DEVELOPMENTS

Perhaps the most significant development in property law during the past year in Texas has been the introduction of relatively novel techniques for financing real estate developments. Real estate developers typically seek to lever minimal equity positions into high ratio financing. Mortgage lenders, on the other hand, have very recently begun to characterize their role as that of an investor, rather than as that of a lender, and consequently require an investor's participation in entrepreneurial profits. In addition to its yield of interest on the money loaned or invested, this participation may take the form of a percentage of gross or net receipts, an equity ownership interest in the property or a variety of other forms, including a sale and lease-back, a sale and purchase-back, or “front-end” investments coupled with back-up commitments in order to obtain mortgage financing.¹

One consequence of these developments has been the appearance of the “ghost of usury” haunting mortgage lending transactions. Although some case law has developed in other states having lower interest ceilings,² there is a dearth of case law in Texas relating to these forms of transactions.³ One line of cases, however, illustrated by the recent case of Beavers v. Taylor,⁴ suggests that when the lender’s participation is contingent upon the occurrence of certain events, there is no usury because of the absence of the essential element of an unconditional obligation to repay.⁵ In Beavers the borrower received $5,000 from the lender and executed a non-interest bearing promissory note in the same amount. A companion agreement provided that, in consideration of the loan and in consideration of services to be rendered by the lender, the borrower agreed to pay a percentage of his gross sales to the lender. The note was secured by a chattel mortgage on accounts receivable and inventory. The aggregate payments to the lender amounted to approximately twenty per cent of the note amount annually. The borrower sued the lender for usurious interest. The trial court rendered judgment for the lender and the borrower appealed.

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¹ Because interest rates are approaching or exceeding the Texas usury ceiling for non-corporate borrowers, even in cases of straight mortgage loans, lenders are requiring that the loan be made nominally to a corporation.
⁴ 434 S.W.2d 230 (Tex. Civ. App.—Waco 1968), error ref. n.r.e.
In affirming the judgment of the trial court, the Waco court of civil appeals held that "[a] loan is not usurious where the promise to pay a sum depends upon a contingency . . . . And a contract is not usurious where the lender is to receive uncertain value, as here, even though the probable value is greater than lawful interest." This rationale would seem to control a case in which the mortgage lender's participation is solely in the form of a percentage of gross or net receipts or an equity ownership interest. However, the Beavers case leaves open the question of whether its holding would be applicable in a case in which the lender's participation is in addition to its fixed interest yield. Such a case may turn on whether or not the fixed rate is at, or close to, the usury ceiling.

The specter of usury appeared in another form, causing apprehension among mortgage lenders who require borrowers to pay to the lender, in addition to the stipulated interest rate, service fees or other similar charges in connection with the loan. In Terry v. Teachworth the borrowers, in order to construct an apartment project, obtained a loan of $475,000, bearing interest at six and one-half per cent per annum. The borrowers were required to pay the lender an origination fee of $7,125 and a $15,000 fee for control and supervision of the loan, including cost and disbursement control and inspection of construction. Following a default in the loan, the property was foreclosed upon and purportedly sold at a trustee's public sale. The borrowers sued to set aside the trustee's deed and to void the requirement to pay interest set forth in the note, asserting that the transaction was usurious. The trial court declared the loan transaction usurious, discharged the requirement to pay interest, voided the trustee's sale and deed, and awarded possession of the property to the borrowers upon their payment of the principal.

On appeal by the lenders, the Houston court of civil appeals concluded that, since the jury had determined that the control and supervision fee was interest, it could not hold as a matter of law that the extra services performed by the lender's employees "in paying sub-contractors, book-keeping, inspections and auditing were extraordinary services for the benefit of appellees [borrowers] and not to be regarded as interest charged on the loan." The court observed that a charge by the lender in the form of a commission or brokerage fee is merely a device for collecting additional interest. The court noted in passing that the services were intended not only to benefit the borrowers, but also to afford protection for the lender's security. However much this decision may have alarmed lenders, its result is consistent with prior Texas case law holding that any yield to the lender for services rendered is interest, despite the manner in

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6 434 S.W.2d at 211. See Thompson v. Hague, 430 S.W.2d 293 (Tex. Civ. App.—Fort Worth 1968), in which a non-interest bearing note was accompanied by an assignment of rents characterized as a "bonus" in lieu of interest. The court held that the rents were interest and "that the value thereof was not contingent or speculative and was so palpably in excess of legal interest as to show an intent to evade the usury law." Id. at 296. See also 16 A.L.R.3d 475, 481 (1967).

7 431 S.W.2d 918 (Tex. Civ. App.—Houston 1968), error ref. n.r.e.

8 Id. at 925.

9 For a spirited criticism of this case, see Small, What Does the Decision Reached in the Recent Case of Terry vs. Teachworth Mean to Mortgage Lenders, in PROCEEDINGS OF THE UNIVERSITY OF TEXAS SCHOOL OF LAW MORTGAGE LENDING INSTITUTE (Sept. 25, 1969).
which such yield is characterized.\textsuperscript{10} This case does not jeopardize the practice of requiring the borrower to pay service or inspection fees to independent third parties (such as architects, inspectors and the like) for services which are important to the lender with respect to the loan or the security.

