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REAL PROPERTY

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THIS Article surveys developments in traditional areas of real property law and related topics, from October 1, 1992 to September 30, 1993.¹ During the Survey period, the courts made a few significant pronouncements and the state legislature found time to promulgate amendments to several Texas statutes which affect real estate practitioners.² Even though cases decided during recent years have unequivocally established the awesome force of the *D'Oench, Duhme* doctrine³ and certain other federal defenses available to the Federal Deposit Insurance Corporation (FDIC),⁴ a stream of cases involving *D'Oench, Duhme* and other federal defenses continued to flow. While some of these cases were easily resolved by applying the basic *D'Oench, Duhme* defense, others presented the courts with questions of the scope of the defense⁵ or more technical issues surrounding the availability of the defense, such as statutes of limitations⁶ and the standard of review applicable to the FDIC's review of a failed bank's records.⁷ In addition, several courts utilized the broad rationale behind *D'Oench, Duhme* and its statutory companion, section 1823(e) of the United States Code (Sec-

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1. Although a few cases discussed in this article were decided prior to October 1, 1992, we have included those discussions because the opinions were published after the final draft of last year's article. As we did last year, we have attempted to address only those cases that are most applicable to the "average" real estate practitioner. Cases which we believe deal with unremarkable fact situations or which neither create new law nor provide worthy or new interpretation of existing law have been purposely omitted or have received only minimal attention. We caution all readers to be aware that some cases actually decided during the Survey period are not published in time for inclusion in this article.

2. See Appendix I.

3. The *D'Oench, Duhme* doctrine was enunciated by the Supreme Court in *D'Oench, Duhme & Co. v. Federal Deposit Ins. Corp.*, 315 U.S. 447 (1942), and has been interpreted and expanded by its progeny.

4. These defenses include, among others, the federal holder in due course doctrine, the federal doctrine which prohibits usury and other punitive damages from being assessed against the FDIC, and the prudential mootness doctrine.

5. See *infra* notes 168-80 and accompanying text.

6. See *infra* notes 197-208 and accompanying text.

7. See *infra* notes 150-67 and accompanying text.

tion 1823(e)),⁸ to accord the FDIC (as well as its predecessors and assignees) favorable interpretations of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA).⁹ These decisions continued the buildup of the arsenal of weapons available to the FDIC to defeat the enforceability of certain contractual agreements between a failed lending institution and its borrowers through the use of the *D'Oench Duhme* doctrine.

I. MORTGAGES

A. MORTGAGES GENERALLY

Though inappropriate for substantial discussion, a number of cases decided during the Survey period deal with general mortgage issues. These cases include a decision holding that the retroactive application of a provision of the Texas Property Code,¹⁰ which requires a holder of a note secured by residential real property to provide the debtor with notice and an opportunity to cure before accelerating the debt, does not violate the Texas Constitution.¹¹ Other cases reaffirmed the following precedents:¹² a party whose property is sold through wrongful foreclosure may recover either the property or damages, but not both;¹³ a purchaser at a valid foreclosure sale, re-

8. 12 U.S.C. § 1823(e) (1988 & Supp. IV 1992), which provides:

No agreement which tends to diminish or defeat the interest of the [FDIC] in any asset acquired by it under this section . . . , either as security for a loan or by purchase . . . , shall be valid against the [FDIC] unless such agreement—

(1) is in writing,

(2) was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution,

(3) was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and

(4) has been, continuously, from the time of its execution, an official record of the depository institution.

9. Pub. L. No. 101-73, 103 Stat. 183 (1989). See *infra* notes 185-87 and 198-230 and accompanying text.

10. TEX. PROP. CODE ANN. § 51.002(d) (Vernon Supp. 1994).

11. *Rey v. Acosta*, 860 S.W.2d 654, 657-58 (Tex. App.—El Paso 1993, n.w.h.).

12. One case decided during the Survey period, *In re Farb Inv. Interest Ltd.*, 155 B.R. 442 (Bankr. S.D. Tex. 1993), wrongly suggests that it is settled law in Texas that a holder of a lien may unilaterally subordinate his lien to a leasehold interest prior to the sale. *Id.* at 445. While we are aware of no Texas cases which support the court's position, two cases impliedly suggest otherwise. See *United General Ins. Agency v. American Nat'l Ins. Co.*, 740 S.W.2d 885, 886 (Tex. App.—El Paso 1987, no writ) (citing *W. MIKE BAGETT, TEXAS FORECLOSURE, LAW AND PRACTICE* § 2.87 (1984)); *Peterson v. NCNB Texas Nat'l Bank*, 838 S.W.2d 263, 266 n.2 (Tex. App.—Dallas 1992, no writ).

13. *Durkay v. Madco Oil Co.*, 862 S.W.2d 14, 21 (Tex. App.—Corpus Christi 1993, writ requested) (relying on *Diversified Inc. v. Gibraltar Sav. Ass'n*, 762 S.W.2d 620, 623 (Tex. App.—Houston [14th Dist.] 1988, writ denied)). The plaintiff in *Madco* claimed that a lender wrongfully foreclosed upon the plaintiff's property and sought the return of the foreclosed property and the voiding of the trustee's deed which conveyed the foreclosed property. In defending this claim, the lender argued that the four year limitations period applicable to suits on contracts, TEX. CIV. PRAC. & REM. CODE ANN. § 16.051 (Vernon 1986 & Supp. 1994), barred the plaintiff's claim. The appellate court concluded, however, that TEX. CIV. PRAC. & REM. CODE ANN. § 16.033(a)(7) (Vernon 1986 & Vernon Supp. 1994), and not § 16.051, governed the case before the court. *Madco*, 862 S.W.2d at 18. At the time considered by the court, § 16.033 provided that a suit to set aside a deed on the basis of a claimed defect specified

ardless of knowledge of claims subordinate to the lien of the foreclosing lender, takes good title to the property free of all such subordinate claims;¹⁴ a mortgagor who suffers damage, loss or injury caused by irregularities in the foreclosure sale process is entitled to sue for damages or sue to invalidate the sale;¹⁵ the twenty-one day notice period under the Texas foreclosure statute¹⁶ does not require the exclusion of both the day of posting and the date of sale;¹⁷ a debtor may waive his right to receive a notice of intent to accelerate a note provided that the waiver is in writing and is clear and unequivocal;¹⁸ and notwithstanding a foreclosure of a lien superior to a leasehold interest, the purchaser at the foreclosure sale and the tenant may agree to continue the lease in full force and effect or such an agreement may be implied by the actions of the parties such as payment and acceptance of rent.¹⁹

The case law over the last several years should lead mortgagees to expect that their documents generally will be enforced as written. However, where the mortgagee's written documents are less than absolutely clear, the mortgagee may suffer consequences not initially intended. Two Survey period

within § 16.033, including a claim that a trustee executed a deed without record of the trustee's authority to do so, must be brought within ten years after the date the deed is recorded with the county clerk. TEX. CIV. PRAC. & REM. CODE ANN. § 16.033(a)(7) (Vernon 1986 & Vernon Supp. 1994). Although the court's conclusion is correct, the precedential value of the court's conclusion is questionable since the court granted a motion for (and issued a new opinion following) a rehearing in which the plaintiff dropped its claim for return of the property and instead sought damages resulting from wrongful foreclosure. Note is made that by an amendment effective September 1, 1993, the Texas legislature amended § 16.033 to reduce the ten year limitations period to four years with respect to suits filed on or after that date. TEX. CIV. PRAC. & REM. CODE ANN. § 16.033(a)(7) (Vernon 1986 & Vernon Supp. 1994).

14. *Grant v. U.S. Dep't of Veterans' Affairs*, 827 F. Supp. 418, 422 (S.D. Tex. 1993); *Gainesville Oil & Gas Co. v. Farm Credit Bank*, 847 S.W.2d 655, 658 (Tex. App.—Texarkana 1993, n.w.h.).

15. *Gainesville Oil & Gas Co.*, 847 S.W.2d at 659; *First State Bank v. Keilman*, 851 S.W.2d 914, 921 (Tex. App.—Austin 1993, writ denied).

16. TEX. PROP. CODE ANN. § 51.002(b) (Vernon 1984 & Supp. 1994).

17. *Parker v. Frost Nat'l Bank*, 852 S.W.2d 741, 743-44 (Tex. App.—Austin 1993, writ granted); *Onwuteaka v. Cohen*, 846 S.W.2d 889, 893 (Tex. App.—Houston [1st. Dist.] 1993, writ denied). In 1993, the Texas state legislature amended TEX. PROP. CODE ANN. § 51.002 to require that the entire day on which the twenty-one day notice of foreclosure is given be included in the calculation of the twenty-one day notice period and that the entire day of the foreclosure sale be excluded from the calculation of the twenty-one day notice period. TEX. PROP. CODE ANN. § 51.002(g) (Vernon Supp. 1994).

18. *Parker*, 852 S.W.2d at 744. In *Parker*, the debtor argued that although the waiver contained in the note clearly and unequivocally waived the debtor's right to a notice of intent to accelerate, the notice was rendered ambiguous because the other loan documents did not contain such a waiver. The court concluded that any requirement that all loan documents contain the waiver of notice of intent to accelerate would be "unnecessarily duplicative." *Id.* The debtor also argued that the foreclosure was wrongful because the noteholder failed to allow the debtor a 20-day period to cure his default under § 51.002(d) of the Texas Property Code, which generally sets forth the noteholder's and debtor's respective obligations and rights regarding notice and cure when the property which is the subject of the foreclosure sale is the debtor's residence. TEX. PROP. CODE ANN. § 51.002(d) (Vernon Supp. 1994). The *Parker* court concluded that the debtor's argument was flawed in one significant respect—the property foreclosed upon was not the debtor's residence. 852 S.W.2d at 744-45. Effective September 1, 1993, the Texas legislature amended § 51.002 by expressly providing that § 51.002 (d) applies only to foreclosures involving a debtor's residence. TEX. PROP. CODE ANN. § 51.002(d) (Vernon Supp. 1994).

19. *Parker*, 852 S.W.2d at 745.

cases are good examples of this maxim. In the first case, *Law Offices of C. Kendall Harrell, P.C. v. Commerce Savings Association*,²⁰ a lender financed an unrelated party's acquisition of an office complex from an affiliate of the lender. The acquired property included a leasehold interest created in a parking agreement entitling the lessee to lease a specified number of parking spaces in a garage located on land adjacent to the acquired property. The lessee under the parking agreement also had the right to sublease parking spaces in the garage to individual third parties. The parking agreement was clearly intended to enable the owner of the office complex to provide parking in close proximity to the office complex for tenants of the complex. Notwithstanding the parking agreement's importance to the purchaser of the office complex, the documents evidencing the acquisition loan neither allocated any portion of the loan proceeds to the acquisition of the leasehold interest nor expressly included the leasehold interest as part of the collateral securing the acquisition loan. Moreover, the deed conveying the office complex to the borrower did not include a description of or a reference to the leasehold interest. The borrower later defaulted on the acquisition loan. Following the default, the lender and the borrower each sent letters to tenants of the office building representing themselves as the proper party to receive the office rentals and parking rentals for the spaces subleased pursuant to the parking agreement. Concerned over who had the legal right to the office and parking rents, certain tenants of the office complex filed interpleader actions against the lender and borrower, requesting the court to determine which party was entitled to those rents.²¹ The lender and borrower made various cross-claims against each other, the most basic of which were competing claims to the office and parking rents. In addition, the borrower went on the offensive, seeking a determination that the borrower was entitled to equitable reimbursement for the operating expenses incurred between the date of default and the date of foreclosure and that it was the owner of the leasehold interest in the parking agreement.

The trial court granted summary judgment to the lender on the issue of ownership of the office rentals, concluding that the assignment of rents was absolute in nature and that the lender became entitled to all rents collected by the borrower from and after the date of default until the date of foreclosure.²² Attempting to expand its recovery, the lender argued that it was

20. 824 F. Supp. 1159 (W.D. Tex. 1993).

21. After the filing of the interpleader action, the RTC became the conservator of the lender and removed the actions from state court to federal court.

22. *Law Offices of C. Kendall Harrell, P.C.*, 824 F. Supp. at 1167, 1172. The form of assignment is set forth on page 1177 of the court's opinion and is nearly identical to the assignment which the Fifth Circuit held to be absolute in *Federal Deposit Ins. Corp. v. International Property Management, Inc.*, 929 F.2d 1033, 1037-38 (5th Cir. 1992). Based on the loan documents, the court determined that the default in payment occurred only after the contractual notice and cure periods expired and that the lender became entitled to the building rents received from and after the date of default. *Law Offices of C. Kendall Harrell, P.C.*, 824 F. Supp. at 1172-75. Notwithstanding these determinations, the court concluded that the borrower was the proper owner of the building rents collected during the month of default because the lender (1) failed to introduce any evidence that the rentals collected during the month of default were collected after the date of default and (2) failed to establish what portion of the rentals col-

entitled to recovery of punitive damages on the theory that the borrower improperly converted the rents. Although the court recognized that the lender had an arguable claim of conversion as to rents received by the borrower after the date of its default, the court declined to so hold because the court had already awarded the lender the rents on the theory of absolute assignment. Moreover, punitive damages were inappropriate since, in the court's judgment, the borrower had not acted wantonly or maliciously.²³

Attempting to acquire the rents through a back door, the borrower argued that it was entitled to equitable reimbursement for operating expenses incurred after the date of the borrower's default.²⁴ The court slammed the door shut, however, concluding that the borrower's contract, and not equity, controlled the issue of reimbursement for operating expenses.²⁵ As one would expect, the court located provisions in the deed of trust obligating the borrower to pay promptly all expenses incurred in connection with the mortgaged property and to reimburse the lender for any expenses incurred in connection with the use, custody, or operation of the mortgaged property.²⁶ These provisions clearly established the borrower's responsibility for the operating costs of the office complex prior to foreclosure, thereby eliminating any possible claim for equitable reimbursement.²⁷

Wanting more than the rents and perhaps to obtain what it thought to be an absolute need for operating and leasing its newly acquired office complex, the lender sought ownership of the leasehold interest in the parking garage, arguing that the definition of the collateral under the loan documents expressly included the leasehold interest. In the alternative, the lender argued that the leasehold interest was an appurtenance to the mortgaged property and therefore a part of the collateral secured by the deed of trust. Not surprisingly, the court appeared somewhat befuddled by the lender's express inclusion argument as there was no specific reference to the leasehold interest in the description of the collateral in the loan documents. Placating the lender, the court acknowledged the collateral description was arguably ambiguous.²⁸ The court concluded, however, that an ambiguous collateral description was not a sufficient reason to declare the leasehold interest a part of the mortgaged property.²⁹ The court then rejected the lender's appurte-

lected during the month of default was attributable to office rents as opposed to the parking rents. *Id.* at 1175.

23. *Id.* at 1178 (citing *George Thomas Homes, Inc. v. Southwest Tension Sys., Inc.*, 763 S.W.2d 797, 797 (Tex. App.—El Paso 1988, no writ)).

24. The lender argued that the borrower was not entitled to reimbursement because of the unclean hands theory and because the borrower failed to exhaust the administrative claims process pursuant to 12 U.S.C. § 1821(d)(3). The court rejected these arguments, but fortunately for the lender, the court (on its own initiative) concluded that the borrower was not entitled to reimbursement under the provisions of the loan documents. *Id.* at 1180. *See infra* notes 25-27 and accompanying text.

25. *Id.* at 1180.

26. *Id.*

27. *Id.*

28. *Id.* at 1182. Based on the limited language of the deed of trust and conveyance documents quoted or summarized in the court's opinion, the court's assumption of ambiguity was probably charitable.

29. *Id.*

nance argument, reasoning that the parking available under the parking agreement was not indispensable to the use and enjoyment of the office complex as required by Texas law.³⁰ Disbelieving the court's position, the lender countered, arguing that the parking spaces were important inducements to prospective tenants. Perhaps so, acknowledged the court, but no evidence appeared in the record indicating that the parking spaces were absolutely necessary in order to obtain new tenants. Moreover, the defaulting and disenfranchised owner had presented evidence showing that it had obtained some tenants without the necessity of providing parking spaces in the garage.³¹

Apparently believing a vendor's lien to be broader in scope than the deed of trust lien, the lender argued that the express vendor's lien retained in the warranty deed that conveyed the improvements to the borrower and/or the implied vendor's lien to which the lender was entitled under common law created a lien against the leasehold interest under the parking agreement. The court acknowledged that both the express vendor's lien and the implied vendor's lien created a lien against the land, the office building, and the appurtenances.³² The court held, however, that neither the express vendor's lien nor the implied vendor's lien covered the leasehold interest in the parking garage, reasoning that the leasehold interest was not an appurtenance, was not expressly conveyed by the deed, and was not acquired with the purchase money.³³

Having lost each argument under the loan and conveyance documents, the lender sought reformation of the deed of trust and warranty deed, arguing that the leasehold interest was not covered by either the loan documents or the warranty deed because of a mistake. The court recognized that under certain circumstances the doctrine of mutual mistake entitles a party to reformation of a contract and that Texas law permits a contract to be set aside if the acts of another party induce a unilateral mistake.³⁴ Under the facts before it, however, the court concluded that no mutual mistake existed because the lender claimed that the leasehold estate was to be covered by the deed of trust lien and the vendor's lien, while the borrower claimed that neither the deed of trust lien nor the vendor's lien was intended to cover the leasehold estate.³⁵ The court further noted that counsel for each party testified that no mistake, "unilateral or otherwise," had occurred with respect to

30. *Id.* at 1183 (citing *Pine v. Gibraltar Sav. Ass'n*, 519 S.W.2d 238, 241 (Tex. Civ. App.—Houston [1st Dist.] 1974, writ ref'd n.r.e.), which concluded that an appurtenance means "all rights and interests in other property [that are] necessary for the full enjoyment of the property conveyed and which [are] used as necessary incidents thereto" and *Ogden v. Jones*, 37 S.W.2d 777, 780 (Tex. Civ. App.—Austin 1931, writ dism'd)).

31. *Law Offices of C. Kendall Harrell, P.C.*, 824 F. Supp. at 1183. Noticeably absent from the court's discussion was whether parking was available in the general area of the office complex and whether the parking was needed to satisfy any applicable zoning ordinance.

32. *Id.* at 1184.

33. *Id.* The first two reasons supported the court's holding as to the express vendor's lien and the last reason supported the court's holding as to the implied vendor's lien. *Id.*

34. *Id.* at 1185.

35. *Id.* at 1185-86.

the drafting of the documents.³⁶ Based on these facts and the sophistication of the parties, the court reached the inescapable conclusion that neither party had been induced by the other to make a unilateral mistake.³⁷

Realizing that it had lost the war over the ownership of the leasehold estate, the lender argued that it was entitled to offset all parking rentals paid in respect of the subleased parking spaces against the deficiency under the note. The court had little difficulty declaring the lender victorious in this skirmish, as the deed of trust granted the noteholder an extremely broad right of offset.³⁸

In the second case, *Federal Deposit Insurance Corp. v. Bodin Concrete Co.*,³⁹ a borrower executed a deed of trust containing a dragnet clause which provided that the mortgage secured a specific promissory note,⁴⁰ together with all other debts "which may hereafter . . . be owing by [the borrower] to the [lender]."⁴¹ Following execution of the mortgage, the bank and the borrower entered into a settlement agreement regarding several notes executed by the borrower prior to the execution of the deed of trust. Several months after the execution of the settlement agreement, two contractors filed mechanic's liens against the property mortgaged to the bank, claiming that the borrower had not paid for materials used at the mortgaged property. A few months after the filing of the mechanic's liens, the borrower defaulted under the settlement agreement and, relying on that default, the bank foreclosed its lien against the mortgaged property. The holders of the mechanic's liens promptly filed a declaratory judgment action, seeking determinations that the bank's foreclosure was void, the bank's deed of trust did not secure the borrower's obligations under the settlement agreement, and that the settlement agreement resulted in an accord and satisfaction of the deed of trust.⁴² The trial court granted summary judgment in favor of the

36. *Id.* at 1186.

37. *Id.*

38. *Id.* at 1187.

39. 869 S.W.2d 372 (Tex. App.—Dallas 1993, writ denied).

40. According to testimony given in the trial court, the borrower executed the promissory note in connection with the bank's issuance of a letter of credit for the benefit of the borrower. Although not a party to the lawsuit filed by the holder of the mechanic's lien, the borrower testified that the bank orally agreed to fund the note only to the extent that draws were funded under the letter of credit and that the bank funded no draws under the letter of credit. The FDIC, which arrived on the scene after the bank failed, argued that *D'Oench, Duhme* and Section 1823(e) barred the borrower's alleged agreement with the bank regarding funding of the note. For a more thorough discussion regarding the *D'Oench, Duhme* doctrine and Section 1823(e) issues in this case, see *infra* notes 216-19 and accompanying text.

41. *Bodin Concrete*, 869 S.W.2d at 374.

42. On an initial appeal of this case, the appellate court concluded that the mechanic's liens were invalid because the holders failed to provide notices required by the statute. On this second appeal, however, the court concluded that each of the suppliers was an original contractor entitled to a constitutional mechanic's lien, and that the constitutional mechanic's liens would be superior to the bank's prior recorded deed of trust as to the materials supplied if the materials supplied could be removed without material injury to the mortgaged property. *Id.* at 381-82 (relying on *Justice Mortgage Investors v. C.B. Thompson Constr. Co.*, 533 S.W.2d 939, 944 (Tex. Civ. App.—Amarillo 1976, writ ref'd n.r.e.)). Because the trial court did not reach a determination as to material injury to the mortgaged property and there was no evidence in the record concerning material injury, the court concluded that the priority issue should be determined by the trial court on remand. *Id.*

bank and the appeals court reversed and remanded. On remand, the trial court found in favor of the holders of the mechanic's liens. The bank then appealed, arguing that the trial court erred in finding that (1) the dragnet clause in the deed of trust applied only to funds advanced to the borrower after the execution of the deed of trust and (2) the bank wrongfully foreclosed.

In construing the dragnet clause, the court concluded that no substantive difference existed between the words "which may hereafter be owing," used in the dragnet clause at issue, and the words "which may hereafter become owing," used in a dragnet clause in a prior case decided by the Texas Supreme Court and which, according to the *Bodin Concrete* court, the Texas Supreme Court construed to encompass only funds advanced in the future.⁴³ Since the borrower executed the notes addressed in the settlement prior to the deed of trust, the *Bodin Concrete* court held that the deed of trust did not secure those notes.⁴⁴ Therefore, the bank had no right to foreclose the lien of the deed of trust on account of a default under those notes or the settlement agreement. Accordingly, the court held that the lender wrongfully foreclosed and voided the foreclosure sale.⁴⁵ Although the court's holding logically follows from the court's construction of the dragnet clause, the court arguably erred in concluding that no difference existed between the phrases "which may hereafter be owing" and "hereafter becomes owing." According to Webster's Dictionary, "become" refers to that which comes to be (i.e., an amount which comes to be owing) while "be" refers to that which exists at any give time.⁴⁶ Therefore, that which "hereafter becomes owing" is logically a future advance, while that which "hereafter may be owing" is that which is owing on any given date, regardless of when advanced.⁴⁷

The *Commerce Savings* and *Bodin Concrete* cases demonstrate that a

43. *Id.* at 377 (citing and quoting *Estes v. Republic Nat'l Bank*, 462 S.W.2d 273, 276 (Tex. 1970)). Actually, the Texas Supreme Court did not attribute any particular meaning to the quoted phrase. Rather the *Estes* court held that the phrase "owing or which may hereafter become owing" by the borrower to the bank unambiguously referred to all indebtedness at any time owed by the borrower to the Bank. *Estes*, 462 S.W.2d at 276.

44. *Bodin Concrete*, 869 S.W.2d at 377.

45. *Id.*

46. WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 136, 139 (1986). Stated more simply, \$50 that you owe to me today may also be owing to me in the future, and if you borrow more money from me in the future, you will become further indebted to me.

47. Two other interpretive issues were presented to the court. The settlement agreement contained a mutual release releasing the parties from "any cause of action" and a provision recognizing that the settlement agreement superseded all prior agreements concerning the subject matter of the settlement agreement. The holders of the mechanic's liens asserted that the bank's right to foreclose its lien upon a default constituted a cause of action. Therefore, the holders of the mechanic's liens argued that the bank released its right to foreclose its lien pursuant to the mutual release contained in the release agreement. The court, with no difficulty, rejected the holders' argument, holding that a private power of sale contained in a deed of trust does not constitute a cause of action under Texas law. *Bodin Concrete*, 869 S.W.2d at 378. The holder of the mechanic's liens also argued that the bank waived its right to foreclose on the basis that the settlement agreement constituted the entire agreement of the parties. The court agreed that the settlement agreement constituted the entire agreement of the parties, but only as to the subject matter of the settlement agreement. *Id.* at 378-79. The court held that because the deed of trust did not secure the debt covered by the settlement agreement, the subject matter of the settlement agreement did not include the deed of trust. *Id.* Accordingly,

mortgagee must be concerned that its documents clearly express the mortgagee's intent. However, Texas courts do not have a license to require that particular provisions in a mortgage document expressly address every contingency in order to be logically read, as demonstrated by *Edwards v. Holleman*.⁴⁸ In *Holleman*, a noteholder accelerated the note and the trustee instituted foreclosure proceedings. Prior to the foreclosure sale, the debtor located a purchaser for the property and requested a payoff figure from the noteholder. The payoff figure included attorney's fees and trustee's fees, to which the debtor objected. Nevertheless, the debtor went forward with the sale and paid the attorney's fees and trustee's fees under protest at the closing. The debtor then brought suit against the noteholder to recover the fees. Perhaps to the shock of the noteholder, the district court entered judgment in favor of the debtor and the noteholder appealed to the Houston Court of Appeals.

The court of appeals examined the language of the loan documents to determine the noteholder's right to demand reimbursement for attorney's fees and/or trustee's fees. The deed of trust provided for the noteholder's right to reimbursement of costs and expenses, including reasonable attorney's fees, incurred by the noteholder in connection with the exercise of its rights and remedies. Inexplicably, however, the Houston Court of Appeals concluded that the trustee's fees were not costs and expenses covered by this deed of trust provision.⁴⁹ The court looked instead to another provision of the deed of trust that provided that the noteholder had the right to apply the proceeds received from a foreclosure sale to the payment of trustee's fees and attorney's fees.⁵⁰ This provision, according to the court, entitled the noteholder to payment for trustee's fees only if a foreclosure sale actually occurred.⁵¹ Disagreeing with the court's conclusion, the noteholder appealed to the Texas Supreme Court, which, in a *per curiam* opinion, concluded that the trustee's fees logically constituted a cost and expense incurred in enforcing the noteholder's rights and remedies; therefore, the trustee's fees were recoverable under the deed of trust.⁵²

B. DEFICIENCY

Section 51.003 of the Texas Property Code, which applies to deficiency actions arising out of foreclosures occurring on or after April 1, 1991, allows any person pursued for a deficiency to request the court to determine the fair market value of the property at the time of foreclosure.⁵³ If the court deter-

the "settlement agreement did not extinguish the [b]ank's foreclosure right under the [deed of trust]." *Id.* at 379.

48. 862 S.W.2d 580 (Tex. 1993).

49. *Edwards v. Holleman*, 842 S.W.2d 704, 706-07 (Tex. App.—Houston [1st Dist.] 1992), *rev'd*, 862 S.W.2d 580 (Tex. 1993).

50. *Id.* at 706.

51. *Id.*

52. 862 S.W.2d at 581. In somewhat of a backhanded slap, the Texas Supreme Court stated that the court of appeals' holding did not logically follow from the deed of trust provision relied on by that court. *Id.*

53. TEX. PROP. CODE ANN. § 51.003(b) (Vernon Supp. 1994).

mines that the property purchased at foreclosure sold for less than its fair market value, the statute requires the reduction of the deficiency by the amount by which the fair market value, less the secured indebtedness not extinguished by the foreclosure, exceeds the sale price.⁵⁴ *Federal Deposit Insurance Corp. v. Schwarzer*,⁵⁵ the first case that applied section 51.003 to a deficiency action, involved a borrower who defaulted on a \$230,000 note secured by a deed of trust. Prior to commencing the foreclosure sale, the noteholder received a financial statement from the borrower establishing the value of the property at \$50,000. To support this value, the borrower submitted the research of a local realtor and statements from local realtors that the property would not sell for more than \$35,800. The noteholder also received two appraisals, one dated approximately sixteen months prior to the foreclosure sale established the value of the property at \$140,000 and the other dated approximately three months prior to the foreclosure sale established the value of the property at \$77,500. The \$77,500 appraisal assumed the property would be sold in two to three months after the date the property was placed on the market.

After receiving this information, the noteholder commenced foreclosure proceedings and, as the highest bidder, acquired the property at the foreclosure sale for a price of \$69,500. The noteholder then brought suit against the borrower to collect the deficiency resulting from the foreclosure sale. After the noteholder brought the deficiency action, the borrower obtained a new appraisal establishing the value at \$153,000, if the property were used for a commercial or apartment development and sold in twelve to eighteen months. Shortly after obtaining this appraisal, the borrower, pursuant to section 51.003, requested the court to determine the fair market value of the foreclosed property.

Although the court did not provide a definition of fair market value, the court's review of the evidence relating to the value of the property provides some guidance as to the evidence a court might accept in determining fair market value. The court gave little weight, if any, to the appraisal dated approximately sixteen months before the foreclosure sale. The \$153,000 appraisal obtained by the borrower after the foreclosure sale fared little better. The court concluded that the \$153,000 value, which assumed that the property would be used for commercial or apartment development, was not realistic for several reasons. First, the property was located approximately twenty to thirty minutes outside of the city off of a major highway; second, some evidence existed indicating that the property served as a habitat for two endangered species; and third, the general real estate market continued to experience a general softening.⁵⁶ Moreover, the court did not lose sight of the fact that the borrower unsuccessfully attempted to sell the property dur-

54. *Id.* § 51.003(c).

55. 812 F. Supp. 700 (W.D. Tex. 1992).

56. *Id.* at 702. The court suggested that until further investigation established that the property did not serve as a habitat for endangered species, the mere allegation that the property might serve as a habitat for endangered species would significantly affect the value of the property. *Id.* at n.4.

ing the preceding three years.⁵⁷

According to the court, the appraisal setting the value of the property at \$77,500 accurately established the fair market value of the property, especially in light of the fact that this value most closely agreed with the borrower's financial statements and the letter supplied by the borrower, both of which relied on consultations with local real estate agents.⁵⁸ The borrower argued that the \$77,500 appraisal did not accurately establish the property's fair market value because the appraisal established value as of a date several months earlier than the foreclosure sale and the appraisal utilized a disposition period of two to three months, as opposed to the period generally used in commercial appraisals (nine to eighteen months). However, the testimony of the preparer of the \$77,500 appraisal and the fact that the borrower had been offering the property for sale for well over eighteen months convinced the court that the appraiser's opinion of fair market value would not differ if the appraiser had determined fair market value as of the foreclosure sale date or if the appraiser had used a disposition period of nine to eighteen months.⁵⁹

C. SUBROGATION

Three cases decided during the Survey period dealing with the principle of equitable subrogation deserve discussion. In one of the cases, *Dietrich Industries, Inc. v. United States*,⁶⁰ a buyer and seller agreed to use the proceeds from the sale of property to obtain a release of the first lien against the property being sold. Even though the sale generated proceeds less than the debt secured by the first lien, the holder of the first lien agreed to release its lien in exchange for receipt of the full sales price. Apparently, either the buyer's title company committed a significant error or the buyer failed to have a title search performed, because a properly recorded tax lien affecting the property existed at the time of closing. The tax lien, however, was subordinate to the first lien which had been released in exchange for the sales proceeds. After becoming aware of the existence of the federal tax lien, the buyer filed a declaratory action against the government seeking a determination that the doctrine of equitable subrogation entitled the buyer to be equitably subrogated to the first lien released in exchange for the sales proceeds. The district court rejected the buyer's equitable subrogation argument and the buyer appealed to the Fifth Circuit.

On appeal, the government argued that an appeals court case, *McDowell v. M.T. Jones Lumber Co.*,⁶¹ controlled the case before the court. In *McDowell*, the court held that a purchaser was not entitled to be subrogated to a lien released in connection with the purchase, even though (1) the purchase price

57. *Id.* at 702. The importance of the court's observation that the property had not sold for three years is somewhat negligible without knowing at what price the property had been offered for sale.

58. *Id.*

59. *Id.* at 702-03.

60. 988 F.2d 568 (5th Cir. 1993).

61. 93 S.W. 476 (Tex. Civ. App. 1906, no writ).

was used to obtain the release of the lien and (2) the purchaser was not aware of a junior lien affecting the property.⁶² The Fifth Circuit agreed that if *McDowell* controlled, the plaintiff's equitable subrogation argument would fail.⁶³ The court, however, concluded that *McDowell* contradicted two Texas Supreme Court decisions, *Fears v. Albea*⁶⁴ and *First National Bank v. Ackerman*,⁶⁵ each of which allowed a purchaser of land to be equitably subrogated to a lien where the seller and purchaser agreed that the sales proceeds would be used to satisfy the debt secured by that lien.⁶⁶ In the court's judgment, the *Fears* and *Ackerman* holdings required the Fifth Circuit to hold that the doctrine of equitable subrogation entitled the buyer to be equitably subrogated to the lien released in exchange for the sale proceeds.⁶⁷ In reaching this holding, the court made clear that the equities favored the buyer, noting that if the buyer had been aware of the government's liens, the buyer would have had the opportunity to structure the transaction in a way that would have protected the buyer's interest in the property.⁶⁸ Moreover, the property records established the inferiority of the government's lien before the release of the lien and the purchase of the property. To elevate the government's position above the party who paid for the release in order to protect its interest in the property would, in the court's opinion, allow the government to receive an unearned windfall.⁶⁹

The government countered with two arguments, neither of which received more than a polite nod from the court. The government first argued that the buyer's constructive knowledge of the federal tax lien barred the buyer from claiming equitable subrogation.⁷⁰ Recognizing that some jurisdictions hold that constructive knowledge bars an equitable subrogation claim, the court concluded that Texas law supports a contrary conclusion.⁷¹ Grasping at the

62. *Id.* at 476-77.

63. *Dietrich Indus.*, 988 F.2d at 571.

64. 69 Tex. 437, 6 S.W. 286 (1887).

65. 70 Tex. 315, 8 S.W. 45 (1888) (holding that purchaser was equitably subrogated to lien where seller promised to use sale proceeds to satisfy lien but failed to do so).

66. *Dietrich Indus.*, 988 F.2d at 571-72.

67. *Id.* at 572.

68. *Id.* at 573.

69. *Id.*

70. As authority for its position in *Dietrich Indus.*, the government relied on *Providence Inst. for Sav. v. Sims*, 441 S.W.2d 516 (Tex. 1969), in which the Texas Supreme Court noted that "[n]egligence on the part of one seeking subrogation is of some importance when the right is wholly dependent upon equitable principles." *Id.* at 519. However, the *Sims* court further noted that it located no Texas cases holding that constructive knowledge barred a party's right to claim equitable subrogation, but that one appellate court had held that a purchaser's constructive knowledge of a junior claim did not defeat the purchaser's right to claim equitable subrogation. *Id.* (citing *Sanger Bros. v. Ely & Waler Dry Goods Co.*, 207 S.W. 348 (Tex. Civ. App.—Fort Worth 1918, writ ref'd)).

71. *Dietrich Indus.*, 988 F.2d at 572 (relying on *Fears v. Albea*, 69 Tex. 437, 6 S.W. 286, 292 (1887)). In *Fears*, the purchaser and seller agreed to use the sales proceeds to satisfy the first lien against the property. At the time of purchase, a properly recorded second lien also existed against the property. However, the purchaser did not perform a search of the applicable real estate records and did not otherwise have actual knowledge of the junior lien. The junior lienholder subsequently foreclosed its lien and was the successful bidder, and the purchaser/owner sued seeking relief. Although the purchaser's constructive notice of the junior lien did not impair the purchaser's right to claim equitable subrogation, the court held that the

last straw, the government reminded the court that a party is not entitled to be equitably subrogated to a lien until the debt secured by the lien is paid in full.⁷² This rule, argued the government, barred the buyer's right to equitable subrogation because the buyer obtained the release by paying less than the entire secured debt. The court recognized the rule cited by the government, but also recognized that the rule existed to protect senior creditors who continue to hold lien rights following partial payment by a party other than the debtor.⁷³ On the facts before the court, although only partial payment had been made, the lienholder had agreed to discharge its lien in exchange for the partial payment. Since no senior lienholder existed and because the rule did not exist to benefit a junior lienholder such as the government, the court concluded that the rule did not bar the buyer's entitlement to equitable subrogation.⁷⁴

In the second equitable subrogation case, *O'Dell v. First National Bank*,⁷⁵ the Texas Supreme Court reached the right result but made an unnecessary holding that could have significant impact on future equitable subrogation cases. In *O'Dell*, the plaintiff purchased approximately 190 acres of land. The plaintiff financed the purchase by assuming a recourse note secured by a first lien against the land and delivering to the seller the plaintiff's recourse promissory note secured by a second lien against the land. The note secured by the first lien contained provisions entitling the obligor to fifteen days notice prior to acceleration of maturity. The plaintiff later sold the land, together with some additional land acquired by the plaintiff, to a third party who financed the purchase with a non-recourse promissory note payable to the plaintiff and secured by a third lien against the property. Thereafter, that purchaser obtained a loan from a bank to satisfy, among other things, the first and second liens. The bank secured its loan with a fourth lien deed of trust which characterized (1) the liens securing payment of the bank's note as subordinate to the third lien, except to the extent of the amount of the first and second lien indebtedness satisfied with the proceeds from the bank's financing⁷⁶ and (2) the first and second liens as valid and subsisting liens assigned to the bank for the purpose of securing the payment of the

foreclosure of the junior lien was valid because the purchaser/owner had constructive knowledge of the junior lien at the time of the purchase, and that the holder of the junior lien, as the purchaser at the foreclosure sale, became the owner of the property. *Fears*, 6 S.W. at 292. The court further held, however, that the property should be sold, with the proceeds being used to first satisfy the principal and interest due on the first lien note and the remainder of the proceeds being paid to the second lien holder. *Id.* Although the first lien note had previously been paid, the court apparently concluded that the amount required to satisfy the principal and interest on the first lien note was equal to that amount of principal and interest which would have been outstanding if the note had not been paid with the proceeds of sale.

