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The Prohibition Against Recovering Attorney Fees in Mortgage Foreclosure: It's Time for Delinquent Debtors to Pay the Piper in North Dakota

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THE PROHIBITION AGAINST RECOVERING ATTORNEY FEES IN MORTGAGE FORECLOSURE: IT'S TIME FOR DELINQUENT DEBTORS TO PAY THE PIPER IN NORTH DAKOTA

ABSTRACT

Shortly before North Dakota entered into statehood, the Legislature for the Dakota Territory adopted a statutory prohibition against the collection of attorney fees in certain debt instruments. This statutory prohibition was carried over into North Dakota law and has remained materially unchanged for well over 100 years. In its current form, North Dakota Century Code section 28-26-04 places a categorical prohibition against any provision in certain debt instruments for the collection of attorney fees in the event of default. Included among these debt instruments are mortgages. Accordingly, North Dakota law prohibits the collection of attorney fees in mortgage foreclosure. This statutory prohibition in conjunction with North Dakota's only available method of foreclosure—judicial foreclosure—and anti-deficiency statutes for certain residential mortgage foreclosure has created a harsh economic reality for lenders. As a result, the lender and both its current and potential customers are adversely impacted by higher costs and a change in lending standards.

North Dakota remains one of the only states in the union to both prohibit the collection of attorney fees in mortgage foreclosure and not allow the less expensive and faster method of foreclosure—nonjudicial foreclosure. In order to remedy this disparity between lenders and delinquent debtors, North Dakota should reform its foreclosure laws by authorizing nonjudicial foreclosure, allowing the collection of reasonable attorney fees in judicial foreclosure, and statutorily limiting the collection of attorney fees in nonjudicial foreclosure.

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I. INTRODUCTION

Across the United States, one in every 501 homes entered into foreclosure in December of 2010.¹ During this same time period, the rate of homes entering into foreclosure in North Dakota was only one in 10,805.² Despite enjoying one of the lowest foreclosure rates in the country, North Dakota remains one of the only states in the union that still prohibits stipulations in certain debt instruments providing for the collection of

1. See Seth Fiegerman, *Why the Midwest Fared Best in the Recession*, MAINSTREET.COM (Jan. 17, 2011), <http://www.mainstreet.com/article/moneyinvesting/news/why-the-midwest-fared-best-in-the-recession>.

2. *Id.*

attorney fees, including home mortgages.³ The prohibition applies even in situations where specific provisions for such costs were previously contemplated by the mortgagor and mortgagee.⁴ The rationale for the preclusion of such stipulations is that such agreements are “against public policy and void.”⁵

This note argues the rationale behind North Dakota Century Code section 28-26-04 is outdated, archaic, and no longer accurately reflects the public policy of North Dakota. Part II summarily describes the history of the statutory prohibition and its underlying rationale. Part III will provide a brief overview of the foreclosure process. Part IV assesses the direct and incidental costs of foreclosure. Part V describes the limited impact North Dakota Century Code section 28-26-04 has had on North Dakota case law. Part VI discusses how North Dakota’s neighboring states approach the recovery of attorney’s fees in foreclosure actions. Finally, Part VII concludes that the North Dakota Legislature should reform North Dakota’s mortgage foreclosure law in order to equitably protect both mortgagors *and* mortgagees in the foreclosure process.

II. BACKGROUND OF NORTH DAKOTA CENTURY CODE SECTION 28-26-04

Generally speaking, each party to a civil lawsuit is responsible for paying its own attorney fees.⁶ This principle is known as the “American rule.”⁷ By requiring each party to bear its costs individually in a lawsuit, the “American rule” seeks to “avoid stifling legitimate litigation by the threat of the specter of burdensome expenses being imposed on an unsuccessful party.”⁸ In other words, the rule discourages parties from pursuing “unnecessary litigation and abuse of the legal system.”⁹ It also attempts to make certain that court proceedings are focused on the actual damages at issue because legal costs are only incidental to the matter.¹⁰

3. Kenneth J. Warren, *Recovering Attorney Fees in Ohio: When Do We Reach the Twentieth Century*, 50 OHIO ST. L.J. 1229, 1233 (1989).

4. *Commercial Bank of Mott v. Stewart*, 429 N.W.2d 402, 403 (N.D. 1988) (noting that attorney fees can be awarded if agreed to but are limited by North Dakota Century Code section 28-26-04).

5. N.D. CENT. CODE § 28-26-04 (2010).

6. *In re Pederson Trust*, 2008 ND 210, ¶ 22, 757 N.W.2d 740, 746.

7. *Danzl v. Heidinger*, 2004 ND 74, ¶ 6, 677 N.W.2d 924, 926.

8. 20 AM. JUR. 2D *Costs* § 55 (2010).

9. MATT GEHRING, MINN. HOUSE RESEARCH DEP’T, ATTORNEY FEE AWARDS IN MINNESOTA STATUTES 1 (2008), available at <http://www.house.leg.state.mn.us/hrd/pubs/attyfee.pdf>.

10. *Id.*

However, there are two exceptions to the “American rule.”¹¹ Either a statute must authorize the collection of attorney fees, or the recovery of attorney fees must be specifically authorized by a contractual provision.¹² In North Dakota, neither exception exists. There is no statutory authority providing for the collection of attorney fees in mortgage foreclosure actions. In fact, not only does North Dakota not statutorily authorize the collection of attorney fees in mortgage foreclosure actions, but it expressly prohibits the collection of such fees even if the parties have agreed to include the recovery of such fees in the event of default.¹³ North Dakota Century Code section 28-26-04 states

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, it is against public policy and void.¹⁴

Broadly understood, the statute places a categorical prohibition against the collection of attorney fees in most debt instruments. Accordingly, the general rule relating to mortgage foreclosure in North Dakota is that, in the absence of any statutory liability, attorney fees incurred by a party in litigation are not recoverable as an item of damages.

