

COLLECTING INTEREST IN KENTUCKY

In Kentucky, the legal rate of interest is 8% per annum. More people know this fact, however, than know what it means.

The "legal rate" of interest is simply that interest which the law allows one to charge on an obligation that falls due in the absence of any interest rate otherwise set by agreement or operation of law. The legal rate is the maximum amount allowable to a creditor who has no other right to charge interest. Despite the rise and fall of interest rates generally, the legal rate of interest has not changed in Kentucky for at least 15 years.

What if a creditor wants to charge more than the legal rate? How can he legally do it? Well, statutes set exceptions to the legal rate of interest on all types of transactions, including, for example, installment sales of automobiles, revolving charge agreements, etc. Unless an exception is carved out in the law for a particular type of extension of credit, KRS 360.010 must be taken into consideration. This is the statute that sets the legal rate at 8%, and also makes certain general exceptions.

KRS 360.010 provides that parties may agree in writing for the payment of interest in excess of the legal rate as follows:

(a) At a per annum rate not to exceed four (4%) percent in excess of the discount rate on 90-day commercial paper in effect at the Federal Reserve Bank in the Federal Reserve District where the transaction is consummated or nineteen (19%) percent, whichever is less, on money due, or to become due upon any contract or other obligation in writing where the original principal amount is fifteen thousand (\$15,000) dollars, or less and

(b) At any rate on money due or to become due upon any contract or other obligation in writing where the original principal amount is in excess of fifteen thousand (\$15,000) dollars . . . [Emphasis added.]

Thus, for agreements in writing for payment in excess of \$15,000, there are no restrictions on interest rates generally in commercial transactions.

But what about the restrictions on interest rates when the parties agree in writing to higher than the legal rate but do not want to be bound by the statutory limit of 4% over the discount rate on 90-day commercial paper or 19%, whichever is less?

Well, first of all, it is important to know that usury—the technical term for interest in excess of that allowed

by law—is not a defense for corporations. See KRS 360.025. In addition, under KRS 360.027, usury is not a defense for limited partnerships or business trusts (unless the principal asset of said limited partnership or business trust is the ownership of a one or two family dwelling). This removes many commercial debtors from the protection of the interest rate limit and allows interest rates in excess thereof to be enforced against them.

What about the requirement that these agreements be in writing? How does an open account shipper obtain the right to charge interest on past due invoices in excess of the legal rate? There are two principal ways to achieve this.

First of all, the seller of goods on account can have its customer sign a general credit agreement in advance which provides for the payment of interest on past due invoices. The second way to justify such interest charges is through the invocation of KRS 355.2-207, the so-called "battle of the forms" provision of the Uniform Commercial Code.

Let us suppose the seller on account includes a provision at the bottom of every one of its invoices to the effect that an interest charge of 2% per month will accrue on past due balances. This addition to the invoice becomes a part of the contract of sale between the parties under KRS 355.2-207 if the purchaser fails to give notice of his objection to this additional term within a reasonable time. Since such interest charges commonly appear on invoices and since they are considered a normal part of doing business in the commercial world, it is very unlikely that the purchaser will object to the interest charge provision upon receipt of the invoice.

Official Comment 5 to the U.C.C. section in question states that "a clause providing for interest on overdue invoices or fixing the seller's standard credit terms where they are within the range of trade practice and do not limit any credit bargained for" is an example of a clause which should be incorporated into the contract between the parties in the absence of timely objection.

Finally, let us consider the situation where the 2% per month finance charge appears on the invoice and is charged by the creditor, but is clearly in excess of the absolute 19% limit in KRS 360.010, and the invoice is for less than \$15,000.00, and the buyer is neither a corporation, nor a limited partnership or business trust.

Is such an interest charge in violation of KRS 360.010, and therefore usurious? It would appear so. Then what penalty faces the creditor who charges such interest on an invoice?

The answer is found in KRS 360.020, which provides that when such excessive interest is charged knowingly, the creditor shall forfeit the entire interest on the debt. In addition, any such usurious interest which has actually been paid can be recovered back in twice its amount from the creditor.

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