Approved February 22, 1988
Date

MINUTES OF THE SENATE COMMITTEE ON JUDICIARY.

The meeting was called to order by Senator Robert Frey at
Chairperson

10:00 a.m./~~p.m.~~ on February 18, 1988 in room 514-S of the Capitol.

All members were present ~~except~~: Senators Frey, Hoferer, Burke, Feleciano, Gaines, Langworthy, Parrish, Steineger, Talkington, Winter and Yost.

Committee staff present:
Gordon Self, Office of Revisor of Statutes
Mike Heim, Legislative Research Department
Jerry Donaldson, Legislative Research Department

Conferees appearing before the committee:

Professor H. Lewis McKinney, University of Kansas
Stanley, L. Lind, Kansas Association of Financial Services
Jim Maag, Kansas Bankers Association
Charles H. Henson, General Counsel, Kansas Bankers Association

Senate Bill 443 - Consumer credit code, prohibiting Rule of 78's.

The chairman announced the vice-chairperson will chair the committee while he is presenting the bill.

Senator Frey explained he had received a call from a person in the lending business with a bank asking him if the provision had been repealed that allowed for changing of interest on loans with conditions that would allow for rebate under Rule of 78's. The handout before them explans why the Rule of 78's ought to be abolished. A copy of the handout is attached (See Attachment I). Senator Frey explained the bill prohibits the authority to use the Rule of 78's at all in any kind of loan.

Senator Frey then introduced Professor H. Lewis McKinney, University of Kansas. Professor McKinney stated he was caught up in this Rule of 78's when he attempted to pay off his loan quickly. He explained to the committee he had purchased a truck and in negotiating for the loan with the salesman he was told there would be no penalty for early payment of the loan. After Professor McKinney made double payments on his loan for ten months, he inquired from GMAC how much interest he had paid on his loan. He was informed he would be penalized twice for early payment. A copy of his letter is attached (See Attachment II). He said no consumer understands the Rule of 78's.

Stanley L. Lind, Kansas Association of Financial Services, appeared in opposition to the bill. He stated the committee knows of its own knowledge that there are literally hundreds of small businesses throughout the state that are not geared to calculate all of their installment credit contracts on an interest bearing basis. If you repeal the Rule of 78's, you force all creditors to then extend credit on an interest-bearing basis which is easy on a computer, but a pain when manually

MINUTES OF THE SENATE COMMITTEE ON JUDICIARY,

room 514-S, Statehouse, at 10:00 a.m./~~p.m.~~ on February 18, 1988.

Senate Bill 443 - continued

operated. Copies of his handouts are attached (See Attachments III). Committee discussion was held with Mr. Lind.

Senate Bill 535 - Debtor's right to action on credit agreement.

Jim Maag, Kansas Bankers Association, explained his association had requested the bill. He said problems continue in lender liability.

Mr. Maag introduced Charles H. Henson, General Counsel, Kansas Bankers Association. Mr. Henson explained the bill will require that to be judicially enforceable by a debtor, a credit agreement must be in writing and signed by the debtor and creditor. A credit agreement is defined in the bill as any agreement to extend credit or make some other similar type of financial accommodation. A copy of his statement is attached (See Attachment IV). Considerable committee discussion was held with Mr. Henson.

The chairman pointed out the handouts from the Kansas Bar Association. Copies of the handout are attached (See Attachments V).

The meeting adjourned.

A copy of the guest list is attached (See Attachment VI).

GUEST LIST

COMMITTEE: SENATE JUDICIARY COMMITTEE DATE: 2-18-88

NAME (PLEASE PRINT)	ADDRESS	COMPANY/ORGANIZATION
Charles Henson	Topeka	Ks Bankers Assn.
Jurel Wright	Topeka	KCUL
T. Humphreys	"	KMHA
S L Leid	KC Ks.	Ks. Assn. of Fin. Servs.
Jim Allen	Topeka	Ks Bankers Assoc
Marjorie Van Buren	TOPEKA	OJA
Karen Dennett	Russell	20th Judicial District
Sharon Swater	Ellsworth	20th Judicial Distric
Jane E. Hrabik	Lyons	— —
Carolyn Burns	Great Bend	— —
Virginia B. Beamer	Oakley	15 Jud. Dist.
Vicki Vecchiolla	Great Bend	20th Jud. Dist
Judy Stunkel	Topeka	C C C
John McSpadden	Topeka	observer
Joe A. Norris	TOPEKA	KCSI
Jon Turner	Topeka	KCSI

Att. VI

SB 743

When you borrow from a bank or other lender, you usually arrange to repay the loan with interest by a specific date in a number of equal installments.

Repaying It Early

But after several payments, you may decide to repay the entire loan earlier than originally scheduled. You ask the creditor for a payoff figure. You may be disappointed to learn that the balance due is higher than you anticipated.

Why is it higher? Perhaps because you thought the interest on the amount borrowed was divided evenly over the number of payments you agreed to make. Thus, you may have believed that if you paid the loan in 10 months instead of 30 you would owe only one-third as much interest.

This is not the way creditors compute interest, however.

The Rule of 78's

Creditors use tables based on a mathematical formula called "The Rule of 78's" - or sometimes "The Sum of the Digits" - to determine how much interest you have paid at any point in a loan. This formula takes into consideration the fact that you pay more interest in the beginning of a loan when you have the use of more of the money, and you pay less and less interest as the debt is reduced. Because each payment is the same size, the part going to pay back the amount borrowed increases as the part representing interest decreases.

When you decide to pay off a loan early, the creditor uses The Rule of 78's to determine your "rebate" - the portion of the total interest charge you won't have to pay.

The Rule is recognized as a practical way to calculate rebates of interest. There are other methods, but this one is widely used, and it is reflected in a number of state lending laws.

Reminders

The final payoff figure on your loan depends primarily on the original time to maturity, but it may be affected by other factors, such as variances in the payment schedule or a lag between the date of calculation and the date of payment.

Keep in mind that paying off a loan in, say, 15 months instead of 30 as originally planned will not produce a saving of one-half of the interest.

You may, however, be entitled to a rebate of certain other charges when you prepay a loan, such as part of a premium for credit insurance.

Finally, the Truth in Lending law requires that your creditor disclose how interest will be computed if you pay the debt in full before maturity. Look for the prepayment disclosure before you sign a loan agreement. Ask for an explanation of anything you do not understand.

