

Late Penalties on Loan Payments in Arkansas – What's the Rule?

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A frequently asked question in the lending community is whether there is an established amount regarding the maximum late fee that can be charged for a late payment made on a loan in Arkansas.

Unfortunately, the answer to such question is that there is no statutory or judicially sanctioned amount that a lender can charge as a “maximum late fee” under Arkansas law. One reason no hard and fast rule regarding late fees has emerged is that courts have a history of examining whether a late fee or charge is simply an attempt to circumvent applicable usury laws. Thus, any fee could potentially be charged, as long as it does not render the loan usurious.

When discussing late charges in the past, the Arkansas Supreme Court has stated that: “It is not possible to state a hard and fast rule which will automatically solve the question of whether a contract is usurious. This is true because no two cases rest upon identical facts, and the facts are frequently the determinative question rather than the rules of law. Such factors include the intentions of the parties, the amount of the loan, the dates and places of contracting, and the performance.” *Bunn Lumber Co. v. Weyerhaeuser Co.*, 268 Ark. 445 (1980).

However, courts have outlined several factors that may offer lenders guidance in determining what fee to impose when a borrower makes a late payment.

Two principal factors that have emerged when determining whether a charge is truly a late penalty are (1) whether the charge is fixed in amount and (2) whether it is assessed as a one-time charge. *Smith v. Figure World Plus, Inc.*, 288 Ark. 355 (1986).

Courts also take into account whether the charges are compounded. Charges have been declared nonusurious when they were fixed in amount, were charged only one time, and were not compounded. *Tackett v. First Sav. of Arkansas, F.A.*, 306 Ark. 15, 22 (1991).

Case law shows that courts in Arkansas have upheld late penalties that were limited to 4% and 5% of the monthly payment on the loan.

In *Tackett*, the court upheld a late fee of 4% of the monthly installment, where the charge was a one-time penalty of a fixed amount and was only assessed for the months in which the payments were late. *Id.*

In *Hayes v. First Nat'l Bank of Memphis*, the Arkansas Supreme Court upheld, as nonusurious, an agreement that incorporated a clause by which the debtors agreed to pay “a default charge equal to 5% of any payment in arrears for more than five days or \$5, whichever was the lesser, but in no event to exceed the maximum default or delinquency charge permitted by law.” *Hayes v. First Nat. Bank of Memphis*, 256 Ark. 328, 331 (1974). The court approved the penalty of either 5% or \$5 on any monthly

late payment stating that the limitation placed on the late charge amount indicated the bank's intention to comply with Arkansas usury law. *Id.*

And a lender's intention matters, because courts specifically examine whether so-called penalties or late charges are merely intended to be a "cloak" or "subterfuge" for charging more than the legal rate of interest. *In re Borum*, 60 B.R. 516, 520 (Bankr. E.D. Ark. 1986); *Bunn v. Weyerhaeuser Co.*, 268 Ark. 445, 450 (1980).

In practice, lenders making loans in Arkansas should (1) set forth the penalty as a percentage of the payment amount due, with a monetary cap on the amount collected; (2) avoid compounding any such charges; and (3) include a usury savings clause in the applicable loan documents. There is no distinction between consumer and commercial loans, so this analysis applies to both categories. While the above suggestions may be taken into consideration if the time comes for litigation, lenders should always keep in mind that "[i]t does not matter whether the added charges are called a 'penalty,' 'late charge,' 'service charge,' or some other name. [Courts] look to the facts of each case to determine whether the additional charges are a cloak for usury; and, if they are, the contract is void." *Bunn v. Weyerhaeuser Co.*, 268 Ark. 445, 450 (1980).