

# CLIENT ADVISORY:

## RI SUPREME COURT DECISION WILL CREATE MAJOR CONCERNS FOR SOME COMMERCIAL LENDERS

The laws of virtually every state prohibit lenders from charging interest on loans in excess of the “usury rate” – the maximum interest rate permitted under the laws of the state. However, usury statutes vary greatly from state to state. Not only do the maximum interest rates vary, but some states exempt certain loans, some count origination and other fees in the calculation of interest, etc. As a result, simply stating an interest rate that, on its face, is less than the maximum rate permitted in a particular state is not always a guarantee that the rate is not usurious.

As a result of the complexity and lack of uniformity of the various states’ usury statutes, it has become common practice for lenders to include so-called “usury savings clauses” in their promissory notes and loan agreements, even where the stated interest rate is well below the maximum interest rate provided by the usury statute. The need for such “savings clauses” is obvious: if a loan is deemed to be usurious, it is void and unenforceable.

### ***NV One, LLC v. Potomac Realty Capital, LLC***

In February 2014, the Rhode Island Supreme Court decided the case of *NV One, LLC v. Potomac Realty Capital LLC* (“*NV One*”). The case turned on the enforceability of a usury savings clause that, on its face, was both well drafted and typical of the clauses found in virtually all commercial loan documentation. However, in *NV One*, the Rhode Island Supreme Court held that the usury savings clause was unenforceable because it violated public policy. As a result, the \$1.8 million commercial loan was found to be usurious and therefore void. Although a substantial portion of the loan had

already been received by the borrower before it defaulted, the result of the decision is that none of the principal, accrued interest and any costs incurred under the loan documents will have to be repaid. The funds loaned by the lender, plus accrued interest and any costs of collection incurred by the lender are simply lost.



As noted above, the usury savings provision of the *NV One* loan documents, based on historic practice and existing case law, was one in which most lenders would have taken comfort. It expressly stated (i) it was the intention of the parties to strictly conform to the usury laws in force during the term of the loan; (ii) the obligations of the borrower were expressly limited so that in no event would the borrower be obligated to pay interest in excess of the maximum amount permitted by law and (iii) in the event the borrower ever paid interest in excess of the maximum rate permitted by law, the excess payment would be applied to the outstanding principal of the loan or if the loan was fully paid, the amount would be refunded.

Although the intent of the parties, as manifested in the usury saving language, seemed clear and unequivocal, the Rhode Island Supreme Court held it to be unenforceable as against public policy. Its rationale was that giving effect to the usury savings clause would place the burden of compliance squarely on the shoulders of borrowers, rather than on lenders, who are in the best position to ensure compliance with usury laws.

Whether or not one agrees with the court's reasoning, the practical implications are clear. First, lenders in Rhode Island will no longer be able to rely upon usury savings clauses. Lenders, particularly those doing business with borrowers in multiple states, will be well advised to review and remain current on the usury statutes in each state where they do business and tailor their loan documents to the laws of each state as needed.

Further, the *NV One* decision is a warning shot for any lenders who are relying upon a usury savings clause as a safety valve for charging usurious interest (even unintentionally). Therefore, lenders should immediately review their portfolios and confirm that any loans subject to Rhode Island law are not incurring usurious interest rates.

The second issue is more problematic. Because the *NV One* case held that the usury savings clause was unenforceable and therefore the loan was void, apparently all a lender can do with any loan to a RI borrower that may prove to be usurious is to hope for the best if the lender discovers that a performing loan is usurious. Asking the borrower to amend the loan documents could well prove to be an invitation for the borrower to check with its legal counsel and then simply stop making payments on the now void loan obligation. This decision may also have financial reporting implications (e.g., increasing their reserve for bad debts, etc.), even if the lender is not regulated.

Finally, going forward, if the facts and circumstances permit, lenders should strongly consider choosing another state's law now that the *NV One* decision has eliminated usury savings clauses as a measure of protection from usury.

In any event, lenders who have made loans subject to Rhode Island law or to Rhode Island borrowers with interest rates that may, under any circumstances, exceed the RI usury rate (21%) should consult their legal counsel to discuss how best to proceed.



**WILLIAM F. MILLER**  
Partner

William F. Miller is a Partner with Pannone Lopes Devereaux & West LLC and a member of the Corporate & Business Law Team. He is a highly skilled attorney with more than 30 years of experience who focuses his practice on corporate and business law matters, including mergers and acquisitions, angel, venture capital and private equity financing, commercial contract matters, intellectual property protection and licensing, and entity and investment fund formation. Mr. Miller frequently advises early stage technology companies, manufacturers, service and distribution companies as well as investors in such companies.

*This memorandum is intended to provide general information of potential interest to clients and others. It does not constitute legal advice. The receipt of this memorandum by any party who is not a current client of Pannone Lopes Devereaux & West LLC does not create an attorney-client relationship between the recipient and the firm. Under certain circumstances, this memorandum may constitute advertising under the Rules of the Massachusetts Supreme Judicial Court and the bar associations of other states. To insure compliance with IRS Regulations, we hereby inform you that any U.S. tax advice contained in this communication is not intended or written to be used and cannot be used for the purpose of avoiding penalties under the Internal Revenue Code or promoting, marketing or recommending to another party any transaction or matter addressed in this communication.*



**PLDW**

PANNONE LOPES DEVEREAUX & WEST LLC

*counselors at law*