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Allen Dale Darden

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THE PENALTY FOR USURY—AN INTERESTING PROBLEM 6

Throughout history, the charging of interest has been subject to regulation. The Code of Hammurabi, circa 1800 B.C., includes maximum rates of interest for loans of grain and silver.¹ The Old Testament contains several warnings prohibiting the charging of interest under certain circumstances.² The Biblical penalties resulting from the failure to heed these warnings were harsh, such as death³ and exclusion from heaven.⁴ Louisiana law includes numerous limits on interest rates as well as penalty provisions for violation of these limits. For example, the Louisiana Civil Code,⁵ the Louisiana Consumer Credit Law,⁶ the Louisiana Credit Union

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1. Note, *The Federal Monetary Control Act of 1980: A Step Toward Deregulation of State Usury Laws*, 83 W. VA. L. REV. 509, 510 (1981).

2. "If you lend money to My people, to the poor among you, you are not to act as a creditor to him; you shall not charge him interest." *Exodus* 22:25 (New American Standard). "You shall not give him your silver at interest, nor your food for gain." *Leviticus* 25:37 (New American Standard). "You shall not charge interest to your countrymen: interest on money, food, or anything that may be loaned at interest." *Deuteronomy* 23:19 (New American Standard).

3. "[H]e lends money on interest and takes increase; will he live? He will not live! He has committed all these abominations, he will surely be put to death; his blood will be on his own head." *Ezekiel* 18:13 (New American Standard).

4. "Who may dwell on Thy holy hill? . . . He [who] does not put out his money at interest . . ." *Psalms* 15:1-5 (New American Standard).

5. LA. CIV. CODE arts. 1938 & 2924; *see infra* note 11 and text accompanying note 19.

6. LA. R.S. 9:3510-:3571 (1983 & Supp. 1984). LA. R.S. 9:3519(A) reads:

A. The maximum loan finance charge for any consumer loan other than one made with a lender credit card that may be charged, contracted for or received by a licensed lender or supervised financial organization may equal but not exceed:

(a) Thirty-six percent per year for that portion of the unpaid principal amount of the loan not exceeding one thousand four hundred dollars;

(b) Twenty-seven percent per year for that portion of the unpaid principal amount of the loan exceeding one thousand four hundred dollars and not exceeding four thousand dollars;

(c) Twenty-four percent per year for that portion of the unpaid principal amount on the loan exceeding four thousand dollars and not exceeding seven thousand dollars; and

(d) Twenty-one percent per year for that portion of the unpaid principal amount of the loan exceeding seven thousand dollars.

LA. R.S. 9:3552(A)(1)(a) reads:

A. Violations discovered as a result of written consumer complaint

(1) Intentional violations or violations not caused by good faith errors.

(a) If the court finds that the extender of credit has intentionally or as a result of error not in good faith violated the provisions of this chapter, the consumer is entitled to a refund of all loan finance charges or credit service charges and has the right to recover three times the amount of such loan finance charge or credit service charge together with reasonable attorney's fees. The right to recover the civil penalty under this subsection accrues only after

(i) written notice is given to the extender of credit by certified mail addressed to the extender of credit's place of business in which the consumer credit transaction arose;

Law,⁷ and the Motor Vehicle Sales Finance Act⁸ all contain interest rate limitations and/or penalty provisions. The federal government has also played a role in the regulation of interest with the passage of the Depository Institutions Deregulation and Monetary Control Act of 1980.⁹

With such a myriad of statutes dealing with the regulation of interest charges, determining which law governs a particular loan or credit sale can be a difficult task. The applicable provision can depend upon the type of lender, the purpose of the loan and the size of the loan. However, a penalty frequently levied on usurious lenders is found in Louisiana Revised Statutes 9:3501.¹⁰ While its penalty of interest forfeiture seems

(ii) a copy of such notice is mailed to the extender of credit's agent for service of process; and

(iii) thirty days have elapsed since receipt of such notice by the extender of credit, and the violation has not been corrected.

7. LA. R.S. 6:641-:669 (1951 & Supp. 1984). LA. R.S. 6:654(B) reads:

B. Notwithstanding any other provision of the law to the contrary, with respect to a loan to a member pursuant to an open-end credit, revolving credit, or line of credit loan account, a credit union may contract to receive and collect a finance charge, which may be such maximum fixed rates or maximum variable rates of interest in any amount, as provided for in the credit union bylaws, which have been approved by the commissioner of financial institutions. The finance charge may be added to the loan balance on the monthly due date or monthly billing date or the proportionate part due may be added when a new advance is made.

8. LA. R.S. 6:951-:964 (Supp. 1984). LA. R.S. 6:957(A)(1) reads:

A. (1) Notwithstanding the provisions of any other existing law, a retail installment transaction entered into on and after September 10, 1982, may include a finance charge not in excess of the following rates:

Class 1. Any new motor vehicle designated by the manufacturer by a year model not earlier than the year in which the sale is made, an amount equivalent to one and one-half percent per month simple interest on the declining balance.

Class 2. Any new motor vehicle not in Class 1 and any used motor vehicle designated by the manufacturer by a year model of the same or not more than two years prior to the year in which the sale is made, an amount equivalent to two percent per month simple interest on the declining balance.

Class 3. Any used motor vehicle not in Class 2 and designated by the manufacturer by a year model not more than four years prior to the year in which the sale is made, an amount equivalent to two and one-half percent per month simple interest on the declining balance.

Class 4. Any used motor vehicle not in Class 2 or Class 3 and designated by the manufacturer by a year model more than four years prior to the year in which the sale is made, an amount equivalent to two and three-fourths percent per month simple interest on the declining balance.

LA. R.S. 6:960(A) reads:

A. Any person who shall wilfully and intentionally violate any provision of this Chapter or engage in the business of a sales finance company in this state without a license therefor as provided in this Chapter shall be guilty of a misdemeanor and upon conviction shall be punished by a fine not exceeding five hundred dollars or by imprisonment for not to exceed six months in jail, or both.

9. Pub. L. No. 96-221, § 501, 94 Stat. 132, 161 (codified as amended at 12 U.S.C. § 1735f-7 notes (1982)).

10. (1983).

relatively innocuous by Biblical standards, Louisiana courts have searched for ways to avoid the effect of the provision. One method employed by the courts will produce an unintended result in light of recent amendments to Civil Code articles 2924¹¹ and 1938. The present and future application of section 3501 is the focus of this article.

Scope of Louisiana Revised Statutes 9:3501

The language of section 3501 seems very clear: "Any contract for the payment of interest in excess of that authorized by law shall result in the forfeiture of the entire interest so contracted." The scope of the statute would appear to be very broad, since it encompasses "any contract." It certainly should apply to contracts stipulating a usurious in-

11. Article 2924 reads:

Interest is either legal or conventional. Legal interest is fixed at the following rates, to wit:

At twelve percent per annum on all sums which are the object of a judicial demand. Whence this is called judicial interest;

And on sums discounted at banks at the rate established by their charters.

The rate of judicial interest resulting from a lawsuit pending or filed during the indicated periods shall be as follows. Prior to September 12, 1980, the rate shall be seven percent per annum. On and after September 12, 1980, until September 11, 1981, the rate shall be ten percent per annum. On and after September 11, 1981, the rate shall be twelve percent per annum.

The amount of the conventional interest cannot exceed twelve percent per annum. The same must be fixed in writing; testimonial proof of it is not admitted in any case.

Except in the cases herein provided, if any person shall pay on any contract a higher rate of interest than the above, as discount or otherwise, the same may be sued for and recovered within two years from the time of such payment.

The owner or discounter of any note or bond or other written evidence of debt for the payment of money, payable to order or bearer or by assignment, shall have the right to claim and recover the full amount of such note, bond or other written evidence of debt and all interest not beyond twelve percent per annum interest that may accrue thereon, notwithstanding that the rate of interest or discount at which the same may be or may have been discounted has been beyond the rate of twelve percent per annum interest or discount. This provision shall not apply to the banking institutions of this state in operation under existing laws or to a consumer credit transaction as defined by the Louisiana Consumer Credit Law.

The owner of any promissory note, bond, or other written evidence of debt for the payment of money to order or bearer or transferable by assignment shall have the right to collect the whole amount of such promissory note, bond, or other written evidence of debt for the payment of money, notwithstanding such promissory note, bond, or other written evidence of debt for the payment of money may include a greater rate of interest or discount than twelve percent per annum; and, such obligation shall not bear more than twelve percent per annum after maturity until paid. This provision shall not apply to a consumer credit transaction as defined by the Louisiana Consumer Credit Law. Where usury is a defense to a suit on a promissory note or other contract of similar character, it is permissible for the defendant to show said usury whether same was given by way of discount or otherwise, by any competent evidence.

terest rate for which no other penalty provision applies. Contracts which are governed by the limitations found in Civil Code article 2924 are subject to section 3501, as article 2924 contains no penalty provision.¹² However, many other areas of Louisiana law which place limits on interest rates also provide for penalties to usurious lenders. For example, the Louisiana Consumer Credit Law (LCCL) provides for a penalty of three times the loan finance charges as well as attorney fees if the borrower can show that the lender committed an intentional violation.¹³ It has been argued that should a borrower fail to prove an intentional violation, the penalty provided in section 3501 should still be available as a remedy.¹⁴ This argument is supported by the language of section 3501, which requires no showing of the lender's intent to charge a usurious interest rate, and by the LCCL, which does not expressly exclude section 3501 as a remedy.¹⁵ Hence, while section 3501 is applicable to loans not expressly covered by another penalty provision, it may also apply when a provided for remedy is for some reason unavailable to the borrower.

Section 3501 dictates that the "entire interest" shall be forfeited. The Louisiana Supreme Court in 1973 decided the case of *Thrift Funds v. Jones*,¹⁶ in which the question of what constituted "entire interest" under section 3501 was considered. The loan in *Thrift Funds* was found to be usurious under Civil Code article 2924.¹⁷ The loan included *capitalized interest*¹⁸ in excess of the conventional rate of interest, which in itself was not usurious. However, article 2924 places a limitation on the lender who makes capitalized interest loans: the lender is limited in the amount of interest he may charge *after* the note becomes due. Thrift Funds' loan provided for eight percent interest on the note from the time it was due until it was paid, which at that time was the maximum allowed by article 2924. Since Thrift Funds added a late charge in addition to the maximum

12. Article 2924 is Louisiana's basic usury provision. However, its application has been greatly reduced by the passage of various statutes, including the Louisiana Consumer Credit Law. These statutes have acted to remove most loans from the coverage of article 2924.

13. LA. R.S. 9:3552(A)(1)(a) (1983).

14. Johnson, *The Work of the Louisiana Appellate Courts for the 1972-1973 Term—Obligations*, 34 LA. L. REV. 231, 244 (1974).

15. *But see* Note, *Usury and Consumer Credit Law in Louisiana*, 53 TUL. L. REV. 1439, 1468 (1979).

16. 274 So. 2d 150 (La.), *cert. denied*, 414 U.S. 820 (1973).

17. Article 2924 allows the charging of an unlimited rate of interest as long as the interest is capitalized into the face amount of the promissory note. For example, assume that a borrower secures a loan of \$500, but gives to the lender a note for \$1000, payable in one year. The note represents \$500 of principal advanced to the borrower, and \$500 of capitalized interest. This constitutes an interest rate of 100% per year, well in excess of the maximum rate of conventional interest allowed in article 2924 (eight percent at the time of Thrift Funds' loan), but it is not considered usurious since it is capitalized into the face amount of the note. Lenders whose loans fall under other statutes, such as the LCCL, may not benefit from article 2924's sanction of unlimited capitalized interest.

18. *See supra* note 17.

eight percent after maturity of the debt, the court concluded that the lender had violated article 2924, the late charge being viewed as a form of interest. The court found the loan to be usurious, and looked to section 3501 as the borrower's remedy. The court decided that the "entire interest" forfeiture language of section 3501 included the usurious late charge, the stipulated eight percent interest from maturity, and the capitalized interest found in the face amount of the note. *Thrift Funds* seems to be in accord with a "plain meaning" construction of the language found in section 3501. Yet, some courts, apparently viewing the forfeiture of the "entire interest" as an excessive penalty, have lessened the impact of section 3501 by looking to Civil Code article 1938.

Reducing the Penalty—The Tarver Rule

Civil Code article 1938 provides that "[a]ll debts shall bear interest at the rate of twelve percent per annum from the time they become due, unless otherwise stipulated."¹⁹ Article 1938 would not appear to apply to a debt for which a usurious rate of interest has been provided, since the parties did stipulate an interest rate, even though it was usurious. However, Louisiana courts have at times avoided this interpretation. For example, in *Tarver v. Winn*²⁰ the Louisiana Supreme Court ruled that a contract stipulating a usurious rate of interest would be treated as if the contract contained no provision for interest at all. "The agreement to pay a greater interest than that allowed by law to be contracted for, makes that part of the contract null and void, and produces no legal effect between the parties contracting, and is the same as if no agreement had been entered into relative to interest."²¹ Since the usurious rate was null, there was no rate stipulated in the contract, and the court looked to the precursor²² of article 1938 to supply an interest rate. The lender was allowed to recover interest at a rate of five percent per year from the date the debt became due, which was the rate specified by the statute when the loan in *Tarver* was made. The court allowed this recovery even though it had earlier noted that "such a stipulation [of a usurious interest rate] causes the forfeiture of the entire interest contracted for."²³ The Louisiana Second Circuit Court of Appeal has twice applied the same rule presented in *Tarver*,²⁴ and in 1969, a federal district court citing *Tarver*

