

August 12, 1966

Opinion No. 406
Answered By Letter
(Ashby)

Honorable M. E. Morris
Treasurer, State of Missouri
Capitol Building
Jefferson City, Missouri



Dear Mr. Morris:

This letter is in response to your recent inquiry whether the present contracts "between the State Treasurer and the various state depository banks authorize the payment of a 4% interest rate as of July 20, 1966, the effective date of an amendment to Regulation Q by the Federal Reserve System or whether new contracts will have to be negotiated effective such date."

We assume that the deposits have been regularly made pursuant to and under the standard Depository Contract form that you have employed in the past.

In our Opinion No. 471 dated December 21, 1965, to you, we had an opportunity to comment on the interest provisions of the standard Depository Contract form wherein we said:

"Pursuant to Section 30.260 (3), RSMo 1959, the Contract contains an escalation clause respecting the interest rate that such state deposits shall bear as follows:

"Second Party agrees to pay to First Party interest on moneys so deposited

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with Second Party at the maximum rate which, by federal law or regulation, a bank which is a member of the Federal Reserve System is permitted, from time to time, to pay on such time deposits.'

"A comment at this time on the validity of a contract provision providing for escalation of interest rates appears appropriate. The general rule covering escalating interest rates in a contract is aptly stated in 47 CJS 'Interest' Section 33(b), p. 44, as follows:

"'The parties may enter into a contract by which the rate of interest to be paid shall change whenever the legal rate changes.'

"See also 30 Am. Jur. 'Interests' Section 28, p. 25; Wychoff v. Wychoff (NJ 1888) 13 at 662; Bankers Bond Co. v. Buckingham (Ky. 1936) 97 S.W. 2d 596.

"The fact that there was an effective change of interest rate on December 6, 1965, for Federal Reserve Banks does not change the nature of the deposit or the obligations of the parties in our opinion. It does not constitute a novation as there has been no consent by the state (Hutcheson & Co. v. Providence-Washington Insurance Company, 341 S.W.2d 142, 146).

"The contract contains the following provision respecting termination:

"'Each party reserves the right to terminate this contract at any time on giving thirty (30) days' written notice to the other party of its intention to do so; and this contract shall continue in effect until so terminated.'

"Considering the principles set out above, we believe the obligations of the parties were fully

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spelled out in the contract, with the change of interest rates increasing the sum payable by debtor banks for use of state money. Simply put, we believe the banks agreed to accept a sum certain under the contract for the duration of the contract or until terminated on 30 days written notice as provided by the contract. They agreed to pay therefor an interest rate on an escalating scale according to the maximum legal rate set by the Federal Reserve Board."

Having reached this conclusion in the above cited opinion to the effect that the paragraph governing interest rates is an escalating clause which provides for an automatic increase in interest rates when such rates are raised by the Federal Reserve Board, we conclude such interest rates are automatically reduced to "the maximum rate which, by federal law or regulation, a bank which is a member of the Federal Reserve System is permitted, from time to time, to pay on such time deposits."

Accordingly, we hold that your depository contract contains an escalation provision on interest which varies automatically ". . . at the maximum rate which, by federal law or regulation, a bank which is a member of the Federal Reserve System is permitted, from time to time, to pay on such time deposits"; and, secondly, such interest rate operates eo instanti as of the effective time date announced by the Federal Reserve Board. No administrative action or new contracts are believed necessary to accomplish this change of interest rate inasmuch as such change of interest is automatic under the terms and provisions of your Depository Contract form.

Yours very truly,

NORMAN H. ANDERSON
Attorney General

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