



January 1998

Banking Law

James W. Doyle

Recommended Citation

James W. Doyle, *Banking Law*, 51 SMU L. REV. 727 (1998)
<https://scholar.smu.edu/smulr/vol51/iss4/4>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

BANKING LAW

*James W. Doyle**

TABLE OF CONTENTS

I. INTRODUCTION	727
II. TEXAS LEGISLATIVE CHANGES.....	727
A. PROPOSITION 8—HOME EQUITY LENDING	727
B. HOUSE BILL 1971—USURY REFORM.....	735
C. HOUSE BILL 10—THE FINANCE CODE	742
D. SENATE BILL 652—LOANS SECURED BY CERTIFICATE OF DEPOSIT.....	743
E. HOUSE BILL 881—PRIORITY OF PAYMENTS AGAINST DECEDENTS	744
III. FEDERAL REGULATORY CHANGES	744
A. FASB RULE 125.....	744
IV. CASE LAW	745
A. ALLONGE.....	745
B. ARBITRATION	747
C. COUNTING DAYS	750
D. IRAS AS EXEMPT PROPERTY	750
E. INSURANCE	751

I. INTRODUCTION

As with past Surveys, this Article is designed to give the banking law practitioner insight into the wide variety of statutory, regulatory and case law changes which will affect his practice. Because the average banking practitioner has a practice which encompasses real estate, creditors' rights, and consumer issues, some overlap between this Article and other articles in this Annual Survey of Texas Law is inevitable.

II. TEXAS LEGISLATIVE CHANGES

A. PROPOSITION 8—HOME EQUITY LENDING

The 75th Texas Legislature created a variety of legislative changes which will affect this practice area. The most salient among them was

* The author is a shareholder in the Houston Office of Winstead, Sechrest & Minick P.C. His practice focuses on banking law. The author wishes to gratefully acknowledge his appreciation to his fellow firm members, Mike O'Neal, Paul Downey, and Robert Wood for their assistance on, respectively, home equity lending, usury, and insurance.

House Joint Resolution 31,¹ the bill that authorized home equity lending in Texas. That resolution proposed an amendment (the Amendment) to article XVI, section 50(a)(6) of the Texas Constitution. It was subject to a voters referendum on November 4, 1997, and passed. Effective January 1, 1998, the Amendment adds to the Texas Constitution article XVI, section 50(a)(6). The Amendment permits home equity loans subject to the following:

- *Voluntary Liens.* The home equity loan must be secured by a voluntary lien with the consent of each owner and each owner's spouse.
- *Purpose.* A home equity loan may be for any purpose.
- *Loan to Value Cap.* The amount of the loan plus the total outstanding principal balance of all other indebtedness secured by the homestead cannot exceed eighty percent of the homestead's fair market value.
- *Nonrecourse Loans.* No personal liability against any owner or the owner's spouse is permitted (unless the owner or spouse obtains the loan by fraud).
- *Judicial Foreclosure.* Only judicial foreclosures are permitted, but the Texas Supreme Court is to promulgate rules of civil procedure for expedited foreclosure proceedings for home equity loans. The "legislative intent" relating to the contemplated special judicial foreclosure process provides for the appointment of a special committee of experts to develop the rules.
- *Fees.* Fees which are to be passed on to or paid by the homeowner are capped at three percent of the original principal amount of a home equity loan. The cap relates to any required fees that are necessary to originate, evaluate, maintain, record, insure, or service the loan.
- *Lines of Credit Prohibited.* No form of open-end accounts are permitted. Thus, home equity revolving lines of credit are not permitted.
- *No Prepayment Penalty.* Prepayment penalties are prohibited.
- *No Additional Collateral.* No additional security for a home equity loan is permitted. Thus, no cross-collateralization or cross-pledging is permitted.
- *Agricultural Property Exclusion.* A home equity loan secured by a homestead property designated for agricultural use is not permitted unless the homestead is used primarily for the production of milk.
- *Agreement on Market Value.* The borrower and lender must acknowledge the fair market value of the home as of the date the loan closes. Any agreement on value must be at a value supportable by an appraisal.
- *Market Value Decrease/Cross Default.* No acceleration of a home equity loan is permitted due to a decrease in the market value

1. Proposed Constitutional Amendment Permitting a Encumbrance Against Homestead Property, Tex. H.R.J. Res. 31, 75th Leg., R.S.

of the homestead or an owner's default on other debt not secured by the homestead.

- *Payments.* Loan payments must be made in equal successive monthly installments that fully cover at least each month's accrued interest.

- *Notice.* A lender is required to give a borrower a written notice when the borrower applies for an equity loan. The notice is essentially a copy of the home equity amendment. If the discussions with a borrower are conducted primarily in a language other than English, a lender must, before closing, provide an additional copy of the required notice translated into the written language in which the discussions were conducted (e.g., Spanish).

- *Cooling Off Period.* A home equity loan cannot be closed before the twelfth day after the later of (i) the date the owner submits an application or (ii) the date the lender provides the owner with the specified notice.

- *No Stacking.* A borrower may have only one home equity loan and there is a one-year limit between successive home equity loans.

- *Closing Location.* A home equity loan may only be closed at the office of the lender, an attorney, or a title company.

- *Application of Proceeds.* A home equity loan cannot be conditioned on an owner applying proceeds of the loan to pay other debt, except debt secured by the homestead or debt to another lender.

- *Rescission Period.* An owner or spouse may rescind, within three days after the loan is made, a home equity loan without penalty or charge.

- *Registration.* Specific types of lenders are permitted to make home equity loans. These lenders include, among others, the following:

- (i) a bank, savings and loan association, savings bank, or credit union doing business under the laws of the State of Texas or the United States;

- (ii) a federally chartered lending instrumentality or a person approved as a mortgagee by the United States government to make federally insured loans; and

- (iii) a person licensed to make regulated loans, as provided by statute of this state.

- *Anti-Severability.* The Amendment contains an anti-severability provision. This provision could invalidate the home equity authority if any provision is held to be preempted by federal law. The provision, however, does not apply to home improvement loans or reverse mortgages.

- *Forfeiture.* The Amendment provides the lender or any holder of the note for the extension of credit shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit within a reasonable time after the lender or holder is notified by the borrower of the lender's failure to comply.²

2. See TEX. CONST. art. XVI, § 50(a)(6).

1. Selected Issues

The language of the Amendment raises several issues:

a. Fee Cap

A home equity loan is an extension of credit that, among other things, does not require the owner or the owner's spouse to pay, in addition to any interest, fees to any person that are necessary to originate, evaluate, maintain, record, insure, or service the extension of credit that exceed, in the aggregate, three percent of the original principal amount of the extension of credit.³

An issue is whether this limit applies only at origination or over the life of the credit. The limit does not expressly state that the limit applies "at any time during the term of an extension of credit," "over the life of the loan," or similar language. The limit, however, does include two terms ("maintain" and "service") that lend themselves to an interpretation that the limit applies over the term of an extension of credit.⁴

Another issue is whether points and certain other charges are considered "interest" or "fees." Certain judicial decisions and prior Texas Credit Code Commissioner interpretations have concluded that points are considered "interest."⁵

b. Proceeds

A home equity loan must be made on the condition that "the owner of the homestead is not required to apply the proceeds of the extension of credit to repay another debt except debt secured by the homestead or debt to another lender."⁶ The phrase "debt to another lender" is not defined. No apparent legislative history exists indicating that the phrase "another lender" is limited to another mortgage lender.

c. Rescission

Although they were undoubtedly intended to mesh, the notice of rescission under section 226.23(a)(3) of Regulation Z is not consistent with the rescission notice set forth in the Amendment. This raises several issues.

i. Timing Problems

Under Regulation Z, a consumer may exercise the right to rescind until

3. *See id.* § 50(a)(6)(E).

4. *See id.* § 50(g) (setting forth a required notice that a lender must provide in connection with a loan. The notice uses the term "make" and does not contain the terms "maintain" and "service." This may reflect the legislators' intent that the limit apply only at origination).

5. *See, e.g.*, Texas Credit Code Commissioner Letter Interpretation Nos. 81-9 (July 14, 1981), 82-14 (July 20, 1982), 82-15 (July 22, 1982), and 82-28 (Dec. 10, 1982).

