VOLUME NO. 34 Opinion No. 22

CONSUMER LOANS - Certain costs contingent upon default not in violation of Consumer Loan Act. Section 47-210 (f), R.C.M. 1947.

HELD: A provision in a loan contract wherein the borrower agrees to pay the costs of legal proceedings occasioned by the borrower's default on the loan is not in violation of section 47-210 (f), R.C.M. 1947.

October 20, 1971

Mr. John A. Dowdall
Consumer Loan Commissioner
Sam W. Mitchell Building
Helena, Montana 59601

Dear Mr. Dowdall:

This is in reply to your recent letter in which you requested my opinion on whether it is a violation of section 47-210 (f), Revised Codes of Montana, 1947, for a loan contract to contain the following language:

> "The undersigned agree(s) to pay the said default charges, and further agree(s) to pay taxable costs, disbursements, and reasonable attorneys fees, which may be incurred by the lender in connection with any suit, action, or proceeding authorized by law to collect on this loan or to realize on the security therefore after default."

Section 47-210 (f), supra, reads:

> "No further charges, no splitting contracts; certain contracts void. No further or other charges shall be directly or indirectly contracted for or received by any licensee except those specifically authorized by this act. No licensee shall divide into separate parts any contract made for the purpose of or with the effect of obtaining charges in excess of those authorized by this act. All balances due to a licensee from any person, as a borrower, or as an endorser, guarantor or surety for any borrower or otherwise, or due from any husband or wife, jointly or severally, shall be considered a part of any loan being made by a licensee to such person for the purpose of computing interest or charges. If any amount in excess of the charges permitted by this act is charged, contracted for, or received, except as the result of an accidental and bona fide error of computation, the contract of loan shall be void and the licensee

shall have no right to collect or receive any principal, charges or recompense whatsoever."

The question you raise is not answered directly either by the statute to which you refer or by decisions of the Montana Supreme Court. Other states have, however, answered the question under statutes similar to those in Montana.

In speaking to the problem of penalty provisions in a loan instrument, the California Court of Appeal in **First American Title Company v. Cook,** 12 Cal. App.3d 592, 90 Cal. Rptr. 645 (1970), at page 647 said:

> "Whether a transaction is usurious must be determined as of the time of the transaction. An agreement which is not usurious in its inception cannot become so by reason of the borrower's default. . . . The penalty provisions to which Cook now objects come into play only in the event of his default. Such payments are not regarded as interest on the loan itself, but as a penalty for nonperformance of a legitimate agreement . . ."

A case decided by the Court of Appeals of Washington, dealing with an allegation that the "late charges" providing for interest rates which combined with the legal rates of interest would be usurious, held that such charges were not usurious. In **Union Bank v. Krueger,** 1 Wash. App. 622, 463 P.2d 273 (1969), the court said:

> "The general rule is that a provision in a note for the payment of money by which the debtor agrees to pay, after maturity, interest at a higher rate than that which is permitted by law, is not sufficient to render the note usurious, provided the parties concerned act in good faith and do not intend to evade the usury law. . . .
>
> "Also, when the contingency, upon which the excessive interest comes into existence, is solely within the borrower's control, and not the lender's, the transaction is not usurious. . . ."

The Supreme Court of Montana has addressed itself to a somewhat similar question in **Bank of Commerce of Owensboro v. Fuqua,** 11 Mont. 285, 28 P. 291, 17 ALR2d 228 (1891). In that case the court dealt with a suit on a bill of exchange and a stipulation therein providing that "the parties hereto agree to pay all attorney's fees in case of suit on this paper." The court said at page 298:

> "If the stipulation was for a certain sum or per centum for attorney's fees, which was grossly out of proportion to the value of the services, it might well be looked upon with suspicion in

> connection with laws forbidding usurious charges for loan of money. But where a reasonable attorney's fee is provided for, dependent on the event of suit for collection of the debt, and such fee is allowed for such services actually performed, where judgement is recovered, we cannot perceive how the usurer could profit by it."

The court also noted that it was within the control and best interest of the borrower to avoid the implementation of the stipulation relating to attorney's fees. The court said at page 297:

> "Now, how would a creditor obtain, through such a stipulation, a greater sum for the use of money than the law permits? The debtor in such case may pay the amount of the principal and the lawful interest, and then the stipulation would be null, for no suit could be maintained on the obligation, and of course no sum collected from the debtor by way of attorney's fee. But, in order to carry out the scheme to evade the law against usury, and enable the holder of the paper to collect more than the law allows for the use of the money, the debtor must collude against his own interest in a case where he is in no way bound so to do, and default in the payment of the obligation, so as to give effect to the stipulation for attorney's fees, and suffer such fees and other costs of suit to be enforced against him."

Based on the above-cited statements it appears that the Montana Supreme Court would recognize the difference between a charge in a loan contract that is usurious on its face and one that is contingent upon the default of the borrower. Since the charges to which you refer are contingent upon the borrower's default, they should not be considered usurious.

THEREFORE, IT IS MY OPINION that:

A provision in a loan contract that the borrower agrees to pay the costs of legal proceedings, brought after the borrower has defaulted on payment of the loan, and in addition to the maximum allowable rate of charge on the loan, does not violate section 47-210, R.C.M. 1947, which establishes the maximum permissible charges under the Montana Consumer Loan Act.

Very truly yours,

ROBERT L. WOODAHL
Attorney General