72. *Dietrich Indus.*, 988 F.2d at 572..

73. *Id.*

74. *Id.* at 572-73.

75. 856 S.W.2d 410 (Tex. 1993).

76. Pursuant to the bank's deed of trust, the bank subordinated its liens up to a stated amount as to the portion of the land covered by the first, second and third liens and fully subordinated its liens to the third lien as to the remainder of the land, a 50 acre tract which apparently had been separately acquired by the third lienholder and constituted a part of the land purchased by the bank's borrower from the third lienholder.

bank's loan. The bank's deed of trust did not, however, provide for any of the notice provisions contained in the first lien note. The bank's note also waived all notices which had been reserved under the first lien note. The bank's borrower subsequently defaulted under the bank's note and the bank, without notifying the holder of the third lien, foreclosed its fourth lien at private sale. On the day following the bank's foreclosure of its fourth lien, the bank notified the holder of the third lien that the bank's foreclosure had extinguished the third lien. Shortly thereafter, the holder of the third lien privately foreclosed the third lien, and filed a declaratory judgment action seeking determinations that the bank had foreclosed a fourth lien, that the fourth lien was subordinate to the third lien and that the foreclosure of the plaintiff's third lien extinguished the bank's fourth lien. On summary judgment, the trial court found that based on the equitable subrogation doctrine the bank had foreclosed the first and second liens, and the holder of the third lien appealed to the San Antonio Court of Appeals.

In a confusing and somewhat cryptic decision that never mentions the words equitable subrogation let alone discusses the concept, the appellate court reversed the trial court.⁷⁷ Relying on the principle that "a mortgage can have no legal effect apart from the debt or obligation which it is designed to secure,"⁷⁸ the court held that the first and second liens ceased to exist at the moment the bank paid the debt secured by those liens.⁷⁹ With its equitable subrogation argument receiving no attention whatsoever, the bank appealed to the Texas Supreme Court.

The Texas Supreme Court recognized that a party is entitled to be subrogated to the liens securing a debt that is satisfied by that party at the request of the debtor and under circumstances that make it appear that the party making the payment is entitled to the benefits of the security for the satisfied debt.⁸⁰ Under this principle, the bank would not be entitled to equitable subrogation unless it established that its borrower was a debtor with respect to the first and second liens. To establish this as fact, the bank argued, somewhat weakly, that although its borrower had purchased the property "subject to" the first and second liens, the bank's borrower could and did assume liability under the first and second lien notes by signing the bank's note, which included the amounts that had previously been outstanding on the first and second lien notes. The court responded that the prior debt must be for the benefit of the debtor who, according to the court, is the party liable for payment of the debt at the time of the "subrogation transaction."⁸¹ Fur-

77. *O'Dell v. First Nat'l Bank*, 855 S.W.2d 1 (Tex. App.—San Antonio 1991), *rev'd*, 856 S.W.2d 410 (Tex. 1993).

78. *Id.* at 4 (citing *Teas v. Republic Nat'l Bank*, 460 S.W.2d 233, 243 (Tex. Civ. App.—Dallas 1970, writ *ref'd n.r.e.*); *Texas Bank & Trust Co. v. Custom Leasing, Inc.*, 402 S.W.2d 926 (Tex. Civ. App.—Amarillo 1966, no writ); *Spencer-Sauer Lumber Co. v. Ballard*, 98 S.W.2d 1054 (Tex. Civ. App.—San Antonio 1936, no writ)).

79. *Id.*

80. *O'Dell*, 856 S.W.2d at 415.

81. *Id.* This is clearly the case in subrogation cases which do not involve a purchase and sale financed through third party financing. The application of these principles are part of the difficulty with the court's broader holding that "the party must at least be an obligor *before* the

thering this concept, the court held that "a party must at least be an obligor before the renewal transaction for the [equitable subrogation] doctrine to apply."⁸² From this holding, the *O'Dell* court logically concluded that the bank was not entitled to rely on the equitable subrogation doctrine because the bank's borrower was not personally liable for the first and second lien notes before the renewal transaction occurred.⁸³ Although the court's conclusion is correct, the court's holding regarding the status of the debtor is broader than necessary. For example, if the holding is strictly applied, a third party lender who refinances a debtor's non-recourse (but secured) obligation owing to a prior lender would not be entitled to rely on the doctrine of equitable subrogation to take advantage of the priority of the prior lender's liens. In addition, in a purchase and sale situation similar to the facts of the *Dietrich* case, the lender providing the acquisition financing would not be entitled to equitable subrogation because its borrower never had liability on the satisfied debt. The *O'Dell* court probably did not anticipate or intend these results, and other courts relying on *O'Dell* should consider limiting the application of the *O'Dell* holding to the facts of the case or perhaps to mortgage subrogation cases involving holders of intervening interests.⁸⁴

The *O'Dell* case should be compared with *Med Center Bank v. Fleetwood*,⁸⁵ which also involved the holder of an intervening interest seeking to avoid a lender's claim that it was entitled to be subrogated to a lien which secured debt satisfied by the lender.⁸⁶ The facts concerning the intervening interest in *Fleetwood*, however, differ in two significant respects. First, the

renewal transaction for the [equitable subrogation] doctrine to apply." *Id.* at 416 (emphasis added); see *infra* notes 81-84 and accompanying text.

82. *Id.* at 416 (emphasis added).

83. *Id.*; cf. *Lindsey, Stephenson & Lindsey v. Federal Deposit Ins. Corp.*, 158 B.R. 75 (N.D. Tex. 1992) (holding a non-recourse note is a debt for purposes of determining the debtor's aggregate debt under 11 U.S.C. §§ 101(12), 109(f) (1988 & Supp. IV 1992)). In reaching its conclusion that the bank's borrower was not the debtor at the time of the subrogation transaction, the court relied on two ancient cases, *Faires v. Cockrill*, 88 Tex. 428, 31 S.W. 190, 194 (1895); and *Oury v. Saunders*, 77 Tex. 278, 13 S.W. 1030, 1031 (1890). Neither of these cases dealt with situations in which the purchaser utilized third party financing to acquire the property. The court should have more appropriately relied on the *Fears* and *Ackerman* cases relied on by the Fifth Circuit in *Dietrich Indus. v. United States*, both of which are subrogation cases involving third party financing used to fund the purchase price in a sale transaction between the lender's borrower and the owner of the property. See *supra* notes 60-74 and accompanying text.

84. The *O'Dell* court could have decided the equitable subrogation argument based solely on its holding that the bank could not claim the benefits of equitable subrogation since the equities favored the third lien holder. 856 S.W.2d at 416. In the court's judgment, the bank's avoidance of the notice provisions (1) unfairly enabled the bank, the fourth lien holder, to obtain the equity in the property and (2) unfairly denied the third lien holder its right to protect the property, the only asset from which the third lien debt could be satisfied. *Id.* The court could have relied on this reasoning to achieve its apparent goal to deny the bank the ability to obtain the equity in the property over and above the amount of the first lien debt without first giving the third lien holder the opportunity of satisfying the first and second lien notes, as contemplated by the notice provision of the first lien note.

85. 854 S.W.2d 278 (Tex. App.—Austin 1993, writ denied).

86. *Id.* at 285 (quoting *Fleetwood v. Med. Ctr. Bank*, 786 S.W.2d 550, 553-54 (Tex. App.—Austin 1990, writ denied)).

initial holder of the lien to which the subsequent lender claimed a right of subrogation also held the intervening interest, a leasehold estate expressly subordinated to the lien. Second, both the lien and the intervening interest arose out of the same financing transaction. Relying on the principle that lenders who refinance or satisfy debt should be entitled to be subrogated to any liens securing the refinanced debt or satisfied debt "unless the superior or equal equities of others would be prejudiced thereby," the court held that the refinancing lender in *Fleetwood* correctly asserted its right of subrogation, thereby extinguishing the subordinate leasehold estate.⁸⁷ Furthering its observation that subrogation strengthens the recognized policy of allowing debtors to refinance their debts, the court concluded that "absent a showing that subrogation results in additional debt having priority over or parity with the intervening interest, a material change in the terms of the superior interest, or other pecuniary loss resulting from the subrogation, there is no prejudice to intervening interest holders."⁸⁸ Generally, the *Fleetwood* court's statements and conclusions are logically made and presented.⁸⁹ If the *O'Dell* court had utilized similar principles and conclusions, the *O'Dell* court could have reached the desired result, without enunciating its broad holding.

D. NOVATION

In two Survey decisions, a party argued that the execution of a new note

87. *Id.* at 287-88.

88. *Id.* at 286. In *Fleetwood*, the holder of the leasehold estate claimed that it carefully crafted the transaction to provide for both the lien and the leasehold estate in order to provide the utmost flexibility concerning its rights in the property covered by both the lien and the leasehold estate. The court, however, concluded that the intention of the intervening party is irrelevant with regard to the subrogation determination. *Id.* at 287. Moreover, allowing the holder of the leasehold estate to prevent subrogation would, in the court's opinion, "violate the policy favoring debtor refinancing of debts and the policy against 'clogging' of the equitable right of redemption of debts." *Id.* at 286 (relying on *Peugh v. Davis*, 96 U.S. 332, 337 (1877); *Laird v. Weis*, 85 Tex. 93, 23 S.W. 864, 865 (1892)).

89. While the majority court recognized that subrogation does not wholly depend on equity where the deed of trust given by the debtor acknowledged the use of the proceeds to pay off the prior debt and subrogated the lender to the rights of the preceding lender regarding the prior lien, a dissenting opinion recognized that subrogation is a doctrine of equity, unchanged by a subrogation agreement between the new lender and the debtor. *Id.* at 287. This difference in opinion, however, did not significantly impact the result of the case in light of the majority's use of equitable principles. The *Fleetwood* court also addressed a subsidiary issue concerning subordination. As stated above, the lessee, who also initially held the lien to which the subsequent lender claimed a right of subrogation, expressly subordinated the lease to the lien. The lessee later subordinated its lien to a lien securing long term financing for the property, but did not expressly subordinate the lease to the lien securing the long term financing. The lessee claimed that its lease had priority over the lien securing the long term financing since the lease had never been subordinated to that lien. Without citing any authority for its position, the court concluded that the lien securing the long term financing had priority over the lease because the lease had been expressly subordinated to the first lien and the first lien had been expressly subordinated to the lien securing the long term financing. *Id.* at 283. The court's conclusion is extremely questionable since no contractual subordination agreement existed between the holder of the lien securing the long term financing and the lessee. *Cf.* *Resolution Trust Corp. v. Kemp*, 951 F.2d 657, 662-63 (5th Cir. 1992) (holding that lot owners were not entitled to obtain the benefits of a subordination agreement between two lenders because lot owners were neither parties to nor third party beneficiaries of the subordination agreement).

extinguished a prior note by reason of a novation, the elements of which are (1) a prior valid contract, (2) an agreement by all parties to a new contract, (3) the extinguishment of the old contract, and (4) a new valid contract.⁹⁰ Both cases recognize that a novation need not be established by a writing, but may be established by the intent of the parties, which may be inferred from the facts and circumstances surrounding the transaction and the conduct of the parties involved in the transaction.⁹¹

In the first novation case, *Vivion v. Grelling*,⁹² the defendant executed a \$500,000 purchase money note in connection with his purchase of certain property. Subsequently, the defendant sold the property to a third party, who agreed to finance the acquisition by assuming the purchase money note and securing its obligation with an assumption deed of trust. In addition, and apparently as conditions to consenting to the sale of the property and the assumption of the prior note, the payee under the purchase money note (1) required the defendant to make a \$50,000 cash payment and (2) required the purchaser to execute a new \$450,000 note and a deed of trust, which provided for the renewal and extension of the lien securing the defendant's \$500,000 note. Thereafter, the purchaser defaulted under the \$450,000 note. The payee then notified the defendant that the defendant was liable under the \$500,000 note and demanded that the defendant continue the payments, failing which the payee would foreclose its lien against the property. As an interim measure, the payee and the defendant entered into a letter agreement pursuant to which the defendant agreed to temporarily make payments to avoid foreclosure and acknowledged continuing liability under the \$500,000 note. Thereafter, the defendant ceased making payments and the payee foreclosed its lien and sued for a deficiency. The trial court concluded that the \$500,000 note had been extinguished through novation and the payee appealed.

The appeals court agreed with the trial court, holding that the \$500,000 note was extinguished through novation.⁹³ In so holding, the court found the following facts and testimony persuasive: (1) the defendant testified that he understood his \$50,000 payment to be in consideration for his release from liability under the \$500,000 note; (2) the purchaser testified that he believed the defendant had been released from all liability under the \$500,000 note; (3) the \$450,000 note, although equal to the unpaid balance of the \$500,000 note, failed to reference the \$500,000 note and contained

90. *Federal Deposit Ins. Corp. v. Waggoner*, 999 F.2d 826, 829 (5th Cir. 1993) (citing *Mandell v. Hamman Oil & Ref. Co.*, 822 S.W.2d 153, 163 (Tex. App.—Houston [1st Dist.] 1991, writ denied)); *Vivion v. Grelling*, 837 S.W.2d 255, 257 (Tex. App.—Eastland 1992, writ denied) (citing *Talamas v. Bressi Int'l*, 727 S.W.2d 72 (Tex. App.—San Antonio 1987, writ ref'd n.r.e.)).

91. *Waggoner*, 999 F.2d at 829 (citing *Chastain v. Cooper & Reed*, 152 Tex. 322, 257 S.W.2d 422, 424 (1953)); *Vivion*, 837 S.W.2d at 258 (citing *Bank of N. Am. v. Bluewater Maintenance, Inc.*, 578 S.W.2d 841 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.)).

92. 837 S.W.2d 255 (Tex. App.—Eastland 1992, writ denied).

93. *Id.* at 258.

terms significantly different than the terms contained in the \$500,000 note;⁹⁴ (4) the defendant designated its last payment under the prior note as "final payment;"⁹⁵ (5) the defendant testified that he entered into the letter agreement in order to have sufficient time to assess the situation; and (6) the defendant's legal counsel recommended that the defendant enter into the letter agreement because he doubted that there was an obligation under the prior note to revive.⁹⁶ After reading the case, one might logically conclude that the case involved a lucky lawyer and a luckier defendant.

In the second novation case, *Federal Deposit Insurance Corp. v. Wagoner*,⁹⁷ the FDIC unsuccessfully argued that a note which consolidated, renewed and extended two prior notes resulted in a novation of the two prior notes. The prior notes each provided that the borrower had no personal liability for the payment of the applicable note. The consolidation note provided that it renewed and extended the two prior notes, but did not carry forward the non-recourse language. The borrower later defaulted under the consolidation note. Approximately two years thereafter, the FDIC, which acquired the notes through a receivership, asserted that the borrower was personally liable for the payment of the consolidation note. The borrower refused to pay and the FDIC sued for collection, arguing that the consolidation note resulted in a novation of the prior notes. The court concluded that a novation of the prior notes had not occurred, relying on the facts that: (1) the consolidated note specifically stated that the prior notes were being renewed and extended; (2) the FDIC offered no evidence of novation other than the notes, while the borrower testified that both parties, at the time of the execution of the consolidation note, agreed not to change the personal liability exceptions contained in the prior notes; and (3) the FDIC waited nearly two years following default to assert that the borrower had personal liability under the consolidation note.⁹⁸ Even though the equities seem to favor the borrower, one is left wondering why the FDIC did not attempt to extend the tentacles of *D'Oench, Duhme*.⁹⁹

II. LENDER LIABILITY

Clearly, the proliferation of lender liability cases has declined during the past several years. Nevertheless, absent a perfect world, we will likely always see cases in which the lender incurs significant liability.¹⁰⁰ Consider, for example, the following case: dad needs money; dad visits friendly banker

94. The differences between the new note and prior note included the principal amount, period of repayment, interest rate and payment terms.

95. The defendant's last payment under the \$500,000 note was apparently made shortly before the sale of the property.

96. *Vivion*, 837 S.W.2d at 256-57.

97. 999 F.2d 826 (5th Cir. 1993).

98. *Id.* at 830-31.

99. See *infra* notes 133-49 and accompanying text.

100. In addition to the cases discussed in the text, see *Hernandez v. Union Nat'l Bank*, 149 B.R. 441, 443 (Bankr. E.D. Tex. 1993) (holding bank's application of a portion of mortgage payment to cost of mortgagee's appraisal not authorized under deed of trust and therefore an act of conversion).

to obtain blank notes payable to bank; dad asks daughter to "sign some papers" which happen to be friendly bank's blank notes; dad delivers signed notes to friendly banker; friendly banker fills out blank notes to his satisfaction and deposits proceeds of notes into daughter's account; dad withdraws funds from daughter's account and repays outstanding debts to bank; notes go into default; bank sues daughter; and bank loses suit on notes based on fraudulent inducement.¹⁰¹ Is anyone surprised?

Although the above case is clearly a situation in which the borrower had a legitimate defense and claim against the lender, most cases decided in recent years, including the case next discussed, show that a borrower must have a solid legal defense in order to assert damages successfully against a lender or to avoid its legal obligations to a lender.¹⁰² In *First State Bank v. Keilman*,¹⁰³ the borrower executed a promissory note which provided for an interest rate at the "prime rate . . . plus Two percent (12.5%) per annum."¹⁰⁴ After the execution of the note and apparently without notifying the borrower, the lender deleted the reference in the note to "(12.5%)" and replaced it with "(2%)." A deed of trust which secured the payment of the note permitted the trustee to sell the property following a default and acceleration of the note "advertising the time, place and terms of the sale of the . . . property . . . and mailing and filing notices as required by section 51.002 [of the] Texas Property Code."¹⁰⁵ Following several renewals and extensions, the borrowers defaulted and the lender posted the property for foreclosure. The borrower and a companion traveled to the place of the foreclosure sale. Prior to the commencement of the foreclosure sale, the borrower temporarily departed, but authorized his companion to bid a specified price for the property if the sale commenced prior to the borrower's return.

101. *First State Bank v. Fatheree*, 847 S.W.2d 391, 396-97 (Tex. App.—Amarillo 1993, writ denied).

102. In *Town N. Nat'l Bank v. Broaddus*, 569 S.W.2d 489 (Tex. 1978), the Texas Supreme Court held that before a maker of a promissory note may present evidence contradicting the express terms of a promissory note on the basis of fraudulent inducement, the maker must make a preliminary showing that the payee used "some type of trickery, artifice, or device . . . in addition to the showing that the payee represented to the maker he would not be liable on such note." *Id.* at 494. In *Federal Deposit Ins. Corp. v. Wallace*, 975 F.2d 227, 229-30 (5th Cir. 1992), the Fifth Circuit made the road to avoidance of liability under promissory notes and other negotiable instruments somewhat more difficult by extending the rule of *Broaddus* to "the whole negotiable instrument context, not merely the making of a promissory note." *Id.* at 230. Stay tuned to see what limits the courts will place on the "whole negotiable instrument context," but based on *Wallace*, the Fifth Circuit will apply the *Broaddus* requirement of trickery to at least promissory notes, modifications of promissory notes, forbearance agreements relating to promissory notes and guaranty agreements. *Id.* The *Wallace* court made several other significant pronouncements with respect to the *Broaddus* rule. First, although the court acknowledged that the issue of trickery is ultimately one of fact, it is a question of law as to whether the maker established the "requisite preliminary showing of trickery" in order to present his case to the fact finder. *Id.* at 231. Secondly, the court severely restricted the parameters of a preliminary showing of trickery by concluding that sworn affidavits executed by FDIC officials stating that the FDIC would, notwithstanding the terms of the forbearance agreement, extend the term of the note if the borrower failed to satisfy the note at the end of the six month period did not establish the requisite preliminary showing of trickery. *Id.*

103. 851 S.W.2d 914 (Tex. App.—Austin 1993, writ denied).

104. *Id.* at 919.

105. *Id.* at 922.

Before the borrower returned, the trustee announced the commencement of the bidding process. The borrower's companion requested that the trustee delay the commencement of bidding until the borrower returned, but the trustee refused. The companion unsuccessfully participated in the bid process due to an apparent misunderstanding between the borrower and the companion regarding the maximum bid that the buyer authorized the companion to make on the borrower's behalf.¹⁰⁶ As often is the case, the foreclosure sale price resulted in a significant deficiency. The lender filed a suit to collect the deficiency and the borrower counterclaimed, alleging material alteration of the note, wrongful foreclosure, and usury. Perhaps to the relief of the borrower's companion, the jury found for the borrower on all issues. Unimpressed, the lender appealed.

On appeal, the lender first asserted that the trial court erred in discharging the borrower from liability under the note due to the lender's alterations of the note. The Austin court recognized that Texas law discharges an obligor from all liability under a note if the note is materially and fraudulently altered.¹⁰⁷ Trying to avoid the bad guy penalty imposed by the trial court, the

106. Apparently the borrower's companion misunderstood the amount up to which he had authority to bid and stopped bidding approximately \$3000 short of the authorized maximum bid amount. Based on the amount of the appraisal and assuming the companion had bid the maximum amount actually authorized, the companion, in all likelihood, would have succeeded in acquiring the property at the property sale.

107. *Keilman*, 851 S.W.2d at 919 (citing TEX. BUS. & COM. CODE ANN. § 3.407(b)(1) (Vernon 1968)). The *Keilman* court's conclusion that § 3.407 requires the alteration of the financial instrument to be both material and fraudulent should be compared to another Survey period case, *Federal Deposit Ins. Corp. v. Plato*, 981 F.2d 852 (5th Cir. 1993), which involved a claim that a lender had fraudulently altered a letter of credit. In *Plato*, three attorneys agreed to purchase an oil coating facility from a corporation. In order to secure certain obligations under the purchase agreement, the buyers were required to provide a letter of credit naming the seller as beneficiary. Before agreement on the final form of the purchase agreement, the buyers submitted an application for a letter of credit naming the seller in the draft of the purchase agreement as the beneficiary and requiring the beneficiary to present a statement of default by the buyers under the purchase agreement as a condition to drawing under the letter of credit. After the buyers submitted the application for the letter of credit, the parties finalized the purchase agreement, and in so doing, changed the name of the seller under the purchase agreement to the parent corporation of the originally named seller. The parties to the executed purchase agreement failed to communicate this change to the bank and the bank issued the letter of credit naming the subsidiary as the beneficiary. In connection with the issuance of the letter of credit, the buyers signed a blank promissory note payable to the bank in the amount of the letter of credit, with the oral understanding that the bank had authority to complete the note upon the bank's funding of a draw made under the letter of credit. Subsequent to the issuance of the letter of credit and pursuant to the request of an officer of the parent corporation, the bank altered the letter of credit to (1) substitute the parent corporation for the originally named subsidiary as the beneficiary under the letter of credit, (2) require the parent corporation, as the newly named beneficiary, to present the statement of default as a condition to drawing under the letter of credit, and (3) extend the expiration of the letter of credit by five days. Prior to the closing of the purchase agreement, the buyers defaulted and the parent corporation drew the full amount of the letter of credit. The bank then completed the blank note and the buyers made some payments due under the note. Eventually, however, the purchasers defaulted under the note and the bank filed suit for collection of the note. The district court found that the bank had materially altered the letter of credit, thereby absolving the buyers from any liability for non-payment of the note. On appeal, the Fifth Circuit concluded that the alterations to the letter of credit, even if material, were "hardly injurious" to the buyer as the change of the named beneficiary conformed the letter of credit to the seller named in the purchase agreement. *Id.* at 857. Apparently not entirely comfortable with its

lender argued that the alterations to the note were not material. Immediately leaning to the lender, the court observed that the lender's change to the note merely conformed the numerical statement of interest to the written formula of prime plus two percent.¹⁰⁸ This change, the court concluded, had no legal effect because under Texas law, unambiguous written words in a promissory note control over arithmetic numbers.¹⁰⁹ Since the change had no legal effect, the court found that the change was not material and concluded that the trial court erred in discharging the borrower from liability under the note.¹¹⁰

The lender next claimed that the trial court erred in concluding that the lender had wrongfully foreclosed against the mortgaged property. In response, the borrower argued that at least four irregularities had occurred that deterred third parties from bidding, thus resulting in a wrongful foreclosure. Addressing the issue, the appellate court recognized that a debtor is entitled to damages for a wrongful foreclosure if an irregularity in the foreclosure process deters third parties from bidding at the foreclosure sale.¹¹¹

The borrower based its first claimed irregularity (and clearly its best argument) on the provision in the deed of trust requiring the trustee to advertise the time, place, and terms of sale *and* to mail and post notices as required by statute before selling the property. The borrower acknowledged that the trustee posted the necessary statutory notice, but argued that this posting did not satisfy the advertising requirement of the deed of trust which, according to the borrower, contemplated advertising by announcement in the local newspaper or over the local radio station. To resolve the issue, the court relied on the Texas Supreme Court's decision in *Smith v. Baldwin*,¹¹² wherein the court used a definition of advertising that included calling to the public attention by any means whatsoever, such as statements made in newspapers, handbills or notices or on television or radio.¹¹³ Under the broad definition of advertising used in *Baldwin*, the court concluded that the post-

analysis under § 3.407, the court relied on *D'Oench, Duhme* to reject the buyer's claims. *Id.* at 858.

108. *Keilman*, 851 S.W.2d at 920. The court found additional support in testimony from the borrower that the rate on the note was a floating rate plus 2 percent. *Id.* at 920-21.

109. *Id.* at 920 (relying on *Guthrie v. Nat'l Homes Corp.*, 394 S.W.2d 494, 495 (Tex. 1965)). Having held that the alteration to the note immaterial, it was not necessary for the court to reach the issue of fraud. Nevertheless, the court concluded that the borrower had the responsibility to prove fraudulent intent and because the borrower had presented no evidence to that effect, the court declined to reach a finding of fraudulent intent. *Id.* at 921.

110. *Id.* at 920.

111. *Id.* at 921 (relying on *Tarrant Sav. Ass'n v. Lucky Homes, Inc.*, 390 S.W.2d 473, 475 (Tex. 1965); *Pentad Joint Venture v. First Nat'l Bank*, 797 S.W.2d 92, 96 (Tex. App.—Austin 1990, writ denied)). Restating the rule of the cited cases, the court concluded that a debtor may recover damages for wrongful foreclosure "only if the mortgagee either (1) fails to comply with statutory or contractual terms, or (2) complies with such terms, yet takes affirmative action that detrimentally affects the fairness of the foreclosure process." *Id.* at 921-22. The court's restatement in clause (1) may be inaccurate with respect to contractual issues if the failure does not deter third parties from bidding or result in a grossly inadequate sales price. This is not to say, however, that the mortgagee could avoid liability for other damages resulting from its breach of contract.

112. 611 S.W.2d 611 (Tex. 1980).

113. *Id.* at 614-15.

ing of the statutory notice constituted a form of advertising.¹¹⁴ Since the deed of trust did not provide for the use of one form of advertising over another, the court concluded that the lender had satisfied the advertising requirement in the deed of trust by posting the statutory notice.¹¹⁵ The court's conclusion, however, ignores the basic contractual interpretation principle that presumes that the parties to a contract intend that each provision in the contract have meaning.¹¹⁶ Applying this principle to the deed of trust, a strong argument exists that the parties intended that the separately stated requirements of advertising and posting have different meanings. Moreover, if the parties intended to satisfy the advertising requirement through the posting of the notice, the deed of trust unnecessarily stated that the trustee be permitted to sell the property only after advertising *and* posting the statutory notice. In effect, the court made meaningless the separate references to advertising and posting of the statutory notice as preconditions to the sale of the property by the trustee.

Having lost its only compelling argument, the borrower somewhat weakly argued that (1) the foreclosure notice provided inadequate notice of the property's location because the notice used a legal description of the property (as opposed to the property's street address), (2) the foreclosure notice provided inadequate information to prospective bidders because the notice did not include the identity of the lender or the telephone and address of the lender and the trustee, (3) the foreclosure notice provided inadequate notice of the pending sale because the notice was posted on a cluttered bulletin board and, during the posting period, was covered by other papers, (4) the trustee's refusal to wait for the return of the borrower prior to commencing the bidding process resulted in an unfair sale, and (5) the foreclosure notice's inclusion of a disclaimer of UCC warranties and a statement that a title insurance policy would not be provided were in conflict with the deed of trust and misled prospective bidders. In the court's opinion, the claimed irregularities (other than the disclaimer of warranties and the statement regarding title insurance) all constituted complaints that the lender failed to take affirmative action not otherwise required by the deed of trust or statute.¹¹⁷ Because a mortgagee has no duty to take steps beyond those set forth in the deed of trust or required by statute,¹¹⁸ the court concluded that the alleged irregularities could not support a wrongful foreclosure claim.¹¹⁹ The

114. *Keilman*, 851 S.W.2d at 922.

115. *Id.*

116. *E.g.*, *Carpenter v. Texas & New Orleans R. Co.*, 89 F.2d 274, 277 (5th Cir. 1937), *cert. denied*, 302 U.S. 703 (1937); *Goldman v. Alkek*, 850 S.W.2d 568, 576 (Tex. App.—Corpus Christi 1993, n.w.h.) (citing *Ervay Inc. v. Wood*, 373 S.W.2d 380, 384 (Tex. Civ. App.—Dallas 1963, writ ref'd n.r.e.); *see also* *Ogden v. Dickinson State Bank*, 662 S.W.2d 330, 332 (Tex. 1983); *General Am. Indem. Co. v. Pepper*, 339 S.W.2d 660, 661 (Tex. 1960).

117. *Keilman*, 851 S.W.2d at 924.

118. *Id.* at 921, 924 (relying on *Pentad Joint Venture v. First Nat'l Bank*, 797 S.W.2d 92, 96 (Tex. App.—Austin 1990, writ denied)).

119. *Id.* at 924. As to the two assertions that the notice did not provide sufficient information, the court acknowledged the facts alleged, but concluded that the Texas statute did not require the omitted information. *Id.* at 923 (relying on *Federal Deposit Ins. Corp. v. Myers*, 955 F.2d 348, 350 (5th Cir. 1992)) (posted notice sufficient even though it did not advertise

remaining claimed irregularities, the disclaimer of UCC warranties and the statement regarding title insurance, did not, in the court's opinion, conflict with the deed of trust or mislead potential bidders.¹²⁰ The deed of trust only required conveyance of the property by a general warranty deed at the foreclosure sale and, in the court's judgment, the disclaimer of UCC warranties had no adverse effect on the warranties of the required deed.¹²¹ Moreover, the disclaimers and the statement regarding title insurance could not possibly mislead potential bidders since all foreclosure purchasers must understand that "[o]ne who bids upon property at a foreclosure sale does so at his peril."¹²² Accordingly, the court held that the alleged irregularities concerning the disclaimer of UCC warranties and title insurance did not constitute an act by the lender that would invalidate the foreclosure sale.¹²³

Undeterred, the borrower took new aim at the lender, arguing that the foreclosure resulted in usury because the market value of the property purchased by the lender at the foreclosure sale plus the deficiency sought constituted a charging of interest in excess of the maximum interest permitted by law. Although the borrower's usury argument would have required some thought if the court had found the foreclosure to be wrongful, the court summarily disposed of the usury claim, stating that the deficiency law existing at the time of the foreclosure clearly permitted the lender's application of the purchase price against the secured debt and the lender's claim for the resulting deficiency.¹²⁴

As several borrowers unsuccessfully attempted in cases discussed in last year's Survey article,¹²⁵ the borrower in *Keilman* invoked the Texas Deceptive Trade Practices Act (DTPA),¹²⁶ arguing that the lender's and the trustee's actions during the foreclosure process were unconscionable under

specific time of sale, nature of property being sold, or address or telephone number of trustee); *Hutson v. Sadler*, 501 S.W.2d 728, 731-32 (Tex. Civ. App.—Tyler 1973, no writ) (holding notice sufficient even though it identified wrong party as owner and holder of note)). Although the court empathized with the borrower's complaint regarding the posting board by acknowledging the general disarray of county courthouse posting boards, the court concluded that a party satisfied the Texas foreclosure statute if the foreclosure notice remains posted for the statutory period as opposed to posted and visible during the statutory period. *Id.* (relying on *Chambers v. Lee*, 566 S.W.2d 69, 73 (Tex. Civ. App.—Texarkana 1978, no writ)). Lastly, the court concluded that neither the deed of trust, the statute, nor Texas law required the trustee to wait for the borrower to return prior to commencing the bidding process. *Id.* (citing *Bering v. Republic Bank*, 581 S.W.2d 806, 808 (Tex. Civ. App.—Corpus Christi 1979, writ ref'd n.r.e.) (holding a trustee has no legal duty to wait)).

120. *Id.* at 924.

121. *Id.*

122. *Id.* (relying on *Henke v. First S. Properties, Inc.*, 586 S.W.2d 617, 620 (Tex. Civ. App.—Waco 1979, writ ref'd n.r.e.)).

123. *Id.*

124. *Id.* at 932. The foreclosure took place in 1989, well before the effective date of the current deficiency statute, TEX. PROP. CODE ANN. § 51.003 (Vernon Supp. 1994), which allows a debtor pursued for a deficiency to request a judicial determination of the fair market value of the property as of the date of foreclosure.

125. *Federal Sav. & Loan Ins. v. Kralj*, 968 F.2d 500, 508 (5th Cir. 1992); *Affiliated Capital Corp. v. Commercial Fed. Bank*, 834 S.W.2d 521, 528 (Tex. App.—Austin 1992, no writ); *William R. Van Wagner et al., Annual Survey of Texas Law, Real Property*, 46 SMU L. REV. 1707, 1709-10 (1993).

126. TEX. BUS. & COM. CODE ANN. §§ 17.41-17.63 (Vernon 1987 & Supp. 1994).

section 1745(5) of the DTPA.¹²⁷ Trying to distinguish its case from the prior cases, the borrower argued that a deed of trust provision that allows for the payment of a fee to the trustee constitutes the purchase of a service. Relying on *Federal Deposit Insurance Corp. v. Munn*,¹²⁸ the court concluded that the objective of the overall transaction related to the extension of credit and that the deed of trust provision requiring payment of the trustee's fee merely provided a method to recover a portion of the costs of foreclosure.¹²⁹ Since extension of credit alone does not entitle a borrower to consumer status under the DTPA,¹³⁰ the court concluded that the borrower failed to establish a cause of action under the DTPA.¹³¹

III. D'OENCH, DUHME, FEDERAL DEFENSES AND RELATED ISSUES

During the last several Survey periods, the FDIC and the Resolution Trust Corporation (RTC) demonstrated the potent power of the *D'Oench, Duhme* doctrine¹³² and its statutory companion, Section 1823(e),¹³³ one of the many statutory provisions codified as a result of FIRREA.¹³⁴ During the current Survey period, the FDIC and RTC continued to argue the applicability of *D'Oench, Duhme* and Section 1823(e), but began to find the outer limits of the reach of the doctrine.¹³⁵ As one court stated, the "FDIC's

127. TEX. BUS. & COM. CODE ANN. § 17.45(5) (Vernon 1987).

128. 804 F.2d 860, 863-64 (5th Cir. 1986).

129. *Keilman*, 851 S.W.2d at 929.

130. See *Riverside Nat'l Bank v. Lewis*, 603 S.W.2d 169, 175 (Tex. 1980).

131. *Keilman*, 851 S.W.2d at 929. In addition to arguing unconscionability as an independent cause of action under the DTPA, the borrower appeared to argue that the foreclosure process itself was unconscionable and therefore wrongful. The court held that a finding of unconscionability under § 17.45(5)(B) (gross disparity between consideration received and price paid) does not support a wrongful foreclosure because inadequacy of price alone could not constitute wrongful foreclosure. *Id.* at 928. In a footnote, the court stated that its opinion did not address the issue of whether a wrongful foreclosure action could ever be supported by a finding of unconscionability under § 17.45(5)(A) (which includes acts or practices that take advantage of another's lack of knowledge, capacity, ability or experience to a grossly unfair degree). *Id.* at 928 n.2.

132. *D'Oench, Duhme & Co. v. Federal Deposit Ins. Corp.*, 315 U.S. 447 (1942).

133. 12 U.S.C. § 1823(e) (1988 & Supp. IV 1992).

134. Financial Institutions Reform, Recovery and Enforcement Act, Pub. L. No. 101-73, 103 Stat. 183 (1989).

135. Similarly, the FDIC lost on several attempts to expand its rights regarding other provisions of FIRREA. For example, in *Dalton v. Federal Deposit Ins. Corp.*, 987 F.2d 1216 (5th Cir. 1993), the FDIC, in its capacity as receiver of a failed bank, initially was a party to a state court action. At the time the suit was filed, 12 U.S.C. § 1819, a provision of FIRREA, barred the FDIC from removing the state court action to federal court. Subsequently, § 1819 was amended in a manner that would allow the FDIC to remove the state court action to federal court and on a date after the amendment, the FDIC substituted the FDIC, in its corporate capacity, for the FDIC, in its receiver capacity.