6. TEX. CONST. art. XVI, § 50(a)(6)(Q)(i).

midnight of the third business day following consummation.⁷ Until the rescission period has expired and the creditor is reasonably satisfied that the creditor has not rescinded, the creditor must not disburse loan proceeds to the consumer.⁸ Under the Amendment, the owner of the homestead may, within three days after the extension of credit is made, rescind the extension of credit without penalty or charge.⁹ An issue is whether the phrase "after the extension of credit is made" is consistent with "consummation" or refers to after the loan proceeds are disbursed.

In addition, the Amendment uses the term "days" instead of business days as used in Regulation Z.¹⁰

ii. Rescission Right of Spouse Problem

Under Regulation Z, a "consumer" has the right to rescind a transaction.¹¹ The term "consumer" is defined as "a natural person in whose principal dwelling a security interest is or will be retained or acquired, if the person's ownership interest in the dwelling is or will be subject to the security interest."¹² Thus, an ownership interest is required. The Amendment, however, grants the rescission right to the owner of the homestead and "any spouse of the owner."¹³

d. Forfeiture

The Amendment provides that the lender, or any holder of the note for the extension of credit, shall forfeit all principal and interest of the extension of credit if the lender or holder fails to comply with the lender's or holder's obligations under the extension of credit within a reasonable time after the lender or holder is notified by the borrower of the lender's failure to comply.¹⁴

e. Refinancings

A home equity loan is a credit authorized and described in the proposed article XVI, section 50(a)(6), of the Texas Constitution.¹⁵ A second home equity loan may not be closed before the first anniversary of the closing of any other home equity loan.¹⁶ Thus, a borrower cannot refinance a home equity loan (*i.e.*, a section (a)(6) loan) for twelve months.

A borrower may refinance an existing home mortgage where the refinance includes an advance of additional funds in certain circumstances.

7. See 12 C.F.R. § 226.15 (1994).

8. See *id.* § 226.15(c).

9. See TEX. CONST. art. XVI § 50(a)(6)(Q)(viii).

10. *Id.*

11. See 12 C.F.R. § 226.15.

12. See *id.* § 226.2(a)(ii).

13. TEX. CONST. art. XVI, § 50(a)(6)(Q)(iii).

14. See TEX. CONST. art. XVI, § 50(a)(6)(Q)(x).

15. See TEX. CONST. art. XVI, § 50(a)(6)(M)(ii).

16. See TEX. CONST. art. XVI, § 50(a)(6)(M)(ii).

The Amendment provides that a refinance of a first mortgage that includes the advance of new money, may not be secured by a valid lien against the homestead unless:

- (1) the refinance is a home equity loan; *or*
- (2) the advance of all the additional funds is for reasonable costs necessary to refinance such debt or for the following purposes: taxes, an owelty of partition, or work and materials used in constructing new improvements.¹⁷

A refinance of debt secured by a homestead of which any portion is a home equity loan, may not be secured by a valid lien against the homestead unless the refinance of the debt is a home equity loan.¹⁸ Accordingly, the twelve month limitation would apply to any such refinancing.

f. Fair Market Value

The term "fair market value" (FMV) is not defined. The owner of the homestead and the lender must sign a written acknowledgment as to the FMV of the homestead property on the date the extension of credit is made.¹⁹ A lender or assignee for value may conclusively rely on the written acknowledgment as to the FMV of the homestead property if:

- (1) the acknowledged value is the estimated value in an appraisal or evaluation prepared in accordance with a state or federal requirement applicable to an extension of credit; and
- (2) the lender or assignee does not have actual knowledge at the time of the payment of value or advance of funds by the lender or assignee that the FMV stated in the written acknowledgment was incorrect.²⁰

Thus, a lender can base FMV on a qualifying appraisal. It is unclear upon what else a lender may rely.

g. Authorized Charges

Article 3A.852 of the Texas Credit Title provides that a lender may not directly or indirectly charge, contract for, or receive an amount that is not authorized under this chapter²¹ in connection with a loan to which this chapter applies. This includes, but is not limited to, fees, compensation, bonuses, commissions, brokerage, discounts, expenses, and every other charge of any nature whatsoever.²² Thus, section 3A.852 prohibits an authorized lender from, directly or indirectly, charging, contracting or receiving a brokerage fee in connection with a secondary mortgage loan.²³ The Commissioner's office has consistently construed the limitations on

17. TEX. CONST. art. XVI, § 50(e).

18. TEX. CONST. art. XVI, § 50(f).

19. TEX. CONST. art. XVI, § 50(a)(6)(Q)(ix).

20. TEX. CONST. art. XVI, § 50(h).

21. See TEX. REV. CIV. STAT. ANN. arts. 5069-3A.507, 3A.508 (Vernon Supp. 1998) (specifying authorized fees).

22. See TEX. REV. CIV. STAT. ANN. art. 5069-3A.852 (Vernon Supp. 1998); see also, TEX. FIN. CODE ANN. § 344.501 (Vernon Supp. 1997).

23. See TEX. REV. CIV. STAT. ANN. art. 5069-3A.852 (Vernon Supp. 1988).

“other charges” under article 5.02(7) of the former Texas Credit Code in a very restrictive manner.

The following is a partial list of prohibited fees:

- (1) Commitment fees;
- (2) Application fees;
- (3) Brokerage fees;
- (4) Messenger fees;
- (5) Recording fees in excess of those charged by public officials (title companies frequently charge additional fees);
- (6) Additional charges, such as escrow fees, added on by title companies;
- (7) Attorneys fees for documentation if the invoice is not “addressed to the lender” but rather is addressed to the borrower, title company or anyone other than the lender, or if the attorney is a salaried employee of the lender;
- (8) Appraisal fees paid to an appraiser who is not “certified” or who is an employee of the lender; and
- (9) A fifteen dollar return fee for a dishonored check in connection with a loan that does not have a contractual provision expressly authorizing the fee.²⁴

Articles 3A.507 and 3A.508 of the Texas Credit Title set forth authorized fees in connection with secondary mortgage loans.²⁵ Article 3A.508 authorizes reasonable fees for an appraisal of real property offered as security for the loan prepared by a certified appraiser who is not an employee of the lender.²⁶ However, note that these fees may not, in the aggregate, exceed the three percent limit.²⁷

h. Anti-Severability

Section 50(j) is an anti-severability provision which could invalidate the home equity authority if any provision is held preempted by Federal law.²⁸ Certain provisions appear susceptible to preemption.²⁹

i. Documents

Chapter 3A of the Texas Credit Title governs consumer loans including secondary mortgage loans. Under article 5069, section 3A.001(3) of the Texas Credit Title, the term “secondary mortgage loan” is defined as a

24. Consumer Credit Code, TEX. REV. CIV. STAT. ANN. art. 5069-5.02 (repealed by Acts of 1997, 75th Leg., R.S., ch. 1008, § 6(a), effective Sept. 1, 1997).

25. See TEX. REV. CIV. STAT. ANN. arts. 5069 - 3A.507, 3A.508 (Vernon Supp. 1988).

26. See TEX. REV. CIV. STAT. ANN. art. 5069-3A.508(4) (Vernon Supp. 1988).

27. See TEX. CONST. art. XVI, § 50(a)(6)(E).

28. See *id.* § 50(j).

29. For example, various commentators have focused on the authority of national banks. National banks are authorized to make real estate loans without regard to state law limitations as to the amount of a loan in relation to the appraised value of the real estate. See 12 U.S.C. § 371 (1994) and 12 C.F.R. § 34.2(c) (1998).

loan³⁰ that is:

- (1) secured in whole or in part by an interest, including a lien or security interest, in real property that is:
 - (A) improved by a dwelling designed for occupancy by four or fewer families; and
 - (B) subject to one or more liens, security interests, prior mortgages, or deeds of trust; and
- (2) not to be repaid before the 91st day after the date of the loan.³¹

Most home equity loans, because they will be secured by inferior liens, will fall within the definition of a "secondary mortgage loan."³² Thus, a lender engaged in home equity lending will also have to comply with chapter 3A, including the disclosure requirements.

