PROGRAM SUMMARY 6-17-23
By: Gary Wallace-Program Summary Committee Chair

CDCBAA Holds Fifth Meeting and MCLE Program of 2023: "UPDATES IN THE AREA OF DEFAULT INTEREST RATES AND HARD MONEY LOANS; and ADVERSAY PROCEEDINGS 101"

On June 17, 2023, the CDCBAA held its fifth members meeting and MCLE program of the year. The meeting and program were conducted as a live webinar via Zoom video. The program topics were: **"UPDATES IN THE AREA OF DEFAULT INTEREST RATES AND HARD MONEY LOANS; and ADVERSAY PROCEEDINGS 101."** Our distinguished panel included Hon. Wayne Johnson | Bankruptcy Judge, Central District of California, Riverside Division; Stella Havkin, Esq. | Havkin and Shrago; Gerrick Warrington, Esq. | Frandzel Robins Bloom & Csato; and Michelle Rodriquez, Esq. | Wright, Finlay & Zak. Former CDCBAA president and current board member Hale Andrew Antico moderated. What follows are some of the highlights of the seminar.

Mr. Warrington led off the panel's discussion by explaining that 11 U.S.C. section 506(b) permits over-secured creditors to include default interest as part of their secured claim. However, the decision of whether default interest is permitted at all under the parties' contract is determined by state law. In making this determination under California law, there are two primary competing policies at play: freedom of contract versus prohibition of "forfeitures." Additionally, because bankruptcy courts are courts of equity, they may also consider the fairness to unsecured creditors of the estate in allowing such default interest. Mr. Harrington then discussed pertinent cases in which default interest rulings were made, and he also addressed the way in which California's liquidated damages statute revision of 1977 (Civil Code sec. 1671) altered the analysis.

Some of the pertinent case law discussed included *Thompson v. Gorner*, 104 Cal. 168 (1894), *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.*, 9 Cal.3d 731 (1973), *Ridgley v. Topa Thrift & Loan Ass'n*, 17 Cal.4th 970 (1998), *East West Bank v. Altadena Lincoln Crossing, LLC*, 598 B.R. 633 (2019), and *Honchariw v. FJM Private Mortgage Fund, LLC*, 83 Cal.App.5th 893 (2022). The current state of the law in this area was summarized as follows: If the loan is fully matured, then the lender may use *Tompson v. Gorner* to assert that C.C. section 1671 does not apply; if the loan has not matured, then default interest applied against the entire balance of the loan may be analyzed as a liquidated damages provision. Other takeaways from a lender's perspective are: Upon default, the lender should give timely notice of default and acceleration before charging default interest on unpaid principal balance; and when drafting a default interest provision, consider including factual recitals that address the proportionality of the damages, the relative bargaining power of the parties, the existence of legal representation

(if any), the difficulty of proving damages and causation, and whether the clause is in a form contract. Both sides to such transactions should be aware as well of the fact that, under California Evidence Code section 622, "The facts recited in a written instrument are conclusively presumed to be true as between the parties thereto, or their successors in interest; but this rule does not apply to the recital of a consideration."

Ms. Havkin suggested that disputes regarding applicable interest rates and enforceability of interest rate provisions be initiated through an adversary proceeding rather than a claim objection because discovery rights are broader in an adversary proceeding, and her experience has been that discovery is frequently needed to resolve such disputes.

Judge Johnson then led a panel discussion of hard money loans and merchant cash agreements (MCAs). MCAs are typically transactions in which the lender advances funds to the debtor and, in exchange, the debtor purportedly assigns to the MCA a portion of its future income. MCAs typically take the position that they are not lenders, but rather factors purchasing receivables pursuant to assignment agreements. A recent decision testing (in part) this defense, *Precision Bus. Consulting, LLC v. Medley (In re Medley)* 2023 Bankr. LEXIS 374, was discussed. There, the MCA was sanctioned $20,000 for violating the automatic stay, and the BAP affirmed.

In the second hour of the program, Judge Johnson discussed adversary proceedings. More specifically, he discussed (1) the differences among motions, applications, objections and adversary proceedings in bankruptcy cases, (2) the scope of adversary proceedings, (3) how initiate these proceedings, (4) service of adversary complaints, and (5) amending pleadings and dismissing complaints. This presentation was part one of a longer presentation that will conclude at a future program (currently scheduled for August 26, 2023). Among Judge Johnson's notable comments and observations were the following:

- Explaining the correct procedural vernacular for obtaining court orders;
- Applications and motions are substantively the same;
- Part VII (Rules 7001 to 7087) of the Federal Rules of Bankruptcy Procedure governs adversary proceedings;
- The significant overlap between the Bankruptcy Rules and the Federal Rules of Civil Procedure due to their frequent incorporation by reference;
- The types of proceedings that must be brought by way of a complaint to initiate an adversary proceeding;
- The express exceptions that permit certain proceedings to be brought other than by way of an adversary proceeding (for example, the reference to Rule 4003(d), which permits proceedings under 11 U.S.C. section 522(f) to avoid liens to be brought by motion rather an adversary proceeding);
- The importance of serving a summons (once issued) on the defendant(s) not later than 7 days after issuance because the court has already set a deadline for a responsive pleading;
- The advantage of being permitted by Rule 7004 to serve the summons and complaint by mail anywhere in the United States rather than by the more cumbersome and expensive personal service method;

- The special rules (e.g., certified versus regular U.S. mail) and challenges of serving noncorporate financial institutions (and how use of the FDIC website can help identify the correct address and agent for service); and
- The value of using motions to dismiss complaints in some instances as an educational opportunity to strength the complaint by exercising the unilateral amendment right under Rule 7015 within the 21 days following service of the motion rather than filing an opposition (but this opportunity only exists once as to the first motion to dismiss).

The seminar was interactive, and attendees were permitted to ask questions. Pop-up poll questions were presented to attendees at various points as well. As usual, a lengthy, detailed and informative program outline was provided to all registered participants.

The next CDCBAA members meeting and Zoom MCLE program will be held on July 15, 2023. The topics will be **"WITNESS TESTIMONY - TESTIFYING IN COURT AND AT MEETINGS OF CREDITORS"** and **"SETTLEMENT AGREEMENTS."** Our speaker will be David Lally, Esq. | Law Office of David Brian Lally. We hope you will join us.

Gary R. Wallace
Law Office of Gary R. Wallace
10801 National Boulevard, Suite 100
Los Angeles, CA 90064
Email: garyrwallace@ymail.com
Office: (310) 571-3511