DIVISION ONE
FILED: 06/20/2013
RUTH A. WILLINGHAM, CLERK
BY: GH

IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

JOHN BROWN, Plaintiff/Appellee, v. STEPHEN SINGER and LISA SINGER, Defendants/Appellants.	)	1 CA-CV 12-0233 DEPARTMENT B **MEMORANDUM DECISION** (Not for Publication – Rule 28, Arizona Rules of Civil Appellate Procedure)

Appeal from the Superior Court in Maricopa County

Cause No. CV2009-009598

The Honorable Larry Grant, Judge

AFFIRMED IN PART, REVERSED IN PART, REMANDED WITH INSTRUCTIONS

William James Fisher — Phoenix
Attorney for Plaintiff/Appellee

Engelman Berger, P.C. — Phoenix
by Thomas R. Nolasco
Attorneys for Defendants/Appellants

H O W E, Judge

¶1 Steve and Lisa Singer ("the Singers") appeal the superior court's judgment in favor of John Brown, on his breach of lease claim and award of damages, attorneys' fees and costs.

For the following reasons, we affirm in part, reverse in part, and remand with instructions.

FACTS AND PROCEDURAL HISTORY

¶2 The Singers lived in a Paradise Valley home that they rented as tenants under a lease with Scali, the homeowner. The Singers intended to eventually purchase the home, and had deposited $100,000 with the owner as a purchase option. This purchase option expired November 30, 2007. If the Singers exercised the option, the deposit money would be credited toward the purchase price. As the November 30 deadline drew near, the Singers realized that they would not be able to purchase the home and contacted a friend, Brown, to become an "assignee" of their purchase option rights, purchase the home, and become their landlord for one year while they lived in the home. As part of their plan, the Singers wanted to recover their purchase option deposit from Scali to use to pay rent to Brown.

¶3 Brown agreed to the arrangement, and Scali and Brown began negotiations to purchase the home. Scali and Brown placed a provision in the home purchase agreement stating that the seller, Scali, was to refund all deposits and option money to the tenant. The Singers and Brown entered into a lease agreement on December 31, 2007, just four days before Brown and Scali were to close on the home.

¶4 The one-page lease was effective January 4, 2008, to January 4, 2009. The lease provided that rent was $10,000 per month, and "[i]f rent is not received within 5 calendar days of the due date, tenant agrees to pay a $500 late fee plus $100 per calendar day for each day late after the 5th day." The lease also stated that it constituted the full and complete agreement between the parties and was intended to be a legally binding contract. It further stated that in the event of litigation, all parties agreed that the opposing party would pay the prevailing party's attorneys' fees and costs.

¶5 Scali, who had not only been the Singers' landlord but also an investor in their business, decided to withhold the $100,000 before the parties were to close on the home, so that he could apply it toward a debt the Singers owed him. Because the Singers did not receive this money, they were not able to pay the first rent payment. Thereafter, the Singers met with Scali and attempted to obtain the $100,000, but were unsuccessful. The Singers made only two $3,000 payments to Brown as partial rent before moving out of the residence on May 12, 2008.

¶6 Brown sued the Singers for breach of the lease, stating that they owed the principal amount of $114,000 as of January 4, 2009, with monthly expense and late charges continuing to accrue thereafter. On June 17, 2011, the court

held a one-day bench trial. Brown testified that the parties agreed that he would purchase the property from Scali, Scali would return the $100,000 to the Singers, and the Singers would use the money to pay the rent. Brown testified that his contract with Scali required Scali to refund all option monies to the tenant to ensure that the $100,000 would be refunded to the Singers. Brown testified that in mid-December, he first learned that Scali might not refund the $100,000, and might offset that money against other debt the Singers owed to him. Brown also testified that he calculated the late fees to start at five percent of the rent, with an additional one percent late charge each late day, and that the total late fee charges owed on the property as of the date of trial were approximately $1.3 million. He also testified that the late fees were an incentive for the tenant to pay rent on time.

¶7 Scali testified that the Singers had paid a nonrefundable $100,000 deposit for an option to purchase the property from him. He stated that he sent the Singers a default notice on December 12, 2007, for a $100,000 loan that he had made to them in October. He decided that he did not want to refund the Singers $100,000 of their option money when they owed him $100,000 on a separate loan. He also stated that he clearly conveyed this to the Singers by December 17, 2007. He admitted that at the time of closing he applied the $100,000 deposit to

offset the other debt. In closing, Brown's attorney noted that the late fee charges were not a penalty.

