IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
FIRST APPELLATE DISTRICT, DIVISION THREE

NO. A163756

IN THE MATTER OF THE ARBITRATION BETWEEN
NICHOLAS AND SHARON HONCHARIW,
Petitioners and Appellants,

and

FJM PRIVATE MORTGAGE FUND; FJM CAPITAL, INC. DBA *FIRST BRIDGE LENDING*; AND FJM MANAGEMENT, LLC, DBA *FIRST BRIDGE LENDING;*
Respondents and Appellees.

APPEAL FROM SONOMA COUNTY SUPERIOR COURT
HONORABLE JENNIFER DOLLARD, JUDGE · CASE NO. SCV267331

PETITION FOR REHEARING

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INTRODUCTION

Pursuant to Rule 8.268 of the California Rules of Court, Respondents FJM Private Mortgage Fund; FJM Capital, Inc., DBA First Bridge Lending; and FJM Management, LLC, DBA First Bridge Lending (collectively, "Respondents") petition this Court for a rehearing after its September 29, 2022 opinion ("Opinion") reversed the order of the Sonoma County Superior Court upholding an arbitrator's decision denying the claims of Petitioners and Appellants Nicholas and Sharon Honchariw (collectively, "Appellants").

Respondents seek rehearing because the Court's Opinion (1) improperly reviewed and reversed the decision of an arbitrator, (2) applied the wrong standard of review and failed to show deference to the factual findings of the arbitrator and the trial court, and (3) misstates or omits several material facts and issues. For these reasons, Respondents respectfully request correction of what they construe to be an error in the law and for the Court to grant rehearing and affirm the Superior Court's decision.

LEGAL ARGUMENT

I. The Court should grant rehearing because it incorrectly reviewed an arbitrator's decision, contrary to well established public policy.

Rehearing is appropriate when the court reaches an erroneous decision because of a mistake of law or when a court's decision is based upon a misunderstanding of a material fact in the case. (*In re Jessup's Estate* (1889) 81 Cal. 408, 471; *Alameda County Management Employees Assn. v. Superior Court* (2011) 195 Cal.App.4th 325, 338, fn. 10.) Additionally, a petition must be granted if the decision was based on an issue not raised or briefed by any party and the court failed to give the

parties an opportunity to present supplementary briefs on that issue. (Cal. Gov't Code, §68081; *California Cas. Ins. Co. v. Sup. Crt.* (1996) 46 Cal.App.4th 1145, 1149-1150.)

Here, as discussed below, the Court reached an erroneous decision based on a mistake of law when it reviewed an arbitrator's award. The Court's decision to review flies in the face of the very purpose of arbitration, which is a *voluntary agreement of the parties* to arbitrate expressly to avoid taking a case through the courts. Furthermore, "Legislature has expressed a 'strong public policy in favor of arbitration as a speedy and relatively inexpensive means of dispute resolution.' " (*Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 9 (*Moncharsh*); *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 Cal.3d 313, 322; *Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 706-707; *City of Oakland v. United Public Employees* (1986) 179 Cal.App.3d 356, 363; see also *Shearson/American Express Inc. v. McMahon* (1987) 482 U.S. 220, 226 [Federal Arbitration Act, 9 U.S.C. § 1 et seq., establishes federal policy in favor of arbitration].)

The key to arbitration's utility, however, is the confidence both parties have that an arbitrator's decision is final and not merely an additional expense in the long judicial process. Without finality, the core purpose of arbitration, which is to bypass the judicial system, is frustrated. "[A]rbitral finality is a core component of the parties' agreement to submit to arbitration. Thus, an arbitration decision is final and conclusive *because the parties have agreed that it be so."* (*Moncharsh*, *supra*, 3 Cal.4th at 10, emphasis in original; *Richey, supra,* 60 Cal.4th at 916.) Thus, it is well established that "[A]n arbitrator's decision is not generally reviewable for errors of fact or law, whether or not such error appears on the face of the award and causes substantial injustice to the parties." (*Moncharsh, supra,* 3 Cal.4th at 6.) Said another way, the public policy in support of the finality of

arbitrator's decisions is so strong that **even blatant mistakes of fact or law in the making of the decision do not provide grounds for review**. (*Richey v. AutoNation, Inc.* (2015) 60 Cal.4th 909*,* 916.)

In its Opinion, the Court reviewed the merits of an arbitrator's decision, which is contrary to well-established public policy. While acknowledging that arbitration is generally not reviewable, the Court then proceeded to review the arbitrator's decision. It is not the role of the Court to consider whether the arbitrator exceeded its power without first determining whether the arbitrator's decision is reviewable *at all*. Even mistakes of law or fact do not provide grounds for review of an arbitrator's decision. Courts " 'indulge every intendment' " to give effect to an arbitrator's decision. (*Moncharsh*, *supra*, 3 Cal.4th at 9.) Furthermore, arbitrator's "may base their decision upon broad principles of justice and equity, and in doing so may expressly or impliedly reject a claim that a party might successfully have asserted in a judicial action." (*Moncharsh*, *supra*, 3 Cal.4th at 10-11.) Thus, after an arbitration decision, "[t]he merits of the controversy between the parties are not subject to judicial review. [Citations.] More specifically, courts will not review the validity of the arbitrator's reasoning. [Citations.]" (*Moncharsh*, *supra*, 3 Cal.4th at 11.)

The trial court considered Plaintiff's petition to vacate the arbitration award and concluded it did not have the authority to review the arbitrator's decision. The trial court considered that the arbitrator heard Plaintiff's Section 1671[1] claim and concluded that Appellants failed to meet their burden in proving the invalidity of the liquidated damage provision. Even a mistake of law or fact by an arbitrator is not reviewable. (*Richey*, *supra*, 60 Cal. 4th at 916.) Because the arbitrator found that Plaintiff failed to meet his burden, judicial corrections are limited to remedying obvious and easily

1 Unless otherwise specified, all further statutory references are to the Civil Code.

correctable mistakes, technical problems, and actions in excess of authority so long as the correction leaves the merits of the decision unaffected. (*Moncharsh, supra, 3 Cal. 4th at 13;* see also*, Heimlich* v. *Shivji* (2019) 7 Cal.5th 350, 367.) For this reason, the Court should grant rehearing as necessary to withdraw its Opinion and affirm the judgment of the Superior Court.

