THE JOINT CIVIL DIVISIONS OF THE SUPREME COURT AND THE END OF "SUPERVENING USURY"; INITIAL COMMENTS

By way of decision no. 24675 of 19 October 2017, the Joint Civil Divisions of the Italian Supreme Court rejected the relevance of so-called supervening usury and held that crossing the threshold rate in the contractual relationship does not, in and of itself, make a clause void or unenforceable or trigger the automatic replacement of the rate that became usurious with the threshold rate applicable at that time, or lead to application of criminal sanctions. The judgment also affirms that the request by the lender to collect the interest in accordance with the rate validly agreed, even if it subsequently exceeds the threshold rate, does not constitute a behaviour contrary to the principle of good faith in the performance of the contract.

Despite the definite relevance of this judgment, several interpretative questions remain open in both civil and criminal areas, which require the adoption of appropriate precautionary safeguards by financial operators.

SUPERVENING USURY IN ITALIAN LEGISLATION AND CASE LAW

This judgment of the Joint Civil Divisions represents a new chapter in the thorny question of liability for supervening usury, establishing, in a clear and unequivocal manner, that it does not incur civil or criminal liability; where the interest rate agreed between the lender and the borrower is, at the time of the agreement, below the threshold rate applicable at that time, any crossing of the threshold during the contractual relationship does not make the clause void or unenforceable or trigger the automatic replacement of the rate that has become usurious with the threshold rate applicable at that time or lead to the application of criminal sanctions.

The meaning of this important judgment can only be appreciated by considering the following stages in the debate:

- Law no. 108 of 7 March 1996 (the "**Anti-Usury Law**") rewrote civil and criminal rules on usury in their entirety, amending on the one hand art. 644 of the Criminal Code – linking the offence to the objective crossing of the legal threshold rate – and, on the other, providing at the second paragragh of art. 1815 of the Civil Code that "*if usurious rates are agreed, the clause is null and void and the interest is not due*". The Anti-Usury Law laid down in detail the administrative procedure for the verification of the usurious nature of interests agreed:

The stages in the debate on supervening usury

- **Law no. 24/2001** lays down that *"interest rates shall be deemed usurious if they exceed the threshold laid down by the law when they are promised and in any case agreed".*
- In the last ten years **case law** of local Courts and Supreme Court as well has been inconsistent as regards the regulation of the effects of crossing of the threshold rate during the contractual relationship.
- **"*Twin*" judgments no. 602/2013 and no. 603/2013**: in case of supervening usury the automatic replacement of the interest over the legal rate with the threshold rate applies.
- By way of **judgment no. 24675 of 19 October 2017,** the Joint Civil Divisions laid down that supervening usury does not incur criminal or civil liability

CLIFFORD
CHANCE

  - The Bank of Italy records the average overall effective rate (*i.e. Tasso Effettivo Globale Medio*, so called "**TEGM**") applied on the credit market in relation to different categories of transactions, which is reported on a quarterly basis in a Decree issued by the Ministry of Economy and Finance and published in the *Gazzetta Ufficiale* and on the websites of the Bank of Italy and the Ministry of Economy and Finance;
  - The threshold rate (*i.e. Tasso Soglia*, so called "**TSU**") is obtained by increasing the TEGM by a quarter and adding a further margin of four percentage points;
  - Where the overall effective rate of the individual contract (*i.e. Tasso Effettivo Globale*, so called "**TEG**") exceeds the TSU, then the contract must be deemed usurious.

- Parliament intervened again with Law no. 24/2001, laying down that "*For the purposes of the application of article 644 of the Criminal Code and article 1815, second paragraph, of the Civil Code, interest shall be deemed usurious when it exceeds the limit laid down by the law* [i.e. the TSU]*, when it is promised or agreed for whatever reason, regardless of the time and payment".* This provision – which survived the scrutiny of the Constitutional Court (judgment no. 29 of 14 February 2002) – seemed to imply the irrelevance, for the purposes of the application of civil and criminal rules on usury, of matters and events subsequent to those at the time of the agreement.
- Following this legislative reform, the case law on the merits and the Supreme Court often considered the possible relevance of supervening usury, also with reference to relations that arose when the Anti-Usury Law was in effect. In particular, Italian Courts considered how to regulate the contracts in which, although the TEG originally complied with the TSU applicable at the time of the agreement, became usurious as a result of the fluctuations in interest rates during the relationship. One need only think of the case of contracts that, on account of the reduction in the rates applied on the market, found themselves faced with a TEGM, and therefore a TSU, significantly lower than those negotiated at the time of the agreement.
- This lively debate gave rise to two diametrically opposed positions by the Supreme Court: one denied and the other affirmed the relevance of supervening usury. This second thread included the "*twin*" judgments of the Supreme Court no. 602/2013 and no. 603/2013, which – ruling on contractual relations still ongoing at the time of the entry into force of the Anti-Usury Law – established the automatic replacement of the rate exceeding the legal interest with the threshold rate. Despite some hurried comments, according to which these judgments amounted to a *volte-face* by the case law in favour of relevance of usury, in reality, such judgments do not apply the criminal sanctions provided by art. 644 of the Criminal Code or make the interest null and void pursuant to art. 1815, paragraph 2, of the Civil Code as amended but, rather, laid down that only interest at the legal rate was due.
- As a result of these judgments, the debate on the relevance of the supervening usury has been restarted once again, above all in the case law on the merits. Due to the recent judgment of the Joint Civil Divisions this debate has now reached a turning point.

