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House Bill 409 - Texas Raises the Ceiling on Residential Mortgage Loans

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HOUSE BILL 409—TEXAS RAISES THE CEILING ON RESIDENTIAL MORTGAGE LOANS

by
Scott M. Rawdin *

PROHIBITIONS against usury[1] have ancient roots.[2] The Old Testament contains several passages that strongly condemn usurious lending practices.[3] In medieval times, the Church denounced usury as a sin.[4] Early Texas law similarly prohibited usury.[5]

The Texas Constitution empowers the legislature to define interest[6] and to fix maximum rates of interest.[7] Absent such legislation fixing a greater rate,[8] the constitution sets a maximum interest rate of ten percent[9] per annum.[10] Contracts for a greater rate of interest are deemed

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1. In its earliest stages, usury was defined as whatever was demanded in return for a loan beyond the loaned good itself. J. NOONAN, THE SCHOLASTIC ANALYSIS OF USURY 20 (1957). That definition has evolved, so that usury in Texas is now defined as "interest in excess of the amount allowed by law." TEX. REV. CIV. STAT. ANN. art. 5069—1.01(d) (Vernon 1971).

2. *See generally* S. HOMER, A HISTORY OF INTEREST RATES 17-65 (1963); B. NELSON, THE IDEA OF USURY (1949); J. NOONAN, *supra* note 1, at 11-20; T. WILSON, A DISCOURSE UPON USURY (1963).

3. "Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of any thing that is lent upon usury . . . ." *Deuteronomy* 23:19. *See also Psalms* 15:5, *Leviticus* 25:36-37.

4. J. NOONAN, *supra* note 1, at 11-20.

5. The Fourth Congress of the Republic of Texas set the maximum interest rate at 12% per annum, and provided that all contracts that stipulated a greater rate were void. 1 J. SAYLES & H. SAYLES, EARLY LAWS OF TEXAS 337-38 (1888). The constitution of 1869 eliminated all usury laws in Texas and prohibited the legislature from passing laws to limit the amount of interest. TEX. CONST. art. XII, § 44 (1869). In 1876, however, protective measures were reintroduced at the same maximum 12% rate. TEX. CONST. art. XVI, § 11 (1876, amended 1891). The 1876 constitution further provided that all interest charged above the maximum rate was usurious and empowered the legislature to "provide appropriate pains and penalties to prevent and punish [usury]." *Id.* This limit was lowered to 10% per annum in 1891. *See* TEX. CONST. art. XVI, § 11 (1876, amended 1891).

6. The legislature has done so in art. 5069—1.01(a) of the Texas Revised Civil Statutes. Interest is defined there as "the compensation allowed by law for the use or forbearance or detention of money." TEX. REV. CIV. STAT. ANN. art. 5069—1.01(a) (Vernon 1971).

7. TEX. CONST. art. XVI, § 11.

8. One example of legislation fixing a greater than 10% per annum rate is S.B. 10, passed by the 66th Legislature in June 1979. That bill authorized a maximum annual interest rate of 18% on all nonagricultural and nonresidential loans of $250,000 or more that are evidenced by a written contract. *See* 1979 Tex. Sess. Law Serv., ch. 305, § 1, at 704-05 (Vernon) (amending TEX. REV. CIV. STAT. ANN. art. 5069—1.07(b)).

9. "Percent," the common abbreviation of the Latin "per centum," will be used throughout this Article. Unless otherwise indicated, all percentages are annual rates.

10. TEX. CONST. art. XVI, § 11. *See also* TEX. REV. CIV. STAT. ANN. art. 5069—1.02 (Vernon 1971) (maximum interest rate set at 10%, except as otherwise fixed by law). Regardless of the state usury ceiling, however, national banks may charge a rate of interest equal to one percent in excess of the federal reserve discount rate. 12 U.S.C. § 85 (1976). As

usurious.[11]

Prior to August 27, 1979, lenders in Texas were limited by a ten percent per annum interest ceiling on loans to noncorporate borrowers who desired to finance the purchase of a residence.[12] As prevailing interest rates in national money markets began to increase in 1978 and 1979, this ten percent interest ceiling decreased the availability of mortgage money to purchasers of homes in Texas.[13] Because lenders had to pay more for the money they were loaning than they could earn under the ten percent limit,[14] lenders either attempted to circumvent the usury law by charging points[15] to the seller,[16] or stopped making residential mortgage loans in Texas altogether,[17] resulting in an untenable situation. To remove this serious obstacle to home ownership, the Sixty-sixth Texas Legislature enacted House Bill 409 (H.B. 409) to allow higher interest rates on residential

of Sept. 7, 1979, national banks could charge an individual borrower an interest rate equal to 11-1/2%.

11. TEX. CONST. art. XVI, § 11. The Texas Legislature has also prescribed usury penalties. Prior to 1979, lenders who contracted for, charged, or received usurious interest were required to forfeit twice the amount of total interest contracted for, plus reasonable attorneys' fees, to the borrower. 1967 Tex. Gen. Laws, ch. 274, § 2, at 610. The 66th Legislature changed the forfeiture amount to three times the "amount of *usurious* interest contracted for," plus reasonable attorneys' fees. 1979 Tex. Sess. Law Serv., ch. 281, § 1, at 604 (Vernon) (emphasis added). It defined "amount of usurious interest contracted for" as "the amount the total interest contracted for, charged, or received exceeds the amount of interest allowed by law." *Id.* The legislature added the requirement that the amount forfeited shall equal at least $2,000 or 20% of the principal, whichever is smaller. *Id.* at 604-05.

12. *See* note 10 *supra.* Corporate borrowers are not subject to the 10% ceiling. "Notwithstanding any other provision of law, corporations . . . may agree to and stipulate for any rate of interest as such corporation may determine, not to exceed one and one-half percent (1-1/2%) per month." TEX. REV. CIV. STAT. ANN. art. 1302—2.09 (Vernon Supp. 1978-1979). Noncorporate borrowers, for purposes of state usury laws, include individuals, trusts, partnerships, limited partnerships, joint ventures, unincorporated associations, and possibly nonprofit corporations. *See generally* Loiseaux, *Some Usury Problems in Commercial Lending*, 49 TEXAS L. REV. 419, 438-41 (1971).

13. *See* TEXAS BUSINESS, May 1979, at 37. *See generally* McNulty, *The Impact of Usury Ceilings on Home Financing*, 8 REAL EST. REV., Summer 1978, at 68.

14. As the cost of money to lenders increased, the permitted Texas rate suddenly became less than the interest rates lenders had to pay for the money they were lending. *See* Wall St. J., Jan. 2, 1979, at 30, col. 1.

15. The word "point" as used in the home mortgage finance industry "simply denotes a fee or charge equal to one per cent (1%) of the principal amount of the loan which is collected by the lender at the time the loan is made." B.F. Saul Co. v. West End Park N., Inc., 246 A.2d 591, 595 (Md. 1978). *See* Loiseaux, *supra* note 12, at 422 (author found no Texas case that uses the term "points").

16. The practice of charging points was itself constrained by Texas usury laws. In Gonzales County Sav. & Loan Ass'n v. Freeman, 534 S.W.2d 903, 908 (Tex. 1976), the Texas Supreme Court ruled that a front-end "premium" charged to borrowers by a lender "will be deemed to constitute interest when seeking to determine the existence or nonexistence of usury" (footnote omitted). Inclusion of points as interest to determine usury further aggravated the shortage of home mortgage money in Texas. Contrast the charging of "points" with the collection of bona fide commitment fees, which are not treated as interest. *Id.*

17. Lomas & Nettleton Financial Corporation announced it would not make any more single family mortgage loans in Texas until the usury laws were changed. Wall St. J., Apr. 30, 1979, at 2, col. 2. *See* Wall St. J., Jan. 2, 1979, at 30, cols. 1-3. Other lenders sharply curtailed their residential lending. Texas Federal Savings and Loan Association's mortgage volume fell by one-half to two-thirds during 1978. Wall St. J., Jan. 2, 1979, at 30, col. 1.

loans.[18] Unfortunately, H.B. 409 may have created more problems than it solved.

Fundamentally, H.B. 409 increases the ceiling on interest rates on loans secured in whole or in part by a lien on certain residential real property to such rates as may be permitted by other applicable law, or to the lesser of twelve percent per annum or a rate (the "floating rate") that is two percent per annum in excess of the average per annum market yield (the "note rate") on ten-year United States Treasury notes and bonds.[19] The floating rate is to be determined by reference to the note rate for the second calendar month preceding the month in which the lender becomes legally bound to make the loan.[20] House Bill 409 restricts its coverage to loans secured in whole or part by a lien on real property "on which is located one or more single family dwellings, or dwelling units for not more than four families in the aggregate . . . ." House Bill 409 also prohibits prepayment charges unless required by an agency created by federal law[21] and incorporates antidiscriminatory and antiredlining provisions for certain lenders.[22]

This Article discusses the scope of H.B. 409 and highlights the more troublesome aspects of the statute. The discussion relies on general rules of statutory construction under Texas law,[23] relevant case authority, and a good deal of guess-work.

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18. 1979 Tex. Sess. Law Serv., ch. 715, at 1766-68 (Vernon). The bill is set out fully in the Appendix.

19. *Id.* § 1 (to be codified at TEX. REV. CIV. STAT. ANN. art. 5069—1.07(d)(1)).

20. *Id.* § 1 (to be codified at TEX. REV. CIV. STAT. ANN. art. 5069—1.07(d)(2)). For example, if a loan agreement becomes binding on March 5, the floating rate is determined by reference to the United States Treasury note rate for the preceding January. *See* note 30 *infra.*

21. *Id.* § 1 (to be codified at TEX. REV. CIV. STAT. ANN. art. 5069—1.07(d)(4)); *see* text accompanying notes 55-73 *infra.*

22. *Id.* § 4 (to be codified at TEX. REV. CIV. STAT. ANN. art. 5069-1.07(e)); *see* text accompanying notes 83-93; 104-29 *infra.*

23. The Texas Legislature has established guidelines for statutory construction for Texas courts. TEX. REV. CIV. STAT. ANN. art. 10 (Vernon 1969) provides the frequently applied plain meaning rule. The plain meaning rule is utilized to resolve questions of construction when words used in a statute are subject to differing interpretations. Nevertheless, courts are proscribed from adopting an interpretation of a statute that gives literal meaning to certain words or clauses if such an interpretation would defeat the legislative intent or would lead to an absurdity, injustice, or uncertainty, and if such an interpretation reasonably can be avoided. Rogers v. Dallas Ry. & Terminal Co., 214 S.W.2d 160, 167 (Tex. Civ. App.—Dallas 1948), *aff'd*, 147 Tex. 617, 218 S.W.2d 456 (1949).