Section 50(a)(6)(Q)(v) of the Amendment requires a lender, at the time the extension of credit is made, to provide the owner of the homestead a copy of all documents signed by the owner related to the extension of credit.³³ An issue is how broadly is the phrase "all documents signed by the owner related to the extension of credit" interpreted?³⁴ Does this phrase include documents such as tax returns, verifications of deposits, and employment and insurance authorization documents that the borrower/owner provides in connection with the extension of credit? In the case of joint owners, does a lender need to provide each owner a complete set of documents?

The Amendment also authorizes reverse mortgages. Reverse mortgages will be limited as follows:

- *Age Limit.* Available only to a person who is or whose spouse is fifty-five years or older.
- *Nonrecourse.* Only permissible without personal liability recourse against the owner or spouse.
- *Advances.* Advances must be based on borrower's homestead equity. A lender cannot reduce the amount or number of advances because of an adjustment in the interest rate if periodic advances are to be made.
- *Payments.* No payment of principal or interest is required until (i) the homestead property is sold or otherwise transferred, or (ii) all borrowers cease occupying the homestead as their principal residence for more than 180 consecutive days.

30. A loan is subject to chapter 3A of the Texas Credit Title if the loan:

- (1) provides for interest in excess of 10% per year;
- (2) is extended primarily for personal, family, or household use;
- (3) is predominantly payable in monthly installments;
- (4) is described by Article 3A.001(3), 3A.501, or 3A.806; and
- (5) is made by a person engaged in the business of making, arranging, or negotiating those types of loans.

TEX. REV. CIV. STAT. ANN. art. 5069-3A.005(b) (Vernon Supp. 1998).

31. TEX. REV. CIV. STAT. ANN. art. 5069-3A.001(3) (Vernon Supp. 1988).

32. *Id.*

33. *See* TEX. CONST. art. XVI, § 50(a)(6)(Q)(v).

34. *Id.*

- *Interest Rate.* Interest rate can be fixed or adjustable and may also provide for interest contingent on appreciation in value of the homestead.

- *Counseling/Affirmation.* May not be made unless the owner attests in writing that the owner has received counseling regarding the advisability and availability of reverse mortgages and other financial alternatives.³⁵

The various requirements for home equity loans do not apply to reverse mortgages. For example, the eighty percent loan to value cap and the fee limit do not apply to reverse mortgages.

Since all of the provisions above are being done in the form of an amendment to the Texas Constitution, as opposed to a statute, any future changes or modifications in the law will require an amendment to the Texas Constitution. An amendment to the Constitution requires two-thirds approval by both houses of the Texas Legislature along with approval by a majority of the voters in a statewide referendum.³⁶

Leslie Pettijohn, Commissioner of the Office of the Consumer Commissioner, together with the Texas Department of Banking, the Texas Savings Loan Department and the Texas Credit Union Department have issued a document entitled "Regulatory Commentary on Equity Lending Procedures." This instrument was issued on January 6, 1998, and is available at their website.³⁷ This instrument purports to provide guidance to lenders in this area. By statute, the Commissioner has authority to issue interpretive ruling of issues arising under what was the Texas Credit Code, now Subtitles B and C of Title 4 and chapter 394 of the Finance Code.³⁸ However, these are not the statutes which amended the Constitution to authorize home equity lending. Thus, Ms. Pettijohn's statutory basis for offering rules or guidelines on this type of lending is unclear.

B. HOUSE BILL 1971—USURY REFORM

The Texas Legislature has enacted House Bill 1971,³⁹ making many changes to the usury statutes, all of which became effective September 1, 1997. On the whole, these are welcome changes to the usury law and should provide a more stable and certain environment for commercial transactions. The new statutes are written in "plain English" and, especially in the case of those statutes which collectively replace article 5069-1.04 for all new transactions, will not require extensive interpretive analysis to determine what they mean. Some of the new statutory language reflects case law developments of the last few years and some of it renders moot bad case law. Especially in the area of penalties and remedies, these changes do away with some of the draconian penalties that existed

35. See TEX. CONST. art. XVI, § 50(a)(6)(g).

36. See TEX. CONST. art. XVII, § 1.

37. Leslie Pettijohn, *Regulatory Commentary on Equity Lending Procedures*, (last modified Jan. 6, 1998) <http://www.occc.state.tx.us/PDFs/Pubdocs/cmnt_016.pdf>.

38. See TEX. FIN. CODE ANN. §§ 394.001-394.104 (Vernon Supp. 1998).

39. Tex. H.B. 1971, 75th Leg., R.S., ch. 1396, 1997 Tex. Gen. Laws. 5202.

under the old law. Not all issues have been addressed in the new legislation, and, doubtless, the new statute will itself give rise to new lines of cases and judicial interpretation. On the whole, however, the new legislation should be an improvement. Do not forget everything you know about usury, and the principles you accept as the bedrock of your understanding of this area of the law, because most of that has not changed. In fact, the old rules will remain the law for all transactions and events entered into or that occurred prior to September 1, 1997.

1. *Effective Date*

The new statutory provisions (for commercial transactions, new articles 5069-1B through 1H) became effective September 1, 1997, and apply to all acts committed and transactions that close on or after September 1, 1997. The old statutes (including article 5069-1.04, which has been repealed) remain in effect for acts that occurred and transactions that closed prior to September 1, 1997.

2. *Statutory References*

Statutory references in loan and related documents will need to change. For purposes of defining "Maximum Lawful Rate" and similar terms, and for purposes of usury savings clauses, existing references to "Article 5069-1.04 *et seq.*, as amended, of the Revised Civil Statutes of Texas" should be changed to "Article 5069-1B.001, *et seq.*, as amended, of the Revised Civil Statutes of Texas." (Alternatively, one could refer generally to "the Texas Credit Title, as amended," which is the short title now given to title 79 of the Revised Statutes, where all the relevant provisions on interest and penalties for both consumer and commercial transactions are now found.)

Any existing references to "Article 5069-1.04, as amended," as the source of the designated interest ceiling, will no longer be accurate in new transactions. This presents something of a problem as far as translation into the new statutory references is concerned if one desires to designate a single statute that is the source of the designated ceiling. The problem is that article 1.04 was the source of all alternative rates of interest previously (*i.e.*, weekly, monthly, quarterly and annual ceilings). Now, the authority for these alternative rate ceilings, descriptions of them and how they are calculated are covered in several separate statutes, all part of new chapter 1D of title 79. You may refer to "Article 5069-1D.001, *et seq.*, as amended" (or to "chapter 1D, title 79") as the source of your designated ceiling.

Note that some terminology has changed. For example, any references to the term "indicated (weekly) rate ceiling," found in article 5069-1.04, should be replaced by the term "weekly rate ceiling," which is the term used in article 5069-1D.003.

There is also a new statute expressly providing for alternative interest rate ceilings for commercial loans. Article 5069-1H.002 authorizes a

creditor to contract for, charge and receive a rate or amount of interest on a commercial loan that does not exceed the applicable ceilings computed in accordance with chapter 1D (*i.e.*, article 5069-1D.001, *et seq.*).⁴⁰ In other words, article 1H.002 authorizes a creditor in a commercial loan to use the same alternative ceilings authorized by article 1D.001 for written contracts. Article 1H.002 adds that an oral agreement for interest exceeding ten percent would be permitted under article 1H.002, while not so under article 1D.001.⁴¹

3. *Current Ceiling*

Although article 5069-1.04 has been replaced in its entirety as the source of the alternative available ceilings for written contracts from and after September 1, 1997 (which otherwise would be limited to a maximum of ten percent), the method of computation of the four available ceilings for any such written agreement (*i.e.*, the weekly, monthly, quarterly and annualized ceilings) remains essentially unchanged. The computation is still based on the auction average rate quoted on a bank discount basis for twenty-six-week Treasury Bills issued by the United States Government, as published by the Federal Reserve Board.⁴²

4. *Spreading*

The spreading doctrine of *Nevels v. Harris*⁴³ is now available by express statutory authority for *all commercial loans*, not just real estate secured loans.⁴⁴ The term "commercial loan" is defined as a loan that is made primarily for business, commercial, investment, agricultural or similar purposes.⁴⁵ It does not include a loan made primarily for personal, family or household use. ("Spreading" is a method of computing the interest rate on a loan for usury calculation purposes by amortizing or "spreading" over the full stated term of the loan all interest and other charges deemed to be interest at any time contracted for, charged or received in connection with such loan).⁴⁶

5. *Prepayment Penalties-Homestead*

No prepayment charge or penalty is permitted on a loan secured by property that is to be the residential homestead of the borrower if the loan is made at an interest rate greater than twelve percent a year, *unless* the charge or penalty is *required* by an agency created by Federal law.⁴⁷

40. See TEX. REV. CIV. STAT. ANN. art. 5069-1H.002 (Vernon Supp. 1998).

41. See *id.*

42. See *id.* arts. 5069-10.003, 10.004, 10.007.

43. 102 S.W.2d 1046 (Tex. 1937).