In \textit{Terry} the loan documents contained an exculpatory clause to the effect that if for any reason the interest to the lender should exceed the maximum statutory rate, such excess would be held for the account of the borrower. The lender argued that such a disclaimer of intent to charge usury inoculated the transaction against the infection of usury. The court of civil appeals concluded, however, that the lender "cannot charge usurious interest and then escape the penalties by disclaiming an intention to do what they had plainly done... If such a disclaimer clause were given full effect under this record, the usury laws would become meaningless."\textsuperscript{11}

It is also interesting to note that, although the jury found no intent on the part of the lender to charge usury, the transaction was nevertheless held to be usurious. Historically, intent to charge usury has been considered an essential element in a usury case. However, courts have recently minimized the importance of intent or regarded it as being self-evident in the transaction.\textsuperscript{12} In \textit{Terry}, for example, the court of civil appeals observed that the lender's "\textit{intent} to charge usurious interest was without legal effect under the circumstances."\textsuperscript{13}

\section*{II. Landlord and Tenant}

\textbf{Baggage Lien Law.} The legislature extended the landlord's lien by enactment of a variation of the hotel operator's baggage lien law. The new statute affords the landlord of any residential house, apartment, duplex, or other single or multi-family dwelling a lien upon all baggage and other non-exempt property found within the tenant's dwelling as security for payment of the tenant's rents.\textsuperscript{14} The exempt property specified is wearing apparel, tools, apparatus and books belonging to any trade or profession. Moreover, when the dwelling is occupied by a family (defined as a person and others whom such person is under a legal or moral obligation to support), the Act also exempts: one automobile and one truck; family library and all family portraits and pictures; household furniture to the extent of one couch and two living room chairs, dining table and chairs, all beds and bedding, and all kitchen furniture and utensils; all agricultural implements, saddles and bridles; and goods subject to a recorded chattel mortgage lien or other financing agreement.

The Act arms the landlord with the right to enter and take possession of such property until the rent is paid and to sell the property to satisfy

\begin{footnotes}
\item[10] See Pearce & Williams, \textit{supra} note 3, at 238-39 nn.27-33.
\item[11] 431 S.W.2d at 926.
\item[12] See generally Pearce & Williams, \textit{supra} note 3.
\item[13] 431 S.W.2d at 926.
\end{footnotes}
the lien. The sale must comply with the procedures required of hotel proprietors. If the landlord is unable to determine who owns the property or whether it is subject to a security interest or is exempt, the landlord is obligated to store the property safely and return it immediately upon request to the rightful owner or mortgagee. In the event of the loss, destruction, theft or sale of such property, the landlord is liable for the full replacement cost thereof. Thus, if the tenant should vacate the dwelling leaving personal property behind, presumably the landlord would be obligated to store and to preserve such property. However, the Act offers no relief to the landlord for costs incurred in so doing.

With respect to a single person, the lien apparently would extend to furniture and other personalty, including an automobile if it were located in the dwelling. (Query: whether the term “dwelling” would include a garage or carport?) In the case of a family, the landlord’s lien does not include goods subject to a recorded chattel mortgage, lien or financing statement, apparently not even to any equity interest therein. The existence of this exemption for a family implies that the landlord’s lien would extend to such items in the case of a tenant who is single. However, since a prior security interest generally has priority over a landlord’s lien as a matter of law, it is probable that only the equity interest in non-exempt property of the single person is subject to the landlord’s lien.

Subletting or Assignment. As a general proposition of Texas law, an assignment of a lease creates privity of contract between the lessor and the assignee. However, because a sublease creates no such privity, a sublessee generally is precluded from exercising certain rights, such as an option to purchase, which could have been exercised by the lessee.

In Novosad v. Clary a lease agreement granted the lessee an option to purchase the property. The lessee, in connection with the sale of its business, assigned the lease to the buyer. The assignment was absolute in form, assigning to the buyer all of the lessee’s interest in the lease. The buyer assumed the lessee’s obligations under the lease and agreed to indemnify the lessee from any liability thereunder. The lease permitted the assignment of the lessee’s interest, but specified that an assignment did not relieve the lessee of his obligations under the lease. Consequently, the lessee reserved the right of re-entry in order to protect himself against continuing liability. Pursuant to the lease agreement, the buyer notified the lessor of his intent to exercise the option to purchase and tendered the purchase price. The lessor, however, refused to sell and convey the property, and the buyer brought suit.

The Houston court of civil appeals held that the lessee’s reservation of the right of re-entry transformed what purported to be an absolute assignment into a sublease. It reiterated the doctrine that there is no privity

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20 431 S.W.2d 422 (Tex. Civ. App.—Houston 1968), error dismissed.
21 The authority cited is Davis v. Vidal, 105 Tex. 444, 151 S.W. 290 (1912), in which the
of contract between a lessor and a sublessee, and denied the buyer the right to exercise the option. The court observed that, although the lessor would have a right of action against the buyer as a "creditor-beneficiary" in case of a breach of the lease, "there is still no privity" between the lessor and the buyer.

The result of this case seems manifestly inequitable for several reasons. The lessor bargained not only to lease the property and grant a purchase option, but also to permit the assignment thereof. The buyer, on the other hand, bargained for the lease and the purchase option. The effect of the court's holding, however, is to permit the lessor to renege on his bargain because of a technical construction of the nature of the document transferring the lessee's interest in the lease. Further, even assuming the court correctly depicted the relationship as lessor-sublessee, it does not necessarily follow that the purchase option should disappear. The court could have held that the purchase option was assigned, even though the purported lease assignment was, as a matter of law, a sublease. This result would neither prejudice the interest of the lessor, nor frustrate the purposes underlying adherence to the privity doctrine in the landlord-tenant context because a separate option agreement is ordinarily assignable. Finally, the result is to be lamented for breathing life into the generally moribund privity doctrine. In any event, this holding underscores the need for paying careful attention in structuring assignments of leases which contain important options or covenants to be enforced against the lessor.