HOW TO USE THE RULE OF 78's

The first step is to add up all the digits for the number of payments scheduled to be made. For a 12-installment loan, add the digits from 1 through 12:

$$1+2+3+4+5+6+7+8+9+10+11+12 = 78$$

The answer is "the sum of the digits" and explains how the rule was named. One might say the total interest is divided into 78 parts for payment over the term of the loan.

To add all the numbers in a series of payments is rather tedious. One can arrive at the answer quickly by using this formula:

$$\frac{N}{2} \times (N+1)$$

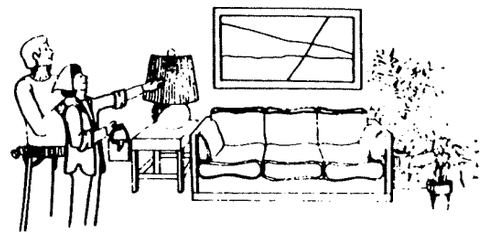
N is the number of payments. In a 12-month loan, it looks like this:

$$\frac{12}{2} \times (12+1) = 6 \times 13 = 78$$

In the first month, before making any payments, the borrower has the use of the whole amount borrowed and therefore pays 12/78's of the total interest in the first payment; in the second month, he still has the use of 11 parts of the loan and pays 11/78's of the interest; in the third, 10/78's; and so on down to the final installment, 1/78.

A Loan for Ann and Dan

Let us suppose that Ann and Dan Adams borrow $3,000 from the Second Street National Bank to redecorate their home. Interest comes to $225, and the total of $3,225 is to be paid in 15 equal installments of $215.



Using the Rule of 78's, we can determine how much of each installment represents interest. We add all the digits from 1 through 15:

$$\frac{15}{2} \times (15+1) = 7.5 \times 16 = 120$$

The first payment will include 15 parts of the total interest, or 15/120's; the second, 14/120's; and so on.

Notice in the following table that the interest decreases with each payment and the repayment of the amount borrowed increases with each payment.

DEPARTMENT OF CONSUMER AFFAIRS
FEDERAL RESERVE BANK OF PHILADELPHIA

Pay't No.	Interest	Reduction of Debt	Total Pay't
1	$ 28.13	$ 186.87	$ 215.00
2	26.25	188.75	215.00
3	24.37	190.63	215.00
4	22.50	192.50	215.00
5	20.63	194.37	215.00
6	18.75	196.25	215.00
7	16.87	198.13	215.00
8	15.00	200.00	215.00
9	13.13	201.87	215.00
10	11.25	203.75	215.00
11	9.37	205.63	215.00
12	7.50	207.50	215.00
13	5.63	209.37	215.00
14	3.75	211.25	215.00
15	1.87	213.13	215.00
	$225.00	$3,000.00	$3,225.00

How Much Is the Rebate?

Now let's assume Ann and Dan want to pay off the loan with the fifth payment. We know the total interest is divided into 120 parts. To find out how many parts will be rebated, we add up the digits for the remaining 10 installments which will be prepaid:

$$\frac{10}{2} \times (10+1) = 5 \times 11 = 55$$

Now we know that 55/120's of the interest will be deducted as a rebate; it amounts to $103.12.

$$\frac{55}{120} \times \$225 = \frac{12375}{120} = \$103.12$$

We see that Ann and Dan do not save two-thirds of the interest (which would be $150.00) by paying off the loan in one-third of the time. But the earlier they repay the loan the higher the percentage of interest they do save.

Check It Out

Perhaps you would like to try using The Rule of 78's. Here is a problem for you. Assume that Ann and Dan pay off their loan at Second Street National Bank with the eleventh payment. How much interest will they save? Remember that the interest over 15 months is divided into 120 parts, and you need to know the number of payments that will be prepaid. Fill in the blanks.

$$\frac{N}{2} \times (N+1) = \frac{\_\_}{2} \times (\_\_+1) = \_\_ \times \_\_ = \_\_.$$

Now multiply the rebate fraction by the total amount of interest on the loan:

_____ x $ ____ = $ ____ rebate

Your answers should be as follows:

$$\frac{4}{2} \times (4+1) = 2 \times 5 = 10$$

$$\frac{10}{120} \times \$225 = \frac{2250}{120} = \$18.75$$

Other pamphlets available include:

How to Establish and Use Credit

Your Credit Rating

How the New Equal Credit Opportunity Act Affects You

The Equal Credit Opportunity Act and...Age

The Equal Credit Opportunity Act and...Women

The Equal Credit Opportunity Act and...Doctors, Lawyers, Small Retailers

The Equal Credit Opportunity Act and...Credit Rights in Housing

Fair Credit Billing

Truth in Leasing

The Fair Debt Collection Practices Act

If You Use a Credit Card

For further information or copies of pamphlets, you may write or call:

Department of Consumer Affairs
Federal Reserve Bank of Philadelphia
P. O. Box 66
Philadelphia, Pennsylvania 19105

Telephone (215) 574-6116

Rev. 4-79

THE RULE OF 78's

or What May Happen When You Pay Off a Loan Early

DEPARTMENT OF CONSUMER AFFAIRS
FEDERAL RESERVE BANK OF PHILADELPHIA

(M)

DEPARTMENT OF HISTORY
University of Kansas

Memo To: Walt Wiltse

Date: Jan. 1988

From: Laura McKenna

Sen. Dole's office has contacted me on this matter. What I ask, very simply, is that our "Truth in Lending" laws - local & national - prevent lending companies from stating there is NO penalty for prepayment of a consumer loan unless it is true! Applying the Rule of 78's to refunds falsifies the "no penalty" statement, and effectively raises the stated interest rate.

Reply:

Thank you for your help.

Att. II

(M.)

(Copy for Wild Hunter)

December 9, 1987

Senator Bob Dole
Senate Office Bldg.
Washington, D.C.

Dear Senator Dole:

I am writing to you about a matter of consumer deception. I know you are up to your eyebrows in work -- your schedule is a killer! -- so I shall make this letter as succinct as possible for a long winded professor.

On March 25, 1986, I purchased a 1986 Chevy S-10 1/2 ton truck at 9.9% interest for 48 months. I financed $4,019.62 on a total sale price of $7,537.16. I carefully explained to the salesman, a Mr. Sestos, before seeing the finance papers that I preferred a maximum 36 month contract which I intended paying off in 24 months. I was not interested in contracts with penalties. All this was made crystal clear, with examples, to the salesman.