Under the general removal provisions of FIRREA, the FDIC has a ninety-day period within which to remove a state court action to federal court, 12 U.S.C. 1819(b)(2) (Supp. IV 1992) and the Fifth Circuit has held that the time period for removal commences with the date the FDIC is substituted as or made a party. *E.g.*, *Diaz v. McAllen State Bank*, 975 F.2d 1145, 1147 (5th Cir. 1992). These holdings, if literally applied to *Dalton*, would have prohibited the FDIC from removing the case since the FDIC was a party litigant prior to obtaining the authority of removal. Not surprisingly, the court concluded that its prior holdings included an implicit assumption that the FDIC, at the time it became a party litigant, had the right and

avoidance powers [under *D'Oench, Duhme* and Section 1823(e)] are awesome, but neither infinite nor unrestrained by the statutory language."¹³⁶ For example, during the Survey period, courts reached the following holdings: *D'Oench, Duhme* and Section 1823(e) do not apply to a bank's sale of an asset in a non-banking related transaction, such as the sale of a wholly owned trust company;¹³⁷ *D'Oench, Duhme* does not bar a tort arising independently of an agreement between the lender and the debtor¹³⁸ or a "tort actually rendering a contract void ab initio—e.g., 'fraud in the factum'";¹³⁹ *D'Oench, Duhme* and Section 1823(e) do not bar the debtor from using as evidence documents in a creditor's files that substantiate repayment of a note;¹⁴⁰ *D'Oench, Duhme* does not bar a defense to a collection of a renewal promissory based on non-recourse language contained in the renewed note;¹⁴¹ and *D'Oench, Duhme* and Section 1823(e) do not bar a homestead claimant from denying the validity of a disclaimer of homestead signed in connection with a deed of trust.¹⁴² On the other hand, the FDIC obtained

authority to remove the case to federal court. *Dalton*, 987 F.2d at 1221. Under the facts of *Dalton*, the FDIC did not have a statutory right to remove the case at the time the FDIC substituted itself in litigation. Accordingly, the court held that the time for removal did not commence until the effective date of the amendment to § 1819, upon which date the FDIC obtained the authority to remove the case to federal court. *Id.* The FDIC, however, failed to remove the action within ninety days after the effective date of the amendment and argued that the period for removal did not commence until the date that the FDIC substituted the FDIC, in its corporate capacity, for the FDIC, in its receiver capacity. Described by the court as an overreaching interpretation of the statute which created removal jurisdiction for cases involving the FDIC, the court refused to hold that the FDIC could extend the removal period merely by substituting one incarnation of the FDIC for another. *Id.* at 1222.

136. *Thigpen v. Sparks*, 983 F.2d 644, 649 (5th Cir. 1993).

137. *Id.* at 646-47.

138. *Resolution Trust Corp. v. Cook*, 840 S.W.2d 42, 48 (Tex. App.—Amarillo 1992, writ denied).

139. *Federal Deposit Ins. Corp. v. Plato*, 981 F.2d 852, 857 (5th Cir. 1993).

140. *First Heights Bank, F.S.B. v. Gutierrez*, 852 S.W.2d 596, 608 (Tex. App.—Corpus Christi 1993, writ denied).

141. *Federal Deposit Ins. Corp. v. Waggoner*, 999 F.2d 826, 828 (5th Cir. 1993).

142. *In re Hughes*, 153 B.R. 736, 744 (Bankr. N.D.Tex. 1993) (relying on *In re Niland*, 825 F.2d 801, 808), modified by 159 B.R. 197 (Bankr. N.D.Tex. 1993); *In re Stephens*, 149 B.R. 414, 417 (Bankr. E.D. Tex. 1992) (relying on *In re Niland*, 825 F.2d at 808). In *In re Hughes*, the FDIC attempted to avoid the effects of Texas law concerning a homestead waiver by arguing that *D'Oench, Duhme* barred the homestead claimant from arguing the invalidity of the homestead waiver. In making this argument, the FDIC relied on *Buchanan v. Federal Sav. & Loan Ins. Corp.*, 935 F.2d 83 (5th Cir. 1991), wherein the Fifth Circuit held that *D'Oench, Duhme* barred the homestead claimant from denying the validity of a mechanic's lien contract because she lent herself to a scheme or arrangement that was likely to mislead the FSLIC loan examiners. *Id.* at 86. Disagreeing with the FDIC, the *In re Stephens* court relied on *Patterson v. Federal Deposit Ins. Corp.*, 918 F.2d 540 (5th Cir. 1990), wherein the Fifth Circuit held that (1) *D'Oench, Duhme* does not bar a homestead claimant from denying the validity of a disclaimer of homestead signed in connection with a deed of trust and (2) the federal holder in due course doctrine does not protect the FDIC from the debtor's homestead defense because the homestead defense is a real defense as opposed to a personal defense. *Id.* at 546-47. Rejecting the FDIC's assertion that *Buchanan* should control over the earlier decided *Patterson* case, the *In re Stephens* court distinguished the cases, pointing out that the debtor in *Buchanan* argued that the deed of trust, as a matter of law, could not encumber the debtor's homestead, while the debtor in *Patterson* argued that the debtor executed the mechanic's lien contract after the date recited therein and after the delivery of materials, thereby invalidating the lien created by the mechanic's lien contract. Although this observation doesn't necessarily validate applying *D'Oench, Duhme* to defeat a homestead claim, the *In re Stephens* court ac-

the following favorable holdings: *D'Oench, Duhme* and Section 1823(e) not only bar debtors' defenses to claims made by the FDIC, but also affirmative claims made by debtors against the FDIC;¹⁴³ legal pleadings located in a bank's records are not records of the bank for purposes of *D'Oench, Duhme* or Section 1823(e);¹⁴⁴ *D'Oench, Duhme* bars a borrower from asserting that a failed lender orally waived a specific provision in a loan agreement, even though there is some evidence in the failed lender's records reflecting that the lender previously deviated from the requirement of the loan provision;¹⁴⁵ *D'Oench, Duhme* bars claims based on breach of good faith or fiduciary duty arising out of oral representations contrary to a loan agreement;¹⁴⁶ *D'Oench, Duhme* cannot be circumvented by a party who "[lends] himself to a scheme that could mislead federal bank examiners, whether or not done unwittingly";¹⁴⁷ and claims of usury cannot be asserted against the FDIC in its corporate capacity because of the penal nature of usury penalties¹⁴⁸ or against the FDIC in its capacity as receiver for a usury violation committed by a failed institution.¹⁴⁹

Several Survey period cases addressing the standard and depth of review required of the FDIC under *D'Oench, Duhme* deserve discussion. The first such case, *First Heights Bank, FSB v. Gutierrez*,¹⁵⁰ involved a circular lending transaction initiated by a federally insured savings and loan institution, the basic effect of which removed \$71,000,000 in defaulted loans from its books through making new loans. To achieve the circular transaction, the savings and loan located a purchaser for the properties which secured the defaulted loans and enlisted the help of an uninsured and insolvent state

knowledgeed the inconsistency of the result with the line of Texas cases holding that a homestead claimant may not deny the validity of an existing mechanic's lien contract and mechanic's lien notes under certain circumstances. *In re Stephens*, 149 B.R. at 418.

The *In re Hughes* Court further distinguished *Patterson* and *Buchanan* by directing the FDIC to *In re Smith* 966 F.2d 973 (5th Cir. 1992), wherein the Fifth Circuit elected not to determine a mechanic's lien case on the basis of *D'Oench, Duhme* and instead reached its result relying on a line of Texas cases recognizing that a homestead claimant may not deny the validity of an existing mechanic's lien contract and mechanic's lien notes where the owner induces a lender to advance funds based on a representation as to the validity of the mechanic's lien notes and mechanic's lien contract. 966 F.2d at 977.

143. *Jackson v. Federal Deposit Ins. Corp.*, 981 F.2d 730, 733 (5th Cir. 1992); *see also Bruneau v. Federal Deposit Ins. Corp.*, 981 F.2d 175, 177 (5th Cir. 1992) (holding *D'Oench, Duhme* and Section 1823(e) barred claims based on bank personnel's misrepresentations and fraudulent acts).

144. *Randolph v. Resolution Trust Corp.*, 995 F.2d 611, 615 (5th Cir. 1993). The court concluded that the Supreme Court's decision in *Langley v. Federal Deposit Ins. Corp.*, 484 U.S. 86 (1987) indicates that bank's records only giving notice of the defense do not satisfy the requirements of *D'Oench, Duhme* and Section 1823(e). *Id.* Pleadings, the court concluded, merely constitute notice of a defense as opposed to an agreement in the bank's records upon which the defense is based. *Id.*

145. *Lake Forest Dev. v. Federal Deposit Ins. Corp.*, 989 F.2d 197, 199, 201 (5th Cir. 1993).

146. *Id.* at 201.

147. *Federal Deposit Ins. Corp. v. Plato*, 981 F.2d 852, 858 (5th Cir. 1993) (relying on *Federal Deposit Ins. Corp. v. Caporale*, 931 F.2d 1, 2 (1st Cir. 1991)).

148. *Federal Deposit Ins. Corp. v. Condo Group Apartments*, 812 F. Supp. 694, 697 (N.D. Tex. 1992).

149. *Id.* at 698.

150. 852 S.W.2d 596 (Tex. App.—Corpus Christi 1993, writ denied).

savings and loan association. The federally insured savings and loan agreed to make a \$20,000,000 loan to the state savings and loan secured by various first lien notes having a value of approximately \$18,000,000. The state savings and loan agreed to use a portion of the proceeds of the \$20,000,000 loan to make a \$15,000,000 loan to the purchaser of the properties to enable the purchaser to pay the cash portion of the purchase price and closing costs.¹⁵¹ The seller of the properties used the majority of the proceeds of the \$15,000,000 loan to pay a profits participation in the purchased properties held by subsidiaries of the federal savings and loan. The seller of the properties pledged the remainder of the loan proceeds to the federally insured savings and loan to secure performance of the purchaser's obligations. Simultaneously with the funding of the \$15,000,000 loan, the federally insured savings and loan loaned \$71,000,000 (the amount of the defaulted loans) to the purchaser, who used those funds to satisfy the defaulted loans. To secure repayment of the \$71,000,000 loan and the \$15,000,000 loan, the purchaser granted first and second liens, respectively, against the purchased properties even though the aggregate amount of the loans significantly exceeded value of the purchased properties. By completing the transaction, the federally insured savings and loan created paper profits for its subsidiaries by selling the property for a price in excess of fair market value and improved its own balance sheet by replacing the defaulted loans with the new loans.¹⁵²

As one might reasonably expect from the facts, (1) the purchaser encountered difficulties and defaulted on its loan obligations, (2) the insolvent state savings and loan association never made payments on the loan to the federally insured savings and loan, (3) the state savings and loan found itself in a receivership, and (4) the government declared the federally insured savings and loan insolvent and closed and reopened the failed lender as a federal savings bank. The federally insured savings and loan filed (and subsequently the successor federal savings bank pursued) an action against the receiver of the state savings and loan, seeking payment of the \$20,000,000 loan and foreclosure of its security. The receiver then filed its own action against the federally insured savings and loan claiming fraudulent inducement and seeking to rescind the entire transaction and cancel the \$20,000,000 note, claiming that the seller's distribution of the sales proceeds to the federally insured savings and loan and its subsidiaries resulted in a repayment of the \$20,000,000 loan. The federal savings bank responded, claiming that *D'Oench, Duhme* barred the repayment defense. The trial court submitted the *D'Oench, Duhme* issue to the jury on the basis of whether "a reasonably prudent loan examiner who was examining the loan files [of the failed federally insured savings and loan would] have concluded that" the bank's loan

151. Apparently, the state savings and loan stood to receive, as an incentive to participate in the transaction, the difference between the \$20,000,000 in loan proceeds received and the \$15,000,000 loan amount funded.

152. Presumably, the state savings and loan received the benefit of the difference between the \$20,000,000 loan made to it and the \$15,000,000 loan made by it.

records established repayment of the \$20,000,000 loan.¹⁵³ The jury answered the *D'Oench, Duhme* issue affirmatively, thereby denying the *D'Oench, Duhme* defense. Based on the jury's overall findings, the trial court upheld the validity of the \$20,000,000 note, but concluded that the transaction manufactured by the federally insured savings and loan substantially repaid the note.¹⁵⁴ The federal savings bank appealed, arguing that the trial court inappropriately used the prudent loan examiner standard as the legal standard to determine whether the FDIC would have discovered the repayment defense when reviewing the bank's records¹⁵⁵ and that the trial court improperly used the phrase "loan files" to describe the bank records to be reviewed by the FDIC.

On appeal, the court agreed with the trial court's use of the reasonably prudent loan examiner standard, relying on a federal district court that had used that standard in applying the *D'Oench, Duhme* doctrine.¹⁵⁶ However, the court's acceptance of the reasonably prudent loan examiner standard is questionable in several respects. First, the standard, as submitted to the jury, assumes, without basis, (1) that the FDIC has the same time and opportunity to review the records of a bank which suddenly fails as would a loan examiner in a private acquisition of bank assets and (2) that the level of examination by a loan examiner is the same under all situations.¹⁵⁷ Second, the standard of a "reasonably prudent loan examiner who examines the loan files" appears to be much more subjective (and therefore broader) than a standard which requires review of agreements "clearly evidenced in the bank's records" and "apparent to [FDIC] examiners."¹⁵⁸ Finally, just as "the *D'Oench, Duhme* doctrine evidences a policy . . . to avoid hair-splitting

153. *Gutierrez*, 852 S.W.2d at 607 n.17. The instructions regarding the *D'Oench, Duhme* issue defined loan files to mean documents created or obtained by the failed federally insured savings and loan that were maintained in its loan files with respect to the loan described above during the period from the date the loans were funded until the date the federally insured savings and loan was declared insolvent. *Id.* at 608 n.18.

154. *Id.* at 604. The court also transferred the first lien notes which had secured the \$20,000,000 loan back to the state savings and loan and held that the federally insured savings and loan's first liens against the properties had merged with its fee title to the properties, which elevated the state savings and loan's second lien to a first lien and secured the return of the first lien notes to the state savings and loan. *Id.*

155. The federally insured savings bank instead argued for a bright-line test not identified in the court's opinion. Presumably, however, the federal savings bank argued for a standard similar to Fifth Circuit's statements that *D'Oench, Duhme* "bars those defenses of which FDIC could not have been put on notice by reviewing records on file with the bank." *Resolution Trust Corp. v. Sharif-Munir-Davidson Devel. Corp.*, 992 F.2d 1398, 1404 (5th Cir. 1993).

156. *Gutierrez*, 852 S.W.2d at 608 (citing *Fair v. NCNB Tex. Nat'l Bank*, 733 F. Supp. 1099, 1105 (N.D. Tex. 1990)). In applying that standard to a fraud defense, the *Fair* court concluded that a reasonably prudent loan examiner would not have concluded from the bank's records that the bank had defrauded the borrower. *Fair*, 733 F. Supp. at 1105. Accordingly, the *D'Oench, Duhme* doctrine barred the debtor's fraud defense. However, whether the noteholder agreed with the standard submitted to the jury is not discernible from the case. Moreover, the noteholder, because of its success, would not likely appeal the use of the standard, thereby limiting the precedential value of the use of the standard.

157. See *Langley v. Federal Deposit Ins. Corp.*, 484 U.S. 86, 91 (1987) (when FDIC is deciding to liquidate failed bank or provide financing for purchase and assumption, FDIC must act "with great speed, usually overnight," to preserve value of failed bank).

158. See *Beighley v. Federal Deposit Ins. Corp.*, 868 F.2d 776, 784 (5th Cir. 1989).

fact-based inquiries of the type that will ensue when assessing the obligations implied from prevailing banking practices,"¹⁵⁹ the *D'Oench, Duhme* doctrine could also logically prohibit the fact-based inquiries of the type that will ensue when a reasonably prudent loan examiner applies prevailing bank practices in conducting its review of a bank's records. Accordingly, until the Fifth Circuit expressly adopts the use of the reasonably prudent loan examiner standard, there is little certainty that the use of that standard is correct.

The court of appeals also approved of the trial court's usage of the broad term "loan files" within the *D'Oench, Duhme* instruction presented to the jury.¹⁶⁰ Using this definition and relying on cases that have concluded that bank records include executive committee minutes, appraisals, construction specifications, and all documents contained in the loan file, the court concluded that the wire transfers made to and from the bank were loan records that sufficiently established the repayment defense.¹⁶¹ Assuming that the wire transfer records relating to the \$20,000,000 loan and the \$15,000,000 loan resided in the bank's files regarding those loans, the court is probably correct in its conclusion that the records of the wire transfers constitute bank records. However, whether the records of the wire transfers clearly evidence the repayment of the \$20,000,000 loan or make it clearly apparent to an FDIC bank examiner that the \$20,000,000 loan has been repaid is far less arguable.¹⁶² Moreover, the state savings and loan's involvement in the federally insured savings and loan's scheme flies in the face of the *D'Oench, Duhme* established principle that a party who wittingly or unwittingly lends himself to a scheme that could mislead bank examiners cannot circumvent *D'Oench, Duhme*.¹⁶³ Reasonably, the court could (and perhaps should) have concluded that the FDIC was entitled to rely upon the facially unencumbered terms of the note signed by the failed state savings and loan, without having to determine why the federally insured savings and loan sent and received wired funds on the same day.¹⁶⁴

159. *Federal Deposit Ins. Corp. v. Hamilton*, 939 F.2d 1225, 1230 n.5. (5th Cir. 1991).

160. *Gutierrez*, 852 S.W.2d at 608.

161. *Id.*

162. The Fifth Circuit has stated the *D'Oench, Duhme* doctrine requires agreements to be "clearly evidenced in the bank's records" and "apparent to bank examiners." *Beighley v. Federal Deposit Ins. Corp.*, 868 F.2d 776, 784 (5th Cir. 1989).

163. *E.g.*, *Federal Deposit Ins. Corp. v. Plato*, 981 F.2d 852 (5th Cir. 1993); *Federal Deposit Ins. Corp. v. Caporale*, 931 F.2d 1, 2 (1st Cir. 1991). In *Plato*, the Fifth Circuit, applying the doctrine of lending oneself to a scheme, concluded that the debtors should have foreseen the consequences of signing a blank note. 981 F.2d at 858. Similarly, the state savings and loan should have foreseen the consequences of participating in the scheme devised by the federally insured savings and loan.

164. The *Gutierrez* case should be compared with *Stiles v. Resolution Trust Corp.*, 831 S.W.2d 24 (Tex. App.—Dallas 1992), *rev'd*, 867 S.W.2d 24 (Tex. 1993). In *Stiles*, the borrower defaulted on its note and the RTC sued for collection of the note. The RTC filed a motion for summary judgment, without stating that *D'Oench, Duhme* barred any defenses alleged by the borrower. The borrower responded to the summary judgment motion, arguing that the borrower had repaid the note. The trial court granted the RTC's motion for summary judgment, without specifying the supporting grounds. The borrower appealed, arguing that *D'Oench, Duhme* did not bar the borrower's repayment defense because the RTC had failed to raise *D'Oench, Duhme* as a defense in its motion for summary judgment. The appeals court discarded the borrower's argument, concluding that the borrower failed to meet its affirmative

Although not addressing the issue of the proper standard of review for bank records imposed on the FDIC, *Resolution Trust Corp. v. Sharif-Munir-Davidson Development Corp.*¹⁶⁵ provides some guidance regarding the depth of review required of the FDIC in connection with reviewing documents in a failed bank's records. In *Sharif*, a borrower and the guarantors of a loan defended a suit on a note and guaranty on the basis that the lender breached a bilateral contractual obligation by unreasonably refusing to approve various leases, thereby decreasing the value of the collateral for the loan and increasing the amount of the deficiency following foreclosure. Although the Fifth Circuit recognized that a borrower may defend a suit brought by the FDIC on the basis of a failed lender's breach of an express provision in a loan agreement between the failed lender and borrower, the court concluded that no such provision existed in the applicable loan agreement which obligated the lender to provide reasonable approval of each lease agreement.¹⁶⁶ Apparently, the borrower and guarantors argued that under state law, if a proposed lease is commercially reasonable, the lender is under an obligation to approve the proposed lease. Without determining whether such a defense existed under state law, the court held that the FDIC is not required to "research every possible defense based on state law, at least when the basis of the defense is not stated explicitly on the face of the documents in question."¹⁶⁷

In two Survey period cases, the Fifth Circuit declined to recognize the *D'Oench, Duhme* doctrine and Section 1823(e) as "transactionally infinite" or as "limitless per se guarantees of victory by federal banking agencies and their successors in interest."¹⁶⁸ In the first such case, *Thigpen v. Sparks*,¹⁶⁹ a national bank (which subsequently failed) agreed to sell a trust company to an individual. In connection with the sale, the bank's chairman made certain oral representations to the purchaser that proved to be false and the purchaser sued. The trial court granted summary judgment to the FDIC on the ground that Section 1823(e) barred the affirmative claims against the FDIC. The purchaser appealed, arguing that the purchase transaction was not covered by Section 1823(e). While not giving up its Section 1823(e) de-

obligation to show that *D'Oench, Duhme* did not bar the borrower's defense. *Stiles*, 831 S.W.2d at 28. After the Survey period, the Texas Supreme Court agreed with the borrower, holding that the trial court inappropriately used *D'Oench, Duhme* as a ground upon which to grant summary judgment since the FDIC failed to raise *D'Oench, Duhme* as a defense in its motion for summary judgment. *Stiles v. Resolution Trust Corp.*, 867 S.W.2d 24, 26 (Tex. 1993).

165. 992 F.2d 1398 (5th Cir. 1993).

166. *Id.* at 1405.

167. *Id.* at 1406 (emphasis omitted). In reaching its holding, the court relied on *Federal Deposit Ins. Corp. v. Hamilton*, 939 F.2d 1225 (5th Cir. 1991), wherein the Fifth Circuit concluded that the FDIC should not be required to investigate prevailing banking customs in order to determine if a defense existed against collection of a promissory note. *Id.* at 1229-30. In the *Hamilton* case, the court stated that "the case law interpreting the *D'Oench, Duhme* doctrine evidences a policy to prevent any such type of investigations and to avoid hair-splitting fact-based inquiries of the type that will ensue when assessing the obligations implied from prevailing banking practice." *Id.* at 1230 n.5.

168. *Alexandria Assoc., Ltd. v. Mitchell Co.*, 2 F.3d 598, 602 (5th Cir. 1993).

169. 983 F.2d 644 (5th Cir. 1993).

fense, the FDIC asserted a defense not previously presented to the Fifth Circuit, arguing that Section 1821(d)(9)(A) of Title 12 of the United States Code,¹⁷⁰ which generally provides that a claim against the FDIC may not be based on or substantially comprised of an agreement which fails to meet the requirements of clauses (1) through (4) set forth in Section 1823(e), also barred the borrower's affirmative claims.¹⁷¹ Significantly, the word "agreement", as used in Section 1821(d)(9)(A) is not, as is Section 1823(e), modified by the phrase "which tends to diminish or defeat the interest of the [FDIC] in any asset acquired by it under this section or section 1821."¹⁷² Congress, according to the FDIC, intended that section 1821(d)(9)(A) apply to any agreement as evidenced by section 1821(d)(9)(A)'s failure to include the modifying language contained in Section 1823(e). The court rejected the FDIC's argument, holding that section 1821(d)(9)(A) applies only to Section 1823(e) agreements.¹⁷³ A contrary holding, concluded the court, would result in absurd results, such as rendering unenforceable the claims of a failed bank's trade creditors and otherwise allowing the FDIC to use a "meat-axe for avoiding debts incurred in the ordinary course of business."¹⁷⁴

Shortly after the *Thigpen* court refused to extend section 1821(d)(9)(A) (and indirectly Section 1823(e)) to all types of agreements, an unlikely party argued to the Fifth Circuit that *D'Oench, Duhme* should be expanded to non-banking transactions. In *Alexandria Associates, Ltd. v. Mitchell Co.*¹⁷⁵ an indirect subsidiary of a federally insured bank (which was subsequently taken over by the FDIC) conveyed to a third party certain interests in real estate partnerships.¹⁷⁶ The purchaser satisfied a portion of the purchase price by delivering its promissory note, secured by a security agreement. Subsequently, the purchaser defaulted, the indirect subsidiary foreclosed,

170. 12 U.S.C. § 1821(d)(9)(A) (1988 & Supp. IV 1992).

171. Clauses (1), (2), (3), and (4) of Section 1823(e) generally require that the agreement be (1) in a writing, (2) executed by the failed institution and the person claiming the adverse interest against the failed institution, contemporaneously with the acquisition of the asset by the failed institution, (3) approved by the failed institution's board of directors or loan committee, as reflected in the corporate minutes, and (4) continuously in the official records of the failed institution from the time of its execution. 12 U.S.C. § 1823(e).

172. 12 U.S.C. § 1823(e) (1988 & Supp. IV 1992).

173. *Id.* at 649. The court's holding is somewhat contrary to the Eighth Circuit's holding in *North Ark. Medical Center v. Barrett*, 962 F.2d 780 (8th Cir. 1992); however, the Fifth Circuit attempted to downplay the difference between the two circuits, stating that the relevant language in *Barrett* was dicta and suggesting that *Barrett* revolved around "loan-related transactions entered into by the bank in its unique capacity as a lending institution." *Thigpen*, 983 F.2d at 649.

174. *Thigpen*, 983 F.2d at 649. In reaching this conclusion, the court observed that no legislative history existed evidencing the meaning of "agreement" as used in § 1821(d)(9)(A). After reaching its holding regarding § 1821(d)(9)(A), the court had little difficulty concluding that the failed bank's sale of the trust company was clearly not an asset acquired by the FDIC, as contemplated by Section 1823(e). *Id.* See Section 1823(e) which requires that the agreement must be contemporaneously executed by the failed institution and the party claiming the adverse interest, *contemporaneously with the acquisition of the asset by the depository institution.* 12 U.S.C. § 1823(e)(2) (1988 & Supp. 1992).

175. 2 F.3d 598 (5th Cir. 1993).

176. A non-banking subsidiary of a bank apparently formed the two defendant general partnerships and that non-banking subsidiary became the corporate general partner of each of the two defendant general partnerships.

and the purchaser sued the indirect subsidiary for securities fraud and various common law tort claims. The indirect subsidiary defended, claiming that *D'Oench, Duhme* and Section 1823(e) barred the purchaser's claims. The district court agreed and, perhaps amazed, the purchaser appealed.

On appeal, the purchaser argued that *D'Oench* does not apply to non-banking transactions, such as the conveyance of the partnership interests by an indirect subsidiary of a federal savings bank.¹⁷⁷ Reasoning that there was no discernible difference between *D'Oench, Duhme* and Section 1823(e) as to whether a transaction should be covered by the common law or statutory doctrine and that, under *Thigpen*, Section 1823(e) would not apply to sale of interests of the nature involved,¹⁷⁸ the court agreed with the purchaser and held that the common law *D'Oench, Duhme* doctrine does not apply to the sale of interests in real estate partnerships, especially when consummated by a third generation subsidiary of a failed institution.¹⁷⁹ In reaching its holding, the Fifth Circuit offered a host of justifications, including its observation that "[c]ommercial expectations simply do not include the belief that every agreement with a bank . . . must be scrutinized, approved, and recorded by the bank's executive committee or board."¹⁸⁰

During the Survey period, the FDIC twice attempted to flex its muscles against local taxing authorities, with conflicting results. In a federal court action, *Birdville Independent School District v. Hurst Associates*,¹⁸¹ the FDIC suffered defeat as the district court held that the provisions of FIRREA, and specifically sections 1825(b)(2), 1821(d)(13)(C), 1821(c)(2)(C) and 1821(j) of the United States Code,¹⁸² do not prohibit a local taxing authority from

177. The purchaser also argued that (1) even if *D'Oench, Duhme* applies to non-banking transactions, the indirect non-banking subsidiaries of a federal savings bank are not entitled to rely on *D'Oench, Duhme* and (2) Section 1823(e) preempts the common law *D'Oench, Duhme* doctrine. The Fifth Circuit concluded that it was not necessary to decide these two issues in light of the court's holding that *D'Oench, Duhme* does not apply to non-banking transactions.

178. *Alexandria Associates*, 2 F.3d at 603-04. The court recognized, however, that a receiver, conservator or successor institution disposing of assets through a liquidation of a failed or troubled institution might be entitled to the benefits of the *D'Oench, Duhme* doctrine. *Id.* at 603 n.30. Accordingly, if in *Alexandria Associates*, the federal savings bank, as opposed to the indirect subsidiary, had disposed of the partnership interest, *D'Oench, Duhme* may have been applicable to that transaction.

179. *Id.* at 604. Although significant, the court's reference to engagement by third generation subsidiaries is somewhat contradictory to its statement that it was not deciding the issue of whether *D'Oench, Duhme* applies to transactions "conducted by a third generation, non-banking subsidiary." *Id.* at 601.

180. *Id.* at 603.

181. 806 F. Supp. 122 (N.D. Tex. 1992).

182. 12 U.S.C. §§ 1821(c)(2)(C), 1821(d)(13)(C), 1821(j), 1825(b)(2), 1825(b)(3) (Supp. 1989). The FDIC primarily relied on 12 U.S.C. § 1825(b)(2), which provides:

When acting as a receiver, the following provisions shall apply with respect to the [FDIC]:

(2) No property of the [FDIC] shall be subject to levy, attachment, garnishment, foreclosure, or sale without the consent of the [FDIC], nor shall any involuntary lien attach to the property of the [FDIC].

12 U.S.C. § 1825 (b)(2) (Supp. I 1989).

The court concluded that the taxing authority sought to foreclose upon the real property owned by another, as opposed to the FDIC's lien interest against that real property. Accordingly, the court held that § 1825(b)(2) did not prevent the taxing authority from foreclosing its

foreclosing a tax lien even though the foreclosure would extinguish a subordinate, contractual lien acquired by the FDIC through the failure of a financial institution.¹⁸³ By contrast, in a state court action, *State v. Bankerd*,¹⁸⁴ the FDIC successfully argued that section 1825(b)(2) prevented the local taxing authority from foreclosing its tax lien.¹⁸⁵ Contrary to the holdings and rationale of *Birdville Independent School District*, the state court concluded that the FDIC's lien interest was property covered by section 1825(b)(2) and that a foreclosure of the tax lien against the real property would constitute a sale, levy, attachment or foreclosure of the FDIC's property, reasoning that the tax lien foreclosure would extinguish the FDIC's lien rights.¹⁸⁶ If required to pick a side, choose *Birdville Independent School District* as the better reasoned and fairest reading of section 1825(b)(2).

During the last Survey period, the Fifth Circuit decided *Resolution Trust Corp. v. Camp*,¹⁸⁷ wherein the court held that the affidavit of an account officer of the RTC is sufficient for summary judgment purposes to prove the RTC's ownership of a note, even though the account officer had no personal knowledge of the loan transaction when it occurred and learned about the loan only after the bank went into receivership.¹⁸⁸ This holding, coupled with the *Camp* court's statement that "suits on promissory notes provide fit grist for [the] summary judgment mill"¹⁸⁹ may have caused the FDIC and

lien, even though the foreclosure would extinguish the FDIC's subordinate lien. *Birdville Indep. Sch. Dist.*, 806 F. Supp. at 127. Section 1821(c)(2)(C) generally provides that the FDIC, when acting as a receiver, is not subject to the direction or supervision of a federal or state agency when exercising its rights and powers, and § 1821(j) generally prohibits courts from taking any action to restrain or affect the FDIC's ability to exercise its rights or powers as a receiver. See 12 U.S.C. §§ 1821(c)(2)(C), 1821(j). The court concluded that if Congress intended for those sections to protect the FDIC's subordinate lien rights, Congress would have so written. Accordingly, the court held that neither of the two sections prohibited the taxing authority from foreclosing its lien. *Birdville Indep. Sch. Dist.*, 806 F. Supp. at 128. Section 1821(d)(13)(C) generally prohibits attachment or execution on assets in the possession of the FDIC as receiver. See 12 U.S.C. § 1821(d)(13)(C). As the court concluded with respect to § 1825(b)(2), the court held that Section 1821(d)(13)(C) did not prevent the taxing authority's foreclosure upon real property owned by a non-governmental agency, as opposed to the FDIC's lien rights against that real property. *Birdville Indep. Sch. Dist.*, 806 F. Supp. at 127. Finally, § 1825(b)(3) generally exempts the FDIC from liability for any penalties or fines, including those arising from another party's failure to pay taxes. See 12 U.S.C. § 1825(b)(3). The court logically concluded that the taxing authority had not sought to hold the FDIC liable, but rather foreclosed a lien against the real property owned by another. *Birdville Indep. Sch. Dist.*, 806 F. Supp. at 128.

183. *Birdville Indep. Sch. Dist.*, 806 F. Supp. at 129. See also *Nueces County v. Whitley Trucks, Inc.*, 865 S.W.2d 124 (Tex. App.—Corpus Christi 1993, n.w.h.). In *Nueces County*, the Corpus Christi Court of Appeals was faced with the same issue presented in *Birdville* and *Bankerd*. The court, after discussing both the *Birdville* and *Bankerd* opinions, chose to follow the *Birdville* rationale in holding that neither section 1825(b)(2) nor section 1825(d) barred the tax district from foreclosing its tax liens against private property which also happened to be encumbered by junior mortgage liens obtained by the FDIC in its capacity as receiver. *Id.* at 864-65.

184. 838 S.W.2d 639 (Tex. App.—San Antonio 1992, writ denied).

185. *Id.* at 641-42.

186. *Id.* at 642.

187. 965 F.2d 25 (5th Cir. 1992).

188. *Id.* at 29.

189. *Id.* (quoting *Federal Deposit Ins. Corp. v. Cardinal Oil Well Serv. Co.*, 837 F.2d 1369, 1372 (5th Cir. 1988)).

RTC to celebrate, especially in light of the massive records problems faced by both. The *Camp* court cautioned, however, that it would not have hesitated to hold the affidavit as insufficient summary judgment proof of note ownership if the obligor could have pointed to evidence in the record that legitimately placed into question ownership of the note.¹⁹⁰ In two Survey cases, the Fifth Circuit began to make clear what facts might legitimately place into question ownership of a note.

In the first case, *Federal Deposit Insurance Corp. v. Selaiden Builders, Inc.*,¹⁹¹ the FDIC's sole summary judgment proof regarding ownership of the note consisted of the affidavit and testimony of a department supervisor and an asset manager, stating that the FDIC, as receiver for a failed institution, owned the promissory note being sued upon.¹⁹² The obligor, on the other hand, pointed to the endorsements on the notes and argued that none of those were to the FDIC as receiver for the failed institution. The FDIC argued that the endorsements omitted the irrelevant words "Association" and "FSA" and that the party to whom the notes were endorsed never existed.¹⁹³ The court, however, found no sympathy for the FDIC and held that the faulty endorsement established a legitimate question as to ownership of the note being sued upon.¹⁹⁴

In the second case, *Federal Deposit Insurance Corp. v. McCrary*,¹⁹⁵ the FDIC, in its corporate capacity, brought suit to collect on a promissory note it claimed to have acquired from the FDIC in its receiver capacity for a failed financial institution. To establish ownership of the note, the FDIC offered an affidavit of its custodian of the applicable loan documents. The FDIC also placed into evidence, but not for purposes of establishing note ownership, a contract of sale pursuant to which the FDIC, in its receiver capacity, transferred to the FDIC, in its corporate capacity, all assets of the failed institution that were not purchased by a third party bank pursuant to a purchase and assumption agreement. In response to the FDIC's motion for summary judgment, the obligor under the note argued that the affidavit failed to establish the FDIC's ownership of the note because the contract of sale neither specified the individual assets to be transferred to the third party bank under the purchase and assumption agreement, nor the individual assets to be conveyed to the FDIC pursuant to the contract of sale. Agreeing with the obligor, the court concluded that the contract's failure to specify the individual assets to be acquired by the third party bank and the FDIC, respectively, supported a legitimate fear that the FDIC was not the owner and holder of the note.¹⁹⁶

190. *Id.*

191. 973 F.2d 1249 (5th Cir. 1992).

192. *Id.* at 1255.

193. *Id.* The endorsement read "the FDIC as Manager of the FSLIC Resolution Fund as Receiver for Vernon Savings & Loan." A correct endorsement would have referred to "Vernon Savings & Loan Association, FSA." *Id.*

194. *Id.*

195. 977 F.2d 192 (5th Cir. 1992).

196. *Id.* at 195.

In view of the number of years that have passed since the large wave of failures of financial institutions occurred in the Fifth Circuit's jurisdictional area during the mid to late 1980s, the FDIC has begun to face significant limitations issues in cases where the FDIC is seeking monetary damages under a contract. The applicable pre-FIRREA limitations statute, section 2415(a) of Title 28 of the United States Code, generally bars the FDIC and its predecessors from bringing any action for money damages founded on a contract, unless the FDIC or predecessor agency files the complaint within six years after the action accrues.¹⁹⁷ The FIRREA statute of limitations, section 1821(d)(14(A)),¹⁹⁸ generally follows section 2415(a), with the exception that the six year period commences to run on the later to occur of the date the FDIC is appointed as conservator or receiver or the date on which the cause of action accrues.¹⁹⁹ During the Survey period, the Fifth Circuit issued two important decisions concerning the six year limitations statutes.²⁰⁰

In the first of these decisions, *Federal Deposit Insurance Corp. v. Belli*,²⁰¹ the Fifth Circuit addressed the issues of when an action accrues for purposes of section 2415(a) and section 1821(d)(14) and whether section 1821(d)(14) applies retroactively. In a clear setback for the FDIC, the Fifth Circuit held that under section 2415(a), a cause of action accrues with respect to a note on the date that the obligor defaults and not, as argued by the Federal Savings and Loan Insurance Corporation, the date that the FSLIC or other federal agency is appointed receiver.²⁰² As to the retroactive effect of section 1821(d)(14), the court held that the FIRREA provision retroactively "applies to claims held by the FDIC that were alive on August 9, 1989"²⁰³ and will not revive claims barred by limitations before August 9, 1989.²⁰⁴ Accordingly, as to note obligations which go into default prior to August 9, 1989, the claim must not only be brought within the applicable time period under section 1821(d)(14)(A), but also must be alive under section 2014(a) on August 9, 1989.

In the second decision, *Federal Deposit Insurance Corp. v. Bledsoe*,²⁰⁵ the court addressed the issue of whether the party to whom the FSLIC assigns a promissory note is entitled to the six year limitations period under section

197. 28 U.S.C. § 2415(a) (1988).

198. 12 U.S.C. § 1821(d)(14(A)) (Supp. IV 1993).

199. *Id.*

200. At least one other decision relating to the six year limitations periods deserves note. In *Davidson v. Mills*, 821 F. Supp. 1176 (W.D. Tex. 1993), the court concluded that § 1821(d)(14) applies to non-judicial actions, such as a foreclosure of a deed of trust lien, as well as the judicial actions such as suits on a note or guaranty. *Id.* at 1179.

201. 981 F.2d 838 (5th Cir. 1993).

202. *Id.* at 840-42.

203. *Id.* at 842.

