UNITED STATES BANKRUPTCY COURT
CENTRAL DISTRICT OF CALIFORNIA
SAN FERNANDO VALLEY DIVISION

In Re:

AJK GADSDEN, LLC,

Debtor.

AJK GADSDEN, LLC,

Plaintiff,

vs.

FANNIE MAE, by and through its servicer, Santander Bank,

Defendant.

CASE NO.: 1:13-bk-12836-MT

Chapter 11

Hon. Maureen Tighe

ADV. NO. 1:13-ap-01174-MT

FINDINGS OF FACT AND CONCLUSIONS OF LAW [LBR 7052-1]

Date: June 9-10, 2014
Time: 9:00 a.m.
Place: Courtroom 302
US Bankruptcy Court
21041 Burbank Blvd., 3rd Flr.
Woodland Hills, CA

I. JURISDICTIONAL STATEMENT

1. This action is a civil proceeding arising in the above captioned Debtor's chapter 11 bankruptcy case, which is now pending in this judicial district, and arising under, arising in and related to Title 11 United States Code. This Court has jurisdiction pursuant to 28 U.S.C. § 1334(b) and 28 U.S.C. § 157 (b)(2)(A), (B), (K) and (O) to hear and determine this proceeding and to enter an appropriate final order and judgment. Accordingly, this adversary proceeding is a core proceeding. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1409.

2. To the extent that any finding of fact is construed to be a conclusion of law, it is hereby adopted as such. To the extent any conclusion of law is construed to be a finding of fact, it is hereby adopted as such.

3. If subsequent proceedings or applicable law results in the determination that this Court does not have jurisdiction pursuant to 28 U.S.C. § 1334(b) to hear and determine this proceeding and to enter an appropriate final order and judgment, than these findings of fact and conclusions of law shall constitute proposed findings of fact and conclusions of law to the United States District Court pursuant to 28 U.S.C. § 157(c)(1).

II. FINDINGS OF FACT

1. AJK GADSDEN LLC ("AJK" or "Debtor") is a California limited liability company that was formed by a group of investors for the purpose of acquiring, managing and then re-selling certain multi-family real property, commonly known as 44720-30 Gadsden Avenue, Lancaster, California ("real property"). (EX 1 - 9 AJK's formation documentation.)

2. On January 22, 2008, Santander Bank, then known as Sovereign Bank, made a $960,000 loan ("loan") to AJK so that AJK could purchase the real property.

3. The loan is secured by a first lien deed of trust that recorded on January 31, 2008. (EX 15 Multifamily Note; EX 18 Multifamily Deed of Trust.)

4. Under the terms of the Note, the non-default rate of interest was fixed at

5.35% per annum.

5. The parties agreed to modify the Note's default rate of interest to a "rate equal to the lesser of (a) sixteen percent (16%) per annum or (b) the maximum interest rate which may be collected from Borrower under applicable law." (EX 15, FM 000020.) That default rate of interest was initially presented to AJK in a December 5, 2007 Loan Commitment that Santander Bank sent to Meridian Capital Group, LLC, the loan broker working for AJK to obtain the financing it needed to buy the real property. (EX 12, FM 000061, Additional Loan Provisions, #5.)

6. Negotiations occurred between Santander Bank and Meridian Capital Group and, as a result, an amended Loan Commitment issued from the lender on January 3, 2008. (EX 13.) Among other things, the amended Loan Commitment set forth the terms of a one-time Extension Option that AJK had specifically requested. The amended Loan Commitment did not change the initially quoted 16% default rate of interest. (EX 14, Meridian Capital's January 16, 2008 conditional acceptance letter.)

7. A the trial, AJK did not call any witness from Meridian Capital to provide the details of these negotiations; however, the Court admitted three items of correspondence between Meridian and Santander Bank that show negotiations over the loan's terms were taking place. (EX 12 -14.) Mr. Tolbert testified to having had some conversations with his partner, Mr. Anthony George, during the loan negotiations, but he did not personally participate in the negotiations, which Meridian Capital was handling for AJK. [ECF # 76, June 9, 2014 trial transcript at p. 80.] Further, Mr. Tolbert admitted on cross-examination that AJK engaged the services of Meridian Capital because none of the lenders with which he and his partner had previously worked were willing to make a loan secured by the Lancaster property on which the investors were seeking an 80% LTV loan. [Id., pp. 82-83.]

8. For its services, Meridian Capital Group was paid $9,600 from the loan proceeds. (EX 23, Borrowers Closing Statement.)

9. After funding the loan, the Note, Deed of Trust and related collateral instruments were assigned to FANNIE MAE ("Fannie Mae" or "Creditor") and Santander Bank was appointed the loan's servicer. (EX 17 Assignment; EX 19 Assignment of Deed of Trust; EX 20 Limited Power of Attorney; EX 21 UCC Financing Statement.)

10. AJK struggled to make timely loan payments; by June 2009 past due amounts began to appear on its monthly loan statements. (EX 65 - FM 000701.) During the loan's term, AJK had numerous contacts with Santander Bank's Customer Service personnel on a variety of issues, including more than $17,500 in defaulted supplemental taxes that were owed on the real property that were not part of the loan's escrow payment. (EX 66, EX 69 - 74.)

11. In the early term of the loan, AJK reported to its investors, infrequently and irregularly, that vacancies in the real property were an ongoing problem. (EX 27 - 34.)

12. By early 2009 AJK's affiliate, AJK Investments, Inc., was cutting its overhead and trying to liquidate another investment property. (EX 26, AJK 3.28.14:22.)

13. By November 2011 AJK's loan payments were running more than 30 days late, after the 1st of the month in which the payment was due. (EX 65 - FM 000729.) That delinquency continued all through 2012 until the loan matured on February 1, 2013. (EX 65 - FM 000740 et seq.) AJK's Manager, Mr. Tolbert, admitted receiving the monthly loan statements, reviewing them, and seeing that late charges and default interest were included. [ECF # 76, June 9, 2014 trial transcript at pp. 84 - 85.]

14. AJK's Manager, Mr. Tolbert, testified that on or about November 15, 2012, he sent a letter written on AJK Investments, Inc. letterhead to Santander Bank advising that he would "like to exercise the extension" on the loan. He mailed the letter to the address in Pennsylvania used for collecting payments and did not mail it,

as required under the Trust Deed, to the Bank's Brooklyn, New York address. Mr. Tolbert admitted on cross-examination that he set the November letter without even checking the operative loan documents for the specifics of how to exercise the extension (i.e., deed of trust, EX 18, p. 48); and, he did not tender the 1% nonrefundable extension fee with the letter and admitted to not knowing the payment had to be made concurrent with the request for the extension. (EX 57.) [ECF # 76, June 9, 2014 trial transcript at pp. 86 - 85; 90:8-11; 94:9-16.] Although he had been dealing with Dennis Tracey at Santander Bank extensively about the loan, he did not copy him or inform him that the extension letter was sent, despite Tracey's admonishments to follow the loan documents carefully in seeking an extension. The Court got the impression that Mr. Tolbert was avoiding Mr. Tracey and hoping to somehow trigger a loan extension that would enable AJK to work itself out of a difficult situation.

15. The November 2012 monthly loan statement that was sent to AJK prior to Mr. Tolbert's November 15, 2012 letter reflected sums owing for past due principal, interest, escrow, late charges and more than $136,000 in default interest. (EX 65, FM 000740.) That loan statement also stated the then unpaid principal balance owed on the loan, from which the 1% extension fee could have been calculated, but Mr. Tracey did not do so.

16. Dennis Tracey, the Vice President in the Workout Division of Santander Bank, was assigned responsibility for the loan in March 2012. Mr. Tracey denied ever receiving Mr. Tolbert's November 15, 2012 letter. (Decl. Tracey, ECF # 38, ¶54.) On cross-examination, Mr. Tolbert admitted that he did not inform Mr. Tracey of his letter, nor did he copy, fax, or attach to any e-mail communications he had with Mr. Tracey, a copy of his November 15, 2012 letter. [ECV # 76, June 9, 2014 trial transcript at pp. 97 - 98.]