A. HISTORY OF NORTH DAKOTA CENTURY CODE SECTION 28-26-04

On March 9, 1889, the Dakota Territory adopted a statute,¹⁵ which provided the basis for North Dakota’s current statutory prohibition¹⁶ against the collection of attorney fees in most debt instruments. Around that same time, the United States Congress passed the Enabling Act of 1889, which authorized certain states to form their own state governments.¹⁷ The Enabling Act further provided for division of the Dakota Territory into

11. *Strand v. Cass Cnty.*, 2008 ND 149, ¶ 9, 753 N.W.2d 872, 875 (“Generally, under North Dakota law, each party to a lawsuit bears its own attorney’s fees absent statutory or contractual authority.”).

12. *Id.*

13. N.D. CENT. CODE § 28-26-04 (2010).

14. *Id.*

15. Act of Mar. 7, 1889, ch. 16, § 1, 1889 N.D. Laws 31 (“That any provision contained in any note, bond, mortgage or other evidence of debt for the payment of an attorney fee in case of default in payment or of proceedings had to collect such note, bond or evidence of debt or to foreclose such mortgage is hereby declared to be against public policy and void.”).

16. N.D. CENT. CODE § 28-26-04.

17. Enabling Act of Feb. 22, 1889, § 1, 25 Stat. 676 (1889).

North Dakota and South Dakota.¹⁸ Following the ratification of their respective state constitutions and the election of state officers in October of 1889, North Dakota and South Dakota were officially recognized as states in November of that year.¹⁹ Both states carried over the laws of the Dakota Territory and began the process of adapting those laws into their constitutions and statutory systems.²⁰

One such law was the original version of North Dakota Century Code section 28-26-04, which has remained largely unchanged. In fact, the only material change came in 1965 when the North Dakota Legislature amended the statute to include security agreements as another type of debt instrument that is precluded from enforcing provisions for the collection of attorney fees in the event of default.²¹ Besides adding security agreements to the list of debt instruments, no other material statutory changes have occurred. In fact, a careful reading of the original and current statutes side-by-side shows almost no differences.

B. RATIONALE BEHIND NORTH DAKOTA CENTURY CODE SECTION 28-26-04

The general rule in American jurisprudence is “that courts will not enforce illegal contracts.”²² Historically, contracts that violated public policy were deemed illegal.²³ Naturally, the question arises as to why some contracts violate public policy while others do not. The basic understanding in the late nineteenth century was that if a contract “conflicts with the morals of the time, and contravenes any established interest of society, it is void, as being against public policy.”²⁴ Today, commentators have acknowledged the difficulty of defining just exactly what public policy means in context of illegal contracts but generally understand it to mean “no person can lawfully do that which has a tendency to be injurious to the public good.”²⁵ Based on those two understandings, the “interest of the public good” appears to be the primary standard for assessing the voidability of contracts on public policy grounds.

18. Enabling Act § 2.

19. CLEMENT A. LOUNSBERRY, *EARLY HISTORY OF NORTH DAKOTA: ESSENTIAL OUTLINES OF AMERICAN HISTORY* 415 (1919).

20. *Id.* at 449-50.

21. 1965 N.D. Laws 296.

22. 17A C.J.S. *Contracts* § 280 (1999).

23. WILLIAM W. STORY, *A TREATISE ON THE LAW OF CONTRACTS* 674 (5th ed. 1874).

24. *Id.*

25. 17A C.J.S., *supra* note 22, § 215.

The mere existence of North Dakota Century Code section 28-26-04 raises two interesting and important questions relating to the evolution of public policy. First, when the statute in its original form was adopted, why was the collection of attorney fees in debt instruments against public policy? Second, and more importantly, does the statute, in its current form, violate the public policy concerns of today?

Because no direct authority exists²⁶ regarding the underlying public policy concerns for the statutory prohibition against the collection of attorney fees in debt instruments when first adopted by the Territorial Legislature, one can only speculate as to the driving force behind the enactment of the statute. However, the answer to the second question is less tenuous because we, as a society, say what the public policy concerns are for the day. When considering whether or not section 28-26-04 violates public policy today, one can arrive at one of two conclusions. Either the collection of attorney fees has the tendency to be injurious to the public good, or section 28-26-04 is based on archaic ideals and no longer reflects the present public policy concerns of North Dakota. If the public policy of every other state in the union can be used as a litmus test for determining the public policy of North Dakota, the latter answer is likely more accurate.

III. THE FORECLOSURE PROCESS

A “mortgage is the most common real estate security” used for obtaining and financing real estate.²⁷ The underlying purpose of foreclosure is to have the mortgaged property applied to a mortgagor’s debt with the hopes of satisfying that debt, or at least a substantial portion thereof.²⁸ Foreclosure is generally only limited by the rules of equity in that when there is default on a debt secured by a mortgage, the mortgagee should be made whole.²⁹ However, it is also understood under the rules of equity that the mortgagee should not be made better off than if the agreement had been fully performed.³⁰

In a conventional residential mortgage foreclosure, the process of foreclosure is governed by the type of foreclosure being employed and on the state law governing that foreclosure. In a typical residential mortgage, two

26. There are no extant legislative history records from the Territorial Legislature.

27. 1 WILLIAM HOUSTON BROWN, *THE LAW OF DEBTORS AND CREDITORS* § 8:3 (2002).