19. Emphasis added.

20. 18 La. Ann. 557 (1866).

21. *Id.* at 558.

22. 1855 La. Acts, No. 291, § 1. This Act read: "Be it enacted by the Senate and House of Representatives of the State of Louisiana in General Assembly convened, That all debts shall bear interest at the rate of five per cent. from the time they become due, unless otherwise stipulated."

23. 18 La. Ann. at 558.

24. *W.W. Page & Son v. Russell*, 7 La. App. 129 (2d Cir. 1927) (10% interest rate was found to be usurious, and considered uncollectable; however, the court allowed five

and the second circuit cases applied article 1938 to provide legal interest to a usurious lender who had been penalized under section 3501.²⁵

Not all Louisiana courts agree with the use of article 1938 to lessen the penalty provided for in section 3501. In 1970, the Fourth Circuit Court of Appeal criticized the federal court's sanction of the *Tarver* rule:

In our opinion the plain purpose of a legislative declaration of "the forfeiture of the entire interest" is defeated by substituting instead a theory that the contract does not stipulate interest and therefore legal interest is payable. This would not be a forfeiture of the entire interest, but only a forfeiture of that part of the stipulated interest above legal interest.

The forfeiture of all interest is a harsh penalty, but it is not unsuited to the practice sought to be suppressed; and it is the clear provision of R.S. 9:3501.²⁶

The most recent decision applying the *Tarver* rule comes out of the Louisiana Third Circuit Court of Appeal. In *Smith v. Ducote*,²⁷ decided in 1981, the third circuit applied the *Tarver* rule to a loan found usurious under article 2924. The court cited the federal court decision and second circuit decisions as authority. In *Smith*, the contract stipulated interest at the rate of ten percent from maturity of the note. The loan was found to be subject to the provisions of article 2924 and was therefore usurious, since article 2924, at the time of the *Smith* loan, limited interest after maturity to eight percent per year. The court recognized that section 3501 required forfeiture of the entire interest, but applied article 1938, allowing the lender seven percent interest from maturity of the debt. It is worth noting that *Smith* was decided after the *Thrift Funds* case. *Thrift Funds* did not concern the use of article 1938 and the *Tarver* approach.²⁸

percent interest from maturity of the debt); *Green v. Johnson*, 14 La. App. 110, 129 So. 384 (2d Cir. 1930) (the court cited both *Tarver* and *Page* as it permitted five percent interest from maturity to a loan which had stipulated a usurious rate of 10%).

25. *Meadow Brook Nat'l Bank v. Recile*, 302 F. Supp. 62 (E.D. La. 1969). In *Meadow Brook*, a loan including capitalized interest also stipulated eight percent interest from the date of the note. This was considered usurious because article 2924 allows interest on a capitalized interest loan only from maturity of the debt, not from its inception. After ordering the forfeiture of all interest, including the capitalized interest, the court awarded legal interest of five percent by using article 1938.

26. *DeSalvo v. Finance Funds Group*, 252 So. 2d 498, 501 (La. App. 4th Cir. 1970).

27. 398 So. 2d 190 (La. App. 3d Cir.), writ denied, 405 So. 2d 531 (1981).

28. When the court in *Thrift Funds* included capitalized interest within the coverage of LA. R.S. 9:3501, the remaining amount due on the note was less than \$300. Loans of less than \$300 were covered by the now repealed Louisiana Small Loan Law, LA. R.S. 6:571-:593 (1951). The Louisiana Small Loan Law provided for forfeiture of the entire principal and interest of loans found to be usurious under the Law. Therefore, the court effectively voided the entire loan and there was no principal balance upon which to apply article 1938 and the *Tarver* approach.

