

## Commitment Fees Might Constitute Interest Under Michigan Law

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June 16, 2021

Lenders often include fees in loan transactions in addition to an interest rate. Typically such fees are not considered interest, as they compensate the lender for various services or commitments provided under the loan agreements. However, a court might disregard the commitment fee label when determining whether a loan has a usurious interest rate. The Michigan Court of Appeals, in *Soaring Pine Capital vs Park Street Group*, Docket No. 349909, did exactly that when it held that a 5% commitment fee should be considered interest under the facts of that loan transaction.

In *Soaring Pine*, the plaintiff lender made a loan of \$1,000,000 to defendant borrowers to finance the flipping of houses purchased through foreclosure sales. The loan matured in one year, and called for interest at 20% per annum, calculated on the basis of a 360-day year, an upfront commitment fee of 5% paid at the closing of the loan and funded from the loan proceeds, and a success fee of \$1,000 from the eventual sale of each house. In addition, the first two months of interest accrued, but were added to the principal balance. The issue before the Court was whether the loan had an interest rate that met or exceeded the 25% criminal usury rate under Michigan law.

The Court first examined the 20% simple interest rate and held that, because it was calculated on the basis of a 360-day year, the 20% interest rate actually was higher than 20% for purposes of determining whether the overall rate was usurious. The Court then examined whether the commitment fee of 5% paid at closing should be considered interest or a fee. The Court rejected the lender's argument that this fee was nothing more than a fee. Rather, the commitment fee was solely profit, and was not part of a separate commitment by the lender, as the lender committed to nothing in return for the fee. In addition, the lender recovered all of its costs and expenses in making the loan through other fees that defendants paid. Finally, plaintiff solicited investors for this loan package by referring to the 5% fee as an "upfront fee" that was part of the overall return the investors should expect by making the investment. Indeed, it appears that the Court found most persuasive that the lender solicited investors on the basis that the fee was profit on the loan in addition to the 20% interest.

The Court also held that the usury savings clause in the loan documents did not save this particular loan from being considered usurious. Although not entirely clear, it appears that the Court found the savings clause ineffective as the commitment fee was designed to circumvent the usury limitation from the outset of the loan, and did not become usurious due to a future event, such as the invocation of a default rate of interest. It also appears that the Court found persuasive that the lender sued to collect the commitment fee in addition to the interest rate, and therefore knowingly sought to collect a usurious rate in the litigation.

The Court concluded that the lender was not entitled to recover any interest on the loan as the remedy for the usurious interest rate. The Court did not address whether the success fee should be considered interest or the impact of "interest on interest" as a result of the accrual of the first two months of interest.

In our current low-interest-rate environment, this opinion likely will not cause regulated financial institutions to rethink the use of fees. However, such lenders should consider whether certain fees, such as renewal fees and extension fees, might result in an interest rate that exceeds the usury rate. Subprime lenders that make high-interest-rate loans with significant additional fees likely should consider whether their overall yield on a loan makes such loans usurious. In addition, it might be advisable when demanding payment or filing suit to determine whether the yield from the applicable interest rate together with fees is less than the usury rate.

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If you have any questions about the *Soaring Pine* decision, or how it may impact you, please contact the authors of this alert or your Miller Canfield attorney.