Michael K. Jeanes, Clerk of Court
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03/20/2013 8:00 AM

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

CV 2009-031722 03/19/2013

HONORABLE GEORGE H. FOSTER, JR.

CLERK OF THE COURT
J. Polanco
Deputy

COMPASS BANK

LORENA E VAN ASSCHEE

v.

M M CLAYTON L L C, et al.

MICHAEL R WALKER

UNDER ADVISEMENT RULING

The Court took under advisement the matter of the determination of a deficiency judgment in this matter. After a one day bench trial the Court has considered the evidentiary record including the testimony of the witnesses, the documents received in evidence and the arguments of counsel. Based on the matters presented the Court finds as follows.

The Defendants defaulted under the terms of certain loan documents. The matter at issue is the amount, if any, of the deficiency that may be assessed to the borrowers and the guarantors.

As to matters that were previously the subject of motions for summary judgment, the Court affirms those prior findings and orders.

As to the matter of default interest and whether in this case the amount constitutes a penalty, the Defendants cite a number of cases from outside this jurisdiction. One case is cited from the Arizona Federal District Court. As to the latter this Court is reminded, ironically, in an unpublished decision that unpublished cases from the district court should not be cited as precedent. In *Leafty v. Aussie Sonoran Capital, LLC*, Not Reported in P.3d, 2012 WL 5539737 (Ariz.App. Div. 1), Judge Timmer, then of the Court of Appeals wrote:

FN3. Leafty cites Judge Neil Wake's order in *Martensen v RG Financing*, CV09–1314–PHX–NVW, 2010 WL 334648 (D.Ariz. Jan. 22, 2010), to support her argument. But the order is an "unpublished decision" and, consequently, "shall not be regarded as precedent nor cited in any court." ARCAP 28(c); *Hourani v. Benson Hosp.*, 211 Ariz. 427, 435, ¶ 27, 122 P.2d 6, 14 (App.2005) (applying prohibition to an unpublished federal court decision).

The Florida bankruptcy case cited by the Defendants stands for the proposition that under Florida law default interest may be contracted for and the bankruptcy court has no power to set it aside. *In re Sundale, Ltd*., 410 B.R. 101 (Bank. S.D. Fla.)

The Defendants also cite an Indiana case analyzing liquidated damages clauses and when they constitute a penalty. *Art Country Squire, LLC v Inland Mortgage Corp*., 745 N.E.2d 885 (Ind. Ct. App. 2001). The discussion in the Indiana Court is not very different from discussions in Arizona cases that address liquidated damages clauses.

Whether a particular contract provision constitutes a penalty is a question of law for the court. *Pima Sav. & Loan Ass'n v. Rampello*, 168 Ariz. 297, 301, 812 P.2d 1115, 1119 (App.1991). Moreover, when contract terms devised by the parties are clear and unambiguous, the court attempts to give them effect. *Hadley v. Sw. Properties, Inc.*, 116 Ariz. 503, 506, 570 P.2d 190, 193 (1977); *Grubb & Ellis Mgmt. Serv.s, Inc. v. 407417 B.C., L.L.C.*, 213 Ariz. 83, 86, ¶ 12, 138 P.3d 1210, 1213 (App.2006). The courts generally do not "alter, revise, modify, extend, rewrite or remake an agreement" the parties have made for themselves. *Goodman v. Newzona Inv. Co.*, 101 Ariz. 470, 472, 421 P.2d 318, 320 (1966). Thus, if the parties provided for liquidated damages, and the damages do not constitute a penalty, we will give effect to their agreement as written. *Roscoe-Gill v. Newman*, 188 Ariz. 483, 485, 937 P.2d 673, 675 (App.1996).

The problem in this case is we are not dealing with a liquidated damages clause. Further, contrary to the Defendants' argument that the Plaintiff bears the burden of proof on this issue, the Defendants' argument is an affirmative defense. Under Arizona law, the initial burden lies with the Defendant. Lakin Cattle Co. v. Engelthaler 101 Ariz. 282, 419 P.2d 66 (1966). Here the record is insufficient to make a prima facie case in support of that defense. The Defendants merely argue that the amount of the interest is too much. No other admissible evidence is submitted to support the notion that the default provision is an unenforceable penalty.

Although the Defendants cite cases from other jurisdictions with holdings suggesting that this Court as a matter of equity should strike down the default interest rate in this case, other jurisdictions maintain that the agreement of the parties should not be struck down or re-written by the courts in the name of equity alone. The Bankruptcy Courts in New York have recognized that equity may not stand to invalidate a negotiated default interest rate:

> Sultan's invocation of equity essentially comes down to a contention that the Default Rate is a penalty. The Court dealt with this issue in *In re 785 Partners LLC*, 470 B.R. 126 (Bankr.S.D.N.Y.2012). Addressing the question of pre-petition interest at the default rate, the Court observed that "[a] higher default interest rate reflects the allocation of risk as part of the bargain struck between the parties, a bargain that benefits the obligor as well as the obligee," *id*. at 131, and "[e]ven where the default rate strikes the judge as high, a court cannot rewrite the parties' bargain based on its own notions of fairness and equity ." *Id*. at 132. In the end, "the agreement must be enforced in accordance with its terms," and "[t]he Debtor's appeal to equitable considerations has no place under New York law." *Id*.

In re Sultan Realty, LLC, Slip Copy, 2012 WL 6681845 (Bkrtcy.S.D.N.Y.)quoting, *In re 785 Partners LLC*, 470 B.R. 126 (Bank. S.D.N.Y.N.Y. 2012). In the ***Sultan*** matter the court noted that the default rate was four times the amount of the non-default rate. In analyzing the matter the court had a sufficient evidentiary record to make a decision as to whether the rate was so shocking to constitute an unenforceable penalty.

The record before this Court on the issue is non-existent. We do know from the loan that the default rate in this case is not quite four times as high as the non-default rate. No other evidence guides the Court as to why this amount constitutes a penalty. It is not the province of this Court to impose its own notions of what might be acceptable or not acceptable given the nature of the negotiations between the parties, the risks involved in the lending transaction at the time the agreement was made, whether the debtors are solvent and other factors the various other jurisdictions have considered in determining whether the default rate is unenforceable. As noted in *In re 785 Partners LLC*, supra:

> The Debtor's arguments regarding the inequitable, unreasonable and penal nature of the Default Rate, and particularly, whether it covered the additional costs of administering a loan in default, is primarily based on hindsight. The Debtor devotes its discussion to the amount of time that the Original Lenders spent *after* the default dealing with the Loans, emphasizing First Manhattan's inability to quantify these efforts due to the lack of time records. (*See Stipulation* at ¶¶ 16–20.) The Debtor has not offered any evidence regarding the parties' intentions or the reason for the selection of the 5% Default Rate when they entered into the Loans, and the Debtor's *post hoc* analysis of the time spent addressing the Loans after default sheds no light on this question.

The record in this case is similarly lacking and the arguments of counsel are not evidence. This Court cannot say as a matter of law that the default rate is unenforceable.

The Court does find that the Plaintiff is entitled to a deficiency judgment. However, the record indicates that the amount of default interest began to run on December 12, 2008. See, Trial Exhibit 21. The Court finds that Plaintiff has no competent evidence that the default interest was imposed before that time. The bank records appear to make an attempt to go back and recapture default interest before then. However, the Plaintiff's sole witness, Mr. Craig Fimple, did not have first-hand knowledge of the events in 2008 and 2009 and his testimony of the accrual date for the default interest is not admissible. To the extent he relies on admissible bank records to establish the earlier date, the Court finds Exhibit 21 to be the more persuasive evidence. The Court finds that Exhibit 21 is an admission by the Plaintiff that is not overcome by the second hand knowledge and interpretation of Mr. Fimple. Accordingly, the Court has recalculated the interest based on the evidence presented, essentially eliminating 47 days of default interest on the first loan and 129 days on the second loan. The calculations are as follows:

The First Loan - Original Principal Balance - $800,000.00

$769,411.16	Outstanding balance as of 9/26/08 and date of default 10/26/08.*
$8412.76	Accrued Interest (non-default) 76 days @ 8.375%
$107,204.61	Accrued Interest @ default rate 209 days @ 24% from December 12, 2008 – per Exhibit 21 through date of trustee's sale
$25,113.38	Property Tax Payment
2,400.00	Appraisal Fee
4,698.87	Trustee's Sale Fee
2,033.00	Trustee's Sale Guarantee Fee
$919,273.78	Total Outstanding balance for Note 1 as of July 9, 2008

The Second Loan - Original Principal Balance - $1,391,828.10

$1,391,828.10	Outstanding balance as of July 15, 2008 and date of default 10/26/08.*
$46,104.30	Accrued Interest (non-default) 159 days @ 7.5%
$184,649.19	Accrued Interest @ default rate 199 days @ 24% From December 12, 2008 – per Exhibit 21, through date of trustee's sale.

$4,698.87	Trustee's Dale Fees
3,065.00	Trustee's Sale Guarantee Fee
$1,630,345.30	Total Outstanding balance for Note 2 as of July 9, 2008.

* As noted above the Court finds default interest begins to run as of December 12, 2008, rather than the earlier date.

Deficiency Owed

$919,273.78	First Note
$1,630345.30	Plus Second Note
$2,549,619.08	Total of Note 1 and Note 2
$2,437,500.00	Less Stipulated FMV of Property
$ 112,119.08	Total Deficiency as of Date of Sale
96,272.91	Accrued Interest 1288 days @ 24%
$208,391.99	**Total Deficiency Balance as of 1/17/13**

The Court finds that overall the Plaintiff is the prevailing party in this matter. It shall submit a form of judgment within 20 days following entry of this decision. Any application for attorneys' fees and costs shall be filed contemporaneously therewith.

The foregoing ruling is all in accordance with the formal written Order signed by the Court on March 19, 2013 and filed (entered) by the Clerk on March 19, 2013.

FILED: Exhibit Worksheet.

ALERT: The Arizona Supreme Court Administrative Order 2011-140 directs the Clerk's Office not to accept paper filings from attorneys in civil cases. Civil cases must still be initiated on paper; however, subsequent documents must be eFiled through AZTurboCourt unless an exception defined in the Administrative Order applies.