



**ARIZONA SUPREME COURT
ORAL ARGUMENT CASE SUMMARY**



**DOBSON BAY CLUB II DD, LLC v. LA SONRISA DE SIENA, LLC
CV-16-0029-PR**

PARTIES:

Petitioner: La Sonrisa de Siena, LLC (**La Sonrisa**)

Respondent: Dobson Bay Club II DD, LLC (**Dobson Bay**)

FACTS:

In 2006, Canadian Imperial Bank of Commerce loaned Dobson Bay \$28.6 million. Dobson Bay signed a promissory note (**Note**) with a maturity date of September 8, 2009. The Note was secured by a deed of trust encumbering commercial properties. Under the Note, Dobson Bay was to make interest only payments with a **Balloon Payment** due upon maturity. In 2009, Dobson Bay and the bank extended the loan with a new maturity date of September 8, 2012. In the summer of 2012 Dobson Bay approached the bank to request a permanent loan or extension and they began negotiating. The bank sent monthly invoices showing the interest amount due and other charges and Dobson Bay continued to pay the monthly invoices.

On September 20, 2012 the bank prepared and sent Dobson Bay a forbearance letter (**Forbearance Agreement**) that Dobson Bay signed and sent back. Under the Forbearance Agreement, the bank would refrain from exercising its remedies under the loan documents solely on account of the maturity date (September 8, 2012) until December 8, 2012.

Article IV of the Note included a late-fee provision, which provided: "If any installment payable under this Note (including the final installment due on the Maturity Date) is not received by Lender prior to the calendar day after the same is due (without regard to any applicable cure and/or notice period), Borrower shall pay to Lender upon demand an amount equal to the lesser of (a) five percent (5%) of such unpaid sum or (b) the maximum amount permitted by applicable law to defray the expenses incurred by Lender in handling and processing such delinquent payment and to compensate Lender for the loss of the use of such delinquent payment, and such amount shall be secured by the Loan Documents."

On October 22, 2012, the bank sent a Notice of Event of Default advising that the Note had matured on September 8, 2012. The notice also stated that the Forbearance Agreement never became effective because the bank never signed the Forbearance Agreement due to administrative delays on its end. The bank sold the loan to La Sonrisa, who recorded a notice of trustee sale on December 7, 2012. Dobson Bay tendered a full payoff of the loan and La Sonrisa refused the tender, prompting Dobson Bay to file its complaint asking the court to force La Sonrisa to release the deed of trust upon payment in full of the Note and asking for other relief.

La Sonrisa claimed that because the loan had matured, La Sonrisa was entitled to proceed to trustee sale even though Dobson Bay offered to pay all amounts due. The trial court entered an order directing La Sonrisa to release the deed of trust upon payment of the amounts due under the loan documents. In addition to default interest, trustee's fees, attorneys' fees, costs, and compound interest charges, La Sonrisa demanded payment of a 5% late charge in the amount of approximately \$1.4 million.

La Sonrisa filed a motion to dismiss Dobson Bay's complaint and both parties moved for summary judgment on the claim to the late charge. La Sonrisa submitted the declaration of an expert witness who said that the late charge was reasonable. The trial court found that La Sonrisa was entitled to a 5% late charge as an enforceable liquidated damages provision based on the uncontroverted declaration as a matter of law. The trial court made other rulings regarding the claims of the parties to other penalties, fees, default interest and compound interest, which are not at issue in this matter.

The Court of Appeals disagreed with the trial court in a published opinion, finding:

“Therefore, with respect to both Canadian Imperial and La Sonrisa, we conclude as a matter of law that neither the anticipated nor actual losses reasonably approximate the \$1.4 million late fee. See Restatement § 356(1) (stating that liquidated damages may be agreed upon ‘but only at an amount that is reasonable in the light of the anticipated or actual loss caused by the breach’).”

In its conclusion, the Court of Appeals also stated:

“We hold, as a matter of law, that absent unusual circumstances the imposition of a flat 5% late-fee on a balloon payment for a conventional, fixed-interest rate loan is not enforceable as liquidated damages . . .”

Dobson Bay Club II DD, LLC v. La Sonrisa De Siena, LLC, 239 Ariz. 132, 138, 140 ¶¶16, 22, 366 P.3d 1022, 1028, 1030 (App. 2016). The Court of Appeals reversed the trial court's grant of partial summary judgment for La Sonrisa and directed the entry of partial summary judgment in favor of Dobson Bay and awarded Dobson Bay its attorneys' fees and costs on appeal.

ISSUES:

Arizona courts have consistently held that an agreement for liquidated damages is enforceable if, at the time the contract is made, both of the following two conditions are met: the amount fixed is a reasonable forecast of just compensation for the harm caused by a breach, and that harm is one that is incapable or very difficult of accurate estimation. Departing from established analytical framework, the court of appeals adopted a sweeping new rule for late fee provisions in fixed-interest rate loan agreements by holding, “as a matter of law, that absent unusual circumstances the imposition of a flat 5% late-fee on a balloon payment for a conventional, fixed-interest rate loan is not enforceable as liquidated damages.” Did the court of appeals

err in adopting this new rule and holding that a 5% late fee is an unenforceable penalty when applied to a final installment payment on a fixed-interest rate loan, despite the fact that at the time the loan agreement was made the harm that would be caused by a breach was very difficult to accurately estimate and the 5% late fee fixed by the parties in the agreement constituted a reasonable forecast of just compensation for that harm?”

Definitions:

Balloon Payment: A large payment due on the date that a promissory note matures. If a borrower is making monthly interest-only payments, the Balloon Payment will often require payment of the full principal amount of the loan when the loan becomes due.

Declaration: A written statement made under oath by a witness in a court case.

Deed of Trust: An agreement where the owner of real property pledges the real property as security for the payment of an obligation, usually a promissory note.

Promissory Note: A document evidencing the agreement of a borrower to repay a loan that includes the payment amounts, interest rate, and maturity date of the loan.

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