When the contract was presented to me, however, it stated the term was 48 months, and I immediately protested and asked if I would be penalized for early payment. The salesman explained that the length of time specified in the contract made no difference because the contract explicitly states: **"You may prepay the unpaid balance at any time without penalty."**

I have taught English in Wichita, and my book Wallace and Natural Selection (Yale University Press, 1972) was nominated for the National Book Award. I can read a simple declarative sentence, and I clearly understood the salesman's statements to me.

I therefore embarked on a double payment per month (average) schedule. By 10 months I had paid twenty payments as I had planned to do when I purchased the truck.

On December 31, 1986, I wrote GMAC to see how much interest I had paid on my loan. True, I had a payment schedule, but I had made double payments which, I thought, should have reduced both principal and interest significantly.

When GMAC finally bothered to reply in February 1987, after two letters from me, I learned I had been had. I was not allowed to prepay my loan "without penalty." The claim was a LIE. I learned instead that there were TWO penalties: (1) A refund is made for "part of the finance charge" using the Rule of 78's. Bottom line? According to an accountant friend of mine and his computer, GMAC was going to screw me for about $85.00 for prepayment. (2) Oh yes, they also wanted another $7.50 fee to calculate the amounts which would be refunded.

What was the "Rule of 78's"? My accountant friend explained virtually no one except an accountant knows (I checked: he is right!), but in essence it allows GMAC (and other finance companies) to screw consumers, thus indirectly raising the interest rate charged by over 1%! So GMAC advertises 9.9%; I pay about 11.2% because I prepay my loan.

Now you tell me: did I pay any penalty or not? Is a rose by another name still a rose or not?

Kansas allows the Rule of 78's, probably because not one legislator knows what it means. Believe it or not, I cannot recall ever having a contract with that deceptive rule included. If you pay off the contract in the number of months prescribed, there is no penalty; if you accelerate payments, then you are penalized. GMAC and other finance companies simply lie to consumers by saying there is no penalty.

Under my set of circumstances, I certainly could have sued Turner Chevrolet, and probably won after considerable time and effort. But I had recently argued a contract case before the Kansas Supreme Court. Although I had won, I was war weary, and the solution is not a shallow court victory. Only a legislative solution will eliminate this deception.

The solution is simple. Subject finance companies to penalties for using any method of calculating refunds except the Actuarial Method. The "Rule of 78's" is really consumer fraud operating under the guise of legitimacy; it penalizes consumers for prepaying contracts.

In the meantime, GMAC has lost all my business, although I would prefer to buy American.

YOu have been extremely helpful in the past; I hope you will be able to assist consumers on this matter also.

Sincerely,

H. Lewis McKinney

H. Lewis McKinney
1230 W. 28th Court
Lawrence, KS 66044
(913) 842-7425

2-18-88

PRESENTATION MADE BEFORE
THE SENATE JUDICIARY COMMITTEE
ON S.B. 443 on FEBRUARY 17, 1988

By Stanley L. Lind, Counsel & Secretary
Kansas Assn. of Financial Services

Mr. Chairman and Members of the Committee:

The Kansas Assn. of Financial Services, the state trade association of the consumer finance companies in Kansas, opposes the enactment of S.B. 443.

This bill has as its purpose the repeal of what is known as the Rule of the Sum of the Digits -or- as more commonly known - the Rule of the 78's.

The basis of the rule -is- that it is one of the five differant mathematical ways by which to compute interest. While its original use was for the calculation of refunds on instalment contracts when the finance charge was calculated upon a dollar per $100 basis, (since it is the only way it can be done), it has been used extensively with calculating the refund on precomputed instalment contracts - because it removes the necessity of having to calculate the interest every time a payment is made. This has caused a great savings in operational costs and mistakes for creditors.

Before the advent of affordable computers in every day businesses in all retail stores and financial institutions, the use of the Rule of 78's was one of the means by which creditors could and can operate as efficiently as they do.

Att. III

With the advent of the computer, there has been a great change. If you will refer to Exhibit No. 1, you will find a graph which illustrates the lessening reliance creditors are placing on the Rule of 78's.

From a high of 92% of precomputed contracts in 1975, we are now down to about the 45% level in 1986 as to the number of instalment contracts which are precomputed - and - thus use the Rule of 78's for refund calculations. There is no doubt that this drop will continue in the same fashion without the enactment of S.B. 443.

In addition to the use of computers - the use of revolving consumer credit has also helped bring about this change. Without doubt, the use of revolving credit will continue to expand.

Does this mean that there is no place for the calculation of refunds by the Rule of 78's today? I submit that the answer to that question is in the negative.

The committee knows of its own knowledge that there are literally 100's of small businesses throughout the state that are not geared to calculate all of their instalment credit contracts on an interest bearing basis.

If you repeal the Rule of 78's, you force <u>all</u> creditors to then extend credit on an interest-bearing basis which is easy on a computer - but a pain when manually operated.

To give you an idea of the use of precomputed contracts by licensed lenders, I have included Exhibit No. II which shows the

dollar amount of precomputed contracts held by Kansas licensed lenders which have used the Rule of 78's from 1975 to 1986. When you consider that there is three times as much instalment sales contracts as there are instalment loans - you can see the dollar amounts involved.

Admittedly - there is an advantage to the creditor in the use of the Rule of 78's on refunds in the first quarter or one-third of the precomputed instalment contract, -but- after the first third of the contract, the results are almost identical. If the contract is paid as contracted - there is no difference.

A factor which must be considered is that because of the mathematical difference between the Actuarial Rule and the Rule of 78's, the difference becomes magnified on the longer term and higher dollar amount contracts. Because of this, the Rule was amended several years ago to require the use of the Actuarial Rule in refunding contracts over 61 months.

My thought -is- that today's use of precomputed contracts is centered in the field of instalment sales contracts and closed-end loan contracts below $5,000.

If you repeal the Rule - this will cause a two-fold impact on creditors who are engaged in extending credit by way of closed-end contracts - whether loans -or- sales - as follows:

1) the loss of income on these contracts by reason of this small difference between the Actuarial Rule -and- the Rule of 78's

2) increase operating costs for the creditors

in two areas of consumer credit where the return is already too low -and- in areas where creditors are seeking an increase in another bill before another committee.

Other well known uses of the Rule of 78's are in the refund of insurance premiums -and- in the Internal Revenue Code where it is one of the alternative means of calculating depreciation.

Our recommendation -is- that the legislature not interfere in the use of this long standing method of calculation -and- permit the market place to determine the best and most efficient method of extending credit.

