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December 2, 2022

Chief Justice Tani Cantil-Sakauye and Associate Justices
Supreme Court of California
350 McAllister Street
San Francisco, CA 94102-4797

Via TrueFiling

RE: *Honchariw v. FJM Private Mortgage Fund, et al.*
Supreme Court Case No. S277159
Amicus Letter in Support of Petition for Review or, in the Alternative, Request for Depublication:

Dear Chief Justice Cantil-Sakauye and Associate Justices:

The Mortgage Bankers Association, the California Mortgage Bankers Association, the California Mortgage Association, the National Private Lenders Association, and the American Association of Private Lenders, (collectively, "Lender Amici") hereby submit this amicus letter pursuant to California Rules of Court Rule 8.500(g) in support of the above-referenced petition for review filed by petitioners FJM Private Mortgage Fund, FJM Capital, Inc. dba First Bridge Lending, and FJM Management, LLC dba First Bridge Lending (collectively, "Petitioners").

I. Interest of Lender Amici:

The Lender Amici are financial services industry groups that, collectively, represent hundreds of institutional and private lenders, loan servicers, mortgage brokers, and ancillary service providers involved in the making, servicing, and enforcement of real estate secured loans to both individuals and businesses in the State of California and throughout the nation. A large number of these loans include arbitration clauses and/or default interest provisions. As such, the members of the Lender Amici are directly and adversely impacted by the published decision of the First Appellate District in the case of *Honchariw v. FJM Private Mortgage Fund.,* Case No. A163756, which was issued on September 29, 2022. Although Petitioners in this action are private money lenders, the potential impact of the appellate court's decision is not limited only to loans by private money lenders. Indeed, as to the opinion's potential impact on arbitrations in general, it is not limited to the financial services industry at all and, as a result, provides an even greater concern and risk as to *any* arbitration agreement and proceeding.

II. Reasons to Grant Review:

Pursuant to Rule 8.500(b), the grounds for review by this Court are:

(1) When necessary to secure uniformity of decision or to settle an important question of law;

(2) When the Court of Appeal lacked jurisdiction;

(2) When the Court of Appeal decision lacked the concurrence of sufficient qualified justices; or

(3) For the purpose of transferring the matter to the Court of Appeal for such proceedings as the Supreme Court may order.

The applicable grounds urged by the Petition here are under the first prong. The Petition seeks to raise three questions with respect to the non-consumer loan that was the subject of the decision: (1) whether Civil Code § 1671 requires consideration of the circumstances surrounding the creation of the contract in order to evaluate the enforceability of a liquidated damages clause; (2) whether, as a matter of public policy, the liquidated damages must bear a reasonable relationship to the actual damages; and (3) whether the appellate court erred in finding that the arbitrator's award was in excess of her powers as contravening public policy.[1]

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[1] Although not listed as one of the two issues in the Petition, the Petition analyzes this issue in Section II of the Argument.

Although the appellate court here cited to this Court's opinion in *Moncharsh v. Heily & Blase, Inc.* (1992) 3 Cal. 4th 1, the appellate court nonetheless sought to avoid the strictures of the holding in that case by a dubious determination that the arbitrator had exceeded her powers by making an award in violation of the public policy behind Civil Code § 1671. In essence, the appellate court here disagreed with the arbitrator's interpretation of the law—which is not supposed to be reviewable absent a provision allowing such review in the arbitration agreement. *Moncharsh, supra,* at 11: "Thus, it is the general rule that, with narrow exceptions, an arbitrator's decision cannot be reviewed for errors of fact or law. In reaffirming this general rule, we recognize there is a risk that the arbitrator will make a mistake. That risk, however, is acceptable for two reasons. First, by voluntarily submitting to arbitration, the parties have agreed to bear that risk in return for a quick, inexpensive, and conclusive resolution to their dispute."

Despite this clear pronouncement by this Court, the appellate court invoked the exception under CCP § 1286.2(a)(4), claiming that the arbitrator's supposed error of law was actually an action in excess of her powers due to the putative public policy concerns under § 1671. Specifically, by not pointing out any other public policy concerns, the appellate court seems to have treated the liquidated damages provision as if the former version of § 1671 (which made such provisions presumptively invalid for <u>both</u> consumer and non-consumer contracts), was still in effect. However, the appellate court failed to provide any cogent analysis of why such provisions should still be deemed to violate public policy. Indeed, the Opinion even acknowledges that, as amended, § 1671 now makes liquidated damages provisions in business agreements presumptively valid, and notes that, in order to be valid, they must bear some reasonable relation to the damages caused by the breach.

Rather than engage in any analysis of the circumstances surrounding the default interest provision at issue or the reasonableness of the charge in light of the potential damages to this lender, the appellate court appears to have simply assumed that the charging of default interest on the entire balance of a loan must always be an unlawful penalty.[2] (*See* appellate opinion at p.13 ["by its very existence, the Honchariws have met their burden of showing an unlawful penalty."].). Such a *per se* rule is unfair, untenable, and contrary to the legislative intent in amending § 1671 to change the presumption on a liquidated damages provision for a non-consumer contract from presumptively *invalid* to presumptively <u>valid</u>. For instance, a lender could charge 0.0001% default interest on the

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[2] Respondents, here, subsequently took out at least two other loans with similar default interest provisions, despite having disputed the provision here, as an unlawful penalty but never raised any issue about those provisions until after they defaulted on those loans as well, at which point they also sued the later lenders.

entire unpaid principal balance and, under the appellate court's holding, this too would be a per se violation of § 1671, without any analysis as to whether this relatively insignificant charge was reasonably related to the much larger loss the lender would likely suffer as a consequence of the default.

The Lender Amici thus agree with the Petitioners that this case both presents an important question of law *and* that there is a need for this Court to establish a uniformity of decision in light of the conflict that has been created between this published opinion and that in the recent published decision in *Gormley v. Gonzalez*2022 WL 6924078 (3rd A.D. Oct. 12, 2022)(affirming the validity of a liquidated damages clause and confirming that, in amending § 1671, the Law Commission specifically stated that "'All circumstances existing at the time of the making of a contract' should be considered when determining whether a liquidated damages provision in a non-consumer contract is unreasonable."). The latter is obvious on its face. As to the former, the need to resolve this important question of law is indeed pressing.

Default interest and arbitration provisions help borrowers and lenders to work together to resolve default situations. With interest rates dramatically increasing, and the specter of recession looming, as well as the lifting of COVID restrictions on foreclosures, the Lender Amici anticipate that, without clarity regarding the enforceability of default interest and arbitration provisions, there will be a dramatic surge in foreclosures and bankruptcies since lenders will have no financial incentive to forbear from foreclosing rather than working with defaulting borrowers to bring their loans current. Nor will lenders have any incentive to make loans to less than perfect borrowers in the first place, because lenders' only recourse for default is foreclosure. As underwriting standards tighten, credit will become less available generally and competition among lenders for a shrinking pool of suitable borrowers will cause several lenders to fail. Some lenders have failed already in just the period since this case was decided. History has shown that such "credit crunches" create a downward spiral for the entire economy and widespread economic harm,

These burdens fall even more heavily on private money lenders, independent banks and other smaller lenders, who typically operate on much tighter margins then large, traditional commercial lenders (*i.e.* have less available to loan at any given time), make loans that tend to have a higher risk of default than those made by institutional lenders, and are therefore more dependent on prompt monthly payments by borrowers and short loan terms to stay in business. For these lenders particularly, the existence and validity of liquidated damages provisions and arbitration clauses are vital to their continued successful operation. Without these lenders, borrowers who cannot obtain traditional funding, will be locked out of financing options and unable to borrow necessary capital.

In contrast, reasonable default interest provisions and arbitration agreements help reduce foreclosures, ameliorate catastrophic risk to both borrowers and lenders, and encourage workouts and robust lending.

III. Conclusion:

In light of the foregoing, the Lender Amici respectfully request that this Court grant the Petition to provide the essential clarity to this contentious issue or, in the alternative, at least depublish the appellate court's decision in this matter.

Respectfully submitted,

s/Jonathan D. Fink

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