CALIFORNIA LAND TITLE ASSOCIATION
FORMS AND PRACTICES COMMITTEE

*****

AGENDA

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February 7-8, 2013

Thursday: 1:00 PM - 5:00 PM
Friday: 9:00 AM - 1:00 PM

Fairmont Newport Beach
4500 MacArthur Blvd.
Newport Beach, CA 92660
949-476-2001

1. Administrative Section  (Elliot Smith)
   A. Approval of the Minutes of the June 6-7 meeting.
      See Exhibit 1A

   B. Approval of the Minutes of the November 1-2 meeting.
      See Exhibit 1B

2. Bankruptcy Section  (Wayne Condict)
   A. McCoy v. Kuiken (In re Kuiken)
      Bankruptcy Appellate Panel – 9th Circuit (So. District of California)
      Filed 1-4-13
      See Exhibit 2A

   B. TC Healthcare I, LLC v. Dupuis (In re Haven Eldercare, LLC)
      U.S. Court of Appeals – 2nd Circuit
      Filed 11-15-12
      See Exhibit 2B

   C. Mass Dept of Unemployment Asst. v. OPK Biotech, LLC (In re PBBPC, Inc.)
      Bankruptcy Appellate Panel – 1st Circuit (District of Mass.)
      Filed 1-17-13
      See Exhibit 2C
D. Collect Access, LLC v. Hernandez (In re Hernandez)  
Bankruptcy Appellate Panel – 9th Circuit (So. District of California)  
See Exhibit 2D  
Filed 12-14-12

E. Heritage Pacific Financial, LLC v. Machuca (In re Machuca)  
Bankruptcy Appellate Panel – 9th Circuit (No. District of California)  
See Exhibit 2E  
Filed 12-14-12

F. Toye v. O’Donnell (In re O’Donnell)  
Bankruptcy Appellate Panel – 1st Circuit (District of Maine)  
See Exhibit 2F  
Filed 12-5-12

G. In re Barry L. Michael  
U.S. Court of Appeals – 3rd Circuit  
See Exhibit 2G  
Filed 10-26-12

H. In re Miller  
Bankruptcy Appellate Panel – 6th Circuit (No. District of Ohio)  
See Exhibit 2H  
Filed 12-27-12

U.S. Court of Appeals – 9th Circuit  
See Exhibit 2I  
Filed 12-4-12

J. Sundale, Ltd. v. Florida Assoc. Capital Enterprises, LLC (In re Sundale, Ltd.)  
U.S. Court of Appeals – 11th Circuit  
See Exhibit 2J  
Filed 11-29-12

K. Dill Oil Co., LLC v. Stephens (In re Stephens)  
U.S. Court of Appeals – 10th Circuit  
See Exhibit 2K  
Filed 1-15-13
L. First American Title Ins. Co. v. Gaskill (In re Gaskill)  
U.S Bankruptcy Court – Western District of Michigan  
See Exhibit 2L  
Filed 9-18-12

M. Green v. HSBC Mortgage Services (In re Green)  
U.S Bankruptcy Court – District of Maryland  
See Exhibit 2M  
Filed 7-25-12

3. Court Decisions Section (David Westcott)

A. LaJolla Group II v. Bruce  
Cal. App. 5th Dist.  
See Exhibit 3A  
Filed 11-28-12

B. R. E. Loans, LLC v. Investors Warranty of America  
Cal. App. 2nd Dist.  
See Exhibit 3B  
Filed 1-23-13

C. Shuster v. BAC Home Loans Servicing  
Cal. App. 2nd Dist.  
See Exhibit 3C  
Filed 11-29-12

D. Cottonwood Duplexes, LLC v. Barlow  
Cal. App. 3rd Dist.  
See Exhibit 3D  
Filed 11-13-12

E. Bank of America v. Superior Court  
Cal. App. 4th Dist., Div. 3  
See Exhibit 3E  
Filed 1-15-13

F. Pfeifer v. Countrywide Home Loans  
Cal. App. 1st Dist.  
See Exhibit 3F  
Filed 12-13-12
4. **Closing Instructions Section** (Terri Winchester)
   Nothing Scheduled.

5. **Governmental Regulations Section**
   Nothing Scheduled.

6. **Subdivision and Land Use Section** (Douglas Borchert)
   Nothing Scheduled.

7. **Legislation Section** (Tim Reardon)
   A. Chapter 201, AB 1314 – Local Government / Reconveyance of deed of trust
      The Legislative Committee did not refer this bill to the Forms and Practices Committee, but it was subsequently added to the CLTA Summary of Legislation.
      See Exhibit 7A

8. **Taxes, Bonds and Assessments Section** (Gytis Nefas)
   Nothing Scheduled.

9. **Title Documents Section** (Ed Rusky)
   A. Electronic recording question.
      See Exhibit 9A.

10. **Title Forms Section** (Paul Flores)
    A. **Non-Action Item**: Motion that recommends that the Board authorize CLTA staff to submit a form filing with the CA DOI re ALTA Technical corrections for the following ALTA endorsements and policy form:
        Ex. 10.A.1 a&b: ALTA 3.2-06
        Ex. 10.A.2 a&b: ALTA 9.8-06
        Ex. 10.A.3 a&b: ALTA 14.3-06
        Ex. 10.A.4 a&b: ALTA Res. Limited Coverage Jr. Loan Policy Rev. 8-1-12
        Ex. 10.A.5: ALTA Technical Correction Explanation
        Ex. 10.A.6: CLTA Form Filing Correspondence dated 12-20-12
Ex. 10.A: CA DOI acceptance of 12-20-12 Form Filing by email dated 1-24-13

B. **Action Item:** Motion that recommends that the Board authorize the CLTA staff to submit a form filing with the CA DOI re ALTA ‘s new and revised forms with an adoption date of 12-3-12 as follows:

- **Ex. 10.B.1:** ALTA 37-06 (CLTA 104.5-06)
- **Ex. 10.B.2:** ALTA 38-06 (CLTA 142-06)
- **Ex. 10.B.3:** Short Form Residential Loan Policy
- **Ex. 10.B.4:** U.S. Policy
- **Ex. 10.B.5:** U.S. Policy–Redline

C. **Action Item:** Motion that recommends that the Board adopt the CLTA 22.1 Trustee’s Sale Guarantee Endorsement for which may be used by Courtesy, Publication and Sale Date Down Endorsements to the Guarantee Form No. 22 (“TSG”).

See Exhibit 10.C.1

D. **Non-Action-Item:** Non-Action Item: Discuss comments regarding the ALTA 28.1-06.

See Exhibit 10.D.1 thru 4

E. **Non-Action Item:** Discuss need for survey re market acceptance of CLTA 122.1A-06 and 122.1B-06, alternatives to ALTA 32-06 Construction Loan Loss of Priority endorsement series.

See Exhibits 10.E.1 thru 6).

F. **Action Item:** Discussion on whether to add new paragraph 4 (See five options in Ex. 10.F.2) to Information Notes section of Guarantee form no. 22. (NOTE: Must precede any Motion that recommends that the Board authorize the CLTA Staff to file with the CA DOI Guarantee Form 22 (“TSG”) as revised (02-08-13) that modifies only the “Informational Notes” section.

See Exhibits 10.F.1 & 2)

G. **Action Item:** Motion that recommends that the Board authorize the CLTA staff to submit a form filing with the CA DOI re: CLTA endorsement form 105-06 (Multiple Mortgages in One Policy) with a revision date of 2-8-13.

See Exhibits 10 G.1 thru 3

11. **Special Sub-Committee - Electronic Recording and Signatures (Paul Flores)**

   A. Notice for Proposed Amendments to Department of Justice Electronic Recording Delivery System (ERDS) program.

   See Exhibit 11A
B. Roster of CLTA Electronic Recordation Task Force.

See Exhibit 11B

12. Special Sub-Committee – Copyright Protection of CLTA Forms and Manual

Nothing Scheduled.

13. CLTA Staff Report

Nothing Scheduled.

14. Court Decisions Section – Honorable Mention (David Westcott)

A. SERA Architects, Inc. v. Klahowya Condominium, LLC
   Oregon Court of Appeals
   Filed 11-7-12

   Court declines to apply the doctrine of equitable subrogation in favor of a lender over the holder of an architect’s lien.

   See Exhibit 14-A

B. Hope Presbyterian Church of Rogue River v. Presbyterian Church
   Oregon Supreme Court
   Filed 11-29-12

   This case stands for the proposition that a local church may seem independent but it might be part of a national whole that holds the real authority puppet strings and, further, the local may actually hold the property in trust for the national organization.

   See Exhibit 14-B

C. Maryland Transit Admin. v. Surface Transportation Board
   U.S. Court of Appeals – 4th Circuit
   Filed 11-21-12

   Railroad right of way case.

   See Exhibit 14-C

D. Brimet II, LLC v. Destiny Homes Marketing, LLC
   Arizona Court of Appeals – Div. 1
   Filed 1-8-13

   Under the doctrine of equitable subrogation, a lender obtained priority over a prior recorded option to the extent the loan proceeds paid off the first deed of trust on the property. However, the owner made payments in an amount that
exceeded the amount owed on the loan secured by the first deed of trust, thereby extinguishing the first priority lien and moving the option into first position.

See Exhibit 14-D

E. Twenty-Nine Palms enterprises v. Bardos
Cal.App. 4th Dist., Div. 2

Filed 10-11-12

In an Indian tribal corporation’s suit to recover money paid for construction work done on tribal land, on the ground that defendant was unlicensed at the time of the contract, a grant of summary judgment in favor of the plaintiff was affirmed where:

1. Defendant argued that sovereign immunity prevented plaintiff from asserting that defendant was not licensed as a contractor under state law because the work was performed on tribal land. This defense was rejected because it is only available to tribal entities and not to non-tribal entities;

2. Defendant was the sole shareholder of a corporation that had a contractor’s license, with defendant as Responsible Managing Officer. But the work was performed as a sole proprietorship under a different fictitious business name, and defendant did not obtain a contractor’s license in that name until after the work was complete. Even though a sole proprietorship is not a legal entity separate from the individual owner, the corporate license belonged to the corporation, which is a separate entity, so he could not perform work under the name of the sole proprietorship:

3. The court rejected defendant’s contention that the corporate identity should be disregarded via the alter ego doctrine because defendant used the sole proprietorship for the purpose of self-dealing, and equity does not require piercing the corporate veil in that circumstance.

4. Defendant could not establish substantial compliance with the licensing requirement because he did not meet the “substantial compliance” criteria of Business and Professions Code Section 7031(e); and

5. Defendant contended that plaintiff should be estopped from relying on Section 7031 because plaintiff told defendant that a license was not required for work performed on tribal land. But equitable principles may not be used to circumvent Business and Professions Code section 7031.

See Exhibit 14-E

F. Allen v. Stoddard
Cal.App. 4th Dist., Div. 4

Filed 1-9-13

C.C.P. Section 366.3, which gives persons who have claims against estates based on promises to make a distribution after death a full year from date of death to file suit, prevails over Probate Code Section 9353, which gives a claimant 90 days after rejection of the claim to file suit. The statutes are in conflict
so C.C.P. 366.3 prevails because a specific and later enacted statute trumps a general and earlier one.

See Exhibit 14-F

G.  **Wooster v. Dept of Fish and Game**  
Cal.App. 3rd Dist.  
Filed 11-26-13

1. The Department of Fish and Game’s failure to comply with its obligation to post signs on the subject property did not extinguish a conservation easement or give the plaintiff a basis for rescinding the easement.

2. The grant of hunting rights to the department, so that the department could prohibit all hunting on the property, was legal and consistent with the statutes governing conservation easements.

See Exhibit 14-G

H.  **Knispel v. Transnation Title Insurance Company** (UNPUBLISHED)  
Cal.App. 2nd Dist.  
Filed 10-30-12

Owner's policy was void because the insured did not have an "insurable interest" to the extent it included as part of the "Land" - by mistake - a certain portion of land that should not have been included.

See Exhibit 14-H
2012
Minutes of the Meeting
of the

CALIFORNIA LAND TITLE ASSOCIATION
FORMS AND PRACTICES COMMITTEE

Held at

Silver Legacy Reno
407 N. Virginia Street, Reno, NV 89501
800-687-8733

June 7-8, 2012
Thursday: 1:00 PM - 5:00 PM
Friday: 9:00 AM - 1:00 PM

Members Present:
Paul Hammann, Chair
Robert Cavallaro, Vice Chair
Doug Borchert
Dan Buchanan
Kathy Boyd
Tom Chandler
Wayne Condict
Jerry Chalmers
Gary Finnell (for Jim Dufficy)
Paul Flores
Jerry Guerino
Dwight Helmer
Greg Herrington
Bill Jourdan
Ric Klarin
Laura Lowe
Gytis Nefas
Tim Reardon
Ed Rusky
Karen Saez
Mark Shepherd
Steve Smith
Roger Therien
David Windle
Dave Westcott

Members Absent:
Chuck Bishop
David Collier
Vicki Crestani
Jeff Dondanville
Jim Dufficy
Larry Griffin
Tim Morgan
Earle Norris
William O’Connell
Dante Sergent
Elliot Smith
Terri Winchester

Also Present:
Craig Page
Heather Starkey
Neil Stonum
1. **Administrative Section (Elliot Smith)**

   It was moved and seconded, and the motion unanimously passed, that the Minutes of the February 2 – 3, 2012 Meeting be approved as written.

2. **Bankruptcy Section (Wayne Condict)**

   A. **In re: Jack Sherman Jefferies v. Charles D. Carlson, Chapter 7 Trustee**  
      U.S. Bankruptcy Appellate Panel – 9th Circuit (Western District of Washington)  
      BK. No. 11-42206  
      Filed 04-30-12

   This case presents the issue of whether an equalizing judgment in a dissolution decree awarded to the Debtor-husband in exchange for his conveyance of his interest in the marital residence constituted a voluntary sale protected by Washington’s homestead statutes that could be claimed as a homestead exemption. The court holds “no,” concluding that the Debtor’s conveyance of the residence was a “forced sale,” and affirms the bankruptcy court.

   There was no practice recommendation and the case was dropped.

   B. **In re: Lorraine McNeal v. GMAC Mortgage, LLC, Homecomings Financial, LLC, a GMAC Company**  
      U.S. Court of Appeals – 11th Circuit  
      No. 11-11352  
      (Appeal from the U.S. District Court for the Northern District of Georgia)  
      Filed 05-11-12

   This decision addresses the issue of whether an allowed but wholly unsecured claim is voidable in a Chapter 7 proceeding under §506(d). The court holds “yes.” In so holding, the court considering itself bound by controlling 11th Circuit precedent, Folendore v. United States Small Bus. Admin., 862 F. 2d 1537 (11th Cir. 1989), and not the U.S. Supreme Court’s decision in Dewsnup v. Timm, 112 S. Ct. 773 (1992), concluding that Dewsnup addressed (and disallowed) the “strip down” of a partially secured lien and not the “strip off” of a wholly unsecured junior lien such as that involved in this case.

   The subject property’s fair market value was $141,416. The amount owed on the “first” lien mortgage was $176,413 and the amount owed on the “second” lien mortgage was $44,444. There was thus no value supporting the amount owed on the “second” lien mortgage.

   As the court states: “Because Dewsnup disallowed only a “strip down” of a partially secured mortgage lien and did not address a “strip off” of a wholly unsecured lien, it is not “clearly on point” with the facts in Folendore or with the facts at issue in this appeal.” The court also noted that the Supreme Court itself “limited its Dewsnup decision expressly to the precise issue raised by the facts of the case. 112 S. Ct. at 778.”

   There was no practice recommendation and the case was dropped.

   C. **In Re: Angel Lepe, Michael H. Meyer, Chapter 13 Trustee v. Angel Lepe**  
      U.S. Bankruptcy Appellate Panel – 9th Circuit (Eastern District of California)  
      No. 10-60264  
      Filed 5-9-12

   This case deals with the issue of whether a First Amended Chapter 13 Plan, confirmed by the bankruptcy court, was proposed in good faith. The court holds “yes.” In so holding, the court disagreed with the Trustee’s characterization that “the only reason [the Debtor] had filed the bankruptcy case was to use chapter 13 to strip the second mortgage on his house.”
The court looked to Goeb v. Heid (In re Goeb), 675 F. 2d 1386 (9th Cir. 1982), as guiding the determination of a chapter 13 debtor’s good faith by a bankruptcy court in the Ninth Circuit. The court states: “In short, Goeb established that, in this circuit, a good faith determination in connection with chapter 13 plan confirmation cannot be based on any single factor or feature of a proposed plan, to the exclusion of review of all other relevant information. Importantly, it is of no moment that a single factor may be indicative of bad faith, or that a specific plan feature is not consistent with the “spirit of chapter 13” or may indicate manipulation of the Bankruptcy Code. Factors indicating good and bad faith may not be considered in isolation, but must always be weighed against the totality of the circumstances in each case.”

There was no practice recommendation and the case was dropped.

D. In re: Shawn Deitz v. Wayne Ford and Patricia Ford
U.S. Bankruptcy Appellate Panel – 9th District (Eastern District of California)
No. 08-13589 Filed 4-23-12

This case involves the issues of whether (1) the bankruptcy court had the constitutional authority to enter a final judgment determining the amount of the claims for damages against the Debtor and (2) claims that arose out of the construction of a residence by the Debtor contractor should be excepted from discharge under §523(a)(2)(A) [based on alleged intentional material misrepresentations with the intent to deceive], (a)(4) [based on misappropriation of monies through fraud, trick and device] and (a)(6) [based on willful and malicious actions that proximately caused financial damage]. The court holds (1) “yes,” considering itself bound by prior Ninth Circuit precedent because the facts can be distinguished from those that led to the recent U.S. Supreme Court decision in Stern v. Marshall, 131 S. Ct. 2594 (2011), and (2) “yes.”

The court determined that Stern “is not clearly irreconcilable with the existing precedent in Kennedy [Cowen v. Kennedy (In re Kennedy), 108 F. 3d 1015 (9th Cir. 1997)] that a bankruptcy court may liquidate a debt and enter a final judgment in conjunction with finding the debt nondischargeable. * * * We hold that, even after Stern, the bankruptcy court had the constitutional authority to enter a final judgment determining both the amount of the Fords’ damage claims against [the Debtor], and determining that those claims were excepted from discharge.”

There was no practice recommendation and the case was dropped.

E. In re: Myrna Jacobson, John M. Wolfe, Chapter 7 Trustee v. Myrna Jacobson; Donald Jacobson
U.S. Court of Appeals – 9th Circuit
No. 10-60040
(Appeal from the 9th Circuit Bankruptcy Appellate Panel-California District) Filed 4-23-12

This is an appeal from a judgment in an adversary proceeding in which a Chapter 7 trustee sought to recover certain money and property and property income he alleged belonged to the Debtor’s bankruptcy estate. The money represented proceeds from the sale of homestead property. The property sought by the trustee was rental property titled solely in the husband’s name. The primary issue presented is whether, in each instance, the money or property constituted “property of the estate.” As to the money sought the court holds “yes;” as to the property and its income sought the court holds “no.”

The money sought by the trustee was the amount then allowed under Civil Procedure Code §704.730(a)(3) – $150,000 – as the homestead exemption. The Debtor and her husband failed to reinvest the $150,000 in a new homestead within six months of receipt, as required by Civil Procedure Code §704.720(b), with the result that the funds lost their exempt status. The court states: “Under the so-called “snapshot” rule, bankruptcy exemptions are fixed at the time of the bankruptcy petition. [Citation omitted]. Those exemptions must be determined in accordance with the state law “applicable on the date of filing.” [Citation omitted]. And “it is the entire state law applicable on the filing date that is determinative” of whether an exemption applies. [Citation
omitted]. In this case, the entire state law includes a reinvestment requirement for the debtor’s share of the homestead sale proceeds.” Because of the failure to reinvest the previously exempt proceeds within the time required by state law, the proceeds lost their exempt status and were thus “property of the estate.”

The property sought by the trustee was determined by the court to be the separate property of the Debtor’s spouse because it was acquired solely in the husband’s name and the Debtor-wife confirmed by executing an interspousal transfer deed before closing of the husband’s acquisition that the property was to be the husband’s separate property.

There was no practice recommendation and the case was dropped.

F. In re: First Yorkshire Holdings, Inc. v. Pacific L 22, LLC
U.S. Bankruptcy Appellate Panel – 9th Circuit (Central District of California)
BK. No. SV 10-26058-AA

This case involves a Chapter 11 bankruptcy proceeding by a junior deed of trust beneficiary and the Debtor’s appeal of an order granting relief from the automatic stay to the assignee-beneficiary of the senior deed of trust. The issues addressed in this BAP opinion are whether the bankruptcy court abused its discretion (1) by failing to make any findings on the equity and value of the Debtor’s property interest in its junior deed of trust under §362(d)(2) and (2) by granting relief from the automatic stay under §362(d)(4) when relief under that subsection could potentially affect other non-debtor parties and because the bankruptcy court made no findings on that matter. The court holds (1) “yes” and (2) “yes,” vacates the order granting relief and remands with instructions to enter findings.

In a footnote, the court cites First Fed. Bank of Cal. v. Cogar (In re Cogar), 210 B.R. 803 (9th Cir. BAP 1997), for the proposition that “property [of the estate] is defined broadly under §541 and includes liens held by the debtor on property of a third party.” Accordingly, there was no question that this Debtor’s junior deed of trust lien is considered property of the estate and implicates the automatic stay under §362(a) when the holder of a senior lien seeks to foreclose out the junior position of the Debtor.

The court states: “Section 362(d)(2) requires the bankruptcy court, on request of a party in interest, to grant relief from the automatic stay when debtor has no equity in the property, and the property is not necessary to debtor’s effective reorganization. Pursuant to §362(g), the moving party has the burden of proof on the issue of debtor’s equity; the debtor has the burden of proof on all other issues. [The senior lien lender] had the burden to establish that [the Debtor] did not have any equity in [the Debtor’s] Lien Interest, and as noted, we are unable to determine what value the bankruptcy court used in determining the lack of equity.”

There was no practice recommendation and the case was dropped.

G. In re: Humberto Cedano v. Aurora Loan Services, LLC; Deutsche Bank Trust Company Americas; The Rali Series 2007-QH8 Trust; SCME Mortgage Bankers, Inc.; Mortgage Electronic Registration Systems, Inc.; Cal-Western Reconveyance Corp.
U.S. Bankruptcy Appellate Panel – 9th Circuit (California Central District)
Bk. No. SV 10-18618 GM

This case involves allegations of wrongful foreclosure of the Debtor’s residence, slander of title, professional negligence by the foreclosing trustee, and a count seeking to cancel the trustee’s deed and to quiet title. The case was brought as an adversary proceeding over four months following delivery of the trustee’s deed. The bankruptcy court dismissed the case with prejudice under Civil Rule 12(b)(6) for failure to “state a claim upon which relief can be granted”. The primary presented in this appeal is whether the bankruptcy court erred in so dismissing. The court holds “no” and affirms the dismissal.
The court had little trouble concluding that the Debtor failed to establish a cause of action for wrongful foreclosure. The court first determined that the facts fit within a recognized exception to the “tender” requirement: “[T]o the extent the Debtor alleged that the foreclosure was substantially defective because unauthorized persons initiated the procedure, rendering the sale void, he has met on of the exceptions to the requirement of tender.” The court then addressed whether the Debtor had otherwise stated a claim for wrongful foreclosure and concludes that he had not done so.

Here are some of the court’s noteworthy statements:

(1) “Under Cal. Civil Code §2924, the party initiating foreclosure proceedings is not required to have a beneficial or economic interest in the note in order to foreclose. [Citations omitted]. Instead, a “trustee, mortgagee, or beneficiary, or any of their authorized agents” may commence the nonjudicial foreclosure process.”

(2) “The terms of the DOT expressly provided MERS with the right to exercise any or all of the lender's, or the lender's successors' and assigns', rights including the right to foreclose and sell the Property.”

(3) “On the NOD, Cal-Western identified itself as “the trustee, the duly appointed substituted trustee or an agent acting for the trustee or beneficiary” under the DOT.”

(4) “The Debtor has not alleged facts that demonstrated MERS was not authorized to initiate foreclosure proceedings. Rather, he argued only that MERS may not have been authorized since MERS did not submit evidence that it was acting on behalf of whomever was the holder of the note. However, as a California court recently held, Cal. Civ. Code §2924 “does not provide for a judicial action” when the issue is not whether the wrong entity initiated foreclosure but whether the entity was merely authorized to do so by the owner of the note.” [Citing Gomes v. Countrywide Home Loans, Inc., 192 Cal. App. 4th 1149 (Cal. Ct. App. 2011).]

(5) “[T]he Debtor alleged that Cal-Western was not authorized to file the NOD because the Substitution of Trustee was not recorded when Cal-Western filed the NOD. But, there is no requirement that the Substitution of Trustee be recorded, only that it be executed. Here, the Substitution of Trustee was executed prior to the NOD, authorizing Cal-Western to initiate the foreclosure.”

(6) “The NOD included the necessary declaration to satisfy Cal. Civ. Code §2923.5(b). * * * Even if the facts alleged are taken as true and the Debtor sufficiently established a claim for violation of Cal. Civil Code §2923.5, it does not follow, as the Debtor asserts, that the Trustee’s Deed Upon Sale is void. The sole remedy for a failure to comply [with the referenced statute] is “limited to postponement of an impending foreclosure.” [Citation omitted]. Because the foreclosure sale has already occurred, there is no remedy available to the Debtor.”

(7) “A trustee under a deed of trust is not a true trustee that owes fiduciary duties to the trustor. [Citations omitted]. The trustee under a deed of trust has only two duties: (1) upon default to undertake the steps necessary to foreclose the deed of trust; or (2) upon satisfaction of the secured debt to reconvey the deed of trust. [T]he Substitution of Trustee, the NOD, and the Notice of Sale complied with Cal. Civil Code §2924. Cal-Western satisfied its duty by taking the steps to foreclose the NOD.”

There was no practice recommendation and the case was dropped.

In re: William A. McIntyre v. BNC Mortgage, LLC, FKA BNC Mortgage, Inc., Appellee, American Home Mortgage Servicing, Inc., successor in interest to BNC Mortgage, LLC, FKA BNC Mortgage, LLC, Movant-Appellee, and Alfred H. Siegel, Chapter 7 Trustee
U.S. Court of Appeals – 9th Circuit
No. 10-56185

In this unpublished opinion, the court affirms the lower courts’ (district court and bankruptcy court) determinations granting an equitable lien in favor of BNC Mortgage, LLC (“BNC”) and ordering the same recorded based on BNC’s erroneous, but in good faith, payment of the note secured by a deed of trust on the Debtor’s (and his spouse’s) real property.

There was no practice recommendation and the case was dropped.
I. In re: Tousa, Inc., et al., Debtors, Senior Transeastern Lenders, Citcorp North America, Inc., Certain First Lien Term Lenders v. Official Committee of Unsecured Creditors
U.S. Court of Appeals – 11th Circuit
No. 11-11071 Filed 5-15-12

This opinion addresses the issues of whether (1) the bankruptcy court erred when it found that the “Conveying Subsidiaries” (a term defined and used throughout the lower court opinions in this case) did not receive reasonably equivalent value pursuant to §548 in exchange for the liens to secure loans used to pay a debt owed only by TOUSA and (2) the Transeastern Lenders (another term defined and used throughout the lower court opinions) were entities “for whose benefit” the Conveying Subsidiaries transferred the liens within the reach of §550(a)(1). The court holds (1) “yes” and (2) “yes,” reverses the judgment of the district court, affirms the liability findings of the bankruptcy court, and remands for further proceedings.

There was no practice recommendation and the case was dropped.

U.S. Supreme Court (No. 10-179)
Filed 6-23-11

Anyone reading this U.S. Supreme Court opinion should be informed in advance by the quotation in the first paragraph: “This ‘suit has, in course of time, become so complicated, that . . . no two . . . lawyers can talk about it for five minutes, without coming to a total disagreement as to all the premises. Innumerable children have been born into the cause: innumerable young people have married into it;’ and, sadly, the original parties ‘have died out of it.’ A ‘long procession of [judges] has come in and gone out’ during that time, and still the suit ‘drags its weary length before the Court.’” Justice Roberts goes on to say: “Those words were not written about this case, see C. Dickens, Bleak House, in 1 Works of Charles Dickens 4-5 (1891), but they could have been.”

This opinion addresses two primary issues: (1) Whether the bankruptcy court had the statutory authority under 28 U.S.C. §157(b) to issue a final judgment on a counterclaim brought by Vickie Lynn Marshall against E. Pierce Marshall in Vickie’s bankruptcy proceeding; and (2) if so, whether it was constitutional to confer that authority on the bankruptcy court. The court holds (1) yes and (2) no, stating in its conclusion:

Article III of the Constitution provides that the judicial power of the United States may be vested only in courts whose judges enjoy the protections set forth in that Article. We conclude today that Congress, in one isolated respect, exceeded that limitation in the Bankruptcy Act of 1984. The Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor’s proof of claim. Accordingly, the judgment of the Court of Appeals is affirmed.

It was recommended that reference to this opinion be included in the appropriate section of the CLTA Manual. There was no practice recommendation and the case was dropped.

K. RadLAX Gateway Hotel, LLC, et al. v. Amalgamated Bank
U.S. Supreme Court (No. 11-166)
566 U.S. _____ (2012) [Certiorari Granted: 565 U.S. _____ (2011)] Filed 5-29-12

This U.S. Supreme Court opinion addresses the issue of whether a Chapter 11 plan of reorganization may be confirmed over the objection of a secured creditor pursuant to §1129(b)(2)(A) if the plan provides for the sale of collateral free and clear of the creditor’s lien but does not permit the creditor to “credit-bid” at the sale. The court holds “no,” affirming the Seventh Circuit’s judgment that had affirmed the bankruptcy court’s denial of the debtors’ Sale and Bid Procedures Motion, thus resolving conflict that had existed among the circuits (e.g. In re Philadelphia Newspapers, LLC, 599 F. 3d 298 (CA 3 2010)).
As the Court observes in a footnote: “The ability to credit-bid helps to protect a creditor against the risk that its collateral will be sold at a depressed price. It enables the creditor to purchase the collateral for what it considers the fair market price (up to the amount of its security interest) without committing additional cash to protect the loan. That right is particularly important for the Federal Government which is frequently a secured creditor in bankruptcy and which often lacks appropriations authority to throw good money after bad in a cash-only bankruptcy auction.”

There was no practice recommendation and the case was dropped.

3. **Court Decisions Section (David Westcott)**

A. **Sumner Hill Homeowners’ Association, Inc., et al., v. Rio Mesa Holdings, LLC et al.**
   Cal. App. 5th District (F058617)
   Super. Ct. No. MCV032689 (Madera County) Filed 5/2/12

   This case involves a dispute between, on one hand, homeowners in a gated subdivision known as Sumner Hill that overlooks the San Joaquin River and, on the other hand, a developer who acquired surrounding land, announced plans for a large-scale development that would include public access directly through the Sumner Hill subdivision, and installed a gate restricting the homeowners’ access to a road within the subdivision that had previously provided unrestricted access to the River.

   The issues presented in the appeal include whether (1) for purposes of the right of public access, the section of San Joaquin River involved in this dispute constitutes a navigable waterway, and (2) a slander of title cause of action may be maintained if the only monetary damages are attorneys’ fees incurred to clear the slandered title. The court spent many pages of its opinion discussing the navigability issue but ultimately found other bases to decide in favor of the plaintiff-homeowners including the applicable statute of limitations. The court holds “yes” on the second issue. Ultimately, the court affirms much of the trial court judgment in favor of the plaintiff-homeowners but reverses as to several aspects.

   It was recommended that the appropriate sections of the CLTA Manual be amended to address this decision. There was no practice recommendation and the case was dropped.

B. **Portico Management Group, LLC v. Alan J. Harrison**
   Cal. App. 3rd District (C062060)
   Super. Ct. No. 03AS01691 (Sacramento County) Filed 12/28/11

   The primary issue presented in this decision is whether a judgment against a trust, and not against the trustees of the trust in their representative capacity, is valid and enforceable. The court holds “no.” The court’s opinion also includes a valuable discussion of the significance of the process of confirming an arbitration award.

   The underlying action involved a suit for specific performance and damages arising out of a purchase and sale agreement for the acquisition of an apartment building that did not close due to the refusal of one of the principals to sign the deed and other closing documents. The plaintiff-buyer compelled arbitration pursuant to a provision of the purchase and sale agreement. The arbitrator awarded the plaintiff damages, attorney fees, and costs in excess of $1.6 million (plaintiff had elected the remedy of damages rather than specific performance).

   When the plaintiff petitioned to confirm the arbitration award, the resulting judgment was entered against the Harrison Children’s Trust (“HCT”), without any reference to the trustees of HCT, and Harrison Family Enterprise II, a limited partnership. The majority in interest in the subject property was in HCT (87.5%) and the minority in interest was in the limited partnership (12.5%). The plaintiff made no effort to modify or correct the arbitration award and waited over three years to seek to amend the subject judgment to add the trustees of HCT as judgment debtors.
The court makes the following statements regarding trusts generally and the subject trust (citations omitted): “In contrast to a corporation, . . ., a trust is not a person but rather ‘a fiduciary relationship with respect to property.’ ‘Legal title to property owned by a trust is held by the trustee . . . A trust . . . is simply a collection of assets and liabilities.’ A trust itself cannot sue or be sued. * * * A trust does not fall within the statutory definition of a judgment debtor. A trust is not included within the definition of person. Since the HCT is not a separate entity, does not itself hold title to any property, and is not a judgment debtor, a judgment against the HCT is meaningless and cannot be enforced. To be enforceable against the trust property, the judgment should have been entered against those who held title to such property – the trustees.”

The court had this to say concerning the importance of the process of confirming an arbitration award (citations omitted): “If anything is confirmed by the instant appeal, it is the significance of the process of confirming an arbitration award. The time to make sure the i’s are dotted, t’s are crossed, and that the award decides all necessary issues in a single, final and self-contained award is before the award is confirmed, not after. That is the best way to ensure that an arbitrator’s decision is truly ‘the end, not the beginning, of the dispute.’ * * * Having accepted and confirmed the arbitration award against the HCT, without any attempt to name the trustees as the proper parties, [the plaintiff] is bound by the terms of the arbitration award.”

There was no practice recommendation and the case was dropped.

C. Jane Brown v. Wells Fargo Bank, NA
Cal. App. 2nd District – Division 6 (2d Civil No. B233679)
Super. Ct. No. 56-2010-00378817-CU-OR-VTA (Ventura County) Filed 4/16/12

The court signals its view of the merits of this appeal in the opening paragraph of its opinion: “Some appeals are filed to delay the inevitable. This is such an appeal. It is frivolous and was ‘dead on arrival’ at the appellate courthouse.” Then, in the third paragraph of its opinion, the court shares its view of the trial and appellate counsel for filing the appeal: “We will affirm the judgment and refer the matter to the California State Bar for consideration of discipline.”

The underlying action sought declaratory and injunctive relief against the plaintiff’s mortgage lender and was filed on the eve of a trustee’s sale. The trial court granted a temporary restraining order and, a month or so later, a preliminary injunction on condition that the plaintiff-borrower deposit $1,700 per month in a client trust account in lieu of a bond. When no monthly payments had been made, the defendant filed an ex parte application to dissolve the preliminary injunction. The plaintiff-borrower’s counsel appeared at the ex parte hearing and argued that the proposed order should not issue ex parte. The court agreed and set a formal hearing for 5 days later. No attempt was made to explain why the required payments had not been made and the trial court dissolved the injunction at the hearing and confirmed that the trustee sale could take place at its scheduled time 2 days later.

The notice of appeal was filed on the same day the trial court dissolved the injunction. As the court states: “The filing of the notice of appeal works as a “stay” of the trial court’s order and stops the trustee’s sale.” [Citing Code of Civil Procedure §916(a) and Royal Thrift & Loan Co. v. County Escrow, Inc., 123 Cal. App. 4th 24 (2004), at pp. 35-36].

The court says this in its conclusion: “The appellate courts take a dim view of a frivolous appeal. Here, with the misguided help of counsel, the trustee’s sale was delayed for over two years. Use of the appellate process solely for delay is an abuse of the appellate process. We give appellant the benefit of the doubt. But we have no doubt about appellate counsel’s decision to bring and maintain this appeal, and at the eleventh hour, seek a dismissal. No viable issue is raised on appeal and it is frivolous as a matter of law.

There was no practice recommendation and the case was dropped.
D. Bank of America, N.A. v. Michael Mitchell
Cal. App. 2nd District – Division 4 (B233924)
Super. Ct. No. MC021935 (Los Angeles County) Filed 4/10/12

This case presents the issue of whether California’s antideficiency law, Code of Civil Procedure §580d, bars an assignee of a “junior” lien deed of trust that was originated by a mortgage lender who also made the loan secured by a “senior” lien deed of trust from pursuing a judgment on the note after the “senior” lien deed of trust foreclosed and wiped out the “junior” lien deed of trust. The court holds “yes,” finding a distinction between the facts in this case and those in Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35 (1963), where the California Supreme Court held that a sold-out “junior” was not barred from seeking a deficiency judgment when its “security has been rendered valueless by a senior sale.”

In Roseleaf, the creditor who made the loan secured by the “senior” lien was different from the one who made the loan secured by the “junior” lien. In this case, both the “senior” and “junior” lien loans were originated by the same creditor, GreenPoint Mortgage Funding, Inc.. Green point foreclosed on its “senior” lien deed of trust and, more than a year later, assigned its “junior” lien deed of trust to Bank of America.

The court found Simon v. Superior Court, 4 Cal. App. 4th 63 (1992), dispositive of this case. There, the court held that the rule articulated in Roseleaf did not apply to protect a junior lienor who also held the senior lien. The court in Simon stated, “[w]e will not sanction the creation of multiple trust deeds on the same property, securing loans represented by successive promissory notes from the same debtor, as a means of circumventing the provision of section 580d. The elevation of the form of such a contrived procedure over its easily perceived substance would deal a mortal blow to the antideficiency legislation in this state.”

The court here makes the following observation: “The result is no different because GreenPoint, after the trustee sale, assigned the second deed of trust to [Bank of America]. An ‘assignee ‘stands in the shoes’ of the assignor, taking his rights and remedies, subject to any defenses which the obligor has against the assignor prior to notice of the assignment.’ Accordingly, because GreenPoint could not have obtained a deficiency judgment against [the borrower], [Bank of America] also is precluded from doing so.”

There was no practice recommendation and the case was dropped.

E. SCI California Funeral Services, Inc. v. Five Bridges Foundation
Cal. App. 1st District – Division 5 (A126053, A126337)
Super. Ct. No. CIV432392 (San Mateo County) Filed 2/14/12

This case addresses the valuation of an easement that “gave its holder the exclusive right to use the surface of the land [and] took ‘essentially the entire fee interest, leaving the owner of the fee with only a nominal value or right of reverter’ [Citation omitted]” in the context of a suit for breach of an asset purchase agreement commenced after the plaintiff learned that the subject easement would not be included among the assets being sold because the seller had agreed by an enforceable oral contact to relinquish the easement to the servient estate owner. The court affirms the trial court’s damage award, which included consideration of “the unique value of the easement to the servient estate,” but reverses in part the order that had denied the plaintiff’s request for attorneys’ fees as the “prevailing party.”

The court agreed that, in a case involving a breach of contract, it was proper to apply the measure of damages prescribed by Civil Code §3300 which states in pertinent part: “[T]he measure of damages, except where otherwise expressly provided by this code, is the amount which will compensate the party aggrieved for all the detriment proximately caused thereby, or which, in the ordinary course of things, would be likely to result therefrom.”

Contrary to the defendant’s view that “the only proper measure of damages from the loss of an appurtenant easement is the diminution in value of the dominant estate served by that
“easement,” the court recognized there are other legally permissible measures of damages and, therefore, “the trial court’s choice of a particular measure under the specific circumstances of the case is a matter of discretion.” As the court states, “where, as here, the trial court must value an asset for which there is no relevant, comparable market, it may consider any valuation methodology that is just, equitable, and not inconsistent with California law.”

The court concluded that it was perfectly proper for the trial court to have considered the subject easement’s great value to (1) the servient estate owner if it could free its property from the burden of the easement and thus develop the property for its highest and best use for commercial purposes and (2) the plaintiff in its ability to use the easement as a bargaining chip to negotiate the purchase of additional acreage from the easement’s servient estate owner in order to enhance the profitability of the plaintiff’s cemetery business. It was clearly significant to this court that the trial court had expressly found that the defendant knew of the subject easement’s value to both the servient estate owner and the plaintiff (from the bargaining chip perspective).

The court states: “The trial court properly considered [the servient estate owner’s] unique desire for reconveyance of the [subject easement] in calculating the amount of damages. Where a particular buyer has a special need for property the buyer does not presently own, the value of the property to that buyer is a factor that may be considered in determining the fair market value of the property, even if no one else shares that buyer’s peculiar position. *** Thus, while the [subject easement] may not have had great value to another hypothetical buyer or even to the dominant estate, this did not diminish its potential value to [the servient estate owner].”

The court pointed out that this concept is further supported by Civil Code §3355 which states: “Where certain property has a peculiar value to a person recovering damages for deprivation thereof, or injury thereto, that may be deemed to be its value against one who had notice thereof before incurring a liability to damages in respect thereof, or against a willful wrongdoer.”

There was no practice recommendation and the case was dropped.

F.  
Adassa Walker v. Ticor Title Company of California  
Cal. App. 4th District – Division 1 (A126710, A126832, A127086, A128390)  
Super. Ct. No. RGO7342384 (Alameda County)  
Filed 3/15/12

The primary issues in this appeal pertain to the award to Ticor of its contractual attorneys’ fees, including whether the trial court erred in considering the plaintiffs’ financial circumstances when setting the amount of the award and in allocating liability among the plaintiffs rather than making the award joint and several, and whether Ticor should have been awarded its expert witness fees.

The court holds that (1) the reduction of Ticor’s attorneys’ fees due to the plaintiffs’ financial circumstances was improper, (2) it was within the trial court’s discretion to apportion the attorneys’ fees award rather than make it joint and several where, as in this case, the plaintiffs were not joint obligors on a single contract and could have sued Ticor separately but chose not to do so with resulting efficiencies that benefitted all parties, and (3) Ticor should have been awarded its expert witness fees under Code of Civil Procedure §998 even though the trial court precluded the testimony of the expert by motion in limine.

There was no practice recommendation and the case was dropped.

G.  
Cal. App. 6th District (H036379)  
Super. Ct. No. 1-09-CV157852 (Santa Clara County)  
Filed 3/16/12

This case presents the primary issue of whether the trial court erred in sustaining the defendants’ demurrer to the plaintiff’s first amended complaint without leave to amend. The substantive issue addressed is whether a valid nonjudicial foreclosure in California requires that the foreclosing assignee of the beneficial interest in the subject deed of trust produce evidence of its physical possession of the secured promissory note. The court affirms the trial court’s judgment of
dismissal and, in so doing, concurs with the trial court’s conclusion that California’s nonjudicial foreclosure law does not require that the promissory note be in the possession of the party initiating the foreclosure.

The court states: “As the parties recognize, many federal courts have rejected this position, applying California law. All have noted that the procedures to be followed in a nonjudicial foreclosure are governed by sections 2924 through 2924k, which do not require that the note be in the possession of the party initiating the foreclosure. [Citations omitted]. We likewise see nothing in the applicable statutes that precludes foreclosure when the foreclosing party does not possess the original promissory note. They set forth ‘a comprehensive framework for the regulation of a nonjudicial foreclosure sale pursuant to a power of sale contained in a deed of trust. The purposes of the comprehensive scheme are threefold: (1) to provide the creditor/beneficiary with a quick, inexpensive and efficient remedy against a defaulting debtor/trustor; (2) to protect the debtor/trustor from wrongful loss of the property; and (3) to ensure that a properly conducted sale is final between the parties and conclusive as to a bona fide purchaser.’ [Citation omitted]. Notably, section 2924, subdivision (a)(1), permits a notice of default to be filed by the “trustee, mortgagee, or beneficiary, or any of their authorized agents.” The provision does not mandate physical possession of the underlying promissory note in order for this initiation of foreclosure to be valid.”

There was no practice recommendation and the case was dropped.

H. Peter Connolly et al. v. Wade Trabue et al.
Cal. App. 1st District – Division 2 (A131984)
Super. Ct. No. DR 080856 (Humboldt County) Filed 4/10/12

This decision addresses the issue of whether the doctrine of laches is applicable in an action involving a claim for a prescriptive easement to serve as a bar to the claim (i.e. as a defense for the party against whom perfection of the prescriptive easement is sought). The court holds “no” and, while agreeing with the trial court’s implicit finding that the necessary elements to establish the prescriptive easement had all been proven by the plaintiff, reverses the trial court’s judgment in favor of the defendants based on the doctrine of laches.

As the court recognized, “the doctrine of laches simply cannot and does not apply here. * * * Although the doctrine of laches is often asserted in cases involving adverse possession [a “legal twin” to a claim of easement by prescription], typically the facts involve a defendant adverse possessor asserting laches as an additional defense against a plaintiff record owner’s action to recover the property. [Citations.] The interrelated nature of laches and , claim of adverse possession. ‘Laches is an implied waiver resulting from knowing acquiescence in existing conditions and an inexcusable delay in asserting a right which results in prejudice to the adverse party. [Citation.] In other words, laches addresses delay in the pursuit of a right when a party must assert that right in order to benefit from it. Fee simple title vests in the adverse possessor by operation of law at the moment the requisite conditions for adverse possession have been established for the statutory period. [Citation.] The adverse possessor is not required to take any further steps to acquire title once those conditions have been met. The statute of limitations runs against the title holder, not the adverse claimant. * * * There was no significant delay because the [adverse possessors] were under no obligation to take further action once they had acquired title by operation of law.”

There was no practice recommendation and the case was dropped.

I. Nathaniel Haynes v. EMC Mortgage Corporation et al.
Cal. App. 1st District – Division 4 (A131023)
Super. Ct. No. RG09481826 (Alameda County) Filed 4/9/12
Pub. Order 4/24/12

The case presents the issue of whether Civil Code §2932.5, requiring the assignee of a mortgagee to record the assignment before exercising a power of sale to sell the real property,
applies to deeds of trust. The court holds “no” and affirms the trial court’s judgment of dismissal following its order sustaining the defendants’ demurrer to the first amended complaint.

The court cites Stockwell v. Barnum, 7 Cal. App. 413 (1908), to support its statement: “That section 2932.5 applies only to mortgages is well settled.” The court also observed that Calvo v. HSBC Bank USA, N.A., 199 Cal. App. 4th 118 (2011), recently followed Stockwell and held that §2932.5 does not apply to deeds of trust.

There was no practice recommendation and the case was dropped.

J. Freeman et al. v. Quicken Loans, Inc.
U.S. Supreme Court (No. 10-1042)
Appeal from the Fifth Circuit Court of Appeals Filed 5/24/12

This decision addresses the issue of whether a plaintiff must prove that a settlement service charge was divided between two or more persons in order to recover against a settlement service provider, for charging allegedly unearned fees, under the Real Estate Settlement Procedures Act, 12 U.S.C. §2607(b), which prohibits giving and accepting “any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service . . . other than for services actually performed.” The court holds “yes” and affirms the Fifth Circuit’s judgment affirming the District Court’s grant of summary judgment to the defendant.

The court states in its conclusion: “In order to establish a violation of §2607(b), a plaintiff must demonstrate that a charge for a settlement services was divided between two or more persons. Because petitioners do not contend that respondent split the challenged charges with anyone else, summary judgment was properly granted in favor of respondent.”

There was no practice recommendation and the case was dropped.

4. Closing Instructions Section (Terri Winchester)
Nothing Scheduled.

5. Governmental Regulations Section
Nothing Scheduled.

6. Subdivision and Land Use Section (Douglas Borchert)

Sumner Hill v. Rio Mesa

This case was summarized under Item 3.A. of the Court Decisions Section.

7. Legislation Section (Tim Reardon)

A. E-mail from Steve Gottheim & Senate Bill 998 – Energy efficiency, renewable energy, and distributed generation on-bill repayment programs

This item, generally related to the subject matter of Property-Assessed Clean Energy (“PACE”) programs, was reviewed and briefly discussed. As it relates to proposed legislation, there was no CLTA Manual change or practice recommendation.
B. Assembly Bill No. 1788 – Property taxation: welfare exception: course of construction

*This item was reviewed and briefly discussed. As it relates to proposed legislation, there was no CLTA Manual change or practice recommendation.*

C. Assembly Bill No. 1683 – Revocable trusts

*This item was reviewed and briefly discussed. As it relates to proposed legislation, there was no CLTA Manual change or practice recommendation.*

D. Assembly Bill No. 2299 – Local government: public safety officials: confidentiality

*This item was reviewed and briefly discussed. As it relates to proposed legislation, there was no CLTA Manual change or practice recommendation.*

8. **Taxes, Bonds and Assessments Section** (Gytis Nefas)

Nothing Scheduled.

9. **Title Documents Section** (Ed Rusky)

Nothing Scheduled.

10. **Title Forms Section** (Paul Flores)

A. **Non-Action Item:** Reviewed CLTA 100-06 series as a result of ALTA’s action to the 9-06 series due to the holding in *Nationwide Life Insurance vs. Commonwealth Land Title Insurance Co.*, 579 F. 3d 304. No changes recommended at this time. The new preamble that the ALTA has adopted may be added to CLTA endorsements in the future.

*This item was reviewed and briefly discussed.*

B. **Action Item:** Motion that Forms and Practices recommend that the Board of Governors authorize the staff to make the revisions by adding a new exclusion to and file these forms with the CA DOI revised as of 06-08-12: CLTA 100-06, 100.23-06, 100.23-06, 100.24-06, 100.26-06 and 100.29-06 with a new exclusion inserted therein.

100-06 (rev. 06-08-12) Exhibits 10 B.1 (Redline) and 10 B.2 (Clean)
100.23-06 (rev. 06-08-12) Exhibits 10 B.3 (Redline) and 10 B.4 (Clean)
100.24-06 (rev. 06-08-12) Exhibits 10 B.5 (Redline) and 10 B.6 (Clean)
100.26-06 (rev. 06-08-12) Exhibits 10 B.7 (Redline) and 10 B.8 (Clean)
100.29-06 (rev. 06-08-12) Exhibits 10 B.9 (Redline) and 10 B.10 (Clean)

The items referenced above were each reviewed and briefly discussed and it was then moved and seconded, and the motion was unanimously passed, to take the action mentioned in the **Action Item** paragraph.

C. **Non-Action Item – Report by Paul Flores:** Summary of CLTA Title Forms Committee’s comments directed to ALTA via Paul Hammann prior to the expiration of the public comment period on the new and revised ALTA endorsements and U.S. Policy Form.

*This item was presented and briefly discussed.*
D. **Non-Action Item:** CLTA TSG Webinar Presenters: Ed Rusky, Greg Herrington and Paul F. and Scheduled for July 12, 2012 at 12 noon.

*This item was presented and briefly discussed.*

E. **Non-Action Item:** SB 4 Amended CA Civil Code Section 2924f - Additional verbiage is required for NODs and NTS for 1-4 SFR units: Proposed Non-action agenda item for Reno meeting in June 2012 / Civil Code 2924f(b)(2)(C) states that “Failure to comply with subparagraph (A) [notice to bidders and owner] or (B) [providing information about postponements] shall not invalidate any sale that would otherwise be valid under Section 2924f.”

*This item was presented and briefly discussed.*

F. **Action Items:** Motion that Forms and Practices recommend that the Board of Governors authorize the staff to withdraw the ALTA 9.4-06/CLTA 100.2.2-06 and ALTA 9.5-06/CLTA 100.2.3-06, effective immediately, assign CLTA nos. as noted below and to file the new and revised ALTA endorsements on behalf of CLTA member companies with the CA DOI as soon as possible.

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*The items referenced in the Action Item paragraph and chart above were each reviewed and briefly discussed and it was then moved and seconded, and the motion was unanimously passed, to take the action mentioned in the Action Item paragraph.*

G. **Action Item:** CLTA/ALTA Homeowner’s Policy – Motion to approve proposed revision to Homeowner’s Policy by adding exclusion language (see 5(d) and (e) from the ALTA 9.7-06 endorsement) to the Homeowner’s Policy. CLTA Forms Section has referred this action item
proposal to the ALTA Forms Committee thru Paul Hammann for concurrent consideration and approval.

Motion that (1) authorizes CLTA Forms Section to coordinate and submit the proposed change to the standard exclusions of the CLTA/ALTA Homeowner's Policy (02-03-10), (2) contingent upon adoption of these changes to the policy in question by ALTA Forms Committee and ALTA Board of Governors and (3) CLTA's Board of Governors will authorize the CLTA Staff to make the same changes to that policy form and file the revised policy form with the CA DOI at that time.

The items referenced in the Action Item paragraph and Motion above were each reviewed and briefly discussed and consensus was reached to take the action detailed in the Motion subject to future confirmation that the ALTA Forms Committee has made its recommendation to the ALTA Board to approve the same revisions to the ALTA Homeowner's Policy so that both the CLTA and ALTA versions of this product continue to include identical provisions.

11. Special Sub-Committee - Electronic Recording and Signatures (Paul Flores)

Nothing Scheduled.

12. Special Sub-Committee – Copyright Protection of CLTA Forms and Manual

Nothing Scheduled.

13. CLTA Staff Report


B. CLTA News Express Bulletin – Attorney General and Democratic Leaders Unveil California Homeowner Bill of Rights Legislation

The items referenced above were each reviewed and briefly discussed.
# 2012

Minutes of the Meeting of the

CALIFORNIA LAND TITLE ASSOCIATION FORMS AND PRACTICES COMMITTEE

Held at

**Fairmont San Jose**
170 S. Market Street, San Jose, CA 95113

**November 1-2, 2012**
Thursday: 1:00 PM - 5:00 PM  
Friday: 9:00 AM - 1:00 PM

<table>
<thead>
<tr>
<th>Members Present:</th>
<th>Therien, Roger - Chair</th>
<th>Klarin, Ric</th>
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<tr>
<td></td>
<td>Cavallaro, Robert - Vice-Chair</td>
<td>Lowe, Laura</td>
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<td>Hammann, Paul - Vice-Chair</td>
<td>Nefas, Gytis</td>
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<td>Borchert, Doug</td>
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<td>Buchanan, Dan</td>
<td>Rusky, Ed</td>
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<td>Chalmers, Jerry</td>
<td>Shepherd, Mark</td>
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<td>Condict, Wayne</td>
<td>Smith, Steve</td>
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<td>Guerino, Jerry</td>
<td>Westcott, David</td>
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<td>Helmer, Dwight</td>
<td>Winchester, Terri</td>
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<td>Herrington, Greg</td>
<td>Windle, David</td>
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<td>Jourdan, Bill</td>
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| Members Absent:        | Bishop, Chuck          | Miron, Avi       |
|                        | Boyd, Kathy            | Morey, Shaun     |
|                        | Chandler, Tom          | Morgan, Tim      |
|                        | Dondanville, Jeff      | O'connell, Bill  |
|                        | Dufficy, Jim           | Saez, Karen      |
|                        | Flores, Paul           | Smith, Elliot    |
|                        | Griffin, Larry         | Thomas, Bill     |

| Also Present:          | Craig Page             |                  |
|                        | Kevin Weaver           |                  |
|                        | Gary Finnell           |                  |
1. **Administrative Section (Elliot Smith)**

   It was moved and seconded, and the motion unanimously passed, that the Minutes of the September 9-10, 2012 Meeting be approved as written.

   Approval of the Minutes of the June 7-8, 2012 meeting was carried over to the February 2013 meeting.

2. **Bankruptcy Section (Wayne Condict)**

   A. **In re: Leafty (Leafty v. Aussie Sonoran Capital)**
   
   U.S. Bankruptcy Appellate Panel – 9th Circuit (District of Arizona)
   
   Filed 10-10-12

   When the lender under a deed of trust obtained a relief from automatic stay to foreclose on a deed of trust on the debtor’s residence, the debtor voluntarily dismissed the Chapter 13 and filed a new Chapter 13 just minutes before the foreclosure sale. On a subsequent appeal to the BAP, the BAP upheld the bankruptcy court decision that § 109 (g) (2) of the Bankruptcy Code precluded the debtor from filing a new bankruptcy action within 180 days from her voluntary dismissal of an action in which a lender had filed a request for relief from automatic stay. The purpose of the section is to prevent abusive filings which endlessly delay foreclosures.

   There was no practice recommendation and the case was dropped.

   B. **In re: Popp**
   
   U.S. Bankruptcy Appellate Panel – 9th Circuit (So. District of California)
   
   Filed 2-24-05

   In this case, the court held that a secured creditor has standing to raise the issue of whether the subject property is actually "property of the estate" in the context of a trustee’s efforts to sell the property under section 363. Because the creditor's lien was being stripped from the property and the creditor wasn't being paid in full, the creditor was sufficiently aggrieved to have standing to contest the sale. The court also held that a sale under section 363 was only appropriate if the property has been determined to be “property of the estate.” In this case, the resolution of a dispute over ownership of the property had not yet been resolved, and therefore the sale was premature and improper. Finally, the court held that the appeal was not moot, notwithstanding the appellant’s failure to obtain a stay. Because the sale itself was not proper under section 363, the protections of 363(m) did not apply. The court also found that equitable mootness did not bar the appeal as it was still possible to impose a remedy in light of the buyer’s agreement to take title without any warranty or assurances by the trustee.

   By way of a practice recommendation, underwriters should be cautioned that insuring a sale from a bankruptcy court, it is very risky to insure before the appeal period has expired. The case was dropped.
C. In re: Mortgages, Ltd. (Stone v. Central and Monroe)
U.S. Bankruptcy Court – District of Arizona Filed 9-27-12

Construction Lender’s Deed of Trust was not entitled to equitable subrogation (for the amount of the loan used to pay off existing non-construction indebtedness incurred before construction began). The AZ bankruptcy court applied the equitable subrogation principles set forth in Restatement of Property as adopted by the Arizona Supreme Court in its 1997 case of Sourcecorp v. Norcutt. Per the Restatement, mechanic’s liens claims represent a limitation on equitable subrogation principles because, unless the future claimants are apprised of the lender’s challenge to their priority, they will continue to extend credit in reliance on their apparent priority over the loan. Subrogation was denied here because 1) the lender did not inform contractors and suppliers of its subrogation claim at the time of its loan; 2) neither did lender inform them at the time of its foreclosure (when they could still do something) and 3) perhaps most significantly, it was the lender’s failure to fully fund its loan that caused the liens to arise in the first place.

By way of a practice recommendation, underwriters should be cautioned that they may not be able to count on equitable subrogation when underwriting a mechanics lien risk. The case was dropped.

D. In re: Reynolds
U.S. Bankruptcy Appellate Panel – 9th Circuit (So. District of California) Filed 8-24-12

The majority opinion of the Bankruptcy Appellate Panel for the Ninth Circuit Court of Appeals held that the Chapter 7 trustee was entitled to reach a maximum of 25% of the debtor’s interest in two spendthrift trusts established under California Probate Code §§15300 et seq. The Court first noted that, while a beneficiary’s interest in the income and principal of a spendthrift trust is protected from the claims of creditors as long as the income or principal remains in the trust, once it is distributed to the beneficiary, it can be reached by creditors. The Court went on to hold that, of the recognized exceptions to this general rule, only the exception in Probate Code §15306.5 (which provides that a money judgment creditor may satisfy its judgment out of the payments to which the beneficiary is entitled out of the spendthrift trust so long as the payment does not exceed 25% of the debtor’s beneficiary interest) was applicable because the debtor was only entitled to receive distributions of principal, not interest, from the trust.

There was no practice recommendation and the case was dropped.

E. In re: Weingarten
U.S. Court of Appeals – 9th Circuit Filed 8-17-12

The children of the settlor of a CA Qualified Personal Residence Trust were denied their motion to intervene in a bankruptcy court proceeding initiated by the trustee to recover the debtor’s personal residence for the bankruptcy estate. The bankruptcy court’s denial of intervention was based on its finding that 1) the debtors/parents would themselves adequately represent the interests of the intervenors/children (in fact they were using the same counsel as the children we using in the intervention motion) and 2) that the intervenor’s interest was NOT a significant protectable interest (the retained interest would expire in 2027 but the court gave no indication of
the age or health of debtors/parents). The manual presently broadly sets forth requirements for addressing the interests of remaindermen in irrevocable trusts including the interests of unborn heirs. The same would hold for QPRTs, the court’s finding of “no significant protectable interest” notwithstanding.

There was no practice recommendation and the case was dropped.

3. Court Decisions (David Westcott)

A. Bates v. MERS
9th Circuit (Federal) Filed 9-17-12

The court upheld the dismissal of plaintiffs' qui tam action under the California False Claims Act ("CFCA") asserting that defendants made false representations in naming MERS as a beneficiary in recorded mortgage documents in order to avoid paying recording fees. The court applied the "public disclosure" exception of the CFCA on the basis that plaintiffs' allegations were substantially similar to information already in the public domain.

There was no practice recommendation and the case was dropped.

B. JP Morgan Chase v. Banc of America
Cal. App. 4th Dist., Div. 3 Filed 9-27-12

The court applied the Doctrine of Equitable Subrogation to subrogate plaintiff's deed of trust to two deeds of trust that had been paid off with the loan proceeds, thereby placing defendant's earlier recorded deed of trust in third position. The evidence showed that plaintiff intended to be in first position, and that defendant intended to be in third position junior to the two deeds of trust that were paid off with the proceeds of plaintiff's loan.

There was no practice recommendation and the case was dropped.

C. Ragland v. U.S. Bank
Cal. App. 4th Dist., Div. 3 Filed 9-11-12

The court overruled the trial court's order sustaining the bank's motion for summary judgment, holding that:
1. Plaintiff raised a triable issue of fact as to whether the bank's representative told her not to make a payment. Plaintiff's failure to tender the amount due does not preclude her from raising this issue because the amount claimed by the bank includes late charges and other charges that would not have been incurred if plaintiff had continued to make payments.
2. Civil Code section 2924g(d), prohibiting a trustee's sale from being conducted prior to the seventh day after an injunction is terminated, creates a private right of action and is not preempted by federal law.
NOTE: Plaintiff conceded that her cause of action for rescission of the trustee's deed was no longer viable because the property was resold to a bona fide purchaser for value.

There was no practice recommendation and the case was dropped.
D.  **Martin v. Van Bergen**  
Cal. App. 2nd Dist.  
Filed 9-6-12

The doctrine of boundary by agreement does not apply where: 1) a boundary was not uncertain where it can be ascertained by an accurate survey; and 2) evidence of an actual agreement to resolve a boundary dispute does not exist.

*There was no practice recommendation and the case was dropped.*

E.  **Burnham v. California Public Employees’ Retirement System**  
Cal. App. 3rd Dist.  
Filed 8-31-12

Presenting a declaration of domestic partnership for filing with the Secretary of State is a necessary prerequisite for a valid domestic partnership. Signing a declaration of domestic partnership and having it notarized is not sufficient alone. Here, because plaintiff's purported domestic partner was deceased when plaintiff presented the declaration of domestic partnership for filing with the Secretary of State, they never became domestic partners. Therefore, Plaintiff was not entitled to the decedent's state pension survivor benefits. The court also held that the putative spouse doctrine did not apply because that doctrine protects the expectation of parties who accumulate property over time believing they are part of a valid union. Here, plaintiff and the decedent attempted to establish a domestic partnership shortly before one of them died, so they did not accumulate property over time in expectation of having a valid union.

*There was no practice recommendation and the case was dropped.*

F.  **Vieira Enterprises v. City of East Palo Alto**  
Cal.App. 1st Dist.  
Filed 8-15-12

The Plaintiff argued that the City of Palo Alto violated his due process by filing notices of installation of Plaintiff’s manufactured homes thereby altering the status of the homes from personal property to real property.

In 2005 Plaintiff delivered two manufactured homes to Mr. and Mrs. Wilson who never paid for the homes and instead lost their property to foreclosure with the unpaid manufactured homes installed on foundations. Plaintiff filed a mechanic’s lien against the property which was apparently ignored. The property was eventually sold to Free at Last Properties and insured by Fidelity whose escrow officer issued an endorsement insuring that the manufactured homes were in fact affixed to the land, relying in part on the City of Palo Alto issuing notices of installment for the manufactured homes. In 2010, Fidelity and Free at Last Properties settled with the Plaintiff for $225,000. Plaintiff then sued the City of Palo Alto for wrongfully issuing the notice of installation.

The issue presented was: Did the City’s issuance of the installation permits alter the legal status of the manufactured homes and cause the Plaintiff damage? The court held, no, the issuance of the permits did not trump the intent of the Plaintiff to install the homes nor did it trump the validity of the mechanic’s lien, both of which the Plaintiff argued earlier gave it a real property interest in the land.

The court reasoned that the Plaintiff cannot create a triable issue of fact by submitting a contrary, self-serving declaration. Furthermore, Health & Safety Code
Section 18551, governing the installation permits issued by Palo Alto, did not trump the common law history affecting fixtures to the land. Accordingly, the court concluded that the issuing of the permits did not amount to a taking by the City and therefore agreed with the trial court in rejecting the Plaintiff’s claim.

There was no practice recommendation but it was suggested that this case be noted in the appropriate section of the CLTA Manual.

G. Pinnacle Museum Tower v. Pinnacle Market Development
California Supreme Court Filed 8-16-12

The court held that a provision in CC&R's providing that the homeowners association and each condominium owner agree to waive their right to a jury trial and to have any construction dispute resolved exclusively through binding arbitration is not unconscionable and is properly enforced against the association, as well as the individual owners.

There was no practice recommendation and the case was dropped.

H. Admin Law Judge Ruling: Fair Claims Settlement Practices Regulations
Filed 8-25-12

A California Administrative Law Judge ruled that the California Department of Insurance’s Fair Claims Settlement Practices Regulations cannot be brought as unfair claims acts. This ruling will limit the CDI’s ability to impose penalties against insurers for claims.

There was no practice recommendation and the case was dropped.

I. Town of Babylon v. Federal Housing Finance Agency
2nd Circuit (Federal) Filed 10-24-12

(A case summary was not submitted.)

There was no practice recommendation but it was suggested that this case be noted in the appropriate section of the CLTA Manual.

J. In re: Fontainebleau Las Vegas Holdings
Nevada Supreme Court Filed 10-25-12

1. NRS Section 108.225 gives mechanics lien claimants priority over all other liens that attach after commencement of a work of improvement, so that a lender who made a loan after commencement of construction is not entitled to equitable subrogation as to proceeds that paid off a loan that was made prior to commencement of construction.

2. Prospective waivers of mechanics liens are unenforceable.

By way of a practice recommendation, underwriters should be cautioned that they may not be able to count on equitable subrogation when underwriting a mechanics lien risk. The case was dropped.
4. **Closing Instructions Section (Terri Winchester)**

Nothing Scheduled.

5. **Governmental Regulations Section**

Nothing Scheduled.

6. **Subdivision and Land Use Section (Douglas Borchert)**

Nothing Scheduled.

7. **Legislation Section (Tim Reardon)**

A. Chapter 26, AB 1484 Community Redevelopment Agencies

Existing law authorizes the city, county, or city and county that authorized the creation of a redevelopment agency to retain the housing assets, functions, and powers previously performed by the redevelopment agency, excluding amounts on deposit in the Low and Moderate Income Housing Fund. This act tolls the time limit for bringing an action until the Department of Finance issues a finding of completion to the successor agency.

The act modifies provisions relating to the transfer of housing responsibilities associated with dissolved redevelopment agencies and defines the term "housing asset" for these purposes. The act imposes new requirements on successor agencies with regard to the submittal of the Recognized Obligation Payment Schedule, the conducting of a due diligence review to determine the unobligated balances available for transfer to affected taxing entities, and the recovery and subsequent remittance of funds determined to have been transferred absent an enforceable obligation. The act authorizes the Department of Finance to issue a finding of completion to a successor agency that completes the due diligence review and meets other requirements. Upon receiving a finding of completion, the act authorizes the successor agency to participate in a loan repayment program and to submit a Long Range Property Management Plan for approval by the Department.

The act authorizes the county auditor-controller and the department to require the return of funds improperly spent or transferred to a public entity and authorizes the department and the Controller to require the State Board of Equalization and the county auditor-controller to offset sales and use tax and property tax allocations, respectively, to the local agency. The act authorizes the Controller to review the activities of a successor agency to determine if an improper asset transfer had occurred between the successor agency and the city or county that created the former redevelopment agency, and would require the Controller to order the return of these assets if such an asset transfer did occur.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*
B. Chapter 55, AB 1683 – Trusts, Wills, and Estates

This act allows revocation of a trust, in addition to current methods, to be made by a writing signed by any other person holding the power of revocation and delivered to the trustee during the lifetime of the settlor or the person holding the power of revocation.

This act specifies that a settlor may grant to another person, including his or her spouse, a power to revoke all or part of that portion of the trust contributed by that settlor, regardless of whether that portion was separate property or community property of that settlor, and regardless of whether that power to revoke is exercisable during the lifetime of that settlor or continues after the death of that settlor, or both.

This act specifies certain requirements of disposing of trust property if a trust is revoked by the settlor.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

C. Chapter 60, AB 2667 – Secured Transactions

This act revises existing law pertaining to a transfer of personal property not accompanied by delivery and change of possession of the property by requiring the transferor or the transferee to file, prior to the date of the intended transfer, a financing statement authorized in an authenticated record by the transferor with respect to the property transferred. This change recognizes signing or electronic authentication as provided in the U.C.C.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

D. Chapter 86, AB 278 / Chapter 87, SB 900 – Foreclosure

These acts (which are identical) add mortgage servicers to the requirement that a mortgagee, trustee, beneficiary, or authorized agent to contact the borrower prior to filing a notice of default to explore options for the borrower to avoid foreclosure. It also extends the operation of these provisions indefinitely, except that it would delete the requirement with respect to a notice of sale. The act, until January 1, 2018, additionally requires the borrower to be provided with specified information in writing prior to recordation of a notice of default and, in certain circumstances, within five business days after recordation. The acts prohibit a mortgage servicer, mortgagee, trustee, beneficiary, or authorized agent from recording a notice of default or, until January 1, 2018, recording a notice of sale or conducting a trustee's sale while a complete first lien loan modification application is pending.

The acts, until January 1, 2018, establish additional procedures to be followed regarding a first lien loan modification application, the denial of an application, and a borrower's right to appeal a denial.

The acts, until January 1, 2018, require a written notice to the borrower after the postponement of a foreclosure sale in order to advise the borrower of any new sale date and time. The acts provide that an entity shall not record a notice of default or otherwise initiate the foreclosure process unless it is the holder of the beneficial interest under the deed of trust, the original or substituted trustee, or the designated agent of the holder of the beneficial interest.
The acts prohibit recordation of a notice of default or a notice of sale or the conduct of a trustee’s sale if a foreclosure prevention alternative has been approved and certain conditions exist and, until January 1, 2018, require recordation of a rescission of those notices upon execution of a permanent foreclosure prevention alternative. The acts, until January 1, 2018, prohibit the collection of application fees and the collection of late fees while a foreclosure prevention alternative is being considered, and would require a subsequent mortgage servicer to honor any previously approved foreclosure prevention alternative.

The acts authorize a borrower to seek an injunction and damages for violations and authorize the greater of treble actual damages or $50,000 in statutory damages intentional or reckless violations. Violations by licensees of the Department of Corporations, the Department of Financial Institutions, and the Department of Real Estate would also be violations of those respective licensing laws.

The requirements described above are applicable only to owner-occupied residential real property not exceeding 4 dwelling units and, until January 1, 2018, only to those entities who conduct more than 175 foreclosure sales per year or annual reporting period.

The acts require, upon request, that a mortgage servicer who conducts more than 175 foreclosure sales per year establish a single point of contact

The acts require that a specified documents declaration, notice of default, notice of sale, deed of trust, assignment of a deed of trust, substitution of trustee, or declaration or affidavit filed in any court relative to a foreclosure proceeding or recorded by or on behalf of a mortgage servicer shall be accurate and complete and supported by competent and reliable evidence. The acts require that before recording or filing any of those documents, a mortgage servicer shall ensure that it has reviewed competent and reliable evidence to substantiate the borrower’s default and the right to foreclose.

The acts, until January 1, 2018, provide for a civil penalty of up to $7,500 per mortgage or deed of trust, in an action brought by specified state and local government entities, and authorizes administrative enforcement against licensees of the Department of Corporations, the Department of Financial Institutions, and the Department of Real Estate.

It was recommended that these acts and there requirements be referenced in the appropriate sections of the CLTA Manual.

E. Chapter 94, AB 1642 – Recording

This act prohibits the county recorder from refusing to record any document that is authorized or required by statute, court order, or local ordinance on the basis of its lack of legal sufficiency.

This act revises that form of acknowledgment specified for a notice of intent to preserve an interest in real property by instead requiring the use of the general acknowledgment form.

It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.
F. Chapter 128, AB 2680 – Local Government

The Williamson Act provisions authorizing a city or county and a landowner to agree to rescind a contract or contracts and simultaneously enter into a new contract or contracts to facilitate lot line adjustments currently expire on January 1, 2013. This act makes these provisions operative indefinitely.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

G. Chapter 180, AB 805 / Chapter 181, AB 806 – Common Interest Developments

This act, on and after January 1, 2014, comprehensively reorganizes and recodifies the Davis-Stirling Common Interest Development Act. It also revises provisions regarding notices, standardizes terminology, establishes guidelines on the relative authority of governing documents, and establishes a single procedure for amendment of a common interest declaration.

This act makes numerous changes regarding the governing documents of a common interest development, conflicts of interest of members of a board of directors of a homeowner’s association, elections and voting, retention of records, and broadens the requirement that liens recorded by the association in error be released.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

H. Chapter 195, AB 1985 – Trusts, Wills, and Estates

This act expands the applicability of certain provisions pertaining to the interpretation of instruments, and pertaining to gifts, mortgages and durable powers of attorney.

This act also expands the applicability of provisions pertaining to eminent domain awards or insurance proceeds paid to a trustee acting for an incapacitated settlor of a trust.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

I. Chapter 202, AB 2326 – Notaries Public

This act expands the types of documents for which a notary public is required to place a party’s fingerprint in the notary journal to include any “other document affecting real property”.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

J. Chapter 204, AB 2475 – Foreclosure

This act extends the current prohibition on foreclosure and certain other actions against a member of the military from three months to nine months after the military service period ends.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*
K. Chapter 210, SB 825 / Chapter 562, AB2610 – Foreclosure

Chapter 210 extends provisions regarding post-foreclosure eviction notices to tenants until December 31, 2019.

Chapter 562 revises certain portions of a notice of sale to require a resident of property upon which a notice of sale has been posted to be advised that if the person is renting the property, the new property owner may either give the tenant a new lease or provide the tenant with a 90-day eviction notice. The notice must also advise a tenant that the new property owner is required to honor the lease unless the new owner will occupy the property as a primary residence or under other limited circumstances.

Chapter 562 provides that changes to the notice become operative on March 1, 2013, or 60 days following posting of a dated notice incorporating those amendments (which include the foreign language translation) on the Department of Consumer Affairs Internet Web site, whichever date is later. These provisions are operative until December 31, 2019.

Chapter 562 makes contains certain other provisions pertaining to evicting a tenant after a foreclosure.

It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.

L. Chapter 255, AB 2273 – Common Interest Developments

This act requires a trustee’s deed, of a property in a common interest development, to be recorded within 30 days following a trustee’s sale.

This act requires that information requested by an association in a recorded request be mailed to the association within 15 business days following the date of the trustee’s sale, rather than the date the trustee’s deed is recorded, as required by existing law.

It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.

M. Chapter 263, AB 2654 – Liens

This act defines "mine" for the purposes of enforcing mining liens as any mining claim or real property worked as a mine, including but not limited to any quarry or pit, from which rock, gravel, sand, or any other mineral-containing property is extracted by any mining, or surface mining, operation.

The act declares that it is the intent of the Legislature in enacting the act to supersede the holding of the Fourth Appellate District Court of Appeals in Sukut Const., Inc. v. Rimrock CA LLC (2011) 199 Cal.App.4th 817.

It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.

N. Chapter 419, SB 323 – Corporations and Partnerships

This act repeals the Beverly-Killea Limited Liability Company Act as of January 1, 2014, and enacts the California Revised Uniform Limited Liability Company Act, as of that date, which recasts provisions governing the formation and operation of limited liability companies. The act also authorizes an operating agreement to be in a record
or implied, in addition to being in writing or oral, and authorizes a combination of those forms.

The act distinguishes between a manager-managed limited liability company and a member-managed limited liability company for purposes of defining the scope of a member's agency and imposing fiduciary duties only on persons in control of a limited liability company. The act authorizes the establishment of classes of members.

This act also authorizes the Secretary of State to issue a certificate of registration with respect to a foreign limited liability company.

The act provides for the filing of specified records and further provides that an individual who signs such a record affirms under penalty of perjury that the information in the record is accurate.

This act allows a limited liability company to be subject to the nonexclusive jurisdiction of courts in another state or the exclusive jurisdiction of California courts. The act also allows a member to consent to arbitration.

This act specifies when a member would be dissociated from a limited liability company and the effects of dissociation on the member.

This act revises and recasts provisions regarding capital contribution standards, liability of members, the allocation of profits and losses, distributions of money and property, withdrawal of membership, assignment of interests, and dissolution of limited liability companies, registration of foreign limited liability companies, and mergers.

The act provides that its provisions shall be operative on January 1, 2014.  

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

O. Chapter 475, AB 1838 – Common Interest Developments

This act prohibits a cancellation fee for certain documents that a homeowners association must provide to a prospective purchaser upon request if the cancellation was requested in writing by the same person who placed the order and if work on the order had not yet been performed or if the work had been compensated.

The act also requires the association to refund all fees for the documents described above if the request was canceled in writing and work on the order had not yet been performed.

*There was no practice or CLTA Manual change recommendation.*

P. Chapter 556, AB 1599 – Foreclosure

This act, with respect to residential real property containing no more than four dwelling units, requires a trustee, beneficiary, or authorized agent to provide to the trustor, attached to a copy of the recorded notice of default and a copy of the notice of sale, a summary of the information required to be contained in those notices in English and five specified languages. The act also requires the notice of default and notice of sale to include a statement, in English and five specified languages, that a summary of the key provisions of the respective notice in English and five specified languages is attached. The act provides that the attached summaries are not required to be recorded or published. Those provisions would become operative on
April 1, 2013, or 90 days following the issuance of summary translations by the Department of Corporations, whichever occurs later.

The act also requires the Department of Corporations to provide a standard translation of the statement and summaries described above for a notice of default and a notice of sale, respectively, in those languages, and to make those documents available without charge on its Internet Web site. The act specifies that any mortgagee, trustee, beneficiary, or authorized agent who provides the department’s translations, in the manner prescribed, shall be in compliance with that provision.

This act incorporates additional changes to Section 2924 of the Civil Code proposed by AB 278 and repeals duplicate provisions of law.

_It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual._

**Q. Chapter 566, SB 1191 – Foreclosure**

This act, until January 1, 2018, requires every landlord who offers for rent a single-family dwelling, or a multifamily dwelling not exceeding four units, and who has received a notice of default with respect to a deed of trust secured by that property to disclose the notice of default in writing to any prospective tenant prior to executing a lease agreement for the property. The act also provides for certain remedies for a violation of those requirements.

The act specifies the content of the written disclosure notice, and would require the notice to be provided in English and other languages.

_There was no practice or CLTA Manual change recommendation._

**R. Chapter 641, AB 2010 – Loans – Reverse Mortgages**

This act requires, in connection with a reverse mortgage, that the certification of counseling from an approved counseling agency, which is required by existing law, must indicate that the counseling was conducted in person, unless the borrower elected to receive the counseling in another manner.

_There was no practice or CLTA Manual change recommendation._

**S. Chapter 781, AB 1700 – Property Taxation**

This act provides that a transfer of a cotenancy interest in real property from one cotenant to the other that takes effect upon the death of the transferor cotenant and that occurs on or after January 1, 2013, does not constitute a change of ownership for property tax purposes. This act also requires the transferee cotenant to sign an affidavit under penalty of perjury.

_There was no practice or CLTA Manual change recommendation._

**T. Chapter 875, SB 1501 – Easements**

This act amends the Open Space Easement Act of 1975 to require, upon the acceptance of any instrument creating an open-space easement, that the recording of the easement be consistent with the provisions of existing law that require county recorders to maintain a comprehensive index of conservation easements and Notice of Conservation Easements on land within that county. The act also requires the resolution made by the city or county, in order to accept a grant of an open-space
easement, to include several additional findings of why preserving the open space land is in the best interest of the state or local government.

*It was recommended that this act and its requirements be referenced in the appropriate section of the CLTA Manual.*

8. **Taxes, Bonds and Assessments Section (Gytis Nefas)**

   Nothing Scheduled.

9. **Title Documents Section (Ed Rusky)**


   *The committee discussed a situation where a Release of a Notice of Independent Solar Energy Producer Contract was recorded, but the solar system remained in place and the property continued to receive electrical service from the energy producer. No practice recommendation was made, but underwriters should be cautioned about the potential issue. The matter was dropped.*

10. **Title Forms Section (Paul Flores)**

    A. **Non-Action Item:** Monitor status of CLTA’s filing with CA DOI (1) two new ALTA endorsement forms and (2) ALTA’s Residential Limited Coverage Junior Loan policy forms with endorsements JR 1 and JR 2 as follows:

        CLTA 135.1-06 or ALTA 30.1-06 (Commercial Participation Interest) (08-01-12)
        CLTA 137.2-06 or ALTA 32.2-06 (Construction Loan- LOP- Insured’s Direct Payment) (08-01-12)
        ALTA Residential Limited Coverage Junior Loan Policy (Rev. 08-01-12)
        ALTA JR 1 (Rev. 08-01-12)
        ALTA JR 2 (Rev. 08-01-12)

        *This item was briefly reviewed and discussed.*

    B. **Non-Action Item:** ALTA U.S. Policy (12-3-12) – Special Comment Period Open Until 11/23/12. Carry and monitor until next CLTA meeting TBA in 2013.

        *This item was briefly reviewed and discussed.*

    C. **Non-Action Item:** Monitor status re CLTA/ALTA Homeowner’s Policy – Forms section members proposed at June 2012 meeting to revise Homeowner’s Policy by adding exclusion language (see 5(d) and (e) from the ALTA 9.7-06 (4-2-12) endorsement) to the Homeowner’s Policy. CLTA Forms Section referred this proposal to the ALTA Forms Committee thru Paul Hammann for consideration and approval.