44. See TEX. REV. CIV. STAT. ANN. art. 5069-1C.101 (Vernon Supp. 1998) applies to real estate secured loans; TEX. REV. CIV. STAT. ANN. art. 5069-1H.004 (Vernon Supp. 1998) applies to commercial loans.

45. See *id.* art. 5069-1H.001(s).

46. See *id.* art. 5069-1H.004.

47. See *id.* art. 5069-1C.102.

6. *Prepayment Penalties-Commercial Loans*

The creditor and obligor may agree to a prepayment charge in a commercial loan and any such charge for prepayment is *not interest*.⁴⁸ Note, however, that “[p]repayment charge or penalty means compensation that is or will become due and payable . . . as a result of any election by the obligor to pay all or a portion of the principal amount before its stated maturity.”⁴⁹ In other words, a prepayment charge in connection with a voluntary prepayment is not interest; but the treatment of prepayment charges or penalties resulting from involuntary prepayment due to acceleration has not changed and, if permitted, such charges may be deemed to be interest.

7. *Late Charges*

Late charges are still deemed interest under Texas law.⁵⁰ The only change resulting from House Bill 1971 in this regard is that the Texas Legislature has declared that on any loans subject to 12 U.S.C. §§ 1735f-7 and 1735f-7a, as amended (*i.e.*, generally, first lien residential real property securing loans made by federally regulated lenders), any late charges imposed by the lender will also be exempt from Texas usury limits by virtue of federal preemption.⁵¹ This avoids any anomaly arising out of the Federal preemption of state usury statutes on these first lien residential real property secured loans. While late charges are still interest, the Legislature has acknowledged that it is not relevant because of the Federal preemption.⁵² Thus, the holding of *Seiter v. Veytia*⁵³ is now irrelevant in the case of first lien residential property.

8. *Interest Computation Period*

Lenders now have express statutory authority to provide for computation of interest on a commercial loan on the basis of a 360 day year consisting of twelve thirty-day months.⁵⁴

9. *Additional Charges*

There is now express statutory authority for certain charges on commercial loans.⁵⁵ These are as follows:

a *late payment charge* on the amount of any installment or other amount in default “in a reasonable amount not to exceed five per-

48. *See id.* art. 5069-1H.005.

49. *Id.* art. 5069-1H.001(8).

50. *See, Hardwick v. Austin Gallery of Oriental Rugs, Inc.*, 779 S.W.2d 438, 443 (Tex. App.—Austin 1989, writ denied) (citing former TEX. REV. CIV. STAT. ANN. art. 5069-1.01 (Vernon 1988)).

51. *See* TEX. REV. CIV. STAT. ANN. art. 5069-1C.103 (Vernon Supp. 1998).

52. *See id.*

53. 756 S.W.2d 303 (Tex. 1988).

54. *See* TEX. REV. CIV. STAT. ANN. art. 5069-1H.003 (Vernon Supp. 1998).

55. *See id.* art. 5069-1H.006.

cent of the total amount of the installment,” provided such amount is past due for a period of “not less than 10 days;” and

“a *returned check fee* in an amount not to exceed \$25 on any check, draft, order or other instrument or form of remittance that is returned unpaid or dishonored for any reason.”⁵⁶

10. *Participations and Equity Kickers*

Go ahead, take that participation interest, and don't worry about it! For any commercial loan in the original principal amount of three million dollars or more (or any renewal or extension of a commercial loan in the original principal amount of three million dollars or more, where the principal amount of the loan at the time of its renewal or extension is three million dollars or more, regardless of whether the loan originated prior to September 1, 1997), the parties may contract for additional charges, including an optional right to participate in the income, revenues, production or profits of the obligor or of an affiliate of the obligor or of any segment of the business or operations of such obligor or affiliate, or derived from any ownership rights of an obligor or of an affiliate of the obligor in real or personal property, including any proceeds of the sale or other disposition of ownership rights.⁵⁷ The parties to such a “Qualified Commercial Loan” may also agree to the payment of a discount or commission, payable in a typical asset securitization transaction, or to permit the lender to convert debt to equity in the obligor or an affiliate of the obligor.⁵⁸ Most significantly, *none of the foregoing will constitute interest under Texas law.*⁵⁹ This change in the law should permit a great deal of flexibility in loan and workout structuring previously unavailable in Texas, and will alleviate some concerns in the drafting of opinion letters for transactions involving equity-kickers and the like.

11. *Penalties and Remedies*

To the great relief of lenders, major changes have been made to the penalty and remedies provisions. Among these are the following:

i. No Common Law Penalties

The only penalties applicable to violations of the new usury statutes are those provided for in the new statutes. No common law penalties apply.⁶⁰

ii. Criminal Penalties

Criminal penalties for usury apply only in transactions involving loans for personal, family or household use and where the interest contracted

56. *Id.* Though the statute does not address this point, a late payment charge generally is deemed interest under Texas law, while the returned check fee is probably not.

57. See TEX. REV. CIV. STAT. ANN. art. 5069-1H.101(b)(4) (Vernon Supp. 1998).

58. See *id.* art. 5069-1H.101(b)(1).

59. See *id.* art. 5069-1H.101.

60. See *id.* art. 5069-1F.007.

for, charged or received is greater than twice the amount authorized by law. Such an offense is a misdemeanor punishable by a fine of not more than \$1,000.⁶¹ So, gone is the threat of criminal liability for usury in commercial transactions, and possible imprisonment for usury in either commercial or consumer transactions.

iii. The Standard Penalty

A creditor who contracts for, charges, or receives interest greater than the amount authorized by law is liable to the obligor for an amount equal to the greater of: (i) three times the amount of the usurious interest contracted for, charged or received, or (ii) the lesser of \$2,000 or twenty percent of the principal amount of the loan.⁶²

iv. Exceeding the Contract Rate

A creditor who *charges or receives* interest in excess of the amount contracted for, but not in excess of the maximum amount allowed by law, is not subject to penalties for usury. Such a creditor may, however, be liable for other remedies and relief as provided by law (for example, remedies available to the borrower due to breach of contract by the lender).⁶³ This provision does away with the problem created by *Hardwick v. Austin Gallery*.⁶⁴

v. The Penalty for "Double Usury"

For usurious interest exceeding twice the maximum rate authorized by law (or, so called "double usury") the penalty has changed significantly. In such cases, and with one major qualification, the lender will be liable to the obligor for three times the usurious interest contracted for, charged or received (per article 1F.001), plus the full amount of the principal of the loan, plus all interest and other amounts charged and received on the loan.⁶⁵ The one qualification and the most significant change in the penalty provisions is that penalties for "double usury" apply only where the creditor has *charged and received* interest that is greater than twice the amount authorized by law.⁶⁶ The lender is no longer subject to the severe penalty of forfeiture of principal merely for *contracting for* double usury. Those of you who recall the significant role the prior penalty statute played in our negotiations of settlements and loan workouts on behalf of borrowers in the 1980s, and the fear that statute inspired in such transactions on the lender side, will recognize the significance of this change in the usury landscape. Combined with the opportunity for cure provided by articles 1F.006 and 1F.103, this change significantly narrows the chance

61. See *id.* art. 5069-1F.008.

62. See *id.* art. 5069-1F.001.

63. See *id.* art. 5069-1F.001(c).

64. 779 S.W.2d 438 (Tex. App.—Austin 1989, writ denied).