Percentage of Precomputed Loans Held By Loan Licensees As A Percentage of the Total Loans
(1975 - 1986)

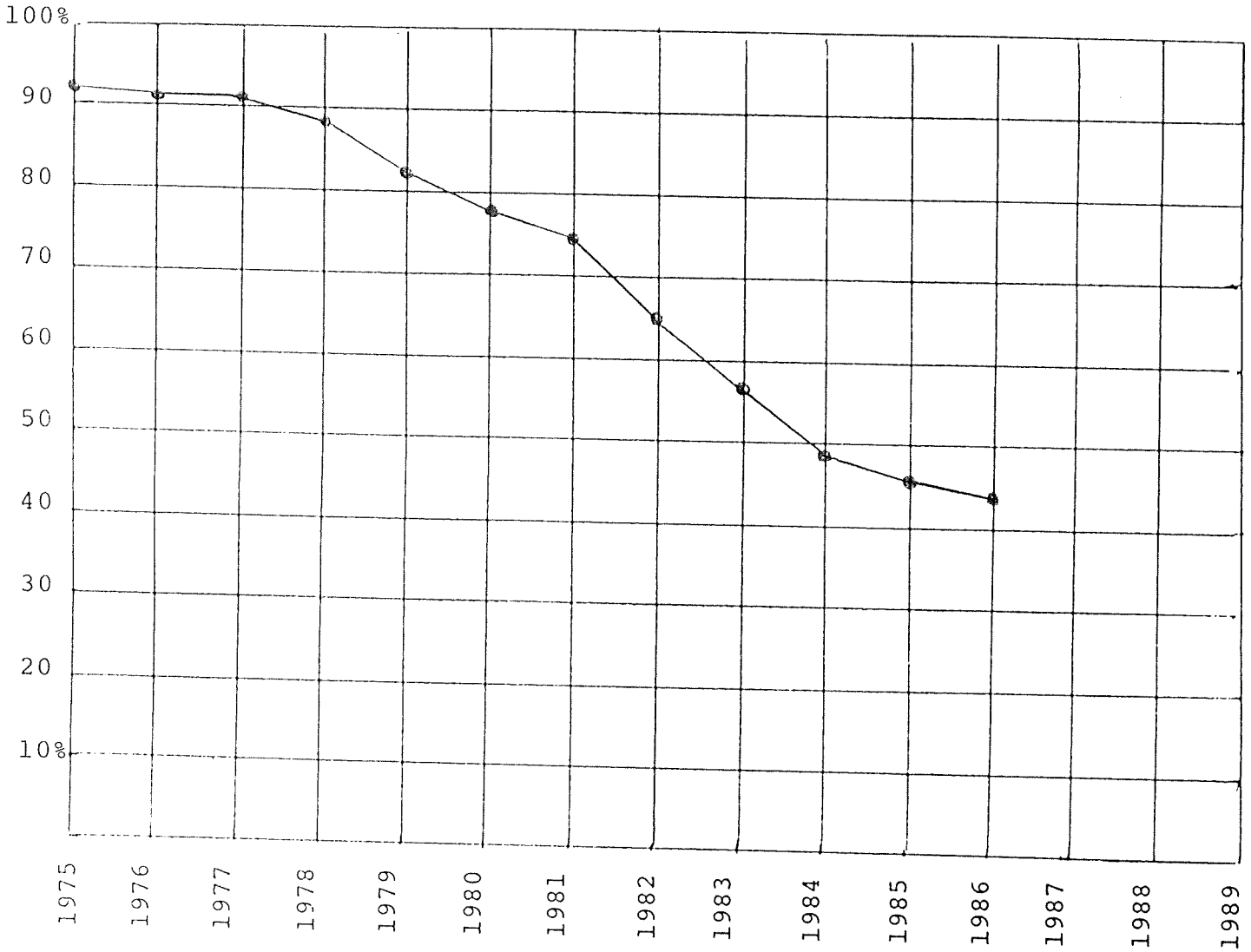


EXHIBIT NO. I

Types of Contracts Used by Licensed Lenders
in Kansas from 1975 thru 1986 -and-
the Percentage of Precomputed Contracts Compared to Total

Year	Total Net Receivables	Interest Bearing Contracts	Precomputed Contracts
1975	189,378,376	16,436,090	172,942,286 (91.3%)
1976	210,835,718	19,800,693	191,035,025 (90.6%)
1977	235,567,171	20,258,091	215,309,080 (91.4%)
1978	274,193,449	30,760,116	243,433,333 (88.7%)
1979	326,336,036	54,658,236	271,677,800 (83.2%)
1980	323,183,659	65,073,183	258,110,476 (79.8%)
1981	326,663,709	77,531,992	249,131,717 (76.2%)
1982	319,402,242	106,616,440	212,785,802 (66.6%)
1983	328,153,396	139,053,166	189,100,230 (57.6%)
1984	364,394,667	182,442,867	181,951,800 (49.9%)
1985	327,457,483	173,438,673	154,018,810 (47.0%)
1986	353,621,299	193,244,906	160,376,393 (45.3%)

EXHIBIT NO. II

Percent Net Profit of Finance Charges to Total Average
Net Receivables of Kansas License Lenders for the Years 1975 to 1986

Black Line = Kansas Licensed Lenders
Blue Line = First National Bank of Chicago National Survey (1980-1986)