II. The Court should grant rehearing because it failed to show deference to the factual findings of the arbitrator and the trial court and made a de novo review.

The Court reached an erroneous decision based on a mistake of law when it failed to show appropriate deference to the factual findings of both the arbitrator and the trial court. While pure questions of law are reviewed de novo, with regard to contested factual issues, the appellate court applies "'the deferential substantial-evidence standard.'" (*People v. Cromer* (2001) 24 Cal.4th 889, 894; *People v. Letner and Tobin* (2010) 50 Cal.4th 99, 145.) The trial court explicitly made a finding that "under Civil Code Section 1671 (b), the Claimants holds (sic) the burden to prove that such default interest provision in the subject loan was invalid as a penalty, and claimants did not meet their burden of proof on this issue." (AA0009.)[2] The trial court considered the evidence and concluded that "Based on the evidence presented, the default interest in this case was assessed by the lender for damages that are difficult and/or impossible to liquidate, due to effects on its balance sheet, their own lending facilities, and the marketability of the loan as submitted in this case." (AA0009.) In other words, the trial court made a finding of fact, based on the evidence presented that Respondent's damages were difficult and/or impossible to liquidate. The trial court further concluded "This Court cannot say that the

2 The term "AA" refers to the *Appellant's Appendix* of exhibits filed by Appellants with this Court on April 18, 2022.

arbitrator exceeded her authority by weighing the evidence and finding that Petitioners failed to meet their burden." (AA0010.)

Furthermore, as with trial courts, appellate courts apply a highly deferential standard of review to the award itself and the arbitrator's resolution of questions of law or fact, in that the merits of the controversy between the parties are not subject to judicial review. (*Moncharsh, supra,* 3 Cal. 4th at 11; *Cooper v. Lavely & Singer Professional Corp*. (2014) 230 Cal. App. 4th 1, 12). In appellate review of an arbitrator's award, courts may not reweigh the evidence but must view the record in the light most favorable to the arbitrators opinion and award and resolve all evidentiary conflicts and indulge all reasonable inferences in support of the award. (*Hasson v. Ford Motor Co.* (1977) 19 Cal.3d 530, 544; see also, *In re Marriage of Mix* (1975) 14 Cal. 3d 604, 614; *Rodrigues v. Keller* (1980) 113 Cal.App. 3d 838, 843 [it is not appropriate for courts to review the sufficiency of the evidence before the arbitrator or to pass upon the validity of the arbitrators reasoning.].) Here, the arbitrator concluded that "the [Appellants] holds the burden to prove that such default interest provision in the subject loan was invalid as a penalty, and [Appellants] did not meet their burden of proof on this issue." (AA0026-0027).

This Court, concluding that the arbitrator exceeded their powers, reviewed and reversed a factual finding, based on the evidence, of both the arbitrator and the trial court. The court expressly did not apply the deferential substantial-evidence standard but conducted a de novo review. The Court made a critical mistake of law in failing to exercise appropriate deference to the factual findings of either the arbitrator or the trial court. (See, *Advanced Micro Devices, Inc. v. Intel Corp.* (1994) 9 Cal.4th 362, 372 [Although section 1286.2 permits the court to vacate an award that exceeds the arbitrator's powers, the deference due an arbitrator's decision on the merits of the controversy requires a court to refrain from substituting its

judgment for the arbitrator's in determining the contractual scope of those powers.].) For this reason, the Court should grant rehearing as necessary to withdraw its Opinion and affirm the judgment of the Superior Court.

III. The court should grant rehearing to correct several misstatements and omissions of material facts and issues in the opinion.

Rehearing is also appropriate in order to correct any misstatements or omissions of material facts and issues in an appellate opinion. (See *In re Jessup's Estate*, *supra*, 81 Cal. at 471; see also *In re Marriage of Goddard* (2004) 33 Cal.4th 49, 53, fn. 2.) The Court's Opinion contains several misstatements and omissions of material facts and issues. The Court should grant rehearing to correct its analysis of these material facts and issues and withdraw its Opinion and affirm the judgment of the Superior Court. Even if the court were to conclude that correcting these misstatements and omissions would not affect the disposition of the appeal, the court should still grant rehearing to correct these misstatements and omissions because Respondents may seek Supreme Court review of the opinion. (See Cal. Rules of Court, Rule 8.500(c)(2); *Hernandez v. Hillsides, Inc.* (2009) 47 Cal.4th 272, 283, fn. 3 [rejecting factual contention by parties that prevailed in the Court of Appeal because they "did not seek rehearing or modification on this or any other factual point"].)

Specifically, the Court should correct the following misstatements and omissions in its Opinion:

1. The Court's reasoning related to the public policy expressed in Section 1671 is based on a misunderstanding of fact. Under Section 1671, in a non-consumer, or commercial, contract, "a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing

at the time the contract was made." (Cal. Civ. Code § 1671(b).) The public policy expressed in Section 1671 is that, in commercial contracts, the parties to the contract who enter into an agreement for commercial purposes are responsible for ensuring the fairness of its terms. It is the burden of the challenging party to prove, against the presumption of validity, that the provision is invalid. Appellants must prove that the liquidated damages provision at issue bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach. (*Ridgley v. Topa Thrift & Loan Ass'n* (1998) 17 Cal. 4th 970, 977 (*Ridgley*).) The amount set as liquidated damages "must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained." (*Garrett v. Coast & Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, 739 (*Garrett*).) In the absence of such relationship, a contractual clause purporting to predetermine damages is construed as a penalty, except where the fixing of the actual damages would be "impracticable" or "extremely difficult." (*Garrett*, *supra*, 9 Cal.3d at 738; *Ridgley, supra,* 17 Cal. 4th at 977.)

