U.S. BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re **CANDELARIO and VERONICA MENDOZA,** **Debtors.**	In Chapter 13 proceedings Case No.: 10-18364 **MEMORANDUM DECISION UPHOLDING OBJECTION TO PROOF OF CLAIM and DENYING MOTION FOR RELIEF FROM STAY**

Late fees. It's all about the late fees. Are over $70,000 in late fees reasonable on $33,000 worth of loans? Under Arizona law, no. As such, the Court upholds the Debtors' objection to Charles Martin's proof of claim and denies Mr. Martin's motion to lift stay.

I. Background & Facts

Between February 1997 and June 2005 Mr. Martin made four loans to Mr. Mendoza.

<u>Loan One</u>

Date:	February 27, 1997
Makers:	Candelario Mendoza Anna Bustamante
Total Lent:	$9,000
Interest Rate:	15%
Monthly Payment:	$214.11
Term:	60 Months
Late Fee:	$5.00 per day
Prepayment Penalty:	25% of early principal reduction
Default Penalty:	10 day cure – declare entire amount due and payable
Default Interest:	18%
Deed of Trust filed:	February 28, 1997
Secured Property:	15845 N. Jerry St, Surprise AZ 85374 ("Property")

<u>Loan Two</u>

Date:	September 9, 1998
Makers:	Candelario Mendoza Anna Bustamante
Total Lent:	$4,400
Interest Rate:	15%
Payment:	$4,400
Term:	Entire amount due November 9, 1998
Late Fee:	$2.00 per day

Prepayment Penalty:	none
Default Penalty:	At Payee’s option entire amount due and payable.
Default Interest:	18%
Deed of Trust:	November 30, 1998
Secured Property:	Property

Loan Three

No details provided on terms of the loan. Both parties agree that it is paid in full.

Loan Four

Date:	June 28, 2005
Makers:	Candelario Mendoza
Total Lent:	$20,000
Interest Rate:	15%
Payment:	263.36
Term:	open – first of each month
Late Fee:	$3.00
Prepayment Penalty:	none
Default Penalty:	At Payee’s option entire amount due and payable.
Default Interest:	none
Deed of Trust:	none

Mr. Martin claims that Loan Four is secured by the Property via cross collateralization provisions in Loans One and Two. The Debtors dispute this claim.

The Debtors began payments of $214.11 on the loans on April 1, 1997. According to Mr. Martin’s records, Debtors continued making $214.11 payments, some occasionally late, until December 21, 1998. Thereafter, the Debtors made irregular payments – as to both amounts and dates-- until May 24, 2004 when the payments stopped completely. Payments, again irregular, resumed on June 11, 2005. The Debtors made their last payment on December 14, 2008. The Debtors did not designate any payments towards any specific loan.

According to his testimony, Mr. Martin applied payments to the loans in what he believed would be most advantageous to the Debtors. Mr. Martin did charge interest, but despite late payments, did not charge default interest. Instead, Mr. Martin charged late fees, as shown on Exhibits 3, 6, and 8, totaling $40,620, $15,460, and $17,316 for Loans One, Two, and Four respectively.

Mr. Martin testified that he provided the Debtor with statements regarding his loans that did reflect the late fees. However, Mr. Martin did not provide these statements during the trial and they are not part of the record. Mr. Martin did provide Exhibit 12 which, according to his testimony, he prepared and gave to the Debtors as a summary of all payments made by the Debtors and how Mr. Martin credited them to each loan. Notably, Exhibit 12's second column – Days Late – and Third column – Late Charge – are empty throughout the document.

The Debtors filed for bankruptcy on June 11, 2010. According to the Debtors' schedules and statements and plan ("Plan"), Mr. Martin holds a $9,000 claim against the Mr. Mendoza and a $4,400 claim against the community. Mr. Martin disagrees with the Debtors, insisting that he is owed at least $118,107.53.[1] Mr. Martin, claiming that the Property is worth only $66,000, objects to the Plan and asks the Court to lift stay so he can foreclose.