28. 55 AM. JUR. 2D *Mortgages* § 573 (2010).

29. *Id.*

30. *Id.*

primary parties are present: the mortgagor and the mortgagee.³¹ The mortgagor is often an individual seeking to purchase property, and a mortgage is often the necessary security device used when the individual needs to borrow funds from a lender in order to make the purchase.³² The individual, or mortgagor, then enters into a mortgage agreement with the mortgagee, most often a lender.³³

The mortgage agreement functions as the legal basis of security for the mortgagee. By entering into such an agreement, the mortgagee gains a legal interest in the purchased property for the sole purpose of protecting its investment.³⁴ Said another way, the mortgage functions as a consensual lien on the property in favor of the mortgagee. If the mortgagor defaults on the mortgage agreement, the mortgagee has the right to claim title of the property and sell it to satisfy the mortgagor's remaining debt on the property.³⁵ This process is referred to as foreclosure. In most states, there exist two types of foreclosures: judicial foreclosure and nonjudicial foreclosure.³⁶

A. JUDICIAL FORECLOSURE

Judicial foreclosure is a type of foreclosure supervised by the courts and sometimes involves the intervention of the court, hence the name "judicial" foreclosure. Black's Law Dictionary defines judicial foreclosure as "[a] costly and time-consuming foreclosure method by which the mortgaged property is sold through a court proceeding requiring many standard legal steps such as the filing of a complaint, service of process, notice, and a hearing."³⁷ All states permit judicial foreclosure, and some states require it.³⁸ For example, North Dakota forbids private lenders from foreclosing by sale.³⁹ Consequently, in North Dakota, lenders are required

31. Eric M. Marshall, *The Protective Scope of the Fair Debt Collection Practices Act: Providing Mortgagors the Protection They Deserve from Abusive Foreclosure Practices*, 94 MINN. L. REV. 1269, 1273 (2010).

32. *Id.*

33. *Id.*

34. 55 AM. JUR. 2D, *supra* note 28, § 573.

35. *Id.*

36. Marshall, *supra* note 31, at 1273.

37. BLACK'S LAW DICTIONARY 719 (9th ed. 2009).

38. *Id.*

39. N.D. CENT. CODE § 35-22-01 (2010) ("Every mortgage of real property held by the state or any of its agencies, departments, or instrumentalities, containing a power of sale, upon default being made in the conditions of such mortgage, may be foreclosed by advertisement in the manner provided by law. *No other mortgage of real property shall be so foreclosed, but must be foreclosed by action.*") (emphasis added).

to foreclose upon property using the costly and time-consuming method of judicial foreclosure.

Judicial foreclosure is initiated by the mortgagee when a mortgagor defaults on the mortgage agreement.⁴⁰ In order to recover the debt owed by the mortgagor, the mortgagee must file a lawsuit against the mortgagor and any other parties who have an interest in the secured property.⁴¹ The mortgagee files complaint as well as a notice of Lis Pendens.⁴² The complaint contains information about the mortgage agreement and describes how the mortgagor has defaulted on the agreement.⁴³ Also outlined within the complaint is the amount of debt owed by the mortgagor and those named as defendants by the mortgagee, often the mortgagor and any third party with interest in the property.⁴⁴ All parties are then served a notice of the complaint either directly or publicly, and litigation proceeds.⁴⁵

To satisfy the debt, the lender has the right to recover funds from the secured property.⁴⁶ In the process of judicial foreclosure, it is the court's responsibility to first determine if the mortgagee is entitled to foreclosure.⁴⁷ If foreclosure is granted, the court then orders a sheriff's sale to auction off the property.⁴⁸ The court then decides how the proceeds from the property sale will be distributed to satisfy the debt.⁴⁹

B. NONJUDICIAL FORECLOSURE

Nonjudicial foreclosure includes power-of-sale foreclosure, foreclosure by advertisement, and voluntary nonjudicial foreclosure.⁵⁰ Nonjudicial foreclosure is almost always faster and less expensive than judicial foreclosure.⁵¹ It is less expensive primarily because formal legal representation is not required for judicial proceedings and it is typically a faster method of

40. Marshall, *supra* note 31, at 1273.

41. *Id.* (citing Christopher A. Camardello, *Understanding Foreclosure on Real Property*, BENCH & B. MINN., Oct. 2008, at 20-21).

42. 51 AM. JUR. 2D *Lis Pendens* § 1 (2010) ('Lis pendens' is a common-law and statutory doctrine which has the effect of providing constructive notice to the world of an alleged claim of a lien or an interest in property. A properly filed notice of lis pendens places a subsequent purchaser of the affected real estate on notice of the interest asserted in the lis pendens.').

43. Marshall, *supra* note 31, at 1273.

44. *Id.*

45. *Id.*

46. 55 AM. JUR. 2D, *supra* note 28, § 573.

47. Marshall, *supra* note 31, at 1273.

48. *Id.* at 1273-74.

49. *Id.*

50. *See, e.g.*, 2 BAXTER DUNAWAY, L. DISTRESSED REAL EST. app.19A (2010).

51. *See 5 id.* § 68:7.

foreclosure. As a result, lenders incur less administrative expenses during the foreclosure process.

