STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

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February 17, 1982 No. 82-7

Mr. Spencer K. Crouch
Russell, Tate & Gowan
Suite 1020, Hamilton Bldg.
Wichita Falls, Texas 76301

Dear Mr. Crouch:

This is to acknowledge receipt of your letter dated January 7, 1982. You ask that we state the position of this Office as to what would be the lawful interest rate ceiling applicable to a type of contract entered into prior to May 8, 1981, the effective date of H.B. 1228, now codified in large part in Art. 1.04, Article 5069 V.T.C.S. I will quote from your letter as follows:

> "In regard to your Interpretation Letter No. 81-30 concerning a variable rate transaction with a 'floating rate' of two points above prime when such transaction was agreed to in 1977, please advise me if you take the same position with respect to such a transaction if the note provides that the floating rate shall not exceed the maximum interest rate allowed by 'applicable law' and the note expressly defines 'applicable law' as follows:
>
> > "'The term 'applicable law' shall mean such laws of the State of Texas or the laws of the United States, whichever laws allow the greater rate of interest, as such laws now exist or may be changed or amended in the future.'"

I have been unable to locate any Texas court decisions dealing with your question. I have, however, borrowed heavily upon two articles which appear in American Law Reports Annotated at 4 ALR2d 932 and 60 ALR3d 472 and the cases cited therein. The three relevant cases mentioned in those articles are Mucklar v. Cross (1868) 32 NJL 423, Wyckoff v. Wyckoff (1888) 44 NJ Eq. 56, 13A 662, and Campbell v. Gawart (1973) 208 NW2d 607 (Michigan Ct. of Appeals). (I have not read the Mucklar case, since I do not have access to it, and am relying on the discussion of it in the Wyckoff case and the ALR articles as to its holding.) In the Mucklar case, the parties agreed to a rate of interest at such rate as was or should thereafter be fixed by the Legislature as the legal rate. The Legislature subsequently increased the legal rate. The court held that the rate provision of the agreement

was valid and that the interest charged on the agreement in question could be increased. Then in the Wyckoff case some twenty years later the court considered an interest provision in certain bonds which provided for payment of "lawful interest thereon," which was 7% per annum on the effective date of the provision. The Legislature subsequently reduced the lawful interest rate from 7% to 6% per annum. The court held that the rate of interest on the bonds was not affected by the legislative change and that the amount properly payable on the bonds remained at 7%. However, the court mentioned the Mucklar case and made the observation that parties may enter contracts by which the rate of interest to be paid shall change whenever the legal rate changes. There was no such contractual provision in the Wyckoff case and therefore it was distinguishable from Mucklar. In the more recent Campbell case the contract in question contained a provision that "The interest rate on this contract shall increase in accordance with the maximum legal rate in the State of Michigan in the event the usury laws are changed from time to time with a top limit, however, of 8%." At the time of the contract the applicable legal rate and the contracted for rate were both 7% per annum, but shortly thereafter the Legislature removed the limit on the type transaction in question. In the same act which removed the interest limitation the Legislature provided the following: "A provision in any note, mortgage or contract or other evidence of indebtedness, heretofore or hereinafter made, that the rate of interest initially effective may be increased for any reason is unenforceable in any contract in this state."

In the Campbell decision the court first stated that the "escalation" of interest provision was not per se invalid, but the effect to be given it is controlled by the way in which the Legislature changes the law. If the Legislature clearly manifests an intent that only contracts executed after a certain date may bear a higher interest rate, a contractual provision to the contrary is of no force and effect. The court stated that a contract that provides for a rate of interest that would have been usurious at the date of its inception to be paid upon the contingency of the Legislature's raising the maximum interest rate is a contract with reference to future law. What that future law will be is the prerogative of the Legislature. If the Legislature changes the law in a way that is wholly prospective, the old maximum rate applies and this is not an impairment of contract. The parties contracted for a higher rate of interest if the Legislature saw fit to allow it. In Campbell the court determined that the Legislature intended to prohibit the escalation of interest provision in question from taking effect and in fact invalidated such agreements which were contingent upon a future occurrence. In Campbell the interest rate on the contract had to remain at 7% per annum.

Therefore, as far as I have been able to determine, the old Mucklar case (1868) is the only court decision which specifically gave effect to an escalation clause similar to the one about which you inquire. (If there is any more recent authority, I would of course appreciate being so advised.) The Wyckoff and Campbell cases comment that such clauses are not per se invalid, and it seems to me that at least in Campbell the court would have given effect to the escalation clause had it not been for the specific legislative expression prohibiting interest rate increases on existing contracts. I find no similar expression of intent by the Texas Legislature in H.B. 1228.

It is the position of this Office that where the parties to a contract such as you have described have expressly agreed that the interest rate may not exceed the legal maximums as they existed at the time of the making of the contract or as they might be changed or amended in the future that effect should be given to this provision. A pre-H.B. 1228 (May 8, 1981) contract which contained such a provision would, in our opinion, be subject to the new maximum interest ceilings as provided for by the new law and the ceilings applicable to that type of contract would have in effect been increased by the Legislature.

Sincerely yours,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner