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To: Clients and Friends

From: David F. Dulock

Subject: Discount Points - Acorn Opinion Does Not Hold Discount Points Are
Included in Home Equity Loan 3% Fee Cap

On January 8, 2009, the Texas Court of Appeals, Third District, at Austin, issued its opinion¹ in the civil suit filed by the Association of Community Organizations for Reform Now (ACORN) seeking to invalidate a number of the home equity interpretations (Rules) issued jointly by the Finance Commission of Texas and the Credit Union Commission of Texas (Commissions). The ACORN opinion, in addition to other decisions affecting the Rules that will be the subject of a later memorandum, affirmed the trial court's judgment invalidating Rule 153.1(11), which defines "interest" for purposes of the three percent fee cap imposed by Section 50(a)(6)(E) of Article XVI of the Texas Constitution (3% fee cap). Rule 153.1(11) defines interest to be "interest as defined in the Texas Finance Code §301.002(4) [sic] and as interpreted by the courts." Section 301.002(a)(4) defines interest, in pertinent part, as "compensation for the use, forbearance, or detention of money."

Immediately upon issuance of the ACORN opinion, the lending community began questioning whether the ACORN opinion holds that discount point(s)² are included in the 3% fee cap. We conclude from our analysis of the opinion that it does not hold that discount point(s) are included in the 3% fee cap, for the following reasons:

1. In endnote 10 of the ACORN opinion, the court writes, "we are not in the position to provide a substitute definition of interest or to definitively categorize 'discount points' ... as either 'interest' or 'fees.'"³

2. The section of the ACORN opinion invalidating Rule 153.1(11) is principally based on the court's reasoning that Section 301.002(a)(4) is a definition of interest for usury purposes only, and necessarily must be a broad definition in order to protect consumers against this abusive and deceptive practice, but its application to the 3% fee cap is inconsistent with the constitutional home equity protection provisions of Section 50(a)(6)(E). Notwithstanding, the 2002 *Tarver* decision⁴ held that discount point(s) are interest for the purposes of the 3% fee cap, basing its decision, in part, on Section 301.002(a)(4) and certain administrative rules that refer to this definition of interest.

3. The Texas Supreme Court, in *Stringer v. Cendant Mortgage Corp.*, 23 S.W.3d 353, 357 (Tex. 2000), cited with approval a Commentary⁵ precursor to the Rules on a home equity constitutional issue unrelated to the 3% fee cap issue. The *Tarver* opinion noted the *Stringer* court's approval of the Commentary and, for that reason, also used the Commentary as a basis for its decision holding that discount point(s) are interest for purposes of the 3% fee cap. That Commentary contains language almost identical to the definition of interest in Rule 153.1(11).

4. All the ACORN opinion did was remove the definition of “interest” from the Rules. It did not substitute another definition of interest nor did it state that a discount point is or is not interest. In fact, the ACORN opinion specifically states that no such determination is made. In addition, we have the *Tarver* decision, which holds a discount point is interest for the purposes of applying the 3% fee cap limitation, and the Texas Supreme Court *Stringer* decision citing with approval the Rules’ precursor Commentary that contains essentially the same definition of interest as Rule 153.1(11) held invalid by the ACORN opinion.

Based on the above, we believe that until a decision by the Texas Supreme Court, or constitutional amendment is enacted, that settles this issue, lenders who fund home equity loans may continue to rely on the *Tarver* decision as authority for treating bona fide and reasonable discount point(s) as interest for the purposes of the 3 % fee cap in Section 50(a)(6)(E) of Article XVI of the Texas Constitution.

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Endnotes

1. *ACORN v. Finance Comm. of Tex. and Tex. Credit Union Comm.*, No. 03-06-00273-CV (Tex.App.-Austin 2010).
2. Added compensation to the lender calculated as a percentage of the loan amount, charged up-front to obtain a lower interest rate. See, *Tarver v. Sebring Capital Credit Corp.*, 69 S.W.3d 708, 709, 711 (Tex.App.-Waco 2002, no pet.)
3. *ACORN* at page 12.
4. *Tarver*, 69 S.W.3d at 712-13.
5. Regulatory Commentary on Equity Lending Procedures, issued October 7, 1998.