Many states allow nonjudicial foreclosure as an alternative to judicial foreclosure because it provides a way to avoid the delay and expense of judicial proceedings.⁵² In fact, most states have adopted statutes explicitly authorizing types of nonjudicial foreclosure.⁵³ In order to nonjudicially foreclose, the mortgage must either contain a power of sale clause or a contractual right that grants the mortgagee the legal ability to sell the property, or the right must be implied by law.⁵⁴

In sum, under the nonjudicial foreclosure process, the lender is authorized by law or contract to foreclose on the mortgaged property in the event of default in order to satisfy the mortgagor's outstanding obligation without the formalities of judicial proceedings. Because nonjudicial foreclosure is less expensive and faster, it often functions as a desirable alternative to judicial foreclosure from a lender's perspective.

IV. DIRECT AND INCIDENTAL FORECLOSURE COSTS

When a mortgagor defaults on his or her mortgage payments, lenders incur substantial costs through the delinquency period, the foreclosure process, and the post-foreclosure process.⁵⁵ In fact, lenders begin incurring costs the very moment a borrower stops making their mortgage payments.⁵⁶ Because most of the costs associated with loan default are time-dependent, a lender's expense continues to grow until the mortgagor either satisfies the debt or when foreclosure is sought by the mortgagee and that process is completed.⁵⁷

When a debtor becomes delinquent on a loan, the lender loses out on income from stopped principle payments, interest payments, and servicing fees.⁵⁸ Additional costs that begin to accrue once the loan becomes delinquent include increased servicing costs and collection fees.⁵⁹ In addition, the lender becomes responsible for maintaining the property if the debtor is

52. See *Soufal v. Griffin*, 198 N.W. 807, 809 (Minn. 1924).

53. See *infra* Part VI (explaining that most states utilize nonjudicial foreclosures).

54. 1 BROWN, *supra* note 27, § 8:17.

55. MORTG. BANKERS ASS'N, CONGRESSIONAL EDUCATION SERIES BRIEFING: LENDER'S COST OF FORECLOSURE 4-5 (May 28, 2008), available at <http://www.nga.org/Files/pdf/0805foreclosuremortgage.pdf>.

56. *Id.* at 4.

57. *Id.*

58. *Id.*

59. *Id.* at 5.

not doing so himself.⁶⁰ Costs associated with maintaining the property include property maintenance, tax payments, and insurance payments.⁶¹

When seeking foreclosure, the lender is then faced with the legal and administrative costs associated with foreclosure and post-foreclosure. These costs include, but are not limited to, court fees, attorney fees, fees to publicize foreclosure notices, auctioneer fees, and title fees.⁶² After the property sale, the lender may even take another financial loss if the principle from the sale is less than the outstanding debt owed by the debtor.⁶³ As a result of these collected losses and accrued costs, lenders are forced to pass the costs off onto its current and future customers and change its lending standards.⁶⁴ These changes do not benefit the general public and make mortgage lending a less consumer-friendly practice.

In examining the costs incurred by mortgage lenders in the event of loan delinquency and foreclosure, it is evident the extent of costs accrued would differ depending on whether the foreclosure was judicial or nonjudicial. With costs being time-dependent, it is safe to assume that a judicial foreclosure would increase costs for the lender. This might be assumed not only because of the often-increased time needed to complete the foreclosure, but also on account of the direct costs associated with entering into a legal proceeding itself. Another major consideration for lenders is the fact that a personal bankruptcy proceeding often accompanies foreclosure.⁶⁵ As a result, legal costs soar even higher because the lender must also acquire legal representation for that proceeding in order to enforce its rights to the property.

In 2007, the Joint Economic Committee released a report stating the average foreclosure costs approximately \$77,935.⁶⁶ Of the total cost, local governments incur \$19,227 in lost property taxes, unpaid utility bills, property, upkeep, sewage, and maintenance.⁶⁷ Neighboring homeowners lose approximately \$1508 on their home values.⁶⁸ Foreclosure results in \$7200 in legal and administrative costs for the homeowner.⁶⁹ Lastly,

60. *Id.*

61. *Id.* at 4-5.

62. *Id.*

63. *Id.* at 5.

64. JOINT ECON. COMM., SHELTERING NEIGHBORHOODS FROM THE SUBPRIME FORECLOSURE STORM 14 (Apr. 2007), available at http://jec.senate.gov/public/?a=Files.Serve&File_id=8c3884e5-2641-4228-af85-b61f8a677c28.

65. MORTG. BANKERS ASS'N, *supra* note 55, at 5.

66. JOINT ECON. COMM., *supra* note 64, at 16.

67. *Id.*

68. *Id.*

69. *Id.* at 14.

lenders bear the brunt of the cost, averaging \$50,000 in legal and administrative expenses.⁷⁰

Because lenders have incurred an overwhelming majority of the costs associated with mortgage foreclosure, they have had to change their lending standards.⁷¹ Consequently, customers and potential customers are adversely affected by higher fees and rates and increased difficulties in obtaining financing.⁷² It stands to reason that because lenders incur most of the cost associated with foreclosure and because the mortgagor is almost always the breaching party, lenders should be permitted to recover their legal costs in order to mitigate their losses for the benefit of the general public.

V. THE IMPACT OF NORTH DAKOTA CENTURY CODE SECTION 28-26-04 ON THE MORTGAGE FORECLOSURE PROCESS IN NORTH DAKOTA

North Dakota has deemed provisions for the recovery of attorney fees in loan agreements “void and against public policy” since its inception as a state. The statutory prohibition has had a lasting impact on residential mortgage foreclosure in North Dakota. The impact has been nothing less than a strict categorical prohibition against the recovery of legal costs in foreclosure for well over 100 years. In fact, aside from the statutory change relating to security agreements in 1965, North Dakota Century Code section 28-26-04 has undergone only one major development in North Dakota case law, at least with respect to mortgages.

Late in March of 1983, Joe and Magdalena Obrigewitch (Obrigewitchs) executed a mortgage as security for their debt with Production Credit Association of Mandan (PCA).⁷³ In June of that same year, the parties entered into another loan agreement, which established the terms and conditions for the repayment of the debt.⁷⁴ Nearly four years later, in October of 1987, the Obrigewitchs entered into yet another loan agreement to supplement their previous two agreements with PCA.⁷⁵ In this new contract, they agreed to pay PCA the outstanding principal balance on their debt by February 1, 1988.⁷⁶ The Obrigewitchs failed to adhere to

70. *Id.*

71. *Id.*

72. *Id.* (“Indeed, substantial losses have led many of these lenders to tighten their lending standards, which will make it even more difficult for families facing foreclosure to refinance their homes, or purchase another if they have already foreclosed.”).

73. *Prod. Credit Ass’n v. Obrigewitch*, 462 N.W.2d 115, 116 (N.D. 1990).

74. *Id.*

75. *Id.*

76. *Id.*

the terms of this supplementary agreement.⁷⁷ Consequently, PCA initiated an action to foreclose on the Obrigwitchs' mortgage and eventually obtained default judgment.⁷⁸ The Obrigwitchs appealed arguing, among other things, a provision in the first loan agreement, which provided for the recovery of legal costs in the event of default, rendered the *entire* agreement void.⁷⁹

Two years before the Obrigwitchs' case was appealed to the North Dakota Supreme Court, an argument similar to the Obrigwitchs was advanced by a consumer involved in a retail contract dispute in *Commercial Bank of Mott v. Stewart*.⁸⁰ In that case, James Stewart (Stewart) executed a retail installment contract with an automotive dealership for the purchase of a car.⁸¹ The retail installment contract granted the seller a security interest in the car, and the contract was subsequently assigned to the Commercial Bank of Mott (CBM).⁸² Not long after executing the installment contract, Stewart defaulted on the car payments, and CBM obtained default judgment against him.⁸³ Stewart appealed from default judgment, arguing, among other things, that the default judgment was defective due to the fact that it authorized the recovery of legal expenses out of the sale of the collateral.⁸⁴

The Supreme Court of North Dakota agreed with Stewart's argument, concluding that the trial court erred by authorizing the recovery of attorney's fees.⁸⁵ The court, however, disagreed with Stewart on whether the default judgment was entirely defective as a result of that error.⁸⁶ The court reasoned North Dakota Century Code section 28-26-04 merely limits an agreement to not allowing for the recovery of attorney's fees but does not void the entire agreement itself.⁸⁷ In other words, the court ruled only the authorization of the recovery of attorney fees was void, not the entire agreement.

The decision in *Mott* set the stage for a predictable outcome in *Production Credit Association of Mandan v. Obrigwitch*.⁸⁸ Relying solely on its holding in *Mott*, the court rejected the Obrigwitchs' argument with

77. *Id.*

78. *Id.* at 116-17.

79. *Id.* at 118.

80. 429 N.W.2d 402 (N.D. 1988).

81. *Stewart*, 429 N.W.2d at 402.

82. *Id.*

83. *Id.* at 402-03.

84. *Id.* at 403.

85. *Id.*

86. *Id.*

87. *See id.*

88. 462 N.W.2d 115 (N.D. 1990).

almost no discussion and held that North Dakota Century Code section 28-26-04 voided *only* the provision for attorney fees in the loan agreement, not the entire loan agreement.⁸⁹ Thus, the ruling in *Obrigwitch* accurately reflects the only development and the current state of affairs relating to the recovery of legal expenses in mortgage foreclosure actions in North Dakota.

VI. OVERVIEW OF THE RECOVERY OF ATTORNEY FEES IN RESIDENTIAL FORECLOSURE IN NORTH DAKOTA, MINNESOTA, SOUTH DAKOTA, AND MONTANA

All states in the United States allow judicial foreclosure in private residential foreclosure.⁹⁰ About half of the states also permit nonjudicial foreclosure.⁹¹ North Dakota is not one of these states.⁹² Moreover, of the

89. *Obrigwitch*, 462 N.W.2d at 118.

90. See ALA. CODE § 35-10-3 (Supp. 2010); ALASKA STAT. § 09.45.170 (2010); ARIZ. REV. STAT. ANN. § 33-721 (2007 & Supp. 2010); ARK. CODE ANN. §§ 18-49-103 to -105 (2003); CAL. CIV. CODE §§ 2924 to 2924I (Deering 2005 & Supp. 2011); COLO. REV. STAT. § 38-39-101 (2010); CONN. GEN. STAT. ANN. §§ 49-1 to -31 (West 2006); DEL. CODE ANN. tit. 10, § 5061(a) (1999); FLA. STAT. §§ 702.01, 45.031 (2010); GA. CODE ANN. § 44-14-49 (2002); HAW. REV. STAT. § 667-1 (1993); IDAHO CODE ANN. § 45-1502 (Supp. 2011); 735 ILL. COMP. STAT. ANN. § 5/15-1501 (West 2003); IND. CODE ANN. § 32-29-1-3 (West 2002); IOWA CODE § 654.1 (2009); KAN. STAT. ANN. § 60-2410 (2005); KY. REV. STAT. ANN. § 426.525 (West 2006); LA. CODE CIV. PROC. ANN. art. 3721 to 3753 (2003); ME. REV. STAT. ANN. tit. 14, § 6321 (2003); MD. CODE ANN., REAL PROP. § 7-105 (LexisNexis 2010); MASS. GEN. LAWS ANN. ch. 244, § 1 (West 2004); MICH. COMP. LAWS ANN. §§ 600.3101 to 600.3180 (West 2010 & Supp. 2011); MINN. STAT. § 581.01 (2010); MISS. CODE ANN. § 89-1-55 (1999); MO. ANN. STAT. § 443.190 (West 2000); MONT. CODE ANN. § 71-1-222 (2011); NEB. REV. STAT. § 25-2137 (2008); NEV. REV. STAT. ANN. § 40.430 (LexisNexis 2006 & Supp. 2009); N.H. REV. STAT. ANN. § 479.10 (2001); N.J. STAT. ANN. §§ 2A:50-1 to -21 (2000); N.M. STAT. ANN. § 39-5-1 (West 2010); N.Y. REAL PROP. ACTS. LAW §§ 1301-1391 (Consol. 1981 & Supp. 2011); N.C. GEN. STAT. §§ 45-4 to -21.33 (2009 & Supp. 2010); N.D. CENT. CODE § 32-19-01 (2010); OHIO REV. CODE ANN. § 2323.07 (West 2004); OKLA. STAT. tit. 12, § 686 (2010); OR. REV. STAT. ANN. § 88.010 (West 2003); 35 PA. STAT. ANN. § 1680.402c (West 2003 & Supp. 2011); R.I. GEN. LAWS § 34-27-1 (1995); S.C. CODE ANN. § 29-3-630 (2007); S.D. CODIFIED LAWS § 21-47-1 (2004); TENN. CODE ANN. §§ 35-5-101 to -112 (2007 & Supp. 2010); TEX. PROP. CODE ANN. § 51.005 (West 2010); UTAH CODE ANN. § 78B-6-901 (LexisNexis Supp. 2010); VT. STAT. ANN. tit. 12, § 4526 (2002); VA. CODE ANN. §§ 55-59 to -66.6 (2010); WASH. REV. CODE ANN. § 61.12.040 (LexisNexis 2010); W. VA. CODE ANN. § 55-12-1 (LexisNexis 2008); WIS. STAT. ANN. § 846.01 (West 2007); WYO. STAT. ANN. § 1-18-101 (2011).

91. See ALA. CODE § 35-10-12; ALASKA STAT. § 34.20.070; ARIZ. REV. STAT. ANN. § 33-807; ARK. CODE ANN. § 18-50-108; CAL. CIV. CODE § 2924; COLO. REV. STAT. §§ 38-38-100.3 to -114; CONN. GEN. STAT. ANN. §§ 49-1 to -31; GA. CODE ANN. § 44-14-162; HAW. REV. STAT. § 667-5; IDAHO CODE ANN. § 45-1505; IOWA CODE § 654.18; ME. REV. STAT. ANN. tit. 14, § 6203-A; MD. CODE ANN., REAL PROP. § 7-105; MASS. GEN. LAWS ANN. ch. 244, § 14 (2010); MICH. COMP. LAWS ANN. §§ 600.3201 to .3280; MINN. STAT. § 580.01; MISS. CODE ANN. § 89-1-55; MO. ANN. STAT. § 443.290; MONT. CODE ANN. § 71-1-313 (2010); NEB. REV. STAT. §§ 76-1001 to -1018 (2009 & Supp. 2010) (deeds of trust only); NEV. REV. STAT. ANN. § 107.080 (LexisNexis 2007 & Supp. 2009); N.H. REV. STAT. ANN. § 479.25; N.Y. REAL PROP. ACTS. LAW §§ 1301-1391; N.C. GEN. STAT. §§ 45-4 to -21.33; OKLA. STAT. tit. 46, § 43 (2001); OR. REV. STAT. ANN. § 86.735; R.I. GEN. LAWS § 34-11-22 (Supp. 2010); S.D. CODIFIED LAWS § 21-48-1; TENN. CODE ANN. §§ 35-5-101 to -112; TEX. PROP. CODE ANN. § 51.005; UTAH CODE ANN. § 57-1-24 (2010); VT. STAT. ANN. tit. 12, § 4531a (Supp. 2010); VA. CODE ANN. §§ 55-59 to -66.6;

states that permit only judicial foreclosure, North Dakota is one of the only remaining to place a categorical prohibition against the recovery of attorney fees in debt instruments.⁹³ Therefore, not only does North Dakota law prohibit lenders from recovering the legal costs associated with foreclosure, it also precludes a lender from availing itself of the faster and less expensive method of foreclosure, nonjudicial foreclosure.

Adding insult to injury, North Dakota also forbids mortgagors from obtaining deficiency judgments in many residential mortgage foreclosures.⁹⁴ As a result, the current mortgage foreclosure landscape in North Dakota provides a no-win situation for lenders.

In contrast, North Dakota's neighboring states have more amenable statutory procedures and less harsh restrictions for lenders who foreclose on delinquent debtors. Yet, at the same time, each state's statutory procedures and limitations on the collection of attorney fees are very different. Regardless of their differences, each state's foreclosure laws create a friendlier environment for lenders than the mortgage law landscape in North Dakota. Of significant relevance is South Dakota's statutory foreclosure system because it shows how South Dakota overcame the statutory prohibition adopted by the Dakota Territory. In addition, both Montana and Minnesota's statutory limitations on the collection of attorney fees are relevant for North Dakota's consideration because they provide two different but equitable approaches to the recovery of attorney fees in non-judicial foreclosure.