        *This item was briefly reviewed and discussed.*
D. **Action-item:** Consider amending the Information Notes section of the TSG (CLTA Guarantee Form No. 22) as a result of the sunset provisions of Civ. Code 2924.8 effective 1/1/2013.

*This item was referred to the Title Forms Section to consider a proposal to eliminate reference to CC2924 entirely or to create a generic reference to CC2924 et seq. in order to avoid the need to periodically amend the form.*

11. **Special Subcommittee - Electronic Recording and Signatures (Paul Flores)**

   Nothing Scheduled.

12. **Special Subcommittee – Copyright Protection of CLTA Forms and Manual**

   Nothing Scheduled.

13. **CLTA Staff Report**

   A. **Methamphetamine Contamination Liens**

   The committee discussed the fact that if a “methamphetamine lien” is wiped out by a foreclosure, the lien is eliminated, but the underlying condition of the property, as disclosed by the lien, remains the same. There was no practice recommendation, but underwriters should be cautioned about the potential issue. The matter was dropped.

14. **Court Decisions Section – Honorable Mention (David Westcott)**

   These cases were not included in the main discussion of Court Decisions because they were deemed to be of marginal significance in California, although still of interest to many members of the Committee. They were briefly discussed but were not summarized in detail and no practice recommendations were made.

   A. **Community Credit Union v. AmeriTitle & Abstract, Inc.**

   Wisconsin Court of Appeals

   Filed 9-18-12

   No policy coverage where a temporary easement for access was shown in the legal description and expired after date of policy.

   B. **Fischer v. First American Title Insurance Company**

   Missouri Court of Appeals

   Filed 9-18-12

   Parties in possession exclusion applies to an adverse possession claim.

   C. **Smith v. Synergy Operating, LLC**

   New Mexico Supreme Court

   Filed 8-24-12

   A joint tenancy was terminated by conduct.
D. **PHH Mortgage Corp. v. Prater**  
Supreme Court of Ohio  
Filed 9-6-12  
Constructive notice by publication of a foreclosure proceeding via a sheriff’s office website is insufficient to constitute due process when that party’s address is known or easily ascertainable. (Good discussion of Mennonite Bd. of Missions v. Adams.)

E. **City of Glendale v. United States**  
9th Circuit  
Filed 9-11-12  
The Secretary of the Interior properly accepted land in trust for an Indian tribe because the Secretary reasonably applied the Gila Bend Indian Reservation Lands Replacement Act, and the Act did not violate the Indian Commerce Clause or the Tenth Amendment.

F. **Equity Income Partners v. Chicago Title Insurance Company**  
U.S. District Court, District of Arizona  
Filed 9-6-12  
Damages under a loan policy are determined by the value of the property at the time the loan is made, even though the amount of loss cannot be calculated until the insured lender forecloses. The court distinguished cases holding that the amount of loss is based on the value of the property at the time the title defect is discovered on the basis that those cases involved owner’s policies and do not apply to loan policies.

G. **Home Federal Savings Bank v. Ticor Title Insurance Company**  
7th Circuit Court of Appeals  
Filed 9-6-12  
The policy exclusion for matters created or suffered by the insured did not apply even though the lender purposefully withheld funds that would have been sufficient to pay the mechanics lien because the lender’s actions did not constitute "misconduct".

H. **Onondaga Nation v State of New York**  
2nd Circuit Court of Appeals  
Filed 10-19-12  
An Indian tribe loses in this claim to ancestral land.

I. **Commonwealth Land Title Insurance Company v. OMG Americas**  
U.S. District Court, District of Utah  
Filed 10-12-12  
An owner’s policy provided coverage for a claim that a lease was void because the BIA official who approved it lacked authority, even though the insured rejected an offer to enter into a new lease.
In re: 

CONRAD J. KUIKEN, JR.,
Debtor.

______________________________

BAP No. SC-12-1218-JuMkPa

CONRAD J. KUIKEN, JR.,

v. 

CONRAD J. KUIKEN, JR.,

Appeal from the United States Bankruptcy Court
for the Southern District of California

Honorable Margaret M. Mann, Bankruptcy Judge, Presiding

Appearances: James C. Mitchell, Esq. on brief for appellant
Daniel T. McCoy.

Before: JURY, MARKELL, and PAPPAS Bankruptcy Judges.

* On October 30, 2012, appellant moved to submit this appeal without oral argument. The Panel unanimously determined that oral argument was not needed by order entered on October 31, 2012.
JURY, Bankruptcy Judge:

Judgment creditor Daniel T. McCoy appeals from the bankruptcy court’s order granting debtor Conrad J. Kuiken, Jr.’s motion to avoid McCoy’s judicial lien under § 522(f).1 In a case of first impression in this circuit, we hold that because the debtor did not maintain a continuous interest in the property subject to the lien from the time the lien fixed until the petition date, he is not entitled to avoid the lien based on his homestead exemption. Therefore, we REVERSE.

I. FACTS2

On August 18, 2003, debtor acquired fee title to real property located in San Diego, California.

On June 4, 2009, McCoy obtained a judgment against debtor in the San Diego Superior Court, Civil Case No. 37-2007-0052760.

On October 9, 2009, McCoy recorded with the San Diego County Recorder’s Office a $16,838 judgment lien in the form of an abstract of judgment.

On July 5, 2011, debtor executed a grant deed conveying fee title to the property to Bayview Resources, LLC (Bayview), for valuable consideration. The deed was duly recorded on July 15,

1 Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and “Rule” references are to the Federal Rules of Bankruptcy Procedure.

2 McCoy contends that the facts are undisputed. Debtor has not participated in this appeal.
On September 28, 2011, Bayview executed a grant deed conveying fee title to the property to debtor as a gift. The deed was duly recorded on October 11, 2011.

On October 24, 2011, debtor filed his chapter 7 petition. In Schedule A, debtor listed the property as owned by Bayview and showed the value of the property as $530,000 encumbered with a secured claim in the amount of $532,969. In Schedule C, debtor claimed the property exempt under Cal. Civ. Proc. Code (CCP) § 704.730(a)(1) in the amount of $13,869. No objections to his claim of exemption were filed. In Schedule D, debtor listed McCoy as a secured creditor with an October 9, 2009 judgment lien for $16,838 in the form of an abstract of judgment against the property.

On January 19, 2012, debtor filed a motion to avoid McCoy’s judicial lien under § 522(f). In the accompanying declaration,

³ This listing was most likely an error as the record shows Bayview transferred the property back to debtor prior to his bankruptcy.

⁴ CCP § 704.730 only specifies the amount of an exemption. From the record provided, it appears that debtor relied on California’s automatic homestead exemption. The requirements to qualify for an automatic homestead exemption are set forth in CCP § 704.710(c):

Homestead means the principal dwelling (1) in which the judgment debtor or the judgment debtor’s spouse resided on the date the judgment creditor’s lien attached to the dwelling, and (2) in which the judgment debtor or the judgment debtor’s spouse resided continuously thereafter until the date of the court determination that the dwelling is a homestead.
debtor declared that he resided in the property at the time of filing his petition.

On February 6, 2012, McCoy objected to debtor’s motion on the grounds that (1) McCoy’s judicial lien became a consensual lien when debtor conveyed the property to a third party for valuable consideration and reacquired it subject to the judicial lien and (2) McCoy’s judicial lien had priority under California law over debtor’s interest in the property and his homestead exemption when debtor reacquired the property from Bayview.

On February 21, 2012, the bankruptcy court issued a tentative ruling rejecting McCoy’s arguments. The bankruptcy court found no authority for the premise that a judicial lien is transformed into a consensual lien due to the transfers of the property. In addition, the court found that the parties agree that debtor owned his house both when the lien attached and when the motion to avoid the lien was brought. The court noted that in Culver, LLC v. Kai-Ming Chiu (In re Chiu), 304 F.3d 905 (9th Cir. 2002), the debtor owned his residence at the time the judgment lien was fixed to it and could avoid the lien even though he no longer owned the house at the time he filed the motion to avoid the lien. The bankruptcy court found that Chiu’s reasoning applied “with equal force here.”

After McCoy filed a supplemental opposition, the bankruptcy court issued a second tentative ruling on March 21, 2012. The bankruptcy court reiterated that at all times McCoy’s judicial lien remained a judicial lien upon the property. Citing Law Offices of Moore & Moore v. Stoneking (In re Stoneking), 225 B.R. 690, 696 (9th Cir. BAP 1998), the court further found that
although debtor’s property interest may have changed after McCoy’s lien fixed, it did not affect debtor’s ability to avoid the lien. Because the debtor’s homestead exemption was applicable as of the petition date, the court further found that debtor was entitled to avoid McCoy’s judicial lien at that time.

The bankruptcy court entered the order granting debtor’s motion to avoid McCoy’s judicial lien on April 13, 2012. McCoy timely appealed the order.5

II. JURISDICTION

The bankruptcy court had jurisdiction over this proceeding under 28 U.S.C. §§ 1334 and 157(b)(2)(K). We have jurisdiction under 28 U.S.C. § 158.

III. ISSUE

Whether the bankruptcy court erred in granting debtor’s motion to avoid McCoy’s judicial lien under § 522(f)(1).

IV. STANDARD OF REVIEW

Where there are no material disputed facts, whether a creditor’s judicial lien is avoidable under § 522(f) is a question of law reviewed de novo. In re Stoneking, 225 B.R. at 692.

V. DISCUSSION

Section 522(f)(1) provides, in pertinent part, that a

5 9th Cir. BAP Rule 8006-1 provides: “The excerpts of the record shall include the transcripts necessary for adequate review in light of the standard of review to be applied to the issues before the Panel....” McCoy did not include a transcript in the record on appeal. Because our review is de novo, we have determined the transcript is not necessary to our review.
debtor:

[M]ay avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is

(A) a judicial lien. . . .

“[U]nder § 522(f)(1), a debtor may avoid a lien if three conditions are met: (1) there was a fixing of a lien on an interest of the debtor in property; (2) such lien impairs an exemption to which the debtor would have been entitled; and (3) such lien is a judicial lien.” In re Chiu, 304 F.3d at 908 (quoting Catli v. Catli (In re Catli), 999 F.2d 1405, 1406 (9th Cir.1993)). On appeal, McCoy contends that the first and third conditions have not been met.

McCoy does not dispute that debtor held an interest in the property before McCoy’s lien fixed. Nonetheless, McCoy contends that debtor’s conveyance of the property to Bayview resulted in a termination of debtor’s previous interest and then, when debtor reacquired the property from Bayview, debtor obtained a “new interest” in the property which came after the fixing of McCoy’s lien. According to McCoy, these facts fall squarely within the holding of Farrey v. Sanderfoot, 500 U.S. 291 (1991) which makes his lien unavoidable. As a result, McCoy argues that the bankruptcy court erred in relying on the holdings in Stoneking and Chiu for its decision.

McCoy is correct that the debtor’s conveyance of the property to Bayview terminated his existing interest in the

6 The second condition, that the debtor had an exemption which was impaired, is not challenged.
property. Bayview is a limited liability company organized under the laws of the State of California, of which debtor was a member. A membership interest in a limited liability company is personal property and is not a direct interest in real property owned by the company. Cal. Corp. Code § 17300 (“A membership interest and an economic interest in a limited liability company constitute personal property of the member or assignee”).

We also agree that the three most relevant published opinions on this issue in the Ninth Circuit, Stoneking, Chiu, and Weeks v. Pederson (In re Pederson), 230 B.R. 158 (9th Cir. BAP 1999), discussed below, do not address a situation where the debtor’s interest in the property at the time the judicial lien fixed was extinguished and replaced by a different interest before the bankruptcy petition is filed. Farrey and a bankruptcy case it cited with favor, Stephens v Walter E. Heller W., Ltd. (In re Stephens), 15 B.R. 485 (Bankr. W.D. N.C. 1981), with facts similar to ours, more directly address the ability of a debtor to avoid the lien using § 522(f).

The issue in Farrey was whether § 522(f) allowed a debtor to avoid the fixing of a lien on a homestead, where the lien was granted to the debtor’s former spouse under a divorce decree that extinguished all previous interests the parties had in the property. 500 U.S. at 292. After examining the language of § 522(f)(1) and the purpose and history surrounding Congress’ enactment of § 522(f), the Supreme Court stated:

[I]t is settled that a debtor cannot use § 522(f)(1) to avoid a lien on an interest acquired after the lien attached. See, e.g., In re McCormick, [18 B.R. 911, 913-14 (Bkrtcy. Ct. WD Pa. 1982)]; In re Stephens, 15 B.R. 485 (Bkrtcy. Ct. WD NC 1981); In re Scott,
B.R. 613 (Bkrtcy. Ct. WD Okla. 1981). As before, the critical inquiry remains whether the debtor ever possessed the interest to which the lien fixed, before it fixed. If he or she did not, § 522(f)(1) does not permit the debtor to avoid the fixing of the lien on that interest.

500 U.S. at 299.

Under the “critical inquiry” analysis, the Supreme Court found that under controlling nonbankruptcy law the divorce decree (1) extinguished the previous interests of the parties; (2) created a new fee simple interest in the homestead in favor of the ex-husband; and (3) imposed a lien in favor of the ex-wife on that homestead. Under those facts, the Court found that the husband did not have an interest in the property before the ex-wife’s lien fixed and, as a result, the husband could not avoid the ex-wife’s lien under § 522(f)(1). In the end, the Supreme Court stated: “We hold that § 522(f)(1) requires a debtor to have possessed an interest to which a lien attached, before it attached, to avoid the fixing of the lien on that interest.” Farrey, 500 U.S. at 301.

The facts in Stephens are remarkably similar to ours. There, judgments were docketed against the debtor while he held title to certain real property. 15 B.R. at 486. The debtor subsequently conveyed the property to his brother. Four days before the debtor filed for bankruptcy, his brother conveyed the property back to him. Id. The bankruptcy court held that the debtor could not avoid the judgment creditors’ liens under § 522(f). In so holding, the bankruptcy court reasoned that (1) when the debtor conveyed the property to his brother, it was subject to the creditor’s judgment liens; (2) the transfer to
the debtor’s brother divested the debtor of all interest in the subject property; and (3) when the debtor re-obtained the property, he did so subject to the judgment liens.

We examined the reach of Farrey’s holding in In re Stoneking, 225 B.R. 690. There, the judicial lien of a creditor fixed on the community property of a husband and wife before the state court awarded the property to the husband in a divorce decree. After the husband filed for bankruptcy, the attorney who held the judicial lien argued that under Farrey, the debtor acquired his interest after the fixing of the lien, and therefore could not avoid it. The bankruptcy court concluded that Farrey was inapplicable under the circumstances and granted the debtor’s motion to avoid the lien. Id. at 692.

We affirmed, noting that the facts of the case were distinguishable from those in Farrey. Unlike Farrey, where the lien attached to a newly-created interest which the debtor did not hold before the fixing of the lien because the divorce decree extinguished his prior property interest, the judicial lien in Stoneking fixed upon the debtor’s community property interest which, under controlling nonbankruptcy law, was later transformed, not eliminated, when in the course of divorce proceedings the court changed it from a community property interest to a fee interest. Due to this distinction, the Panel held that the debtor could avoid the lien under the “critical inquiry” of Farrey: whether the debtor possessed the interest to which the lien fixed, before it fixed. 225 B.R. at 693.

The Panel reasoned:

While a debtor may not avoid a lien that attached
before he held any interest in the property, it does not necessarily follow that a debtor cannot avoid a lien merely because his property interests were augmented after attachment of the lien. If a debtor could have avoided such a lien on community-held real property pursuant to section 522(f)(1) before acquiring sole ownership of the property, that debtor should not lose the right to avoid that same lien after acquiring sole ownership . . . . Applying Farrey under such circumstances to preclude the avoidance of a third-party lien “is inconsistent with [section 522(f)’s] main purpose, is not fair, and is contrary to common sense.”

Id. at 695 (citation omitted). The Stoneking Panel simply did not address a circumstance where the debtor was divested entirely of the interest he held after the lien fixed.

The Ninth Circuit came to a similar conclusion in Chiu, albeit on different facts from those in Stoneking. In Chiu, there was no dispute that the debtors owned the subject property before the lien fixed. Debtors did not avoid the lien during the bankruptcy and subsequently sold the property, at which time they were notified that the lien had to be paid. The debtors reopened their case and filed a motion to avoid the lien, claiming that it impaired their homestead exemption. The bankruptcy court determined that the lien avoidance related back to the date of the filing and granted the motion to avoid the lien. The Panel affirmed on appeal. The Ninth Circuit affirmed, holding that a debtor must possess an interest to which the lien fixed before it fixed and when the bankruptcy petition is filed, but need not possess an interest in the property at the time of avoidance. 304 F.3d at 908-09. The Ninth Circuit in Chiu did not face a situation where the interest the debtors held on the petition date was not the same interest they held when the lien fixed.
Under a different set of facts, our Panel followed Farrey when it denied the debtor’s lien avoidance in Pederson. When creditor Weeks obtained a state court judgment against the debtor in 1993 and recorded an abstract in Contra Costa County, the debtor owned no real property. A year later the debtor acquired title to real property in the county. Under California law, the judgment lien created by the recording of the abstract of judgment attached to her interest in the property when she acquired it. Debtor filed a chapter 13 petition in 1997 and moved to avoid the lien, which the bankruptcy court granted. Relying on Farrey, the Panel reversed because the debtor did not have the property interest to which the lien attached at some time before the lien attached, holding that the critical inquiry was whether the debtor ever possessed the interest to which the lien fixed before it fixed. Pederson, 230 B.R. at 164. Again, although instructive, Pederson described a situation where the debtor never had any interest in the property before the lien recorded, different from this case where debtor had a fee interest when the lien fixed, voluntarily granted it away entirely, then reacquired the fee interest before seeking bankruptcy relief.

Thus, Stoneking, Chiu and Pederson are distinguishable, and Farrey and Stephens control here, because the debtor’s interest in the property when he filed bankruptcy was a different and discontinuous interest from the one he held when McCoy’s lien affixed. When the interest once held is entirely extinguished by transfer, voluntary or as a matter of law, a judicial lien which attached when a debtor had that interest cannot be avoided.
when the debtor acquires a new interest. The interest held when
the lien fixed is gone and the debtor reacquires a different
interest subject to the judicial lien, just as McCoy argues.\footnote{Although 
\textit{Stephens} and some other bankruptcy court cases
which have decided this issue for the creditors have based their
reasoning in part on bad faith or fraudulent conduct of the
debtor in conveying the real property, our record does not
support a bad faith analysis, nor does our decision rely on any
such determination.}

Beyond \textit{Stephens}, our holding is consistent with the outcome
of several bankruptcy court decisions from other jurisdictions.
The trial court in \textit{In re Jackaman}, 2000 WL 192973 (Bankr. E.D.
Pa. 2000), denied lien avoidance where the debtor had sole
ownership in real property when the judgment lien fixed but
conveyed his fee simple interest to himself and his spouse as
tenants in the entirety. The court reasoned that under
controlling nonbankruptcy law debtor’s prior interest was
extinguished by the transfer and his new interest was
“different” and would not support avoidance. Relying on \textit{Farrey},
the court reasoned that § 522(f) only entitles the debtor to
avoid the fixing of a lien “on the same interest to which it
fixed.” \textit{Id.}, at *6.

Similarly, the bankruptcy court in \textit{The Cradle Co. v. Banner}
(In \textit{re Banner}), 394 B.R. 292 (Bankr. D. Conn. 2008), denied lien
avoidance where the debtor owned property in joint tenancy with
her then-husband when the lien recorded. After a divorce, the
debtor and her ex-husband quitclaimed the property to her
boyfriend for financing purposes. Prior to the debtor’s
bankruptcy petition, her boyfriend deeded a one-half interest in
the property back to her and she attempted to use § 522(f) to avoid the impairment on her homestead. Reasoning that the debtor reacquired her interest in the property subject to the judicial lien, the bankruptcy court found under controlling nonbankruptcy law the new interest was not the “same” interest held when the lien affixed and avoidance was not allowed. Id. at 306-07. The court relied on Farrey and Jackaman to support its decision.

Because we reverse on the reasoning above, we need not address in any detail McCoy’s argument that his judicial lien became a consensual lien when Bayview took a fee title interest in the property subject to McCoy’s lien. Suffice it to say we do not find the argument persuasive. Here, the origin of McCoy’s lien was through the legal process. A “judicial lien” is defined as a “lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding.” § 101(36). Therefore, McCoy’s lien meets the statutory definition of a judicial lien. Finally, there is no evidence in the record to support a voluntary and contractually binding agreement between Bayview and McCoy regarding his lien. Rather, the record suggests that Bayview took the property subject to the lien not because of any agreement, but by operation of law. McCoy’s lien remained on the property until it was satisfied. CCP § 697.390. Accordingly, because McCoy’s lien is a judicial lien, the third condition for the avoidance of McCoy’s lien has been met. However, as analyzed above, the first prong was not.

VI. CONCLUSION

In this case, debtor transferred and then reacquired his
interest in the real property after McCoy’s lien fixed. Under applicable nonbankruptcy law, this meant that the debtor had no interest in the property in the interim. He thus acquired a different interest - one to which a lien had already affixed - when he later reacquired the property. As a result, debtor may not avoid the lien under § 522(f) and we REVERSE.
At a stated term of the United States Court of Appeals for the Second Circuit, held at the Daniel Patrick Moynihan United States Courthouse, 500 Pearl Street, in the City of New York, on the 15th day of November, two thousand twelve.

PRESENT:  BARRINGTON D. PARKER,
          REENA RAGGI,
          GERARD E. LYNCH,
          Circuit Judges.

IN RE HAVEN ELDERCARE, LLC,
          Debtor.

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TC HEALTHCARE I, LLC,
          Plaintiff-Appellant,

v.                                                  No. 12-468-bk

RACHEAL DUPUIS,
          Defendant-Appellee.

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FOR APPELLANT:  Dominic Fulco III, Emily A. Gianquinto, Reid and Riege, P.C., Hartford, Connecticut.

FOR APPELLEES:  Racheal Dupuis, pro se, Whitehall, New York.
Appeal from a judgment of the United States District Court for the District of Connecticut (Mark R. Kravitz, Judge).

UPON DUE CONSIDERATION, IT IS HEREBY ORDERED, ADJUDGED, AND DECREEED that the judgment entered on January 12, 2012, is AFFIRMED.

Appellant TC Healthcare I, LLC (“TC Healthcare”) filed a motion in the Bankruptcy Court for the District of Connecticut seeking to have the bankruptcy court enforce its June 2008 order (the “Sale Order”) authorizing the sale of certain assets belonging to Debtors Haven Eldercare, LLC and its subsidiaries (“Haven”) free and clear of any liens, claims, or encumbrances pursuant to 11 U.S.C. § 363. Specifically, TC Healthcare, which had entered into an agreement in the course of the Haven bankruptcy to purchase and operate certain Haven facilities, sought an order from the bankruptcy court declaring that it was not liable to appellee Racheal Dupuis under the terms of a pre-bankruptcy contract between Dupuis and Haven relating to tuition reimbursement. Before TC Healthcare filed its motion in the bankruptcy court, a Vermont small claims court had entered a judgment holding TC Healthcare liable to Dupuis under that contract. The bankruptcy court denied TC Healthcare’s motion on the ground that it was barred by the doctrine set forth in Rooker v. Fidelity Trust Co., 263 U.S. 413 (1923), and District of Columbia Court of Appeals v. Feldman, 460 U.S. 462 (1983). TC Healthcare appealed, and the district court affirmed the bankruptcy court on the alternate ground that the motion was barred by res judicata. This appeal followed. We assume the parties’ familiarity with the underlying facts and the
procedural history of the case, which we reference only as necessary to explain our decision to affirm.

“An appeal from a district court’s review of a bankruptcy court ruling is subject to plenary review.” In re Halstead Energy Corp., 367 F.3d 110, 113 (2d Cir. 2004). “We accept [a] bankruptcy court’s findings of fact unless clearly erroneous, but review its conclusions of law de novo.” Id. at 114.

Like the district court, we conclude that TC Healthcare’s enforcement motion is barred by res judicata, making it unnecessary to discuss the applicability of the Rooker-Feldman doctrine to the facts of this case. See Thyroff v. Nationwide Mut. Ins. Co., 460 F.3d 400, 405 (2d Cir. 2006) (noting that court may affirm on any ground supported by the record). In analyzing the application of res judicata, federal courts must “give to a state-court judgment the same preclusive effect as would be given that judgment under the law of the State in which the judgment was rendered.” Migra v. Warren City Sch. Dist., 465 U.S. 75, 81 (1984). Accordingly, to determine the preclusive effect of the judgment of the Vermont small claims court, we must look to Vermont law.

Under that law, res judicata “will preclude a claim from being litigated if (1) a previous final judgment on the merits exists, (2) the case was between the same parties or parties in privity, and (3) the claim has been or could have been fully litigated in the prior proceeding.” Iannarone v. Limoggio, 190 Vt. 272, 279 (2011) (internal quotation marks omitted). “The doctrine does not require that claims must have been actually litigated in an earlier proceeding; rather, res judicata bars parties from litigating claims or causes of action
that were or should have been raised in previous litigation.” Lamb v. Geovjian, 165 Vt. 375, 380 (1996). Moreover, under Vermont law, a party is generally barred by res judicata from mounting a collateral attack on the subject matter jurisdiction of the court rendering a prior decision. “Unless a court has usurped power not accorded to it, its exercise of subject matter jurisdiction is binding in subsequent proceedings as long as the jurisdictional question was litigated and decided or the parties had an opportunity to contest subject-matter jurisdiction but failed to do so.” In re B.C., 169 Vt. 1, 8 (1999) (citing Nemaizer v. Baker, 793 F.2d 58, 65 (2d Cir. 1986)). A mere error in the court’s exercise of jurisdiction does not constitute such a usurpation; rather “a court will be deemed to have plainly usurped jurisdiction only when there is a total want of jurisdiction and no arguable basis on which it could have rested a finding that it had jurisdiction.” Nemaizer v. Baker, 793 F.2d at 65 (internal quotation marks omitted).

TC Healthcare first argues that res judicata does not apply because the Vermont small claims court was without jurisdiction to enter the judgment. Specifically, TC Healthcare contends that the bankruptcy court, in its July 2008 Sale Order, retained exclusive jurisdiction over any disputes relating to that order. This argument is without merit. First, despite the wording of the Sale Order, the bankruptcy court’s jurisdiction was concurrent rather than exclusive, because 28 U.S.C. § 1334(b) provides bankruptcy courts with “original but not exclusive jurisdiction” over claims such as Dupuis’s, which are related to bankruptcy
proceedings.\textsuperscript{1} Second, even if the bankruptcy court’s jurisdiction were exclusive, TC Healthcare would be unable to show that the Vermont court had “usurped” jurisdiction. TC Healthcare had an opportunity to contest the jurisdiction of the small claims court during a December 2010 hearing that was held on Dupuis’s complaint. See \textit{In re B.C.}, 169 Vt. at 8.

Indeed, it appears that it unsuccessfully attempted to enter into evidence a copy of the bankruptcy court’s Sale Order, which would have informed the Vermont court that the bankruptcy court had purported to retain exclusive jurisdiction. Unfortunately for TC Healthcare, it was not prepared at the hearing to offer the Sale Order in an admissible form.

Having failed to admit the order into evidence, TC Healthcare cannot show that the small claims court “usurped jurisdiction” because, in the absence of the order, the matter before the small claims court was a simple state common law action for an amount under $5,000, which was well within that court’s jurisdiction. See Vt. R. Small Cls. P. 2(a) (affording the small claims court jurisdiction over “[a]ctions on claims for money damages not exceeding $5,000”).

TC Healthcare next argues, as it did in the district court, that the judgments of the Vermont small claims courts are without \textit{res judicata} effect pursuant to the decision of the Supreme Court of Vermont in \textit{Cold Springs Farm Development, Inc. v. Ball}, 163 Vt. 466 (1995). The district court addressed this issue in both its January 10, 2012 order affirming

\textsuperscript{1} \textit{In re Hotel Syracuse, Inc.}, 155 B.R. 824 (Bankr. N.D.N.Y. 1993), cited by TC Healthcare, is inapposite because the jurisdiction there arose under what is now 28 U.S.C.\textsuperscript{s} 1334(e), which grants to the district courts exclusive jurisdiction over all property of the debtor and the estate. \textit{Id.} at 833. \textit{Flanagan v. Arnaiz}, 143 F.3d 540 (9th Cir. 1998), also involved a finding of exclusive jurisdiction.
the bankruptcy court’s denial of TC Healthcare’s enforcement motion and its January 23, 2012 order denying TC Healthcare’s motion for reconsideration. Having conducted an independent review of the relevant case law, we reject TC Healthcare’s reliance on Cold Springs Farm for substantially the reasons set forth by the district court in the above decisions.

Finally, TC Healthcare argues for the first time on appeal that res judicata does not preclude an order barring enforcement of the Vermont judgment. This argument is waived, see Virgilio v. City of New York, 407 F.3d 105, 116 (2d Cir. 2005) (“In general we refrain from passing on issues not raised below.”) (internal quotation marks omitted)), and in any event is without merit. Allowing collateral attack on a judgment when framed as a challenge to enforcement of the judgment “would be to make a mockery of the well settled doctrine of res judicata.” United States v. Secor, 476 F.2d 766, 770 (2d Cir. 1973); see Lerman v. Lerman, 148 Vt. 629 (1987) (applying res judicata to bar attack on enforcement); Wursthaus, Inc. v. Cerrata, 149 Vt. 54 (1987) (same).

We have considered TC Healthcare’s other arguments and conclude that they are without merit. Accordingly, the judgment of the district court is AFFIRMED. Dupuis’s motion to include documents is DENIED as moot. TC Healthcare’s motion to strike portions of Dupuis’s brief is also DENIED.

FOR THE COURT:
CATHERINE O’HAGAN WOLFE, Clerk of Court
FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

______________________________
BAP NO. MB 12-042
______________________________
Bankruptcy Case No. 09-16725-FJB
______________________________
PBBPC, INC., f/k/a Biopure Corporation,
Debtor.
______________________________
MASSACHUSETTS DEPARTMENT OF
UNEMPLOYMENT ASSISTANCE,
Appellant,

v.

OPK BIOTECH, LLC,
Appellee.

______________________________
Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. Frank J. Bailey, U.S. Bankruptcy Judge)
______________________________
Before
Haines, Deasy, and Tester,
United States Bankruptcy Appellate Panel Judges.

______________________________
Daniel J. Hammond, Esq., and Douglas S. Martland, Esq., on brief for Appellant.
Douglas B. Rosner, Esq., and Gregory O. Kaden, Esq., on brief for Appellee.

January 17, 2013
Deasy, U.S. Bankruptcy Appellate Panel Judge.

The Massachusetts Department of Unemployment Assistance (the “DUA”) appeals from the bankruptcy court order (the “Order”) enforcing the sale of the debtor’s assets free and clear of any interest in said assets, including the DUA’s right to tax the purchaser at the debtor’s unemployment contribution rate. For the reasons set forth below, the Order is AFFIRMED.

BACKGROUND

I. The Sale

The debtor, PBBPC, Inc., formerly known as Biopure Corporation (the “Debtor”), filed a petition for chapter 11 relief on July 16, 2009. At that time, the Debtor had limited operations and only five employees. On the petition date, the Debtor filed a motion seeking approval of bid procedures and ultimately the sale of substantially all of its operating assets to OPK Biotech, LLC (“OPK”), free and clear of liens, claims, charges, security interests, restrictions, and encumbrances of any kind or nature, pursuant to § 363(f). The Debtor served the court approved notices and orders related to the auction and sale (the “Sale Notices”) on, inter alia, the attorney general for the Commonwealth of Massachusetts at One Ashburton Place, Boston, Massachusetts.

On August 20, 2009, the bankruptcy court entered an order approving the sale to OPK (the “Sale Order”). The Sale Order provided, among other things, that: (1) the transfer to OPK would be free and clear of all encumbrances, including any claims pursuant to any successor or successor-in-interest liability theory; (2) OPK would not be deemed a successor of the Debtor; and (3) OPK would not have any liability for any obligation of the Debtor or any claim against the Debtor related to the purchased assets by reason of the transfer of such assets.

In the Sale Order, the bankruptcy court found that OPK would not have purchased the Debtor’s assets unless the transfer was “free and clear of all [e]ncumbrances of any kind or nature” including, but not limited to, successor liabilities for unemployment related claims including “claims that might arise under . . . state unemployment compensation laws or any other similar state laws.” Additionally, the Sale Order provided that, except as otherwise specifically set forth in the Asset Purchase Agreement, OPK neither assumed nor was obligated to pay or otherwise discharge any debts, obligations, or liabilities of
the Debtor arising pursuant to the Debtor’s ownership or operation of its facilities before the purchase.

OPK closed on the purchase of the Debtor’s operating assets on September 9, 2009, and commenced operations in Massachusetts on October 1, 2009. Prior to the closing, the Debtor had terminated all but one of its remaining employees. Because the Debtor had laid off nearly all of its employees at the end of 2008, its experience rating was very high, which resulted in an unemployment contribution rate of 12.27 percent.

II. The DUA Proceedings

Following the closing, OPK advised the DUA of its acquisition of the Debtor’s assets. The DUA, in turn, notified OPK that it was considered a “successor employer” within the meaning of the Massachusetts unemployment insurance statute, that the Debtor’s account had been transferred to it, and that OPK’s contribution rate for 2009 and 2010 was 12.27 percent. The DUA further advised OPK that as a successor employer, it was “liable for any past or future benefit charges attributable to the predecessor’s account.” The record reflects that the DUA continued to impose a 12.27 percent contribution rate for 2011.

OPK filed an administrative appeal, challenging the DUA’s imposition of successor status on the grounds that OPK and the Debtor lacked substantially common ownership, interest, or control, which might give rise to a successor relationship under the Massachusetts unemployment insurance statute. The DUA refused to change its determination. Consequently, in March 2011, OPK moved the bankruptcy court to enforce the Sale Order (the “Motion to Enforce”), and the parties agreed to postpone further administrative proceedings pending the bankruptcy court’s disposition of the motion.

III. The Bankruptcy Court Proceedings

In the Motion to Enforce, OPK sought an order: (1) declaring that the sale to OPK was free and clear of the Debtor’s experience rate and contribution rate as those terms are defined in state law; (2) requiring the DUA to refund to OPK overpayments resulting from the attribution of the Debtor’s experience rate; and (3) compelling the DUA to assign to OPK a 2.89 percent contribution rate as an employer newly subject to Mass. Gen. Laws ch. 151A, § 14, retroactive to the sale date and without
regard to the Debtor’s pre-sale ratings.

In support of its request, OPK advanced five core arguments. First, OPK asserted that because the Debtor served the Sale Notices on the attorney general of the Commonwealth of Massachusetts, and neither the Commonwealth nor the DUA objected, the DUA irrevocably waived its right to object to the sale itself or the terms of the Sale Order. Second, OPK contended that § 363(m) protected the Sale Order from attack and reconsideration. Third, OPK asserted that, even assuming the Sale Order was subject to attack, the proper vehicle would have been a motion to reconsider or modify the order. Fourth, OPK argued that the bankruptcy court should enforce the Sale Order because at least four of the five disjunctive requirements for a sale free and clear under § 363(f) were satisfied. Lastly, OPK asserted that even if the DUA had timely objected to the Sale Notices, § 363(f) and the underlying policies of the Bankruptcy Code preempted the successor liability provision in the Commonwealth’s unemployment compensation statute.

In its opposition to the Motion to Enforce, the DUA maintained that the Debtor’s service of the Sale Notices did not conform to MLBR App. 4(f), and that the DUA had not otherwise received notice of the Sale Notices. Because notice was allegedly inadequate, the DUA argued that it was permitted to challenge the Sale Notices and the Sale Order. Second, the DUA claimed that OPK did not meet the conditions for a sale free and clear under § 363(f) because: (1) its lack of objection did not constitute consent, in the absence of proper notice; and (2) a money satisfaction was not possible. Third, the DUA argued, “while prohibiting the transfer of the Debtor’s experience account to OPK [might] enhance the payment to creditors, such enhancement would come at the expense of all other Massachusetts employers.” Fourth, and most significantly for purposes of this appeal, the DUA asserted that the Debtor’s experience rating was not an interest within the meaning of § 363(f) and, therefore, the
bankruptcy court lacked authority to protect OPK from taxation on the basis of the Debtor’s experience rating. For this proposition, the DUA relied heavily on *Michigan Employment Sec. Comm’n v. Wolverine Radio Co., Inc.* (In re Wolverine Radio Co., Inc.), 930 F.2d 1132, 1145-49 (6th Cir. 1991).

Lastly, the DUA contended that it correctly determined that OPK was a successor within the meaning of the Massachusetts unemployment insurance statute.

**IV. The Bankruptcy Court Decision**

After notice and a hearing in June 2011, the bankruptcy court took the matter under advisement. In February 2012, the bankruptcy court issued its Memorandum of Decision, wherein it held that the Debtor’s experience and contribution rate were interests within the meaning of § 363. See *In re PBBPC, Inc.*, 467 B.R. 1 (Bankr. D. Mass. 2012). In reaching this conclusion, the court determined as a preliminary matter that it had authority to revisit the Sale Order on two grounds. First, it found that the DUA did not receive proper notice of the sale. Accordingly, the court stated, “[a] judgment obtained without notice to a party is invalid against that party and therefore can have no preclusive effect as to that party.” *Id.* at 7. Second, the bankruptcy court concluded that it need not address OPK’s argument that the Sale Order was protected from collateral attack by § 363(m), reasoning as follows:

This argument requires a difficult decision as to whether [ ] § 363(m), and the policy of finality it embodies, should override constitutional concerns about lack of notice. However, were the Court to find that the Sale Order is now subject to collateral attack and reconsider the merits in light of the objections and arguments the DUA now adduces, the Court would, for the reasons set forth below, conclude (i) that authority to sell pursuant to § 363(f) was properly granted and (ii) that the debtor’s experience rating is an “interest” within the meaning of § 363(f) that, in view of the authorization under § 363(f), the Commonwealth may not apply to OPK. Accordingly, the court may sustain the Sale Order on the merits and need not address the § 363(m) issue.

*Id.* at 7-8 (footnote omitted). The court’s analysis then proceeded to the requirements of § 363(f). It
readily found the presence of one the five predicate conditions enumerated in § 363(f) for a sale free and clear, concluding that the DUA “could be compelled to accept a money satisfaction.” Id. at 8.

Thus, the only issue that remained for the court to address was “whether the right of taxation that the DUA [was] charged with enforcing [was] an ‘interest’ in property of the estate within the meaning of § 363(f).” Id. For purposes of this analysis, the bankruptcy court “assume[d] without deciding that OPK [was] a successor employer within the meaning of” the applicable statute. Id. at 9. Acknowledging that an employer’s contribution rate was an “atypical” interest in property, the court nonetheless determined that there was still:

[A] good reason to view this right as an interest in estate assets: it imposes a debtor’s experience rating on the buyer precisely because, and only because, the buyer purchased assets of the bankruptcy estate. By operation of the state statute, the debtor’s experience rating travels with the assets and encumbers their purchaser.

Id. The court further concluded:

[T]he relationship between the asset and the right in question is dispositive. The clear relationship between the DUA’s right to tax according to the debtor’s experience rating and the asset transfer on which that right is predicated makes the DUA’s right an interest within the meaning of § 363(f).

Section 363(f) therefore applies to the DUA’s interest. As OPK argues and the DUA does not dispute, where § 363(f) does apply, it preempts any state law to the contrary. The [S]ale [O]rder thus preempts the application of successor status to OPK under [Mass. Gen. Laws. ch.] 151A, § 14.

Id. at 10.

Noting the absence of binding First Circuit precedent, in reaching the foregoing conclusion, the bankruptcy court embraced the reasoning of United Mine Workers of Am. 1992 Benefit Plan v. Leckie Smokeless Coal Co. (In re Leckie Smokeless Coal Co.), 99 F.3d 574, 581-82 (4th Cir. 1986) (holding that Congress did not expressly indicate that it intended to limit the scope of “interests in property” in § 363(f) to in rem interests). It simultaneously rejected as “unsatisfying” and “wrongly decided” the case
relied upon by the DUA, Wolverine Radio, supra (holding experience rating was not an interest within the meaning of § 363(f)). PBBPC, 467 B.R. at 10. The bankruptcy court concluded the Memorandum of Decision by indicating that it would enter an order:

(i) declaring that the sale to OPK pursuant to the Sale Order was free and clear of the Debtor’s experience rate and contribution rate as those terms are defined in Mass. Gen. Laws c[h]. 151A, § 14, and (ii) requiring the DUA to refund to OPK overpayments attributable to its attribution to OPK of the Debtor’s experience rate.

Id.

Thereafter, the DUA and OPK entered into a stipulation, whereby they agreed that the DUA would assign to OPK the new non-construction employer experience rate of 2.83 percent, effective as of October 1, 2009, through the 2011 contribution year. The parties also agreed on the amount of OPK’s overpayment and resulting refund. Thereafter, OPK sought court approval of the stipulation and a final order, as contemplated by the Memorandum of Decision. Accordingly, on July 2, 2012, the court entered the Order, which provided:

For the reasons set forth in the Court’s earlier memorandum of decision [#444] on OPK’s Motion to Enforce Order Authorizing Sale [#403], the Court hereby (i) declares that the sale to OPK pursuant to the Sale Order was free and clear of the Debtor’s experience rate and contribution rate as those terms are defined in Mass. Gen. Laws c[h]. 151A, § 14, and (ii) orders the DUA to refund to OPK overpayments attributable to its attribution to OPK of the Debtor’s experience rate. The Court further hereby allows the Motion of OPK to Approve Stipulation [#444] and accordingly now approves the stipulation, which stipulation quantifies the refund required by this order and specifies the manner in which the refund has been and is to be effected.

This appeal followed.

JURISDICTION

A bankruptcy appellate panel is “‘duty-bound’” to determine its jurisdiction before proceeding to the merits, even if not raised by the litigants. See Boylan v. George E. Bumpus, Jr. Constr. Co., Inc. (In
re George E. Bumpus, Jr. Constr. Co., Inc.), 226 B.R. 724, 725-26 (B.A.P. 1st Cir. 1998) (quoting Fleet Data Processing Corp v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998)). A panel may hear appeals from “final judgments, orders, and decrees [pursuant to 28 U.S.C. § 158(a)(1)] or with leave of the court, from interlocutory orders and decrees [pursuant to 28 U.S.C. § 158(a)(3)].” In re Bank of New England Corp., 218 B.R. at 645. “A decision is final if it ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.” Id. at 646 (internal quotations and citations omitted). Because the Order effectively terminated the litigation between the parties, it is final. Accordingly, we have jurisdiction.

STANDARD OF REVIEW

A bankruptcy court’s findings of fact are reviewed for clear error and its conclusions of law are reviewed de novo. See Lessard v. Wilton-Lyndeborough Coop. School Dist., 592 F.3d 267, 269 (1st Cir. 2010). The bankruptcy court’s interpretation of particular statutes is a question of law which the Panel reviews de novo. United States v. Sterling Consulting Corp. (In re Indian Motocycle Co., Inc.), 261 B.R. 800, 805 (B.A.P. 1st Cir. 2001); BankBoston, N.A. v. Claflin (In re Claflin), 249 B.R. 840, 842 (B.A.P. 1st Cir. 2000). Accordingly, we review the bankruptcy court’s interpretation of § 363(f) de novo.

DISCUSSION. The Issue on Appeal

In its statement of issues, the DUA identified the following issues on appeal: (1) whether the seller’s experience rate is an interest within the meaning of § 363(f); and (2) if so, does § 363(f) preempt Mass. Gen. Laws ch. 151A, § 14(n). However, the DUA did not brief the second issue and, therefore,
has waived it. See Eakin v. Goffe, Inc. (In re 110 Beaver Street P’ship), 355 Fed. Appx. 432, 437 (1st Cir. 2009) ("An appellant waives any issue which it does not adequately raise in its initial brief.").

Therefore, the sole issue on appeal is whether the DUA’s right to tax OPK based on the Debtor’s high experience rating is an interest in property within the meaning of § 363(f). That statute provides that:

(f) The trustee may sell property under subsection (b) or © of this section free and clear of any interest in such property of an entity other than the estate, only if –

1. applicable nonbankruptcy law permits sale of such property free and clear of such interest;

2. such entity consents;

3. such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

4. such interest is in bona fide dispute; or

5. such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f). The parties do not dispute that at least one of the statutory conditions for approval of a sale free and clear of an interest in property is satisfied.

The DUA contends that a debtor’s experience rating under Massachusetts unemployment insurance law is not an interest under § 363(f), relying primarily on the decision in Wolverine Radio, supra. The DUA argues that “using a debtor’s employment history to calculate a loss expectation for a successor’s experience rating is entirely unrelated to recouping an unpaid prepetition obligation from the corporation.” According to the DUA, a debtor’s experience rating is not a vehicle to recapture an unpaid debt but, rather, “a simple, prognostic tool premised on the notion that the same business, with the same employees, is likely to have a similar number of unemployment claims, going forward.” Accordingly, under this theory, a debtor’s experience rating is not an interest in property within the meaning of § 363(f). Although the DUA acknowledges the “modern trend” of bankruptcy courts to ascribe a broad
meaning to the term “any interest” as used in § 363, it argues that the bankruptcy court’s
“characterization of a debtor’s experience rating as an interest goes too far.”

OPK argues that the bankruptcy court properly determined that the Debtor’s experience rating is
an interest within the meaning of § 363(f). In support, OPK contends that this determination is consistent
with: (1) the modern trend to view the term “interest” expansively; (2) the “fresh start” policy of the
Bankruptcy Code; and (3) the purpose of sales free and clear under § 363(f) to “maximize the value of
the asset, and thus enhance the payout made to creditors.” OPK further argues that “[t]he transfer of
substantially all of a debtor’s assets to a third party alone triggers the DUA’s statutory right” to tax such
third party based on the debtor’s experience rating. According to OPK, this nexus between a debtor’s
assets and the DUA’s right to collect unemployment taxes at a certain rate supports the court’s definition
of “interest.”

II. The Meaning of “Any Interest” Under § 363(f)

The Bankruptcy Code does not define the term “any interest” as used in § 363(f). Courts
confronted with the task of defining the scope of the term have been unable to supply a precise
definition. Thus, the issue continues to be addressed on a case-by-case basis, with a review of relevant
case law revealing a divergence of opinion. See, e.g., Precision Indus., Inc. v. Qualitech Steel SBQ,
LLC, 327 F.3d 537, 545 (7th Cir. 2003); In re Trans World Airlines, Inc., 322 F.3d 283, 288-89 (3d Cir.
2003); Folger Adam Security, Inc. v. DeMatteis/MacGregor JV, 209 F.3d 252, 258 (3d Cir. 2000)
(citation omitted).

Although some courts have narrowly construed “any interest” to mean only in rem interests in
property, see, e.g., Fairchild Aircraft Inc. v. Cambell (In re Fairchild Aircraft Corp.), 184 B.R. 910, 917-
favor a broader interpretation, “which includes other obligations that may flow from ownership of the
property.” Folger, 209 F.3d at 258 (citing 3 Collier on Bankruptcy ¶ 363.06[1]) (citing Leckie, 99 F.3d
at 582) (holding that debtor coal mine operators could sell their assets under § 363(f) free and clear of
successor liability that otherwise would have arisen under federal statute); P.K.R. Convalescent Ctrs.,
Inc. v. Commonwealth of Va., Dep’t of Med. Assistance Serv. (In re P.K.R. Convalescent Ctrs., Inc.),
189 B.R. 90, 92-94 (Bankr. E.D. Va. 1995) (holding that § 363(f) permitted sale free and clear of state’s
depreciation-recapture interest in the debtor’s property); WBQ P’ship v. Commonwealth of Va. Dep’t of
to recover depreciation was within “interests” under § 363(f)); Volvo White Truck Corp. v.
Chambersburg Beverage, Inc. (In re White Motor Credit Corp.), 75 B.R. 944 (Bankr. N.D. Ohio 1987)
(holding that § 363(f) precluded tort claims against asset purchaser)).

The Seventh Circuit broadly interpreted the term “any interest” in § 363(f) when it determined
that a lessee’s possessory interest in a chapter 11 debtor’s real property was an “interest” within the
meaning of § 363(f):

. . . [T]he Code itself does not suggest that “interest” should be understood in a special or
narrow sense; on the contrary, the use of the term “any” counsels in favor of a broad
interpretation. See United States v. Gonzales, 520 U.S. 1, 5, 117 S. Ct. 1032, 1035, 137
L. Ed. 2d 132 (1997). As commentators have pointed out, the Supreme Court elsewhere
has observed that the term “interest” is a broad term no doubt selected by Congress to
avoid “rigid and technical definitions drawn from other areas of the law. . . .” Russello v.
United States, 464 U.S. 16, 21, 104 S. Ct. 296, 299, 78 L. Ed. 2d 17 (1983); see Steven R.
Haydon & Nancy J. March, Sale of Estate Property Free and Clear of Real Property
Leasehold Interests Pursuant to § 363(f): An Unwritten Limitation?, 19 American Bankr.
Inst. J. 20, 20 (2000). . . . The Russello Court thus concluded that “interest,” as used in
the Racketeer Influenced and Corrupt Organizations statute, 18 U.S.C. § 1963(a)(1),
“comprehends all forms of real and personal property, including profits and proceeds.”
464 U.S. at 21, 104 S. Ct. at 299, 104 S. Ct. 296. . . .

Precision Indus., Inc., 327 F.3d at 545. The Seventh Circuit also noted that an inclusive interpretation of
the phrase “any interest” is “consistent with the expansive use of that same phrase in other provisions of

The Code itself does not suggest that “interest” should be understood in a special or
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464 U.S. at 21, 104 S. Ct. at 299, 104 S. Ct. 296. . . .
the Code.” Id. (citing 11 U.S.C. §§ 541(a)(3), (4), and (7), which identify various interests comprising property of the estate).

In concluding that the coal mine operators could sell their assets free and clear of their obligations to a certain benefits plan and fund under the Coal Act, the Fourth Circuit rejected a restrictive view of the phrase “any interest,” noting that:

. . . [W]hile the plain meaning of the phrase “interest in such property” suggests that not all general rights to payment are encompassed by the statute, Congress did not expressly indicate that, by employing such language, it intended to limit the scope of [§] 363(f) to in rem interests, strictly defined, and we decline to adopt such a restricted reading of the statute here.

Leckie, 99 F.3d at 582 (citations omitted). Persuaded by the right of the benefit plans to seek payment based upon the use of the assets sold in coal mining operations, the court concluded that the plans’ right to payment constituted an “interest in property” within the meaning of § 363(f). Id. The court specifically held:

[I]f Appellees had never elected to put their assets to use in the coal-mining industry, and had taken up business in an altogether different area, the Plan and Fund would have no right to seek premium payments from them. Because there is therefore a relationship between (1) the Fund’s and Plan’s rights to demand premium payments from Appellees and (2) the use to which Appellees put their assets, we find that the Fund and Plan have interests in those assets within the meaning of [§] 363(f).

Id. (footnote omitted). Thus, Leckie “seems to suggest that the term ‘any interest’ is intended to refer to obligations that are connected to, or arise from, the property being sold.” Folger, 209 F.3d at 259 (citation omitted).

Post-Leckie, the Third Circuit similarly interpreted § 363’s use of the term “interest in property” broadly in Trans World Airlines. There, the court held that the rights of flight attendants under a travel voucher program that the debtor-airline had established in settlement of a sex discrimination action qualified as an “interest in property.” Trans World Airlines, 322 F.3d at 288. The court reasoned that the
term should be read broadly, in order “to authorize a bankruptcy court to bar any interest that could potentially travel with the property being sold.” Id. As the Third Circuit further explained: “[t]he trend seems to be toward a more expansive reading of ‘interests in property’ which encompasses other obligations that may flow from ownership of the property.” Id. at 289.

More recently, in Indiana State Police Pension Trust v. Chrysler LLC (In re Chrysler LLC), 576 F.3d 108, 126 (2d Cir. 2009), cert. granted and judgment vacated on other grounds, 130 S. Ct. 1015, 175 L. Ed. 614 (2009), the Second Circuit utilized an expansive interpretation of “any interest” under § 363(f), in holding that the bankruptcy court was permitted to authorize the sale of substantially all of the debtor’s auto manufacturing assets free and clear of product liability claims. The court noted that the “possibility of transferring assets free and clear of existing tort liability was a critical inducement to the [s]ale,” and “was necessary in order to preserve some [55,000] jobs, . . . and to provide funding for employee-related liabilities, including retirement benefits. . . .” Id. (citation omitted). Accordingly, the Second Circuit ruled:

It is the transfer of Old Chrysler’s tangible and intellectual property to New Chrysler that could lead to successor liability (where applicable under state law) in the absence of the Sale Order’s liability provisions. Because appellants’ claims arose from Old Chrysler’s property, § 363(f) permitted the bankruptcy court to authorize the Sale free and clear of appellants’ interest in the property.

Id.

We conclude that the more expansive reading of the term “any interest” advanced by the Seventh, Fourth, Third, and Second Circuits in the cases cited above is more consistent with the language of the Bankruptcy Code and the policy expressed in § 363. We therefore conclude that the term “any interest” as used in § 363(f) is sufficiently elastic to include the Debtor’s experience rate. Indeed, the record reflects that the transfer of an employer’s contribution rate to a successor asset purchaser is really an attempt to recover the money that the predecessor employer would have paid if it had
continued in business. The liability for the increased rate thus follows any purchase of substantially all of the assets of an employer. The transfer of those assets alone, not the continuation of the Debtor’s business, is sufficient to trigger the imposition of successor liability on a purchaser. As the bankruptcy court correctly observed in its Memorandum of Decision:

. . . [T]here is a good reason to view this right as an interest in estate assets: it imposes a debtor’s experience rating on the buyer precisely because, and only because, the buyer purchased assets of the bankruptcy estate. By operation of the state statute, the debtor’s experience rating travels with the assets and encumbers their purchaser.

PBBPC, 467 B.R. at 9. Indeed, here, as in Chrysler and Trans World Airlines, the possibility of transferring assets free and clear of successor liability was a critical inducement to the sale. Because the right to tax at the higher successor rate arose from the sale of the Debtor’s property, § 363(f) permitted the bankruptcy court to authorize the sale free and clear of that rate.

Although Wolverine Radio, supra, is factually similar to the case before us, like the bankruptcy court below, we find the rationale of that decision unpersuasive. There, the Sixth Circuit framed the issue as whether the bankruptcy court may determine the tax rate applicable to the successor entity and, concluded that an employer’s contribution rate was not an interest in property under § 363. In this case, however, the bankruptcy court is not setting the tax rate. Rather, the DUA has two rates that it could impose: a new employer rate or the Debtor’s rate. Applying the Debtor’s rate as a successor is clearly intended to recover for the benefit of the Commonwealth, and other employers, sums that the Debtor would have paid had it remained in business. Since the motivation and underlying rationale for the successor rate structure is to recover money from the purchaser of the Debtor’s assets for the benefit of the state and other employers, it is an interest in the property sold. Like the court in Leckie, “we find no legal basis for [the] argument that, as a general matter, property cannot be sold to an unrelated third party free and clear of a debtor’s future tax obligations.” 99 F.3d at 586. Indeed, “the Code itself articulates no such restriction[.]” Id.

CONCLUSION

For the foregoing reasons, the Order is AFFIRMED.
ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re: JOSE J. HERNANDEZ, Debtor.

COLLECT ACCESS LLC, Appellant,
v.
JOSE J. HERNANDEZ, Appellee.

BAP Nos. SC-12-1209-JuMkPa
SC-12-1217-JuMkPa
(consolidated appeals)
Bk. No. 11-15921

Argued and Submitted on November 15, 2012
at Pasadena, California

Filed - December 14, 2012

Appeal from the United States Bankruptcy Court
for the Southern District of California

Honorable Margaret M. Mann, Bankruptcy Judge, Presiding

Appearance: Tappan Zee, Esq., Zee Law Group, P.C. argued for
appellant Collect Access LLC. Jorge Halperin,
Esq. and Elizabeth P. Swiller, Esq.,
submitted on brief for appellee Jose J.
Hernandez.

Before: JURY, MARKELL, and PAPPAS Bankruptcy Judges.
JURY, Bankruptcy Judge:

Appellant-creditor, Collect Access LLC (Collect), levied on funds in chapter 7 debtor’s deposit account in the amount of $712.39. Twenty days later, debtor filed his bankruptcy petition and claimed the funds exempt. Debtor sought an ex parte turnover order requiring Collect to surrender the funds. The bankruptcy court found that debtor had an interest in the funds despite the levy and ordered turnover. Collect moved to vacate the turnover order which the bankruptcy court denied. Collect appeals from that order.²

For the reasons stated, we AFFIRM the bankruptcy court’s result, but we rely on different grounds.

¹ Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and “Rule” references are to the Federal Rules of Bankruptcy Procedure.

² The bankruptcy court treated Collect’s motion to vacate as a timely motion for reconsideration under Rule 9023, which tolled the time to appeal the original order. Accordingly, we have jurisdiction to review both the underlying order and the order denying reconsideration. Wall St. Plaza, LLC v. JSJF Corp. (In re JSJF Corp.), 344 B.R. 94, 99 (9th Cir. BAP 2006). Further, Collect’s Notice of Appeal (NOA) designates only the order denying its motion to vacate and does not attach the underlying turnover order. Rule 8001(a) does not require the NOA to designate the order or judgment from which an appeal is taken, but our local rule, 9th Cir. BAP Rule 8001(a)-1, does. We may depart from our local rule absent prejudice. In re JSJF Corp., 344 B.R. at 100. There is no prejudice here as the parties have briefed the issues with respect to the turnover order. We thus review the turnover order.
I. FACTS

On August 30, 2002, the California state court entered a judgment in favor of First Select, Inc. (First Select) and against Jose J. Hernandez, the debtor in this case.

On January 22, 2008, First Select recorded an abstract of judgment for the sum of $2,091.71 in the County of San Diego.

On May 19, 2008, First Select renewed the judgment for the sum of $3,723.19.

On July 12, 2011, apparently as a successor to First Select, Collect submitted a writ of execution to the Los Angeles County Sheriff’s Department (Sheriff). On August 26, 2011, the writ was served on Wells Fargo Bank (Bank). On September 7, 2011, the Sheriff received from the Bank $712.39 that was in debtor’s deposit account.

On September 27, 2011, debtor filed his bankruptcy petition. At the time of his filing, the levied funds were in the Sheriff’s possession. Debtor claimed the funds exempt under Cal. Civ. Proc. Code (CCP) § 703.140(b)(5). 4

On October 29, 2011, the chapter 7 trustee filed her report of no distribution.

3 The standing of Collect to pursue execution on the judgment has not been challenged.

4 CCP § 703.140(b)(5) is referred to as the “wild card” exemption because it can be used to protect any kind of property. Goswami v. MTC Distrib. (In re Goswami), 304 B.R. 386, 390 (9th Cir. BAP 2003). The wild card exemption allows debtors to exempt up to $925, along with any unused portion of the $17,425 exemption amount under CCP § 703.140(b)(1).
On November 3, 2011, debtor filed an ex parte motion for turnover of the funds under § 542, contending they were property of his estate, had been exempted, and therefore belonged to him. The next day the bankruptcy court entered an order requiring the Sheriff to turn over $712.39 to debtor (Turnover Order I).

On November 7, 2011, before receiving the order, the Sheriff transferred the funds to Zee Law Group (Zee), the attorney for Collect.

On November 11, 2011, debtor sought ex parte a second turnover order, this time directed at Zee. The bankruptcy court granted debtor’s request by order entered on November 30, 2011 (Turnover Order II).

On December 1, 2011, Collect filed an opposition to debtor’s turnover request. First, relying on the holding in Del Riccio v. Super. Ct. of L.A. Cnty., 115 Cal.App. 2d 29, 31 (Cal. Ct. App. 1952), Collect argued that the funds were no longer property of debtor or his estate because ownership of the funds passed from debtor to the judgment creditor once the Sheriff received the funds. Second, Collect maintained that the chapter 7 trustee neither asserted a preference claim nor sought to recover the levied funds. Third and last, Collect argued that debtor had waived his claim of exemption against the funds because he did not timely assert it. Six days later, Collect filed an ex parte application to quash Turnover Order II (Motion to Vacate).
Debtor responded to Collect’s opposition, this time alleging that he had the right to recover the funds under § 522(g) and (h) rather than § 542. Debtor maintained that he listed the levied funds in Schedule B and claimed them exempt in Schedule C, the trustee filed a report of no distribution thereby abandoning the asset and, as a result, debtor could seek to recover the funds. Debtor further argued that the levy constituted a preference under § 547. He also maintained that he did not waive his exemption in the funds, because he claimed them exempt under CCP § 703.140(b)(5) when he filed his petition. Finally, debtor alleged that Collect violated the automatic stay by continually refusing to turn over the funds and requested $1,100 in attorneys’ fees.

On January 17, 2012, the bankruptcy court issued a tentative ruling indicating its reasons for entering the turnover orders. The court explained that under CCP § 697.710, a levy on property under a writ of execution creates a lien on the property from the time of the levy until the expiration of two years after the date of issuance of the writ unless the judgment is sooner satisfied. The court reasoned that because Collect’s execution lien was unsatisfied on the date of debtor’s bankruptcy filing, the funds remained part of debtor’s estate under the holdings in United States v. Whiting Pools, Inc., 462 U.S. 198, 207, 76 L.Ed. 2d 515, 103 S.Ct. 2309 (1983) and Ramirez v. Fuselier (In re Ramirez), 183 B.R. 583, 591 (9th Cir. BAP 1995). In the end, the bankruptcy court opined that debtor
may be eligible to recover actual fees and costs associated with his two motions seeking a turnover order.

On January 19, 2012, the bankruptcy court heard oral argument from the parties and took the matter under submission.


On April 3, 2012, the bankruptcy court entered the order denying Collect’s Motion to Vacate Turnover Order II. On April 9, 2012, Collect timely appealed.5

Meanwhile, on April 4, 2012, debtor filed a motion for costs, damages and fees. On April 26, 2012, debtor filed a motion to avoid Collect’s lien under § 522(f) and a motion for contempt.

On June 14, 2012, the bankruptcy court heard the three motions. The court (1) granted debtor’s motion to avoid Collect’s lien; (2) denied his motion for contempt because Collect had complied with Turnover Order II by that time, and (3) granted debtor’s motion for costs, damages and fees,

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5 This appeal was transmitted to the Panel and assigned BAP No. SC-12-1209. On April 18, 2012, Collect filed a second NOA which was also transmitted to the Panel and assigned BAP No. SC-12-1217. A notice of Deficient Appeal and Impending Dismissal (NOD) was issued in this later appeal, since it appeared untimely. On May 23, 2012, this Panel determined that the NOD was satisfied and that appellant had filed a timely NOA. Since Collect’s NOAs were identical and requested review of the same set of orders, the Panel entered an order consolidating the appeals on the same date.
awarding debtor $3,572.06 in actual damages and $1,000 in
punitive damages for Collect’s failure to turn the funds over to
debtor pursuant to the court’s orders.

On June 19, 2012, the bankruptcy court entered the order
awarding the fees and damages.

On June 20, 2012, debtor filed a motion to dismiss this
appeal as moot on the grounds that Collect complied with
Turnover Order II and its lien was avoided under § 522(f). On
July 25, 2012, the Panel issued an order denying debtor’s motion
to dismiss the appeal as moot, but authorized the parties to
further address the issue in their briefs. We discuss the
mootness issue below.

II. JURISDICTION

The bankruptcy court had jurisdiction over this proceeding
under 28 U.S.C. §§ 1334 and 157(b)(2)(A), (B) and (E). We have

III. ISSUES

A. Whether this appeal is moot;

B. Whether the bankruptcy court erred in finding that the
  levied funds held by the Sheriff were property of debtor’s
  estate subject to turnover;

C. Whether the bankruptcy court erred in denying
  Collect’s Motion to Vacate Turnover Order II; and

D. Whether the bankruptcy court erred by granting
  debtor’s ex parte motion for turnover of the funds without an
  adversary proceeding.
IV. STANDARDS OF REVIEW

Whether an appeal is moot and whether property is property of the estate are questions of law we review de novo. See Menk v. Lapaglia (In re Menk), 241 B.R. 896, 903 (9th Cir. BAP 1999); Mwangi v. Wells Fargo Bank, N.A. (In re Mwangi), 432 B.R. 812, 818 (9th Cir. BAP 2010). We also review de novo the bankruptcy court’s conclusions of law, including statutory interpretations. DeMassa v. MacIntyre (In re MacIntyre), 74 F.3d 186, 187 (9th Cir. 1996).

A bankruptcy court’s denial of a motion for reconsideration is reviewed for abuse of discretion. First Ave. W. Bldg., LLC v. James (In re Onecast Media, Inc.), 439 F.3d 558, 561 (9th Cir. 2006). To determine whether the bankruptcy court abused its discretion, we conduct a two-step inquiry: (1) we review de novo whether the bankruptcy court “identified the correct legal rule to apply to the relief requested” and (2) if it did, whether the bankruptcy court's application of the legal standard was illogical, implausible or “without support in inferences that may be drawn from the facts in the record.” United States v. Hinkson, 585 F.3d 1247, 1261-62 (9th Cir. 2009) (en banc).

Whether an adversary proceeding was required is an issue that requires us to interpret and apply Rule 7001, which is a matter for de novo review. Ruvacalba v. Munoz (In re Munoz), 287 B.R. 546, 550 (9th Cir. BAP 2002).

We may affirm on any ground supported by the record. Siriani v. Nw. Nat’l Ins. Co. (In re Siriani), 967 F.2d 302, 304
V. DISCUSSION

A. Mootness

Before reaching the merits, we consider debtor’s mootness argument. An appeal is constitutionally moot when events occur during the pendency of the appeal that make it impossible for the appellate court to grant effective relief. Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC), 391 B.R. 25, 33 (9th Cir. BAP 2008). Debtor contends that the following events render this appeal moot: (1) the funds are now in the hands of the debtor; (2) the lien which gave rise to Collect’s claim has been avoided; and (3) the underlying debt has been discharged. Under these circumstances, debtor argues, effective relief is no longer available. On the other hand, Collect maintains that if the Panel reverses the bankruptcy court and finds that debtor’s interest in the funds was extinguished after the levy, we can order debtor to return the funds to Collect. Collect further argues that it would not have been a violation of the automatic stay for Collect to retain the funds postpetition if, under California law, ownership of the funds passed from debtor to the judgment creditor once the Bank released the funds to the Sheriff. On these grounds, Collect contends effective relief is available.

Debtor, as the party arguing for dismissal based on mootness, “has the heavy burden of establishing that there is no effective relief remaining for a court to provide.” Suter v.
Goedert, 504 F.3d 982, 986 (9th Cir. 2007). Debtor has not met his burden here. Where the order appealed involves the distribution of money and the party who received the funds is a party to the appeal, the appeal is not moot because we have the power to fashion effective relief by ordering the party to return the money. See Spirtos v. Moreno (In re Spirtos), 992 F.2d 1004, 1007 (9th Cir. 1993). Under this rule, we can implement effective relief because debtor is a party to the appeal, and we can order him to repay the money to Collect upon reversal of the bankruptcy court’s ruling. Debtor’s discharge also would not impact the return of the funds to Collect. If debtor had no interest in the funds after the levy, they would have been rightfully in the Sheriff’s possession. In addition, under these facts, no stay violation would have occurred. Accordingly, we conclude that the appeal is not moot.

B. Property of the Estate

A bankruptcy court may order turnover of property to the debtor’s estate if, among other things, such property is considered “property of the estate.” See §§ 541(a) (defining property of the estate), 542(a) (authorizing turnover of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title). Section 541(a) provides that property of the estate includes all legal or equitable interests of the debtor in property as of the commencement of the case. The primary question on appeal is whether the prepetition levied
funds in the hands of the Sheriff on the petition date were in fact property of debtor’s bankruptcy estate. We hold that they were.


California statutory law governs generally the rights and obligations of debtors and creditors with respect to the enforcement of money judgments. In examining the statutory scheme, the bankruptcy court first found that the Sheriff’s levy under Collect’s writ of execution resulted in an execution lien, rather than a transfer of the ownership of the funds. In re Hernandez, 468 B.R. at 402; see also CCP § 697.710 (“A levy on property under a writ of execution creates an execution lien on the property from the time of levy . . . .”). Next, the court found that before the execution lien could be transformed into ownership of the funds, the Sheriff had to release the funds to the judgment creditor. Id. In reaching this conclusion, the court relied on CCP §§ 697.710 and 724.010(b). Under CCP
§ 697.710, entitled “Creation and Duration of Execution Lien”, an execution lien created by levy “survives for the earlier of two years, or when the judgment is satisfied.” Id. Under CCP § 724.010(b), the court reasoned, the judgment is not fully satisfied until the creditor receives the levied funds from the levying officer and files an acknowledgment of satisfaction. On this basis, the bankruptcy court concluded that since the Sheriff still held the funds when debtor filed his petition, Collect only held a lien on the funds because the second step of satisfaction had not yet occurred. Id. at 402-03.

The bankruptcy court’s analysis relies on the incorrect statutory scheme. The California legislature has enacted a “comprehensive and precisely detailed scheme governing enforcement of money judgments.” Ford Motor Credit Co. v. Waters, 166 Cal.App.4th Supp. 1, 7 (Cal. App. Dep’t Super. Ct. 2008). In CCP §§ 700.010-700.200, “the judgment creditor is advised of all methods of levy available to enforce a money judgment. Those statutes tell the judgment creditor and levying officer how to levy on assets . . . , as here relevant, bank accounts.” Id.

CCP § 700.140 entitled “Deposit accounts” provides in relevant part:

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This subsection provides: “Where a money judgment is satisfied by levy, the obligation of the judgment creditor to give or file an acknowledgment of satisfaction arises only when the judgment creditor has received the full amount required to satisfy the judgment from the levying officer.”
(a) To levy upon a deposit account, the levying officer shall personally serve a copy of the writ of execution and a notice of levy on the financial institution with which the deposit account is maintained. . . . The execution lien reaches only amounts in the deposit account at the time of service on the financial institution, including any item in the deposit account that is in the process of being collected, unless the item is returned unpaid to the financial institution.

. . .

(e) When the amount levied upon pursuant to this section is paid to the levying officer, the execution lien on the deposit account levied upon terminates.

Under the plain language of CCP § 700.140, Collect obtained an execution lien on the amounts in the deposit account at the time of the service on the financial institution. These amounts were not available for debtor’s use. The lien was terminated under subsection (e) at the time the funds were paid to the levying officer. The termination of Collect’s execution lien occurred well before debtor’s bankruptcy. Given this statutory framework that applies to deposit accounts, the bankruptcy court’s reliance on CCP §§ 697.710 and 724.010(b) for its analysis was misplaced.

Nonetheless, we do not think the plain language of CCP § 700.140 provides an answer to the ownership question Collect raises on appeal. Although the statute suggests that debtor’s interest in the funds was transferred when the funds were paid to the levying officer and the lien terminated, the statute does not plainly say so. Compare In re Ramirez, 183 B.R. at 589 (noting that although relevant California statute stated when levy was complete, it did not state that a completed levy transferred ownership of the property).
Collect relies on Del Ricco, 115 Cal.App.2d 29, to support its position that the transfer of funds to the Sheriff extinguished all rights that debtor had in the property prepetition. Although Collect urges the Panel to rely on Del Ricco to adopt a bright line rule, we decline to read the case so broadly. In Del Riccio, after a judgment was obtained, a writ of execution was issued and levied upon a bank in which the defendant had the sum of $6,426.66. While the sheriff had the money in his possession, defendant applied for and obtained a court order prohibiting the sheriff from paying any money to the plaintiffs. The plaintiffs moved to vacate the order which the court denied. The defendant then moved for an order staying execution upon posting a cash undertaking in the action. After defendant posted a satisfactory bond, the court made a further order staying the execution. Plaintiffs appealed.

The California Court of Appeal found that the trial court had the power to impose a stay of execution, but had no power to undo what had already been done so as to deprive the creditor of ownership and use of the money collected under the writ. The appellate court discussed the parties’ interest held in money in levy as follows:

When the writ has been regularly issued and executed, money collected, while in the hands of the officer, is property of the judgment creditors and not the debtor. Nothing can be done with it other than to turn it over to the creditor. The possession of the officer solely for the use and benefit of the creditor is possession by the latter . . . . Correspondingly, when the debtor’s money is taken on a valid execution it ceases to be his and he immediately becomes entitled to partial or full satisfaction of the judgment.

Del Ricco has not been overruled, but the rule of law it
established is not a complete answer to the bankruptcy issue before us. Although *Del Ricco* does say that money collected while in the hands of the Sheriff is the property of the judgment creditor, the decision discussed only the trial court’s power with respect to a valid execution. The court had no reason to examine the various statutory rights and obligations of the judgment creditor vis-a-vis the debtor after the execution. Therefore, we do not read *Del Ricco* as stating a per se rule that the levying officer’s possession of money after a valid execution accomplishes a complete transfer of ownership of the property, without limitation, and in disregard of other statutes in the enforcement of money judgment scheme.

The bankruptcy court’s analysis in *In re Caldwell*, 111 B.R. 836 (Bankr. C.D. Cal. 1990), sheds further light on the property of the estate analysis. There, the bankruptcy court partially relied on *Del Ricco* in analyzing the conflicting claims of the debtors and the State Board of Equalization in funds held by a bank. Under Cal. Rev. & Tax Code § 6703, a notice of levy was the equivalent of a levy. The *Caldwell* court found that “[a] levy transfers ownership in property. This usually takes place when a law enforcement officer seizes the property.” *Id.* at 838. Citing *Del Ricco*, the bankruptcy court noted that under Cal. Rev. & Tax Code § 6703, the bank in effect became the executing officer for the benefit of the Board.7 *Id.*

7 See also *McCaffey Canning Co. v. Bank of Am.*, 109 Cal. App. 415, 423-24 (Cal. Ct. App. 1930) (“While the property was in the custody of the sheriff, it was constructively in the possession of plaintiff through the sheriff as his agent.”).
Accordingly, the court concluded that under California law, the Board’s notice of levy (which was the equivalent of a levy) extinguished the debtors’ property interest in the funds. “In other words, the Notice of Levy transferred ownership of the Funds from debtors to the Board.” Id. Finally, because the debtors had no right of redemption under Cal. Rev. & Tax Code § 6703, the court observed that “a levy under [this statute] terminates any and all interests a debtor may have in the property.” Id. at n.2.

If anything, Caldwell’s analysis instructs us to delve further into whether the effect of the levy was to divest debtor of all interests in the property seized for purposes of a property of the estate analysis. Use of the term “ownership” to identify the interests of the parties does not help because the term is not defined. The Bankruptcy Code does not define property, ownership, or owner; however, dictionary definitions provide guidance. Property is defined as “[t]he right to possess, use, and enjoy a determinate thing . . . ; the right of

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8 Here, just as in Caldwell, debtor had no redemption rights with respect to the funds. Likewise, although the bankruptcy court partially relied on Whiting Pools for its decision, debtor had none of the interests which were identified by the Supreme Court in Whiting Pools as interests sufficient to consider the seized property part of the debtor’s estate. There, the IRS’s levy was on tangible property that was subject to the requirements of a statutory tax sale which provided the debtor with notice rights, redemption rights, and rights to the surplus from the sale. 462 U.S. at 211. Thus, although Whiting Pools provides a summary of the law in the turnover/property of the estate analysis, its facts are distinguishable from those here. Whiting Pools is also distinguishable in that it was a debtor-in-possession in a reorganization that sought turnover. As discussed below, a chapter 7 debtor generally does not have standing to seek a turnover order under § 542.
ownership . . . . Also termed bundle of rights.” Black’s Law Dictionary 1335 (9th ed. 2009). Ownership is defined as “[t]he bundle of rights allowing one to use, manage, and enjoy property, including the right to convey it to others. . . .” Id. at 1215. An owner is “[o]ne who has the right to possess, use, and convey something; a person in whom one or more interests are vested.” Id. at 1214. Taken together, these definitions demonstrate that a debtor’s “bundle of rights” in property must be identified on a case-by-case basis.

It appears from the bankruptcy court’s findings of fact that virtually all of the funds in debtor’s account on the day of the levy consisted of social security benefits. The bankruptcy court found that debtor’s only source of income other than $100 of family contributions was $636 in monthly social security benefits. In re Hernandez, 468 B.R. at 404. Collect does not dispute this finding on appeal. 10

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9 The Code of Federal Regulations (CFR), which govern state and federal financial institutions, sets forth rules regarding social security benefits in a debtor’s deposit account. “State and federal financial institutions must, before complying with a creditor’s garnishment order, determine whether certain exempt federal benefits (e.g., social security, supplemental security income, etc.; see 31 CFR § 212.2(b)) have been electronically deposited into the debtor’s account within the preceding two months and, if so, protect whatever amount was deposited during that period. In short, banks may not freeze the entire account and the debtor retains access to the exempt funds. [See 31 CFR § 212.1 et seq.; see also 31 CFR § 212.3 (definitions)].” Hon. Alan M. Ahart, Cal. Prac. Guide: Enforcing Judgments and Debts § 6:560.10 (2012). It is not apparent from the record whether these regulations were followed in this case and, therefore, whether the execution here was valid.

10 CCP § 703.080 provides:

(continued...)
Under California law, government benefits such as social security are intended exclusively for the benefit and support of qualified recipients. These funds are exempt and cannot be subject to collection. See Kruger v. Wells Fargo Bank, 521 P.2d 441, 458-60 (Cal. 1974).\(^\text{11}\) Under CCP § 704.080(b), social security benefits in deposit accounts are exempt in the amount of $2,425 and the exemption is automatic. The debtor need not make a claim and thus there could be no transfer of ownership in the funds by waiver or by operation of law. See CCP

\(^{10}\)(...continued)

(a) Subject to any limitation provided in the particular exemption, a fund that is exempt remains exempt to the extent that it can be traced into deposit accounts or in the form of cash or its equivalent.

(b) The exemption claimant has the burden of tracing an exempt fund.

(c) The tracing of exempt funds in a deposit account shall be by application of the lowest intermediate balance principle unless the exemption claimant or the judgment creditor shows that some other method of tracing would better serve the interests of justice and equity under the circumstances of the case.

Collect raised no issue in the bankruptcy court regarding debtor’s burden of tracing his exempt social security benefits which were made into his deposit account. Consequently, any tracing issue is waived on appeal. Campbell v. Verizon Wireless S-CA (In re Campbell), 336 B.R. 430, 434 n.6 (9th Cir. BAP 2005) (citing O’Rourke v. Seaboard Sur. Co. (In re E.R. Fegert, Inc.), 887 F.2d 955, 957 (9th Cir. 1989) (“The rule in this circuit is that appellate courts will not consider arguments that are not ‘properly raise[d]’ in the trial courts.”).

\(^{11}\) Federal statutes also provide that social security and supplemental security income benefits (whether paid or payable) ordinarily are not subject to execution, levy, attachment, garnishment or other legal process; or to the operation of bankruptcy laws. See 42 U.S.C. §§ 407, 1382(d).
§ 703.030(b).12 “Some exemptions need not be claimed. They are automatic and are denoted by the statutory terms of art ‘exempt without making a claim,’ which has the effect of eliminating the applicability of the procedure for enforcing a money judgment.’” In re Hernandez, 468 B.R. at 404 (citing In re Petruzzelli, 139 B.R. 241, 243 (Bankr. E.D. Cal. 1992)). One treatise further explains:

Theoretically, a claim of exemption should never have to be filed for property ‘exempt without making a claim.’ In practice, however, if such property is levied upon by the judgment creditor, a claim of exemption may have to be filed to obtain its release—unless the creditor can be persuaded to order it released. [CCP § 703.510(b)] (But so long as no sale has occurred, the levying officer should release the property whether or not the exemption filing is timely.).


Exemptions under California law are wholly statutory and cannot be enlarged [or diminished] by the courts. Ford Motor Credit Co., 166 Cal. App. 4th Supp. at *8. Furthermore, “the exemption laws are designed to facilitate the debtor’s financial rehabilitation and have the effect of shifting social welfare costs from the community to judgment creditors. Consequently, the exemption statutes should be construed, so far as

12 CCP § 703.030(b) provides:

Except as otherwise specifically provided by statute, property that is described in this chapter or in any other statute as exempt without making a claim is not subject to any procedure for enforcement of a money judgment.
practicable, to the benefit of the judgment debtor.” Id. at *9. California’s exemption philosophy is echoed in bankruptcy law. Because debtor had an exempt property interest in the funds, we conclude that Collect’s levy did not operate to extinguish those interests. See In re Hernandez, 468 B.R. at 404 (debtor’s exemption rights in the funds had not been terminated prepetition). To adopt Collect’s argument for a bright line ownership rule under these circumstances would render the automatic exemption for social security benefits meaningless and allow creditors to levy on exempt funds that they are not entitled to under both state and federal law. In short, debtor had grounds to recover the exempt funds and could have challenged the levy in the state court prepetition on that basis.\(^\text{13}\)

As property in which debtor held a legal or equitable interest when his petition was filed, the bankruptcy court’s conclusion that the funds in question constituted property of the estate was correct. See In re Varney, 449 B.R. 411 (Bankr. D. Idaho 2011) (even potentially exempt assets nonetheless become property of the estate upon the commencement of the bankruptcy case); In re McAlister, 56 B.R. 164, 166 (Bankr. D. Or. 1985) (even exempt property must initially be regarded as property of the estate and then claimed and distributed as exempt).

\(^{13}\) Even if the ten-day rule to claim an exemption did apply to some or all of the funds, the state court had authority “to relieve a person upon such terms as may be just from failure to claim an exemption within the time and in the manner prescribed in the applicable enforcement procedure.” CCP § 703.030(c).
Although we conclude that the funds were property of debtor’s estate, we note a procedural irregularity with debtor’s motion for a turnover order under § 542. Section 542(a) enables the bankruptcy trustee, or the debtor-in-possession in a reorganization case to seek turnover of the debtors’ assets, for the benefit of the estate. Indeed, in Whiting Pools, it was the debtor-in-possession in a reorganization case that sought turnover. Under the statute, a chapter 7 debtor is not mentioned and generally has no standing to bring an action for turnover. See In re Freeman, 331 B.R. 327, 329 (Bankr. N.D. Ohio 2005) (the general provision in the Bankruptcy Code governing turnover, confers this right upon the trustee); Price v. Gaslowitz (In re Price), 173 B.R. 434, 440 (Bankr. N.D. Ga. 1994) (turnover action is one facet of a chapter 7 trustee’s general duties under § 704(1)).

The procedural irregularity was remedied however by debtor’s response to Collect’s opposition. The ultimate relief that debtor sought was to preserve his exemption in the levied funds by invoking § 522(g) and/or by exercising the trustee’s avoiding powers under § 522(h). Moreover, as of the

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14 Sections (g) and (h) provide:

(g) Notwithstanding sections 550 and 551 of this title, the debtor may exempt under subsection (b) of this section property that the trustee recovers under section 510(c)(2), 542, 543, 550, 551, or 553 of this title, to the extent that the debtor could have exempted such property under subsection (b) of this section if such property had not been transferred, if—

(1)(A) such transfer was not a voluntary transfer of
commencement of the case, the automatic stay under § 362(a) arises, which enjoins any and all collection efforts against the debtor. As an enforcement mechanism, a debtor is afforded a private right of action to seek redress under § 362(k)(1).

“Section 522’s right to claim exemptions in property of the estate bestows standing on debtors for purposes of § 362(k)(1).” In re Mwangi, 432 B.R. at 822. Therefore, debtor’s statutory standing to seek the return of the funds levied upon was conferred by statutes other than § 542(a). Further, debtor’s procedural irregularity did not in any way affect the bankruptcy court’s ability to enter an order that required Collect to surrender the funds to debtor. Since this is a protection of exemption case rather than one for turnover, the bankruptcy

Eventually, debtor did avoid the lien under § 522(f).
court had the authority to enter an order requiring Collect to surrender the funds to debtor under § 105(a). See § 105(a) (“The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”). Once the property came into the estate, it revested in debtor when his exemption claim went unchallenged. See In re Mwangi, 432 B.R. at 821 (noting that “[p]roperty claimed as exempt leaves the estate and revests in the debtor.”). Finally, debtor’s ex parte motion seeking the return of his exempt funds was a contested matter under Rule 9014 requiring reasonable notice and opportunity for a hearing. No adversary proceeding was required under Rule 7001. Here, Collect had ample opportunity to contest Turnover Order II through written opposition and oral argument at the eventual hearing on its Motion to Vacate. That said, Collect does not contend on appeal that it was prejudiced in any way by the procedure used.

VI. CONCLUSION

Accordingly, we AFFIRM the bankruptcy court’s order, albeit for different reasons, and hold that the prepetition levied funds in the hands of the Sheriff on the petition date were property of debtor’s estate under § 541(a) due to debtor’s exemption rights in the funds. Therefore, the bankruptcy court properly ordered Collect to surrender the funds.
ORDERED PUBLISHED

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re: ) BAP No. NC-12-1081-MkHPa
RAUL MACHUCA, JR., ) Bk. No. 10-55227
Debtor. ) Adv. No. 10-05301

HERITAGE PACIFIC FINANCIAL, LLC,
Appellant,
v.
RAUL MACHUCA, JR.,
Appellee.

Argued and Submitted on October 18, 2012
at San Francisco, California
Filed – December 14, 2012
Appeal from the United States Bankruptcy Court
for the Northern District of California
Honorable Charles D. Novack, Bankruptcy Judge, Presiding

Appearances: Brad A Mokri, Esq. argued for Appellant Heritage
Pacific Financial, LLC; and Stanley Zlotoff, Esq.
argued for Appellee Raul Machuca, Jr.

Before: MARKELL, HOLLOWELL and PAPPAS, Bankruptcy Judges.
MARKELL, Bankruptcy Judge:

I. INTRODUCTION

Heritage Pacific Financial, LLC ("HPF") sued debtor Raul Machuca, Jr. ("Machuca"), alleging that a debt incurred by Machuca was nondischargeable. HPF not only lost, but the bankruptcy court entered summary judgment for Machuca. HPF did not appeal that order. Machuca thereafter sought an award of roughly $9,000 in attorneys’ fees under 11 U.S.C. § 523(d). The bankruptcy court granted Machuca’s attorneys’ fees motion. HPF then appealed from the fee order. We AFFIRM.

II. FACTS

In January 2007, Machuca purchased a single-family residence in Salinas, California ("Property"). To finance his purchase, Machuca obtained two real estate secured loans. The senior loan was for $1 million. The junior loan, which is the subject of this appeal, was for $147,000 ("Loan"). It was made by National City Bank ("National City").

Most of Machuca’s actions in obtaining the Loan are undisputed. In December 2006, Machuca telephoned Westar Real Estate and Mortgage, a loan brokerage firm, seeking to obtain a loan to purchase the Property. During this phone call, Machuca answered many questions regarding his finances. These included the name of his employer and the amount of his salary.

1Unless specified otherwise, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and all “Rule” references are to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.
Sometime later, Machuca was notified that National City had approved his loan. He was asked to and did attend a meeting to sign the necessary loan documentation. At the meeting, he signed and initialed a stack of documents. Machuca testified that he did not read any of the documents, although he admits that he signed them in order to obtain the loan. These documents included a standard form loan application ("Application").

Most of the documents that Machuca signed are not in the record before us. We do have, however, multiple copies of the Application signed by Machuca. They are each dated January 16, 2007. We also have multiple copies of the signed promissory note ("Note"). They are each dated January 12, 2007 – four days before the date of the Application.

The record also includes:

1. An unsigned and undated version of the Application ("Unsigned Application"), presumably filled out by Westar during or after the telephone call between Machuca and Westar.

2. A document entitled Uniform Underwriting and Transmittal Summary ("Underwriting Summary").


4. Closing Instructions from National City to Chicago Title Co. ("Closing Instructions") anticipating a disbursement date of January 17, 2007.

The Application stated that Machuca was a correctional
officer who had worked for the California Department of
Corrections for five years. That much was true. It also
stated, however, that his “base employment income” was $20,725
per month, or almost $250,000 a year. That was untrue.
According to Machuca, however, not only was the stated salary
amount false, it was patently absurd. For purposes of this
litigation, however, both sides agreed that the $20,750 amount
was inaccurate.

Machuca made his Loan payments for a little over a year.
He then defaulted. After several more years, in May 2010, he
filed a chapter 13 bankruptcy. During this time, HPF had
acquired National City’s rights under the Loan. After Machuca
filed his bankruptcy, HPF filed an adversary proceeding seeking
a determination that the Loan was a nondischargeable debt under
§ 523(a)(2)(A) and (B).

Machuca responded by filing a motion to dismiss the
§ 523(a)(2)(A) claim, which the bankruptcy court granted.
Machuca then filed a motion for summary judgment on HPF’s

2The Unsigned Application and the Underwriting Summary
listed Machuca’s income differently than did the Application.
Those documents listed his base employment income as $7,250 per
month, plus additional “other income” of $13,475 per month.
According to the Unsigned Application, $3,725 of the “other
income” consisted of Machuca’s overtime wages. The source of the
remaining $9,750 per month in “other income” was not specifically
described in either document.

These documents perhaps suggest that whoever filled out the
final version of the Application erroneously listed Machuca’s
claimed aggregate monthly income – his base employment income and
his “other income” – as his base employment income.
remaining § 523(a)(2)(B) claim.\(^3\)

In his summary judgment motion, Machuca primarily argued a lack of reasonable reliance on the Application. He asserted that National City did not actually rely on his income representation and that, even if it did, such reliance would have been unreasonable. Machuca’s argument focused on the discrepancies in income between the Application and the Unsigned Application. Machuca also noted that the cover sheet accompanying the Underwriting Summary identified the loan type as a “stated income” loan, the upshot of which was that National City had never asked Machuca to provide any tax returns or pay stubs to verify any of his income.\(^4\) Machuca further pointed out

\(^3\)Section 523(a)(2)(B) provides that a debt is nondischargeable if the debtor obtained “money, property, services, or an extension, renewal, or refinancing of credit” by using a statement in writing -

(i) that is materially false;

(ii) respecting the debtor’s or an insider’s financial condition;

(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive . . . .


\(^4\)By identifying his Loan as a stated income loan, Machuca implicated the now-discredited practice of indiscriminately making mortgage loans without verifying the income stated on the loan application. Lenders who made these so-called “liar’s loans” often did not care what income the borrowers listed and sometimes actively encouraged misstatements of income. Indeed, (continued...)
that the dates on the loan documents indicated that National
City had approved the Loan before he signed the Application.

In its opposition to the summary judgment motion, HPF
contested Machuca’s claim of a lack of reasonable reliance. It
supported its contentions with three items of evidence: (1) the
language in the Application; (2) the declaration of HPF’s
managing partner Ben Ganter (“Ganter”); and (3) the declaration
of HPF’s expert Mark G. Schuerman (“Schuerman”).

According to HPF, the Application’s certification of the
truth and correctness of the Application’s information supported
both National City’s and HPF’s reliance without HPF’s
introduction of any independent evidence of that reliance. In
the same vein, HPF also pointed to the Application’s provision
stating that the lender and its successors and assigns “may
rely” on the information in the Application.

Ganter’s declaration attempted to establish that both
National City and HPF had relied on the information regarding
Machuca’s income set forth in the Application. Although
possibly relevant for HPF, Ganter’s declaration did not explain

4(...continued)

the economic incentives associated with originating such high-
risk, high-interest rate loans led some brokers to falsify loan
applications without the borrower’s knowledge or active
participation. For a discussion of these and related points, see
Charles W. Murdock, Why Not Tell the Truth?: Deceptive Practices
and the Economic Meltdown, 41 Loy. U. Chi. L.J. 801, 843-46
(2010); see also Andrea J. Boyack, Lessons in Price Stability
925, 947-50 (2010); Patricia A. McCoy, Andrey D. Pavlov & Susan
M. Wachter, Systemic Risk Through Securitization: the Result of
Deregulation and Regulatory Failure, 41 Conn. L. Rev. 1327, 1351-
53 (2009).
how he would have any reason to know anything about National
City’s reliance.

Finally, Schuerman opined that both lenders and loan
purchasers routinely rely on the certifications, acknowledgments
and information contained in loan applications, and that this
reliance is a crucial factor in the secondary mortgage market.
He also opined that income representations are particularly
important to junior secured debt holders and purchasers because
any collateral supporting their junior position would be lost if
a senior lienholder foreclosed.

Schuerman did not attempt to give any opinion as to how the
types of patent defects evident in Machuca’s application might
have affected a lender’s or a successor’s reliance. In fact,
Schuerman’s declaration mostly ignored: (1) the income
discrepancies between the Application and the Unsigned
Application; (2) the implausible amount of base employment
income claimed by a five-year state corrections officer; (3) the
last-minute signing of the Application, just before funding of
the Loan and after the date of the promissory note; (4) National
City’s approval and funding of the Loan without income
verification; and (5) HPF’s purchase of the loan without income
verification.⁵

⁵Schuerman did claim that HPF and the secondary mortgage
market typically rely on the “stated income” in loan
applications. If he meant to suggest, however, that such
reliance actually and reasonably occurs without independent
income verification, especially when there are red flags extant
on the face of the loan documents, his suggestion contradicts
everything that has been revealed about stated income loans in
(continued...)
The bankruptcy court heard the summary judgment motion on November 28, 2011. It adopted Machuca’s lack-of-reliance argument, and granted summary judgment. According to the bankruptcy court, Boyajian v. New Falls Corp. (In re Boyajian), 564 F.3d 1088 (9th Cir. 2009) made only the original lender’s reliance relevant with respect to § 523(a)(2)(B)’s reliance element. 6

The bankruptcy court further ruled that HPF had not met its burden of presenting evidence from which National City’s actual or reasonable reliance could be inferred. HPF attempted to show reasonable reliance from the contents of the loan documents Machuca signed, and from an unsupported inference that Machuca inserted the contents to induce a lender’s reliance. But the bankruptcy court was unpersuaded. It identified the following

5(...continued)

the wake of the subprime lending crisis. In other words, there is a reason why knowledgeable people in the mortgage lending industry cynically referred to these loans as “liar’s loans.” See note 4, supra.

6Actually, this misstates Boyajian’s holding. Boyajian held that an assignee’s reliance was not necessary to satisfy § 523(a)(2)(B)’s reliance element when the assignee had already established the original lender’s reasonable reliance. See id. at 1090. Boyajian did not address the question of whether, and under what circumstances, the assignee’s reliance might be sufficient by itself under § 523(a)(2)(B).

The Panel has indicated that an assignee’s reliance, under appropriate circumstances and when not contested, can support a finding of reliance under § 523(a)(2)(B)(iii). See Tustin Thrift & Loan Ass’n v. Maldonado (In re Maldonado), 228 B.R. 735, 737-740 (9th Cir. BAP 1999). Given the bankruptcy court’s finding that no reasonable person could rely upon the income and other contents of the Application, this case does not present the unaddressed issue of whether an assignee’s alleged but contested reliance is sufficient to satisfy § 523(a)(2)(B)(iii). Cf. id. at 737 (such reliance conceded and not contested).
as reasons it rejected HPF’s argument: (1) HPF presented no
competent evidence from which the court could ascertain National
City’s business practices in making stated income loans; (2) the
Application was signed and dated after the date on the
promissory note, and just before the loan closed; and (3) “red
flags” — that is, facts which would require a reasonable person
to investigate further before making the loan — were present,
and these red flags should have caused National City to question
and investigate Machuca’s income representations if National
City sufficiently cared about the income representations to
constitute reliance. Combined with other arguments, these
factors persuaded the bankruptcy court that HPF had failed to
carry its summary judgment burden with respect to
§ 523(a)(2)(B)’s reliance element.

As the bankruptcy court put it, HPF had not presented any
evidence from which the court reasonably could infer National
City’s reasonable reliance on Machuca’s income representations.
Moreover, the court stated that no lender could have reasonably
relied upon the Application and the other evidence in the
record, given the numerous red flags contained in those
documents. Accordingly, the bankruptcy court granted Machuca’s
summary judgment motion, and entered its order confirming that
grant on December 19, 2011.7 HPF did not appeal that order, nor

7The bankruptcy court also stated that it was going to
sustain Machuca’s evidentiary objections to both Ganter’s
declaration and Schuerman’s declaration. We could not, however,
find these objections in the record. Nonetheless, the propriety
of the bankruptcy court’s evidentiary rulings is not at issue in
this appeal. For purposes of determining whether the bankruptcy
(continued...)
Machuca then filed a motion to recover his attorneys’ fees under § 523(d). HPF opposed, arguing that its filing and prosecution of the adversary proceeding was substantially justified, as it had a reasonable basis in both law and fact for its position.

Relying on its then-final summary judgment order, the bankruptcy court rejected HPF’s substantial justification argument. More specifically, the court focused on the complete absence of competent evidence that could support an inference of reasonable reliance. According to the bankruptcy court, this absence of evidence established that HPF did not have a reasonable basis in law and fact for its defense of the summary judgment motion. As the court explained:

The law is straightforward: You need reasonable reliance by National City. Yet despite this clear requirement, no admissible facts of any kind were presented, no personal knowledge offered by any personal — was again, was offered to establish reasonable reliance. This is not surprising given the fact that stated income loans were magnets for misrepresentations and a convenient excuse by lenders to bypass even the most rudimentary attempt at due diligence of the borrower’s income, all in an effort to make the loan and sell it on the secondary market.

Hr’g Trans. (Jan. 24, 2012) at 8:7-16.

The bankruptcy court entered an order on January 26, 2012, court erred in finding that HPF lacked substantial justification for its position, we can and will consider the contents of both declarations, even though the bankruptcy court considered them inadmissible for purposes of the summary judgment motion. See First Card v. Hunt (In re Hunt), 238 F.3d 1098, 1103 (9th Cir. 2001) (stating that a finding regarding substantial justification “need not be based solely on the admissible evidence before the court”).
granting Machuca’s fee motion. HPF timely filed a notice of
appeal on February 7, 2012.⁸

III. LIMITED REVIEW

HPF’s February 7, 2012 notice of appeal only refers to the
bankruptcy court’s January 26, 2012 order granting Machuca’s fee
motion. It does not mention the court’s December 19, 2011
summary judgment ruling. Nonetheless, HPF’s opening appeal
brief suggests that HPF is now seeking appellate review of both
the fee order and the summary judgment. That we cannot do. An
order granting summary judgment on all remaining counts is final
for purposes of filing an appeal. Key Bar Invs., Inc. v. Cahn
(In re Cahn), 188 B.R. 627, 630 (9th Cir. BAP 1995).⁹ HPF’s
election not to appeal the bankruptcy court’s summary judgment
ruling means that the summary judgment order is now final, and
cannot be collaterally attacked.

Accordingly, the scope of our review in this appeal is
limited to the bankruptcy court’s fee order.

IV. APPLICATION OF § 523(d)

HPF’s appeal challenges the bankruptcy court’s substantial

⁸The bankruptcy court had jurisdiction pursuant to 28 U.S.C.
§§ 1334 and 157(b)(2)(I) and (O). We have jurisdiction under 28
U.S.C. § 158, subject to the jurisdictional issue discussed
below.

⁹The pendency of Machuca’s fee motion did not toll the time
to appeal the summary judgment ruling. It was a collateral
matter to the disposition of the adversary proceeding; see Rule
8002(b). See also Lindblade v. Knupfer (In re Dyer), 322 F.3d
1178, 1186 (9th Cir. 2003) (“[W]e have held that unresolved
issues related to attorneys’ fees do not defeat finality,
regardless of whether the attorneys’ fees are available under a
statute, by contract, or as a sanction for bad faith
litigation.”).
Before 1984, § 523(d) read as follows:

If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment against such creditor and in favor of the debtor for the costs of, and a reasonable attorney’s fee for, the proceeding to determine dischargeability, unless such granting of judgment would be clearly inequitable.

A justification ruling. “Substantial justification” has a long history, and one not wholly within the Bankruptcy Code. We thus begin our analysis with a review of the origins and purpose of § 523(d)’s substantial justification standard.

A. Statutory Development of § 523(d)

Prior to 1984, § 523(d) did not contain a substantial justification standard for awarding attorneys’ fees. Rather, it contained an explicit shifting of fees in favor of the consumer debtor, unless such a shift was “clearly inequitable.” The purpose of § 523(d) as originally drafted was to deter groundless nondischargeability actions brought primarily to coerce settlements from honest debtors who couldn’t effectively fight back. See S. Rep. No. 95-989 at 80 (1978).

When Congress enacted the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, § 307(b), 98 Stat. 333 (“BAFJA”), however, it cut back on this broad grant. It replaced the “clearly inequitable” standard with a standard that allowed attorneys’ fees under § 523(d) only if the creditor’s position was not “substantially justified.”

This standard was not created out of whole cloth. Congress borrowed it from the Equal Access to Justice Act (“EAJA”). See

10 Before 1984, § 523(d) read as follows:

If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment against such creditor and in favor of the debtor for the costs of, and a reasonable attorney’s fee for, the proceeding to determine dischargeability, unless such granting of judgment would be clearly inequitable.
Senate Report 98-65 accompanied a predecessor bill that ultimately led to the enactment of BAFJA. That predecessor bill, commonly known as the Omnibus Bankruptcy Improvements Act of 1983 (“OBIA”), contained proposed amendments to § 523(d)’s attorneys’ fees provision identical to those contained in BAFJA. See OBIA, S. 445, 98th Cong. § 209(b) (1983).

First Card v. Hunt (In re Hunt), 238 F.3d 1098, 1103 (9th Cir. 2001) (citing First Card v. Carolan (In re Carolan), 204 B.R. 980, 987 (9th Cir. BAP 1996)). In adopting this different, more creditor-friendly, standard, Congress wished to shift incentives so that creditors would not be unduly discouraged from pursuing well-founded nondischargeability actions. As Congress put it:

The original congressional intent in the drafting S. 523(d) of the existing Bankruptcy Code was to discourage frivolous objections to discharge of consumer debts, but not to discourage well-founded objections by honest creditors. The language of the subsection, however, makes the award of the debtor’s costs and attorney’s fees virtually mandatory in an unsuccessful challenge of a consumer debt. It has been interpreted as requiring the award of fees and costs even when the creditor acted in good faith. Cf., In re Majewski, 7 B.R. 904 (Bd. D. Conn. 1981). The net effect of this provision has been to preclude creditors from objecting to discharge of any consumer debt unless they are certain that the court will sustain the objection.

The Committee, after due consideration, has concluded that amendment of this provision to incorporate the standard for award of attorney’s fees contained in the Equal Access to Justice Act strikes the appropriate balance between protecting the debtor from unreasonable challenges to dischargeability of debts and not deterring creditors from making challenges when it is reasonable to do so. This standard provides that the court shall award attorney’s fees to a prevailing debtor where the court finds that the creditor was not substantially justified in challenging the dischargeability of the debt, unless special circumstances would make such an award unjust.


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B. Application of the Substantial Justification Standard to HPF

To support a request for attorneys’ fees under § 523(d), a debtor initially needs to prove: (1) that the creditor sought to except a debt from discharge under § 523(a), (2) that the subject debt was a consumer debt, and (3) that the subject debt ultimately was discharged. Stine v. Flynn (In re Stine), 254 B.R. 244, 249 (9th Cir. BAP 2000). “Once the debtor establishes these elements, the burden shifts to the creditor to prove that its actions were substantially justified.” Id.; see also In re Hunt, 238 F.3d at 1103 (citing In re Carolan, 204 B.R. at 987, and holding that “the creditor bears the burden of proving that its position is substantially justified”).

To satisfy the substantial justification standard, HPF needed to demonstrate that it had a reasonable factual and legal basis for its claim. See In re Hunt, 238 F.3d at 1103 (citing Pierce v. Underwood, 487 U.S. 552, 565 (1988)). As stated in the legislative history, and mirrored in subsequent cases:

To avoid a fee award [under § 523(d)], the creditor must show that its challenge had a reasonable basis both in law and in fact. The requirement that the creditor must show that it was substantially justified to avoid a fee award is necessary because it is far easier for the creditor to demonstrate the reasonableness of its action than it is for the debtor to marshal the facts to prove that the creditor was unreasonable.


1. The Relationship Between Summary Judgment and Substantial Justification

Substantial justification is thus a higher standard than that used to determine whether litigation is frivolous. Pierce,
Although frivolous litigation is never substantially justified, under EAJA some nonfrivolous litigation also fails the test. The issue often arises when a creditor loses an action otherwise filed in good faith by summary judgment, directed verdict, or a judgment on the pleadings. In such cases, the bankruptcy court must scrutinize the merits of the action with particular care, as these types of outcomes often suggest a lack of substantial justification. See Keasler v. United States, 766 F.2d 1227, 1231 (8th Cir. 1985) (interpreting EAJA); see also F.J. Vollmer Co. v. Magaw, 102 F.3d 591, 595 (D.C. Cir. 1996) (“In some cases, the standard of review on the merits is so close to the reasonableness standard applicable to determining substantial justification that a losing agency is unlikely to be able to show that its position was substantially justified.”).

But not all such losses lead to fee-shifting. There is no presumption of a lack of substantial justification just because a debtor prevailed on summary judgment. As this Panel has said on prior occasions, the substantial justification requirement “should not be read to raise a presumption that the creditor was not substantially justified simply because it lost.” In re Carolan, 204 B.R. at 987; see also Hill v. INS (In re Hill), 775 F.2d 1037, 1042 (9th Cir. 1985); S. Rep. No. 98-65 at 59 (“The standard, however, should not be read to raise a presumption that the creditor was not substantially justified, simply because it lost the challenge.”).

For instance, a novel but reasonable legal theory in support of its opposition to Machuca’s summary judgment motion
might have served as a basis for concluding that HPF’s opposition was substantially justified. See Renee v. Duncan, 686 F.3d 1002, 1017-18 (9th Cir. 2012) (interpreting EAJA and citing Timms v. United States, 742 F.2d 489, 492 (9th Cir. 1984)). So too might have a legal theory subject to a split of non-binding authority when there is no case on point. See Mattson v. Bowen, 824 F.2d 655, 656-57 (8th Cir. 1987) (also interpreting EAJA).

HPF asserts none of these justifications. Instead, it defends on the record the bankruptcy court used to grant summary judgment against it. In particular, it asserts that it was substantially justified in its position on reliance under § 523(a)(2)(B)(iii).

In so doing, it burdened itself with an almost insurmountable task. HPF did not appeal the summary judgment ruling and must contend with the issue preclusive effect of that judgment. See Steen v. John Hancock Mut. Life Ins. Co., 106 F.3d 904, 912 (9th Cir. 1997) (“The determination of an issue on a motion for judgment on the pleadings or a motion for summary judgment is sufficient to satisfy the ‘litigated’ requirement for collateral estoppel.”) (citing Restatement (Second) of Judgments § 27 cmt. d (1982); and Papadakis v. Zelis (In re Zelis), 66 F.3d 205, 208 (9th Cir. 1995)).

As noted above, the bankruptcy court’s order granting summary judgment was final. HPF cannot collaterally attack that judgment through the § 523(d) proceeding. At most, after the appeal time had run, it might have sought relief under Rule 9024 (incorporating Federal Rule of Civil Procedure 60(b)). See 18B
Charles Alan Wright et al., Federal Practice and Procedure § 4478 (2d ed. 2012) ("After final judgment, direct relief from the judgment is governed by the rules governing direct and collateral attack—principally found in Civil Rule 60(b) . . . .").

But HPF neither appealed nor sought relief under Rule 9024. In the face of such inaction, this Panel must take the grant of the summary judgment at its face value: HPF’s complaint and response to the summary judgment motion presented no genuine issue of material fact regarding reliance under § 523(a)(2)(B)(iii). See In re Hunt, 238 F.3d at 1102 n.5 (failure to appeal merits decision meant that creditor waived “any right to challenge the evidentiary rulings that led to it” in subsequent proceeding seeking attorneys’ fees under § 523(d)). In short, the doctrine of issue preclusion estops HPF from arguing that the bankruptcy court was wrong, or that HPF had an undisclosed basis in law and fact for its reliance claim. Id.; Steen, 106 F.3d at 912. As a consequence, HPF cannot argue that it had a reasonable factual and legal basis for its fraud claim. See In re Hunt, 238 F.3d at 1103. Its position was thus not substantially justified.

2. Substantial Justification, Abuse of Discretion, and the Record on Reasonable Reliance

Even if HPF could surmount its issue preclusion hurdle, it would then face another virtually insuperable hurdle: the abuse of discretion standard. This circuit has specifically held that § 523(d) orders are subject to the abuse of discretion appellate review standard. In re Hunt, 238 F.3d at 1101.
Under this highly deferential standard of review, we first “determine de novo whether the [bankruptcy] court identified the correct legal rule to apply to the relief requested.” United States v. Hinkson, 585 F.3d 1247, 1262 (9th Cir. 2009) (en banc). And if the bankruptcy court identified the correct legal rule, we then determine under the clearly erroneous standard whether its factual findings and its application of the facts to the relevant law were: “(1) illogical, (2) implausible, or (3) without support in inferences that may be drawn from the facts in the record.” Id. (internal quotation marks omitted).

In order to apply the first part of this standard – whether the bankruptcy court used the correct legal rule – we examine the bankruptcy court’s ruling on Machuca’s summary judgment motion. This in turn requires us to consider its treatment of § 523(a)(2)(B)’s reliance element, on which the summary judgment motion hinged.

Reasonable reliance is not defined in the Bankruptcy Code; to ascertain whether it exists, the bankruptcy court must employ a “prudent person” test. Cashco Fin. Servs., Inc. v. McGee (In re McGee), 359 B.R. 764, 774 (9th Cir. BAP 2006). Under the prudent person test, the bankruptcy court must objectively assess whether the creditor exercised the same degree of care expected from a reasonably prudent person entering into the same type of business transaction under similar circumstances. See First Mut. Sales Fin. v. Cacciatori (In re Cacciatori), 465 B.R. 545, 555 (Bankr. C.D. Cal. 2012); see also Gertsch v. Johnson & Johnson, Fin. Corp. (In re Gertsch), 237 B.R. 160, 170 (9th Cir. BAP 1999). Bankruptcy courts must make this assessment on a

Against this background, it is standard learning that a creditor cannot simply ignore red flags that directly call into question the truth of the statements on which the creditor claims to have relied. See In re McGee, 359 B.R. at 775. Under such circumstances, the creditor must support its reasonable reliance claim with evidence explaining why it was reasonable for it to rely on the statements notwithstanding the red flags. Id. As the bankruptcy court used this standard, it “identified the correct legal rule.” Hinkson, 585 F.3d at 1262.

It also applied that legal rule correctly. In response to the summary judgment, HPF argued that a trier of fact reasonably could infer reasonable reliance from: (1) the language of the Application; (2) Ganter’s self-serving statement that HPF and National City had relied on Machuca’s income representation; and (3) Schuerman’s statement that mortgage lenders and the secondary mortgage market typically rely on income representations. But HPF’s evidence does not contradict the fact that it and its witnesses ignored the red flags associated with the Loan. HPF’s response to the summary judgment motion simply failed to account in any meaningful way for the impact those red flags necessarily would have had on a hypothetical prudent person’s assessment of whether any reliance should be placed on Machuca’s income representation.

Against this background, it was not illogical, implausible or without adequate support in the record, Hinkson, 585 F.3d at
Scott acknowledged that, in the summary judgment context, the district court had to “view the facts and draw reasonable inferences ‘in the light most favorable to the party opposing the [summary judgment] motion.’” Id. at 378 (quoting United States v. Diebold, Inc., 369 U.S. 654, 655 (1962) (per curiam)). Nonetheless, Scott held that “the light most favorable” to the

(continued...)
In sum, given the undisputed facts before the bankruptcy court undermining HPF’s reasonable reliance claims, no trier of fact reasonably could have found § 523(a)(2)(B)’s reliance element satisfied. With the correct legal rule applied, and an application of the facts to that rule supported by logical, plausible and supportable inferences from the record, there was no abuse of discretion in finding a lack of substantial justification for HPF’s position.

V. CONCLUSION

For all of the reasons set forth above, we AFFIRM the order granting Machuca’s fee motion.

12(...continued)

opposing party did not include ignoring the reality of undisputed facts in the record.
NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP NO. EP 12-015

Bankruptcy Case No. 11-20198-JBH
Adversary Proceeding No. 11-02034-JBH

DAVID O’DONNELL,
Debtor.

THOMAS A. TOYE, III,
Plaintiff-Appellee,

v.

DAVID O’DONNELL,
Defendant-Appellant.

Appeal from the United States Bankruptcy Court
for the District of Maine
(Hon. James B. Haines, Jr., U.S. Bankruptcy Judge)

Before
Lamoutte, Feeney, and Cabán,
United States Bankruptcy Appellate Panel Judges.

James F. Molleur, Esq., on brief for Appellant.
Kelly W. McDonald, Esq., on brief for Appellee.

December 5, 2012

Per Curiam.
David O’Donnell (“O’Donnell”) appeals from a bankruptcy court judgment in favor of Thomas A. Toye III (“Toye”) determining that O’Donnell’s obligation to Toye was nondischargeable pursuant to § 523(a)(2)(B) because the extension of credit was obtained by use of a false financial statement. On appeal, O’Donnell argues that the bankruptcy court clearly erred in finding that he caused his personal financial statement “to be made or published with intent to deceive” Toye, as required by § 523(a)(2)(B) (iv). For the reasons set forth below, we AFFIRM.

BACKGROUND

In 2007, O’Donnell and Rudy Ferrante (“Ferrante”) established Alder Street Properties, LLC for the purpose of acquiring and holding certain apartment buildings on Alder Street and Cumberland Avenue in Portland, Maine (the “Alder Street transaction”). Under the purchase agreement for the properties, O’Donnell and Ferrante were required to provide a $350,000.00 down payment at closing, and they asked Kevin Smith, a commercial loan broker, to help arrange the financing for a bridge loan (the “Loan”). Smith, who had assisted O’Donnell and Ferrante in several prior transactions, approached Toye to see if he would be interested in financing the Loan. Smith and Toye had also worked together on several prior transactions. In connection with the Loan, Smith prepared personal financial statements for O’Donnell and Ferrante and sent them to Toye. The document purporting to be O’Donnell’s personal financial statement (the “Financial Statement”) was dated December 3, 2007, and was signed with O’Donnell’s name, although O’Donnell maintains that he did not sign it himself, and the evidence did not show otherwise. It indicated that O’Donnell had a net worth of $2,570,733.00, that his ownership in real estate (owned either individually or through LLCs) was valued at approximately $1,620,000.00, and that he had monthly income of $38,265.00. It is undisputed that the Financial Statement was a materially false statement of his financial condition as it overstated property ownership and net rental income, and did not include encumbrances on various properties.

After receiving the Financial Statement, Toye agreed to extend the Loan. In connection
therewith, Alder Street Properties LLC executed a promissory note in the amount of $350,000.00, and both O’Donnell and Ferrante provided personal guaranties of the note. As additional security, O’Donnell executed a mortgage and security agreement with respect to certain real property in Augusta, Maine. The goal was to refinance within a few months and pay off the Loan. The refinancing never occurred, however, and Toye was never repaid.

Toye sued O’Donnell in the Kennebec County Superior Court for the debt due under his personal guaranty, and on August 27, 2009, the state court entered judgment against O’Donnell in the amount of $417,974.00.

In July 2009, Ferrante filed a chapter 7 petition, and Toye brought an adversary action against Ferrante seeking a determination that the debt owed to him on account of his personal guaranty was nondischargeable pursuant to § 523(a)(2)(B). After a trial, the bankruptcy court determined that Ferrante had provided Toye with a false financial statement within the meaning of § 523(a)(2)(B) on which Toye reasonably relied and, as a result, declared Ferrante’s debt to Toye to be excepted from discharge.

O’Donnell filed a chapter 7 petition in February 2011. Thereafter, Toye filed a two-count adversary complaint alleging: (1) that O’Donnell’s debt to him was nondischargeable pursuant to § 523(a)(2)(B) because the debt was obtained by use of a false financial statement; and (2) that Ferrante’s fraud on Toye (as determined by the bankruptcy court in Ferrante’s bankruptcy case) should be imputed to his partner, O’Donnell, for purposes of determining the dischargeability of O’Donnell’s debt under § 523(a)(2)(B).

In a Joint Pre-Trial Memorandum, the parties indicated that there was no dispute that the Financial Statement was materially false, that it purported to relay O’Donnell’s financial condition, or that Toye relied on it in extending the Loan. Rather, the primary factual dispute centered on the fourth
prong under § 523(a)(2)(B) – whether O’Donnell caused the Financial Statement to be made or published with the intent to deceive Toye. O’Donnell also challenged whether Toye’s reliance on the Financial Statement was justified, and whether Smith was Toye’s agent in connection with the Loan. As to the imputation of fraud claim, the parties indicated that the primary factual dispute was whether O’Donnell and Ferrante were partners.

On March 8, 2012, the bankruptcy court held a trial at which Toye, Smith, and O’Donnell testified and numerous exhibits were introduced into evidence. O’Donnell testified that Smith had handled the financing for numerous prior transactions for O’Donnell and Ferrante, and that in connection with those transactions, Smith had prepared personal financial statements for O’Donnell and submitted them to the lenders on his behalf. With respect to the Alder Street transaction, O’Donnell testified that he knew Smith needed specific financial information from him, and he provided Smith with certain bank statements, tax returns, his social security number, and records regarding his stock portfolio and retirement accounts. He insisted, however, that he did not provide any false information to Smith, and did not know the details of any financial statement that Smith was preparing to give to Toye with respect to the Alder Street transaction. According to O’Donnell, Smith never met with him to review the Financial Statement, and the first time he saw the Financial Statement was at a state court hearing after Toye obtained judgment against him. O’Donnell also asserted that although the Financial Statement was signed with his name, he did not sign the Financial Statement himself, and he did not know who signed it. Specifically, O’Donnell testified as follows:

Q: And what was your understanding as to the extent to which you would have to give information to Kevin Smith that he could forward to Mr. Toye about your personal financial circumstances?

A. Kevin – Kevin Smith told me that to, you know, to give Tom some – a sense of security
and, you know, because Tom had never met me. I don’t know if he’d ever met Rudy but he never met me. He needed some documents like my PrimeVest account, my retirement accounts, my stock, you know, stock — stock accounts and my Social Security Number and some tax returns.

... 

Q: All right. So Kevin asked you for tax returns, he asked you for financial records.

A. Yes.

Q: And your Social Security Number so he could check out your credit.

A. Yes.

... 

Q: Did you understand that Kevin was creating a personal financial statement that would include all the real estate that you owned and monthly income and expenses for your buildings?

A. Jim, I honestly didn’t know what kind of financial statement he was putting together. I didn’t know what it — he just told me what I needed to bring to get to them so I got that information that he required to him.

Q: And you had — you had actually sat down with Kevin Smith and prepared a personal financial statement back in June of 2007, about six months before.

A. Yes. Yup.

Smith testified about his business relationship with O’Donnell and Ferrante, and how he had assisted them with several prior transactions by preparing financial statements and other documentation.

With respect to the Alder Street transaction, Smith testified about how the Loan was structured and what information he relied upon when preparing the Financial Statement. According to Smith, he gathered certain information from O’Donnell’s tax returns, bank account statements, and investment account statements. He obtained income information from rent rolls or tax returns. Real estate ownership, valuations, and mortgages came from various sources, such as credit reports, city assessment records, Rudy Ferrante, or Chris Smith (a property manager assisting Ferrante and O’Donnell). Although Smith insisted that he had documentation for all the information contained in the Financial Statement, he could
not definitely state who provided him with each individual piece of documentation. Smith agreed that although it was standard practice for him to talk to people about any financial statements he was preparing for them, he did not review the Financial Statement with or provide the Financial Statement to O’Donnell, nor did he see O’Donnell sign the Financial Statement.

After the close of evidence, the bankruptcy court concluded that Toye had met his burden of proof on most elements of his claim under § 523(a)(2)(B), but took under advisement the issue of whether O’Donnell had “caused [the Financial Statement] to be made or published with intent to deceive.” See 11 U.S.C. § 523(a)(2)(B)(iv).

On March 20, 2012, the bankruptcy court entered its Final Judgment in favor of Toye, excepting O’Donnell’s obligation to Toye from discharge under § 523(a)(2)(B). In its oral findings and conclusions, the bankruptcy court found that although O’Donnell tried to portray Smith as Toye’s agent, Smith was actually O’Donnell’s agent in the Alder Street transaction. The bankruptcy court stated:

Mr. Smith said he could help find the bridge financing that Mr. O’Donnell wanted. Mr. O’Donnell gave him some figures relating to accounts and the like. Mr. Smith, through his familiarity and past work with Mr. O’Donnell whereby he had helped find financing, put together a financial statement on Mr. O’Donnell’s behalf and submitted it to Mr. Toye.

Although the bankruptcy court acknowledged that O’Donnell did not actually review or sign the Financial Statement, it stated that nondischargeability under § 523(a)(2)(B) can be based on whether the debtor “turned a blind eye to it in reckless disregard of the truth or falsity of the propositions asserted in the [F]inancial [S]tatement.” In this regard, the bankruptcy court stated:

In this case, Mr. O’Donnell said to Smith, go ahead and give him what . . . Mr. Toye needs to extend the credit. Those papers prepared by Mr. Smith with the authority of Mr. O’Donnell and submitted in order to get 400-and-some-thousand dollars worth of financing approved by virtue of Mr. O’Donnell’s personal guarant[y], were done on the authority and at the instruction of Mr. O’Donnell and no one else. For Mr. O’Donnell is too clever and too nice for Mr. O’Donnell to disclaim that he has responsibility for the financial statement was materially false that he set in motion and that he turned a – willfully turned a blind eye to the content of

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that. . . . [H]e did it intending whatever it was to be sufficient in Mr. Toye’s eye . . . and he did that happily not caring what the exact content was. That’s damning under Section 523(a)(2)(B), it’s willful disregard of the truth of what was represented and submitted in order to obtain the financing that he desired and ultimately received.

As to the alternative theory under which Toye asserted that Ferrante’s fraud could be imputed to O’Donnell, the bankruptcy court found that the evidence did not establish that existence of a partnership or joint venture sufficient to impute Ferrante’s fraud on O’Donnell.

This appeal followed.

JURISDICTION

Before addressing the merits of an appeal, we must determine that we have jurisdiction, even if the issue is not raised by the litigants. See Boylan v. George E. Bumpus, Jr. Constr. Co. (In re George E. Bumpus, Jr. Constr. Co.), 226 B.R. 724 (B.A.P. 1st Cir. 1998). We have jurisdiction to hear appeals from: (1) final judgments, orders, and decrees; or (2) with leave of court, from certain interlocutory orders. 28 U.S.C. § 158(a); Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998). A decision is considered final if it “ends the litigation on the merits and leaves nothing for the court to do but execute the judgment,” id. at 646 (citations and internal quotations omitted), whereas an interlocutory order “‘only decides some intervening matter pertaining to the cause, and . . . requires further steps to be taken in order to enable the court to adjudicate the cause on the merits.’” Id. (quoting In re American Colonial Broad. Corp., 758 F.2d 794, 801 (1st Cir. 1985)). Generally, a bankruptcy court’s determination regarding the dischargeability of a debtor’s obligations under § 523(a)(2) is a final appealable order. See Blacksmith Invs., Inc. v. Woodford (In re Woodford), 418 B.R. 644, 649 (B.A.P. 1st Cir. 2009); Aoki v. Atto Corp. (In re Aoki), 323 B.R. 803, 811 (B.A.P. 1st Cir. 2005); Cambio v. Mattera (In re Cambio), 353 B.R. 30, 31 n.1 (B.A.P. 1st Cir. 2004). Werthen v. Werthen (In re Werthen), 282 B.R. 553, 555-56 (B.A.P. 1st Cir. 2002), aff’d, 329 F.3d 269 (1st Cir.
2003). Accordingly, we have jurisdiction to hear this appeal.

**STANDARD OF REVIEW**

Appellate courts apply the clearly erroneous standard to findings of fact and *de novo* review to conclusions of law. See *Lessard v. Wilton-Lyndeborough Coop. School Dist.*, 592 F.3d 267, 269 (1st Cir. 2010). A bankruptcy court’s determination of whether a requisite element of a nondischargeability claim under § 523(a)(2)(B) is present is a factual determination which is reviewed for clear error.

*Douglas v. Kosinski* (In re Kosinski), 424 B.R. 599, 607 (B.A.P. 1st Cir. 2010) (citing *Lentz v. Spadoni* (In re Spadoni), 316 F.3d 56, 58 (1st Cir. 2003); *Palmacci v. Umpierrez*, 121 F.3d 781, 785 (1st Cir. 1997); *Century 21 Balfour Real Estate v. Menna* (In re Menna), 16 F.3d 7, 11 (1st Cir. 1994)); see also *Morrison v. Western Builders of Amarillo, Inc.* (In re Morrison), 555 F.3d 473, 482 (5th Cir. 2009) (“The bankruptcy court’s determination of intent to deceive is a finding of fact subject to the clearly erroneous standard of review.”); *Northland Nat’l Bank v. Lindsey* (In re Lindsey), 443 B.R 808, 812-13 (B.A.P. 8th Cir. 2011) (“Whether a requisite element of a claim of nondischargeability under § 523(a)(2)(B) has been satisfied is a factual determination that is reviewed for clear error.”).

A finding is clearly erroneous when, although there is evidence to support it, the reviewing court “is left with the definite and firm conviction that a mistake has been committed. *Hannigan v. White* (In re Hannigan), 409 F.3d 480, 482 (1st Cir. 2005) (quoting *Anderson v. Bessemer City, N.C.*, 470 U.S. 564, 573 (1985)); *Chase v. Harris* (In re Harris), 385 B.R. 802, 804 (B.A.P. 1st Cir. 2008). If the trial court’s account of the evidence is plausible in light of the record viewed in its entirety, a reviewing court may not reverse, even if convinced that if it had been sitting as a trier of fact, it would have weighed the evidence differently. *In re Harris*, 385 B.R. at 804 (citations omitted). When reviewing the evidentiary record, great deference is accorded to the bankruptcy court’s factual determinations when they are based
on the credibility and the demeanor of the witnesses. See Palmacci v. Umpierrez, 121 F.3d at 785; Rodriguez-Morales v. Veterans Admin., 931 F.2d 980, 982 (1st Cir. 1991).

DISCUSSION

I. Section 523(a)(2)(B) Exception to Discharge

Section 523(a)(2)(B) makes nondischargeable any debt:

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by –

(B) use of a statement in writing –

(i) that is materially false;
(ii) respecting the debtor’s or an insider’s financial condition;
(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
(iv) that the debtor caused to be made or published with intent to deceive[.]


O’Donnell concedes the existence of the first three elements. He challenges, however, the bankruptcy court’s findings with respect to the fourth prong of § 523(a)(2)(B). Thus, the only issue before us is whether, upon the record before it, the bankruptcy court clearly erred when it found that Toye had met his burden of proving that: (1) O’Donnell caused the Financial Statement to be made or published; and (2) that he did so with the intent to deceive Toye.

II. Whether the bankruptcy court clearly erred in finding that O’Donnell caused the Financial Statement to be made or published.

The bankruptcy court found that O’Donnell, through his agent Smith, caused the false Financial Statement to be made. O’Donnell argues that § 523(a)(2)(B)(iv) was not satisfied because he did not prepare or sign the Financial Statement, nor had he ever reviewed, adopted, or otherwise authenticated or ratified it. He also argues that bankruptcy court erred in finding that Smith was his agent in
connection with the Loan.

It is well established that a debtor need not personally prepare or sign the written statement to satisfy the requirements of § 523(a)(2)(B). See Am. Gen. Fin. Servs., Inc. v. Johnson (In re Johnson), 436 B.R. 116, 119 (Bankr. E.D. Mo. 2010) (“To satisfy the materially false writing requirement of [§] 523(a)(2)(B), the written statements need not be physically prepared by a debtor.”). Thus, a debtor cannot escape liability under § 523(a)(2)(B) just because a financial statement was completed by someone else. See Insouth Bank v. Michael (In re Michael), 265 B.R. 593, 598 (Bankr. W.D. Tenn. 2001). Rather, the requirements of § 523(a)(2)(B) are met as long as the financial statement was either written by the debtor, signed by the debtor, written by someone else but adopted or used by the debtor, or if the debtor caused the statement to be prepared. See Mitsubishi Motor Sales of Caribbean, Inc. v. Seda Ortiz, 418 B.R. 11, 22 (D.P.R. 2009) (stating that to prove elements of § 523(a)(2)(B), the statement “must have been either written by the debtor, signed by the debtor, or written by someone else but adopted and used by the debtor.”); Tower Credit, Inc. v. Williams (In re Williams), 431 B.R. 150, 157 n.16 (Bankr. M.D. La. 2010) (“As long as the written statement is written, signed, adopted or used by the debtor, the basic precondition concerning the writing requirement to the non-dischargeability complaint under [§] 523(a)(2)(B) is met”); Regions Bank v. Whisnant (In re Whisnant), 411 B.R. 559, 564-65 (Bankr. E.D. Tenn. 2009) (holding that statement does not have to be prepared by debtor to satisfy the written statement requirement; however, debtor “must have either created it, had it created, or allowed it to be ‘published’ by making it public or circulating it.”); Chevy Chase Fed. Sav. Bank v. Graham (In re Graham), 122 B.R. 447, 451 (Bankr. M.D. Fla. 1990) (“A written statement does not have to be physically prepared by a defendant. The requirements of § 523(a)(2)(B) are met if the existence of a written statement was caused to be prepared by the defendant.”).
O’Donnell maintains that he did nothing to adopt or authenticate the Financial Statement. According to O’Donnell, in order to adopt a financial statement for purposes of § 523(a)(2)(B), a debtor must take some affirmative and intentional action to approve the content of that statement. O’Donnell claims he never took any such affirmative action; he never reviewed the Financial Statement before it was submitted to Toye, did not sign it himself, and, in fact, did not even know of its existence until after Toye obtained a judgment against him in state court. Thus, he argues, he cannot be deemed to have adopted the content of the false Financial Statement. Toye argues, however, that since O’Donnell caused the Financial Statement to be made by enlisting Smith to complete and submit the paperwork for the Loan, he is responsible for its contents. We agree.

The bankruptcy court found that Smith was O’Donnell’s agent with respect to the Alder Street transaction, and that Smith prepared the paperwork “on the authority and at the instruction of O’Donnell and no one else.” There is ample support in the record for the bankruptcy court’s finding that Smith was acting as O’Donnell’s agent in connection with the Loan. Both Smith and O’Donnell testified that Smith had assisted Ferrante and O’Donnell on several prior business transactions, including two transactions (the NCCS Transaction and the Katahdin Transaction) within six months prior to the Alder Street transaction. O’Donnell testified that he relied on Smith, who had greater expertise in commercial lending, to address all necessary paperwork for those prior transactions. He did not tell Smith which forms to fill out or give him a list of forms; instead, O’Donnell trusted Smith to generate all necessary documents. In both instances, Smith received certain financial information from O’Donnell, obtained some information from other sources, filled out a personal financial statement for O’Donnell, and submitted it to the respective lenders.

With respect to the Loan, the record shows that although Ferrante primarily handled the Alder
Street transaction, and asked Smith to arrange the financing, O’Donnell knew about this request and acquiesced in Smith’s involvement. Moreover, O’Donnell admitted that he provided Smith with certain financial information relating to his accounts, which Smith then used to prepare a financial statement on O’Donnell’s behalf. Based on the prior history between the parties, the bankruptcy court could infer that O’Donnell knew or should have known that asking Smith to complete paperwork for the Loan, and providing him with certain personal financial information, would necessarily mean that Smith would prepare and deliver any necessary personal financial statements, just as he had in the two prior instances. See Coughlin v. First Nat’l Bank of Boston (In re Coughlin), 27 B.R. 632, 636 (B.A.P. 1st Cir. 1983) (“Courts may assume that debtors intend the natural consequences of their acts.”). Based on this evidence, the bankruptcy court did not clearly err in finding that Smith was acting as O’Donnell’s agent in connection with the Loan, and that by requesting his agent to complete and submit the paperwork for the Loan, he caused the Financial Statement to be made or published for purposes of § 523(a)(2)(B). The next question is whether the bankruptcy court erred in finding that O’Donnell had the requisite intent to deceive.

III. Whether the bankruptcy court erred in finding that O’Donnell had the requisite intent to deceive Toye.

O’Donnell argues that there is no evidence that he intended to deceive Toye, and challenges the bankruptcy court’s finding that he acted with reckless disregard as to the truth of the Financial Statement.

A creditor can prove intent to deceive through direct or circumstantial evidence. In re Sheridan,
57 F.3d 627, 633 (7th Cir. 1995). A debtor, however, will rarely admit that he intended to deceive a creditor. Courts have thus held that intent to deceive under § 523(a)(2)(B) may be inferred from the totality of the circumstances surrounding the debtor’s acts, including the debtor’s reckless indifference to, or reckless disregard of, the accuracy of the financial information submitted to the creditor. See, e.g., Insurance Co. of N. Am. v. Cohn (In re Cohn), 54 F.3d 1108, 1119 (3d Cir. 1995) (“[A] creditor can establish intent to deceive by proving reckless indifference to, or reckless disregard of, the accuracy of the information in the financial statement of the debtor when the totality of the circumstances supports such an inference.”); Southeast Neb. Coop. Corp. v. Schnuelle (In re Schnuelle), 441 B.R. 616, 624 (B.A.P. 8th Cir. 2011) (citations omitted); Helena Chem. Co. v. Richmond (In re Richmond), 429 B.R. 263, 298 (Bankr. E.D. Ark. 2010); First State Bank of Munich v. Braathen (In re Braathen), 364 B.R. 688, 702 (Bankr. D.N.D. 2006); see also In re Coughlin, 27 B.R. at 636. “A bankruptcy court’s determination that a debtor did not act with the intent to deceive is a finding of fact” and subject to the clearly erroneous standard of review. Hudgens v. New Equip. Leasing Inc. (In re Hudgens), 149 Fed. App’x 480, 486 (7th Cir. 2005) (citation omitted). “Ultimately . . . , where a debtor testifies as to her subjective intent, the bankruptcy court must make a credibility determination, considering the debtor’s testimony, along with other objective circumstantial evidence of the debtor’s subjective intent.” AT&T Universal Card Servs. v. Mercer (In re Mercer), 246 F.3d 391, 409 (5th Cir. 2001) (citing In re Sheridan, 57 F.3d at 633-34).

As one court stated:

A determination of intent under this section is much like a determination of reasonable reliance; an objective standard to be determined by the fact finder. Intent to deceive may either be demonstrated by proof that the debtor acted intentionally or knowingly or in the alternative that debtor’s conduct exhibited reckless indifference to the existing facts. Necessarily, debtor’s intent cannot be divined in a vacuum but must be viewed in light of the circumstances of the case. Therefore, a debtor’s credibility is an important factor in determining whether the debtor’s intent to deceive was
present. . .


The bankruptcy court found that O’Donnell, through his agent Smith, had caused the false Financial Statement to be made, and that in doing so, O’Donnell “willfully turned a blind eye to the content” of the Financial Statement and, therefore, acted with “willful disregard of the truth of what was represented and submitted in order to obtain the financing that he desired and ultimately received.”

O’Donnell argues that the bankruptcy court’s conclusions are inconsistent with the evidence. According to O’Donnell, although he admits that he provided certain financial information to Smith, that information was completely accurate and he cannot be held responsible for false information provided to Toye in a financial statement which he did not review or approve. Thus, O’Donnell claims, there was no evidence that he intended to deceive Toye.

A bankruptcy court can, however, find evidence of intent to deceive despite a debtor’s claim of ignorance. See, e.g., FDIC v. Reisman (In re Reisman), 149 B.R. 31, 38 (Bankr. S.D.N.Y. 1993).

A debtor cannot escape liability under section 523(a)(2)(B) by firmly putting his head in the sand and later claiming not to have known of the falsity of representations that were made on his behalf while his head was covered. Such conduct is sufficiently reckless to give rise to nondischargeable liability under section 523(a)(2)(B).


For example, in In re Reisman, the bankruptcy court found that the debtor caused false financial statements to be submitted with the intent to deceive the bank even though the statements in issue were prepared and furnished to the bank by the debtor’s accountant. In that case, the debtor claimed ignorance
of the fact that his accountant prepared and delivered false financial statements in order to induce the
bank to extend credit to the debtor. 149 B.R. at 33. The bankruptcy court found that the debtor caused
the false financial statement to be submitted to the bank with intent to deceive because the debtor knew
his personal financial statement was required as a condition of the loan, he was aware that his accountant
submitted the statements to the bank, he recklessly disregarded their accuracy and, in any case, the
debtor accepted the benefits of his accountant’s misdeeds and thus was liable on agency principals. Id. at
38.

This case presents a similar situation. As noted above, O’Donnell was an experienced real estate
developer, and in many prior instances where he provided personal guaranties, he was required to
submit personal financial statements prepared either by Smith or by someone else. With respect to the
Alder Street transaction, he knew that he needed to provide a personal guaranty, and that Toye would
require additional assurances as he had no prior dealings with O’Donnell. O’Donnell personally
submitted certain financial information to Smith, and O’Donnell knew that Smith would use his
financial information to prepare some kind of personal financial statement to give to Toye. Thus,
O’Donnell had a responsibility to inquire about what kind of documentation Smith was preparing and to
follow up with Smith in order to review the accuracy of the Financial Statement before it was submitted
to Toye. At trial, O’Donnell testified that he did not know what kind of financial statement Smith was
preparing to give to Toye, but the bankruptcy court apparently did not find that assertion to be credible
or plausible. Although the bankruptcy judge did not expressly make a credibility finding, he was clearly
in the best position to evaluate the testimony of the witnesses, and implicit in his finding that O’Donnell
had “turned a blind eye” is a rejection of O’Donnell’s claims of innocence. As noted above, where intent
is at issue, we must give the bankruptcy judge’s assessment of O’Donnell’s credibility great deference.
In re Bonnanzio, 91 F.3d at 302 (citations omitted). The bankruptcy judge considered the totality of the circumstances, including O’Donnell’s actions and his testimony, and found that O’Donnell acted with reckless disregard for the truth or accuracy of the Financial Statement. Although the bankruptcy judge’s findings regarding O’Donnell’s intent to deceive could have been more amply supported in his bench ruling, we are not “left with the definite and firm conviction that a mistake has been committed.” In re Hannigan, 409 F.3d at 482. (citation and internal quotations omitted).

Moreover, even if we were to accept O’Donnell’s argument that he was unaware that the Financial Statement was submitted to Toye, he is nevertheless responsible for the acts of his agent, Smith. “When agents act within the scope of their actual or apparent authority, the principal is liable for their acts of fraud.” In re Reisman, 149 B.R. at 38 (citations omitted). Smith acted within the scope of his ostensible authority when he submitted the Financial Statement to Toye on O’Donnell’s behalf, and O’Donnell accepted the benefits of Smith’s submission of the false Financial Statement (i.e., the Loan from Toye). O’Donnell cannot escape the consequences of his agent’s bad acts.

Thus, we conclude that the record, taken as a whole, supports the bankruptcy court’s finding that O’Donnell acted with the requisite intent to deceive, and that the bankruptcy court’s finding is not clearly erroneous.

CONCLUSION

We conclude that the bankruptcy court did not err in finding that Toye had met his burden of proving that O’Donnell caused the Financial Statement to be made or published with the intent to deceive Toye. Accordingly, we AFFIRM the bankruptcy court’s determination that Toye’s claim is excepted from discharge under § 523(a)(2)(B).
Good morrow to each of you this day.
I came across this case out of the 3rd circuit and it answers the question of what happens to funds held by the trustee when a CH 13 converts to a 7 pursuant to 348(f)
The court holds that the funds held by the trustee must be returned to the debtor.
While the issue of funds upon conversion is usually of little interest in the title aspects the case instructs what can be done by the trustee to avoid this result.
The cloud in the silver lining is that great care should be taken to read completely the confirmed plan.
The dissent purports to say the debtor received a windfall but if the purpose of the wage attachment was to make payments to the secured creditor and the secured creditor obtains a relief from stay and forecloses and the debtor loses the house why should the other creditors get those funds.
The creditors, the debtor and the trustee all could have moved to amend the plan and certainly 3 years would have been ample time.
Best wishes for the holidays.
PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 11-1992

In Re: BARRY L. MICHAEL,
Debtor

CHARLES J. DEHART, III, Trustee,
Appellant

Appeal from the United States District Court
for the Middle District of Pennsylvania
(D.C. Civil Action No. 4-10-cv-01848)
District Judge: Honorable John E. Jones, III

Argued May 7, 2012

Before: SLOVITER, AMBRO,* and ROTH, Circuit Judges

(Opinion filed: October 26, 2012)

* Due to the passing of the Honorable Louis H. Pollak, Judge
Ambro was added to complete this panel.
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This appeal raises a question of first impression involving the interpretation of Chapter 13 of the Bankruptcy Code, 11 U.S.C. §§ 101 et seq., in the common circumstance of a debtor converting his or her case from a Chapter 13 adjustment of debts under a reorganization plan to a Chapter 7 liquidation of assets and distribution to creditors. 1 If at the time of conversion the Chapter 13 trustee is holding funds acquired post-petition by the

1 The primary goal of a Chapter 13 case is the confirmation and completion of a reorganization plan, which results in the discharge of the Chapter 13 debtor’s debts. See 11 U.S.C. § 1328(a) (providing for discharge “as soon as practicable after completion by the debtor of all payments under the plan”). If a debtor cannot confirm or complete a plan, his case most likely either will be converted to a Chapter 7 liquidation or dismissed. But see id. § 1328(b) (detailing the circumstances in which a debtor may receive a discharge despite not completing a plan). Empirical studies show that about a third of Chapter 13 debtors successfully confirm and complete a plan. See, e.g., Katherine Porter, “The Pretend Solution: An Empirical Study of Bankruptcy Outcomes,” 90 Tex. L. Rev. 103, 107–11 (2011) (summarizing studies published from 1989 through 2006, all of which concluded that only one in three cases filed under Chapter 13 ended in a completed reorganization plan, and noting that the ratio of discharge to conversion or dismissal has “persisted for more than thirty years”).
debtor for eventual distribution to creditors under a confirmed Chapter 13 reorganization plan, must the trustee return the funds to the debtor or distribute them to creditors under the provisions of the plan? The District Court affirmed the Bankruptcy Court’s holding that those funds are to be returned to the debtor at the time of conversion. We agree and thus affirm the District Court’s decision.

I. Facts and Procedural History

Appellee Barry Michael filed a voluntary petition under Chapter 13 of the Bankruptcy Code in September 2005. In June 2006, the Bankruptcy Court confirmed his Chapter 13 reorganization plan (the “Plan”). The Plan provided that Michael would pay approximately $277 per month to the Chapter 13 trustee, Appellant Charles J. DeHart, III (the “Trustee”), for 53 months, and the Trustee would direct the monies received to creditors holding secured and priority claims. Among these creditors was GMAC Mortgage, which held a mortgage on Michael’s residence. Michael agreed also to make regular mortgage payments to GMAC outside of the Plan. The Plan further provided that, to the extent funds were available, creditors holding unsecured claims would be paid pro rata. To complete his bargain and fund the Plan, Michael allowed his wages to be attached and paid directly to the Trustee.

Michael, however, was unable to make mortgage payments to GMAC outside of the Plan, and in August 2006 the Bankruptcy Court granted GMAC relief from the automatic stay to allow it to foreclose on Michael’s residence. Because Michael did not move to amend the Plan or modify the wage attachment order, the Trustee continued to receive automatic payments from Michael’s employer. When the Trustee
attempted to forward the funds to GMAC as provided by the Plan, GMAC refused to accept the payments (ostensibly because it wanted to foreclose—pun intended—an estoppel and/or waiver defense to its mortgage foreclosure). The funds continued to accumulate in the Trustee’s account until Michael moved to convert his case to Chapter 7 in October 2009.

Several days after the conversion, Michael filed a motion seeking an order compelling the return to him by the Trustee of the accumulated funds, which amounted to $9,181.62. The Trustee objected, arguing that the funds should be distributed pro rata to unsecured creditors as provided by the Plan.

Both the Bankruptcy and District Courts noted that the Bankruptcy Code does not provide a clear answer on whether undistributed plan payments held by a Chapter 13 trustee should be returned to the debtor or distributed to creditors under a plan when a Chapter 13 case is converted to Chapter 7. Each court assessed the main arguments advanced by the parties and discussed by other (mainly bankruptcy) courts regarding statutory language, legislative intent, and the goals of the Code. They both concluded that the funds must be returned to Michael. The Trustee filed a timely notice of appeal.²

² The Bankruptcy Court had jurisdiction under 28 U.S.C. §§ 157 and 1334. The District Court had jurisdiction under 28 U.S.C. §§ 158(a) and 1334. We have jurisdiction under 28 U.S.C. §§ 158(d) and 1291. Because a district court sits as an appellate court to review a bankruptcy court, we review a bankruptcy court’s “legal determinations de novo, its factual findings for clear error, and its exercises of discretion for abuse thereof.”
II. Discussion

We have a pure question of law—what does the Bankruptcy Code require a Chapter 13 trustee to do with undistributed funds received pursuant to a confirmed Chapter 13 plan when that Chapter 13 case is converted to Chapter 7? Not only does the Code provide no clear answer to this question, in reading it one finds an internal tension, as separate provisions seemingly lead to divergent results.

Both the Bankruptcy and District Courts began their analyses, as do we, with the Bankruptcy Reform Act of 1994’s amendments to the Bankruptcy Code. Included in those amendments was § 348(f), on which this appeal ultimately turns. That section provides that on conversion of a case from Chapter 13 to another Chapter, “property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion.” 11 U.S.C. § 348(f)(1)(A) (emphasis added). In the case of a bad faith conversion, “the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.” Id. § 348(f)(2) (emphasis added).

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*re Goody’s Family Clothing Inc.*, 610 F.3d 812, 816 (3d Cir. 2010).

The Chapter 13 Standing Trustees in our Circuit filed an *amicus* brief in support of the Trustee. The National Association of Consumer Bankruptcy Attorneys submitted an *amicus* brief in support of Michael.
Prior to the addition of § 348(f), courts considering the disposition of funds held by a Chapter 13 trustee at the time of conversion reached three different results: the funds were (i) property of the new Chapter 7 estate, (ii) property of the debtor, or (iii) property of creditors under a confirmed Chapter 13 plan. See, e.g., In re Boggs, 137 B.R. 408, 411 (Bankr. W.D. Wash. 1992) (concluding that the debtor is entitled to undistributed funds held by the Chapter 13 trustee on conversion to Chapter 7); Waugh v. Saldamarco (In re Waugh), 82 B.R. 394, 400 (Bankr. W.D. Pa. 1988) (holding that the Chapter 13 trustee must pay out undistributed funds to the creditors as provided by the Chapter 13 plan on conversion); In re Tracy, 28 B.R. 189, 190 (Bankr. D. Me. 1983) (holding that the Chapter 13 trustee must turn over undistributed funds to the Chapter 7 trustee on conversion). Courts of Appeals primarily debated whether the funds became property of the Chapter 7 estate. Compare Calder v. Job (In re Calder), 973 F.2d 862, 865–66 (10th Cir. 1992) (holding that post-petition funds that were part of the Chapter 13 estate became property of the Chapter 7 estate on conversion to Chapter 7), Matter of Lybrook, 951 F.2d 136, 138 (7th Cir. 1991) (same); and Armstrong v. Lindberg (In re Lindberg), 735 F.2d 1087, 1089–90 (8th Cir. 1984) (same), with Bobroff v. Cont’l Bank (In re Bobroff), 766 F.2d 797, 803–04 (3d Cir. 1985) (holding that a post-petition tort claim did not become property of the Chapter 7 estate on conversion).

Section 348(f) removed the first result, but did not resolve explicitly whether the Chapter 13 trustee should give the funds to the debtor or distribute them to creditors under the confirmed Chapter 13 plan. As developed below, § 348(f)’s language and legislative history express Congress’s preference as to what property belongs to a debtor after conversion, and ultimately direct our decision.
To understand the full import of § 348(f), we provide a brief overview of a Chapter 13 case. The filing of a Chapter 13 petition creates an estate consisting of all of the debtor’s legal and equitable interests in property. 11 U.S.C. §§ 301(a), 541(a).\(^3\) “[I]n addition to the property specified in section 541” that exists at the filing of the Chapter 13 petition, the estate includes “all property of the kind specified in [section 541] that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first . . . .” Id. § 1306(a). This includes “earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted . . . .” Id. § 1306(b). As is the case here, these earnings ordinarily fund the Chapter 13 plan. See, e.g., 8 Collier on Bankruptcy ¶ 1322.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2012) (“Chapter 13 was designed to facilitate adjustments of the debts of individuals with regular income through flexible repayment plans funded primarily from future income.”).

A debtor must begin making payments to the Chapter 13 trustee “not later than 30 days after the date of the filing of the plan or the order for relief [defined below], whichever is earlier . . . .” 11 U.S.C. § 1326(a)(1). The trustee must retain these payments “until confirmation or denial of confirmation [of

\(^3\) In pertinent part, § 301 reads: “A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.” Section 541(a) provides that “[t]he commencement of a case under section 301 . . . creates an estate.”
a plan]... If a plan is not confirmed, the trustee shall return any such payments not previously paid... to the debtor, after deducting any unpaid claim allowed under section 503(b).” Id. § 1326(a)(2).

Confirmation of a reorganization plan under Chapter 13 affects the estate, debtor, creditors, and Chapter 13 trustee. The confirmed plan vests all of the property of the estate in the debtor, id. § 1327(b); binds the debtor and its creditors, id. § 1327(a); and obligates the trustee to distribute the debtor’s payments under the plan to creditors, id. § 1326(a)(2), (c).4 At any time during the Chapter 13 proceeding, the debtor has a near absolute right to convert his case. Id. § 1307(a) (“The debtor may convert a case under this chapter to a case under chapter 7 of this title at any time. Any waiver of the right to convert under this subsection is unenforceable.”). Regardless when conversion takes place, it “does not effect a change in the date of the filing of the petition.” Id. § 348(a).

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4 In pertinent part, § 1326(a)(2) reads: “If a plan is confirmed, the trustee shall distribute any such payment [made under § 1326(a)(1)] in accordance with the plan as soon as is practicable.” Section 1326(c) similarly states: “Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.” Sections 1327(a) and (b), respectively, provide that: “[t]he provisions of a confirmed plan bind the debtor and each creditor,” regardless whether a creditor accepted the plan; and “[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.”
Conversion also “terminates the services” of the Chapter 13 trustee. *Id.* § 348(e). Though his services are ended after conversion, the trustee is required to account for the funds that came into his possession by filing a final report under Federal Rule of Bankruptcy Procedure 1019(5)(B)(ii). In addition, if the case is converted prior to confirmation of a plan, the trustee must return any payments held by him to the debtor after deducting adequate funds for him to pay allowed administrative expense claims. *See* 11 U.S.C. § 1326(a)(2).

Accordingly, when a debtor converts a Chapter 13 case to Chapter 7, the order converting the case is effectively backdated to the time of the order for relief under Chapter 13, which is the date of the filing of the Chapter 13 petition. *See id.* § 301(b) (“The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter.”). Section 348(f), to repeat, states that “property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor as of the date of conversion.” *Id.* § 348(f)(1) (emphasis added). Because under § 348(a) “the date of the filing of the petition” is the date the debtor filed the Chapter 13 petition, this suggests that property of the Chapter 13 estate acquired *post*-petition is excluded from the property of the new Chapter 7 estate. But does that property belong to the debtor or to its creditors waiting for Chapter 13 plan payments?

It is here we turn to § 1327(b), which vests all property of the Chapter 13 estate in the debtor on plan confirmation. The implication is that property held by the Chapter 13 trustee after plan confirmation is “under the control of the debtor as of the date of [a later] conversion” for purposes of § 348(f)(1). Even before the addition of § 348(f), the Ninth Circuit Court arrived
at this conclusion regarding the vesting of monies received by the Chapter 13 trustee from the debtor during the Chapter 13 proceeding. *Arkison v. Plata (In re Plata)*, 958 F.2d 918 (9th Cir. 1992).

Confirmation . . . binds the creditors and the debtor to the provisions of the plan and vests all property of the estate in the debtor except as otherwise provided in the plan. The monies received by the Chapter 13 trustee from the debtors during the Chapter 13 proceeding became part of the Chapter 13 estate. The debtors’ creditors acquired a nonvested interest in these monies by the plan and the order confirming the plan. A Chapter 13 creditor’s interests do not vest until the monies are distributed. . . . The debtors’ interests in the monies have not been extinguished.

*Id.* at 922 (quoting *Resendez v. Lindquist*, 691 F.2d 397, 399–400 (8th Cir. 1982) (Bright, J., dissenting)). Moreover, under § 348(e), after conversion the services of the Chapter 13 trustee are terminated, which seemingly renders it powerless to make payments to creditors under a Chapter 13 plan.

Nevertheless, confirmation of a plan is a significant event in a Chapter 13 case. This has led several courts, in decisions primarily written before the addition of § 348(f), to conclude that undistributed plan payments held by a Chapter 13 trustee should be disbursed to creditors after conversion. They reason that the funds should be treated as trust funds for the benefit of creditors, or that creditors held a vested interest in the funds at the time the trustee received them, because the debtor
voluntarily parted with the funds and §§ 1326(a)(2) and (c) state that the trustee “shall” distribute payments as provided by the plan. See, e.g., In re Galloway, 134 B.R. 602, 603 (Bankr. W.D. Ky. 1991) (holding that after a debtor “voluntarily part[s] with wages and deliver[s] them to the custody of a trustee in performance of a confirmed Chapter 13 plan, the creditors have a vested right to receive those payments pursuant to the plan”); In re Waugh, 82 B.R. at 400 (observing that the word “shall” in § 1326(a)(2) “creates the condition of a trust. Creditors have the right to the funds in an active confirmed chapter 13 plan on payment by the debtor”); In re Rutenbeck, 78 B.R. 912, 913 (Bankr. E.D. Wis. 1987) (“[T]he undistributed funds ought to be treated as trust funds for the benefit of the creditors under the confirmed plan and distributed to those creditors in accordance with the terms of the plan.”); In re Lennon, 65 B.R. 130, 137 (Bankr. N.D. Ga. 1986) (holding that the “mandatory provision” of § 1326(a)(2) “has the effect of vesting an interest in creditors provided for by a confirmed plan in all payments pursuant to such plan”)

These courts also emphasize that a confirmed plan binds creditors to a new relationship with a debtor, one that requires creditors to forgo certain rights in exchange for the debtor’s promise to make payments under the plan. See, e.g., Ledford v. Burns (In re Burns), 90 B.R. 301, 304 (Bankr. S.D. Ohio 1988) (“[A] Chapter 13 Plan represents a legislatively sanctioned, and judicially approved[,] new series of rights and responsibilities among the debtor and the debtor’s creditors.”). Thus despite the termination of the Chapter 13 trustee’s services after conversion, they conclude that a “valid confirmation order of the Bankruptcy Court should not be made a nullity by a later failure of the debtor to observe a confirmed plan.” Spero v. Porreco (In re Porreco), 426 B.R. 529, 537 (Bankr. W.D. Pa. 2010) (quoting In
re Waugh, 82 B.R. at 400); see also In re Pegues, 266 B.R. 328, 336–37 (Bankr. D. Md. 2001) (“Although the service of the chapter 13 trustee is terminated by Section 348(e), it is clear that Congress intended that the chapter 13 trustee shall wind up the affairs of the chapter 13 estate, including disbursing monies on hand to the appropriate recipient.”); In re Burns, 90 B.R. at 304 (“While it would be inappropriate to ignore other provisions of the Bankruptcy Code, it would be equally inappropriate to fail to judicially implement an order that the court has previously entered, particularly one in which the debtors voluntarily proposed the provisions, advocated their adoption and requested the court to order as binding upon the debtors and their creditors.”).

Additionally, these courts further cite § 1326(a)(2) for its language requiring the Chapter 13 trustee to return any payments held by it to the debtor if a plan is not confirmed (after deducting funds for it to pay allowed administrative expense claims). Read alone, this section arguably indicates that if a plan is not confirmed the trustee must return accumulated funds to the debtor, and that if a plan is confirmed the trustee, by implication stemming from the absence of similar language, is required to distribute accumulated funds to creditors as provided by the plan. That is, if Congress intended for undistributed funds held by the trustee post-confirmation to be returned to a debtor, it could have included similar language regarding post-confirmation payments in § 1326(a)(2). See In re Burns, 90 B.R. at 304. Moreover, holding that the funds are to be returned to debtors produces the anomalous result that all or a portion of administrative expense claims may be paid in a Chapter 13 case converted pre-confirmation, but not in one converted post-confirmation.
In contrast, other courts, again in decisions written primarily before the addition of § 348(f), have read the same provisions of the Code and concluded that the debtor is entitled to undistributed plan payments held by the Chapter 13 trustee at the time of conversion. These courts focus on § 348(a) and the Congressional policy of encouraging debtors to attempt Chapter 13 without penalty if the attempt fails. See, e.g., In re Boggs, 137 B.R. at 411 (“[T]he Congressional policy of encouraging debtors to repay their creditors via Chapter 13 is furthered by debtors (and their counsel) knowing they will not be penalized for attempting Chapter 13.”); McCullough v. Luna (In re Luna), 73 B.R. 999, 1003 (N.D. Ill. 1987) (concluding that § 348(a), “which determines the operative date for the filing of [the debtor’s] Chapter 7 proceeding, protects [the debtor] from being penalized by providing that the Chapter 7 estate is deemed to have been filed at the time the Chapter 13 estate was filed”); In re Bullock, 41 B.R. 637, 640 (Bankr. E.D. Pa. 1984) (“[T]he case is deemed to have been filed as a chapter 7 proceeding and that portion of the debtor’s postpetition wages, which were deducted from his salary, were deposited in the chapter 7 estate although they were not properly includable therein . . . . Since the deducted wages were not part of the chapter 7 estate, the debtor is entitled to recover such wages in full . . . .”).

In response to those courts holding that undistributed funds should be paid out to creditors, contrary rulings have reasoned that conversion effectively vacates the confirmed plan. “[Section] 1307(a) gives debtors the absolute right to convert to Chapter 7 at any time. Analytically, a Chapter 13 plan has no relevance to or import in a case under any other chapter. . . . If a plan is vacated or no longer in effect, a Chapter 13 trustee has no authority for further disbursement to creditors.” In re Boggs, 137 B.R. at 410; see also In re Doyle, 11 B.R. 110, 111 (Bank.
E.D. Pa. 1981) (holding that, once a case is converted, the order confirming the plan is no longer effective). Other decisions simply conclude that the termination of the trustee’s services “precludes the Trustee from taking any action with respect to these funds after the conversion.” In re Luna, 73 B.R. at 1002; see also In re Perkins, 36 B.R. 618, 620 (Bank. M.D. Tenn. 1983) (holding that the Chapter 13 trustee loses all authority to act when the conversion becomes effective).

These courts also find nothing “unjust” in returning undistributed plan payments to a debtor. Rather, they note that creditors ultimately will receive as much, if not more, than they would have received if the debtor initially had filed under Chapter 7.

Since § 1325(a) requires a finding that the holder of each allowed unsecured claim will receive not less than the holder would receive under Chapter 7 to confirm a plan, it is not self-evident that the dilution effect of treating pre-conversion creditors as pre-petition creditors in the converted Chapter 7 necessarily inflicts a net loss on actual pre-petition creditors. Those creditors have had the benefit of distribution from debtors’ wage contributions, which would not have been available to them under Chapter 7. In all, there seems no inherent inequity in refunding undisbursed wage contributions to debtors on conversion.

In re Boggs, 137 B.R. at 410.
Notwithstanding strong arguments regarding the binding effect of plan confirmation, those courts holding that undistributed payments under a confirmed Chapter 13 plan should be disbursed to creditors after conversion overlook that no provision in the Bankruptcy Code classifies any property, including post-petition wages, as belonging to creditors. Rather, property comes into and flows out of the estate. In the context of a Chapter 13 case, § 1327(b) vests all property of the Chapter 13 estate in the debtor on confirmation of the plan. Thus when the debtor transfers funds to the Chapter 13 trustee to fulfill its obligations under a confirmed plan (or, as here, wages are assigned directly to the Chapter 13 trustee under a garnishment order), the funds become part of the estate, and the debtor retains a vested interest in them. Though creditors have a right to those payments based on the confirmed plan, the debtor does not lose his vested interest until the trustee affirmatively transfers the funds to creditors. Also, §§ 1326(a)(2) and (c) only address the obligation of the trustee to distribute payments in accordance with a confirmed plan; they do not vest creditors with any property rights.

Conversion to a Chapter 7 case necessarily ends the Chapter 13 case, which also terminates that Chapter 13 estate. Section 348(f) clarifies what becomes of property of the now nonexistent Chapter 13 estate. It provides that property of the Chapter 7 estate “consist[s] of property of the estate, as of the date of filing of the [Chapter 7] petition, that remains in the possession of or is under the control of the debtor on the date of conversion.” 11 U.S.C. § 348(f)(1) (emphases added). Because § 1327(b) vests all property of the Chapter 13 estate in the debtor, including any post-petition property held by the Chapter 13 trustee at the time of conversion (such as funds transferred to the estate for eventual distribution to creditors), on conversion
property of the Chapter 13 estate usually is “under the control of the debtor.” And because § 348(a) establishes that conversion does not change the effect of the Chapter 13 petition’s filing, the Chapter 7 petition date is deemed to be the same date that the debtor began the Chapter 13 case. Hence property acquired post-petition that is in the Chapter 13 estate at the time of conversion is not property of the new Chapter 7 estate. Rather, the debtor retains a vested interest in the property, and thereby the property reverts to the debtor on conversion, assuming that the debtor does not convert in bad faith. Moreover, absent

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5 Not all property necessarily will meet this requirement. For example, a debtor whose title to particular property is terminated by a divorce decree while his Chapter 13 case is pending no longer has control of the property when the case is converted to Chapter 7, and thus the property is not part of the Chapter 7 estate after conversion even though it was included initially in the Chapter 13 estate. See, e.g., Yoon v. Krick (In re Krick), 373 B.R. 593, 608 (Bankr. N.D. Ind. 2007) (holding that a parcel of real estate that was included in a couple’s Chapter 13 estate at the time of the filing of their Chapter 13 petition, and in connection with marital dissolution proceedings was determined to be the property of the parents of the former wife debtor, was not property of that debtor’s converted Chapter 7 estate because she did not have an interest in the real estate and thus it was not under her control).

6 On the issue of vesting, the Trustee draws our attention to § 349(b)(3), which provides that the dismissal of a case under the Bankruptcy Code, including a Chapter 13 case, “revests the property of the estate in the entity in which such property was vested immediately before the commencement of the case under this title.” None of the sub-sections of § 348 contains similar
anything to the contrary (and we know of nothing), by providing that a debtor who converts in bad faith is not entitled to this post-petition property, § 348(f)(2) logically requires that a debtor receive the property if he acts in good faith.

“revesting” language. As such, it may be argued that Congress intended to distinguish the two methods of terminating an estate (conversion and dismissal), and that if it meant for property of the estate to “revest” in the debtor on conversion, it would have included similar language in § 348. See In re Plata, 958 F.3d at 923 (Brunetti, J., dissenting) (distinguishing §§ 348 and 349). However, in the Chapter 13 context this argument overlooks that (i) under § 1326(a)(2) the trustee must return all payments held by it to the debtor if a plan is not confirmed, or (ii) under § 1327(b) property of the estate already is vested in the debtor at the time of the conversion after confirmation of a plan. Sections 348 and 349 are broad provisions applicable to every Chapter of the Bankruptcy Code. The specific provisions of Chapter 13 supersede any distinction that may be read into these proceeding general provisions.