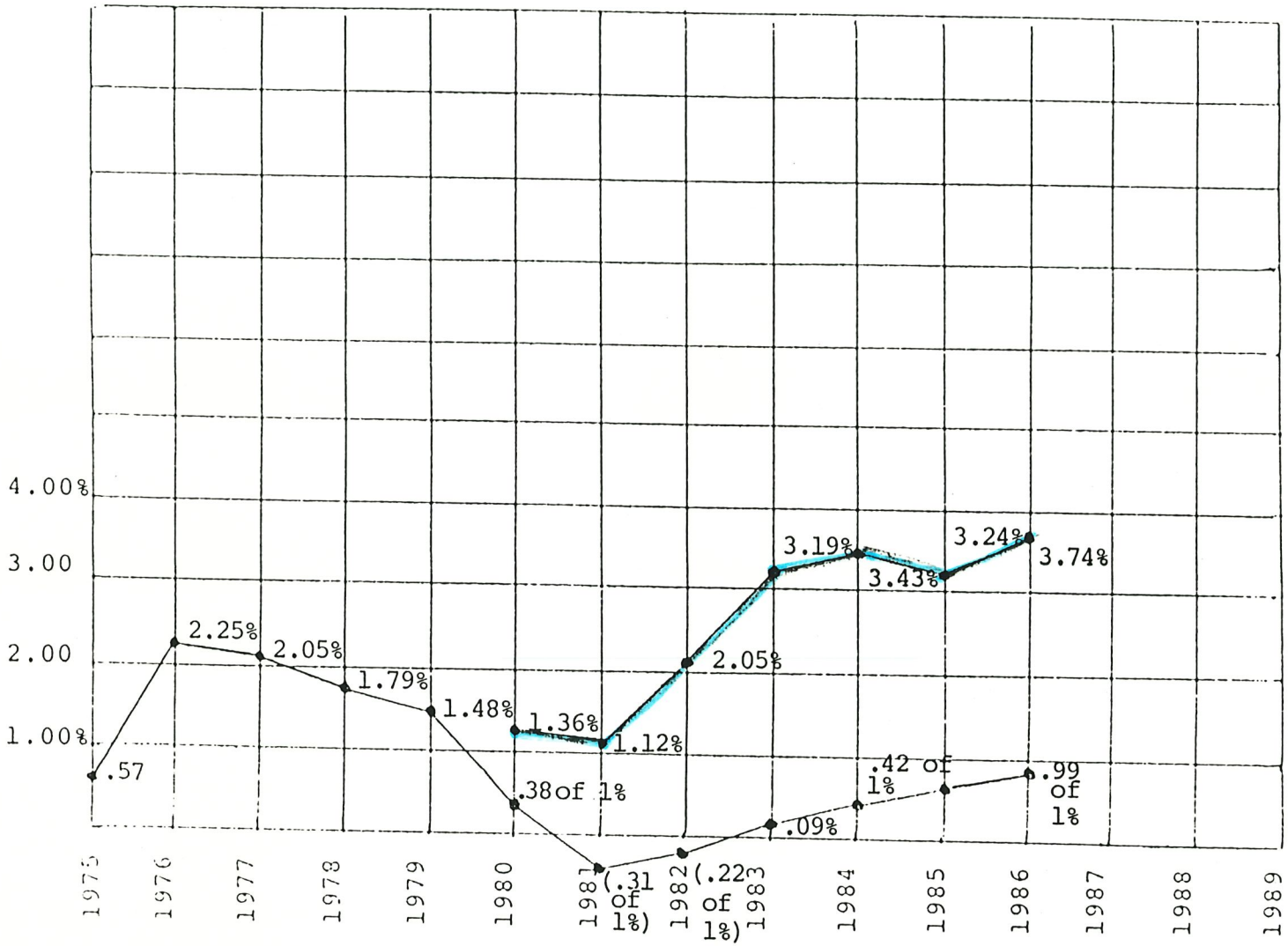


EXHIBIT NO. I

2-18-88

EIDSON, LEWIS, PORTER & HAYNES
LAWYERS
1300 MERCHANTS NATIONAL BANK BUILDING
EIGHTH AND JACKSON STREETS
TOPEKA, KANSAS 66612-1252
913-233-2332
TELECOPIER (913) 233-7905

PHILIP H. LEWIS
JAMES W. PORTER
WILLIAM G. HAYNES
CHARLES N. HENSON
AUSTIN NOTHERN
CHARLES D. MCATEE
DALE L. SOMERS
K. GARY SEBELIUS
RICHARD F. HAYSE
RONALD W. FAIRCHILD
JOHN H. WACHTER
ANNE L. BAKER
PATRICIA A. REEDER

THOMAS D. HANEY
GREGORY F. MAHER
JOHN D. ENSLEY
N. LARRY BORK
CATHERINE A. WALTER
AARON G. HOVE
E. LOU BJORGAARD PROBASCO
W. JOHN BADKE
PATRICIA E. HAMILTON

OF COUNSEL:
O. B. EIDSON

February 17, 1988

The Honorable Robert Frey, Chairman
Senate Committee on Judiciary
State Capitol Building
Topeka, Kansas

RE: S. B. 535

Dear Mr. Chairman and Members of the Committee:

S. B. 535 would require that to be judicially enforceable by a debtor, a credit agreement must be in writing and signed by the debtor and creditor. A credit agreement is defined in the bill as any agreement to extend credit or make some other similar type of financial accommodation. The bill would create a statute of frauds for this type of agreement, as for many years the law has provided that no action may be maintained to charge a person to answer for the debt of another, or on any agreement for the sale of real estate, or on any agreement not to be performed within one year, etc., unless the agreement is in writing. These and similar requirements have been in the law for many years, not to prevent injured persons from obtaining redress, but to prevent fraud and perjury in the event of later judicial dispute, and to avoid future litigation by having the agreement reduced to writing.

The bill requires a credit agreement to be in writing to be enforceable by a debtor. The reason for not including a creditor is that creditors do not seek to enforce agreements to lend money or otherwise extend credit; creditor suits are upon unsatisfied debt created through extensions of credit.

Thank you for your consideration of this proposed legislation.

Sincerely yours,

Charles N. Henson
General Counsel
Kansas Bankers Association

CNH/cjs

Att. IV

2-18-88

Redmond, Redmond & Nazar
ATTORNEYS AT LAW
331 EAST DOUGLAS
WICHITA, KANSAS 67202-3405

CHRISTOPHER J. REDMOND
EDWARD J. NAZAR
THOMAS E. MALONE
MARTIN R. UFFORD

W. THOMAS GILMAN
LAURIE B. WILLIAMS
MARY PATRICIA HESSE

OWEN J. REDMOND (1919-1981)

TELEPHONE
(316) 262-8361
TELECOPIER
(316) 263-0610

February 2, 1988

FEB 4 1988

KANSAS BAR ASSOCIATION

Mr. Ron Smith
Kansas Bar Association
P.O. Box 1037
Topeka, KS 66601

Re: Proposed Senate Bill No. 535

Dear Ron:

I am in receipt of your letter dated January 28, 1988 and the enclosed copy of Senate Bill No. 535. I have several comments regarding the proposed legislation.

First, the bill appears to be unconstitutional. It appears to be an attempt to limit parol evidence otherwise admissible in an action by a creditor on a promissory note and security documents. The bill attempts to limit the rights of debtors, as a class, without corresponding limitations on other persons subject to the parol evidence rule. Accordingly, I would imagine a very strong argument could be made that the proposed legislation is a violation of debtors' right to equal protection under the law.

Secondly, I would think that the proposed legislation is unnecessary. It would be interesting to note the statistics gathered by the Kansas Bankers Association to support the bill. I would be surprised if many lenders have lost money as a result of notes and security documents being held to be invalid as a result of oral agreements entered into either before or after the execution of the respective documents. Also, I would imagine attorney's fees for defending such actions are de minimis as most actions that I have been associated with using similar defenses have been resolved either by summary judgment or by settlement. Accordingly, I am not certain that there is a sufficiently compelling reason to limit a long established evidentiary rule.