The Court held in its Opinion that Respondents presented only de minimis evidence in support of its argument that fixing the actual damages would be "impracticable" or "extremely difficult." (Typed opn. 11.) However, both the arbitrator and the trial court discussed the fact that Respondents presented more extensive evidence that the damages were difficult and/or impossible to liquidate, due to effects on its balance sheet, their own lending facilities, and the marketability of the loan as submitted in this case. (AA0009, 0027.) The Court misunderstood the facts, having failed to consider all of the evidence presented in the record.

2. The Court based its Opinion, in part, on a mistaken interpretation of *Najarian Holdings LLC v. Corevest American Finance Lender LLC*, (N.D. Cal., Oct. 9, 2020, No. 20-CV-00799-PJH) 2020 WL 5993225 (*Najarian*). The Opinion states that "in *Najarian Holdings LLC v. Corevest American Finance Lender LLC*, [the Federal District Court for the Northern District of California] found late-payment fees calculated as a percentage of the outstanding principal balance to be void under section 1671." (Typed opn. 5.) However, in *Najarian*, the court did not consider late-payment fees under Section 1671 substantively. In *Najarian,* the court narrowly considered the sufficiency of a complaint subject to a motion to dismiss and strike and concluded that the plaintiff made sufficient allegations related to Section 1671 to survive a motion to dismiss. *Najarian* is not a substantive ruling on the law, but a review of the pleading to determine if the allegations were sufficient to continue with an eventual adjudication on the merits.
3. The Court failed to consider whether the arbitrator's award could have been corrected without affecting the merits of the decision upon the controversy submitted, which is a required element of the narrow exception under Cal. Civ. Proc. Code § 1286.2(a)(4). An arbitrator's award may be vacated if the court determines the arbitrator exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted. (Cal. Civ. Proc. Code § 1286.2(a)(4).) The Court reversed the order of the trial court and ordered Appellants to recover their costs. While the Court made a lengthy analysis of whether the arbitrator exceeded her powers, the Court did not consider or discuss whether the arbitrator's award could have been corrected without affecting the merits of the decision upon the controversy submitted.

The use of the conjunctive "and" makes it clear that any attempt to void the decision of an arbitrator requires both elements of Section 1286.2(a)(4) to be met.

4. The Court made a mistake of law when it considered evidence which was not put before the trial court for its consideration. In its petition to the trial court, Appellants failed to attach a copy of either their original or their amended demand for arbitration. The trial court found that "[t]he Court cannot determine that the arbitrator exceeded her powers without reviewing the claims that were put before her. On that basis alone, Petitioners have failed to meet their burden to warrant vacating the award. [Citations.]" (AA0009).

In a clear contravention of established law, Appellants attached a copy of both their original and their amended demand for arbitration to their appendix for the Court's review – evidence which was not put before the trial court. (AA0185-0199). Factfinding is the "basic responsibility" of trial courts "rather than appellate courts." (*Pullman-Standard v. Swint* (1982) 456 U.S. 273, 291 [quoting *DeMarco v. United States* (1974) 415 U.S. 449, 450 n.22]; see also *Zenith Radio Corp. v. Hazeltine Research, Inc.* (1969) 395 U.S. 100, 123 ["appellate courts must constantly have in mind that their function is not to decide factual issues"].) It is "the province of the trial court to decide questions of fact and of the appellate court to decide questions of law." (*In re Zeth S.* (2003) 31 Cal. 4th 396, 405 [quoting *Tupman v. Haberkern*, (1929) 208 Cal. 256, 262-63.].) A consequence of this division is that an appellate court's review is cabined by the universe of facts that were "before the trial court for its consideration." (*Zeth S.*, *supra*, 31 Cal. 4th at 405.) "Generally, documents and facts that were not presented to the trial court and which are not part of the record on appeal cannot be considered on

appeal." (*Truong v. Nguyen* (2007) 156 Cal. App. 4th 865, 882.) Neither the demand for arbitration or amended demand for arbitration are proper evidence upon which the Court's Opinion should have been based.

5. The Court made a mistake of law when it shifted the burden of proof to Respondents. Under Section 1671, a liquidated damages provision in a commercial contract is presumed valid; it is the burden of the party seeking to invalidate the provision to establish that it was unreasonable under the circumstances existing at the time the contract was made. (Cal. Civ. Code § 1671(b).) Thus, Appellants bear the burden of proving that the liquidated damage provision underlying this action was unreasonable under the circumstances existing at the time the contract was made. The provision is presumptively valid, but the Court's Opinion reads decidedly as a ruling that *Respondents* failed to meet a burden which they did not and do not bear. The Court's Opinion held that Respondents presented only de minimis evidence in support of its arguments. (Typed opn. 11.) However, it is clear by the very statute that it is not the Respondents burden to prove validity of the liquidated damage clause because it is presumed valid. The Opinion is based upon an improper shifting of the evidentiary burden to Respondents.
6. The Court made a mistake of law in failing to consider all of the circumstances and only deciding based on an "actual damages" analysis. Recently, on October 12, 2022, the California Court of Appeal for the Third Appellate District also had occasion to consider the reasonableness of a liquidated damage clause under Section 1671. (See *Gormley v. Gonzalez* (Cal. Ct. App. Oct. 12, 2022) No. C093201, 2022 WL 6924078.) In *Gormley* the court made an in-depth analysis of the legislative intent behind Section 1671 and the

proper standard of review for determining whether a liquidated damages provision is reasonable.