Moreover, if a Chapter 13 debtor is concerned about obtaining funds held by the Chapter 13 trustee, he can dismiss his case rather than convert. As noted by the Ninth Circuit Court, we can discern “no justification for requiring a debtor to dismiss, rather than convert . . . [,] in order to preserve his exemption rights. Aside from creating a trap for the unwary, such a requirement would merely elevate form over substance and inject a needless degree of extra work on the part of all concerned.” In re Plata, 958 F.2d at 922; see also In re Boggs, 137 B.R. at 410 (“Debtors, whose motion was prompted in part by health problems, are willing to have their case dismissed if necessary to obtain the funds the Trustee holds.”).
We also believe that returning undistributed funds to the debtor better aligns with the Chapter 13 trustee’s limited duties post-conversion and the effect of conversion on a confirmed Chapter 13 plan. Though the trustee must account for the funds that came into his possession by filing a final report after conversion under Federal Rule of Bankruptcy Procedure 1019(5)(b)(ii), it does not follow that he is permitted to distribute funds under a plan that is no longer operative, particularly if those funds remain vested in the debtor until distribution. In light of § 348(e)’s termination of the trustee’s services post-conversion, his duties thereafter should be narrowly construed. If a Chapter 13 case is converted to a Chapter 7 case after plan confirmation, the vested funds revert to the debtor, and their return should be considered part of the Chapter 13 trustee’s short list of remaining duties.7

7 In the pre-confirmation context, the trustee is obligated to pay allowed administrative expenses from accumulated payments he is holding. Id. § 1326(a)(2). Though this creates the anomalous outcome that if a Chapter 13 proceeding is converted pre-confirmation administrative expense claims will be paid from undistributed plan payments, but if the proceeding is converted post-confirmation no administrative expense claims can be paid from undistributed plan payments, this inconsistency is addressed by the Federal Rules of Bankruptcy Procedure. Rule 1019(6) provides for the filing after conversion of pre-confirmation administrative expense claims. Fed. R. Bank. P. 1019(6) (“Upon the filing of the schedule of unpaid debts incurred after commencement of the case and before conversion, the clerk, or some other person as the court may direct, shall give notice to those entities listed on the schedule of the time for filing a request for payment of an administrative expense . . . .”).
The legislative history of § 348(f) supports that Congress’s intended outcome is that payments held by the Chapter 13 trustee revert to the debtor on conversion. Congress stated that it was overruling the holdings of *Matter of Lybrook* and similar cases, and “adopting the reasoning” of our decision in *Bobroff*. H.R. Rep. No. 835, 103d Cong., 2d Sess. 57 (1994). It included the following illustration of the “serious disincentive to file chapter 13 filings” it sought to eliminate with § 348(f).

*Id.*

[A] debtor who had $10,000 equity in a home at the beginning of the case, in a State with a $10,000 homestead exemption, would have to be counseled concerning the risk that after he or she paid off a $10,000 second mortgage in the chapter 13 case, creating $10,000 in equity, there would be a risk that the home could be lost if the case were converted to chapter 7 (which can occur involuntarily). If all of the debtor’s property at the time of conversion is property of the chapter 7 estate, the trustee would sell the home . . . to realize the $10,000 in equity for the unsecured creditors and the debtor would lose the home.

In addition, if a debtor continues a Chapter 13 case until a plan is confirmed before converting merely to escape the trustee’s payment of administrative expense claims under § 1326(a)(2), the debtor should be found to have converted in bad faith under § 348(f)(2), and all post-petition property should be awarded to the Chapter 7 estate to be distributed to creditors, including those holding administrative expense claims.
Id. By analogy from this example, a debtor who contributes post-petition earnings to the Chapter 13 estate under a confirmed plan when the Chapter 13 trustee has not distributed those funds to creditors should not lose those earnings on conversion. Section 348(f)(1) provides that the earnings are not property of the new Chapter 7 estate. The Chapter 7 trustee thus cannot transfer those earnings to unsecured creditors. Holding that the Chapter 13 trustee must disburse the earnings to creditors under the Chapter 13 plan after conversion would result in creditors receiving a portion of the Chapter 13 estate when the legislative history of § 348(f) suggests that this property belongs to the debtor.

Such an outcome also would dissuade debtors from filing under Chapter 13. Encouraging them to attempt to repay their debts through a reorganization plan rather than liquidate was the reasoning underlying our decision in Bobroff. We noted that

[i]f debtors must take the risk that property acquired during the course of an attempt at repayment will have to be liquidated for the benefit of creditors if chapter 13 proves unavailing, the incentive to give chapter 13 -- which must be voluntary -- a try will be greatly diminished. Conversely, when chapter 13 does prove unavailing “no reason of policy suggests itself why the creditors should not be put back in precisely the same position as they would have been had the debtor never sought to repay his debts . . . .”

Bobroff, 766 F.2d at 803 (quoting In re Hannan, 24 B.R. 691, 692 (Bankr. E.D.N.Y. 1982)). In this context, holding that the
Chapter 13 trustee must distribute undisbursed plan payments to creditors would contravene Congress’s reasoning in adopting § 348(f).

Additionally, in adding § 348(f) Congress rejected the analysis of those Courts of Appeals holding that undistributed funds after Chapter 13 plan confirmation belong to creditors. Those Courts based their decisions on fairness to creditors, concluding that “a rule of once in, always in[,] is necessary to discourage strategic, opportunistic behavior that hurts creditors . . .” Matter of Lybrook, 951 F.2d at 137. To account for such “game-the-system” behavior, Congress included § 348(f)(2), which in effect “gives the court discretion, in a case in which the debtor has abused the right to convert and converted in bad faith, to order that all property held at the time of conversion shall constitute property of the estate in the converted [here, Chapter 7] case.” H.R. Rep. No. 835, 103d Cong., 2d Sess. 57 (1994). The punishment for acting in bad faith is that property that otherwise would belong to the debtor goes instead to his Chapter 7 estate for distribution to creditors. But, as already noted, if a debtor does not act with bad faith in converting, logically the property should not go automatically to creditors; otherwise the penalty for a bad faith conversion would be diminished significantly.

Indeed, since the passage of § 348(f), all Courts of Appeals that have considered the disposition of a Chapter 13 estate’s property on conversion to Chapter 7 have concluded that the policy reasoning we expressed in Bobroff now has become settled law. See Stamm v. Morton (In re Stamm), 222 F.3d 216,

8 The Trustee argues that the reasoning of Bobroff does not apply here because it did not involve a confirmed plan. Though
217–18 (5th Cir. 2000) (noting that in Baker v. Rank (In re Baker), 154 F.3d 534 (5th Cir. 1998), “[w]e stated that Congress added Section 348(f) ‘to resolve the circuit split,’ quoted the relevant statutory language, and noted that Congress ‘took issue with In re Lybrook.’ The clear implication . . . is that Section 348(f)(1), where applicable, establishes that the post-petition income does not remain property of the estate upon conversion.” (quoting In re Baker, 154 F.3d at 536 n.2)); Young v. Key Bank of Maine (In re Young), 66 F.3d 376, 378 (1st Cir. 1995) (concluding that post-petition contributions of income by the debtor pursuant to a confirmed plan were not property of the Chapter 7 estate on conversion and noting that “[t]he Bankruptcy Reform Act of 1994 answered the very question that confronts us. It essentially codified the Bobroff rule . . .”). See also Bell v. Bell (In re Bell), 225 F.3d 203, 217 (2d Cir. 2000) (observing that “[i]n the Bankruptcy Reform Act of 1994, Congress resolved this circuit split . . . by enacting 11 U.S.C. § 348(f)”); 8 Collier on Bankruptcy ¶ 348.07[1] (“The addition of [§ 348(f)] clarified that Congress had intended the result reached by cases that had not included in the postconversion chapter 7 estate the property acquired by the debtor during the preconversion chapter 13 case.”).

confirmation of a plan is a significant event in a Chapter 13 case, nothing in Bobroff suggests the pre-confirmation status of that bankruptcy case was critical to our reasoning, nor does anything in the language of § 348(f) or its legislative history indicate Congress’s intent that bankruptcy courts treat undistributed post-petition property differently depending on whether the Chapter 13 case was converted before or after confirmation of the plan.
Overall, a textual reading of § 348(f), particularly in light of its legislative history, leads us to conclude that undistributed plan payments held by a Chapter 13 trustee at the time of conversion must be returned to the debtor absent bad faith. This result furthers Congress’s preference that on conversion to Chapter 7 a Chapter 13 debtor receive all post-petition property that is held by the Chapter 13 trustee, but still is under the control of the debtor, so that debtors are encouraged to attempt to repay their debts through reorganization rather than liquidation.

We recognize that a practical consequence of this method of encouragement is that, when a debtor converts to Chapter 7 after a Chapter 13 plan has been confirmed, the total amount of payments to creditors under the plan will depend on the timing of conversion and the practices of the Chapter 13 trustee. The Bankruptcy Code requires the Chapter 13 trustee to make disbursements “as soon as practicable.” 11 U.S.C. § 1326(a)(2). In practice, the most efficient method of administering payments may be for the trustee to accumulate and distribute them to creditors at an established time. See, e.g., In re Hardin, 200 B.R. 312, 313 (Bankr. E.D. Ky. 1996) (noting that “often some accumulation will occur . . . prior to the making of a distribution to creditors”). For example, some trustees make plan disbursements twice a month, while some only once a month. Or a trustee may be holding funds for a reason particular to a case, as here. Section 348(f)(2)’s bad faith provision may correct for a debtor’s opportunistic behavior, but outside a finding of bad faith it will not prevent a converting debtor receiving funds intended initially for Chapter 13 creditors. To deal with this potential happenstance, we foresee that creditors
will request more frequent distributions from the Chapter 13 trustee.\footnote{9}

\footnote{9 Creditors may avail themselves of other options to increase the likelihood that they will receive payments made by a debtor under a confirmed plan.}

(1) If a Chapter 13 trustee is accumulating funds because a creditor is refusing to receive payments under the plan, as here, creditors can move to modify the plan. See 11 U.S.C. § 1329(a)(1) (“At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the . . . holder of an allowed unsecured claim, to . . . increase or reduce the amount of payments on claims of a particular class provided for by the plan.”).

(2) Creditors can move to compel the trustee to make distributions under the plan immediately after the debtor files its motion to convert.

(3) Section 1327(b) provides that “[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.”

Creditors can object to a proposed plan that does not provide that plan payments vest in creditors immediately on receipt by the Chapter 13 trustee. They likewise can request that similar language be included in the Bankruptcy Court’s order confirming the plan. Though we do not rule on the issue, such language may be sufficient to remove undistributed plan payments held by the trustee from property “under the control of the debtor on the date of conversion.” 11 U.S.C. § 348(f)(1).
As applied here, when the Plan was no longer feasible, Michael exercised the right to convert his case to Chapter 7 and sought the return of his post-petition earnings still in the Trustee’s possession. Because there is no evidence that he converted in bad faith, those funds are his property by virtue of § 348(f), and should not be distributed to his creditors. The Bankruptcy and District Courts’ decisions reflect the result that Congress contemplated in enacting § 348(f). We thus affirm.
Barry Michael converted his bankruptcy from Chapter 13 to Chapter 7. The question we must answer is whether Michael’s undistributed post-confirmation, but pre-conversion, wages, which were paid to the Chapter 13 trustee pursuant to the confirmed reorganization plan, should be distributed to his creditors pursuant to the plan or returned to Michael. The Majority concludes that the addition of 11 U.S.C. § 348(f) to the Bankruptcy Code mandates that the funds revert to Michael. I respectfully disagree. The language of § 348(f) does not require such a result.

I turn first to the context in which this situation is most likely to occur. When a Chapter 13 plan of reorganization has been confirmed, the debtor will make regular payments to the Chapter 13 trustee. In many cases, the funds come from a wage attachment as happened here. At regular intervals -- monthly, bi-monthly -- the trustee, pursuant to § 1326(c), shall pay out the funds to the creditors as provided for in the confirmed plan. The trustee is the conduit for the funds to get to the creditors. Thus, the funds held by the trustee prior to these pay-outs do not build up significantly. If, ultimately, the debtor cannot keep up with the provisions of the plan and decides to convert to Chapter 7, the accumulated funds in the hands of the trustee are not of a sizeable amount. Thus, there has been little reason to dispute their disposition.
The reason for the accumulation of the funds here was because GMAC Mortgage refused to accept the payments pursuant to the plan after August 15, 2006, and sent the checks back to the trustee. Michael had been unable to keep up his own regular payments on the mortgage; as a result, on August 15, GMAC Mortgage obtained relief from the automatic stay in order to foreclose. Michael’s wage attachment, however, continued on until October 2009 when he converted his bankruptcy to a Chapter 7. Although the plan provided for distribution to other secured and unsecured creditors, the trustee did not make payments to them. For that reason, more than $9,000 accumulated in the hands of the trustee. During this three year period, either Michael or the trustee could have requested an amendment to the plan. Neither did so. Michael continued to make payments for the benefit of his creditors. He also continued to enjoy the benefits of a Chapter 13 plan.1

There is little precedent to assist us in resolving this situation. There is evidence, however, that at least within the Third Circuit, the custom has been that, when a debtor converted a Chapter 13 bankruptcy to a Chapter 7, the Chapter 13 trustee paid out the accumulated funds to the creditors as provided for in the plan. In fact, in December 2011, the Third Circuit Judicial Council approved the Western District of Pennsylvania Local Bankruptcy Rule

1Generally, the benefits available to a debtor under a Chapter 13 plan of reorganization are the saving of a residence from foreclosure, the curing a mortgage delinquency over time with more affordable payments, the maintaining of possession and use of an automobile or other personal property, and the automatic stay.
3021-1(f), which provides that “[i]n the event of conversion or dismissal following the confirmation of a chapter 13 plan, then the chapter 13 trustee shall distribute all funds received prior to the effective date of the conversion or dismissal, in accordance with the terms of the confirmed plan.” The Clerk of the Bankruptcy Court for the Western District of Pennsylvania believes that this rule codified a long time practice, going back to 2004. This rule -- or practice -- has not been challenged until, in this case, the sum held by the trustee became a sizeable one. The issue then is: Who gets the benefit of this windfall, the debtor or the creditors?

To answer this question, we must determine whether these funds -- on conduit through the trustee to the creditors in accord with the confirmed plan -- are property of the Chapter 13 estate.

As the Majority observes, prior to the Bankruptcy Reform Act of 1994 (Act), courts were sharply divided on whether post-petition and post-confirmation property, which was acquired by the debtor during a Chapter 13 case, remained property of the bankruptcy estate or was returned to the debtor upon the estate’s conversion to Chapter 7. Compare Resendez v. Lindquist, 691 F.2d 397, 399 (8th Cir. 1982) with Bobroff v. Cont’l Bank (In re Bobroff), 766 F.2d 797, 803 (3d Cir. 1985). The Act sought to resolve this dispute with the amendment to § 348, which provided that “when a case under chapter 13 . . . is converted to a case under another chapter,” 11 U.S.C. § 348(f)(1), the “property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion,” id. at § 348(f)(1)(A).
I agree that the amendment described what became of property or rights to property acquired by the debtor during the pendency of the Chapter 13 proceedings. I have no argument against this interpretation. Mr. Bobroff\(^2\) keeps his potential tort recovery and Mr. Lybrook\(^3\) keeps the farm land inherited from his father because the tort recovery and the farmland inheritance were not property of the estate as of the date of the filing of the petition.\(^4\) To the extent that Michael’s wages were not attached, the amendment also covered these unattached wages earned during the course of the Chapter 13 bankruptcy. On conversion, these wages would not be transferred to the Chapter 7 estate. See Stamm v. Morton (*In re Stamm*), 222 F.3d 216, 217 (5th Cir. 2000) (“Section 348(f)(1), where applicable, establishes that the [debtors’] post-petition income does not remain property of the estate upon conversion”). There is simply no language that suggests otherwise. See *e.g.*, *In re Pegues*, 266 B.R. 328, 331-32 (Bankr. D. Md. 2001); *In re Bell*, 248 B.R. 236, 239 (Bankr. W.D.N.Y. 2000); *In re Hardin*, 200 B.R. 312, 313 (Bankr. E.D. Ky. 1996).

However, we are not dealing simply with wages here but with that portion of the wages that had been attached

\(^2\)Bobroff, 766 F.2d at 803.

\(^3\)Matter of Lybrook, 951 F.2d 136 (7th Cir. 1991).

\(^4\)I would note, however, that neither the *Bobroff* nor the *Lybrook* Chapter 13 plans were confirmed. A confirmed plan would have dealt with these property expectations during the period of reorganization. It would appear that the consideration of these additional assets may be a factor in the failure of approval of a plan of reorganization.
under the plan and paid to the trustee for distribution to the creditors. I maintain that there is a crucial difference. It is my position that, although the debtor’s unattached wages earned during the reorganization period will not be included in the Chapter 7 estate, the attached wages that have been paid to the trustee pursuant to the plan should be. Under the plan, these wages are under the supervision and control of the trustee. Because these funds are under the supervision and control of the trustee, they should be paid out by the trustee in accord with the provisions of the plan. Moreover, the attached wages are the quid pro quo that the debtor has given up during the pendency of the reorganization in return for being permitted to stave off foreclosure and cure the mortgage default, retain the use of his automobile, and enjoy the automatic stay.

The Majority depends on Bobroff to support its decision. However, a careful analysis of Bobroff reveals that the Court’s decision was motivated by its fear of potential inequities that might result when the recovery from a debtor’s post-petition litigation was included in a converted Chapter 7 estate. Central to the Court’s decision was the notion that creditors should not receive a windfall from funds that would not have been in the bankruptcy estate if the initial filing had been for a Chapter 7 proceeding. According to the Court, such a result would be inconsistent with the Bankruptcy Act.

The plan provides in paragraph 1 that “[t]he future earnings of the Debtor are submitted to the supervision and control of the trustee – Debtor’s employer shall pay to the Trustee the sum of $138.62 bi-weekly, beginning in May, 2006 for a period of 53 months, plus $1,294.67 paid as of April 4, 2006.”
Code’s goal of encouraging debt repayment. See Bobroff, 766 F.2d at 803. If a debtor had to risk losing either all or a portion of the property he acquired during his repayment attempt, the incentive to try voluntary repayment would be substantially diminished. Id. The Court, therefore, opined that post-petition funds should revert to the debtor in order to ensure that both the creditors and debtor would be returned to “precisely the same position they were in had the debtor never sought to repay his debts . . .” Id. 6

The concerns the Court expressed in In re Bobroff, however, are not present in Chapter 13 proceedings where a debtor derives a benefit from the confirmed bankruptcy plan. Once a reorganization plan is confirmed, the relationship between the debtors and creditors change; the provisions of the plan bind the parties, generating benefits and corresponding responsibilities. 11 U.S.C. § 1327(a); see Ledford v. Burns (Matter of Burns), 90 B.R. 301, 304 (Bankr. S.D. Ohio 1988) ("[A] Chapter 13 Plan represents a legislatively sanctioned, and judicially approved new series of rights and responsibilities among the debtor and the debtor’s creditors"). In fact, under a confirmed plan, each party receives a benefit. The debtor is entitled to continue “receiving whatever benefits [he] believed were significant enough for [him] to have converted to and proceeded in

6Of course, Bobroff is also distinguishable from this case in the fact that the Court in Bobroff held that because the debtor was not eligible for Chapter 13, “the conversion to that chapter was void ab initio and the provisions of § 1306 cannot be invoked to determine which property comprises the estate.” Bobroff, 706 F.3d at 803.
Chapter 13,"\(^7\) In re Bell, 248 B.R. at 239, and the creditors receive the money paid into the Chapter 13 estate, In re Pegues, 266 B.R. at 336. Thus, the debtor makes payments in order to fulfill his obligations under the reorganization plan and in exchange for the benefits he derives from the plan.\(^8\) In

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\(^7\)Although varied, the benefits a debtor receives may include: saving a residence from foreclosure, curing a mortgage delinquency over time with more affordable payments, maintaining possession over an automobile or other personal property, or having the benefit of the automatic bankruptcy stay remain in place for an extended period of time.

\(^8\)Conversion does not retroactively alter this arrangement and undo the benefits the debtor received from the plan. See e.g., In re Pegues, 266 B.R. at 336; In re Galloway, 134 B.R. 602, 603 (Bankr. W.D. Ky. 1991); Waugh v. Saldamarco, (In re Waugh), 82 B.R. 394, 398-99 (W.D. Pa. 1988); In re Redick, 81 B.R. 881, 887 (E.D. Mich. 1987). The funds the debtor paid were in exchange for the benefits of the reorganization plan. Revocation of the plan only alters this dichotomy going forward; it does not “retroactively revoke the intent,” In re Bell, 248 B.R. at 239, that debtors had when they initially chose to file under Chapter 13; nor does it retroactively alter the fact that a debtor made payments “to continue to enjoy the ongoing benefits of that plan,” id at 240.

The Bankruptcy Code supports this view. Sections 1326(a)(2) & (c) affirmatively set forth the Chapter 13 trustee’s obligation to distribute a debtor’s payments to creditors pursuant to the terms of the confirmed plan. See 11 U.S.C. § 1326(a)(2) & (c). Although § 348(e) terminates the
re Bell, 248 B.R. at 239; see In re Lennon, 65 B.R. 130, 136 (N.D. Ga. 1986) (“These payments are specifically earmarked and set aside for distribution to creditors provided for by the confirmed plan”).

Here, unlike in Bobroff, the payments Michael made were in exchange for the benefits he derived from the plan. Therefore, if the undistributed funds revert to him, instead of being distributed to the creditors in accordance with the plan’s terms, Michael would receive a windfall. See O’Quinn v. Brewer (In re O’Quinn), 143 B.R. 408, 413 (Bankr. S.D. Miss. 1992) (“It appears to this Court to be patently unfair to allow a debtor to drive and depreciate an automobile, occupy a home or use household goods based on a promise to his creditors in the form of a court approved plan, and then allow the debtor to snatch away the monies which the trustee is holding to make the payments, but has not yet disbursed, by allowing the debtor to pick an opportune time to convert”). He would obtain the benefits the confirmed plan offered

services of the trustee when a case is converted to chapter 7, the trustee is still required to perform certain tasks. See Fed. R. Bankr. P. 1019. Federal Rule of Bankruptcy Procedure 1019 details several of these post-conversion duties. See e.g., id. at 1019(4), 1019(5)(B)(ii). Thus, the Rule demonstrates that Congress did not intend § 348(e) to be interpreted too literally. Since Congress intended for the trustee to perform several ancillary duties to clean-up and finalize the administration of the estate, In re Parrish, 275 B.R. 424, 430 and & n.7 (Bankr. D. Colo. 2002), there is no logical reason why distribution of funds pursuant to the previously confirmed reorganization plan cannot be included as one of those administrative duties.
without having to pay his creditors. Such a result would not only be patently unfair, but also contradict the reasoning of Bobroff. Michael would be in a better position (and his creditors in a worse position) than he would have been if he had initially filed for bankruptcy under Chapter 7.

Therefore, my interpretation of § 348(f) will not discourage voluntary debt repayment under Chapter 13. It merely requires debtors to honor their obligations to creditors as was agreed under the confirmed plan. In re Bell, 248 B.R. at 240. I hope that we will not see the reversal of a Third Circuit practice that over the years has balanced the benefits to both parties under a plan of reorganization by providing that the undistributed funds held by the trustee will be distributed to the creditors pursuant to the confirmed plan. If we adopt the Majority’s position, we will be permitting a windfall in this unusual case where inaction by the debtor and by the trustee has permitted funds to accumulate in a situation in which that normally would not occur.

For the above reasons, I respectfully dissent.

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Although the Majority does not explicitly state, it implies that § 348(f)’s bad faith provision, see 11 U.S.C. § 348(f)(2), would prevent this type of harm from befalling creditors. This argument is unconvincing. One can conjure many scenarios where a debtor files for Chapter 13 bankruptcy, with bona fide intentions of repaying his financial obligations, only to discover that he miscalculated his ability to repay his creditors. This type of conduct cannot be characterized as “game-the-system” behavior.
THOMAS H. FULTON, Bankruptcy Appellate Panel Judge. In this appeal Cecil H. Miller (the Debtor) and his daughter Latrese Hyshaw (“Hyshaw”) (collectively “the Appellants”) appeal
January 10, 2012 orders of the United States Bankruptcy Court of the Northern District of Ohio authorizing the trustee in the Debtor’s chapter 7 bankruptcy (the “Trustee”) to employ an auctioneer and sell at public auction three pieces of real property (the “Properties”) free and clear of liens.

For the reasons that follow, the panel affirms the bankruptcy court’s January 10, 2012 orders authorizing the Trustee to employ an auctioneer and sell the Properties.

I. ISSUES ON APPEAL

The issues in this appeal are as follows: (1) whether the Appellants have standing to appeal the court’s order granting the Trustee’s motion to sell the Properties; (2) whether the Trustee’s proposed sale complies with the requirements of 11 U.S.C. § 363(f) governing sales of estate property free and clear of interests; and (3) whether Federal Rule of Bankruptcy Procedure 6004(c) required the Trustee to serve Hyshaw or the Debtor’s widow, Latraill Miller (“Latraill Miller”), with notice of the motion to sell the Properties.

II. JURISDICTION AND STANDARD OF REVIEW

The Bankruptcy Appellate Panel of the Sixth Circuit has jurisdiction to decide this appeal. The United States District Court for the Northern District of Ohio has authorized appeals to the Panel, and no party has timely elected to have this appeal heard by the district court. 28 U.S.C. § 158(b)(6), (c)(1). A final order of the bankruptcy court may be appealed as of right pursuant to 28 U.S.C. § 158(a)(1). For purposes of appeal, a final order “ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.” Midland Asphalt Corp. v. United States, 489 U.S. 794, 798, 109 S. Ct. 1494, 1497 (1989) (citations omitted). A bankruptcy court’s order authorizing the sale of property of the estate is an appealable final order. Winget v. J.P. Morgan Chase Bank, N.A., 537 F.3d 565, 578 (6th Cir. 2008).
A bankruptcy court’s order authorizing the sale of assets under 11 U.S.C § 363(b) is reviewed under an abuse of discretion standard. *Stephens Industries, Inc. v. McClung*, 789 F.2d 386, 388-89 (6th Cir. 1986). “An abuse of discretion occurs only when the [trial] court relies upon clearly erroneous findings of fact or when it improperly applies the law or uses an erroneous legal standard.” *Kaye v. Agripool, SRL (In re Murray, Inc.),* 392 B.R. 288 (B.A.P. 6th Cir. 2008). The bankruptcy court’s decision, under this standard, will only be disturbed if it “relied upon clearly erroneous findings of fact, improperly applied the governing law, or used an erroneous legal standard.” *Elec. Workers Pension Trust Fund of Local Union #58, IBEW v. Gary’s Elec. Serv. Co.,* 340 F.3d 373, 378 (6th Cir. 2003) (citing *Blue Cross & Blue Shield Mut. v. Blue Cross & Blue Shield Ass’n*, 110 F.3d 318, 322 (6th Cir. 1997)). See also *Mayor and City Council of Baltimore, Md. v. W. Va. (In re Eagle-Picher Indus., Inc.),* 285 F.3d 522, 529 (6th Cir. 2002) (“An abuse of discretion is defined as a ‘definite and firm conviction that the [court below] committed a clear error of judgment.’”) “The question is not how the reviewing court would have ruled, but rather whether a reasonable person could agree with the bankruptcy court’s decision; if reasonable persons could differ as to the issue, then there is no abuse of discretion.” *Barlow v. M.J. Waterman & Assocs. Inc. (In re M.J. Waterman & Assocs., Inc.),* 227 F.3d 604, 608 (6th Cir. 2000).

**III. FACTS**

The factual and procedural background of this case is essentially undisputed. On February 9, 2009, the Debtor granted his daughter Hyshaw three pieces of real property for no consideration. (Appellee’s Br. at 5). Several months later, on June 29, 2009, the Debtor filed a voluntary chapter 7 bankruptcy petition. The Debtor received his chapter 7 discharge on February 22, 2010.

The three pieces of real property that the Debtor transferred to Hyshaw (the “Properties”) are and have been heavily encumbered. The U.S. Small Business Administration (the “SBA”) holds liens on the Properties in excess of $118,000. Collectively, the Properties are valued at approximately $23,000.
The Debtor’s transfer of the Properties to Hyshaw did not pass unnoticed. On March 15, 2010, the Trustee initiated an adversary proceeding against the Debtor and Hyshaw. The Trustee’s complaint contained three counts: it sought to avoid the Debtor’s transfer to Hyshaw as a fraudulent transfer, obtain authorization to sell the Properties free and clear of liens, and determine the validity, priority, and extent of liens on the Properties. On June 16, 2010, shortly after the commencement of the adversary proceeding, the Debtor died.

On February 22, 2011, the Trustee and the Appellants moved for summary judgment on the Trustee’s fraudulent transfer claim. Together with his motion for summary judgment, the Trustee submitted to the court “Stipulations of Material Fact.” In this document, the Trustee, the Appellants, and the Small Business Administration stipulated that:

The Small Business Administration has consented to the payment of the Chapter 7 Trustee’s administrative fees, attorneys’ fees, and costs of sale, prior to the payment of the mortgage of the Small Business Administration from the proceeds of any eventual sale in this case.

The Small Business Administration has also consented to the payment of the first $5,000 of proceeds of sale after payment of the administrative fees, attorneys’ fees, and costs of sale to the Chapter 7 Trustee, prior to any distribution of sale proceeds on the properties located at 843 Cameron Drive, Youngstown, Ohio; 349 Breaden Street, Youngstown Ohio; and 7489 Brentwood, Youngstown Ohio.


On June 28, 2011, the bankruptcy court granted the Trustee’s summary judgment motion as to the fraudulent transfer claim, ruling that the Properties “constitute property of the Debtor’s bankruptcy estate.” (Summary Judgment Order at 13, Adv. Proc. No. 10-40576, ECF No. 72). The bankruptcy court, however, dismissed without prejudice the Trustee’s requests to sell the Properties and determine the validity, priority, and extent of liens on the Properties. The court gave its reasoning as follows:
It appears that any potential sale of the properties would provide no benefit to the estate because the amount of the SBA liens far surpasses the combined value of the Properties. As a consequence, no purpose can be served by this Court determining the validity or priority of liens against the Properties because the Properties will come back into the estate fully encumbered by the SBA liens.

(Id. at 13-14). The court did not mention the Trustee’s stipulated agreement with the SBA regarding the sale of Properties. Neither party appealed the bankruptcy court’s ruling.

On October 18, 2011, the Trustee filed motions to sell the Properties and appoint an auctioneer. In his motion to sell the Properties (“Motion to Sell”), the Trustee again recounted his agreement with the SBA regarding the sale of the Properties—the same agreement described in the Stipulations in the adversary proceeding. The Trustee confirmed that the SBA had “agreed to a carve-out from the sale proceeds to provide funds to the Chapter 7 Trustee to satisfy all the Trustee’s fees and costs, the attorney for the Trustee’s fees and costs, and the first $5,000 beyond attorney’s fees and Trustee’s fees, to go to the Trustee for distribution to the unsecured creditors.” (Id.).

On December 30, 2011, Hyshaw objected to the Trustee’s motions. In her Objections, she argued that “it appears any potential sale of the Properties would provide no benefit to the estate because the amount of the SBA liens far surpasses the combined value of the Properties.” (Id. at 2). Hyshaw then argued that the value of the Properties was so low that it was possible “that the amount of [the Trustee’s] combined fees and costs could exceed the value of the properties leaving no money left for unsecured creditors.” (Id. at 3). Finally, Hyshaw stated that the Debtor’s widow, LaTraill Miller had not been given notice of the Motion to Sell, and that the Trustee was “without authority to sell the property” because the titles were recorded in Hyshaw’s name. (Id. at 3). In the filed objections Hyshaw repeatedly implied that, because the court had dismissed without prejudice the Trustee’s requests for sale and determination of validity of liens in the adversary proceeding, the court was somehow obligated to deny the Motion to Sell.
The bankruptcy court held the hearing on the Motion to Sell on January 5, 2012. At the hearing, Trustee’s counsel explained to the court that the SBA was in agreement as to the sale of the Properties and that the sale of the Properties was expected to pay both expenses and fees as well as $5,000 to unsecured creditors even if the Properties sold for only half their appraised value. Furthermore, the Trustee’s counsel assured the court that the Trustee would have the option of abandoning the Properties if the auction failed to produce an acceptable bid. The bankruptcy court then granted the Trustee’s motions to sell the Properties and appoint an auctioneer.

Thomas Michaels (“Michaels”), the attorney for the Debtor and Hyshaw, presented Hyshaw’s objections at the hearing. The bankruptcy court asked Michaels what basis Hyshaw had to object to the sale of the Properties. After Michaels responded that Hyshaw was an heir to the Debtor’s estate, the bankruptcy court stated: “The property is not in a probate estate and will not be in a probate estate unless the Trustee abandons it . . . . So as a potential heir to the estate of [the Debtor], that’s entirely speculative.” (Tr. of Hr’g at 6, Bankr. Case No. 09-42411, ECF No. 95). Shortly after this exchange, Michaels changed the focus of his presentation from his client Hyshaw to Latraill Miller, arguing that there “has to be a determination of at least Latraill Miller, the decedent’s spouse, what her interest in these properties are.” (Id.). To this the bankruptcy court replied: “It’s property of the estate. I have never heard of Latraill Miller until you mentioned her. If she doesn’t show up in the chain of title, I don’t know whether she is entitled to notice or not. If there is a deficiency, you’ve just indicated that you don’t represent her, so you can’t speak on her behalf.” (Id. at 7).

On January 10, 2012, the bankruptcy court issued orders granting the Trustee’s Motion to Sell the Properties and appoint an auctioneer. Fourteen days later, on January 24, the Debtor’s attorney and Hyshaw filed a notice of appeal of the court’s orders.

In their Statement of Issues and Designation of Record, the Appellants argued that the bankruptcy court had erred in approving the Trustee’s Motion to Sell. The Appellants listed a
number of arguments as to why they believed the bankruptcy court erred. These arguments included: (i) that it was improper for the bankruptcy court to grant the Motion to Sell after it had dismissed the Trustee’s request to sell the Properties during the adversary proceeding; (ii) that the Trustee had not shown that the sale of the Properties would benefit the estate; (iii) that the Trustee failed to provide Latraill Miller with notice of the Motion to Sell; (iv) that the Debtor’s interest in the Properties had transferred to Latraiill Miller on the Debtor’s death; and (v) that the Trustee was “not in control” of the Properties either on the date the Motion to Sell was filed or the date the motion was granted. (Id. at 2).

In their brief to this panel, the Appellants now make a somewhat different set of arguments. First, the Appellants argue that the Trustee failed to satisfy the requirements of 11 U.S.C. § 363(f), governing the sale of property free and clear of liens. Second, the Appellants argue that the Trustee failed to give Hyshaw and Miller proper notice of the Motion to Sell as required by Rule of Bankruptcy Procedure 6004(c).

In his reply brief, the Trustee fails to delve into details regarding the propriety of the sale order. Instead, it appears that the Trustee has devoted most of his efforts to arguing the propriety of the court granting summary judgment in the adversary proceeding to avoid the Debtor’s transfer of the Properties to Hyshaw. Toward the end of his brief the Trustee does, however, make a few points to support his position in this appeal: First, he states that his agreement with the SBA will give the sale a chance to bring in funds for unsecured creditors. Second, he claims that the Motion to Sell was “served upon Latreese Hyshaw and Latrail[l] Miller through [ ] attorney Thomas Michaels.” (Id. at 9). The Trustee further states that “the argument that the property belonged to Latrail[l] Miller, the widow of Cecil Miller, immediately upon his death is incorrect, since the property had been transferred to his daughter Latreese [Latrese] Hyshaw, prior to the instant bankruptcy case.” (Id. at 9).
IV. DISCUSSION

As described above, the Appellants have made a number of arguments in opposition to the bankruptcy court’s order authorizing the Trustee to sell the Properties. The Panel need not address those arguments, however, because the Appellants lack standing to appeal the bankruptcy court’s order.

It is appropriate for the Panel to raise the issue of standing *sua sponte*. S.E.C. v. Basic Energy, 273 F.3d 657, 665 (6th Cir. 2001). The lack of standing is a jurisdictional bar to appellate review. Harker v. Troutman (In re Troutman Enters.), 286 F.3d 359, 364 (6th Cir. 2002). An appellate court must therefore raise the issue of standing *sua sponte* because it is “under an independent obligation to police its own jurisdiction.” Basic Energy, 273 F.3d at 665.

“Appellate standing in bankruptcy cases is more limited than Article III standing or the prudential requirements associated therewith.” Troutman, 286 F.3d at 364. In order to have standing to appeal a bankruptcy court order, an appellant must be a “person aggrieved” by the bankruptcy court’s order. Fid. Bank, N.A. v. M.M. Group, Inc., 77 F.3d 880, 882 (6th Cir. 1996). This doctrine limits standing to those persons who “have been directly and adversely affected pecuniarily by the order . . . . Only when the order directly diminishes a person’s property, increases his burdens, or impairs his rights will” an appellant have standing to appeal. Id.; Travelers Cas. & Sur. v. Corbin (In re First Cincinnati, Inc.), 286 B.R. 49, 51 (B.A.P. 6th Cir. 2002) (citations omitted). The burden of proving that a party is a “person aggrieved” is on the appellant asserting standing to pursue an appeal. Fid. Bank, 77 F.3d at 882.

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1The Trustee has filed a motion to dismiss this appeal based on the Appellants’ lack of standing, and the Appellants have responded. Because the Panel raises the issue of standing *sua sponte*, there is no need to address the parties’ arguments.
Courts rarely find that a chapter 7 debtor is a “person aggrieved” by a bankruptcy court order regarding the disposition of property of the estate. *Monus v. Lambros*, 286 B.R. 629, 634 (N.D. Ohio 2002).

The advent of the chapter 7 estate and the appointment of the chapter 7 trustee divest the chapter 7 debtor of all right, title and interest in nonexempt property of the estate at the commencement of the case. Since title to property of the estate no longer resides in the chapter 7 debtor, the debtor typically lacks any pecuniary interest in the chapter 7 trustee’s disposition of that property.

*Spenlinhauer v. O’Donnell*, 261 F.3d 113, 118 (1st Cir. 2001) (citing 11 U.S.C. §§ 541(a) and 704(a)); *see also* 11 U.S.C. § 323. Pursuant to 11 U.S.C. § 727, the chapter 7 discharge releases the debtor from all personal liability for his debts. These Bankruptcy Code sections work together to restrict a chapter 7 debtor’s standing to appeal an order from the bankruptcy court. “[A] hopelessly insolvent debtor does not have standing to appeal orders affecting the size of the estate, since such an order would not diminish the debtor's property, increase his burdens, or detrimentally affect his rights.” *In re El San Juan Hotel*, 809 F.2d 151, 154-55 (1st Cir. 1987) (citations omitted). As a result, the chapter 7 trustee is often the only party who has standing to appeal an order that impacts the disposition of property of the estate. *Richman v. First Woman’s Bank (In re Richman)*, 104 F.3d 654, 657 (4th Cir. 1997).

There are two exceptions to a chapter 7 debtor’s limited standing:

(1) if the debtor can show that a successful appeal would generate assets in excess of liabilities, entitling the debtor to a distribution of surplus under Bankruptcy Code 726(a)(6), . . . or (2) the order appealed from affects the terms of the debtor’s discharge in bankruptcy.

*Kowal v. Malkemus (In re Thompson)*, 965 F.2d 1136, 1144 n.12 (1st Cir. 1992) (citations omitted). If the debtor fails to present concrete evidence that either exception applies, he does not have standing to challenge a bankruptcy court order. *United States v. Jones*, 260 B.R. 415, 418 (E.D. Mich. 2000). To proceed under the first exception, “the debtor cannot simply claim that there is a
theoretical chance of a surplus in the estate, but must show that such surplus is a *reasonable possibility.*” *Simon v. Amir (In re Amir),* 436 B.R. 1, 10 (B.A.P. 6th Cir. 2010) (internal quotation marks and citations omitted) (emphasis added); *Nangle v. Surratt-States (In re Nangle),* 288 B.R. 213, 216 (B.A.P. 8th Cir. 2003).

In this case, neither the Debtor nor Hyshaw is a “person aggrieved” with standing to appeal the bankruptcy court’s order authorizing the sale of the Properties and appointment of an auctioneer. The Properties are underwater; encumbered by SBA liens of far greater value than the Properties themselves. Thus, the Debtor cannot show that an appeal of the sale order would result in any surplus to which he would be entitled. Furthermore, the Debtor has made no statements—much less presented concrete evidence—indicating that the sale order would affect his discharge. Thus, the Debtor has no pecuniary interest in the Properties sufficient to make him a “person aggrieved” by the Properties’ sale.

As for Hyshaw, the same considerations operate to deny her standing to appeal the bankruptcy court’s order. Though Hyshaw may be an heir to the Debtor, and though her name may appear on the Properties’ recorded titles, these facts do not give her a pecuniary interest in the Properties. As explained earlier, the Debtor will receive no surplus from the sale of the underwater Properties and has alleged no effect that the sale might have on his own personal liabilities. Thus, sale of the Properties will have no pecuniary impact on whatever inheritance Hyshaw may receive from the Debtor. The Debtor cannot pass on to Hyshaw any surplus that he himself would not receive. Nor can he pass on any liabilities that he himself would not incur. Moreover, the mere presence of Hyshaw’s name on the recorded titles to the Properties fails to give her a pecuniary interest in the Properties. Her name is present on the recorded titles because she received a transfer of the Properties from the Debtor shortly before the Debtor’s bankruptcy. But that transfer was avoided by the bankruptcy court during the Trustee’s adversary proceeding. Because Hyshaw will receive neither a surplus nor liabilities from the sale of the Properties, she has no pecuniary interest sufficient to allow her to appeal the bankruptcy court’s order. Having determined that the Appellants
lack standing to appeal the bankruptcy court’s order, the Panel will refrain from addressing the issues raised in the Appellants’ briefs.

V. CONCLUSION

For the foregoing reasons, the Panel affirms the January 10, 2012 bankruptcy court orders authorizing the Trustee to sell the Properties and appoint an auctioneer.
In the Matter of:  
**BELLINGHAM INSURANCE AGENCY, INC.,**  

*Debtor,*

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**EXECUTIVE BENEFITS INSURANCE AGENCY,**  

*Appellant,*

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**v.**

**PETER H. ARKISON, TRUSTEE,** solely in his capacity as  
Chapter 7 Trustee of the estate of Bellingham Insurance Agency, Inc.,  

*Appellee.*

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No. 11-35162  
D.C. No. 2:10-cv-00929-MJP  

OPINION

Appeal from the United States District Court  
for the Western District of Washington  
Marsha J. Pechman, Chief District Judge, Presiding  

Argued and Submitted  
October 13, 2011–Seattle, Washington  

Filed December 4, 2012
Before: Alex Kozinski, Chief Judge, Richard A. Paez, Circuit Judge, and Raner C. Collins,* District Judge.

Opinion by Judge Paez

* The Honorable Raner C. Collins, United States District Judge for the District of Arizona, sitting by designation.
SUMMARY

Bankruptcy

Affirming the district court’s affirmance of the bankruptcy court’s summary judgment, the panel held that a non-Article III bankruptcy judge lacks constitutional authority to enter a final judgment in a fraudulent conveyance action against a nonclaimant to the bankruptcy estate, but that the nonclaimant here waived its right to an Article III hearing.

The panel held that following Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989), and Stern v. Marshall, 131 S. Ct. 2594 (2011), the public rights exception to the rule of Article III adjudication does not encompass federal-law fraudulent conveyance claims, even though Congress designated such claims as core bankruptcy proceedings. The panel stated that in light of Stern, In re Mankin, 823 F.3d 1296 (9th Cir. 1987), was overruled. The panel held that 11 U.S.C. § 157(b)(1) provides bankruptcy courts the power to hear fraudulent conveyance cases and to submit reports and recommendations to the district courts.

The panel also held that the right to a hearing in an Article III court is waivable, and that here the nonclaimant consented to the bankruptcy judge’s adjudication of the fraudulent conveyance claim by failing to object until the case reached the court of appeals.

** This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.
The panel held that the bankruptcy trustee satisfied all elements of a constructively fraudulent transfer of the debtor’s property under 11 U.S.C. § 548 and under Washington State law. In addition, the nonclaimant was a successor corporation of the debtor and therefore liable for its debts.

COUNSEL

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Lynne F. Riley; Riley Law Group LLC, Boston, Massachusetts; and Jessica D. Gabel; Georgia State University College of Law, Atlanta, Georgia, for Amicus Curiae National Association of Bankruptcy Trustees.

Nathaniel Garrett; Jones Day, San Francisco, California, for Amicus Curiae Jones Day.

Sarang Vijay Damle and Robert Loeb; U.S. Department of Justice Civil Division, Washington, D.C., for Amicus Curiae United States of America.

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Matthew Rutledge Schultz and Christopher Daniel Sullivan; Trepel Greenfield Sullivan & Draa LLP, San Francisco, California, for Amicus Curiae Concerned Chapter 7 and 11 Trustees and Plan Administrators.
Paez, Circuit Judge:

This quotidian bankruptcy case presents a novel question: can a non-Article III bankruptcy judge enter a final judgment in a fraudulent conveyance action against a nonclaimant to the bankruptcy estate? Federal law empowers bankruptcy judges to do so, but we hold that the Constitution forbids it.

The Executive Benefits Insurance Agency suffered an adverse final judgment in a fraudulent conveyance at the hands of a bankruptcy judge. But our decision today is no reprieve, because we also hold that the company consented to the adjudication of the fraudulent conveyance claim by a bankruptcy judge by failing to object until the case reached this court. Thus, unencumbered by constitutional doubts, we review the entry of summary judgment de novo, and affirm.

I

Nicholas Paleveda and his wife, Marjorie Ewing, operated a welter of companies, including Aegis Retirement Income Services, Inc. (“ARIS”) and the Bellingham Insurance Agency, Inc. (“BIA”). ARIS designed and administered defined-benefit pension plans, and BIA sold insurance and annuity products that funded those plans.

BIA and ARIS were closely related: Paleveda owned 100% of ARIS and served as the CEO and sole director of BIA until February 14, 2006, when Ewing took over. Ewing owned 80% of BIA and served as ARIS’s general manager. ARIS and BIA shared an office and a phone number. Because ARIS lacked sufficient assets to operate independently, it
routed all of its income and expenses through BIA, kept joint accounting records with BIA, and declared its income on consolidated tax returns with BIA.

By early 2006, BIA was insolvent. And though the company ceased operations on January 31, 2006, it did not stop acting entirely. Two weeks after closing its doors, the company irrevocably assigned the insurance commissions from one of its largest clients, the American National Insurance Company, to Peter Pearce, a longtime BIA and ARIS employee who had often acted as a conduit for insurance commissions between BIA and its clients.

The day after BIA stopped operating, Paleveda used BIA funds to incorporate the Executive Benefits Insurance Agency, Inc. (“EBIA”). In 2006, $373,291.28 of commission income earned between January 1 and June 1 was deposited into an account held jointly by ARIS and EBIA. Pearce deposited $123,133.58 and EBIA deposited the remainder. At the end of the year, all of the deposits were credited to EBIA via an “intercompany transfer.”

In the meantime, BIA had filed a voluntary Chapter 7 bankruptcy petition in the United States Bankruptcy Court for the Western District of Washington. The Trustee, Peter Arkison—the Appellee in this case—filed a complaint against EBIA and ARIS in the same court to recover the commissions deposited into the EBIA/ARIS account, which the Trustee alleged to be property of the estate. The complaint alleged eighteen causes of action, including federal- and state-law preferential and fraudulent transfer claims and a claim that

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1 As the district court did, we draw these facts from the uncontroverted accounting evidence produced by the Trustee.
EBIA was a successor corporation of BIA and therefore liable for its debts.

The bankruptcy court granted summary judgment in favor of the Trustee, concluding that the deposits into the EBIA/ARIS account were fraudulent conveyances of BIA assets and that EBIA was a “mere successor” of BIA. The bankruptcy court entered a final judgment for $373,291.28.²

EBIA appealed to federal district court. The district court affirmed, holding that the commissions paid into the ARIS/EBIA account were fraudulent transfers under both the Bankruptcy Code, 11 U.S.C. § 548, and Washington’s Uniform Fraudulent Transfer Act, Wash. Rev. Code § 19.40.041. The district court also affirmed the bankruptcy court’s judgment that EBIA was liable for BIA’s debts as a corporate successor.

² In total, EBIA was credited with $373,291.28 in commission income for the January 1, 2006 to June 1, 2006 period, an amount that formed the basis of the bankruptcy court’s judgment. Of this total, $123,133.58 was deposited by Pearce, and the remaining $250,836.98 was deposited by EBIA itself.

In his declaration, the Trustee’s accounting expert, Michael Quackenbush, appears to have improperly summed these figures. He avers, “There are five deposits buy [sic] Pearce totaling $122,454.30. There are 14 additional deposits into the ARIS account by EBIA for commissions it earned totaling $277,885.82. Thus the total commissions deposited into the ARIS account for commissions earned from BIA related business was $373,291.28.” In fact, the sum of $122,454.30 and $277,885.82 is $400,340.12, according to Microsoft’s venerable Windows Calculator. Some expert. The accountant also summed the deposits within each category incorrectly: the Pearce deposits actually total $123,133.58, and the EBIA deposits total $250,157.70. Because the corrected figures sum to $373,291.28, however, the expert’s errors did not undermine the accuracy of the bankruptcy court’s judgment.
EBIA appealed. In a motion to dismiss submitted prior to oral argument, EBIA objected for the first time to the bankruptcy judge’s entry of final judgment on the Trustee’s fraudulent conveyance claims. Styled as a motion to vacate the judgment for lack of subject-matter jurisdiction, and relying on *Stern v. Marshall*, 131 S. Ct. 2594 (2011), the motion argued that the bankruptcy judge was constitutionally proscribed from entering final judgment on the Trustee’s claims. It is to this vexing constitutional issue that we first turn.

II

A

Bankruptcy judges are appointed for terms of 14 years, 28 U.S.C. § 152(a)(1), and their salaries are subject to Congressional diminution. *Id.* § 153(a). Hence, bankruptcy judges cannot exercise “[t]he judicial Power of the United States,” which is vested by the Constitution in courts whose judges enjoy life tenure and salary protection. U.S. Const. art. III, § 1.

Nonetheless, bankruptcy judges enjoy substantial statutory authority. Although the district courts have exclusive jurisdiction over “all cases under title 11,” *id.*

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3 Following oral argument in this appeal, we invited briefs from amicus curiae on the questions: 1) whether bankruptcy courts may enter a final, binding judgment on an action to avoid a fraudulent conveyance, and 2) whether, if they cannot enter such final judgments, bankruptcy courts may hear the proceeding and submit a report and recommendation to a federal district court. See Exec. Benefits Ins. Agency v. Arkison (*In re Bellingham Ins. Agency, Inc.*), 661 F.3d 476 (9th Cir. 2011). We appreciate the many thoughtful briefs that were submitted in response to our invitation.
§ 1334(a), they may refer all of the cases within that broad jurisdiction to bankruptcy judges, id. § 157(a). What the bankruptcy court may do with a given referred proceeding depends on whether the proceeding is denominated a “core” or a “non-core” proceeding. In all “core proceedings arising under title 11, or arising in a case under title 11,” a bankruptcy judge has the power to “hear and determine the controversy” and enter final orders, subject only to appellate review. Id. § 157(b)(1). In a non-core proceeding “that is otherwise related to a case under title 11,” however, a bankruptcy judge may only “submit proposed findings of fact and conclusions of law to the district court.” Id. § 157(c)(1). The entry of final judgment in non-core proceedings is the sole province of Article III judges.

Section 157(b)(2) enumerates sixteen nonexclusive examples of “core proceedings.” Among these are “proceedings to determine, avoid, or recover fraudulent conveyances.” Id. § 157(b)(2)(H). The bankruptcy judge hearing the Trustee’s claim was thus empowered by statute to enter a final judgment. Indeed, until quite recently, the exercise of that statutory power was routine and uncontroversial. See, e.g., Jones v. Schlosberg, No. 04-00571, 2005 WL 6764810, at *5–6 (C.D. Cal. 2005) (affirming a bankruptcy court’s entry of judgment in a fraudulent conveyance action); see also Duck v. Munn (In re Mankin), 823 F.2d 1296, 1300–01 (9th Cir. 1987) (holding that both state- and federal-law fraudulent conveyance actions are core proceedings). But following the Supreme Court’s decision in Stern v. Marshall, the view that such judgments are consistent with the Constitution is no longer tenable.
To explain why this is so, we must begin somewhat earlier, with the Supreme Court’s epochal decision in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982). The Bankruptcy Reform Act of 1978 invented the modern bankruptcy judge, subject to the same conditions as today: a 14-year term and a mutable salary. *Id.* at 53. *Northern Pipeline* was the Supreme Court’s first effort to demarcate the constitutional limits of these judges’ authority.

Northern Pipeline filed a Chapter 11 petition for reorganization in a bankruptcy court. *Id.* at 56. It then filed a suit against Marathon Pipe Line for a prepetition breach of contract and warranty. *Id.* Marathon sought to dismiss the suit on the grounds that the claim at issue could only be decided by an Article III judge. *Id.*

A plurality of the Court agreed that the assignment of Northern Pipeline’s state-law claims for resolution by a bankruptcy judge violated Art. III of the Constitution. *Id.* at 87 (Brennan, J., plurality opinion); *id.* at 91 (Rehnquist, J., concurring in judgment). The plurality admitted to only three exceptions to the rule of Article III adjudication: territorial courts, *id.* at 64, military tribunals, *id.* at 66, and cases involving “public” as opposed to “private” rights, *id.* at 67.4

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4 A majority of the *Northern Pipeline* Court also acknowledged that it is constitutionally permissible for an Article III court to assign factfinding responsibility to an adjunct, provided that the Article III court retains “the essential attributes of the judicial power.” 458 U.S. at 77 (quoting *Crowell v. Benson*, 285 U.S. 22, 51 (1932) (internal quotation marks omitted)). Nonetheless, “the bankruptcy court is not an ‘adjunct’ of either the district court or the court of appeals.” *Id.* at 91 (Rehnquist, J., concurring in the
Outside of the narrowly drawn exceptions for territorial and military courts, the distinction between public and private rights was the crucial determinant of whether a dispute belonged in an Article III court: “Our precedents clearly establish,” the Court explained, “that only controversies in the former category may be removed from Art. III courts and delegated to legislative courts or administrative agencies for their determination. Private-rights disputes, on the other hand, lie at the core of the historically recognized judicial power.” Id. at 70 (internal citations and footnote omitted).

While a majority of the Court could not agree on the scope of the public rights exception, a majority did agree that the public rights exception could not justify the adjudication of Northern Pipeline’s claims by a non-Article III officer. See id. at 69 (plurality opinion); id. at 91 (“To whatever extent different powers granted under [the Bankruptcy Reform] Act might be sustained under the ‘public rights’ doctrine . . . I am satisfied that the adjudication of Northern’s lawsuit cannot be so sustained.”) (Rehnquist, J., concurring).

Despite consigning the breach of contract and breach of warranty claims at issue to the category of private rights, the Northern Pipeline plurality hinted that some quantum of bankruptcy proceedings might fall within the public rights exception:

[T]he restructuring of debtor-creditor relations, which is at the core of the federal bankruptcy power, must
be distinguished from the adjudication of state-created private rights, such as the right to recover contract damages that is at issue in this case. The former may well be a “public right,” but the latter obviously is not.

*Id.* at 71.

Following the *Northern Pipeline* decision, Congress amended the statutes governing bankruptcy jurisdiction and bankruptcy judges. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (the “1984 Act”). The legislation enacted, among other reforms, the division of claims in bankruptcy cases into core and non-core proceedings. This distinction was clearly inspired by the *Northern Pipeline* plurality’s dictum that certain proceedings “at the core of the federal bankruptcy power . . . may well be a ‘public right.’” 458 U.S. at 71; *see also* *In re Mankin*, 823 F.2d at 1305.

The cases following *Northern Pipeline* created substantial new ambiguity about the content and import of the public rights exception. In *Thomas*, the Court addressed a law that required pesticide manufacturers to submit research data to the Environmental Protection Agency on a new product’s “health, safety, and environmental effects.” 473 U.S. at 571. The law allowed subsequent registrants of similar products to rely on the proprietary data, but required them to compensate the first manufacturer for the data and to submit to binding arbitration of any disagreement over the fee amount. *Id.* at 573–74. The *Northern Pipeline* plurality had defined public rights as “matters arising between the Government and persons subject to its authority in connection with the performance of the constitutional functions of the executive
or legislative departments.” 458 U.S. at 67–68 (plurality opinion) (internal quotation marks omitted). The Thomas Court rejected that definition, opting for a more fluid position: “the public rights doctrine reflects simply a pragmatic understanding that when Congress selects a quasi-judicial method of resolving matters that ‘could be conclusively determined by the Executive and Legislative Branches,’ the danger of encroaching on the judicial powers is reduced.” 473 U.S. at 589 (quoting Northern Pipeline, 458 U.S. at 68). Under this newly pragmatic approach, the Court was convinced that “the right created by [the statute] is not a purely ‘private’ right.” Id. Rather, it bore “many of the characteristics of a ‘public’ right”: it “serve[d] a public purpose as an integral part of a program safeguarding the public health” and “represent[ed] a pragmatic solution to the difficult problem of spreading the costs of generating adequate information regarding the safety, health, and environmental impact of a potentially dangerous product.” Id. at 589–90.

Similarly, in Commodity Futures Trading Commission v. Schor, 478 U.S. 833, 851 (1986), the Supreme Court abjured “formalistic and unbending rules” for “determining the extent to which a given congressional decision to authorize the adjudication of Article III business in a non-Article III tribunal impermissibly threatens the institutional integrity of the Judicial Branch.” Instead, the Court held that determining when a proceeding required an Article III court entailed balancing several factors “with an eye to the practical effect that the congressional action will have on the constitutionally assigned role of the federal judiciary”:

Among the factors upon which we have focused are the extent to which the “essential attributes of judicial
“power” are reserved to Article III courts, and, conversely, the extent to which the non-Article III forum exercises the range of jurisdiction and powers normally vested only in Article III courts, the origins and importance of the right to be adjudicated, and the concerns that drove Congress to depart from the requirements of Article III.

_Id._ (citing _Thomas_, 473 U.S. at 587, 589–93). This multifactor standard demanded a certain hierophancy on the part of the lower courts, which had to comb through the Court’s inconsistent statements about the metes and bounds of Article III to apply it. But the standard did reflect a pragmatic accommodation of the realities of modern bankruptcy practice and the logistical and administrative difficulty of circumscribing the authority of the bankruptcy courts.

Encouraged by the Supreme Court’s retreat from a formalist conception of the public rights exception and the limitations of Article III more generally, we concluded in 1987 that certain controversies at the core of the bankruptcy process implicated public rights. _See In re Mankin_, 823 F.2d at 1308 (“The public rights doctrine in large part simply constitutionalizes the historical understanding of what need and need not be committed to Article III officers for determination. While, as indicated above, it has always been understood that the property rights of creditors cannot be committed exclusively to the political branches for determination, by the same token it has always been understood that bankruptcy proceedings need not be solely determined by Article III officers.”). We also held that the portion of bankruptcy-related proceedings that fit within the public rights exception was coextensive with that portion which had been designated as “core” by the 1984 Act. _Id._
Today, we acknowledge Mankin’s demise. It has been felled by two cases: Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989), and Stern v. Marshall, which together point ineluctably to the conclusion that fraudulent conveyance claims, because they do not fall within the public rights exception, cannot be adjudicated by non-Article III judges.

In Granfinanciera, the Court considered whether a non-claimant to a bankruptcy estate has a Seventh Amendment right to a jury trial when sued by the bankruptcy trustee under 11 U.S.C. § 548 to recover allegedly fraudulent prepetition conveyances. 492 U.S. at 36. Because Congress had designated fraudulent conveyance actions core proceedings, which non-Article III judges could decide, the Court defined the issue as “whether the Seventh Amendment confers on petitioners a right to a jury trial in the face of Congress’ decision to allow a non-Article III tribunal to adjudicate the claims against them.” Id. at 50. And that required the Court to again construe the public rights exception, because “Congress may only deny trials by jury in actions at law . . . in cases where ‘public rights’ are litigated.” Id. at 51.

Was a fraudulent conveyance proceeding a matter of public right? The Court’s answer was, if not unequivocal, at least conclusive: “Although the issue admits of some debate, a bankruptcy trustee’s right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2) seems to us more accurately characterized as a private rather than a public right as we have used those terms in our Article III decisions.” Id.

Because the result in Mankin cannot be reconciled with the reasoning in Stern, we may overrule it without taking this case en banc. See Miller v. Gammie, 335 F.3d 889, 899 (9th Cir. 2003).
at 55. The Court echoed the *Northern Pipeline* plurality’s distinction between the (possibly) public-right “restructuring of debtor-creditor relations”—the “core of the federal bankruptcy power”—and the “adjudication of state-created private rights.” *Northern Pipeline*, 458 U.S. at 71. Fraudulent conveyance actions, the *Granfinanciera* Court explained, are obviously in the latter category, because they “are quintessentially suits at common law that more nearly resemble state-law contract claims brought by a bankrupt corporation to augment the bankruptcy estate than they do creditors’ hierarchically ordered claims to a pro rata share of the bankruptcy res.” 492 U.S. at 56.

*Granfinanciera* clarified that fraudulent conveyance actions are not matters of public right, and that a noncreditor retains a Seventh Amendment right to a jury trial on a bankruptcy trustee’s fraudulent conveyance claim. Some courts, however, seemed disinclined to deduce from those holdings that such litigants also retain a right to be heard by an Article III court. *See, e.g.*, McFarland v. Leyh (*In re Tex.*

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6 Notably, the *Granfinanciera* Court did not decide the question whether even the “restructuring of debtor-creditor relations” was in fact a “public right.” 492 U.S. at 56 n.11 (“We do not suggest that the restructuring of debtor-creditor relations is in fact a public right. This thesis has met with substantial scholarly criticism, and we need not and do not seek to defend it here. Our point is that even if one accepts this thesis, the Seventh Amendment entitles petitioners to a jury trial.” (citation omitted)). Neither did the *Stern* Court decide whether the public rights exception constitutionally validates any of the powers that bankruptcy judges today exercise. *See* 131 S. Ct. at 2614 n.7 (“We noted [in *Granfinanciera*] that we did not mean to ‘suggest that the restructuring of debtor-creditor relations is in fact a public right.’ . . . Because neither party asks us to reconsider the public rights framework for bankruptcy, we follow the same approach here.”). We, of course, follow the Court’s example in declining to take up the question.
Following *Stern*, we can no longer resist *Granfinanciera*’s logic. The issue in *Stern* was whether a bankruptcy court could enter final judgment on a state-law claim for tortious interference with a gift expectancy, which Vickie Marshall had filed as a compulsory counterclaim to Pierce Marshall’s proof of claim in her ongoing bankruptcy proceeding. See 131 S. Ct. at 2601. The Supreme Court held that it could not, because “Vickie’s counterclaim cannot be deemed a matter of ‘public right’ that can be decided outside the Judicial Branch.” *Id.* at 2611. In the course of a lengthy exegesis of its own public-rights precedents, the Court explained that the state-law counterclaim at issue was indistinguishable from the fraudulent conveyance claim in *Granfinanciera*: “Vickie’s counterclaim—like the fraudulent conveyance claim at issue in *Granfinanciera*—does not fall within any of the varied formulations of the public rights exception in this Court’s cases.” *Id.* at 2614. This common character of the claims in *Granfinanciera* and *Stern* means that neither can be consigned to the bankruptcy courts without doing violence to the constitutional separation of powers:

What is plain here is that this case involves the most prototypical exercise of judicial power: the entry of a final, binding judgment *by a court* with broad substantive jurisdiction, on a common law cause of action, when the action neither derives from nor depends upon any agency regulatory regime. If such
an exercise of judicial power may nonetheless be taken from the Article III Judiciary simply by deeming it part of some amorphous “public right,” then Article III would be transformed from the guardian of individual liberty and separation of powers we have long recognized into mere wishful thinking.

Id. at 2615. Here, the Trustee’s fraudulent conveyance claims are not matters of “public right,” and, *ipso facto*, cannot be decided outside the Article III courts.7

Our conclusion is buttressed by the Supreme Court’s equation of litigants’ Article III rights with their Seventh Amendment jury trial rights in bankruptcy-related cases. *Granfinanciera* itself drew the comparison explicitly:

Indeed, our decisions point to the conclusion that, if a statutory cause of action is legal in nature, the question whether the Seventh Amendment permits Congress to assign its adjudication to a tribunal that does not employ juries as factfinders requires the

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7 Our analysis is unaffected by the Sixth Circuit’s recent decision in *Onkyo Europe Electronics GMBH v. Global Technovations Inc. (In re Global Technovations Inc.),* 694 F.3d 705, 722 (6th Cir. 2012). There, the Sixth Circuit concluded that it was “crystal clear that the bankruptcy court had constitutional jurisdiction under *Stern* to adjudicate whether the sale of GTI was a fraudulent transfer.” *Id.* But it was “crystal clear” because “it was not possible . . . to rule on [the creditor’s] proof of claim without first resolving the fraudulent-transfer issue.” *Id.* (quoting *Stern,* 131 S. Ct. at 2616). That rendered *In re Global* “fundamentally unlike” both *Granfinanciera* and our case, “where the bankruptcy estate reached out to file a fraudulent-transfer claim against a party who had filed no claim against the estate.” *Id.*
same answer as the question whether Article III allows Congress to assign adjudication of that cause of action to a non-Article III tribunal. For if a statutory cause of action, such as respondent’s right to recover a fraudulent conveyance under 11 U.S.C. § 548(a)(2), is not a “public right” for Article III purposes, then Congress may not assign its adjudication to a specialized non-Article III court lacking “the essential attributes of the judicial power.”

492 U.S. at 53. And the Court in Stern characterized cases involving Seventh Amendment jury trial rights as binding authority on the Article III issue. Stern described Granfinanciera—a case about Seventh Amendment rights—as deciding that “Congress could not constitutionally assign resolution of the fraudulent conveyance action to a non-Article III court.” 131 S. Ct. at 2614 n.7.

The Stern Court again transmuted a Seventh Amendment case into an Article III precedent in its analysis of Langenkamp v. Culp, 498 U.S. 42 (1990). Langenkamp itself stated that the case “present[ed] the question whether creditors who submit a claim against a bankruptcy estate and are then sued by the trustee in bankruptcy to recover allegedly preferential monetary transfers are entitled to jury trial under the Seventh Amendment.” Id. at 42–43. On the Stern Court’s reading, however, Langenkamp also decided whether such a claim could be heard in bankruptcy at all: “We explained [in Langenkamp] that a preferential transfer claim can be heard in bankruptcy when the allegedly favored creditor has filed a claim . . . . If, in contrast, the creditor has not filed a proof of claim, the trustee’s preference action does not ‘become[ ] part of the claims-allowance process’ subject to resolution by the
bankruptcy court.” 131 S. Ct. at 2617 (alteration in original) (emphasis added) (quoting Langenkamp, 498 U.S. at 45).

Stern fully equated bankruptcy litigants’ Seventh Amendment right to a jury trial in federal bankruptcy proceedings with their right to proceed before an Article III judge. Hence, Granfinanciera’s statement that “[u]nless a legal cause of action involves ‘public rights,’ Congress may not deprive parties litigating over such a right of the Seventh Amendment’s guarantee to a jury trial” is powerful evidence that Congress also may not deprive such parties of their right to an Article III tribunal. 492 U.S. at 53.

Several amici object that the claim at issue in Stern was a state-law claim, and that the Trustee’s § 548 fraudulent conveyance claim is indistinguishable from the preferential transfer claim at issue in Katchen v. Landy, 382 U.S. 323 (1966). Katchen held that bankruptcy referees acting under the Bankruptcy Acts of 1898 and 1938 could exercise summary jurisdiction over a voidable preference claim brought by a bankruptcy trustee against a creditor who filed proof of claim in the bankruptcy proceeding. Id. at 329–30, 332–33. The Stern Court did distinguish Katchen on the grounds that “the trustee bringing the preference action was asserting a right of recovery created by federal bankruptcy law.” 131 S. Ct. at 2618 (“Vickie’s claim, in contrast, is in no way derived from or dependent upon bankruptcy law; it is a state tort action that exists without regard to any bankruptcy proceeding.”). And Granfinanciera noted that actions to recover preferences are “indistinguishable . . . in all relevant respects” from actions to recover fraudulent conveyances. 492 U.S. at 48–49. There is an argument, then, that bankruptcy courts can render final judgment on a fraudulent
conveyance claim whose source of law is the Bankruptcy Code.

That is wrong for two reasons. First, the dispositive distinction between the claims in *Stern* and *Katchen* was that in *Katchen*, the trustee’s preference action “would necessarily be resolved in the claims allowance process” because the defendant had filed a proof of claim against the bankruptcy estate. *Stern*, 131 S. Ct. at 2618. The preference action necessarily had to be resolved in the course of deciding whether to allow the defendant’s claim on the estate. By contrast, Vickie Marshall’s counterclaim in *Stern* required the bankruptcy court to “make several factual and legal determinations that were not disposed of in passing on objections to Pierce’s proof of claim for defamation.” *Id.* at 2617 (internal quotation marks omitted). “There thus was never reason to believe that the process of ruling on Pierce’s proof of claim would necessarily result in the resolution of Vickie’s counterclaim.” *Id.* at 2617–18.

Second, a rule that classified any federal-law claim as a “public right” would render *Stern* internally contradictory. Assume that the *Stern* Court’s observation that “Vickie’s claim . . . is in no way derived from or dependent upon bankruptcy law” was the sole basis by which the Court distinguished the counterclaim in that case from the preference action in *Katchen*. If that were so, the *Stern* Court’s characterization of the holding in *Granfinanciera*—that “Congress could not constitutionally assign resolution of the fraudulent conveyance action to a non-Article III court,” 131 S. Ct. at 2614 n.7—would be incoherent, because the claim in *Granfinanciera* arose under § 548 of the Bankruptcy Code. See 492 U.S. at 36.
Granfinanciera involved a federal-law claim, and Stern involved a state-law claim. But Stern held that both claims required an Article III court. Thus, the only principled basis on which to distinguish Katchen from both Stern and Granfinanciera is that Katchen involved a claim against a creditor that necessarily had to be resolved in the course of the claims-allowance process, and Stern and Granfinanciera did not.

In this case, EBIA is a noncreditor to the BIA bankruptcy estate. Hence, it is not subject to the bankruptcy court’s equitable jurisdiction; the trustee can recover monies fraudulently conveyed to it only by initiating a legal action. Cf. Langenkamp, 498 U.S. at 45 (“If a party does not submit a claim against the bankruptcy estate, however, the trustee can recover allegedly preferential transfers only by filing what amounts to a legal action to recover a monetary transfer.”). That legal action need not necessarily have been resolved in the course of allowing or disallowing the claims against the BIA estate. For that reason, the claim belonged in an Article III court. See Stern, 131 S. Ct. at 2618 (“Congress may not bypass Article III simply because a proceeding may have some bearing on a bankruptcy case; the question is whether the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process.”). That the Trustee asserted a federal-law fraudulent conveyance claim against EBIA is of no moment to our conclusion that the claim is nonadjudicable by a bankruptcy judge.

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Taken together, Granfinanciera and Stern settle the question of whether bankruptcy courts have the general
authority to enter final judgments on fraudulent conveyance claims asserted against noncreditors to the bankruptcy estate. They do not. We now turn to a subsidiary question: whether bankruptcy judges may constitutionally hear such claims, and prepare recommendations for de novo review by the federal district courts.

III

Federal law authorizes bankruptcy judges to “hear and determine all cases under title 11 and all core proceedings arising under title 11, or arising in a case under title 11.” 28 U.S.C. § 157(b)(1). Bankruptcy judges have the narrower power to “hear” a proceeding that is “not a core proceeding but that is otherwise related to a case under title 11,” and to “submit proposed findings of fact and conclusions of law to the district court” for the entry of final judgment. *Id.* § 157(c)(1).

Our conclusion today creates a gap in this framework: Federal law classifies fraudulent conveyance proceedings as “core” proceedings, 28 U.S.C. § 157(b)(2)(H), but the Constitution prohibits bankruptcy judges from entering a final judgment in such core proceedings. Nowhere does the statute explicitly authorize bankruptcy judges to submit proposed findings of fact and conclusions of law in a core proceeding; § 157(c)(1) is expressly limited to “non-core” proceedings. Is the power “to hear and determine” capacious enough to include the power to submit proposed findings in a core proceeding? Or are bankruptcy courts impotent to address fraudulent conveyance proceedings, because they fall in the interstices of § 157?
We have noted that Congress enumerated the examples of core proceedings in § 157(b)(2) with “a view toward expanding the bankruptcy court’s jurisdiction to its constitutional limit.” *Mankin*, 823 F.2d at 1301; see also *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 (1995). With respect to any bankruptcy-related claim, then, the bankruptcy courts must be vested with as much adjudicatory power as the Constitution will bear. In light of this statutory objective, the power to “hear and determine” a proceeding surely encompasses the power to hear the proceeding and submit proposed findings of fact and conclusions of law to the district court. Section 157(b)(1) empowers bankruptcy courts to “hear and determine” fraudulent conveyance claims in a manner consistent with the strictures of Article III—and that includes the more modest power to submit findings of fact and recommendations of law to the district courts.

In sum, § 157(b)(1) provides bankruptcy courts the power to hear fraudulent conveyance cases and to submit reports and recommendations to the district courts. Such cases remain in the core, and the § 157(b)(1) power to “hear and determine” them authorizes the bankruptcy courts to issue proposed findings of fact and conclusions of law. Only the power to enter final judgment is abrogated.8

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8 In dicta, the Seventh Circuit has implied that bankruptcy courts cannot propose findings of fact and conclusions of law in any proceeding classified as core by § 157. *See Ortiz v. Aurora Health Care, Inc. (In re Ortiz)*, 665 F.3d 906, 915 (7th Cir. 2011). We do not find the *Ortiz* court’s analysis of the issue thoroughly reasoned. *See also Waldman v. Stone*, ___ F.3d ___, 2012 WL 5275241, at *8 (6th Cir. Oct. 26, 2012) (observing in dicta that “§ 157(b)(1) authorizes the bankruptcy court to ‘enter appropriate orders and judgments,’ not to propose them,” but acknowledging that “one might argue that . . . Congress’s grant of the greater power to enter final judgments implies a lesser authority to
Our conclusion is consistent with the *Stern* Court’s tacit approval of bankruptcy courts’ continuing to hear and make recommendations about statutory core proceedings in which entry of final judgment by a non-Article III judge would be unconstitutional. The district court that heard *Stern* before it reached the Supreme Court took the view that the bankruptcy court had lacked the constitutional authority to enter final judgment on Vickie Marshall’s counterclaim. See *Stern*, 131 S. Ct. at 2602. For that reason, the district court treated the bankruptcy court’s judgment as “proposed[,] rather than final,” and reviewed the judgment de novo. *Id.* (alteration in original). Nowhere did the *Stern* Court object to the district court’s judgment. Instead, the Court noted that Pierce Marshall “ha[d] not argued that the bankruptcy courts are barred from hearing all counterclaims or proposing findings of fact and conclusions of law on those matters.” *Id.* at 2620 (internal quotation marks omitted). Immediately thereafter, the Court explained, “We do not think the removal of counterclaims such as Vickie’s from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree . . . that the question presented here is a ‘narrow’ one.” *Id.* Stripping the bankruptcy courts of the power to entertain state-law counterclaims in any capacity would have roiled the prevailing bankruptcy schema. The Court was surely suggesting that bankruptcy courts were not “barred from hearing all counterclaims or proposing findings of facts and conclusions of law on those matters.” *Id.* (internal quotation marks omitted); see also *Heller Ehrman LLP v. Arnold & Porter, LLP (In re Heller Ehrman)*, 464 B.R. 348, 355–56 (N.D. Cal. 2011) (noting the near-universal approbation by district courts and bankruptcy courts of the view that *Stern* permits bankruptcy courts to submit reports propose them.”).
and recommendations in bankruptcy-related proceedings even when the entry of final judgment is unconstitutional).

For these reasons, we conclude that bankruptcy courts have statutory authority to hear and enter proposed findings of fact and conclusions of law in a fraudulent conveyance proceeding asserted by a bankruptcy trustee against a noncreditor, subject to de novo review by a federal district court.

IV

Several amici contend that even if defendants in fraudulent conveyance suits have a right to a hearing in an Article III court, that right is waivable. We agree, and hold that EBIA waived its right to an Article III hearing.

The waivable nature of the allocation of adjudicative authority between bankruptcy courts and Article III courts is well established. Prior to the Bankruptcy Act of 1978, federal law distinguished between “summary” matters, which involved property in the actual or constructive possession of the court, and “plenary” matters, which did not. See Northern Pipeline, 458 U.S. at 53. Bankruptcy referees were vested with jurisdiction over summary matters, but plenary suits could only be tried by an Article III judge. But the right to an Article III judge in plenary proceedings could be waived by the litigants. See MacDonald v. Plymouth County Trust Co., 286 U.S. 263, 267 (1932).

Following the genesis of the modern bankruptcy system, the Supreme Court clarified that “Article III, § 1’s guarantee of an independent and impartial adjudication by the federal judiciary of matters within the judicial power of the United
States . . . serves to protect primarily personal, rather than structural, interests.” *Schor*, 478 U.S. at 848.9 *Stern* further made clear that § 157 “does not implicate questions of subject matter jurisdiction.” 131 S. Ct. at 2607. Accordingly, “as a personal right, Article III’s guarantee of an impartial and independent federal adjudication is subject to waiver.”10 *Schor*, 478 U.S. at 848; *see also* Daniels-Head & Assocs. v. William M. Mercer, Inc. (In re Daniels-Head & Assocs.), 819 F.2d 914, 918 (9th Cir. 1987). And in fact, § 157(c)(2) expressly provides that bankruptcy courts may enter final judgments in non-core proceedings “with the consent of all the parties to the proceeding.” 28 U.S.C. § 157(c)(2).

9 *Schor* did hold that “notions of consent and waiver cannot be dispositive” of Article III problems when “the encroachment or aggrandizement of one branch at the expense of the other” is at stake, because in such cases structural principles are implicated in addition to private rights entitlements. 478 U.S. at 850–51, 860 (internal quotation marks omitted). In fact, that was the case in *Schor*, because the case involved whether an Executive Branch administrative agency could adjudicate a state-law counterclaim. *Id.* at 852. But the allocation of authority between bankruptcy courts and district courts does not implicate structural interests, because bankruptcy judges are “officer[s] of” the district court and are appointed by the Courts of Appeals. *See* 28 U.S.C. § 151, 152(a)(1).

10 The same principle permits federal magistrate judges, acting with the consent of the litigants, to enter final judgments in proceedings that would otherwise be the exclusive province of Article III courts. *See* 28 U.S.C. § 636(c)(1); *Pacemaker Diagnostic Clinic of Am., Inc. v. Instromedix, Inc.*, 725 F.2d 537, 547 (9th Cir. 1984) (en banc) (“We hold that consensual reference of a civil case to a magistrate is constitutional . . . .”). And consent to a magistrate judge’s case-dispositive authority may be implied from a litigant’s actions. *See* Roell v. Winthrow, 538 U.S. 580, 586–87 (2003).
If consent permits a non-Article III judge to decide finally a non-core proceeding, then it surely permits the same judge to decide a core proceeding in which he would, absent consent, be disentitled to enter final judgment. The only question, then, is whether EBIA did in fact consent to the bankruptcy court’s jurisdiction.

We have previously held that a bankruptcy litigant impliedly consents to the bankruptcy court’s jurisdiction when he fails to timely object. In In re Daniels-Head, 819 F.2d at 919, we held “that appellant’s failure to object to the bankruptcy court’s jurisdiction constitutes consent to that jurisdiction.” Similarly, in Mann v. Alexander Dawson Inc. (In re Mann), 907 F.2d 923, 926 (9th Cir. 1990), we held that a debtor’s decision to file an adversary proceeding in bankruptcy court, and his failure to object to the court’s jurisdiction prior to the time it rendered judgment against him, meant that “he consented to the court’s jurisdiction.” Id.

This case, of course, is somewhat different, because the Trustee, not EBIA, initiated the adversary proceeding. But EBIA’s conduct bore considerable indicia of consent. EBIA initially demanded a jury trial, invoking its rights under Granfinanciera, which the district court treated as a motion to withdraw the reference. See Defs.’ Answer at 14, In re Bellingham Ins. Agency, No. 06-11721 (Bankr. W.D. Wash. Aug. 2, 2008), ECF No. 169; Mot. to Withdraw the Reference, Arkison v. Exec. Benefits Ins., No. 10-cv-00171 (W.D. Wash. Jan. 28, 2010), ECF No. 1. But EBIA elected not to pursue a hearing in an Article III court. Instead, EBIA petitioned the district court to stay its consideration of the motion to withdraw the reference to give the bankruptcy court time to adjudicate the Trustee’s motion for summary judgment. See Order, Arkison v. Exec. Benefits Ins., No. 10-
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cv-00171 (W.D. Wash. Mar. 26, 2010), ECF No. 5. In other words, EBIA did not simply fail to object to the bankruptcy judge’s authority to enter final judgment in the fraudulent conveyance action; it affirmatively assented to suspend its demand for a jury trial in district court to give the bankruptcy judge an opportunity to adjudicate the claim.

A month later, the bankruptcy court entered summary judgment in Arkison’s favor. EBIA abandoned its motion to withdraw the reference, and the district court dismissed the action. See Order, Arkison v. Exec. Benefits Ins., No. 10-cv-00171 (W.D. Wash. July 2, 2010), ECF No. 8. EBIA then separately appealed the bankruptcy court’s judgment in the district court for the Western District of Washington. EBIA did not argue at any point during that appeal that the bankruptcy court lacked authority to issue a final judgment in the fraudulent conveyance action. In fact, EBIA did not raise a constitutional objection to the bankruptcy court’s entry of final judgment in favor of the Trustee until after the briefing in this appeal was complete, when it filed a motion to vacate the bankruptcy court’s judgment on the eve of oral argument. Because EBIA waited so long to object, and in light of its litigation tactics, we have little difficulty concluding that EBIA impliedly consented to the bankruptcy court’s jurisdiction. See United States v. Olano, 507 U.S. 725, 731 (1993) (“‘No procedural principle is more familiar to this Court than that a constitutional right,’ or a right of any other sort, ‘may be forfeited . . . by the failure to make timely assertion of the right before a tribunal having jurisdiction to determine it.’”) (quoting Yakus v. United States, 321 U.S. 414, 444 (1944))). Cf. In re Ortiz, 665 F.3d at 909–10, 915 (refusing to find implied consent to a bankruptcy judge’s authority where the debtors moved for the bankruptcy judge
to abstain from jurisdiction and petitioned the district court to withdraw the reference from the bankruptcy judge).