Thirdly, the same results can be obtained by prudent drafting of loan agreements. Many banks utilize the same

Att. V

language as contained in Section 2 of the proposed legislation to limit by agreement evidence which the proposed legislation seeks to limit. Perhaps rather than limiting the rights of debtors through the proposed legislation, the Kansas Bankers Association should redraft their forms to include a standard clause containing language similar to that contained in Section 2 of the proposed legislation.

If any legislators have any questions regarding this proposed bill, I would be happy to answer the same. If you have any questions, please advise.

Sincerely,

REDMOND, REDMOND & NAZAR

W. Thomas Gilman

WTG/cr

MARTINDELL, SWEARER, CABBAGE,
RICKSECKER & HERTACH
ATTORNEYS AT LAW
400 WILEY BUILDING
P. O. BOX 1907
HUTCHINSON, KANSAS 67504-1907

ROBERT C. MARTINDELL
WILLIAM B. SWEARER
ELWIN F. CABBAGE
JERRY L. RICKSECKER
GERALD E. HERTACH
WILLIAM F. BRADLEY, JR.
ANDREW L. OSWALD
JOHN B. SWEARER

JOAN M. SAYLOR
CAROLYN H. PATTERSON

OF COUNSEL
J. RICHARDS HUNTER
HARRY H. DUNN

TELEPHONE
(316) 662-3331

February 5, 1988

Mr. Ron Smith,
KBA Legislative Counsel
Kansas Bar Association
P.O. Box 1037
Topeka, KS 66601

Dear Ron:

You contacted our office regarding Senate Bill No. 535. First, I don't understand what problem it is designed to correct. I note the notation on the top that it is a Banker's Association bill. My supposition is that it is directed at the lender liability problem and is designed to prevent notes and credit agreements from being the subject of tort claims for such things as misrepresentation, etc., in the context where alleged modifications have been made to the note or agreement which are verbal rather than in writing.

It is my experience that bankers are equally guilty of having conversations with the debtor which they then record in their "credit memos" without getting the debtor's signature. It appears that this bill is an addition to the statute of frauds. I wonder how effective it will be in the event that the debtor calls the creditor and they make an agreement regarding disposition of the collateral, which is then recorded by the banker in the credit memos but then the debtor fails to follow through. I seriously doubt that any court would refuse to enforce such a verbal agreement in the light of a statute such as Senate Bill No. 535. In other words, it appears to be overly broad and its purpose is not clear.

Regarding Senate Bill No. 527, as you know, this simply makes the Lemon Law a part of the Kansas Consumer Protection Act. Under the KCPA there are attorneys fees and statutory penalties which are available for unconscionable acts. The KCPA is extremely broad. The KCPA is directed primarily at the formation of the agreement and remedies for taking advantage of

a consumer at that stage. On the other hand, the Lemon Law is directed primarily at problems which occur after the agreement to purchase the automobile is made. Since these agreements are seldom custom agreements in the case of an automobile purchase, formulation of the agreement is hardly the problem that it is in the KCPA situation. Again, the purpose is not entirely clear. It appears that the intention is to add the remedies and definitions of the KCPA onto those of Lemon Law. I have not examined the bills closely but each has a definition section and they should be compared to make sure the definitions are not inconsistent or contradictory. I sincerely feel that it merely muddles the law to tie a law directed at solving automobile warranty problems in to a bill designed to prevent deceptive door to door sales and high pressure sales tactics.

Thanks for the opportunity to comment.

Sincerely yours,

William F. Bradley, Jr.

WFB:ldm

MICHAEL E. WHITSITT
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SUITE 100, CLOVERLEAF 3 BUILDING
6405 METCALF
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(913) 831-1333

February 2, 1988

Ron Smith
KBA Legislative Council
1200 Harrison
P. O. Box 1037
Topeka, Kansas 66601

Re: S.B. 535, Credit Agreements

Dear Ron:

Generally, I think the purpose of the Senate Bill 535 is beneficial, and an act similar to this should be adopted as a part of the Statute of Frauds. In that regard, it seems to me that Section 2 is probably overly broad. It probably should be restricted to a writing signed by the creditor to be reasonable.

However, I see no particular reason why the scope of Section 2 could not remain the same as it is, in other words to require a writing signed by both the debtor and the creditor.

Respectfully,

Michael E. Whitsitt

MEW:be

Fielder and Disney

Attorney at Law
110 East Forest Street
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Girard, Kansas 66743

Timothy L. Fielder
Barry K. Disney

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(316) 724-4214
and
(316) 724-4217

February 1, 1988

Mr. Ron Smith
Kansas Bar Association
1200 Harrison
P.O. Box 1037
Topeka, KS 66601

RE: SB 535; concerning credit agreements; relating to debtor's right to action thereon

Dear Mr. Smith:

I am in receipt of your Memorandum dated January 28, 1988.

I assume that the underlying purpose of the bill is intended to substantially reduce a debtor's ability to proceed against a creditor for a financial loss or injury, whether real or imagined, arising out of some financial transaction. I believe that the act, as drafted, falls short of its purpose as follows:

1. Section 1(a) defines a "credit agreement" but does not state that it has to be in writing. This section appears to me to codify "oral" agreements or "understandings" or "courses of action" as credit agreements.

2. Section 1(a) defines a credit agreement to include "to make any other financial accommodation". What does this phrase mean? I suspect it may mean whatever any creditor or debtor would desire it to mean. This phrase is too vague and over broad. Personally, I would strike the phrase from the bill rather than try to define it as any definition would only tend to mire one deeper. If the bankers association is trying to accomplish some specific purpose with this phrase, I suggest that the same be specifically set out.

3. Who is a "person" under this act?

4. Subsection (b) and (c) of Section 1 again imply that a credit agreement between a creditor and a debtor does not have to be in writing.

5. Section 2 of the act states that for a debtor to bring an action against a creditor, the credit agreement must be in writing and signed by the parties. I suspect that a court would have a couple of problems with this section. First, the debtor only is prevented from bringing an action in court when the credit agreement is not in writing. And second, this is the only place in the act that states that a credit agreement must be in writing. A court could hold:

a) that the legislature intended that both parties be limited to a credit agreement in writing and inert the words "a creditor and a debtor" in this section; or

b) that this section (or act) void or unenforceable because of one of the parties to the credit agreement is barred to a remedy while the other is not; or,

c) that section 2 (or act) is void or unenforceable because it is in conflict with section 1 in that one section requires a credit agreement to be in writing to be enforceable while the other section does not.

