Charging Interest on Unpaid Legal Bills

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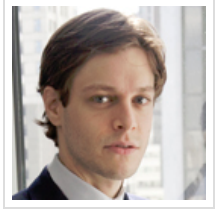

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The big challenge in collecting fees in matrimonial cases is to push yourself and your firm ahead of the Bloomingdale's bill. Lawyers representing clients in other areas have similar concerns about making the payment of the lawyers a priority. Bloomingdale's charges 1 percent per month on outstanding and overdue balances. Banking institutions, including Visa, charge even more. A client who perceives himself tight for funds will happily defer payment owed to a lawyer if other creditors are charging interest and the lawyer is not.

Lawyers who have these concerns frequently contract with their clients to charge interest on their overdue invoices to discourage clients from deferring payment. This interest is designed more to discourage the client from postponing payment than as additional income for the lawyer. Since these interest penalties are designed to put payment of legal bills in parity with the rest of a client's bills, rates need to at least approach the rates non-lawyers apply to their past due balances. Many New York lawyers charge a 1 percent monthly late fee.

However, a pair of decisions by Justice Jeffrey A. Spinner of Suffolk County Supreme Court suggests that a retainer agreement providing for a law firm to assess any more than 6 percent annually on its unpaid balances risks being deemed usurious. See, Christine Simmons, "**Judge Blasts Firm for 'Usurious' Retainer Agreement**," New York Law Journal (Aug. 6, 2013). This misapplication of the usury laws will undermine lawyers, who, by charging meaningful interest, seek only to ensure their bills are paid promptly. Furthermore, it is inconsistent with dicta from the Court of Appeals and at least one lower court, which found that the maximum interest rate set forth in Banking Law §14 and provided by the Banking Board (16 percent per year since 1980) is applicable to lawyers for the purposes of defining usury.

DECISION AND REASONING

In ***Bryan L. Salamone, P.C. v. Cohen***, 40 Misc.3d 338, 342-43, 965 N.Y.S.2d 324 (Sup. Ct. Suffolk County, May 3, 2013) (*Salamone 1*) Justice Spinner ruled that a retainer agreement providing for 1.5 percent "compounding" interest per month on overdue balances (which the court calculated as 18 percent interest per year) was usurious because it exceeds the 6 percent default interest rate set forth in GOL §5-501 (1). Spinner cited ***Eikenberry v. Adirondack Spring Water***, 65 N.Y.2d 125, 490 N.Y.S.2d 484 (1985), for its holding that civil usury statutes apply to interest charged on overdue balances even though such interest charges do not constitute a loan. See *Salamone 1*, at 343. Under *Eikenberry*, an agreement that interest shall be charged on an overdue balance constitutes a forbearance for purposes of GOL §5-501 (1)-(2).

In ***Bryan L. Salamone P.C. v. Cohen***, WL 3958242, 2103 N.Y. Slip Op 51253 (Sup. Ct. Suffolk County, Aug. 1, 2013) (*Salamone 2*) Spinner explained why the maximum interest rate a law firm can charge is that 6 percent set forth in subsection 1 of GOL §5-501: Even though GOL §5-501 references Banking Law §14-a as the source for the maximum interest rate, the Banking Law's maximum rate does not apply to a law firm, because, according to Spinner, the Banking Law itself does not apply to a law firm. A law firm is a personal services corporation, not one of the entities enumerated in the general

parts of the Banking Law, sections 1 and 2 thereof. See *Salamone 2*, at *3.[1]

OTHER PERSPECTIVES

There are some problems with the reasoning of *Salamone 1* and *2*.

Eikenberry, which Spinner cites, did apply the usury laws to an agreement between a law firm and client charging interest on the law firm's unpaid balances. However, in contrast with *Salamone 1* and *2*, the Court of Appeals found the applicable maximum rate of interest for such agreements to be that set forth in Banking Law §14 and established by the Banking Board. 65 N.Y.2d 125, 127-28 (citing Banking Law §14, and observing that the plaintiff law firm could have charged 8.5 percent interest during 1976-78, because that was the maximum rate of interest provided by the Banking Board during the period). See 3 NYCRR 4.1, 3 NY ADC 4.1 (listing maximum interest rates promulgated by the Banking Board for all periods since July 1, 1968).