Although every word in a statute is presumed to be used for a purpose, Perkins v. State, 367 S.W.2d 140, 146 (Tex. Crim. App. 1963), courts may supply, omit, and transpose words or phrases in a statute in order to arrive at legislative intent. *See* Patterson v. City of Dallas, 355 S.W.2d 838 (Tex. Civ. App.—Dallas 1962, writ ref'd n.r.e.), *appeal dismissed*, 372 U.S. 251 (1963). Notwithstanding the foregoing, courts are without authority to do more than declare and enforce the law and may not assume the legislative role of remedying statutory defects. Hilliard v. Wilkerson, 492 S.W.2d 292, 295 (Tex. Civ. App.—Fort Worth 1973, writ granted). The fundamental rule in statutory construction is to ascertain and give effect to the intent of the legislature, Jessen Assocs., Inc. v. Bullock, 531 S.W.2d 593, 599 (Tex. 1975), and courts may liberally construe legislative enactments in order to give effect to legislative intent. City of San Marcos v. Lower Colo. River Auth., 508 S.W.2d 403, 407 (Tex. Civ. App.—Austin 1974), *modified in other respects*, 523 S.W.2d 641 (Tex. 1975) (court held that

I. SCOPE OF H.B. 409

Section 1 of H.B. 409 increases the maximum interest rate allowable on loans that are secured or to be secured by an interest in real property "on which is located one or more single family dwellings."[24] An interpretation of the phrase, "on which is located," is necessary to ascertain the scope of this statute. Application of the "plain meaning" rule of statutory construction[25] to H.B. 409 suggests that the statute is limited to loans secured or to be secured by an interest in real property on which one or more single-family residences are already located. This interpretation would exclude loans for construction of new homes. There is no evidence of legislative intent contrary to this interpretation.

This apparent failure to include construction loans within the scope of the statute creates a gap in the Texas usury laws, resulting in a continuing ceiling of ten percent per annum for construction loans of less than $250,000 made to noncorporate borrowers. This anomaly is the product of insufficient coordination among the three separate usury bills adopted in the Sixty-sixth Legislature. Senate Bill 10[26] (S.B. 10) supplants section (b) of article 5069—1.07.[27] Under the amended section, a noncorporate bor-

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home-rule city had power to regulate electricity rates by ordinance for electricity sold within city limits).

While these general principles of statutory construction do not provide a conclusive guide as to the meaning of H.B. 409, and no Texas statute provides problems of construction analogous to those of H.B. 409, the plain meaning rule of statutory construction coupled with the legislature's obvious intent to raise interest rates on home mortgage loans and discourage discriminatory lending practices in Texas must be looked to for guidance as to how Texas courts will construe H.B. 409.

24. That section provides in part:

> (d)(1) On any loan or agreement to loan secured or to be secured in whole or in part by a lien, mortgage, security interest, or other interest in or with respect to real property on which is located one or more single family dwellings, or dwelling units for not more than four families in the aggregate, interest may be charged at such rates as may be permitted by other applicable law or at the lesser of the following rates:
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> (i) 12 percent per annum; or
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> (ii) a rate equivalent to the average per annum market yield rate adjusted to constant maturities on 10-year United States Treasury notes and bonds as published by the board of governors of the Federal Reserve System for the second calendar month preceding the month in which the lender becomes legally bound to make the loan plus an additional two percent per annum rounded off to the nearest quarter of one percent per annum.

1979 Tex. Sess. Law Serv., ch. 715, § 1, at 1766 (Vernon).

25. *See* note 23 *supra*.

26. *See* note 8 *supra*.

27. Senate Bill 10 amended art. 5069—1.07(b) to read as follows:

> (b) Notwithstanding any contrary provisions of law, any person may agree to pay, and may pay pursuant to such an agreement, any rate of interest not exceeding 18 percent per annum, if such agreement is evidenced by a written bond, note, or other contract of such person providing for a loan or other extension of credit in the original principal amount of $250,000 or more, or any series of advances of money if the aggregate of all sums advanced or agreed or contemplated to be advanced pursuant to such agreement equals or exceeds $250,000, or any extension or renewal of such loan or other extension of credit (regardless of whether or not the outstanding principal balance

rower seeking a construction loan for a one- to four-family dwelling unit is limited to the old ten percent per annum ceiling, thereby decreasing the likelihood of obtaining financing in today's money market, unless the loan equaled or exceeded $250,000 and the borrower did not intend to reside in the dwelling. Thus, neither H.B. 409 nor S.B. 10 provide interest rate relief to small scale home builders or to the potential homeowner who desires to finance construction of a home on a lot he already owns.

As H.B. 409 does not apply to construction loans, to what loans does it apply? The statute specifies "any loan or agreement to loan" that may be secured to some extent by a lien or other interest in real property on which are located one or more single-family dwellings.[28] Nothing in the statute requires that the borrower either own the real property or reside in the dwelling located thereon. Moreover, there is no limitation on the amount of property that can be covered by a mortgage or other lien under H.B. 409 so long as a qualifying dwelling unit is located somewhere on the real property.

II. Availability of Higher Interest Rates Under H.B. 409: Mechanics of the Statute

A. *When is a Lender "Legally Bound to Make a Loan"?*

Section (d)(1) of amended article 5069—1.07 allows interest to be charged at the lesser of twelve percent or the floating rate pegged to the market yield on specified federal obligations.[29] Ascertaining the floating rate requires a determination of the average market yield[30] for ten-year

thereof at the time of such renewal or extension is $250,000 or more); and as to any such agreement to pay or payment, the claim or defense of usury by such person or such person's heirs, personal representatives, successors, substitutes, or anyone else on such person's behalf, or by any person acting as guarantor, surety, accommodation maker, or endorser for or with respect to such agreement to pay or payment, or by any person assuming the obligation of such payment or otherwise becoming liable therefor, or by any person owning or acquiring property subject to a lien securing such agreement to pay or such payment is prohibited. Notwithstanding anything to the contrary contained herein, this Subsection (b) shall not apply to any loan or other extension of credit secured by (i) a lien on a building, constructed or to be constructed, which both is used or intended to be used as a single one-to-four family residence and is occupied or intended to be occupied by a person obligated to pay such loan or other extension of credit or (ii) a lien on land intended to be used primarily for agricultural or ranching purposes. Nothing herein shall be construed to limit or otherwise affect the provisions or application of Article 2.09, Texas Miscellaneous Corporation Laws Act, as amended (Article 1302—1.01 et seq., Vernon's Texas Civil Statutes), with respect to loans or other extensions of credit not covered hereby.

1979 Tex. Sess. Law Serv., ch. 305, § 1, at 704-05 (Vernon).

28. *See* note 24 *supra*.

29. *Id.*

30. These yields on actively traded issues adjusted to constant maturities are published in a Federal Reserve Statistical Release (Form G. 13 [415]). According to that release, the source for the yields is the U.S. Treasury. For example, a lender who became legally bound to make a loan on Sept. 7, 1979, could charge 11% per annum because the market yield for July, the second calendar month preceding commitment, was 8.95%. This is determined by

United States Treasury notes and bonds[31] existing two months preceding the month in which the lender becomes "legally bound to make the loan."[32] Although the meaning of this term is essential to determine the floating rate, H.B. 409 does not define when a lender is "legally bound to make the loan."

The plain meaning rule provides that unless a phrase in a statute is a term of art used in a particular trade or subject matter, such a phrase shall take on its ordinary meaning.[33] The phrase "legally bound" does not appear to be a term of art in the real estate area. The term "to bind" has been defined to mean "to obligate; to bring or place under definite duties or legal obligations, particularly by a bond or covenant; to affect one in a constraining or compulsory manner with a contract or a judgment."[34] Thus, the initial inquiry into a determination of when a lender is legally bound to make a loan should focus on when a legal obligation has been created between the lender and the borrower.

Requirement of a Contract. Whether a lender is legally bound to make a loan will often depend on the type of commitment, if any, issued by the lender and the nature of its terms. A written commitment from the lender to the borrower may become an enforceable contract upon the borrower's acceptance if the terms of the contract define with sufficient certainty the nature and the extent of each party's obligations. No binding contract exists if essential terms are left open for future negotiations between the parties.[35] Similarly, if there is no evidence of mutual assent or a meeting of

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adding 2% to the average market yield rate, rounded off to the nearest quarter of 1%, for the month of July. (8.95%, rounded to 9.0%) plus 2.0% equals 11.0%.

31. Treasury notes are obligations of the U.S. Government with intermediate maturities, typically not less than one year nor more than five years. Notes are largely bearer issues, although certain issues may be issued in registered form. F. GARCIA, MUNN'S ENCYCLOPEDIA OF BANKING AND FINANCE 743 (6th ed. 1962). Bonds, in contrast, are typically issued with maturities of over five years. *Id.* at 755. A number of states have chosen a similar floating rate, in which the ceiling is tied to some market rate of interest. Nine states had floating rates in mid-1977. McNulty, *supra* note 13, at 72.

32. *See* note 24 *supra*.

33. TEX. REV. CIV. STAT. ANN. art. 10, § 1 (Vernon 1969). *See* note 23 *supra*.

34. BLACK'S LAW DICTIONARY 213 (rev. 4th ed. 1968); *see* Stone v. Bradbury, 14 Me. 185, 193 (1837).

35. In Willowood Condominium Ass'n v. HNC Realty Co., 531 F.2d 1249 (5th Cir. 1976), the Fifth Circuit held that two letters describing loan terms to a developer from a commercial lender contained sufficient ambiguities and lacked essential terms so as to preclude the formation of a contract. The two letters had set forth the terms upon which the loan would be made and stated that the loan committee had acted favorably upon the loan. In holding that a contractual obligation did not arise, the Fifth Circuit restated the Texas law as follows:

> It is hornbook law as well as clearly the law of Texas that " '[a] court cannot enforce a contract unless it can determine what it is. It is not enough that the parties think that they have made a contract; they must have expressed their intentions in a manner that is capable of understanding.' . . ." "It is said to be fundamental that a person may not be subjected by law to a contractual obligation unless the character of such obligation is fixed with a reasonable degree of definiteness by an express or implied agreement of the parties . . . ."

Id. at 1251 (citations omitted).

the minds, no contract is formed.[36]

A loan commitment can be an enforceable contract if the traditional elements of a contract are present. Nevertheless, the loan commitment may, and usually does, contain conditions that suggest that a lender is not legally bound to fund the loan. These conditions may be interpreted either as conditions precedent to the formation of a contract or as conditions precedent to an obligation to perform an existing agreement.[37] Terms such as "if," "provided that," "on condition that," or other phrases that condition performance generally denote an intent for a condition and not a covenant or promise.[38] If the loan commitment is otherwise a valid contract, the existence of a condition precedent to a right to immediate performance or to a successful suit for breach of a contractual duty does not render the issuer any less bound to make the loan.[39] The borrower's ability to enforce the lender's performance or to sue for a breach of contractual duty does not arise, however, until the conditions precedent to the right to immediate performance are satisfied.[40]

There is some question whether a commitment containing conditions requiring the personal satisfaction of the lender constitutes a legally binding contract or instead presents an illusory contract upon which the lender would never be legally bound. A limitation on a promisor's duty, however, does not invalidate the contract as long as that limitation does not make his own promise illusory.[41] Under Texas law an expression of personal dissatisfaction by one of the parties to a contract must be made in subjective good faith[42] or must be objectively reasonable.[43] If, however,

36. *Id.*

37. Hohenberg Bros. v. George E. Gibbons & Co., 537 S.W.2d 1, 3 (Tex. 1976). The Texas Supreme Court aptly described the second of the two types of conditions precedent as "those acts or events, which occur subsequently to the making of a contract, that must occur before there is a right to immediate performance and before there is a breach of contractual duty." *Id.* (citations omitted).

38. *Id.*

39. *See* Lynch v. Stebbins, 127 Me. 203, 142 A. 735 (1928) (a promise to pay something on the happening of a certain event binds the promisor, though he is not liable to perform while the condition is unfulfilled).

40. For example:

> If one contracts to purchase a vessel at sea upon her safe arrival in port, no one will dispute that the obligation to deliver on one side, and to pay on the other, arises upon her safe arrival. The vessel may never arrive, and the contract is not absolute to performance on either side til the contemplated contingency occurs; but *the contract is binding* and only awaits the event, to become binding also to performance.

3A A. CORBIN, CORBIN ON CONTRACTS § 625 n.3 (1960) (quoting Corson v. Mulvany, 49 Pa. 88 (1865) (emphasis added)).

41. 3A A. CORBIN, *supra* note 40, § 644.

42. *See* Atlas Torpedo Co. v. United States Torpedo Co., 15 S.W.2d 150 (Tex. Civ. App.—Amarillo 1929, no writ). "When a contract is made subject to the approval or disapproval of either of the parties or a third party, it is the good faith of the party who is to be satisfied and not the reasonableness of his dissatisfaction which constitutes the test of the right." *Id.* at 152. *See also* Giles v. Union Land Co., 196 S.W. 312 (Tex. Civ. App.—Galveston 1917, writ ref'd) (vendee justified in refusing title as tendered in that he in good faith and not capriciously declared himself dissatisfied); Fessman v. Barnes, 108 S.W. 170 (Tex. Civ. App. 1908, no writ) (defendant may not, arbitrarily and without reason, refuse to

the commitment contains a condition to be fulfilled to the satisfaction of a third party, such as an architect or an engineer, the courts are more likely to hold that personal satisfaction must be met before performance is required.[44] If the condition to be satisfied involves objective tests, such as operative fitness or mechanical utility rather than personal tastes, there can be substantial compliance and the condition can be satisfied even though the promisor thinks otherwise.[45] The extent and quality of this performance can be measured by objective tests, scientific and mechanical in nature, that are uniform in application for all persons.[46]

According to the above analysis, if the lender's commitment to the borrower contains an offer to make a loan with specific terms setting forth the material elements of the obligations of both parties and such offer is accepted by the borrower, a valid and binding contract exists even though the lender may not be required to fund the loan until each of the conditions precedent to that obligation has been satisfied. It is often easier to determine that a valid contract exists than to determine whether all conditions precedent to performance have been satisfied. Thus, it is likely that the legislature intended the phrase "legally bound to make the loan" to mean that point in time when a valid and binding contract is formed.

Interpretation of a written commitment agreement under H.B. 409 may not frequently arise, however, because lenders typically will not issue a written commitment for a residential mortgage. Often, the borrower will call or visit the loan officer and ask that a loan be made on certain terms. The loan officer will then request a copy of the contract of sale, require a survey, an appraisal, a loan application, and then, after loan committee approval, verbally inform the potential borrower that a loan can be made. Such a situation raises the question of whether an oral commitment to make a loan is legally binding on the lender. If a writing is required to bind the lender but no written commitment is issued, then it follows that the lender is not bound until the day the loan is closed. The Statute of Frauds[47] requires that a contract for the sale of real estate be in writing

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pay under contract calling for plaintiff to dig a well to provide a water supply satisfactory to defendant).

43. *See, e.g.*, Fessman v. Barnes, 108 S.W. 170 (Tex. Civ. App. 1908, no writ). "[H]is action in expression of dissatisfaction must be founded on such facts as would induce such action on the part of a reasonable man." *Id.* at 171.

44. 3A A. CORBIN, *supra* note 40, § 646.

45. *Id. See* Texas Pac. Coal & Oil Co. v. Barker, 117 Tex. 418, 6 S.W.2d 1031 (1928).

46. 3A A. CORBIN, *supra* note 40, § 646.

47. The Texas Statute of Frauds applicable to loan agreements provides:

> (a) A promise or agreement described in Subsection (b) of this section is not enforceable unless the promise or agreement, or a memorandum of it, is
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> (1) in writing; and
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> (2) signed by the person to be charged with the promise or agreement or by someone lawfully authorized to sign for him.

and contain an adequate property description to be enforceable.[48] Similarly, an oral contract to make a loan on real estate, to be secured by the borrower's mortgage or deed of trust lien, is within the Statute of Frauds and unenforceable for failure to be in writing.[49]

Although Texas is a "lien theory" jurisdiction,[50] for purposes of the Statute of Frauds a mortgage is deemed a conveyance of real estate as security for the payment of a debt.[51] Thus, an oral contract to grant a mortgage comes within the Statute of Frauds,[52] and no oral loan commitment is legally binding until reduced to writing. Consequently, H.B. 409 ties the fixing of the ceiling interest rate to the date of issuing a written commitment to a potential borrower. Depending on which direction the market for ten-year Treasury notes and bonds is moving, lenders and borrowers will have a conflict of interest in setting the date on which the lender becomes legally bound to make a loan under H.B. 409. In a period

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(b) Subsection (a) of this section applies to

. . . .

(4) a contract for the sale of real estate;

. . . .

(6) an agreement which is not to be performed within one year from the date of making the agreement . . . .

TEX. BUS. & COM. CODE ANN. § 26.01 (Vernon 1968 & Supp. 1978-1979).

48. In Williams v. Ellison, 493 S.W.2d 734, 736 (Tex. 1973), the Texas Supreme Court defined the test for a sufficient description of property:

> This Court has consistently stated that the test for determining the sufficiency of the description of land in contracts to convey land, for compliance with the statute of frauds, is that "[t]o be sufficient, the writing must furnish within itself, or by reference to some other existing writing, the means or data by which the land to be conveyed may be identified with reasonable certainty."

Exactly what threshold of description is required is unclear. One court held a description to be legally sufficient when it contained a street address and lot dimensions as well as the lot and block number in the city and county in which the property was located, notwithstanding the absence of a reference to the map or deed records. *See* Pockrus v. Connelly, 521 S.W.2d 115 (Tex. Civ. App.—Beaumont 1975, writ ref'd n.r.e.). In contrast, another court held that a property description that consisted of a map not drawn to scale and not showing the width or length of boundary lines was insufficient to meet the requirements of the Statute of Frauds. *See* Guenther v. Amer-Tex Constr., 534 S.W.2d 396 (Tex. Civ. App.—Austin 1976, no writ).

49. *See* Edward Scharf Assoc. v. Skiba, 538 S.W.2d 501 (Tex. Civ. App.—Waco 1976, no writ). In *Skiba* the plaintiffs who had entered into a contract of sale for a new home thereafter applied to the lender for a purchase money loan. The lender committed to loan the money to the borrower; when the lender later refused to make the loan, the borrowers lost their earnest money and sustained additional damages. The trial court awarded judgment to the borrowers in their suit against the lender for specific performance and damages, but on appeal, the court reversed and held that the oral contract, which contemplated the creation of a lien on realty, was unenforceable under the Statute of Frauds. *Id.* at 503.

50. *See* Duffy, *The Character of Mortgages of Real Estate in Texas*, 12 S. TEX. L.J. 129 (1970). In a lien theory state, the mortgagee takes only a security interest in the realty. In contrast, in states following the title theory, the mortgagee takes title to the underlying realty. *Id.* at 129-32. In Texas, a deed of trust with a power of sale is the preferred real estate security document because it avoids the necessity of and is faster than judicial foreclosure. The term "mortgage" as used in this Article will refer to both mortgages and deeds of trust.

51. Poarch v. Duncan, 91 S.W. 1110 (Tex. Civ. App. 1906, writ ref'd).

52. *See* Woodman v. Bishop, 203 S.W.2d 977 (Tex. Civ. App.—San Antonio 1947, no writ) (contract contemplating creation of a lien on land must be in writing to be binding).

of rising interest rates, a lender may, in fact, desire to avoid becoming legally bound until the loan is actually closed.

Legislative History. Aside from this plain meaning interpretation of "legally bound," other sections of H.B. 409 and the statute's legislative history support the interpretation outlined above. An earlier version of H.B. 409 contained a "sunset" clause:

> (f) Section (d) of this Article does not apply to a loan made on or after September 1, 1981. On a loan of the type described by Section (d) that is made on or after that date, interest may not be charged at a rate greater than 10% per annum. For purposes of this section, a loan is made on the date that the note is executed.[53]

The final version of the "sunset" provision states that "[t]he interest rates authorized by this subsection shall not be applicable to any loan made on or after September 1, 1981, unless the lender had become legally bound to make such loan prior to such date."[54] By this revision, the legislature obviously intended that the words "legally bound to make such loan" mean something different from the date the loan is made. Of course, if no binding commitment is issued prior to the making of the loan, the critical date for determining the applicable interest rate ceiling will be the date the loan is made.

B. *Could the Collection of a Prepayment Charge or Penalty Not Required by an Agency Created by Federal Law Render a Loan Usurious?*

Section (d)(4)[55] of amended article 5069—1.07 prohibits the collection of prepayment charges and penalties on loans made pursuant to section (d)(1) of the statute, except where such collection is "required by an agency created by federal law."[56] The most important of several questions arising from this provision is what is the effect if a lender collects such a charge? A borrower might argue that such a charge should be deemed interest, thereby rendering a loan already bearing the maximum rate usurious.

Historically, Texas courts have not treated prepayment charges[57] as interest[58] on the ground that the charges are not compensation for the use of money but, rather, compensation for the privilege of repaying a loan

53. H.B. 409, 66th Legis., Reg. Sess. (as passed house, May 9, 1979).

54. 1979 Tex. Sess. Law Serv., ch. 715, § 1, at 1766 (Vernon).

55. No prepayment charge or penalty may be collected on any loan transaction of the class defined in Subsection (d)(1) bearing a rate of interest in excess of that authorized by Article 1.04, Title 79, Revised Civil Statutes of Texas, 1925, except where such collection is required by an agency created by federal law.
1979 Tex. Sess. Law Serv., ch. 715, § 1, at 1766 (Vernon).

56. *See* note 55 *supra* and text accompanying note 66 *infra*.

57. Prepayment charges are typically computed as a given percentage of the outstanding principal balance of the indebtedness.

58. *See* Gulf Coast Inv. Corp. v. Prichard, 438 S.W.2d 658, 661 (Tex. Civ. App.—Dallas), *writ ref'd n.r.e.*, 447 S.W.2d 676 (Tex. 1969) (prepayment penalty was not compensation "for the use, or forebearance or detention of money").

before maturity.[59] Because they were not interest, prepayment charges could not render a loan usurious.[60]

A disgruntled borrower forced to pay a prepayment charge not required by an agency created by federal law, however, could point out that the prohibition against prepayment charges is contained in a usury statute and the absence of any other penalty in the statute indicates that the legislature intended to treat the collection of prepayment charges as the collection of additional interest, thereby rendering the loan usurious. Moreover, the borrower could argue that the legislature would not have included a separate subsection prohibiting prepayment charges unless it intended that violations of the subsection be penalized. The only statutory penalty available would appear to be the usury penalty.[61]

Notwithstanding the foregoing arguments, it is doubtful that a lender who collects a prepayment charge in violation of H.B. 409 would be subject to a usury penalty. Rather than reversing a long-established rule of Texas case law, a court could simply require the lender to refund any such charge, without imposing the punitive usury provisions. Furthermore, lenders could persuasively counter the above arguments by emphasizing that clear and unequivocal language in the statute would be required to overturn the long-established rule that prepayment charges are not interest.[62] House Bill 409 merely prohibits the collection of such penalties by certain lenders under certain circumstances. Moreover, since the usury statute is penal in nature, lenders could argue that it should be strictly construed and not applied beyond its plain meaning.[63]

Because treating prepayment penalities as interest would overturn firmly established prior law, it is likely that the legislature intended only what it expressly stated in the statute and no more: the collection of prepayment penalties is prohibited on all loans with interest rates in excess of ten percent unless required by agencies created by federal law. The provision's purpose may be completely served through ordinary remedies such as an injunctive suit to prevent collection of prepayment charges or a damages action to recover such charges, without resort to the usury penalities.[64]

Interestingly, a proposed house committee amendment would have in-

59. Boyd v. Life Ins. Co., 546 S.W.2d 132, 133 (Tex. Civ. App.—Houston [14th Dist.] 1977, writ ref'd).

60. *Id.*

61. *See* note 11 *supra.*

62. *See* note 58-60 *supra* and accompanying text.

63. *See* City of San Marcos v. Lower Colo. River Auth., 508 S.W.2d 403, 407 (Tex. Civ. App.—Austin 1974), *modified in other respects*, 523 S.W.2d 641 (Tex. 1975) (statutes imposing penalties or forfeitures will be strictly construed in determining whether the act applies to persons not clearly included by the language of the law); Hull v. Chapman, 464 S.W.2d 705, 708 (Tex. Civ. App.—Tyler 1971, writ dism'd) (penal statute will be strictly construed so as not to extend it beyond its plain meaning or apply it to situations it was not intended to remedy).

64. An important distinction should be noted between "contracting for" prepayment charges and "collecting" prepayment charges. House Bill 409 prohibits only the latter; hence, a lender could include such a provision in the promissory note without violating the statute.

sured the borrower's right to prepay a loan bearing more than ten percent per annum under H.B. 409.[65] The enacted version of the prepayment provision does not protect the borrower in this fashion because a lender could simply fail to grant the borrower the right to prepay. Without the express grant, the borrower has no such right.

C. *What Is an Agency Created by Federal Law?*

As indicated above, H.B. 409's prohibition on collection of prepayment charges and penalties contains an exception for charges "required by an agency created by federal law."[66] What is an "agency created by federal law" and when does such an agency require prepayment penalities? The statute itself gives no guidance beyond the words used and there is no helpful legislative history available. The legislature's choice of wording is broader than it could have been, as it includes not only "federal agencies" but also all "agencies created by federal law." For purposes of the federal Administrative Procedure Act, an agency is defined as "each authority of the United States, whether or not it is within or subject to another agency."[67] Government-owned or -controlled corporations have been held to be administrative agencies when they are organized to administer specific federal statutory provisions.[68] Given the importance of the secondary mortgage market and government mortgage insurance to the residential mortgage lending industry, and the peculiar wording of the statute, it is probable that H.B. 409's limited authorization of the collection of prepayment charges contemplates the requirements of organizations such as the Federal National Mortgage Association (FNMA), the Government National Mortgage Association (GNMA),[69] the Federal Home Loan

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65. Amend H.B. No. 409 by adding to Section 1 thereof the following:

> (d)(3) The provisions of Subsection (d)(1) shall not be applicable to any loan transaction if the loan contract provides for a rate of interest in excess of that authorized by Article 1.04, Title 79, Revised Civil Statutes, 1925, and fails to give the obligor the full right of prepayment without charge or penalty.

Amendment # 2, Texas Legislative Service, House Committee Amendments to H.B. 409 (May 4, 1979).

66. *See* note 55 *supra*.

67. 5 U.S.C. § 551(1) (1976).

68. *See* Acron Inv., Inc. v. Federal Sav. & Loan Ins. Corp., 363 F.2d 236 (9th Cir. 1966) (Federal Savings & Loan Insurance Corporation is an agency for purposes of 28 U.S.C. § 451 (1976)).

69. FNMA and GNMA collectively perform the three functions originally possessed by the predecessor Federal National Mortgage Association, created by the National Housing Act in 1943. Pub. L. No. 73-479, 48 Stat. 1246. These three functions are (1) managing and liquidating the portfolio of mortgages acquired by the predecessor FNMA before 1954; (2) performing the special assistance functions of channeling federal funds to encourage selected types of mortgages, or to maintain a high level national economy; and (3) providing a secondary market facility for home mortgages. Murray, *The Developing National Mortgage Market: Some Reflections and Projections*, 7 REAL PROP. PROB. & TR. J. 441 (1972). Title VII of the Housing and Urban Development Act of 1968 partitioned the predecessor FNMA into the present FNMA and GNMA. Pub. L. No. 90-448, 82 Stat. 476. The mortgage portfolio managing and liquidating function and the special assistance function were delegated to GNMA, a federally chartered corporation that was created as an agency within the Department of Housing and Urban Development. 12 U.S.C. §§ 1717, 1720-1723 (1976). The secondary market function was delegated to the present FNMA, a federally chartered but

Mortgage Corporation (FHLMC),[70] and the Federal Housing Administration (FHA).[71] Viewed in this way, H.B. 409's prepayment provision appears to be an attempt to balance borrowers' need to refinance mortgage loans if and when interest rates decline with the need of lenders to satisfy requirements of the secondary mortgage market and mortgage insurers.

Of the foregoing organizations, only the FLHMC and FNMA currently require the use of a prepayment penalty and then only in their approved form of note for conventional loans.[72] However, the FNMA/FHLMC form of note for use in Texas on all conventional loans originated after January 1, 1980 will grant the borrower the right to prepay the loan without a prepayment penalty.[73]

III. CONSTITUTIONAL VALIDITY OF H.B. 409

House Bill 409 contains several features that may subject it to a constitutional attack. The first basis for such an attack is the clause of H.B. 409 providing for an alternative to the floating rate provision in the event the floating rate is found unconstitutional. The second basis for attack is the antidiscrimination and antiredlining features of section 4 of H.B. 409.

A. *Is It Constitutionally Permissible to Draft a Statute with Alternative Provisions?*

Section 3 of H.B. 409[74] was added in the anticipation that a Texas court

privately owned corporation which purchases conventional and VA- and FHA-insured loans from home mortgage lenders. 12 U.S.C. §§ 1717-1719, 1723 (1976). *See generally* 1 PRACTICING LAW INSTITUTE, FEDERAL NATIONAL MORTGAGE ASSOCIATION 9-11 (1975).

70. FHLMC is authorized to purchase loans from certain federally insured lenders such as savings and loan associations and insured commercial banks, under section 305(a)(1) of the Federal Home Loan Mortgage Corporation Act. 12 U.S.C. § 145(a)(1) (1976). *See* Burns, *The Federal Home Loan Mortgage Association—The First 400 Days and Beyond—A Legal View*, 30 FED. B.J. 303 (1971); Murray, *supra* note 69, at 445-46.

71. The Federal Housing Administration Regulations, issued pursuant to § 203 of the National Housing Act, govern the eligibility requirements for mortgages covering one- to four-family dwellings. Section 203.22 requires that such mortgages contain a provision permitting the mortgagor to prepay the mortgage in whole or in part after giving the mortgagee 30 days advance written notice of intention to prepay. Moreover, it prohibits such mortgages from providing for a charge on account of such prepayment. 24 C.F.R. § 203.22 (1979).

72. FNMA Conventional Home Mortgage Selling Contract Supplement, 2 FED. BANKING L. REP. (CCH) ¶25,721.05. The FNMA/VA Mortgage Contract Supplement specifically states that a prepayment penalty is not required in the government-insured home mortgages it covers. *Id.* ¶25,539A.

73. FNMA/FHLMC Uniform Instrument—Texas—1 to 4 Family—8/79.

74. Section 3 provides as follows:

> In the event that the floating rate provisions of Section 1 of this Act are held to be unconstitutional, then Article 1.07, Title 79, Revised Civil Statutes of Texas, 1925, as amended (Article 5069—1.07, Vernon's Texas Civil Statutes), is amended by adding a new Subsection (d) in lieu thereof to read as follows:
>
> (d)(1) On any loan or agreement to loan secured or to be secured in whole or in part by a lien, mortgage, security interest, or other interest in or with respect to real property on which is located one or more single family dwellings, or dwelling units for not more than four families in the aggregate, interest may be charged at the rate of 12 percent per annum. A "dwelling unit"

may hold the floating interest rate provision of article 5069—1.07(d)(1) to be unconstitutional. To protect the entire statute from invalidity, section 3 of H.B. 409 provides an alternative by restating essentially the same basic language used in section 1 but deleting the floating interest rate provision and, curiously, the phrase "such rates as may be permitted by other applicable law."[75] This contingency drafting was designed to take advantage of judicial interpretations of the severability of unconstitutional portions of statutes.

A court has the power to review legislation and invalidate any unconstitutional sections of such legislation.[76] When a court so acts, the validity of the remainder of the statute is also in jeopardy. The general rule is that a court will attempt to sustain the remaining legislation, provided it can determine that the legislature would have enacted the remnant of the statute without the offending provision and that the remaining legislation is capable of execution.[77] The court's decision depends on the content of each statute.[78]

> shall mean for the purpose of this section a unified combination of rooms that is designed for residential use by one family.
>
> (2) The interest rates authorized by this subsection shall not be applicable to any loan made on or after September 1, 1981, unless the lender had become legally bound to make such loan prior to such date.
>
> (3) No prepayment charge or penalty may be collected on any loan transaction of the class defined in Subsection (d)(1) bearing a rate of interest in excess of that authorized by Article 1.04, Title 79, Revised Civil Statutes of Texas, 1925, except where such collection is required by an agency created by federal law.

1979 Tex. Sess. Law Serv., ch. 715, § 3, at 1766-67 (Vernon) (footnote omitted).

75. *Id.*

76. *See generally* 1 C. SANDS, STATUTES AND STATUTORY CONSTRUCTION § 2.01 (4th ed. 1972).

77. *See* Southern Canal Co. v. State Bd. of Water Eng'rs, 311 S.W.2d 938, 942 (Tex. Civ. App.—Austin), *aff'd*, 159 Tex. 227, 318 S.W.2d 619 (1958).

78. *See* City of Farmersville v. Texas-Louisiana Power Co., 55 S.W.2d 195, 204 (Tex. Civ. App.—Dallas 1932), *rev'd*, 67 S.W.2d 235 (Tex. Comm'n App. 1933, judgmt adopted). Two approaches to severability are revealed in a comparison of the intermediate and senior appellate courts' reasoning. The court of civil appeals held:

> "It is undoubtedly elementary law that the same statute may be in part constitutional and in part unconstitutional, and, if the parts are wholly independent of each other, that which is constitutional may stand, and that which is unconstitutional will be rejected; but if the different parts of the act are so intimately connected with and dependent upon each other as to warrant a belief that the legislature intended them as a whole, and that if all could not be carried into effect the legislature would not have passed the residue independently, and some parts are unconstitutional, all the provisions which are thus dependent upon each other must fail."

55 S.W.2d at 204 (quoting Johnson v. State, 59 N.J.L. 535, 37 A. 949, 950 (1897)).

The Texas Commission of Appeals reversed, stating that by striking out the void section of the statute, the statute would have a broader scope than the legislature intended. The Commission stated the controlling rule:

> "If, by striking out a void exception, proviso or other restrictive clause, the remainder, by reason of its generality, will have a broader scope as to subject or territory, its operation is not in accord with the legislative intent, and the whole would be affected and made void by the invalidity of such part."

67 S.W.2d at 238 (quoting 1 J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 306 (J. Lewis 2d ed. 1904)).

Legislative attempts to provide for such contingencies are not unusual.[79] Statutes frequently contain provisions stating that if a part of the statute is declared unconstitutional, then the remainder of the statute shall remain effective.[80] The courts are receptive to such language, unless they are convinced that it is so routine as to be mere boilerplate and not an expression of legislative intent that the statute be saved.[81]

A review of Texas law discloses no other Texas statute containing a clause comparable to section 3,[82] which, rather than merely stating that a section shall be sustained to the extent possible, goes on to draft the section as it would appear if the offensive language were struck down. Because the courts have been receptive even to the more general savings clause, however, this more self-conscious attempt by a legislature, far from being considered invalid, should be considered to be the strongest possible evidence of the legislature's will that the statute be saved.

B. *May the Texas Legislature Constitutionally Distinguish Among Lending Institutions with Respect to Antidiscrimination and Antiredlining Requirements?*

Section 4 of H.B. 409 penalizes certain types of lending institutions if they engage in prohibited discrimination or redlining[83] practices in connection with residential loans.[84] That section's penalty is an interest ceil-

79. *See* 2 C. SANDS, *supra* note 76, § 44.08.

80. For example, in City of Houston v. State, 171 S.W.2d 203, 207 (Tex. Civ. App.—Galveston), *rev'd*, 142 Tex. 190, 176 S.W.2d 928, *appeal dismissed*, 322 U.S. 711 (1943), the statute in question included a saving clause that

> "should any section or part of this ordinance be held unconstitutional, illegal or invalid, such unconstitutionality, illegality or invalidity of such section or part shall in no wise affect, impair or invalidate the remaining portion thereof, but as to it the same shall be and remain in full force and effect."

81. 2 C. SANDS, *supra* note 76, at § 44.08.

82. *See* note 74 *supra*.

83. "Redlining" describes the process used by banks and other lending institutions to refuse systematically to grant mortgages and make home improvement loans in certain urban neighborhoods. *See* Note, *Attacking the Urban Redlining Problem*, 56 B.U.L. REV. 989, 989 (1976).

84. The full text of § 4 is as follows:

> Article 1.07, Title 79, Revised Civil Statutes of Texas, 1925, as amended (Article 5069—1.07, Vernon's Texas Civil Statutes), is amended by adding Subsection (e) to read as follows:
>
> (e)(1) In this subsection "financial institution" means a state bank, state savings and loan association, mortgage banking institution, credit union, national bank, or federal savings and loan association, and "housing accomodation" means improved or unimproved real property, or a portion of that property, that is used or occupied or is intended, arranged, or designed to be used or occupied as the residence of one or more individuals.
>
> (2) A financial institution may not charge interest under Subsection (d), Section 1 or Subsection (d) of Section 3 of this Act and the maximum rate of interest that it may charge is limited to 10 percent if the financial institution in connection with such loan discriminates in providing or granting financial assistance to purchase, rehabilitate, improve, or refinance a housing accommodation due, in whole or in part, to the consideration of:
>
> (i) conditions, characteristics, or trends in the neighborhood where the property is located, unless the financial institution can demonstrate that such a

ing of ten percent, and it applies to the following classes of lenders: state banks, state savings and loan associations, mortgage banking institutions, credit unions, national banks, and federal savings and loan associations.[85] Noticeably absent from the group are such other home mortgage lenders as life insurance companies. Because the statute thus regulates some classes of lenders and omits others, to be constitutionally valid the statutory classification must satisfy the equal protection requirements of both the Texas[86] and the United States Constitutions.[87] The statute regulates one class of lenders by limiting its authority to charge higher rates of interest, thus infringing only that class's economic interests. Unlike infringements of fundamental liberties such as freedom of speech, which are subjected to "strict scrutiny" review,[88] a classification that does not create a "suspect classification"[89] and that infringes only economic interests must satisfy only the deferential "rational relationship" standard of review,[90]

> consideration in the particular case is required to avoid an unsafe or unsound business practice; or
>
> (ii) race, color, religion, sex, marital status, national origin, or ancestry; or in appraising a housing accommodation or in determining whether or not, or under what terms and conditions, to provide financial assistance to purchase, rehabilitate, improve, or refinance a housing accommodation, considers:
>
> (i) the racial, ethnic, religious, or national origin composition of the neighborhood or geographic area surrounding the property; or
>
> (ii) whether or not that composition is undergoing change, or is expected to undergo change.

1979 Tex. Sess. Law Serv., ch. 715, § 4, at 1767 (Vernon) (footnote omitted).

85. *Id.* § (e)(1).

86. *See* TEX. CONST. art. I, § 3, which provides: "All free men . . . have equal rights . . . ." Although phrased specifically in terms of "men," the Texas equal protection guarantee has been interpreted by Texas courts analogously to the United States Supreme Court's interpretations of the fourteenth amendment provision, thereby including within its protection not only men but also women and such artificial "persons" as corporations. *See, e.g.*, San Antonio Retail Grocers, Inc. v. Lafferty, 156 Tex. 574, 297 S.W.2d 813 (1957).

87. U.S. CONST. amend. XIV, § 1.

88. *See, e.g.*, Shelton v. Tucker, 364 U.S. 479, 488 (1960) (freedom of speech). *See also* Skinner v. Oklahoma, 316 U.S. 535 (1942) (classification of habitual offenders to be subjected to compulsory sterilization must satisfy strict scrutiny).

89. Suspect classifications, for purposes of equal protection analysis, are generally those classes whose members are powerless to change their membership in the class, including classifications based on race, illegitimacy, alien status, and poverty. For an early statement of the suspect classification concept, see United States v. Carolene Products Co., 304 U.S. 144, 152 n.4 (1938).

90. In Lindsley v. Natural Carbonic Gas Co., 220 U.S. 61 (1911), the Court sustained a statute that prohibited drawing mineral waters out of the ground for the purpose of distilling out and selling separately the gas trapped in the water, although drawing water out of rock was permitted. The test by which the Court upheld the statutory classification was as follows:

> 1. The equal-protection clause of the 14th Amendment does not take from the State the power to classify in the adoption of police laws, but admits of the exercise of a wide scope of discretion in that regard, and avoids what is done only when it is without any reasonable basis, and therefore is purely arbitrary. 2. A classification having some reasonable basis does not offend against that clause merely because it is not made with mathematical nicety, or because in practice it results in some inequality. 3. When the classification in such a law is called in question, if any state of facts reasonably can be conceived that would sustain it, the existence of that state of facts at the time the law was enacted must be assumed. 4. One who assails the classification in such a

which has been applied by courts to both the Texas[91] and United States[92] equal protection provisions. Under this relaxed standard the legislature's classification of lenders for purposes of redlining regulation should easily pass muster, because the Texas Constitution itself empowers the Texas Legislature to "classify loans and lenders" for purposes of regulating interest rates.[93]

C. *Has the Legislature Unconstitutionally Delegated Its Authority to Set Maximum Interest Rates?*

The Texas Constitution specifically authorizes the legislature to fix maximum rates of interest.[94] The Texas attorney general recently construed this enumerated power, advising that "the Legislature may not delegate its power to establish maximum interest rates" and that if the legislature "fails to exercise its power to state the maximum by attempting to delegate it to an administrative agency, the constitutional maximum will come into effect."[95] Although the attorney general opinion addressed the issue of delegating interest rate-setting to federal agencies actually engaged in making loans, H.B. 409 raises the question of whether the legislature has improperly delegated its power by linking the maximum rate that a lender can charge to the market yield on specified federal obligations. The language of the statute itself casts doubt on the constitutionality of the floating rate provisions.[96] The improper delegation, if any, is seen in allowing the maximum rate of interest that may be charged on home loans under the floating rate, in effect, to be determined by the note rate[97] until the floating rate reaches twelve percent. The argument would be that until this ceiling is reached, the maximum rate of interest is a floating rate to be determined

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> law must carry the burden of showing that it does not rest upon any reasonable basis, but is essentially arbitrary.

Id. at 78-79.

91. Under art. I, § 3 of the Texas Constitution,

> [T]he Legislature has the power, however, to adopt any classification it sees fit, provided there is any reasonable basis for such classification. . . . [It] has the power to make any classifications and exemptions which are not arbitrary and unreasonable. . . . In determining whether a classification is arbitrary and unreasonable . . . the test is whether there is any basis for the classification which could have seemed reasonable to the Legislature.

Ground Water Conservation Dist. No. 2 v. Hawley, 304 S.W.2d 764, 767-68 (Tex. Civ. App.—Amarillo 1957, writ ref'd n.r.e.) (citations omitted).

92. *See* note 90 *supra.*

93. TEX. CONST. art. XVI, § 11. *See* Wagner v. Austin Sav. & Loan Ass'n, 525 S.W.2d 724, 728 (Tex. Civ. App.—Beaumont 1975, no writ), where the court noted the special power given only to savings and loan associations to charge premiums in making loans as an example of a permitted "lender classification" by the legislature.

94. TEX. CONST. art. XVI, § 11; *see* note 7 *supra* and accompanying text.

95. TEX. ATT'Y GEN. LA-146 (1977). Article XVI, § 11 of the Texas Constitution sets a maximum annual rate of 10% when the legislature fails to legislate otherwise. *See* note 10 *supra.*

96. *See* note 24 *supra.*

97. As of Sept. 7, 1979, that rate was 9%, yielding a floating rate of 11%. *See* note 30 *supra.*

according to a rate of interest on federal obligations set by a federal agency.

The validity of the delegation of legislative authority depends on whether the Texas Legislature has prescribed sufficient standards to guide the discretion which is conferred. If sufficient standards are prescribed, then the power that is conferred is not legislative and the delegation is lawful.[98]

The better view is that the legislature has not delegated any authority, legislative or otherwise, but has merely selected the note rate as an objective economic indicator to be determined from time to time independently of maximum allowable rates of interest in Texas.[99] House Bill 409 does not in fact confer any power on the board of governors of the Federal Reserve System to set maximum rates of interest on home loans in Texas. Instead, the legislature has chosen the note rate as an objective standard for determining usury, with the limitation that the maximum rate of interest may not, in any event, exceed an annual rate of twelve percent.

As a general principle a Texas court determining the constitutionality of a statute is charged with the duty of construing it so as to render it valid, if it can be done lawfully.[100] This duty cannot be relied upon, however, as assurance that the floating rate provision of H.B. 409 will be held to be constitutional. Assuming that the floating rate provisions of H.B. 409 are unconstitutional, it then becomes necessary to determine when the fixed twelve percent rate would take effect.[101] It is unclear whether the alternative provision is intended to be effective (a) as of the date of the holding of unconstitutionality, or (b) retroactively as of the effective date of H.B. 409. If the twelve percent alternative does not take effect retroactively, and if a holding of unconstitutional delegation means that the floating rate was never effective, a lender who collected eleven percent interest in reliance on the floating rate provision may be guilty of usury and be subject to the appropriate usury penalty.

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98. *See* Housing Auth. v. Higginbotham, 135 Tex. 158, 172, 143 S.W.2d 79, 87 (1940), in which the court stated that "[i]n the delegation of legislative authority the legislature must set up standards . . . . Such standards may be broad where conditions must be considered which cannot be conveniently investigated by the legislature." *See also* Moody v. City of Univ. Park, 278 S.W.2d 912, 922 (Tex. Civ. App.—Dallas 1955, writ ref'd n.r.e.), in which the court stated:

> "It is fundamental that a legislative body may not delegate unlimited legislative powers and functions to an administrative agency. Whenever the legislative body vests any administrative agency, such as a zoning board, with the power to exercise discretion, it must spell out the limits of that discretion by the establishment of some standard to guide the agency. Such a standard may be general and at the same time be valid if it is capable of reasonable application."

(quoting 1 E. YOKLEY, ZONING LAW AND PRACTICE 327 (3d ed. 1953)).

99. Distinguish this independent, unrelated federal action from the issue raised in TEX. ATT'Y GEN. LA-146 (1977): whether exempting VA and FHA loans from Texas usury laws is an unconstitutional delegation of legislative authority because the respective federal agencies involved set the usury threshold. *See* note 95 *supra*.

100. *See* notes 76-78 *supra* and accompanying text.

101. *See* notes 74-82 *supra* and accompanying text.

A law that is found unconstitutional is generally held to be void from its inception, and no acts performed under it are justified.[102] On equitable principles, however, those who act in good-faith reliance on a statute should not be held accountable for acts committed before that statute is held unconstitutional.[103] Whether these equitable principles would protect a lender who makes home mortgage loans at more than ten percent interest in reliance on H.B. 409 is questionable.

IV. REDLINING AND DISCRIMINATION PENALTIES OF H.B. 409

A. *When Does a Financial Institution Discriminate Based Upon Prohibited Classifications?*

The most troublesome portions of H.B. 409 are found in section 4. That section of the bill adds section (e)(2) to article 5069—1.07 and delineates various acts of discrimination in the financing of "housing accommodations" as defined in the statute.[104] This section suffers from both poor wording and confusing organization. Unfortunately, it attempts to rectify a social problem by limiting rates of interest that certain lenders can charge, but it fails to prohibit discriminatory behavior directly. Moreover, it provides no remedy to a person who fails to obtain a loan because of the delineated discriminatory behavior.

Section (e)(2) of article 5069—1.07 prohibits a financial institution from charging the new maximum interest rates if such lender, in granting financial assistance to purchase, rehabilitate, improve, or refinance a housing accommodation, commits any of three prohibited practices. A lender is to be penalized if it (1) discriminates against persons on the basis of race, color, religion, sex, marital status, national origin, or ancestry; (2) discriminates against property located in neighborhoods with certain characteristics; or (3) considers the sociological composition of the neighborhood or the degree to which it is changing or likely to change while appraising a house or determining on what terms and conditions the lender might loan money.[105] The scope of this section is disturbingly unclear.

Lenders may take some comfort in the legislature's use of the ambiguous phrasing "in connection with such loan," which may serve as a limitation

102. *See* Miller v. Davis, 136 Tex. 299, 150 S.W.2d 973 (1941) (unconstitutional statute purporting to create a nonprofit corporation held not even sufficient to create a de facto corporation); *cf.* Sharber v. Florence, 131 Tex. 341, 115 S.W.2d 604 (1938) (original rights obtained under a judgment will be protected in spite of a void statute, but rights acquired under such void statute will not be similarly protected).

103. *See* Wichita County v. Robinson, 155 Tex. 1, 276 S.W.2d 509 (1954) (tax assessor-collector not required to repay compensation he received under an unconstitutional statute).

104. *See* note 84 *supra*. For general discussions of other state and federal attempts to curb redlining, see Givens, *The "Antiredlining" Issue: Can Banks Be Forced to Lend?*, 95 BANKING L.J. 515 (1978); Van Alstyne, *Redlining—The Cure Worse than the Illness*, 3 J. CONTEMP. L. 264 (1977); Note, *supra* note 83; Note, *Redlining—The Fight Against Discrimination in Mortgage Lending*, 6 LOY. CHI. L.J. 71 (1975); Note, *The Home Mortgage Disclosure Act of 1975: Will It Protect Urban Consumers From Redlinings?*, 12 NEW ENG. L. REV. 957 (1977).

105. *See* note 84 *supra*.

on the scope of the section. If "in connection with such loan" refers to a particular loan in connection with which the lender discriminated, the penalty would appear to apply only to those improper loans. This narrow construction gains some support from the language of section 4 as a whole. "Such loan" is singular, and section (e)(2) of amended article 5069—1.07 refers to "a [singular] housing accommodation." In addition, the unsound business exception of section (e)(2)(i) uses the phrase "in the particular case."[106] One possible construction of section (e)(2) might be: The maximum rate of interest that a lender may charge on a particular loan is limited to ten percent if it commits one of the discriminatory acts. Although this construction is narrow, it is reasonable, because any broader construction would provide no additional benefit to the victims of redlining in the making of the particular loan, although it would admittedly make redlining more onerous for the lender. Because of the ambiguous wording, however, the ten percent limit could be applied not only to loans in which the lender discriminated, but to all loans made by the lender. As a practical matter, the first construction is unlikely because it is doubtful that one who receives a loan to the exclusion of another, or at a lower interest rate, could successfully sue to reduce his loan to ten percent on the ground that he was the beneficiary of illegal discrimination against another. Additionally, the ten percent limitation, being a de facto penalty, should be strictly construed by the courts.[107]

Furthermore, the phrase "in connection with such loan" may serve to narrow the range of persons with standing to sue for a violation of this section. This nexus requirement would seem to bar suits by third parties seeking to vindicate a purported right held by citizens in general to reside in a community with a vibrant central city or to live in a nondiscriminatory society.[108] Under the narrower construction only those who have been discriminated against would have standing to sue. Of course, for a borrower who has been wrongfully denied a loan, rather than given one on less favorable terms, the statute's reduction of the interest to ten percent is a meaningless remedy.

Thus, section (e)(2) may be narrow both in scope and remedy. The organization of section (e)(2), however, makes it unclear just how narrow it is. A prior house version of H.B. 409 supports the narrower interpretation. The earlier version specifically applied the phrase "in connection with such loan" to both the first and second portions of section (e)(2). In construing H.B. 409, a court might treat the earlier house version as evidence of the legislature's intent at the time of passage of H.B. 409.[109]

106. *Id.*
107. *See* note 63 *supra.*
108. *Compare* Gladstone, Realtors v. Village of Bellwood, 99 S. Ct. 1601, 60 L. Ed. 2d 66 (1979) (residents of village had standing to contest "racial steering" under 42 U.S.C. § 3604 (1976) *with* Warth v. Seldin, 422 U.S. 490 (1975) (residents of neighboring towns denied standing to challenge restrictive zoning statute). *See generally* Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975) (construing standing under Securities Exchange Act § 10(b), 15 U.S.C. § 78j(b) (1976)).
109. *See* H.B. 409, 66th Legis., Reg. Sess. (as passed house, May 9, 1979).

As discussed above, section (e)(2) is rather peculiarly organized. The first part of section (e)(2) prohibits discrimination "in providing or granting financial assistance . . . due . . . to the consideration of" certain characteristics of either the borrower or the residential property.[110] The second part of section (e)(2) calls for the same sanction if the lender considers the sociological composition of the neighborhood or the extent to which it will change in appraising a housing accommodation, determining whether or not to provide financial assistance in connection therewith, or deciding on what terms and conditions to make such a loan. These two parts of section (e)(2) appear to overlap. All the preliminary procedures enumerated in the second part of section (e)(2) seem to be necessarily subsumed under the first part. An appraisal, a decision to grant assistance, and a decision on terms and conditions of that assistance are all steps toward "providing or granting financial assistance." The legislature's separate treatment of the steps involved in a lender's credit analysis and of the final decision to grant the loan, plus the construction of the phrase "in connection with such loan," may be important. If, however, the phrase "in connection with such loan" applies only to the first part, and the nexus requirement is not applied to the prohibited preliminary procedures of the second portion, a financial institution may be successfully sued by a borrower who may not have been individually victimized by redlining.

B. *What is the Meaning of "Considers" as Used in H.B. 409?*

An example of the vagueness of section (e)(2) appears in the first portion of that section, which prohibits discrimination "due, in whole or in part, to the *consideration* of" certain personal and neighborhood characteristics.[111] Similarly, the second portion of section (e)(2) imposes a penalty if the lender "considers" the sociological composition of the area where the mortgaged property is located.[112] It is unclear exactly what evaluative process, whether objectively determinable or not, is contemplated to be included in "consideration."