¶8 The court found that because the Singers failed to timely exercise the purchase option, they lost the $100,000 deposit. The court further found that the lease between Brown and the Singers was a valid contract, and the parties had made no mutual mistake concerning the formation of the contract. The court also found that because the purchase option had expired, it could not constitute a condition precedent to the formation of the contract between Brown and the Singers. Therefore, the court ruled that the Singers breached the lease contract with Brown. The ruling did not address the amount of the award granted to Brown, but the court asked Brown to submit an appropriate proposed order.

¶9 Before Brown submitted a proposed order, the Singers moved for reconsideration of the court's ruling and requested an evidentiary hearing on the amount of damages. They stated that they had anticipated that Brown would seek late fees of $1.4 million, and noted that the court's ruling did not address the reasonableness of the late fees or whether they were enforceable. While the calculation of damages was not discussed at trial, Brown had submitted into evidence an exhibit that calculated damages. In the exhibit, Brown apparently compounded the late fees daily beginning in January 2007 and continued to

charge late fees until the date of trial. For example, for each day the first month's rent payment was not paid, the Singers were charged $100 per day plus a $500 charge. By the second month, the Singers were charged $200 per day because they had not paid rent for the first and second months plus another $500 charge. This continued throughout the lease term, until by the twelfth month, the Singers had been charged $1,200 per day, and this amount accrued each day until the day of trial. Brown's trial exhibit showed that the Singers owed in total $1,311,000 in late fees, from January 4, 2008 until June 17, 2011, the date of trial.

¶10 As the Singers had anticipated, Brown submitted his proposed order requesting total damages of $1,545,718.00.[1] Without addressing the Singers' motions, the court granted judgment in favor of Brown, and awarded him his requested damages plus interest at the rate of ten percent from September 2, 2011, until fully paid. Costs and attorneys' fees were awarded to Brown. The Singers timely appeal this judgment.

[1] The record does not explain how this number was determined. Apparently, Brown continued to charge the Singers late fees after the date of trial and until the date of judgment. According to Brown's trial exhibit, aside from late fees, the Singers owed him the principal amount due on the lease ($114,000), electric and water bills ($3,639), Maintenance, repairs, pest control and cleaning charges ($4,678) and charges for damages and stolen property ($4,150).

DISCUSSION

¶11 The Singers argue that (1) the lease should be rescinded for the parties' mutual mistake; (2) the failure of the condition precedent voids the lease agreement; (3) the lease's late fee provision is unenforceable because it is a penalty and unconscionable; (4) the trial court erred by failing to allow the Singers to present evidence of the unconscionability of damages; (5) the lease agreement did not support Brown's damage award for utilities; and (6) the final judgment improperly stated that post-judgment interest would be incurred at a rate of ten percent.

¶12 We review the interpretation of a contract de novo because it is a question of law. *Grubb & Ellis Mgmt. Servs., Inc. v. 407417 B.C., L.L.C.*, 213 Ariz. 83, 86, ¶ 12, 138 P.3d 1210, 1213 (App. 2006). We will not set aside the trial court's factual findings unless they are clearly erroneous or unsupportable by any credible evidence. *Kocher v. Ariz. Dep't of Revenue*, 206 Ariz. 480, 482, ¶ 9, 80 P.3d 287, 289 (App. 2003).

I. Mutual Mistake

¶13 The Singers argue that the lease contract should be rescinded due to the parties' mutual mistake because both parties believed that Scali would refund $100,000 to the Singers. We reject this argument because substantial evidence

supports the trial court's finding that the parties made no mutual mistake.

¶14 A party seeking to rescind a contract for mutual mistake must show by clear and convincing evidence that (1) the parties were mutually mistaken about a "basic assumption" of the contract; (2) the party seeking avoidance must show that the mistake had a material effect on the agreed exchange of performances; and (3) the party did not bear the risk that the mistake might occur. *Emmons v. Superior Court*, 192 Ariz. 509, 513, ¶ 15, 968 P.2d 582, 586 (App. 1998); Restatement (Second) of Contracts § 152 cmt. (a) (1981). A party bears the risk of mistake when he is aware at the time he enters the contract that he has only limited knowledge about the facts to which the mistake relates, but treats this limited knowledge as sufficient. Restatement (Second) of Contracts § 154 (1981).

¶15 Here, the Singers bore the risk of mistake because they entered into a lease contract with limited knowledge whether they would receive the $100,000. They knew at the time of signing the lease agreement that their purchase option on the property had lapsed. Although they may have believed that they would reacquire that money from Scali, the Singers entered into the lease contract bearing the risk that they would not, because they put nothing into the lease agreement that made the arrangement contingent upon their receipt of that money.

