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A MAN, A PLAN, A CANAL (AND A RAVEN, TOO)…

By W. Christopher Barrier

I never did figure out why a raven was like a writing desk, but I do think I know why Arkansas' usury law has been like the Panama Canal (and sometimes has had a through-the-looking-glass quality to it, now that I think about it).

When the Canal was about to be returned to the Panamanians, there was a lot of gnashing of teeth and beating of chests, and now virtually no one appears to think about it at all. Likewise, the provisions of the Arkansas constitution dealing with usury continued to cause anguish and cries of outrage, even after the passage of Amendment 60 and even with the residential real property preemptions.

Lay my burden down…

However, once Arkansas-based banks were effectively relieved of its burdens by Congress, lawyers, lenders, commentators and regular people just stopped giving it much thought or attention at all. Which may explain why regular people, and even lawyers, occasionally appear to forget just how much bite that bear trap can have.

In the spring of 2006, in the case of *Van Carr Enterprises v. Hamco,* the Arkansas Supreme Court was faced with a convoluted but nonetheless interesting case. Landlord had leased to Tenant a commercial property, which lease contained an option to purchase the property, which purchase would be financed by the Landlord, as seller.

Surprise!!

But, when Tenant exercised the option, it was faced with leases for other parts of the property that Landlord had entered into with affiliated entities. Tenant insisted that the existence of the leases violated Landlord's obligation to convey clear and unencumbered title. Further, those leases called for rents that were significantly below market. Landlord insisted that Tenant take the property encumbered by the leases, so Tenant went to court.

However, not only did Tenant want the leases cancelled (or maybe the terms changed), it also claimed that it was entitled to the seller financing from Landlord---but without any interest, because the interest rate called for by the contract exceeded the permissible maximum at the time the contract was executed. (It was tied to the Federal Reserve discount rate, but added more than five percentage points to that rate to produce the contract rate.)

Teeth gnashed, roles reversed…

The Landlord did indeed gnash its teeth and beat its chest. In an interesting turn around, it claimed, as the lender, that the contract to provide financing was void, due to the impermissible interest rate, and should not be specifically performed. In the alternative, Landlord claimed the Tenant had waived the claim of usury in exercising the option.

The Court pointed out that the constitutional provision does indeed make such contracts void---but only “as to the unpaid interest.” It affirmed the trial court’s decision that the Landlord tote the note, but without interest. (Typically, that would not mean level payments of principal, but payments of only the principal component of the payments called for by an amortization schedule.) And claims of waiver just virtually never work in the context of usury.

Off with their leases!!!

Adding insult to injury (but following the law), the trial court cancelled the other leases so as to give the Tenant what it had bargained for, which the supreme court affirmed. The overall financial impact on Landlord of both components of the court’s judgment was huge, underscoring the potential perils faced by non-institutional lenders who neglect to school themselves on the law.

The supreme court’s decision is straightforward, but, if not read carefully, may produce some confusion, even among lawyers, on one point. The decision refers to “usurious interest,” leading at least one of my acquaintances to think the court meant that only the interest above the legal rate was relevant in setting penalties. There was also no doubling of interest at all in the *Van Carr* case.

Say what you mean…

In the first place, the court in the 1991 case of *Dillon v. RTC,* affirmed that when the constitution sets as the penalty “twice the interest paid,” it means just that. It simply does **not** say “twice the interest paid **in excess of the legal maximum…**”

Secondly, the *Van Carr* litigation started before the financing went into effect and before the Tenant had paid any interest at all---so there was nothing to double. Paraphrasing the Red Queen, the constitution means what it says, and the supreme court unquestionably gets to say what it means…

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