There are two potential objections to our conclusion that EBIA impliedly consented to the bankruptcy judge’s authority. The first is that Federal Rules of Bankruptcy Procedure 7008 and 7012, which implement the statutory core/non-core dichotomy, preclude a finding of implied consent. These rules provide that an adversary proceeding complaint “shall contain a statement that the proceeding is core or non-core and, if non-core, that the pleader does or does not consent to entry of final orders or judgment by the bankruptcy judge”; a similar requirement applies to responsive pleadings. See Fed. R. Bankr. P. 7008(a), 7012(b). A 1987 advisory committee note to Rule 7008 provides that “only express consent in the pleadings or otherwise is effective to authorize entry of a final order or judgment by the bankruptcy judge in a non-core proceeding.”

We have subsequently held, however, that a litigant’s actions may suffice to establish consent. See In re Mann, 907 F.2d at 926; accord In re Tex. Gen. Petroleum Corp., 52 F.3d at 1337; Abramowitz v. Palmer, 999 F.2d 1274, 1280 (8th Cir. 1993); Canal Corp. v. Finnman (In re Johnson), 960 F.2d 396, 403 (4th Cir. 1992).

Indeed, Roell—decided in 2003—precludes any objection on the basis of the bankruptcy rules. 538 U.S. at 586. At the time Roell was decided, Federal Rule of Civil Procedure 73(b) specified that if parties consented to a magistrate judge’s dispositive power over their case, their consent was required to “be memorialized in ‘a joint form of consent or separate forms of consent setting forth such election.’” 538 U.S. at 586 (quoting Fed. R. Civ. P. 73(b) (2003)).
Federal Magistrate Act, however, stated only that “[u]pon the consent of the parties, a full-time United States magistrate judge . . . may conduct any or all proceedings in a jury or nonjury civil matter and order the entry of judgment in the case, when specially designated to exercise such jurisdiction by the district court.” 28 U.S.C. § 636(c)(1). Noting that “§ 636(c)(1)[ ] speaks only of ‘the consent of the parties,’ without qualification as to form,” the Court held that implied consent could satisfy the statute, notwithstanding the specific procedure described in Rule 73(b). Roell, 538 U.S. at 586.

Like the provision of the Federal Magistrate Act at issue in Roell, the text of § 157(c) only requires consent simpliciter. See 28 U.S.C. § 157(c)(2) (requiring “the consent of all the parties to the proceeding”). By contrast, § 157(e) permits bankruptcy judges to conduct jury trials “with the express consent of all the parties” (emphasis added). The adjectival distinction suggests that Congress intended to allow parties to consent by their actions to the authority of bankruptcy courts to enter dispositive orders on any bankruptcy-related claim. Accordingly, in cases like this one—in which the defendant was aware of its right to seek withdrawal of the reference but opted instead to litigate before the bankruptcy court—consent is established.

The second potential objection is that Stern was not decided until EBIA’s appeal was pending before this court. True, but EBIA had ample reason to be alert to the possible jurisdictional problem. We published Marshall v. Stern, 600 F.3d 1037 (9th Cir. 2010), on March 19, 2010, before EBIA asked the district court to stay its motion to withdraw the reference. That predicate opinion featured a lengthy perscrutination of the Article III question. Although we reached a different set of conclusions than the Supreme Court
ultimately did, the opinion should have been sufficient to alert EBIA to the possible jurisdictional problem. The same is true of Granfinanciera, which thoroughly foreshadowed the result in Stern. And we know that EBIA’s counsel was aware of Granfinanciera, because the company asserted—and then abandoned—the very Seventh Amendment right that case established.

Further, the Stern Court applied the doctrine of litigant consent even when little authority existed to notify the litigant that a constitutional objection was there for the making. In Stern, Pierce Marshall propounded the novel argument that the bankruptcy court lacked jurisdiction to enter final judgment on his defamation claim because § 157(b)(5) granted to district courts exclusive jurisdiction over “personal injury tort” claims. 131 S. Ct. at 2606. The Court held that Pierce consented to the bankruptcy court’s jurisdiction over the claim when he failed to timely object. Id. at 2608. By contrast, Pierce voiced his objection to the bankruptcy court’s jurisdiction over Vickie’s counterclaim from the outset of the litigation. See id. at 2601.

Although EBIA may not be as sophisticated or creative as Pierce, it fully litigated the fraudulent conveyance action before the bankruptcy court and the district court, without so much as a peep about Article III—even going so far as to abandon its motion to withdraw the reference. “[T]he consequences of a litigant sandbagging the court—remaining silent about his objection and belatedly raising the error only if the case does not conclude in his favor—can be . . . severe.” Id. at 2609 (internal quotation marks, alterations, and citations omitted). Having lost before the bankruptcy court, EBIA cannot assert a right it never thought to pursue when it still believed it might win. Id.
Because we conclude that EBIA consented to the bankruptcy court’s jurisdiction, we proceed to the merits of that judgment.

The district court affirmed the bankruptcy court’s grant of summary judgment on the claim that the transfer of BIA’s assets to EBIA constituted a fraudulent transfer. See 11 U.S.C. § 548. Section 548 empowers the trustee to avoid a transfer of the debtor’s property, or any obligation incurred by the debtor, that was fraudulently made or incurred within two years of the bankruptcy petition. A trustee may exercise the avoidance power when the transfer was actually intended to hinder, delay, or defraud a creditor. Id. § 548(a)(1)(A). Even in the absence of actual fraudulent intent, the trustee can avoid a “constructively” fraudulent transfer: one that was made in exchange for less than “reasonably equivalent value” at a time when the debtor was insolvent. Id. § 548(a)(1)(B).

The district court held that the trustee satisfied all elements of a constructively fraudulent transfer, because BIA transferred to EBIA all of its assets when EBIA began operating in February 2006, including its phone number, book of business, and especially its stream of insurance commissions. BIA received nothing in return.

EBIA’s only defense is that it received no items of value from BIA prior to the filing of the bankruptcy petition. EBIA argues first that any commission streams that changed hands were transferred to the related entity ARIS, not to EBIA, and
second that everything else that was transferred was either a liability or an asset with negligible value.¹¹

EBIA’s assertions are belied by the record. EBIA is correct that the Trustee’s expert accountant, Michael Quackenbush, testified that $373,291.28 was deposited into an account held jointly by ARIS and EBIA. But, as the district court correctly noted, those commissions were credited to EBIA via intercompany transfers in the accounting software. The evidence that this money was transferred from BIA to EBIA is overwhelming. BIA executed a written assignment of its commissions from a major client to an employee, Peter Pearce, who immediately became an EBIA employee upon BIA’s dissolution. Pearce deposited $123,133.58 into the ARIS/EBIA account. And EBIA itself deposited more than $250,000 in additional commissions that obviously belonged to BIA.

EBIA is entitled to any reasonable inference that would suggest an explanation of the provenance of these sums other than the one the Trustee proposes. See Bodett v. CoxCom, Inc., 366 F.3d 736, 742 (9th Cir. 2004). But EBIA makes no serious attempt to offer a nonfraudulent explanation. EBIA’s only rebuttal evidence is the declaration of erstwhile BIA CEO Nicholas Paleveda, who claims that the commissions Pearce deposited into the account belonged to Pearce personally. In his declaration, he also asserts that the remaining quarter-million dollars of commissions credited to EBIA between January 1 and June 1 came from new business

¹¹ EBIA’s piteous examples of such assets include “unemployed actuaries” and “a lease arrangement . . . for an office that no clients visited.” Appellant’s Opening Br. 9.
that the company drummed up without relying on BIA’s old business relationships.

Both claims are incredible. Property of the estate includes intangible assets, such as corporate goodwill and a “book of business.” See Stoumbos v. Kilimnik, 988 F.2d 949, 963–64 (9th Cir. 1993). The transfer of an ongoing business concern can constitute a fraudulent transfer. See, e.g., id. The Trustee produced to the bankruptcy court the document assigning the commissions from BIA’s client American National to Pearce, and various witnesses testified that Pearce’s role at BIA was to act as a conduit for commissions between the company and its clients. Further, Paleveda stated that EBIA did not earn any revenue until May 2006. Paleveda thus suggests that in a matter of weeks—from May to June 1—EBIA earned hundreds of thousands of dollars of new commissions that were unrelated to BIA’s old business.

Put simply, there is no genuine dispute of material fact that these transfers were constructively fraudulent and recoverable by the Trustee under § 548. See Stoumbos, 988 F.2d at 953.

The bankruptcy court also granted summary judgment on the Trustee’s claim that EBIA violated Washington’s Uniform Fraudulent Transfer Act, Wash. Rev. Code §§ 19.40.011–19.40.904. The definition of a constructively fraudulent transfer under the Washington Uniform Fraudulent Transfer Act is essentially identical to the definition of a constructively fraudulent transfer under § 548 of the Bankruptcy Code. It is any transfer that is made “[w]ithout receiving a reasonably equivalent value in exchange for the transfer or obligation” while the debtor:
(i) Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

(ii) Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

_Id._ § 19.40.041(a)(2).

EBIA does not argue in its briefs that we ought to distinguish between the state- and federal-law causes of action. We therefore conclude that the district court properly affirmed the bankruptcy court’s grant of summary judgment on the Trustee’s state-law constructive fraudulent transfer claim.

The district court also concluded that the Trustee adduced sufficient evidence to demonstrate actual fraudulent intent by BIA. Our conclusion that the transfers to EBIA were constructively fraudulent under Washington law is a sufficient basis on which to affirm the judgment. _See Thompson v. Hanson_, 219 P.3d 659, 664 (Wash. 2009). Hence, we need not reach the question of whether the transfers were actually fraudulent.

**B**

In addition to addressing the Trustee’s fraudulent conveyance claims, the bankruptcy court granted summary judgment on the Trustee’s claim that EBIA was a successor corporation of BIA, and therefore liable for the latter’s debts. We agree that EBIA is BIA’s successor.
The rule in Washington is that “a corporation purchasing the assets of another corporation does not become liable for the debts and liabilities of the selling corporation.” Cambridge Townhomes, LLC v. Pac. Star Roofing, Inc., 209 P.3d 863, 868 (Wash. 2009). An exception is made, however, when “the purchaser is a mere continuation of the seller.” Id. (internal quotation marks omitted). Several factors dictate whether a business is a “mere continuation” of its predecessor, including “a common identity between the officers, directors, and stockholders of the selling and purchasing companies, and the sufficiency of the consideration running to the seller corporation in light of the assets being sold.” Id. The nub of the inquiry is whether “the purchaser represents merely a ‘new hat’ for the seller.” Cashar v. Redford, 624 P.2d 194, 196 (Wash. Ct. App. 1981) (internal quotation marks omitted).

EBIA marshals a variety of facts in an attempt to prove that the two companies are authentically distinct entities. For instance, EBIA notes that none of BIA’s seven shareholders became EBIA shareholders. EBIA also adopted a radically different business image, including a “completely different name” and a new logo and website. Finally, EBIA remarks that its business model represents a sea change from BIA’s, because BIA focused exclusively on 412(i) retirement plans, while EBIA traffics in a broader range of defined-benefit retirement plans.

EBIA is indulging in what Freud called the narcissism of minor differences.\textsuperscript{12} EBIA’s statement that there were no common shareholders between the two entities is technically true but deeply misleading. Paleveda was the sole owner of

EBIA and the CEO of BIA prior to EBIA’s incorporation; his wife, Marjorie Ewing, owned eighty percent of BIA. Because a “common identity of the officers, directors, and stockholders” is the “crucial factor” in the “mere continuation” judgment, Cashar, 624 P.2d at 196, the fact that the same married couple owned and operated both BIA and EBIA is virtually dispositive. In any case, a variety of other factors militate in favor of a finding of successor liability. The core employees remained the same, there was no consideration paid for BIA’s transfer of assets, and the essential business—marketing and selling defined-benefit plans funded by insurance policies—remained the same. Cf. Cambridge Townhomes, 209 P.3d at 869.

Weighed against these fundamental commonalities, minor divergences like the company names, logos, and websites are immaterial. The evidence shows that EBIA was nothing more than a “new hat” for Paleveda and Ewing. The bankruptcy court correctly granted summary judgment to the Trustee on the issue of successor liability.

VI

Fraudulent conveyance claims are “quintessentially suits at common law” designed to “augment the bankruptcy estate.” Granfinanciera, 492 U.S. at 56. Thus, Article III bars bankruptcy courts from entering final judgments in such actions brought by a noncreditor absent the parties’ consent. But here EBIA consented to the bankruptcy court’s jurisdiction, rendering that court’s entry of summary judgment in favor of the Trustee constitutionally sound. That judgment was also correct.

AFFIRMED.
IN THE UNITED STATES COURT OF APPEALS

FOR THE ELEVENTH CIRCUIT

No. 12-11450
Non-Argument Calendar

D.C. Docket No. 1:11-cv-20635-KAM,
BKCY No. 07-21016-LMI

In Re: SUNDALE, LTD., f.k.a. Sundale Associates, Ltd.,

Debtor.

SUNDALE, LTD.,
KENDALL HOTEL AND SUITES, LTD.,

Plaintiffs - Appellants,

versus

FLORIDA ASSOCIATES CAPITAL ENTERPRISES, LLC,

Defendant - Appellee,

Appeal from the United States District Court
for the Southern District of Florida

(November 29, 2012)

Before MARCUS, FAY and ANDERSON, Circuit Judges.

PER CURIAM:
Appellants Sundale, LTD (“Sundale”) and Kendall Hotel and Suites, LLC (“KHS”) (collectively, “Sundale”) appeal from the district court’s judgment upholding the bankruptcy court’s finding of fact and conclusions of law in support of a final judgment in favor of Plaintiff/Counterdefendant Florida Associates Capital Enterprises, LLC (“FACE”). In Sundale’s bankruptcy proceedings, FACE sought a declaratory judgment regarding the extent, validity and priority of the claims it had that stemmed from secured loans it had made to Sundale; in response, Sundale asserted various affirmative defenses and filed counterclaims against FACE, including a claim of recoupment of more than three million dollars in payments Sundale had made to FACE concerning the secured loans. In this appeal, Sundale argues that: (1) the district court erred in concluding that the bankruptcy court had jurisdiction over Sundale’s counterclaims; (2) the district court’s review of the bankruptcy proceedings did not cure the bankruptcy court’s unconstitutional exercise of jurisdiction; and (3) the bankruptcy court misapplied Florida law in ruling on the merits. After careful review, we affirm.

We review subject matter jurisdiction de novo. Adventure Outdoors, Inc. v. Bloomberg, 552 F.3d 1290, 1294 (11th Cir. 2008). We review “the district court’s decision to affirm the bankruptcy court de novo, which allows us to assess the bankruptcy court’s judgment anew, employing the same standard of review the
district court itself used.”  In re Globe Mfg. Corp., 567 F.3d 1291, 1296 (11th Cir. 2009). The bankruptcy court’s factual findings are reviewed for clear error. Id. Factual findings are clearly erroneous if “the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed.” Jones v. Childers, 18 F.3d 899, 904 (11th Cir. 1994) (quotation omitted). “Conclusions of law, whether from the bankruptcy court or the district court, are reviewed de novo.” In re Jennings, 670 F.3d 1329, 1332 (11th Cir. 2012) (quotation omitted). Mixed questions of law and fact are also reviewed de novo. In re Piper Aircraft Corp., 244 F.3d 1289, 1295 n.2 (11th Cir. 2001).

The relevant facts are these. Phillip Scutieri, Jr. (“Mr. Scutieri”) is the principal of both Sundale and KHS. Raymond G. Chambers (“Mr. Chambers”), a successful businessman involved in leveraged buyouts in the 1980s, had a very close personal and professional relationship with the Scutieri family for over forty years.

On November 20, 1997, Mr. Scutieri’s mother, Delphine Scutieri (“Mrs. Scutieri”), advised her son that she believed that Mr. Chambers had taken certain assets from her husband’s estate to begin Chambers’s leveraged buyout business. After Mrs. Scutieri’s suspicions were relayed to Mr. Chambers, Mr. Chambers sent a letter to Mrs. Scutieri in which he promised to “share everything” with Mrs.
Over the next five months, representatives from the two parties attempted to resolve the dispute between them, and eventually Mr. Scutieri relayed that the Scutieris would require $420,000,000 to resolve the dispute.

Thereafter, Mrs. Scutieri apparently asked Mr. Chambers to give $10 million to her son to develop a nine-acre tract of land in Miami, Florida owned by Sundale (the “Sundale Property”), with the remaining amount due (approximately $410,000,000) to be worked out. According to Mr. Chambers, he said he would not loan the $10,000,000, but that he would tell his “financial advisors that they, (A), help [Mr. Scutieri] get a conventional first mortgage loan on the [Sundale Property] and, (B), if that loan fell short of the $10,000,000, that [Chambers] would recommend to them that [Chambers’s] entities provide up to $2 million in a subordinated second mortgage loan.” A witness to a meeting between the parties testified otherwise, attesting that Mr. Chambers promised to give $10,000,000 as an “initial payment of getting the monies back to [Mrs. Scutieri].” Shortly after this meeting, Mr. Chambers’s representatives created FACE, the sole purpose of which was to provide funding for Mr. Scutieri’s Sundale project.

Between July 30, 1999, and March 20, 2000, FACE (and/or its members) loaned Sundale a total of $7,300,000, through various promissory notes, personal guarantees, and mortgage and security agreements. On September 7, 2001,
Sundale closed a $12,000,000 loan with Ocean Bank for the Sundale project (the “Ocean Bank Loan”). The terms of the agreement provided for FACE’s loans to be reduced to $3,250,000, and for FACE to subordinate its lien to the lien of Ocean Bank with respect to the remaining indebtedness. Sundale was obligated to make quarterly interest payments until November 29, 2002, and then monthly payments thereafter. Sundale made all interest payments due to FACE through May 2005.

On December 11, 2007, both Ocean Bank and FACE sent default notices to Sundale. The next day, Sundale filed for protection under Chapter 11 of the United States Bankruptcy Code, and KHS did the same on January 30, 2008. On May 1, 2008, FACE initiated this adversary proceeding by filing a two-count complaint seeking a determination of the extent, validity, and priority of its asserted lien on the Sundale Property. On November 17, 2008, Sundale and KHS responded by denying FACE’s allegations and asserting a number of affirmative defenses. On July 30, 2009, Sundale and KHS filed a Second Amended Answer, for the first time asserting two counterclaims, one seeking a declaration that FACE’s liens were not valid and enforceable and one for recoupment.

Both Sundale’s affirmative defenses and counterclaims relied upon the same factual and legal bases, namely that FACE’s lien was invalid and unenforceable
because the funds advanced by FACE were intended to be a disguised loan as an initial payment by Mr. Chambers to the Scutieri family as partial payment of the monies Mr. Chambers wrongfully diverted from the estate of Mr. Scutieri’s father. The Bankruptcy Court ultimately ruled in favor of FACE, finding that FACE “overwhelmingly established a prima facie case that it holds a valid, perfected lien against the Sundale Property and the Trustee Property. Conversely, the Defendants failed to meet their burden of proof in every aspect with regard to their affirmative defenses and their counterclaims.” The district court affirmed the bankruptcy court’s determination of the extent, validity and priority of FACE’s claims against Sundale, and it also held -- following the Supreme Court’s recent decision in Stern v. Marshall, 131 S.Ct. 2594 (2011) -- that the bankruptcy court had the authority to rule on these claims. The district court noted, in the alternative, that if the bankruptcy court had exceeded its authority to enter a final judgment, it was treating the bankruptcy court’s findings of fact and conclusions of law as a report and recommendation, which the district court adopted and ratified. This timely appeal follows.

First, we are unpersuaded by Sundale’s claim that the bankruptcy court lacked jurisdiction to enter final judgment on its counterclaims. Congress has divided bankruptcy proceedings into three categories: (1) those that arise under
title 11; (2) those that arise in a title 11 case; and (3) those that are related to a case under title 11.  Stern, 131 S.Ct. at 2603 (citing 28 U.S.C. § 157(a)). “District courts may refer any or all such proceedings to the bankruptcy judges of their district,” and bankruptcy courts may “enter final judgments in ‘all core proceedings arising under title 11, or arising in a case under title 11.’” Id. (quoting §§ 157(a), (b)(1)). Congress has chosen 16 specific types of proceedings that are considered to be “core proceedings” in which bankruptcy courts are statutorily authorized to render final judgments. See id. (citing §§ 157(b)(1)-(2)). Section 157(b)(2)(C) defines “counterclaims by the estate against persons filing claims against the estate” to be one of these “core proceedings.” “Parties may appeal final judgments of a bankruptcy court in core proceedings to the district court, which reviews them under traditional appellate standards.” Id. at 2603-04.

Stern involved a tortious interference counterclaim, arising under state common law, which the bankruptcy court had determined to be a “core proceeding” as defined by § 157(b)(2)(C). See id. at 2601-02. After determining it had jurisdiction over the matter, the bankruptcy court rendered a final judgment on the state law counterclaim. See id. at 2601. The Supreme Court determined that the bankruptcy court had the statutory authority under 28 U.S.C. § 157(b) to issue a final judgment on the state law counterclaim, but that it was a violation of
Article III of the United States Constitution for Congress to confer that authority upon the bankruptcy court. See id. The Supreme Court ultimately held that “[t]he Bankruptcy Court below lacked the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor’s proof of claim.” Id. at 2620. The Supreme Court also made clear that it did not intend its decision in Stern to have broad implications: “We do not think the removal of counterclaims such as [the debtor’s] from core bankruptcy jurisdiction meaningfully changes the division of labor in the current statute; we agree with the United States that the question presented here is a ‘narrow’ one.” Id.

As the district court explained, Stern is inapplicable here. That case involved a tortious interference counterclaim that was a “state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor’s proof of claim in bankruptcy.” Id. at 2611. The complaint in Stern was filed by a creditor seeking a declaration that his defamation claim was not dischargeable in the bankruptcy proceedings. Id. at 2601. The “proof of claim” at issue was “for the defamation action, meaning that [the creditor] sought to recover damages for [the claim] from [the] bankruptcy estate.” Id. The debtor “responded to [the creditor]’s initial complaint by asserting truth as a defense to
the alleged defamation and by filing a counterclaim for tortious interference.” Id. That counterclaim alleged that the creditor “had wrongfully prevented [the debtor’s husband] from taking the legal steps necessary to provide [the debtor] with half his property.” Id. The counterclaim for tortious interference was the claim deemed by the Supreme Court to be a “state law action independent of the federal bankruptcy law and not necessarily resolvable by a ruling on the creditor’s proof of claim in bankruptcy.” Id. at 2611.

Here, the state law counterclaim Sundale travels on in its brief is recoupment -- and as the Florida state courts have explained, recoupment is “a purely defensive matter springing from the same transaction as the plaintiffs’ cause of action, which is available only to reduce or satisfy a plaintiffs’ claim . . . . A recoupment defense is analogous to a compulsory counterclaim, in that both ‘spring’ from the same transaction as the plaintiff’s cause of action.” Kellogg v. Fowler, White, Burnett, Hurley, Banick & Strickroot, P.A., 807 So. 2d 669, 670 n.2 (Fla. 4th Dist. Ct. App. 2001) (citing Metropolitan Cas. Ins. Co. of N.Y. v. Walker, 9 So.2d 361, 362 (Fla. 1942)). Sundale argues to us that FACE’s proof of claim hinged on the money that Sundale had not paid FACE, whereas its recoupment counterclaim hinged on the money that Sundale had paid to FACE. Sundale thus argues that resolving the proof of claim would not resolve its
counterclaim. This distinction is without merit. Indeed, the crux of Sundale’s case theory is that none of the money FACE transferred to Sundale was ever intended to be a loan, but rather the first of many payments Mr. Chambers was to make to the Scutieri family to satisfy a $420,000,000 debt. Sundale relied on this theory to advance numerous affirmative defenses against FACE’s proof of claim and as the premise for its recoupment (and declaratory judgment) counterclaims. All of the affirmative defenses and the counterclaims thus have one common thread -- whether both the money FACE transferred to Sundale and the money that Sundale later transferred back to FACE was premised on a loan by FACE (FACE’s version) or a repayment by FACE (Sundale’s version). As a result, a rejection of Sundale’s version of the events as defenses to FACE’s claims also undermines Sundale’s counterclaims. Similarly, a finding in favor of Sundale on its defenses to FACE’s claims would necessarily result in a favorable ruling for Sundale on its counterclaims. Either way, a resolution of the proof of claim necessarily resolves the recoupment and declaratory judgment counterclaims.

Sundale also seems to suggest that under Stern, a bankruptcy court only has jurisdiction to enter final judgment on federal bankruptcy law claims -- and no state law claims. However, the Supreme Court made no such distinction. Under the clear language of the decision, the Supreme Court held that bankruptcy courts
lack “the constitutional authority to enter a final judgment on a state law counterclaim that is not resolved in the process of ruling on a creditor’s proof of claim.” 131 S.Ct. at 2620 (emphasis added). Because the underlined phrase is included, it must follow that a bankruptcy court would have jurisdiction to enter final judgment on state law counterclaims that are necessarily resolved in the process of ruling on a creditor’s proof of claim. See also id. at 2618 (bankruptcy court jurisdiction to enter final judgment exists if “the action at issue stems from the bankruptcy itself or would necessarily be resolved in the claims allowance process”).

In short, because Sundale’s counterclaims are necessarily resolved by resolution of FACE’s proof of claim, the self-declared narrow holding in Stern is distinguishable from the facts before us. Therefore, we agree with the district court that the bankruptcy court had jurisdiction to enter a final judgment in this case.

We also find no merit to Sundale’s argument that the bankruptcy court erred in applying Florida law. As for Sundale’s claim that the bankruptcy court misinterpreted Florida law by holding that Sundale could not have reasonably relied on FACE’s misrepresentations because they were made in an adversarial context, the lower court relied on binding Eleventh Circuit case law, in the Florida
law context, which concluded that “plaintiffs were unjustified in relying on representations made by the defendants” since, among other things, “the parties had been in an adversarial relationship since well before the execution of the Agreement.” Mergens v. Dreyfoos, 166 F.3d 1114, 1118 (11th Cir. 1999).

Moreover, all of the Florida state cases Sundale cites seem to rest on the principle that one party had no notice that the other party could not be believed. See, e.g., Greene v. Kolpac Builders, Inc., 549 So. 2d 1150, 1152 (Fla. 3d App. Dist. 1989) (allowing a misrepresentation claim “[a]bsent circumstances which would have put Greene on notice that Kolpak’s word could not be believed”); Schlapper v. Maurer, 687 So. 2d 982, 984 (Fla. 5th App. Dist. 1997) (a lawyer’s “professional responsibility owed to the court and the opposing parties imposed on him an obligation not to lie about or misrepresent facts critical to the case” (emphasis removed)). Given the history of the parties in this case, it cannot be said that Sundale had no notice of Mr. Chambers’s dealings with them. Thus, the lower court did not misapply the Florida law of misrepresentation.

As for Sundale’s claim that the bankruptcy court’s analysis of duress improperly relied on its speculative finding that Sundale could have obtained funds by mortgaging the undeveloped adjacent property, the bankruptcy court relied on various other factors in reaching the conclusion that Sundale was not
under financial duress. Moreover, the bankruptcy court relied on record evidence to find that the undeveloped adjacent property was unencumbered, and Sundale fails to offer anything more than speculation to suggest that it could not have obtained a mortgage on that property at the time of the alleged duress as it did a year later.

As for Sundale’s claim that the bankruptcy court erred in finding that the debtors could not prove misrepresentations relating to the 1999 transactions based on the execution of the 2001 documents, as well as its claim that the bankruptcy court’s conclusion that FACE was entitled to seek subordination was circular, Sundale cites no case law or legal argument for these issues in his brief and therefore has waived them. See Fed. R.App. P. 28(a)(9)(A) (providing that an appellant’s brief must set forth his “contentions and the reasons for them, with citations to the authorities and parts of the record on which the appellant relies”); Continental Tech. Servs., Inc., v. Rockwell Int’l Corp., 927 F.2d 1198, 1199 (11th Cir. 1991). Further, because there was no error in the rulings on duress and misrepresentation, these arguments fail.

Finally, Sundale claims that the bankruptcy court erred in concluding that the notes payable to FACE and mortgages in FACE’s favor were enforceable, because, it says, Sundale received no consideration from FACE. As an initial
matter, Sundale does not dispute that FACE’s subordination in 2001 of its security interest in the Sundale property to Ocean Bank’s security interest constituted consideration. Sundale argues, nonetheless, that FACE’s earlier “loans” to Sundale did not constitute consideration because the money came from Mr. Chambers’s trusts or other sources, rather than from FACE itself. However, Sundale admits that some of these earlier transfers were in fact made in FACE’s name, see Blue Br. at 5, and cites nothing for the proposition that these transfers could not be considered valid consideration from FACE.

**AFFIRMED.**
UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

ARVIN E. STEPHENS; KAREN J. STEPHENS, f/d/b/a Ninnekah Quick Mart,

Debtors,

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DILL OIL COMPANY, LLC; DANNY DILL; NANCY DILL,

Appellants,

v. No. 11-6309

ARVIN E. STEPHENS; KAREN J. STEPHENS, f/d/b/a Ninnekah Quick Mart,

Appellees,

NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS,

Amicus Curiae.

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT FOR THE WESTERN DISTRICT OF OKLAHOMA (No. 10-14028-WV)

James Bellingham of Bellingham & Loyd, P.C., Oklahoma City, Oklahoma, for Appellants.
This appeal presents an issue of first impression for our circuit: whether the 2005 amendments to the Bankruptcy Code exempt individual Chapter 11 debtors from the absolute priority rule. The bankruptcy court answered this question in the affirmative. It therefore confirmed the Debtors’ proposed plan of reorganization over certain creditors’ objections that the plan violated the absolute priority rule. On appeal, the bankruptcy appellate panel certified the case for direct appeal. Exercising our jurisdiction under 28 U.S.C. §§ 158(d)(2)(A) & 158(a)(1), we now reverse the bankruptcy court’s order confirming the plan and remand for further proceedings.

Background


* The Honorable William J. Martinez, United States District Judge, District of Colorado, sitting by designation.
Ninnekah Quick Mart, LLC (collectively, “Debtors”) filed for relief under Chapter 11 of the Bankruptcy Code. Aplt. App. 28. Dill Oil Company, LLC and Danny and Nancy Dill (collectively, “the Dills”) objected to confirmation on the ground that the proposed plan violated the absolute priority rule (“APR”), which bars junior claimants, including debtors, from retaining any interest in property when a dissenting class of senior creditors has not been paid in full. Id. at 28, 30; see Search Mkt. Direct, Inc. v. Jubber (In re Paige), 685 F.3d 1160, 1183 (10th Cir. 2012) (discussing APR).

Debtors owned a chain of convenience stores for which the Dills were the primary supplier of gasoline and gas station products. Aplt. App. 28. Due to the rising price of gas and a diminishing customer base, Debtors’ stores began operating at a loss. Id. at 120. Eventually, Debtors became liable to the Dills for approximately $1.8 million. Id. at 28. In December 2008, Debtors executed

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mortgages in favor of the Dills on various tracts of real estate, including a house and farmlands. Id. at 28, 120. The Dills’ mortgages, however, were subordinate to existing mortgages on the properties. Id. at 28.

On December 30, 2010, Debtors filed a proposed plan of reorganization. Id. at 17. Pursuant to the plan, the Dills would be paid approximately $15,000 as a secured creditor, but their remaining claim would be considered unsecured. Id. at 28. Under the plan, Debtors would retain possession and control of their property; the Dills would receive a monthly payment for five years, totaling about 1% of their unsecured claim. Id. at 29, 76.

The Dills subsequently filed an objection to Debtors’ proposed plan. Id. at 29, 97, 198. Because their vote constituted approximately 96% of Class 8’s claims, the Dills’ rejection precluded approval of the plan under § 1129(a). Id. at 102, 132.

On May 20, 2011, the bankruptcy court entered an order confirming the plan under § 1129(b)’s “cram down” mechanism. Id. at 17, 29. The Dills argued that the plan was unconfirmable because it violated the APR. Id. at 29. The bankruptcy court rejected this contention, holding instead that the plain language of the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) abrogated the APR as to individual Chapter 11 debtors. Id. at 21–22.

The Dills timely filed a notice of appeal on June 1, 2011, seeking reversal of the confirmation order. Id. at 25, 32. The Dills proceeded to the bankruptcy court
appellate panel ("BAP"), which sua sponte issued a certification of final order for direct appeal to this court based on its determination that the case presents a question of public importance for which there is no controlling law. Id. at 25. We granted permission to appeal. Id. at 15.

Discussion

A. Should this Appeal Be Dismissed Under the Doctrine of Equitable Mootness?

Debtors urge us to dismiss this appeal under the doctrine of equitable mootness, which “allows a court to decline to hear a bankruptcy appeal, even when relief could be granted, if implementing the relief would be inequitable.” In re C.W. Mining Co., 641 F.3d 1235, 1239–40 (10th Cir. 2011). Equitable mootness is a discretionary, prudential doctrine. See id. at 1240. We have held that a court should apply the doctrine when reaching the merits would be unfair or impractical, taking into consideration the following questions:

1. Has the appellant sought and/or obtained a stay pending appeal?
2. Has the appealed plan been substantially consummated?
3. Will the rights of innocent third parties be adversely affected by reversal of the confirmed plan?
4. Will the public-policy need for reliance on the confirmed bankruptcy plan—and the need for creditors generally to be able to rely on bankruptcy court decisions—be undermined by reversal of the plan?
5. If appellant’s challenge were upheld, what would be the likely impact upon a successful reorganization of the debtor? And
6. based upon a quick look at the merits of appellant’s challenge to the plan, is [the argument] legally meritorious or equitably compelling?
In re Paige, 584 F.3d 1327, 1339 (10th Cir. 2009). The party seeking to prevent the court from reaching the merits bears the burden of proving these factors weigh in favor of dismissal. See id. at 1339–40.

The Dills did not seek a stay pending their appeal, but this factor alone does not preclude the court from granting relief. See id. at 1339 (citing In re Inv. Co. of the Sw., Inc., 341 B.R. 298, 308 (B.A.P. 10th Cir. 2006)). And although the plan has, according to Debtors, been substantially consummated, this does not act as a “blanket discharge of [the] judicial duty to examine carefully each request for relief.” In re AOV Indus., Inc., 792 F.2d 1140, 1148 (D.C. Cir. 1986); see also In re Paige, 584 F.3d at 1342 (explaining that substantial consummation is “not dispositive”).

Instead, “[t]he effects that reversal will have on non-party creditors is probably the foremost concern in our analysis.” In re Paige, 584 F.3d at 1343 (emphasis added); see also In re SI Restructuring, Inc., 542 F.3d 131, 135–36 (5th Cir. 2008). “The other factors are often given much less weight and, in some cases, completely ignored.” In re Paige, 584 F.3d at 1339. Here, reversal will likely compel conversion to a Chapter 7 proceeding. See 11 U.S.C. § 1112; Aplee. Br. 27–28. According to Debtors, the Dills will receive little or nothing under Chapter 7 due to superior liens on non-exempt assets. See Aplee. Br. 28. But the Dills’ argument—which Debtors have not disputed—is that under Chapter 7 either: 1) the secured creditors will receive their property; or 2)
Debtors will reaffirm the creditors’ secured debts and retain the property. See Aplt. R. Br. 14. In either scenario, we find it unlikely that non-party creditors will be adversely affected in any significant way, and Debtors have failed to convince us otherwise. See In re Paige, 584 F.3d at 1343–44.

Although we recognize that Debtors have devoted substantial time and resources toward the plan’s implementation, and we appreciate that reversing the confirmation order will likely preclude a successful reorganization, we also note that the Dills have approximately $1.8 million at stake. Moreover, this case involves a “matter of public importance” for which “there is no controlling decision” in this circuit, Aplt. App. 25, and we believe the Dills’ argument is legally meritorious. As the BAP emphasized in its certification order, “[u]ntil the meaning of the BAPCPA amendments to Chapter 11 is clarified, debtors and creditors in every individual Chapter 11 case must anticipate the possibility of the expense and delay associated with litigation over this issue.” Id. at 34. Because of the private and public interest in resolving this legal issue, we decline to apply the doctrine of equitable mootness. See In re Paige, 584 F.3d at 1348.

B. Does BAPCPA Repeal the Absolute Priority Rule with Respect to Individual Chapter 11 Debtors?

This appeal presents a question of statutory interpretation. Accordingly, we review the bankruptcy court’s determination de novo. In re Kirkland, 572 F.3d 838, 840 (10th Cir. 2009). “[T]he starting point is always the language of the
statute itself. If the language is clear and unambiguous, the plain meaning of the
statute controls.” United States v. Quarrell, 310 F.3d 664, 669 (10th Cir. 2002)
(citation omitted). If, on the other hand, the text is ambiguous—i.e., “capable of
being understood by reasonably well-informed persons in two or more different
senses”—we must inquire further to discern Congress’s intent. See id. (quotation
omitted).

1. Is the statutory language clear and unambiguous?

We begin our analysis by focusing exclusively on the language of the
Bankruptcy Code. See Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716, 723
(2011). Section 1129 of the Code sets out the general requirements for
confirmation of a reorganization plan. Section 1129(a) allows for confirmation
where each class of creditors consents. Alternatively, § 1129(b) provides a
“cram-down” mechanism, whereby a plan may be confirmed without the consent
of each class if, among other things, the plan is “fair and equitable.” Section
1129 outlines the “fair and equitable” criteria, which include the absolute priority
rule. Specifically, § 1129(b)(2)(B)(ii), as amended by BAPCPA, provides that:

the holder of any claim or interest that is junior to the claims of such
class will not receive or retain under the plan on account of such
junior claim or interest any property, except that in a case in which
the debtor is an individual, the debtor may retain property included
in the estate under section 1115, subject to the requirements of
subsection (a)(14) of this section.

(emphasis added).
Section 1115, which BAPCPA added, in turn states:

(a) *In a case in which the debtor is an individual, property of the estate includes, in addition to the property specified in section 541*—

1. all property of the kind specified in section 541 that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or controverted to a case under chapter 7, 12, or 13, whichever occurs first; and

2. earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or controverted to a case under chapter 7, 12, or 13, whichever occurs first.

(b) Except as provided in section 1104 or a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate.

(emphasis added).

Although a number of courts have held this language to be unambiguous, they have reached starkly different conclusions regarding the “plain” meaning. Compare *SPCP Grp., LLC v. Biggins*, 465 B.R. 316, 322 (M.D. Fla. 2011) (“The plain reading of this statute” is that § 1115 “includes . . . property specified in section 541.”), with *In re Steedley*, No. 09-50654, 2010 WL 3528599, at *2 (Bankr. S.D. Ga. Aug. 27, 2010) (“Nothing in the plain language of § 1115 suggests that it subsumes § 541.”). The very existence of this dichotomy seems indicative of the text’s ambiguity. Indeed, several courts have recognized that §§ 1115 and 1129(b)(2)(B)(ii) are susceptible to two different yet plausible

2 Section 541 defines property of the estate to include “all legal or equitable interests of the debtor in property as of the commencement of the case.” 11 U.S.C. § 541. Section 103, in turn, provides that § 541 applies in Chapter 11 cases, including those which involve individual debtors. See 11 U.S.C. § 103(a).
interpretations. See, e.g., In re Maharaj, 681 F.3d 558, 569 (4th Cir. 2012); In re Lindsey, 453 B.R. 886, 903 (Bankr. E.D. Tenn. 2011).

To date, the Bankruptcy Appellate Panel for the Ninth Circuit and five bankruptcy courts (one of which was affirmed by a district court) have adopted a “broad view,” holding that the BAPCPA amendments eliminate the APR as applied to an individual’s entire estate.\(^3\) In contrast, the Fourth Circuit and seventeen bankruptcy courts have reached the opposite conclusion, holding that the BAPCPA amendments only exempt from the APR that property which § 1115 adds to an individual estate—not the pre-petition property already defined by § 541.\(^4\)


According to the broad view, § 1115 incorporates and supercedes § 541. Under § 1115, an individual’s estate includes post-petition property and earnings in addition to the pre-petition property established by § 541. In re Tegeder, 369 B.R. 477, 480 (Bankr. D. Neb. 2007); see also In re Shat, 424 B.R. 854, 863 (Bankr. D. Nev. 2010) (“Initially, Section 1115 creates a baseline estate of all the property covered by Section 541. It then adds to that [post-petition property].”). When § 1129(b)(2)(B)(ii) references the property “included by” § 1115, it “refer[s] to all property Section 1115 itself references.” In re Shat, 424 B.R. at 863. Section 1115 thus absorbs § 541 for individual Chapter 11 cases. Id. at 865. Therefore, the APR no longer applies to any property of an individual debtor’s estate.

In contrast, the narrow view holds that § 1115 merely adds to—but does not replace—§ 541’s definition of estate property for individual debtors. See, e.g., In re Draiman, 450 B.R. 777, 821 (Bankr. N.D. Ill. 2011). Section 1115 “includes” in the estate only that property which was not already included by § 541. See In re Gbadebo, 431 B.R. 222, 229 (Bankr. N.D. Cal. 2010). In other words, § 1115 includes only post-petition property and earnings. In re Draiman, 450 B.R. at 821. In support of the narrow view, several courts have pointed to § 1115’s grammatical structure. See, e.g., In re Arnold, 471 B.R. 578, 602 (Bankr. C.D. Cal. 2012) (explaining that because the phrase, “in addition to the property

applies to individual Chapter 11 debtors).
specified in section 541” is “not the direct object of the transitive verb, ‘includes,’” the phrase therefore “is not an answer to the question what is included as ‘property of the estate’ under § 1115”). Accordingly, only post-petition property added by § 1115 is exempt from the APR; the APR continues to apply to § 541’s pre-petition property.

After examining the divergent interpretations of the statutory language, we agree with the Fourth Circuit that “either construction is plausible.” In re Maharaj, 681 F.3d at 569. In light of this linguistic ambiguity, we endeavor to ascertain Congress’s intent. See United States v. Hohri, 482 U.S. 64, 69–71 (1987).

2. Is there a clear Congressional intent to repeal the absolute priority rule as applied to individual Chapter 11 debtors?

Nowhere in BAPCPA’s sparse legislative history is there an explanation of what changes result from § 1115. See In re Lindsey, 453 B.R. at 903; Bruce A. Markell, The Sub Rosa Subchapter: Individual Debtors in Chapter 11 After BAPCPA, 2007 U. Ill. L. Rev. 67, 90. Consequently, courts have reached opposite conclusions regarding the legislative objective. Compare In re Shat, 424 B.R. at 862–65, with In re Gbadebo, 431 B.R. at 229–30. In deciphering Congress’s intent, we recognize BAPCPA’s aim of curbing the abusive practices of unscrupulous debtors, see H.R. Rep. No. 109-31, pt. 1, at 3–5 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 90–92, but we remain mindful that “a central purpose of the Code” is to provide the honest but unfortunate debtor with a “fresh start,”

This inherent tension makes it difficult to identify a singular objective behind § 1115.

Advocates of the broad view emphasize that the BAPCPA amendments evince an intent to model Chapter 11 on Chapter 13, which has no absolute priority rule. See In re Friedman, 466 B.R. at 483; In re Shat, 424 B.R. at 868. In support, they cite a number of provisions that are essentially copied from Chapter 13. See, e.g., In re Roedemeier, 374 B.R. 264, 275–76 (Bankr. D. Kan. 2007). Further, proponents of the broad view emphasize that abolishing the APR with respect to individual debtors does not leave unsecured creditors without any power or protection. Instead, unsecured creditors can rely on the safeguards of § 1129(a)(15)’s disposable income test, see In re Shat, 424 B.R. at 863–64, and § 1129(a)(7)’s “best interests” test, see Amicus Br. of Nat’l Ass’n of Consumer Bankr. Attorneys at 6.

In contrast, those ascribing to the narrow view argue that, “[e]ach one of these new provisions,” even where modeled on Chapter 13, “appears designed to impose greater burdens on individual chapter 11 debtor’s rights so as to ensure a greater payout to creditors.” In re Gbadebo, 431 B.R. at 229 (emphasis added); see also H.R. Rep. No. 109-31, pt. 1, at 2–5, 80–81. Narrow view proponents urge that if Congress intended to abolish the APR with respect to individual debtors, “it would have done so in a far less convoluted way.” In re Maharaj, 681 F.3d at 565–66. For instance, Congress could have raised Chapter 13’s debt
ceiling or expressly exempted individual debtors at the beginning of § 1129(b)(2)(B)(ii). See In re Karlovich, 456 B.R. 677, 682 (Bankr. S.D. Cal. 2010). Moreover, BAPCPA’s legislative history lists several debtor protections but makes no mention of eliminating the APR. See H.R. Rep. No. 109-31, pt. 1, at 2, 17–18. Advocates for the narrow view argue that, had Congress intended such a drastic change, it surely would have included the amendment in its list of debtor protections. See In re Maharaj, 681 F.3d at 572. Instead, the amendments are best understood as preserving the status quo. See, e.g., id. at 569–70 (noting that the exemption of post-petition property and earnings ensures that the APR operates as it did prior to BAPCPA’s passage).

Because both the statutory language and Congress’s intent are ambiguous, we heed the presumption against implied repeal. “[R]epeals by implication are not favored and will not be presumed unless the intention of the legislature to repeal is clear and manifest.” Nat’l Ass’n of Home Builders v. Defenders of Wildlife, 551 U.S. 644, 662 (2007) (quotations omitted). Where a party contends “that legislative action changed settled law,” that party “has the burden of showing that the legislature intended such a change.” Green v. Bock Laundry Mach. Co., 490 U.S. 504, 521 (1989). These interpretive principles are particularly critical in bankruptcy cases, where parties rely on settled rules in conducting and structuring business. Thus, “[p]re-BAPCPA bankruptcy practice is telling because we will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.”

We therefore REVERSE the bankruptcy court’s order confirming the plan and REMAND for further proceedings.
480 B.R. 291  
United States Bankruptcy Court,  
W.D. Michigan.  

In re Jan M. GASKILL, Debtor.  
First American Title Insurance Company, Plaintiff,  
v.  
Jan M. Gaskill, Defendant.  


Synopsis  
Background: Title insurance company filed adversary complaint against Chapter 13 debtor who, at all relevant times, was title insurance agency's vice president, treasurer, and co-owner, asserting that debtor's failure to remit premium payments owed to it under an insurance agency agreement constituted "defalcation while acting in a fiduciary capacity" and that the resulting debt should be excepted from discharge. Trial was held.  

Holdings: The Bankruptcy Court, James D. Gregg, Chief Judge, held that:  

[1] under Michigan law, debtor was not a “fiduciary” with respect to the premium funds, and  

[2] even assuming that debtor owed title insurance company a “fiduciary” duty, debtor's complete lack of control over or culpability for the failure to remit the premium funds to company precluded a finding that she breached her duties by “defalcation.”  

Debt held dischargeable.  

Attorneys and Law Firms  


OPINION REGARDING NONDISCHARGEABLE DEBT ADVERSARY PROCEEDING

JAMES D. GREGG, Chief Judge.

I. INTRODUCTION.

This adversary proceeding involves losses sustained by the Plaintiff, First American Title Insurance Company ("First American") when Advantage Title and Escrow Agency, Inc. ("Advantage Title") failed to remit premium payments owed to it under an insurance agency agreement. At the time the losses were sustained, Jan M. Gaskill (the "Debtor") was Vice President and Treasurer of Advantage Title. First American asserts that the Debtor's failure to remit premiums constituted "defalcation while acting in a fiduciary capacity" and that the resulting debt should be nondischargeable under § 523(a)(4) of the Bankruptcy Code.¹

¹ The Bankruptcy Code is set forth in 11 U.S.C. §§ 101–1532 inclusive. Specific provisions of the Bankruptcy Code are referred to in this opinion as “§ ——.”

II. JURISDICTION.

This court has jurisdiction over this bankruptcy case. 28 U.S.C. § 1334. The case and all related proceedings have been referred to this court for decision. 28 U.S.C. § 157(a); Local Rule 83.2(a) (W.D.Mich.). This adversary proceeding is a statutory core proceeding. 28 U.S.C. § 157(b)(2)(1) (determinations regarding dischargeability of a debt). Notwithstanding the holding in Stern v. Marshall, —— U.S. ——, 131 S.Ct. 2594, 180 L.Ed.2d 475 (2011), this court is constitutionally authorized to enter a final order. See Tibble v. Wells Fargo Bank, N.A. (In re Hudson), 455 B.R. 648, 656 (Bankr.W.D.Mich.2011) (the Stern decision is extremely narrow; “[e]xcept for the types of counterclaims addressed in Stern v. Marshall, a bankruptcy judge remains empowered to enter final orders in all core proceedings”). This opinion constitutes the court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

III. FACTS.

In March 2002, Sandy Peck ("Peck") established Advantage Title. When the corporation was formed, Peck was the sole shareholder. Not long after Advantage was formed, Peck asked the Debtor to join her in this new business venture. Peck and the Debtor had previously worked
together at another title insurance agency, and had been close friends for over twenty years. The Debtor had also been an insurance agent licensed by the State of Michigan since August 10, 1994. She accepted Peck's invitation and was appointed as Vice President and Treasurer of the corporation on March 21, 2002. On April 15, 2002, Advantage Title opened for business. Approximately one year later, in April 2003, the Debtor received a fifty percent ownership interest in Advantage Title and continued to hold the positions of Vice President and Treasurer. (Tr. at 71–72.) On a day-to-day basis, the Debtor handled closings for Advantage Title.

Just prior to the official opening of Advantage Title, First American and Advantage Title entered into a written Policy Issuing Agency Contract (“Agency Agreement”) dated March 18, 2002. (Plaintiffs Ex. 1.) Under the Agency Agreement, Advantage Title was authorized to act as First American's agent by issuing title insurance commitments and policies in First American's name. The Agency Agreement provided that any such insurance policy or commitment must be “signed, personally, by such designated signatories of [Advantage Title], who have been authorized by [Advantage Title] and approved in writing by [First American].” (Id. at ¶ 2(b).) The only signatory identified in the Agency Agreement as “presently approved” by First American was Peck. The Agency Agreement was amended on several occasions. None of these amendments identified additional approved signatories. (Id.; Tr. at 48–49.) Notwithstanding the multiple amendments, the Debtor was never listed as an approved signatory who was an authorized agent of First American.

The Agency Agreement also required Advantage Title to provide monthly reports to First American of all policies issued and to maintain a segregated account to hold premiums due to First American. 2 (Plaintiff's Ex. 1 at ¶ 5, 6.) First American was to receive twenty-percent of the premiums collected with Advantage Title retaining eighty-percent. (Tr. at 77). Pursuant to the Agency Agreement, First American was authorized to audit the books and records of Advantage Title.

Although the agreement required monthly reporting, the Debtor explained that reports were not provided to First American on a regular basis. (Tr. at 94.) Similarly, James Casson, a Vice President of First American, testified that, in practice, the segregation of premiums required under the agreements was rarely complied with by agents. (Tr. at 51.)

At the time the Agency Agreement was executed, Peck was the sole shareholder of Advantage Title. Peck, in her capacity as President, negotiated and signed the Agency Agreement, and all subsequent amendments, on behalf of Advantage Title. (Plaintiff's Ex. 1, Tr. at 33.) Peck remained First American's main contact at Advantage Title throughout their agency relationship. In fact, aside from quarterly lunch meetings, which Gaskill sometimes attended, First American dealt exclusively with Peck. (Tr. at 35–36.)

Advantage Title had a number of escrow accounts at different times during its history, but it eventually maintained only an operating account. (Tr. at 75.) The Debtor had authority to write checks from all of the accounts held by Advantage Title. However, in practice, Peck had the sole
responsibility for maintaining the operating account, paying the corporation's bills and remitting First American's portion of the premiums collected. Additionally, Peck alone communicated with Advantage Title's accountant to prepare all necessary tax returns and financial statements. (Tr. at 75–76.) The Debtor did not receive or review the corporation's mail or pay its bills. Nor did the Debtor review the tax returns, the quarterly or annual financial statements of the company, or the bank account statements. (Tr. at 86.)

While Peck handled the operating side of the business, the Debtor was responsible for handling the agency's closings. When disbursements were made at closings, one check was issued payable to Advantage Title for the full premium amount, as well as for the closing costs. (Tr. at 79, 137.) The Debtor then provided the check to Peck who, the Debtor reasonably believed, deposited the funds into the operating account of Advantage Title. (Tr. at 79.) The Debtor generated monthly or bi-monthly reports listing policies issued and the total premiums collected. (Tr. at 79–80; 94.) The reports also specified the amount to be remitted to First American and the amount to be retained by Advantage Title. (Id.) She then provided these reports to Peck who was responsible for forwarding the reports to First American, together with a check for its portion of the premium. (Tr. at 95; 107–08.)

Advantage Title held an operating line of credit with Union Bank for some period of time. In 2008, the bank (or its successor) advised Advantage Title that collateral would be necessary to continue the line of credit. (Tr. at 119.) Due to her ongoing divorce proceedings, Peck was only able to offer “a couple vehicles” as collateral; to supply collateral, the Debtor mortgaged her home. (Tr. at 120.) As a result, Peck and the Debtor, upon the advice of their corporate counsel, entered into an agreement on November 19, 2008, regarding the “considerable debt” incurred by Advantage Title, including but not limited to the operating line of credit at Union Bank. The agreement provided in part that “[i]n the event [Advantage Title] is unable to meet its obligation, and any creditor demands payment from the Shareholders, or either of them, the Shareholders agree that each Shareholder shall be responsible for and shall pay 50% of any amount demanded by any creditor.” (Plaintiffs Ex. 6.) Although this document creates a contractual obligation between Peck and the Debtor if one of them becomes personally liable or pays on a corporate debt, it does not represent a personal guarantee of Advantage Title's debts to creditors. After reading the exhibit, the court finds it creates a contribution or indemnification relationship between Peck and the Debtor.

4 Although not explicitly in the record, Union Bank merged with another bank before 2008 and its name was changed. Because the bank was referred to as “Union Bank” during the trial, the court will do likewise in this opinion.

Some time in 2008, the close friendship between the Debtor and Peck began to deteriorate. (Tr. at 82.) On June 9, 2009, Peck abruptly advised the Debtor that she was moving to Texas. (Tr. at 81–82.) Peck left just days later. (Tr. at 81.)
After Peck's departure, things began “crashing in” at Advantage Title. (Tr. at 114.) The Debtor began receiving and reviewing the mail. Each day, the Debtor received notices that various corporate bills had not been paid, including premiums for their Errors and Omissions insurance, several years of property taxes, and state taxes. (Tr. at 83.) The Debtor also began working with a new accountant for the corporation to gather information for preparation of 2008 tax returns. In doing so, she discovered that much of the corporation's financial documentation was missing. (Tr. at 109–110.) At first, these developments were surprising to the Debtor. Prior to Peck's sudden departure, the Debtor believed that Advantage Title's financial situation was “tight.” (Tr. at 86.) Even so, the Debtor had a “rough” idea of Advantage Title's general operating expenses, and she believed that the funds being generated by Advantage Title were *297 sufficient to cover these expenses. (Tr. at 115.)

Then the reason for the hidden financial deficiencies became clear: the Debtor discovered credit card statements which revealed that Peck—her former close friend and now missing business co-owner—had been using corporate credit cards to make undisclosed personal purchases over the course of several years. (Tr. at 112–13.) According to the Debtor's estimate, these purchases totaled approximately $250,000. (Id.) Because the Debtor also discovered a number of the reports she generated following closings in Peck's desk, she advised her contact at First American that Peck had left and that she suspected First American may not have received all premiums owed. (Tr. at 83–84; 114–15.) First American then audited the books and records of Advantage Title with the Debtor's assistance. (Tr. at 93–95.) The audit revealed significant shortfalls in the accounts where the premiums owed by Advantage Title to First American were maintained. It was ultimately determined that Advantage Title had failed to remit $99,902.85 in premiums which should have been paid to First American under the Agency Agreement. 5

5 At the beginning of trial, the parties stipulated that $99,902.85 was the amount of unpaid premiums at issue in this adversary proceeding. (Tr. at 18.) This amount represents the twenty-percent “that was supposed to have been remitted to First American” under the Agency Agreement for policies that Advantage Title wrote and First American underwrote. (Id.)

The court finds it very curious that First American failed to recognize that it had not received approximately $100,000 in premiums for policies it had underwritten. Although the Agency Agreement requires Advantage Title to provide First American with monthly reports of all policies issued, First American either did not receive information from Advantage Title regarding the issuance of new policies, or failed to review such information to the extent it was received. There is absolutely no evidence, however, that First American ever inquired with anyone at Advantage about the lack of premium payments. It is certain that no such inquiries were ever made to the Debtor. Instead, somewhat ironically, it was the Debtor who first alerted First American about unfiled reports and unpaid premiums. The Debtor fully cooperated and assisted First American in its audit to determine the unpaid amounts that were owing to it.
On November 5, 2009, First American filed a complaint in the Barry County Circuit Court, State of Michigan, against Advantage Title, the Debtor, and Peck for breach of the Agency Agreement, defalcation and breach of fiduciary duty, and conversion. On December 1, 2010, the Barry County Circuit Court granted First American's motion for summary disposition against Advantage Title and entered a money judgment against Advantage Title in the amount of $319,040.20 for conversion of the premiums, fraud/defalcation under Mich. Comp. Laws Ann. § 500.1207, and breach of contract in the amount of $101,102.85. In the same order, the state court denied First American's motion for summary judgment against the Debtor.

On March 10, 2010, Peck filed a petition for relief under chapter 7 in the United States Bankruptcy Court for the Eastern District of Michigan. On June 6, 2010, First American filed an adversary complaint seeking a nondischargeable judgment against Peck in the amount of $303,514.32 (the unpaid premiums multiplied by three) resulting from Peck's conversion of the premiums, plus costs and reasonable attorney fees. On October 29, 2010, the bankruptcy court in the eastern district entered a default judgment against Peck in the amount $304,772.32.

By the time of her bankruptcy filing, Peck had changed her name to Sandra Falk.

On February 13, 2011, the Debtor filed her petition for relief under chapter 13 of the Bankruptcy Code in this court. On May 13, 2011, First American filed this adversary complaint seeking a judgment for nondischargeable debt against the Debtor under § 523(a)(4) and § 523(a)(6) in the amount of $303,514.32 (the premiums multiplied by three) resulting from the Debtor's alleged failure to remit the premiums, plus costs and reasonable attorney fees.

Although First American's complaint in this adversary proceeding contained counts alleging embezzlement under § 523(a)(4) and conversion under § 523(a)(6), First American informed the court, in its preliminary statement on the record at trial, that it was not pursuing those causes of action. (AP Dkt. No. 1, Tr. at 16–17.) The sole remaining issue in this adversary proceeding is whether the Debtor committed defalcation while acting in a fiduciary capacity under § 523(a)(4).

On July 10, 2012, this court held a trial. During the trial, three witnesses testified: the Debtor; James Casson, Vice President of First American; and Belinda Falconer, a former employee of Advantage Title. All witnesses testified credibly. The Debtor gave particularly credible testimony regarding her duties and responsibilities at Advantage Title, her lack of knowledge that Peck was not making the requisite payments to First American, her shock at discovering Peck's misuse of corporate funds, and her lack of any specific knowledge of the corporation's true financial situation. The Debtor's testimony was adequately corroborated by Falconer's explanations of the division of duties and responsibilities at Advantage Title and the corporation's internal procedures. After the close of proofs, the court took the adversary proceeding under advisement.

IV. ISSUE.
The issue presented is whether the Debtor committed “defalcation while acting in a fiduciary capacity” such that the debt owed to First American for unpaid premiums is nondischargeable under § 523(a)(4).

V. DISCUSSION.

Section 523(a)(4) excepts from discharge any debt “for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.” First American alleges that the Debtor committed defalcation while acting in a fiduciary capacity by failing to remit the premium payments to First American as required by the Agency Agreement.

[1] “A debt is non-dischargeable as the result of defalcation when a preponderance of the evidence establishes: (1) a pre-existing fiduciary relationship, (2) a breach of that relationship, and (3) resulting loss.” Patel v. Shamrock Floorcovering Servs., Inc. (In re Patel), 565 F.3d 963, 968 (6th Cir.2009) (citing Board of Trustees of the Ohio Carpenters’ Pension Fund v. Bucci (In re Bucci), 493 F.3d 635, 639 (6th Cir.2007)). Because there is no dispute that the unpaid premiums represent a “loss” to First American, the critical issues in this adversary proceeding are whether the Debtor owed a fiduciary duty to First American and, if so, whether she breached that duty through “defalcation.”

A. Did the Debtor Owe First American a Fiduciary Duty?

[2] [3] The term “fiduciary capacity” is construed more narrowly under § 523(a)(4) than in some other contexts and applies only to express or technical trust relationships that result from specific property being placed in the hands of the debtor. R.E. America, Inc. v. Garver (In re Garver), 116 F.3d 176, 179 (6th Cir.1997). Although the existence of a fiduciary relationship under § 523(a)(4) is governed by federal law, courts look to state law to determine whether an express or technical trust has been created. Commonwealth Land Title Co. v. Blaszak (In re Blaszak), 397 F.3d 386, 390–91 (6th Cir.2005); Capitol Indemnity Corp. v. Interstate Agency, Inc. (In re Interstate Agency, Inc.), 760 F.2d 121, 124 (6th Cir.1985) (“the nature of the property interest in question” is determined under state law).

[4] It is not difficult to conclude, and the Debtor does not dispute, that a fiduciary relationship existed between Advantage Title and First American under Michigan law. In Capitol Indemnity Corp. v. Interstate Agency, Inc. (In re Interstate Agency, Inc.), 760 F.2d 121 (6th Cir.1985), the Sixth Circuit Court of Appeals addressed facts resembling those in this adversary proceeding: pursuant to an agency agreement, the corporate debtor, Interstate, had authority to accept premiums for insurance policies underwritten by Capitol Indemnity Corporation (“Capitol”). Interstate failed to remit the premiums to Capitol as required by the agreement. After both Interstate and its
president and majority shareholder, Arthur Lilly, filed for bankruptcy protection, Capitol sought to have the resulting debt excepted from discharge under § 523(a)(4).

8 See Debtor's Answer ¶ 23, AP Dkt. No. 7 (“Ms. Gaskill admits that a fiduciary relationship existed between Advantage Title and Plaintiff” but “denies that a fiduciary relationship existed between herself as an individual and Plaintiff.”)

The Sixth Circuit held that the Michigan Insurance Code “clearly establishes an insurance agency relationship as an express trust fiduciary relationship.” In re Interstate Agency, Inc., 760 F.2d at 124. The relevant statutory provision states:

An agent shall be a fiduciary for all money received or held by the agent in his or her capacity as an agent. Failure by an agent in a timely manner to turn over the money which he or she holds in a fiduciary capacity to the persons to whom they are owed is prima facie evidence of violation of the agent’s fiduciary responsibility.

Mich. Comp. Laws Ann. § 500.1207(1). In Interstate, the Sixth Circuit noted that Michigan courts construing this statute have consistently “held that premium payments received by an insurance agency have the status of trust funds for the benefit of the insurance principal.” In re Interstate Agency, Inc., 760 F.2d at 124 (citing Citizens Mutual Automobile Insurance Co. v. Gardner, 315 Mich. 689, 24 N.W.2d 410 (1946); Travelers Insurance Co. v. Bishop, 298 Mich. 600, 299 N.W. 731 (1941); Glerum v. Spencer, 251 Mich. 163, 231 N.W. 38 (1930)).

9 Since Interstate was decided, the statute has been amended to make minor grammatical changes. The court has cited the current statutory language.

[5] [6] In Interstate, the Sixth Circuit further concluded that the individual debtor, Lilly, as president and majority shareholder of the insurance agency, also owed a fiduciary duty to Capitol. Under general corporate law, a corporation is a distinct legal entity and, unless the corporate veil is pierced, officers, directors and shareholders are shielded from personal liability for the debts or actions of the corporation. See *300 Kline v. Kline, 104 Mich.App. 700, 702, 305 N.W.2d 297, 298 (1981) (Michigan law “treats a corporation as an entirely separate entity from its stockholders”) (citing Bourne v. Sanford, 327 Mich. 175, 191, 41 N.W.2d 515, 522 (1950)); see also Cash America Fin. Servs., Inc. v. Fox (In re Fox), 370 B.R. 104, 113 (6th Cir. BAP 2007) (under Ohio law, corporate officer is not personally liable for the debts of the corporation, absent piercing of the corporate veil). An exception to this general rule applies, however, when officers or directors “personally cause their corporation to act unlawfully.” Livonia Bldg. Materials Co. v. Harrison Constr. Co., 276 Mich.App. 514, 519, 742 N.W.2d 140, 143–44 (2007) (citing People v. Brown, 239 Mich.App. 735, 739–40, 610 N.W.2d 234 (2000)). Thus, the court in Interstate explained that under “well established” Michigan law, “a corporate officer or agent is personally liable for torts committed by him even though he was acting for the benefit of the corporation.” 10
In re Interstate, 760 F.2d at 125 (quoting A & M Records, Inc. v. M.V.C. Distributing Corp., 574 F.2d 312 (6th Cir.1978)) (emphasis in original).

The Michigan Supreme Court recently reaffirmed this well-settled principle. Dept. of Agriculture v. Appletree Marketing, LLC, 485 Mich. 1, 17, 779 N.W.2d 237, 246 (2010) (corporate officers “may be held personally liable for their individual tortious acts done in the course of business, regardless of whether they were acting for their personal benefit or the corporation's benefit.”). The court explained that imposition of personal liability in such instances does not require piercing of the corporate veil, but rather derives from the concept that a corporate officers may not escape liability for “their own tortious misconduct” by “hid[ing] behind the corporate form.” Appletree Marketing, 485 Mich. at 18–19, 779 N.W.2d at 247 (emphasis in original).

The Sixth Circuit relied on these principles to conclude that Lilly had breached his fiduciary duty to Capitol and was personally liable for the resulting debt. However, the facts in Interstate are much different from the facts in this adversary proceeding in several notable ways.

In Interstate, Lilly, a licensed insurance agent, had signed the agency agreement on behalf of the corporation. Lilly had also personally guaranteed the agency agreement, and several subsequent agreements for repayment of the premiums owed to Capitol. The court explained that these facts, in addition to his role as president and large shareholder of Interstate, provided “overwhelming evidence” of Lilly's “full knowledge and responsibility for the handling of Interstate's trust undertakings.” In re Interstate Agency, Inc., 760 F.2d at 125. Based on this evidence, the Sixth Circuit suggested that Lilly could be “imputed” with “participation in Interstate's breach of fiduciary duty to Capitol.” Id. More importantly, the court held that Lilly was “personally acting in a fiduciary capacity” and that he had “breached his fiduciary duty stemming from these separate obligations: 1) his status as president of Interstate; 2) his personal status as an insurance agent under the Michigan Code; and 3) his personal signing of the agency agreements.” Id. Because Lilly was also “personally responsible for the defalcation of the funds” held in trust for Capitol, the Sixth Circuit reversed the district court's conclusion that Lilly was not personally liable for Interstate's corporate debt and held that the debt to Capitol was not dischargeable in Lilly's personal bankruptcy case.

It is easy to discern that Lilly's culpability in directing and controlling his corporation's misappropriation of the premiums was critical to the Sixth Circuit's holding in Interstate. This result makes sense. Corporate officers are personally liable for their own tortious acts and should not be permitted to hide behind the *301 corporate form to escape liability for their actions. In re Interstate, 760 F.2d at 125; Appletree Marketing, LLC, 485 Mich. at 17–19, 779 N.W.2d at 246–47. The Sixth Circuit has explained:

If the fiduciary relationship is not imposed upon the corporate officer charged with maintaining the fiduciary relationship, then § 523(a)(4) could be rendered meaningless in cases where the fiduciary relationship is established between a creditor and a corporate fiduciary only. All a debtor would have to do to avoid §

[7]
523(a)(4) is place the corporation in the position as fiduciary rather than himself. He could then breach the fiduciary relationship with impunity.

_Lagere & Walkingstick Ins. Agency, Inc. v. Huff (In re Huff),_ 124 F.3d 197, 1997 WL 560060, *3 (6th Cir. Sept. 5, 1997) (unpublished table opinion) (quoting _Sun Life Ins. Co. of America v. Koszuth (In re Koszuth),_ 43 B.R. 104, 108 (Bankr.M.D.Fla.1984) (emphasis added)). Indeed, the vast majority of cases that have relied on _Interstate_ to impose liability on a corporate officer under § 523(a)(4) involve individuals who controlled their corporations and personally caused or directed the breaches of fiduciary duty that led to the losses at issue. _See, e.g., Woodworking Enters., Inc. v. Baird (In re Baird),_ 114 B.R. 198, 204–05 (9th Cir. BAP 1990) (president and sole shareholder of corporation was personally liable for breaches of Arizona builder's trust fund statute because he was “the only person responsible for disbursing funds held by [his corporation]” and therefore “directly and actively participated in the defalcation” of those funds); _Baker v. Wentland (In re Wentland),_ 410 B.R. 585, 599 (Bankr.N.D.Ohio 2009) (defendant, who was president of corporation and controlled corporation's finances, was personally liable for failure to apply funds withheld from employee's wages to payments of health insurance premiums); _Nuchief Sales, Inc. v. Harper (In re Harper),_ 150 B.R. 416, 419 (Bankr.E.D.Tenn.1993) (corporate stockholder, officer, director, bookkeeper and day-to-day operational supervisor was personally liable for corporation's breaches of fiduciary duty under the Perishable Agricultural Commodities Act; the “focus of fiduciary liability is _upon the actor responsible for the act_ rather than the corporate form;” with regard to corporate fiduciary obligations, “it is the _employee or officer responsible for implementing the fiduciary responsibilities_ who is liable for any acts of defalcation”) (emphasis added).

[8] This reasoning does not apply with equal force when a debtor is not the corporate control person who actually causes or participates in the corporation's breach of its fiduciary duties. _See, e.g., Porter Capital Corp. v. Campbell (In re Campbell),_ 2008 WL 4682785, at *8 (Bankr.E.D.Tenn. Oct.21, 2008) (unpublished opinion) (declining to impose personal liability under § 523(a)(4) and _Interstate_ when there was no evidence corporate officer “directed or participated in the alleged misappropriation” and “played no role in the financial management” of the corporation). In stark contrast to the facts in _Interstate_, the Debtor in this case had a very limited relationship with First American. The Debtor was not a signatory to the Agency Agreement. She did not personally guarantee Advantage's debt to First American. More importantly, it is undisputed that the Debtor played no role whatsoever in the failure to properly remit premiums to First American. The Debtor handled closings, received the premium payments, and turned those payments over to Peck. The Debtor then prepared reports of the premiums received and the amounts owed to First American under the Agency Agreement. She turned those reports over to Peck with the understanding that *302 Peck would remit the premiums to First American. It was Peck who was responsible for paying First American and Peck who failed to meet this obligation.
Also, from First American's point of view, it dealt solely with Peck. It did not add the Debtor as a signatory when the Agency Agreement was amended on multiple occasions, it made no inquiries to the Debtor until Peck “skipped town,” and it was unable to show that the Debtor was involved in any material financial relationship with it. Further, First American's loss was attributable, in great part, to its failure to review reports and remittances submitted by Peck, not the Debtor.

Regardless of the important factual distinctions between the two cases, First American attempts to rely on the Sixth Circuit's holding in Interstate to support its assertion that the Debtor owed it a fiduciary duty based on her status as a corporate officer, specifically Vice President and Treasurer, of Advantage Title, and as an insurance agent under Michigan law. First American then alleges that the Debtor breached these duties by “sticking her head in the sand”—that is, by failing to apprise herself of Advantage Title's true financial situation and by neglecting to monitor whether premium payments were being made to First American as required by the Agency Agreement. The court rejects the assertion that these grounds support imposition of personal liability under the facts of this case.

[9] Specifically, the court holds that the grounds relied upon by First American are not sufficient, by themselves, to establish that the Debtor owed First American a fiduciary duty. First, although Michigan law imposes fiduciary duties on corporate officers and directors, see Mich. Comp. Laws Ann. § 450.1541a, it does not provide that corporate assets are held in trust by corporate officers or that corporate officers act as trustees with regard to the assets of the corporation. Michigan Web Press, Inc. v. Wilcox (In re Wilcox), 310 B.R. 689, 696–97 (Bankr.E.D.Mich.2004); Digital Commerce, Ltd. v. Sullivan (In re Sullivan), 305 B.R. 809, 825 (Bankr.W.D.Mich.2004). In the absence of the culpability and control such as exhibited by the individual debtor in Interstate, the court finds that the Debtor did not owe First American a fiduciary duty based solely on her status as an officer of Advantage Title.

Second, First American is correct that the Michigan Insurance Code provides that licensed insurance agents are fiduciaries “for all money received or held by the agent.” Mich. Comp. Laws Ann. § 500.1207(1). The few cases interpreting this provision have applied this fiduciary status to both corporate entities and the individual agents who control them. See, e.g., In re Interstate, 760 F.2d at 125; IBF Ins. Group, Inc. v. Travelers Indemnity Co., 2005 WL 3190513 (Mich.App. Nov. 29, 2005) (unreported opinion) (individual who was president, majority shareholder, and sole employee of insurance agency owed insurance company a fiduciary duty based on his “personal status as an insurance agent under the Michigan Insurance Code”); see also In re Huff, 124 F.3d 197, 1997 WL 560060 at *3 (under similar Kentucky statute, individual insurance agent who was president of insurance agency and personal signatory to producer agreement, owed fiduciary duty to insurance company for unpaid premiums). Without exception, these cases all involved individuals who controlled their corporate entities, were signatories to the agency agreements with the insurance companies, and were personally responsible for the failure to remit premiums under
the agreements. Here, Advantage Title is the agent designated under the Agency Agreement with First American. The Debtor did not sign the Agency Agreement on behalf of Advantage Title and is not designated as an approved signatory under the agreement. In accordance with the reasonable division of labor at Advantage Title, the Debtor accepted the premium payments at closing, but immediately turned them over to Peck for deposit in Advantage Title’s operating account. Under the specific facts of this case, the court holds that the Debtor was not a fiduciary with respect to the premium funds.

If the court accepted First American’s argument, all officers within the management structure of a corporation could be held liable for unpaid premiums, even in the absence of any control over the corporation’s financial affairs.

B. Did the Debtor Breach Her Fiduciary Duty by Defalcation?

Even assuming the Debtor owed First American a fiduciary duty under Michigan law, the Debtor’s complete lack of control over or culpability for the failure to remit the premium funds to First American precludes a finding that the Debtor breached her duties by defalcation. For purposes of § 523(a)(4), the term “defalcation” is defined under federal law. Carlisle Cashway, Inc. v. Johnson (In re Johnson), 691 F.2d 249, 254 (6th Cir.1982). The Sixth Circuit has held that defalcation “‘encompass[es] embezzlement and misappropriation by a fiduciary, as well as the failure to properly account for such funds.’” Patel v. Shamrock Floorcovering Servs., Inc. (In re Patel), 565 F.3d 963, 970 (6th Cir.2009) (quoting Commonwealth Land Title Co. v. Blaszak (In re Blaszak), 397 F.3d 386, 390 (6th Cir.2005)). Although “some circuits have held that ‘defalcation’ might include ‘innocent’ or merely negligent conduct,” the Sixth Circuit has rejected this concept of “defalcation per se.” In re Patel, 565 F.3d at 970 (citing In re Johnson, 691 F.2d at 257) (additional citations omitted). Instead, the Sixth Circuit requires a showing that the debtor was “objectively reckless in failing to properly account for or allocate funds.” Id. (citing In re Johnson, 691 F.2d at 257).

Accordingly, although the Michigan Insurance Code states that “failure to turn over funds” held by an agent constitutes prima facie evidence of a breach of fiduciary responsibility, this is not dispositive on the issue of whether the Debtor committed a “defalcation” under § 523(a)(4). Cf. In re Patel, 565 F.3d at 971 (under Michigan Builders Trust Fund Act, “failure to pay subcontractors first [is] ‘evidence of the intent to defraud’ ” but this language is not dispositive in nondischargeability cases).

Conduct is generally considered “reckless” if “the actor knows, or has reason to know, ... of facts which create a high degree of risk of ... harm to another” and the actor “deliberately proceeds to act, or to fail to act, in conscious disregard of, or indifference to, that risk.” Restatement (Second) of Torts § 500 cmt. a (1965); see also Prosser & Keeton on the Law of Torts § 34, at 213–14 (5th ed. 1984); Black’s Law Dictionary (9th ed. 2009) (reckless conduct is “characterized by the creation of a substantial and unjustifiable risk of harm to others and by a conscious (and sometimes deliberate) disregard for or indifference to that risk”). Objective recklessness occurs when, although the actor herself does not realize or appreciate the risk of harm to another, a reasonable person in her position would do so. See Restatement (Second) of Torts § 500 cmt. a (1965): Farmer v. Brennan, 511
U.S. 825, 836, 114 S.Ct. 1970, 1978, 128 L.Ed.2d 811 (1994) (contrasting the civil law objective standard for recklessness with the criminal law subjective test and explaining that a “person is objectively reckless if she “acts or (if the person has a duty to act) fails to *304 act in the face of an unjustifiably high risk of harm that is either known or so obvious that is should be known”) (citations omitted). This type of recklessness must “be determined from an objective examination of the actions of the parties in a particular set of circumstances.” Demjanjuk v. Petrovsky, 10 F.3d 338, 349 (6th Cir.1993).

[14] [15] When applied to fiduciaries, this objective standard charges the fiduciary “with knowledge of the law” and does not require subjective bad faith or intent to violate a fiduciary duty. In re Johnson, 691 F.2d at 255. If money held in trust is used by a debtor for purposes other than those for which it was entrusted, the debtor has committed defalcation, “so long as the use was not the result of mere negligence or a mistake of fact.” Id. at 257.

Applying these standards, the court determines that the Debtor's actions with regard to the premium payments were not objectively reckless. Without question, the evidence establishes that it was Peck, and not the Debtor, who caused and controlled Advantage Title's failure to remit the premiums. 13 In accordance with the reasonable and agreed upon division of duties at Advantage Title, the Debtor received the premium payments and turned them over to Peck. The Debtor also provided Peck with reports of amounts owed to First American. It was Peck's responsibility to remit the payments. Because Peck misused the corporate credit cards for her own personal benefit, 14 Peck kept premiums that should have been remitted to First American.

13 Despite First American's arguments to the contrary, the wrongful acts of Peck and Advantage Title should not be imputed to the Debtor. The Sixth Circuit has previously held, in the context of a partnership, that “the fraud of one partner can be imputed to another partner who had no actual knowledge of it” for purposes of nondischargeability under § 523(a)(2)(A) if the fraud occurred in the course of the partners' business and if the innocent partner shared in the benefits of the fraud. BancBoston Mortgage Corp. v. Ledford, 970 F.2d 1556, 1561 (6th Cir.1992), cert. denied, 507 U.S. 916, 113 S.Ct. 1272, 122 L.Ed.2d 667 (1993). The holding in Ledford was based on principles of partnership and agency law, which generally provide that each partner acts as an agent of the partnership and is jointly liable for the partnership's debts. See Mich. Comp. Laws Ann. §§ 449.9(1); 449.15.

Advantage Title was a corporation, not a partnership, and the principles that support imposing vicarious liability on an innocent partner do not apply to corporate entities, officers and shareholders. Unlike partners, corporate officers, directors, and shareholders are shielded from personal liability for corporate torts unless they participated in the wrongful act or the corporate veil is pierced. See Porter Capital Corp. v. Campbell (In re Campbell), 2008 WL 4682785, at *5 (Bankr.E.D.Tenn. Oct. 21, 2008) (unpublished opinion) (citing Cash America Fin. Servs., Inc. v. Fox (In re Fox), 370 B.R. 104, 113 (6th Cir. BAP 2007)). Imputing liability for a corporation's tortious conduct to an individual officer or director, or from one corporate shareholder to another, would violate general corporate law, and “would extend vicarious liability beyond the traditional agency/partnership relationship, an extension the courts thus far have refused to undertake.” Id. The wrongful acts of one corporate officer should not be imputed to another.

14 There is no evidence that the Debtor personally benefitted from Peck's misuse of the credit cards. To the contrary, the evidence is that both the Debtor and the corporation were harmed by Peck's defalcation of the premiums.

Notwithstanding this established relationship, First American argues that the Debtor breached her fiduciary duties by failing to apprise herself of the corporation's general financial situation, and, more specifically, by failing to ensure that Peck was remitting the premiums to First American. As
an officer of Advantage Title, the court agrees that the Debtor should have been more informed about the corporation's financial situation. But it cannot be said that her actions were objectively reckless. The delegation of responsibility for remitting the premiums to Peck was a legitimate division of corporate responsibilities that did not create an unreasonable risk of harm to First American. This is particularly true given the evidence that Peck was First American's main contact at Advantage Title and First American could have readily seen that the reports submitted were lacking and that the amount of funds remitted was suspect. Further, under the specific circumstances, the Debtor did not know or have reason to suspect that her business co-owner and long-time friend was using corporate funds for her own personal benefit rather than remitting them to First American as required under the Agency Agreement. The Debtor may have been less than diligent in her role as officer, but she was not objectively reckless.

VI. CONCLUSION.

First American has failed to prove that the Debtor owes a nondischargeable debt for defalcation while acting in a fiduciary capacity. Any debt which might be owed by the Debtor to First American shall be subject to the chapter 13 discharge, or to the chapter 7 discharge, if the case is converted. A separate judgment shall be entered accordingly.

Parallel Citations

57 Bankr.Ct.Dec. 8
Synopsis

**Background:** Adversary proceeding was brought by Chapter 13 debtor and trustee for determination that, due to fact that its deed of trust was not recorded, lender that refinanced an earlier deed of trust debt did not have enforceable lien, and lender asserted right to be equitably subrogated to rights of lender whose claim it paid off.

**Holdings:** The Bankruptcy Court, Thomas J. Catliota, J., held that:

[1] deed of trust lender that refinanced debtor's obligation on an existing, first-priority deed of trust loan, and that, as result of this loan transaction, was intended by parties to have first-priority lien on debtor's property, was entitled to be equitably subrogated to rights of lender whose claim it paid off;

[2] filing of prepetition state court action by deed of trust lender operated as lis pendens, and served to provide Chapter 13 trustee, in his strong-arm capacity as a hypothetical bona fide purchaser, with constructive notice of its lien rights; and

[3] even assuming that lis pendens was avoidable as preference, avoidance of lis pendens would not have effect of retroactively erasing the constructive notice that it provided.