65. See TEX. REV. CIV. STAT. ANN. art. 5069-1F.002 (Vernon Supp. 1998).

66. See *id.*

of an otherwise well-intentioned lender having to pay the ultimate price for failing to perceive the contractually usurious structure inherent in a creative loan or workout transaction. Much of the leverage once enjoyed by the borrower in such cases is now also gone.

12. *Corrective Action by Lender (Existing Law)*

Pursuant to existing statutes a lender may avoid liability for having contracted for, charged or received usurious interest by taking any necessary action and making any necessary adjustment, including the payment of interest on any refund due the borrower, not later than the sixtieth day after the date the creditor actually discovered the violation, provided that the lender is the one who gives notice to the borrower of the violation, and not the other way around, and provided this corrective action is taken before the borrower files suit alleging the violation.⁶⁷ The violation is deemed "actually discovered" at the time of the discovery of the violation in fact and not at the time when an ordinarily prudent person, through reasonable diligence, could or should have discovered or known of the violation.⁶⁸ However, actual discovery of a violation in one transaction may constitute actual discovery of the same violation in other transactions where the violation is of such a nature that it would necessarily have been repeated in other transactions.⁶⁹

13. *Procedural Condition to Filing Suit for Usury (New Law)*

In cases where a creditor has *contracted for* or *charged* usurious interest, as a condition to filing suit seeking usury penalties the obligor must give written notice to the lender at least sixty days before filing suit advising the lender "in reasonable detail of the nature and amount of the violation."⁷⁰ The lender receiving such a notice then has an opportunity to correct the violation during the period beginning on the date the notice is received and ending on the sixtieth day after that date.⁷¹ Correction of such violation will relieve the lender from any liability.⁷² The foregoing notice requirement is not applicable to an obligor filing a counterclaim alleging usury in an original action filed by the creditor.⁷³ Note that the obligor, as a plaintiff, has to give notice before filing suit only where the allegation is based either on a "contracting for" or "charging" violation but that there is no such procedural requirement where the claim is for receipt of usurious interest.⁷⁴ This probably reflects a general attitude

67. *See id.* art. 5069-1.06 (Vernon 1996).

68. *See id.*

69. *See id.* art. 5069-1F.103 (Vernon Supp. 1998).

70. *Id.* art. 5069-1F.006(b) (Vernon Supp. 1998).

71. *See id.* art. 5069-1F.006(c).

72. *See id.* art. 5069-1F.006(b), (c) (Vernon Supp. 1998).

73. *See id.* art. 5069-1F.006(d).

74. *Compare id.* art. 5069-1F.006(a), which defines the limitations on an action brought for usurious interest *contracted for charged or received with id.* art. 5069-1F.006(b) which requires the potential claimant to give the lender notice, and an opportunity to cure

that the creditor should not have to suffer the harshness of the usury penalty where the usury is not immediately apparent or results from "bona fide error," but that the creditor who has actually received payment of the usurious interest should have known better.

14. *Legal Interest*

"Legal interest" is defined as interest charged or received in the absence of any agreement to pay contract interest.⁷⁵ Article 5069-1C.002 provides that when a creditor and obligor have not agreed that the obligor will be charged interest, the creditor nevertheless may charge and receive interest at the legal interest rate of six percent beginning on the thirtieth day after the date on which the amount owed became due.⁷⁶ Also, if the obligor agreed to pay any compensation that constitutes interest, regardless of whether the rate is stated in the agreement, the obligor is deemed to have agreed to pay the rate produced by the amount of that interest.⁷⁷ (In other words, an interest rate will be imputed).

15. *Legal Interest During Interest-Free Period*

Pursuant to article 5069-1F.102, a creditor will not be liable to an obligor for usury simply for charging or receiving *legal interest* in the interest-free period under article 1C.002. (This probably renders moot the rule of *Steve's Sash & Door Co. v. Ceco Corp.*,⁷⁸ but may not fully address what happens in the event the creditor *exceeds* the legal rate in the interest-free period).

16. *Alamo Lumber Rule*

The much anticipated statutory treatment of the *Alamo Lumber*⁷⁹ rule did not occur. It remains unchanged.

C. HOUSE BILL 10—THE FINANCE CODE

House Bill 10, which creates the Finance Code, represents an effort by the Texas Legislature to consolidate the statutes previously applicable to banks, saving and loan associations, credit unions and other authorized lenders in Texas. It also contains the prior statutes relating to various bank related activities such as those conducted by trust companies, check sale operations, currency exchanges, funeral services, debt collectors, telephone solicitors, contest giveaways and pawn shops.

While it contains no substantive change to current law, the Finance Code organizes the various prior laws in what will be a more easy to use

before bringing an action, where various interest has been *contracted for or charged* (emphasis added).

75. See TEX. REV. CIV. STAT. ANN. art. 5069-1B.002(a)(8) (Vernon Supp. 1998).

76. See *id.* art. 5069-1C.002.

77. See *id.*

78. 751 S.W.2d 473 (Tex. 1988).

79. *Alamo Lumber Co. v. Gold*, 661 S.W.2d 926 (Tex. 1983).

system. However, it is important to note that there were various amendments to the Texas Credit Code,⁸⁰ which occurred during the last legislative session which are not noted in the Finance Code, and will not be noted in the Finance Code until after the 1999 legislative session. Therefore, the practitioner will need to check both the Finance Code and the underlying substantive provisions of the former Texas Credit Code until the 1999 session laws are available.

D. SENATE BILL 652—LOANS SECURED BY CERTIFICATES
OF DEPOSIT

Texas case law is a prime example of why the amendment to the definition of certificate of deposit contained in Senate Bill 652 was necessary.⁸¹ An early code case found that a non-negotiable certificate of deposit was nonetheless an "instrument" for purposes of the Uniform Commercial Code.⁸² In holding that a non-negotiable certificate of deposit was an "instrument" in which a secured interest can only be perfected by transfer of possession, the appellate court was apparently incorrectly blurring the lines that the drafters of the Uniform Commercial Code established when they made the distinction between a document that was not negotiable and one that was.⁸³ Non-negotiable certificates of deposit became the norm because banks desired to retain the right of offset on their depositor's funds when the depositor deposited money and asked that the deposit be evidenced by a certificate.

A similar dispute involving a bank which issued a negotiable certificate of deposit and claimed a purchase money security interest therein, versus a bank asserting a security interest in the certificate of deposit as a result of being the holder thereof pursuant to an endorsement and security agreement, resulted in the holder prevailing.⁸⁴ As a result, most banks began issuing their certificates of deposit in non-negotiable form hoping that, so long as they had no notice of a security interest asserted by a third party, they could prevail by asserting a common law right of offset. Thus a contest between a party holding a security interest perfected by possession in a non-negotiable certificate of deposit, versus the bank that issued the non-negotiable certificate of deposit and who asserted either a contractual security interest or a common law right of offset would result

80. For example, those amendments contained in House Bill 1971 (Usury Reform).

81. Act of May 13, 1997, 75th Leg., 1st C.S., ch. 217, 1997 Tex. Sess. Law Serv. 1086 (Vernon) (to be codified as an amendment to TEX. BUS. & COM CODE ANN. § 9.105 (Vernon Supp. 1998)).

82. See *First Nat'l Bank in Grand Prairie v. Loan Star Life Ins. Co.*, 524 S.W.2d 525 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.).

83. See *id.* at 529. Clearly the fact that the bank had actual knowledge that this non-negotiable certificate of deposit had been pledged influenced the court's decision and probably results in the no reversible error holding by the Supreme Court. An analysis based upon the holder of the non-negotiable instrument being perfected under article 9.105 as it then existed is incorrect. However, actual notice by the issuer of a non-negotiable certificate of deposit would prevent that issuer from asserting a greater interest.

84. See *Dallas/Fort Worth Airport Bank v. Dallas Bank & Trust Co.*, 667 S.W.2d 572 (Tex. Civ. App.—Dallas 1984, no writ).

in the issuer prevailing. This amendment is intended to solidify the position of the issuing bank by indicating that when they issue a non-negotiable certificate of deposit and note in their books and records that they assert a security interest by restricting the right of withdrawal on the account, this constitutes possession for purposes of perfecting their security interest in a document which has now been defined to be an instrument. Thus future courts should have less difficulty addressing this issue so long as the issuing bank establishes the requisite restrictions on withdrawals to evidence their security interest.

E. HOUSE BILL 881—PRIORITY OF PAYMENTS AGAINST DECEDENTS

Lenders must always consider their status as it relates to claims arising under probate. House Bill 881 increases the priority claim of funeral expenses and expenses of the last illness from \$5,000 to \$15,000. It provides that those claims are to be paid as class 1 claims. With this increase in the amount of class 1 priority claims, lenders must give more consideration to the election which must be made pursuant to section 306 of the Probate Code in each case where they are a secured lender. As a secured lender, an election must be made as to whether that lender desires to have its claim allowed and approved as a claim to be paid in the due course of administration, or allowed and approved and fixed as a preferred debt and lien against a specific property securing the indebtedness.⁸⁵ If the election is made to be paid in the due course of administration, the claim will be paid in full only to the extent the estate is solvent.

III. FEDERAL REGULATORY CHANGES

A. FASB RULE 125

The Financial Accounting Standards Board of the Financial Accounting Foundation (FASB) adopted Standard No. 125 in June of 1996. It deals with accounting for transfers and servicing of financial assets. The effective date for parts of that Standard was deferred from December 31, 1996, to December 31, 1997.⁸⁶ One area where this Standard will have impact upon banking institutions is upon the language of the typical participation agreement: i.e., the agreement by which a lender, whether for loan limit purposes or credit risk purposes sells a portion of a loan it makes to another lender.

FASB 125 provides, in part, that a transferor only removes from their books a financial asset where the transferor surrenders control over that asset. FASB 125 also provides that the transferor surrender control over transferred assets if and only if all of the following conditions are met:

The transferred assets have been isolated from the transferor—presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership.

85. See generally TEX. PROB. CODE ANN. § 306 (Vernon 1988).

86. See generally FASB Standard No. 127.

a. Either (i) each transferee obtains the right free of conditions that constrain it from taking advantage of that right to pledge or exchange the transferred assets or (ii) transferee is a qualifying special-purpose entity and the holder of beneficial interests in that entity have the right free of conditions that constrain them from taking advantage of that right to pledge or exchange those interests.

b. The transferor does not maintain effective control over the transferred assets through (i) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity or (ii) an agreement that entitles the transferor to repurchase or redeem transferred assets that are not easily obtainable.⁸⁷

The typical participation agreement used by the banking industry provides that the purchasing bank may not further sell, transfer, assign or pledge its interest in the note purchased without the prior written consent of the selling institution. The typical participation agreement also provides that the selling bank may repurchase, at par, and at any time, the participated interest sold.

The inclusion of either of these provisions in a participation agreement entered into after December 31, 1997, will prevent the participated interests sold from being removed from the selling bank's financial statements, at least to the extent of generally accepted accounting principles.⁸⁸ Traditionally, the clause preventing subsequent resales or pledges of a participated interest have been included in the participation agreement because of the lead lender's desire to know who it was participating its loan with. This is important because decisions made on participated credits are subject to the approval of the participating bank. Also, underwriting concerns relating to federal securities laws violations arising out of being construed as an underwriter where a participated credit was widely disseminated exist.

To comply with this new FASB requirement, the average participation certificate and agreement will need to be revised.

IV. CASE LAW

A. ALLONGE

This year the Texas Supreme Court addressed an issue which has been uncertain in Texas for many years—what constitutes an “allonge” to a negotiable instrument.⁸⁹ The issue in this case is whether or not a sheet of paper which is stapled to a negotiable instrument has an “allonge”

87. See FASB Standard 125.

88. Whether for regulatory accounting, particularly for purposes of determining loan limits, the regulators will adopt the provisions of FASB Rule 125 has yet to be determined. The author's conversation with members of the Office of the Comptroller of Currency suggest that the inclusion of either of the above clauses in a participation agreement will prevent them from treating the loan as having been sold for regulatory accounting—loan limit purposes.

89. See *Southwestern Resolution Corp. v. Watson*, No. 97-0148, 41 Tex. Sup. Ct. J. 80, 1997 WL 683859 (Oct. 30, 1997) (per curiam).

thereto (a part thereof). In this case, the promissory note presented at trial was printed on 8½ x 14 inch paper so that the text completely covered both sides thereof except for a 2 x 4 inch area on the bottom right corner of the back. That area was filled by endorsement from the FDIC as receiver for the original payee to Invest Capital Corp. There was no other space on the note for any additional endorsements. On a separate 8½ x 11 inch sheet are two endorsements, one from Invest to DOSOHS, Inc. and the other from DOSOHS, Inc. to Southwestern Resolution Corp. These endorsements do not in any way refer to the original note.⁹⁰ The dispute is whether or not Southwestern Resolution Corp. is a holder in due course or merely a holder of the subject promissory note. To qualify as a holder, Southwest must demonstrate that the instrument is a negotiable instrument. For an instrument to be negotiable, the provisions of the Texas Business & Commerce Code applicable at the time of the facts of this case *required* that any endorsement be written "on the instrument or on a paper so firmly affixed thereto as to become a part thereof."⁹¹ The current statute provides that "for the purposes of determining whether a signature is made on an instrument, a paper affixed to the instrument is a part of the instrument."⁹² At trial it was demonstrated that the sheet attached to the note had several staple holes in it.⁹³ Southwestern's president testified that when Southwestern received the note, the sheet containing the endorsements had been stapled to it but that it had been removed on several occasions so that the note and endorsements could be photocopied.⁹⁴ The trial court found that the endorsement page was not firmly affixed. The Court of Appeals affirmed holding that the president's admission that the note and the endorsement sheet had been detached and that multiple staple holes were in the two pages were evidence that the endorsement sheet was not "firmly affixed" to the note.⁹⁵ The Supreme Court, however, found that the endorsement sheet and the note were firmly affixed.⁹⁶ The Supreme Court cites various authority, from other states, for the proposition that stapling is a method of attaching an allonge.⁹⁷ In fact, the comments and notes to the tentative draft of Article III indicate that: "the indorsement must be written on the instrument itself or on an allonge which, as defined in Section ___, [sic] is a strip of paper so firmly pasted, stapled or otherwise affixed to the instrument as to become part of it."⁹⁸ The Supreme Court also cited various

90. *See id.* at *8 (Obviously careful counsel would make a reference in any attachment to the underlying instrument in an effort to help identify what it is attached to).

91. *See* TEX. BUS. & COM. CODE ANN. § 3.202(b) (Vernon 1994) (amended by Tex. H.B. 1728, ch. 921 § 1, 1995, Tex. Gen. Laws 4588).

92. TEX. BUS. & COM. CODE ANN. § 3.204(a) (Vernon Supp. 1996).

93. *See Southwestern*, 1997 WL 683859, at *9.

94. *See id.*

95. *Southwestern Resolution Corp. v. Watson*, No. 03-95-00580-CV, 1996 WL 668846 (Tex. App.—Austin Nov. 20, 1996) (not designated for publication), *rev'd*, 41 Tex. Sup. Ct. J. 80 (1997).

96. *See Southwestern*, 1997 WL 683859, at *10.

97. *See id.*

98. *Id.*

authorities for the proposition that stapling is a modern equivalent of gluing and pasting.⁹⁹ However, it is clear that once an item has been glued or pasted, it is less likely to be removed than an item which has been stapled. Accordingly, it appears that the Court was most persuaded by the change in language that has occurred between the former provision of the Texas Business & Commerce Code and the current version. In fact the Court indicates that the requirement "has been relaxed in the current code" from the "firmly affixed" to simply "fixed" requirements.¹⁰⁰

It may also be not so much that stapling is the modern manner of "affixing" an allonge to an instrument so much as the proclivity to photocopy instruments and the requirement that you separate them to photocopy them. Obviously, the former method of pasting or gluing was more likely to occur in the pre-photocopy era. Thus, the Court may simply be acknowledging the fact that instruments are photocopied continuously and to require that a document be glued or taped would result in much greater damage to the instrument each time it was separated than occurs when items are stapled.