**Tax Escalator.** In Caranas v. Jones the tenant was required to pay the increase in ad valorem taxes over those levied during the first lease year. The leased premises were not separately assessed by the taxing authority, but formed part of a larger tract which was assessed. The landlord calculated the tax increase attributable to the leased premises and notified the tenant. When the tenant failed to pay such amount, the landlord declared the lease forfeited and attempted to recover possession of the premises. The Dallas court of civil appeals concluded that the landlord's calculation of the tenant's tax increase was based upon an approximation of the amount due and therefore was unliquidated. Thus, the court held, it would be inequitable to forfeit the lease without affording the tenant an opportunity to pay the precise amount of taxes due as determined by the court.

In essence, the court seems to hold that, unless the leased premises are separately assessed, a lease may never be forfeited because of failure to pay the taxes until a court has determined the portion of the taxes attributable to the leased premises. Apparently, any effort by the landlord to calculate the taxes attributable to the leased premises will be futile if the tenant

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"[I]f the instrument executed by the lessee conveys the entire term and thereby parts with all of the reversionary estate in the property, the instrument will be construed to be an assignment; but, if there remains a reversionary interest in the estate conveyed, the instrument is a sublease." Id. at 447, 111 S.W. at 291.

10 431 S.W.2d at 427.

19431 S.W.2d 905 (Tex. Civ. App.—Dallas 1969), error ref. n.r.e.

20 437 S.W.2d 901 (Tex. Civ. App.—Dallas 1969), error ref. n.r.e.
elects to contest such calculation. This case suggests that the landlord should either have each leased tract separately assessed or provide a formula in the lease agreement for calculating the portion of taxes to be paid by the tenant.

**Default in Failing To Pay Taxes.** The case of *Forest Park Lanes, Ltd. v. Keith*\(^2\) illustrates the extreme consequences befalling a ground lessee who fails to pay ad valorem taxes as required by the lease. The lessee constructed on the premises at its expense a building costing approximately $500,000. The ground lessor subordinated its fee to a leasehold mortgage securing a $175,000 note executed by the lessee. The lessee then subleased a portion of the property to a sublessee who constructed a building costing approximately $175,000. The ground lease required the lessee to pay all ad valorem taxes when due. Failure to pay the taxes within sixty days after receipt of notice demanding payment was a default. The lessee and sublessee failed to pay the taxes, and the lessor so notified the lessee. The sublessee’s attorney assured the lessor that the taxes had been paid. Upon discovering that the taxes had not been paid, the lessor terminated the lease. Thereafter, following a default in the $175,000 note, the ground lessor purchased the note, foreclosed on the leasehold mortgage and purchased the interest for $5,000. The ground lessor then sued to cancel the lease and to recover the rental, taxes and attorneys fees due under the lease.

The court of civil appeals held that the lessor was entitled to terminate the lease. Although the court acknowledged that the lessor was thus enriched in receiving the improvements constructed on the property, the lessor’s gain is “one resultant from contingencies concerning which the parties had contracted. . . . [T]he parties’ freedom to contract as they choose necessarily requires that they be held bound by the provisions of any contract they choose to make.”\(^3\) In denying the lessee and the sublessee equitable relief, the court stressed that there was no act or omission on the part of the lessors misleading them or concealing from them any beneficial information. The knowledge of the sublessee’s attorney that the taxes were unpaid, despite his assertion to the contrary, was held chargeable to the principal. This case illustrates the mechanical problem of the sublessor in policing the sublessee to insure that obligations such as the payment of taxes and insurance passed on to the sublessee are discharged.

**Commencement of Construction.** The commencement of construction is frequently an important event, not only in leases, but also in construction contracts and mortgage loan commitments. Apparently, before the decision in *S.K.Y. Investment Corp. v. H. E. Butt Grocery Co.*,\(^3\) there were no Texas cases attempting to define the term “commencement of construction.” In that case the lease provided that if the landlord had not com-

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2. Id. at 931.
menced construction by a specified date, the tenant could terminate the lease. The evidence showed that ground leveling and bulldozing of brush were the only activities which had occurred by the specified date. The tenant terminated the lease and the landlord sued. The court of civil appeals held that for purposes of the lease such activities did not qualify as "commencement of construction," and in doing so enunciated the following test for determining the occurrence of that event:

(1) a manifest commencement of some work or labor on the ground which everyone can readily see and recognize as the commencement of a building and

(2) the work must have been begun with the intention and purpose then formed to continue the work until the completion of the building.

In another interesting feature of this case, the landlord argued that its failure timely to commence construction was caused by the tenant's wrongful failure, both to furnish to landlord's architect the tenant's requirements for interior design and to furnish financial information to landlord's potential construction lender. The lease dictated that construction was to be in accordance with plans and specifications to be prepared by the landlord and approved by the tenant. The landlord's architect testified that the tenant refused to furnish information which was necessary to complete the working drawings and specifications and to prepare construction cost estimates. The court held, however, that there was no provision in the contract requiring the tenant to furnish this information, and because of the existence of the written contract, the court refused to admit evidence to the effect that furnishing such information is normal and customary in such transactions. Thus, by withholding information apparently necessary to proceed with the construction, the tenant was permitted to escape from the lease on the basis that construction was not commenced timely.

III. MECHANICS LIENS

Policy of Mechanic's Lien Act. Two recent mechanic's lien cases conflicted as to the underlying policy of the mechanic's lien statutes. In one case a subcontractor filed his lien affidavit, but the affidavit contained an acknowledgment rather than a jurat. The Austin court of civil appeals concluded that the language of article 5455 requiring an "affidavit ... a sworn statement" meant that the failure to include a jurat was fatally defective. The court announced the salutary rule that "[i]t is elementary that substantial compliance with the provisions of these statutes is essential to recovery under them," but held that the substitution of an acknowledgment for a jurat failed substantially to comply with the statute.

