



STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

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October 9, 1981 No. 81-24

Mr. Jewett E. Huff
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Dear Mr. Huff:

This is to acknowledge receipt of your letter dated June 16, 1981 concerning whether two similar types of credit agreements should now be classified as "open-end accounts" as that term is defined by Art. 1.01(f), Article 5069, V.T.C.S. Since your letter describes these agreements in clear detail, I have decided to herein quote the two descriptions as well as one other paragraph of your letter. These three paragraphs of your letter are as follows:

- "(1) Does the term 'open-end account' apply to special contracts for credit evidenced by an 'advancing' promissory note? An 'advancing' note is one for credit not to exceed a specified face amount, to be advanced in whole or in increments upon request of the borrower at times (which may be specified or unspecified in the note) on or after the date of execution thereof but prior to maturity, with interest being borne only on the balance outstanding from time to time, but containing a single fixed maturity date for full repayment of all principal and interest remaining unpaid at maturity. A typical example of such a contract would be an interim construction note for a stated principal amount, whereunder advances are to be made in increments (but not to exceed in the aggregate the face amount of the note) at times to be determined in the future (often, but not always, determinable with reference to the progress of the construction), but providing that such advances as are made shall in any event be repaid in full, with interest, at some specified maturity date, and customarily containing the privilege of prepayment without penalty.
- "(2) Does the term 'open-end account' apply to all special contracts for credit evidenced by a 'readvancing' note? Such a note, like the 'advancing' note, provides for a stated principal

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amount, to be advanced in whole or in increments at the request of the borrower from time to time prior to the stated maturity date, upon which date all outstanding principal, with interest, is to be repaid in full; but providing not only the privilege of prepayment in whole or in part without penalty, but also providing a 'revolving' feature which is its principal distinction from the 'advancing' note. This revolving feature permits the borrower, after having borrowed the full face amount of the note and prepaid all or some portion thereof, to request a readvancement of funds prior to maturity, so long as the aggregate amount outstanding at any one time does not exceed the face amount of the note. A typical example of such a contract would be a short-term note (frequently with a maturity date of 6 months, and seldom if ever more than one year) for the financing of a merchant's inventory, which provides for future advances (often, but not always, limited to some stated percentage of his invoice price of inventory being purchased), with the unpaid balance of such advances being at all times limited to the face amount of the note.

"In both instances (either the advancing or readvancing note), even though prepayments are permitted at any time without penalty, the agreement typically calls for only one required payment, that being of the entire balance outstanding at the fixed maturity date. Seldom, if ever, is there any obligation on the borrower's part to make any scheduled payments of principal at all prior to such maturity date; certainly such notes do not involve any repayment scheme of an installment nature, nor any 'minimum periodic payment' such as those required in conventional open-end accounts. In the typical case, therefore, any principal payments made prior to maturity are therefore made by the borrower on a purely voluntary basis in order to reduce his interest expense at a time when funds are not needed. In those few cases where interim principal payments are required, they are almost invariably conditioned upon the occurrence of events more or less completely within the borrower's control or upon some deficiency in the collateral security. For example, in an inventory loan secured by a security interest in the inventory items purchased with the proceeds of the loan, the security agreement might require the borrower to apply the proceeds of any sale of that item to the indebtedness, and (in the case of the readvancing note) frequently conditions his right to a future readvance of those same funds upon the purchase of replacement items of inventory."

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I apologize for the delay in responding to your inquiry but the construction and application of Art. 1.01(f) is one of the most difficult problems with which this Office has been presented since the enactment of H.B. 1228. In formulating our position on this question, as we do with all others, we have placed emphasis upon representations made to the Legislature as to the effect of the Bill, legislative debate, and what we perceive to have been legislative intent in enactment of H.B. 1228, as well as the language of the Article in question. Article 1.01(f) is as follows:

"'Open-end Account' means any account, under a written contract under which the creditor may permit the obligor to make purchases or borrow money from time to time, and under which interest or time price differential may from time to time be computed on an outstanding unpaid balance. The term includes, but is not limited to, accounts under agreements described by Section (4), Article 3.15; Section (4), Article 4.01; and Chapters 6 and 15 of this Title."