Further, Scali testified that the Singers were aware by December 17, 2012, that Scali was not going to give back the $100,000, yet the Singers signed the lease contract on December 31. Substantial evidence thus supports the court's finding that no mutual mistake existed about the formation of the lease contract between the Singers and Brown.

II. Condition Precedent

¶16 The Singers also argue that the return of the $100,000 option money was a condition precedent to their performance under the lease agreement with Brown. We reject this argument because substantial evidence supports the trial court's finding no failure of a condition precedent because the Singers failed to exercise their option to purchase the property.

¶17 The parties to a contract may create a condition precedent by agreeing that a fact must exist before the duty to perform arises. 17A C.J.S. Contracts § 446 (2013). Conditions precedent are not favored, and courts are not inclined to construe a provision as a condition precedent unless the contract's language plainly and unambiguously requires such a construction. *Angle v. Marco Builders, Inc.,* 128 Ariz. 396, 399-400, 626 P.2d 126, 129-30 (1981).

¶18 Here, the lease terms are unconditional, and no evidence in the record shows that the Singers and Brown had orally agreed that the lease was conditional upon the receipt of

$100,000 from Scali. While the parties may have believed that the money would be returned, and the Singers may not have gone through with the lease if they had known that they were not going to receive that money, nothing shows that Brown and the Singers had agreed that this was a condition that must occur before the lease contract would be enforced. In fact, the lease does not mention the receipt of the option money from Scali. The trial court found no failure of a condition precedent because the Singers failed to act before the option lapsed on November 30, 2007. Substantial evidence supports the trial court's finding.

III. Late Fees as a Penalty

¶19 The Singers argue that the late fee provision demanding $500 plus $100 per day——which, according to Brown's calculations that the trial court accepted, resulted in late fee charges of approximately $1.3 million——is unenforceable because it is a penalty. They also argue that the trial court should have conducted an evidentiary hearing before awarding such damages.

¶20 Brown argues that the Singers have waived these arguments because they did not raise them in the answer or pretrial statement. But the Singers did not waive them. Although the Singers did not contest the specific amount of damages in either pleading, Brown did not state in the complaint the amount

of damages he sought, and stated in the joint pretrial statement only that he sought compensatory damages resulting from the Singers' breach of the lease agreement without providing the amount of damages. The Singers were under the impression that Brown was seeking damages of approximately $80,000, which included $40,000 in late fees, according to their bench memorandum filed before trial. In the bench memorandum, they argued that the late fees were unconscionable as a penalty and not proper liquated damages. When they learned instead at the bench trial that Brown was seeking more than $1 million in late fees, they moved for an evidentiary hearing on the amount of damages and objected to Brown's proposed judgment, arguing that the late fee amount was an unenforceable penalty. Because the Singers were not aware of the amount of damages sought by Brown until trial, and argued that the late fee amount was unenforceable as a penalty as soon as they learned of the amount, they preserved their arguments for appeal.

¶21 We agree that that the lease's late fee provision is not an enforceable liquidated damages clause. Liquidated damages clauses are encouraged as a mechanism for parties to avoid litigation and equitably resolve potential conflicts. *Pima Sav. and Loan Ass'n v. Rampello*, 168 Ariz. 297, 299, 812 P.2d 1115, 1117 (App. 1991). Such clauses can set the amount of damages, "but only at an amount that is reasonable in the light of the

anticipated or actual loss caused by the breach, and the difficulties in proof of loss. A term fixing unreasonably large liquidated damages is unenforceable on the grounds of public policy as a penalty." Restatement (Second) of Contracts § 356 (1981). Whether a provision is a liquidated damages clause or a penalty is a question of law for the court. *Pima Sav. and Loan Ass'n,* 168 Ariz. at 300, 812 P.2d at 1118.

¶22 A liquidated damages clause will be upheld only if (1) the amount fixed in the contract is a reasonable forecast of just compensation for harm caused by breach, and (2) the harm caused by breach is incapable or very difficult of accurate estimation. *Id*. The difficulties of proof of loss are determined at the time the contract is made and not at the time of the breach. *Id*. Additionally, the fixed amount is reasonable to the extent that it approximates the loss anticipated at the time of the making of the contract, even though it may not approximate the actual loss. *Id*. The amount retained upon a contract's breach will be considered a penalty if it is unreasonable. *Id*. The party seeking damages has the burden of persuasion to show that the clause is for liquidated damages and not a penalty. *Mech. Air Eng'g Co. v. Totem Const. Co.*, 166 Ariz. 191, 194, 801 P.2d 426, 429 (App. 1989).