B. ARBITRATION

As so many bank loan documents now contain arbitration clauses, I continue to search for cases dealing with this issue as I believe it impacts most practitioners. As with the last Survey article, there are several arbitration cases which bear the practitioner's attention.

The Texas Supreme Court recently had an opportunity to address the issue of waiver.¹⁰¹ This case arose out of an employment agreement entered into between Mr. Gonzales and his employer, EZ Pawn. The arbitration agreement was part of a stock option plan offered to Mr. Gonzales and other employees. Mr. Gonzales could choose either to participate or not participate in the plan; and, he was advised by EZ Pawn to seek independent legal advice if he had any questions concerning the plan. Mr. Gonzales elected to participate in the stock option plan. The written agreement evidencing Mr. Gonzales' option provided that Gonzales and EZ Pawn agreed to initiate arbitration any time "any cognizable civil claim which may exist against the other . . . no later than 180 days after any cognizable alleged cause of action accrues."¹⁰² Gonzales subsequently sued EZ Pawn for wrongful discharge. This suit was initiated in August of 1994. While preparing to take Gonzales' deposition in June of 1995, EZ Pawn discovered the arbitration agreement, which it claimed that it had archived, and requested that the claim be arbitrated.¹⁰³ Gon-

99. *See id.* at *11.

100. *Id.* at *9. Compare and contrast TEX. BUS. & COM. CODE ANN. § 3.204(a) (Vernon Supp. 1998) to the former provision found at TEX. BUS. & COM. CODE ANN. § 3.202(b) (Vernon 1996).

101. *EZ Pawn Corp. v. Mancias*, 934 S.W.2d 87 (Tex. 1996).

102. *Id.* at 89.

103. *See id.*

zales refused to arbitrate.¹⁰⁴ EZ Pawn moved to compel arbitration and to abate the civil proceeding.¹⁰⁵ The trial court denied EZ Pawn's motion.¹⁰⁶ On mandamus, the Civil Court of Appeals affirmed the trial court.¹⁰⁷ The Texas Supreme Court held that under the Federal Arbitration Act,¹⁰⁸ EZ Pawn is entitled arbitration. The Court pointed out that EZ Pawn did not waive its right to arbitrate under the Federal Arbitration Act because Gonzales did not establish waiver as a valid defense to arbitration.¹⁰⁹ The Court went on to show that Gonzales misconstrued the time limitations in the arbitration agreement.¹¹⁰ "The agreement requires each party to initiate arbitration of that party's own claim against the other within 180 days after the claims accrue, it does not require a party to 'initiate' arbitration of the other party's claim" within that same 180 days.¹¹¹ Obviously, as the Court points out, one party could not initiate arbitration of another party's claim. If it could, EZ Pawn would not now try to compel Gonzales to arbitrate. To defeat his obligation to arbitrate, Gonzales had to show that EZ Pawn acted inconsistent with the agreement *and* that EZ Pawn's conduct prejudiced him.¹¹² The Court went on to point out "that the burden to prove waiver is a heavy one. Delay alone does not necessarily demonstrate prejudice."¹¹³ The Court also noted that "[w]aiver in cases where litigation has begun will be found only where the party seeking to enforce the agreement substantially invokes a judicial process to the other party's detriment."¹¹⁴

Finally, the Court made two findings that may apply in most situations where a bank desires to compel arbitration. First, it found that Gonzales' failure to read the agreement did not excuse him from arbitration. The Court indicated that it presumes a party who has had the opportunity to read an arbitration agreement and who signs it knows its contents.¹¹⁵ Second, the Court found that "there is nothing per se unconscionable about arbitration agreements."¹¹⁶ Even assuming that unequal bargaining power exists, this does not establish grounds for defeating an agree-

104. *See id.*

105. *See id.*

106. *See id.*

107. *See* EZ Pawn Corp. v. Gonzalez, 921 S.W.2d 320 (Tex. App.—Corpus Christi 1996, writ denied).

108. 9 U.S.C. § 1 (1994).

109. *See* EZ Pawn Corp. v. Gonzalez, 934 S.W.2d at 89.

110. *See id.*

111. *Id.*

112. *See id.*

113. *Id.* at 90.

114. *Id.* at 89.

115. *See id.* at 90. Note that many bank arbitration provisions incorporate by reference a separate pamphlet or the American Arbitration Association rules which will contain some of the terms and conditions relating to the arbitration. Often, those rules are not hand-delivered to the borrower. Query whether the outcome would differ if the party complaining of the arbitration clause was able to sustain his burden that the documents relating to the arbitration agreement were not provided.

116. *Id.*

ment to arbitrate.¹¹⁷

The second case the practitioner should be familiar with is *Bruce Terminix Co. v. Carroll*.¹¹⁸ Bruce Terminix Co. and Kay Bates entered into a contract by which Terminix agreed to protect the Bates' home from termites.¹¹⁹ The contract contained an arbitration clause compelling the parties to settle any controversy or claim between them and arising out of or relating to the contract to be settled by arbitration.¹²⁰ In April of 1994, Ms. Bates filed a complaint against Terminix alleging fraud, negligent misrepresentation, breach of contract and violation of the Texas Deceptive Trade Practices Act.¹²¹ Terminix timely answered the suit and pro-pounded eighteen interrogatories and nineteen requests for production, all of which Bates answered.¹²² In August of 1994, Terminix filed a motion to abate the suit and to compel arbitration. Bates contested the motion but the court orally granted Terminix's motion to compel arbitration and instructed the parties to submit a written order to that effect for his signature. A written order was never signed because the parties could not reach an agreement as to the content of the order. No further action was taken until November of 1996 when the trial court heard Bates' motion to vacate the earlier order compelling arbitration.¹²³ The record indicates that the judge took no action on that motion.¹²⁴ Bates filed yet another request to abate the order compelling arbitration and a hearing was held on that motion in March 1997.¹²⁵ The court then held that Terminix had waived its right to arbitration.¹²⁶ Terminix then sought a writ of mandamus alleging that the judge abused its discretion by vacating a 1994 order compelling arbitration.¹²⁷ The appellate court denied its request. Here the court based its holding on Terminix's failure to initiate the arbitration process for nearly three years after the court granted its motion to compel arbitration.¹²⁸

This case is interesting for another reason. In its holding, the court took time to expressly disagree with two prior cases which held that in all cases the plaintiff bears the "laboring oar" to further the arbitration process whenever the other party reasonably asserts his right to contractual arbitration.¹²⁹ In overruling those two cases this court, even while finding that Terminix had waived its right to arbitration, was acknowledging the position taken by the Supreme Court in *EZ Pawn*, that it is illogical to

117. *See id.* at 90.

118. 953 S.W.2d 537 (Tex. App.—Waco, 1997) (no pet. h.).

119. *See id.* at 538.

120. *See id.*

121. *See id.*

122. *See id.*

123. *See id.* at 539.

124. *See id.*

125. *See id.*

126. *See id.*

127. *See id.*

128. *See id.* at 541.

129. *Moore v. Morris*, 931 S.W.2d 726, 729 (Tex. App.—Austin 1996, no writ); *Mamlin v. Susan Thomas, Inc.*, 490 S.W.2d 634, 639 (Tex. Civ. App.—Dallas 1973, no writ).

place the burden of proceeding to arbitration on the plaintiff where the plaintiff has, in lieu of arbitrating, instituted a civil action.

C. COUNTING DAYS

Each Survey year seems to present another case regarding how days are counted with which the practitioner must familiarize himself.¹³⁰ This year gives us a case which demonstrates how to count the time period available to a Texas homestead owner to reinvest the proceeds arising out of the sale of their homestead. The case of *In re Maloney*¹³¹ again demonstrates how a relatively straightforward proposition, such as that contained in section 41.001c of the Property Code,¹³² is subject to various interpretations.

