

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:

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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.

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4201 2nd Ave W v. First State Bank & Trust, et al., 2023 ND 43, Docket No. 20220309, Filing Date 3/16/2023

The attorneys at Olson & Burns P.C. had another successful trip to Bismarck and the North Dakota Supreme Court, and once again generated case law beneficial to lenders. This case clarifies that lenders may first foreclose on real estate collateral and later foreclose on personal property collateral (or vice versa) without concern for the rules of the deficiency judgment statutes so long as the real estate action doesn't litigate personal property issues and the personal property action doesn't litigate real property issues.

The Facts

In 2015, the bank loaned approximately \$4.34 million to Racers Store 102, LLC ("Racers"), for its operations of a Williston convenience store. As security for the loan, Racers delivered to the bank a leasehold mortgage, security agreement, and fixture filing against real and personal property including a liquor license, coffee kiosk, walk-in freezer, and Kohler generator. In 2016, Racers defaulted on its loan and the bank commenced a foreclosure action. The complaint sought to compel the sale of real and personal property to satisfy the debt. The bank took a judgment of foreclosure of the fee real estate only, and the judgment addressed and disposed of *only* the real estate. The bank purchased the real property at the sheriff's sale for approximately \$3.2 million, leaving over \$1 million in remaining debt.

During the foreclosure proceedings, the bank took control of the convenience store and contracted with 4201 to operate the store while the foreclosure action was pending. By a bill of sale and assignment, original borrower Racers transferred its rights, titles, and interests in the ground lease where the convenience store was located and the assets of the store to 4201; those assets included the very valuable liquor license. 4201 then entered into a forbearance agreement with the bank. The parties subsequently discovered the liquor license could not be transferred until delinquent property taxes were paid. The bank and 4201 executed an addendum to the forbearance agreement agreeing to pay equal shares of the property taxes and whereby the liquor license would become an asset of 4201, subject to the existing lien held by the bank.

The bank and 4201 also entered into a personal property pledge in which 4201 pledged to give the bank a continuing first priority lien in the liquor license, 4201 agreed not to sell, assign, or transfer the liquor license, and 4201 agreed to reimburse the bank for its attorney's fees and expenses incurred in defending its interest in the liquor license.

In 2021, the bank decided to end operation of the store and offered to sell the liquor license to 4201. 4201 then brought a legal action seeking a declaratory judgment finding that the bank no longer held a valid and enforceable lien on the liquor license, coffee kiosk, walk-in freezer, or Kohler generator. The bank answered and filed a counterclaim seeking compensation from 4201 for unjust enrichment while operating the store. Following a bench trial, the district court determined the bank continued to hold a valid and enforceable security interest in the liquor license and other collateral. The court dismissed the bank's counterclaim and ordered 4201 to pay the bank's reasonable attorney's fees as it had agreed to do under the personal property pledge.

The Appeal and Argument

4201 appealed to the North Dakota Supreme Court. It argued the bank's foreclosure action against Racers extinguished its security interest in the liquor license because the bank did not pursue a deficiency judgment against Racers and so the bank lost any interest it had in the license.

Section 32-19-06.1 of the North Dakota Century Code describes the method by which a mortgagee may request a deficiency judgment during a real property foreclosure. The statute states in part: "In an action involving the foreclosure of a mortgage on commercial real property, the plaintiff shall state in the pleading whether a deficiency judgment will be sought and if sought shall identify the parties claimed to be personally liable and demand a deficiency judgment against those parties." Clearly, the statute does not *require* a mortgagee to seek a deficiency judgment – it only outlines what is required *if* the mortgagee requests one.

Additionally, nothing in the statute requires a mortgagee to foreclose against secured personal property in the same action as real property. Instead, the Court noted, secured creditors may proceed against all collateral in a single action *or* they may recover on a debt against personal property collateral after foreclosing a mortgage securing the same debt.

The Court found that the bank had reserved the right to seek a deficiency judgment in its foreclosure complaint, and had requested that certain personal property in which it had a security interest be sold prior to the land sale. *However*, it found that the bank's decision to *not* move forward with a deficiency judgment *or* the sale of personal property at that time did not destroy a later foreclosure remedy. The Court agreed that because Racer's debt was not fully extinguished by the land sale (approximately \$1 million remained), the bank was allowed to maintain its security interests in the remaining collateral and foreclose upon those interests *later* to satisfy the remaining debt. Significantly, there was no indication in the record that any issues regarding personal property collateral were actually litigated by the parties in the real estate foreclosure action. Even though the complaint referred to personal property, that merely put Racers on notice as to the general nature of the bank's claims; because the personal property issues weren't litigated, the bank was free to sell the real property in one lawsuit and take a different course of action with the personal property.

The Result

By signing the addendum, 4201 acknowledged that the bank maintained an existing lien in the liquor license and that 4201 was taking any interest in the license subject to the bank's priority. Accordingly, the Court agreed that the bank maintained a valid and enforceable lien in the liquor license and other collateral, and that it was entitled to foreclose upon those items in its dealings with 4201. Additionally, the bank was entitled to its reasonable attorneys' fees and costs that were contracted for in the pledge agreement.

The Takeaway

Proceeding with *one action* against all collateral is one choice available to a secured creditor. The other choice is that a secured creditor may bring *separate actions* by: (1) proceeding under the default provisions of the Uniform Commercial Code against the personal property collateral, and (2) proceeding under the law of real property against the real estate collateral. Note that the litigation and judgment in the real estate action should only dispose of the real estate, and the litigation and judgment in the personal property action should only dispose of the personal property. Keep them truly separate!