¶23 Brown has not fulfilled his burden. The late fee amount at issue here, of $500 for the first late day and an

additional $100 per day per late month, is not a reasonable forecast of just compensation for the harm caused by the breach. An appropriate late fee charge may compensate a landlord for the expense and inconvenience in collecting late rent or as an incentive to the tenant to timely pay rent. *Gershin v. Demming*, 685 N.E.2d. 1125, 1128 (App. 1997). The late fee provision here, however, resulted in approximately $1.3 million in late fees and is more than ten times the total contract price for the full lease term. Further, the method of assessing the fees—— continuing to charge daily late fees after the lease term expired and until judgment——is a penalty and not a method to compensate Brown for actual damages resulting from the Singers' breach. *See Gershin*, 685 N.E.2d. at 1128-29 (daily late fee could not be assessed after expiration of term of lease, since by that time actual damages could be ascertained and fee became penalty rather than liquidated damages). Brown presented no evidence at trial demonstrating that the late fee charge amount represented a reasonable estimate of actual harm caused by the breach. Without more in the record, the $1.3 million in late fee charges is an unreasonable amount to pay for a $120,000 lease making it a penalty and against public policy.[2] Moreover, Brown

[2] The Restatement (Second) of Contracts § 356, comment (c) provides the following illustration:

presented no evidence that the harm caused by the Singers' failure to pay rent of $10,000 a month for twelve months was incapable or very difficult of accurate estimation.

¶24 Because we find that the liquidated damages clause is an unreasonable penalty, we refuse to enforce it and limit Brown's recovery of late fees only to actual loss. *Mech. Air Eng'g Co.*, 166 Ariz. at 193, 801 P.2d at 428. We therefore reverse the award of the late fees to Brown and remand with instructions for the court to award Brown $114,000 in unpaid rent, and to hold an evidentiary hearing for Brown to prove actual damages for yard clean up and maintenance, pool repair and maintenance, home cleaning, pest control, repairs and paint, stolen lights and mirrors, and damage to the master bedroom door that were discussed but never determined at trial.

IV. Utilities Award and Post-Judgment Interest

¶25 The Singers argue that the court's judgment includes damages for electric and water bills, but the lease agreement does not provide that the tenant must pay utilities, so they

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> A contracts to build a house for B for $50,000 by a specified date or in the alternative to pay B $1,000 a week during any period of delay. A delays completion for ten days. If $1,000 a week is unreasonable in the light of both the anticipated and actual loss, A's promise to pay $1,000 a week is, in spite of its form, a term providing for a penalty and is unenforceable on the grounds of public policy.

should not be obligated to bear those costs. The Singers also argue that the judgment must be amended because it applies a higher interest rate than required under A.R.S. § 44-1201(B). Brown concedes these points on appeal, and we agree. We reverse the damage award for utilities owed after the Singers vacated the home and remand to the trial court to set the correct interest rate.

V. Attorneys' Fees and Costs on Appeal

¶26 The Singers request an award of attorneys' fees and costs on appeal pursuant to A.R.S. § 12-341.01(A), -331, and Arizona Rule of Civil Appellate Procedure ("ARCAP") 21. Brown requests attorneys' fees under ARCAP 21.[3] Section 12-341.01(A) provides that attorneys' fees may be awarded to the successful party in a contested action arising out of contract. Although Brown has prevailed, we decline to award attorney's fees. However, pursuant to § 12-341, we award the Singers their costs on appeal upon compliance with ARCAP 21.

CONCLUSION

¶27 For the above mentioned reasons, we affirm in part, reverse in part and remand with instructions that the court award Brown $114,000 in unpaid rent, and hold an evidentiary

[3] Rule 21 is not a substantive basis for a fee award. *Bed Mart, Inc. v. Kelley*, 202 Ariz. 370, 375, ¶ 24, 45 P.3d 1219, 1224 (App. 2002).

hearing for Brown to prove actual damages for yard clean up and maintenance, pool repair and maintenance, home cleaning, pest control, repairs and paint, stolen lights and mirrors, and damage to the master bedroom door.

_____/s/_____
RANDALL M. HOWE, Judge

CONCURRING:

__/s/_____
PATRICIA K. NORRIS, Presiding Judge

__/s/_____
ANDREW W. GOULD, Judge