In another case, a subcontractor sent the original of the notice of lien...
claim and the statement of account, properly verified, to the prime contractor. The copies sent to the surety, however, were not signed or verified. The Houston court of civil appeals noted that:

Under a strict interpretation of the statute [article 5160]\(^9\) it would be necessary for a claimant to furnish a sworn statement of account (with the notices of the claim) to the surety or sureties as well as the prime contractor. . . . In following the rule . . . which requires us to give this remedial statute the most comprehensive and liberal construction possible, we conclude that the appellee has substantially complied with the notice requirements of the statute and that this is sufficient.\(^8\)

**Assignment of Claim.** In *Wartham v. Trane Co.*\(^2\) the assignee of the debt of a materialman who had filed a mechanic's and materialman's lien brought suit to foreclose the lien. The materialman did not affix and secure the lien until after he had assigned the debt to the assignee. The Supreme Court of Texas held that "one furnishing labor and materials may perfect a mechanic's and materialman's lien after assignment of his debt and that the lien will inure to the benefit of the assignee regardless of whether the assignor was acting as agent of the assignee."\(^3\)

**IV. Partition**

In *Lichtenstein v. Lichtenstein Building Corp.*\(^3\) the landlord constructed a building, and in connection with the construction financing executed a deed of trust and assignment of leases. The landlord then leased the property to a tenant under a lease which gave the landlord no right to re-enter for any purpose. The landlord next conveyed an undivided one-half interest in the property to the defendant. Later, the landlord brought a partition suit. The defendant as co-owner contested the partition, asserting that the owner had no possessory interest in the property because of the existing lease, deed of trust and assignments.

The court of civil appeals stated that Texas law requires three necessary requisites to enforce partition: "First, the partitioners must be joint owners; second, of the land, or any interest therein; and, third, the party seeking the partition must have an equal right to possession with the other joint owners. . . . The general rule recognized in other states as in Texas is, that in absence of a statute providing otherwise, only an estate in possession is subject to partition."\(^4\) But, the court continued, "an estate in possession means merely an estate in present enjoyment. If a person is entitled to enjoy the present rents of the property as one of the co-owners thereof, he fulfills the requirement of actual possession under the statute."\(^5\)

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\(^2\) 437 S.W.2d at 882. In *City of Mason v. West Texas Util. Co.*, 150 Tex. 18, 237 S.W.2d 273 (1951), the Supreme Court of Texas stated that "[i]f a statute is curative or remedial in its nature, the rule is generally applied that it be given the most comprehensive and liberal construction possible. It certainly should not be given a narrow, technical construction which would defeat the very purpose for which the statute was enacted." *Id.* at 29, 237 S.W.2d at 280.
\(^3\) 432 S.W.2d 520 (Tex. 1968).
\(^4\) Id.
\(^6\) Id. at 767-68.
\(^7\) Id. at 769. The court noted in passing that, of course, "the partition sale must be subject to the lease and the lessees become tenants to the purchaser of the rents and the reversion." *Id.* at 768.
Thus, the right to receive rents, being constructive possession, is sufficient to warrant partition.36

V. Mortgages

Fire as Default Under Deed of Trust. In Erickson v. Rocco37 a house, subject to a deed of trust lien, burned. The insurer cancelled the insurance after the fire and refused to settle the claim. The owners made no effort to rebuild the house. The deed of trust required the owners to keep the premises in good order and repair and to maintain insurance against loss by fire. About six months after the fire, the beneficiary of the deed of trust accelerated the note and began foreclosure proceedings. The owners sought a temporary injunction to enjoin the foreclosure.

In affirming the trial court's order granting the injunction, the Houston court of civil appeals observed that the purpose of the covenant to keep the premises in good repair is to preserve the value of the security of the lien holder.

But, when considered in connection with the other language of the contract, it is also obvious that the parties did not intend that there be a breach of that covenant when the grantors failed to keep the premises in good order because of a fire which burned the premises. A loss in the value of the security resulting from the fire was provided for in another provision of the contract, that provision requiring the grantors keep the premises insured against loss from fire.38

The court noted that, because insurance was unavailable on the house after the fire, the covenant to maintain insurance became impossible to perform without any fault of the owners. The court stressed that the notice from the lender to the owner failed specifically to complain about the failure to procure insurance: "There is authority for the proposition that a lien holder is not entitled to foreclose his lien because of the breach of the covenant to keep premises insured without having given the owners notice of their default in this respect and an opportunity to correct it."39 The court concluded that "[u]nder the circumstances we cannot say that the evidence showed as a matter of law such a breach of the covenant to keep the property insured as that the trial court could not, in the exercise of its equitable powers, temporarily enjoin the foreclosure of the lien."40

The court adverted to the fact that the owners had continued making their monthly payments and then remarked:

If facts should develop pending the final trial which place the appellants' security in jeopardy they may be heard on motion to dissolve the temporary injunction . . . . On the other hand, the plaintiffs, because of their insurance company's refusal to pay their claim and the intervenor's insistence that they rebuild their house, are likely to lose their lot unless the foreclosure is enjoined.41

36 Id. at 768.
37 433 S.W.2d 746 (Tex. Civ. App.—Houston 1968), error ref. n.r.e.
38 Id. at 710.
39 Id. at 712.
40 Id.
41 Id. at 753.
The dissenting judge, however, stated that "[t]his is not a case where the mortgagee attempted to take advantage of some technical, temporary, or minor default." In his view, it is "equally fundamental that when a deed of trust provides that insurance shall be maintained by the mortgagors, that a default in that respect provides the right of foreclosure. The failure to maintain insurance justifies foreclosure as fully as default in the installment payment obligations." The dissenter characterized the case as one in which "the major part of Farm and Home's security has been undoubtedly destroyed by fire . . . . As long as the remainder continues uninsured, appellants stand to suffer further impairment, if not total destruction, of their security. This is the very thing that the continued-insurance covenant was designed to prevent." In addition, the dissenting judge concluded that, although the owner did not commit waste, his failure to close or repair the house for a period of six months following the fire was also a default. "Failure to prevent waste has been held quite clearly to be a sufficient ground for foreclosure."