The Court held a trial on the matter on April 26, 2011. The parties completed post-trial briefing on May 19, 2011.

II. Analysis

Are the late fees allowed? Late fees are liquidated damages as they are "meant to compensate the lender for its internal costs in administering the delinquent borrower, such as contacting the borrower to prompt its payment, or selecting a lawyer to initiate foreclosure." Michael T. Madison, Jeffry R. Dwyer, and Steven W. Bender, Law of Real Estate Financing § 5:106 (July 2011). In Arizona, liquidated damages clauses are generally enforceable, but "will be deemed to be to a penalty, and therefore unenforceable, if [they] provide[] for an unreasonably large sum of damages." *Mining Investment Group, LLC v. Roberts*, 177 P.3d 1207, 1212 (Ariz. App. Div. 1 2008). Whether a contract provision is a penalty or not is a question of law. *Pima Sav. and Loan Ass'n v. Rampello*, 812 P.2d 1115, 1119 (Ariz. App. 1991). Liquidated damages clauses are only enforceable at "an amount that is reasonable in the light of the anticipated or

[1] The amount Mr. Martin claims he is owed varies from document to document.

Proof of claim :	$126,000.00
Objection to Plan:	$125,707.91
Motion for relief from stay:	$122,400.73
Joint pretrial statement:	$118,107.53
Post-trial brief:	$126,008.01

For purposes of the decision, the Court will accept the amount stated on the joint pretrial statement .

actual loss caused by the breach and the difficulties of proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on grounds of public policy as a penalty." RESTATEMENT (SECOND) OF CONTRACTS § 356(1).

As a preliminary matter, the Court is unconvinced that Mr. Martin was actually charging late fees. The left hand column of Exhibit 12 is a document prepared by Mr. Martin as part of a reconciliation meeting between the parties. Notably, Exhibit 12's second and third columns – Days Late and Late Charge – each are empty throughout the document. This indicates to the Court that Mr. Martin was either not making late charges or, if he was, he did not disclose them to the Debtors.

Even if Mr. Martin was making late charges, they are unreasonable and meant as a penalty. Loans One, Two, and Four provide for monthly penalties of up to $155, $62, and $93 respectively. For loans that go unpaid for months at a time, these amounts obviously have no connection to Mr. Martin's losses on the various loans. Tellingly, the late fee provisions in the notes for Loans Two and Four both state that the late fee "shall be charged as a penalty on any payment that is past due." In all, Mr. Martin asks for 21,626 days of late charges on all the loans. Twenty-one-thousand-six-hundred-twenty-six days of late charges are not intended to cover for anticipated or actual losses that were difficult to prove. Rather, they are meant as a penalty and are therefore unenforceable on public policy grounds.

Now that the Court has determined that there are no late fees, calculating the amount paid on the loans turns into a mathematical problem. Exhibit 12, prepared by Mr. Martin, is the best evidence of the payments made by the Debtors on all four loans. The Court has prepared a reconciliation showing the payments made by the Debtors against each loan (attached as Exhibit A). Exhibit A shows that the Debtors paid off Loans One and Two in August 2003.[2] Thereafter, the Debtors continued making payments until Loan Three was paid off in July 2004. However, between August 2003 and July 2004 the Debtors were also still making payments on Loans One and Two, resulting in

[2] The Debtors Exhibit B shows payments on Loan 2 which are not reflected on Mr. Martin's exhibits. The Court accepts Exhibit 12 as the best evidence of payments received.

overpayment of just over $4,000. When this amount is pre-applied to Loan Four, which was not originated until 2005, the beginning loan balance drops to just under $16,000. Because Loan One, Two, and Three are paid off by July 2004, all payments made by the Debtors beginning in June 2005 are applied to Loan Four leaving a total balance due on Loan Four of just over $2,000 by the time the bankruptcy is filed.