A broad definition of the word "consider" by the courts would create uncertainty throughout the lending industry. As a routine business practice, financial institutions gather and use information about the social and economic composition of the areas in which they do business. The various social and economic data that are prohibited considerations in section (e)(2) inescapably enter a lender's decision-making process. Thus, the existence of a violation of section (e)(2) will depend on the meaning given to the term "consider" by the Texas courts; that is, whether mere awareness or knowledge of the prohibited factor by the lender is sufficient, or whether some weight must have been given to it in making the loan decision. The term "consider" is not defined in the statute, but an early Dallas court of civil appeals decision defined the term "considered" in a review of

110. *See* note 84 *supra*.
111. (Emphasis added); *see* note 84 *supra*.
112. *See* note 84 *supra*.

the influence of improperly admitted evidence upon a trial judge sitting as fact-finder. The court stated: "[T]he word 'considered' has reference to and means, when used in connection with the admission of incompetent evidence, the consideration of same *by which effect is given thereto* in arriving at the conclusion reached in the trial of a cause."[113] If this definition is applied to the analogous lending decision, a lender will have violated section (e)(2) when it gives some weight to one of the prohibited factors in making the loan decision.[114]

C. *Is Section 4 of H.B. 409 Unconstitutionally Vague?*

Uncertainty as to the definition of the word "considers" may pose serious problems for the validity of the statute. First, the ambiguity of the term "consider" may render the statute unconstitutionally vague.[115] The United States Supreme Court has subjected statutes to two major tests for vagueness, and H.B. 409 may fail under either. Under the notice theory, the question posed is whether a person of ordinary intelligence can determine from a reading of the statute that his conduct is prohibited.[116] It is arguable that lenders will be unable to make such a determination under the statute as written. The second test focuses not on notice to the defendant but rather on whether the statute possesses "an ascertainable standard of guilt" for the court and jury to apply.[117] A similar doubt exists here. An appellate court might find these vagueness arguments compelling.

A second distinct problem with the ambiguity of "consider" concerns the imposition of penal sanctions. Generally, penal sanctions will not be imposed unless causation is proved. If H.B. 409 requires this element of proof, the borrower will have to prove that his personal or neighborhood characteristics were a factor in the lender's decision. Moreover, this burden of proof is heavier than a mere showing that the lender had knowledge or awareness of the prohibited factor.

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113. Taylor v. Gossett, 269 S.W. 230, 233 (Tex. Civ. App.—Dallas 1925, writ dism'd) (emphasis added).

114. *Cf.* TEX. REV. CIV. STAT. ANN. art. 5069—2.07 (Vernon Supp. 1978-1979) (prohibiting the denial of certain consumer and other regulated loans "*solely* on the basis of sex" (emphasis added)).

115. Vagueness in a statute may render it invalid under the due process clause of the fourteenth amendment of the United States Constitution, on the grounds that such uncertainty provides insufficient notice to the persons who may be charged with a violation, or that it is insufficient to guide judges and juries in assessing culpability. U.S. CONST. amend. XIV, § 1. *See generally* Note, *The Void-for-Vagueness Doctrine in the Supreme Court*, 109 U. PA. L. REV. 67 (1960). The void-for-vagueness doctrine has been applied chiefly to invalidate criminal statutes (*see* Papachristou v. City of Jacksonville, 405 U.S. 156 (1972)) and statutes infringing first amendment rights. *See, e.g.*, NAACP v. Button, 371 U.S. 415, 432-37 (1963). Because the Texas usury statute is penal in nature, it is analogous to a criminal statute; hence, the void-for-vagueness analysis is applicable.

116. *See* Connally v. General Constr. Co., 269 U.S. 385, 391 (1926) (a criminal statute so vague that men of common intelligence must guess at its meaning lacks the first essential of due process of law).

117. *See* United States v. L. Cohen Grocery Co., 255 U.S. 81, 89 (1921) (Food Control Act of 1917 set up no ascertainable standard of guilt and is thus repugnant to constitutional requirements under the fifth and sixth amendments).

The foregoing analysis may be tested in several hypothetical situations. For purposes of discussion, suppose that *A* is a financial institution as defined in H.B. 409, *B* a potential borrower purchasing a home in a prestigious area, and *C* a potential borrower purchasing a home in a blighted neighborhood. The first, most troublesome situation is one in which *C*'s application for a loan is discriminatorily rejected. Even if *C* can prove discrimination, section (e)(2) provides no remedy to *C*. The crucial phrase is "in connection with such loan." As there is no loan, there can be no penalty under section (e)(2). Consequently, H.B. 409 may not have the impact intended by its drafters.

A second possible situation arises when *A* gives *C* a loan at twelve percent interest and gives *B* a loan at eleven percent interest. Assume that *C* and *B* are sociologically and economically equivalent except for the neighborhood where they intend to reside. *C* could probably prove that his higher interest rate was a result of discriminatory redlining of his neighborhood by *A*.

Interest rates constitute terms or conditions of the loan agreement, and as such, are governed by the second part of section (e)(2),[118] which requires proof that the borrower was discriminated against, not on the basis of a personal characteristic such as race but because of the sociological composition of his neighborhood. Assuming *C* can offer the necessary proof, section (e)(2) provides a remedy: the loan from *A* to *C* would be held usurious. Thus, the rule of section (e)(2) is that if a lender chooses to discriminate, it is prohibited from charging the new maximum rate of interest; rather, a ten percent annual interest rate is the ceiling for such discriminatory loans.

A third interesting situation would be a suit by *C* as class representative of all residents in the blighted neighborhood who had been charged disproportionately higher interest rates by *A*. If *C* can prove discrimination against the class because of the sociological composition of the neighborhood, the remedy under section (e)(2) could be a declaration that each loan charging a rate in excess of ten percent is usurious.

Two less likely fact situations involve suits brought by *B*. In one, *B* is charged eleven percent annually while *C* is charged eleven and one-half percent annually. *B* could claim that section (e)(2) does not limit itself to situations of unfavorable discrimination but proscribes all discrimination. Thus, if *B* is able to show that he received favorable treatment based on one of the designated factors, there would be "discrimination in connection with" that loan. As a result, the lender would be limited to ten percent interest annually, and both *B*'s and *C*'s loans would be usurious.[119]

A final fact situation involves a suit by *B* on behalf of *C* and all borrowers similarly situated. *B* does not allege discrimination in favor of himself, but rather unfavorable discrimination against *C* and the members of his

118. *See* note 84 *supra*.
119. *See* text accompanying notes 121-29 *infra*.

class. If *B* can withstand a challenge to his standing,[120] he may argue that section (e)(2) prohibits *A* from charging more than ten percent annually on all loans because it discriminated against a class of borrowers by considering one or more of the factors enumerated in section (e)(2).

D. *Is a Loan Rendered Usurious if a Court Finds that a Lender Who Charged More than Ten Percent Under H.B. 409 Engaged in the Proscribed Redlining or Discriminatory Behavior?*

Generally speaking, the question of usury is determined at the inception of the contract.[121] Therefore, if a loan contract providing for interest exceeding ten percent is found to be discriminatory under H.B. 409, that loan will be deemed usurious from the time it was made.

Section (e)(2) of amended article 5069—1.07 uses the phrase "that it may charge," rather than "that it may charge following a holding of discrimination." Accordingly, the lender is on notice that the legal ceiling for interest rates on its loans is ten percent if the lender is later determined to have violated section (e)(2), at least with respect to the particular loan. Subjecting lenders to the threat of a usury penalty is obviously intended to be a deterrent to redlining and discriminatory lending practices.

A lender confronted by a usury suit might argue that the ten percent ceiling should not relate back to the inception of the loan, because such a relation back would be either a retroactive law, prohibited by the Texas Constitution,[122] or an improper retrospective application of a statutory provision in the absence of clear legislative intent that it meant such a result.[123] Such arguments, however, lack support in the Texas case law involving retroactive claims; the only successful claims based on retroac-

120. *B* could argue that he is an "aggrieved party" because he has been deprived of the right to enjoy a well-developed central city. Such an argument, however, would probably fail. *See* note 108 *supra* and accompanying text. *See generally* Gladstone, Realtors v. Village of Bellwood, 99 S. Ct. 1601, 60 L. Ed. 2d 66 (1979); Note, *Standing to Sue Under Section 812 of the Fair Housing Act: Gladstone, Realtors v. Village of Bellwood, infra* p. 917.

121. Pinemont Bank v. DuCroz, 528 S.W.2d 877, 879 (Tex. Civ. App.—Houston [14th Dist.] 1975, writ ref'd. n.r.e.).

122. "No bill of attainder, ex post facto law, retroactive law, or any law impairing the obligation of contracts, shall be made." TEX. CONST. art. I, § 16. The retroactivity argument could be made only if the lender's loan contract at the higher rate constitutes a vested right. Unless vested rights are destroyed or impaired, a retroactive law will not be held invalid. City of Fort Worth v. Morrow, 284 S.W. 275, 276 (Tex. Civ. App.—Fort Worth 1926, writ ref'd). Exactly what constitutes a vested right is uncertain, but it is clear that art. I, § 16 of the Texas Constitution protects more than just property rights. *See* Mellinger v. City of Houston, 68 Tex. 37, 3 S.W. 249 (1887).

123. Miller & Miller Motor Freight Lines v. Gilliland, 232 S.W.2d 886, 889 (Tex. Civ. App.—Fort Worth 1950, writ dism'd); *see* Purser v. Pool, 145 S.W.2d 942 (Tex. Civ. App.—Eastland 1940, no writ) (statute should have a prospective operation unless legislative intent is clear that it should operate retrospectively). *See also* Hutchings v. Slemons, 141 Tex. 448, 174 S.W.2d 487 (1943) (real estate dealers license act should not operate retrospectively to preclude suit on an oral contract for commissions); Lee v. Universal Life Ins. Co., 420 S.W.2d 222 (Tex. Civ. App.—Houston [14th Dist.] 1967, writ ref'd n.r.e.) (amendment to insurance code making policy incontestable after two years should not be applied to a policy issued prior to amendment).

tivity challenged application of a statute not in effect when the prohibited event occurred.[124] In the instant case, however, the statute would be effective prior to the prohibited behavior. The facts existing at the time the loan is made will thus determine which rate is applicable to a given loan, even though those facts may not be determined until after the loan is made. Given the vagueness of the statutory language, the effect may be to create uncertainty in the financial community. Financial institutions engaging in activities that may be interpreted as redlining or discrimination must take the risk that their loans may be governed by the ten percent limit. The ultimate effect, probably consistent with the legislative intent, will be to deter financial institutions from loan practices even remotely approximating redlining or discriminatory behavior. A cautious approach by lenders is warranted in light of the uncertain application of section (e)(2). Financial institutions would be well advised to regard the provision as validly limiting the entire loan to ten percent if the lender engages in the proscribed behavior. Each loan file should be carefully maintained to show an absence of discriminatory intent.

