



STATE OF TEXAS

# OFFICE OF CONSUMER CREDIT COMMISSIONER

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RQ-92-5

Mr. Harvey R. Hardwick  
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and

Mr. Sam Kelley  
815 Brazos, Suite 702  
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Dear Messrs. Hardwick and Kelley:

Re: Request of Interpretations of Chapter 1 and Chapter 6 of Article 5069

Your client intends to purchase home improvement retail installment contracts from builders throughout the State of Texas. The procedure for purchasing such contracts would be as follows:

1. The buyer and home improvement contractor would enter into a contract for labor and materials and trust deed for certain home improvement goods and services. This instrument would create a first or second lien on the buyers' homestead.
2. The buyer and home improvement contractor would simultaneously enter into a retail installment contract whereby the buyer agrees to pay the contractor for the certain home improvements in monthly installments up to a maximum term of 180 months.
3. The first installment payment, however, will normally be set up for 60 days from the date of the retail installment contract. Upon completion, the contractor assigns the retail installment contract and contract for labor and materials and trust deed to your client.
4. Though there is a long first payment period, time price differential will not begin to accrue until the date the contract is purchased by your client, the financial institution. This means that no finance charge is imposed for the construction period. If the construction is delayed, the first payment due date will be extended so that the first payment will be due 60 days from the date the proceeds are advanced.

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5. All retail installment contracts will be insured until Title I of the National Housing Act as implemented under Title 12 U.S.C. §1701 *et seq.* and applicable federal regulations.

6. Prior to entering into the retail installment contract, the contractor will take a credit application from the buyer for the purpose of obtaining credit through your client, the financial institution. The contractor arranges the financing with your client and is totally responsible for completing all documents and closing the transaction.

7. It is assumed that all transactions constitute home solicitation transactions under the Texas Credit Code, Art. 5069-13.01, *et seq.*, and the F.T.C. regulations for door-to-door sales under Title 16, Code of Federal Regulations, Part 429.1.

#### QUESTIONS TO BE ANSWERED

1. Are the transactions described above subject to the provisions of Tex. Rev. Civ. Stat. Ann. art. 5069 - Chapter 6?

This indirect dealer program has raised several important questions for your client. The first question concerns whether the home improvement program outlined above would be properly structured under Chapter 6 of Art. 5069, hereinafter referred to as "Chapter 6." It is our opinion that because the contractor/dealer is substantively involved in arranging the credit with your client, the financial institution, these home improvement transactions constitute retail installment transactions subject to Chapter 6. *Espinoza v. Victoria Bank & Trust Co.*, 572 S.W.2d 816 (Tex. Civ. App. - Corpus Christi 1978, writ ref'd n.r.e.); Al Endsley Letter Interpretation No. 86-5 (September 26, 1986).

In *Espinoza* the issue before the court was whether the documents comprising the transaction constituted loan documents subject to Chapter 4 of the Texas Credit Code or a retail installment contract subject to Chapter 7 of the Texas Credit Code. The Espinozas brought suit against Victoria Bank & Trust ("Bank") alleging in part that the contractual documents constituted an installment loan under Chapter 4 of the Credit Code and that such loan was usurious. In the alternative, the Espinozas alleged that the documents constituted a retail installment contract subject to Chapter 7 of the Texas Credit Code and that the documents contained certain disclosure violations.

This suit arose out of the Espinozas' purchase of a used mobile home from Padre Mobile Homes located in Corpus Christi, Texas. The Espinozas visited Padre Mobile Homes' lot and decided to purchase the home. At that time they executed a Purchase Agreement on April 21, 1975, whereby they agreed to buy and Padre Mobile Homes agreed to sell the mobile home in question. The amount financed stated in the Purchase Agreement was \$9,018. The finance charge disclosed in the Purchase Agreement was \$8,114.40 and the annual interest rate disclosed was 14 1/2% per annum. The total amount payable of \$17,132.40 was to be paid by the Espinozas in 120 monthly installments of \$142.77 each. In addition to executing the Purchase Agreement, the Espinozas

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signed two other documents on April 21, 1975. The first document was an Application for Credit to finance their purchase of the mobile home. The second was an Application for Insurance to County Mutual Insurance Company for the insurance premium disclosed in the Purchase Agreement. After signing the Purchase Agreement, the Application for Credit and the Application for Insurance, the Espinozas understood that Padre Mobile Homes would attempt to find a financial institution which was willing to finance their purchase of the mobile home. At that time they did not know that the Bank would ultimately finance their acquisition. Thereafter, the Espinozas were advised that the Bank had agreed to finance their purchase of the mobile home. The Espinozas then executed a document entitled "Security Agreement, Note and Installment Contract." Under its provisions, the Espinozas agreed to pay to the order of the Bank the sum of \$17,132.40 in 120 successive monthly installments of \$142.77 each. Included therein was a finance charge of \$8,114.40. The document provided that the annual percentage rate was 14 1/2% per annum.