Priorities. In *Providence Institution for Savings v. Sims* the owner (Nortex) executed a deed of trust securing payment of a note to the bank. Subsequently, a supplier perfected a mechanic's lien on the property. About five months later, the owner executed another deed of trust securing payment of a second note payable to Hughes Investment Co. in the amount of $180,000. The deed of trust provided that "[t]he beneficiary shall be subrogated to all rights, titles, liens and interests securing the payment of indebtedness discharged, paid or retired out of the proceeds of the loan evidenced by said Note." Hughes, the lender under the second loan, applied the net proceeds of the loan to the bank's first lien indebtedness. The supplier then sought to foreclose his mechanic's lien. Subsequently, the holder of the first lien indebtedness subordinated its lien to the lien of the deed of trust securing the second note. After a default under the second lien note, the deed of trust securing such note was foreclosed by the exercise of the power of sale, and the property was purchased at the foreclosure sale by the plaintiff. Thereafter, the supplier obtained a judgment against the owner for the amount of his claim and for foreclosure of his mechanic's lien. The plaintiff then brought suit to enjoin the foreclosure sale and to remove the mechanic's lien as a cloud on its title.

The Texas supreme court held that the plaintiff owned the property free and clear of the mechanic's lien. The court stated that:

> We recognize the general rule that a person who is subrogated to the rights or securities of another may not enforce the same until the claim of the latter against the debtor has been paid in full. The rule is for the protection of the prior creditor, who cannot equitably be compelled, without his consent, to place another on equal footing with respect to security held for the satisfac-
tion of the entire indebtedness. If the prior creditor consents to pro tanto subrogation of one who makes partial payment, however, no one else is entitled to object . . . . A person making partial payment is entitled to enforce his right of subrogation when the prior creditor is estopped to deny that his claim was paid in full. 48

The supreme court dismissed the argument that the subordination agreement executed by the bank made both its lien and that of Hughes Investment inferior to the mechanic's lien. The court stated that:

Before the bank subordinated, it held the first lien and Hughes Investment was entitled to pro tanto subrogation thereto as against everyone except the bank. By virtue of the subordination agreement, the lien securing the bank's indebtedness became inferior to the lien securing the indebtedness to Hughes Investment but both liens remained superior to the mechanic's lien. The rule that ordinarily governs priorities when a first lien is subordinated to a third lien has no application under the facts of this case. 49

The subcontractor also argued that the holder of the second note is charged with constructive notice of the mechanic's lien and thus should not be entitled to prevail on equitable grounds. The court acknowledged the position taken by some courts that a constructive notice of the intervening lien is sufficient basis for denying subrogation.

Where purely equitable subrogation is the issue, each case is usually controlled by its own facts. In the present case, however, the right of subrogation does not depend entirely upon equitable principles. Nortex expressly agreed that Hughes Investment would be entitled to subrogation, and the proceeds of the $180,000.00 note were used, pursuant to that agreement, to discharge part of the indebtedness secured by the first lien. The first lien was never released but was later subordinated to the lien of Hughes Investment, and there is no contention that respondent was placed in a worse position by the transaction. We hold that under these circumstances neither actual nor constructive knowledge of the intervening lien will defeat the right of subrogation to which the debtor agreed in the later deed of trust. 50

VI. EASEMENTS

A common problem in the development of large tracts of formerly rural property is the existence of "floating" easements—that is, general grants of easements covering an entire tract of property. Usually, these easements can be limited or abandoned after negotiations with the easement beneficiary. Houston Pipeline Co. v. Dwyer, 51 however, has offered some consolation to developers in holding that once a utility line has been constructed the easement beneficiary's rights under his general easement become fixed and limited.

In Central Power & Light Co. v. Holloway 52 the owners of the property in 1942 granted to the utility company an easement for an electric transmission line for the purpose of "constructing, reconstructing, inspecting, patrolling, hanging new wire on, maintaining, and removing said line,

48 Id. at 519.
49 Id.
50 Id. at 519-20.
51 374 S.W.2d 662 (Tex. 1964).
poles, wires and appurtenances; the right to relocate along the same general direction of said line."

The utility company then constructed an electric transmission line, but later proposed to reconstruct the line by reducing the number of poles and extending the height of the line by approximately fifteen feet. The owners sought to enjoin the reconstruction of the line, arguing that the Dwyer principle precluded the utility company from changing its existing utility line. The court of civil appeals denied the injunction, however, distinguishing the Dwyer case on the basis that the easement in Dwyer did not grant to the easement beneficiary the right to relocate the electric line. The court noted that "we do not believe that the parties intended such a narrow construction or an unreasonable result, that would require the company to re-install its electric line at the exact same elevation where it was first placed. . . . The right to relocate would not be limited to a relocation horizontally along the same general direction but also the right to relocate vertically as well."

VII. ZONING

The problem of dealing with a nonconforming use of property which has continued for a long period of time is illustrated in Swain v. Board of Adjustment. In 1929, the city of University Park enacted a comprehensive zoning ordinance, which designated the subject property as restricted for apartment use. In 1933, the owner of the property filed an application with the Board of Adjustment for a permit to build a service station. Following a hearing before the Board, the application was granted and a service station constructed. Subsequently, the city enacted other comprehensive zoning ordinances which restricted the use of the property for two-family dwelling purposes. A service station was operated continuously on the property until 1965, when the city engineer notified the owner that the property was being used in violation of the ordinances. The Board subsequently ordered the removal of the service station. The Dallas court of civil appeals held that the 1933 action of the Board of Adjustment in granting the application to construct a service station was void ab initio because such a grant was a legislative function and the Board had no statutory power to legislate. The court noted further that no vested rights were acquired by the use of the property contrary to the purpose of the ordinance. Moreover, the court held that the citizens of the city, acting through their governing authority, were not estopped to assert their rights under the zoning ordinance by virtue of the continued use under the void permit.