Summary judgment for defendant.
MEMORANDUM OF DECISION

THOMAS J. CATLIOTA, Bankruptcy Judge.

Before the Court is the motion for summary judgment (the “Motion”) (Docket No. 38) filed by counter-defendants Maria Jill Green (the “Debtor”) and Nancy Spencer Grigsby, chapter 13 trustee (the “Trustee” and together with the Debtor, the “Plaintiffs”). The counter-plaintiff/cross-claimant Chase Home Finance LLC, Servicer for Government National Mortgage Association (“Chase”) filed an opposition and cross-motion for summary judgment (the “Cross–Motion”) (Docket No. 39). A hearing was held on February 9, 2012 to consider the Motion and Cross–Motion. Post-hearing briefs were filed by the Debtor on February 23, 2012 (Docket No. 49), the Trustee on February 27, 2012 (Docket No. 53) and Chase on March 5, 2012 (Docket No. 54). No further hearing is necessary. For the reasons set forth herein, the Cross–Motion will be granted.

Material Facts Not in Dispute

On September 7, 2010, the Debtor filed a voluntary petition for relief under chapter 13 of the Code. Shortly thereafter on September 30, 2010, the Debtor commenced the instant adversary proceeding against Defendant HSBC Mortgage Services, Inc. (“HSBC”) to determine the secured status of its claim. The Debtor filed the amended complaint (the “Complaint”) on October 4, 2010 against HSBC, who had filed a proof of claim in the amount of $63,462.66 in the Debtor's bankruptcy case. Case No. 10–30606, Claim No. 2–1. The claim is secured by the Debtor's real property located at 14136 Reverend Rainsford Court, Upper Marlboro, Maryland 20772 (the “Property”). The Complaint seeks a determination of the validity, priority, and extent of HSBC's lien against the Property.

The material facts pertinent to this adversary proceeding are not in dispute. On December 21, 2005, the Debtor signed a purchase money note and deed of trust in the amount of $260,000 in favor of IndyMac Bank, F.S.B. The note was secured by a first priority deed of trust against the...
Property, which was recorded on February 1, 2006 in the land records of Prince George's County, Maryland (the “IndyMac First DOT”). The Debtor also signed a second promissory note in the amount of $65,000 and granted a second priority deed of trust in favor of IndyMac, which deed of trust was also recorded on February 1, 2006 (the “IndyMac Second DOT”).

Chase is the servicer of a loan obtained by the Debtor on June 4, 2008 from Government National Mortgage Association. This refinance loan in the original principal amount of $274,050 was provided by First Horizon Home Loans, a Division of First Tennessee Bank (“First Horizon”). The Debtor signed a deed of trust securing the loan (the “First Horizon DOT”). The First Horizon DOT was intended to provide a first priority lien against the Property in favor of First Horizon. The proceeds of the refinance loan were applied to satisfy the IndyMac First DOT. A copy of the certificate of satisfaction for the IndyMac First DOT was filed in the land records on June 13, 2008. However, for unknown reasons, the First Horizon DOT was never recorded. The IndyMac Second DOT was not paid off by the First Horizon loan and remained recorded in the land records. In 2008, the IndyMac Second DOT was transferred to HSBC.

Subsequently on August 4, 2010, First Horizon filed a complaint (the “State Court *793 Action”) against the Debtor and HSBC in the Circuit Court for Prince George's County, Maryland requesting a declaratory judgment that the First Horizon DOT is, nunc pro tunc, a valid and enforceable lien on the Property under the equitable legal theories of equitable mortgage and equitable subrogation. First Horizon Home Loans v. Maria Jill Green, Case No. CAE 10–24006.

The Debtor then filed her chapter 13 petition and shortly thereafter the instant adversary proceeding against HSBC to determine the secured status of its claim. On October 20, 2010, Chase, who now holds the First Horizon DOT and Promissory Note, filed its initial secured proof of claim in the Debtor's case in the amount of $270,063.23.¹ Case No. 10–30606, Claim No. 6–1. The Debtor stated in the original complaint in this adversary proceeding that Chase allegedly held a secured first deed of trust against the Property in the amount of $267,571. The Debtor sought to value the Property at $225,156 and asked the Court to determine that the IndyMac Second DOT in the amount of $64,041 was avoidable under 11 U.S.C. § 506 ² of the Bankruptcy Code. On December 16, 2010, the Debtor and HSBC entered into a consent order resolving this adversary proceeding (Docket No. 14). HSBC conceded that the First Horizon DOT lien exceeds the fair market value of the Property. Thus, pursuant to § 506, HSBC's claim was wholly unsecured and would be treated accordingly under the Debtor's chapter 13 plan.

¹ The claim was thereafter amended multiple times. Chase's most recent proof of claim was filed on March 22, 2011 as an unsecured claim in the amount of $270,063.23. The Debtor's objection to that amended proof of claim was filed on March 25, 2011 and remains pending (Docket No. 51).

² Unless otherwise noted, all statutory references are to the Bankruptcy Code, 11 U.S.C. § 101 et seq., as currently in effect.
On July 18, 2011, in the adversary proceeding, the Debtor filed a motion to vacate the consent order (Docket No. 16) arguing that because Chase's lien was not perfected, HSBC holds the senior lien, which is not subject to strip off pursuant to 11 U.S.C. § 506. Immediately thereafter on July 20, 2011, Chase filed a motion to intervene, which was granted by the Court on September 13, 2011.

Chase filed an answer to the complaint and counterclaim against the Plaintiffs and cross-claim against HSBC on September 13, 2011. Chase is seeking declaratory judgment that the First Horizon DOT has a first lien position against the Property. Alternatively, Chase seeks to establish that the First Horizon DOT is equitably subrogated to the first lien position that the IndyMac First DOT held. The last two counts request an equitable mortgage and a constructive trust. The Debtor and the Trustee then filed the Motion; prior to entering into the consent order, HSBC filed an answer to the Complaint, however, HSBC has failed to respond to the cross-claim asserted against it by Chase.

Conclusions of Law

The parties agree there are no material facts in dispute and the matter is ripe for summary judgment. Therefore, the Court will only briefly address the summary judgment standards:

A court may award summary judgment only when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 247, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986); In re Apex Express Corp., 190 F.3d 624, 633 (4th Cir.1999). In evaluating a summary judgment motion, a court “must consider whether a reasonable [factfinder] could find in favor of the non-moving party, taking all inferences to be drawn from the underlying facts in the light most favorable to the nonmovant.” Apex, 190 F.3d at 633. In doing so, a court is not entitled to either weigh the evidence or make credibility determinations. See Anderson, 477 U.S. at 255, 106 S.Ct. 2505 (“Credibility determinations, the weighing of the evidence, and the drawing of legitimate inferences from the facts are jury functions, not those of a judge”). If the moving party is unable to demonstrate the absence of any genuine issue of material fact, summary judgment is not proper and must be denied. See Celotex Corp. v. Catrett, 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986).


Here, Chase contends that it is entitled under the doctrine of equitable subrogation to assert the rights under the IndyMac First DOT. Plaintiffs, however, contend that the Trustee's rights under § 544(a)(3)—those of a bona fide purchaser for value without notice—defeat Chase's claim for equitable subrogation. Chase responds that the filing of the State Court Action constitutes a lis
pendens against the Property that defeats Plaintiffs’ § 544(a)(3) claim because it put a prospective purchaser on notice of the equitable subrogation claim. Plaintiffs counter that the lis pendens is an avoidable preference under § 547, and once avoided, § 544(a)(3) defeats Chase's equitable subrogation claim or, at least, results in the Trustee holding an interest in the Property superior to Chase's interest under the IndyMac First DOT. Thus, the ultimate issue before the Court is whether the lis pendens is an avoidable preference under § 547 and, if so, what is the effect of avoidance on Chase's equitable subrogation claim.

For the reasons that follow, the Court concludes that Plaintiffs' effort to defeat Chase's equitable subrogation claim by avoiding the lis pendens as a preferential transfer must fail. The Court therefore concludes that Chase is entitled to assert its equitable subrogation rights.

Equitable Subrogation, Lis Pendens and § 544(a)(3).

Equitable subrogation is a well-established and accepted legal doctrine that is widely applied in law and is common in bankruptcy. Subrogation is broadly defined as the “substitution of one person in the place of another with reference to a lawful claim or right.” Rinn v. First Union National Bank of Maryland (Rinn), 176 B.R. 401, 407 (D.Md.1995) (citation omitted). The doctrine is governed by equitable principles and is “intended to provide relief against loss to a meritorious creditor who has paid the debt of another.” Id. The doctrine provides that one who pays the lien of another and takes a new lien as security will be subrogated to the rights of the first lien holder as against any intervening lien holders. G.E. Capital Mortgage Services v. Levenson, 338 Md. 227, 657 A.2d 1170, 1175 (1995).

“Once applied, subrogation places the party subrogated in the shoes of the creditor .... [and]t[he party acquires all rights, securities, and remedies the creditor has against the debtor and is [regarded] as constituting one and the same person with the creditor whom he succeeds.” Rinn, 176 B.R. at 408 (internal quotation and citation omitted). As the Supreme Court summarized: “One who rests on subrogation stands in the place of one whose claim he has paid, as if the payment giving rise to the subrogation had *795 not been made.” United States v. Munsey Trust Co., 332 U.S. 234, 242, 108 Ct.Cl. 765, 67 S.Ct. 1599, 1603, 91 L.Ed. 2022 (1947).

The court in Rinn went on to explain that:

Courts have traditionally applied the doctrine of subrogation in the context of one who pays off a mortgage or encumbrance which the principal debtor has failed to discharge. As the court stated in Levenson v. Capital Mortgage, 101 Md.App. 122, 643 A.2d 505, 510 (1994): [T]he weight of authority extends the application of the doctrine of equitable subrogation to situations in which the initial and refinancing lenders are not the same, provided the refinancing lender's money is intended to be used, and is used, to eliminate a specific
encumbrance, and the refinancing lender intended “to get as security for his
loan either the land free and clear of the encumbrance or else the benefit of the
encumbrance itself” rather than rely upon the general credit of the mortgagor.

Rinn, 176 B.R. at 408–09 (emphasis in original).

[6] Here, the undisputed facts make out a prima facie case that Chase is entitled under the doctrine
of equitable subrogation, to assert the rights under the IndyMac First DOT. The funds from the
First Horizon loan and secured by the First Horizon DOT were intended to be used, and in fact
were used, to satisfy the IndyMac First DOT. Chase alleges, and the Plaintiffs do not dispute,
that IndyMac, as the holder at the time of the refinancing of both the IndyMac First DOT and the
IndyMac Second DOT, understood that the proceeds from the First Horizon Loan were to be used
to pay off the IndyMac First DOT and that First Horizon was to receive a first priority deed of
trust. The certificate of satisfaction filed as to the IndyMac First DOT as well as the settlement
sheet from the First Horizon loan indicate that the parties intended the First Horizon loan to pay
off the IndyMac First DOT. All parties understood that the First Horizon DOT was to be timely
recorded, and the reason it was not recorded is unknown in the land records. These undisputed
facts make out a claim for equitable subrogation.

3 It does not appear that HSBC, as the holder of the IndyMac Second DOT, disputes these allegations as it has chosen not to participate
in this action.

The Plaintiffs seek to avoid Chase's equitable subrogation claim under § 544 of the Bankruptcy
Code. Section 544(a)(3) provides, in pertinent part:

(a) The trustee shall have, as of the commencement of the case, and without regard to any
knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer
of property of the debtor or any obligation incurred by the debtor that is voidable by—

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom
applicable law permits such transfer to be perfected, that obtains the status of a bona fide
purchaser and has perfected such transfer at the time of the commencement of the case, whether
or not such a purchaser exists.


4 Under the framework of § 544, § 544(a)(1) and (3) pertain to real estate; § 544(a)(2) pertains to personalty. See, e.g., In re McLean

[7] Pursuant to this provision, a trustee is given the rights and powers of a bona fide purchaser
of real property if, at *796 the time the bankruptcy case commenced, a hypothetical buyer could
have obtained bona fide purchaser status. In re Michigan Lithographing Co., 997 F.2d 1158, 1159
(6th Cir.1993). “The purpose of § 544 is to arm the trustee with sufficient powers to gather in the
property of the estate. Thus, the trustee is considered a *bona fide* purchaser of real property in the bankruptcy estate and may avoid obligations of the debtor that are voidable by such a purchaser.” *In re Halabi*, 184 F.3d 1335, 1337 (11th Cir.1999) (citing 11 U.S.C. § 544(a)(3)). A trustee's avoidance powers as a *bona fide* purchaser is determined by state substantive law. *Glanz v. RJF International Corp.*, 205 B.R. 750, 753 (Bankr.D.Md.1997) (The extent to which a trustee may exercise rights under § 544(a) is governed by applicable state law.).

[9] [10] [11] Under Maryland substantive law, a *bona fide* purchaser for value is someone who purchases real property without notice or knowledge of any infirmity in the title. *See Leet v. Totah*, 329 Md. 645, 620 A.2d 1372, 1380–1381 (1993). “Where a grantee accepts conveyance of property with actual knowledge that there has been a prior sale of part of that property, he is not a *bona fide* purchaser, notwithstanding the fact that the prior deed was not recorded.... Even constructive notice of prior unrecorded equities will preclude the grantee from being a *bona fide* purchaser.” *Lewis v. Rippons*, 282 Md. 155, 383 A.2d 676, 680 (1978).

Constructive notice that precludes a grantee from being a *bona fide* purchaser can result from a *lis pendens*. The rationale behind the common law doctrine of *lis pendens* is that:

[T]he law does not allow litigant parties to give to others, pending the litigation, rights to the property in dispute, so as to prejudice the opposite party. Where a litigation is pending between a plaintiff and a defendant as to the right to a particular estate, the necessities of mankind require that the decision of the court in the suit shall be binding, not only on the litigant parties, but also on those who derive title under them by alienations made pending the suit, whether such alienees had or had not notice of the pending proceedings.


[12] The filing of the State Court Action, filed in the Circuit Court of Prince George's County, Maryland constituted a *lis pendens* on the Property. *See* Md. Rule 12–102(a) and (b). Any subsequent transferee of the Property was on notice of the facts giving rise to Chase's equitable subrogation claim and could not be a *bona fide* purchaser without notice of the claim. The *lis pendens* therefore defeats the Trustee's claim under § 544(a)(3).

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5 Maryland Rule 12–102(a) describes the scope of *lis pendens* in Maryland.

(a) Scope. This Rule applies to an action filed in a circuit court or in the United States District Court for the District of Maryland that affects title to or a leasehold interest in real property located in this State.

Subsection (b) refers to real property:

(a) Creation—Constructive notice. In an action to which the doctrine of *lis pendens* applies, the filing of the complaint is constructive notice of the *lis pendens* as to real property in which the county in which the complaint is filed. In any other county, there is constructive notice only after the party seeking the *lis pendens* files either a certified copy of the complaint or a notice giving rise to the *lis pendens*, with the clerk in the other county.
Unjust Enrichment.

Plaintiffs contend that equitable subrogation is intended to prevent unjust enrichment. They further contend that the doctrine should not apply here because the Debtor's obligations exceed the value of the Property. They argue that in the absence of equitable subrogation, an amount equal to the value of the Property must be paid to the Trustee under the Chapter 13 plan for pro rata distribution to all of Debtor's creditors. They argue that the Debtor will not be unjustly enriched because she will not directly retain the value of the Property. The Court disagrees with the premise of Plaintiffs' argument—that a borrower (as opposed to her creditors) must receive the proceeds from the property for equitable subrogation to apply. The application of equitable subrogation is not dependent on whether the equity in the property will be paid to the borrower directly, rather than the borrower's other creditors.

Equitable subrogation cases are often brought as disputes between the lender who claims equitable subrogation and a subsequent secured lien holder, in cases where the total equity in the property is not sufficient to satisfy both claims. See e.g., Glen Burnie Mut. Sav. Bank v. U.S., 733 F.Supp.2d 623 (D.Md.2010); Egeli v. Wachovia Bank, N.A., 184 Md.App. 253, 965 A.2d 87 (2009); G.E. Capital Mortgage Servs., Inc. v. Levenson, 338 Md. 227, 657 A.2d 1170 (1995); Bennett v. Westfall, 186 Md. 148, 46 A.2d 358 (1946). In these cases, the prevailing creditor is paid first from the property and the losing creditor is often left without being fully repaid. In none of these cases will the borrower receive any proceeds from the property, and that fact is not significant to the court's determination.

This case is such an example. According to the Debtor's schedules, the Debtor contends the Property is worth approximately $200,000. Chase's proof of claim is in the amount of $270,063. HSBC holds a lien against the Property and has filed a proof of claim in the amount of $63,462. If Chase prevails, Chase would hold a first lien position in the Property, all of the value of the Property would be applied to its debt and Chase would hold an unsecured deficiency claim for the balance; HSBC would not receive anything from the Property and would hold a wholly unsecured claim. If Chase does not prevail, HSBC would hold a first lien position in the Property and would be paid in full; 6 Chase would hold an unsecured claim and would share pro rata in the balance of the equity in the Property with the Debtor's other creditors. The unjust enrichment if Chase does not prevail would inure to HSBC, who would receive a first lien position where there is no dispute that such a result was not intended, and which would result from the loan made by Chase's predecessor that was intended to have the first lien position.

6 Consistent with Plaintiffs' position here, the Debtor's pending chapter 13 plan proposes to place HSBC in first lien position on the Property.

Lis Pendens and § 547.
The Plaintiffs contend that the *lis pendens* was created during the preference period and is therefore avoidable under § 547 of the Code. Section 547 empowers the trustee to avoid any transfer, including the fixing or perfection of a lien occurring within 90 days of the filing of the bankruptcy petition, if the transfer is due to an antecedent debt or is made while the debtor is insolvent that would allow the creditor to receive more than it would have been paid if the transfer had not occurred in a chapter 7 case. 11 U.S.C. § 547. The Debtor further contends that once the *lis pendens* is avoided, § 544 comes back into play and allows the Plaintiffs to avoid the equitable subrogation claim. This Court disagrees.

As stated above, the critical fact that defeats the Trustees status as a bona fide purchaser under § 544 is the notice provided by the *lis pendens*. By the terms of § 544(a), the Trustee's standing is determined “as of the commencement of the case.” 11 U.S.C. § 544(a). As of the commencement of the Debtor's case, under Maryland law all parties were on notice of Chase's equitable subrogation claim as a result of the filing of the State Court Action. The avoidance of the *lis pendens* as a preferential transfer could not have the effect of retroactively erasing that notice—the proverbial bell cannot be unrung.

The facts in this case are somewhat akin to those in *Logan v. CitiMortgage, Inc. (In re Schubert)*, 437 B.R. 787 (Bankr.D.Md.2010) (Keir, C.J.). There the debtors obtained a refinance of their deed of trust loan with CitiMortgage. CitiMortgage waited approximately one month to file its deed of trust in the land records. The filing occurred during the prepetition preference period. The trustee sought to avoid the recordation of the deed of trust pursuant to § 547. The court held that, although CitiMortgage's recordation of the deed constituted a preferential transfer, it nevertheless was entitled to be equitably subrogated to the original deed of trust, which was paid off in full outside the preference period.

As pertinent here, Chief Judge Keir held that, because CitiMortgage recorded its deed of trust prior to the filing of the bankruptcy case, relief under § 544 was not available to the trustee. *Id.* at 791, n. 4. The Court specifically rejected the notion that the avoidance of the recordation of the deed as a preferential transfer could reinvigorate the trustee's powers under § 544.

Furthermore, the avoidance of the preferential transfer under Sections 547 and 550 to the extent the lien is avoided, does not erase the original recordation and the notice it provided to other creditors. The court rejects any argument that because avoidance of the preferential transfer, CitiMortgage would hold an unrecorded lien which the Trustee is entitled to avoid under the strong-arm powers of Section 544 which essentially serve to cut off unperfected liens and security interests at the time of the bankruptcy petition. The existence of CitiMortgage's interest in the Property would still be apparent from the land
records despite avoidance and therefore provides notice sufficient to defeat the
right to avoid arising under Section 544.

*In re Schubert*, 437 B.R. at 796–97. This rationale is equally applicable here.

The Plaintiffs rely on *Wells Fargo Funding v. Gold*, 432 B.R. 216 (E.D.Va.2009) in support of
their contention that the *lis pendens* should be avoided as a preferential transfer pursuant to § 547.
Their reliance is misplaced, however, as the factual situation here is distinguishable from *Gold*. In
*Gold*, the bankruptcy court granted the chapter 11 trustee’s motion to sell free and clear of liens
over the objections of several creditors. Those creditors had been swindled by the debtor into
purchasing loans on his residence; however, the deeds of trust were never recorded. Prior to the
filing of the petition, Wells Fargo, one of the creditors, filed a notice of *lis pendens*.

The bankruptcy court ruled that the trustee could not utilize § 544(a)(3) to avoid Wells Fargo's
unrecorded deed of trust because the *lis pendens* constituted notice to defeat the trustee’s status as
a bona fide purchaser. With respect to § 547, the court held that the filing of a *lis pendens* does
not operate as a transfer or *799* create a lien. *Id.* at 223. It held, however, that Wells Fargo's
successful prosecution of the suit underlying the *lis pendens* would result in a transfer, and that
transfer would relate back to the date of the filing of the *lis pendens* under Virginia law. Thus, the
filing of a *lis pendens* “does not create a lien, but it is a ‘consequential action’ which § 547 permits
the trustee to avoid, provided it occurs within the 90–day period.” *Id.* at 224. These determinations
by the bankruptcy court were affirmed on appeal.

Significantly, in *Gold*, the lender was not seeking equitable subrogation arising from a transaction
that occurred prior to the preference period. In *Gold*, the legal effect of the *lis pendens* was twofold:
(1) it provided notice sufficient to defeat the trustee’s status under § 544; and (2) if the lender
were successful in the underlying suit, the resulting transfer would relate back to the date of the
filing of the *lis pendens*, and that date was squarely within the preference period. It is for the latter
reason that the court avoided the *lis pendens* under § 547, not the former. Here, to be sure, the *lis
pendens* provided notice sufficient to defeat the trustee's status under § 544. However, once Chase
is successful on its equitable subrogation suit, its rights relate back to the date it issued the loan and
paid off the then IndyMac First DOT, and that date is outside the preference period. The avoidance
of the *lis pendens*, even if available under § 547, would not defeat Chase's claim because Chase's
remedy rests on equitable subrogation, not the recordation of its deed of trust.7

For this reason, the Court makes no determination as to whether a *lis pendens* can be avoided under § 547 if filed within the preference
period in a case such as *Gold*.

**Conclusion**
For the foregoing reasons, Chase is entitled to be equitably subrogated to the position of the IndyMac First DOT, and summary judgment shall be entered in its favor. A separate order shall issue.

Parallel Citations

68 Collier Bankr.Cas.2d 367
CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FIFTH APPELLATE DISTRICT

LA JOLLA GROUP II et al.,
   Plaintiffs and Appellants,

v.

DANIEL A. BRUCE et al.,
   Defendants and Respondents.

   F061829
   (Super. Ct. No. 10CECG02268)

OPINION

APPEAL from a judgment of the Superior Court of Fresno County. Donald S. Black, Judge.

Wilkins, Drolshagen & Czeshinski, James H. Wilkins and Quentin Cedar for Plaintiffs and Appellants.

Betts, Rubin & McGuinness, James B. Betts and Joseph D. Rubin for Defendants and Respondents.
When their family home in Fresno, California (the Property) was foreclosed on pursuant to a forged or fraudulent second deed of trust, Rebecca and Victorino Baquiran filed an action to quiet title to the Property and recorded a lis pendens. Thereafter, the party that had purchased the Property in good faith at the foreclosure sale, La Jolla Group II and its partners, Leroy Kleim and Alan Boyajian (collectively appellants), filed a complaint for slander of title against the Baquirans and the Baquirans’ attorney, Daniel A. Bruce and the Law Office of Zinkin & Bruce (collectively respondents), alleging that the recording of the lis pendens was unprivileged and wrongfully prevented appellants from being able to sell the Property. Respondents then filed a special motion to strike the slander of title complaint under Code of Civil Procedure section 425.16 (also known as an “anti-SLAPP” motion). In ruling on the motion, the trial court concluded that (1) the recording of the lis pendens was a protected activity under section 425.16 and (2) appellants did not establish a probability of prevailing on their slander of title complaint. The trial court reached the latter conclusion because the evidence of forgery reflected the second deed of trust was void (not merely voidable) and because the absolute privilege of Civil Code section 47, subdivision (b) (hereafter Civil Code section 47(b)) applied to the recording of the lis pendens. Accordingly, respondents’ special motion to strike was granted. Appellants appeal from that order. We will affirm.

FACTS AND PROCEDURAL HISTORY

On or about June 28, 1989, Victorino Baquiran purchased the Property. At that time, Mr. Baquiran executed a first deed of trust to secure the loan used to purchase the Property. His wife, Rebecca Baquiran, was placed on title to the Property and the

1 Unless otherwise indicated, all further statutory references are to the Code of Civil Procedure. The term “SLAPP” is “an acronym for ‘strategic lawsuit against public participation.’” (Jarrow Formulas, Inc. v. LaMarche (2003) 31 Cal.4th 728, 732, fn. 1.)
Baquirans made it their family home for more than 16 years, until they were evicted by appellants in June 2005.

The Forged Second Deed of Trust and Resulting Foreclosure

In July 2003, the Baquirans received notice that foreclosure proceedings were being commenced based on a second deed of trust on the Property securing a promissory note in favor of Steven and Carrie Mahlum. Prior to receiving that notice, the Baquirans had no knowledge that a deed of trust in favor of the Mahlums had been recorded on the Property. Indeed, the Baquirans had never borrowed money from, or even met, the Mahlums. The Mahlums likewise acknowledged that although they had received some payments from Zarrell Williams, which they thought related to the second deed of trust, they had never received any payments from the Baquirans.

It was later discovered that the second deed of trust was procured through the fraud or forgery of the Baquirans’ former mortgage broker, Williams. Williams had brokered a refinance of the Baquirans’ first deed of trust in April 1997, just prior to the date appearing on the second deed of trust naming the Mahlums as beneficiaries. Although the Baquirans admitted their signatures on the second deed of trust appeared to be authentic, they contended they were deceived because the document was materially altered and they never intended to sign a deed of trust in favor of the Mahlums. It was the Baquirans’ theory that during the refinance transaction in 1997, Williams, by means of fraud and deceit, had them execute documents not related to or utilized in the refinance, which documents Williams later altered to fraudulently obtain a loan from the Mahlums in the Baquirans’ name, and then Williams converted the proceeds of that loan for his own use. James A. Blanco, a handwriting and document expert retained by respondents, examined the second deed of trust and concluded that it had been materially altered. At various places, information had been covered over with “whiteout” and replaced by other information. For example, under the beneficiary section of the
document, two names were covered over using a masking fluid and replaced with the names of Steven and Carrie Mahlum.

On February 24, 2004, before the forgery by Williams had been brought to light, the Property was foreclosed upon and sold at a nonjudicial foreclosure sale to La Jolla Group II and David and Linda Hovannisian. On March 17, 2004, appellants initiated eviction proceedings against the Baquirans. The Baquirans initially hired attorney Joseph C. Raineri, who was able to obtain a stay of eviction until January 2005. However, the Baquirans eventually concluded that Mr. Raineri had abandoned them and was not protecting their rights. Thereafter, in February 2005, the Baquirans retained Mr. Bruce to represent them in this matter.

**The Baquirans’ Complaint to Quiet Title and Lis Pendens**

On May 25, 2005, the Baquirans, represented by Mr. Bruce, filed a complaint to quiet title against, among others, appellant La Jolla Group II. In that complaint, the Baquirans alleged the disputed second deed of trust was “a forgery and/or a fraudulently obtained document that was created by Williams,” and they sought (1) to cancel the purported foreclosure sale based upon the forged deed of trust and (2) to restore possession and title of the Property to the Baquirans. On June 14, 2005, the Baquirans recorded a notice of pending action (the lis pendens) concerning the Property. The pending action specified in the lis pendens was the Baquirans’ complaint to quiet title. The lis pendens was signed by Mr. Bruce.

On December 16, 2005, appellant La Jolla Group II filed a motion to expunge the lis pendens. On February 2, 2006, the motion proceeded to hearing. The Honorable Judge Alan M. Simpson considered the papers, evidence and arguments presented by the parties and declined to expunge the lis pendens. As part of his written order denying the motion, Judge Simpson found that the Baquirans “ha[d] shown the probable validity of their claim.” The written order further explained: “The Rebecca Baquiran declaration,
combined with the evidence of alteration of the deed of trust pursuant to which the property was sold, support [the Baquirans’] theory that the deed of trust was a forgery.”

Criminal Conviction of Zarrell Williams

Meanwhile, criminal charges were filed by the Fresno County District Attorney against Williams for multiple acts of theft, forgery and similar crimes against several victims. As to Williams’s conduct perpetrated against the Baquirans, the consolidated information specifically charged Williams with four distinct crimes: grand theft of money, forgery of a deed of trust, knowingly performing notarial act on a false or forged trust deed, and procuring or offering a false or forged instrument (deed of trust) for filing or recording. The consolidated information set forth the following facts in support of these particular counts:2 (1) Williams was a loan broker who first worked with Rebecca Baquiran in the early 1990’s when she obtained a personal loan, and again in 1997 when he arranged a consolidation loan for the Baquirans through EquiCredit. In the same time period, Williams made a number of hard money property loans on behalf of the Mahlums. (2) When the Mahlums failed to receive certain payments on those property loans, Williams advised them that he had a loan, including a note and deed of trust, on the Property. (3) Williams produced for the Mahlums a deed of trust and assignment of rents purportedly signed by the Baquirans that had been filed with the Fresno County Recorder’s Office on June 4, 1998. That deed of trust was subsequently found to have been altered by Williams. (4) The deed of trust and assignment of rents was forged by Williams with intent to defraud. (5) The forged deed of trust was notarized by Williams with knowledge that it contained a false statement or was forged.

On September 13, 2006, the jury found Williams guilty as charged on each of the counts relating to the Property, including forgery of the deed of trust, knowingly

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2 The counts are numbered here for convenience; such enumeration did not appear in the original.
performing a notarial act on a false or forged trust deed, and procuring or offering a false or forged deed of trust for filing or recording. Williams was also convicted on all but one of the other crimes charged against him that involved other defrauded victims. He was sentenced to serve three years four months in prison.

Withdrawal of the Lis Pendens

On July 6, 2009, the Baquirans recorded a notice of withdrawal of lis pendens. According to Mr. Bruce, the lis pendens was withdrawn as part of a negotiated settlement reached between the Baquirans, the Mahlums and All-Cal Foreclosure Services, Inc. The Mahlums and All-Cal Foreclosure Services, Inc. were additional defendants in the quiet title action.

Appellants’ Complaint for Slander of Title

On June 29, 2010, appellants filed their complaint for slander of title against respondents. The complaint for slander of title alleged that the recording of the lis pendens was not privileged and wrongfully prevented appellants from being able to sell the Property from June 2005 to July 2009, resulting in damages to appellants. Allegedly, the Baquirans’ admission that their signatures on the second deed of trust were authentic established that there was no justifiable basis for alleging the second deed of trust was a forgery or for seeking to invalidate the foreclosure sale. Thus, according to the complaint for slander of title, the recording of the lis pendens was false, wrongful and unprivileged since it purportedly had no evidentiary basis.

Respondents’ Special Motion to Strike

On August 6, 2010, respondents moved to strike appellants’ slander of title complaint pursuant to section 425.16 (the “anti-SLAPP” statute) on the grounds that (1) recording the lis pendens was a protected activity under the statute (see § 425.16, subd. (e)) and (2) appellants could not establish a probability of prevailing on the slander of title claim (§ 425.16, subd. (b)(1)). In their opposition, appellants conceded that the filing of the lis pendens was a protected activity under the statute. Therefore, the focus of
the motion was on the second step or prong of the analysis under section 425.16—that is, whether appellants could show a probability of prevailing on the merits of their complaint for slander of title.

After considering the evidence and arguments presented by the parties, the trial court found that the disputed deed of trust was a forgery since it had been materially altered by Williams. Therefore, it was “void” and not merely voidable; and, as a consequence, it could not convey title—not even to a good faith purchaser at a foreclosure sale. The trial court further held that under the circumstances, the litigation privilege of Civil Code section 47(b) was applicable to the recording of the lis pendens. For these reasons, the trial court concluded appellants did not have a probability of prevailing and, therefore, the special motion to strike was granted.

Appellants’ notice of appeal followed.

DISCUSSION

I. Standard of Review

We review de novo the trial court’s ruling on an anti-SLAPP motion. (Flatley v. Mauro (2006) 39 Cal.4th 299, 325.) “Resolving the merits of a section 425.16 motion involves a two-part analysis, concentrating initially on whether the challenged cause of action arises from protected activity within the meaning of the statute and, if it does, proceeding secondly to whether the plaintiff can establish a probability of prevailing on the merits. [Citation.]” (Overstock.com, Inc. v. Gradient Analytics, Inc. (2007) 151 Cal.App.4th 688, 699 (Overstock.com).) In our de novo review, “[w]e consider “the pleadings, and supporting and opposing affidavits … upon which the liability or defense is based.” (§ 425, subd. (b)(2).) However, we neither “weigh credibility [nor] compare the weight of the evidence. Rather, [we] accept as true the evidence favorable to the plaintiff [citation] and evaluate the defendant’s evidence only to determine if it has defeated that submitted by plaintiff as a matter of law.” [Citation.]{[Citation.]” (Flatley v. Mauro, supra, at p. 326.)
II. Overview of the Anti-SLAPP Statute

“[T]he Legislature enacted section 425.16, the anti-SLAPP statute, to provide for
the early dismissal of unmeritorious claims filed to interfere with the valid exercise of the
constitutional rights of freedom of speech and petition for the redress of grievances.
[Citation.]”  (Club Members for an Honest Election v. Sierra Club (2008) 45 Cal.4th 309, 315.)  “The Legislature authorized the filing of a special motion to strike such claims
(§ 425.16, subds. (b)(1), (f)), and expressly provided that section 425.16 should ‘be
construed broadly.’  [Citations.]”  (Ibid.) The resolution of an anti-SLAPP motion
“requires the court to engage in a two-step process.  First, the court decides whether the
defendant has made a threshold showing that the challenged cause of action is one arising
from protected activity….  If the court finds such a showing has been made, it then
determines whether the plaintiff has demonstrated a probability of prevailing on the
Enterprises).)

The present appeal concerns, in particular, the second step under the statutory
analysis—namely, whether appellants have demonstrated a probability of prevailing on
their claim for slander of title.  (§ 425.16, subd. (b)(1).)  In order to establish a probability
of prevailing on a cause of action in the context of an anti-SLAPP motion, a plaintiff
must state and substantiate a legally sufficient claim.  (Rusheen v. Cohen (2006) 37
Cal.4th 1048, 1056.)  “Put another way, the plaintiff “must demonstrate that the
complaint is both legally sufficient and supported by a sufficient prima facie showing of
facts to sustain a favorable judgment if the evidence submitted by the plaintiff is
credited.”  [Citations.]”  (Ibid.)  That is, the plaintiff must “““make a prima facie
showing of facts which would, if proved at trial, support a judgment in plaintiff’s
favor.””  [Citation.]”  (ComputerXpress, Inc. v. Jackson (2001) 93 Cal.App.4th 993,
1010.)  “In deciding the question of potential merit, the trial court considers the pleadings
and evidentiary submissions of both the plaintiff and the defendant (§ 425.16,
subd. (b)(2)); though the court does not weigh the credibility or comparative probative strength of competing evidence, it should grant the motion if, as a matter of law, the defendant’s evidence supporting the motion defeats the plaintiff’s attempt to establish evidentiary support for the claim.” (Wilson v. Parker, Covert & Chidester (2002) 28 Cal.4th 811, 821.) Accordingly, “the motion to strike should be granted if the defendant ‘defeats the plaintiff’s showing as a matter of law, such as by establishing a defense or the absence of a necessary element.’” [Citation.] (Carver v. Bonds (2005) 135 Cal.App.4th 328, 344.)

III. Motion to Strike Under Section 425.16 Was Properly Granted

Under the first step of the analysis under section 425.16, respondents must make a threshold showing that the challenged cause of action arose from protected activity within the meaning of the statute. (§ 425.16, subd. (b)(1); Equilon Enterprises, supra, 29 Cal.4th at p. 67; Overstock.com, supra, 151 Cal.App.4th at p. 699.) Here, the complaint for slander of title was premised on a single activity: the recording of the lis pendens. Unquestionably, the recording of the lis pendens constituted a written statement made in connection with issues under consideration in a judicial proceeding—that is, the underlying quiet title action. (§ 425.16, subd. (e).) Therefore, as conceded by appellants in their opening brief, the challenged complaint for slander of title arose out of protected activity under section 425.16, and respondents satisfied their burden under the first step of the analysis.

We now turn to the heart of this appeal, which is the second step of the statutory analysis. In response to the anti-SLAPP motion, once respondents made their initial threshold showing, the burden shifted to appellants to demonstrate a probability of

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3 Section 760.010, et seq., which governs quiet title actions, provides that immediately upon commencement of such an action, the plaintiff shall file a lis pendens in the office of the county recorder. (§ 761.010.)
prevailing on their claim. (§ 425.16, subd. (b)(1); Park 100 Investment Group II, LLC v. Ryan (2009) 180 Cal.App.4th 795, 805). That meant appellants had to state and substantiate a legally sufficient cause of action for slander of title. (Rusheen v. Cohen, supra, 37 Cal.4th at p. 1056.) As noted above, we consider (but we do not weigh) the evidence presented by both sides, and we may decide that respondents’ evidence defeats appellants’ showing as a matter of law, “‘such as by establishing a defense or the absence of a necessary element.’” [Citation.]” (Carver v. Bonds, supra, 135 Cal.App.4th at p. 344.)

As explained below, we conclude that appellants have not established a tenable claim for slander of title. We reach this conclusion on two separate grounds: First, the absolute privilege under Civil Code section 47(b) was applicable to the recording of the lis pendens in this case. Second, the evidence of forgery established as a matter of law that the second deed of trust was void and, therefore, appellants never acquired title to the Property. Each of these grounds would be a sufficient basis to conclude that appellants have no probability of prevailing on their claim. We shall discuss them separately, beginning with the issue of privilege.

A. Privilege of Civil Code Section 47(b)

Appellants’ sole cause of action was for slander of title. The elements of a cause of action for slander of title are (1) a publication, which is (2) without privilege or justification, (3) false, and (4) causes pecuniary loss. (Manhattan Loft, LLC v. Mercury Liquors, Inc. (2009) 173 Cal.App.4th 1040, 1051.) The critical question here is whether the publication in the present case—the lis pendens recorded by the Baquirans—was privileged under Civil Code section 47(b).
Civil Code section 47(b) provides that, with certain exceptions, a publication made in any judicial proceeding is privileged. Because of the vital purposes served by this privilege, it is “‘absolute’” in nature and applies to all causes of action except malicious prosecution. (Hagberg v. California Federal Bank (2004) 32 Cal.4th 350, 360; Silberg v. Anderson (1990) 50 Cal.3d 205, 215.) The purposes of Civil Code section 47(b) are “‘to afford litigants and witnesses free access to the courts without fear of being harassed subsequently by derivative tort actions, to encourage open channels of communication and zealous advocacy, to promote complete and truthful testimony, to give finality to judgments, and to avoid unending litigation.’” (Jacob B. v. County of Shasta (2007) 40 Cal.4th 948, 955.) To further these important goals, the privilege is applied broadly. (Ibid.)

“The usual formulation is that the privilege applies to any communication (1) made in judicial or quasi-judicial proceedings; (2) by litigants or other participants authorized by law; (3) to achieve the objects of the litigation; and (4) that have some connection or logical relation to the action. [Citations.]” (Silberg v. Anderson, supra, 50 Cal.3d at p. 212.) “It is not limited to statements made during a trial or other proceedings, but may extend to steps taken prior thereto, or afterwards. [Citation.]” (Rusheen v. Cohen, supra, 37 Cal.4th at p. 1057.) It applies to “any publication required or permitted by law in the course of a judicial proceeding to achieve the objects of the litigation, even though the publication is made outside the courtroom and no function of the court or its officers is involved.” (Silberg v. Anderson, supra, at p. 212.)

The publication at issue here was the lis pendens recorded in connection with the Baquirans’ complaint to quiet title to the Property. “‘A lis pendens is a recorded document giving constructive notice that an action has been filed affecting title or right to

4 Civil Code section 47(b) is often referred to as the litigation privilege. (Rusheen v. Cohen, supra, 37 Cal.4th at p. 1057.)
possession of the real property described in the notice.’ [Citation.] A lis pendens may be filed by any party in an action who asserts a ‘real property claim.’ (Code Civ. Proc., § 405.20.) Section 405.4 defines a “Real property claim” as ‘the cause or causes of action in a pleading which would, if meritorious, affect (a) title to, or the right to possession of, specific real property ….’” (Kirkeby v. Superior Court (2004) 33 Cal.4th 642, 647, fn. omitted.)

Previously, the absolute privilege of Civil Code section 47(b) has been broadly applied to the recording of a lis pendens. (Albertson v. Raboff (1956) 46 Cal.2d 375, 379 (Albertson).) “If the publication has a reasonable relation to the action and is permitted by law, the absolute privilege attaches. [Citations.] It therefore attaches to the recordation of a notice of lis pendens, for such a publication is permitted by law, and like other documents that may be filed in an action, it has a reasonable relation thereto and it is immaterial that it is recorded with the county recorder instead of being filed with the county clerk.” (Id. at p. 381.)

Albertson’s holding, however, has been somewhat limited or “partially abrogated” by a 1992 amendment to Civil Code section 47. (Park 100 Investment Group II, LLC v. Ryan, supra, 180 Cal.App.4th at p. 813, fn. 5; Palmer v. Zaklama (2003) 109 Cal.App.4th 1367, 1378-1379 (Palmer).) That amendment added the provision that is currently set forth at Civil Code section 47, subdivision (b)(4) (hereafter Civil Code section 47(b)(4)), which states: “A recorded lis pendens is not a privileged publication unless it identifies an action previously filed with a court of competent jurisdiction which affects the title or right of possession of real property, as authorized or required by law.” (Italics added.) As a result of this provision, “the litigation privilege … applies if the lis pendens (1) identifies an action ‘previously filed’ in a court of competent jurisdiction that (2) affects title or right to possession of real property.” (Alpha & Omega Development, LP v. Whillock Contracting, Inc. (2011) 200 Cal.App.4th 656, 665 (Alpha & Omega), italics added.)
Here, the subject lis pendens expressly identified the Baquirans’ previously filed action—namely, the Baquirans’ complaint to quiet title. In addition, that action was clearly one that affected title or right to possession of the Property, since it sought to quiet title to the Property through cancellation of the foreclosure sale and restoration of title and possession to the Baquirans, all on the ground that the second deed of trust was a forgery. Thus, the statutory conditions for application of the privilege to a recorded lis pendens, as set forth in Civil Code section 47(b)(4), have plainly been satisfied in this case. It follows that the privilege of Civil Code section 47(b) applies to the subject lis pendens, thereby precluding liability for slander of title.

Appellants nevertheless contend the privilege of Civil Code section 47(b) does not apply to the lis pendens in this case. They argue that because the Baquirans’ complaint to quiet title lacked evidentiary merit to the extent the facts showed the second deed of trust was merely “voidable” rather than void, the privilege did not attach. In so arguing, appellants take the position that the privilege only applies to a recorded lis pendens if it is shown that the underlying action has evidentiary merit. In support of that proposition, appellants rely on language from Palmer, supra, 109 Cal.App.4th 1367, a prior decision of this court. We now consider that decision at length.

In Palmer, the plaintiffs acquired ownership of a house in Bakersfield by purchasing it at a sheriff’s sale that took place to satisfy a judgment lien in a creditor’s collection action. Later, the former owners filed a bankruptcy action and also filed an appeal in the collection action. In connection with these court filings, the former owners recorded a lis pendens that effectively prevented the plaintiffs from being able to sell or refinance the property. (Palmer, supra, 109 Cal.App.4th at pp. 1370-1374.) The plaintiffs then sued the former owners for slander of title, asserting that the actions brought by the former owners were not the type of proceedings for which it was appropriate to file a lis pendens. (Id. at p. 1381.) Palmer agreed with the plaintiffs’ theory, holding that the privilege of Civil Code section 47(b) did not apply to the lis
pendens in question, since the underlying collection and bankruptcy actions filed by the
former owners did not allege a real property claim. (Palmer, supra, at p. 1381.) On that
record, the holding in Palmer was correct.

The language relied on herein by appellants came at the end of Palmer’s
discussion of developments in the law. Palmer summarized the revisions enacted in 1992
to the lis pendens statutes, in which former sections 409 to 409.9 were repealed and
replaced by sections 405 to 405.61. (Palmer, supra, 109 Cal.App.4th at pp. 1377-1378.)
Palmer noted that under the new statutory scheme, a motion to expunge a lis pendens
could be based not only on a failure to plead a real property claim (§ 405.31), but also on
a failure of the claimant to establish by a preponderance of the evidence the probable
validity of the real property claim (§ 405.32).5 (Palmer, supra, at pp. 1377-1378.) Thus,
the revised lis pendens statutes provided that a lack of evidentiary merit would be a
ground for expungement: “If the claimant does plead a real property claim, but the
claim pleaded has no evidentiary merit, the lis pendens must be expunged upon motion
under [section] 405.32.” (Id. at p. 1378.)

Palmer observed that in the same year that these revisions to the lis pendens
statutes took place (1992), the Legislature also amended section 47 of the Civil Code to
add subdivision (b)(3), now subdivision (b)(4), which “partially abrogated” the holding
of Albertson that recording a notice of lis pendens is absolutely privileged. (Palmer,
supra, 109 Cal.App.4th at pp. 1378-1379.) After quoting the language of Civil Code
section 47(b)(4), Palmer concluded its summary of the lis pendens statutes and Civil
Code section 47(b)(4) with the following statement: “Therefore, if the pleading filed by
the claimant in the underlying action does not allege a real property claim, or the alleged

5 Section 405.3 states that “[p]robable validity” means “with respect to a real
property claim,” it is “more likely than not that the claimant will obtain a judgment
against the defendant on the claim.”
claim lacks evidentiary merit, the lis pendens, in addition to being subject to expungement, is not privileged. It follows the lis pendens in that situation may be the basis for an action for slander of title.” (Palmer, supra, at p. 1380, italics added.)

Appellants rely on the above quoted language in Palmer, supra, 109 Cal.App.4th 1367 to support their position that the litigation privilege does not apply to a lis pendens if the underlying action is lacking in evidentiary merit. Respondents counter that Civil Code section 47(b)(4) contains no evidentiary merit exception and they argue it would be improper to insert such an exception into the statute. In this regard, respondents argue that the subject language in Palmer, to the extent it added an evidentiary test to the privilege statute, is not a correct statement of the law. We agree with respondents.

In Alpha & Omega, supra, 200 Cal.App.4th 656, the Fourth District Court of Appeal recently examined Civil Code section 47(b)(4) and concluded there is no “‘lack of evidentiary merit exception’” under the statute. (Alpha & Omega, supra, at p. 667.) There, as in our case, a party suing for slander of title had argued—based on the language in Palmer, supra, 109 Cal.App.4th 1367—that the privilege did not attach if the underlying real property claim lacked evidentiary merit. (Alpha & Omega, supra, at p. 666.) The Court of Appeal explained its rejection of that interpretation of the statutory privilege:

“We reject Alpha’s interpretation of subdivision (b)(4) of Civil Code section 47. In discerning the Legislature’s intent, we look to the words of the statute, ‘assigning them their usual and ordinary meanings, and construing them in context. If the words themselves are not ambiguous, we presume the Legislature meant what it said, and the statute’s plain meaning governs.’ [Citations.] [¶] The language of subdivision (b)(4) of Civil Code section 47 is not ambiguous and in any event is not reasonably susceptible to a construction that would create an additional exception to the absolute litigation privilege based on the lack of ‘evidentiary merit’ of a claimant’s real property claim in connection with a recorded lis pendens.” (Alpha & Omega, supra, 200 Cal.App.4th at pp. 666-667.)

We believe this analysis of the privilege statute is correct. Civil Code section 47(b)(4) does not contain a lack of “‘evidentiary merit’” exception to the
litigation privilege, and it would be improper for us to insert what the Legislature has plainly omitted. (Alpha & Omega, supra, 200 Cal.App.4th at pp. 666-667; see § 1858 [courts role is to declare terms of a statute, not to “insert what has been omitted”].) “It is a prime rule of construction that the legislative intent underlying a statute must be ascertained from its language; if the language is clear, there can be no room for interpretation, and effect must be given to its plain meaning. [Citations.] “An intent that finds no expression in the words of the statute cannot be found to exist. The courts may not speculate that the legislature meant something other than what it said. Nor may they rewrite a statute to make it express an intention not expressed therein.”’ [Citation.]” (Mutual Life Ins. Co v. City of Los Angeles (1990) 50 Cal.3d 402, 412.)

Civil Code section 47(b)(4) clearly describes the conditions for application of the privilege to a recorded lis pendens as follows: “A recorded lis pendens is not a privileged publication unless it identifies an action previously filed with a court of competent jurisdiction which affects the title or right of possession of real property, as authorized or required by law.” (Civ. Code, § 47(b)(4).) Those conditions are: (1) the lis pendens must identify a previously filed action and (2) the previously filed action must be one that affects title or right of possession of real property. We decline to add a third requirement that there must also be evidentiary merit.6

We also agree with the analysis in Alpha & Omega that this construction of the statute is further supported by the statutory definition of what constitutes a real property claim. (See Alpha & Omega, supra, 200 Cal.App.4th at p. 667.) A party who “asserts a real property claim” may record a lis pendens. (§ 405.20.) Section 405.4 defines a “[r]eal property claim” as “the cause or causes of action in a pleading which would, if

6 It is apparent that Palmer, supra, 109 Cal.App.4th 1367, in adding an evidentiary requirement, erroneously merged the evidentiary standard for a motion to expunge into the distinct question of whether the privilege applies.
meritorious, affect (a) title to, or the right to possession of, specific real property ….”
Thus, “[s]ection 405.4 does not define [a] ‘real property claim,’ or lack thereof, on the basis of the strength or weakness of the evidence to support that claim. Instead, it is clear from the plain language of section 405.4 that a ‘real property claim’ is determined from the cause or causes of action set forth in the pleading(s).” (Alpha & Omega, supra, 200 Cal.App.4th at p. 667.) Consistent with this definition, Civil Code section 47(b)(4) states in like terms that, for the privilege to apply, a recorded lis pendens must identify “an action … which affects” title or possession of real property. In other words, the action must assert a real property claim, which respondents clearly did here.

Moreover, we believe that if the Legislature had intended to erect an evidentiary hurdle or create an exception to the privilege based on lack of evidentiary merit, it would have said so. Since the Legislature did not do so, we are not at liberty to insert what has been omitted. For these reasons, we reject appellants’ proposition that the availability of the litigation privilege to a recorded lis pendens depends upon whether the claimant is able to make a certain evidentiary showing of merit to support the real property claim. On this issue, the dicta in Palmer, supra, 109 Cal.App.4th 1367, that is relied upon by appellants was in error and we decline to follow it.

In conclusion, we hold that the absolute privilege of Civil Code section 47(b) applied to the recorded lis pendens in this case and, therefore, appellants cannot prevail on their complaint for slander of title as a matter of law. Accordingly, the trial court correctly granted respondents’ special motion to strike.

B. The Forged Deed Was Void

The second reason the trial court’s anti-SLAPP ruling was correct is based on the evidence of forgery. Appellants argue that since the Baquirans admitted they may have signed the second deed of trust, it was merely voidable, not void. Respondents contend that since the second deed of trust was materially altered, it was a forgery and therefore void. As we briefly explain, respondents are correct.
“A deed is void if the grantor’s signature is forged or if the grantor is unaware of the nature of what he or she is signing. [Citation.] A voidable deed, on the other hand, is one where the grantor is aware of what he or she is executing, but has been induced to do so through fraudulent misrepresentations. [Citation.]” (Schiavon v. Arnaudo Brothers (2000) 84 Cal.App.4th 374, 378.) “Although the law protects innocent purchasers and encumbrancers, ‘that protection extends only to those who obtained good legal title. [Citations.] … [A] forged document is void ab initio and constitutes a nullity; as such it cannot provide the basis for a superior title as against the original grantor.’ [Citations.]” (Id. at pp. 379-380.) A forgery includes “‘a false making of a writing’” that “‘falsely purports to be the writing of another.’” (Wutzke v. Bill Reid Painting Service, Inc. (1984) 151 Cal.App.3d 36, 41-42, italics omitted.) A deed that has been materially altered after it was signed is a forgery. (Montgomery v. Bank of America (1948) 85 Cal.App.2d 559, 563 [“Since the deed was altered without the knowledge, consent or approval of plaintiffs, after it had been signed by them and transmitted to the escrow holder, it was void.”]; (Wutzke v. Bill Reid Painting Service, Inc., supra, at pp. 43-44 [a forged deed is void].)

Here, respondents have produced uncontradicted evidence to establish that the second deed of trust was materially altered after it was signed. The Baquirans were apparently induced to sign a deed of trust in favor of Allstar Financial Services and Ronna L. Williams, which deed of trust was later altered by Zarrell Williams to create something materially different—a deed of trust in favor of the Mahlums. Existing names and other information were covered over by Williams with masking fluid and the Mahlums’ names as beneficiaries were fraudulently inserted to replace what was there before. The second deed of trust was altered by Williams in an attempt to fraudulently support an unrelated loan or debt he had with the Mahlums. The Baquirans never met the Mahlums, never sought a loan from the Mahlums and never borrowed any money from them. In short, the Baquirans never contemplated, never authorized and never signed a
deed of trust in favor of the Mahlums. Respondents contend that this evidence conclusively shows that the second deed of trust in favor of the Mahlums was a forgery. We agree. Since the second deed of trust was materially altered after it was signed, it was a forgery and was therefore void. (Montgomery v. Bank of America, supra, 85 Cal.App.2d at p. 563 [materially altered deed was void].)

Since the second deed of trust was a forgery and was void, appellants received no title by it. (Schiavon v. Arnaudo Brothers, supra, 84 Cal.App.4th at pp. 379-380.) Accordingly, for this additional reason, appellants failed to establish a probability of prevailing on their claim for slander of title and the special motion to strike was properly granted.

**DISPOSITION**

The order granting respondents’ special motion to strike is affirmed. Costs on appeal are awarded to respondents.

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Kane, J.

WE CONCUR:

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Wiseman, Acting P.J.

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Cornell, J.

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7 Appellants suggest the deed of trust may have been “blank” when signed. The purported evidence on this point was vague, equivocal (as to particular transaction) and hearsay, and for these reasons could not support a judgment in appellants’ favor. And even if the evidence on this point were admissible, it would not change the outcome because it does not dispute or contradict the critical fact that the deed was materially altered after it was signed and hence a forgery. Finally, we fail to see how the “blank” deed theory could conceivably support appellants’ position, since a blank deed is also void. (See Trout v. Taylor (1934) 220 Cal. 652, 656; Green v. MacAdam (1959) 175 Cal.App.2d 481, 486.)
Several loans on real property may be secured by a single deed of trust and cross-defaulted, that is, a default on one will be a default on all. Here we conclude that unless the parties otherwise agree, the priority of the loans does not change.

Plaintiff agreed to subordinate its existing trust deed to a new trust deed in favor of defendants securing a note in the amount of $4,006,600. Defendant's new trust deed, however, secured that note plus two other notes for a total of $21 million. The notes were "cross-defaulted."

Plaintiff claimed that defendants breached the subordination agreement because the loan secured by the defendants' trust deed exceeded $4,006,600. The trial court agreed and granted plaintiff summary judgment in its action for declaratory relief. We reverse.
Defendants did not breach the subordination agreement. The notes secured by defendants' trust deed are treated as separate loans. Plaintiff's trust deed is subordinate only to the $4,006,600 loan. The agreement to cross-default the loans is between defendants and their borrower. It does not affect plaintiff's right to protect its interest by curing the default under the $4,006,6000 note.

FACTS

Martin Weyrich Winery, LLC and related entities (collectively Weyrich) owned a parcel of real property in San Luis Obispo County known as "Jack's Ranch." The ranch was encumbered by a number of loans including a third trust deed held by R.E. Loans LLC (RE), securing a loan of $6.5 million.

In 2006, Weyrich refinanced the loans secured by Jack's Ranch. Weyrich paid the first two loans and paid RE $3.5 million on its existing loan. In return, RE subordinated its existing deed of trust to a new loan from Transamerica Financial Life Insurance Company (Transamerica) in the amount of $4,006,600.

The subordination agreement provides that RE will subordinate its trust deed to "a new loan in the principal sum of $4,006,600[] secured by new first deed of trust . . . in favor of [Transamerica]."

Paragraph 1 of the subordination agreement provides that RE's trust deed will be subordinate in all respects, "including all renewals, modifications, and extensions thereof that do not increase the rate of interest that is charged on the new loan, and that do not increase the principal amount of the new loan other than by the accrual of interest or other charges that may become due under the terms of the new loan."

Similarly, paragraph 8 of the subordination agreement provides in part: "New Lender may extend the time for payment, surrender any security, collateral or claims related to the indebtedness of Borrower to New Lender and may make any settlements and compromise thereof; all without notice to or consent of the Existing Lender and without affecting New Lender's rights hereunder provided that the same do not increase the rate of interest that is charged on the new loan, and do not increase the
principal amount of the new loan other than by the accrual of interest or other charges that may become due under the terms of the new loan."

The agreement also contains an integration clause as follows: "This Subordination Agreement, when executed, shall constitute the one and only agreement or set of rights and obligations as between New Lender and the Existing Lender. The Existing lender expressly agrees that the Existing Lender shall not be entitled to rely upon any fact, circumstance, assumption, representation, or understanding which is not expressly set forth in this Subordination Agreement."

After RE recorded the subordination agreement, Transamerica recorded a trust deed encumbering Jack's Ranch in April 2007. The trust deed recites that it secures a note in the principal amount of $4,006,600. It also recites that it secures "any and all obligations and covenants of Trustor under . . . any other agreement . . . including without limitation . . . that certain . . . Loan Agreement dated as of even date herewith between Trustor and Beneficiary . . . ."

The loan agreement between Weyrich and Transamerica provides that the trust deed not only secures a note in the amount of $4,006,600, but also notes in the amount of $11,227,500 and $5,912,750. The loan agreement states that the loans are intended to be "cross-defaulted . . . ." A default under any of the loans is a default under all the loans. The loan agreement also states that the loans are "cross-collateralized . . . ." The loans are secured by trust deeds encumbering two properties in addition to Jack's Ranch.

Transamerica assigned its interest in the trust deed to Investors Warranty of America, Inc., (Investors).

On July 23, 2009, the trustee recorded a notice of default. The notice informed Weyrich that the amount necessary to cure the default is $26,307,307.93. The notice states the obligation secured is a note for $4,006,600. The notice further states in all capital letters that payment has not been made of: "THE BALANCE OF THE PRINCIPAL [SUM] TOGETHER WITH INTEREST AND DEFAULT INTEREST DUE THEREON; COSTS AND EXPENSES, OTHER FEES, COSTS AND EXPENSES
ASSOCIATED WITH THE PROTECTION OF THE SECURITY WHICH IS CROSS-DEFAULTED AND CROSS-COLLATERALIZED WITH OTHER LOAN DOCUMENTS AND OBLIGATIONS EXECUTED BY TRUSTOR, LOAN NO. 700192 AND 700193. THE DEFAULT AMOUNT CONTAINED HEREIN INCLUDES THE AGGREGATE AMOUNT DUE AS OF THE DATE REFERENCED HEREON. TO CURE THE DEFAULT, YOU MUST PAY ALL SUMS DUE . . . ."

The notice of sale estimated the principal, interest and fees to be paid under the sale as $5,135,945.51. Investors bid $4.625 million at the trustee's sale and received a deed to Jack's Ranch.

RE brought an action against Investors and others for declaratory relief. RE asked the court to declare its trust deed to be a first lien on Jack's Ranch and that its first trust deed was not affected by the trustee's sale. Investors cross-complained for declaratory relief. Investors asked the court to declare the subordination agreement valid and enforceable and that RE's interest in Jack's Ranch has been extinguished. The parties made cross-motions for summary judgment.

The trial court granted RE's motion for summary judgment and denied Investors' motion. In granting RE's motion, the court concluded Transamerica failed to comply with the terms of the subordination agreement. RE agreed to subordinate its trust deed to a loan in the principal sum of $4,006,600. Instead, Transamerica's trust deeds secured loans in excess of $21 million.

DISCUSSION

I.

Summary judgment is properly granted only if all papers submitted show there is no triable issue as to any material fact and the moving party is entitled to a judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c).) The court must draw all reasonable inferences from the evidence set forth except where such inferences are contradicted by other inferences or evidence that raises a triable issue of fact. (Ibid.) In examining the supporting and opposing papers, the moving party's affidavits or declarations are strictly construed and those of his opponent liberally construed, and
doubts as to the propriety of granting the motion should be resolved in favor of the party opposing the motion. (Szadolci v. Hollywood Park Operating Co. (1993) 14 Cal.App.4th 16, 19.)

The moving party has the initial burden of showing that one or more elements of a cause of action cannot be established. (Saelzer v. Advanced Group 400 (2001) 25 Cal.4th 763, 768.) Where the moving party has carried that burden, the burden shifts to the opposing party to show a triable issue of material fact. (Ibid.) Our review of the trial court's grant of the motion is de novo. (Id. at p. 767.)

II.

RE argues the subordination agreement is unenforceable because Transamerica failed to comply with its terms. (Citing Protective Equity Trust #83 Ltd. v. Bybee (1991) 2 Cal.App.4th 139, 150; 5 Miller & Starr, Current Law of California Real Estate (3d ed. 2009) Recording and Priorities, § 11:213, p. 11:718.) RE points out the subordination agreement is limited to one loan in the amount of $4,006,600. RE claims Transamerica breached the agreement by using its trust deed to secure three loans totaling $21,196,850.

Our Supreme Court considered the effect of multiple notes secured by a mortgage in Hocker v. Reas (1861) 18 Cal. 650. There, a mortgage secured two notes, each of which had different due dates. The mortgagor defaulted when the first note became due, and the mortgagee foreclosed. The mortgagor exercised his right of redemption. The court determined that the mortgagor redeemed the property subject to the mortgage lien of the second note.

Hocker is factually distinguishable. But it illustrates that where a number of notes are secured by a single trust deed, they are treated as separate secured loans.

Here Investors' trust deed secured three notes, one of which was for $4,006,600. RE agreed to subordinate its trust deed to a trust deed securing a note in that amount. To the extent Investors' trust deed secured a note in the amount of $4,006,600, it was senior to RE's trust deed. To the extent Investors' trust deed secured other notes it is junior to RE's trust deed. That would be the result had each note been secured by its own
trust deed. There is no reason why a different result should pertain because the notes are secured by a single trust deed.

The transaction between Weyrich and Transamerica did not breach the subordination agreement because RE's trust deed was subordinate only to the $4,006,600 loan. Nothing in the subordination agreement prohibits the creation of the liens junior to RE's trust deed.

Nor did the transaction between Weyrich and Transamerica breach the subordination agreement's prohibition on modifying the principal amount of the loan. RE's trust deed was subordinate only to the $4,006,600 loan. It is true that the agreement between Weyrich and Transamerica called for all three loans to be "cross-defaulted." But the agreement between Weyrich and Transamerica was not binding on RE.

RE points out that the notice of default states the amount necessary to cure the default is $26,307,307.93. RE claims, without citation to authority, that it was required to pay over $26 million to protect its trust deed.

But the language in the notice of default on which RE relies is required by Civil Code section 2924c, subdivision (b)(1). It begins in capital letters: "If your property is in foreclosure because you are behind on your payments, it may be sold without any court action . . . ." It further advises: "[Y]ou may have the legal right to bring your account into good standing by paying all of your past due payments plus permitted costs and expenses . . . . This amount is ___ . . . ." The mandatory language of Civil Code section 2924c, subdivision (b)(1) is directed to the property owner, not the holder of a junior trust deed. It advises Weyrich that it is in default in the amount of $26 million. It states in capital letters that the $26 million is based not only on the default of the $4,006,600 loan but on default under two other loans. The notice does not purport to advise the holder of a junior trust deed how much it must pay to protect its interest.

In fact, the notice of default advises that the foreclosure is based on a note for $4,006,600. The notice of sale estimates the principal, interest and fees to be paid under the sale as $5,135,945.51, not $26 million. Investors purchased the property at the foreclosure sale for $4.625 million.
There is nothing in law or logic that would require RE to cure the default under all of Weyrich's loans in order to protect its interest. RE could have protected its interest by tendering the amount necessary to cure the default under the $4,006,600 note alone, the only note to which its trust deed was subordinate. RE points to no evidence it attempted to do so.

The judgment is reversed. Costs on appeal are awarded to appellants.  

CERTIFIED FOR PUBLICATION.

GILBERT, P.J.

We concur:

YEGAN, J.

PERREN, J.
Dodie A. Harmon, Judge

Superior Court County of San Luis Obispo


James P. Ballantine for Plaintiff, Cross-defendant and Respondent.
Appellants Daniel and Yvette Shuster borrowed $670,000 to purchase a home. The deed of trust securing the loan did not name a trustee. Here we hold that the omission of a trustee does not preclude nonjudicial foreclosure of the deed of trust.

After the Shusters fell more than $90,000 behind in payments, the beneficiary of the deed of trust substituted respondent ReconTrust Company, N.A. (ReconTrust) as trustee to initiate nonjudicial foreclosure proceedings. The beneficiary also assigned its interest in the deed of trust to respondent BAC Home Loans Servicing, LP (BAC), which later assigned its interest to respondent Arch Bay Holdings, LLC - Series 2010B (Arch Bay). Arch Bay purchased the property at the foreclosure sale.

The Shusters sued to set aside the sale, primarily because the deed of trust failed to designate a trustee. Although an issue of first impression in California, the weight of authority from other jurisdictions supports the trial court’s conclusion that the

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1 BAC formerly was known as Countrywide Home Loans Servicing, LP, as servicer for HSBC Bank USA, N.A. Bank of America, N.A. is the successor by merger to BAC.
omission of a trustee does not prevent enforcement of the deed of trust. Accordingly, ReconTrust, as substituted trustee, had authority to commence foreclosure under Civil Code section 2924, subdivision (a)(1).² The Shusters’ claims also fail because they do not allege tender of the amounts due under the loan. We affirm.

PROCEDURAL AND FACTUAL BACKGROUND

In 2006, the Shusters borrowed $670,000 from WMC Mortgage Corp. (WMC) to purchase a residence located at 2610 Bloom Street, Simi Valley, California (Property). WMC recorded a deed of trust against the Property to secure the debt. The deed of trust did not name a trustee, but designated Mortgage Electronic Registration Systems, Inc. (MERS) as beneficiary, giving MERS "the right to foreclose and sell the Property, and to take any action required of Lender including, but not limited to, releasing and canceling [the trust deed]."

In 2010, the Shusters defaulted. MERS substituted ReconTrust as trustee, and assigned its beneficial interest in the deed of trust to BAC. ReconTrust recorded a notice of default, claiming arrearages in excess of $90,000. The Shusters failed to cure the default, and ReconTrust recorded a notice of trustee's sale. BAC assigned its beneficial interest in the deed of trust to Arch Bay, which acquired the Property at the sale.

The Shusters filed a complaint for quiet title, wrongful foreclosure and breach of contract, alleging respondents had no right to foreclose under the deed of trust. They sought cancellation of all recorded documents related to the foreclosure, plus actual and punitive damages. Respondents demurred and requested that the trial court take judicial notice of certain recorded documents related to the foreclosure. The Shusters did not object to the request for judicial notice. The trial court granted the request and sustained the demurrers with leave to amend.

The Shusters filed a first amended complaint alleging causes of action for cancellation of instruments, wrongful foreclosure and breach of contract. Respondents

² All statutory references are to the Civil Code.
again demurred and requested that the trial court take judicial notice of the foreclosure documents. The Shusters did not object to the request.

Following supplemental briefing regarding the enforceability of a deed of trust that omits a trustee, the trial court concluded the omission "is no impediment to enforcement of the Trust Deed . . . ." The court sustained BAC and ReconTrust's demurrer without leave to amend, and entered an order of dismissal on June 7, 2011.

The trial court granted Arch Bay's request for judicial notice and sustained its demurrer with leave to amend. The court determined that Arch Bay had purchased the Property pursuant to a properly noticed trustee's sale and that the Shusters had failed to plead a viable ownership interest. The court observed that MERS, as the beneficiary, "had the authority to substitute in the trustee and assign its interest to BAC . . . . It does not matter that MERS never had any ownership interest or obligation under the security instrument; it was the listed beneficiary." The court further noted "there has been no tender or offer of a tender by Plaintiffs."

The Shusters filed a second amended complaint, again alleging claims for cancellation of instruments, wrongful foreclosure and breach of contract. Arch Bay demurred and requested that the trial court take judicial notice of the same foreclosure documents. For the first time, the Shusters objected to the request for judicial notice. The trial court overruled the objections and sustained the demurrer without leave to amend, remarking the Shusters "do not plead additional material facts in their [second amended complaint]; [i]nstead, they formulate novel arguments based on prior allegations." The trial court entered a judgment of dismissal on August 26, 2011. The Shusters appeal.

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3 Although the second amended complaint alleged claims against BAC and ReconTrust, they did not demur to that complaint because the trial court already had dismissed them from the case.
DISCUSSION

Standard of Review

We review an order sustaining a demurrer de novo, exercising our independent judgment to determine whether a cause of action has been stated under any legal theory. (Ochs v. PacifiCare of California (2004) 115 Cal.App.4th 782, 788.) We accept as true properly pleaded allegations of fact, but not contentions, deductions or conclusions of fact or law. (Blank v. Kirwan (1985) 39 Cal.3d 311, 318.) We also consider matters subject to judicial notice. (Dunn v. County of Santa Barbara (2006) 135 Cal.App.4th 1281, 1298.) “The burden is on [appellant] to demonstrate the manner in which the complaint might be amended, and the appellate court must affirm the judgment if it is correct on any theory.” (City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1998) 68 Cal.App.4th 445, 459-460.)

Omission of Trustee in Deed of Trust

The fundamental premise of the Shusters' allegations is that respondents lacked authority to foreclose under the power of sale given by the deed of trust. The Shusters assert the deed of trust's failure to designate a trustee transformed the instrument into a "mortgage." They contend that because a mortgage may be foreclosed only through a judicial foreclosure, the trustee's sale of the Property through a nonjudicial foreclosure is invalid and must be set aside. (See 4 Witkin, Summary of Cal. Law (10th ed. 2005) Security Transactions in Real Property, § 5, p. 795 [unless mortgage contains a power of sale, mortgagee's only remedy is judicial foreclosure].)

As we have noted, although other jurisdictions have rejected this theory, it appears to be an issue of first impression in California. In In re Bisbee (1988) 157 Ariz. 31 [754 P.2d 1135] (Bisbee), the appellants maintained that when a deed of trust fails to name a trustee, "there [is] no one to receive a transfer of the property, and, therefore, no lien [is] created." (At p. 1137.) After reviewing traditional trust laws and the Arizona real property statutes -- modeled after California law -- the court concluded a valid trust is created notwithstanding the failure to designate a trustee. (Id. at p. 1138.) This ruling is consistent with California probate cases stating equity will not allow a trust to fail for
lack of a trustee. *(In re Barter's Estate* (1947) 30 Cal.2d 549, 556; *Estate of McCray* (1928) 204 Cal. 399, 403.)

*Bisbee* emphasized a trustee under a deed of trust holds "bare legal title -- sufficient only to permit him to convey the property at the out of court sale. All other incidents of title remain in the trustor. . . . [Citation.]" *(Bisbee, supra, 754 P.2d at p. 1138.)* Because the trustor is free to transfer the property and to enjoy all other incidents of ownership, the court determined a deed of trust is essentially a mortgage with the power to convey upon default. *(Ibid.)* The court observed "[a] trustee under a deed of trust has neither the legal powers nor the obligations of a trustee under traditional trust law. Instead he serves as a type of common agent for both parties." *(Ibid.)* As a result, "the mere failure to designate trustees does not render the deeds of trust invalid as between the parties to the trust deed instruments." *(Ibid.)* In other words, the naming of the trustee is irrelevant to the creation of the deed of trust, so long as a trustee is named prior to the foreclosure. *(Id. at p. 1137 ['[T]he only effect of the absence of a valid trustee is that no action required to be taken by the trustee may be taken until a successor trustee is appointed']); In re Burche (Bankr. W.D. Mo. 2000) 249 B.R. 518, 524, fn. omitted ['[A deed of trust] is not invalid if it fails to name a trustee, especially if the mortgagee reserves the right to name a successor trustee']; New York Life Ins. Co. v. Kennedy (1926) 146 Va. 197, 206 [135 S.E. 882, 885] ['While it is usual for the parties to name the trustee, this is not essential to the validity of the deed of trust'].)

*Mid City Management Corp. v. Loewi Realty Corp.* (5th Cir. 1981) 643 F.2d 386, 388 *(Mid City)* upheld a nonjudicial foreclosure sale where, as here, the deed of trust failed to name a trustee. After the borrower defaulted, the beneficiary substituted a trustee who held the foreclosure sale. *(Ibid.)* The court determined the failure to name an original trustee did not render the deed of trust unenforceable or prevent the subsequent appointment of a substitute trustee to sell the property. *(Ibid.)* The court perceived the omission "was so palpable a mistake that proceedings for reformation of the [deed of trust] were unnecessary." *(Ibid.)*
The Shusters make no attempt to distinguish *Bisbee, Mid City* or the other out-of-state authorities. Nor do they mention the California authorities holding that equity will not allow a trust to fail for lack of a trustee. (*In re Barter's Estate, supra, 30 Cal.2d at p. 556; Estate of McCray, supra, 204 Cal. at p. 403.*) Instead, they analogize to cases establishing that a conveyance with no grantee is void. (E.g., *Green v. MacAdam* (1959) 175 Cal.App.2d 481, 485-486; *Overton v. Harband* (1935) 6 Cal.App.2d 455, 460.)

The Shusters' analogy fails. A grantee is not the same as a trustee. The character of "title" provided by a grant deed differs substantially from that provided by a deed of trust. A grant deed conveys a fee simple title to the grantee for all purposes. (*Bank of Italy Etc. Assn. v. Bentley* (1933) 217 Cal. 644, 656, superseded by statute on other grounds as stated in *Ung v. Koehler* (2005) 135 Cal.App.4th 186, 192-194.) In contrast, a trustee under a deed of trust "carries none of the incidents of ownership of the property, other than the right to convey upon default on the part of the debtor in the payment of his debt." (*Ibid.; Kachlon v. Markowitz* (2008) 168 Cal.App.4th 316, 335.) We agree with the trial court that the omission of the trustee does not preclude enforcement of the deed of trust. It is sufficient that MERS, as beneficiary, appointed a substitute trustee prior to the foreclosure. (See *Bisbee, supra*, 754 P.2d at p. 1138.)

"Holder in Due Course" Theory

The Shusters also contend that respondents had no right to foreclose because they were not the "holder in due course" of the promissory note, and that only WMC, as the original holder of the note, had that right. They are incorrect. California's statutory nonjudicial foreclosure scheme (§§ 2924-2924k) does not require that the foreclosing party have a beneficial interest in or physical possession of the note. (*Debrunner v. Deutsche Bank Nat. Trust Co.* (2012) 204 Cal.App.4th 433, 440-441 ["We . . . see nothing in the applicable statutes that precludes foreclosure when the foreclosing party does not possess the original promissory note"]; *Lane v. Vitek Real Estate Indus. Group* (E.D. Cal. 2010) 713 F.Supp.2d 1092, 1099 [California "does not require a
beneficial interest in both the Note and the Deed of Trust to commence a non-judicial foreclosure sale].) Section 2924, subdivision (a)(1) specifically permits the "trustee, mortgagee, or beneficiary, or any of their authorized agents" to institute foreclosure by recording a notice of default. (See Debrunner, at p. 440; Lane, at p. 1098.) The trial court correctly concluded that ReconTrust, as trustee, had statutory authority to commence foreclosure. 4

*Failure to Allege Tender of Amounts Due Under Loan*

Respondents assert that regardless of the trial court's other rulings, the Shusters' claims fail because they do not allege tender of the amounts due and owing under the loan. We agree. Each of the Shusters' causes of action alleges irregularities in the foreclosure process which they claim invalidate the sale. As a general rule, a debtor cannot set aside the foreclosure based on irregularities in the sale without also alleging tender of the amount of the secured debt. (*Karlsen v. American Sav. & Loan Assn.* (1971) 15 Cal.App.3d 112, 117 ["A valid and viable tender of payment of the indebtedness owing is essential to an action to cancel a voidable sale under a deed of trust"]; see *Abdallah v. United Savings Bank* (1996) 43 Cal.App.4th 1101, 1109 [sustaining demurrer for lack of tender of amounts due and owing under the loan].) "The rationale behind the rule is that if [the borrower] could not have redeemed the property had the sale procedures been proper, any irregularities in the sale did not result in damages to the [borrower]." (*FPCI RE–HAB 01 v. E & G Investments, Ltd.* (1989) 207 Cal.App.3d 1018, 1022; *Lona v. Citibank, N.A.* (2011) 202 Cal.App.4th 89, 112.)

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4 The Shusters summarily assert the trial court abused its discretion by overruling their objections to the request for judicial notice filed with Arch Bay's third demurrer. The Shusters waived these objections by failing to oppose the trial court's grant of the same judicial notice request in the two prior demurrer proceedings. (See *Younan v. Caruso* (1996) 51 Cal.App.4th 401, 406, fn. 3 ["[F]ailure to timely object to the propriety of judicial notice . . . is deemed a waiver of that objection"]). In any event, the Shusters have not demonstrated reversible error. They imply the trial court "seems" to have erred by taking judicial notice of the contents of documents, but do not specify where this occurred in the record or how it affected the judgment. (See Cal. Rules of Court, rule 8.204(a)(1)(C); *Guthrey v. State of California* (1998) 63 Cal.App.4th 1108, 1115.)
Courts recognize certain exceptions to the tender rule, such as when the borrower challenges the validity of the underlying debt, asserts a counterclaim or set-off against the beneficiary or demonstrates the deed of trust is void on its face. (See Lona v. Citibank, N.A., supra, 202 Cal.App.4th at pp. 112-114.) The second amended complaint does not allege facts implicating these exceptions. At oral argument, the Shusters' counsel highlighted that respondents initially provided the trial court with a copy of the original promissory note signed by the Shusters and then, six months later, provided a copy of the endorsed note. Citing this delay, the Shusters speculate "there is something not quite right going on," perhaps even forgery, but are unable to articulate any facts supporting this theory or demonstrating prejudice.

In 2010, the Shusters owed more than $90,000 in back payments. Two years later, they continue to occupy the Property "rent free," claiming they are entitled to possession because respondents did not judicially foreclose. They do not allege facts showing that a judicial foreclosure would be anything other than a futile act or delay tactic. (See Lona v. Citibank, N.A., supra, 202 Cal.App.4th at p. 112; FPCI RE–HAB 01 v. E & G Investments, Ltd., supra, 207 Cal.App.3d at p. 1022.) The nonjudicial foreclosure occurred because the Shusters failed to make their loan payments. Unable to avoid that foreclosure, they are unlikely to avoid another. In the absence of an allegation of tender or offer of tender, the trial court properly sustained the demurrers without leave to amend.

We are mindful that foreclosures are a far too frequent occurrence in today's difficult financial times. But the hardship must not become a haven for those who, as here, do not appear to make any good faith effort to resolve the issue but, instead, seek shelter in minor ministerial omissions or speculative acts that neither misled nor
prejudiced them.

DISPOSITION

The judgment of dismissal as to each respondent is affirmed. Respondents shall recover their costs on appeal.

CERTIFIED FOR PUBLICATION.

PERREN, J.

We concur:

GILBERT, P. J.

YEGAN, J.
David Worley, Judge
Superior Court County of Ventura

________________________________________

Mark Brifman for Appellants.
The Ryan Firm, Timothy M. Ryan and Michael W. Stoltzman, Jr., for Respondent Arch Bay Holdings, LLC - Series 2010B.
IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
THIRD APPELLATE DISTRICT
(Shasta)

COTTONWOOD DUPLEXES, LLC,
   Plaintiff and Respondent,

v.

SETH BARLOW,
   Defendant and Appellant.

APPEAL from a judgment of the Superior Court of Shasta County, Bradley L. Boeckman, Judge. Reversed.

Wells, Small, Fleharty & Weil and Tyler Maize Lalaguna for Defendant and Appellant.

Arthofer & Tonkin Law Offices and Kenneth B. Arthofer for Plaintiff and Respondent.

In this quiet title action, the trial court narrowed and shortened a road and utility easement that a predecessor of plaintiff Cottonwood Duplexes, LLC (Cottonwood) had

* Pursuant to California Rules of Court, rules 8.1105 and 8.1110, this opinion is certified for publication with the exception of part III of the Discussion.
granted to defendant Seth Barlow because, in the court’s view, “the reasonable use requirements of [Barlow’s property] both presently and in the future do not require the full size and scope of the [original] easement.”

On appeal, Barlow asserts that no “recognized rule of law . . . authorized [the trial court] to terminate [his] property rights” by reducing the size of his easement against his will, no matter what the evidence showed. We agree. Accordingly, we will reverse.

FACTUAL AND PROCEDURAL BACKGROUND

In August 1978, Ned Gatchett recorded a parcel map dividing certain property adjacent to Interstate 5 in Shasta County into four parcels. (A copy of the recorded parcel map No. 833-78 is attached as appendix A to this opinion.) Parcel No. 4 was adjacent to the south side of Rhonda Road. Parcels Nos. 1, 2, and 3 lay next to each other south of parcel No. 4, with the north side of each parcel adjacent to the south side of parcel No. 4. (Parcel No. 1 was the westernmost of the three parcels; parcel No. 3 was the easternmost, lying adjacent to Interstate 5; parcel No. 2 lay between the other two parcels.) As depicted on the map, access to parcels Nos. 2 and 3 could only be had by a private road and public utility easement which was to run across the northern 60 feet of parcels Nos. 1, 2, and 3.1 The parcel map identified the easement as Gatchett Lane.