The trial court denied the Espinozas relief under the Credit Code and appeal was perfected. The Espinozas argued in part that the Bank made an installment loan and that the interest charged was usurious as a matter of law. The court held that the documents before them constituted a retail installment contract subject to Chapter 7 of the Texas Credit Code and not an installment loan subject to Chapter 4. The legal test used by the court when determining that the transaction was a retail installment transaction is as follows:

... [W]e believe that *Manning*<sup>1</sup> is relevant in that it points the way to what we think is a satisfactory legal test for determining whether or not a transaction should be treated under the Credit Code as an installment loan where the purchaser does not arrange for his own credit. Comporting with the rule that a court should consider the substance of a transaction rather than its mere form, we hold that, regardless of the labels the parties place on a transaction, or the forms that they use, where the dealer is substantively involved in arranging for the buyer's credit through a lending institution, the transaction is not an installment contract but rather a retail installment sales contract. [Emphasis added.]

572 S.W.2d at 823.

The court concluded that based upon the facts before it that the entire transaction amounted to a retail installment sales transaction. The court based this conclusion on the fact that the Espinozas did not initially seek out the Bank to loan them the money with which to buy the mobile home. Instead they sought out the dealer in the mobile homes. The dealer, in turn, obtained financing from the Bank to finance the transaction.

Additionally, we have previously adopted the test set out in *Espinoza* for determining if a transaction constitutes an installment loan or a retail installment transaction. See Letter Interpretation No. 86-5. The procedures and circumstances under which your client intends to purchase retail installment contracts from builders is very similar to the factual situation before the

<sup>1</sup> *Manning v. Princeton Consumer Discount Co. Inc.*, 390 F. Supp. 320 (E.D. Pa. 1975), aff'd 533 F.2d 102 (3rd Cir. 1976).

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court in *Espinoza*. Accordingly, we have concluded that the indirect home improvement program in which your client intends to engage, would be properly structured under Chapter 6 of the Texas Credit Code.

We are aware of an apparent conflicting holding in *Briercroft Service Corp. v. De Los Santos*, 776 S.W.2d 198 (Tex. App. - San Antonio 1988, writ denied). In *Briercroft*, the court held that a home improvement transaction, insured under Title I of the National Housing Act, constituted a loan transaction and not a retail installment transaction subject to Chapter 6. This case arose out of certain home improvements to Mr. and Mrs. De Los Santos' home performed by Alamo Builders & Supply ("Alamo"). During the early part of October of 1983, an agent of Alamo visited De Los Santos at his home to discuss possible construction of home improvements. At such time De Los Santos agreed to the home improvements. Accordingly, a "Contract for Labor and Materials," dated October 3, 1983, was executed between De Los Santos and Alamo. This contract described the home improvements to be performed and De Los Santos agreed to pay Alamo \$13,000 for the construction of the improvements and that the \$13,000 would be evidenced by a Note for such amount to be executed by De Los Santos upon completion of the home improvements. The contract also provided that the principal balance would be payable to the order of Alamo in 120 monthly installments of \$216.34 bearing interest at the rate of 15 1/2% per annum. It should be noted that a partially executed document entitled "Retail Installment Contract" which described the proposed home improvements was a part of the record, however, it was not signed by Alamo or by Mr. De Los Santos, therefore the Court did not consider it further.

Also on October 3, 1983, De Los Santos was provided with "Truth-In-Lending Disclosures" and they also completed and executed a document entitled "Credit Application for Property Improvement Loan." The Credit Application recited that De Los Santos was applying to Briercroft Service Corp. for a loan of \$13,000 to be repaid in 120 months and that Briercroft Service Corp. will provide the funds.

On October 4, 1983, Briercroft Service Corp. advised De Los Santos that it intended to make a loan to them in the sum of \$13,000 to be repaid in monthly installments of \$216.34 with interest thereon at the rate of 15 1/2% per annum. The notice also advised De Los Santos that Briercroft would disburse the amount of the loan to Alamo when a Completion Certificate was completed by De Los Santos and received by Briercroft Service Corp.

