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Glastonbury Landowner's Association, Inc.

Sent by email:

Dear Board of Directors:

You recently asked me to provide a legal opinion regarding the interest rate language found in your Covenants, specifically, Section 11.06. I have reviewed the following documents:

1. Montana Code Annotated, specifically the Non-Profit Act;
2. Montana Case Law; and
3. GLA's current governing documents including your Covenant and Bylaws.

According to Article 11.06, the Association is supposed to charge 1 and ½ percent interest per month, compounded monthly. This equate to approximately 18% per year, but compounded monthly, not yearly.

As we have discussed, Covenants are contracts (i.e. agreements). According to Montana law, the highest interest rate allowable by agreement is the following:

(1) Parties may agree in writing to the payment of any rate of interest that does not exceed the greater of 15% or an amount that is 6 percentage points per year above the prime rate published by the federal reserve system in its statistical release H.15 Selected Interest Rates for bank prime loans dated 3 business days prior to the execution of the agreement. Interest must be allowed according to the terms of the agreement.

(2) A loan that is not usurious when made is lawful for the duration of the loan, provided the loan agreement is not substantially changed. This subsection does not apply to loan renewals.

(3) The provisions of this section do not apply to regulated lenders as defined in 31-1-111.

Mont. Code Ann. § 31-1-107 (West)

For a time, interest rates were such that 18% did not violate the law because prime plus 6% was above 18%. However, on December 16, 1982 (the date of the original covenants were

filed), prime was 11.50. Therefore, 18% was above 11.50 plus 6. Therefore, even if we go back to 1982 (as contemplated by the code), charging 18% is usury and violates the law. As you know, technically covenants are treated like contracts. An illegal provision in a contract makes the contract void.

"Where a contract has but a single object and such object is unlawful, whether in whole or in part, or wholly impossible of performance or so vaguely expressed as to be wholly unascertainable, the entire contract is void."

Mont. Code Ann. § 28-2-603 (West)

Now, this happens a lot. We never know what life will bring us. Therefore, attorneys developed severability clauses to get around the entire contract being void. Your Covenants, Section 12.04, contains this clause. The law supports these clauses. Thus, the effect would most likely be that a Court would find that the 1 ½% rate portion of unenforceable. (I say most likely because you never know what a court would do.) Therefore, in my opinion, the Board should not enforce the 18% interest rate.

However, as Mr. Hesse pointed out, there is another statute which may allow more interest. However, there is not a single case looking at both statutes. It seems that no one has ever asked which one rules. Since MCA 31-1-107 is more particular, and directly on point (versus 31-1-106), I would guess (and it is a guess) that the Court would enforce the language in 31-1-107.

Where does that leave the Board? Pursuant to your powers, you do have the right to do things to enforce the covenants, etc. The drafters already thought that charging interest on overdue bills is necessary to enforce the covenants. Therefore, it is my opinion that the Board, in good faith, can put forward for a vote an amendment that the Association will charge a different amount of interest for overdue assessments.

Also, I believe that the variance provision may allow you to not charge them in the interim. According to Section 12.01, "The Association reserves the right to waive or grant variances to any of the provision of this Declaration, where, in its discretion, it believes the same to be necessary and where the same will not be injurious to the rest of the Community."

In this case, if I am right and the interest rate is too much, then you could be sued for damages. According to Montana law:

(2) When a greater rate of interest has been paid, the person by whom it has been paid or the person's heirs, assigns, executors, or administrators may recover from the person, firm, or corporation taking, receiving, reserving, or charging interest a sum double the amount of interest paid, provided that the action must be brought within 2 years after the payment of the interest,

and provided that, before any suit may be brought to recover the usurious interest, the party bringing suit makes written demand for return of the interest paid.

Mont. Code Ann. § 31-1-108 (West)

In other words, if you charge the interest, you could be sued for double the amount they paid. Also, if they won, which seems likely, then you would have to pay fees and costs. This would seem to be a great harm to the community. On the other hand, if you made a variance to lower the interest in the interim to 12% or 15%, that is only 3-6% less. I do not know your numbers, and you will have to look at them, but I suspect the revenue would be far less than paying double, plus attorney's fees and costs. However, you will have to determine that after a meeting.

Regarding the 5% penalty, this is different. It is what attorneys call a "liquidated damages clause." Such provisions are typically void, except when the parties have agreed that damages are hard to determine.

(1) Every contract by which the amount of damage to be paid or other compensation to be made for a breach of an obligation is determined in anticipation thereof is to that extent void, except as expressly provided in subsection (2).

(2) The parties to a contract may agree therein upon an amount which shall be presumed to be an amount of damage sustained by a breach thereof when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage.

Mont. Code Ann. § 28-2-721 (West)

Based on my reading of the covenants, this is not a penalty that came about through mutual discussions between the parties. It came about as a penalty for non-payment that was included by the drafters. Now, that being said, these are amended covenants that were voted on by the community as a whole (as opposed to the original covenants which were put in place by the developer.) Therefore, there is an argument that this was a penalty that you all believed was a fair amount because damages are hard to prove. This could go either way. That being said, courts typically frown on liquidated damage clauses. "In Montana, liquidated damages clauses in contracts are generally prima facie void."

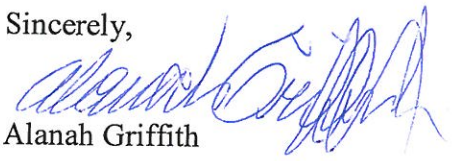
Story v. City of Bozeman, 259 Mont. 207, 228, 856 P.2d 202, 215 (1993). I believe the most likely outcome would be that the Court would find that the clause is unenforceable. So, where does that leave the Board? Once again, I believe the Board can in good faith, not enforce this provision.

In summary, there is no way to guess what a Court would determine in this matter, there never is. However, it would seem that your covenants allow you to make a variance in this case if you determine that the potential cost outweighs the loss of interest. If you were challenged in

Court, you would have a good argument for prevailing on this matter, but keep in mind that you can never see into the mind of a judge.

Please contact me with any questions.

Sincerely,



Alanah Griffith