Key terms and calculation mechanism

- **TEGM:** average overall effective rate recorded by the Bank of Italy and published on a quarterly basis;
- **TSU**: threshold rate that is obtained through the following formula (TEGM + 25%) + 4%;
- **TEG:** effective rate of **the individual contract, in other words the overall cost of the** credit applied to the individual contract;
- A contract is said to be usurious when the TEG of the individual contract exceeds the TSU

THE JUDGMENT OF THE SUPREME COURT: INNOVATIONS INTRODUCED AND MATTERS STILL OPEN

The **decision of the Joint Civil Divisions** affirms the following important principles of law:

- The **irrelevance of supervening usury**: where the interest rate agreed between the lender and the borrower is, at the time of the agreement, lower than the threshold applicable at the time, the crossing of the threshold during the contractual relationship does not make the clause void or unenforceable or trigger the automatic replacement of the rate that became usurious with the threshold rate applicable at that time or lead to the applicability of the criminal sanctions;

- The **lender's request to collect the interest** in accordance with the validly agreed rate, even if it **subsequently exceeded the threshold rate, does not constitute, in and of itself, behaviour contrary to the principle of good faith** in performing the contract.

This judgment, ruling on the relevance of **the time of the agreement** in order to establish whether a contract is usurious or not, led to a significant increase in the **certainty of contractual relationships**. This leads to more efficient commercial exchanges and **assignment of the receivable**, allowing operators to immediately identify the only relevant time for the purpose of determining whether a contract is usurious or not.

However, the decision leaves open a number questions. Indeed, the Supreme Court, after admitting that the behaviour of the lender, who asks the borrower to pay the interest (which became) usurious, was not contrary to good faith, affirms that "*(…)* ***in case of specific methods or circumstances****, the* ***request for interest exceeding the threshold rate following their agreement could be deemed improper pursuant to art. 1375 of the Civil Code*** *(…). Preserving the validity and effectiveness of contractual clauses does not mean denying the* ***feasibility of other instruments provided for by law, which protect the borrower where the specific prerequisites are met***".

In particular:

- **What are the limits** upon the right of the lender to seek and obtain from the borrower the payment of the interest (that became) usurious? **To what extent can** the right of the lender to seek and obtain from the borrower the interest (that became) usurious **be considered compliant with the principle of good faith** in the performance of the contract? As a result of the leaving of the mathematical criterion provided by the Anti-Usury Law, it is easy to understand that it is not immediately possible to identify whether or not an interest rate has become "*excessively*" usurious;

- What are the "***other instruments provided for by law***" on which the borrower can rely and, subsequently, use following the lender's request for payment of such interest (that became) usurious? The authors who initially analysed and commented this judgment, are of the view that in case of excessive imbalance between contractual terms and conditions, the *other* feasible *instruments* would appear linked to matters which bring the contract to an end, such as (i) termination

The legal principle set forth by the court:

In case of supervening usury:

- No application of criminal sanctions.
- The contractual clause is not void.
- The automatic replacement of the rate that became usurious with the rate applicable at that time does not apply.
- The request by the lender to collect interest is not contrary to good faith.
- In case of excessive imbalance between the contractual terms and conditions *"other instruments for protecting the borrower provided by the law where specific prerequisites are met"*.

CLIFFORD
CHANCE

of the contract for excessive onerousness pursuant to art. 1467 of the Civil Code or (ii) unilateral termination by the borrower pursuant to art. 1464 of the Civil Code, which allows the non-defaulting party whose performance has become partially impossible to terminate the contract where it has no interest in its partial fulfilment.

Addressing these issues therefore present new challenges for both Authors and case law. However, given the wide reach of the holdings of the Court, it cannot be excluded that case law can reach, as occurred in the past, different solutions to situations which are analogous to each other.

How can the lender protect itself as a preventive measure, thereby avoiding judicial terminations to the contractual relations?
In the last few years there has been wide use of the so-called **safeguard clauses**, which provide explicitly that "*the amount of the interest agreed cannot exceed the limit laid down by art. 2, paragraph 4 of law no. 108/1996, it being understood that should this limit be exceeded their amount is equal to the same limit*". Despite the recent ruling by the Joint Civil Divisions of the Supreme Court, such clauses appears to be the best practice when drafting bank contracts, so that there is no risk of exposure to judicial reinterpretation of the terms and conditions of the agreement.

THE OFFENCE OF USURY AND SUPERVENING USURY

With reference to **criminal law consequences of supervening usury**, the judgment of the Joint Civil Divisions of the Supreme Court has been handed down in a context that, until today, has been unable to provide definitive answers regarding supervening usury.