204. *Id.* at 842-43. The Fifth Circuit and the Supreme Court recognize the general principle that a transfer of a note cannot revive a claim already barred by a state statute of limitations. *Guaranty Trust Co. v. United States*, 304 U.S. 126, 142 (1938); *Federal Deposit Ins. Corp. v. Hinkson*, 848 F.2d 432, 434 (5th Cir. 1988). However, neither the Supreme Court nor the Fifth Circuit has directly reached this holding as to FIRREA.

205. 989 F.2d 805 (5th Cir. 1993).

2415(a). Prior to *Bledsoe*, some courts held that such an assignee is entitled to the benefits of the six year statute,²⁰⁶ while at least one court held that an assignee is not entitled to those benefits.²⁰⁷ Relying on the cases extending the *D'Oench, Duhme* doctrine to private assignees and the common law principles which recognize that an assignee steps into the shoes of its assignor, the *Bledsoe* court held that assignees of the FDIC are entitled to the same six year limitations as the FDIC.²⁰⁸

The Fifth Circuit, through a line of cases, has clearly established the principle that a federal appellate court, in exercising its judicial discretion, may permit the FDIC to raise *D'Oench, Duhme* and Section 1823(e) for the first time on appeal, if the appeal is from a judgment entered in favor of the failed lender and the FDIC did not have the opportunity to raise the doctrines at the trial level.²⁰⁹ In a 1992 case, *Larsen v. Federal Deposit Insurance Corp.*,²¹⁰ the Texas Supreme Court recognized that federal courts have some flexibility to allow the FDIC to raise *D'Oench, Duhme* and Section 1823(e) for the first time on appeal, but concluded that a Texas court has no discretion to permit an argument, whether based on *D'Oench, Duhme*, Section 1823(e) or otherwise, to be raised for the first time on appeal, absent a showing of fundamental error.²¹¹ Although the *Larsen* holding is broad enough

206. *E.g.*, *Jon Luce Builder, Inc. v. First Gibraltar Bank*, 849 S.W.2d 451, 455 (Tex. App.—Austin 1993, writ denied); *Pineda v. PMI Mortgage Ins. Co.*, 843 S.W.2d 660 (Tex. App.—Corpus Christi 1992), *writ denied per curiam*, 851 S.W.2d 191 (Tex. 1993). In a decision decided after the end of the Survey period, *Jackson v. Thweatt*, 37 Tex. S. Ct. J. 546 (Mar. 12, 1994), the Texas Supreme Court affirmed the Austin Court of Appeals' holding in *Thweatt v. Jackson*, 838 S.W. 2d 725 (Tex. App.—Austin 1992) that in an action to recover on assets purchased from the FDIC, the purchaser is entitled to the benefits of the six year statute of limitations period provided by § 1821(d)(14). 37 Tex. S. Ct. J. at 560. In *Jon Luce Builder*, the Austin court also addressed a statute of limitations issue and, contrary to the Fifth Circuit's decision in *Belli*, concluded that under § 2415(a) the FSLIC's cause of action accrued on the date of the appointment of the FSLIC as receiver. *Jon Luce Builder*, 849 S.W.2d at 454. In this instance, however, harmless error occurred because (1) the state limitations statute did not bar the action at time of appointment of the FSLIC as receiver and (2) the borrower brought its suit against the FSLIC and the FSLIC filed its counterclaim seeking payment of the note prior to the expiration of the state statute of limitations period.

207. During the Survey period, the Dallas Court of Appeals issued its opinion in *Federal Debt Management, Inc. v. Weatherly*, 842 S.W.2d 774, 778-79 (Tex. App.—Dallas 1992), holding that the purchaser of assets from the FDIC is not entitled to the six year limitations period provided under § 1821(d)(14). *Id.* at 778-79. After the Survey period, the Texas Supreme Court reversed the Dallas Court of Appeals, holding that in an action to recover on assets purchased from the FDIC, the purchaser is entitled to the benefits of the six year statute of limitations period provided by § 1821(d)(14). *Federal Debt Management, Inc. v. Weatherly*, 37 Tex. S. Ct. J. 555, 560 (March 12, 1994).

208. *Bledsoe*, 989 F.2d at 811. To prevent the FDIC from abusing the court's holding and the possibility of creating an infinite limitations period, the court stated that "the FDIC cannot gain an additional six years by assigning the note to a private party and then receiving it again." *Id.* at 811 n.8.

209. *E.g.*, *Resolution Trust Corp. v. McCrory*, 951 F.2d 68 (5th Cir. 1992), *cert. denied*, 113 S. Ct. 459 (1992); *In re 5300 Memorial Investors, Ltd.*, 973 F.2d 1160, 1163-64 (5th Cir. 1992). A corollary principle is that the FDIC is prohibited from raising *D'Oench, Duhme* and Section 1823(e) for the first time on appeal if the appeal is from a judgment adverse to the failed lender and voids the asset that the FDIC is seeking to protect. *McCrory*, 951 F.2d at 71 (citing *Thurman v. Federal Deposit Ins. Corp.*, 889 F.2d 1441, 1447 (5th Cir. 1989)).

210. 835 S.W.2d 66 (Tex. 1992).

211. *Id.* at 74.

to cover cases in favor of or against a failed lender, a question remains as to whether the *Larsen* holding applies only to cases against the failed lender that result in a voiding of the asset, since those facts existed in *Larsen*. In *Gray v. Federal Deposit Insurance Corp.*,²¹² the Houston Court of Appeals provided its answer to the question, holding that consistent with *Larsen*, regardless of whether the trial court's judgment is in favor of or against the failed lending institution, "the federal common law defenses . . . cannot be raised for the first time on appeal to disturb a trial court judgment that adjudicates the respective rights of the parties and that is rendered before the receivership."²¹³ Although the scope of this holding is extremely broad, the court implicitly limited its holding to the circumstances of the case, which involved (1) the issuance of a trial court judgment in favor of the failed lender, (2) the substitution of the FDIC, as receiver, for the failed lender following the filing of the failed lender's appeal and (3) the appellate court's reversal of the trial court on the grounds that, as a matter of law, the trial court failed to render summary judgment in favor of the borrower on the basis of an absolute defense plead by the borrower that would have survived a *D'Oench, Duhme* and Section 1823(e) challenge.²¹⁴

In a case discussed earlier, *Federal Deposit Insurance Corp. v. Bodin Concrete Co.*,²¹⁵ the Dallas Court of Appeals utilized *Larsen* to enable the FDIC to raise *D'Oench, Duhme* and Section 1823(e) defenses for the first time on remand. In *Bodin Concrete*, the holders of mechanic's liens filed a declaratory action against a lender, seeking, among other relief, a finding that the lender wrongfully foreclosed its lien. The trial court granted summary judgment in favor of the lender and the holder of the mechanic's lien appealed. Following the filing of the appeal, the lender became insolvent and the FDIC, as receiver, was substituted in the litigation for the failed lender. The appeals court reversed and remanded the case for further proceedings. During the remand trial, the payee of the note, who apparently was unrelated to the holder of the mechanic's lien, testified that (1) the note which secured

212. 841 S.W.2d 72 (Tex. App.—Houston [1st Dist.] 1992), *set aside*, 848 S.W.2d 85 (Tex. 1993). After the Survey period, the Texas Supreme Court set aside the Houston court's decision pursuant to a joint motion of the parties resulting from settlement of the case.

213. *Id.* at 81. The court's holding does not expressly apply to Section 1823(e) since it is a statutory defense, as opposed to a common law defense. Presumably, however, the court intended that its holding apply to Section 1823(e) since the FDIC based its defense on both *D'Oench, Duhme* and Section 1823(e).

214. The implicit understanding arises out of the court's statement that its holding does not address the FDIC's ability to raise a *D'Oench, Duhme* type defense for the first time on appeal where the party seeking a voiding of the asset fails to show that every event necessary to the voiding of the asset took place prior to the failure of the lending institution and where the trial court's error permits the appellate court to reverse and remand, but not reverse and render. *Id.* In the *Gray* case, the estate of the obligor argued that the bank failed to give the estate notification of repossession and intended disposition pursuant to § 9.504 of the Texas Business and Commerce Code. TEX. BUS. & COM. CODE ANN. § 9.504 (Vernon 1991). The court concluded that, as a matter of law, the bank failed to give reasonable notice to the estate as required by § 9.504. *Gray*, 841 S.W.2d at 85. Based on this conclusion, the appeals court found that, as a matter of law, the trial court should have entered judgment against the failed lender, thereby voiding the claim against the estate prior to the date that lender failed. *Id.* at 89.

215. 869 S.W.2d 372 (Tex. App.—Dallas 1993, writ denied).

the lender's deed of trust was delivered to the lender in connection with the lender's issuance of a letter of credit for the benefit of the payee, (2) the bank agreed that the note would not be funded except to the extent draws were presented under the letter of credit and (3) the letter of credit expired without any draws having been presented thereunder. The FDIC defended, arguing that the bank's oral agreement was barred by *D'Oench, Duhme* and Section 1823(e). The trial court concluded that the FDIC was barred from raising *D'Oench, Duhme* and Section 1823(e) on remand because the FDIC failed to raise those defenses in the initial appeal and entered judgment for the holders of the mechanic's liens.²¹⁶ The FDIC appealed, claiming, among other points, that the trial court erred in concluding that the FDIC was barred from raising *D'Oench, Duhme* and Section 1823(e) on remand. With little difficulty, the Dallas Court of Appeals agreed with the FDIC, reasoning that the remand trial afforded the FDIC its first opportunity to raise *D'Oench, Duhme* and Section 1823(e), as the *Larsen* case prohibited the FDIC from raising those defenses in the initial appeal.²¹⁷ If the *Larsen* case is interpreted to absolutely prohibit the FDIC from raising *D'Oench, Duhme* or Section 1823(e) for the first time on appeal except in the case of fundamental error, the court's holding in *Bodin Concrete* appears necessary in order to avoid placing the FDIC in a Catch-22 situation.²¹⁸

More sweeping in theory than *D'Oench, Duhme* and Section 1823(e) is the pliable assertion that state law will be preempted when it frustrates the FDIC's ability to accomplish objectives mandated by the Congress. One case decided during the Survey period, *Sweet Jan Joint Venture v. Federal Deposit Insurance Corp.*,²¹⁹ provides some indication of the breadth of the preemption defense. *Sweet Jan* presented the federal district court with the issue of whether two notes transferred by a federal savings bank to the FSLIC as part of a bulk transfer constituted a fraudulent conveyance under the Texas fraudulent conveyance statute.²²⁰ Under one of these notes, the federal savings bank had potential liability for failing to fund certain amounts that its predecessor had agreed to fund. Under the other note, the plaintiffs had no apparent defense, except for a right of setoff if the federal savings bank was found liable under the first note.²²¹ The borrower claimed that the transfer of these notes to the FSLIC violated the Texas Uniform Fraudulent Transfer Act²²² because the transfers were made to take advan-

216. *Id.* at 375-76.

217. *Id.* at 379. This rationale is consistent with Fifth Circuit cases which provide that the FDIC may raise *D'Oench, Duhme* and Section 1823(e) for the first time on appeal if the trial court judgment is in favor of the failed lender and the FDIC had no opportunity to raise the defenses at the trial level. *See supra* note 210 and accompanying text.

218. This holding also seems consistent with *Gray*, 841 S.W.2d at 81. *See supra* note 213 and accompanying text.

219. 809 F. Supp. 1253 (N.D. Tex. 1992). The facts of this case are more fully set forth in the concurrently released opinion of *Sweet Jan Joint Venture v. Federal Deposit Ins. Corp.*, 809 F. Supp. 1246 (N.D. Tex. 1992).

220. TEX. BUS. & COM. CODE ANN. § 24.005 (Vernon 1987).

221. *Id.*; *Sweet Jan*, 809 F. Supp. at 1256. The plaintiffs considered the right of offset extremely important due to the bank's then precarious financial condition. *Id.*

222. TEX. BUS. & COM. CODE ANN. § 24.001-.013 (Vernon 1987 & Supp. 1994).

tage of the federal defenses that would prohibit the borrower from arguing that it could offset its damages incurred under the first note against amounts owed on the second note. The FDIC argued that the transfers of the borrower's notes were not fraudulent under the fraudulent conveyance act because they were part of a bulk transfer made to satisfy certain provisions of the Internal Revenue Code. Moreover, argued the FDIC, all of the notes which were part of the bulk transfer were selected on the basis of the same objective criteria. Relying on prior case law,²²³ the court held that, notwithstanding the federal savings bank's intent in transferring the borrower's notes to the FSLIC, the state fraudulent conveyance act was preempted. To hold otherwise would, according to the court, unduly chill if not completely compromise the FDIC's ability to operate in similar cases.²²⁴ Moreover, where the application of a state law, such as the Texas fraudulent conveyance act, can overturn the FDIC's or its predecessor's assistance decisions, that state law, in the court's judgment, must give way to the powers and authority of the FDIC and its predecessor entities.²²⁵

The FDIC and RTC also have certain statutory rights regarding their ability to reject certain written agreements. For example, under section 1821(e) of Title 12 of the United States Code,²²⁶ a receiver of an insured depository institution may promptly, after being appointed receiver, disaffirm any contract or lease to which that depository institution is a party and (1) the performance of which, in the receiver's discretion, is burdensome to the institution and (2) the disaffirmance or repudiation of which, in the receiver's discretion, would promote the orderly administration of the institution's affairs. In *Fowler v. Resolution Trust Corp.*,²²⁷ the El Paso Court of Appeals concluded that the RTC had not successfully repudiated a lease pursuant to section 1821(e) because the RTC had failed to establish the burdensome nature of the lease and that the repudiation of the lease would promote the orderly administration of the failed institution's affairs.²²⁸ The court's holding, however, is subject to criticism, since the court at no time discusses the fact that the statute enables the receiver to make the determination of whether, *in the receiver's discretion*, the lease would be burdensome and whether, *in the receiver's discretion*, the revocation would promote the orderly administration of the institution's affairs.²²⁹

223. *Valley Ranch Dev. Co. v. Sunbelt Sav.*, 714 F. Supp. 817 (N.D. Tex. 1989), *aff'd on other grounds sub nom.*, *Gulley v. Sunbelt Sav.*, 902 F.2d 348 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 673 (1991). In the context of an initial receivership function involving the transfer of assets effected by a purchase and sale assumption transaction, the *Valley Ranch* court upheld the preemption of the Texas fraudulent transfer law, reasoning that it "stands as an obstacle to the accomplishment and . . . objectives of Congress." *Valley Ranch*, 714 F. Supp. at 818.

224. *Sweet Jan*, 809 F. Supp. at 1256.

225. *Id.*

226. 12 U.S.C. § 1821(e) (1988).

227. 855 S.W.2d 31 (Tex. App.—El Paso 1993, n.w.h.).

228. *Id.* at 37.

229. The *Fowler* court also concluded that the RTC had not ratified the lease by accepting rental payments for four months following the foreclosure, reasoning that the mere acceptance of rent by a governmental agency does not estop an agency from rejecting the lease. *Id.* at 35. Interestingly, however, even though the lease appears to have been subordinate to the lien, the

IV. USURY AND RELATED ISSUES

During the Survey period, lenders and obligees benefitted from the following holdings relating to usury issues, some of which are very familiar: even if interest commences before disbursement of a loan, the spreading doctrine will be utilized to determine if the loan, over its entire term, is usurious;²³⁰ a notice of acceleration which erroneously demands payment of installments of principal and interest previously paid will not support a claim of usury because the demand arises out of a failure to credit paid amounts as opposed to a demand or charge for interest;²³¹ the discovery rule does not apply to usury claims;²³² a late charge assessed in a non-lending transaction will not support a claim of usury;²³³ a payment based on a percentage of sales will not support a claim of usury because of the contingent nature of the payment;²³⁴ a court's assessment of prejudgment interest or postjudgment interest will not support a usury claim;²³⁵ and a guarantor may not assert a claim that

RTC did not attempt to avoid the lease on the basis that the foreclosure of the lien extinguished the lease.

230. *R.V. Indus. v. Urdiales*, 851 S.W.2d 306 (Tex. App.—San Antonio 1992), *rev'd per curiam sub nom.*, *R.V. Indus. v. County of Webb*, 851 S.W.2d 216 (Tex. 1993) (correcting error of lower court stating that the county should take nothing; judgment should have stated that R.V. Industries and others would take nothing).

231. *Kentor v. Karotkin*, 852 S.W.2d 261, 267 (Tex. App.—Austin 1992, writ denied).

232. *Aguilar v. Anderson*, 855 S.W.2d 799, 803 (Tex. App.—El Paso 1993, writ denied). In *Aguilar*, the court also stated that the limitations period provided for under TEX. REV. CIV. STAT. ANN. art. 5069-1.06(3) (Vernon 1987) commenced to run on the date that the payor made its first payment under the installment note, regardless of the amount of that payment. *Aguilar*, 855 S.W.2d at 803 (relying on *Cook v. Frazier*, 765 S.W.2d 546 (Tex. App.—Ft. Worth 1989, no writ); *Danziger v. San Jacinto Sav. Ass'n*, 732 S.W.2d 300, 303 (Tex. 1987)). The court's reliance on *Danziger* is misplaced as the relevant portions of *Danziger* deal with the issue of the period over which interest is spread in order to determine if usury occurred and not the commencement of the statute of limitations. *Cf.* TEX. REV. CIV. STAT. ANN. art. 5069-1.06(3) (Vernon 1987) (stating that usury claim must be brought "within four years from the date when the usurious interest was charged or collected"); *Bexar County Ice Cream Co., Inc. v. Swensen's Ice Cream Co.*, 859 S.W.2d 402, 405 (Tex. App.—San Antonio, 1993 writ denied) (holding that limitations period under article 5069-1.06(3) commenced to run on date of last payment of alleged usurious charge and not on date of contract, even though contract provided for allegedly usurious charge).

233. *Swensen's*, 859 S.W.2d at 406-07.

234. *Id.* at 407.

235. *Solomon v. Briones*, 805 S.W.2d 916 (Tex. App.—San Antonio 1991), *writ denied per curiam*, 842 S.W.2d 278, 279 (Tex. 1992) (holding that a demand for postjudgment interest arising from judicial process is not a charging under the usury laws); *Sage Street Assoc. v. Northdale Constr. Co.*, 36 Tex. Sup. Ct. J. 1118, 1120 (June 30, 1993). Each of these cases represents a logical extension of *George A. Fuller Co. v. Carpet Serv., Inc.*, 823 S.W.2d 603 (Tex. 1992), wherein the Texas Supreme Court formed the beginnings of the principle that a claim of usury may not accrue solely out of the judicial process by holding that a claim for prejudgment interest in a pleading filed with a court will not serve as a basis for a usury claim. *Id.* at 605-06. In *Sage Street*, the borrower attempted a constitutional end run around *Carpet Services*, by arguing that an assessment of prejudgment interest by the court was usurious under TEX. CONST. art. XVI, § 11. The court had no difficulty rejecting the constitutional argument, applying the *Carpet Services* rationale that a significant difference exists between the interest awarded by a court as a result of a breach of contract and the consensual interest charged in a private transaction and that the subject of pleading and awarding prejudgment interest is "best dealt with in the context of the judicial process . . . rather than through the Texas usury laws." 36 Tex. Sup. Ct. J. at 1119, 1120 (quoting *Carpet Services*, 823 S.W.2d at 603).

the debt which it guaranteed is usurious.²³⁶ Although the vast majority of usury cases decided during the Survey period favor lenders and obligees, a borrower successfully convinced the El Paso Court of Appeals to hold that a pleading for an incorrect amount of penalty charges does not preclude a debtor from collecting the proper amount of damages when usury is actually proved.²³⁷

Three cases decided during the Survey period deserve more than a reference to the holding.²³⁸ In the first case, *Moore v. Liddell, Sapp, Zively, Hill & LaBoon*,²³⁹ a borrower attempted to extend the *Alamo Lumber* doctrine²⁴⁰ to a lender's requirement that its borrower guarantee the debt of a third party as a condition to a loan to the borrower.²⁴¹ The court refused to extend *Alamo Lumber* to a guaranty of another party's debt, reasoning that the guaranty was a secondary and contingent debt and vastly different from payment and assumption.²⁴² In the court's opinions, the inclusion of the amount of the guaranteed debt in the interest paid under the borrower's obligation would "go against the parties expectations and greatly increase uncer-

236. *Federal Deposit Ins. Corp. v. Condo Group Apartments*, 812 F. Supp. 694 (N.D. Tex. 1992).

237. *Berryman v. El Paso Natural Gas*, 838 S.W.2d 610, 615 (Tex. App.—Corpus Christi 1992), *rev'd on other grounds*, 858 S.W.2d 362 (Tex. 1993).

238. Perhaps a fourth case, *Pearcy Marine, Inc. v. Acadian Offshore Serv., Inc.*, 832 F. Supp. 192 (S.D. Tex. 1993) deserves a little attention because of the uniqueness of the case. In *Pearcy Marine*, a noteholder became financially strapped. To generate much needed cash, the lender requested the obligor under the note to prepay a portion of the note in exchange for the noteholder's agreement to forgive interest thereafter due under the note. Apparently believing the deal to be attractive, the borrower agreed to the lender's proposal, but also seized the opportunity to extract the noteholder's written agreement to pay the cost of certain repairs to two vessels that had been under charter to the noteholder. This agreement required the noteholder to promptly pay the repair costs, failing which the obligor had the right to offset the amount of the costs against the note obligation. Apparently the noteholder failed to pay any repair charges and the obligor offset an amount approximately equal to 600% of the amount prepaid. In contesting the offset, the noteholder claimed that the amounts offset against the note constituted usury. The noteholder argued that the prepayment by the obligor constituted a loan and that the forgiven interest on the note and the offset of the alleged repair charges against the note constituted interest on the "prepayment loan." Although impressed by the noteholder's imagination and inventiveness, the court had little difficulty in concluding that the prepayment was not a loan. *Id.* at 196-97. Purely for the sake of argument, the court assumed the prepayment charge to be a loan and immediately concluded that neither the forgiven interest on the note nor the repair charges would constitute interest for purposes of a usury determination. The court stated that if it treated the forgiven interest as anything more than a reduction of interest, every borrower who renegotiated a lower interest rate on his debt would be guilty of usury. *Id.* at 197. As to the repair costs, the court concluded that these costs would be in the nature of contingent charges that would not be includable in a usury calculation. *Id.* at 198 (relying on *Moore v. Liddell, Sapp, Zively & LaBoon*, 850 S.W.2d 291, 294 (Tex. App.—Austin 1993, writ denied). This case is indicative of the fact that some courts will pay some attention to ridiculous, but imaginative, arguments.

239. 850 S.W.2d at 293.

240. In *Alamo Lumber Co. v. Gold*, 661 S.W.2d 926 (Tex. 1983), the court held that if a lender requires its borrower to assume or pay the debt of another as a condition to the extension of credit to the borrower, the amount of the third party debt assumed or paid shall be deemed to be interest for purposes of usury. *Id.* at 928.

241. In *Moore*, the borrowers were a father and son and as a requirement of various loans to the father and son, the bank required the father to separately guarantee the son's pre-existing and future debt to the bank.

242. 850 S.W.2d at 293-94.

tainty in lending transactions."²⁴³ Although the court's holding makes good sense on the basis of the contingent nature of a guaranty,²⁴⁴ the court's reference to the expectations of the parties and uncertainty in lending transactions is weak at best.

Article 5069-1.07(f) of the Texas Revised Civil Statutes²⁴⁵ generally prohibits the charging of a prepayment penalty on a loan secured by the borrower's residential homestead if the interest rate on the loan exceeds the amount specified in subsection (d) of article 5069-1.07(f).²⁴⁶ In *Groseclose v. Rum*,²⁴⁷ the borrower obtained a residential loan which provided for interest at the rates of 9.50% per annum during the first loan year, 10.00% per annum during the second loan year, 11.00% per annum during the third loan year, 12.00% per annum during the fourth loan year and 12.50% per annum thereafter. The note evidencing the loan prohibited prepayment. The borrower attempted to sell the property and retire the note prior to maturity, but the lender refused to accept prepayment of the note. The borrower filed a declaratory action, arguing that the lender's prohibition on prepayment violated article 5069-1.07(f). The trial court granted the borrower's motion for summary judgment and the lender appealed.

On appeal, the lender first argued that a prohibition on prepayment does not constitute a prepayment charge under article 5069-1.07(f). The court, although recognizing that a difference existed between a prepayment charge or penalty and a prepayment clause prohibiting prepayment, concluded that a prepayment clause prohibiting prepayment violates article 5069-1.07(f).²⁴⁸ To conclude otherwise, the court reasoned, would frustrate the purpose of article 5069-1.07(f), which is to allow homeowners to prepay loans financed at a high rate of interest.²⁴⁹

Having lost the battle on the no prepayment clause issue, the lender then argued that the interest rate of the loan did not exceed 12% per annum, the maximum interest rate then permitted under 5069-1.07(d)(1),²⁵⁰ relying on the interest spreading statute, article 5069-1.07(a).²⁵¹ The borrower argued that the spreading statute applies only in usury cases and therefore was not applicable to the issue before the court. The court agreed that the spreading statute applies only to usury cases, but nevertheless sided with the lender,

243. *Id.* at 294.

244. See *Swensen's*, 859 S.W.2d at 406-07, wherein the court held that late payment fees assessed on royalty payments not timely made would not support a usury claim because the royalty payments were contingent in nature.

245. TEX. REV. CIV. STAT. ANN. art. 5069-1.07(f) (Vernon 1987).

246. Subsection (d) provides for a maximum rate of the lesser of (1) 12% per annum or (2) the average per annum market yield rated adjusted to constant maturities on ten-year United States Treasury Notes plus 2%, rounded to the nearest 1/4%. *Id.* § 5069-1.07(4).

247. 860 S.W.2d 554 (Tex. App.—Dallas 1993, n.w.h.).

248. *Id.* at 557.

249. *Id.*

250. TEX. REV. CIV. STAT. ANN. art. 5069-1.07(d)(1) (Vernon 1987).

251. Article 5069-1.07(a) generally provides that in determining whether interest on a loan secured by real estate is usurious, all interest collected, charged or received from the borrower shall be spread in equal parts over the stated term of the loan. TEX. REV. CIV. STAT. ANN. art. 5069-1.07(a) (Vernon 1987).

holding that if the interest on the loan to the borrower exceeded 12% as alleged by the borrower, the loan to the borrower would be usurious under article 5069-1.07(f) and the spreading statute would apply.²⁵² The court reached this holding by reasoning that (1) because 5069-1.07(f) prohibits a lender from charging a prepayment penalty on a loan which bears interest in excess of the rate specified in article 5069-1.07(d)(1), a rate charged in excess of that specified in 5069-1.07(d)(1) exceeds the rate permitted by law and (2) because a rate charged in excess of that specified in 5069-1.07(d)(1) exceeds the rate permitted by law, that rate is usurious under article 5069-1.01(d),²⁵³ which defines usury to include contracting for interest in excess of a rate permitted by law.²⁵⁴ The basic flaw in the court's reasoning is its conclusion that a rate in excess of article 5069-1.07(d)(1) is in excess of the maximum rate permitted by law. Article 5069-1.07(f) does not prohibit contracting for a rate in excess of that set forth in article 5067-1.07(d)(1), but rather merely provides that one may not assess a prepayment charge if the interest rate exceeds that specified in article 5067-1.07(d)(1). A reading of this opinion leaves the clear impression that the court was more interested in reaching a particular result rather than establishing the basis upon which that result could be reached.

Real estate practitioners, when dealing with commitment and other fees charged in connection with a loan, should be aware of article 342-508 of the Texas Revised Civil Statutes.²⁵⁵ Article 342-508 provides in part:

No bank shall charge . . . any loan fee or any other charge . . . for the granting of a consumer loan unless authorized by law. . . . In all consumer loan transactions in which the amount loaned is \$100 or more and the loan period is one month or more, a bank may charge any borrower the reasonable value of services rendered in connection with the making of any loan, in an amount agreed upon, but not to exceed \$15 for each loan transaction. If the amount that the bank charges for those services exceeds \$15, the amount of interest contracted for shall be forfeited.²⁵⁶

In *Brazosport Bank v. Oak Park Townhouses*,²⁵⁷ a bank charged a borrower two fees in connection with making a loan, both of which fees exceeded \$15. The bank collected one of the fees prior to the funding of the loan in consideration for the issuance of the bank's loan commitment. The bank collected the second fee in consideration for renewing the loan after it had matured. After the renewal, the borrower defaulted and the bank accelerated the note. Thereafter, the bank initiated a lawsuit to collect on the note. Following a loss in the trial court, the bank appealed from the trial court's determina-

252. *Groseclose*, 860 S.W.2d at 558.

253. TEX. REV. CIV. STAT. ANN. art. 5069-1.01(d) (Vernon 1987).

254. *Groseclose*, 860 S.W.2d at 558.

255. TEX. REV. CIV. STAT. ANN. art. 342-508 (Vernon Supp. 1994).

256. *Id.*

257. 837 S.W.2d 652, 656 (Tex. App.—Houston [14th Dist.] 1992), *rev'd on other grounds*, 851 S.W.2d 189 (Tex. 1993). In reversing this case, the Texas Supreme Court expressed no opinion regarding the court of appeals' reasoning which supported the reversal of the trial court. 851 S.W.2d at 191 n.4.

tions that (1) the bank's commitment fee and renewal fee were not authorized under article 342-508, and (2) the bank's collection of interest, in addition to the commitment fee and renewal fee, constituted usury.²⁵⁸

On appeal, the bank argued that the first sentence of article 342-508 did not require the forfeiture of interest, as the bank's fees were not charged for rendering services. Agreeing with the bank's reading of article 342-508 and relying on the jury's findings that the fees were for making and renewing the loan as opposed to a charge for the reasonable value of the bank's services, and the fact that interest is a charge authorized by law, the court concluded that article 342-508 did not prohibit the bank from collecting interest and, accordingly, reversed the trial court's finding of usury.²⁵⁹ Its analysis unfinished, the court concluded that the bank violated the first sentence of article 342-508 by charging the commitment fee because the bank failed to establish that the commitment fee constituted either interest or a bona fide commitment fee.²⁶⁰ Noting that the first sentence of article 342-508 does not provide for an express remedy in the event a bank charges an authorized fee, the court concluded that the most appropriate remedy is the return of the fee, as opposed to loss of interest or imposition of usury penalties.²⁶¹

V. CHOICE OF LAW

*Tel-Phonic Services, Inc. v. TBS International, Inc.*²⁶² is the only choice of law case decided during the Survey period that could potentially impact future decisions. *Tel-Phonic Services* involved various disputes relating to a contract containing a choice of law provision. Although not the primary issue of the case, the Fifth Circuit addressed the issue of what law applied to contractual disputes between the parties to the contract and what law applied to claims of fraudulent inducement and breach of fiduciary duty asserted in the case. As to the contractual disputes, the Fifth Circuit declared

258. At the time of the default by the borrower in *Brazosport Bank*, article 342-508 was different from the current version of article 342-508 in several respects. First, the prior version of article 342-508 applied to all loans, as opposed to just consumer loans. Second, the prior version of article 342-508 not only provided for the forfeiture of interest if the fee for the bank's services exceeded \$15.00, but also limited the fee that a bank could charge for its services to \$15.00. Act of June 10, 1977, 65th Leg., R.S., ch. 370, § 1, 1977 Tex. Gen. Laws 1003.

259. *Id.* at 656-57.

260. In *Gonzales County Sav. & Loan Ass'n v. Freeman*, 534 S.W.2d 903, 906 (Tex. 1976), the Texas Supreme Court recognized a lender may charge bona fide commitment fees and that such fees do not constitute interest. On the other hand, if a fee is not a bona fide commitment fee under *Gonzales*, then for usury purposes the fee is to be treated as interest. *Id.* In *Brazosport Bank*, the court concluded that the evidence regarding the commitment fee did not conclusively establish the commitment fee to be a bona fide commitment fee or interest. On this basis, the court declined to make a determination that the commitment fee constituted a charge authorized by law. *Brazosport Bank*, 837 S.W.2d at 656-57. The court's refusal to treat the commitment fee as a charge authorized by law is somewhat questionable since under *Gonzales*, the fee should have been either a bona fide commitment fee or interest, both of which are authorized by law. *Gonzalez*, 543 S.W.2d at 906. As to the renewal fee, the court concluded that the evidence established that fee to be interest, and, accordingly, a charge authorized by law. *Brazosport Bank*, 837 S.W.2d at 657.

261. *Id.* at 656-57.

262. 975 F.2d 1134 (5th Cir. 1992).

its task to be simple, relying on the Texas Supreme Court's decision in *Duncan v. Cessna Aircraft Co.*²⁶³ as establishing the principle that Texas recognizes the right of parties to a contract to agree to a contractual choice of law provision. Although the court's statement regarding *Duncan v. Cessna* is correct, the court ignores the analysis required with respect to a contractual choice of law clause later established by the Texas Supreme Court in *DeSantis v. Wackenhut Corp.*²⁶⁴ As to the fraudulent inducement claim, the court concluded that Texas courts would apply section 201 of the RESTATEMENT (SECOND) OF CONFLICTS OF LAWS.²⁶⁵ Reasoning that fraud in the inducement is of the nature of a misrepresentation relating to a contract, the court utilized *comment a* to section 201 to conclude that the law chosen by the parties in the contract governed the fraud in the inducement claim.²⁶⁶ Although the Fifth Circuit seems to imply improperly that the Texas courts have adopted the RESTATEMENT (SECOND) CONFLICT OF LAWS in its entirety, the court's application of *comment a* to section 201 does not seem out of line. Additionally, the court's conclusion that an action involving fraudulent inducement is governed by contractual choice of law provisions as opposed to tort choice of law provisions appears appropriate since Texas courts have previously held that a party who has been the subject of fraud may elect to rescind the contract or, in the alternative, sue for damages under the contract.²⁶⁷ The court finally concluded that the breach of fiduciary duty claim should be controlled by the law selected by the parties in the contract, reasoning that the claim sounded in contract since the fiduciary duty, if any, would have arisen out of the contractual relationship of the parties.²⁶⁸

Far more important than the Fifth Circuit's decision in *Tel-Phonic Services* is the legislature's addition of section 35.51 to the Texas Business & Commerce Code,²⁶⁹ which generally provides that the parties to a transaction²⁷⁰ in which a party pays or receives or is obligated to pay or entitled to receive, or lends or borrows or is entitled to borrow or receive, funds or credit in excess of \$1,000,000 (a "qualified transaction") may elect in writing (with some exceptions):²⁷¹

- (i) to have the laws (other than conflict of law rules) of any jurisdiction having a reasonable relationship with the transaction²⁷² govern an

263. 665 S.W.2d 414 (Tex. 1984).

264. 793 S.W.2d 670 (Tex. 1990). *DeSantis* generally requires that the validity of a contractual choice of law clause be analyzed under RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 187 (1971). *Id.* at 677-681.

265. *Tel-Phonic Services*, 975 F.2d at 1142.

266. *Id.* (relying on RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 201 cmt. a (1971), which generally provides that questions involving misrepresentation in a contract are to be determined by the law chosen by the parties, provided they have made an effective choice.)

267. *Dallas Farm Mach. Co. v. Reaves*, 307 S.W.2d 233, 239 (Tex. 1957).

268. *Tel-Phonic Services*, 975 F.2d at 1142.

269. TEX. BUS. & COM. CODE ANN. § 35.51 (Vernon Supp. 1994).

270. A transaction is defined in TEX. BUS. & COM. CODE ANN. § 35.51(a)(1) (Vernon Supp. 1994). Section 35.51 does not apply, however, to choice of law provisions relating to construction contracts. Such provisions are instead governed by TEX. BUS. & COM. CODE ANN. § 35.52 (Vernon Supp. 1994). See *infra* notes 280-82 and accompanying text.

271. *Id.* § 35.51(a). See § 35.51(e) and (f) for certain exceptions to this rule.

272. Section 35.51(d) provides a non-exclusive laundry list of facts that will establish a

issue relating to the transaction (including enforceability of an agreement), regardless of whether the selected jurisdiction's law would be contrary to a fundamental or public policy of Texas,²⁷³ and

- (ii) to have the laws (other than conflict of law rules) of any jurisdiction govern the interpretation or construction of any agreement relating to the transaction or a provision of an agreement relating to the transaction, regardless of whether the transaction bears a reasonable relationship to the selected jurisdiction.²⁷⁴

Section 35.52 also provides that if the law chosen by the parties in a qualified transaction renders a particular provision of an agreement unenforceable or invalid, then the law of the jurisdiction (other than the conflict of law rules) having the most significant relation to the transaction, the subject matter of the transaction and the parties will apply to the applicable provision.²⁷⁵ Although the statute does not suggest the basis of determining the jurisdiction with the most significant relation, the courts presumably will follow the most significant relationship test adopted in *Duncan v. Cessna Aircraft Co.*²⁷⁶

Real estate practitioners should be aware that section 35.51 expressly applies to real estate transactions, other than a determination of any of the following: whether a transaction transfers or creates an interest in real property for security purposes; the nature of an interest in real property that is transferred or results from a foreclosure or is otherwise created by a transaction; the method for foreclosure of a lien against real property; or the manner and effect of recording or failing to record evidence of a transaction transferring real property or creating a real property interest.²⁷⁷

Section 35.51 clearly provides contracting parties with an easier route to choosing a particular forum's law and, from this perspective, the state legislature is to be commended. Although the authors are not aware of any formal written discussion concerning the constitutionality of section 35.51, there may be an issue regarding whether section 35.51 violates the open courts provision of the Texas State Constitution.²⁷⁸ The constitutionality

reasonable relationship between the transaction and the selected jurisdiction. *Id.* § 35.51(d). The laundry list includes the following: (1) a party to the transaction is a resident of the selected jurisdiction; (2) a party to the transaction has its place of business in the selected jurisdiction, or if a party conducts its business in multiple jurisdictions, either that party's chief executive office or an office from which the party conducts a substantial part of the negotiations relating to the transaction is located in the selected jurisdiction; (3) all or a part of the subject matter of the transaction is located in the selected jurisdiction; (4) a party to the transaction is required to perform a substantial part of its obligations (including the obligation to make payments) relating to the transaction in the selected jurisdiction; and (5) a substantial part of the negotiations were conducted, and at least one party executed an agreement relating to the transaction, in the selected jurisdiction. *Id.*

273. *Id.* § 35.51(b).