I will be happy to discuss this act with anyone should they so desire.

Very truly yours,

Timothy L. Fielder
FIELDER & DISNEY

TLF:nmd

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WELTMER BUILDING
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RODERICK E. WELTMER
WAYNE K. WESTBLADE, ASSOCIATE

L. E. WELTMER (1893-1979)
L. M. WELTMER (1922-1981)

February 1, 1988

Mr. Ron Smith
Kansas Bar Association
1200 Harrison
P. O. Box 1037
Topeka, KS 66601-1037

Response to SB 535 Concerning Credit Agreements

Dear Mr. Smith:

I wholly support Senate Bill 535 prohibiting a debtor from maintaining an action on a credit agreement unless the agreement is signed by the creditor and the debtor. As a foreclosure attorney for The Federal Land Bank of Wichita, we have encountered numerous counter-claims in foreclosure alleging an oral agreement to do a certain type of forebearance or not to foreclose at all. All these counter-claims have been frivilous, and after taking expensive depositions of the defendants, the counter-claims have collapsed.

The Bill does not address another side of this situation, however. Several debtors have attempted to delay foreclosure by alleging an oral agreement with the creditor not to foreclose or to take other forebearance action. Here again, these defenses have proved frivilous after expensive depositions have been taken of the defendants. Therefore, I would recommend that a section be added to read as follows: "A debtor may not use a credit agreement as a defense to an action to collect on a promissory note or to foreclose a mortgage, unless the credit agreement is in writing and is signed by the creditor and the debtor."

Thank you.

Very truly yours,

WELTMER LAW OFFICE

By Wayne K. Westblade
WKW:jm

Bankers Assoc. Bill

Session of 1988

SENATE BILL No. 535

By Committee on Judiciary

1-27

AN ACT concerning credit agreements; relating to debtor's right to action thereon.

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

Section 1. As used in this act:

(a) "Credit agreement" means an agreement to lend or delay repayment of money, goods or things in action, to otherwise extend credit or to make any other financial accommodation;

(b) "creditor" means a person who extends credit or extends a financial accommodation under a credit agreement with a debtor; and

(c) "debtor" means a person who obtains credit or receives a financial accommodation under a credit agreement with a creditor.

Sec. 2. A debtor may not maintain an action on a credit agreement unless the agreement is in writing and is signed by the creditor and the debtor.

Sec. 3. This act shall take effect and be in force from and after its publication in the statute book.

(a) conflicts with definition of "agreement" in 16a-1-301(3). of Kansas Consumer Credit Code.

Sec. 2 appears to deprive debtor of any cause of action on extensions of open-end credit. 16a-1-301.

Certainly pro-creditor. Not in the spirit of the Kansas Consumer Credit Code. One-sided and unfair unless Creditor is also deprived of any cause of action on oral agreements and extensions or waivers.

SHUGHART THOMSON & KILROY
A Professional Corporation

MEMORANDUM

TO: Ron Smith, KBA Legislative Counsel

FROM: William B. Prugh

DATE: February 8, 1988

RE: S.B. Nos. 527, 535

S.B. No. 527

The proposal gives the consumer an alternate remedy to that in the U.C.C. and the U.C.C.C. by providing a 1-year unlimited warranty similar to the "extended warranty" plans many automobile manufacturers offer their customers.

Section (e) provides that the consumer must exhaust the informal dispute settlement procedures available under the federal guidelines applicable to new car purchases, if the manufacturer has implemented such procedures.

I suggest that another section be added providing that this statute is NOT intended to limit, hinder or defeat any warranty plan provided the consumer by the manufacturer, such as an extended warranty plan that provides for warranty coverage for as long as five or seven years under some plans. I believe that the consumer who purchases an extended warranty plan may prefer to follow the remedies provided under that contract, or at least to have the option to choose which procedure to follow.

S.B. No. 535

This Bill requires a consumer credit agreement to be in writing and signed by both parties. I support its goals, but I question whether it is intended to be an amendment to the Uniform Consumer Credit Code or to extend the U.C.C.C. somewhat? The Bill does not cross-reference any existing statute, so the answer is unclear.

MARTINDELL, SWEARER, CABBAGE,
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OF COUNSEL
J. RICHARDS HUNTER
HARRY H. DUNN

TELEPHONE
(316) 662-3331

February 5, 1988

Mr. Ron Smith,
KBA Legislative Counsel
Kansas Bar Association
P.O. Box 1037
Topeka, KS 66601

Dear Ron:

You contacted our office regarding Senate Bill No. 535. First, I don't understand what problem it is designed to correct. I note the notation on the top that it is a Banker's Association bill. My supposition is that it is directed at the lender liability problem and is designed to prevent notes and credit agreements from being the subject of tort claims for such things as misrepresentation, etc., in the context where alleged modifications have been made to the note or agreement which are verbal rather than in writing.

It is my experience that bankers are equally guilty of having conversations with the debtor which they then record in their "credit memos" without getting the debtor's signature. It appears that this bill is an addition to the statute of frauds. I wonder how effective it will be in the event that the debtor calls the creditor and they make an agreement regarding disposition of the collateral, which is then recorded by the banker in the credit memos but then the debtor fails to follow through. I seriously doubt that any court would refuse to enforce such a verbal agreement in the light of a statute such as Senate Bill No. 535. In other words, it appears to be overly broad and its purpose is not clear.

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a consumer at that stage. On the other hand, the Lemon Law is directed primarily at problems which occur after the agreement to purchase the automobile is made. Since these agreements are seldom custom agreements in the case of an automobile purchase, formulation of the agreement is hardly the problem that it is in the KCPA situation. Again, the purpose is not entirely clear. It appears that the intention is to add the remedies and definitions of the KCPA onto those of Lemon Law. I have not examined the bills closely but each has a definition section and they should be compared to make sure the definitions are not inconsistent or contradictory. I sincerely feel that it merely muddles the law to tie a law directed at solving automobile warranty problems in to a bill designed to prevent deceptive door to door sales and high pressure sales tactics.

Thanks for the opportunity to comment.

Sincerely yours,

William F. Bradley, Jr.