The legislature has long been invested in the calculation of liquidated damages. Section 1670, enacted in 1872, formerly provided that a liquidated damage provision was void unless it complied with the former version of Section 1671, which stated: " 'The parties to a contract may agree therein upon an amount which shall be presumed to be the 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 damages.' " (*Gormley*, *supra*, 2022 WL 6924078, at *3.) However, in 1977, the California Legislature adopted the recommendation of a California Law Revision Commission (the Commission) which repealed section 1670 and amended section 1671. (*Id.* at 4.) Pursuant to the amendment, for non-consumer contracts Section 1671(b) created " 'a *new general rule* favoring the enforcement of liquidated damages provisions.' " (*Id.* at 4 [citing Cal. Law Revision Com. com., Deering's Ann. Civ. Code (2005 Ed.) foll. § 1671, p. 392.].) The reversal of the presumption of invalidity was made for the express purpose of allowing "parties with relatively equal bargaining power . . .to develop and agree to a reasonable liquidated damages provision with assurance that the provision will be held valid." (Recommendation Relating to Liquidated Damages (Dec. 1976) 13 Cal. Law Revision Com. Rep. (1976) p. 1742.) Additionally, the Commission stated that to determine the reasonableness of a particular liquidated damage provision:

> " '*All* the circumstances existing at the time of the making of the contract are considered, *including* the relationship that the damages provided in the contract bear to the range of harm that reasonably could be

> anticipated at the time of the making of the contract. *Other relevant considerations* in the determination of whether the amount of liquidated damages is so high or so low as to be unreasonable *include, but are not limited to*, such matters as the relative equality of the bargaining power of the parties, whether the parties were represented by lawyers at the time the contract was made, the anticipation of the parties that proof of actual damages would be costly or inconvenient, the difficulty of proving causation and foreseeability, and whether the liquidated damages provision is included in a form contract.' "

(*Gormley*, *supra*, 2022 WL 6924078, at *4 [citing Recommendation Relating to Liquidated Damages (Dec. 1976) 13 Cal. Law Revision Com. Rep. (1976) p. 1742], emphasis in original; see also *Weber, Lipshie & Co. v. Christian* (1997) 52 Cal.App.4th 645, 654-656 [quoting Commission's comment, and using it to decide validity of liquidated damages provision].)

"In nonconsumer cases, then, courts are directed to consider *all* circumstances, not just whether it would be difficult to fix the amount of actual damages and whether the amount selected is a reasonable estimate of the loss that could be anticipated." (*Gormley*, *supra*, 2022 WL 6924078, at *4.) While an estimate of the actual damages is certainly a consideration when determining whether the provision is unreasonable, it is *not the sole consideration*.

Here, the Court did not consider circumstances beyond actual damages in its Opinion. The Court did not consider that Respondent Nicholas Honchariw is an experienced attorney and investor, a fact considered by both the arbitrator and the trial court. There is no evidence of inequality of bargaining power between Respondents and Appellants. In contravention of legislative intent, the Court solely considered the liquidated damage provision according to the

outdated scheme in *Ridgley*. While this Court concludes that the amendment of Section 1671 had no effect on its analysis under *Ridgley*, the Third Appellate District concurrently came to the opposite conclusion.

7. Pursuant to Rule 8.1125 of the California Rules of Court, Respondents respectfully request that the Opinion not be published in the event Respondents petition for rehearing is denied. If this Court grants Respondents petition for rehearing, it should order that the Opinion is not citable pending review. (See Cal. Rules of Court, Rule 8.1115(e)(3).) The Opinion deviates from well-established law concerning the reviewability of arbitrator's decisions, and thus creates confusion in the law. It also employs broad language that could be misinterpreted to expand the Court's holding related to Section 1671 to apply to all liquidated damage clauses calculated according to the amount of unpaid principal, without allowing for the difficult and/or impossible exception articulated in *Garrett* and *Ridgley*.

IV. The Court has jurisdiction to rule on this petition until October 31, 2022.

A petition for a rehearing must be sought within 15 days after the filing of the decision. (Cal. Rules Crt., Rule 8.268(b)(1)(a).) This Court's decision was filed September 29, 2022. Therefore, this petition is timely.

A Court of Appeal may rule on a petition for rehearing at any time before the decision becomes final. (Cal. Rules Crt., Rule 8.268(a).) Decisions become final 30 days after filing. (Cal. Rules Crt., Rule 8.264(b)(1).) 30 days after the Opinion was filed is October 29, 2022, which is a Saturday. The Code of Civil Procedure governs computing and extending the time to do any act required or permitted under the California Rules of Court. (Cal. Rules Crt., Rule 8.60(a).) Saturdays and Sundays are

considered holidays under the California Code of Civil Procedure, thus the deadline for this Court's decision to become final is the next day from October 29, 2022 that is not a holiday, which is October 31, 2022. (Cal. Civ. Proc. Code §§ 12, 12(a), 12(b).) Therefore, this Court retains jurisdiction to rule on this Petition until October 31, 2022.

CONCLUSION

For the reasons stated above, the court should grant rehearing as necessary to withdraw its Opinion and affirm the judgment of the Superior Court.

Respectfully submitted,

Dated: October 14, 2022

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CERTIFICATE OF WORD COUNT

I, the undersigned appellate counsel, certify that this brief consists of 4,116 words, exclusive of cover page, table of contents, table of authorities, and certificate, pursuant to California Rules of Court, Rule 8.204(c)(5), relying on the word count of the Microsoft Word computer program used to prepare the brief.

Dated: October 14, 2022

Adeline R. Tungate

ATTACHMENT: COURT OF APPEAL OPINION

Filed 9/29/2022

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION THREE

NICHOLAS AND SHARON HONCHARIW, Petitioners and Appellants, v. FJM PRIVATE MORTGAGE FUND, LLC, et al., Defendants and Respondents.	A163756 (Sonoma County Super. Ct. No. SCV267331)

In the case before us, petitioners and appellants Nicholas and Sharon Honchariw took out a loan secured by real property. When they defaulted, the lender imposed a late-payment fee provided for in their loan agreement. The Honchariws commenced arbitration, in which they contended the late-payment fee was unlawful (1) pursuant to regulations applicable to a mortgage-loan originator with a license regulated by the Department of Real Estate, and (2) because it was a liquidated damage constituting an unlawful penalty in violation of section 1671.[1] The arbitrator denied both claims. A petition to vacate the arbitration award in the trial court failed, and the order on that petition was appealed.

[1] Unless otherwise specified, all further statutory references are to the Civil Code.