274. *Id.* § 35.51(c).

275. *Id.* § 35.51(e).

276. 665 S.W.2d 414 (Tex. 1984).

277. TEX. BUS. & COM. CODE ANN. § 35.51(f)(1), (g) (Vernon Supp. 1994).

278. TEX. CONST. art. I, § 13. Section 13 provides that "[a]ll courts shall be open, and every person for an injury done him, in his lands, goods, person or reputation, shall have remedy by due course of law." *Id.*

issue is beyond the scope of this article, but prior to utilizing section 35.51 as the sole basis of substantiating a contractual choice of law provision, practitioners should give this issue appropriate consideration. Moreover, real estate practitioners giving legal opinions regarding the enforceability of a contractual choice of law provision should, as belt and suspenders, consider analyzing the enforceability of the clause as contemplated by *DeSantis*.

In addition to the choice of law provisions of section 35.51, the Texas legislature added section 35.52 to provide that a party to a contract that is principally for the repair or construction of improvements to real property located within Texas may void any provision which makes the contract or disputes thereunder subject to the law of another state or litigation or arbitration in another state.²⁷⁹ A contract is principally for the repair or construction of improvements if a party's principal obligation under the contract is to provide labor or materials for the construction or repair of improvements, as a contractor or subcontractor.²⁸⁰ A contract is not principally for the repair or construction of improvements if the contract is (1) a partnership agreement or any other agreement covering an entity or trust, (2) an agreement providing for a loan or other extension of credit and any promise to construct or repair improvements under the contract is done so only as part of its agreement with the provider of the loan or credit or (3) an agreement for the management of real property or improvements and the promise to construct or repair is done so as a part of the overall property management obligation.²⁸¹

VI. HOMESTEAD

The courts decided numerous homestead cases during the Survey period, none of which require discussion. However, a number of the holdings and/or recognized principles are worthy of note: to claim a business homestead, the property claimed as the homestead must be (1) located in the same urban area as the claimant's residential homestead, (2) reasonably adapted and necessary to the homestead claimant's calling or business and (3) used as a place from which the homestead claimant operates its calling or business;²⁸² the mere rental of property for use by a tenant does not generally

279. TEX. BUS. & COM. CODE ANN. § 35.52 (Vernon Supp. 1994).

280. *Id.* § 35.52(b).

281. *Id.* § 35.52(c). The provisions of § 35.52(c) are not exclusive, thereby leaving the door open for courts to establish which other contracts are and are not contracts principally for the construction or repair of improvements. *Id.* § 35.52(d).

282. TEX. PROP. CODE ANN. § 41.002 (Vernon Supp. 1994); *In re Hughes*, 153 B.R. 736, 741 (Bankr. N.D. Tex. 1993) (where homestead claimant resided at and conducted business from same structure and the business conducted from the structure constituted the claimant's primary and most profitable business within the urban area, court concluded that claimant established the structure as claimant's business homestead), *modified by* 159 B.R. 197 (Bankr. N.D. Tex. 1993) (the opinion published at 153 B.R. 736 has been withdrawn because reconsideration of the opinion is pending). See *In re Finkel*, 151 B.R. 779, 781 (Bankr. W.D. Tex. 1993) (because spouse of a deceased restaurant operator failed to establish that she had continued the operation of the restaurant business following her husband's death, court held that she had abandoned the business homestead at which her husband had operated the restaurant). In formulating the elements of the business homestead, the *Finkel* court improperly stated that its

constitute a calling or business for the purpose of establishing a business homestead,²⁸³ but where the homestead claimant occupies a portion of a structure as a residence as well as its place of business, the mere rental of the remaining portion of the structure will not necessarily defeat the homestead character of the structure;²⁸⁴ a waiver or disclaimer of homestead is generally ineffective, but such a waiver may be effective if, at the time the homestead is encumbered, the claimant's occupancy of the property is dubious;²⁸⁵ the extension, consolidation and renewal of a loan properly secured by a lien against the borrower's residential homestead will not affect the validity of the lien against the homestead so long as the borrower acts in good faith and does not intentionally increase the burden on the homestead for purposes other than those necessary to accomplish the extension, consolidation or renewal;²⁸⁶ in order for a family to claim a homestead, the claimant must show that (1) the family personally used the claimed homestead as its homestead²⁸⁷ and (2) the head of the family had the legal or moral responsibility to support the remainder of the family members and the remainder of the family members depended on the head of the family for support;²⁸⁸ although a purchaser of property constituting the seller's homestead may generally assert the seller's homestead protection against liens which arose during the

formulation of the elements of a business homestead was consistent with *Webb v. Reserve Life Ins. Co.* (*In re Webb*), 954 F.2d 1102, 1108 (5th Cir. 1992).

283. *In re Finkel*, 151 B.R. at 782 (citing *Mays v. Mays*, 43 S.W.2d 148, 152 (Tex. Civ. App.—Beaumont 1931, no writ), distinguishing *Orr v. Orr*, 226 S.W.2d 172, 175 (Tex. Civ. App.—Amarillo 1949, no writ)). In *In re Finkel*, the court concluded that the claimant's rental of restaurant property to a corporation in which she owned a 49% interest did not, in and of itself, constitute a calling or business. The court also concluded that neither the claimant's ownership of a 49% interest in a corporation which operated the restaurant business nor the claimant's minimal participation in the operation of the restaurant business supported a finding that the restaurant constituted the claimant's business homestead. *Id.* at 783-87.

284. *In re Hughes*, 153 B.R. 736, 741-43 (Bankr. N.D. Tex. 1993), *modified by* 159 B.R. 197 (Bankr. N.D. Tex. 1993) (the opinion published at 153 B.R. 736 has been withdrawn because reconsideration of the opinion is pending).

285. *Id.* at 744 (relying on *In re Niland*, 825 F.2d 801, 808 (5th Cir. 1987)), *modified by* 159 B.R. 197 (Bankr. N.D. Tex. 1993); *Stephens v. Federal Deposit Ins. Corp.* (*In re Stephens*), 149 B.R. 414, 417 (Bankr. E.D. Tex. 1992) (relying on *In re Niland*, 825 F.2d at 808); *see also* *NCNB Texas Nat'l Bank v. Carpenter*, 849 S.W.2d 875, 881 (Tex. App.—Fort Worth 1993, n.w.h.) (citing *First Interstate Bank v. Bland*, 810 S.W. 2d 277, 285-86 (Tex. App.—Fort Worth 1991, no writ) as support for the principle that a borrower may be estopped from claiming a homestead where the borrower represents to the lender that the encumbered property is not the borrower's homestead, the lender relies on the borrower's representation and, at the time the representation is made, the physical facts of the property open to observation support a conclusion that the property is not the borrower's homestead).

286. *Freytag v. American Fed. Bank* (*In re Freytag*), 155 B.R. 150, 154 (Bankr. N.D. Tex. 1993) (relying on *Machicek v. Barcak*, 170 S.W.2d 715, 717 (Tex. 1943)). In *In re Freytag*, the court concluded that, in connection with a refinancing of existing homestead debt, the addition of accrued interest and loan fees and other fees charged as an integral part of the refinancing to the principal balance and changing the amount of scheduled payments did not constitute an improper intentional increase of the burden on the homestead, as contemplated by *Machicek*. *Id.* at 155.

287. *NCNB Texas Nat'l Bank v. Carpenter*, 849 S.W.2d 875, 879 (Tex. App.—Fort Worth 1993, n.w.h.) (citing *First Interstate Bank v. Bland*, 810 S.W.2d 277, 286 (Tex. App.—Fort Worth 1992, no writ)).

288. *Id.* (citing *Henry S. Miller Co. v. Shoaf*, 434 S.W.2d 243, 244 (Tex. Civ. App.—Eastland 1968, writ ref'd n.r.e.)).

seller's ownership of the property but which did not attach to the property because of its homestead status, such a lien will attach to the acquired property if the seller abandoned or alienated the homestead after the perfection of the lien and prior to the recordation of the purchaser's deed;²⁸⁹ abandonment of a homestead requires both cessation of use of the homestead and the intent to permanently abandon the homestead;²⁹⁰ section 41.002(c) of the Texas Property Code²⁹¹ does not provide an exclusive means of determining whether a homestead is a rural homestead;²⁹² and section 41.001(c) of the Texas Property Code²⁹³ ceases to protect the proceeds from the sale of a homestead at such time as the party seeking protection under section

289. *Intertex, Inc. v. Kneisley*, 837 S.W.2d 136, 138 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (relying on *Hoffman v. Love*, 494 S.W.2d 591, 594 (Tex. Civ. App.—Dallas 1973, writ ref'd n.r.e.)). In *Intertex*, two parties claimed ownership of certain property under constable deeds delivered following execution on judgment liens. One judgment lien was filed at a time the prior owner used the property as his homestead. Thereafter, that owner sold its property, thereby alienating the homestead. Prior to the date the purchaser recorded its deed, another creditor of the seller obtained a judgment against the seller and filed a judgment lien against the conveyed property. After the purchaser recorded its deed, the second judgment creditor executed against the conveyed property and received a constable's deed. Subsequently, a party claiming rights to the property under the first judgment creditor brought suit to try title against a party claiming rights to the property under the second judgment creditor. After losing at the trial level, the party claiming the rights to the property under the first judgment creditor appealed. The appeals court reversed, concluding that, due to the gap between the sale of the homestead and the filing of the deed, the first judgment creditor's lien attached at the time the seller sold the homestead. *Id.* at 138. In reaching this conclusion, the court relied on *Hoffman*; however, the court's reliance on *Hoffman* is improper as that decision did not address the gap issue. Nevertheless, as a general matter, the court's conclusion seems logical in light of the alienation of the homestead and TEX. PROP. CODE ANN. § 13.001(a) (Vernon Supp. 1994), which generally provides that a conveyance of real property is void as to a creditor unless the conveyance instrument has been acknowledged, sworn to or proved and filed of record.

290. *Womack v. Redden*, 846 S.W.2d 5, 7 (Tex. App.—Texarkana 1992, writ denied) (relying on *Franklin v. Woods*, 598 S.W.2d 946, 949 (Tex. Civ. App.—Corpus Christi 1980, no writ)). In *Womack*, the court concluded that although the homestead claimant argued that she never intended to abandon her homestead, strong circumstantial evidence supported the lower court's finding that the claimant intended to abandon her homestead. *Id.* at 8. This evidence included the claimant's failure to live in the claimed homestead for a period of several years, although her husband lived in the claimed homestead during this period of time, the claimant's purchase and occupancy of another home with community funds, the claimant's removal of all furnishings from the claimed homestead following her husband's death and the claimant's failure to visit the homestead for several years preceding her husband's death. *Id.*

291. TEX. PROP. CODE ANN. § 41.002(c) (Vernon Supp. 1994).

292. *United States v. Blakeman*, 997 F.2d 1084 (5th Cir. 1992); *Thornberry v. Davis (In re Davis)*, 152 B.R. 133 (Bankr. S.D. Tex. 1992). The *Davis* court also concluded that § 41.002(c) applies only "in foreclosure situations where the issue of homestead status has already been resolved." *Id.* at 135. The court reached this conclusion, relying on footnote 18 in *Bradley v. Pacific S.W. Bank (In re Bradley)*, 960 F.2d 502, 511 n.18 (5th Cir. 1992), wherein the Fifth Circuit recognized that § 41.002(c) may not apply to all homestead disputes, but that it at least applies to cases involving threatened foreclosure of a homestead. The *In re Davis* court statement that § 41.002(c) applies only to foreclosure situations twists the Fifth Circuit's position set forth in note 18 of *In re Bradley* and more recently in *Blakeman*. The better position is that § 41.002(c) is a non-exclusive method of determining whether a homestead is rural, especially as § 41.002(c) in no way indicates that it preempts common law or that it is otherwise intended to be the exclusive method for determining the existence of a rural homestead.

293. TEX. PROP. CODE ANN. § 41.002(c) (Vernon Supp. 1994).

41.001(c) acquires another homestead.²⁹⁴

VII. MECHANIC'S LIENS

Two mechanic's lien cases decided during the Survey period deserve discussion.²⁹⁵ In the first mechanic's lien case, *Valdez v. Diamond Shamrock Refining and Marketing Co.*,²⁹⁶ a subcontractor performed work in connection with the construction of improvements on a 7.9 acre tract of land. Prior to completion of construction of the improvements, the owner of the 7.9 acres replatted the land into two separate tracts, one of which consisted of 7.1 acres and the other of which consisted of .8 acres. The owner thereafter sold the .8 acre tract (in an undeveloped state) to a third party. Following the sale, the subcontractor filed a lien against the entire 7.9 acres, but did not deliver a notice of the filed mechanic's lien to the purchaser of the .8 acre tract. Thereafter, the subcontractor sought to foreclose its lien against the acquired parcel. However, the trial court entered judgment in favor of the purchaser and the appeals court affirmed.²⁹⁷ Not to be denied, the subcontractor appealed to the Texas Supreme Court.

Recognizing that section 53.022(c) of the Texas Property Code²⁹⁸ provides that a mechanic's lien extends to the entire lot on which work is being performed, the court found it necessary to determine the meaning of "lot" as used in section 53.022(c). The purchaser argued that the term lot should only apply to the improvements and the land immediately surrounding the improvements. Rejecting the purchaser's position, the court found no evidence that the legislature intended the term "lot" to have a meaning other than that usually given to the term lot. Relying on a legal dictionary, the court concluded that the term "lot" as used in section 53.022(c) refers to a "single tract of land as recorded in the county deed records" at the time of commencement of construction.²⁹⁹ Since the .8 acre tract constituted a part of a single platted tract of land at the time of commencement of construction of the improvements, the court concluded that the subcontractor's lien, if properly perfected, extended to the .8 acre tract.³⁰⁰

294. *England v. Federal Deposit Ins. Corp. (In re England)*, 975 F.2d 1168, 1175 (5th Cir. 1992). The district court case, *In re England*, 141 B.R. 495 (Bankr. N.D. Tex. 1991) is discussed in last year's Survey article on Real Property. See William R. Van Wagner et al., *Real Property, Annual Survey of Texas Law* 46 SMU L. REV. 1707, 1764 (1993) [hereinafter Van Wagner, 1993 Annual Survey].

295. Two additional cases are worthy of note: *Dossman v. Nat. Loan Investors, L.P.*, 845 S.W.2d 384, 387 (Tex. App.—Houston [1st Dist.] 1992, writ denied) (holding that a statutory mechanic's lien does not secure payment of attorneys fees); *J&J Equipment, Inc. v. Pilkinton*, 850 S.W.2d 804, 806 (Tex. App.—Corpus Christi 1993, writ denied) (stating that a mechanic's lien statute does not confer a lien for demolition or removal of structures, unless a written agreement between parties provides that such a lien may be filed).

296. 842 S.W.2d 273 (Tex. 1992).

297. The court of appeals decision is reported at 820 S.W.2d 956, and is discussed at length in last year's Survey article. See Van Wagner, 1993 Annual Survey, *supra* note 294, at 1785-87.

298. TEX. PROP. CODE ANN. § 53.022(c) (Vernon 1984 & Supp. 1994).

299. *Valdez*, 842 S.W.2d at 275 (relying on BLACK'S LAW DICTIONARY 946 (6th ed. 1990)).

300. *Id.* at 275.

The purchaser further argued that even if the subcontractor's mechanic's lien extended to the .8 acre tract, the subcontractor did not properly perfect its lien against the .8 acre tract since the subcontractor failed to deliver written notice of the unpaid balance to the purchaser, as owner of the .8 acre tract, in accordance with section 53.056(b) of the Texas Property Code.³⁰¹ Relying on another provision of the Texas Property Code (and ignoring the plain meaning analysis that the court used in interpreting section 53.022(c)), the court concluded that the term "owner," as used in section 53.056(b), refers to the "owner or reputed owner."³⁰² Perhaps feeling insecure with this position, the court held that, as a matter of law, a purchaser's knowledge of the recent construction of improvements on a single piece of property is sufficient to impose constructive notice of a worker's right to assert a mechanic's lien within the statutory period.³⁰³ In light of this holding and the stipulated fact that construction had commenced on the 7.1 acre tract prior to the purchaser's acquisition of the .8 acre tract, the court had little difficulty concluding that the subcontractor's mechanic's lien attached to the .8 acre tract.³⁰⁴

In the second mechanic's lien case, *Vulcan Materials Co. v. Jack Raus, Inc. (In re HLW Enterprises of Texas, Inc.)*,³⁰⁵ the IRS, as a tax lien claimant, asserted a right to construction payments made by an owner to a general contractor and held by the general contractor as retainage payable to a subcontractor indebted to the IRS. At the same time, a supplier of the subcontractor (who had filed a lien for nonpayment) asserted entitlement to a portion of the retainage on the basis that a portion of the retainage represented amounts owed by the subcontractor to the supplier for payment of materials. Seeking to avoid liability for improper distribution of the retainage, the general contractor filed an interpleader action seeking a judicial determination of the proper distribution of the retainage. The IRS argued that its tax lien had priority over the supplier's lien claim since the IRS's lien arose prior to the mechanic's lien.³⁰⁶ Recognizing that the IRS's

301. TEX. PROP. CODE ANN. § 53.056(b) (Vernon 1984 & Supp. 1994). Section 53.056(b) generally provides that if a lien claim arises from a debt incurred by a subcontractor, the claimant must give the original contractor written notice of the unpaid balance not later than the 15th day of the second month following each month in which the claimant's labor was performed or material delivered. The same notice must be given to the owner or reputed owner and original contractor not later than the 15th day of the third month in which all or part of the claimant's labor was performed or material was delivered. *Id.*

302. *Valdez*, 842 S.W.2d at 276. The court relied on TEX. PROP. CODE ANN. § 53.054(a)(2) which, for purposes of a mechanic's lien affidavit, allows the claimant to list the "owner or reputed owner" of the property upon which the subcontractor performed work or supplied materials. TEX. PROP. CODE ANN. § 53.054(a)(2) (Vernon 1984 & Supp. 1994). This provision, according to the court, is "necessarily implicated" when interpreting other references to the term "owner" within the Texas Property Code. *Valdez*, 842 S.W.2d at 276.

303. *Id.*

304. *Id.*

305. 157 B.R. 592 (Bankr. W.D. Tex. 1993).

306. Generally, the priority of a federal tax lien is governed by the principle of "first in time is the first in right." *Id.* at 595 (citing *e.g.*, *United States v. McDermott*, 113 S. Ct. 1526 (1993)). When determining priority under this rule, (1) a federal tax lien's priority dates from the date of filing of the notice of tax lien, regardless of the date the federal tax lien attaches and (2) the priority date of the competing lien dates from the date on which the lien has been

lien had priority over its mechanic's lien, the subcontractor invoked an alternative means of recovery permitted under sections 162.001 and 162.003 of the Texas Property Code,³⁰⁷ which generally provide that (1) construction payments made to a contractor or subcontractor pursuant to a construction contract for the improvement of real property are trust funds³⁰⁸ and (2) the contractors, subcontractors, laborers and suppliers furnishing labor or materials for the construction of the improvements are the beneficiaries of the trust funds.³⁰⁹ Generally, the supplier argued that the subcontractor had no interest in the retainage because the retainage constituted a trust fund held for the payment of the supplier's unpaid bills. Accordingly, the IRS's tax lien could not attach to the retainage. The IRS countered, arguing that section 162.001 should be read as creating a trust fund for the benefit of a materialman only at such time as the party with whom the materialman directly contracted receives a construction payment. If the court adopted such a reading, the supplier would not be entitled to any portion of the retainage since the retainage had not yet been paid to the subcontractor. Although recognizing the plausibility of the IRS's argument, the court concluded that the specific wording of the statute mandated a conclusion that when any contractor or subcontractor received a payment from an owner, that payment gave rise to the trust for the benefit of all materialmen and other beneficiaries recognized under section 162.003.³¹⁰

VIII. LANDLORD AND TENANT

During the Survey period, the courts were presented with various landlord and tenant issues, some of which resulted in the following holdings and statements: a material modification of a lease must be in writing if the lease is required to be in writing;³¹¹ a non-waiver provision contained in a lease

perfected in the sense that "the identity of the lienor, the property subject to the lien, and the amount of the lien are established." *McDermott*, 113 S. Ct. at 1528 (quoting *United States v. New Britain*, 347 U.S. 81, 84 (1954)). As to mechanic's liens, the date of perfection likely dates from the date the mechanic's lien is filed pursuant to the state statute since that is the date that the identity of the property subject to the lien becomes known. Interestingly, the *McDermott* case concluded that the date of priority of a judgment lien against after acquired property is the date that the property is acquired by the debtor and not the date the judgment lien is recorded. *McDermott*, 113 S. Ct. at 1529-30.

307. TEX. PROP. CODE ANN. §§ 162.001, 162.003 (Vernon 1984).

308. *Id.* § 162.001.

309. *Id.* § 162.003.

310. *In re HLW Enterprises*, 157 B.R. at 597. The court relied on that portion of § 162.001 which provides that trust payments include payments "made to a contractor or subcontractor." *Id.* (citing TEX. PROP. CODE ANN. § 162.001 (Vernon 1984)). The court could have found more favorable language in § 162.003, which provides that mechanics, contractors, materialmen and other named parties are beneficiaries of "any trust funds paid or received in connection with the improvement." *Id.* § 162.003. Moreover, there exists at least one Texas appellate court case which supports the court's holding. *McCoy v. Nelson Util. Serv., Inc.*, 736 S.W.2d 160, 164 (Tex. App.—Tyler 1987, writ ref'd n.r.e.) (holding that retainage held by owner and payable to contractor constituted a trust fund for the benefit of contractor's materialmen).

311. *General Elec. Credit Corp. v. Timely Secretarial Serv., Inc.* (*In re Timely Secretarial Serv., Inc.*), 987 F.2d 1167, 1173 (5th Cir. 1993) (relying on *Kerrville HRH, Inc. v. City of Kerrville*, 803 S.W.2d 377, 388-89 (Tex. App.—San Antonio 1990, writ denied)). The most

may be waived just as any other provision contained in the lease;³¹² a tenant may exclude third parties, including the landlord, from entering the tenant's premises, unless the entering party has a contractual or other legal right to enter;³¹³ a tenant has an insurable interest in leased property where the tenant derives pecuniary advantage from the property or would suffer pecuniary loss from the destruction of the property;³¹⁴ for purposes of determining whether a constructive eviction occurred, the tenant's abandonment of the premises more than two years after becoming aware of the condition allegedly causing the constructive eviction did not constitute abandonment of the premises within a reasonable period of time;³¹⁵ the mere use of the word "warranty" to create a covenant within a lease will not necessarily create an express warranty for purposes of a claim under the Texas Deceptive Trade

significant issue in *Timely Secretarial* concerned the question of whether agreements between a debtor and a creditor to lift an automatic stay must be in writing. Without answering the question, the Fifth Circuit gave a strong indication that such agreements must be in writing or otherwise made a part of the record to be enforceable. *Timely Secretarial*, 987 F.2d at 1173, n.6. In refusing to enforce the alleged oral agreement which would modify the terms of a written lease, the *Timely Secretarial* court not only relied on the principle cited in the text, but also a provision in the lease which required all amendments to be in writing. The court's reliance on the contract provision requiring all amendments to be in writing is overly broad. Specifically, one line of Texas cases holds that a written contract containing a no-oral modification provision may be orally modified, so long as the contract is not required by law to be in writing (e.g., *Hyatt Cheek Builders v. Board of Regents*, 607 S.W.2d 258, 265 (Tex. Civ. App.—Texarkana 1980, writ dismissed)), while another line of cases more broadly holds that a written contract containing a no-oral modification provision may be orally modified, on the theory that a written bargain is of no higher legal degree than an oral one, e.g., *Apperson v. Shofner*, 351 S.W.2d 367, 369 (Tex. Civ. App.—Waco 1961, no writ). Moreover, a provision of article 2 of the Texas Uniform Commercial Code, TEX. BUS. & COM. CODE § 2.209(c) (Tex. UCC) (Vernon 1984), provides that an agreement subject to article 2 which contains a no-oral modification clause may not be orally modified, except that if a merchant supplies a form to another merchant containing a no-oral modification clause, that form must be separately signed by the merchant receiving the form. *Id.* § 2.209.

312. *Winslow v. Dillard Dep't Stores*, 849 S.W.2d 862 (Tex. App.—Texarkana 1993, writ denied); *Zwick v. Lodewijk Corp.*, 847 S.W.2d 316, 318 (Tex. App.—Texarkana 1993, writ denied). In reaching its holding, the *Winslow* court relied on *Zwick*. In *Zwick*, the court rejected the waiving party's reliance on *Giller Indus., Inc. v. Hartley*, 644 S.W.2d 183, 184 (Tex. App.—Dallas 1982, no writ), which held that, as a matter of law, an anti-waiver clause contained in a lease allowed a landlord to declare a default for failure to timely pay rent, even though the landlord had accepted late rent payments for the preceding six months. The *Zwick* court appropriately distinguished *Giller*, noting that the anti-waiver clause in *Giller* provided that waiver of past defaults would not constitute a waiver of future defaults, while the anti-waiver provision in *Zwick* provided that the lessor's failure to timely declare a default or take action thereon would not constitute a waiver of that default. *Zwick*, 847 S.W.2d at 317, n.2.

313. *Mobil Pipe Line Co. v. Smith*, 860 S.W.2d 157, 160 (Tex. Civ. App.—El Paso 1993, writ dismissed w.o.j.).

314. *Jones v. Texas Pac. Indem. Co.*, 853 S.W.2d 791 (Tex. App.—Dallas 1993, n.w.h.). In *Jones*, the court concluded that the tenant had no insurable interest in the property because the tenant occupied the property as a tenant at sufferance following a foreclosure. *Id.* at 795.

315. *Holmes v. P.K. Pipe & Tubing, Inc.*, 856 S.W.2d 530, 538 (Tex. App.—Houston [1st Dist.] 1993, n.w.h.).

Practices Act (DTPA);³¹⁶ the Texas Smoke Detector Statute³¹⁷ exclusively provides for the landlord's duties and the tenant's remedies with respect to residential smoke alarms,³¹⁸ and those duties and rights may be enlarged only by specific written agreement between the landlord and tenant;³¹⁹ the Texas Smoke Detector Statute does not violate the open courts provision of the Texas Constitution³²⁰ or due process;³²¹ and options to renew a lease generally must be exercised strictly according to the option provisions.³²²

One case decided during the Survey period addresses claims based on breach of the implied covenant of suitability for commercial purposes established by the Texas Supreme Court in *Davidow v. Inwood North Professional Group*.³²³ The *Davidow* court explained that this warranty means that there are no latent defects in facilities vital to the use of the commercial premises and that those facilities will remain in a suitable condition during the term of the lease.³²⁴ In *Gober v. Wright*,³²⁵ the Houston Court of Appeals declared that, as a matter of law, only the tenant's express agreements within the lease to repair certain defects limit the implied warranty of suitability for commercial purposes.³²⁶ The court's declaration broadens the holding of *Davidow* and the *Davidow* court's explanation of its holding. Specifically, there is little reason to assume that the *Davidow* court intended to override express contractual agreements between a landlord and tenant relating to such matters as casualty damage or interruption of utilities, both of which would likely result in a temporary interruption of vital facilities. Clearly, the *Davidow* court did not address these issues or discuss whether there could be any exceptions to its holding other than the one stated exception relating to agreements by the tenant to undertake repairs relating to the defective facility.³²⁷

316. *Enterprise-Laredo Assoc. v. Hachar's, Inc.*, 839 S.W.2d 822, 831 (Tex. App.—San Antonio 1992), writ denied per curiam, 843 S.W.2d 476 (Tex. 1992). The contested provision in *Hachar's* stated that the "[l]andlord warrants that Tenant shall not be required to pay a charge for the use of common areas" greater than that charged to any other tenant. *Id.* at 830. Reasoning that a warranty commonly extends to the character, quality, title, quantity, capacity, condition or fitness of the goods or thing sold, the *Hachar's* court concluded that the landlord's warranty was not a warranty for purposes of the DTPA but rather constituted a covenant not actionable under the DTPA. *Id.* at 831-32. *But cf.* *Golman v. Alkek*, 850 S.W.2d 568, 572-74 (Tex. App.—Corpus Christi 1993, writ requested) (holding that the covenant of quiet enjoyment contained in lease construed to be warranty for purposes of DTPA).

317. TEX. PROP. CODE ANN. §§ 92.251-92.262 (Vernon 1984 & Supp. 1994).

318. *Epps v. Ayer*, 859 S.W.2d 107 (Tex. App.—Eastland 1993, writ denied); *Coleman v. United Sav. Ass'n*, 846 S.W.2d 128, 132 (Tex. App.—Fort Worth 1993, n.w.h.).

319. TEX. PROP. CODE ANN. § 92.006 (Vernon Supp. 1994).

320. TEX. CONST. art. I, § 13.

321. *Cannon v. Lemon*, 843 S.W.2d 178, 183 (Tex. App.—Houston [14th Dist.] 1992, writ denied).

322. *Hush Puppy of Longview, Inc. v. Cargill Interests, Ltd.*, 843 S.W.2d 120 (Tex. App.—Texarkana 1992, no writ). In *Hush Puppy*, the court held that a renewal option expired due to the tenant's failure to exercise the option within 90 days of the expiration of the lease as required by the option provisions. *Id.* at 122.

323. 747 S.W.2d 373 (Tex. 1988).

324. *Id.* at 377.

325. 838 S.W.2d 794 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

326. *Id.* at 798.

327. *Davidow*, 747 S.W.2d at 377.

Perhaps one justification for the breach of the implied warranty of suitability established by *Davidow* is to ease the burden imposed by the breach of a covenant of quiet enjoyment, which generally requires a tenant to establish a constructive eviction by showing that (1) the landlord intended that the tenant no longer enjoys the use of the premises, (2) a material act of the landlord substantially interfered with the intended use and enjoyment of the premises, (3) the tenant is permanently deprived of the use of the premises and (4) the tenant abandoned the premises within a reasonable period of time after the commission of the landlord's material act.³²⁸ In *Goldman v. Alkek*,³²⁹ the tenant sued for breach of the covenant of quiet enjoyment, but avoided the requirement of showing a constructive eviction. The appellate court reasoned that the tenant should not be required to demonstrate the general requirements of constructive eviction because the tenant sought damages, as opposed to avoidance of rent and the termination of the lease.³³⁰ Therefore, according to the court, the tenant need to only show a breach of the express terms of the contractual covenant of quiet enjoyment.³³¹ Although this portion of the court's opinion makes legal sense, the court improperly went on to construe the contractual covenant of quiet enjoyment as a warranty of quiet enjoyment covered by the DTPA.³³² Although the court recognized that a mere breach of contract is not actionable under the DTPA, the court insisted on characterizing the covenant of quiet enjoyment as a warranty that the landlord breached by subjecting the tenant to obligations not required under the lease, thereby committing deceptive acts.³³³ The court apparently concluded that the warranty status of the covenant arose from the express language of the covenant, which generally provided that the tenant would be entitled to peaceable and quiet possession of the premises "without hindrance or molestation of Lessor."³³⁴ Regardless of the fact that the quoted words expanded the covenant of quiet enjoyment, the expansion should have not caused the covenant to be converted to a warranty.

Two cases decided during the Survey period address the issue of whether a provision in a lease requiring all modifications and amendments to be in writing is enforceable as written. In *Zwick v. Lodewijk Corp.*,³³⁵ the Texarkana Court of Appeals chose to ignore a provision of a contract requiring all amendments and provisions of a lease to be in writing and permitted an oral amendment to the lease to be enforced. The court based the enforceability of

328. *Goldman v. Alkek*, 850 S.W.2d 568 (Tex. App.—Corpus Christi 1993, writ requested).

329. *Id.*

330. *Id.* at 572.

331. *Id.*

332. *Id.* at 574.

333. *Id.* In reaching this holding, the court relied on TEX. BUS. & COM. CODE ANN. § 17.46(b)(19) (Vernon Supp. 1994), which generally provides that a deceptive trade practice includes a representation that a guaranty or warranty confers rights or remedies which are not included in the guaranty or warranty. The court inappropriately used § 17.46(b)(19) since the covenant of quiet enjoyment does not constitute a warranty.

334. *Goldman*, 850 S.W.2d at 572.

335. 847 S.W.2d 316 (Tex. App.—Texarkana 1993, writ denied).

the oral amendment on the basis of an exception to the statute of frauds.³³⁶

Another decision decided during the Survey period, *In re Timely Secretarial Service, Inc.*³³⁷ addressed a similar contract clause. Arriving at a contrary result, the Fifth Circuit concluded that not only the statute of frauds, but also a clause within the lease, required all modifications to the lease to be in writing, thereby barring an alleged oral modification to the lease.³³⁸ If forced to choose, select *Timely Secretarial* as being correct and label *Zwick* as a prime example of a court inappropriately choosing to ignore the express requirements of the parties' contract.

*Alexander v. Cooper*³³⁹ clearly establishes that it is imprudent, at best, to stick a negotiated lease document in a drawer after its execution by the parties. In *Alexander*, the lessee leased certain property and the improvements thereon. The lease provided that all alterations and improvements placed upon the leased property during the term would become the lessor's property. Improvements included all buildings, equipment and fixtures. Some time after the execution of the lease and apparently without reviewing the lease instrument, the lessee constructed a car wash operation on the property, which included a building and car washing equipment bolted to the building. Shortly before the expiration of the lease, the lessee removed all car washing equipment from the property, including the equipment bolted to the car wash structure constructed by the lessee. The lessor thereafter sued the lessee for unauthorized removal of the car wash equipment. The trial court found for the lessor and the lessee appealed. Having little trouble concluding that the car wash equipment constituted improvements under the lease, the appellate court held that the car wash equipment had become the lessor's property upon installation and should have been surrendered with the other portions of the leased premises.³⁴⁰

Generally, a lessee can be comfortable with its right to occupy its leased premises to the exclusion of others, except to the extent that the lessee otherwise agrees in writing. Even though the court in *Mobil Pipe Line Co. v. Smith*³⁴¹ agreed with this general principle,³⁴² the court concluded that an owner of land covered by a lease may, without the consent of the lessee of that land, grant a pipeline easement under the surface of the leased land, but the lessee may recover damages resulting from interference with the lessee's right to possession of the surface.³⁴³ The court reached this holding by relying on various cases addressing the correlative rights of a landowner, its surface lessee and its mineral lessee.³⁴⁴ The lessee argued that these cases were

336. *Id.* at 319 (relying on TEX. BUS. & COM. CODE ANN. § 26.01 (Vernon 1984); Troutman v. Interstate Promotional Printing Co., 717 S.W.2d 428, 429 (Tex. App.—San Antonio 1986, writ ref'd n.r.e.)).

337. 987 F.2d 1167 (5th Cir. 1993).

338. *Id.* at 1173.

339. 843 S.W.2d 644 (Tex. App.—Corpus Christi 1992, n.w.h.).

340. *Id.* at 646-47.

341. 860 S.W.2d 157 (Tex. App.—El Paso 1993, writ disp'd w.o.j.).

342. *Id.* at 159.

343. *Id.* at 159-60.

344. *Id.*

inapposite because each involved a severance of an estate into a surface estate and a subsurface estate, thereby creating competing interests between the two estates. The court rejected this distinction, concluding that if a landowner has the right to burden the estate of a lessee with a mineral estate, surely it could burden the estate of a lessee with a pipeline easement, which in the court's judgment was far less burdensome than a mineral estate.³⁴⁵ Both the lessee's and court's position have merit, but the lessee's position appears better argued based on existing case law.

Although not a landlord/tenant case, the holding of *Harmon v. General Motors Corp.*³⁴⁶ could well be applicable to certain premises liability claims brought by an employee of a tenant against the landlord. Relying on a Texas Supreme Court case,³⁴⁷ the Fifth Circuit concluded that, as a matter of law, an employee of a contractor who entered an area not authorized by the contract between the contractor and the owner became a trespasser, regardless of the employee's knowledge of whether he was authorized to enter the particular area.³⁴⁸

In *Barnes v. Wendy's International, Inc.*,³⁴⁹ an employee of a tenant suffered personal injuries as a result of a fall within the premises and sued the landlord. Realizing that a landlord is not generally liable for areas controlled by the tenant unless the landlord has undertaken, but failed to perform, a repair obligation or has agreed to repair the premises,³⁵⁰ the employee argued that certain provisions of the lease obligated the landlord to make repairs which, if performed, could have prevented the personal injury. Specifically, the employee argued that the provisions in the lease which granted the landlord the right to re-enter the premises in the case of a tenant default constituted a retention of control by landlord over the premises, thereby giving rise to a duty to maintain the premises. The court summarily dismissed the employee's argument, concluding that the lease granted the landlord a right, without imposing an obligation.³⁵¹ Having lost the control argument against the landlord, the employee, claiming third party beneficiary status to the lease, next argued that the landlord should be liable for its failure to enforce a provision in the lease which required the tenant to carry worker's compensation insurance to the extent required by law. Again, the court had little difficulty dismissing the tenant's argument, concluding that the contract evidenced no intent to confer third party beneficiary status upon the employee.³⁵² Even if the parties intended that the employee be a third

345. *Id.* at 160.

346. 999 F.2d 964 (5th Cir. 1993).

347. *Id.* at 965-66 (relying on *Burton Constr. & Shipbldg. Co. v. Broussard*, 154 Tex. 50, 273 S.W.2d 598, 602-03 (1954) (holding that a person who rightfully occupies or is on an owner's land and who then enters upon another portion of the owner's land which the person has no right to occupy or use, such person becomes a trespasser or mere licensee)).

348. *Harmon*, 999 F.2d at 966, n.3.

349. 857 S.W.2d 728 (Tex. App.—Houston [14th Dist.] 1993, n.w.h.).

350. *E.g.*, *George v. City of Fort Worth*, 434 S.W.2d 903, 907 (Tex. App.—Fort Worth 1968, writ ref'd n.r.e.).

351. *Barnes*, 857 S.W.2d at 730.