Having determined the claim amount, the Court must now determine if the claim is secured or unsecured. Both parties acknowledge that the Loan Four deed of trust is signed only by Mr. Mendoza. In Arizona, the signature of both spouses is required to encumber the community's interest in real property. A.R.S. §25-214(C)(1). Therefore, Mr. Martin's claimed secured status depends on provisions in Loans One and Two. As explained in his closing arguments:

> Mendoza was to keep payments of any prior mortgage and real property taxes up to date (Trial Ex. 2 at Provision 3; Trial Ex. 5 at Provision 3) and if he did not, the amounts required to be paid to Martin could be and were, in the case of the $20,000.00 Note, added to the balance of the loans. (Trial Ex. 2 at provision 21; Trial Ex. 5 at Provisions 8& 16).

Pl.'s Post-Hr'g. Memo. ¶ 9. Mr. Martin's logic fails because by the time Mr. Martin lent the $20,000 to Mr. Mendoza, Loans One and Two were paid off thereby extinguishing any cross collateralization provisions they contained.

III. Conclusion

The Debtors have paid all but $2,257.87 on their loans to Mr. Martin. The $2,257.87 is unsecured. Accordingly, the Debtors objection to the proof of claim is sustained to that extent and Mr. Martin's motion for relief from stay is denied. Counsel for Debtors is to upload a separate form of order for each matter.

So ordered.

Dated: September 26, 2011

CHARLES G. CASE II
UNITED STATES BANKRUPTCY JUDGE

COPY of the foregoing mailed by the BNC and/or sent by auto-generated mail to:

All interested parties

EXHIBIT A

Loan 1	Loan 2	Loan 3	Loan 4
$ 9,000.00	$ 4,400.00	?	$ 20,000.00
60 months	Due 11-9-98	?	240 months
15%	15%	?	15%

	Payments		Loan 1			Loan 2			Loan 3	Loan 4		
Month	**Pymt Date**	**Total Pymt**	**Principal**	**Interest**	**Payment**	**Principal**	**Interest**	**Payment**	**Payment**	**Principal**	**Interest**	**Payment**
Apr-97	4/1/97	$ 214.11	$ 9,000.00	$ 112.50	$ 214.11							
May-97	4/30/97	214.11	8,898.39	111.23	214.11							
Jun-97	5/31/97	214.11	8,795.51	109.94	214.11							
Jul-97	6/30/97	214.11	8,691.34	108.64	214.11							
Aug-97	8/1/97	214.11	8,585.88	107.32	214.11							
Sep-97			8,479.09	105.99								
Oct-97	9/2/97	214.11	8,585.08	107.31	214.11							
	9/29/97	214.11			214.11							
Nov-97			8,264.17	103.30								
Dec-97	11/3/97	214.11	8,367.47	104.59	214.11							
	11/28/97	214.11			214.11							
Jan-98			8,043.85	100.55								
Feb-98	1/5/98	214.11	8,144.39	101.80	214.11							
Mar-98	2/9/98	214.11	8,032.09	100.40	214.11							
Apr-98	3/2/98	214.11	7,918.38	98.98	214.11							
	4/1/98	214.11										
May-98			7,803.25	97.54								
Jun-98	5/3/98	214.11	7,900.79	98.76	214.11							
Jul-98	6/3/98	214.11	7,785.44	97.32	214.11							
Aug-98	7/6/98	214.11	7,668.65	95.86	214.11							
Sep-98	8/15/98	214.11	7,550.40	94.38	214.11							
Oct-98	9/15/98	214.11	7,430.67	92.88	214.11							
Nov-98	10/13/98	214.11	7,309.44	91.37	214.11	$ 4,400.00	$ 55.00					
Dec-98			7,186.70	89.83		4,455.00	55.69					
Jan-99	12/21/98	831.22	7,276.53	90.96	758.22	4,510.69	56.38	$ 73.00				
Feb-99	1/14/99	269.11	6,609.27	82.62	214.11	4,494.07	56.18	55.00				
Mar-99	2/9/99	614.11	6,477.77	80.97	214.11	4,495.25	56.19	400.00				
Apr-99	3/4/99	214.11	6,344.64	79.31	214.11	4,151.44	51.89					
	3/26/99	1,000.00					-	1,000.00				
May-99	4/6/99	214.11	6,209.83	77.62	214.11	3,203.33	40.04					
Jun-99	5/15/99	214.11 [1]	6,073.35	75.92	214.11	3,243.37	40.54					
Jul-99	6/29/99	1,000.00	5,935.15	74.19		3,283.91	41.05	1,000.00				
Aug-99	7/7/99	628.22	6,009.34	75.12	628.22	2,324.96	29.06					
Sep-99			5,456.24	68.20		2,354.03	29.43					
Oct-99	9/8/99	332.10	5,524.44	69.06	332.10	2,383.45	29.79					
	9/28/99	544.90			330.00		-	214.90				
Nov-99	10/29/99	364.08	4,931.40	61.64	349.11	2,198.34	27.48	14.97				
Dec-99			4,643.93	58.05		2,210.85	27.64					
Jan-00	12/18/99	500.00	4,701.98	58.77	449.11	2,238.49	27.98	50.89				
Feb-00			4,311.65	53.90		2,215.58	27.69					
Mar-00			4,365.54	54.57		2,243.27	28.04					
Apr-00			4,420.11	55.25		2,271.32	28.39					
May-00	4/17/00	1,000.00	4,475.36	55.94	756.00	2,299.71	28.75	244.00				
Jun-00			3,775.30	47.19		2,084.45	26.06					
Jul-00	6/20/00	261.85	3,822.50	47.78	131.77	2,110.51	26.38	62.34	$ 67.74			
Aug-00	7/25/00	261.85	3,738.51	46.73	131.77	2,074.55	25.93	62.34	67.74			
Sep-00			3,653.47	45.67		2,038.14	25.48					
Oct-00	9/8/00	261.85	3,699.14	46.24	131.77	2,063.62	25.80	62.34	67.74			
Nov-00	10/17/00	261.85	3,613.61	45.17	145.00	2,027.07	25.34	58.00	58.85			
Dec-00	11/2/00	360.02	3,513.78	43.92	134.47	1,994.41	24.93	62.74	162.79			
Jan-01			3,423.23	42.79		1,956.60	24.46					
Feb-01			3,466.02	43.33		1,981.06	24.76					
Mar-01			3,509.34	43.87		2,005.82	25.07					
Apr-01			3,553.21	44.42		2,030.90	25.39					
May-01			3,597.63	44.97		2,056.28	25.70					
Jun-01	5/17/01	2,000.00	3,642.60	45.53	922.39	2,081.99	26.02	436.38	641.23			

Jul-01	6/20/01	400.00	2,765.74	34.57	136.94	1,671.63	20.90	62.34	200.72			
	6/29/01	100.00					-		100.00			
Aug-01	7/21/01	526.00	2,663.37	33.29	136.94	1,630.19	20.38	62.34	326.72			
Sep-01	8/30/01	500.00	2,559.72	32.00	191.94	1,588.22	19.85	80.38	227.68			
Oct-01	9/21/01	500.00	2,399.78	30.00	136.94	1,527.70	19.10	85.38	304.68			
Nov-01			2,292.84	28.66		1,461.41	18.27					
Dec-01	11/18/01	500.00	2,321.50	29.02	136.94	1,479.68	18.50	85.38	304.68			
	12/1/01	500.00					-	85.38	304.68			
Jan-02	12/28/01	500.00	2,213.57	27.67	136.94	1,327.42	16.59	85.38	304.68			
Feb-02			2,104.30	26.30	136.94	1,258.63	15.73					
Mar-02	2/2/02	500.00	1,993.67	24.92	136.94	1,274.36	15.93	85.38	304.68			
Apr-02	3/23/02	500.00	1,881.65	23.52	136.94	1,204.91	15.06	85.38	304.68			
May-02	5/1/02	500.00	1,768.23	22.10	138.64	1,134.59	14.18	59.11	302.25			
Jun-02			1,651.69	20.65		1,089.67	13.62					
Jul-02			1,672.34	20.90		1,103.29	13.79					
Aug-02	7/10/02	500.00	1,693.24	21.17	248.65	1,117.08	13.96	103.11	148.24			
	7/30/02	122.00					-	10.73	111.27			
Sep-02			1,465.76	18.32		1,017.20	12.72					
Oct-02	9/25/02	500.00	1,484.08	18.55	143.97	1,029.92	12.87	194.76	161.27			
Nov-02			1,358.66	16.98		848.03	10.60					
Dec-02	11/14/02	500.00	1,375.64	17.20	440.00	858.63	10.73	60.00	-			
Jan-03			952.84	11.91		809.36	10.12					
Feb-03			964.75	12.06		819.48	10.24					
Mar-03			976.81	12.21		829.72	10.37					
Apr-03	3/10/03	300.00	989.02	12.36	169.92	840.09	10.50	67.74	67.74			
May-03			831.46	10.39		782.86	9.79					
Jun-03			841.86	10.52		792.64	9.91					
Jul-03			852.38	10.65		802.55	10.03					
Aug-03			863.03	10.79		812.58	10.16					
Sep-03	8/7/03	3,984.80	873.82	10.92	884.75	822.74	10.28	833.02	752.06			$ 1,514.97 [2]
Oct-03	9/12/03	360.00					-		81.70			278.30
			-	-		-	-					-
Nov-03	10/17/03	360.00	-	-		-	-		81.70			278.30
Dec-03	11/19/03	360.00	-	-		-	-		81.70			278.30
Jan-04	12/27/03	360.00	-	-		-	-		81.70			278.30
Feb-04	1/17/04	360.00	-	-		-	-		81.70			278.30
Mar-04	2/18/04	360.00	-	-		-	-		81.70			278.30
Apr-04			-	-		-	-					-
May-04	4/3/04	360.00	-	-		-	-		81.70		**Total**	278.30
Jun-04	5/24/04	720.00	-	-		-	-		163.40		**Overpayment**	556.60
Jul-04	6/25/04	360.00	-	-		-	-		360.00		$ 4,019.67	-
Aug-04	7/14/04	173.78	-	-		-	-		173.78			-
Sep-04			-	-		-	-					-
Oct-04			-	-		-	-					-
Nov-04			-	-		-	-					-
Dec-04			-	-		-	-					-
Jan-05			-	-		-	-					-
Feb-05			-	-		-	-					-
Mar-05			-	-		-	-					-
Apr-05			-	-		-	-					-
May-05			-	-		-	-					-
Jun-05			-	-		-	-					-
Jul-05	6/11/05	254.85	-	-		-	-			$ 15,980.33		254.85
Aug-05	7/28/05	504.84	-	-		-	-			15,725.48	196.57	504.84
Sep-05	8/24/05	580.00	-	-		-	-			15,417.21	192.72	580.00
Oct-05	9/29/05	580.00	-	-		-	-			15,029.92	187.87	580.00
Nov-05	10/28/05	580.00	-	-		-	-			14,637.80	182.97	580.00
Dec-05	11/30/05	580.00	-	-		-	-			14,240.77	178.01	580.00
Jan-06	12/29/05	580.00	-	-		-	-			13,838.78	172.98	580.00
Feb-06			-	-		-	-			13,431.76	167.90	-
Mar-06			-	-		-	-			13,599.66	170.00	-
Apr-06	3/16/06	1,000.00	-	-		-	-			13,769.66	172.12	1,000.00
May-06			-	-		-	-			12,941.78	161.77	-

Jun-06	5/26/06	750.00	-	-	-	-		13,103.55	163.79	750.00
Jul-06	6/20/06	750.00	-	-	-	-		12,517.34	156.47	750.00
Aug-06			-	-	-	-		11,923.81	149.05	-
Sep-06			-	-	-	-		12,072.86	150.91	-
Oct-06			-	-	-	-		12,223.77	152.80	-
Nov-06	10/4/06	1,000.00	-	-	-	-		12,376.56	154.71	1,000.00
Dec-06	11/8/06	1,000.00	-	-	-	-		11,531.27	144.14	1,000.00
Jan-07	12/23/06	1,000.00	-	-	-	-		10,675.41	133.44	1,000.00
Feb-07			-	-	-	-		9,808.86	122.61	-
Mar-07			-	-	-	-		9,931.47	124.14	-
Apr-07			-	-	-	-		10,055.61	125.70	-
May-07	4/10/07	1,000.00	-	-	-	-		10,181.30	127.27	1,000.00
Jun-07	5/10/07	1,000.00	-	-	-	-		9,308.57	116.36	1,000.00
Jul-07			-	-	-	-		8,424.93	105.31	-
Aug-07	8/1/07	900.00	-	-	-	-		8,530.24	106.63	900.00
Sep-07			-	-	-	-		7,736.87	96.71	-
Oct-07	9/22/07	750.00	-	-	-	-		7,833.58	97.92	750.00
Nov-07			-	-	-	-		7,181.50	89.77	-
Dec-07	11/10/07	750.00	-	-	-	-		7,271.27	90.89	750.00
Jan-08			-	-	-	-		6,612.16	82.65	-
Feb-08	1/28/08	700.00	-	-	-	-		6,694.81	83.69	700.00
Mar-08			-	-	-	-		6,078.49	75.98	-
Apr-08			-	-	-	-		6,154.48	76.93	-
May-08			-	-	-	-		6,231.41	77.89	-
Jun-08	5/9/08	700.00	-	-	-	-		6,309.30	78.87	700.00
Jul-08			-	-	-	-		5,688.17	71.10	-
Aug-08	7/8/08	2,000.00	-	-	-	-		5,759.27	71.99	2,000.00
Sep-08	8/7/08	1,500.00	-	-	-	-		3,831.26	47.89	1,500.00
Oct-08	8/29/08	1,000.00				-			-	1,000.00
Nov-08			-	-	-	-		2,379.15	29.74	-
Dec-08			-	-	-	-		2,408.89	30.11	-
Jan-09	12/14/08	500.00	-	-	-	-		2,439.00	30.49	500.00
Feb-09								1,969.49	24.62	-
Mar-09								1,994.11	24.93	-
Apr-09								2,019.03	25.24	
May-09								2,044.27	25.55	
Jun-09								2,069.82	25.87	
Jul-09								2,095.70	26.20	
Aug-09								2,121.89	26.52	
Sep-09								2,148.42	26.86	
Oct-09								2,175.27	27.19	
Nov-09								2,202.46	27.53	
Dec-09								2,229.99	27.87	
								2,257.87		
		Total Pymts	**Total Int**	**Total Pymts**	**Total Int**	**Total Pymts**	**Total Pymts**	**Princ Due**	**Total Int**	**Total Pymts**
		49,867.85	**4,437.85**	**13,437.85**	**1,442.71**	**5,842.71**	**6,561.20**	**2,257.87**	**9,256.90**	**23,979.36**

NOTES:
1. All payments in Total Pymt and Loan 3 Payment Columns taken from Exhibit 12, except June 1999 Totally Pymt which is cut off in Exhibit 12, but appears in Exhibit 3.
2. Overpayment in Loan 4 Payment column calculated by subtracting the payments for Loans 1, 2 & 3 from the Total Pymt amount.