WFB:ldm

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MICHAEL P. WADDELL

LESTER L. MORRIS
1901-1966

FERD E. EVANS, JR.
RETIRED

February 1, 1988

RECEIVED

FEB - 4 1988

KANSAS BAR ASSOCIATION

Mr. Ron Smith
KBA Legislative Counsel
Kansas Bar Association
1200 Harrison, P. O. Box 1037
Topeka, Kansas 66601

RE: Senate Bill 535

Dear Ron:

Thank you for your memo of January 28, 1988. Senate Bill 535, in my opinion seeks to write out of the Kansas Statutes any obligation on bankers and other lenders to act in good faith. I aave recently been involved in at least one case where the bankers, in my opinion, lied outright to their customer, assuring him continued credit, collecting their crop proceeds and then denying them the credit previously assured. It seems to me that S.B. 535 will significantly curtail the rights of borrowers in this state and give lenders, particularly in the agricultural arena, a distinctly unfair advantage.

This Bill strikes me as a typical lobbyist's bill which provides answers that are "simple, plausible, and wrong." Needless to say, the question of lender liability is a complex one. However, the courts are the best forum for shaping that area of the law.

Yours very cordially,

Robert E. Nugent, III
For the Firm

REN:cm

P. S. I would answer questions on this Bill if asked.

MCILVAIN LAW OFFICE

February 2, 1988

Ron Smith
KBA Legislative Counsel
P.O. Box 1037
1200 Harrison
Topeka, KS 66601

Dear Sir:

I just received your letter of January 28 regarding SB 535. I'm somewhat suspicious of any banker's bill to limit debtor's rights in a one-sided manner. However, I'm not sure what the intended or probable effect is. Could you give me your opinion?

Despite my uncertainty about its effects and reach, I have one concern initially. Farmers are used to doing business by oral agreements and small banks have generally gone along with this until things turn sour. Lenders will almost always have a written agreement initially. However, during an ongoing lending relationship, many things are often agreed orally, such as sale of secured livestock or crops and disposition of the proceeds. These agreements often contradict and override (intentionally) the written agreements in specific instances. I'm concerned lenders will use this to renege on their oral agreements - while strictly enforcing all the provisions in their favor, which will generally be enshrined in written agreements.

Sincerely;

Ross R. McIlvain
McIlvain Law Office
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(316) 437-2600

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February 3, 1988

Mr. Ron Smith
KBA Legislative Counsel
Kansas Bar Association
P. O. Box 1037
Topeka, Kansas 66601

In re: SB 535; concerning credit agreements

Dear Ron:

Thank you for your letter of January 28, 1988 relative to SB 535.

In my opinion the bill either goes too far or does not go far enough. Obviously, the bill is intented as a protection to lenders to protect lenders from claims on lender liability. It would appear to me that the starting point should be a provision whereby a commitment for a loan would not be binding upon either the creditor or the debtor unless in writing and signed by the parties. Next, it would appear that if the intention is to go further and to protect creditors against claims that an oral agreement was made to delay payment, the bill could include language to accomplish that purpose, but again to have the bill provide that it is not enforceable either by the creditor or the debtor unless in writing and signed by the parties. Third, the bill as drawn probably could be construed to include an oral promise to pay money not evidenced in writing which on the face of the bill would still be enforceable against the debtor but not by the debtor.

As a result of the above, the bill in its present forms may well be unconstitutional under the equal protection clause and could lay a trap for the unwary creditor.

Yours very truly,

Elvin D. Perkins

EDP:jmz

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February 3, 1988

RECEIVED

FEB - 4 1988

KANSAS BAR ASSOCIATION

Mr. Ron Smith
KBA Legislative Counsel
Kansas Bar Association
P. O. Box 1037
Topeka, Kansas 66601

Dear Ron:

It has come to my attention that Senate Bill No. 535, requiring "credit agreements" to be in writing and signed has been proposed by the Committee on the Judiciary. I write to urge your vigorous opposition to the bill.

Much of my law practice for the past five years has been devoted to representation of borrowers against lending institutions who act unfairly, unreasonably, or in bad faith toward our clients. It is typical for lending institutions to exercise a high degree of influence over their customers and, oral assurances and agreements are the norm. Generally, however, the oral assurances and agreements are those which mitigate the impact of written form documents and, rendering the oral assurances invalid will greatly prejudice borrowers across the state.

It should also be clear to legislators that this legislation will give license to all bankers to continue making oral assurances and agreements knowing that they can never have these assurances used against them. Consequently, the bill will encourage more widespread lender abuse, and the principal recipient of such abuse will be Kansas farm borrowers.

I sincerely urge your vigorous opposition to the bill and would appreciate any opportunity to lend my assistance to block this legislation in the interest of all borrowers across Kansas and especially farm borrowers.

Sincerely yours,

Richard D. Greene

RDG:jjl

First National Bank
P.O. Box 215
Washington, Kansas 66968
Phone 913/325-2221

February 3, 1988

Ron Smith, KBA Legislative Counsel
Kansas Bar Association
1200 Harrison
P. O. Box 1037
Topeka, KS 66601

Dear Mr. Smith:

I received your memorandum dated January 28, 1988 and am writing to inform you that I fully support, both as an attorney and a banker, Senate Bill No. 535 as it is written.

Any further information regarding this bill will be appreciated.

Sincerely,

Jon C. Snapp
Vice President

JCS/kh

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DOUGLAS M. CROTTY III
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DALE H. CORLEY,
OF COUNSEL

February 8, 1988

Mr. Ron Smith
KBA Legislative Counsel
Kansas Bar Association
1200 Harrison
P. O. Box 1037
Topeka, Kansas 66601

Re: SB 535

Dear Mr. Smith:

Without having the benefit of the background of this proposed legislation, it is my presumption that the Kansas Bankers Association is proposing this bill in order to curb the growing problem of creditors facing defenses based on oral agreements contrary to the written loan agreement.

I believe the bill could be substantially reduced in terms of verbiage and included within the present Statute of Frauds. See K.S.A. 33-106. The Statute of Frauds probably needs to be gone over legislatively anyway and this provides the opportunity to further define when a writing is required in order to prohibit the action.

Finally, the rule of law that part performance or acceptance of the benefits of an oral contract, commonly referred to as an estoppel theory, will operate to vitiate the need for a writing needs to be curtailed in the financial agreement setting. Therefore, if the committee is truly seeking to protect creditors and require writings, language should be included in the bill to legislatively overrule these doctrines. I leave the language of such legislation to your studious draftsmanship. Finally, the statute should be more definite to prohibit the maintenance of any defense, cross or counterclaim without the presence of the required writing.

Sincerely,

Gerald O. Schultz

GOS/rs