However, *Thrift Funds* clearly stands for the proposition that section 3501 is to be construed most favorably to the borrower, since the supreme court considered all forms of interest, including capitalized interest, to be covered by the forfeiture provision of section 3501. In spite of the clear implication of *Thrift Funds* favoring borrowers, the third circuit, by continuing to apply the *Tarver* rule, has sanctioned the partial avoidance of the penalty provided by section 3501.

It cannot be denied that the usurious lender was penalized under section 3501 even though the *Tarver* rule was applied. Under the facts of *Smith*, a usurious rate of ten percent was reduced to the rate found in article 1938, or seven percent at that time. The loan in *Smith* was subject to article 2924, which allowed up to an eight percent rate; consequently, the lender in *Smith* ended up receiving seven percent when he could have legally contracted for eight percent. Therefore, even using the *Tarver* approach, the legal lender enjoyed an advantage over the usurious lender, provided the usurious rate was challenged by the borrower and provided the legal lender charged the maximum allowable rate.

This advantage might be said to encourage compliance with the law. Yet, for many lenders the risk of losing one percent interest may not outweigh the possible gains received from an unchallenged usurious rate.²⁹ That issue is moot however, as the legislature has since changed the interest rates found in articles 2924 and 1938 and, thereby, completely removed the advantage a legitimate lender held over a challenged usurious lender for a *Smith*-type loan (no capitalized interest) when the *Tarver* rule is applied.

The Tarver Rule Today

In 1980, the legislature raised the legal rate of interest found in article 1938 to ten percent.³⁰ In 1981 it was again raised, this time to twelve percent.³¹ Article 2924 was also amended in 1981. However, the legislature passed two acts amending article 2924 which contain conflicting provisions.³² One of the acts left the maximum conventional rate of interest at eight percent,³³ but the other raised the rate to twelve percent.³⁴

29. The loan in *Smith* contained no capitalized interest. The penalty to usurious lenders would of course be greater if capitalized interest had to be forfeited as required by *Thrift Funds*.

30. 1980 La. Acts, No. 402, § 1.

31. 1981 La. Acts, No. 574, § 1 & No. 639, § 1. There was no conflict in the provisions of these two acts amending article 1938.

32. Johnson, *Developments in the Law, 1980-1981—Obligations*, 42 LA. L. REV. 388, 389 (1982).

33. 1981 La. Acts, No. 574, § 1.

34. 1981 La. Acts, No. 639, § 1.

In 1982, the legislature tried again, this time installing twelve percent as the maximum conventional rate.³⁵

In 1861, when the loan in *Tarver* was made, a legal lender enjoyed a maximum three percent greater return than a penalized usurious lender after article 1938 was applied.³⁶ In 1979, when the loan in *Smith* was made, the advantage had decreased to a maximum of one percent. Yet, for a loan subject to article 2924 made in December 1980, the *legal lender* would actually be penalized for obeying the law. The usurious lender, after having the illegal rate excised from the contract, would receive ten percent after maturity upon application of article 1938 and the *Tarver* rule, which is two percent *greater* than the maximum rate allowed by article 2924. Under the present law, the legal lender enjoys no advantage over a penalized usurious lender, since both rates now stand at twelve percent.

Conclusion

The Louisiana Supreme Court in *Thrift Funds* made it clear that Louisiana Revised Statutes 9:3501 was intended to be a harsh penalty to the usurious lender. The *Tarver* approach, especially in light of the present interest rates found in Civil Code articles 2924 and 1938, is not consistent with this view. The penalized usurious lender will still receive twelve percent interest after application of article 1938, which equals the maximum rate the law abiding lender may charge for loans subject to article 2924. If Louisiana courts persist in applying *Tarver*, the legislature should move to prevent such an application. This could be achieved through amendment of section 3501 to forbid the imposition of legal interest on a loan found to be usurious. Such a change would create more consistent application of section 3501 statewide and provide significant incentive for lenders to observe the interest rate limitations of article 2924.

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35. 1982 La. Acts, No. 142, § 1.

36. The maximum benefit to the legal lender is determined by subtracting the rate found in article 1938 from the maximum allowed rate in article 2924. The rates in effect during the *Tarver* and *Smith* loans are shown below as well as situations resulting from recent amendments to articles 1938 and 2924.

Date	Article 1938	Article 2924
	Percentage Rate	Maximum Conventional Percentage Rate
1861 (<i>Tarver</i>)	5	8
Dec. 1979 (<i>Smith</i>)	7	8
Dec. 1980	10	8
Dec. 1981	12	8 (Act 574), 12 (Act 639)
Dec. 1982	12	12