In September 1978, a week after the parcel map was recorded, Ned and his wife, Benita -- who were the owners of parcels Nos. 2, 3, and 4 -- and James and Nita Leak -- who were the owners of parcel No. 1 -- recorded a road maintenance agreement with

1 It appears that at the time of this property division there was a 15-foot-wide road made of gravel and asphalt that ran along the north part of the 60-foot-wide strip that became the road and utility easement. Immediately adjacent to the road on the south side was an irrigation ditch that was used to irrigate parcels Nos. 1, 2, 3. The road ultimately turned south “into the middle of what became parcel 1,” providing access to that parcel and the house on it.
respect to Gatchett Lane.² By means of this agreement, the Gatchetts and Leaks granted to each other the easement running across the northern 60 feet of parcels Nos. 1, 2, and 3, as depicted on the parcel map. Pursuant to the terms of the agreement, the easement was “for the benefit of and appurtenant to the” the parties’ properties (including parcel No. 4) and “the burdens and benefits of th[e] agreement [was to] run to the grantees and vendees, or other successors in interest, of the parties.”

In 1989, Ned Gatchett subdivided parcel No. 4 on map No. 833-78 into six parcels, numbered 1 through 6 from west to east. (A copy of the tentative tract map showing this subdivision is attached to this opinion as appendix B.) In 2002, Gatchett sold the easternmost parcel (parcel No. 6) to Barlow. Included in the grant deed to Barlow was “[a]n easement for road and utility purposes over the North 60 feet of Parcel 1, 2 and 3 as shown on Parcel Map No. 833-78 . . . .”

Sometime after 2002, Gatchett sold parcels Nos. 2 and 3 on map No. 833-78. Thereafter, Trion Development (Trion) proposed a 16-lot subdivision (Cottonwood Creek Meadow) for those parcels. (A copy of tract map 1912 showing this subdivision is attached to this opinion as appendix C.) Access to the Cottonwood Creek Meadow subdivision was to be provided by three new public roads. The first, Cremia Place, would run in a southerly direction parallel to Interstate 5. The second, Manzi Way, would run west from Cremia Place approximately 50 feet south of and parallel to the Gatchett Lane easement. The third, Silvario Court, would run south from Manzi Way to a cul-de-sac.

² From what can be inferred from the evidence, the division of the Gatchetts’ property was accomplished (at least in part) so that the Gatchetts could sell the Leaks the property that became parcel No. 1, which lay at the end of the existing asphalt road referred to as Gatchett Lane.
The first phase of the subdivision project involved 11 lots located south of Manzi Way. The second phase involved the remaining five lots located north of Manzi Way. Each of the lots in the second phase was 107 feet deep, but the Gatchett Lane easement covered the northern 60 feet of each lot. Accordingly, a note on the tract map stated as follows: “THERE SHALL BE NO BUILDING ON LOTS 1 THRU 5 OF PHASE 2 UNTIL GATCHETT LANE IS QUIT CLAIMED IN ITS ENTIRETY OR THE 60-FOOT GATCHETT LANE ROAD AND UTILITY EASEMENT IS REDUCED TO 15-FOOT (ALONG THE NORTHERLY PROPERTY LINE).”

Cottonwood was the lender that financed Trion’s development of the subdivision. When Trion defaulted on its loan obligations, Cottonwood foreclosed and became the owner of the subdivision. When Cottonwood took over the project, Manzi Road and Silvario Court had been completed and accepted as public roads and seven of the 11 lots in phase one of the project had been built out.

One of Cottonwood’s principals, Bob Meissner, investigated the use of Gatchett Lane and determined that “it came down to a single family residence,” which was apparently the house on parcel No. 1 of map No. 833-78 previously owned by the Leaks. Because the owners of that property (the Greens) now had access to their property via Manzi Way, they no longer needed to use Gatchett Lane, which by now was a dirt road, and so Cottonwood negotiated a settlement with the Greens under which they gave up their right to the Gatchett Lane easement. Thereafter, most of the remaining adjacent property owners also agreed to abandon their rights to the Gatchett Lane easement.³ The

³ The owners of parcel No. 4 on the 1989 tract map (appendix B) only partially abandoned the easement, retaining an easement for ingress and egress to their property over a strip of land 12 feet wide. The owners of parcel No. 5 on the 1989 tract map (appendix B), who were initially defendants in this action, agreed to abandon the Gatchett Lane easement after the action commenced, but in its place Cottonwood granted them a 12-foot-wide easement also.
sole holdout was Barlow. Cottonwood offered Barlow as much as $30,000 to abandon his easement, but he refused.

Unable to obtain the easement by purchase, Cottonwood commenced this action against Barlow in August 2010 by filing a complaint for declaratory relief and to quiet title to get the court to give it the easement for nothing. Cottonwood sought a judicial determination that Barlow’s easement “has been extinguished and/or is otherwise no longer legally recognizable as a result of the original intentions of the developer who created the Gatchett Lane easement, subsequent changes to the subdivision map and reasonable needs and historical uses by the parties. In the alternative, [Cottonwood sought] a judicial determination that the scope and width of the . . . Gatchett Lane easement has been significantly reduced and that [the] easement should be determined to be extinguished and/or not legally recognizable except for such portion less than or not exceeding 15 feet in width located at the northern most end of the Gatchett Lane easement.”

The case was tried in June 2011. The trial court found that the Gatchett Lane easement was originally created to serve the access needs of the property located west and south of the easement (i.e., parcels Nos. 1, 2, and 3 on parcel map No. 833-78) (appendix A). Subsequently, as a result of “evolution of [the] subdivision mapping,” Manzi Way was created to provide primary access to the southerly and westerly parcels previously served by the Gatchett Lane easement. The court further found that the other adjacent landowners had either voluntarily relinquished their rights to the easement or had agreed to reduce the easement to 12 feet. Also, Cottonwood’s experts had testified “there was no reasonable likelihood that the County of Shasta would ever allow any type of primary access road to service . . . Barlow’s property within the confines of the Gatchett Lane easement” and at best the county “might possibly allow a commercial driveway entrance as wide as 32 feet.” All utilities serving Barlow’s property are located on Rhonda Road, and the telephone poles are on Barlow’s property north of the
easement. Also, Barlow’s property has “adequate and full access from both the north on
Rhonda Road and east from Cremia Place without having to resort to any access from the
Gatchett Lane easement.”

Based on these facts, the court ruled that “the reasonable use requirements of the
Barlow Parcel both presently and in the future do not require the full size and scope of
the Gatchett Lane easement.” The court also noted that reducing the size of Barlow’s
easement consistent with his “reasonable access requirements” would “allow
[Cottonwood] to proceed with appropriate use of its property and its approved
subdivision without the impediment of the full 60 foot wide Gatchett Lane easement
across the entire northerly boundary of [Cottonwood]’s property,” which would
“constitute[] imposition of the least burden on [Cottonwood]’s parcel within the proper
confines of the law relating to easements.” Accordingly, the court determined that
Barlow’s easement should “not exceed a strip of land thirty-two feet (32’) in width
spanning the northerly most border of the Servient Tenement commencing at Cremia
Place on the easterly most border of the Servient Tenement and continuing west until the
thirty-two foot (32’) strip of land reaches the westerly border of Lot 5 (Phase 2 of Tract
Map No. 1912).” (A depiction of the more limited easement the court ordered is attached
to this opinion as appendix D.) As to the remainder of the original easement Gatchett
granted to Barlow in 2002, the court quieted title in favor of Cottonwood and declared
that Barlow and his successors were to have “no right, title, estate, interest or lien of
an[y] type whatsoever in and to” that property. The court also limited Barlow’s easement
to “ingress and egress purposes,” thus eliminating Barlow’s utility easement altogether.

The court entered judgment in August 2011. Barlow timely appealed.
DISCUSSION

I

Partial Extinguishment Of A Granted Easement

The 2002 grant deed from Gatchett gave Barlow an easement for road and utility purposes over a 60-foot-wide strip of adjoining property that ran the length of the southern boundary of his lot (and beyond). By its decision in this case, the trial court narrowed Barlow’s easement by 28 feet and shortened it so that it runs just over half the length of his property. (See appendix D.) The court also limited the use of the easement to ingress and egress only. In other words, the trial court partially extinguished Barlow’s road easement and completely extinguished his utility easement based on the court’s determination that Barlow did not reasonably require, and in the future would not reasonably require, the entirety of the granted easement, and the smaller road easement would constitute the least burden on Cottonwood’s property consistent with Barlow’s reasonable needs.

In reaching its decision, the trial court did not cite any existing law authorizing a court to partially extinguish a granted easement based on the court’s determination of the dominant tenement’s reasonable needs. Instead, the court concluded that its action was justified by “a reasonable extension” of the decision in Scruby v. Vintage Grapevine, Inc. (1995) 37 Cal.App.4th 697 (Scruby). On appeal, Barlow contends “Scruby does not provide authority to [partially] terminate an otherwise valid easement.” We agree.

In Scruby, the plaintiffs owned some land with a single family home in the Napa Valley. (Scruby, supra, 37 Cal.App.4th at p. 700.) The defendant owned and operated a winery on land adjacent to the plaintiff’s property. (Ibid.) The only access to the

4 “The land to which an easement is attached is called the dominant tenement; the land upon which a burden or servitude is laid is called the servient tenement.” (Civ. Code, § 803.)
plaintiffs’ landlocked property from the highway was over a nonexclusive 52-foot-wide roadway and utility easement across the defendant’s property that ended in a 100-foot diameter cul-de-sac, which the defendant’s predecessor had deeded to the plaintiffs. (Id. at pp. 700-701.) The plaintiffs actually used only a 15-foot wide area of the easement for access to their property. (Id. at p. 706.) Nevertheless, after the defendant placed water tanks and planted grape vines within the area covered by the easement that the plaintiffs were not using, the plaintiffs filed a complaint seeking to compel their removal and to enjoin the defendant from interfering with the plaintiffs’ use of the easement. (Id. at pp. 701, 706.) The trial court denied the plaintiffs relief because the defendant’s use of the property covered by the easement was not interfering with the plaintiffs’ use of that portion of the easement necessary for ingress and egress to the plaintiffs’ property. (Id. at pp. 701-702.)

The Court of Appeal affirmed the trial court’s decision, holding “that a deed granting a nonexclusive easement of a specified width does not, as a matter of law, give the owner of the dominant tenement the right to use every portion of the easement... [T]he owner of the servient tenement [has] the right to place improvements upon the easement as long as they do not unreasonably interfere with the right of the owner of the dominant tenement to ingress and egress.” (Scruby, supra, 37 Cal.App.4th at pp. 700, 708.) In reaching this conclusion, the court noted (among others) the following “controlling principles of law”: (1) “The owner of the dominant tenement must use his or her easements and rights in such a way as to impose as slight a burden as possible on the servient tenement”; (2) “Every incident of ownership not inconsistent with the easement and the enjoyment of the same is reserved to the owner of the servient estate”; (3) “The owner of the servient estate may make continued use of the area the easement covers as long as the use does not ‘interfere unreasonably’ with the easement’s purpose”; and (4) “An obstruction which unreasonably interferes with the use of a roadway easement can be ordered removed ‘for the protection and preservation’ of the easement.” (Id. at
Relying on these principles, the court concluded that the plaintiffs had “not been granted the right to exclusive use of each and every square inch of the easement area. Rather, [the defendant] may make continued use of the easement area although it may not do anything that unreasonably interferes with [the plaintiffs] having access to their property.”  (Id. at p. 706.) Because “the [trial] court’s finding that [the defendant’s] use of the easement area had not unreasonably interfered with [the plaintiffs’] right of ingress and egress was fully supported by substantial evidence,” the finding was “binding on appeal.”  (Ibid.) In a footnote, the Court of Appeal noted that the determination that the defendant’s “current use of a portion of the easement does not interfere with [the plaintiffs’] right of ingress and egress to their property as presently developed” did not result in a “pro-tanto extinguishment of the granted easement.”  (Id. at p. 706, fn. 2.)

In California, “[i]t is axiomatic that cases are not authority for propositions not considered.”  (People v. Gilbert (1969) 1 Cal.3d 475, 482, fn. 7.) Because Scruby did not consider whether a court can partially extinguish a granted easement if the evidence shows that the owner of the dominant tenement does not reasonably need, either now or in the future, the entirety of the easement, Scruby is not authority for the proposition that a court has such power.

Cottonwood contends, however, that the trial court’s judgment here should be affirmed as a “[l]ogical [e]xtension” of the legal principles applied in Scruby.  (Underlining and bold text deleted.) In essence, it is Cottonwood’s view that where the evidence shows that the owner of the dominant tenement is not using the entirety of a granted easement, the owner of the servient tenement may make reasonable use of the part the dominant owner is not using, but where the evidence further shows that there is no reasonable likelihood the dominant owner will be able to use the entirety of the easement in the future, the court has the power to extinguish that part of the easement that it determines is not reasonably needed to service the dominant tenement.
The legal principles applied in *Scruby* cannot be logically “extended” to sanction the *extinguishment* of a granted easement, either in whole or in part, against the will of the easement owner. Neither *Scruby* nor any of the legal principles on which the Court of Appeal relied in *Scruby* dealt with, let alone authorized, *extinguishment* of a granted property right just because, in the court’s view, the owner of that right does not appear to need it, either now or in the future. *Scruby* dealt with the scope of *use* of an easement, not its continued *existence*.

It has always been the law in California that “[a]n easement acquired by deed is not lost by mere non-user. ‘It must be accompanied with the express or the implied intention of abandonment, and the owner of the servient estate, acting upon the intention of abandonment and the actual non-user, must have incurred expenses upon his own estate. The three elements, non-user, intention to abandon, and damage to the owner of the servient estate, must concur in order to extinguish the easement.’” (*Smith v. Worn* (1892) 93 Cal. 206, 212.) Here, there was no evidence Barlow intended to abandon any part of the easement Gatchett granted him. Instead, what the evidence showed was that the owner of the servient tenement changed the plans for the development of the servient tenement in such a way as to make it unlikely that Barlow will be able to use the entirety of the easement he was granted. Thus, Cottonwood’s argument here rests on the premise that “changed circumstances over the history and development of the” servient tenement can result in the partial extinguishment of a granted easement, without the dominant owner intending to abandon the easement. In other words, the owner of the servient tenement can, by making a part of a granted easement for all practicable purposes unusable, compel the extinguishment of that part of the easement against the will of the dominant owner. No California case, or any logical extension of a California case, supports this premise.

Cottonwood argues “the public policy in favor of putting land to beneficial use” supports the trial court’s decision here. It is true that California law recognizes a “‘rule
of sound public policy that lands should not be rendered unfit for occupancy or successful cultivation.”” (Kellogg v. Garcia (2002) 102 Cal.App.4th 796, 803.) What Cottonwood fails to recognize, however, is that even if Barlow’s retention of the easement Gatchett granted him in 2002 prevents Cottonwood from building out the remaining five residential lots in the Cottonwood Creek Meadow subdivision (because the county will not issue building permits with the original easement in place), this situation is the result of Cottonwood’s predecessor choice to subdivide the servient tenement in a manner that required abandonment or at least reduction of the Gatchett Lane easement to complete the development. There was no evidence Cottonwood’s predecessor was compelled to design the subdivision the way it was designed. Presumably the subdivision could have been designed so that Manzi Way was laid out on that portion of the servient tenement covered by the Gatchett Lane easement (although such a design might have resulted in fewer lots). Thus, if we were to accept Cottonwood’s public policy argument, we would be sanctioning the partial extinguishment of a granted easement when it was the voluntary, unilateral actions of the servient owner that rendered a portion of the servient tenement covered by the easement unusable. Whatever preference there is in California law to promote the productive use of land, it does not operate to require such a result as the one Cottonwood advances here.

For the foregoing reasons, we conclude the trial court erred in determining that the partial extinguishment of Barlow’s easement was justified by an extension of the decision in Scruby.

II

Illegality

Cottonwood contends the trial court’s decision can be justified by the “body of law that states that an easement cannot be used for illegal purposes” because the evidence showed that a county road using the entirety of the 60-foot Gatchett Lane easement “would not be permitted either now or in the future.”
This argument lacks merit because none of the cases Cottonwood cites approved the extinguishment, either in whole or in part, of an easement based on illegal use. While the owner of a dominant tenement may be enjoined from using an easement where that use is illegal -- for example, using an easement for the keeping of horses in violation of a municipal ordinance that restricts the keeping of horses on residential property -- such an easement is not void for illegality. (Baccouche v. Blankenship (2007) 154 Cal.App.4th 1551, 1557-1559.) Here, at most the evidence showed that there is no reasonable prospect that the 60-foot-wide road easement will ever be used as a county road because the county will not approve a county road on the easement with Manzi Way now lying less than 50 feet to the south. The cases on which Cottonwood relies do not support even the partial extinguishment of the easement based on this showing.

III

Apportionment Of Easement Rights

Cottonwood contends that the trial court’s decision is justified because the landowners to the west have either fully or partially abandoned their rights in the easement, and that portion of the Gatchett Lane easement is “not reasonably required by [Barlow] to access his property.” We disagree.

Both of the cases on which Cottonwood relies for this argument -- Herbert v. Russell (1969) 1 Cal.App.3d 63 and Leggio v. Haggerty (1965) 231 Cal.App.2d 873 -- involved the partition of an easement pursuant to Civil Code section 807. (See Herbert, at p. 65; Leggio, at p. 881.) That statute provides that “[i]n case of partition of the dominant tenement the burden must be apportioned according to the division of the dominant tenement, but not in such a way as to increase the burden upon the servient tenement.” (Civ. Code, § 807.)

Here, Cottonwood appears to be suggesting that notwithstanding Gatchett’s express grant of an easement to Barlow in 2002 over parcels Nos. 2 and 3 as shown on the 1989 tentative tract map (not to mention parcel No. 1), under Civil Code section 807
Cottonwood cannot be burdened with the easement beyond the western boundary of Barlow’s property (which includes the entire portion of the easement lying on parcel No. 2 as shown on the 1989 tentative tract map) because that portion of the easement benefitted only those lots that were part of former parcel No. 4 on parcel map No. 833-78 that lie to the west of Barlow’s parcel. In other words, Cottonwood’s argument appears to be that because Barlow could never have benefitted from the easement granted to him over that part of Gatchett’s land that lay to the west of Barlow’s parcel, Barlow “should not be entitled to claim” that part of the easement and burden Cottonwood’s property with it when the owners whose land that part of the easement benefitted have either fully or partly relinquished their rights to the easement.

We reject this argument for two reasons. First, Cottonwood points to no evidence that it ever requested that the trial court apportion the Gatchett Lane easement pursuant to Civil Code section 807. “It is the general rule that a party to an action may not, for the first time on appeal, change the theory of the cause of action.” (Panopoulos v. Maderis (1956) 47 Cal.2d 337, 340.) Second, Cottonwood’s apportionment argument does not justify the action Cottonwood asks us to take in this appeal -- affirming the judgment in its entirety. According to Cottonwood, it has “provided further and independent legal authority for the affirmance of the judgment based on . . . easement law providing for apportionment of easement rights where two or more parcels are considered the dominant tenements . . . .” Under Cottonwood’s apportionment argument, however, at best the trial court would have been entitled to quiet title in Cottonwood only to that portion of the Gatchett Lane easement that lies west of the western boundary of Barlow’s property. By no logic that we can see would Cottonwood’s apportionment argument have allowed the court to do what it did here -- narrow Barlow’s easement by 28 feet and shorten it to where it runs only a little more than half the length of his property, rather than all the way to the western boundary. (See appendix D.) Thus, even if Cottonwood’s failure to raise this argument in the trial court was not a bar to us considering it, under no circumstances
can that argument justify doing what Cottonwood asks us to do, which is to affirm the judgment.

DISPOSITION

The judgment is reversed, and the case is remanded to the trial court with instructions to enter judgment in favor of Barlow. Barlow shall recover his costs on appeal. (Cal. Rules of Court, rule 8.278(a)(1).)

ROBIE, Acting P. J.

We concur:

MAURO, J.

HOCH, J.
PARCEL MAP NO. 833-78
FOR
HED B. GATCHEET
(15 PM 167)

TYPICAL STREET SIDE
PROPERTY CORNER

TRACT 1912
COTTONWOOD CREEK MEADOW
PHASE 1
FOR
TRION DEVELOPMENT
A CALIFORNIA CORPORATION

NOTE: ALL DATA AND MEASUREMENTS ARE APPROXIMATE AND WERE DETERMINED USING THE PHOTOGRAPIHS AND SURVEYING TOOLS AT THE TIME OF THE SURVEY. THEY ARE SUBJECT TO ERROR AND SHOULD BE CONFIRMED WITH A SURVEYOR.

SCALE 1/4" = 1'-0"
JUNE 2007
BOOK 24 MAPS PAGE 72

TRIAN DEVELOPMENT
2151 THREE VALLEYS ROAD
P.O. BOX 999
ROSEBURG, OR 97470
(541) 494-9600
EXHIBIT C

PRIVATE EASEMENT

BEING A PORTION OF PARCELS 3, AS SHOWN ON PARCEL MAP 833-78, 
RECORDED IN BOOK 15 OF PARCEL MAPS AT PAGE 147, SHASTA 
COUNTY RECORDS, IN THE UNINCORPORATED TERRITORY OF SHASTA 
COUNTY, CALIFORNIA

FOR
Barlow
BY
DUANE K. MILLER

DATE: 6-10-11

JUNE 10, 2011

SCALE: 1" = 60'

SHEET 1 OF 1

APPENDIX D
Original proceedings; petition for a writ of mandate/prohibition to challenge an order of the Superior Court of Orange County, Derek W. Hunt. Petition granted.


No appearance for Respondent.

Geraci Law Firm, Josh A. Lazar and Amy E. Martinez for Real Party in Interest.
INTRODUCTION

When an insurer retains counsel to defend its insured, a tripartite attorney-client relationship arises among the insurer, insured, and counsel. As a consequence, confidential communications between either the insurer or the insured and counsel are protected by the attorney-client privilege, and both the insurer and insured are holders of the privilege. In addition, counsel’s work product does not lose its protection when it is transmitted to the insurer.

In this case, we hold the same tripartite attorney-client relationship arises when a title insurer retains counsel to prosecute an action on behalf of the insured pursuant to the title policy. Our holding leads us to grant the petition for writ of mandate or prohibition brought by Bank of America, N.A. (B of A), and Fidelity National Title Insurance Company (Fidelity).

Fidelity is the insurer and B of A is the insured under a lender’s title policy insuring a deed of trust. When B of A made a claim under the policy, Fidelity retained the law firm of Gilbert, Kelly, Crowley & Jennett LLP (GKCJ) to prosecute, on B of A’s behalf, the underlying lawsuit for equitable subrogation, injunctive relief, declaratory relief, and fraud. Defendant Pacific City Bank (PCB) served subpoenas duces tecum on Fidelity’s parent company and Lawyers Title Insurance Company (Lawyers Title), requesting production of documents, including communications between GKCJ and Fidelity regarding the litigation. B of A moved to quash or modify the subpoenas on the ground they sought confidential communications and documents protected by the attorney-client privilege or attorney work product doctrine. The respondent court denied the motions to quash or modify, and B of A and Fidelity brought this petition for writ of mandate or prohibition to challenge the court’s order.

The respondent court erred as a matter of law. A tripartite attorney-client relationship exists among Fidelity, B of A, and GKCJ by virtue of Fidelity’s retention of GKCJ to represent B of A. Confidential communications between Fidelity and GKCJ
therefore are protected from disclosure by the attorney-client privilege. It does not matter that Fidelity retained GKCJ to prosecute rather than defend a lawsuit, as the respondent court stated and PCB contends, because the title insurer’s obligation to protect its insured’s title is the same in either case. Nor does it matter that Fidelity retained GKCJ subject to a reservation of rights because Fidelity’s reservation of rights did not create a conflict requiring Cumis counsel, and GKCJ was not acting as Cumis counsel.

B of A has established it will suffer irreparable injury unless we grant extraordinary relief. We therefore grant the writ petition and order the issuance of a writ of mandate directing the respondent court to grant B of A’s motions to quash or modify the subpoenas duces tecum, with further directions as set forth in the disposition.

FACTS AND PROCEDURAL HISTORY

I.

The Petition’s Allegations Are Deemed True.

In April 2012, B of A and Fidelity filed their petition for a writ of mandate or prohibition challenging the respondent court’s order denying B of A’s motions to quash or modify the subpoenas duces tecum. Ultimately, we issued an order to show cause. When the Court of Appeal issues an order to show cause, the real party in interest may file “a return by demurrer, verified answer, or both.” (Cal. Rules of Court, rule 8.487(b)(1).) In response to the order to show cause, PCB filed an unverified “Return Brief” that included neither an answer nor a demurrer to the writ petition.

In the absence of a true return, all well-pleaded and verified allegations of the writ petition are accepted as true. (Code Civ. Proc., § 1094; Caliber Bodyworks, Inc. v. Superior Court (2005) 134 Cal.App.4th 365, 372-373, fn. 5; Shaffer v. Superior Court (1995) 33 Cal.App.4th 993, 996, fn. 2; Coppinger v. Superior Court (1982) 134

An unverified return does not constitute a demurrer to a mandate petition and therefore should be stricken for purposes of addressing the petition’s merit. ([Universal City Studios, Inc. v. Superior Court (2003) 110 Cal.App.4th 1273, 1287.]

In [County of San Bernardino v. Superior Court (1994) 30 Cal.App.4th 378, 382, footnote 6, the real parties in interest filed a document called “responsive brief” that did not respond to the formal allegations of the petition. The Court of Appeal noted its order issuing an alternative writ requested a formal return, meaning an answer or a demurrer. ([Ibid.]) By filing a responsive brief, the real parties in interest did not follow the correct procedures. ([Ibid.])

Here too, PCB filed an unverified “Return Brief” that did not respond to the formal allegations of the writ petition. Because PCB did not file a true return with a verified answer or demurrer to the allegations of the writ petition, we deem the well-pleaded and verified allegations of the petition to be true. These true allegations are set forth in parts II. and III. of this section.

PCB argues its failure to submit a true return is a mere technicality which we should overlook because B of A and Fidelity did not include with their exhibits in support of the writ petition a copy of PCB’s “Supplemental Brief in Opposition to Plaintiff’s Motions to Quash/Modify Pacific City Bank’s Subpoenas to Fidelity and Lawyer’s Title; Declaration of Josh Lazar” (PCB’s supplemental brief). The failure to submit a return with a verified answer or demurrer is not a technicality, but is an integral and critical step in the procedure for determining the merit of a petition for extraordinary relief. Further, B of A and Fidelity’s mistake does not excuse that of PCB; each must be judged on its own and bear its own consequence determined under the relevant standard.

As to the assertion B of A and Fidelity did not provide a complete record, California Rules of Court, rule 8.486(b)(1)(B) requires a petition seeking review of a trial court ruling to be accompanied by a record that includes “[a]ll documents and exhibits submitted to the trial court supporting and opposing the petitioner’s position.” This rule
required B of A and Fidelity to include PCB’s supplemental brief in the exhibits accompanying the writ petition. The consequence for failure to “submit the required record or explanations” is that we “may summarily deny a stay request, the petition, or both.” (Cal. Rules of Court, rule 8.486(b)(4), italics added.) Summary denial of B of A and Fidelity’s writ petition would be an overly harsh consequence for the failure to include a single pleading in a lengthy record, particularly so because B of A and Fidelity did include in the exhibits both PCB’s opposition and amended opposition to the motions to quash or modify the subpoenas. In addition, before issuing an order to show cause, we requested informal opposition from PCB, and, with its return, PCB submitted an appendix that included the supplemental brief and other pleadings.

While California Rules of Court, rule 8.486(b)(4) gives us discretion in deciding whether to summarily deny a writ petition for failure to submit the required record, the failure to file a true return gives us no option but to accept the well-pleaded allegations of the writ petition as true. Unlike a document omitted from the exhibits, a verified answer to the writ petition cannot be supplied from another source, certainly not from the petitioner. B of A and Fidelity should have included PCB’s supplemental brief in the exhibits to their writ petition, but their failure to do so does not excuse PCB’s failure to file a true return.

II.

Underlying Facts

In July 2007, Helena A. Cho applied for a loan from B of A to refinance her home mortgage. At that time, the property was encumbered by a $630,000 deed of trust in favor of American Sterling Bank, which had been recorded on November 10, 2005.

PCB also argues the record is inadequate because B of A and Fidelity submitted an unsigned declaration, an unsigned motion, and documents with counsel’s handwritten notes. As required, B of A and Fidelity appear to have submitted the declaration and motion in the form in which they were filed in the respondent court. The handwritten notes appear on two pages of the record, and are illegible.
B of A approved the refinance loan, under the terms of which the loan proceeds would be used to pay off the American Sterling Bank loan. B of A’s loan would be secured by a first deed of trust. On October 19, 2007, Cho executed a $608,000 promissory note in favor of B of A. On October 30, the loan funded, and a deed of trust securing the loan was recorded in the Orange County Recorder’s Office. B of A paid a little over $598,000 to satisfy the American Sterling Bank loan.

In connection with the B of A loan to Cho, Transnation Title Insurance Company (Transnation) issued a title insurance policy to B of A (the Transnation Policy) insuring the priority of B of A’s deed of trust over any other lien or encumbrance. The Transnation Policy provided that Transnation would defend B of A in any litigation involving a covered claim and that Transnation had the right to institute and prosecute any action to establish the lien of the insured mortgage or to prevent or reduce damage or loss to B of A. Transnation was acquired by Lawyer’s Title, which in turn was acquired by Fidelity.

Unbeknownst to B of A, at about the same time that Cho refinanced with B of A, Cho (on behalf of her business DC Marketing) obtained a $1.5 million business line of credit from PCB. The line of credit was secured not only by Cho’s business assets, but also by a deed of trust recorded against Cho’s home on October 25, 2007, five days before the recordation of B of A’s deed of trust.

In November 2010, PCB recorded a notice of default under its deed of trust and sent the notice to B of A in December 2010. In February 2011, PCB recorded a notice of trustee’s sale, scheduling the sale for the following month. To protect its security interest, B of A retained the law firm of Miles, Bauer, Bergstrom & Winters, LLP (MBBW). PCB refused MBBW’s request to postpone the sale and purchased the property with a full credit bid.

Two days before the scheduled sale date, MBBW, on behalf of B of A, tendered to Fidelity a claim under the Transnation Policy. Fidelity accepted the claim
and retained temporary counsel to commence the underlying action to subrogate B of A to the position of the American Sterling Bank encumbrance that B of A had satisfied. In April 2011, temporary counsel filed the complaint for equitable subrogation and declaratory relief. In June, Fidelity retained GKCJ to represent B of A in the underlying action. Fidelity is paying GKCJ’s fees to represent B of A.

B of A, represented by GKCJ, filed a first amended complaint asserting causes of action for equitable subrogation, injunctive relief, declaratory relief, and fraud.

The writ petition alleges: “During GKCJ’s representation of [B of A] in the underlying action, GKCJ attorneys have communicated extensively with Fidelity regarding the facts of the underlying action, the status of the underlying action, [B of A]’s communications, GKCJ’s litigation strategy, GKCJ’s assessment of the strengths and weaknesses of each party’s case and GKCJ’s recommendations and opinions regarding settlement and other possible resolutions of the underlying action. GKCJ has also transmitted its research and other written work product to Fidelity. Further, the great majority of GKCJ’s communications with Fidelity have been with Lindsy Doucette, who is a licensed attorney, and include Ms. Doucette’s mental thoughts and impressions as an attorney. GKCJ and its attorneys have believed at all times that there was a tripartite relationship between [B of A], Fidelity and GKCJ and GKCJ’s communications with Fidelity were protected by the attorney-client privilege and the attorney work product privilege.”

III.

Procedural History

In January 2012, PCB served deposition subpoenas duces tecum on Fidelity’s parent company, Fidelity National Financial, Inc., and on Lawyer’s Title. The subpoenas were essentially the same and sought documents that included communications between GKCJ and Fidelity.
B of A moved to quash or modify the subpoenas duces tecum (the motions to quash) to exclude communications between GKCJ and Fidelity on the ground they were protected by the attorney-client privilege and/or were protected attorney work product. B of A argued in the motions to quash and supporting documents that GKCJ had been hired by Fidelity and that a tripartite attorney-client relationship existed among B of A, GKCJ, and Fidelity. B of A’s moving papers included a declaration of counsel that GKCJ was retained by Fidelity to represent B of A under the Transnation Policy.

PCB filed oppositions to the motions to quash and argued, among other things, the tripartite attorney-client relationship was destroyed because Fidelity was providing coverage to B of A under a reservation of rights.

In March 2012, at the hearing on the motions to quash, the respondent court requested B of A to prepare and file (1) a declaration of Fidelity’s claims counsel, pertaining to Fidelity’s retention of GKCJ and (2) a privilege log of all communications between GKCJ and Fidelity. The hearing on the motions to quash was continued to April.

In compliance with the court’s request, B of A filed a declaration from Lindsay Doucette, claims counsel at Fidelity, setting forth facts regarding its retention of GKCJ. The declaration stated, “Fidelity retained GKCJ to represent [B of A] and Fidelity in this matter in a tripartite relationship pursuant to the terms of the [Transnation] Policy by way of referral on or about May 4, 2011.” As to Fidelity’s general relationship with GKCJ, the declaration stated: “Pursuant to the November 10, 2010 Letter of Engagement, it was my impression and intent that Fidelity and GKCJ, as retained counsel, maintained an attorney-client relationship for matters Fidelity referred to GKCJ and that all communications between Fidelity and GKCJ referring to or relating to matters referred to GKCJ would be confidential and subject to the attorney-client privilege.” B of A also filed a 36-page privilege log of all communications between GKCJ and Fidelity that were sought by the subpoenas duces tecum.
At the resumption of the hearing, the respondent court denied the motions to quash. The court ruled there was no attorney-client relationship between GKCJ and Fidelity because GKCJ was retained to prosecute the underlying action as opposed to defending an existing action. The court stated, “[t]here is [a] distinction between an equitable subrogation case and quiet title case, a case in which one is defending an action as opposed to one in which one is prosecuting an action . . . .” According to the respondent court, Fidelity did not have a “favored position” or “sacred role” in the litigation.

In its minute order, the respondent court ruled: “1. On its own motion the court determines that the motion is properly a motion for [a] protective order respecting the documents identified on the privilege logs submitted and prepared by plaintiff. ¶ 2. The court finds that none of the documents listed on the privilege log (Exhibit A to defendant’s March 28, 2012 ‘Amendment to Opposition,’ etc.) is privileged and shall be produced to defense counsel as specified below. ¶ 3. The court finds that none of the documents listed on the privilege log (attached to plaintiff’s April 3, 2012 ‘Supplemental Brief,’ etc.) is privileged and shall be produced to defense counsel as specified below. ¶ 4. The court stays its foregoing orders of production until April 27, 2012.”

**STANDARD OF REVIEW**

The standard of review for a discovery order is abuse of discretion. (Costco Wholesale Corp. v. Superior Court (2009) 47 Cal.4th 725, 733 (Costco).) “The appropriate test for abuse of discretion is whether the trial court exceeded the bounds of reason. When two or more inferences can reasonably be deduced from the facts, the reviewing court has no authority to substitute its decision for that of the trial court.” (Shamblin v. Brattain (1988) 44 Cal.3d 474, 478-479.)

“The abuse of discretion standard . . . measures whether, given the established evidence, the act of the lower tribunal falls within the permissible range of
options set by the legal criteria. ‘The scope of discretion always resides in the particular law being applied, i.e., in the “legal principles governing the subject of [the] action . . . .”’

Action that transgresses the confines of the applicable principles of law is outside the scope of discretion and we call such action an “abuse” of discretion.’’ (Department of Parks & Recreation v. State Personnel Bd. (1991) 233 Cal.App.3d 813, 831.)

“[W]hen a trial court’s decision rests on an error of law, that decision is an abuse of discretion.” (People v. Superior Court (Humberto S.) (2008) 43 Cal.4th 737, 746.) It is an abuse of discretion to apply the wrong legal standard. (Costco, supra, 47 Cal.4th at p. 733.)

DISCUSSION

I.

A Tripartite Attorney-client Relationship Exists Among Fidelity, B of A, and GKCJ.

PCB argues the respondent court’s finding that no attorney-client relationship existed between Fidelity and GKCJ was supported by substantial evidence. B of A and Fidelity’s writ petition alleges that, in June 2011, “Fidelity retained GKCJ to represent [B of A] and GKCJ took over [B of A]’s representation in the underlying action,” and that “Fidelity is paying GKCJ for its representation of [B of A] in the underlying action.” We deem these allegations to be true because PCB did not answer them. In addition, B of A and Fidelity submitted a declaration confirming that Fidelity retained GKCJ to represent B of A in the underlying action pursuant to the terms of the Transnation Policy.

Fidelity’s retention of GKCJ to represent B of A is sufficient to establish a tripartite attorney-client relationship between Fidelity, B of A, and GKCJ. (Gafcon, Inc. v. Ponsor & Associates (2002) 98 Cal.App.4th 1388, 1406 [“In California, it is settled that absent a conflict of interest, an attorney retained by an insurance company to defend
its insured under the insurer’s contractual obligation to do so represents and owes a fiduciary duty to both the insurer and insured”); Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone (2000) 79 Cal.App.4th 114, 127 (Gulf Ins.) [“Counsel retained by an insurer to defend its insured has an attorney-client relationship with the insurer”]; State Farm Mutual Automobile Ins. Co. v. Federal Ins. Co. (1999) 72 Cal.App.4th 1422, 1429 (State Farm Mutual) [“Between the attorney and the insurer who retained the attorney and paid for the defense, there exists a separate attorney-client relationship endowed with confidentiality”].) The principles regarding an insurer’s duties to provide counsel for the insured are the same under title insurance policies as under general liability policies. (Lambert v. Commonwealth Land Title Ins. Co. (1991) 53 Cal.3d 1072, 1077; Israelsky v. Title Ins. Co. (1989) 212 Cal.App.3d 611, 620.)

In American Mut. Liab. Ins. Co. v. Superior Court (1974) 38 Cal.App.3d 579, 591-592, the court explained the nature of the tripartite attorney-client relationship: “In the insured-insurer relationship, the attorney characteristically is engaged and paid by the carrier to defend the insured. The insured and the insurer have certain obligations each to the other . . . arising from the insurance contract. Both the insured and the carrier have a common interest in defeating or settling the third party’s claim. If the matter reaches litigation, the attorney appears of record for the insured and at all times represents him in terms measured by the extent of his employment. [¶] In such a situation, the attorney has two clients whose primary, overlapping and common interest is the speedy and successful resolution of the claim and litigation. Conceptually, each member of the trio, attorney, client-insured, and client-insurer has corresponding rights and obligations founded largely on contract, and as to the attorney, by the Rules of Professional Conduct as well. The three parties may be viewed as a loose partnership, coalition or alliance directed toward a common goal, sharing a common purpose which lasts during the pendency of the claim or litigation against the insured. Communications are routinely exchanged between them relating to the joint and common purpose—the
successful defense and resolution of the claim. Insured, carrier, and attorney, together form an entity—the defense team—arising from the obligations to defend and to cooperate, imposed by contract and professional duty. This entity may be conceived as comprising a unitary whole with intramural relationships and reciprocal obligations and duties each to the other quite separate and apart from the extramural relations with third parties or with the world at large. Together, the team occupies one side of the litigating arena.”

That is the situation in this case. Fidelity retained GKCJ to represent B of A. As a consequence, a tripartite attorney-client relationship among them arose; Fidelity, B of A, and GKCJ formed a “loose partnership, coalition or alliance” that was directed to the “common goal” of protecting B of A’s security position, and communications exchanged among them are privileged. (American Mut. Liab. Ins. Co. v. Superior Court, supra, 38 Cal.App.3d at p. 592.)

Contrary to PCB’s argument, it does not matter whether there is a formal retainer agreement between Fidelity and GKCJ. A formal contract is not required to create an attorney-client relationship. (Gulf Ins., supra, 79 Cal.App.4th at p. 126.) Retaining GKCJ to represent B of A was enough in itself to establish the tripartite attorney-client relationship. Thus, “[GKCJ] represents two clients, the insured and the insurer.” (State Farm Mutual, supra, 72 Cal.App.4th at p. 1429.)

II.

The Tripartite Attorney-client Relationship Exists Notwithstanding Fidelity’s Reservation of Rights.

PCB argues a tripartite attorney-client relationship does not exist because Fidelity agreed to provide counsel for B of A under a reservation of rights. According to PCB, the tripartite attorney-client relationship is limited to the situation in which an
insurer, without a reservation of rights, hires an attorney to defend the insured from a liability claim.

A reservation of rights in itself does not create a disqualifying conflict requiring the appointment of Cumis counsel. (James 3 Corp. v. Truck Ins. Exchange (2001) 91 Cal.App.4th 1093, 1108.) “If the issue on which coverage turns is independent of the issues in the underlying case, Cumis counsel is not required.” (Ibid.) “[N]ot every reservation of rights entitles an insured to select Cumis counsel. There is no such entitlement, for example, where the coverage issue is independent of, or extrinsic to, the issues in the underlying action [citation] or where the damages are only partially covered by the policy. [Citations.]” (Dynamic Concepts, Inc. v. Truck Ins. Exchange (1998) 61 Cal.App.4th 999, 1006.)

Fidelity made its reservation of rights because B of A submitted its claim to Fidelity only two days before the March 25 foreclosure sale. Whether B of A promptly notified Fidelity of the claim does not appear to be related to any of the issues in the underlying lawsuit against PCB for equitable subrogation, injunctive relief, declaratory relief, and fraud.

In addition, the record does not support a finding GKCJ was acting as Cumis counsel, that is, independent counsel, for B of A. (See Civ. Code, § 2860, subd. (a).) Fidelity retained GKCJ to represent B of A, there is no evidence B of A independently retained GKCJ, B of A made no demand for Cumis counsel, and neither Fidelity nor B of A has ever asserted GKCJ has been acting as Cumis counsel.

PCB relies on First Pacific Networks, Inc. v. Atlantic Mut. Ins. Co. (N.D.Cal. 1995) 163 F.R.D. 574, to assert “there is [no] longer any confidential relationship between an insured and the insurance company after the insurer issues its reservation of rights . . . .” The magistrate judge in that case concluded that no attorney-client relationship existed between the insurer and the insured’s Cumis counsel. (Id. at p. 578.) The magistrate judge did not conclude the insurer’s reservation of rights
automatically created a disqualifying conflict requiring the retention of *Cumis* counsel, and such a conclusion would be contrary to California law.\(^3\)

But assuming for purposes of analysis the reservation of rights in this case did create a disqualifying conflict, PCB’s argument fails for two fundamental reasons. First, the right to invoke the conflict would belong solely to B of A. “The right to independent representation paid for by the insurer in the circumstances found in the *Cumis* decision was expressly stated by the *Cumis* court to be a right belonging to the insured [citation], not the insured’s adversary.” (*McGee v. Superior Court* (1985) 176 Cal.App.3d 221, 228.) PCB, as B of A’s adversary, cannot assert B of A’s right to *Cumis* counsel in order to create a waiver of the attorney-client privilege and attorney work product doctrine as to communications between GKCJ and the insurer, Fidelity.

Second, if GKCJ were serving as *Cumis* counsel, then it and B of A would have a duty “to disclose to the insurer all information concerning the action except privileged materials relevant to coverage disputes, and timely to inform and consult with the insurer on all matters relating to the action.” (Civ. Code, § 2860, subd. (d).) “Any information disclosed by the insured or by independent counsel is not a waiver of the privilege as to any other party.” (*Ibid.*)

**III.**

**The Tripartite Attorney-client Relationship Exists When the Title Insurer Retains Counsel to Prosecute Litigation on Behalf of the Insured Under the Policy.**

At the hearing in April 2012, the respondent court found no attorney-client relationship between GKCJ and Fidelity existed because GKCJ was retained to prosecute the underlying action as opposed to defending an existing one. The court stated, “[t]here

\(^3\) California state appellate courts are not bound by federal court decisions, except for those of the United States Supreme Court. (*People v. Avena* (1996) 13 Cal.4th 394, 431; see 9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 507, pp. 570-571.)
is [a] distinction between an equitable subrogation case and quiet title case, a case in which one is defending an action as opposed to one in which one is prosecuting an action . . . .” The respondent court erred as a matter of law in making this artificial distinction.

We turn first to the Transnation Policy because that is the contract setting forth Fidelity’s obligations to B of A. (Bank of the West v. Superior Court (1992) 2 Cal.4th 1254, 1264-1265 [insurance policies “are still contracts to which the ordinary rules of contractual interpretation apply”].) The Transnation Policy is an American Land Title Association (ALTA) loan policy, form 1191-187. Paragraph 5 of the Conditions section of the Transnation Policy is entitled “Defense and Prosecution of Actions” and has two components. First, paragraph 5(a) provides (in relevant part) that “the Company, at its own cost and without unreasonable delay, shall provide for the defense of an Insured in litigation in which any third party asserts a claim covered by this policy adverse to the Insured.” Second, paragraph 5(b) provides: “The Company shall have the right, in addition to the options contained in Section 7 of these Conditions, at its own cost, to institute and prosecute any action or proceeding or to do any other act that in its opinion may be necessary or desirable to establish the Title or the lien of the Insured Mortgage, as insured, or to prevent or reduce loss or damage to the Insured.” (Italics added.)

Thus, the Transnation Policy not only obligates Fidelity to defend B of A, but, as a standard ALTA lender’s policy, also gives Fidelity the right to initiate and prosecute litigation, such as a lawsuit to quiet title against an adverse claim. (See Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2012) ¶ 6:2668, p. 6H-31 (rev. #1, 2012).) “[T]he [title] insurer may undertake legal action to eliminate the defect or perfect the insured’s title. . . . If legal action is pursued, it may take the form of, inter alia, a quiet title action, a declaratory relief action, or an action in probate court for a declaration regarding the interpretation of a trust or will.” (Cal. Title Insurance Practice (Cont.Ed.Bar 2d ed. 2011) § 12.53, p. 565 (rev. 6/08).)
In *Jarchow v. Transamerica Title Ins. Co.* (1975) 48 Cal.App.3d 917, 924, 927 (*Jarchow*), the court examined a title insurer’s duty to prosecute litigation to protect an insured. In that case, a title insurer denied the insured’s request to initiate a lawsuit to eliminate a neighbor’s easement. (*Id.* at p. 924.) The Court of Appeal concluded the insured’s complaint stated a claim for bad faith and emotional distress because the insurer breached its duty to take affirmative measures to eliminate the easement and provide clear title. (*Id.* at pp. 940, 943.) The court examined the duty to defend provision of the title policy and explained: “This provision of the title policy sets forth two obligations of the insurer: (1) To defend the insured’s title if a third party claims, in a judicial proceeding, an interest insured against by the policy, and (2) in the event that a third party claimant chooses not to litigate his claim, to take affirmative action (by filing an action to quiet title or by offering to compromise the third party’s claim) to provide the insured with title as stated in the policy. The obligations to defend and to ‘take other appropriate action’ are kindred duties designed to achieve the same objective: the integrity of the insured’s title. Since these duties address the same fundamental concern, both must be equally accessible to insureds; legal rules regarding application of the one must, likewise, apply to the other.” (*Id.* at pp. 941-942.)

The *Jarchow* court noted, “[t]he case law regarding a title insurer’s bifurcated obligation to seek judicial determination of insured-against title defects deals almost exclusively with the duty to defend.” (*Jarchow, supra*, 48 Cal.App.3d at p. 942.) In *Jarchow*, however, the third party did not sue the insured. Instead, the third party

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4 The policy in *Jarchow* was a standard form California Land Title Association (CLTA) standard coverage policy, No. 4000-1963 (amended 1969), with the following provision on the insurer’s duty to defend: “‘The Company, at its own cost and without undue delay shall provide (1) for the defense of the Insured in all litigation consisting of actions . . . commenced against the Insured . . .; or (2) for such action as may be appropriate to establish the title . . . as insured, which litigation . . . is founded upon an alleged defect, lien or encumbrance insured against by this policy. . . .’” (*Jarchow, supra*, 48 Cal.App.3d at p. 941.)
persuaded the city planning commission to impose restrictions on the insured’s ability to develop the property protected by the policy. (*Ibid.*) In such a situation—when the insurer must prosecute a lawsuit to protect its insured’s interest—the insurer’s duties are the same as when an insurer is called upon to provide a defense to a lawsuit brought by a third party. (*Id.* at pp. 941-942.)

Although *Jarchow* did not concern the tripartite attorney-client relationship among insurer, insured, and counsel, the principle that a title insurer’s duties to defend and to initiate a lawsuit are “kindred duties” addressing “the same fundamental concern” (*Jarchow, supra*, 48 Cal.App.3d at pp. 941-942) is equally relevant here. Whether a title insurer is defending an action or prosecuting one, the object of protecting the integrity of the insured’s title is the same. There is no logical reason why a tripartite attorney-client relationship should exist in one case but not the other.

To distinguish between defending an action and prosecuting one would deny a tripartite attorney-client relationship from ever forming in many situations in which a title insurer takes action to protect its insured’s title. Both CLTA and ALTA policies have provisions for defense and prosecution of lawsuits. (See 3 Cal. Insurance Law & Practice (Matthew Bender 2012) Title Insurance, appen. A, pp. 39-87 to 39-88 (rel. 64-4/2009) [CLTA standard policy]; *id.*, appen. B, p. 39-104 (rel. 64-4/2009) [ALTA owner’s policy]; *id.*, appen. C, pp. 39-120 to 39-121 (rel. 64-4/2009) [ALTA loan policy].)

As both *Jarchow* and this case illustrate, it often is necessary for the title insurer to initiate a quiet title, declaratory relief, or equitable subrogation action to protect the insured’s title. Here, a lawsuit by PCB against B of A was not forthcoming; the foreclosure sale extinguished B of A’s lien, and, therefore, the means available to Fidelity to protect its insured’s interest was to prosecute the underlying action for equitable subrogation and declaratory relief. If a tripartite attorney-client relationship did not arise in such a situation, the title insurer would be unable to communicate with counsel.
retained to represent the insured without the risk of being forced to disclose confidential or privileged information.

Citing *In re Imperial Corp. of America* (S.D.Cal. 1995) 167 F.R.D. 447, PCB argues, “[e]xisting case law limits the ‘tripartite’ relationship to the narrow situation where an insurer, *without a reservation of rights*, hires an attorney to *defend* the insured from a liability claim.” *In re Imperial Corp. of America* is inapposite: The issue in that case was whether, under federal law, the tripartite attorney-client relationship among insurer, insured, and counsel arises in litigation under a directors and officers liability policy. (*Id.* at p. 451.) The court concluded such a tripartite relationship did not arise because the directors and officers liability policy did not include a duty to defend or give the insurer the right to retain counsel for the insured. (*Ibid.*) Thus, the insured’s counsel did not have an attorney-client relationship with the insurer. (*Id.* at p. 452.)

It is true that California opinions dealing with the tripartite attorney-client relationship have done so in the context of a liability policy. (E.g., *State Farm Mutual*, supra, 72 Cal.App.4th 1422 [automobile liability policy]; *American Mut. Liab. Ins. Co. v. Superior Court*, supra, 38 Cal.App.3d 579 [attorney malpractice liability policy].) But none has limited the relationship to liability policies or rejected the relationship when a title insurer initiates litigation on behalf of the insured pursuant to the terms of the title policy. In addition to the duty to defend, standard title policies, such as the Transnation Policy, include the insurer’s “right” to initiate litigation to protect the insured’s title.

PCB argues we should reject B of A and Fidelity’s request to create a new type of protected communications and defer the matter to the Legislature. The type of communications we are protecting—those between attorney and client—is not new; rather, we are concluding that Fidelity and GKCJ have an attorney-client relationship by virtue of Fidelity’s retention of GKCJ to represent B of A.
IV.

**Fidelity Did Not Waive B of A’s Right to Assert the Attorney-client Privilege and Attorney Work Product Doctrine.**

PCB argues Fidelity waived any right to object to production of privileged documents and information because it did not bring its own motion to quash the subpoenas or serve objections to them. For the same reason, PCB argues Fidelity is not a “proper party” to the writ petition.

The attorney-client privilege may be claimed only by the holder of the privilege, a person who is authorized by the holder to claim the privilege, or the person who was the attorney at the time of the communication. (Evid. Code, § 954.) As relevant here, the “‘holder of the privilege’” is defined as the client. (Id., § 953.)

We have concluded a tripartite attorney-client relationship exists among Fidelity, B of A, and GKCJ; they are “a unitary whole” and share a “common purpose” lasting “during the pendency of the claim or litigation.” (American Mut. Liab. Ins. Co. v. Superior Court, supra, 38 Cal.App.3d at p. 592.) As a consequence, B of A and Fidelity are joint clients of GKCJ. “Each of the joint clients holds the privilege protecting their confidential communications with the attorney; one client may not waive the privilege without the consent of the other.” (Roush v. Seagate Technology, LLC (2007) 150 Cal.App.4th 210, 223.) Since B of A, one joint holder of the attorney-client privilege, did move to quash the subpoenas and serve objections to the requests for production, it was unnecessary that Fidelity do the same to prevent disclosure of privileged communications and attorney work product.

For similar reasons, we need not decide whether Fidelity is a proper party to the writ petition. There is no question B of A is a proper party, and any relief we grant
of necessity would extend to Fidelity even if it did not have standing to challenge the respondent court’s order.

V.

B of A Did Not Waive the Attorney-client Privilege or the Attorney Work Product Doctrine.

Earlier in the litigation, B of A asserted the attorney-client privilege and the attorney work product doctrine in response to interrogatories propounded by PCB. In March 2012, the respondent court, in ruling on PCB’s motion to compel further responses to those interrogatories, ruled that B of A had waived privilege objections by failing to submit a privilege log as required by a case management order from June 2011. B of A challenged the respondent court’s ruling by petition for writ of mandate (appellate case No. G046691), which we summarily denied.\(^5\)

PCB argues B of A waived the attorney-client privilege and work product doctrine as to documents and information sought by the subpoenas duces tecum because B of A failed to file a privilege log in response to the earlier-served interrogatories. PCB asserts, “it would be contradictory for this Court to hold that Petitioner could obtain a protective order preventing disclosure of the very documents to which it affirmed that BofA had waived any privilege by failure to comply with the trial court’s June 15, 2011 Case Management Order.”

A summary denial of a petition for writ of mandate is not a denial on the merits and does not become law of the case. (Kowis v. Howard (1992) 3 Cal.4th 888, 893-894.) By having summarily denied B of A’s prior writ petition, we are not “hamstrung into deciding” this writ petition against B of A. (Amalgamated Bank v. Superior Court (2007) 149 Cal.App.4th 1003, 1020.)

\(^5\) We have granted PCB’s request to take judicial notice of the proceedings in appellate case No. G046691.
PCB argues too that B of A waived any claims of attorney-client privilege and attorney work product by failing to submit a privilege log in response to the subpoenas. The requirement of submitting a privilege log was imposed by the respondent court’s June 15, 2011 case management order, which stated that “in respect to all future discovery responses . . . , all objections on the grounds that the information sought by any written discovery is contained in attorney client privileged documents [or] documents protected by the work product doctrine . . . will be sustained on the following basis only.

¶ Within seven days of the response or within seven days of this order, whichever has come later, the objecting parties are ordered both to serve on counsel and simultaneously to file in court, a privilege log . . . .” The order states the court will deem any privilege objection to have been withdrawn if the privilege log fails to specify documents to specifically numbered discovery requests.

When the case management order was made and when the respondent court ruled on the motions to quash, the Code of Civil Procedure did not require preparation of a privilege log to preserve objections based on privilege or attorney work product. At those times, case law held the term “privilege log” did not appear in the Code of Civil Procedure and was “commonly used by courts and attorneys to express the requirements of subdivision (g)(3) of [Code of Civil Procedure] section 2031 [now Code of Civil Procedure section 2031.240, subdivision (b)].” (Hernandez v. Superior Court (2003) 112 Cal.App.4th 285, 292; see also People ex rel. Lockyer v. Superior Court (2004) 122 Cal.App.4th 1060, 1073; Best Products, Inc. v. Superior Court (2004) 199 Cal.App.4th 1181, 1188-1189.)

Recent legislation amended subdivision (c)(1) of Code of Civil Procedure section 2031.240 to require the preparation of a privilege log “if necessary” to “provide sufficient factual information for other parties to evaluate the merits” of a claim of privilege or protected work product. (Legis. Counsel’s Dig., Assem. Bill No. 1354 (2011-2012 Reg. Sess.); see Stats. 2012, ch. 232, § 1.) The amendment did not become
effective until January 1, 2013 (Cal. Const., art. IV, § 8, subd. (c)(1) [effective date of new statutes is January 1, following 90 days after enactment]), and section 2031.240, subdivision (c)(1) applies only to responses to inspection demands.

A court has no authority to issue courtroom rules that are in conflict or inconsistent with statute. (Rutherford v. Owens-Illinois, Inc. (1997) 16 Cal.4th 953, 967; Pacific Trends Lamp & Lighting Products, Inc. v. J. White, Inc. (1998) 65 Cal.App.4th 1131, 1134-1135.) To the extent the case management order imposed requirements or conditions greater than or inconsistent with the Code of Civil Procedure in effect at the time to preserve claims of privilege and work product, the order was invalid. (See Hernandez v. Superior Court, supra, 112 Cal.App.4th at pp. 292-293 [court rule requiring creation of privilege log in responding to interrogatories is invalid].)

In any case, B of A did not file a response to the subpoenas duces tecum, but filed motions to quash (Code Civ. Proc., § 1987.1), which the respondent court called motions for protective orders (id., § 2031.060). Thus, the case management order, even if valid, did not require B of A to submit a privilege log. When, at the hearing in March 2012, the respondent court requested that B of A prepare and file a privilege log of all communications between GKCJ and Fidelity, B of A did so.

VI.

The Communications Identified in B of A’s Privilege Log Are Protected by the Attorney-client Privilege.

Confidential communications between lawyer and client are broadly protected from disclosure. (Evid. Code, §§ 950-954.) “The attorney-client privilege, set forth at Evidence Code section 954, confers a privilege on the client ‘to refuse to disclose, and to prevent another from disclosing, a confidential communication between client and lawyer . . . .’ The privilege ‘has been a hallmark of Anglo-American jurisprudence for almost 400 years.’ [Citation.] Its fundamental purpose ‘is to safeguard
the confidential relationship between clients and their attorneys so as to promote full and open discussion of the facts and tactics surrounding individual legal matters. [Citation.] . . .” (Costco, supra, 47 Cal.4th at p. 732.)

The privilege protects communications between legal professionals within the law firm representing the client (Fireman’s Fund Ins. Co. v. Superior Court (2011) 196 Cal.App.4th 1263, 1273-1274), communications between a business entity and its in-house counsel acting in a legal capacity (Alpha Beta Co. v. Superior Court (1984) 157 Cal.App.3d 818, 825), and communications made during preliminary consultation, regardless whether the attorney is ultimately retained (Hooser v. Superior Court (2000) 84 Cal.App.4th 997, 1003). The privilege protects communications made by electronic means, such as e-mail. (Evid. Code, § 917, subd. (b).)

“The party claiming the privilege has the burden of establishing the preliminary facts necessary to support its exercise, i.e., a communication made in the course of an attorney-client relationship. [Citations.] Once that party establishes facts necessary to support a prima facie claim of privilege, the communication is presumed to have been made in confidence and the opponent of the claim of privilege has the burden of proof to establish the communication was not confidential or that the privilege does not for other reasons apply. [Citations.]” (Costco, supra, 47 Cal.4th at p. 733.)

B of A met its burden. We have reviewed the privilege log appearing at pages 294 through 329 of volume II of the exhibits submitted with the writ petition. Every entry on the log is a communication (either letter or e-mail) between B of A and GKCJ, Fidelity and GKCJ, attorneys at GKCJ, or an attorney and legal assistant at GKCJ. The first communication was made on April 29, 2011, and concerns retention of GKCJ, and the last communication was made on March 29, 2012, and concerns transmission of strategic documents. There is no indication that any communication was disclosed to a third party other than those “present to further the interest of the client in the consultation.
or those to whom disclosure is reasonably necessary for the transmission of the information . . . .” (Evid. Code, § 952.)

The attorney-client privilege would not be defeated if the confidential communications contained material discoverable by other means. “The attorney-client privilege attaches to a confidential communication between the attorney and the client and bars discovery of the communication irrespective of whether it includes unprivileged material.” (Costco, supra, 47 Cal.4th at p. 734.)

Citing Coito v. Superior Court (2012) 54 Cal.4th 480, 502 (Coito), PCB argues it is necessary to submit the documents identified on the privilege log to the respondent court for in camera inspection to determine whether any are absolute work product. An in camera inspection is not necessary or permitted. In Coito, the California Supreme Court confirmed a trial court may, if necessary, conduct an in camera inspection to determine whether absolute or qualified work product protection applies to the material in dispute. (Ibid.) The documents on the privilege log in this case are communications protected by the attorney-client privilege and are not subject to disclosure for in camera inspection. (Costco, supra, 47 Cal.4th at pp. 736-737 [court may not compel in camera disclosure of document for which privilege is asserted].)

Documents identified as Nos. 13, 44, 49, 74-77, 112, 114, 115, 117-119 are e-mails and include the description “Re: Transmission of Strategic Documents/Pleadings including analysis and legal assessment” or “Re: Transmission of File Documents including analysis and legal assessment.” We read these entries as identifying communications which themselves include analysis and legal assessment, not merely as cover letters for the transmission of other documents that are not protected by the attorney-client privilege or work product doctrine.

Material that includes an attorney’s analysis and legal assessment constitutes attorney work product. Under Code of Civil Procedure section 2018.030, subdivision (a), “[a] writing that reflects an attorney’s impressions, conclusions, opinions,
or legal research or theories is not discoverable under any circumstances.” Such writings enjoy absolute protection. (Coito, supra, 54 Cal.4th at p. 485.) The documents so identified and described in the privilege log as Nos. 13, 44, 49, 74-77, 112, 114, 115, 117-119 are therefore protected as attorney work product in addition to receiving protection by the attorney-client privilege. If those documents transmitted other documents and pleadings, apart from the communications themselves, for which B of A and Fidelity assert work product protection, then those documents and pleadings must be brought to the respondent court’s attention and analyzed separately. (Costco, supra, 47 Cal.4th at p. 735 [transmission of unprivileged material from attorney to client does not protect the material from discovery].) In that case, in camera inspection of the transmitted documents and pleadings might be necessary to determine whether absolute or qualified work product protection applies. (Coito, supra, at p. 502.) As we have noted, we do not read the privilege log in that manner.

PCB challenges the privilege log as unverified and asserts B of A and Fidelity have not submitted evidence to support the claim of privilege. The respondent court did not require B of A to verify the privilege log and, though inapplicable, Code of Civil Procedure section 2031.240, subdivision (b) does not require a verification. B of A met its evidentiary burden in the respondent court of proving a tripartite attorney-client relationship by presenting evidence that Fidelity retained GKCJ to represent B of A. In addition, B of A and Fidelity allege in their writ petition that GKCJ attorneys communicated extensively with Fidelity regarding the facts of the underlying action, the status of the underlying action, communications, GKCJ’s litigation strategy, GKCJ’s assessment of the strengths and weaknesses of each party’s case, and GKCJ’s recommendations and opinions regarding settlement and other possible resolutions of the underlying action. B of A and Fidelity allege: “GKCJ has also transmitted its research and other written work product to Fidelity. Further, the great majority of GKCJ’s communications with Fidelity have been with Lindsy Doucette, who is a licensed
attorney, and include Ms. Doucette’s mental thoughts and impressions as an attorney.” We accept those allegations as true because PCB did not file a return with a verified answer denying them.

VII.

Review by Extraordinary Writ Is Warranted.

Review of a discovery ruling by extraordinary writ will be granted if the ruling threatens immediate harm, such as loss of a privilege against disclosure, for which no other remedy exists. (Doe v. Superior Court (2011) 194 Cal.App.4th 750, 754; O’Grady v. Superior Court (2006) 139 Cal.App.4th 1423, 1439.) Appeal from a final judgment is not an adequate remedy when a court orders production of privileged materials because, once the privileged materials have been disclosed, the harm has occurred and cannot be undone. (Union Bank of California v. Superior Court (2005) 130 Cal.App.4th 378, 388; Raytheon Co. v. Superior Court (1989) 208 Cal.App.3d 683, 686.)

Review by extraordinary writ is warranted here because the respondent court’s order denying the motions to quash will result in the production of privileged materials and “threaten[s] the confidential relationship between [B of A] and its attorney.” (Costco, supra, 47 Cal.4th at p. 741.) In addition, PCB did not deny the allegations of irreparable injury and inadequate remedy in B of A and Fidelity’s writ petition.

DISPOSITION AND ORDER

The petition for writ of mandate or prohibition is granted. Let a writ of mandate issue directing the respondent court to vacate its order denying the motions by B of A to quash or modify the subpoenas duces tecum and to issue a new order granting the motions with respect to the documents identified on the privilege log appearing at pages 294 through 329 of volume II of the exhibits submitted with the writ petition. This
court’s order staying the proceedings in the respondent court is vacated. B of A and Fidelity shall recover costs incurred in this proceeding.

FYBEL, J.

WE CONCUR:

BEDSWORTH, ACTING P. J.

ARONSON, J.
Allen Pfeifer (Allen) and Florence A. Pfeifer (Florence), a son and his mother (collectively, the Pfeifers), have a mortgage insured by the Federal Housing Administration (FHA). They filed a third amended complaint against Countrywide Home Loans, Inc. (Countrywide) and ReconTrust Company (Recon), after a nonjudicial foreclosure proceeding was commenced against their property. The trial court sustained a demurrer by Countrywide and Recon (collectively, the lenders) without leave to amend against the Pfeifers’ third amended complaint and then entered judgment in favor of the lenders.

The Pfeifers appeal and challenge the trial court’s rulings that they did not have a cognizable legal claim against Recon under the federal Fair Debt Collection Practices Act (FDCPA or the Act). They also challenge, among other things, the trial court’s denial of their requests for declaratory relief and for wrongful foreclosure based on the lenders’ failure to conduct a face-to-face interview as mandated by the servicing regulations of the Department of Housing and Urban Development (HUD).
We conclude that the deed of trust incorporates by reference the servicing requirements of HUD, including the face-to-face interview, and the lenders had to comply with the servicing terms prior to conducting a valid nonjudicial foreclosure. We also hold that tender is not required in the present situation, because the borrowers are seeking to enjoin a pending foreclosure sale based on the lenders’ failure to comply with the servicing requirements incorporated in the FHA deed in trust. Although we agree with those courts that refuse to permit any private right of action for failure to comply with the HUD regulations and the Pfeifers cannot seek damages based on their wrongful foreclosure action, we concur with those courts distinguishing an offensive action from a defensive action. Thus, we conclude that the servicing requirements are conditions precedent to the acceleration of the debt or to foreclosure. Consequently, the Pfeifers may seek to enjoin the lenders from proceeding with a nonjudicial foreclosure based on the lenders’ failure to perform an HUD servicing requirement.

Accordingly, we reverse the trial court’s judgment as to the Pfeifers’ request for injunctive relief based on their wrongful foreclosure claim and their request for declaratory relief. We, however, otherwise affirm the trial court’s judgment, including the lower court’s ruling that the Pfeifers do not have a claim for damages against Recon for violating the FDCPA, because Recon is not a debt collector under the statute.

BACKGROUND

On August 31, 2009, the Pfeifers filed a complaint against the lenders to enjoin a foreclosure, for declaratory relief, for an accounting, and for elder abuse. The Pfeifers filed a first amended complaint, and the lenders demurred. On June 28, 2010, the trial court sustained the lenders’ demurrer with leave to amend the Pfeifers’ pleading. The Pfeifers filed a second amended complaint and, after obtaining new counsel after the death of their original attorney, received the court’s permission to file a third amended complaint.

1 On September 3, 2009, the trial court denied the Pfeifers’ application for a preliminary injunction.
The Pfeifers filed their third amended complaint on January 25, 2011, which set forth the following seven causes of action: breach of the implied covenant of good faith and fair dealing against the lenders, wrongful foreclosure against the lenders, breach of contract against the lenders, fraud and deceit against the lenders, a violation of the FDCPA against Recon, financial elder abuse against Countrywide, and a request for declaratory relief against the lenders. The Pfeifers requested, among other things, general and punitive damages as well as an order canceling the notice of default and notice of trustee sale.

In their pleading, the Pfeifers alleged that they owned property in Hayward, California, and that Florence is the mother of Allen. The pleading asserted that Florence was incompetent and suffered from Alzheimer’s disease and that the original lender knew, or reasonably should have known, that Florence was incompetent and unable to provide consent to a loan agreement. In May 2011, Allen was appointed as guardian ad litem to represent the interests of his mother.

The Pfeifers had a mortgage insured by the FHA. The note indicated that on April 25, 2008, the Pfeifers borrowed $606,977.00 at 6.125 percent interest from Alameda Mortgage Corporation (Alameda Mortgage). The monthly payment was $3,688.06. The deed of trust was filed on April 30, 2008.

According to the Pfeifers’ third amended complaint, Countrywide purchased the loan made by Alameda Mortgage in the principal amount of $606,977, but this transaction “was a sham and fictitious one.” This loan was secured by the Pfeifers’ home in Hayward. The Pfeifers alleged that Alameda Mortgage “was essentially a front for Countrywide. Alameda Mortgage was only the nominal lender and did not use its own money to make the loan. Instead, it used the money from Countrywide and the entire transaction was premised on the fact that Countrywide would promptly become the owner of the loan, and would then securitize it. Countrywide set the terms of the deal and enforced all the underwriting standards and guidelines.” The pleading stated that Alameda Mortgage was a dual agent of both Countrywide and them. Bank of America
purchased Countrywide, and Bank of America received the servicing rights of the Pfeifers’ loan.2

After Countrywide declared the Pfeifers’ loan in default, Countrywide, according to the Pfeifers’ third amended complaint, retained Recon to collect the debt. The third amended complaint stated that Recon became the trustee of the deed of trust after the Pfeifers defaulted on their obligations. The Pfeifers alleged that Recon was a “debt collector” as used in FDCPA. They further asserted that Mortgage Electronic Registration Systems, Inc. (MERS), a Delaware corporation, was the “nominee beneficiary of the subject loan” but did not have any beneficial interest in the loan. MERS, according to the pleading, is a subsidiary of MERSCORP, a Reston, Virginia corporation. These corporations, the Pfeifers asserted, failed to register to do business in California.

On May 13, 2009, Recon recorded a notice of default. The notice of default stated pursuant to Civil Code section 2924, subdivision (c) the following: “Upon your written request the beneficiary . . . will give you a written itemization of the entire amount you must pay.” The notice of default also stated that at this time the Pfeifers owed $27,313.25 to reinstate their loan.

The Pfeifers claimed in their third amended complaint that on May 13, 2009, Recon recorded the notice of default prior to providing them with the 30-day advance debt validation notice required by the FDCPA. If they had received proper notice, they would have been able to explain, according to their pleading, that a truck had collided with their property and that they had collected checks in the amount of $13,844.99, $637.00, and $314.00 (for a total of $14,795.99) in damages, which could have been credited to their mortgage. They declared that Countrywide failed to credit them with this money and unlawfully kept the money. They maintained that Countrywide also received

2 The Pfeifers noted that they did not know the identity of the actual investor owning the underlying note and deed of trust and requested such information under title 15 of the United States Code section 1641.
$4,691 for mortgage payments that were not properly credited to their mortgage. Additionally, the Pfeifers asserted, “Countrywide unlawfully ‘force placed’ insurance thereby wrongfully charging [their] account approximately $637.00.” They alleged that they had adequate insurance at all relevant times. They averred that Recon had a mandatory duty under the FDCPA to investigate these accounting problems and correct them prior to recording a notice of default. Furthermore, they stated that Recon was not entitled to any immunity from suit and was not entitled to claim “any bona fide error defense for failure to comply with debt validation procedure in the FDCPA.”

With regard to their second cause of action, wrongful foreclosure, the Pfeifers alleged, among other things: “The instant loan is insured by the [FHA] and is subject to the pre-foreclosure requirements provided by the FHA. These requirements include a requirement of a face-to-face interview between an agent of the lender and the borrower prior to commencing any foreclosure proceedings. The scope of this interview is summarized in [title 24 of the Code of Federal Regulations section] 203.604(b), which is incorporated by reference. Defendants have breached this obligation and prematurely commenced a foreclosure proceeding. Plaintiffs are entitled to the cancellation of the notice of default and notice of sale until defendants comply with these regulations. These regulations have the force of law and may be enforced by the borrowers. . . .” The Pfeifers asserted that they were “entitled to a restraining order to stop the nonjudicial foreclosure proceedings and to compel defendants to meet their obligations under federal” law.

The lenders requested that the trial court take judicial notice of the note, deed of trust, notice of default and election to sell under the deed of trust, and the notice of the trustee’s sale, which had been referenced in the Pfeifers’ third amended complaint. They also requested judicial notice of the substitution of trustee filed in the Alameda County Official Records.

The first page of the deed of trust identifies the deed of trust as an “FHA California Deed of Trust.” Paragraph 9 in the deed of trust sets forth the “grounds for
acceleration of debt.” When a default occurs, this paragraph provides under subdivision (a) that the “[l]ender may, except as limited by regulations issued by the Secretary, in the case of payment defaults, require immediate payment in full of all sums secured by this Security Instrument if: [¶] (i) Borrower defaults by failing to pay in full any monthly payment required by this Security Instrument prior to or on the due date of the next monthly payment, or (ii) Borrower defaults by failing, for a period of thirty days, to perform any other obligations contained in this Security Instrument.” Subdivision (b) states under “sale without credit approval,” that the “[l]ender shall, if permitted by applicable law . . . and with the prior approval of the Secretary, require immediate payment in full of all sums secured by this Security Instrument . . . .” In subdivision (d), under the heading of “Regulations of HUD Secretary,” the agreement reads as follows: “In many circumstances regulations issued by the Secretary will limit Lender’s rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security Instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary.”

Paragraph 4 in the deed of trust sets forth the application of insurance proceeds to the principal balance. It provides that in the event of loss, “[a]ll or any part of the insurance proceeds may be applied by Lender, at its option, either (a) to the reduction of the indebtedness under the Note and this Security Instrument, first to any delinquent amounts applied in the order in paragraph 3, and then to prepayment of principal, or (b) to the restoration or repair of the damaged Property. Any application of the proceeds to the principal shall not extend or postpone the due date of the monthly payments which are referred to in paragraph 2, or change the amount of such payments. . . .”

The notice of default and election to sell under the deed of trust filed May 13, 2009, provided in relevant part: “IF YOUR PROPERTY IS IN FORECLOSURE BECAUSE YOU ARE BEHIND IN YOUR PAYMENTS, IT MAY BE SOLD WITHOUT ANY COURT ACTION, and you may have the legal right to bring your account in good standing by paying all of your past due payments plus permitted costs
and expenses within the time permitted by law for reinstatement of your account . . . .” The notice provided that “[t]his amount is $27,313.25, as of 05/11/2009 and will increase until your account becomes current.” The notice further provided the following: “Upon your written request, the beneficiary or mortgagee will give you a written itemization of the entire amount you must pay.”

On June 27, 2011, the trial court sustained the lenders’ demurrer to the Pfeifers’ third amended complaint without leave to amend. The court explained: “First, it appears that there was no requirement in the deed of trust that insurance proceeds be applied to the mortgage principal in lieu of monthly payments. Next, plaintiffs appear to concede through no stated opposition that any claim under California Civil Code section 2923.5 fails because the statute is inapplicable to plaintiffs’ deed of trust. Further, there is no statutory duty to modify a loan under California Civil Code section 2923.6. Moreover, the federal loan/modification programs on which plaintiffs rely do not appear to offer a private right of action or designate borrowers in plaintiffs’ situation as third-party beneficiaries. In addition, it appears that the named beneficiary, MERS, has the right to foreclose on the property, assign its rights and/or make a substitution of trustee. [Citations.] [¶] In order to maintain any claim based on a purported irregularity in the foreclosure sale procedure, plaintiffs are required to allege tender of the amount owed on the secured debt. [Citation.] Plaintiffs fail to adequately allege tender.” The court also noted that the Pfeifers failed to state sufficient facts to support a claim of financial elder abuse.

On July 6, 2011, the court entered judgment in favor of the lenders and stated that the Pfeifers “shall take nothing by their” third amended complaint against the lenders. The Pfeifers filed a timely notice of appeal.

On May 1, 2012, this court on its own motion issued the following order: “The parties are to provide supplemental briefs to address the reasoning in a recent Virginia case, Mathews v. PHH Mortgage Corp. (2012) [724] S.E.2d [196] [(Mathews)] on the issues raised on appeal. Additionally, the parties are to address whether paragraph 9 in
the deed of trust was a negotiated provision and discuss any significance of this issue. Any argument must be supported with citations to the record and explain how the third amended complaint may or may not be amended to address this issue. No other issue may be raised in the supplemental brief. . . .”

On May 11, 2012, this court issued the following order: “The [California] Attorney General is hereby accorded amicus curiae status and is invited to submit an amicus brief on behalf of appellants Allen and Florence Pfeifer. Any such brief should be served and filed by June 15, 2012, and should respond to the cases cited in respondent’s brief, filed on February 17, 2012. We have requested the parties to submit supplemental briefing that will be filed during the month of May 2012, and the supplemental briefs will address why this court should not adopt the analysis of Mathews v. PHH Mortgage Corp., supra, 724 S.E.2d 196]. Any amicus brief the Office of Attorney General chooses to file should likewise address the analysis employed in said case. Any party may serve and file an answer to the amicus brief within 25 days after it is filed. . . .”

The parties filed supplemental briefs and the California Attorney General (the Attorney General) filed an amicus curiae brief on July 16, 2012. Lenders filed a response to the amicus curiae brief on August 9, 2012. On August 10, 2012, we granted the unopposed application by Wells Fargo Bank, N.A. (Wells Fargo) for permission to file an amicus curiae brief in support of the lenders. No response was filed to Wells Fargo’s amicus curiae brief.

DISCUSSION

I. Standard of Review

The standard of review governing an appeal from the judgment after the trial court sustains a demurrer without leave to amend is well established. ‘We treat the demurrer as admitting all material facts properly pleaded, but not contentions, deductions or conclusions of fact or law. [Citation.] We also consider matters which may be judicially noticed.’ [Citation.] Further, we give the complaint a reasonable interpretation, reading it as a whole and its parts in their context. [Citation.] When a demurrer is sustained, we
determine whether the complaint states facts sufficient to constitute a cause of action. [Citation.] And when it is sustained without leave to amend, we decide whether there is a reasonable possibility that the defect can be cured by amendment: if it can be, the trial court has abused its discretion and we reverse; if not, there has been no abuse of discretion and we affirm. [Citations.] The burden of proving such reasonable possibility is squarely on the plaintiff.” (Blank v. Kirwan (1985) 39 Cal.3d 311, 318.)

II. Claim that Recon Violated the FDCPA

The fifth cause of action in the Pfeilers’s third amended complaint alleges a violation of the FDCPA against Recon. The Pfeifers concede that Recon is not liable for any claim against them as a debt collector under California law, but assert that the state law is preempted by the FDCPA (15 U.S.C. § 1692) and Recon is liable for its unfair debt collection under the federal law.

The purpose of the FDCPA is “to eliminate abusive debt collection practices by debt collectors, to insure that those debt collectors who refrain from using abusive debt collection practices are not competitively disadvantaged, and to promote consistent State action to protect consumers against debt collection abuses.” (15 U.S.C. § 1692(e).) The word “‘creditor’ means any person who offers or extends credit creating a debt or to whom a debt is owed, but such term does not include any person to the extent that he receives an assignment or transfer of a debt in default solely for the purpose of facilitating collection of such debt for another.” (15 U.S.C. § 1692a(4).) “The term ‘debt’ means any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.” (15 U.S.C. § 1692a(5).)

The FDCPA defines “‘debt collector’” as “any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the collection of any debts, or who regularly collects or attempts to collect, directly or indirectly, debts owed or due or asserted to be owed or due another. . . .” [T]he
term includes any creditor who, in the process of collecting his own debts, uses any name other than his own which would indicate that a third person is collecting or attempting to collect such debts. . . .” (15 U.S.C. § 1692a(6).)

In order to establish a claim under the FDCPA against Recon, the facts as alleged must show that Recon was a “debt collector” as defined by the Act, that Recon’s challenged conduct constituted “debt collection,” and that the debt collection actions violated a provision of the Act. (See, e.g., Heintz v. Jenkins (1995) 514 U.S. 291, 294.)

In their pleading, the Pfeifers allege that Countrywide retained Recon to collect the debt after Countrywide declared the Pfeifers’ loan in default. They further declared that Recon became the trustee of the deed of trust and that Recon was a “debt collector” as used in the FDCPA. Recon mailed the Pfeifers the notice of default pursuant to Civil Code section 2924, subdivision (c), which stated that the Pfeifers owed $27,313.25 together with unspecified unpaid impound payments. Recon recorded a notice of default and filed the notice of trustee’s sale.

The Pfeifers argue that Recon was a debt collector because it “was hired by the unknown owner of the note and deed of trust for the specific purpose of collecting an alleged default.” It alleged that Recon “recorded a premature notice of default” prior to giving the Pfeifers the notice required by the FDCPA. They maintain that the opinion of the administrative agency responsible for enforcing the Act supports their argument that Recon was a debt collector under the FDCPA and courts should defer to the interpretation of a statute by the administrative agency responsible for enforcing that statute. (See, e.g., Ford Motor Credit Co. v. Milhollin (1980) 444 U.S. 555, 566 [the “general proposition” is “that considerable respect is due ‘ “the interpretation given [a] statute by the officers or agency charged with its administration” ’ ”].)

In support of their argument, the Pfeifers cite the amicus brief by the Consumer Financial Protection Bureau (the Bureau) in Birster v. American Home Mortgage Servicing, Inc. (11th Cir. 2012) 481 Fed. Appx. 579, which is an appeal from Birster v. American Home Mortg. Servicing, Inc. (S.D.Fla. 2011) 796 F.Supp.2d 1376 (Birster).
its amicus brief, the Bureau took an official position that trustees must comply with the entire FDCPA, and not merely title 15 of the United States Code section 1692f(6), in connection with a nonjudicial trustee sale.\(^3\) Title 15 of the United States Code section 1692f(6) defines “debt collector” for this provision as any entity whose “principal purpose” is “the enforcement of security interests.” Six categories of people/entities are specifically excluded from the definition of “debt collector,” but enforcers of security interests do not appear on that list. The Bureau stated that it disagreed with the conclusion of some courts that enforcers of security interests qualify as debt collectors for purposes of title 15 of the United States Code section 1692f(6) and therefore cannot be debt collectors under the FDCPA. The Bureau stated that an entity satisfying both definitions of “debt collector” remains a “debt collector” subject to the entire FDCPA even if it is enforcing a security interest in a particular case.