In ***Kutner v. Antonacci***, 16 Misc.3d 585, 837 N.Y.S.2d 859 (Nassau Dist. Ct., May 25, 2007), the court ruled that contract provisions for the attorney to charge 16 percent interest per year on balances not paid within 15 days of billing were unenforceable. 827 N.Y.S.2d, at 860-63. Such provisions "cannot be deemed 'fair and reasonable' in light of the fact that pre-judgment and post-judgment interest accrues at nine percent per year...interest on bank accounts are half that rate, and interest on home equity loans and personal loans from financial institutions are generally below 16% per year." 827 N.Y.S.2d, at 863. (internal citations omitted).

However, consistent with *Eikenberry*, and in contradiction of *Salamone 1* and *2*, the Nassau County District Court stated that the interest rate of 16 percent was not usurious because it did not exceed the maximum rate of interest prescribed in Banking Law §14-a of 16 percent per year. Id. This distinction is important because a finding of usury voids the contract. See e.g. *Stanley Weisz, P.C. Retirement Plan v. VCHD Assoc.*, 237 A.D.2d 276, 655 N.Y.S.2d 381 (2d Dept. 1997) (declaring a mortgage null and void and dismissing the complaint seeking foreclosure on the mortgage because the loan was issued at an interest rate of 24 percent, and citing the 16 percent per year limit of the Banking Law §14-a).

In ***Ween v. Dow***, 35 A.D.3d 58, 822 N.Y.S.2d 257 (1st Dept. 2006), the First Department addressed, inter alia, charging interest on the unpaid balance on an attorney fee. The First Department did not rule on whether any particular interest rate was excessive because there was insufficient documentation to determine what interest rate the law firm was attempting to charge or how it was compounded. 822 N.Y.S.2d, at 262. However, the court observed that the interest rate charged by a law firm must be reasonable, and must comply with applicable usury laws. Id. The court cited City Bar Formal Opinion 2000-2, which provides no additional guidance. (In response to the question what interest rates ethically may be charged by a lawyer, the city bar said the rates must meet the reasonableness requirement with respect to fees in general, and "must also comply with all applicable laws, including usury laws.")

NON-ATTORNEYS

Non-attorneys may charge interest on unpaid balances well in excess of 6 percent per year without being considered in violation of usury laws. For example, in *Sogeti USA, v. Whirlwind Buildings Systems*, 274 F.App'x. 105, 2008 WL 1859887 (2d Cir., 2008), the U.S. Court of Appeals for the Second Circuit enforced a consultant's monthly service charge of 1.5 percent on unpaid invoices, ruling it was not usurious. 274 F.App'x, at 108. "Because the monthly service charge does not constitute a loan or forbearance...the usury statute is inapplicable." Id. (internal citations omitted). Similarly, in ***Emerick Associates, v. Classic Tool Design***, 260 A.D.2d 875, 876, 688 N.Y.S.2d 792 (3d Dept. 1999), in which the plaintiff seller sued to recover the balance due on a sale of pumps to defendant together with interest, the Third Department enforced the seller's 1.5 percent monthly "finance charge" on balances past due more than 30 days.

In ***Waterbury v. City of Oswego***, 251 A.D.2d 1060, 674 N.Y.S.2d 530 (4th Dept. 1998), the plaintiff argued that a municipality's 10 percent monthly fee for past due water bills was usurious. Appellate Division rejected plaintiff's argument, noting that the purpose of the late fee was to get residents to pay their water bills on time. The charge was a penalty, not a loan. Id. Similar reasoning can be applied to a law firm's retainer agreements: The purpose of the interest charge is not to make a profit from "loaning" money to clients, or forbearing from suing them, but to ensure that clients pay their bills on time.

The practitioner must now be concerned that the entire retainer agreement could be tainted by a potentially usurious interest rate. Yet the alternative of not charging interest or charging a minimal interest rate that is not competitive with interest rates charged by others doesn't answer the problem. Clearly, Justice Spinner was trying to protect the client but in doing so he has raised substantial issues

that concern all practitioners who charge interest.

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