352. *Id.* at 731.

party beneficiary of the lease, the court concluded that the employee's claim must fail because Texas law does not require an employer to carry worker's compensation insurance.³⁵³

IX. PARTITION

A co-tenant of real property has a right to partition of the co-owned property under section 23.001 of the Texas Property Code³⁵⁴ and the courts have generally recognized that right as absolute.³⁵⁵ For example, in *Carter v. Charles*,³⁵⁶ an ex-wife brought an action against her ex-husband to partition property in which each owned an undivided interest pursuant to a divorce decree. The ex-husband claimed that a two-year limitations period contained in section 3.90 of the Texas Family Code and the doctrine of res judicata barred the partition action.³⁵⁷ Recognizing the right to partition as absolute, the appeals court concluded that even if section 3.90 barred enforcement under the Family Code, that section does not bar an otherwise valid partition action.³⁵⁸ Moreover, stated the court, the ex-wife's action sought only to enforce her partition right with respect to the joint ownership interests awarded by the court and not to relitigate the property divisions awarded by the divorce decree.³⁵⁹

While the Texas Property Code grants the statutory right to partition, the judicial procedures for conducting a partition action are set forth in Rule 771 of the Texas Rules of Civil Procedure.³⁶⁰ A common challenge to a judicial partition is the argument that the trial court failed to reject a commissioner's report as materially erroneous or unequal and unjust in accordance with Rule 771 of the Texas Rules of Civil Procedure.³⁶¹ In *Ellis v. First City National Bank*,³⁶² the petitioner argued that the commissioner's report unjustly partitioned the property between the co-tenants. In support of the petitioner's claim, one of the commissioners testified that he did not consider the division fair, and several other parties testified that the commissioner's report awarded the other co-owners a disproportionate share of the most attractive land. The petitioner further argued that due to the number of co-owners (twenty-nine), the limited road frontage and lake frontage could not be fairly divided among the co-owners. The court, however, concluded that this evidence did not establish, as a matter of law, the unequal or unjust nature of the commissioner's report and the court therefore declined to over-

353. *Id.* The court also concluded that even if the contract imposed an obligation on the tenant to carry worker's compensation insurance, any claim would be against the tenant and not the landlord. *Id.*

354. TEX. PROP. CODE ANN. § 23.001 (Vernon 1984).

355. *E.g.*, *Carter v. Charles*, 853 S.W.2d 667, 671 (Tex. App.—Houston [14th Dist.] 1993, n.w.h.) (citing *Ware v. Ware*, 809 S.W.2d 569, 571 (Tex. App.—San Antonio 1991, no writ)).

356. *Id.*

357. TEX. FAM. CODE ANN. § 3.90 (Vernon 1993).

358. *Carter*, 853 S.W.2d at 671.

359. *Id.* at 672.

360. TEX. R. CIV. P. 771.

361. *Id.*

362. 864 S.W.2d 555 (Tex. App.—Tyler 1993, n.w.h.).

turn the trial court's acceptance of the divisions of property set forth in the commissioner's report.³⁶³

The most interesting partition case decided during the Survey period is a case involving the doctrine of equitable partition, which one court described as follows:

[O]ne cotenant has no power to divest the title of other cotenants by selling specific parts of the common property, yet under the well-settled doctrine of equitable partition the court in adjusting the equities of all the interested parties will protect such purchasers by setting aside to them the particular tracts purchased, if it can be done without injury to the other owners, where . . . [the] property is of equal and uniform value; and will set aside to the nonjoining cotenants the equivalent of their interest in all the land out of the unsold tract if it is sufficient to satisfy same.³⁶⁴

In *Barfield v. Holland*,³⁶⁵ three individuals, J.H., Otha and Tessie,³⁶⁶ jointly owned a tract of land consisting of approximately 100 acres. The three owners surveyed the tract of land into three tracts (A, B and C) of approximately equal acreage, but did not seek to judicially partition the land. Thereafter, in simultaneous transactions, J.H. conveyed his undivided interest in the surface of tract B to Otha and Otha conveyed her undivided interest in the surface of tract A to J.H. Both deeds reserved all minerals in favor of the conveying party. Approximately six years later, J.H. and Otha conveyed their respective undivided interests in the surface of tract C to Tessie, but reserved all minerals in their respective deed. Tessie at no time conveyed to J.H. or Otha any part of her undivided interests in tracts A and B. The three deeds apparently were properly recorded in the appropriate real property records. Subsequently, Holland acquired J.H.'s undivided interest in tract A, Otha's undivided interest in tract B and Tessie's undivided interest in tract C. None of the deeds reserved minerals and each party conveyed its interest by general warranty deed. Holland subsequently leased the minerals and production thereafter commenced. Following the commencement of production on each of the tracts, J.H. Otha and Tessie claimed rights to the minerals and, as a result, Holland filed suit seeking a determination that he owned 100% of the minerals. The trial court found for Holland, concluding that he acquired 100% of the minerals through the doctrine of equitable partition. Naturally, J.H., Otha and Tessie appealed.

Reversing the trial court, the appeals court concluded that although the doctrine of equitable partition required a finding that J.H., Otha and Tessie partitioned the surface of the entire tract by allocating the surface of tract A to J.H.,³⁶⁷ the surface of tract B to Otha and the surface of tract C to Tessie,

363. *Id.* at 557.

364. *Larrison v. Walker*, 149 S.W.2d 172, 177 (Tex. Civ. App.—Texarkana 1941, writ ref'd).

365. 844 S.W.2d 759 (Tex. App.—Tyler 1992, writ denied).

366. J.H., Otha and Tessie, through marriage, death or conveyance, further divided, shared or conveyed their ownership interests, but for ease of discussion of the case, these subsequent divisions are irrelevant and ignored.

367. Although the court seems to say this finding is of no concern to Holland, *see id.* at

the doctrine could not be utilized by Holland to adjust the ownership of the mineral interests owned by J.H., Otha and Tessie, as cotenants, which had been expressly reserved from the deeds pursuant to which J.H., Otha and Tessie divided the overall tract.³⁶⁸ Equitable partition, in the court's judgment, did not apply to the plaintiff's claim of ownership of 100% of the minerals; rather the claim constituted a suit on title, which should be governed by a construction of each of the deeds in the chain of title. Since the minerals had been effectively severed from the partition deeds and those deeds had been recorded in the appropriate records, Holland had no claim to the minerals other than the mineral interest that each grantor had with respect to the individual tract conveyed by such grantor.³⁶⁹

X. ADVERSE POSSESSION

If a party does not obtain good title through a conveyance, he or she may try adverse possession. For example, in *Barfield v. Holland*,³⁷⁰ a party claimed title to minerals beneath the surface of its property through adverse possession. Although the court recognized that adverse possession of the surface estate generally extends to the underlying mineral estate, the court also recognized that after the mineral estate is severed from the surface estate, adverse possession of the mineral estate may be claimed only through production of the minerals and taking them from the ground.³⁷¹ Since the claimant did not claim adverse possession on the basis of production of the minerals, the court found for the legal property owner.³⁷²

765. Holland would not have acquired an undivided 100% interest in the surface of tracts A and B without the application of the doctrine of equitable partition, as Tessie never conveyed her undivided interest in the surface of tract A to J.H. and never conveyed her undivided interest in the surface of tract B to Otha.

368. *Id.* at 765. The court stated that "the doctrine of equitable partition applies only to an adjustment of equities between the cotenants themselves." *Id.* This statement fails to acknowledge the holdings in the equitable partition cases relied on by the court, which recognize that the doctrine exists to protect a vendee who acquires from a cotenant a specific parcel of land, where and to the extent that can be done without prejudice to the interests of the remaining cotenant. *See id.* at 763-64.

369. *Id.* at 765. Holland also argued that the doctrines of estoppel and ratification and acquiescence supported his claim to 100% of the minerals under the entire 100 acres. As to the doctrine of ratification and acquiescence, the court recognized the applicability of the doctrine to equitable partition cases. *Id.* However, having already concluded that Holland's claim for 100% of the minerals under the 100 acre tract could not be based on equitable partition, the court refused to apply the ratification and acquiescence doctrine to the facts before it. *Id.* at 766. The court also recognized that the doctrine had been applied to situations in which a cotenant attempted to convey a specific part of common property to a third party, but neither J.H., Otha nor Tessie had attempted to convey a specific part of common property. *Id.* In making his estoppel argument, Holland claimed that each of the cotenants, in conveying the individual tracts to Holland, made certain misrepresentations regarding the state of their title. Maybe so, implied the court, but land titles are governed by deeds, the interpretation thereof and recording statutes, and not by personal representations, warranties, reliance and estoppel. *Id.* at 766-67.

370. 844 S.W.2d 759 (Tex. App.—Tyler 1992, writ denied).

371. *Id.* at 767 (citing *e.g.*, *Greene v. White*, 137 Tex. 361, 153 S.W.2d 575, 585 (1941); *Steed v. Crossland*, 252 S.W.2d 784 (Tex. Civ. App.—Beaumont 1952, writ ref'd n.r.e.)).

372. *Id.* at 769-70.

*Knupp v. Miller*³⁷³ involved 24 acres of land consisting of a 12.5 acre tract and an 11.5 acre tract. A stand of trees suitable for lumber existed on the eastern half of the 24 acres, while no such stand existed on the western half of the tract. Miller claimed ownership of the 12.5 acres through a deed which contained an inaccurate beginning point and maintained that the 12.5 acres consisted of the eastern half of the 24 acre tract. The defendant claimed ownership of the 11.5 acre tract through a deed which also contained an inaccurate beginning point and also maintained that the 11.5 acre tract consisted of nearly all of the eastern half of the 24 acre tract. The defendant harvested the trees and Miller sued, claiming ownership of the tract through his deed and through adverse possession under the three, five, ten and twenty five year adverse possession statutes.³⁷⁴ During the trial, Miller presented testimony from a surveyor supporting Miller's claim that his 12.5 acre tract consisted of the eastern half of the 24 acre tract. Miller presented further evidence that he had fenced in the 12.5 acres, that he had maintained and repaired the fence lines, that he had from time to time cleared the land of brush, that he had cut timber from the land, and that others had assisted him in the management of the 12.5 acre tract. Finally, Miller supported his chain of title by submitting into evidence his deed and an abstract of title. The jury found that Miller established adverse possession of the 12.5 acres tract under the three, five, ten and twenty-five year statutes and the defendant appealed. With little discussion, the appeals court found the evidence clearly sufficient to support the jury's findings regarding adverse possession.³⁷⁵

In *McAllister v. Samuels*,³⁷⁶ the Samuels purchased a residential lot which bordered a lot owned by the McAllisters. The two lots were separated by a fence which the Samuels desired to tear down and replace with a new fence along a new fence line. The McAllisters, however, suggested that the new fence be constructed in the same location as the old fence. Each party commissioned a survey to determine the proper boundary line and, to the dismay of the McAllisters, both surveys reflected the old fence line to be located on the Samuels' lot, approximately nine inches inside the boundary line of the two lots. Buoyed by the surveys, the Samuels removed the old fence and constructed a new fence on the common boundary line reflected in the

373. 858 S.W.2d 945 (Tex. App.—Beaumont 1993, n.w.h.).

374. TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.024, 16.025, 16.026, 16.028 (Vernon 1986).

375. *Knupp*, 858 S.W.2d at 952. One justice filed a dissent, arguing that the court had no jurisdiction to hear the case because in a trespass to try title case the petition must contain a description of the property by metes and bounds or with sufficient certainty to identify the same. Because Miller never sought reformation of the deed to correct the error, the dissenting justice argued that the judgment did not describe the same property as the petition and therefore awarded title to property not in controversy. *Id.* at 956. The majority, however, concluded that the deed's reference to the 12.5 acre tract being the "same land in a deed from Harriet Bean, et al, to Bernal Kerr" sufficiently supported Miller's position that the deed erroneously referred to a commencement point of the "S.E. corner of a 24 acre tract set apart by Allie Powell and James Powell" and should have instead referred to the S.E. corner of a 24.5 acre tract set apart by Harriet Bean and Albert Bean. *Id.* at 955.

376. 857 S.W.2d 768 (Tex. App.—Houston [14th Dist.] 1993, n.w.h.).

surveys. The skirmish having escalated to a war, the McAllisters sued, claiming that they had acquired the nine-inch strip of land through adverse possession. The trial court declared the Samuels the winners and the McAllisters appealed.

The appeals court reviewed the McAllisters' claim for adverse possession under the three, five, ten and twenty-five year adverse possession statutes.³⁷⁷ The court had little difficulty rejecting the adverse possession claims under the three year, five year and twenty-five year statutes, as each of those statutes requires possession through a deed or some other written instrument and the McAllisters made no such claim of title to the nine-inch strip of land.³⁷⁸ The ten year statute requires a claimant to hold property in peaceable, quiet and adverse possession and to cultivate, use and enjoy the property claimed by the claimant.³⁷⁹ Adverse possession is generally defined to mean an actual and visible appropriation of real property, commenced and continued under a claim of right that is inconsistent with and hostile to another person's claim to the same real property.³⁸⁰ In denying the McAllisters' claim of adverse possession based on the ten-year adverse possession statute, the court focused on two requirements of adverse possession.³⁸¹ First, there must exist a "visible appropriation" of the property and second the appropriation must be "hostile" to the claims of another party.³⁸² Applying the fair notice requirements generally applicable to the doctrine of encroachment,³⁸³ the court concluded that the slight nature of the nine-inch encroachment could not constitute notice of actual and visible appropriation of the strip. Although the court's result is probably correct, the court's holding improperly emasculates a party's right, under section 16.10, to make an adverse possession claim as to any tract similar to the nine-inch tract in *McAllister*.³⁸⁴ The court should have more appropriately utilized the reasoning of

377. TEX. CIV. PRAC. & REM. CODE ANN. §§ 16.024, 16.025, 16.026, 16.028 (Vernon 1986).

378. *Id.* §§ 16.024, 16.025, 16.028.

379. *Id.* § 16.026.

380. *Id.* § 16.021(1).

381. *McAllister*, 857 S.W.2d at 776.

382. *Id.*

383. *Id.* The doctrine of encroachment is generally invoked to defend against a party's claim that, through adverse possession of a portion of a tract which is part of a larger tract, the claimant has obtained ownership of the larger tract. *E.g.*, *McCall v. Grogan-Cochran Lumber Co.*, 186 S.W.2d 677, 679 (Tex. 1945). In applying the encroachment doctrine, the *McCall* Court concluded that the claimant's use and possession of the smaller tract must provide sufficient notice to show the other party that the claimant's possession was "incidental or subsidiary to the claimant's possession of the smaller body of land." *Id.* The *McAllister* court utilized the fair notice requirements of the encroachment doctrine even though *McAllister's* claim did not include a larger tract. *McAllister*, 857 S.W.2d at 776. The *McAllister* court should have more appropriately relied on *McDonnold v. Weinacht*, 465 S.W.2d 136 (Tex. 1971), wherein the Texas Supreme Court concluded that under the predecessor of § 16.026, a claimant's appropriation of land "must be of such a character as to indicate unmistakably an assertion of a claim of exclusive ownership in the [claimant]." *McDonnold*, 465 S.W.2d at 141.

384. The court ran into trouble by relying on cases in which the courts recognized that the encroachment doctrine will refute a party's claim that its use of an insignificant portion of a large tract entitles that party to make an adverse possession claim as to the larger tract. *See Grogan Mfg. Co. v. Lane*, 173 S.W.2d 655 (Tex. Civ. App.—Galveston 1943, writ ref'd w.o.m.) and cases cited therein.

the *McDonnold* case and the overall notice provided by the facts to determine whether the McAllisters' occupancy and use of the nine-inch tract constituted a visible appropriation of the nine-inch tract.³⁸⁵

*Parker v. McGinnes*³⁸⁶ demonstrates the importance of designedly enclosing property intermittently used for farming and grazing by constructing a fence on the perimeter boundaries. In *Parker*, L.B. and his brother annually grew rice or grazed cattle on two platted, but unfenced, lots from 1943-1975. Initially, L.B. and his brother leased the lots. In 1957, L.B. acquired a one-half interest in the lots from the lessor's father and recorded that deed several years later. In 1975, L.B. received a deed for both lots from the widow of the lessor's father and recorded the deed shortly thereafter. From 1967 until 1974, L.B. leased the lots to a third party, who used the lots for grazing cattle. In connection with the grazing, the lessee constructed a fence around the perimeter of the lots. At the end of the lease term, L.B. removed the lessee's fence and shortly thereafter a neighboring property owner, Parker, planted rye grass on the lots, grazed cattle on the lots, surveyed the lots and constructed a fence around the lots. In 1977, Parker determined that a person other than L.B. held record title to the lots and Parker obtained a deed from that person. In 1980, Parker ceased grazing cattle on the lots and someone removed Parker's fence. In 1981, L.B. planted a rice crop on the lots in December of 1980 or January of 1981. Following the harvest of the rice crop, Parker constructed a new fence around the lots and used the lots for pasture and hay until 1984. During 1984, someone removed Parker's new fence and L.B. planted a final rice crop. Shortly thereafter, Parker filed a trespass to try title action against L.B. and others to establish title to the lots. L.B. answered, claiming that he had obtained title to the property through the three, five, ten, and twenty-five year adverse possession statutes. The trial court entered partial summary judgment in favor of Parker by awarding record title to Parker, but submitted all issues concerning L.B.'s adverse possession claims to the jury. The jury found that L.B. had peaceable and continuous possession of the lots for ten years or more from 1943 until 1982 and that L.B. (or others claiming under him) had peaceable and continuous possession for any twenty-five year period existing between the years 1943 and 1982.³⁸⁷ Parker appealed.

On appeal, the appellate court focused on the issue of whether L.B. adversely possessed and cultivated, used or enjoyed the lots for a period of at least ten consecutive years. The court initially recognized that if an adverse possession claim is based on grazing, the claimant must fence the land to show that the land is designedly enclosed and that the claimant asserts a claim hostile to the real owner.³⁸⁸ The court further recognized, however, that adverse possession claims, such as L.B.'s, based on mixed grazing and

385. See discussion *supra* note 384.

386. 842 S.W.2d 357 (Tex. App.—Houston [1st Dist.] 1992, writ denied).

387. *Id.* at 359.

388. *Id.* at 360 (relying on *Cunningham v. Eastham*, 465 S.W.2d 189, 193 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ *ref'd n.r.e.*) (citing *Orsborn v. Deep Rock Oil Corp.*, 153 Tex. 281, 267 S.W.2d 781 (1954)).

farming use will turn on the facts of each case.³⁸⁹ Based on the facts before it, the court acknowledged that L.B. proved that he had alternately farmed and grazed cattle on the lots for the requisite periods of ten and twenty-five years, but concluded that L.B. failed to prove that he had farmed the lots for ten consecutive years or that he had fenced the land during the years in which he had not farmed the lots.³⁹⁰ Absent these showings, the court concluded that, under applicable case law, L.B. had failed to show that he had met all requirements necessary to adversely possess the lots for the required periods of time.³⁹¹

XI. CONVEYANCING

Conveyancing cases proved to be a fruitful source of litigation during the Survey period. Although some cases do not warrant discussion because they exceed the scope of this article or are merely noteworthy,³⁹² a number of

389. *Id.*

390. *Id.* at 362.

391. *Id.*

392. *Temple-Inland Forest Prod. Corp. v. U.S.*, 988 F.2d 1418 (5th Cir. 1993) (where (1) grantor reserved minerals on certain land, (2) deed provided that, upon initial expiration date (and any extension thereof), the reservations would be extended for successive five year periods as to all areas within a one-half mile radius of each well operating on the applicable expiration date and (3) deed provided that if upon any expiration date mineral operations were not being conducted, then the right of the grantor to mine and remove minerals would terminate, the court construed the reservation as follows: first, if on the initial expiration date no well was being operated, then the reserved interest would terminate; and second, if any well was operating on the initial expiration date or a subsequent expiration date, then (x) the mineral reservation would be renewed as to each then operating well (and the area within a 1/2 mile radius) for successive 5 year periods and (y) the mineral reservation would terminate as to any well (and the area within a 1/2 mile radius) if, on any expiration date, the well was no longer operating.); *Natland Corp. v. Baker's Port, Inc.*, 865 S.W.2d 52 (Tex. App.—Corpus Christi 1993, n.w.h.) (upland land owner gained title to land created by gradual run-off of material dredged from channel by U.S. Army Corp of Engineers and placed on shore line); *Dyson Descendant Corp. v. Sonat Exploration Co.*, 862 S.W.2d 942 (Tex. App.—Houston [1st Dist.] 1993, n.w.h.) (holding that defective nature of acknowledgment of deed due to notary's pecuniary interest in transaction did not cause deed to be ineffective because defect did not exist on face of acknowledgement); *Wyatt v. McGregor*, 855 S.W.2d 5, 10 (Tex. App.—Corpus Christi 1993, writ denied) (stating that property description was sufficient for deed where description provided three sides of tract, thereby leaving only one line to satisfy the property's limits); *McInroe v. Lloyd*, 847 S.W.2d 362, 364 (Tex. App.—Fort Worth 1993, n.w.h.) (holding that where provision in deed provided for vendor's lien and further provided that deed would not become absolute unless grantee fully exercised an option to purchase and the deed otherwise complied with terms of option agreement, vendor's lien held to secure both payment of note and the grantee's obligation to exercise the option in accordance with the option agreement); *Trison Inv. Co. v. Woodard*, 838 S.W.2d 790, 794 (Tex. App.—Dallas 1992, writ denied) (holding that even though husband had obligation to pay a note owing to ex-wife upon the earlier to occur of a stated date or sale of certain property, implied vendor's lien held not to attach to that property to secure payment of the note because divorce agreement did not apportion consideration between real and personal property and gave the husband the right to hold the property free of any claim of his ex-wife); *Savell v. Savell* 837 S.W.2d 836, 839-40 (Tex. App.—Houston [14th Dist.] 1992, writ denied) (explaining that where appellant and appellee agreed that, notwithstanding recitation of consideration in deed, grantee gave no consideration in connection with delivery of deed, (i) law permitted parties to offer evidence as to whether grantor intended delivery of deed and (ii) recordation of deed did not conclusively establish delivery of the deed); *MTrust Corp. v. LJH Corp.*, 837 S.W.2d 250, 252-53 (Tex. App.—Fort Worth 1992, writ denied) (holding that statute of frauds satisfied where property descriptions consisted of maps which reflected abstract numbers, survey information and block

cases are significant or interesting enough to warrant extending the unforeseeable end of this article.

Texas law has long recognized that an "as is" clause is enforceable in contracts for sale.³⁹³ On the other hand, Texas law has also previously recognized that an "as is" clause will not defeat an action for fraud based on an affirmative misrepresentation.³⁹⁴ In *Prudential Insurance Co. v. Jefferson Associates, Ltd.*,³⁹⁵ the court was presented with the issue, among others, of whether the "as is" clause contained in the contract would defeat the claims of the purchaser. In *Jefferson*, the seller and buyer entered into a contract of sale which gave the buyer the right to inspect the subject property and which provided for sale of the property on an "as is" basis. Following the closing of the sale, the buyer discovered that the improvements had asbestos-containing materials and filed suit against the seller, alleging affirmative misrepresentation under the DTPA, fraud and fraudulent concealment of the asbestos containing materials. Upon the conclusion of presentation of evidence to the jury, the parties agreed to submit the issue of liability on a general charge requesting the jury to determine if the buyer should be entitled to damages as a result of any "wrongful conduct" of the seller. The jury found that the seller engaged in "wrongful conduct" and awarded actual and punitive damages. Shocked, the seller appealed, bringing numerous points of error, including an argument that no or insufficient evidence supported the jury's finding of wrongful conduct.

Because of the submission of the liability issue on a general charge, the appellate court concluded that the law required the court to uphold the judgment of the trial court if the evidence provided sufficient proof to establish any theory of liability plead by the buyer.³⁹⁶ On this basis, the court chose not to expressly address the jury's finding of "wrongful conduct" and instead sought to determine whether sufficient evidence existed to support a finding of affirmative misrepresentations actionable under the DTPA or actionable fraud,³⁹⁷ both of which were plead by the buyer and neither of which, according to the court, would be barred by the "as is" clause.³⁹⁸ The court's

numbers for the area in which the land was located and schedule which listed individual tracts and general location).

393. *E.g.*, *Mid Continent Aircraft Corp. v. Curry County Spraying Serv., Inc.*, 572 S.W.2d 308 (Tex. 1978); *Singleton v. LaCoure*, 712 S.W.2d 757 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.).

394. *Cockburn v. Mercantile Petroleum, Inc.*, 296 S.W.2d 316, 326 (Tex. Civ. App.—Dallas 1956, writ ref'd n.r.e.) (relying on TEX. REV. CIV. STAT. ANN. art. 4004, now codified as TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 1987)). The court in *Cockburn* did not distinguish between "as is" agreements and other types of agreements, but instead stated that an "as is" agreement is subject to rescission or damages under art. 4004 as any other cause of action covered by art. 4004 where there is evidence and jury findings of fraud. *Id.* In *Cockburn*, although the contract at issue contained an "as is" clause, the seller's agent actually represented that all five of the gas wells which were the subject of the contract were producing wells when, in fact, not all five wells were producing wells. *Id.* at 322.

395. 839 S.W.2d 866 (Tex. App.—Austin 1992, writ granted).

396. *Id.* at 869.

397. *Id.*

398. *Id.* at 873 (relying on *Weitzel v. Barnes*, 691 S.W.2d 598, 600 (Tex. 1985) (holding that affirmative misrepresentation as to the quality of goods purchased creates liability irre-

conclusion, however, that an "as is" clause does not bar claims under the DTPA or claims based on fraud is overly broad. For example, in a Texas Supreme Court case relied on by the *Jefferson* court, the Texas Supreme Court held that an "as is" contract would not defeat a claim under the DTPA where the claim is based on an affirmative misrepresentation, but the court also recognized that if the defendants had remained silent "as to the quality of the relevant systems, the outcome of [the] case would have been different."³⁹⁹ Moreover, although another case relied upon by the *Jefferson* court recognized the fraud exception to the "as is" doctrine, the facts of that case indicate that the defendant made an affirmative, false representation as a material inducement to the purchaser.⁴⁰⁰ If the fraud exception to the "as is" clause is not limited to situations where a party makes affirmative false representations or fraudulently conceals facts, much of the intended effect of an "as is" clause would be emasculated.⁴⁰¹ Moreover, failure to so hold arguably renders the "as is" clause generally ineffective in light of the fact that the Texas Supreme Court has, in the absence of an "as is" clause, described a seller's disclosure obligation under a contract as the duty to "disclose material facts which would not be discoverable by the exercise of ordinary care and diligence on the part of the purchaser, or which a reasonable investigation and inquiry would not uncover."⁴⁰² Surely, the introduction of an "as is" clause should be held to reduce the general disclosure obligation imposed on a seller of real estate. The Texas Supreme Court has granted writ of error with respect to the "as is" issues in this case and the court hopefully will expressly set forth the type of fraud and DTPA claims that are not barred by an "as is" clause.⁴⁰³

With respect to the plaintiff's claim of a violation of the DTPA based on an affirmative misrepresentation, the *Jefferson* court concluded that an agent of the seller affirmatively represented the quality of the building by stating that the building had no defects, other than one problem relating to the concrete floor in the mechanical room of the building, and that the building was "one of the finest little properties in the City of Austin" and was a "superb, super fine building."⁴⁰⁴ While the buyer argued that these statements constituted affirmative representations and that the representations were breached

spective of contractual disclaimer); *Cockburn v. Mercantile Petroleum, Inc.*, 296 S.W.2d 316, 326 (Tex. Civ. App.—Dallas 1956, writ ref'd n.r.e.) (holding that "as is" clause does not defeat action for fraud)).

399. *Weitzel*, 691 S.W.2d at 601.

400. See *Cockburn*, 296 S.W.2d at 326.

401. An "as is" contract most generally includes an inspection right and it seems reasonable to conclude that the parties to such a contract fully intend that the purchaser should not be entitled to complain of any defect which could have been discovered in a reasonable inspection.

402. *Smith v. National Resort Communities*, 585 S.W.2d 655, 658 (Tex. 1979).

403. Because the DTPA has been held to create an independent cause of action, see *Smith v. Baldwin*, 611 S.W.2d 611, 616 (Tex. 1980), the Texas Supreme Court could justifiably conclude that an "as is" clause does not bar any liability under the DTPA. Accordingly, if the parties to a contract desire not to have the DTPA apply to their contract, the parties, to the extent permitted under § 17.42 of the DTPA, should include a provision in their contract expressly waiving the provisions of the DTPA.

404. 839 S.W.2d at 871.

because of the existence of the asbestos containing materials in the building, the seller argued that the agent's statements were nothing more than puffing. Even though the court acknowledged that the agent's representations might not be sufficient to support a specific cause of action, the court concluded that they were legally sufficient to support the jury's finding of "wrongful conduct" in response to the general charge of liability.⁴⁰⁵ As to whether sufficient evidence existed to support a conclusion that the seller had fraudulently concealed the existence of the asbestos containing materials in the building, the seller argued that no such concealment could have occurred since the seller did not have actual knowledge of the existence of the asbestos containing materials in the building at the time of the sale of the building. While acknowledging that it did not produce any direct evidence showing that the seller had actual knowledge of the existence of the asbestos containing materials in the building, the buyer argued that it had produced sufficient circumstantial evidence to enable the jury to impute such knowledge to the seller. Recognizing that circumstantial evidence may be used to support a cause of action,⁴⁰⁶ the court relied primarily on several facts proved by the buyer in holding that sufficient circumstantial evidence existed to sustain the jury's finding of wrongful conduct.⁴⁰⁷ Just as the court failed to reach a

405. *Id.* at 873. In fact, the court may have erred in reaching a determination that the agent's statements constituted affirmative representations as opposed to mere puffing. Specifically, the court concluded that the agent's statements were similar to a statement that the building was perfect or meticulously constructed, both of which have been held to constitute actionable misrepresentations. *Pennington v. Singleton*, 606 S.W.2d 682, 687 (Tex. 1980) (finding that false statement that boat was in excellent or perfect condition constituted actionable misrepresentation under the DTPA); *HOW Ins. Co. v. Patriot Fin. Serv., Inc.*, 786 S.W.2d 533, 544-46 (Tex. App.—Austin 1990, no writ) (use of term "meticulous construction" denoted high quality of construction and is a representation of a material fact which, if false, constitutes actionable misrepresentation under the DTPA). On the other hand, a statement that a Mercedes is the best engineered car in the world, when in fact it is not, does not qualify as an actionable representation under the DTPA. *Autohaus, Inc. v. Aguilar*, 794 S.W.2d 459, 454 (Tex. App.—Dallas 1990, writ ref'd n.r.e.). The seller's agent's statement that the building was one of the best little buildings in Austin, Texas seems very similar to the statement regarding Mercedes automobiles and probably should not have constituted an actionable misrepresentation. Moreover, the statement regarding defects in the building arguably does not cover such matters as to the makeup of the materials used in the construction of the building.

406. 839 S.W.2d at 872-73 (citing *McMillen Feeds, Inc. v. Harlow*, 405 S.W.2d 123, 130 (Tex. Civ. App.—Austin 1966, writ ref'd n.r.e.)).

407. *Id.* at 873. In support of its holding, the court relied primarily on the following evidence: (1) the seller's agent stated that the seller did not have plans and specifications for the base building, when in fact it did; (2) a confidential memorandum written by the seller directing its nationwide employees not to fill out a potential (or perhaps existing) tenant's disclosure forms relating to whether asbestos containing materials existed in buildings owned by seller and leased or to be leased to that tenant; (3) the seller's circulation of articles relating to the health hazards of asbestos to personnel within the national corporate office and with instructions not to circulate the articles outside of the seller; and (4) a policy proposal relating to the disclosure of certain matters and the modification of that proposal by the seller's chief legal counsel for real estate matters to delete a provision relating to the disclosure of asbestos containing materials within buildings owned by seller. The points in clauses (2), (3), and (4) seem to provide no support for a conclusion that the seller knew that the building contained asbestos materials. The point in clause (1) provides some evidential support, but certainly some question exists as to whether it alone is sufficient to establish that the seller knew that the building contained asbestos materials. Moreover, in light of the obvious extensive discovery performed by the buyer, the inability to produce some direct evidence is quite amazing, unless,

specific conclusion that the seller's agent's representations were false and actionable under the DTPA, the court also failed to reach a specific conclusion that the buyer provided sufficient evidence to establish the specific elements of fraudulent concealment.

The court's conclusions that the buyer satisfied its burden of proving a DTPA violation and fraudulent concealment by establishing "wrongful conduct" are improper in two respects. First, the conclusions are contrary to the court's recognition that in order to uphold the jury's determination of wrongful conduct, the law required the court to find that the defendant proved a specific theory of recovery plead by the defendant. Clearly, the court did not reach such a conclusion. Second, even assuming the correctness of the court's general statement that an "as is" clause does not bar liability under the DTPA or in the case of fraud, the plaintiff should be required to prove each element of its action under the DTPA and fraud claim in order to avoid the "as is" clause. If a plaintiff must do nothing more than to plead a DTPA or fraud action or prove "wrongful conduct" (whatever that means), then it seems likely that in most disputes an "as is" clause could be avoided. Based on this reasoning, the Texas Supreme Court would have basis to reverse the Austin Court of Appeals.⁴⁰⁸

*Luker v. Arnold*⁴⁰⁹ is a case of some significance because it creates new law.⁴¹⁰ In *Luker*, a developer acquired a residential subdivision site, established various residential lots within the subdivision, established and recorded a declaration of restrictions and covenants with respect to the subdivision and apparently constructed certain infrastructure improvements. As with most residential subdivision developments, the developer intended to sell individual lots to contractors, who in turn would construct residences for sale to individuals. The lots did not have city sewer services and, accordingly, each future lot owner would be required to install a septic system in order to utilize the lot as a residence. One of the provisions in the declarations generally required that the construction of any residence or other

of course, the seller's representatives had no conscious knowledge of the existence of the asbestos containing materials and did not intend to deceive the buyer.

408. As mentioned in the text, the parties agreed to submit the issue of liability on a general charge and as a result the various elements of each theory of liability were not presented to the jury. If the general charge had not been given to the jury, the various elements of the DTPA and fraudulent concealment claims, in all probability, would have been presented to the jury. The existence of the general charge could cause the Texas Supreme Court to reach a conclusion which it might not reach if the general charge had not been given. If this is the case, hopefully the Texas Supreme Court will so state.

409. 843 S.W.2d 108 (Tex. App.—Fort Worth 1992, n.w.h.).

410. Although the most important portions of this case relate to the court's holding regarding the developer's implied warranty to develop in a good and workmanlike manner, this case may also be cited in the future on the basis of its determination that the plaintiff was a consumer for purposes of the DTPA. Basically, the developer argued that the DTPA did not confer consumer status upon the plaintiff as to the plaintiff's relationship with the developer because the plaintiff had not acquired goods or services from the developer. The court, however, concluded that the DTPA did confer consumer status on the plaintiff as to the developer because the other defendants in the case as to whom the plaintiff was a consumer were inextricably intertwined with the developer. 843 S.W.2d at 112 (relying on *Qantel Business Sys. v. Custom Controls*, 761 S.W.2d 302, 305 (Tex. 1988)).

structure not be commenced until the developer approved the structure, as well as the plans and specifications for the structure. The plaintiff acquired from an individual five duplexes which had been constructed in the subdivision. Following the acquisition, the plaintiff discovered problems with the septic system serving the duplexes and sued the developer.⁴¹¹ The trial court entered judgment in favor of the plaintiff, based on a jury finding that the developer had violated the DTPA by breaching the declaration and an implied covenant that the developer had failed to develop and replat the subdivision in a good and workmanlike manner.⁴¹²

On appeal, the developer argued that a developer does not impliedly warrant that it has developed a subdivision in a good and workmanlike manner. Agreeing that current law did not provide for such an implied warranty,⁴¹³ the Fort Worth court decided to make new law, holding that "a developer owes an implied warranty to develop in a good and workmanlike manner."⁴¹⁴ Relying on other Texas cases which have extended the implied warranty of good and workmanlike manner to contractors and others, its holding satisfied the public interest in protecting consumers from defective work.⁴¹⁵ Having established a warranty for purposes of the DTPA, the court concluded that the developer breached that warranty because (1) the size of the lots, which had originally been established by the developer, did not provide sufficient area for a septic field and (2) the builder failed to properly install the septic system.⁴¹⁶

Three conveyancing cases involved claims to the earnest money required by a purchase and sale agreement. The lesson provided by the first of these cases, *Equisource Realty Corp. v. Crown Life Insurance Corp.*,⁴¹⁷ is that each party should strictly comply with the notice and termination provisions of its contractual agreement when claiming the earnest money under the contract. In *Equisource* the purchase and sale agreement permitted the purchaser to inspect the property during a stated period of time. Prior to the expiration of the inspection period, the purchaser had the right to terminate the contract for any reason. If, upon the expiration of the inspection period, the purchaser failed to notify the seller of the purchaser's election to termi-

411. The plaintiff also sued the seller, but this aspect of the case is irrelevant to the discussion.

412. *Id.* at 110.

413. *Id.* at 115.

414. *Id.* at 116.

415. *Id.* (referring specifically to *Melody Home Mfg. Co. v. Barnes*, 741 S.W.2d 349 (Tex. 1987)).

416. The court concluded that the developer was in the best position to prevent improper lot sizes and to ensure a contractor's compliance with the declarations. 843 S.W.2d at 116. As to the contractor's failure to comply with the declarations, the court noted that the declaration gave the developer the right to approve all structures, plans and specifications. *Id.* The court also noted that the developer had provided its written approval by stating that the duplexes complied with all provisions of the declarations. *Id.* The court's opinion does not indicate, however, that the contractor failed to comply with a specific provision of the declarations. For this reason, the court's conclusion that the developer breached the implied warranty of good and workmanlike manner due to the contractor's failure to perform in accordance with the declaration is subject to question.

