



Banking & Finance Law Alert

A Corporate Department Publication

February 2009

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Ohio Supreme Court Confirms Legality of Attorney Fees Provisions Related to Defaulted Residential Mortgage Loans

In *Wilborn v. Bank One Corporation* (Slip Opinion No. 2009-Ohio-306), the Supreme Court of Ohio upheld a provision in a residential mortgage contract that required a defaulting borrower to pay a lender's reasonable attorney fees as a condition for reinstating a defaulted loan and terminating foreclosure proceedings. Although this decision merely upholds a common practice among lenders, there should be little doubt now that Ohio lenders may require the payment of attorney fees to reinstate a mortgage in foreclosure, particularly if the mortgage was a standardized Fannie Mae or Freddie Mac document.

Wilborn was a class action that challenged a contractual provision requiring the payment of a lender's attorney fees as a condition to reinstatement of a defaulted residential mortgage loan. The *Wilborn* plaintiffs argued that such clauses are void and against public policy because attorney fees are not recoverable when the lender prosecutes a foreclosure case through sale and confirmation.

Ohio holds to the "American Rule" with respect to the recovery of attorney fees: a prevailing party in a civil action may not recover attorney fees unless a contract or statute specifically provides otherwise. Even if a contract does provide for recovery of attorney fees, that provision may still be unenforceable for a number of reasons. For example, if a court determines that a contract was one of adhesion, where the party with little or no bargaining power had no realistic choice as to the terms of the agreement, the court may refuse to enforce the disputed provision. Dating back to an Ohio Supreme Court decision from 1893, Ohio courts have long refused to enforce provisions for payment of attorney fees upon default of a consumer or residential debt obligation as being void and against public policy.

As a result of this legal history, the *Wilborn* Court was forced to navigate a twisting and very narrow path to conclude that lenders may enforce a contractual obligation to pay attorney fees as a condition to reinstating a defaulted mortgage loan. In so doing, the Court first rejected the argument that R.C. § 1301.21 prohibited the recovery of attorney fees in such circumstances. R.C. § 1301.21 authorizes recovery of attorney fees for contracts worth more than \$100,000 that do not establish indebtedness for primarily personal, family or household purposes. The Court held that R.C. § 1301.21 merely enumerated one

circumstance under which the recovery of attorney fees was permitted but was not drafted or intended to expressly prohibit attorney fees in all other circumstances.

The Court also distinguished between the legal right of redemption in foreclosure proceedings and a borrower's contractual right to reinstate a defaulted loan. By law, a defaulting borrower in foreclosure is entitled to redeem his or her property by paying the entire principal and interest due before confirmation of the sheriff's sale. When that happens, the lender has a legal duty to dismiss the foreclosure proceedings and may not condition that dismissal on payment of attorney fees. This differs from a contractual right to reinstate a loan. In that instance, the borrower typically pays only the amounts needed to make the loan current and continues all future payments on the previously agreed-upon schedule. In light of these differences, the Court found that "the defaulting borrower's agreement to pay the lender's attorney fees incurred in connection with the foreclosure proceedings is a reasonable exchange for the right to require the lender to reinstate the defaulted mortgage loan and to forbear the lender's legal rights to foreclose, be presently paid in full, and sever the relationship with the defaulted borrower."

The Court next addressed the *Wilborn* plaintiffs' argument that their mortgage loan documents were contracts of adhesion because they were not the product of free and understanding negotiation between parties with equal bargaining power. Indeed, little to no negotiation of these largely standardized form documents was (or ever will be) permitted, particularly since the uniformity of residential mortgage loans is critical to securitizing and selling those loans on a secondary market.

The Court rejected this argument as well. Instead, the Court pointed to the fact that both Fannie Mae and Freddie Mac — two of the driving forces behind creation of the secondary market for residential mortgage loans — engaged in extensive negotiations and public meetings with lenders and consumer advocates while creating standardized residential mortgage loan forms. The Court therefore found that, although an individual borrower may have had little bargaining power regarding the terms and conditions of his or her mortgage, the process by which the template for these forms was created precluded any argument that the mortgages were contracts of adhesion. Rather, according to the Court, the contracts were the result of "sophisticated parties, all with competing interests and wielding significant bargaining power, freely entering discussions, compromises, and negotiations for the purpose of creating" these mortgages.

So what does the *Wilborn* decision mean for Ohio mortgage lenders?

- First, it generally confirms the legality of the longstanding practice of requiring defaulted borrowers to pay attorney fees to reinstate defaulted residential mortgage loans.
- Second, it reinforces the benefits to the market of relying on standardized loan documents. Not only do standard terms allow for assignments and trading of mortgage loans, they also provide lenders with a degree of certainty as to the remedies available to them should they abandon foreclosure proceedings in favor of reinstatement.
- Finally, it leaves open the very real possibility that attorney fees provisions in more customized and less standard loan documents may not pass muster with the courts.

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