STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

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October 15, 1985   85-12

Mr. Hennon Gilbert, Sr.
Gilcom Corporation
10715 Gulfdale
San Antonio, Texas 78216

Dear Mr. Gilbert:

This is to acknowledge receipt of your recent letter in which you pose several questions and request that this office set out our position on the issues you raise in light of the recent Texas Supreme Court decision of Yates Ford, Inc. and Ford Motor Credit Company vs. Ramirez, Resendez, Vela, Hinojosa and Laso, 692 SW2d 51 (Tex. 1985). There were originally five plaintiffs in five separate lawsuits but since all cases involved the same questions of law the Texas Supreme Court wrote only one opinion which resolved all issues as to all five cases. The decision will hereinafter be referred to as the Ramirez decision.

This writer filed amicus curia briefs in both the Court of Appeals and the Supreme Court on one of these issues involved in Ramirez, i.e., the proper method(s) of determining the number of "odd days" in an irregular first payment contract made pursuant to Article 5069 - Chapter 7, V.T.C.S. The Supreme Court agreed with the previously taken position of this office that the number of "odd days" could be determined by either what has been referred to as the Texas "statutory" method or by the method prescribed by Regulation Z, 12 CFR 3226.

The questions presented by your letter, although not identical, all depend upon whether, after the number of "odd days", if any, has been determined in a credit contract, the total dollars in time price differential or interest for the contract may only be determined by utilization of the method prescribed as appropriate in Ramirez, or may the maximum lawful amount of dollars of interest or time price differential be determined differently than as described in the decision.

First, a brief examination of the court's holding in Ramirez is appropriate. Reference will be made to only one contract since all five were treated the same by the Supreme Court for the purpose of computation of total dollars in allowable time price differential charge on the contracts.

On March 10, 1979, Samuel Ramirez bought a 1979 Ford and executed a retail installment contract in the amount of $7,048.42 on which a time price differential of $1,868.18 was charged. The contract was subject to Article 5069 - Chapter 7, V.T.C.S. The first payment on the contract was due on April 16, 1979, therefore this contract had an "irregular" first payment period, i.e., the first payment due date was not exactly one month from the date of the contract. In the case of this contract there were 6 "odd days" no matter whether the statutory method or the Regulation Z method of counting days was utilized.

At the time of the Ramirez contract Chapter 7 provided only for an add-on type of time price differential charge in Article 7.03. Other methods of charges computation were authorized as of May 8, 1981 by House Bill 1228 of the 67th Texas Legislature (See Article 7.03(7) and Article 1.04(n)(4)).

Article 7.03(4) now and at the time of the Ramirez contract provides for the method of computation of the maximum allowable charges on an irregular repayment contract. That provision is as follows:

> "If a retail installment contract is payable other than in substantially equal successive monthly installments, as where payable in irregular or unequal installments either in amount or periods thereof, or in equal successive monthly installments followed by or interspersed with an irregular, unequal or larger installment or installments, or in other than monthly installments or if the first installment is not payable one month from the date of the contract, the charge may not exceed an amount which, having due regard for the schedule of installment payments, will provide the same effective return as if the contract were payable in substantially equal successive monthly installments beginning one month from the date of the contract."

In applying this provision to the Ramirez contract the Supreme Court first noted that the phrase "same effective return" means the "annual percentage rate" and that the charge for the "odd days" cannot exceed the amount provided by application of the annual percentage rate of the contract. That view has been and still is the position of this office. The court then set out "the formula" for determination of the number of dollars which could be charged in time price differential for the 6 "odd days." In doing so the majority opinion of the Supreme Court stated that it was using the formula applied by the court of appeals. That formula and the resulting calculations of the "odd days" time price differential charge assumes that the entire amount of the "odd days" charge will be paid at the time the first installment of the contract is paid. The formula described by the Supreme Court comports with the long standing position of this office if it is assumed that the schedule of payments is as described above, i.e., the "odd days" charge is paid on the first scheduled installment date.

However, Article 7.02(4) also requires that due regard be given to the schedule of payments when determining the allowable charge on the transaction. The Supreme Court recognized that the phrase "same effective return" as used in that article means that the dollar charge for the "odd days" cannot exceed that produced by the annual percentage rate of the contract. Two contracts to which the same annual percentage rate is applicable may have very different maximum amounts of allowable dollar charges if the schedules of payments differ markedly. This difference in total amount of allowable dollar charges comes about because of the application of the principle of "time value of money" which this office believes to be the appropriate method of determining allowable charges for the use, forebearance or detention of money. If a certain amount of credit is extended for a certain period of time at a certain rate of interest or time price differential, the total dollar amount of allowable charges will differ if in one contract the obligation is repayable in substantially equal consecutive monthly payments and in another instance the obligation is repayable in smaller consecutive monthly payments with the last payment being a much larger "balloon."

For example, without going into detailed calculation, assume two different contracts which both have the same amount financed of $8,466.03 at the same 13.56% rate of charge and both of which are repayable in 42 payments and both of which have an irregular first payment period of one month plus 14 days. One contract is to be repaid in 42 substantially equal consecutive monthly installments of $255.61 each while the other is to be repaid in 41 consecutive monthly installments of $200 each with one final "balloon" payment of $3,168.14. The application of the "time value of money" principle to each contract results in a larger allowable dollar charge for credit on the "balloon" payment contract because the debtor had use of more of the creditor's money for a longer period of time. In the first contract, application of the rate of charge to the amount financed having due regard for the schedule of payments results in a total allowable charge of $2,269.59. In the second, giving due regard to the schedule of payments including the balloon, the total allowable charges would be $2,902.11, which is $632.52 more than in the substantially equal consecutive monthly repayment contract.

It is felt that the position of this office is in conformity with the holding in Talbert v. First National Bank in Center. 664 SW2d 126, (Tex. App. - Tyler, 1984, ref.n.r.e.). There the court was called upon to construe the provisions of Article 5069 - 4.01(3), which is virtually identical to Article 7.03(4), the applicable provision in the Ramirez case. In the Talbert case, on page 131, the court stated:

> "It stands to reason that the amount of the finance charge would be greater on a loan with the balloon payment because the borrower had the use of more of the lender's money for a longer period of time than if the borrower had repaid the loan using equal monthly installments. Therefore, it is reasonable that the borrower should pay a greater finance charge because of the greater use of the lender's money for a longer period.

It is our view that the calculations set out by the Supreme Court in the Ramirez and related cases were based on a formula which assumes that the charge for "odd days" time price differential would be repaid on the first payment date, and we do not read the decision as precluding different calculations which reflect due regard for different types of repayment schedules. In fact, at one point the court recognizes the complexity of the matter when the majority noted that competent mathematicians might disagree as to the proper method of calculations.

This office certainly has no authority to disagree with or to take a position contra to a decision of the Supreme Court of Texas and there is no intent in this letter to do so. We do believe, however, that the Ramirez decision should be read to apply to fact situations when a formula is utilized which assumes that the "odd days" charge will be repaid at the time of the first scheduled installment. We do not believe the court intended to hold that different repayment schedules of credit transactions can have no effect on the total amount of lawful dollar charges for time price differential or interest. We are of the opinion that the Talbert decision correctly states the law on this issue.

It is still the position of this office that the "time value of money" principle should be utilized in connection with simple interest rates as well as in those instances such as in the Ramirez case when there is a need for conversion of an add-on rate to an annual percentage rate.

Sincerely,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner