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NOT TO BE PUBLISHED IN THE OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

SA CHALLENGER, INC., Plaintiff and Appellant, v. GERSON I. FOX, Defendant and Respondent.	B259985 (Los Angeles County Super. Ct. No. SC114300)

APPEAL from a judgment of the Superior Court of Los Angeles County, Gerald Rosenberg, Judge. Affirmed in part, and reversed in part with directions.

Katten Muchin Rosenman, Joshua D. Wayser, Steve Cochran, Brian J. Tanada and Ryan J. Larsen for Plaintiff and Appellant.

Slaughter, Reagan & Cole, William M. Slaughter and Gabriele M. Lashly for Defendant and Respondent.

SA Challenger, Inc. appeals from the judgment confirming an arbitration award of approximately $1.3 million in attorney fees and costs in favor of Gerson I. Fox entered after the arbitrator found Fox was not liable on a loan guaranty because his purported signature on the guaranty was not genuine. Challenger contends the superior court erred in declining to vacate the arbitration award based on the arbitrator's refusal to hear evidence (Code Civ. Proc., § 1286.2, subd. (a)(5))[1] and denying a setoff for a judgment in favor of Challenger, as assignee, in another action and a sanctions award in favor of Challenger in this proceeding.

We affirm the order denying the petition to vacate the arbitration award, but reverse the judgment and remand for the superior court to enter a new judgment that recognizes a setoff for both the judgment in the other action and the sanctions award in this case.

FACTUAL AND PROCEDURAL BACKGROUND

1. *The Parties and Other Participants in the Litigation*

Challenger is a wholly-owned subsidiary of U.S. Bank National Association, formed to handle foreclosure assets. U.S. Bank typically assigns the promissory note and deed of trust to Challenger prior to a foreclosure.

Fox retired from the jewelry business in the 1990's and began investing in real estate. He was in his mid-to-late 80's at the time of the arbitration proceedings in this case and was suffering from heart problems and type 2 diabetes. Because of his age and physical health, Fox was assisted in his business and legal affairs by his son, Theodore (Ted) Fox.

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[1] Statutory references are to this code.

Michael Kamen invested in real estate and ran a property management company known as MIKA Realty Group. Kamen and Fox invested together in numerous real estate transactions beginning in the 1990's. MIKA managed the properties. Fox was a passive investor.

Rick Barreca became MIKA's chief executive officer in October 2006. Kevin Golshan was a real estate investor and a friend of Kamen.

2. *The Madison Heights Investment and Loan Guaranty*

In November 2007, following discussions among Barreca, Kamen and representatives of California National Bank, the bank made a $13.8 million secured loan to Madison Heights Partners, LLC for an industrial real estate project near Detroit, Michigan. A guaranty dated November 20, 2007 for the Madison Heights loan appears to bear the signatures of Kamen, Golshan and Fox as guarantors.

On October 16, 2009 California National Bank recorded a notice of default on the loan. The Federal Deposit Insurance Corporation later took over California National Bank and transferred the Madison Heights loan to U.S. Bank, which assigned the loan to Challenger.

3. *The Initial Trial Court Proceedings*

On September 28, 2011 Challenger filed a verified complaint against Kamen, Golshan and Fox as guarantors, alleging breach of the Madison Heights guaranty. In November 2011 Challenger applied for a writ of attachment against Fox.

On December 13, 2011 Fox filed a verified answer expressly admitting he had signed the Madison Heights guaranty. Fox's counsel of record at the time was Kyle T. Oh of Lee & Oh.

In March 2012, still represented by Oh, Fox filed a declaration in opposition to Challenger's application for an attachment denying that his signature on the Madison Heights guaranty was genuine. Fox declared, "I thought I had signed the Guaranty for the loan in this matter, but when I, today, looked at what is supposed to be my signature, I realized that it is not my signature."[2] In March 2012 the trial court granted the application and issued the writ of attachment, finding that Challenger was likely to prevail on the merits against Fox.

In May 2012, represented by new counsel (Arent Fox LLP), Fox applied ex parte to amend his answer. In support of the application Fox declared he had not carefully reviewed either the complaint or the guaranty when he signed the original verification because he was in poor health and was overwhelmed by this case and other litigation. After he learned of the application for a writ of attachment in March 2012, the declaration continued, he examined the documents more closely and realized the signature on the guaranty was not his. Fox declared that he never signed the Madison Heights guaranty, never authorized anyone to sign for him and never agreed to personally guaranty the Madison Heights loan. The trial court granted the application, and on July 17, 2012 Fox filed an amended verified answer denying his signature on the guarantee was genuine.

On August 1, 2012 the trial court granted Challenger's motion to compel arbitration.

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[2] Oh also submitted a declaration in opposition in which he stated, "I received a notification from Mr. Fox today [March 14, 2012] for the first time that the signature contained in the guaranty for the loan with Challenger was not his."

4. *Fox's Legal Malpractice Complaint Against Oh*

On December 17, 2012 Fox filed a complaint for legal malpractice and breach of fiduciary duty against the Lee & Oh law firm, Oh and other firm attorneys. Fox alleged the lawyer defendants never met or spoke with him, had not reviewed the original answer with him and never explained the legal significance of the admission that he had signed the Madison Heights guaranty. Rather, Fox alleged, the lawyer defendants simply sent him a verification to sign, which he did. In fact, his signature on the guaranty was a forgery.

On April 29, 2013 the trial court stayed the malpractice action pending the resolution of this case.

5. *The Arbitration*

In September 2013 Challenger tried its case against Fox and Golshan before an arbitrator.[3] Fox testified the signature on the Madison Heights guaranty was not his and presented the testimony of a qualified handwriting expert, who concluded it was "virtually certain" that the signature on the guaranty was not Fox's.

Challenger presented the deposition testimony of Fox's business associates, Barreca, Kamen and Golshan, who each testified he had seen Fox's signature on many prior occasions and identified the signature on the guaranty as belonging to Fox. Challenger called no expert to rebut the testimony of Fox's handwriting expert.

After the matter had been submitted for decision, the arbitrator granted Challenger's first motion to present additional evidence. Challenger then submitted, and the arbitrator

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[3] Kamen had filed for bankruptcy protection in March 2012 and was not a party to the arbitration.

considered, Fox's deposition testimony in another case in which Fox stated he had signed the Madison Heights guaranty in this case.

On November 21, 2013 Challenger filed a second motion to present additional evidence. Challenger's counsel declared he had just discovered Fox's legal malpractice action against Oh.[4] Challenger argued Fox should have disclosed the complaint in discovery and asserted Ted Fox had provided misleading testimony in the arbitration proceeding by suggesting Fox was only contemplating a lawsuit against Oh, rather than admitting a lawsuit had actually been filed.[5] Challenger contended, as a result of Fox's malpractice action against Oh, information that otherwise would be privileged regarding Fox's responsibility for the verified answer might now be discoverable.

Fox opposed the second motion to present additional evidence. In reply papers Challenger attached the answer filed

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[4] Challenger explained it had learned of the malpractice action on November 20, 2013 through a filing in Kamen's bankruptcy case.

[5] Challenger's counsel asked Ted Fox, "[A]s you sit here now, you believe that Mr. Oh – that it's Mr. Oh's fault that there's an answer with your father's name on it admitting that he signed the guaranty, correct?" Ted Fox answered, "I know that it's Mr. Oh's fault." The following exchange then took place,

"The Arbitrator: Do you plan to sue him?

"The Witness: Your Honor, it's my – I'm thinking about it. It's not my goal to have my father involved in many more lawsuits. He's an elderly man. I'm trying to avoid stressful things for him as much as possible. However, yes, I'm going to pursue that because at some point – I'm going to look into pursuing that rather."

by Oh and his law firm in the malpractice action, which contained a general denial and 16 boilerplate affirmative defenses, including "comparative fault of plaintiff." In a supporting declaration counsel for Challenger stated he had contacted counsel for the lawyers sued by Fox. He continued, "Based upon the attached answer and other available information, I expect that documents and/or testimony from prior counsel to Mr. Fox is to the effect that Ted Fox conveyed to prior counsel that Mr. Fox told Ted Fox that the content of the verified answer is accurate. That includes the admission of Mr. Fox that he signed the guaranty."

The arbitrator denied the motion, citing Challenger's lack of diligence in discovering the lawsuit and seeking to depose Oh.

On December 19, 2013 the arbitrator issued his Arbitrator's Statement of Decision and Preliminary Award. On May 27, 2014 the arbitrator issued a Corrected Arbitrator's Statement of Decision and Final Award. The arbitrator found that Challenger had not proved Fox had signed the Madison Heights guaranty or authorized another person to execute the guaranty on his behalf. The arbitrator awarded Challenger nothing on its complaint against Fox and more than $9 million on its complaint against Golshan, who had presented no defense.

The arbitrator awarded Fox slightly less than $1.3 million in attorney fees and costs against Challenger. That sum included no fees for services rendered by Lee & Oh.

6. *Confirmation of the Arbitration Award and Denial of a Setoff*

Fox petitioned to confirm the arbitration award.[6] Challenger, in turn, petitioned to vacate the award or, in the alternative, to set off against the judgment in favor of Fox a $26 million judgment in favor of Challenger, as assignee, and against Fox in another action and a $4,319.85 award of sanctions against Fox in this case for failure to appear at a deposition.[7]

Challenger argued that, by denying Challenger's second motion to reopen and present additional evidence, the arbitrator had refused to hear material evidence, resulting in substantial prejudice to Challenger and requiring the arbitration award be vacated pursuant to section 1286.2, subdivision (a)(5). In support of its claim for a setoff, Challenger filed a declaration by its attorney stating Fox claimed he was unable to pay the judgment and sanctions. The declaration also attached a copy of a $26 million California judgment filed in March 13, 2012 in favor of U.S. Bank and against Fox and an acknowledgment of the assignment of the judgment to Challenger filed on February 13, 2014.

Fox argued in opposition that the arbitrator had properly denied the second motion to present additional evidence based on Challenger's lack of diligence in obtaining Oh's testimony. He

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[6] Fox incorrectly designated its request to confirm the arbitration award a "motion," rather than a "petition" as required by section 1285.

[7] Concurrently with its petition to vacate the arbitration award in favor of Fox, Challenger petitioned to confirm the award of more than $9 million entered in its favor and against Golshan for breach of the Madison Heights guaranty.

also asserted the purported new evidence was not material. As to Challenger's claim for a setoff, Fox contended his attorneys' liens for fees earned in this action had priority over the $26 million judgment.

After hearing argument on July 29, 2014, the court entered an order confirming the arbitration award and denying in its entirety Challenger's motion to vacate the award or apply a setoff. Judgment was entered on October 22, 2014.

7. *Fox's Bankruptcy and the Automatic Stay*

On September 17, 2015, while Challenger's appeal was pending, Fox filed a voluntary petition for relief under Chapter 7 of the United States Bankruptcy Code, resulting in an automatic stay of this appeal (11 U.S.C. § 362). Slaughter, Reagan & Cole, one of the law firms representing Fox, filed a proof of claim for $130,248.69 in unpaid legal fees and costs. An attachment listed the amounts of unpaid fees in several matters, including only $715 in this case. Arent Fox, LLP, another law firm representing Fox, filed a proof of claim for $461,384.41 in unpaid legal fees and costs, stating the entire amount was unsecured.

On July 19, 2016 the bankruptcy court entered an order granting Challenger partial relief from the automatic stay, lifting the stay only as to the challenge to the denial of a setoff. The bankruptcy trustee subsequently abandoned this litigation as an estate asset, lifting the automatic stay in its entirety.

DISCUSSION

1. *The Trial Court Properly Denied the Motion To Vacate the Arbitration Award*

a. *Governing law*

Section 1286.2, subdivision (a)(5), sets out one of the narrow statutory exceptions to the general rule than an

arbitrator's decision is not reviewable for errors of fact or law. (See *Moshonov v. Walsh* (2000) 22 Cal.4th 771, 775-776; *Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 11-12, 27-28.) It authorizes the court to vacate an arbitration award if it determines "[t]he rights of the party were substantially prejudiced by the refusal of the arbitrators to postpone the hearing upon sufficient cause being shown therefor or by the refusal of the arbitrators to hear evidence material to the controversy or by other conduct of the arbitrators contrary to the provisions of this title."

Section 1286.2, subdivision (a)(5), however, does not authorize judicial review of every ruling by an arbitrator excluding evidence. Such a construction would create a broad exception to the general rule of limited judicial review of arbitration awards and would significantly undermine the strong presumption in favor of arbitral finality. (See *Schlessinger v. Rosenfeld, Meyer & Susman* (1995) 40 Cal.App.4th 1096, 1110 [considering applicability of former § 1286.2, subd. (e), now subd. (a)(5)]; *Hall v. Superior Court* (1993) 18 Cal.App.4th 427, 438-439 [same].) Instead, subdivision (a)(5) acts "as a safety valve in private arbitration that permits a court to intercede when an arbitrator has prevented a party from fairly presenting its case." (*Hall*, at p. 439; accord, *Epic Medical Management, LLC v. Paquette* (2015) 244 Cal.App.4th 504, 518; *Schlessinger*, at p. 1111.) In applying subdivision (a)(5) the court generally accepts the arbitrator's legal conclusions and, based on that legal context, decides whether the party seeking to vacate the award was substantially prejudiced by the evidentiary ruling—that is, prevented from fairly presenting its case—before deciding whether the excluded evidence was material. (*Epic*, at p. 518;

Schlessinger, at p. 1111; *Hall*, at p. 439; see *Moncharsh v. Heily & Blase*, *supra*, 3 Cal.4th at p. 13.)

b. *The arbitrator did not prevent Challenger from fairly presenting its case*

As discussed, based on a conversation with Oh's lawyer in the malpractice action, Challenger's counsel argued to the arbitrator that he expected Oh would testify Ted Fox had informed Oh that Gerson Fox told his son the content of the verified answer was accurate. In its petition to vacate the arbitration award Challenger argued, as it does again on appeal, that this proffered evidence was material, and its exclusion prejudicial, since it provided support for the testimony Challenger presented from Fox's business associates (Golshan, Kamen, and Barreca) authenticating Fox's signature and reinforced other evidence purportedly showing that Fox was a member of Madison Heights Partners, LLC and a guarantor of the loan. Although recounting a conversation between Ted Fox, as Fox's representative, and Fox's counsel, Challenger contends the evidence was admissible because Fox waived the lawyer-client privilege when he sued Oh and also because Fox put Oh's alleged negligence at issue in the arbitration proceedings by claiming he had signed the original verification by mistake. Challenger also argues the arbitrator erred in ruling it had not acted with diligence in discovering the malpractice action and seeking to present this additional evidence.

The proffered testimony concerning Ted Fox's statement to Oh at the time the original verification was executed was, at most, cumulative. Accordingly, we need not address either the lawyer-client privilege issues discussed by the parties or the question of Challenger's diligence in discovering the malpractice

action against Oh, which had been a matter of public record for nine months prior to the start of the arbitration hearing.

There was never any dispute that in December 2011 Fox believed the content of the original verified answer was accurate. Fox readily acknowledged he thought at the time he executed the verification that he had signed the Madison Heights guaranty. It was only later, according to his repeated explanations, that he realized he had not done so. The arbitrator heard and considered this evidence. Further confirmation of Fox's original mistaken belief was unnecessary. And nothing in Challenger's offer of proof suggested Oh would contradict Fox's additional testimony that he had not met with Oh or personally reviewed the original answer with him. In sum, the arbitrator's decision not to reopen the evidentiary hearing to consider Oh's proposed testimony did not substantially prejudice Challenger or prevent it from fairly presenting its case.

2. *The Trial Court Erred by Denying a Setoff*

The right to a setoff is based in equity. "[Setoff] was founded on the equitable principle that 'either party to a transaction involving mutual debts and credits can strike a balance, holding himself owing or entitled only to the net difference.'" (*Granberry v. Islay Investments* (1995) 9 Cal.4th 738, 744; accord, *Jess v. Herrmann* (1979) 26 Cal.3d 131, 142.) "[I]t is well settled that a court of equity will compel a set-off when mutual demands are held under such circumstances that one of them should be applied against the other and only the balance recovered." (*Harrison v. Adams* (1942) 20 Cal.2d 646, 648.)

The right to a setoff is not absolute and may be restricted on equitable grounds. (*Jess v. Hermann*, *supra*, 26 Cal.3d at pp. 142-143; *Kruger v. Wells Fargo Bank* (1974) 11 Cal.3d 352,

267; *Wm. R. Clarke Corp. v. Safeco Ins. Co. of America* (2000) 78 Cal.App.4th 355, 358-359.) "The offset of judgment against judgment is a matter of right absent the existence of facts establishing competing equities or an equitable defense precluding the offset." (*Brienza v. Tepper* (1995) 35 Cal.App.4th 1839, 1848; accord, *Salaman v. Bolt* (1977) 74 Cal.App.3d 907, 919.)

Challenger presented evidence in the superior court that it holds a $26 million judgment against Fox in another action. A California trial court entered a $26 million judgment in favor of U.S. Bank on March 13, 2012 based on a Pennsylvania judgment, and U.S. Bank assigned the California judgment to Challenger in February 2014. An assigned judgment is a proper basis for a setoff. (*Harrison v. Adams*, *supra*, 20 Cal.2d at p. 649.) Accordingly, Challenger was entitled to a setoff absent facts establishing equitable grounds to deny it.

Fox argued in opposition to Challenger's setoff request that his attorneys had liens on his recovery in this action that were entitled to priority. "'A lien in favor of an attorney upon the proceeds of a prospective judgment in favor of his client for legal services rendered has been recognized in numerous cases.'" (*Southern California Gas Co. v. Flannery* (2016) 5 Cal.App.5th 476, 494.) However, "'[i]n California, an attorney's lien is created only by contract—either by an express provision in the attorney fee contract [citations] or by implication where the retainer agreement provides that the attorney is to look to the judgment for payment for legal services rendered.'" (*Ibid.*) "[A]n attorney's lien is not created by the mere fact that an attorney has performed services in a case." (*Carroll v. Interstate Brands Corp.* (2002) 99 Cal.App.4th 1168, 1172.)

In superior court Fox referred to declarations by his attorneys that he claimed had been presented to the arbitrator in support of his motion for attorney fees. However, Fox did not submit those attorney declarations to the court and offered no other evidence to support his assertion that such liens existed. Fox also failed to offer evidence of the amount of unpaid fees purportedly secured by attorney liens.[8] Absent such evidence there was no basis for the court to find attorney liens existed or to conclude there were equitable grounds to deny a setoff for the $26 million judgment and the $4,319.85 sanctions award.

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[8] With a surreply filed the day before the hearing on Challenger's petition to vacate the arbitration award, Fox submitted a declaration attaching a copy of his fee agreement with Slaughter & Reagan dated November 26, 2012, including a provision creating a lien in favor of the law firm. The court refused to consider the surreply. Fox does not challenge that ruling on appeal. In any event, as discussed, the proof of claim filed by the Slaughter law firm in Fox's bankruptcy proceeding indicated that Fox owed the firm only $715 for unpaid fees in this case.

DISPOSITION

The order confirming the arbitration award and denying the petition to vacate that award is affirmed. The judgment is reversed with directions to the superior court to determine the proper amount of the setoff and to enter a new judgment applying the setoff as determined. The parties are to bear their own costs on appeal.

PERLUSS, P. J.

We concur:

ZELON

SEGAL, J.