The home improvements proceeded and on October 31, 1983, a Completion Certificate was signed. Thereafter, Briercroft Service Corp. disbursed the \$13,000 to Alamo upon receipt of the Completion Certificate and funded a National Housing Act Loan under Title I. Thereafter, a Note dated October 31, 1983, in the principal sum of \$13,000 payable to the order of Alamo was executed by De Los Santos. Thereafter, the Note was negotiated and assigned by Alamo to Briercroft Service Corp. and by it to Briercroft Savings Association.

De Los Santos was not satisfied with the work performed by Alamo and brought suit against Alamo, Briercroft Service Corp., and Briercroft Savings Association. De Los Santos alleged violations of the Federal Trade Regulations (16 C.F.R. §433.2), Texas Deceptive Trade Practices Act and of the Texas Credit Code. Judgment was entered in favor of the De Los Santos and against Alamo,

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Briercroft Service Corp., and Briercroft Savings Association on the D.T.P.A. claims. Only Briercroft Service Corp. and Briercroft Savings Association appealed the judgment. By way of cross-point, De Los Santos asserted that the trial court erred in denying them statutory penalties pursuant to Art. 5069-8.01. De Los Santos contended that it was established as a matter of law that Briercroft Service Corp. and Briercroft Savings Association had violated Chapter 6 of the Texas Credit Code. De Los Santos maintained that the transaction was a "retail installment transaction" subject to Chapter 6 of the Texas Credit Code. The San Antonio court rejected this contention and held that the home improvement transaction constituted a loan transaction not a retail sales transaction subject to Chapter 6 of the Texas Credit Code. The court determined that the documents comprising the transaction did not contain time price differential because Alamo never offered to make the home improvements for a cash price nor did it offer to perform the work for a credit price. The court determined that Alamo and De Los Santos, from the very beginning of the discussion concerning the home improvements understood that the transaction with Alamo was to be financed by the extension of credit in the form of a loan from Briercroft Service Corp. The court stated that there was no intention by Alamo to carry the transaction and charge time price differential to De Los Santos to pay for the home improvements over a period of time. The court concluded that where a retail sale is made possible by a third party (Briercroft Service Corp.) who lends money to the buyer, the sale is accomplished by the making of a loan where interest is charged. Consequently, the documents comprising the transaction could not be subject to Chapter 6 because they did not charge time price differential.

It is our opinion that *Briercroft* can be distinguished from the indirect home improvement program of your client. In *Briercroft*, the document evidencing the obligation to pay was not a retail installment contract but was rather a promissory note. The home improvement program proposed by your client would include a retail installment contract which would evidence the obligation to pay and which would include all of the statutory notices required under Chapter 6. We feel that this key factor distinguishes the holding in *Briercroft* from the holding in *Espinoza*. Chapter 6 of the Credit Code controls the home improvement financing business of your client as described above.

2. Does Tex. Rev. Civ. Stat. Ann. art. 5069-1.09 exempt the transactions described above from the maximum rate limitations of Tex. Rev. Civ. Stat. Ann. art. 5069-6.02(9)(a)?

The second issue raised by your client's home improvement program concerns the applicable rate ceiling. Since the transactions in question are considered home solicitation transactions within the meaning of Chapter 13 of Art. 5069, it would appear that the maximum rate that can be contracted for would be limited to the Chapter 6 add-on rates under Art. 5069-6.02(9)(a) as adjusted by the rate bracket adjustments under Art. 5069-2.08.

It is our position that the add-on rates would not be the applicable rate ceiling because of Art. 5069-1.09. As mentioned above, all retail installment contracts purchased will be insured by the Federal Housing Administration, pursuant to Title I of the National Housing Act. Article 5069-1.09 provides:

Any loan insured by the Federal Housing Administration, . . . its amendments and supplements . . . , may bear such rate of interest, or be discounted at such rate as is permitted under the National Housing Act, its amendments and supplements, and

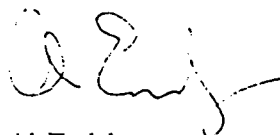
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the regulations promulgated from time to time by the Federal Housing Administration . . . .

A loan insured under the Federal Housing Administration includes any issuance of funds or an advance of credit. *See* 24 C.F.R. 201.2(A). Consequently the term "loan" as used in Art. 1.09 would include credit sales subject to Chapter 6.

Art. 5069-1.09 exempts the home improvement transactions described here in from the rate limitations of Art. 5069-6.02(9)(a). The transactions described herein may bear any rate of finance charge, whether defined as interest or time price differential, as may be permitted under the National Housing Act and regulations of the Federal Housing Administration.

Sincerely,



Al Endsley

AE:jjm

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This interpretation was approved by the Finance Commission of Texas at its meeting on March 30, 1993, pursuant to Article 5069-2.02A(10), Vernon's Texas Civil Statutes.