We shall reverse as the trial court erroneously failed to vacate an award that constitutes an unlawful penalty in contravention of the public policy set forth in section 1671.

FACTUAL AND PROCEDURAL BACKGROUND

Nicholas and Sharon Honchariw took out a $5.6 million dollar bridge loan, with 8.5% interest assessed per annum, secured by a first lien deed of trust on real property. Included in the record on appeal is a "NOTE SECURED BY A DEED OF TRUST," dated "12/13/2018" and executed between "FJM Private Mortgage Fund, LLC a California Limited Liability Company, as to an undivided 100.00% interest (CFL License # 6054701) (who will be called 'Lender')" and Nicholas and Sharon Honchariw (the "Loan"). (FJM Private Mortgage Fund, LLC is hereinafter referred to as "FJM Fund.")

The Honchariws defaulted on their September 1, 2019, monthly payment. By missing that payment of $39,667, the Honchariws triggered certain late-payment fee provisions set forth in the Loan: (1) a one-time 10% fee assessed against the overdue payment ($3,967); and (2) a default interest charge of 9.99% per annum assessed against the total unpaid principal balance of the Loan ("any unpaid principal balance of the loan at the time of default shall bear interest at the rate of nine and ninety-nine percent (9.99%) . . . above the herein stated note rate, automatically and without notice, from the time of default, until this Note has been paid in full, or until the specific default has been cured"). We shall refer to the sum of these amounts as the "Late Fee."

The Honchariws filed a demand for arbitration on October 7, 2019. The arbitration demand alleged (1) the Loan was in violation of the "Real Estate Loan [L]aw," (Business & Professions Code § 10240, et seq.), and (2) the Late Fee was an unlawful penalty in violation of section 1671. "First Bridge

Lending" and "FJM Capital, Inc." (hereinafter jointly referred to as "FJM Capital") averred the loan was not subject to the Real Estate Loan Law, and that the late-payment fee did not violate section 1671. The arbitrator agreed with FJM Capital on both points and denied the demand for arbitration. We shall refer to the arbitration award as "the Award."

The Honchariws petitioned to vacate the Award in November 2020. They sought to vacate the Award on the basis that the arbitrator exceeded their authority by denying claims in violation of "nonwaivable statutory rights and/or contravention of explicit legislative expressions of public policy," specifically identifying both the rights protected by the Real Estate Loan Law's prohibition against lenders charging more than 10% of the installment amount due (Bus. & Prof. C., §§ 10248.1, 10242.5) and section 1671.

The trial court denied the petition, holding the Honchariws " 'did not meet their burden of proof' to show that the 'default interest provision in the subject loan was invalid as a penalty. . . .' " "[E]ven when the Court considers the evidence presented in this motion, the Court cannot conclude that the arbitrator exceeded her powers by denying [the Honchariws'] claims."

A timely appeal ensued.

DISCUSSION

I. Standard of Review and Governing Law

An arbitrator's decision "is not generally reviewable for errors of fact or law, whether or not such error appears on the face of the award and causes substantial injustice to the parties." (*Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 6 (*Moncharsh*).)[2] Code of Civil Procedure section 1286.2 provides

[2] The parties dispute whether the trial court conducted a de novo review of the arbitral decision in addition to its deferential review and the trial court order itself is not clear on the standards employed. As explained, *infra*, we review the arbitrator's decision on a de novo basis. Therefore, the

an exception to this general rule where "[t]he arbitrators exceeded their powers and the award cannot be corrected without affecting the merits of the decision upon the controversy submitted." (Code Civ. Proc., § 1286.2, subd. (a)(4); see also, *City of Palo Alto v. Service Employees Internat. Union* (1999) 77 Cal.App.4th 327, 333.)

"Arbitrators may exceed their powers by issuing an award that violates a party's unwaivable statutory rights or that contravenes an explicit legislative expression of public policy. [Citations.]" (*Richey v. AutoNation, Inc.* (2015) 60 Cal.4th 909, 916 (*Richey*).) The public policy so contravened must be a "well-defined and dominant" public policy as "ascertained 'by reference to the laws and legal precedents and not from general considerations of supposed public interests.' " (*W.R. Grace and Co. v. Local Union 759, Intern. Union of United Rubber, Cork, Linoleum and Plastic Workers of America* (1983) 461 U.S. 757, 766 (*W.R. Grace*); see also *Department of Human Resources v. International Union of Operating Engineers* (2020) 58 Cal.App.5th 861, 873–880.) " '[W]hether the arbitrator exceeded his or her powers . . ., and thus whether the award should have been vacated on that basis, is reviewed on appeal de novo.' [Citation.]" (See *Ahdout v. Hekmatjah* (2013) 213 Cal.App.4th 21, 33.)

A brief review of section 1671 is sufficient to conclude that it expresses "well-defined and dominant" public policy such that a challenge predicated thereon escapes the general prohibition against review of arbitral decisions. (See *W.R. Grace*, *supra*, 461 U.S. at p. 766; *Moncharsh*, *supra*, 3 Cal.4th at pp. 31–33; *Richey*, *supra*, 60 Cal.4th at p. 916.)

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standards applied by the trial court, including any potential error resulting from the standard applied, is of no consequence.

Section 1671 provides that a liquidated damages provision is either presumptively valid or invalid depending upon the subject matter of the contract. If the contract involves "the retail purchase, or rental . . . of personal property or services, primarily for . . . personal, family, or household purposes," (§ 1671, subd. (c)(1)), or involves "a lease of real property for use as a dwelling," (§ 1671, subd. (c)(2)), then a liquidated damages provision in that contract is presumptively void. (§ 1671, subd. (d).) We shall refer to those contracts described by subdivisions (c)(1)–(c)(2) as "consumer contracts." For all other contracts, which we shall refer to as "non-consumer contracts," "a provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made." (§ 1671, subd. (b).)

Simply put, a liquidated damages provision is presumed valid if it is in a non-consumer contract but presumed invalid if it is in a consumer contract. (See *Ridgley v. Topa Thrift & Loan Assn.* (1998) 17 Cal.4th 970, 977 (*Ridgley*).) The case before us involves a non-consumer contract as it is neither for the purchase of property for personal use nor does it involve a primary dwelling. (§ 1671, subds. (c)(1)–(c)(2).) Whether or not an agreement is a non-consumer contract or consumer contract, it may not violate public policy.

Section 1671 expresses clear public policy as "ascertained 'by reference to the laws and legal precedents and not from general considerations of supposed public interests.' " (*W.R. Grace, supra*, 461 U.S. at p. 766.) It is the public policy of California that liquidated damages bear a "reasonable relationship" to the actual damages that the parties anticipate would flow from breach; conversely, if the liquidated damages clause fails to so conform,

it will be construed as an unenforceable "penalty." (*Garrett v. Coast & Southern Fed. Sav. & Loan Assn.* (1973) 9 Cal.3d 731, 739 (*Garrett*).) The amount set as liquidated damages "must represent the result of a reasonable endeavor by the parties to estimate a fair average compensation for any loss that may be sustained." (*Ibid.*) In the absence of such relationship, a contractual clause purporting to predetermine damages "must be construed as a penalty." (*Ibid.*) "Civil Code section 1671 and the case law interpreting it aim to combat unfair and unreasonable *coercion* arising from an imbalance of bargaining power." (*Constellation-F, LLC v. World Trading 23, Inc.* (2020) 45 Cal.App.5th 22, 27.)

Because an arbitrator may exceed their powers by enforcing a contract that is in violation of public policy, we conclude de novo review is appropriate. (*Moncharsh*, *supra*, 3 Cal.4th at p. 31.) "Based on section 1671(b)'s presumption that liquidated damage provisions in nonconsumer contracts are valid, the party challenging the provision bears the burden to show the provision was unreasonable under the circumstances existing when the parties entered into the contract. [Citations.]" (*Vivatech Internat., Inc. v. Sporn* (2017) 16 Cal.App.5th 796, 806.)

II. The Late Fee Violates Civil Code Section 1671[3]

The Late Fee provided for the following penalty based on even one missed monthly payment at any time during the life of the Loan: a one-time 10% fee of the overdue monthly payment and a default interest charge of 9.99% per annum assessed against the total amount of unpaid principal balance of the Loan.

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[3] We do not reach the issue of which regulatory scheme governed the Loan as it is not necessary to do so in order to resolve this appeal.

As our Supreme Court explained in *Garrett*, late-payment fees serve a "dual purpose." First, they are "compensat[ion] [to] the lender for its administrative expenses and the cost of money wrongfully withheld." (*Garrett*, *supra*, 9 Cal.3d at pp. 739–740.) Second, "they encourage the borrower to make timely future payments." (*Ibid.*) Late-payment fees, however, may violate section 1671 and amount to unlawful penalties if their "primary purpose is to compel prompt payment through the threat of imposition of charges bearing little or no relationship to the amount of the actual loss incurred by the lender." (*Id.* at p. 740.)

The late-payment fee reviewed in *Garrett* was assessed against the "*unpaid principal balance of the loan obligation.*" (*Garrett*, *supra*, 9 Cal.3d at p. 740, italics in original.) Our Supreme Court held that such "a charge for the late payment of a loan installment which is measured against the unpaid balance of the loan must be deemed to be punitive in character." (*Ibid.*) The Court reasoned this is because "[i]t is an attempt to coerce timely payment by a forfeiture which is not reasonably calculated to merely compensate the injured lender." (*Ibid.*) Further, "a borrower on an installment note cannot legally agree to forfeit what is clearly a penalty in exchange for the right to exercise an option to default in making a timely payment of an installment." (*Id.* at p. 737.)

FJM Capital argues that *Garrett* cannot be relied upon to decide the legality of the Late Fee here imposed because it reviewed a prior version of section 1671 (revised effective July 1, 1978) that made all liquidated damages provisions (regardless of the characterization of the contract at issue) presumptively invalid. It goes so far as to say that *Garrett* was "legislatively overruled" with the enactment of current section 1671. We disagree. While the current version of section 1671 declares all liquidated damages clauses

presumptively invalid as to consumer contracts (as opposed to all contracts),[4] *Garrett* remains good law for the proposition that a late fee assessed against the entire unpaid balance of a loan constitutes an unlawful penalty and there is nothing in current section 1671 or the case law following *Garrett* holding otherwise.

In *Ridgley*, *supra*, 17 Cal.4th at pp. 977–982, decided two decades after the enactment of current section 1671, our Supreme Court considered the legality of a liquidated damages provision in a non-consumer contract, specifically referring to section 1671, subdivision (b). (See *Ridgley*, *supra*, 17 Cal.4th at p. 977 [" '[A] provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.' "].) It reversed the lower court, finding a promissory note to contain an unlawful penalty where it imposed six months' interest if the borrowers prepaid the loan principal, but also provided that the six months' interest charge would not be imposed six months after execution of the note unless the borrowers had made a late interest payment or otherwise defaulted. (*Id.* at p. 980.)

In so doing, it cited to *Garrett* approvingly and without reservation: " 'a charge for the late payment of a loan installment which is measured against the unpaid balance of the loan must be deemed to be punitive in character. It

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[4] Former section 1670 provided: " '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 the next section.' " Former section 1671 read: " 'The parties to a contract may agree therein upon an amount which shall be presumed to be the 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.' " (See *Garrett*, *supra*, 9 Cal.3d at p. 734, fn. 1.)

is an attempt to coerce timely payment by a forfeiture which is not reasonably calculated to merely compensate the injured lender.' ([*Garrett*, *supra*, 9 Cal.3d] at p. 740, fn. omitted; [Citations.]") (*Ridgley*, *supra*, 17 Cal.4th at p. 978.)[5] As the *Ridgley* court explained: "In short, '[a]n amount disproportionate to the anticipated damages is termed a "penalty." ' " (*Id.* at p. 972.) "A contractual provision imposing a 'penalty' is ineffective, and the wronged party can collect only the actual damages sustained." (*Perdue v. Crocker National Bank* (1985) 38 Cal.3d 913, 931; see also *Ebbert v. Mercantile Trust Co. of California* (1931) 213 Cal. 496, 499 ["[A]ny provision by which money or property would be forfeited without regard to the actual damage suffered would be an unenforceable penalty."].)

More recently, in another non-consumer contract case, the Federal District Court for the Northern District of California, in *Najarian Holdings LLC v. Corevest American Finance Lender LLC*, found late-payment fees calculated as a percentage of the outstanding principal balance to be void under section 1671. (*Najarian Holdings LLC v. Corevest American Finance Lender LLC*, 2020 U.S. Dist. LEXIS 188667, 2020 WL 5993225 at pp. *1–2 (N.D. Cal. Oct. 9, 2020) [plaintiffs are in the business of purchasing residences at foreclosure sales and then reselling those residences].) In so doing, it applied *Ridgley*, *supra*, 17 Cal.4th at p. 977, which quotes to the passage reproduced above from *Garrett*. (See *Najarian Holdings LLC v. Corevest American Finance Lender LLC*, at p. *2.) Subsequent California

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[5] Moreover, even though the loan at issue in *Garrett* was extended to finance a primary residence, and thus, would today be considered a "consumer" loan, (*Garrett*, *supra*, 9 Cal.3d at p. 739), *Ridgley* cited *Garrett* to reiterate the same principle, i.e., that late-payment fees assessed upon the entire unpaid balance of a loan is an unenforceable penalty as a matter of law. (*Ridgley*, *supra*, 17 Cal.4th at p. 978.)

appellate court decisions have also cited *Garrett*, *supra*, 9 Cal.3d at pp. 739–740 approvingly, albeit in dicta. (See *Creditors Adjustment Bureau, Inc. v. Imani* (2022) 82 Cal.App.5th 131, 136; *Greentree Financial Group, Inc. v. Execute Sports, Inc.* (2008) 163 Cal.App.4th 495, 501.)[6]

The two cases primarily relied upon by FJM Capital – *Walker v. Countrywide Home Loans, Inc.* (2002) 98 Cal.App.4th 1158, 1171 (*Walker*) and *Hoffman v. Security Pacific National Bank* (1981) 121 Cal.App.3d 964, 967, fn. 1 (*Hoffman*) – are readily distinguishable and do not assist our analysis. *Walker* was concerned with whether property inspection fees should be considered late-payment fees for purposes of section 2954.4, which limits late-payment fees for certain single-family dwellings. (*Walker*, *supra*, 98 Cal.App.4th at pp. 1165–1166.) In reviewing the evolution of the law of liquidated damages as applied to single-family dwellings, the *Walker* court observed that *Garrett* analyzed a since-superseded liquidated damages statute and cited to *Garrett* to illustrate the functions of liquidated damages clauses. (*Walker*, *supra*, 98 Cal.App.4th at p. 1171.) In dicta, the *Walker* court stated that if the liquidated damages issue were before it, it would affirm, as the late-payment fee imposed by the lender bore a reasonable relationship to the damages the parties expected the lender to sustain upon breach, thereby satisfying section 1671. (*Id.* at p. 1172.) *Hoffman* was concerned with whether a bank's charges for its customers writing insufficient funds checks amounted to penalty damages. (*Hoffman*, *supra*, 121 Cal.App.3d at pp. 968–969.) Neither *Walker* nor *Hoffman* addressed whether *Garrett* remains good law for the proposition that liquidated

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[6] *Garrett*, *supra*, 9 Cal.3d at page 739, is also cited by a leading real estate treatise for the general proposition that late-payment fees cannot be assessed against the unpaid principal of a secured loan. (See Miller & Starr, Calif. Real Estate (4th ed., 2022), § 13:96.)

damages assessed against the unpaid principal balance of a loan are unreasonably related to the lender's expected damages as a matter of law.

Finally, FJM Capital argues that, whether or not *Garrett* controls, the Late Fee represents the parties' attempt to calculate FJM Capital's anticipated damages in the event of default and whatever the parties agreed to is lawful. This argument is premised upon the parties' statement in the Loan documentation that FJM Fund would incur difficult to estimate expenses[7] as a result of default coupled with the conclusory and de minimis testimony of Louis Bardis, the "principal owner and managing director" of FJM Capital. Bardis was asked whether " 'the late charge was in fact representing a fair and reasonable estimate.' " He answered: " 'Yes.' " There were no follow-up questions and no documentary support. Bardis' one-word answer and the parties' blanket statements in the Loan documentation are insufficient to support a finding that FJM Capital had attempted to estimate their damages in the amount of breach and that the Late Fee represents the reasoned outcome of such an attempt. The answer " '[y]es' " is not a demonstration of a "reasonable relationship" between the Late Fee and "the range of actual damages that the parties could have anticipated would flow from a breach." (*Ridgley*, *supra*, 17 Cal.4th at p. 977.)

FJM Capital also cites two bankruptcy cases – *East West Bank v. Altadena Lincoln Crossing, LLC* (C.D. Cal. 2019) 598 B.R. 633 (*East West*) and *In re 3MB, LLC* (E.D. Cal. 2019) 609 B.R. 841 (*3MB*) – for the proposition

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[7] The Loan indicates that the Late Fee will be assessed because a default, "will result in [FJM Fund] incurring additional expense in servicing the loan, including, but not limited to sending out notices of delinquency, computing interest, and segregating the delinquent sums from not delinquent sums on all accounting, loan and data processing records, in loss to [FJM Fund] of the use of the money due, and in frustration to [FJM Fund] in meeting its other financial commitments."

that "[t]he amount of damages [a lender] actually incurred is irrelevant to the reasonableness of the liquidated damages clause." (*3MB*, *supra*, 609 B.R. at p. 851.) FJM Capital argues that actual damages are not relevant where the parties agree in the loan documents that a liquidated damages amount is reasonable.

This argument fails. In both *East West* and *3MB*, the borrower defaulted on fully matured obligations and was assessed a default interest at maturity. (See *East West*, *supra*, 598 B.R. at p. 636; *3MB*, *supra*, 609 B.R. at p. 848.) Here, just as in *Garrett*, the borrower defaulted on a partially mature obligation and was given a choice between making their note payment or defaulting and facing a "coercive" penalty. (*Garrett*, *supra*, 9 Cal.3d at p. 740.) *3MB* itself noted that our Supreme Court in *Garrett* recognized the significance of the charge being assessed against the entire principal for a partially matured obligation:

> "The [*Garrett*] court held that late charges based on the entire unpaid [principal] balance for failure to pay an installment was punitive and was not rationally calculated to merely compensate the injured lender. [Citation.] *Garrett* specifically distinguished *Thompson* [*v. Gorner* (1894) 104 Cal. 168 (*Thompson*)],[8] noting that at maturity, the borrower in *Thompson* 'owed only what he had contracted to pay had there been no default, the principal amount plus accrued interest. If these amounts were not then paid, the parties agreed that interest at the higher rate would accrue.' [*Garrett*, *supra*, 9 Cal.3d at p. 737.] That is precisely the situation here. 3MB failed to pay the 'balloon' at maturity and default interest began to accrue."

(*3MB*, *supra*, 609 B.R. at pp. 848–849.)

Further, FJM Capital's position that the language of the Loan must govern the result is belied by the language in section 1671 that contains

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[8] As the *3MB* court summarized *Thompson*: "[D]efault interest following note maturity has long been allowed in California without resort to a liquidated damages analysis." (*3MB*, *supra*, 609 B.R. at p. 848.)

presumptions, and not conclusions, regarding the validity of a liquidated damages provision. If, as FJM contends, the validity of a given clause were purely a function of agreement and the Legislature intended to "legislatively overrule" former section 1671, it could have provided that liquidated damages provisions in non-consumer contracts are lawful, full stop. Instead, the Legislature provided for a presumption of validity (in non-consumer contracts), which in no way precludes a finding of invalidity where a liquidated damages presumption violates public policy. (See *Becerra v. Superior Court* (2020) 44 Cal.App.5th 897, 917.) The Honchariws cannot be legally bound by an agreement to pay a late-payment fee that violates public policy. (See *Wilson v. Stearns* (1954) 123 Cal.App.2d 472, 480.)

In sum, based on *Garrett* and its progeny, liquidated damages in the form of a penalty assessed during the lifetime of a partially matured note against the entire outstanding loan amount are unlawful penalties. Not surprisingly, our review of the caselaw reveals no case in which a liquidated damages provision was upheld when a borrower missed a single installment, and then was penalized pursuant to that provision, even in part, by a late-payment fee assessed upon the entire outstanding principal balance, much of it still to be owed. Put another way, by its very existence, the Honchariws have met their burden of showing an unlawful penalty.[9] (*Garrett*, *supra*, 9 Cal.3d at p. 740.)

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[9] The Restatement (Second) of Contracts summarizes this principle as follows: "The central objective behind the system of contract remedies is compensatory, not punitive. Punishment of a promisor for having broken his promise has no justification on either economic or other grounds and a term providing such a penalty is unenforceable on grounds of public policy." (§ 356 Liquidated Damages and Penalties.)

Thus, because the Late Fee includes a 9.99% interest rate assessed against the entire unpaid principal balance of the Loan at any time a single payment is missed, it is indistinguishable from the late-payment fee invalidated in *Garrett*. We shall reverse.

DISPOSITION

The order is reversed. The Honchariws shall recover their costs on appeal.

Petrou, J.

WE CONCUR:

Fujisaki, Acting P.J.

Rodríguez, J.

Trial Court:	Sonoma County Superior Court
Trial Judge:	Hon. Jennifer Dollard
Counsel:	Nicholas Honchariw, in pro. per., for Petitioners and Appellants. Law Offices of Mark J. Romeo, Mark J. Romeo for Defendants and Respondents.

PROOF OF SERVICE
STATE OF CALIFORNIA, COUNTY OF LOS ANGELES

I am employed in the County of Orange, State of California. I am over the age of 18 and not a party to the within action; my business address is 90 Discovery, Irvine, California 92618.

On October 14, 2022, I served the foregoing document described as: **PETITION FOR REHEARING** on the interested parties in this action as follows:

SEE ATTACHED SERVICE LIST

[X] BY MAIL: I deposited such envelope in the mail at Irvine, California. The envelope was mailed with postage thereon fully prepaid. I am "readily familiar" with the firm's practice of collection and processing correspondence for mailing. Under that practice it would be deposited with U. S. postal service on that same day with postage thereon fully prepaid at Irvine, California in the ordinary course of business. I am aware that on motion of the party served, service is presumed invalid if postal cancellation date or postage meter date is more than one day after date of deposit for mailing in affidavit.

[] **BY OVERNIGHT DELIVERY:** I placed the sealed envelope(s) or package(s) designated by the express service carrier for collection and overnight delivery by following the ordinary business practices of Geraci Law Firm. I am readily familiar with the firm's practice for collecting and processing of correspondence for overnight delivery, said practice being that, in the ordinary course of business, correspondence for overnight delivery is deposited with delivery fees paid or provided for at the carrier's express service offices for next-day delivery the same day as the correspondence is placed for collection.

[ ] BY FACSIMILE TRANSMISSION: Based on agreement of the parties to accept service by facsimile transmission, I transmitted said documents to the offices of the addressee(s) listed above via facsimile. No error was reported by the facsimile machine that I used.

[X] BY ELECTRONIC MAIL [EMAIL]: Based on a court order or an agreement of the parties to accept service by e-mail or electronic transmission via Court's Electronic Filing System (EFS) operated by ImageSoft TrueFiling (TrueFiling) as indicated on the attached service list:

I declare under penalty of perjury under the laws of the State of California that the above is true and correct.

Executed October 14, 2022, at Irvine, California.

By: /s/ Angel Lewis
ANGEL M. LEWIS

SERVICE LIST

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