The court dismissed an attack that such action was unconstitutional as an unreasonable exercise of police power, and concluded that a municipality has a right, within the proper exercise of the zoning regulations and within the exercise of its police power, to reasonably require the discontinuance of a prior nonconforming use. The court noted in passing that

54 Id. at 439-40.
55 433 S.W.2d 727 (Tex. Civ. App.—Dallas 1968), error ref. n.r.e.
the owner had recouped his investment over a period of years and that
the adjacent property owners were being subjected to losses in valuation
of property because of the nature of the present use of the property. It
would be interesting to know if the result would have been the same if
the property had recently been sold for a substantial purchase price. Also,
Swain may cause some speculation as to the outcome of related factual
situations, such as: one in which a change in zoning is obtained permitting
the use of the property for an office building; a building permit is issued
for the construction; the office building is built; and a technical defect
in the manner of passing or the form of the zoning ordinance is discov-
ered and raised.

VIII. CONDEMNATION

Property Damage for Public Use. City of Houston v. Renault, Inc.\(^6\) is
perhaps the most significant condemnation case decided during the past
year because the Supreme Court of Texas, in reversing the judgment of
the Waco court of civil appeals, expressly disapproved doctrine announced
by a prior supreme court in City of Waco v. Roberts.\(^7\) Suit had been
brought against the city of Houston to recover damage caused to 1,620
Renault and Peugot automobiles and trucks by the impounding of surface
waters on the land where the vehicles were stored. Plaintiffs sought recovery
under one of two major theories: (1) the property was damaged by
negligence; and (2) the property was damaged for public use within the
meaning of the constitutional provisions relating to eminent domain.\(^8\) The jury found that the adjacent street as maintained by the city im-
powered the natural flow of the surface waters on the premises in question
and that such impounding was a proximate cause of the plaintiffs' dam-
age. However, it refused to find that the city's conduct was negligent.

The supreme court held that in the absence of negligence or intentional
wrongdoing the city was not responsible for the damages. After an ex-
tensive review of authorities concerning liability for impounding or di-
verting surface waters, the court concluded that at common law a private
individual would not be liable for damages, unless the action or omission
causing damage was negligent or intentional. The court further held that,
in the absence of a contrary statute, the common law should apply to a
municipal corporation. (A statute makes it unlawful for "any person,
firm or private corporation" [but does not specifically refer to a municipal
corporation] to impound or divert surface waters so as to cause damage
to another.)\(^9\) The court distinguished a number of prior cases on the basis
that such cases involved either: (1) damages caused by diversion or im-
pounding of flood rather than surface waters, (2) damages caused by negli-
gence of the city, or (3) damages derived from statutory duties applicable
to counties and railroads, but not to municipal corporations.

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\(^6\) 431 S.W.2d 322 (Tex. 1968).
\(^7\) 121 Tex. 217, 48 S.W.2d 577 (1932).
\(^8\) TEX. CONST. art. I, § 17.
\(^9\) TEX. REV. CIV. STAT. ANN. art. 7589a (1954).
The jury found that the damages to plaintiffs were proximately caused by their negligent failure to ascertain the drainage characteristics of the property. One wonders whether the court's decision was affected by the fact that if the constitutional provisions were held to apply, plaintiffs would have been entitled to recover damages in spite of their contributory negligence. The concurring opinion of the late Mr. Justice Norvel seems to focus on this issue:

The respondents' neglect contributed to the loss sustained by them. An individual defendant, not having the power of eminent domain, would not be liable. I do not think Article I, Section 17, of the Texas Constitution affects the situation. When personal property is negligently placed upon land subject to flooding, the owner of such property should not be allowed to recover against a defendant because of the circumstances that the defendant is vested with the power of eminent domain.  

The court's conclusion that the constitutional provision is not applicable with respect to this type of damage to property is probably sound, but the substantial injury to the plaintiffs in this case may indicate a need for the legislature to extend the protection of the statutes by imposing a duty with regard to surface waters upon municipalities, as well as upon "any person, firm or corporation."

Pleading Enhancement of Remainder. In a significant victory for condemors, the Supreme Court of Texas reversed the judgment of the Tyler court of civil appeals and held that the condemnor need not plead enhancement of the value of the remainder as an offset to damages to the remainder. The court relied heavily on the fact that the elements of damages to the remainder are spelled out in the statute, which provides that evidence shall be heard both as to the damages sustained by the owner and as to the benefits that will result. The court noted that the burden of proving damages to the remainder is on the condemnor and that the evidence of enhancement was rebuttal evidence tending to disprove the landowner's contention that the value of the remainder was damaged.

Admissibility of Cost of Removing or Reconstructing Improvements. In State v. Walker the Supreme Court of Texas rejected a condemnor's novel theory that evidence concerning the value of two unaffected warehouse buildings on the remainder and the cost of removing such buildings should be admitted as bearing upon what measures were necessary to put the remaining property to its highest and best use. The court cited State v. Zaruba as a controlling statement of the rule to be followed in regard to the admission of testimony relating to the cost of reconstructing improvements situated on land not taken. The point was made that the cost

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60 431 S.W.2d at 327.
61 Tarrant County Water Control & Improvement Dist. No. 1 v. Hubbard, 433 S.W.2d 681 (Tex. 1968).
63 441 S.W.2d 168 (Tex. 1969).
64 418 S.W.2d 499 (Tex. 1967).
of reconstructing improvements is admissible when the depreciation of value of the remainder can be minimized by such reconstruction.

