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E-Commerce Lighting, Inc. v. E-Commerce Trade, LLC: **Impact of Third-party Arbitration on Lenders***

In general, lenders do not include arbitration clauses in commercial loan documents in order to preserve the lender's right to seek judicial relief in the event a borrower defaults on the loan. However, could lenders now find themselves needing to intervene in arbitration between their borrowers and another party involving collateral pledged for the loan? Based on a recent decision from the California Court of Appeals, the answer may be "yes" if the lender wants to ensure its rights to collateral are preserved in certain situations.

In *E-Commerce Lighting, Inc. v. E-Commerce Trade, LLC*, 302 Cal. Rptr. 3d 218 (Ct. App. 2022), the Court of Appeal found that an arbitrator may in some cases conclusively divest a lender's rights to collateral that is related to arbitration between the borrower and another party, even if the arbitrator exceeded its powers pursuant to Cal. Code of Civil Procedure Sections 1286.6(d) and 1286.2(a)(4).

In the court case, the lender lent money to its borrower E-Commerce Trade, LLC ("Trade"), to finance the purchase of an e-commerce business from E-Commerce Lighting, Inc. ("Lighting"). To secure its loan, the lender was granted a security interest in all of Trade's assets, including any judgments against Lighting. A dispute arose between Trade and Lighting and the parties arbitrated the dispute, but the lender was never notified of the arbitration, did not know of the arbitration and furthermore did not agree to the arbitration.

Trade initiated a proceeding in trial court to correct the arbitration award, and the lender promptly intervened. While the trial court found that the arbitrator exceeded his arbitration powers, the court allowed the award to remain but removed the offset, thereby allowing the lender to enforce its security interest against Trade's full award against Lighting. However, the appellate court overturned the lower court's decision holding that because the offset was part of the "merits" of the judgment the trial court could not correct the award, and even if the arbitrator exceeded his powers by offsetting the award (which the appellate court did not address), the appellate court found that the trial court could not vacate the award because the parties had not specifically asked the court to do so.

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E-Commerce Lighting, Inc. is concerning for lenders when their collateral is the subject of arbitration between their borrowers and other parties since the arbitrator may grant awards that infringe on the lender's rights in the collateral, and in light of the appellate court's holding, lenders may need to interject in the arbitration to preserve their rights.

Notably, a petition has been filed with the California Supreme Court to review the court case. Recently the California Bankers Association (CBA) filed an *amicus curiae* letter supporting the Supreme Court's review of the case. First, the CBA argues that the Court of Appeal's opinion is contrary to established law, forces lenders to arbitration that occurred without their consent, and imposes a high administrative burden on lenders doing business in California. Second, the CBA argues that if the appellate court's decision is not reversed, it may require lenders that wish to protect their property interests to closely monitor and intervene in arbitration proceedings, consequently investing additional resource to ensure that their security interests are not extinguished. Lastly, the CBA asserts that when lenders are uninformed of the arbitration proceedings, their rights may be surrendered without due process.

As of the drafting of this article, the California Supreme Court has not yet decided whether to review the court case. For more information, please contact Joel Cook at **JCook@ABLAWYERS.com**.