The parties to this case assume that the exemption period was 180 days.¹³³ The applicable facts are that the individual sold her home on November 21, 1995, and on May 21, 1996, filed for bankruptcy. The court, however, in lieu of assuming that six months were the total of six periods of thirty days each, or 180 days, concluded that the time period began and ended on one month periods beginning and ending on the same day in each consecutive month.¹³⁴ For example, October 5 through November 5 comprised one month even though it consists of thirty-one days. Thus the court concluded that the six months' exemption began the day *after* the sale of the homestead, November 22, 1995, and ran until May 22, 1996.¹³⁵ Thus, the proceeds from the sale of the house were exempt from the claims of the creditors. This ruling is consistent with the provisions of the Code Construction Act which provides "[i]n computing a period of days, the first day is excluded and the last day is included."¹³⁶

D. IRAS AS EXEMPT PROPERTY

*In re Carmichael*¹³⁷ the issue before the Bankruptcy Court was whether or not an individual retirement account constitutes exempt property for purposes of the federal exemptions. To qualify as exempt, the interest must be in "the debtor's right to receive a payment under a stock, bonus, pension, profit sharing, annuity or similar plan or contract."¹³⁸ While the court found that the IRA was not a stock bonus, pension, profit sharing

130. The reader may recall *In re Nelson*, 134 B.R. 838 (Bankr. N.D. Tex. 1991) that held if you mailed your notice at 4:00 p.m. and conducted your foreclosure sale at 2:00 p.m. 21 days later you gave insufficient notice. This case was overturned by the Legislature by Act of September 1, 1993, 73rd Leg. R.S., ch. 48, § 5, 98.

131. 201 B.R. 175 (Bankr. W.D. Tex. 1996).

132. The proceeds of a sale of a homestead are not subject to seizure for a creditor's claim for six months after the date of sale.

133. As noted, the statute provides for six months.

134. See *In re Maloney*, 201 B.R. at 176.

135. See *id.*

136. TEX. GOV'T CODE ANN. § 311.014(a) (Vernon 1988); see also James W. Doyle, *Banking Law*, 50 SMU L. REV. 965, 972 (1997).

137. 100 F.3d 375 (5th Cir. 1996).

138. 11 U.S.C. 522 (d)10E (1994).

or annuity plan or contract, the court found that it was a "similar plan or contract." Potentially more persuasive was the Trustee's argument that the absence of an anti-alienation provision in the individual retirement account would destroy its exemptability.¹³⁹ The IRA is at all times subject to the debtor's control. The debtor can obtain payments under the IRA before age fifty-nine and one-half. The court found, however, that once an asset qualifies under the exemption provisions of § 522(d)(10)E, the question of control is irrelevant.¹⁴⁰ Thus, by providing that an IRA is a "similar plan or contract" for purposes of § 522(d)(10)E, the IRA is available under the federal exemptions even though the debtor can, under certain circumstances, obtain the right to receive payment prior to the age of fifty-nine and one-half.

The issue of how a debtor who has more than one acre of land in an urban area may designate which acre of such land is to be homestead was addressed in *In re Tinsley*.¹⁴¹ In this case the debtor owned real property consisting of his residence on 3.1 acres of the land. As the area was in an urban area, only one acre of that property qualified as exempt under the Texas homestead laws.¹⁴² The debtor designated one acre of land including his house, pool, the surrounding landscape and an access driveway as his one acre homestead. Various creditors of the debtor argued that the debtor's designation of the exempt one acre amounted to fraud on their rights because the remaining acreage would be undesirable and not subject to access. The debtor responded that the impact of his exercise of his homestead rights need not be considered when determining the value of non-exempt acreage. The court held that where a debtor has more than one acre of land in an urban area the debtor is free to designate which acre of such land is his homestead under Texas law notwithstanding the impact that designation may have on others.¹⁴³ This case is one of a long line of Texas cases supporting the free and unhindered exercise by a Texas resident of his homestead rights.

E. INSURANCE

Last year's Survey reported upon the outcome of *Barnett Bank v. Nelson*.¹⁴⁴ In that case, the United States Supreme Court ruled that qualifying national banks could sell insurance.¹⁴⁵ A qualifying national bank is one that has a branch in a town of 5,000 inhabitants or less.¹⁴⁶ By virtue of the parity provision of the Texas Constitution, a state charter bank in Texas can likewise sell insurance.¹⁴⁷

139. See *In re Carmichael* 100 F.3d at 378.

140. See *id.*

141. 1997 WL 829344 (Bankr. N.D. Tex. April 17, 1997).

142. See TEX. PROP. CODE ANN. § 41.002 (Vernon Supp. 1998).

143. See *Tinsley*, 1997 WL 829344, at *14.

144. See Doyle, *supra* note 136, at 970.

145. See *Barnett Bank v. Nelson*, 517 U.S. 25 (1996).

146. 12 C.F.R. § 7.1001 (1993).

147. See TEX. CONST. art. XVI, § 16(c).

The second battle which arose out of the *Barnett* case was whether or not banks could sell annuities. In that case, *Texas Bankers Association v. Bomer*,¹⁴⁸ the court held that national banks are authorized under the National Banking Act to sell annuities and that the provisions of the Texas Insurance Code that prohibit the exercise of that authority are preempted. The court's ruling fills a gap left in the wake of two important banking decisions left by the United States Supreme Court. In *NationsBank of North Carolina, N.A. v. Veritable Annuity Life Insurance Co.*,¹⁴⁹ the Supreme Court addressed bank sales of annuities, but not in the context of state law limiting the sales. One year later in the *Barnett Bank* case, the Supreme Court held that a bank could sell insurance over any state law limitation, but that case did not address the sale of annuities.¹⁵⁰

Following the *Barnett* case, the Texas Insurance Commissioner, Elton Bomer, issued interim procedures enabling national and state banks to sell insurance from offices in towns with 5,000 or less.¹⁵¹ These interim procedures did not provide for the sale of annuities.¹⁵² In the last legislative session the Texas Legislature passed legislation amending the Texas Insurance Code to provide for the licensing of banks to sell insurance as an agent and requiring the sales office to be located in towns with 5,000 or fewer.¹⁵³ The authority in the National Banking Act under which annuity sales are authorized contains no requirement regarding the location of the sales office.¹⁵⁴ This is in part because the Court held that the sale of annuities was the sale of an investment, which could occur as its sale is incidental to the business of banking.¹⁵⁵

In the *Bomer* case, the Insurance Commissioner argued that federal law did not apply and that national banks in Texas could not sell annuities because for a corporation to sell insurance in Texas it must be organized under the Texas Business Corporations Act or the Texas Professional Corporations Act and every officer, director and shareholder must be individually licensed as an agent.¹⁵⁶ The presiding judge in the *Bomer* case disagreed. He first found that the question of whether or not an annuity is insurance is a federal question and that any states' determination that an annuity issue regulated like insurance is not controlling. Further he found that the Supreme Court in *Valic II* concluded that annuities were investment products, that their sale was incidental to the business of banking and any state regulation limiting a national bank's right to sell

148. 1997 U.S. Dist. LEXIS 13456 (W.D. Tex. Aug. 5, 1997).

149. 513 U.S. 251 (1995).

150. See 517 U.S. 25 (1996).

151. See Tex. Commissioner's Bulletin No. B-0043-96 (June 20, 1996).

152. See *id.*

153. See Tex. H.B. 3391, ch. 596 § 2, 1998 Tex. Gen. Laws 2084 (codified in part at TEX. INS. CODE art. 21.07, § 1C (Vernon Supp. 1998)).

154. See *NationsBank v. Variable Annuity Life Ins. Co. (VALIC II)*, 513 U.S. 251 (1995).

155. See *id.*

156. See TEX. INS. CODE ANN. art. 21.07-1, § 4 (Vernon Supp. 1998).

insurance would be preempted.¹⁵⁷ The Texas Banking Commissioner has announced that state banks may avail themselves of the opportunity to sell annuities based on the parity provision under the Texas Constitution permitting state banks to do anything that a national bank can do in Texas.¹⁵⁸

157. See *Texas Bankers Ass'n*, 1997 U.S. Dist. LEXIS 13456.
158. See TEX. FIN. CODE ANN. § 32.009 (Vernon Supp. 1998).

