365/360 Interest Calculation: Latest Developments in Ohio Case Law Provide Guidance in Interest Calculation Methods

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The Ohio Supreme Court decision *JNT Properties, LLC* and the recent application of its holding in the class action appeal in *Ely Enterprises, Inc.* has reaffirmed Ohio lenders' use of the 365/360 method for computing annual interest.

Banks have struggled with a solution to the challenging task of calculating equal daily and monthly interest charges during a traditional 365 day calendar year or 366 day leap year. Typically one of three computations is used to calculate interest charges: the 365/365 method (exact day interest), the 360/360 method (ordinary interest), and the 365/360 (bank interest). Banks most commonly use the 365/360 calculation method for commercial loans to standardize the daily interest rates based on a 30-day month.[1] To calculate the interest payment under the 365/360 method, banks multiply the stated interest rate by 365, then divide by 360. However, due to the numerator and denominator not matching, the 365/360 method has been held to increase the effective interest rate by 0.01389 in a non-leap year.

In the state of Ohio, and across the rest of the country, borrowers have challenged the use of the 365/360 method and its modest impact on the effective interest rate, generally by asking the courts to address the clarity of the 365/360 clauses in the underlying promissory note. Two recent Ohio cases have addressed the ambiguity of the 365/360 clauses.

In *JNT Props.*, the Ohio Supreme Court addressed whether the clause that defined the 365/360 method was ambiguous. Under the heading "Payment," the promissory note stated how the interest was calculated: "The *annual interest rate* for this Note is computed on a 365/360 basis; that is, by applying the ratio of the *annual interest rate* over a year of 360 days, multiplied by the outstanding principal balance, multiplied by the actual number of days the principal balance is outstanding." While the court found that the use of "annual interest rate" instead of "interest rate" was imprecise, the clause read in context was not ambiguous. Therefore, since there was no doubt to the intent of the clause — to define the method to calculate interest payments — a reasonable person would realize that the interest rate of the note was calculated based on the 365/360 method.[2]

The Ohio Supreme Court's interpretation of the note's 365/360 clause immediately impacted Ohio courts' construction of challenges to interest calculation provisions. In *Ely*, the Eighth Court of Appeals found that the *Ely* fixed rate loan language was "substantially similar" to the *JNT Props.* adjustable rate loan 365/360 clause.

After obtaining a commercial loan, which contained a 365/360 clause, *Ely* brought suit claiming damages resulting from the discrepancy between a strict per annum interest rate and the amount of interest owed under the 365/360 method. The trial court initially granted the bank's motion to dismiss for lack of unambiguous terms and found that the application of the 365/360 method for calculating interest is permitted by law. The appellate court reversed defendant's motion to dismiss, finding an inconsistency between the calculation and monthly payment amount and the more specific terms of principal and stated interest rate. On remand to the trial court, the plaintiff certified a class of plaintiffs defined under the 365/360 language of the fixed rate loans, "The annual interest rate of this Note is computed on a 365/360 basis; that is, by applying the ratio of the annual interest rate over a year of 360 days, multiplied by the outstanding principal balance, multiplied by the actual number of days the principal is outstanding." The defendant appealed the trial court's certification, claiming that the class certification was inappropriate, because the lead plaintiff did not satisfy the state's class action requirements.

The Ohio Supreme Court's intervening decision, *JNT Props.*, affected the appellate court's decision on the propriety of class certification, even though the *JNT Props.* decision was based on a determination of lack of contract ambiguity. Because the appellate court found practically no difference between the two 365/360 clauses, and the Ohio Supreme Court held that there was no ambiguity in the *JNT Props.* calculation method, there remained no question of law common to all class members in *Ely*. Accordingly, the case lacked the state's class action requirements of commonality and predominance.

Moreover, the appellate court in *Ely* recognized that the use of 365/360 method for calculation of commercial loan interest charges was common throughout the country. In a variety of both federal and state court cases, courts have held that the substantially same interest calculation clause did not give rise to an inconsistency with the phrase "per annum." While the appellate court's holding that the 365/360 clause was unambiguous may be distinguishable where the contractual language is not "substantially similar," *Ely* also offers strong guidance on applying the Ohio Supreme Court's decision in future cases.

The Ohio Supreme Court's decision in *JNT Props.*, and the application of its holding in *Ely*, are extremely important to the thousands of commercial loan transactions that have involved similar uses of the 365/360 method and "per annum" clauses. With a vast number of pending and potential class action lawsuits in Ohio, and across the country, these decisions reaffirmed the use of the 365/360 method of interest calculation in notes. Therefore, notes with substantially similar language may not be found automatically ambiguous as a matter of law.

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[1] Courts have noted that 82% of commercial banks use 365/360 for at least some of their loans, large banks use the method at an even higher rate, and 365/360 was most frequently used for commercial loans.

[2] In the appellate court, the bank relied on correspondence and an affidavit of a senior vice president to support the argument that the parties intended the yearly interest rate to be calculated based on the 365/360 method.