A. RECOVERY OF ATTORNEY FEES IN SOUTH DAKOTA

South Dakota is similar to North Dakota in that it authorizes lenders to initiate foreclosure by the judicial foreclosure process.⁹⁵ However, unlike North Dakota, South Dakota law does permit lenders to initiate foreclosure by the nonjudicial foreclosure process if a "power of sale" clause is included within the mortgage agreement.⁹⁶ The "power of sale" clause is necessary to initiate nonjudicial foreclosure because it authorizes the lender

WASH. REV. CODE ANN. § 61.24.030; W. VA. CODE ANN. § 38-1-3 (LexisNexis 2005). *But see* WYO. STAT. ANN. § 34-4-102(a); 1 EDWARD J. PRONLEY, WISCONSIN PRACTICE SERIES: METHODS OF PRACTICE § 7.2 (4th ed. 2010) ("Despite the repeal of the nonjudicial foreclosure procedure in Wisconsin, it seems all mortgages used in Wisconsin still contain a power of sale clause.").

92. *See* N.D. CENT. CODE § 35-22-01 (2004). North Dakota law only permits the state, or state agencies, to foreclose by advertisement. *Id.*

93. *See* Warren, *supra* note 3, at 1233.

94. *See* N.D. CENT. CODE § 32-19-03 (forbidding deficiency judgments for mortgage foreclosures on residential property of four or less units).

95. S.D. CODIFIED LAWS § 21-47-1.

96. *Id.* § 21-48-1.

to sell the property to satisfy the balance due in the event of default. In sum, South Dakota allows mortgagees to foreclose nonjudicially *only if* the contract provides for nonjudicial foreclosure, as opposed to a system that permits nonjudicial foreclosure even if the contract does not provide for it.

Also similar to North Dakota, South Dakota carried over into its laws the prohibition against the collection of attorney fees which had previously been enacted by the Territorial Legislature in 1889.⁹⁷ However, unlike North Dakota, South Dakota has materially altered their statute and, as a result, now permits the recovery of attorney fees in mortgage foreclosure.⁹⁸ Accordingly, attorney fees are now recoverable in both judicial and nonjudicial foreclosures in South Dakota and they are limited only by the court's discretion.⁹⁹

B. RECOVERY OF ATTORNEY FEES IN MONTANA

Montana's foreclosure laws are in many ways similar to those of South Dakota. For example, Montana allows lenders to foreclose on deeds of trust or mortgages in default by either judicial or nonjudicial foreclosure.¹⁰⁰ One of the major differences between the South Dakota and Montana foreclosure processes is the limitation each state places on deficiency judgments. In South Dakota, deficiency judgments are permitted in most cases with the exception of where the mortgage is foreclosed by nonjudicial voluntary procedure.¹⁰¹ In contrast, Montana does not permit deficiency judgments following nonjudicial foreclosure.¹⁰² Rather, deficiency judgments are available to mortgagors only if judicial foreclosure is utilized.¹⁰³

Another difference between the foreclosure laws in South Dakota and Montana is the amount of attorney's fees that are recoverable in the event of default. Montana, like South Dakota, authorizes the court to award reasonable attorney fees in judicial foreclosure.¹⁰⁴ However, unlike South

97. *Id.* § 15-17-39.

98. See 1993 S.D. Sess. Laws 221; see also *infra* Part VII.

99. See S.D. CODIFIED LAWS § 15-17-38 ("Attorney fees may be taxed as disbursements on mortgage foreclosures either by action or advertisement.").

100. MONT. CODE ANN. §§ 71-1-222, -313 (2011).

101. See *id.* § 21-48A-1(2). Nonjudicial voluntary foreclosure is different than judicial and nonjudicial foreclosure in that the foreclosure is not forced by the mortgagee. Rather, the parties mutually agree to foreclose. In effect, the mortgagor gives up all interest in the property, and the mortgagor waives any rights to a deficiency judgment. *Id.*

102. *Id.* § 71-1-317.

103. See *id.* § 71-1-305. But see *id.* § 71-1-232 (forbidding deficiency judgments in judicial foreclosure where the parties had executed a purchase money mortgage).

104. *Id.* § 15-17-38 ("Attorney fees may be taxed as disbursements on mortgage foreclosures either by action or advertisement.").

Dakota, Montana limits the recovery of legal costs in nonjudicial foreclosure to reasonable attorney fees “not [to] exceed, in the aggregate, [five percent] of the amount due on the obligation, both principal and interest”¹⁰⁵ For example, if a home with the remaining obligation of \$150,000 is nonjudicially foreclosed upon, the lender may recover a maximum of \$7,500 in attorney fees under Montana law. In sum, a lender in Montana or South Dakota has the option to foreclose by the method of either judicial or nonjudicial foreclosure and may also be permitted to recover a substantial amount of attorney’s fees associated with the foreclosure.

C. RECOVERY OF ATTORNEY FEES IN MINNESOTA

Minnesota foreclosure law is similar to both South Dakota and Montana in that it too permits both judicial¹⁰⁶ and nonjudicial¹⁰⁷ foreclosure, and because it allows deficiency judgments in foreclosures.¹⁰⁸ Minnesota also allows the recovery of attorney fees in judicial and nonjudicial foreclosure.¹⁰⁹ In judicial foreclosure, the court establishes and limits the award of attorney fees using its discretion. When determining the fee, the courts in Minnesota consider time spent on the matter, abilities and experience of the attorneys, the disputed amount involved, responsibilities assumed by the attorneys, and the results of the foreclosure.¹¹⁰ Accordingly, when judicial foreclosure is used in Minnesota, attorney fees are limited only by the court’s discretion.