Enhancement of Value Occasioned by the Public Facility. *Barshop v. City of Houston*\(^6\) seems to extend *City of Dallas v. Shackelford*\(^6\) in holding that a condemnee is entitled to recover for enhanced value occasioned by the public facility for which his property is being taken up to the time the condemnor manifests a definite purpose to take the land. In 1950, the city of Houston initiated a study of its future airport needs. Six years later, a group of citizens incorporated as the Jetero Ranch Company undertook to acquire a block of land (the "Jetero tract") for a proposed airport site. This tract was in the vicinity of the Barshop tract which is the subject matter of this action. In 1958, the city purchased the Jetero tract. In early 1959, a firm known as Select Homes purchased the Barshop tract for $79,000 and in turn sold it to Barshop in April 1960, for $90,000. On October 11, 1960, Houston enacted an ordinance which authorized the City Attorney to offer Barshop $63,192 for the tract, but this offer was not communicated to Barshop until thirty-two months later. On October 26, 1960, Houston passed an ordinance designating a large body of land (including the Barshop tract) as that within which the airport would be located. The ordinance also authorized the Director of Aviation to determine which parts would and would not be needed. On October 23, 1961, Houston adopted a Master Plan for Development of the Jetero Intercontinental Airport which included the Barshop tract. On June 18, 1963, Houston made an offer to Barshop and on September 29, 1963, instituted condemnation proceedings. It was stipulated that Houston "took" the property on July 7, 1964.

In the trial court, the city of Houston repeatedly sought to exclude all evidence of enhanced value caused by the Jetero Airport. The trial court, however, admitted the evidence and refused to instruct the jury to disregard any increase in market value due to the location of the airport for which the tract was being acquired. The trial court submitted only one issue: the market value of the Barshop tract on July 7, 1964, the agreed date of taking.

The Houston court of civil appeals reversed and remanded,\(^6\) ordering the trial court to instruct the jury on retrial that it could consider no enhancement in value attributable to the airport which occurred after October 11, 1960, the date of Houston's ordinance authorizing an offer to Barshop. The Supreme Court of Texas, however, reversed the decision of the court of civil appeals. The basis for the supreme court's reversal would appear to be found in the following language: "The court's [the court of civil appeals] selection of that date [October 11, 1960], in our opinion, finds no basis in the trial court proceedings, since Houston consistently

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\(^6\) 442 S.W.2d 682 (Tex. 1969).
\(^6\) 141 Tex. 528, 199 S.W.2d 503 (1947).
\(^6\) City of Houston v. Barshop, 431 S.W.2d 914 (Tex. Civ. App.—Houston 1968).
urged that all enhanced value should be excluded.\(^{68}\) This seems even clearer in the light of the following language:

The trial court was not in error in overruling Houston's objections to all enhanced value evidence, when at least a large part of it was admissible . . . . The jury instruction which Houston requested was not a substantially correct one in view of our holding that enhanced value, at least to some date, was proper for the jury's consideration.\(^{69}\)

The supreme court does not seem to go so far as to disagree with the court of civil appeals' view that October 11, 1960, was the proper date for cutting off evidence as to enhancement based on the airport. The decisive point was that the city of Houston sought to exclude too much and failed to limit its objections to evidence and its request for an instruction.

**Admissibility of Other Sales.** Perhaps the most frequent issue to reach the appellate courts in condemnation proceedings is whether or not evidence as to certain allegedly comparable sales was properly admitted or excluded by the trial court. In those instances in which an appellate court decides that error was committed, the issue then becomes whether or not the error was such as was reasonably calculated to cause and probably did cause rendition of an improper judgment so as to require reversal. A review of the cases reveals that the trial court is allowed extremely broad discretion in either admitting or excluding evidence of a sale as "comparable." Even if such admission or exclusion is held to be error, in most instances the appellate courts will hold that such error does not require reversal. The lesson for counsel of either condemnor or condemnee is clear—strive mightily to secure the desired evidentiary ruling from the trial court because in all likelihood the appellate courts will not reverse the judgment.

Six cases decided by courts of civil appeals illustrate the latitude permitted by the trial court in determining whether or not a sale is "comparable."\(^{70}\) Three cases illustrate that, even though the admission of such evidence is held to be error, the appellate courts seldom find the error sufficient to require reversal.\(^{71}\) Two of these same cases also serve as reminders that evidence concerning sales to entities with the power to condemn are not admissible, even though in the particular instance the sale appears entirely voluntary.\(^{72}\)

**Other Points of Interest.** *City of Wichita Falls v. Thompson*\(^{73}\) serves as a

\(^{68}\) 442 S.W.2d at 685.

\(^{69}\) Id. at 686.


\(^{73}\) 431 S.W.2d 909 (Tex. Civ. App.—Fort Worth 1968), error ref. n.r.e.
reminder to condemning authorities that they must limit the amount of property which they take to the amount reasonably necessary for public use, and that the power of eminent domain may not be exercised if the governing body of the authority has clearly abused its discretion. The opinion of the court of civil appeals contains a good discussion of the two classes of attack which may be made upon the power to condemn: (1) an attack on the condemnation as being for a purpose not authorized by statute, and (2) an attack upon the taking of specific property as being a clear abuse of discretion or a fraudulent act of the condemning authority. In this case the city had condemned an entire tract of land situated in an area where the city planned to construct a lake for municipal water supply. The landowner contested the city’s right to condemn that portion of the land lying above the 930-foot contour line. The jury found that the city acted with a clear abuse of discretion in determining that the land above such contour was necessary or convenient for purposes of the reservoir. Evidence had been presented that the city intended to use the land above the reservoir for cabin sites and the like. The court of civil appeals held that a fact issue for a jury exists as to the question of whether fraud or gross abuse of discretion has occurred in connection with determining the necessity for taking a particular tract of land.