If the maximum rate of interest that a lender can charge is indeterminate at the time the loan is made, that fact might provide a defense to usury by allowing the lender to argue the absence of usurious intent.[125] Nevertheless, this argument is unlikely to prevail in the face of the general rule that the intent required for usury is merely the intent to make the bargain made.[126] If the interest charged exceeds the legal maximum and the requisite intent is present, the lender is subject to an article 5069—1.06 penalty.[127]

It is unlikely that a lender could avoid this result by inserting a "savings provision"[128] in the loan contract, because a savings clause is not effective

124. *See, e.g.*, Cain v. State, 105 Tex. Crim. 204, 287 S.W. 262 (1926).

125. In American Century Mortgage Investors v. Regional Center, Ltd., 529 S.W.2d 578, 584 (Tex. Civ. App.—Dallas 1975, writ ref'd n.r.e.), the borrower attempted to assert a usury claim after he had used a subterfuge to obtain the loan at the higher corporate rate, but the court held that there was no usurious intent by the lender in the absence of actual knowledge of the subterfuge. The court stated the relevant test:

> Unless the loan papers show on their face an intention to charge interest at a greater rate than permitted by law, the burden is on the party pleading usury to show the existence of some agreement, device, or subterfuge to charge usury and that both parties had that purpose in contemplation.

Id. at 583 (citations omitted).

126. *See* Miller v. First State Bank, 551 S.W.2d 89, 98 (Tex. Civ. App.—Fort Worth 1977), *aff'd as modified*, 563 S.W.2d 572 (Tex. 1978). The Fort Worth appeals court labeled this a well-settled rule, citing, in part, Moore v. Sabine Nat'l Bank, 527 S.W.2d 209 (Tex. Civ. App.—Austin 1975, writ ref'd n.r.e.). Miller v. First State Bank, 551 S.W.2d at 98. In *Moore* the creditor had charged an excessive time-price differential, and the Austin court rejected the so-called "accidental or bona fide error defense," stating that a creditor may not excuse its violation of a statute by a showing that it did not intend to violate the act. Moore v. Sabine Nat'l Bank, 527 S.W.2d at 213. *See also* Townsend v. Adler, 510 S.W.2d 175 (Tex. Civ. App.—Houston [14th Dist.] 1974, no writ) (ignorance of usury laws no defense when lender admitted intending to receive more than double the legal rate).

127. *See* note 11 *supra*.

128. *See* Tanner Dev. Co. v. Ferguson, 561 S.W.2d 777 (Tex. 1977), involving a promissory note that contained a typical "savings provision":

when a loan contract is usurious on its face.[129] A savings clause would affirm the lender's intention to comply with the applicable usury ceiling and possibly contain language allowing the lender to spread the excess interest over the life of the loan so that the total interest collected would average ten percent annually.

V. CONCLUSION

The legislature responded to the Texas mortgage money crisis by enacting H.B. 409. The passage of this bill will probably increase the availability of mortgage money in Texas, but as of the writing of this Article it is not certain that this will be the result. Texas lenders will still be competing with lenders in states with higher usury limits to sell their loans in the secondary mortgage market.

As the preceding discussion indicates, H.B. 409 may create more problems that it solves. It remains to be seen how the various questions raised in this Article will be resolved. It is hoped that this Article will provide some guidance to real estate practitioners in analyzing the application and effect of H.B. 409.

> "In no event shall Grantor be required to pay, for the use, forbearance or detention of the money evidenced by the note secured hereby, more than the maximum legal rate of interest allowed by the laws of Texas, and the right to demand any such excess shall be and is hereby waived; any payment of an amount in excess of the legal rate shall be considered a mistake with the excess being applied to the principal of the note secured hereby; and this provision shall control every other provision of the note and deed of trust."

Id. at 780 (quoting from the deed of trust). The *Tanner* court held that advance quarterly payments of interest could be "spread" over the subsequent years of the note so that the total interest would be less than ten percent and thus nonusurious. *Id.* at 786-87.

Article 5069—1.07a of the Texas Revised Civil Statutes specifically authorizes "spreading":

> (a) On any loan or agreement to loan secured or to be secured, in whole or in part, by a lien, mortgage, security interest, or other interest in or with respect to any interest in real property, determination of the rate of interest for the purpose of determining whether the loan is usurious under all applicable Texas laws shall be made by amortizing, prorating, allocating, and spreading, in equal parts during the period of the full stated term of the loan, all interest at any time contracted for, charged, or received from the borrower in connection with the loan.

TEX. REV. CIV. STAT. ANN. art. 5069—1.07(a) (Vernon Supp. 1978-1979). The court in *Tanner*, however, specifically stated that the case was decided without regard to art. 5069—1.07(a). 561 S.W.2d at 786.

129. *See* Terry v. Teachworth, 431 S.W.2d 918 (Tex. Civ. App.—Houston [14th Dist.] 1968, writ ref'd n.r.e.) (disclaimer of intent to charge usurious interest cannot save a transaction from the taint of usury).

Appendix

H.B. No. 409[130]

An Act relating to the rate of interest on loans secured by certain residential property.

Be it enacted by the Legislature of the State of Texas:

Section 1. Article 1.07, Title 79, Revised Civil Statutes of Texas, 1925, as amended (Article 5069—1.07, Vernon's Texas Civil Statutes), is amended by adding Subsection (d) reading as follows:

(d)(1) On any loan or agreement to loan secured or to be secured in whole or in part by a lien, mortgage, security interest, or other interest in or with respect to real property on which is located one or more single family dwellings, or dwelling units for not more than four families in the aggregate, interest may be charged at such rates as may be permitted by other applicable law or at the lesser of the following rates:

(i) 12 percent per annum; or

(ii) a rate equivalent to the average per annum market yield rate adjusted to constant maturities on 10-year United States Treasury notes and bonds as published by the board of governors of the Federal Reserve System for the second calendar month preceding the month in which the lender becomes legally bound to make the loan plus an additional two percent per annum rounded off to the nearest quarter of one percent per annum.

A "dwelling unit" shall mean for the purpose of this section a unified combination of rooms that is designed for residential use by one family.

(2) Before the 20th day of each month, the savings and loan commissioner shall ascertain the average per annum market yield rate adjusted to constant maturities on 10-year United States Treasury notes and bonds for the preceding calendar month and cause such rate to be published in the Texas Register.

(3) The interest rates authorized by this subsection shall not be applicable to any loan made on or after September 1, 1981, unless the lender had become legally bound to make such loan prior to such date.

(4) No prepayment charge or penalty may be collected on any loan transaction of the class defined in Subsection (d)(1) bearing a rate of interest in excess of that authorized by Article 1.04, Title 79, Revised Civil Statutes of Texas, 1925, except where such collection is required by an agency created by federal law.

Sec. 2. The savings and loan section of the finance commission and the savings and loan commissioner are hereby directed to exercise the rule-making powers delegated to them by law and promulgate specific rules and regulations with respect to the procedure to be followed in making variable interest rate real estate loans by savings and loan associations subject to the Texas Savings and Loan Act.

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130. Footnotes omitted.

Sec. 3. In the event that the floating rate provisions of Section 1 of this Act are held to be unconstitutional, then Article 1.07, Title 79, Revised Civil Statutes of Texas, 1925, as amended (Article 5069—1.07, Vernon's Texas Civil Statutes), is amended by adding a new Subsection (d) in lieu thereof to read as follows:

(d)(1) On any loan or agreement to loan secured or to be secured in whole or in part by a lien, mortgage, security interest, or other interest in or with respect to real property on which is located one or more single family dwellings, or dwelling units for not more than four families in the aggregate, interest may be charged at the rate of 12 percent per annum. A "dwelling unit" shall mean for the purpose of this section a unified combination of rooms that is designed for residential use by one family.

(2) The interest rates authorized by this subsection shall not be applicable to any loan made on or after September 1, 1981, unless the lender had become legally bound to make such loan prior to such date.

(3) No prepayment charge or penalty may be collected on any loan transaction of the class defined in Subsection (d)(1) bearing a rate of interest in excess of that authorized by Article 1.04, Title 79, Revised Civil Statutes of Texas, 1925, except where such collection is required by an agency created by federal law.

Sec. 4. Article 1.07, Title 79, Revised Civil Statutes of Texas, 1925, as amended (Article 5069—1.07, Vernon's Texas Civil Statutes), is amended by adding Subsection (e) to read as follows:

(e)(1) In this subection "financial institution" means a state bank, state savings and loan association, mortgage banking institution, credit union, national bank, or federal savings and loan association, and "housing accommodation" means improved or unimproved real property, or a portion of that property, that is used or occupied or is intended, arranged, or designed to be used or occupied as the residence of one or more individuals.

(2) A financial institution may not charge interest under Subsection (d), Section 1 or Subsection (d) of Section 3 of this Act and the maximum rate of interest that it may charge is limited to 10 percent if the financial institution in connection with such loan discriminates in providing or granting financial assistance to purchase, rehabilitate, improve, or refinance a housing accommodation due, in whole or in part, to the consideration of:

(i) conditions, characteristics, or trends in the neighborhood where the property is located, unless the financial institution can demonstrate that such a consideration in the particular case is required to avoid an unsafe or unsound business practice; or

(ii) race, color, religion, sex, marital status, national origin, or ancestry; or

in appraising a housing accommodation or in determining whether or not, or under what terms and conditions, to provide financial assistance to purchase, rehabilitate, improve, or refinance a housing accommodation, considers:

(i) the racial, ethnic, religious, or national origin composition of the neighborhood or geographic area surrounding the property; or

(ii) whether or not that composition is undergoing change, or is expected to undergo change.

Sec. 5. If any provision of this Act or any rate of interest fixed hereby is held invalid, such invalidity shall not affect any other provision of this Act which can be given effect without the invalid provision and the legislature hereby declares it would have passed such valid provisions despite such invalidity.

Sec. 6. The importance of this legislation and the crowded condition of the calendars in both houses create an emergency and an imperative public necessity that the constitutional rule requiring bills to be read on three several days in each house be suspended, and this rule is hereby suspended, and this Act shall take effect and be in force from and after its passage, and it is so enacted.

Passed by the House on May 9, 1979: Yeas 79, Nays 48, 16 present, not voting; House concurred in Senate amendments to H.B. No. 409 on May 22, 1979; Yeas 92, Nays 41, 11 present, not voting; passed by the Senate, with amendments, on May 16, 1979: Yeas 21, Nays 10.

Approved June 13, 1979.

Effective Aug. 27, 1979, 90 days after date of adjournment.

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