As is obvious to any reader, this language is very broad and susceptible of various interpretations, most of which if not all having some measure of validity. However, much of the language of Art. 1.01(f) was apparently copied from the definition of "open-end credit" in Regulation Z in effect at the time H.B. 1228 was drafted and considered by the Legislature. We have decided that our basic approach to what is and is not an "open-end account" within the meaning of Art. 1.01(f), as to the elements which the state and Regulation Z definition have in common, will be to conform with what is and is not "open-end credit" as set out in old Regulation Z, the new Simplified Regulation Z, and the interpretations and commentary promulgated by the Federal Reserve Board. We are aware of the fact that Regulation Z is not applicable to business and commercial transactions, while Art. 1.01(f) applies to all types of credit. Also, the Texas definition is applicable to those accounts in which the creditor permits the debtor to make purchases or borrow money from time to time while Regulation Z indicates that the creditor should reasonably contemplate repeated transactions. The latter test could result in fact question determinations from time to time which I do not feel would be necessary under the Texas definition, since it would be applicable if the agreement permits future credit extensions. Also, I do not feel that the Texas definition requires that the creditor have the right of deferred payment, such as is usually the case with farm supply stores which sell to their customers on "open accounts," the entire balance being due on a day certain during the month following the purchase. Such an account would be an "open-end account" as defined in Art. 1.01(f). We feel, however, that an attempt to adopt the basic tenets of Regulation Z as to elements common with those of the Texas definition will provide for a consistent viewpoint by both state and federal regulatory agencies and will conform with the intent of the 67th Legislature in enacting H.B. 1228.

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Article 1.01(f) itself provides some assistance in determining what is an "open-end account" when it makes references to Articles 3.15(4), 4.01(4), 6.01 and 15.02. Articles 3.15(4) and 4.01(4) provide for an open-end line of credit arrangement with a bank, savings and loan, or licensed lender. These provisions in the past were primarily used for bank credit card operations but have been used somewhat less in recent years since the passage of Chapter 15 in 1979. The reference to Art. 6.01 would include in the "open-end account" definition the retail charge agreements and revolving charge agreements as defined in Art. 6.01(g) and (p) and more fully discussed in Art. 6.03. The reference to Chapter 15 includes typical bank-type credit card plans and other lines of credit arrangements under Chapter 15. All of these various types of plans which are set out in Art. 1.01(f) are not identical in all respects, but they have in common at least two very important characteristics: (1) they all "revolve" and (2) the parties never know at the outset the total number of advances (charges) or total amount of credit which will be extended during their existence.

Article 1.01(f) specifically provides that "open-end accounts" are not limited to those authorized by the Articles mentioned therein, and I think their inclusion in 1.01(f) indicates the general type of credit arrangement contemplated by the Legislature to be covered by that definition.

It is probably not possible (at least for this writer) to clearly delineate certain characteristics which may be applied to all possible fact situations and easily determine whether a particular agreement is an "open-end account." However, certain characteristics are, we feel, important.

First, and most simply, it must be evidenced by a written agreement.

Secondly, the creditor permits the obligor to make purchases or borrow money from time to time. This is virtually identical to the Regulation Z approach.

Thirdly, the interest or time price differential charge may from time to time be computed on an outstanding unpaid balance.

And the parties generally do not know the total amount of credit which will be extended pursuant to the agreement nor do they usually know when or in precise amounts what the various loans or purchases will be.

Our position is, therefore, that the type of transaction you describe as an "advancing" promissory note would not be considered an "open-end account" as defined by Art. 1.01(f). In such an arrangement, in our opinion, there is really only one loan made although it may be advanced in increments over a period of time. The obligor does not borrow money from time to time as contemplated by Art. 1.01(f). This result conforms with that taken by the Federal Reserve Board. It would also result in

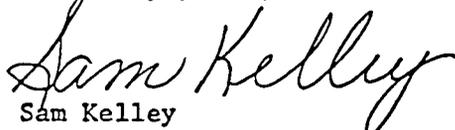
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the typical interim construction loan not being considered an "open-end account."

We are, however, of the opinion that the credit extension you described as a "readvancing note" would fall within the Art. 1.01(f) definition of "open-end account." When the parties enter into such an agreement, the creditor places a limit on the amount of credit to be outstanding at one time (such as in a bank credit card), but neither party knows the total amount(s) of loans which will be made over the term of the agreement. There may be many separate loans made pursuant to a "readvancing note" agreement and even though the credit limit might be \$1,000,000 at any one time, because of the revolving nature of the agreement, there might be any number of separate loans made resulting in a total credit extension of \$2,000,000, which sum is unknown to either of the parties at the inception of the agreement. We are of the opinion, therefore, that the type of transaction you describe as a "readvancing note" would fall within the Art. 1.01(f) definition of "open-end account." I believe that this approach also would be consistent with Regulation Z.

As a general approach, we believe that when the central and primary purpose of an agreement is that future and probably undetermined transactions can be permitted under the contract and added to the balance owing on the contract, and the other elements previously mentioned are present, an "open-end account" exists. Articles 1.04(h)(1) and 1.04(h)(2) provide for ceilings that can change from time to time on open accounts. These sections are in recognition of the fact that the date an "open-end account" is signed will not necessarily reflect the cost of new credit transactions made pursuant to the agreement in subsequent months or years.

Sincerely yours,



Sam Kelley
Consumer Credit Commissioner