In Huckabee v. State the landowner had alleged damages of $30,000 based on loss of profits from his fried chicken franchise business which would be interrupted by excavation and construction of a highway for which a part of his land was being taken. The court of civil appeals upheld the action of the trial court in sustaining the state’s special exception to these pleadings, holding that a condemnee is not entitled to damages for temporary interruption of business where the evidence shows that the property remaining after taking is not adequate to continue operation of the business. The court of civil appeals also held that while it was error to exclude an expert witness’ testimony of market value based on the income approach, such error was not reversible because of similar testimony from other witnesses.

In State v. Brunson the Corpus Christi court of civil appeals held that it was error to arrive at a reasonable rental value during a sixty-four-month period of unlawful detention of a house trailer by securing a jury finding of its monthly rental value and then multiplying such figure by the number of months. The court noted that the damages by the use of such method were equal to more than twice the difference between the market value of the trailer at the time the unlawful detention commenced and the time it was returned to the owner. The Supreme Court of Texas affirmed the judgment of the court of civil appeals, but held that the proper measure of damages to be applied upon retrial is the market value of the trailer at the time of taking, plus interest at the legal rate since the date of taking when no deposit in court is made. No reduction is to be made because the state subsequently returned the trailer to the

74 431 S.W.2d 927 (Tex. Civ. App.—Beaumont 1968), error ref. n.r.e.
75 431 S.W.2d 242 (Tex. Civ. App.—Corpus Christi 1968), error granted.
owner, because the legislature has not made any provision for same, although the court pointed out that the legislature has the power to direct the use of a tort measure of damages.6

In Wilcockson v. Colorado Municipal Water District7 the Austin court of civil appeals held that so-called obligations of the condemnor to provide drilling mounts and connect such mounts by dikes with the shore and to provide and operate a barge were not limitations or restrictions on the property being taken. Rather, such obligations were in the nature of unilateral promises as to future conduct of the condemnor. Therefore, it was error for the trial court to instruct the jury to consider such obligations in assessing damages to the condemnee's mineral interest.

In Keeton Packing Co. v. State8 the Amarillo court of civil appeals, in reversing a summary judgment entered by the trial court, held that the evidence raised fact questions as to the failure of consideration and as to whether the State Highway Commission had acted arbitrarily and capriciously, or had abused its discretion in not transferring land back to the original grantor after failure of consideration. Here the power of eminent domain was not used. According to the landowner's testimony, he was approached by an agent of the Highway Commission who represented that a highway would be built in a certain location across a portion of his property which would greatly enhance the value of his adjacent property. The landowner therefore deeded the land to the state for highway purposes. Subsequently, the highway was relocated and only a tiny sliver of the property deeded was used for highway purposes. The owner sought to have the land not so used reconveyed to him. The state, however, urged the city to intervene to try to acquire the property for public street purposes. It should be noted that the reversal was based upon the allegations of misrepresentation constituting failure of the real consideration for which the property was conveyed to the state without any compensation. It seems apparent that if the state had taken the land or purchased it under threat of condemnation, the state would be free to do what it wanted to with the excess land, even though it subsequently changed its mind as to the exact location of the highway.

In an opinion which includes a good discussion of the meaning of the phrase "considered as severed land," the Tyler court of civil appeals held that where portions of land taken were not self-sufficient economic units and were not independent of the remainder of their respective parent tracts, the value of each portion was its proportionate part of the value of the entire tract from which it had been taken.9

Texas Pig Stands, Inc. v. Krueger90 is a very interesting case dealing with the apportionment of the award between the lessor and lessee of realty. As the San Antonio court of civil appeals expressed the situation: "A most difficult problem is presented in that under the terms of the lease all of

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7 437 S.W.2d 203 (Tex. Civ. App.—Austin 1969), error ref. n.r.e.
8 437 S.W.2d 20 (Tex. Civ. App.—Amarillo 1968), error ref. n.r.e.
90 441 S.W.2d 940 (Tex. Civ. App.—San Antonio 1969), error ref. n.r.e.
said improvements were owned by lessee and yet it is undisputed that they could not economically be removed." The verdict of the jury and judgment of the court were predicated on the proposition that the fee owner was entitled to all compensation for the improvements. The lessee complained of this result and asked that the judgment be modified to award it the value of improvements. The state, also appealing, urged that since the lessee was indisputably the owner of the improvements the judgment for the lessor should be reduced by approximately $40,000, but in all other respects affirmed, thereby giving the state the benefit of the value of the improvements. The court rejected the state’s argument summarily, and held that where the lessee erects improvements on the land and has the right to remove them by virtue of his agreement with the lessor, the lessee is entitled to that part of the award which has been allowed for the value of such improvements. The court then discussed the two approaches to solving what it described as “an extremely difficult problem, both from the standpoint of testimony of value and of the appropriate definition to be given the jury.” One of the approaches used is to compensate the lessee on the basis of the market value of the improvements owned by him separate and apart from his compensation for the present value of the difference between the contract rental and the fair market rental of the premises. The other approach is that in determining the compensation to the lessee, the leasehold estate and the improvements should be viewed as a unit and not as separate items. The latter view is the one which the court followed. The court pointed out that the trial court’s instruction should appropriately advise the jury of the ownership of the improvements so that, in valuing the leasehold estate, they would take such improvements into account. The court then affirmed the judgment of the trial court that condemnees recover from the state the total sum and reversed the judgment apportioning such sum, remanding it to the trial court for apportionment between the lessor and lessee in accordance with the principles set forth in the opinion.

81 441 S.W.2d at 943.
82 Id. at 945.