17. Between Mr. Tracey's assignment to the loan and the filing of this bankruptcy proceeding on April 25, 2013, he had numerous communications with Mr.

Tracey pertaining to the loan and one face-to-face meeting at the real property in August 2012. On more than one occasion Mr. Tracey encouraged Mr. Tolbert to review the loan documents to see if an extension was provided for and, if it was, to comply with all of its terms and conditions; otherwise, Mr. Tracey advised, AJK needed to be searching for new financing. (EX 59, 61, 62, and 63.)

18. On February 1, 2013, the loan matured.

19. Fannie Mae filed a civil lawsuit against AJK and the loan guarantors and sought, among other relief, the appointment of a rents receiver. (Decl. Tracey, ECF # 38, ¶ 68.)

20. On April 25, 2013, AJK filed its voluntary Petition to commence a bankruptcy under Chapter 11 of the United States Bankruptcy Code (Code).

21. On August 14, 2013, Fannie Mae timely filed its proof of claim in the bankruptcy (POC 4). In its proof of claim, Fannie Mae asserted that it was the holder of the Note that is secured by the Deed of Trust. Fannie Mae claimed that the Note's unpaid principal balance was $891,294.06, with which AJK agreed in the Joint Pretrial Stipulation [ECF # 36].

22. Also in Fannie Mae's POC 4, it is claimed that AJK owes past due default interest of $211,974.23 and late charges of $10,152.85.

23. AJK initiated this adversary proceeding challenging the amount of default interest claimed in Fannie Mae's POC 4,for which the procedures set forth under the FRBP and the Code are applicable.

24. In its adversary complaint, among other things, AJK alleged that the loan's default interest was an unlawful penalty under California statutory law; and, further, AJK asserted it had timely exercised a 5-year extension of the loan that Fannie Mae had anticipatorily breached by refusing to grant, thereby excusing AJK's failure to comply with the loan extension's terms and conditions. [ECF # 41.]

25. Fannie Mae moved to dismiss the adversary complaint under FRCP 12(b)(6) or, in the alternative, to strike under FRCP 12(f) or for a more definite

statement under FRCP 12(e) [ECF # 5]. AJK filed opposition [ECF # 8]. The matter was heard and denied on October 2, 2013. [ECF # 16.] Fannie Mae also moved for relief from the bankruptcy automatic stay and on August 1, 2013 the Court entered two Interim Orders requiring AJK to make adequate protection payments to Fannie Mae's servicer, Santander Bank. [ECF # 42, 43.]

26. The parties submitted a Joint Pretrial Stipulation [ECF # 56] that set forth eight (8) facts that were admitted and would require no proof at trial. The Stipulation also set forth those controverted facts and law that the Court may be required to determine in the trial. The Court approved the Joint Pretrial Stipulation at a hearing held April 24, 2014. Also pursuant to that Pretrial Conference, it was stipulated that the direct testimony of the parties' witnesses would be submitted pre-trial by declaration. Thereafter, the declarations of expert Michael Chulak [ECF # 37], and Dennis Tracey [ECF # 38] were submitted on behalf of Fannie Mae; and the declarations of expert Thomas Tarter [ECF # 39], Kelvin Tolbert [ECF # 41] and Anthony George [ECF # 40] were submitted on behalf of AJK.

27. At trial, Fannie Mae objected to the declaration of Anthony George because he had not been identified in AJK's Pretrial Stipulation as a trial witness for AJK. The objection was sustained and the declaration of Anthony George was excluded from evidence. [ECF # 76, June 9, 2014 trial transcript, pp. 104-114.]

28. Fannie Mae also moved to exclude the report and testimony of AJK's expert, Mr. Tarter, arguing that is a layman whose opinions were substantially based on his interpretation of the decision of *Ridgley v. Topa Thrift & Loan Assoc.* (1998) 17 Cal.4th 970 ("*Ridgley*"). [ECF # 43.] The Court overruled Fannie Mae's objections as Mr. Tartar's opinions went more to the weight the Court should give Mr. Tarter's testimony. [ECF # 76, June 9, 2014 trial transcript, pp. 11 - 27.] In fact, Mr. Tarter's testimony was illuminating and based on his over 40 years of experience in the banking industry. It was factual and not a legal opinion, but it did not rise to the level needed to overcome the factual evidence in this case, the contractual provisions

and the required legal presumptions.

29. On the first day of trial the testimony of AJK's expert, Mr. Tarter, and Mr. Tolbert for AJK were received and admitted. [ECF # 76.] Also, Mr. Chulak, Fannie Mae's rebuttal expert, testified out-of-order. Thereafter AJK rested.

30. On the second day of trial Fannie Mae made a motion under FRBP 7052 and Federal Rules of Civil Procedure 52(c) for judgment in its favor on two primary issues on which AJK's adversary complaint was based: whether the default interest is invalid under applicable California statutory law (*Cal. Civ. Code* § 1675(b)), and whether or not AJK had duly and timely exercised a five-year extension of the loan. [ECF # 77, June 10, 2014 trial transcript, pp. 4 - 58.] The Court granted the 52(c) motion with respect to debtor's failure to exercise the loan extension and it ruled that AJK, as Plaintiff, failed to meet is burden of proof and the loan matured February 1, 2013 prior to AJK commencing the bankruptcy action. As to the issue of the validity of the default interest the Court requested that the parties continue with their evidence.

31. Mr. Tracey on behalf of Santander Bank, the servicer of the loan for Fannie Mae, testified. [ECF # 77, June 10, 2014 trial transcript, pp. 59 - 90.] Mr. Tracey was asked to calculate what amount of added interest would be charged under the default rate feature of the loan, over a hypothetical 16 month period, based on the highest unpaid principal due on the loan during that period (commencing November 2011).[1] The additional interest rate was 10.65%, and when applied to an unpaid principal balance of $910,343, Mr. Tracey calculated it resulted in $129,269 in additional interest on top of the Note's base rate of 5.35%. (*See,* EX 15, Multifamily Note, FM0003 and FM 0020.) Mr. Tracey's testimony underscored the fact that the $211,974.23 in default interest which AJK was challenging in its adversary complaint, has two components (the base Note rate of 5.35% plus an additional 10.65%) that, when combined, reached the 16% default rate of interest. [ECF # 77, June 10, 2014

[1] The evidence showed that the loan fell chronically delinquent commencing November 2011 and continued until its maturity in February 2013 - a 16 month period.

trial transcript, pp. 71 - 72.]

32. Mr. Tarter's testimony was not significantly different, but the conclusions he drew were. The Court finds that Exhibit B to the Tarter expert report [EXt 77] ("Tarter Calculations") accurately sets forth the Bank's calculation of default interest on the Loan based on the accrual of default interest set forth on the Bank's monthly statements [Trial Exhibit 65]. As set forth in the Tarter Calculations, the Bank claims $158,917.57 in gross default interest ("Gross Default Interest") through December 14, 2012 which includes $108,704.73 in default interest calculated per the January 22, 2008 Promissory Note ¶ 8 [EX 15] at 10.65% over the base rate of 5.35% on the principal amount of the Loan ("Base Default Interest") and $50,212.84 in default interest calculated at twice the Base Default Interest rate of 10.65% over the base rate of 5.35% on the principal amount of the Loan for a total of 188 overlapping days ("Double Default Interest"). Tracey's handwritten notes and calculations are consistent with the Tarter Calculations and reflect the accrual of additional Base Default Interest and Double Default Interest in December, 2012 and January, 2013 and February, 2013. [EX 80].

33. Mr. Tarter "didn't have a problem" with the additional 10.65% interest that, combined, brought the default interest to 16%, as his concern was more the method of how the interest was calculated. [ECF # 76, June 9, 2014 trial transcript, p. 64:21-25[2]; 65: 9-18.] His conclusion was also based on the numeric, dollar amount, of all the default interest during the November 2011 - February 2013 loan period, which he felt was disproportionate to the cost of administering the loan. [Id., p. 65:1 - 8.]

34. Mr. Tarter agreed that the fact the lender based its default interest on the unpaid principal balance was not punitive by itself. [ECF # 76, June 9, 2014 trial transcript, p. 63:13-17.] Likewise, he also did not have any problem with the late

[2] "Q. All right. So if I understand you and your hypothetical, it's not the rate of the default interest, which in this case it became sixteen percent. What your concern is, is in the final dollar-amount number that is being charged? A. Yes, ma'am."

charges that were charged on the loan. [Id., p. 63:8-12.] His opinion was that the combination of a late fee, overlapped by the default interest which was also calculated on the grace period culminated in a punitive charge.

35. Mr. Tarter had no knowledge of the actual administrative costs Fannie Mae's servicer, Santander Bank, was incurring in 2012 as it administered the then chronically defaulted loan (i.e., office rent, salary of Mr. Tracey, etc.). [Id., p. 57:12-58:2.] He also did not focus on the specific language in the Note concerning damages.

36. Fannie Mae called as its rebuttal expert, Mr. Michael Chulak. Mr. Chulak's declaration and appended report were submitted and admitted in evidence. (EX 78) [ECF # 37; ECF # 76, June 9, 2014 trial transcript, pp. 67 - 72.] Mr. Chulak concluded, based on his professional and prior banking experience that a default interest rate of 16% was commercially reasonable and, having reviewed the correspondence between the lender and AJK's broker leading up to the loan, that the borrower had agreed to the default rate as an arm's length, commercial transaction. In Mr. Chulak's declaration, he supplemented his report with additional opinions concerning the (a) administrative costs the lender incurred to manage the loan (i.e., personnel time and overhead), which he opined were not minimal; and (b) the fact that while general damages a lender can suffer when a loan defaults are significant, the amount of such damages is "extremely difficult to calculate in dollars." (*See,* Chulak Report, p. 7, et seq.) Therefore, the parties' contractual agreement to the default rate of interest was appropriate and reasonable.

37. Within the Note's terms, AJK expressly acknowledged that its failure to make timely payments "will cause" the lender to incur additional expenses in servicing and processing the loan; and that if the payment fell more than 30 days delinquent, that the lender's risk of nonpayment would "materially increase[]" for which risk the lender was entitled to additional compensation. (EX 15, ¶ 8.) Accordingly, "AJK agree[d] that the increase in the rate of interest payable under this

Note to the Default Rate represents a *fair and reasonable estimate, taking into account all circumstances existing on the date of this Note*, of the additional costs and expenses [Fannie Mae] will incur by reason of [AJK's] delinquent payment and the additional compensation [Fannie Mae] is entitled to receive for the increased risks of nonpayment associated with a delinquent loan." (EX 15, Multifamily Note, ¶ 8, emphasis added.)

III. CONCLUSIONS OF LAW

1. The Court granted, in part, the FRBP 7052 and FRCP 52(c) motion for judgment in favor of Fannie Mae, and ruled that the loan matured, without being extended, on February, 1, 2013. (June 10, 2014 Trial Transcript pp. 54-56.) It now focuses its attention upon the validity of the default interest claimed by the lender, under applicable law.

2. AJK as the plaintiff in the adversary proceeding bore the burden of proof in several particulars: First, the validity of POC 4 filed by Fannie Mae is presumed to be valid and it is the objector's burden to overcome that presumption. (*In re Consolidated Pioneer Mortg.*(9th Cir. BAP, 1995) 178 B.R. 222; 11 USC § 502(a).) Local Rule 3007-1(c) requires an objection to a claim to be supported by admissible evidence "sufficient to overcome the evidentiary effect of a properly documented proof of claim." And, the "evidence must demonstrate that the proof of claim should be disallowed, reduced, [etc.]"

3. The "default rate should be enforced, subject only to the substantive law governing the loan agreement, unless a provision of the Bankruptcy Code provides otherwise." (*General Electric Capital Corp. v. Future Media Productions, Inc.* (9th Cir. 1008) 547 F. 3d 956, 961, citing *Travelers Cas. & Sur. Co. of Am. v. Pacific Gas & Elec. Co.* (2007) 549 U.S. 443, 127 S.Ct. 1199, 167 L.Ed.2d 178.)

4. The "bankruptcy court should apply a presumption of allowability for the contracted for default rate, 'provided that the rate is not unenforceable under applicable nonbankruptcy law.' 4 *Collier on Bankruptcy*, ¶ 506.04[2][b][ii] (15th ed.

1996)." (*General Electric Capital Corp. v. Future Media Productions, Inc., supra,* at p. 961.)

5. When a secured creditor is oversecured, 11 U.S.C. § 506(b) allows the creditor's claim to include any reasonable fees, costs, or charges provided under the parties' agreement. The court generally does not inquire into reasonableness under this section where the contract provides for such fees and the relevant contract and state law supports them.

6. In this commercial loan, Mr. Tarter and Mr. Chulak, the parties' respective experts both agreed that a default rate of 16% was within a range of commercial reasonableness. Ultimately, the Plaintiff's expert (a) found the total amount of default interest charged in the last 16 months of the loan to was disproportionate to the loan's principal balance; and (b) that an overlap in default interest was charged when more than one payment became delinquent ($50,212.84).

7. Here, the default component of the default interest rate is 10.65%; the 16% rate is combination of the underlying base Note rate of 5.35% plus the added 10.65% to bring it up to the 16% default rate that the parties negotiated at arm's length. In *In re Skyler Ridge* the court found a 14.75% post-petition rate of interest to be valid and allowed it in connection with the lender's oversecured claim. *In re Skyler Ridge,* 80 B.R. 500 (C.D. Cal. 1987).

8. As AJK agreed to a 16% default rate of interest, the Court is not inclined to second guess the reasonableness of that rate, particularly in view of the fact that the parties' experts both agreed that the rate itself was commercially reasonable given the type of loan involved, the location of the multifamily property that secures it, and the high loan-to-value ratio that AJK's witness acknowledged was so unattractive to local lenders with whom it previously worked, that it was forced to seek financing from then Sovereign Bank, in New York. Any restriction on the contracted-for rate of interest "must thus come from state law, and not from bankruptcy law." (*In re Skyler Ridge, supra,* 80 B.R. at 511; see also *Bank of Honolulu v. Anderson (In re*

Anderson) (9th Cir. BAP 1986) 69 Bankr. 105, 108 in which the court ruled that the contract interest rate is what the bankruptcy court is to apply, without regard to reasonableness, when dealing with an oversecured creditor.)

9. Under *Cal. Civil Code* section 1671(b) in a commercial context, a contract for liquidated damages is deemed 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."

10. The opinion of AJK's expert was more focused on events that transpired years after the parties had entered into the loan and did not take into adequate consideration evidence of the circumstances that existed "at the time" AJK's broker was negotiating the terms of the loan with the lender. To the contrary, the evidence demonstrates that the default rate of interest was the subject of some negotiations between AJK's broker and the lender because it appeared in the initial Loan Commitment of December 5, 2007 (EX 12) , was not modified in the amended Loan Commitment of January 3, 2008 as the parties negotiated other terms, including an extension option (EX 13); and no issue was taken with it when AJK's broker affirmed the terms on January 16, 2008(EX 14). Additionally, Mr. Tarter's opinions never took into account that AJK was a sophisticated investor and its manager, Mr. Tolbert, was a licensed real estate broker.

11. AJK relies upon the decision in *Ridgley v. Topa Thrift & Loan Assoc,.* 17 Cal.4th 979 (1998). *Ridgley* involved a prepayment penalty, not a default interest rate. The issue under the Supreme Court's review in *Ridgley,* therefore, is a prepayment penalty and not default interest. While Ridgley holds that a liquidated damages clause will be considered unreasonable, and hence unenforceable under section 1671(b), if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach, *Ridgley* at 977, the case does not address facts such as those present in this case showing the reasonable anticipation of hard to quantify damages at the time the loan was entered into. It also

does not address a commercial loan such as this and an analysis under 11 U.S.C. § 506(b).

12. Likewise, AJK's reliance on *Garrett v. Coast and Southern Federal S&L Assoc.* (1973) 9 Cal.3d 731 ("*Garrett*") is not controlling in this commercial loan context. *Garrett* involved a consumer class action challenging late charges and the presumption of validity under *Cal. Civil Code* section 1671(b) did not arise because *Garrett* was decided before the code was amended in 1978.

13. The Court has carefully considered the more recent Oregon District Court opinion cited to by AJK, *California Bank & Trust v. Shilo Inn,* 2012 WL 5605589) (D. Oregon 2012), but finds the evidence at issue there quite distinguishable from the evidence adduced at trial here. There, the parties appeared to have not introduced evidence of any initial difficulty the borrower had getting a loan, the risky nature of the loan, and any lengthy history of late payments. Notably, while the district court invalidated the automatic default payment, it did not order the fees repaid as an evidentiary hearing was still to be had to establish actual damages. Here, the parties specifically stipulated in the note multiple times that the borrower's "failure to make timely payments will cause the Lender to incur additional expenses in servicing and processing the Loan, that during the time that any monthly installments or payment under this Note is delinquent for more than 30 days, Lender will incur additional costs and expenses arising from the loss of the use of the money due and from the Lender's ability to meet its other obligations and to take advantage of other investment opportunities, and that it is extremely difficult and impractical to determine those additional costs and expenses." (Note, p. 3, para 8.)

14. The argument by AJK that there must be a "reasonable relationship" with actual damages that are ultimately suffered by the lender in the event of default is not the legal standard to be applied, even under *Ridgley* and *Garrett*, on which AJK relies. The burden of proof on the issue of reasonableness is to focus on what circumstances existed at the time the contract was made. "The validity of the

liquidated damages provision depends upon its reasonableness at the time the contract was made and not as it appears in retrospect. Accordingly, the amount of damages actually suffered has no bearing on the validity of the liquidated damages provision." (*El Centro Mall, LLC v. Payless ShoeSource, Inc.* (2009) 174 Cal.App.4th 58, 63, quoting the Law Revision Commission Comments to section 1671(b). In the proper time-context (when the contract was made) the Court is given considerable leeway to determine the reasonableness of a liquidated damage clause. Among those things it can consider are:

- The relationship that the contract damages bear to the range of harm that reasonably can be anticipated;
- The relative equality of the bargaining power of the parties;
- Whether the parties were represented by lawyers or brokers when the contract was made;
- The anticipation that proof of actual damages would be costly or inconvenient ; and
- The difficulty of proving causation and foreseeability.

(*Cal. Law Revision Com. Com.,* West's Ann. Civ. Code (2014 ed.) foll. § 1671.) The court may also look at the purposes that are stated in the contract provision itself as to why the liquidated damages are being set. (*El Central Mall, LLC, supra,* at p. 64.) As stated earlier, AJK acknowledged and agreed that the lender would suffer damages that would be extremely difficult to calculate, and an increased risk in the event of payment default. It was therefore reasonable for AJK to agree to the 16% default interest in connection with the high-risk loan it was seeking.

15. Based on the foregoing, the Court concludes that AJK as the plaintiff in this adversary proceeding has not sustained its burden of proof, both under the Bankruptcy Code and California law. The Court therefore concludes that the loan's default interest rate is valid.

16. AJK's secondary challenge to the default interest is that "double" default interest was assessed because, when two loan payments were in default, the interest was calculated and charged with respect to each defaulted payment. The method by which interest would be computed is expressly set forth in the Multifamily Note (EX 15) at paragraph 2(b). There, it is provided that interest shall be based on each monthly payment, by multiplying the unpaid principal balance by the applicable interest rate, dividing that product by 360, and then multiplying that quotient by the actual number of days that elapsed during the month. The Court finds that the terms by which the interest would be calculated were expressly agreed to by AJK when it executed the Note. Moreover, although Mr. Tolbert, AJK's managing partner, was aware of the accruing default interest, he never challenged or addressed his concerns over the charges with the lender. Accordingly, the Court finds that the default interest, as calculated by the lender, was done in conformity with the terms of the Note.

17. Based upon the claims alleged in the Complaint, and the failure on the part of AJK to meet is burden of proof in all respects, and the findings set forth above, the Court determines that Fannie Mae is the prevailing party and it is entitled to its attorney's fees and costs.

THE COURT SO FINDS AND CONCLUDES.

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Date: August 12, 2014

Maureen A. Tighe
United States Bankruptcy Judge