In particular, **initially, the Criminal Divisions of the Supreme Court held that criminal liability may be incurred for supervening usury** on the assumption that "*the interest must be deemed usurious if it exceeds the legal threshold at the time of the agreement and not at the time of payment regardless of the fact that the offence of usury may be deemed to have been committed at this subsequent point in time*" (Supreme Court, Division V, 20 February 2013, no. 8353).

However, recently, the Supreme Court has also issued several decisions going in the opposite direction.

In particular, bearing in mind that art. 644 of the Criminal Code punishes anyone who **gives or promises** usurious interests or other usurious benefits**,** the Supreme Court stressed that the offence has a dual nature and "*where the promise is followed – through the payment in instalments of the agreed interest – by the actual transfer of usurious interests, such behaviour does not constitute a non-punishable* post factum*, but fully belongs to the damaging act that incurs criminal liability*" (more recently, Supreme Court, Division II, 24 November 2017, no. 53479). Such decision gives rise to a series of important practical consequences:

- The offence of usury can be committed also by those persons who, although they were not a party to the contract, intervene subsequently at the time of the **collection of the receivable** (Supreme Court, Section II, 24 November 2017, no. 53479);

- In case of **collection of interest that only subsequently became usurious** "***the possible crossing of the threshold rate must be verified, quarter by quarter, for the entire duration of the payment by instalments*** (Supreme Court, Division II, 12 July 2016, no. 39334).

The offence of usury 1/2

- **Behaviour**: anyone who obtains, promises or procures from others, in any form, for himself or others, in return for money or some other benefit, interest or other usurious advantage.
- **Usurious interest**:
  - If it exceeds the threshold rate laid down by law (so-called presumed interest);
  - Even if it is below such limit it is in any case disproportionate when the person who gave or promised it is in economic or financial difficulty (so-called concrete usury).
- **Intent**: oblique *vs* direct (Supreme Court 25 October 2013, no. 49318).
- **Sanctions**: prison term of two to ten years and a fine of Euro 5,000 to Euro 30,000.

Also with reference to the **degree of awareness of the offender**, in the last few years the Supreme Court has frequently changed its view. In particular, even if most of the judgments deemed necessary and sufficient to prove that the agent had accepted the risk, in other words that the consideration obtained by promise or received exceeded the legal threshold, there was no lack of decisions which adopted a more tolerant opinion as well as declarations of liability for *culpa in vigilando*:

- On the one hand, the Supreme Court has recently stated that "***The offence of usury can be punished only for direct intent****, which consists of a* ***wilful intent to obtain usurious benefits****; indeed, recklessness postulates a plurality of events that does not occur in the offence of usury; such crime consists of obtaining the payment or promising interests or usurious benefits in exchange for money or any other moveable things"* (Supreme Court, 25 October 2016, no. 49318).

- On the other hand, specifically in relation to usury in banking contracts, the Supreme Court has also recently established the "*criminal liability* ***towards the Chairman of the board of directors and its members*** *considering the powers of direction and coordination and, more generally, the "duty of guarantee" safeguarding compliance with the legal provisions"*, *and due to the fact that* "***the senior management has a duty to supervise and prevent the threshold rate from being exceeded****"* (Supreme Court, Division II, 23 November 2011, no. 46669, reprised by the judgment of the Supreme Court, Division II, 2 February 2017, no. 4961);

We therefore conclude that, even if the recent judgment of the Joint Civil Divisions expressly denied the application of criminal sanctions, it appears premature to confirm that there is no risk of future court decisions, above all on the merits, establishing that criminal liability can be incurred as a result of supervening usury. The holdings by the Supreme Court, according to which the simple collection of interest that only subsequently became usurious is not, in and of itself, contrary to the duty of good faith in the performance of the contract, appear difficult to conciliate with positions taken by the lower instance criminal courts that the collector is required to verify, from time to time, the non-usurious character of its request.

Pending verification of whether the criminal case law on the merits and that of the Supreme Court complies with the principles enshrined by the Joint Civil Divisions, remedies such as safeguard clause and the continuous monitoring of the rate, also at the time of the collection of interests by the lender, currently appear to be the only secure safeguards.

The offence of usury 2/2

- **Aggravating factors:** amongst others
  - Having carried on a professional, banking or stock brokerage activity;
  - Having requested as security shareholdings or real estate property.

- **Obligatory confiscation**: in case of a conviction or plea bargain obligatory confiscation of assets that constitute the price or proceed of the offence or sums of money, assets or profits and the profit that the offender has at his disposal including through an interposed person for an amount equal to the value of the interest or other usurious benefits or compensation.

CLIFFORD
CHANCE

CONTACTS

Fabio Guastadisegni
Partner

T +39 028063 4353
E Fabio.Guastadisegni@cliffordchance.com

Jean Paule Castagno
Counsel

T +39 028063 4317
E Jean-Paule.Castagno@cliffordchance.com

Andrea Alfonso Stigliano
Associate

T +39 028063 4319
E Andrea.Stigliano@cliffordchance.com

Iolanda D'Anselmo
Trainee Lawyer

T +39 028063 4294
E Iolanda.Danselmo@cliffordchance.com

www.cliffordchance.com

Clifford Chance, Piazzetta M.Bossi, 3, 20121 Milan, Italy