417. 854 S.W.2d 691 (Tex. App.—Dallas 1993, n.w.h.).

nate the contract, then the purchaser became obligated to deposit additional earnest money and to close the purchase, failing which the earnest money would be paid to the seller. On the final day of the inspection period, the purchaser notified the escrow agent holding the earnest money that the purchaser elected to terminate the contract. Although the escrow agent attempted to telecopy notice of the termination to the seller, the transmission did not occur.⁴¹⁸ Neither the purchaser nor the escrow agent later notified the seller of the purchaser's termination and the purchaser failed to deposit the additional earnest money as required by the contract. The seller then terminated the contract and sued for the earnest money. The trial court awarded summary judgment to the seller and the purchaser appealed, arguing that the escrow agent acted as the seller's agent under the contract for receipt of notice of termination.⁴¹⁹ Although the court of appeals recognized that the escrow agent acts as a fiduciary to both the buyer and seller in the performance of its role as escrow agent under the contract, the court concluded that the escrow agent is not the agent of a party to the contract for receipt of notices unless so appointed. Because the contract did not authorize the escrow agent to receive notices and the purchaser failed to produce any other evidence that the seller had authorized the escrow agent to receive notices on behalf of the seller, the court concluded that the seller did not receive the notice of termination prior to the expiration of the inspection period.⁴²⁰ Accordingly, the court of appeals upheld the trial court's summary judgment.⁴²¹

In the second earnest money case, *Herbage v. Snoddy*,⁴²² the earnest money contract contained a financing contingency which required the buyer to use all reasonable efforts to obtain a fifteen-year bullet loan in a specified principal amount payable in monthly installments not in excess of a stated amount. Although the financing contingency provision did not require the loan to bear a specific rate of interest, the contract arguably provided for a rate not in excess of ten percent per annum.⁴²³ When applying for the loan, the buyer completed a hand written application for the specified fifteen-year bullet loan, but at an interest rate of 9-7/8% per annum. However, the typed loan application signed by the buyer provided for a thirty-year loan at an interest rate of 10-1/2% per annum. The lender declined the borrower's typed loan application and the buyer terminated the contract and requested the return of the earnest money. The trial court held that the buyer

418. There is no indication of the reason for the unsuccessful telecopy transmission. The contract notably permitted delivery by telecopy. Because of the contract clause, it is somewhat curious that neither the purchaser nor the title company made this an issue in the case.

419. *Id.* at 696. In making its argument, the purchaser relied on general agency and principal law and a Texas case that, according to the purchaser, recognized that an escrow agent acts as the agent for both the buyer and the seller. *Id.* (relying on *Campbell v. Barber*, 272 S.W.2d 750, 753 (Tex. Civ. App.—Fort Worth 1954, writ ref'd n.r.e.)).

420. *Id.* at 697.

421. *Id.*

422. 864 S.W.2d 695 (Tex. App.—Houston [1st Dist.] 1993, writ requested).

423. With the principal amount, the monthly payments and the term of the loan all known, the rate, as well as the bullet amount payable at the end of the term, are mathematically calculable.

breached its obligation under the contract to apply for financing conforming to the contract provision and accordingly awarded damages to the seller. The buyer appealed.

On appeal, the buyer argued that (i) it had complied with the contract by applying for a fifteen-year bullet loan at an interest rate not exceeding 10% and (2) when the lender refused to make the loan on those terms, the buyer became entitled to the earnest money.⁴²⁴ The court, however, construed the contract and the law as (1) requiring the buyer to show that he was unable to obtain third party financing in the stated amount at a rate of 10% per annum⁴²⁵ and (2) not requiring the buyer to accept an interest rate in excess of 10% per annum.⁴²⁶ The seller directed the court's attention to *Smith v. Evans*⁴²⁷ as standing for the principle that if a buyer's obligations under a contract are conditioned upon the buyer's ability to obtain a loan upon stated terms, then that condition is not met if the buyer fails to apply for a loan complying with the stated terms.⁴²⁸ The court, however, distinguished the *Smith* case, pointing out that the *Smith* court concluded that the buyer's breach resulted from the buyer making only one application for the required loan, thereby making "it impossible to determine whether a loan on the specified terms would be 'approved' by a lender."⁴²⁹ However, unlike the facts before the *Smith* court, the facts before the *Herbage* court made it possible to determine if a loan on the specified terms would have been approved by the lender. Specifically, the fact that the lender refused to make a loan to the buyer at 10 1/2% per annum permitted, in the court's judgment, a conclusion that a lender would not have approved a loan to the buyer at 10% per annum.⁴³⁰ Clearly, the court concluded, there would be little reason for a lender to reject the borrower's application at 10 1/2% per annum and then approve a loan on the same terms, with the exception of a rate at 10% per

424. The buyer's argument, as noted by the dissent, 864 S.W.2d at 701-02, complies with the express requirements of the contract. However, such a construction would permit the buyer to avoid the contract merely by applying for a 15 year bullet loan at a very low rate and with a very large bullet payment at the end of the term.

425. The court stated that if the buyer's only evidence consisted of the hand written application which provided for an interest rate of 9-7/8% per annum, the buyer would have breached the financing provision. *Id.* at 698-99. The court reasoned that proof of an application at 9-7/8% per annum would not be evidence of whether the lender would have agreed to a loan at 10% per annum. *Id.* at 699.

426. *Id.* at 698. Although the court's conclusion has basis, the court is subject to some criticism because its finding assumes that the buyer and seller absolutely agreed to an interest rate of 10% per annum and the amount of the bullet payment payable by the buyer at the end of the term. However, there is no evidence discussed that would indicate that there was such an agreement between the parties. Moreover, by adjusting the bullet amount, the loan could provide for an interest rate greater or less than 10% per annum without changing the amount of the monthly payments. Perhaps the most important point of this case is the parties to an earnest money contract must clearly express their agreements regarding the requirements of a financing contingency clause.

427. 620 S.W.2d 627, 628 (Tex. Civ. App.—Dallas 1981, no writ).

428. 864 S.W.2d at 699. Interestingly, the dissent argued that *Smith* supported a finding in favor of the buyer because the buyer submitted a loan application for a 15 year bullet loan at a rate not exceeding 10% per annum, as required by the contract. *Id.* at 700-02.

429. *Id.* (quoting *Smith*, 620 S.W.2d at 628).

430. *Id.* at 699-700.

annum.⁴³¹ For these reasons, the court held that the buyer's application for the loan at 10 1/2% per annum substantially complied with the requirements of the financing contingency provision of the contract, thereby entitling the buyer to the return of the earnest money.⁴³²

In the last earnest money case, *Enclave, Inc. v. Resolution Trust Corp.*,⁴³³ the court not surprisingly held that a buyer breached its contract by failing to close its contract on the closing date set forth in the tenth extension agreement entered into between the seller and buyer over a two-year period.⁴³⁴ The more interesting feature of this case is the court's conclusion regarding the buyer's claim that the earnest money deposited under the contract constituted an unenforceable penalty. Although dicta,⁴³⁵ the court concluded that the earnest money under the contract did not constitute an unenforceable penalty.⁴³⁶ The amount of the earnest money, in the judgment of the court, clearly met the test of reasonability applicable to liquidated damages in light of the numerous unmet closings, the buyer's failure to close and the fact that the total amount of earnest was money approximately 5% of the purchase price.⁴³⁷

431. *Id.* at 700. The court noted that, in the abstract, a borrower might qualify for the same loan at a lower rate. *Id.* n.6. However, the seller provided no evidence that the lender would have made a loan to the buyer at a rate of 10% per annum or that loans were then being made in the market place at 10% to borrowers similar to the buyer. Moreover, the court noted that the seller's own evidence indicated that the lender rejected the buyer's application for a 30 year loan at 10 1/2% per annum on the grounds of the buyer's income and the value of the home. *Id.* at 699. Interestingly, the court also indicates that the seller made no claim that the buyer could have bought down the interest rate from 10 1/2% to 10% per annum. *Id.* This statement leaves an improper implication that a buyer should be required to buy down the interest rate in order to obtain the interest rate provided for in a financing contingency provision of a contract. Clearly, such a requirement would alter the buyer's financial expectations.

432. The court also stated that the buyer's willingness to accept a higher rate actually benefitted the seller and that an ironic result would occur if the court held that the buyer's offer to pay a higher price defeated the buyer's claim for the earnest money. *Id.* at 700.

433. 986 F.2d 131 (5th Cir. 1993).

434. *Id.* at 133. Although the contract and certain of the extensions provided that time was of the essence, the buyer argued that at the time the parties agreed to the ninth amendment, time was no longer of the essence. The court had little difficulty rejecting the buyer's assertion, citing the fact that the original contract provided that time was of the essence. Furthermore, the court cited a Texas case which held that when parties contractually extend the time for performance under a contract, the extensions are evidence that the parties consider time to be material. *Id.* at 133 (citing *Siderius, Inc. v. Wallace Co.*, 583 S.W.2d 852, 864 (Tex. Civ. App.—Tyler 1979, no writ)).

435. The court actually held that the buyer had released all claims regarding the earnest money pursuant to a settlement agreement entered into between the seller and buyer following the buyer's failure to close after the ninth extension. *Id.* at 133-34. The court's conclusion that the earnest money did not constitute an unenforceable penalty is therefore dicta.

436. Under the original contract, the buyer deposited earnest money of \$182,000. Pursuant to the various extensions, the buyer increased the earnest money to \$451,500 and paid the seller extension fees totaling \$135,878.73.

437. Although the court's conclusion is correct because the amount of the earnest money approximated 5% of the purchase price and damages for breach of a real estate contract are generally recognized as uncertain, (see *Stewart v. Basey*, 245 S.W.2d 484, 486 (Tex. 1952)), the numerous unmet closings and the fact that the transaction never closed should be irrelevant to the issue of the validity of the liquidated damages.

XII. EASEMENTS AND RESTRICTIONS

Although no significant easement or restriction cases were decided during the Survey period, several cases deserve note⁴³⁸ and two cases deserve discussion.

Samuelson v. Alvarado,⁴³⁹ although not establishing new law, provides interesting facts and a proper application of the doctrine of implied easement by necessity. In *Samuelson*, Menefee owned two tracts of land, one having access to a public road and the other being located directly behind the first tract and having no direct access to the public road. Menefee sold the rear tract to her brother and the deed granted her brother an "access license" through her property in order to permit her brother access to the public road. For approximately seven years, Menefee's brother used a strip of land along a boundary of Menefee's tract in order to access the public road. Apparently, after several years, Menefee became upset with her brother and constructed a fence which diverted access from this access strip to another path within Menefee's property and which ran through a cesspool located on Menefee's property. To emphasize her unhappiness, Menefee also constructed a gate on the path and immediately in front of the cesspool, thereby

438. *Sargent v. Smith*, 863 S.W.2d 242 (Tex. App.—Beaumont 1993, n.w.h.) (where (1) developer established and recorded declaration of restrictions and declaration established a private lake and park area for the use and enjoyment of lot owners within developer's subdivision consisting of 24 lots, (2) there existed some evidence that developer intended to convey to each lot owner a 1/24 interest in the lake and park area and that several lot owners had in fact acquired a 1/24 interest in the lake and park area, (3) several years after recording the declaration, developer conveyed by quitclaim deed a portion of the park area to a third party in connection with that third party's acquisition of a large tract adjacent to the subdivision and (4) quitclaim deed had incomplete blanks, incorrect wording, no date of execution and improper acknowledgement, court held that grantee under quitclaim deed acquired no title to park area and stated that if the grantee had acquired such an interest, the rights of the lot owners burdened that interest); *Silver Spur Addition Homeowners v. Clarksville Seniors Apartments*, 848 S.W.2d 772 (Tex. App.—Texarkana 1993, writ denied) (where declaration of restrictions (1) provided that only "one family residences" may be constructed on lots and prohibited the lots from being used for any business purpose other than apartment houses, (2) required construction of specific size single family dwellings on all but 12 lots and (3) provided no specific designation of use for those 12 lots other than noted in (1) above, the court concluded that restrictions prohibited the construction of apartments on any lot specifically addressed in declaration other than the 12 lots); *Peacock v. Schroeder*, 846 S.W.2d 905 (Tex. App.—San Antonio 1993, no writ) (lessee under oil and gas lease entitled to implied ingress and egress easement of necessity over lessor's adjoining property where land subject to the oil and gas lease would be landlocked absent such easement); *Mobil Pipeline Co. v. Smith*, 860 S.W.2d 157 (Tex. App.—El Paso 1993, writ dismissed w.o.j.) (lessor may, without consent of lessee of land, grant pipeline easement under surface of land, subject to lessee's right to recover damages for interference with lessee's right of possession of surface) (see *supra* notes 341-45 and accompanying text for discussion). In the *Sargent* case cited above, the court stated that a quitclaim conveys no title or actual interest in land, but rather transfers only a claim. 863 S.W.2d at 246. This statement is contrary to established Texas case law, which holds that a quitclaim deed, in the absence of limiting language, conveys such right, title and interest in the property covered by the quitclaim deed as fully as if the grantor had executed a deed purporting to transfer fee title. *Lott v. Lott*, 370 S.W.2d 463 (Tex. 1963). Nevertheless, the *Sargent* court's conclusion is probably harmless error in light of (A) its conclusion that the defects in the quitclaim deed rendered the deed ineffective (which conclusion also is subject to some question), 863 S.W.2d at 250, and (B) the fact that the rights of the lot owners in the park were superior to any right acquired in the park under the quitclaim deed. *Id.* at 248-49.

439. 847 S.W.2d 319 (Tex. App.—El Paso 1993, no writ).

effectively requiring her brother to walk through the cesspool in order to open the gate and obtain access to the public road. With feelings surely hurt, the brother sued his sister, requesting the court to establish his right to an easement by necessity along the strip of land he had used for nearly eight years. The trial court held that the brother established his right to an easement by necessity along the strip of land designated by the brother and, in an effort to separate the feuding brother and sister, ordered the brother to construct a fence between the access strip and the sister's land.⁴⁴⁰ The sister appealed.

On appeal, Menefee conceded that her brother had a right to pass over her property to access the public road, but apparently argued that she had the right to designate the location of the access path. The court reminded Menefee, however, that her brother was not claiming under the license, but rather asserting entitlement to an easement by necessity. Accordingly, although Menefee, as the owner of the servient estate, had the right to select a reasonable location of the easement at the commencement of the term of the easement, she failed to exercise this right and acquiesced to the easement claimed by her brother over the strip of land along the border of Menefee's tract.⁴⁴¹ Once the parties established the location of the easement, Menefee had no right to relocate the easement without her brother's consent.⁴⁴² As to the fence which the trial court ordered constructed, the court concluded that the trial court, through judicial fiat, effectively conveyed fee simple title to the strip of land in question to the brother and accordingly reversed this portion of the trial court's judgment.⁴⁴³

In an express easement case, *Jones v. Fuller*,⁴⁴⁴ B.D. divided three tracts of real property between his three children through conveyance by gift deeds. B.D. apparently executed the deeds simultaneously, but delivered the property to the grantees over a five year period. Although not a model of clarity, each of the deeds contained the following provision:

Grantor [B.D. Douthitt] does hereby convey to the Grantee herein . . . and assigns the right, privilege and as an appurtenance to the lands and premises herein described to the free and uninterrupted use . . . together with an easement and right of way for passage . . . over and across any and all lands now owned and/or right of ways and easements now owned or to which Grantor . . . might have a right of way and easement to reach the hereinabove described lands . . . in order that the Grantee herein and the Grantees in the other deeds mentioned herein may have a free, unobstructed and uninterrupted passageway and easement to and from a public road and across the lands owned . . . by the Grantor herein to reach the lands herein and hereby conveyed from a public

440. *Id.*

441. *See id.* at 323 (relying on *Cozby v. Armstrong*, 205 S.W.2d 403, 407 (Tex. Civ. App.—Fort Worth, 1947, writ ref'd n.r.e.); *Grobe v. Ottmers*, 224 S.W.2d 487, 489 (Tex. Civ. App.—San Antonio 1949, writ ref'd n.r.e.)).

442. *See id.* (relying on *Meredith v. Eddy*, 616 S.W.2d 235, 240 (Tex. Civ. App.—Houston [1st Dist.] 1981, no writ)).

443. *Id.*

444. 856 S.W.2d 597 (Tex. App.—Waco 1993, writ denied).

road or a means of ingress and egress to and from the hereinabove described lands and premises.⁴⁴⁵

Only one of the conveyed tracts had access to a public road (the front tract). At the time of conveyance, a private road crossed the middle of the front tract, continued over the second (middle) tract and stopped at the adjoining boundary of the third (rear) tract. The owners of the middle and rear tracts used this road to access the public road. Sometime after the initial conveyances, the owners of the middle and rear tracts, at the request of the owner of the front tract, commenced using a second private access road that ran along the northern boundary of the front tract and stopped at the adjoining boundary of the middle tract. Several years later, the owner of the front tract conveyed to B.D. that portion of the front tract which included the second access road and conveyed to a third party the remainder of the front tract.⁴⁴⁶ The purchaser of the remainder of the front tract, apparently unhappy with the location of the first access road, subsequently blocked access to the first access road and began entering and leaving the front tract from and to the public road by using the portion of the front tract that had been conveyed to B.D. Incensed, the owners of the middle and rear lots sued, claiming an express easement for ingress and egress over the first access road and that the purchaser had constructive knowledge of the easement and location thereof. The trial court found for the purchaser and the owners of the middle and rear lots appealed.

Apparently recognizing that not one of the deeds could be read to create effective easements claimed by the middle and rear lot owners, the appellate court held that as a matter of law the deeds were component parts of a single transaction and therefore must be read and interpreted together.⁴⁴⁷ Having reached this holding, the court interpreted the common provision in the deeds quoted above as a clear expression of the grantor's intention to create easements appurtenant over and across the front tract to provide the owners of the middle and rear tracts access to the public road.⁴⁴⁸ The purchaser argued that even if the deeds created an express easement, the validity of that easement could not be upheld because the deeds failed to specify the location of the easement. The court, however, found little difficulty with this point because the middle and rear lots obtained access to the public road over the first access road at the time of the execution of the deeds in favor of the children and, under Texas law, the location of the easement could not be changed without the consent of the owners of those lots.⁴⁴⁹ Moreover, con-

445. *Id.* at 599-600.

446. Although not stated in the facts, the owner of the front tract apparently made the conveyance to B.D. in order to assure access to the public road from the middle and rear tracts.

447. *Id.* at 601-02 (relying on *Rudes v. Field*, 146 Tex. 133, 204 S.W.2d 5, 7 (1947)).

448. *Id.* at 602.

449. *Id.* at 602 (relying on *Elias v. Horak*, 292 S.W. 288, 290 (Tex. Civ. App.—Austin 1927, writ ref'd)). The court seems to ignore the fact that, without any apparent objection and at the request of the owner of the front tract, the owners of the middle and rear tracts used the second access road and, except when the second access road became unusable, did not use the first access road for the eight year period immediately preceding the transfer of the front lot to

cluded the court, the purchaser had been made constructively aware of the existence of the express easements through the recordation of the deeds in favor of the children and, like the court, the purchaser should have construed all of the gift deeds together since the deeds were component parts of the same transaction.⁴⁵⁰

XIII. EMINENT DOMAIN

As in prior Survey periods, the courts were relatively busy deciding eminent domain cases during this Survey period. In addition to the holdings and cases discussed in this section, the courts reached the following holdings: where a lease does not terminate upon the occurrence of a condemnation and the tenant has not waived the rights it may have in respect to a condemnation award, the tenant is entitled to share in the condemnation award if the condemnation resulted in a loss of all or a part of the tenant's leasehold interest;⁴⁵¹ the damage alleged in an action based on inverse condemnation must not result from the condemnor's negligence;⁴⁵² the state's condemnation of land for purpose of constructing a post office constitutes a taking for a public use;⁴⁵³ a city's refusal to rezone a landowner's property from residential to industrial to allow for a junk yard did not constitute an

the purchaser. Certainly the purchaser could have argued that these events constituted the consent of the parties to the relocation of the first access easement. One must wonder whether the purchaser presented this argument or the court simply ignored the purchaser's argument.

450. *Id.* at 603.

451. *Texaco Refining and Marketing, Inc. v. Crown Plaza Group*, 845 S.W.2d 340 (Tex. App.—Houston [1st Dist.] 1992, writ requested). In *Crown Plaza*, Texaco leased property pursuant to a lease which provided that the lessee had the option to terminate the lease in the event of a condemnation of a portion of the premises. If Texaco failed to terminate the lease, the lease term would continue and the rent would be equitably adjusted. Apparently the lease did not require Texaco to waive any rights that it may have in a condemnation award. In fact, a condemnation of a portion of the premises occurred near the end of the lease term and the remaining property provided insufficient area to continue to operate a gas station. Furthermore, Texaco elected not to terminate the lease and instead exercised a renewal option, since Texaco's share of the condemnation award (100%) greatly exceeded its rental obligation during the renewal term. The lessee claimed that Texaco acted in bad faith. The trial court agreed, but the appellate court reversed, concluding that not only did Texaco not act in bad faith in exercising its contract rights, but also that Texaco had no duty to act in good faith. *Id.* at 342.

452. *Dalon v. City of DeSoto*, 852 S.W.2d 530 (Tex. App.—Dallas 1992, writ ref'd) (erosion resulting on landowner's property and caused by city's upstream repairs and maintenance activities would not support an inverse condemnation action as the erosion resulted from alleged negligent acts of city).

453. *Texas Fruit Palace, Inc. v. City of Palestine*, 842 S.W.2d 319 (Tex. App.—Tyler 1992, writ denied), *cert. denied*, 114 S. Ct. 305 (1993) (relying on TEX. L. GOV'T CODE § 280.01 (Vernon Supp. 1994), which generally allows a city or state to condemn land for the use of the United States government). In *Texas Fruit Palace*, the owner of the leasehold which the city condemned also alleged that the city acted in bad faith in condemning the property. None of the bad faith arguments were persuasive, however, and the court easily rejected each such argument. Nevertheless, practitioners should be aware that claims of bad faith, when properly plead and submitted to the jury, may have viability in light of the Texas Supreme Court's decision in *Westgate, Ltd. v. State*, 843 S.W.2d 448, 454 (Tex. 1992), wherein the court acknowledged that the policy reasons on which it held that the condemning authority's delay, reasonable or unreasonable, in completing an announced condemnation will not support an inverse condemnation claim "might not be applicable where the condemning authority is accused of intentionally injuring a landowner." *Id.* The *Westgate* court, however, expressly

inverse condemnation;⁴⁵⁴ and the accommodation doctrine applies to the determination of whether a condemning authority inversely condemned a leasehold mineral interest; however, if there is only one reasonable manner by which the minerals may be produced, the lessee has the right to pursue that use even under the accommodation doctrine and if the condemning authority's use of the surface eliminates the lessee's ability to exercise the only reasonable means of recovery of minerals, then an inverse condemnation of the mineral estate has occurred.⁴⁵⁵ In addition to the foregoing holdings, practitioners should be aware that the Texas Supreme Court has granted writ of error⁴⁵⁶ on an unpublished court of appeals opinion, *Taub v. City of Deer Park*, and one of the points of error the court agreed to review addresses the issue of whether the city's dual roles as arbiter of the fate of the landowner's zoning application and as condemnor of portions of the owner's land should be considered as a factor bearing on the question of whether a taking occurred.⁴⁵⁷

*Saunders v. Titus County Fresh Water Supply Dist. No. 1*⁴⁵⁸ demonstrates the fact that a condemning authority may not use its condemnation authority to take one's land to resolve the authority's private dispute with another property owner. In *Saunders*, the condemning authority condemned a portion of Hackler's land to create a reservoir. After the creation of the reservoir, Hackler sued the condemning authority, claiming that the authority, as a result of the condemnation, cut off access to the remainder of Hackler's property. Attempting to avoid an adverse judgment, the condemning authority sought to acquire a strip of Saunders' land for the purpose of creating a private access road for use by Hackler. Saunders refused to sell and the

declined to address the issue of whether the condemning authority acted in bad faith because, even though properly plead, the jury issues did not include the issue of bad faith. *Id.* at 455.

454. *City of Pharr v. Pena*, 853 S.W.2d 56 (Tex. App.—Corpus Christi 1993, writ denied). In *Pena*, the court concluded that the city's considerations of aesthetics and preservation of property values for refusing to rezone the property would not serve as a basis for an inverse condemnation claim. *Id.* at 61. The landowner also argued that representatives of the city had made representations to the landowner that the city would cooperate with his rezoning request if the landowner would request annexation into the city. After assuming the city representative made the representations as alleged, the court concluded that the city could not be bound by those agreements since they would constitute a surrender of the city's police power. *Id.* at 61-62. Moreover, although the *Pena* court recognized that the Texas Supreme Court's decision in *Westgate, Ltd. v. State*, discussed *supra* note 453, acknowledged that a city's bad faith might serve as a basis for an inverse condemnation claim and that the representations allegedly made by the city could support a bad faith claim, the *Pena* court declined to reach a decision because, as in *Westgate*, the issues submitted to the jury did not include the issue of bad faith. *Id.* at 62 n.3.

455. *Tarrant County Water Control and Improvement Dist. No. 1 v. Haupt, Inc.*, 854 S.W.2d 909 (Tex. 1993). The accommodation doctrine, first articulated by the Texas Supreme Court in *Getty Oil Co. v. Jones*, 470 S.W.2d 618, 622 (Tex. 1971), generally provides that if a lessee's method of recovery of minerals would preclude or impair the surface owner's current use of the surface and under the established practices of the industry an alternative method of recovery of the minerals is available that would allow the current use of the surface, the lessee will be required to adopt the alternative method of recovery.

456. 37 Tex. Sup. Ct. J. 144 (1993).

457. This issue could also logically involve the issue of bad faith raised by *Westgate, Ltd. v. State*, discussed *supra* note 453.

458. 847 S.W.2d 424 (Tex. App.—Texarkana 1993, n.w.h.).

authority instituted condemnation proceedings during which Saunders argued, under various theories, that the condemnation authority had no authority to proceed with the condemnation. The trial court entered judgment in favor of the condemning authority and Saunders appealed.⁴⁵⁹

On appeal, the Texarkana appellate court had little difficulty reversing the trial court. Although recognizing a condemning authority's right to condemn a private party's land for the relocation of a public road, the court concluded that Texas does not recognize a condemning authority's right to condemn a private party's land for the purpose of relocating a private road.⁴⁶⁰ Not disagreeing with the court's analysis, the condemning authority instead argued that the condemnation of Saunders' land constituted a condemnation for public use in that the State would own the condemned strip and a possibility existed that the condemned strip would be used by the public.⁴⁶¹ Not to be argued with, the court insisted that the condemning authority commenced the condemnation action only to satisfy Hackler's demand for access to his property.⁴⁶² Accordingly, the court reversed the trial court judgment and set aside the condemnation.⁴⁶³

During the Survey period, the Texas Supreme Court withdrew its previously published majority opinion in *Westgate, Ltd. v. State*⁴⁶⁴ and substituted a new majority opinion.⁴⁶⁵ The portion of the opinion relating to the substantive claim of inverse condemnation remained unchanged, but the court substantially altered the portion of its opinion dealing with the questions to be submitted to the jury regarding damages to the remainder tract. The court generally held that the trial court has the discretion to submit either the three jury questions enunciated in *State v. Carpenter*⁴⁶⁶ or the three jury questions enunciated in *Uselton v. State*,⁴⁶⁷ based on the circum-

459. *Id.*

460. *Id.* at 429.

461. *Id.* at 428 (relying on *Maher v. Lasater*, 163 Tex. 356, 354 S.W.2d 923 (1962)); *Estate of Waggoner v. Gleghorn*, 378 S.W.2d 47 (Tex. 1964).

462. 847 S.W.2d at 428.

463. *Id.* at 429.

464. 35 Tex. Sup. Ct. J. 1042 (July 4, 1992).

465. 843 S.W.2d 448 (Tex. 1992).

466. 126 Tex. 604, 89 S.W.2d 194, 201-02 (1936). In *Carpenter*, the Court determined that the issues to be submitted to the jury are as follows:

- (1) the market value of the part taken, considered as severed land;
- (2) the market value of the remaining tract of land, exclusive of the part taken, immediately before the taking; and
- (3) the market value of the remaining tract of land immediately after the taking.

Id.

467. 499 S.W.2d 92, 97-99 (Tex. 1973). In *Uselton*, the Court enunciated the issues to be submitted to the jury as follows:

- (1) the market value of the part taken, considered as severed land;
- (2) the market value of the entire tract before the taking; and
- (3) the market value of the remainder after the taking, giving consideration to the uses to which the condemned part is to be subjected.

Id.

Under the *Uselton* approach, the total measure of damages is usually the difference between the determinations under clauses (2) and (3) above; however, if the difference is less than the market value determined under clause (1), the measure of damages is the market value of the part taken. *Id.*

stances of each case and with the understanding that the *Uselton* approach is preferable where the part taken is small or irregularly shaped.⁴⁶⁸ The court, however, because of the broad-form submission requirement under Rule 277 of the Texas Rules of Civil Procedure,⁴⁶⁹ reduced the three jury questions required by *Carpenter* to the following:

- (1) the market value of the part taken, considered as severed land; and
- (2) damages to the remainder, with an instruction that such damages should be determined by considering the difference between the pre-taking value of the remainder and the post-taking value.⁴⁷⁰

Similarly, the court reduced the *Uselton* jury questions to the following:

- (1) the market value of the part taken, considered as severed land; and
- (2) the damages to the landowner's property, with an instruction that the damages should be determined by considering the difference between (a) the value of the entire tract before taking, and (b) the market value of the remainder after the taking, giving consideration to the uses to which the condemned part is to be subjected.⁴⁷¹

*State v. Biggar*⁴⁷² is an inverse condemnation case which demonstrates the Austin appellate court's recent penchant to protect landowners and their property interests from the State's overreaching hands.⁴⁷³ In *Biggar* the landowners owned a tract of land upon which they intended to construct an office facility. The landowners obtained a site development plan approved by the City of Austin and thereby greatly enhanced the value of the land. The site development plan required the landowners to satisfy certain conditions by a specified date, failing which the site development plan would terminate. The conditions included a requirement that the landowners obtain the State's agreement to the relocation of a drainage channel located on the site to another acceptable location. The landowners promptly commenced negotiations with the State to agree upon an exchange of land to accommodate the relocation. After substantial negotiations, the State tentatively approved an exchange of land that would accommodate the relocation. At about this same time, however, the State and the county commenced efforts to widen the right-of-way which abutted the landowner's land. To accomplish the widening, the State and county sought to condemn land bordering the right-of-way, including a portion of the landowner's land. The State bid on the land, but the landowners refused the bid as they believed that the bid did not nearly reflect the true value of the land with the site development plan in place. The State reconsidered its offer and in this process the State's appraiser determined the value of the landowners' land to indeed be much greater and so advised the State's legal counsel. The appraiser also advised

468. 843 S.W.2d at 457.

469. TEX. R. CIV. P. 277.

470. 843 S.W.2d at 457.

471. *Id.*

472. 848 S.W.2d 291 (Tex. App.—Austin 1993, writ granted).

473. See also the Austin's court's opinions in *State v. Schmidt*, 805 S.W.2d 25 (Tex. App.—Austin 1991), *rev'd*, 867 S.W.2d 769 (Tex. 1993); *State v. Austex, Ltd.*, 862 S.W.2d 1 (Tex. App.—Austin 1991), *rev'd*, 867 S.W.2d 769 (1993); *Morales v. Chrysler Realty Corp.*, 843 S.W.2d 275 (Tex. App.—Austin 1992, n.w.h.).

the State's legal counsel that if the landowner did not complete the land exchange relating to the relocation of the State's drainage channel within the near future, the site development plan would terminate. Lo and behold, the State withdrew its initial technical approval of the land exchange and refused to reconsider its position, the site development plan terminated due to the landowners' inability to complete the land exchange to allow the relocation of the drainage channel and the value of the landowners' land plummeted. Understandably incensed, the landowners brought suit against the State, alleging inverse condemnation as a result of the State's failure to proceed with the land exchange and further alleging that the State had ceased processing of the land exchange to reduce the condemnation award that the State and county would be required to pay the landowners in connection with the widening of the right-of-way. The trial court found in favor of the landowners and the State appealed.

On appeal, the State initially argued that the doctrine of sovereign immunity barred all of the landowners' claims. Commencing with a simple "we disagree," the court directed the State to a Texas Supreme Court holding that governmental immunity offers no shield from a claim of inverse condemnation.⁴⁷⁴

The State next argued that the landowners' claim of inverse condemnation must fail because the State had no legal duty to agree to an exchange of land to accommodate the relocation of the drainage channel. In the court's judgment, *City of Austin v. Teague*⁴⁷⁵ and a case cited approvingly by the *Teague* Court, *San Antonio River Authority v. Garrett Brothers*,⁴⁷⁶ controlled the issue before the court. The *Biggar* court found particularly relevant a statement in *Garrett Brothers* that "where the purpose of the governmental action is the prevention of development of land that would increase the cost of a planned future acquisition of such land by government. . . . [the government] can no longer pretend to be acting as a neutral arbiter . . . [or as] an impartial weigher of the merits of competing interest among its citizens."⁴⁷⁷ Just as the condemning authority had sought to enrich itself in *Teague* and *Garrett Brothers*, the State, according to the *Biggar* court, sought to enrich itself at the expense of the landowners by refusing to agree to the land exchange and thereby significantly reducing the value of the landowners' land.⁴⁷⁸ The

474. 848 S.W.2d at 294-95 (citing *Steele v. City of Houston*, 603 S.W.2d 786, 791 (Tex. 1980)). Cf. *Dalon v. City of De Soto*, 852 S.W.2d 530 (Tex. App.—Dallas 1992, writ ref'd n.r.e.) (supporting the proposition that damage alleged in an inverse condemnation action must not result from condemner's negligence).

475. 570 S.W.2d 389 (Tex. 1978). In *Teague*, a developer sought to improve his raw land and in that regard applied for the required permits. Although the developer complied with the engineering and other technical requirements to obtain the permits, the city refused to issue the permits due to public pressure to preserve the scenic view provided by the developer's raw land. The Texas Supreme Court concluded that the city acted without authority and arbitrarily and capriciously in refusing to issue the permits because the city intended to prevent all development on the city's property by not issuing the permit and to preserve a scenic easement for the public benefit. *Id.* at 391.

476. 528 S.W.2d 266 (Tex. Civ. App.—San Antonio, 1975, writ ref'd n.r.e.).

477. *Id.* at 274.

478. *Biggar*, 848 S.W.2d at 297.

State attempted to distinguish *Teague* and *Garrett Brothers* on the basis that each of those cases involved the condemning authority's refusal to issue permits contemplated by an ordinance as opposed to a discretionary exchange of land. The court, however, directed the State to a State statute and certain state highway department regulations which authorized the State to participate in exchanges of real property and allow petitioners to propose property sales and exchanges.⁴⁷⁹ The State countered, arguing that exchanges were authorized only in the case of surplus property and the existing drainage channel located on the landowners' land clearly did not constitute surplus. Unimpressed and clearly in no mood to find for the State, the court stated that the applicable State regulations provided for an exchange even when the easement area sought to be exchanged is not yet surplus.⁴⁸⁰

The State finally asserted that the exchange provisions provided for by statute and applicable regulations allowed the State full discretion in determining whether to accept a proposed exchange. The *Biggar* court reminded the State of the lessons taught by *Teague* and *Garrett Brothers*, and evidence in the record that indicated the State routinely granted other requested exchanges, and further evidence reflecting that no State witness could ever recall a requested exchange being turned down once the State granted the technical approval as it had in this case.⁴⁸¹ In the court's judgment, following the State's technical approval of a proposed exchange, the State is required to complete the exchange.⁴⁸²

Although the Austin appellate court, at least temporarily, soundly defeated the State in *Biggar*, the Austin court has suffered reversal of at least six of its recent decisions entered against the State primarily because of the Texas Supreme Court's opinion in *State v. Schmidt*.⁴⁸³

479. *Id.* (relying on TEX. REV. CIV. STAT. ANN. art. 6673a, § 1(a) (Vernon Supp. 1994); State Dep't of High. & Publ. Transp., *Right of Way Manual* §§ 421.07-08 (bk. 1, ed. 6 n.d.)).

480. *Id.* (citing *Right of Way Manual* § 421.08).

481. *Id.* at 297.

482. *Id.* The Texas Supreme Court has granted writ of error with respect to (1) whether the State had the discretionary ability to refuse the exchange proposed by the landowners and (2) whether the *Biggar* court correctly held that an exchange of real property is no different than the issuance of a permit by a governmental authority, for purposes of applying the holdings and principles enunciated in *Teague* and *Garrett Brothers*. 36 Tex. Sup. Ct. J. 1088, 1089 (Mar. 39, 1994). The State has a reasonable argument regarding its discretion to withhold its consent to a proposed exchange, even after technical approval, but, at least under the *Biggar* facts, the State's actions should serve as the basis for a bad faith claim. The significant issue in this regard, however, is whether the submissions to the jury included the issue of bad faith. See *Westgate, Ltd. v. State* discussed in note 454 *supra*.

483. 867 S.W.2d 769 (Tex. 1993) consolidated with *State v. Austex, Ltd.* Both *Schmidt* and *Austex* were decided by the Austin Court of Appeals. In addition, the holding in *Schmidt* is cited as the primary reason for the reversal of the Austin Court of Appeals in *State v. Allen*, 37 Tex. Sup. Ct. J. 313 (Jan. 5, 1994); *State v. Donnie Ruth Moore Edwards*, 868 S.W.2d 321 (Tex. 1993) *per curiam*; *State v. Munday Enterprises*, 868 S.W.2d 319 (Tex. 1993); *State v. Centennial Mortgage Corp.*, 867 S.W.2d 783 (Tex. 1993). Prior to *Schmidt*, the State, apparently tiring of its sound beatings by the Austin court in connection with the modifications of Highway 183, tried a new tactic in *Morales v. Chrysler Realty Corp.*, 843 S.W.2d 275 (Tex. App.—Austin, 1992 n.w.h.). Instead of arguing that, as a matter of law, the damages were community in nature and therefore non-compensable and losing that argument prior to reaching the jury, the State introduced testimony that the remainder property had been damaged by loss of access, reduced visibility and construction disruption, but joined issue with the property

In *Schmidt*, the State of Texas and City of Austin sought to convert state highway 183, an open access highway, into a controlled access highway. In connection with the conversion of highway 183 to a controlled access highway, the State and City intended to elevate the highway approximately thirty-seven feet above a portion of the existing open access highway which abutted property separately owned by Schmidt and Austex. The State instituted condemnation proceedings, seeking to acquire a portion of Schmidt's and Austex's property to facilitate the construction of the controlled access highway. However, both Schmidt and Austex rejected the amount of the award offered by the State, each claiming that the State's offer did not consider the damage that would result to the remainder of its tract due to lessened visibility to passing traffic and the inconvenience of construction activities. Austex additionally claimed that the State's offer did not consider the damage that would result to the remainder of its tract due to diversion of traffic and increased circuitry to access its property. The jury agreed with Schmidt and Austex and awarded significant damages. The State appealed to the Austin Court of Appeals, but found no solace there.