On the other hand, nonjudicial foreclosure has an objective statutory limitation in Minnesota. Like Montana, Minnesota statutorily limits the recovery of legal costs in nonjudicial foreclosures.¹¹¹ While Montana limits the recovery of attorney fees to five percent of the remaining obligation, Minnesota limits the recovery using certain statutory fees established by a sliding scale relating the original principal of the loan.

Specifically, the statutory fees are based on the amount of debt secured by the mortgage and the date the mortgage was executed.¹¹² For example, for mortgages executed after May 31, 1971, where the original principle

105. *Id.* § 71-1-320.

106. *See* MINN. STAT. § 581.01 (2010).

107. *See id.*

108. *See id.* § 582.30(1). *But see id.* § 582.30(2) (not allowing deficiency judgments where nonjudicial foreclosures have a redemption period of less than six months).

109. *Id.* § 481.02(4).

110. STEVEN J KIRSCH, MINNESOTA PRACTICE: METHODS OF PRACTICE § 50.7 (3d ed. 2009).

111. *See* MINN. STAT. § 582.01; *see also* KIRSCH, *supra* note 110, § 49.25.

112. *See* MINN. STAT. § 582.01; *see also* KIRSCH, *supra* note 110, § 49.25.

amount secured by the mortgage exceeds \$10,000, the maximum allowance for attorney fees in nonjudicial foreclosure is \$275, plus \$35 for each additional \$5000 of the original principal amount. The minimum amount of attorney fees available in nonjudicial foreclosure for mortgages executed after July 31, 1992 has been updated to \$500. Thus, if a lender borrowed \$150,000 to a mortgagor after July 31, 1992 and then foreclosed under the nonjudicial foreclosure process sometime after, it would be entitled to an amount not to exceed \$1480.¹¹³

In sum, Minnesota law permits both judicial and nonjudicial foreclosure. In the event a lender forecloses using judicial foreclosure, it would be allowed to recover reasonable attorney fees which would be established and limited by the court's discretion. In the event a lender forecloses using nonjudicial foreclosure, it would be entitled to the award of attorney fees not to exceed the statutory limitations determined by a sliding scale based on the original principal amount secured by the mortgage and the date the mortgage was executed.

VII. PROPOSAL TO REFORM MORTGAGE FORECLOSURE LAWS IN NORTH DAKOTA

Lenders incur substantial losses when delinquent debtors default on their mortgages. As a consequence, lenders change their lending strategies and pass on those costs to other customers. To mitigate their losses, lenders avail themselves of the foreclosure processes that best protect their business interests in a given situation. Under the current law in North Dakota, lenders are limited to one foreclosure process—judicial foreclosure—which is the slower and more expensive method of foreclosure. In addition, North Dakota remains the only state in the union to categorically prohibit the recovery of legal costs in all methods of mortgage foreclosure.¹¹⁴

That said, it is time for delinquent debtors to pay the piper in North Dakota. North Dakota's foreclosure laws should be modernized and made more amicable to lenders. This modernization would include two minor reforms that would have a substantial impact on North Dakota's foreclosure landscape. First, North Dakota should follow South Dakota's lead and amend its statute to allow for exceptions for the collection of attorney fees in certain debt instruments. Second, North Dakota should adopt a statutory

113. See MINN. STAT. § 582.01. The amount recoverable is not to exceed \$500 for the first \$10,000 of the original principal secured by the mortgage plus \$35 for each additional \$5000 of the principal.

114. See discussion *supra* Part IV.

procedure allowing nonjudicial foreclosure since they are faster and less expensive.

When the South Dakota Legislature amended its prohibition against the collection of attorney fees in debt instrument by adding the qualifying phrase “except as elsewhere authorized,” South Dakota’s foreclosure laws drastically changed. One year earlier, South Dakota “elsewhere authorized” the collection of attorney fees in mortgage foreclosure, resulting in a more equitable environment for lenders in the state.

Accordingly, amending North Dakota Century Code section 28-26-04 by adding the qualifying phrase “except as elsewhere authorized,” or its functional equivalent, would be the first step to permitting the collection of attorney fees in mortgage foreclosure. The second step involves statutorily authorizing courts to award reasonable attorney’s fees in judicial foreclosure actions. The final step would include adopting a statutory procedure for nonjudicial foreclosure which reasonably limits the recovery of legal costs similar to the systems in South Dakota,¹¹⁵ Montana,¹¹⁶ or Minnesota.¹¹⁷ If these three minor revisions are made, it would simultaneously modernize and beneficially change the mortgage foreclosure landscape in North Dakota for lenders *and* the general public.

*Stephen D. Larson**

115. South Dakota limits the recovery of legal costs in nonjudicial foreclosure by the court’s discretion. *See* S.D. CODIFIED LAWS § 15-17-38 (2010).

116. Montana limits the recovery of legal costs in nonjudicial foreclosure based on the outstanding debt obligation. *See* MONT. CODE ANN. § 71-1-320 (2011).

117. Minnesota limits the recovery of legal costs in nonjudicial foreclosure by a statutory schedule based on the original principal amount of the mortgage. *See* MINN. STAT. § 582.01.

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