community BANKER

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Welcome to the latest issue of the COMMUNITY BANKER.

The Community Banker is prepared by attorneys at Olson & Burns P.C. to provide information pertaining to legal developments affecting the field of banking. In order to accomplish this objective, we welcome any comments our readers have regarding the content and format of this publication. Please address your comments to:

Community Banker
c/o Olson & Burns P.C.
P.O. Box 1180
Minot, ND 58702-1180

olsonpc@minotlaw.com
Also, visit our web site at:
www.minotlaw.com

The attorneys at Olson & Burns represent a wide range of clients in the financial and commercial areas. Our attorneys represent more than 30 banks throughout North Dakota.

Applicability of N.D.C.C. § 28-26-04 to Collection Fees Other than Attorney's Fees

We are asked on occasion whether state law prohibits clauses in loan documents that provide for the lender's recovery of any collection costs after a default, or whether the law only applies to provisions for repayment of attorney's fees. As this article explains, the statute prohibits just the collection of attorney's fees.

The law creditors love to hate, N.D.C.C. § 28-26-04, provides that

> Any provision contained in any note, bond, mortgage, security agreement, or other evidence of debt for the payment of an attorney's fee in case of default in payment or in proceedings had to collect such note, bond, or evidence of debt, or to foreclose such mortgage or security agreement, is against public policy and void.

This statute actually predates the State of North Dakota; it was enacted by the Dakota Territory legislature, and has managed to survive mostly-unchanged since then. The statute has only seen one major revision - in 1965 the legislature added "security agreement" to the list of documents.

The North Dakota Supreme Court addressed the "collection expenses vs. collection attorney's fees" question in 1894, and found that loan documents that require the defaulting borrower liable for repayment of collection expenses *other* than attorney's fees are permissible. First Nat'l Bank v. Laughlin, 61 N.W. 473, 398-99 (1894). This case was cited up to the 1930s; the holding was never challenged and so remains "good" law. Other than Laughlin, the statute has been discussed a handful of times; these cases all generally point to a plain-language interpretation of the statute: it applies to attorney and legal fees, but *not* to other costs of collection.

Not too long ago, a debtor used the statute as a basis for appealing the award of the cost of repossession, cost of sale, attorney's fees, and legal expenses. Commercial Bank of Mott v. Stewart, 429 N.W.2d 402, 403 (1988). The court held that the statute blocked only the award of attorney's fees and legal expenses, but the repo and sale expenses *were* chargeable to the debtor.

Likewise, a disputed loan agreement provision required a debtor to pay "all expenses, fees, and disbursements, including reasonable attorneys fees incurred either before or after any default in connection with this Agreement and the documents related to it." Production Credit Ass'n v. Obrigewitch, 462 N.W.2d 115, fn. 3 (1990). Again, the court held that N.D.C.C.§ 28-26-04 "only voids the provision for payment of attorney fees." Finally, our Supreme Court focused on this statute in T.F. James Co. v. Vakoch, 2001 ND 112 and T.F. James Co. v. Vakoch, 2000 ND 9. In both cases, the court separated out "attorney's fees" and "costs"; the court's analyses and holdings discuss the statute's effects on attorney's fees only.

In sum, N.D.C.C. § 28-26-04 only prohibits provisions in loan documents that grant the creditor recovery of attorney's fees. It does not prohibit provisions regarding the recovery of non-attorney collection fees such as repo costs, costs of a sale, etc.

This is pretty good news for lenders, but it's not our final word on the subject . . . lenders should also be aware of two important matters:

Matter One: Lenders, be watchful. If you want to recover collection costs (other than attorney's fees, of course), your loan documents must *clearly* provide for that, for example:

> Borrower shall pay immediately upon demand, after expenditure, all sums expended or expenses incurred by the Lender in acting under any of the terms of this [mortgage or promissory note or security agreement, or guaranty], including, without limitation, any

reasonable fees and expenses (including reasonable attorneys' fees) incurred in connection with any release of the collateral or any portion thereof, or to compel payment under the promissory note or any other amount secured hereby or in connection with any default thereunder, including without limitation attorney's fees incurred in any bankruptcy or judicial or nonjudicial foreclosure proceeding, with interest from the date of expenditure.

Matter Two: Even though North Dakota law does not allow a creditor to recover attorney's fees for collections in state court, *do not delete these provisions from your loan documents*. Why not? Because,

a. The attorney's fees provisions will be ignored as unenforceable in state court, and won't affect the validity of your document.

b. In North Dakota an oversecured creditor in a bankruptcy proceeding *may* collect attorneys' fees incurred during the course of the bankruptcy *if* the loan documents provide for the payment of fees. Accordingly, with an eye toward a possible bankruptcy, lenders do include language for the payment of attorney's fees incurred in protecting the collateral or enforcing the agreement. Thanks to the work of the attorneys at Olson & Burns and our victory in In re Schriock Const. Inc., 104 F.3d 200 (8th Cir. 1997), we opened the door for creditors to recoup their attorney's fees in bankruptcy court if the creditor is oversecured. Now, in the states included in the 8th Circuit, a creditor may recover attorney's fees if it can demonstrate that: (1) it is oversecured in excess of the fees requested; (2) the fees are reasonable; and (3) the agreement giving rise to the claim provides for attorneys' fees.

Best wishes on your successful recovery.