Confident in its position, the State appealed to the Texas Supreme Court, claiming that the severance damages claimed by the landowners were not recoverable (1) under existing case law, (2) because the damages resulted from the State's construction and new use of the existing highway and the taking of property from other landowners to widen the highway, as opposed to just the taking of the strips of land by the State, and (3) as a result of Section 21.042(d) of the Texas Property Code.⁴⁸⁴

As to the State's first defense, the Court concluded that the Court had previously prohibited recovery for loss of value due to diversion of traffic and circuitry of travel in both actual and inverse condemnation cases.⁴⁸⁵ Although the court acknowledged that it had not previously decided the damage issue regarding impaired visibility and disruption of construction activities, the court concluded there existed no good reason to treat those damages differently than damages resulting from diversion of traffic and circuitry of travel.⁴⁸⁶

owner on the amount of damage suffered. By arguing the same position as the property owner, the State apparently hoped to obtain a jury instruction that the damages should be limited by any damages that constituted community damages. This strategy thoroughly backfired on the State, however, as the trial court refused to submit any such issue. On appeal to the Austin court, the State suffered absolute defeat as result of the court's holding that the trial court did not err by refusing to limit the evidence regarding damages presented by the State or entered into the record by the property owner without objection from the State. *Id.* at 277. Moreover, the court concluded that the record was devoid of any community damage testimony and any limiting instruction regarding community damages would have only confused the jury. *Id.*

484. TEX. PROP. CODE ANN. § 21.042(d) (Vernon 1984).

485. 867 S.W.2d at 776.

486. *Id.* In so concluding, the court expressly disapproved of *State v. Buck*, 489 S.W.2d 642 (Tex. Civ. App.—Corpus Christi 1972, writ ref'd n.r.e.) and *Milam County v. Akers*, 181 S.W.2d 719 (Tex. Civ. App.—Austin 1944, writ ref'd w.o.m.) to the extent inconsistent with *Pennysavers Oil Co. v. State*, 334 S.W.2d 546 (Tex. Civ. App.—San Antonio 1960, writ ref'd), *State v. Baker Bros. Nursery*, 366 S.W.2d 212 (Tex. 1963) or *State v. Wood Oil Distrib., Inc.*, 751 S.W.2d 863 (Tex. 1988).

The State fared just as well with respect to its second argument. Initially, the court stated that the Court had theretofore recognized as applicable to Texas condemnation cases the rule enunciated in *Campbell v. U.S.*⁴⁸⁷ that "just compensation assured . . . to an owner, a part of whose land is taken for public use, does not include the diminution in value of the remainder caused by the acquisition and use of adjoining lands of others for the same undertaking."⁴⁸⁸ The *Schmidt* Court further stated, however, that the *Campbell* rule should not be applied if:

- (1) the land taken from the condemnee landowner was indispensable to the . . . project;
- (2) the land taken constituted a substantial (not inconsequential) part of the tract devoted to the project; and
- (3) the damages resulting to the land not taken from the use of the land taken were inseparable from those to the same land flowing from the condemnor government's use of its adjoining land in the . . . project.⁴⁸⁹

Applying these rules to the facts, the *Schmidt* Court concluded that the diminution, if any, in the value of the remainder tracts caused by diversion of traffic, circuity of travel, impaired vision and construction activity arose out of the State's modifications to the existing highway and not out of the use of the strip taken from each tract.⁴⁹⁰ Accordingly, the court concluded that the alleged damages were not recoverable from the State.⁴⁹¹

The State based its third and final argument on the provisions of section 21.042(d) of the Texas Property Code,⁴⁹² which generally provides that the commissioners, in arriving at a condemnation award, shall consider the injury or benefit that is peculiar to the property owner and that relates to property owner's use, ownership or enjoyment of particular property, but shall not consider any injury or benefit experienced by the property owner in common with the general community. After muddling through a few ancient cases and admitting that the principle of general community damages is easier to articulate than define, the court concluded that "[w]hether an injury is community cannot be decided simply by setting the size of the relevant area. 'Community' in this context means not only where, but more importantly, what kind."⁴⁹³ In other words, the nature of the injury and not the location of the injury is the more critical factor in determining whether an injury is community.⁴⁹⁴ Notwithstanding that these principles fail to adequately and clearly state the concept of community damages, the court had little difficulty concluding that the damages were community primarily on the theory that although one or more of the claimed damages could affect Austex and Schmidt differently than all other property owners from whom land was taken, the distinction, in the court's judgment, was one of degree

487. 266 U.S. 368 (1924).

488. *Id.* at 372.

489. 867 S.W.2d at 778 (quoting *United States v. 15.65 Acres of Land*, 689 F.2d 1329, 1332 (9th Cir. 1982), *cert. denied*, 460 U.S. 1041 (1983)).

490. *Id.*

491. *Id.*

492. TEX. PROP. CODE ANN. § 21.042(d) (Vernon 1984).

493. 867 S.W.2d at 781.

494. *Id.*

and not of kind.⁴⁹⁵

XIV. LEGISLATIVE DEVELOPMENTS

During 1993, the 73rd Legislature of the State of Texas passed numerous bills dealing with real estate related topics.⁴⁹⁶ Attached as Appendix I is a summary of most bills passed by the legislature that could logically affect a real estate practitioner.⁴⁹⁷ Several bills, however, deserve some special attention. One such bill, House Bill (HB) 2537, will most significantly affect developers of land.⁴⁹⁸ This law provides that any person undertaking the development of over one acre of land must conduct soil testing to determine if any part of the tract overlies a closed municipal solid waste landfill.⁴⁹⁹ As used in the statute, the term development includes new construction and alterations of existing improvements.⁵⁰⁰ Regardless of whether the testing reveals the presence of a landfill, the owner or lessee who is developing the land must submit the test results to the Executive Director of the Texas Natural Resources Conservation Commission (TNRCC) at least 30 days prior to the commencement of the development.⁵⁰¹ If the soil testing indicates the presence of a landfill, the owner or lessee developing the land must then obtain a development permit from the TNRCC, and the application for the permit must be made no less than 45 days before the development begins.⁵⁰² As of the date of the writing of this article, the TNRCC has not yet published any regulations regarding the procedures and criteria for soil testing. The authors of this article understand, however, through conversations with other lawyers, that the TNRCC, at this time, has taken the position that soil testing does not need to be performed for any development over one acre until regulations are published by the TNRCC, unless there is a known landfill at the development. However, if a landfill is discovered during the development of a tract of land greater than one acre in size, then the TNRCC has taken the position that all development must cease and the landfill must be reported to the Executive Director of the TNRCC, who will then decide what steps need to be taken to comply with the statute before development may recommence.

Another bill, HB 1081, places a duty on a seller of single family residential real property to disclose the condition of the residence, including certain items specified in the statute.⁵⁰³ Fortunately, the statute provides a pre-

495. *Id.*

496. Among these is the statute regarding the effectiveness of a contractual choice of law provision in written agreements, which is discussed in *supra* notes 269-81.

497. See also DAVIES ET AL., 1993 LEGISLATIVE UPDATE (REAL ESTATE LAW), VOL. 31 REAL ESTATE PROBATE & TRUST LAW REPORTER NO. 4, 46 (July 1993).

498. HB 2537 is codified as TEX. HEALTH & SAFETY CODE ANN. § 361.531-361.540 (Vernon Supp. 1994).

499. *Id.* § 361.538.

500. *Id.* § 361.531(1).

501. *Id.*

502. *Id.* §§ 361.532, 361.533. A violation of the statute is subject to civil penalties not to exceed \$10,000 for each violation of the statute. *Id.* § 361.540.

503. TEX. PROP. CODE ANN. § 5.008 (Vernon Supp. 1994).

scribed form of notice so that sellers do not have to guess or speculate at length regarding what particular disclosures are required.⁵⁰⁴ The statute further provides that the notice is to the best of the seller's knowledge and that the disclosure is not a warranty by the seller or its agent.⁵⁰⁵ Significantly, the notice is not required in connection with a sale of a new residence, an acquisition of a residence acquired at a foreclosure sale, or a sale by a mortgagee who obtained title pursuant to a foreclosure sale.⁵⁰⁶ In the event the required notice is not given to the purchaser before the contract is executed by the purchaser, then the purchaser may terminate the contract within seven days after receiving the notice.⁵⁰⁷

One final amendment to the Texas Property Code worthy of some discussion is an amendment to section 51.002 regarding the timing of the various notices required in connection with a non-judicial foreclosure sale of real property. The legislature first clarified that section 51.002(d) applies only to residential debtors; thus, only residential debtors need to be given the twenty-day demand and opportunity to cure required by section 51.002(d) before the twenty-one day notice of foreclosure sale is given.⁵⁰⁸ This amendment clears up some arguments made by debtor's counsel in the past that the second sentence of section 51.002(d) requires twenty days' notice and opportunity to cure regardless of whether the real property is the debtor's residence.⁵⁰⁹ The legislature then added a new subsection which clarifies the computation of the required twenty-one day notice of foreclosure sale. Specifically, when computing the twenty-one day notice period for the notice of foreclosure sale, the entire calendar day on which the notice of sale is given is included, regardless of the time of day at which the notice of sale is given, and the entire calendar day of the foreclosure sale is excluded.⁵¹⁰ This amendment effectively eliminated repeated arguments that section 51.002(b) required twenty-one full twenty-four hour time periods.⁵¹¹

504. *Id.* § 5.008(b).

505. *Id.* § 5.008(b), (d).

506. *Id.* § 5.008(e).

507. *Id.* § 5.008(f).

508. TEX. PROP. CODE ANN. § 51.002(d) (Vernon Supp. 1994).

509. Prior to the amendment, although the first sentence of § 51.002(d) talked in terms of the notice required in connection with a foreclosure of a debtor's residence, the second sentence did not contain any such qualification, but merely stated that "The debtor must be given at least twenty days to cure the default before the entire debt is due and notice of sale is given". *Id.* However, this argument clearly conflicted with the entire context of § 51.002(d).

510. *Id.* § 51.002(g).

511. For example, prior to this amendment, if a notice of sale was delivered and posted at 1:00 p.m. on the third Tuesday prior to the foreclosure sale in question, and the foreclosure sale was held at 10:00 a.m. on the foreclosure Tuesday, then debtors who were desperately seeking ways to avoid foreclosure (or sue for wrongful foreclosure) would claim that the lender had not complied with the statute (which required notice of the sale twenty-one days prior to the sale), as the debtor did not have the benefit of a full twenty-one days (each day being twenty-four hours) prior to the foreclosure sale. Because of this amendment, lenders will no longer need to be concerned about what time of day the notice is posted and mailed to the debtor in the event the lender waits until the third Tuesday prior to the foreclosure sale date.

XV. MISCELLANEOUS TOPICS

In a case which will impact the drafting of documents in all types of transactions, including real estate transactions, the Texas Supreme Court extended the "express negligence" doctrine from indemnity agreements to releases of liability and further held that indemnities and releases to which the express negligence doctrine applies must be conspicuous.⁵¹² In *Dresser* the Texas Supreme Court held that "fair notice requirements" apply equally to releases as well as to indemnity agreements when the effect of the release or indemnity is to relieve a party in advance for its own negligence.⁵¹³ In the court's opinion, fair notice requirements include both the express negligence doctrine and a conspicuousness requirement.⁵¹⁴ The court then adopted the standard for conspicuousness set forth in section 1.201(10) of the Texas Business and Commerce Code for indemnity and release provisions which relieve a party in advance for its own negligence.⁵¹⁵

The *Dresser* decision makes several drafting considerations obvious.⁵¹⁶ First, even in instances where an indemnity clause contained in an agreement complies with the express negligence doctrine, the indemnity clause may not comply with the conspicuous requirements imposed by the *Dresser* court. Consequently, any documents containing any such indemnifications should be carefully reviewed, and the applicable language indemnifying a party for its own negligence should be highlighted in some way so as to satisfy the conspicuousness requirement. In light of the court's examples given in the opinion, the applicable language should be either capitalized or highlighted in contrasting type, such as a bold typeface. Second, the real estate practitioner should carefully review a document for provisions releasing his or her client in advance from its own negligence. Any such releases must be drafted to comply with the express negligence doctrine and the conspicuousness requirements which are applicable to indemnity clauses. In other words, the language must clearly express the intent of the parties that

512. *Dresser Indus., Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505 (Tex. 1993).

513. *Id.* at 507-08.

514. *Id.* at 508. The express negligence doctrine was enunciated by the Texas Supreme Court in *Ethyl Corp. v. Daniel Constr. Co.*, 725 S.W.2d 705, 707-08 (Tex. 1980), where the court held that a party seeking to be indemnified from its own negligence in advance must clearly express that intent in specific terms within the four corners of the agreement. *Id.*

515. *Id.* at 511 (citing TEX. BUS. & COM. CODE ANN. § 1.201(10) (Tex. UCC) (Vernon Supp. 1994)). Section 1.201 states that a clause is conspicuous when "it is so written that a reasonable person against whom it is to operate ought to have noticed it." TEX. BUS. & COM. CODE ANN. § 1.201(10) (Tex. UCC) (Vernon 1987). The court then stated that language in capital headings, language of a contrasting type and language in an extremely short document were examples which satisfied the conspicuousness requirement. 853 S.W.2d at 510.

516. For instance, a lease typically contains various indemnification and release provisions where the tenant and landlord release and/or indemnify each other with respect to acts resulting on property within the respective parties' control. A waiver of subrogation provision in a lease should also be carefully examined to ascertain that the waiver complies with the fair notice requirements. Another example is a seller of real estate who enters into a contract which allows the purchaser to enter onto the seller's land to perform certain testing in connection with the purchaser's due diligence of the property (e.g., soil and environmental tests). In this case, the seller will want to be sure that the indemnity provisions comply with the express negligence doctrine and conspicuousness requirements.

a party be released in advance for its own negligence, and the release must be highlighted through the use of capitalized letters, different typeface, or some other similar method which would ensure that a reasonable person against whom the release is to operate should have noticed the release provision. Clearly, indemnity, release, and waiver provisions which were once ignored because they were buried in the boiler plate provisions of a contract will be heavily negotiated as they become the most prominent provisions in a contract.

APPENDIX I
TEXAS REAL ESTATE STATUTES-1993

All statutes effective September 1, 1993 unless otherwise noted

HB 2537 DEVELOPMENT OF LAND — TESTING FOR
LANDFILL

Adds Subchapter R, Chapter 361, Health and Safety Code; amends Section 363.064, Health and Safety Code.

- A. Any person undertaking the development of over one acre of land must conduct soil testing to determine if any part of the tract overlies a closed municipal solid waste landfill.
- B. Engineer who conducts the testing is required to notify Texas Natural Resources Conservation Commission (TNRCC) if he determines the tract overlies a closed municipal solid waste landfill.
- C. Regardless of whether testing reveals the presence of a landfill, owner or lessee of the land for which a test is done must submit the test results to the Executive Director of the TNRCC 30 days before development begins.
- D. If land overlies a landfill, owner or lessee of the land must obtain a permit from the TNRCC before developing the land.
- E. Civil penalties of up to \$10,000 for each violation of the Act.

HB 1218 CLARIFICATION OF COMMERCIAL LANDLORD'S
LOCKOUT REMEDY FOR NONPAYMENT OF RENT

Amends Section 93.002(f), Property Code.

In connection with posting a written notice on a commercial tenant's front door, after a lockout, stating the name of the individual or company from whom or which a new key may be obtained, the new key need only be provided *if the tenant pays the delinquent rent*.

HB 1113 TEXAS BUSINESS AND COMMERCE CODE OMNIBUS
BILL

Modifies Texas enactment of Uniform Commercial Code by repealing Chapter 6 (concerning bulk transfers), adding Chapter 2A (concerning leases of goods) and adding Chapter 4A (concerning funds transfers). Also modifies Chapter 24, Business and Commerce Code (concerning fraudulent transfers), and adds new sections to Chapter 35, Business and Commerce Code (concerning contractual choice of law provisions for transactions of \$1,000,000 or more). Highlights pertaining to real estate are:

- A. *Chapter 2A.*

- Applies to a lease of goods even if the goods become “fixtures.” Fixture filing protects lessor against competing claims by lienholders or others with an interest in the real estate. Generally, lessor may get priority if the fixture filing is recorded within 10 days after the goods became fixtures and if lessee has an interest of record in, or possession of, the real estate.
- Construction mortgage may take priority over lessor’s interest if the construction mortgage was recorded before the goods became fixtures and before completion of construction.
- Without a fixture filing, lessor still has a superior interest if the fixtures are (1) readily removable factory or office machines, (2) readily removable equipment that is not primarily used or leased for use in the operation of real estate, or (3) readily removable replacements of domestic appliances that are subject to a consumer lease.
- Lessor with a superior interest who removes fixtures must compensate an encumbrancer or owner of the real estate who is not the lessee for the cost of repair (but not for any diminution in value) of real estate caused by the absence of the goods removed or any necessity of replacing them.
- Upon default under a lease that covers both real property and goods, a non-defaulting party can proceed under Chapter 2A as to the goods only, or under real property laws as to both real property and the goods, in which case Chapter 2A will not apply.

B. *Fraudulent Transfer Act.*

Changes to the fraudulent transfer rules allow a transferee who has made certain types of improvements in good faith to have a lien on the assets transferred, at least under state law. The lien, which is for the value of the improvements, is prior to the rights of the voiding creditor.

C. *New Choice of Law Sections.*

- Parties to transactions involving \$1,000,000 or more are generally permitted to agree in writing upon the law of a particular jurisdiction to govern their transaction so long as the transaction bears a “reasonable relation” to that jurisdiction. Choice of law is to be honored even if the chosen law is contrary to a fundamental or public policy of Texas.
- Statute specifies means for meeting the “reasonable relation” test.
- Parties can also agree in writing that the law of a jurisdiction governs the *interpretation* of an agreement regardless of whether the transaction bears any reasonable relation to that jurisdiction.

- New rules do not apply to a determination of the law that governs whether a transaction transfers or creates an interest in real property (for security purposes or otherwise) or other matters relating to the creation of a real property interest, to foreclosures of real property liens, or to the manner and effect of recording or failing to record a document concerning an interest in real property. Also, new rules do not apply when another statute provides that the transaction will be governed by laws of a particular jurisdiction.
- Exceptions to the foregoing rules exist with respect to contracts principally for construction or repair of improvements to real property in Texas.

HB 2005 USURY CURE — COMMERCIAL LOANS (effective 8/30/93)

Adds Article 5069-1.06(4) and (5), Texas Civil Statutes.

- A. Commercial lender may cure usury violations as follows: within 60 days after the date lender actually discovers the usury violation, lender must correct the violation by performing any required duty or act or by refunding any usurious amount. Lender must also give written notice to obligor of the violation before obligor has given written notice of, or has filed an action alleging, the violation.
- B. Commercial lender given until March 1, 1994 to cure existing usury violations if lender gives written notice to obligor of the violation before obligor has given written notice of, or has filed an action alleging, the violation.

HB 1368 SECURITY DEVICES FOR RESIDENTIAL RENTAL PROPERTY

Amends Sections 92.001, 92.005, Property Code; Subchapter D, Chapter 92, Property Code.

- A. New requirements for security devices in residential rental property.
 - Expanded definitions of security devices (*e.g.*, “door viewer” and “keyless bolting device”) and expanded coverage of doors and windows (*e.g.*, upgraded security on exterior doors; extra security on sliding glass doors; security for French doors). Upgrades generally applicable to new construction after 9/1/93 and to all units after 1/1/95.
 - Rekeying of security devices required on each tenant turnover.
 - Certain security devices can be requested by tenant at tenant’s expense.
 - Explanation of landlord’s duty to repair or replace security devices. Seven day response time to tenant request; shortened to 72 hours if unauthorized entry or personal violence.

- B. Remedies available to tenants for landlord's failure to install or rekey security devices. Besides a lawsuit, tenant may install or rekey and deduct reasonable costs thereof from rent. Tenant may also serve written request for compliance by landlord; landlord's failure may result in unilateral termination of lease without court proceedings.
- C. Remedies available to tenants for landlord's failure to comply with tenant's request regarding security devices. Landlord has defense if tenant has not fully paid costs requested by landlord under statute.
- D. Management company or managing agent included with owner in definition of "landlord."
 - Management company or managing agent who is *not* the owner of the dwelling has defense if company or agent does not have funds of the dwelling owner in its possession with which to comply; makes a written request of the dwelling owner to fund and allow security device action; and provides tenant with notice stating that the company or agent has taken the preceding actions but the owner has not provided the company or agent with the necessary funds and explaining the remedies to the tenant.
 - Tenant's remedies on notice from management company - unilateral lease termination or exercise of other remedies under the statute.

SB 170 SWIMMING POOL ENCLOSURES (Section 1 effective 9/1/93; Section 2 effective 1/1/94)

Adds Subchapter C, Chapter 214, Local Government Code; Chapter 757, Subtitle A, Title 9, Health and Safety Code.

- A. Section 1 — Municipality may establish, by ordinance, minimum standards for swimming pool fences and enclosures.
 - Municipality that adopts an ordinance may remedy a substandard enclosure or fence. Municipality can assess its expenses on, and municipality has a lien against, the property upon which the swimming pool or the enclosure or fence is situated unless property is a homestead. Lien is primary to other liens except tax liens and previously recorded mortgage liens.
 - Ordinance may provide for penalty not to exceed \$1000 per day.
- B. Section 2 — Numerous specific requirements imposed on pool enclosures and doors and windows opening into a pool yard. Applies to (1) a pool owned, controlled or maintained by an owner of a multi-unit rental complex or by a property owner's association and (2) doors and windows of rental dwellings opening into the pool yard of a multi-tenant rental complex or condominium, cooperative or townhome project.
 - "Pool" includes spa or hot tub over 18 inches deep.

- Affirmative duties to exercise ordinary and reasonable care (1) to inspect (not less than every 31 days) and maintain pool yard enclosures, gates and self closing and self latching devices and (2) to maintain the window latches, sliding door latches, sliding door pin locks and sliding door security bars after request or notice from the tenant that the devices are malfunctioning or in need of repair.
 - Texas Board of Health may impose stricter rules.
- C. Section 2 — Tenant of a multi-unit rental complex, a member of a property owner's association, a governmental entity or any other person may maintain an action against the owner or property owner's association for failing to comply with the requirements of the statute. Remedies include:
- Punitive damages if the owner or owner's association acted intentionally, maliciously or with gross negligence.
 - Judgment for a civil penalty of not more than \$5000 if the owner or owner's association fails to comply with the statute within a reasonable time after written notice by a tenant.
- D. Statute exempts from some of its requirements pool yard enclosures constructed before 1/1/94 which comply with applicable municipal ordinances existing on 1/1/94.

HB 1149 PROPERTY INTEREST TRANSFERRED BY RECEIVER OR CONSERVATOR OF A FAILED DEPOSITORY INSTITUTION (effective 8/30/93)

Adds Section 12.017, Property Code.

- A. If a financial institution is placed in receivership or conservatorship by state or federal agency, a person at any time may record an affidavit or memorandum of a sale, transfer, purchase or acquisition agreement between the receiver or conservator of the failed depository institution and another depository institution.
- B. If the sale, transfer, purchase or acquisition agreement transfers or sells an interest in land or in a mortgage or other lien vested according to the property records in the failed depository institution, a recorded affidavit or memorandum under this section is constructive notice of the transfer or sale.
- C. Failure of the affidavit or memorandum to be executed by the record owner or failure of the affidavit, memorandum or agreement to contain the language of conveyance does not create a defect in title to the land or the lien.

HB 273 TEXAS REVISED PARTNERSHIP ACT (effective 1/1/94)

Enacts new partnership act to eventually replace Texas Uniform Partnership Act.

- A. Generally, follows structure of 1992 version of Uniform Partnership Act.
- B. Some substantive differences between Texas Act and 1992 Uniform Partnership Act, including:

- Withdrawal of a partner does not require winding up the partnership; instead, the interest of the withdrawing partner must be redeemed at fair value unless a majority in interest of the remaining partners elect to wind up.
 - Creditors of the partnership must exhaust partnership assets before collecting from individual partners who have joint and several liability for partnership debts.
 - Partners' duties are defined as "loyalty and care."
- C. New Act applies to all partnerships after December 31, 1998, to partnerships formed on or after the effective date of the Act and to pre-existing partnerships that elect to adopt the Act.

HB 1239 REVISIONS TO TEXAS LIMITED LIABILITY COMPANY ACT, TEXAS BUSINESS CORPORATION ACT AND ASSUMED BUSINESS OR PROFESSIONAL NAME ACT

Amends named acts.

- A. General purposes of amendments include:
- Increase flexibility of Business Corporation Act.
 - Refine provisions governing formation and operation of limited liability companies.
 - Reduce inadvertent inclusion of provisions that would keep limited liability companies from being taxed like partnerships.
- B. Specific amendments include:
- Elimination of requirement for annual meetings of shareholders of mutual funds.
 - Clarification that corporate entity is to be disregarded in contract cases only in the event of actual fraud.
 - Refinement of merger provisions.
 - Professional limited liability companies permitted for architects, attorneys, doctors, accountants and certain other professionals.

HB 156 UNIFORM CONDOMINIUM ACT (effective 1/1/94)

Adds Chapter 82, Title 7, Property Code.

- A. Enacts the Uniform Condominium Act, with certain modifications. Generally, governs every condominium for which a declaration is recorded on or after January 1, 1994.
- B. Certain provisions of the Act will apply to all condominiums in Texas. Examples: minimum insurance requirements; 90-day redemption period after a foreclosure at which a condominium association purchases a unit. Otherwise, condominiums existing before January 1, 1994 continue to be subject to the current condominium statute unless an election is made by the condominium association to be governed by the new Act.

SB 314 BROKER'S ABILITY TO REPRESENT MORE THAN ONE PARTY

Amends Section 15C, Article 6573a, Vernon's Texas Civil Statutes.

- A. Real estate broker may not act as agent for more than one party to a transaction unless broker provides the parties with the applicable agency form promulgated by the Real Estate Commission and enters into written agreements in which all parties to the transaction authorize broker to represent more than one party. Written agreement must set forth the source of any expected compensation to the broker.
- B. Broker representing both sides has the following duties:
- Broker shall not disclose to the buyer or tenant that the seller or landlord will accept a price less than the asking price unless otherwise instructed in writing.
 - Broker shall not disclose to the seller or landlord that the buyer or tenant will pay a greater price than that offered unless otherwise instructed in writing.
 - Broker shall not disclose any confidential information unless otherwise instructed in writing or required to under applicable law.
 - Broker shall treat all parties to the transaction honestly and impartially.
- C. Written agreement authorizing broker to represent more than one party sufficient to establish the signing party's consent if agreement sets forth in conspicuous bold or underlined print the broker's obligations in B above.

HB 1081 SELLER'S DUTY TO DISCLOSE CONDITION OF HOME TO PURCHASER (effective 1/1/94)

Adds Section 5.008, Subchapter A, Property Code.

- A. Seller of residential real property comprising not more than one dwelling unit must give to purchaser a prescribed form of notice disclosing the condition of specified items, including:
- Various appliances, fixtures and amenities.
 - Structure of the house and various systems within the house.
 - Checklist as to various problems (such as termites, toxic waste, asbestos, radon gas, flood plain, unplatted easements, etc.).
 - Homeowners' assessments.
 - Violations of deed restrictions.
- B. Notice is to best of Seller's knowledge, not a warranty of Seller or its agent.
- C. Disclosures do not apply to various stated transfers, including new houses and transfers from a lender who obtained the residence through foreclosure.
- D. Notice to be delivered by seller to purchaser on or before the effective date of the sales contract. If a contract is entered into without seller providing the notice, purchaser may terminate the contract for any reason within 7 days after receiving the notice.

HB 1395 RESIDENTIAL CONSTRUCTION LIABILITY (effective 8/30/93)

Amends Sections 27.001(2) and (3), Property Code.

- A. Limits placed on contractor liability on residential construction as follows:
- Definition of "structural failure" as actual physical damage to load bearing portion of residence caused by failure of load-bearing portion.
 - Clarification that "goods" do not include a residence and "personal injury" does not include mental anguish.
 - Additional circumstance for which the contractor will *not* be liable for damages — the contractor's reliance on written information relating to the property that was obtained from official government records, if the contractor did not know and could not reasonably have known of the falsity or inaccuracy of the information.
- B. Limits damages recoverable under the statute for a construction defect.
- C. Adds a "reasonable" requirement with respect to the offer and the attempted repairs made in connection with a settlement, the failure to do either of which removes the limitations on damages and defenses provided for in the statute.
- D. Adds a provision requiring that a claimant must prove causation.

HB 113 INSURANCE PAYMENT HELD BY LENDER

Adds Article 21.48B, Subchapter E, Chapter 21, Insurance Code.

- A. In situations where a claim under an insurance policy for damage to a one-to-four family residential real property is paid to the insured and a lender holding a security interest in the property and the lender holds all or part of the insurance claim payment pending completion of all or part of the repairs:
- Lender must notify the insured within 10 days after the insurance proceeds are received of the requirements that must be met before the lender releases the insurance proceeds.
 - Within 10 days after the insured requests payment of the insurance proceeds, lender must either pay the proceeds if lender's requirements are met or notify the insured, in specific detail, of the reasons the request is rejected and what remaining requirements must be satisfied before the insurance proceeds will be released.
 - If lender fails to comply with the notice or payment procedures, lender must pay to the insured interest on the insurance proceeds held at the rate of 10% per annum.
- B. No interest is due on insurance proceeds applied to the secured debt in accordance with the governing loan documents.
- C. Applies only to insurance claim payments paid on or after January 1, 1994.

**SB 1243 ADDITIONAL FUNDING OF PETROLEUM STORAGE
TANK REMEDIATION FUND**

Amends Section 403.092, Government Code; amends Section 26.3573, Water Code; adds Section 26.35735, Water Code.

- A. Permits transfer of up to \$120 million from general revenue fund to petroleum storage tank remediation fund on 9/1/93 (or as soon as practical thereafter) to be used in 1994 and 1995 to pay reimbursement claims and administrative expenses of the fund. General revenue fund will be repaid with fees collected under Water Code 26.3574.
- B. Water Code amended to:
 - Increase amount which may be spent on fund's administrative expenses from 3% of fund's gross receipts to 5%, with the additional 2% being allocated to expense of conducting claims audits, reimbursing eligible owners and operators, and disposing of contaminated soils.
 - Permit Water Commission to establish priorities for payments and to suspend payments.
 - Prohibit payment of interest on any claim.
 - Require Water Commission to annually audit payment claims (random sampling is permitted).

**HB 1429 PROMPT PAYMENT TO CONTRACTORS AND
SUBCONTRACTORS**

Adds Chapter 28, Property Code.

- A. Owner must pay contractor within 45 days after receipt of written request for payment from contractor or within 5 days after owner receives loan proceeds with which to make such payment.
- B. In written contract to construct single family residence, owner and contractor may extend 45 day period to 60 days.
- C. Amounts paid after due date bear interest at 18% per annum.
- D. Contractor who receives payment from owner must pay its subcontractors (subject to good faith dispute provisions under the statute) no later than 7 days after the contractor receives payment.
- E. Subcontractor who receives payment from contractor must pay each of its subcontractors (such to good faith dispute provisions under the statute) no later than 7 days after subcontractor receives contractor's payment.

SB 540 ELIMINATION OF ARCHITECTURAL BARRIERS

Amends Article 9102, Vernon's Texas Civil Statutes.

- A. Permits Commissioner of Licensing and Regulation to modify or waive standards due to impracticability, subject to proof requirements.

- B. Requirements for submission of plans and specifications for construction or renovation applicable only where the estimated construction costs are \$50,000 or more. Inspection requirement for such construction or renovation not later than the first anniversary date of completion of such construction or renovation.

SB 176 DURABLE POWER OF ATTORNEY ACT

Repeals Section 36A, Probate Code; adds Chapter XII, Probate Code.

- A. Establishes new requirements for a durable power of attorney. To be durable, a power of attorney must be acknowledged and state that it is not affected by subsequent disability or incapacity of the principal or that it becomes effective on the disability or incapacity of the principal.
- B. Under repealed Section 36A, power of attorney had to be signed by two witnesses and publicly recorded to be durable.
- C. Recordation requirement *still applies* for real property transactions requiring execution and delivery of a recorded instrument.
- D. Statutory form of durable power of attorney provided.

HB 2644 REGULATION OF REAL ESTATE APPRAISERS

Amends Article 6573a.2, Vernon's Texas Civil Statutes.

- A. Expands powers and duties of Texas Appraiser Licensing and Certification Board and describes procedures for initiation, review and investigation of complaints against appraisers.
- B. Includes a reciprocity provision.
- C. Permits opinions by real estate brokers or salesmen licensed under the Real Estate License Act as to the recommended listing price for real estate, if such opinion is not referred to as an appraisal.
- D. Expands definition of statutory "offenses" to a knowing or intentional furnishing of false information in connection with an affidavit filed under the statute.

HB 452 FORFEITURE NOTICE REGARDING CONTRACT FOR DEED

Amends Section 5.062, Property Code.

- A. Imposes additional notice requirements on a seller attempting to enforce a forfeiture of interest and the acceleration of the indebtedness under a contract for deed. The notice to the purchaser must now include an itemization of the exact delinquent amount, a statement of any additional charges claimed and the period to which the delinquency and additional charges relate.
- B. Affidavit of a person knowledgeable of the fact that notice was given enables a bona fide subsequent purchaser for value to take title free and clear of the contract.

HB 1565 CASH PAYMENT FOR RENTAL OF RESIDENTIAL PROPERTY

Adds Section 92.010, Property Code.

- A. Landlord must accept a tenant's cash rental payment unless the lease requires otherwise, and landlord must provide a receipt and maintain a record book.
- B. Tenant may file suit to enjoin a landlord from violation of this section, and if he prevails may recover court costs and attorney's fees, as well as the greater of one month's rent or \$500 for each violation.

**HB 1144 TITLE INSURANCE COMPANY AFFIDAVITS —
RELEASE OF LIENS ON RESIDENTIAL PROPERTY**
(effective 8/30/93)

Adds Section 12.017, Property Code.

- A. Applies only to mortgage on property consisting exclusively of one to four family residence including a residential unit in a condominium regime.
- B. Title company authorized to execute and file affidavit of payment to a mortgagee.
 - Affidavit may not be filed until 60 days have elapsed since the date payment was received by the mortgagee.
 - Affidavit may not be filed until title company has given the mortgagee at least 15 days notice in writing of its intention to execute and record the affidavit and the mortgagee has failed to respond to that notification.
 - Evidence of mortgagee's receipt of payment must be attached to affidavit.
- C. Affidavit executed and recorded in accordance with the statute releases the mortgage.

HB 1143 RECOVERY OF REAL PROPERTY CONVEYED BY AN INSTRUMENT WITH TECHNICAL DEFECTS

Amends Section 16.033(a), Civil Practice and Remedies Code.

- A. A person with a right of action for the recovery of real property conveyed by an instrument with one of the stated defects must bring suit not later than 4 (instead of the former 10) years after the date the instrument was recorded.
- B. Stated defects comprised primarily of specified failures in signatures, acknowledgments and evidence of authority.

SB 355 RIGHT OF REDEMPTION OF REAL PROPERTY SOLD AT A TAX SALE (effective 1/1/94, subject to voter approval)

Amends Section 34.21, Tax Code.

- A. Continues the 2-year redemption period after a tax sale only for an owner of a residence homestead or agricultural property.

- B. The owner of any other type of real property sold at a tax sale may redeem the property within 6 months after the date on which the purchaser's deed is filed.

HB 1300 CLARIFYING CHANGES TO PROPERTY CODE

Amends various Sections, Property Code.

- A. Confirmation that Property Code, Section 51.002(d), only applies to residential debtors; thus, only residential debtors need be given 20 days' opportunity to cure default before the 21-day notice of foreclosure sale is given.
- B. Entire calendar day on which the 20-day notice to cure is given is included in computing the 20-day cure period. Entire calendar day on which the notice of foreclosure sale is given is excluded from the 20-day cure period.
- C. Entire calendar day on which the 21-day notice of foreclosure sale is given is included in computing the 21-day notice of foreclosure sale period. Entire calendar day of the foreclosure sale is excluded from the 21-day period.

HB 1876 CANCELLATION OF JUDGMENT AND JUDGMENT LIENS AFTER BANKRUPTCY DISCHARGE

Adds Sections 52.041, 52.042, 52.043, Property Code.

- A. Judgment is discharged and any abstract of judgment or judgment lien is released without further action in any court if (1) the lien is against real property owned by the debtor before a petition was filed under federal bankruptcy law and (2) the debt or obligation evidenced by the judgment is discharged in the bankruptcy.
- B. Judgment liens for debts or obligations not discharged in bankruptcy or against property not exempted in bankruptcy and abandoned during bankruptcy are not affected.

HB 496 PLATTING REQUIREMENTS

Amends Section 212.004(a) and (c), Local Government Code.

- A. Requires owner of land to prepare and file subdivision plat if lots are either combined or divided or to lay out streets, alleys, etc. Prior statute required filing of subdivision plat where lots were divided to lay out streets, alleys, etc. Excepted from amended provisions are divisions of land into 5 acres or more, provided each division has access and no public improvements are being dedicated.
- B. Finally, regarding variances requested by replat, 3/4ths of the members of the planning commission (or other governing body) that are present at the meeting must approve the requested variance. Prior statute provided for 3/4ths of the members of the planning commission (or other governing body).