The amicus brief by the Bureau in Birster did not address whether the pursuit of a foreclosure, by itself, constitutes debt collection under the Act. In Birster, the challenged conduct related to the enforcement of a security interest and included attempts to collect overdue payments that included visiting the home and making harassing and threatening phone calls to induce payment of the debts. (See Birster, supra, 796 F.Supp.2d at p. 1377.) Thus, the Bureau’s amicus brief does not affect the authority that has concluded that acts required to institute foreclosure proceedings, alone, are not debt collection activities under the FDCPA. In Santoro v. CTC Foreclosure Services (9th Cir. 2001) 12 Fed.Appx. 476, the Ninth Circuit considered claims by mortgagors against the loan service company and foreclosure service company for alleged violations under the Act. The court explained that a foreclosure sale notice issued in compliance with Civil Code section 2924 et seq. does not seek to collect a debt and such notices are not the type of conduct that is forbidden under the Act.\(^4\)

\(^3\) We took judicial notice of this amicus brief.

\(^4\) We note that federal courts have conflicting conclusions about the applicability of the FDCPA to the act of foreclosing. (Compare Perry v. Stewart Title Co. (5th Cir.
Similarly, in *Gonzalez v. CNA Foreclosure Service, Inc.* (S.D. Cal. 2011) 2011 WL 2580681, the court concluded that CNA Foreclosure Services, Inc. (CNA) was not a “‘debt collector’ within the meaning of the FDCPA.” (*Gonzalez*, at p. *3.*) It held that a foreclosure sale notice issued in compliance with Civil Code section 2924 et seq. did not seek to collect a debt. (*Gonzalez*, at p. *3.*) The court found that “[t]he sole purpose of CNA’s business is to act as a trustee for lenders to facilitate the foreclosure process. . . . All the information CNA includes in the notices regarding any amounts owed are provided by the lenders, CNA does not interact with the borrowers regarding the amounts owed, nor has CNA ever collected money on behalf of the lenders.” (*Id.* at p. *4.*)

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1985) 756 F.2d 1197, 1208 [holding that mortgagees are not debt collectors under the FDCPA] with *Wilson v. Draper & Goldberg, P.L.L.C.* (4th Cir. 2006) 443 F.3d 373, 376-377 [holding that a trustee sale is a debt collection under the FDCPA].) District courts in the Ninth Circuit have held that “‘foreclosing on a property pursuant to a deed of trust is not a debt collection within the meaning’” of the FDCPA. (See, e.g., *Izenberg v. ETS Services, LLC* (C.D.Cal. 2008) 589 F.Supp.2d 1193, 1199; *Hulse v. Ocwen Federal Bank, FSB* (D.Or. 2002) 195 F.Supp.2d 1188, 1204.)

In their supplemental brief, the Pfeifers argue that the deed of trust incorporates the foreclosure protections in the FDCPA. Our court order requesting supplemental briefing did not permit argument on this issue, and we therefore will not consider this argument. Furthermore, we note that no such allegation was set forth in the Pfeifers’ third amended complaint.

The Pfeifers also cite in their supplemental brief, *Reese v. Ellis, Painter, Ratterree & Adams, LLP* (11th Cir. 2012) 678 F.3d 1211, a case recently decided, to support their argument that they have a private right of action under the FDCPA. Since this case was decided after the original briefs were filed in this court, we will briefly address the applicability of this case to the Pfeifers’ claim of an action under the FDCPA. In *Reese*, a law firm representing the lender sent the plaintiffs a letter and documents demanding payment. The documents specifically stated that the law firm “‘IS ATTEMPTING TO COLLECT A DEBT’” and that “‘THIS LAW FIRM IS ACING AS A DEBT COLLECTOR ATTEMPTING TO COLLECT A DEBT.’” (*Reese*, at p. 1217.) We thus conclude that *Reese* is clearly distinguishable from the present case; the Pfeifers have not alleged that there is any document from Recon that included collection demand language or an assertion by Recon that it was attempting to collect a debt other than the notice required under Civil Code section 2924.
The Pfeifers have alleged that Recon sent a notice of the pending foreclosure sale, but this allegation is insufficient to show that Recon engaged in debt collection activities bringing it under the ambit of the FDCPA. We agree with those courts that have held that giving notice of a foreclosure sale to a consumer as required by the Civil Code does not constitute debt collection activity under the FDCPA.5

We need not consider the Pfeifers’ contention that the FDCPA creates a private cause of action for injunctive relief. Since we conclude that the Pfeifers have not made a claim under the FDCPA, we need not consider what remedies are available under this Act.

III. Foreclosing Without First Complying with the HUD Servicing Regulations

A. Introduction

The Pfeifers have a mortgage insured by the FHA, and the terms of their note and mortgage subject the mortgage to the servicing requirements under HUD. In their pleading, the Pfeifers allege that the lenders began foreclosing on their property without adhering to the HUD servicing requirements, as they did not have a face-to-face interview with them as required by the Code of Federal Regulations.6 (See 24 C.F.R. § 203.604; see also 24 C.F.R. § 203.500.) They maintain that the HUD regulations are conditions precedent that must be complied with prior to a mortgagee’s having the right to foreclose. Consequently, they maintain that, as alleged in their pleading, they are entitled to a restraining order based on wrongful foreclosure and a court order declaring that any

5 The lenders argue that the Pfeifers’ attempt to distinguish between debt collection and security interest enforcement is artificial. We need not consider whether there is a significant distinction for purposes of the FDCPA because, as already discussed, the only “debt collection” activity alleged by the Pfeifers is that Recon gave notice of a foreclosure as mandated by the Civil Code; thus, we conclude that Recon was not a debt collector under the Act.

6 The Pfeifers allege that the lenders did not comply with the loss mitigation measures required by Civil Code section 2923.5, but their allegations regarding the lenders’ failure to comply with the HUD servicing requirements is limited to the requirement of a face-to-face interview.
attempt to foreclose would be void as the lenders did not satisfy a condition precedent to foreclosure.

The lenders respond that they did not have to comply with the face-to-face servicing requirement. They assert that HUD regulations are concerned exclusively with the relations between the mortgagee and the government and do not create any duties to the borrower. They maintain that the Pfeifers are attempting to sidestep the well-settled holding that the federal regulations provide no private right of action for mortgagors. (See, e.g., Roberts v. Cameron-Brown Co. (5th Cir. 1977) 556 F.2d 356, 360.) Moreover, they argue that state law does not permit placing additional requirements onto the statutory nonjudicial foreclosure scheme. Additionally, they assert that even if the HUD loss mitigation requirements are conditions precedent, the face-to-face interview is not required. Moreover, the Pfeifers never paid or alleged that they would pay their entire loan and therefore, according to the lenders, they cannot claim wrongful foreclosure.

B. Relevant Law

As already noted, the Pfeifers have a mortgage insured by the FHA. Congress created the FHA through the National Housing Act of 1934 (NHA). (See Nehemiah Corp. of America v. Jackson (E.D. Cal. 2008) 546 F.Supp.2d 830, 834.) In 1965, the FHA became a part of HUD and it is still a component of HUD. (Nehemiah Corp., at p. 834, citing 42 U.S.C. § 3534(a).) HUD promulgated mortgage-servicing regulations under the authority granted to it by the NHA (12 U.S.C. § 1701 et seq.) in order to carry out its loan insurance programs. The NHA provides: “Upon default or imminent default . . . of any mortgage insured under this [title], mortgagees shall engage in loss mitigation actions for the purpose of providing an alternative to foreclosure . . . .” (12 U.S.C. § 1715u(a), fn. omitted.)

Under the NHA, mortgagees are induced to make essentially risk-free mortgages by being guaranteed against loss in the event of default by the mortgagor. (Anderson v. U.S. Dept. of Housing & Urban Dev. (10th Cir. 1983) 701 F.2d 112, 113-114.) This program allows mortgagees to offer loans to low-income families at a more favorable rate
than would otherwise be available in the market. (Ibid.) The availability of affordable mortgages, in turn, promotes Congress’s “national goal” of “‘a decent home and suitable living environment for every American family.’” (12 U.S.C. § 1701t.)

Pursuant to the authority conferred by Congress, HUD promulgated regulations pertaining to HUD-insured mortgages. The regulations regarding a mortgagee’s servicing responsibilities of such mortgages are codified in title 24, part 203 (Single Family Mortgage Insurance), subpart C (Servicing Responsibilities) of the Code of Federal Regulations. (24 C.F.R. § 203.500 et seq.)

For mortgages insured by the FHA, servicers are required to follow servicing regulations mandated by the HUD Secretary before initiating foreclosure. (Wells Fargo v. Neal (2007) 398 Md. 705, 719-720 [922 A.2d 538, 546-547]; 12 U.S.C. § 1709 et seq.; 24 C.F.R. § 203.500 et seq.) Title 24 of the Code of Federal Regulations provides in pertinent part: “It is the intent of [HUD] that no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this subpart have been followed.” (24 C.F.R. § 203.500.) Elsewhere, the regulations require that “[b]efore initiating foreclosure, the mortgagee must ensure that all servicing requirements of this subpart have been met. . . .” (24 C.F.R. § 203.606(a).) Except in specific circumstances not relevant to the allegations set forth in the present case: “The mortgagee must have a face-to-face interview with the mortgagor, or make a reasonable effort to arrange such a meeting, before three full monthly installments due on the mortgage are unpaid. If default occurs in a repayment plan arranged other than during a personal interview, the mortgagee must have a face-to-face meeting with the mortgagor, or make a reasonable attempt to arrange such a meeting within 30 days after such default and at least 30 days before foreclosure is commenced . . . .” (24 C.F.R. § 203.604(b).)

C. The Deed of Trust

The FHA deed of trust in the present case, at paragraph 9, sets forth the “grounds for acceleration of debt.” When a default occurs, this paragraph provides under subdivision (a) that the “[l]ender may, except as limited by regulations issued by the
Secretary, in the case of payment defaults, require immediate payment in full of all sums secured by this Security Instrument . . . .” In subdivision (d), under the heading of “Regulations of HUD Secretary,” the agreement reads as follows: “In many circumstances regulations issued by the Secretary will limit Lender’s rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security instrument does not authorize acceleration or foreclosure if not permitted by regulations of the Secretary.”

Paragraph 18 in the deed of trust includes a provision for appointment of a foreclosure commissioner to conduct the nonjudicial trustee sale if the loss mitigation provisions required by paragraph 9 are unsuccessful.

D. The Face-to-Face Interview as a Condition Precedent

1. The Lenders’ Obligations Under the FHA Deed of Trust

The Attorney General in its amicus brief and the Pfeifers contend that the abovementioned language in paragraph 9 of the deed of trust requires compliance with the HUD regulations prior to initiating a foreclosure. “The rights and powers of trustees in nonjudicial foreclosure proceedings have long been regarded as strictly limited and defined by the contract of the parties and the statutes.” (I.E. Associates v. Safeco Title Ins. Co. (1985) 39 Cal.3d 281, 287.)

“In contract law, ‘a condition precedent is either an act of a party that must be performed or an uncertain event that must happen before the contractual right accrues or the contractual duty arises.’ [Citation.] The existence of a condition precedent normally depends upon the intent of the parties as determined from the words they have employed in the contract. [Citation.]” (Realmuto v. Gagnard (2003) 110 Cal.App.4th 193, 199.)

Here, the express language of paragraph 9 in the deed of trust states that the mortgagee is not authorized to foreclose on a property “if not permitted by” the HUD regulations. The HUD regulations require face-to-face meetings (24 C.F.R. § 203.604) and, as alleged in the third amended complaint, such meetings did not occur in the present case. Additionally, as set forth above, the HUD regulations also specify that “no
mortgagee shall commence foreclosure or acquire title to a property until” these HUD regulations have been followed. (24 C.F.R. § 203.500; see also 24 C.F.R. § 203.606(a).)

The lenders and Wells Fargo in its amicus brief argue that the duties under the regulations run to HUD, not the borrower. The lenders argue that paragraph 9 in the deed of trust, which governs acceleration and default, references regulations promulgated pursuant to a statute under which the Pfeifers have no private right of action and the Pfeifers are attempting to avoid the consequences of having no standing to assert a claim under the NHA. (See Davies v. Sallie Mae, Inc. (2008) 168 Cal.App.4th 1086, 1094-1096.) The NHA “and the regulations promulgated thereunder deal only with the relations between the mortgagee and the government, and give the mortgagor no claim to duty owed nor remedy for failure to follow.” (Roberts v. Cameron-Brown Co., supra, 556 F.2d at p. 360.) Thus, courts have refused to imply a private right of action under the NHA and its implementing regulations. (See Moses v. Banco Mortg. Co. (5th Cir. 1985) 778 F.2d 267, 277-273, fn. 2.) The lenders and Wells Fargo maintain that the Pfeifers’ claim requires the court to interpret the regulations issued by the Secretary under the NHA. Thus, according to the lenders and Wells Fargo, the Pfeifers are attempting to enforce provisions of the NHA and to use state contract law to circumvent Congress’s choice not to grant a private right.

The question before us is not the enforcement of the regulations under the NHA and the lenders’ duty to HUD. Rather, the issue is whether foreclosure is proper if the lender has not complied with the HUD servicing requirements as set forth in the FHA deed of trust. This does not require this court to enforce provisions of the NHA, but simply prevents a nonjudicial foreclosure when the borrower has an equitable defense based on the failure to comply with federal regulations designed to prevent foreclosures that are incorporated into the FHA deed of trust.

Courts have held that the HUD regulations, including the failure to make a reasonable attempt to conduct a face-to-face meeting with borrowers before initiating a foreclosure suit, are conditions precedent and must be followed before a mortgagee has
the right to foreclose on a HUD-insured property. Courts have held that a mortgagee’s noncompliance can be asserted as an affirmative defense or an equitable defense to a judicial-foreclosure action. (See e.g., Lacy-McKinney v. Taylor, Bean & Whitaker Mortg. Corp. (Ind.Ct.App. 2010) 937 N.E.2d 853, 864; Wells Fargo v. Neal, supra, 922 A.2d at pp. 543-544; Washington Mut. Bank v. Mahaffey (Ohio Ct.App. 2003) 154 Ohio App.3d 44, 49-51 [796 N.E.2d 39, 42-44]; Federal Land Bank of St. Paul v. Overboe (N.D. 1987) 404 N.W.2d 445, 449; Fleet Real Estate Funding Corp. v. Smith (1987) 366 Pa. Super. 116, 121-124 [530 A.2d 919, 922-923]; Bankers Life Co. v. Denton (1983) 120 Ill.App.3d 576, 579 [458 N.E.2d 203, 205].) These cases hold that the HUD regulations do not create an implied cause of action for damages, but may be used defensively as an affirmative defense to a judicial foreclosure action instituted by the creditor. (See, e.g., Wells Fargo, at pp. 543-544.) Thus, the court in Wells Fargo held that the mortgagee could not state an affirmative cause of action for breach of contract, but could raise a violation of the regulations in pursuit of an injunction blocking foreclosure. (Id. at p. 541.)

The lenders maintain that the foregoing cases are distinguishable because they did not involve a nonjudicial foreclosure. The parties did not cite, nor did we locate, any California case directly addressing the issue raised by this appeal. This court, however, did locate a case from another jurisdiction, Mathews, supra, 724 S.E.2d 196, which involved a FHA mortgage, a claim that the deed of trust incorporated the HUD regulations and that the mortgagee failed to follow the regulations, and a nonjudicial foreclosure sale. We thus requested supplemental briefing by the parties to address the application and reasoning of Mathews.

2. The Reasoning of the Court in Mathews

In Mathews, supra, 724 S.E.2d 196, the borrowers had an FHA loan and they sought declaratory relief that a pending foreclosure sale would be void based on the

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7 The Pfeifers also cite Kersey v. PHH Mortgage Corp. (E.D. Va. 2010) 682 F.Supp.2d 588. However, this opinion was vacated on August 13, 2010.
mortgagee’s failure to carry out the face-to-face interview before initiating foreclosure. 
(Id. at p. 198.) The court noted that “[a] trustee’s power to foreclose is conferred by the deed of trust” and “[t]hat power does not accrue until its conditions precedent have been fulfilled.” (Id. at p. 199.) The deed of trust in Mathews contained the identical provisions as paragraphs 9 and 18 of the Pfeifers’ deed of trust. The Mathews court noted that HUD requires that a FHA deed of trust state expressly that it “does not authorize acceleration or foreclosure if not permitted by the regulations of the Secretary.” (Mathews, at p. 201, italics omitted.) The Mathews court observed that “[t]hese words ‘are clear and unambiguous’ ” and that “[t]hey express the intent of the parties that the rights of acceleration and foreclosure do not accrue under the Deed of Trust unless permitted by HUD’s regulations.” (Ibid.) The court concluded that “the references to HUD’s regulations in the Deed of Trust are sufficient to incorporate them insofar as they prevent the borrower from [the lenders’] accelerating or foreclosing.” (Ibid.) The court reasoned that these regulations were enforceable by borrowers as conditions precedent to acceleration and foreclosure because HUD, section 203.17(a), requires the language in paragraph 9 to be incorporated into FHA deeds of trusts. (Mathews, at p. 202.)

3. The Policies Underlying the HUD Servicing Requirements

The lenders argue that the reasoning in Mathews is flawed. They maintain that the federal regulations required to be incorporated into the FHA deeds of trust are for HUD’s benefit, to minimize HUD’s losses, and are not to protect the consumers. (See 24 C.F.R. §§ 203.500 & 203.501.)

The lenders discount the reasoning in Mathews partially because they claim that the Mathews court ignored the principal purpose of the HUD servicing requirements.

We agree that a principal purpose of the HUD regulations is to benefit HUD, and we agree with the reasoning of those courts that hold that the Pfeifers cannot bring a private right of action against the lenders. “The overall purpose of the FHA mortgage

8 All further unspecified code sections refer to title 24 of the Code of Federal Regulations.
insurance program is to encourage leading lenders, in exchange for a government
guarantee of the loan, to extend mortgages to those carrying higher credit risks. . . . Thus,
the regulations do not control directly the relationship between the mortgagor and
mortgagee and may not be invoked by the mortgagor as a sword in an offensive cause of
action against the mortgagee.” (Wells Fargo v. Neal, supra, 922 A.2d at p. 546.)

The lenders, however, discount that another goal of the HUD servicing regulations
is to prevent foreclosure in HUD mortgages. The court in Lacy-McKinney v. Taylor Bean
& Whitaker Mortg. Corp., supra, 937 N.E.2d 853, observed that the public policy of
HUD supported a conclusion that the HUD servicing responsibilities “are binding
conditions precedent that must be complied with before a mortgagee has the right to
foreclose on a HUD property.” (Id. at pp. 863-864.) The court cited the policy, which
had been explicitly set forth by a New Jersey court, as follows: “‘Families who receive
HUD-insured mortgages do not meet the standards required for conventional mortgages.
It would be senseless to create a program to aid families for whom homeownership would
otherwise be impossible without promulgating mandatory regulations for HUD-approved
mortgagees to insure that objectives of the HUD program are met. Foreseeable obstacles
to these families’ maintaining regular payments, such as temporary illness, unemployment
or poor financial management, should be handled with a combination of understanding
and efficiency by mortgagees or servicers. Poor servicing techniques such as
computerized form letters and unrealistic forbearance agreements as were used by
Associated defeat the purpose of the NHA and the HUD program. The prevention of
foreclosure in HUD mortgages wherever possible is essential. The HUD program’s
objectives cannot be attained if HUD’s involvement begins and ends with the purchase of
the home and the receipt of a mortgage by a low-income family.’ ” (Id. at p. 863, quoting
906].)

Accordingly, we reject the lenders’ argument that the purpose of the HUD
servicing requirements is to benefit HUD exclusively and conclude that a significant
purpose is to prevent foreclosures, which also benefits the borrower.

4. State Law and HUD Regulations

When distinguishing between cases involving judicial foreclosures and nonjudicial foreclosures, the lenders maintain that California adheres to a strict statutory scheme for nonjudicial foreclosure, which is codified in Civil Code sections 2924 et seq. They contend that California law does not permit the courts to graft new requirements onto the statutory nonjudicial foreclosure requirements. They rely on *Moeller v. Lien* (1994) 25 Cal.App.4th 822 (*Moeller*) and *I.E. Associates v. Safeco Title Ins. Co., supra*, 39 Cal.3d at page 287 when advancing this argument.

As explained in *California Golf, L.L.C. v. Cooper* (2008) 163 Cal.App.4th 1053 (*California Golf*), the cases cited by the lenders “did not conclude that no remedies outside those provided by the nonjudicial foreclosure statutes are available simply because the Legislature intended to occupy the field. Instead, [these courts] also considered the policies advanced by the statutory scheme, and whether those policies would be frustrated by the allowance of the additional remedy. (*I.E. Associates v. Safeco Title Ins., supra*, 39 Cal.3d at pp. 288-289 [concluding that expanding the notice obligations of the trustee would not be supported by policy]; [see also,] *Residential Capital v. Cal-Western Reconveyance Corp.* [(2003)] 108 Cal.App.4th [807,] 827, 829, [declining to ‘graft[ ] a tort remedy onto a comprehensive statutory scheme in the absence of a compelling justification for doing so,’] and concluding that the addition of the proposed remedy would not fit within the comprehensive statutory scheme]; *Moeller v. Lien, supra*, 25 Cal.App.4th at p. 834 [concluding that ‘[i]t would be inconsistent with the comprehensive and exhaustive statutory scheme regulating nonjudicial foreclosures to incorporate another unrelated cure provision into statutory nonjudicial foreclosure proceedings’].)” (*California Golf*, at p. 1070.)

The court in *California Golf, supra*, 163 Cal.App.4th 1053, noted the following: “It is clear, then, that the mere existence of a comprehensive statutory scheme does not necessarily eliminate all further remedies without the consideration of the relevant policy
concerns. Indeed, California courts have repeatedly allowed parties to pursue additional remedies for misconduct arising out of a nonjudicial foreclosure sale when not inconsistent with the policies behind the statutes. In *Alliance Mortgage Co. v. Rothwell* (1995) 10 Cal.4th 1226, 1231, . . . , our Supreme Court concluded that a lender who obtained the property with a full credit bid at a foreclosure sale was not precluded from suing a third party who had fraudulently induced it to make the loan. The court concluded that ‘“the antideficiency laws were not intended to immunize wrongdoers from the consequences of their fraudulent acts”’ and that, if the court applies a proper measure of damages, ‘“fraud suits do not frustrate the antideficiency policies because there should be no double recovery for the beneficiary. ”’ (Id. at p. 1238.) In *South Bay Building Enterprises, Inc. v. Riviera Lend-Lease, Inc.* (1999) 72 Cal.App.4th 1111, 1121, . . . , the court held that a junior lienor retains the right to recover damages from the trustee and the beneficiary of the foreclosing lien if there have been material irregularities in the conduct of the foreclosure sale. (See also *Melendrez v. D & I Investment, Inc.* [(2005)] 127 Cal.App.4th [1238,] 1257-1258; *Lo v. Jensen* (2001) 88 Cal.App.4th 1093, 1095 . . . [a trustee’s sale tainted by fraud may be set aside].)” (*California Golf*, at pp. 1070-1071.) The court in *California Golf* concluded that the policy interests furthered by the statutory scheme governing nonjudicial foreclosure sale were not undermined by the policy interests underlying Commercial Code section 3312, which governs the use of cashier’s checks. (*California Golf*, at pp. 1071-1072.)

Here, the lenders have not persuasively argued that obligating lenders to comply with HUD’s face-to-face interview requirements in FHA loans would compromise the policy regarding nonjudicial foreclosure sales. The purposes for the nonjudicial foreclosure statutes are the following: ‘‘‘(1) to provide the creditor/beneficiary with a quick, inexpensive and efficient remedy against a defaulting debtor/trustor; (2) to protect the debtor/trustor from wrongful loss of the property; and (3) to ensure that a properly conducted sale is final between the parties and conclusive as to a bona fide purchaser.’’’ [Citations.]” [Citation.]’ [Citation.]” (*California Golf, supra*, 163 Cal.App.4th at p.
1070.) Requiring compliance with the HUD face-to-face interview would not deprive the lenders of a quick and inexpensive remedy; it merely would ensure that the lenders comply with the express terms set forth in the HUD regulations and incorporated into the FHA deeds of trust prior to seeking this quick and inexpensive remedy. Furthermore, the goal of protecting the borrower from a wrongful loss of property is enhanced as the interview may prevent the need for foreclosure. The lenders voluntarily agreed to purchase these FHA loans in exchange for the government’s backing against default. Thus, as the Attorney General stresses, they voluntarily subjected themselves to the additional requirements designed to avoid the necessity for foreclosure.

5. The Interview as Distinct from Loss Mitigation Measures

The lenders argue that even if loss mitigation measures in the HUD servicing regulations are conditions precedent, the face-to-face interview is not. They maintain that the interview requirement is to establish a repayment plan and is not intended as a loss mitigation measure. They assert that the face-to-face interviews are not a material term in the deed of trust and the failure to have face-to-face interviews does not prejudice the borrower.

The lenders emphasize that section 203.501 identifies the loss mitigation measures, and the interview is not mentioned in this provision. Unlike the loss mitigation measures, the interview requirement does not require the lender to offer any relief to the borrower. The HUD regulations impose the duty to mitigate “[b]efore four full monthly

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9 Section 203.501 reads: “Mortgagees must consider the comparative effects of their elective servicing actions, and must take those appropriate actions which can reasonably be expected to generate the smallest financial loss to the Department. Such actions include, but are not limited to, deeds in lieu of foreclosure under § 203.357, pre-foreclosure sales under § 203.370, partial claims under § 203.414, assumptions under § 203.512, special forbearance under §§ 203.471 and 203.614, and recasting of mortgages under § 203.616. HUD may prescribe conditions and requirements for the appropriate use of these loss mitigation actions, concerning such matters as owner-occupancy, extent of previous defaults, prior use of loss mitigation, and evaluation of the mortgagor’s income, credit and property.”
installments due on the mortgage have become unpaid” (§ 203.605(a)), but the interview must take place “before three full monthly installments due on the mortgage are unpaid” (§ 203.604(b)). Thus, the duty to mitigate, according to the lenders, arises only after the borrower misses four monthly payments. They argue that paragraph 9 should be construed narrowly to incorporate only those sections that deal specifically with a failure to make payments due.

The lenders add that HUD’s own 1989 notice of policy published in the Federal Register, which addressed the creation of mortgage instruments for use in the FHA mortgage insurance program, supports their position that paragraph 9 is required simply to “inform the borrower” of HUD’s servicing responsibilities, and does not indicate a requirement that the interview be completed prior to foreclosure. The lenders quote extensively from HUD’s notice of policy, which was published on June 29, 1989, under “Requirements for Single Family Mortgage Instruments” in the Federal Register. Under section 27599, it states the following: “A commenter made specific suggestions to eliminate language referring to regulations issued by the Secretary in the default section of the mortgage instrument as well as other similar references. The commenter noted that such language would create foreclosure proceedings that would be more time consuming and expensive. The borrower’s attorneys could commence exhaustive discovery to determine whether the lender met all of the servicing requirements. We rejected the commenter’s suggestions that the references to regulations by the Secretary will impair the lender’s ability to successfully defend a suit. HUD does not intend to create a conflict between the mortgage language and regulations, and there should be no adverse impact of informing the borrower that some regulations procedures exist which limit a lender’s rights to foreclose.” (54 Fed.Reg. 27599 (June 9, 1989).)

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10 Section 203.605(a) provides that the duty to mitigate is as follows: “Before four full monthly installments due on the mortgage have become unpaid, the mortgagee shall evaluate on a monthly basis all of the loss mitigation techniques provided at § 203.501 to determine which is appropriate. Based upon such evaluations, the mortgagee shall take the appropriate loss mitigation action. . . .”
The HUD’s notice of policy continues as follows: “We note that the proposed mortgage language does not incorporate all of HUD’s servicing requirements into the mortgage, but simply prevents acceleration and foreclosure on the basis of the mortgage language when foreclosure would not be permitted by HUD regulations. For example, [section] 203.606, specifically prohibits a mortgagee from foreclosing unless three full monthly payments due on the mortgage are unpaid. As long as this requirement remains in the regulations, we do not expect mortgagees to violate it even though the mortgage fails to repeat the requirement, and we believe that a borrower could appropriately raise the regulatory violation in his or her defense. If a mortgagee has violated parts of the servicing regulations which do not specifically state prerequisites to acceleration or foreclosure, however, the reference to regulations in the mortgage would not be applicable. HUD retains the general position recited in [section] 203.500, that whether a mortgagee’s refusal or failure to comply with servicing regulations is a legal defense is a matter to be determined by the courts.” (54 Fed.Reg. 27599.)

The language in the Federal Register cited by the lenders does not evince an intent to permit lenders to ignore the interview requirement. This language does not indicate that the loss mitigation measures are the sole requirements preventing acceleration and foreclosure. (See 54 Fed.Reg. 27599.) The deed of trust incorporates the interview requirements and it would be inappropriate to deny that this contract language has any effect.

As already discussed, the deed of trust expressly incorporated regulations issued by the HUD Secretary, including the requirement of a face-to-face interview, and such regulations must be followed prior to acceleration and foreclosure. The commencement of the duty to mitigate and the interview are not mutually exclusive.

Moreover, we disagree with the lenders that the interview is not a material term and has no benefit for the borrower. As already discussed, a clear objective of the HUD servicing objectives is to minimize the possibility of foreclosure. “Collection techniques must be adapted to individual differences in mortgagors and take account of the
circumstances peculiar to each mortgagor.” (§ 203.600.) Under the HUD regulations, a lender is required to “have a face-to-face interview with the mortgagor, or make a reasonable effort to arrange such a meeting, before three full monthly installments due on the mortgage are unpaid. If default occurs in a repayment plan arranged other than during a personal interview, the mortgagee must have a face-to-face meeting with the mortgagor, or make a reasonable attempt to arrange such a meeting within 30 days after such default and at least 30 days before foreclosure is commenced . . . .” (§ 203.604(b).) A face-to-face meeting is intended to occur before the duty to mitigate arises and provides the lender with the opportunity to discuss a repayment plan and to inform the borrower of any other available assistance; this is especially significant when the borrower has a general lack of experience in financial management and limited access to information about resources to avoid foreclosure. This provision may not require a lender to grant the borrower forbearance or a loan modification, but it does provide the lender with the opportunity to discuss various options and resources with the borrower to avoid further default.

One of the purposes of the interview is to provide borrowers with information about possible resources or loss mitigation options that might have permitted them to avoid foreclosure. “One of the largest complaints of homeowners who are sued in foreclosure is that when they began having trouble making payments, they were unable to have any meaningful communication with their lender regarding their circumstances or options.” (Bahls & Hunt, Abhorring a Forfeiture: The Importance of Equitable Jurisdiction in a Foreclosure Crisis (2012) 41 Stetson L.Rev. 779, 806, fn. omitted.) In Bankers Life Co. v Denton, supra, 458 N.E.2d 203, the court concluded that the legislative purpose of the NHA “is to assist in providing a decent home and a suitable living environment for every American family. Thus, the primary beneficiaries of the [NHA] and its implementing regulations are those receiving assistance through its various housing programs. This would include the . . . mortgagors of a [HUD] insured mortgage.” (Bankers Life, at p. 205.)
We conclude that the face-to-face interview is a material term in the FHA deed of trust and failing to comply with this term is prejudicial to the borrower.

6. *The Ejusdem Generis Doctrine Does Not Apply*

The lenders contend that the *Mathews* court incorrectly read into paragraph 9 of the deed of trust the interview as a condition precedent to foreclosure as the *Mathews* court failed to apply the *ejusdem generis* canon of construction.

“Under the principle of *ejusdem generis* (literally, ‘of the same kind’) [citations], where specific words follow general words in a contract, ‘the general words are construed to embrace only things similar in nature to those enumerated by the specific words.’ [Citations].” (*Nygard, Inc. v. Uusi-Kerttula* (2008) 159 Cal.App.4th 1027, 1045, fn. omitted; see also *Huverserian v. Catalina Scuba Luv, Inc.* (2010) 184 Cal.App.4th 1462, 1468-1469.)

The lenders claim that paragraph 9 permits acceleration of the entire amount due if the borrower fails “to pay in full any monthly payment required by this Security Instrument prior to or on the date of the next monthly statement” or fails “for a period of thirty days, to perform any other obligations contained in this Security Instrument.” They argue that under the *ejusdem generis* rule, the reference to “except as limited by regulations issued by” HUD, which is at the beginning of the paragraph, must be interpreted to refer to regulations of the same kind. Regulations of the same kind, they argue, are found under section 203.606.11 Paragraph 9, according to the lenders, refers to

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11 Section 203.606 provides: “(a) Before initiating foreclosure, the mortgagee must ensure that all servicing requirements of this subpart have been met. The mortgagee may not commence foreclosure for a monetary default unless at least three full monthly installments due under the mortgage are unpaid after application of any partial payments that may have been accepted but not yet applied to the mortgage account. In addition, prior to initiating any action required by law to foreclose the mortgage, the mortgagee shall notify the mortgagor in a format prescribed by the Secretary that the mortgagor is in default and the mortgagee intends to foreclose unless the mortgagor cures the default.

“(b) If the mortgagee determines that any of the following conditions has been met, the mortgagee may initiate foreclosure without the delay in foreclosure required by
regulations that prohibit or permit debt acceleration under sections 203.550(d) and 203.554. Thus, according to the lenders, a foreclosure cannot occur in only those situations where the default is a present inability to pay a substantial escrow shortage or the default is a failure to pay a late charge or charges. The lenders declare that HUD’s own policy statement, as set forth in the Federal Register, stated that not all of HUD’s servicing requirements were incorporated into the mortgage.

paragraph (a) of this section: (1) The mortgaged property has been abandoned, or has been vacant for more than 60 days. (2) The mortgagor, after being clearly advised of the options available for relief, has clearly stated in writing that he or she has no intention of fulfilling his or her obligation under the mortgage. (3) The mortgaged property is not the mortgagor’s principal residence and it is occupied by tenants who are paying rent, but the rental income is not being applied to the mortgage debt. (4) The property is owned by a corporation or partnership.” (§ 203.606)

12 Section 203.550(d) states: “The mortgagee shall not institute foreclosure when the only default of the mortgagor occupant is a present inability to pay a substantial escrow shortage, resulting from an adjustment pursuant to this section, in a lump sum.”

13 Section 203.554 provides: “(a) A mortgagee shall not commence foreclosure when the only default on the part of the mortgagor is the failure to pay a late charge or charges (§ 203.25), except as provided in § 203.556. (b) A late charge attributable to a particular installment payment due under the mortgage shall not be deducted from that installment. However, if the mortgagee thereafter notifies the mortgagor of his obligation to pay a late charge, such a charge may be deducted from any subsequent payment or payments submitted by the mortgagor or on his behalf if this is not inconsistent with the terms of the mortgage. Partial payments shall be treated as provided in 203.556. (c) A payment may be returned because of failure to include a late charge only if the mortgagee notifies the mortgagor before imposition of the charge of the amount of the monthly payment, the date when the late charge will be imposed and either the amount of the late charge or the total amount due when the late charge is included. (d) During the 60-day period beginning on the effective date of transfer of the servicing of a mortgage, a late charge shall not be imposed on the mortgagor with respect to any payment on the loan. No payment shall be treated as late for any other purpose if the payment is received by the transferor servicer, rather than the transferee servicer that should receive the payment, before the due date (including any applicable grace period allowed under the mortgage documents) applicable to such payment.”

14 The language in HUD’s policy statement quoted by the lenders is the following: “We note that the proposed mortgage language does not incorporate all of HUD’s servicing requirements into the mortgage, but simply prevents acceleration and
We reject the lenders’ argument that we should apply the *ejusdem generis* rule. The doctrine of *ejusdem generis* is employed as an interpretive aid only when the language in the contract or statute is ambiguous. (*The Zumbrun Law Firm v. California Legislature* (2008) 165 Cal.App.4th 1603, 1619.) Moreover, use of the *ejusdem generis* doctrine is inappropriate where to do so “would frustrate the intent underlying the statute.” (*Moore v. California State Bd. of Accountancy* (1992) 2 Cal.4th 999, 1012; see also *Huverserian v. Catalina Scuba Luv, Inc.*, supra, 184 Cal.App.4th at pp. 1468-1469 [*“In a contract, ‘[w]here general words follow the enumeration of particular kinds or classes of persons or things, the general words will, unless a contrary intent is manifested, be construed as applicable only to persons or things of the same general nature or class as those specifically enumerated” ’ “*].)

We disagree that there is an ambiguity in paragraph 9, and no language in the deed of trust indicates that the interview requirement under the HUD regulations is to be excluded. The lenders’ construction clearly frustrates the intent of the parties as expressly set forth in the deed of trust. Paragraph 9 unambiguously states that all of the HUD regulations apply and, in subdivision (d), of paragraph 9, under the heading of “Regulations of HUD Secretary,” the agreement reads as follows: “In many circumstances regulations issued by the Secretary will limit Lender’s rights, in the case of payment defaults, to require immediate payment in full and foreclose if not paid. This Security instrument *does not authorize acceleration or foreclosure if not permitted by regulations* of the Secretary.” (Italics added.)

Furthermore, the HUD regulations make it plain that mortgagees must comply with all servicing requirements, including the interview requirements, prior to foreclosing. The HUD regulations provide in pertinent part as follows: “It is the intent of [HUD] that no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this subpart have been followed.” (§ 203.500.) Elsewhere, the foreclosure on the basis of the mortgage language when foreclosure would not be permitted by HUD regulations.” (54 Fed.Reg. 27599.)
regulations require that “[b]efore initiating foreclosure, the mortgagee must ensure that all servicing requirements of this subpart have been met. . . .” (§ 203.606(a).)

Similarly to Mathews, numerous courts in various jurisdictions hold that the face-to-face interview is a condition precedent to foreclosure. (See, e.g., U.S. Bank, N.A. v. Detweiler (2010) 191 Ohio App.3d 464, 472 [946 N.E.2d 777, 783]; Lacy-McKinney v. Taylor, Bean & Whitaker Mortg. Corp., supra, 937 N.E.2d at p. 864; Bankers Life Co. v. Denton, supra, 458 N.E.2d at p. 205.) We agree with these decisions that the HUD regulations are conditions precedent that must be followed before a mortgagee has the right to initiate a nonjudicial foreclosure on a FHA mortgage. Under the clear and unambiguous language in paragraph 9 of the deed of trust, the lenders had to comply with the HUD servicing regulations before commencing foreclosure on the Pfeiffer’s FHA mortgage. Here, according to the Pfeifers’ third amended complaint, the lenders did not comply with the HUD regulations, as they did not have a face-face interview. (See § 203.604; see also § 203.500 [“no mortgagee shall commence foreclosure or acquire title to a property until the requirements of this subpart have been followed”].)

Wells Fargo in its amicus brief maintains that the Mathews court did not recognize the limitation on section 203.604(c) that provides that a face-to-face meeting is not required if the “‘mortgaged property is not within 200 miles of the mortgagee, its servicer, or a branch office of either.’” It argues that the Mathews court incorrectly interpreted “branch office” to mean “every type of business and service supplied by the mortgagee, including loan origination . . . .” (Mathews, supra, 724 S.E.2d at pp. 203-204.) The interpretation of “branch office” is not an issue before us. The Pfeifers have alleged that the lenders did not have a face-to-face interview as required by the Code of Federal Regulations. Whether a face-to-face interview actually occurred and whether such an interview was not required because the mortgaged property was not within 200 miles of the “mortgagee, its servicer, or a branch office of either,” are factual issues not currently before us.
7. *The Significance of Requiring Specific Language in the FHA Deed of Trust*

At this court’s request, we asked the parties to discuss whether the HUD regulations were actually negotiated and whether the fact that these terms were mandated by the regulations was significant. The borrowers claim that they did negotiate for these terms and request leave to amend their pleading to add this claim. The lenders maintain that these terms were not negotiated and merely reflect the language required by section 203.17(a)(2)(i) to be in the deed of trust. We will presume for the purposes of this appeal that the terms were not negotiated, as it is clear that all FHA deeds of trust include this requisite language.

We, however, agree with the *Mathews* court that the fact that this language is mandated is of no consequence. The *Mathews* court rejected the argument that the language in the deed of trust should not be construed to incorporate the regulations because the language was imposed by HUD rather than negotiated by the parties. (*Mathews, supra, 724 S.E.2d at p. 202.* ) The court explained that there was no reason to require this language in the deeds of trust unless it was to apply to the relationship between the lender and the borrower. The court elaborated: “The regulations themselves govern the relationship between the lender and the government; there is no reason to refer to them in the deed of trust other than to affect the duties of the parties to it. If . . . HUD has a contrary intention, it may either (a) cease to require or allow language that incorporates its regulations as conditions precedent to acceleration or foreclosure in the deeds of trust or (b) require or allow language that expressly states its intent that its regulations are not conditions precedent. It has done neither.” (*Mathews, at pp. 202-203.* )

Furthermore, as already noted, the lenders voluntarily agreed to offer or purchase FHA loans in exchange for the government’s backing against defaults and voluntarily subjected themselves to program requirements under the HUD regulations.
8. The Consequences of the Borrowers’ Defaulting on the Loan

The lenders emphasize that the Pfeifers defaulted on their loan. They argue that this default should bar the Pfeifers’ claims against them.

“The rights and powers of trustees in nonjudicial foreclosure proceedings have long been regarded as strictly limited and defined by the contract of the parties and the statutes.” (I.E. Associates v. Safeco Title Ins. Co., supra, 39 Cal.3d at p. 287.) As the court in Mathews explained, “The fact that a borrower is in arrears does not allow the trustee to circumvent the conditions precedent” to foreclosure. (Mathews, supra, 724 S.E.2d p. 199.) Indeed, “[t]he conditions precedent in the deed of trust which govern the accrual of [the trustee’s] latent power to foreclose” do not become relevant until the borrower has “first breached the deed of trust in some way.” (Ibid.) “Therefore, prohibiting the borrower who has breached from bringing an action to enforce the conditions precedent in a deed of trust would nullify such conditions. The mere fact of the borrower’s breach alone would become, de facto, the only condition precedent to foreclosure.” (Id. at pp. 199-200.) The court in Mathews emphasized that “lenders require deeds of trust precisely because they contemplate the possibility of non-payment [and] . . . the deed of trust is a contract in which the parties have agreed that material breach of the note by nonpayment will not deprive borrowers of their rights to enforce conditions precedent.” (Id. at p. 200.)

We agree with the reasoning of the Mathews’ court and hold that the Pfeifers’ default does not bar their claim that the lenders cannot proceed with the foreclosure prior to complying with the HUD servicing requirements.

9. Failure to Allege Full Tender

The lenders point out that the Pfeifers did not allege tender of the amount owed on their secured debt. This failure to allege full tender should, according to the lenders, prevent the Pfeifers from asserting any wrongful foreclosure claim.

“A full tender must be made to set aside a foreclosure sale, based on equitable principles.” (Stebley v. Litton Loan Servicing, LLP (2011) 202 Cal.App.4th 522, 526.)
Courts, however, have not required tender when the lender has not yet foreclosed and has allegedly violated laws related to avoiding the necessity for a foreclosure. (See, e.g., *Mabry v. Superior Court* (2010) 185 Cal.App.4th 208, 225-226.)

As already discussed, one of the purposes of the interview process is to prevent foreclosure. Thus, to permit a foreclosure when the lender has not complied with the requirements that may have prevented any need for a foreclosure would defeat a salient purpose of the HUD regulations. The only remedy available to a borrower who is delinquent on the loan—but who has not had a face-to-face interview—is to postpone the foreclosure sale. If the face-to-face interview occurred, “it is highly conceivable that” the Pfeifers, “may [have been] able to remedy their delinquenc[y] and avoid foreclosure.” (See *Wells Fargo v. Neal*, supra, 922 A.2d at p. 553.)

Moreover, the Pfeifers have alleged in their third amended complaint that any foreclosure would be void based on the lenders’ failure to comply with the HUD regulations. Courts have recognized various exceptions to the tender rule, including an exception based on an allegation that a foreclosure sale is void. (See *Dimock v. Emerald Properties* (2000) 81 Cal.App.4th 868, 877-878 [equity is not necessary to challenge a void sale and a person overcoming a void sale is “not required to tender any of the amounts due under the note”]; see also *In re Salazar* (S.D. Cal. 2011) 448 B.R. 814, 819 [tender of the full amount of the loan would not be required to set aside the sale if the bank was not authorized to foreclose the deed of trust under Civil Code section 293.5].)

Additionally, in the present case, no foreclosure sale has occurred. A number of courts have explicitly held that the tender rule applies only in cases seeking to set aside a completed sale, rather than an action seeking to prevent a sale in the first place. (See *Barrionuevo v. Chase Bank, N.A.* (N.D. Cal. 2012) ___ F.Supp.2d ___ [2012 WL 3235953, at p. *4]; *Vissuet v. Indymac Mortg. Services* (S.D. Cal. Mar. 19, 2010, No. 09-CV-2321-IEG (CAB)) 2010 WL 1031013.) The fact that a borrower is in arrears does not allow the lender to circumvent the conditions precedent.
The cases cited by the lenders in support of applying the tender rule are distinguishable from the present case in that they did not involve a challenge to a void sale or an objection to a foreclosure proceeding prior to a sale. (See, e.g., Abdallah v. United Savings Bank (1996) 43 Cal.App.4th 1101, 1109; United States Cold Storage v. Great Western Savings & Loan Assn. (1985) 165 Cal.App.3d 1214, 1222-1226 [plaintiff challenged irregularities in sale notice or procedure after trustee sale was held]; Arnolds Management Corp. v. Eischen (1984) 158 Cal.App.3d 575, 577 [“before a junior lienor may set aside a nonjudicial foreclosure of real property under a deed of trust because of irregularities in the sale, the junior lienor must first tender the full amount owing on the senior obligation”]; Lawrence v. Aurora Loan Services LLC (E.D. Cal. Jan. 25, 2010, No. CV F09-1598 LJO DLB) 2010 WL 364276 [dismissed claim to set aside nonjudicial foreclosure sale of the property based on being provided improper notice when there was no offer to tender amount owed].) The lenders also quote the following from Alicea v. GE Money Bank (N.D. Cal. Jul. 16, 2009, No. C 09-00091 SBA) 2009 WL 2136969: “When a debtor is in default of a home mortgage loan, and a foreclosure is either pending or has taken place, the debtor must allege a credible tender of the amount of the secured debt to maintain any cause of action for wrongful foreclosure.” (Id. at p. *3.) Alicea involved a situation where the foreclosure sale had already occurred. Additionally, there was no allegation in Alicea that the foreclosure sale was void.

We thus conclude that the Pfeifers do not need to allege that they will tender or have tendered the full amount due on their note.

E. Conclusion

Accordingly, we conclude that the failure to allege tender of the full amount owed on the obligation does not bar the Pfeifers’ claim for declaratory relief or their request for injunctive relief based on wrongful foreclosure, because the lenders have not yet foreclosed and the Pfeifers have alleged that the lenders have not complied with the HUD servicing regulations, which are conditions precedent to foreclosing. We hold that the Pfeifers can request the court to enjoin the nonjudicial foreclosure procedure based on the
failure to conduct a face-to-face interview as mandated by the FHA deed of trust and can request declaratory relief stating that the lenders do not have the authority to proceed with a nonjudicial foreclosure until they comply with the HUD servicing regulations. The Pfeifers do not, however, have a claim for damages.

IV. Other Claims

In their third amended complaint, the Pfeifers also set forth causes of action for breach of the implied covenant of good faith and fair dealing, breach of contract, and fraud and deceit.\textsuperscript{15} Except for the breach of contract claim, the Pfeifers’ opening brief did not include any specific argument or supporting authority regarding these causes of action; therefore, we will consider any appeal of these claims waived.\textsuperscript{16} “‘Although our review of a [demurrer] is de novo, it is limited to issues [that] have been adequately raised and supported in plaintiffs’ brief. [Citations.] Issues not raised in an appellant’s brief are deemed waived or abandoned. [Citation.]’” (\textit{Davies v. Sallie Mae, Inc., supra}, 168 Cal.App.4th at p. 1096.) An appellate court “will not develop the appellants’ arguments for them . . . .” (\textit{Dills v. Redwoods Associates, Ltd.} (1994) 28 Cal.App.4th 888, 890, fn. 1.)

We agree with the trial court’s rejection of the breach of contract claim. The HUD regulations at issue here were promulgated under the NHA, and we agree with the majority of courts that have concluded that the breach of these regulations do not ordinarily provide a private right of action. (See \textit{Roberts v. Cameron-Brown Co., supra}, 556 F.2d at p. 360.) Accordingly, we hold that there is no private right of action available to the Pfeifers for the lenders’ noncompliance with the servicing regulations.\textsuperscript{17} (See \textit{Federal Nat. Mortg. Ass’n v. LeCrone} (6th Cir. 1989) 868 F.2d 190, 193.)

\textsuperscript{15} The Pfeifers expressly abandoned their sixth cause of action for financial elder abuse for this appeal.

\textsuperscript{16} We will not consider any arguments raised for the first time in the Pfeifers’ reply brief.

\textsuperscript{17} We also agree with the trial court’s rejection of the wrongful foreclosure claim to the extent that the Pfeifers are seeking any damages. In their third amended complaint
DISPOSITION

The judgment is reversed as to the Pfeifers’ claims for wrongful foreclosure and for declaratory relief; the order denying injunctive relief is also reversed. With respect to all other causes of action, the judgment is affirmed. The parties are to bear their own costs on appeal.

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Lambden, J.

We concur:

_________________________
Haerle, Acting P.J.

_________________________
Richman, J.

and/or in their reply brief in this court, the Pfeifers claim wrongful foreclosure based on Civil Code sections 2923.5 and 2923.6, and an entitlement to modify the loan repayment terms pursuant to the Home Affordable Modification Program (HAMP).

Civil Code section 2923.5 applies to “mortgages or deeds of trust recorded from January 1, 2003, to December 31, 2007, inclusive.” (Civ. Code, § 2923.5, subd. (i).) Here, the deed of trust securing the Pfeifers’ note was recorded in April 2008, and Civil Code section 2923.5 does not apply. The Pfeifers have no private right of action under Civil Code section 2923.6, and this statute does not require loan servicers to modify loans. (See, e.g., Rodriguez v. JP Morgan Chase & Co. (S.D. Cal. 2011) 809 F.Supp.2d 1291, 1296.)

Finally, as to HAMP, the Pfeifers have no right to enforce the HAMP loan modification provisions. The majority of federal courts have concluded that homeowners are not intended third-party beneficiaries of HAMP contracts. (See Wigod v. Wells Fargo Bank, N.A. (7th Cir. 2012) 673 F.3d 547, 559, fn. 4; Lucia v. Wells Fargo Bank, N.A. (N.D. Cal. 2011) 798 F.Supp.2d 1059, 1070-1071.) We agree with the reasoning of these courts, and conclude that the Pfeifers are presumed incidental beneficiaries unless they demonstrate a clear intent to the contrary. (See Klamath Water Users Protective Ass’n v. Patterson (9th Cir. 1999) 204 F.3d 1206, 1211.) The Pfeifers have not directed us to any part of the deed of trust establishing an intent to make them third-party beneficiaries.
Trial Court: Alameda County Superior Court

Trial Judge: Hon. Richard Keller

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Assembly Bill No. 2314

CHAPTER 201

An act to amend Section 2929.3 of the Civil Code, and to amend Sections 17980 and 17980.7 of the Health and Safety Code, relating to real property.

[Approved by Governor August 27, 2012. Filed with Secretary of State August 27, 2012.]

LEGISLATIVE COUNSEL'S DIGEST

AB 2314, Carter. Real property: blight.

(1) Existing law, until January 1, 2013, requires a legal owner to maintain vacant residential property purchased at a foreclosure sale or acquired by that owner through foreclosure under a mortgage or deed of trust. Existing law, until January 1, 2013, authorizes a governmental entity to impose civil fines and penalties for failure to maintain that property of up to $1,000 per day for a violation. Existing law, until January 1, 2013, requires a governmental entity that seeks to impose those fines and penalties to give notice of the claimed violation and an opportunity to correct the violation at least 14 days prior to imposing the fines and penalties, and to allow a hearing for contesting those fines and penalties.

This bill would delete the repeal clause for these provisions and thus extend the operation of these provisions indefinitely.

(2) The State Housing Law requires the housing or building department or, if there is no building department, the health department, of every city, county, or city and county, or a specified environmental agency, to enforce within its jurisdiction all of the State Housing Law, the building standards published in the State Building Standards Code, and other specified rules and regulations. If there is a violation of these provisions or any order or notice that gives a reasonable time to correct that violation, or if a nuisance exists, an enforcement agency is required, after 30 days’ notice to abate the nuisance, to institute any appropriate action or proceeding to prevent, restrain, correct, or abate the violation or nuisance.

This bill would prohibit an enforcement agency from commencing any action or proceeding until at least 60 days after a person takes title to the property, unless a shorter period of time is deemed necessary by the enforcement agency in its sole discretion, as specified, if the person has purchased and is in the process of diligently abating any violation at a residential property that had been foreclosed on or after January 1, 2008.

This bill would require any entity that releases a lien securing a deed of trust or mortgage on a property for which a notice of pendency of action, as defined, has been recorded against the property, as specified, to notify in writing the enforcement agency that issued the order or notice within 30 days of releasing the lien.
(3) Existing law authorizes, among other things, the enforcement agency to seek and the court to order imposition of specified penalties or the enforcement agency, tenant, or tenant association or organization to seek, and the court to order, the appointment of a receiver for a substandard building, if the owner of the property fails to comply within a reasonable time with the terms of an order or notice.

This bill would authorize a court to require the owner of the property to pay all unrecovered costs associated with the receivership in addition to any other remedy authorized by law.

The people of the State of California do enact as follows:

SECTION 1. Section 2929.3 of the Civil Code is amended to read:

2929.3. (a) (1) A legal owner shall maintain vacant residential property purchased by that owner at a foreclosure sale, or acquired by that owner through foreclosure under a mortgage or deed of trust. A governmental entity may impose a civil fine of up to one thousand dollars ($1,000) per day for a violation. If the governmental entity chooses to impose a fine pursuant to this section, it shall give notice of the alleged violation, including a description of the conditions that gave rise to the allegation, and notice of the entity’s intent to assess a civil fine if action to correct the violation is not commenced within a period of not less than 14 days and completed within a period of not less than 30 days. The notice shall be mailed to the address provided in the deed or other instrument as specified in subdivision (a) of Section 27321.5 of the Government Code, or, if none, to the return address provided on the deed or other instrument.

(2) The governmental entity shall provide a period of not less than 30 days for the legal owner to remedy the violation prior to imposing a civil fine and shall allow for a hearing and opportunity to contest any fine imposed. In determining the amount of the fine, the governmental entity shall take into consideration any timely and good faith efforts by the legal owner to remedy the violation. The maximum civil fine authorized by this section is one thousand dollars ($1,000) for each day that the owner fails to maintain the property, commencing on the day following the expiration of the period to remedy the violation established by the governmental entity.

(3) Subject to the provisions of this section, a governmental entity may establish different compliance periods for different conditions on the same property in the notice of alleged violation mailed to the legal owner.

(b) For purposes of this section, “failure to maintain” means failure to care for the exterior of the property, including, but not limited to, permitting excessive foliage growth that diminishes the value of surrounding properties, failing to take action to prevent trespassers or squatters from remaining on the property, or failing to take action to prevent mosquito larvae from growing in standing water or other conditions that create a public nuisance.

(c) Notwithstanding subdivisions (a) and (b), a governmental entity may provide less than 30 days’ notice to remedy a condition before imposing a
civil fine if the entity determines that a specific condition of the property threatens public health or safety and provided that notice of that determination and time for compliance is given.

(d) Fines and penalties collected pursuant to this section shall be directed to local nuisance abatement programs, including, but not limited to, legal abatement proceedings.

(e) A governmental entity may not impose fines on a legal owner under both this section and a local ordinance.

(f) These provisions shall not preempt any local ordinance.

(g) This section shall only apply to residential real property.

(h) The rights and remedies provided in this section are cumulative and in addition to any other rights and remedies provided by law.

SEC. 2. Section 17980 of the Health and Safety Code is amended to read:

17980. (a) If any building is constructed, altered, converted, or maintained in violation of any provision of, or in violation of any order or notice that gives a reasonable time to correct that violation issued by an enforcement agency pursuant to this part, the building standards published in the California Building Standards Code, or other rules and regulations adopted pursuant to this part, or if a nuisance exists in any building or upon the lot on which it is situated, the enforcement agency shall, after 30 days’ notice to abate the nuisance or violation, or a notice to abate with a shorter period of time if deemed necessary by the enforcement agency to prevent or remedy an immediate threat to the health and safety of the public or occupants of the structure, institute any appropriate action or proceeding to prevent, restrain, correct, or abate the violation or nuisance. Notwithstanding the above, if a person has purchased and is in the process of diligently abating any violation at a residential property that had been foreclosed on or after January 1, 2008, an enforcement agency shall not commence any action or proceeding until at least 60 days after the person takes title to the property, unless a shorter period of time is deemed necessary by the enforcement agency, in its sole discretion, to prevent or remedy an immediate threat to the health and safety of the neighboring community, public, or occupants of the structure.

(b) If any entity releases a lien securing a deed of trust or mortgage on a property for which a notice of pendency of action, as defined in Section 405.2 of the Code of Civil Procedure, has been recorded against the property by an enforcement agency pursuant to subdivision (a) of Section 17985 of the Health and Safety Code or Section 405.7 or 405.20 of the Code of Civil Procedure, it shall notify in writing the enforcement agency that issued the order or notice within 30 days of releasing the lien.

(c) (1) Whenever the enforcement agency has inspected or caused to be inspected any building and has determined that the building is a substandard building or a building described in Section 17920.10, the enforcement agency shall commence proceedings to abate the violation by repair, rehabilitation, vacation, or demolition of the building. The enforcement agency shall not require the vacating of a residential building unless it concurrently requires
expeditious demolition or repair to comply with this part, the building standards published in the California Building Standards Code, or other rules and regulations adopted pursuant to this part. The owner shall have the choice of repairing or demolishing. However, if the owner chooses to repair, the enforcement agency shall require that the building be brought into compliance according to a reasonable and feasible schedule for expeditious repair. The enforcement agency may require vacation and demolition or may itself vacate the building, repair, demolish, or institute any other appropriate action or proceeding, if any of the following occur:

(A) The repair work is not done within the period required by the notice.
(B) The owner does not make a timely choice of repair or demolition.
(C) The owner selects an option which cannot be completed within a reasonable period of time, as determined by the enforcement agency, for any reason, including, but not limited to, an outstanding judicial or administrative order.

(2) In deciding whether to require vacation of the building or to repair as necessary, the enforcement agency shall give preference to the repair of the building whenever it is economically feasible to do so without having to repair more than 75 percent of the dwelling, as determined by the enforcement agency, and shall give full consideration to the needs for housing as expressed in the local jurisdiction’s housing element.

(d) (1) Notwithstanding subdivision (c) and notwithstanding local ordinances, tenants in a residential building shall be provided copies of any of the following:

(A) The notice of any violation described in subdivision (a) that affects the health and safety of the occupants and that causes the building to be substandard pursuant to Section 17920.3 or in violation of Section 17920.10.
(B) An order of the code enforcement agency issued after inspection of the premises declaring the dwelling to be in violation of any provision described in subdivision (a).
(C) The enforcement agency’s decision to repair or demolish.
(D) The issuance of a building or demolition permit following the abatement order of an enforcement agency.

(2) Each document provided pursuant to paragraph (1) shall be provided to each affected residential unit by the enforcement agency that issued the order or notice, in the manner prescribed by subdivision (a) of Section 17980.6.

(e) All notices issued by the enforcement agency to correct violations or to abate nuisances shall contain a provision notifying the owner that, in accordance with Sections 17274 and 24436.5 of the Revenue and Taxation Code, a tax deduction may not be allowed for interest, taxes, depreciation, or amortization paid or incurred in the taxable year.

(f) The enforcement agency may charge the owner of the building for its postage or mileage cost for sending or posting the notices required to be given by this section.

SEC. 3. Section 17980.7 of the Health and Safety Code is amended to read:
17980.7. If the owner fails to comply within a reasonable time with the
terms of the order or notice issued pursuant to Section 17980.6, the following
provisions shall apply:

(a) The enforcement agency may seek and the court may order imposition
of the penalties provided for under Chapter 6 (commencing with Section
17995).

(b) (1) The enforcement agency may seek and the court may order the
owner to not claim any deduction with respect to state taxes for interest,
taxes, expenses, depreciation, or amortization paid or incurred with respect
to the cited structure, in the taxable year of the initial order or notice, in lieu
of the enforcement agency processing a violation in accordance with Sections
17274 and 24436.5 of the Revenue and Taxation Code.

(2) If the owner fails to comply with the terms of the order or notice to
correct the condition that caused the violation pursuant to Section 17980.6,
the court may order the owner to not claim these tax benefits for the
following year.

(c) The enforcement agency, tenant, or tenant association or organization
may seek and the court may order, the appointment of a receiver for the
substandard building pursuant to this subdivision. In its petition to the court,
the enforcement agency, tenant, or tenant association or organization shall
include proof that notice of the petition was served not less than three days
prior to filing the petition, pursuant to Article 3 (commencing with Section
415.10) of Chapter 4 of Title 5 of Part 2 of the Code of Civil Procedure, to
all persons with a recorded interest in the real property upon which the
substandard building exists.

(1) In appointing a receiver, the court shall consider whether the owner
has been afforded a reasonable opportunity to correct the conditions cited
in the notice of violation.

(2) The court shall not appoint any person as a receiver unless the person
has demonstrated to the court his or her capacity and expertise to develop
and supervise a viable financial and construction plan for the satisfactory
rehabilitation of the building. A court may appoint as a receiver a nonprofit
organization or community development corporation. In addition to the
duties and powers that may be granted pursuant to this section, the nonprofit
organization or community development corporation may also apply for
grants to assist in the rehabilitation of the building.

(3) If a receiver is appointed, the owner and his or her agent of the
substandard building shall be enjoined from collecting rents from the tenants,
interfering with the receiver in the operation of the substandard building,
and encumbering or transferring the substandard building or real property
upon which the building is situated.

(4) Any receiver appointed pursuant to this section shall have all of the
following powers and duties in the order of priority listed in this paragraph,
unless the court otherwise permits:

(A) To take full and complete control of the substandard property.

(B) To manage the substandard building and pay expenses of the
operation of the substandard building and real property upon which the
building is located, including taxes, insurance, utilities, general maintenance, and debt secured by an interest in the real property.

(C) To secure a cost estimate and construction plan from a licensed contractor for the repairs necessary to correct the conditions cited in the notice of violation.

(D) To enter into contracts and employ a licensed contractor as necessary to correct the conditions cited in the notice of violation.

(E) To collect all rents and income from the substandard building.

(F) To use all rents and income from the substandard building to pay for the cost of rehabilitation and repairs determined by the court as necessary to correct the conditions cited in the notice of violation.

(G) To borrow funds to pay for repairs necessary to correct the conditions cited in the notice of violation and to borrow funds to pay for any relocation benefits authorized by paragraph (6) and, with court approval, secure that debt and any moneys owed to the receiver for services performed pursuant to this section with a lien on the real property upon which the substandard building is located. The lien shall be recorded in the county recorder’s office in the county within which the building is located.

(H) To exercise the powers granted to receivers under Section 568 of the Code of Civil Procedure.

(5) The receiver shall be entitled to the same fees, commissions, and necessary expenses as receivers in actions to foreclose mortgages.

(6) If the conditions of the premises or the repair or rehabilitation thereof significantly affect the safe and sanitary use of the substandard building by any tenant, to the extent that the tenant cannot safely reside in his or her unit, then the receiver shall provide relocation benefits in accordance with subparagraph (A) of paragraph (3) of subdivision (d).

(7) The relocation compensation provided for in this section shall not preempt any local ordinance that provides for greater relocation assistance.

(8) In addition to any reporting required by the court, the receiver shall prepare monthly reports to the state or local enforcement agency which shall contain information on at least the following items:

(A) The total amount of rent payments received.

(B) Nature and amount of contracts negotiated relative to the operation or repair of the property.

(C) Payments made toward the repair of the premises.

(D) Progress of necessary repairs.

(E) Other payments made relative to the operation of the building.

(F) Amount of tenant relocation benefits paid.

(9) The receiver shall be discharged when the conditions cited in the notice of violation have been remedied in accordance with the court order or judgment and a complete accounting of all costs and repairs has been delivered to the court. Upon removal of the condition, the owner, the mortgagee, or any lienor of record may apply for the discharge of all moneys not used by the receiver for removal of the condition and all other costs authorized by this section.
(10) After discharging the receiver, the court may retain jurisdiction for a time period not to exceed 18 consecutive months, and require the owner and the enforcement agency responsible for enforcing Section 17980 to report to the court in accordance with a schedule determined by the court.

(11) The prevailing party in an action pursuant to this section shall be entitled to reasonable attorney’s fees and court costs as may be fixed by the court.

(12) The county recorder may charge and collect fees for the recording of all notices and other documents required by this section pursuant to Article 5 (commencing with Section 27360) of Chapter 6 of Division 2 of Title 3 of the Government Code.

(13) This section shall not be construed to limit those rights available to tenants and owners under any other provision of the law.

(14) This section shall not be construed to deprive an owner of a substandard building of all procedural due process rights guaranteed by the California Constitution and the United States Constitution, including, but not limited to, receipt of notice of the violation claimed and an adequate and reasonable period of time to comply with any orders which are issued by the enforcement agency or the court.

(15) Upon the request of a receiver, a court may require the owner of the property to pay all unrecovered costs associated with the receivership in addition to any other remedy authorized by law.

(d) If the court finds that a building is in a condition which substantially endangers the health and safety of residents pursuant to Section 17980.6, upon the entry of any order or judgment, the court shall do all of the following:

(1) Order the owner to pay all reasonable and actual costs of the enforcement agency including, but not limited to, inspection costs, investigation costs, enforcement costs, attorney fees or costs, and all costs of prosecution.

(2) Order that the local enforcement agency shall provide the tenant with notice of the court order or judgment.

(3) (A) Order that if the owner undertakes repairs or rehabilitation as a result of being cited for a notice under this chapter, and if the conditions of the premises or the repair or rehabilitation thereof significantly affect the safe and sanitary use of the premises by any lawful tenant, so that the tenant cannot safely reside in the premises, then the owner shall provide or pay relocation benefits to each lawful tenant. These benefits shall consist of actual reasonable moving and storage costs and relocation compensation. The actual moving and storage costs shall consist of all of the following:

   (i) Transportation of the tenant’s personal property to the new location. The new location shall be in close proximity to the substandard premises, except where relocation to a new location beyond a close proximity is determined by the court to be justified.

   (ii) Packing, crating, unpacking, and uncrating the tenant’s personal property.

   (iii) Insurance of the tenant’s property while in transit.
(iv) The reasonable replacement value of property lost, stolen, or damaged (not through the fault or negligence of the displaced person, his or her agent or employee) in the process of moving, where insurance covering the loss, theft, or damage is not reasonably available.

(v) The cost of disconnecting, dismantling, removing, reassembling, reconnected, and reinstalling machinery, equipment, or other personal property of the tenant, including connection charges imposed by utility companies for starting utility service.

(B) (i) The relocation compensation shall be an amount equal to the differential between the contract rent and the fair market rental value determined by the federal Department of Housing and Urban Development for a unit of comparable size within the area for the period that the unit is being repaired, not to exceed 120 days.

(ii) If the court finds that a tenant has been substantially responsible for causing or substantially contributing to the substandard conditions, then the relocation benefits of this section shall not be paid to this tenant. Each other tenant on the premises who has been ordered to relocate due to the substandard conditions and who is not substantially responsible for causing or contributing to the conditions shall be paid these benefits and moving costs at the time that he or she actually relocates.

(4) Determine the date when the tenant is to relocate, and order the tenant to notify the enforcement agency and the owner of the address of the premises to which he or she has relocated within five days after the relocation.

(5) (A) Order that the owner shall offer the first right to occupancy of the premises to each tenant who received benefits pursuant to subparagraph (A) of paragraph (3), before letting the unit for rent to a third party. The owner’s offer on the first right to occupancy to the tenant shall be in writing, and sent by first-class certified mail to the address given by the tenant at the time of relocation. If the owner has not been provided the tenant’s address by the tenant as prescribed by this section, the owner shall not be required to provide notice under this section or offer the tenant the right to return to occupancy.

(B) The tenant shall notify the owner in writing that he or she will occupy the unit. The notice shall be sent by first-class certified mail no later than 10 days after the notice has been mailed by the owner.

(6) Order that failure to comply with any abatement order under this chapter shall be punishable by civil contempt, penalties under Chapter 6 (commencing with Section 17995), and any other penalties and fines as are available.

(e) The initiation of a proceeding or entry of a judgment pursuant to this section or Section 17980.6 shall be deemed to be a “proceeding” or “judgment” as provided by paragraph (4) or (5) of subdivision (a) of Section 1942.5 of the Civil Code.

(f) The term “owner,” for the purposes of this section, shall include the owner, including any public entity that owns residential real property, at
the time of the initial notice or order and any successor in interest who had
actual or constructive knowledge of the notice, order, or prosecution.

(g) These remedies shall be in addition to those provided by any other
law.

(h) This section and Section 17980.6 shall not impair the rights of an
owner exercising his or her rights established pursuant to Chapter 12.75
(commencing with Section 7060) of Division 7 of Title 1 of the Government
Code.
R. Therien

From: Roger Therien [rtherien@oldrepublictitle.com]
Sent: Thursday, January 17, 2013 9:52 AM
To: rtherien1@gmail.com
Subject: FW: Counties with Electronic Recording

From: Rusky, Ed [mailto:erusky@firstam.com]
Sent: Thursday, January 17, 2013 8:18 AM
To: Roger Therien
Subject: Counties with Electronic Recording

I just thought I would forward the comments below. Perhaps we could take a moment in February to poll the F&P folks to see if there is any more updated information on this subject.

Orange, San Bernardino and Riverside are fully functional electronic recording hubs. L.A. allows it, but it still somewhat a work in progress. San Diego is scheduled to come online next, but we do not have an estimation of when they may go live. Ventura is a holding pattern until funds are available for the move.

I will have to check with our recording service to see if any of the counties north of Ventura have signed on. The process of converting from traditional over the counter recordings to electronic recordings was going full steam ahead until the recession hit and then it obviously stalled out because of lack of funding for the transition.

Let me get back to you with more info on the rest of the state.

Edward S. Rusky
Vice President
Senior National Underwriting Counsel
Senior Division Counsel, NCS SWD

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Email: erusky@firstam.com

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ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

1. For purposes of this endorsement:
   a. “Improvement” means a building, structure, road, walkway, driveway, curb, subsurface utility or water well existing at Date of Policy or to be built or constructed according to the Plans that is or will be located on the Land, but excluding crops, landscaping, lawns, shrubbery, or trees.
   b. “Plans” means those site and elevation plans made by [name of architect or engineer] dated ____ , last revised ________, designated as [name of project] consisting of ___ sheets.

2. The Company insures against loss or damage sustained by the Insured in the event that, at Date of Policy
   a. according to applicable zoning ordinances and amendments, the Land is not classified Zone ____________________;
   b. the following use or uses are not allowed under that classification:
   c. There shall be no liability under paragraph 2.b. if the use or uses are not allowed as the result of any lack of compliance with any condition, restriction, or requirement contained in the zoning ordinances and amendments, including but not limited to the failure to secure necessary consents or authorizations as a prerequisite to the use or uses. This paragraph 2.c. does not modify or limit the coverage provided in Covered Risk 5.

3. The Company further insures against loss or damage sustained by the Insured by reason of a final decree of a court of competent jurisdiction either prohibiting the use of the Land, with any existing Improvement, as specified in paragraph 2.b. or requiring the removal or alteration of the Improvement, because of a violation of the zoning ordinances and amendments in effect at Date of Policy with respect to any of the following matters:
   a. Area, width, or depth of the Land as a building site for the Improvement
   b. Floor space area of the Improvement
   c. Setback of the Improvement from the property lines of the Land
   d. Height of the Improvement, or
   e. Number of parking spaces.

4. There shall be no liability under this endorsement based on:
   a. the invalidity of the zoning ordinances and amendments until after a final decree of a court of competent jurisdiction adjudicating the invalidity, the effect of which is to prohibit the use or uses;
   b. the refusal of any person to purchase, lease or lend money on the Title covered by this policy.
This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of
the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or
(iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is
inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this
endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ______________________________________

Authorized Signatory
ENDORSEMENT
Attached to Policy No. __________
Issued by
BLANK TITLE INSURANCE COMPANY

1. For purposes of this endorsement:
   a. “Improvement” means a building, structure, road, walkway, driveway, curb, subsurface utility or water well existing at Date of Policy or to be built or constructed according to the Plans that is or will be located on the Land, but excluding crops, landscaping, lawns, shrubbery, or trees.
   b. “Plans” means those site and elevation plans made by [name of architect or engineer] dated _____, last revised __________, designated as [name of project] consisting of ___ sheets.

2. The Company insures against loss or damage sustained by the Insured in the event that, at Date of Policy
   a. according to applicable zoning ordinances and amendments, the Land is not classified Zone _____________;
   b. the following use or uses are not allowed under that classification:
   c. There shall be no liability under paragraph 2.b. if the use or uses are not allowed as the result of any lack of compliance with any condition, restriction, or requirement contained in the zoning ordinances and amendments, including but not limited to the failure to secure necessary consents or authorizations as a prerequisite to the use or uses. This paragraph 2.c. does not modify or limit the coverage provided in Covered Risk 5.

3. The Company further insures against loss or damage sustained by the Insured by reason of a final decree of a court of competent jurisdiction either prohibiting the use of the Land, with any existing Improvement, as specified in paragraph 2.b. or requiring the removal or alteration of the Improvement, because of a violation of at Date of Policy, the zoning ordinances and amendments in effect at Date of Policy have been violated with respect to any of the following matters:
   a. Area, width, or depth of the Land as a building site for the Improvement
   b. Floor space area of the Improvement
   c. Setback of the Improvement from the property lines of the Land
   d. Height of the Improvement, or
   e. Number of parking spaces.

4. There shall be no liability under this endorsement based on:
   a. the invalidity of the zoning ordinances and amendments until after a final decree of a court of competent jurisdiction adjudicating the invalidity, the effect of which is to prohibit the use or uses;
   b. the refusal of any person to purchase, lease or lend money on the Title covered by this policy.
This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ______________________________________

Authorized Signatory
ENDORSEMENT
Attached to Policy No. __________

Issued by
BLANK TITLE INSURANCE COMPANY

1. The insurance provided by this endorsement is subject to the exclusions in Section 4 of this endorsement; and the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

2. For purposes of this endorsement only:
   a. “Covenant” means a covenant, condition, limitation or restriction in a document or instrument in effect at Date of Policy.
   b. “Future Improvement” means a building, structure, road, walkway, driveway, curb to be constructed on or affixed to the Land in the locations according to the Plans and that by law will constitute real property, but excluding any crops, landscaping, lawn, shrubbery, or trees.
   c. “Improvement” means a building, structure located on the surface of the Land, road, walkway, driveway, or curb, affixed to the Land at Date of Policy and that by law constitutes real property, but excluding any crops, landscaping, lawn, shrubbery, or trees.
   d. “Plans” means the survey, site and elevation plans or other depictions or drawings prepared by (insert name of architect or engineer) dated ____, last revised ________, designated as (insert name of project or project number) consisting of ___ sheets.

3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. A violation of an enforceable Covenant by an Improvement on the Land at Date of Policy or by a Future Improvement, unless an exception in Schedule B of the policy identifies the violation;
   b. Enforced removal of an Improvement located on the Land or of a Future Improvement as a result of a violation of a building setback line shown on a plat of subdivision recorded or filed in the Public Records at Date of Policy, unless an exception in Schedule B of the policy identifies the violation; or
   c. A notice of a violation, recorded in the Public Records at Date of Policy, of an enforceable Covenant relating to environmental protection describing any part of the Land and referring to that Covenant, but only to the extent of the violation of the Covenant referred to in that notice, unless an exception in Schedule B of the policy identifies the notice of the violation.
4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) resulting from:
   a. any Covenant contained in an instrument creating a lease;
   b. any Covenant relating to obligations of any type to perform maintenance, repair, or remediation on the Land; or
   c. except as provided in Section 3.c, any Covenant relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ____________________________________________
   Authorized Signatory
ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

1. The insurance provided by this endorsement is subject to the exclusions in Section 4 of this endorsement; and the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

2. For purposes of this endorsement only:
   a. “Covenant” means a covenant, condition, limitation or restriction in a document or instrument in effect at Date of Policy.
   b. “Future Improvement” means a building, structure, road, walkway, driveway, curb to be constructed on or affixed to the Land in the locations according to the Plans and that by law will constitute real property, but excluding any crops, landscaping, lawn, shrubbery, or trees.
   c. “Improvement” means a building, structure located on the surface of the Land, road, walkway, driveway, or curb, affixed to the Land at Date of Policy and that by law constitutes real property, but excluding any crops, landscaping, lawn, shrubbery, or trees.
   d. “Plans” means the survey, site and elevation plans or other depictions or drawings prepared by (insert name of architect or engineer) dated ____, last revised __________, designated as (insert name of project or project number) consisting of ___ sheets.

3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. A violation of an enforceable Covenant by an Improvement on the Land at Date of Policy or by a Future Improvement, unless an exception in Schedule B of the policy identifies the violation;
   b. Enforced removal of an Improvement located on the Land or of a Future Improvement as a result of a violation of a building setback line shown on a plat of subdivision recorded or filed in the Public Records at Date of Policy, unless an exception in Schedule B of the policy identifies the violation; or
   c. A notice of a violation, recorded in the Public Records at Date of Policy, of an enforceable Covenant relating to environmental protection describing any part of the Land and referring to that Covenant, but only to the extent of the violation of the Covenant referred to in that notice, unless an exception in Schedule B of the policy identifies the notice of the violation.
4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) resulting from:
   a. any Covenant contained in an instrument creating a lease;
   b. any Covenant relating to obligations of any type to perform maintenance, repair, or remediation on the Land; or
   c. except as provided in Section 3.c, any Covenant relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances; or
   d. contamination, explosion, fire, vibration, fracturing, earthquake or subsidence.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: _______________________________________

Authorized Signatory
ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

1. The insurance for Advances added by Sections 2 and 3 of this endorsement is subject to the exclusions in Section 4 of this endorsement and the Exclusions in the Policy, except Exclusion 3(d), the provisions of the Conditions and the exceptions contained in Schedule B.
   a. “Agreement,” as used in this endorsement, shall mean the note or loan agreement, repayment of Advances under which is secured by the Insured Mortgage.
   b. “Advance,” as used in this endorsement, shall mean only an advance of principal made after the Date of Policy as provided in the Agreement, including expenses of foreclosure, amounts advanced pursuant to the Insured Mortgage to pay taxes and insurance, assure compliance with laws, or to protect the lien of the Insured Mortgage before the time of acquisition of the Title, and reasonable amounts expended to prevent deterioration of improvements, together with interest on those advances.
   c. “Changes in the rate of interest,” as used in this endorsement, shall mean only those changes in the rate of interest calculated pursuant to a formula provided in the Insured Mortgage or the Agreement at Date of Policy.

2. The Company insures against loss or damage sustained by the Insured by reason of:
   a. The invalidity or unenforceability of the lien of the Insured Mortgage as security for each Advance.
   b. The lack of priority of the lien of the Insured Mortgage as security for each Advance over any lien or encumbrance on the Title.
   c. The invalidity or unenforceability or lack of priority of the lien of the Insured Mortgage as security for the Indebtedness, Advances and unpaid interest resulting from (i) re-Advances and repayments of Indebtedness, (ii) earlier periods of no indebtedness owing during the term of the Insured Mortgage, or (iii) the Insured Mortgage not complying with the requirements of state law of the state in which the Land is located to secure Advances, (iv) failure of the Insured Mortgage to state the term for Advances, or (v) failure of the Insured Mortgage to state the maximum amount secured by the Insured Mortgage.
   d. The invalidity or unenforceability of the lien of the Insured Mortgage because of the failure of the mortgagors to be at least 62 years of age at Date of Policy.

3. The Company also insures against loss or damage sustained by the Insured by reason of:
   a. The invalidity or unenforceability of the lien of the Insured Mortgage resulting from any provisions of the Agreement that provide for (i) interest on interest, (ii) changes in the rate of interest, or (iii) the addition of unpaid interest to the principal portion of the Indebtedness.
   b. Lack of priority of the lien of the Insured Mortgage as security for the Indebtedness, including any unpaid interest that was added to principal in accordance with any provisions of the Agreement, interest on interest, or interest as changed in accordance with the provisions of the Insured Mortgage, which lack of priority is caused by (i) changes in the rate of interest, (ii) interest on interest, or (iii) increases in the Indebtedness resulting from the addition of unpaid interest.
“Interest,” as used in this paragraph 3, shall include lawful interest based on appreciated value.

4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) resulting from:

   a. The invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage as security for any Advance made after a Petition for Relief under the Bankruptcy Code (11 U.S.C.) has been filed by or on behalf of the mortgagor;

   b. The lien of real estate taxes or assessments on the Title imposed by governmental authority arising after Date of Policy;

   c. The lack of priority of the lien of the Insured Mortgage as security for any Advance to a federal tax lien, which Advance is made after the earlier of (i) actual knowledge of the Insured that a federal tax lien was filed against the mortgagor, or (ii) the expiration, after notice of a federal tax lien filed against the mortgagor, of any grace period for making disbursements with priority over the federal tax lien provided in the Internal Revenue Code (26 U.S.C.);

   d. Any federal or state environmental protection lien; or

   e. Usury, or any consumer credit protection or truth-in-lending law. [; or

   f. Any mechanic’s or materialmen’s lien.]

5. The Indebtedness includes Advances.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ______________________________________

Authorized Signatory
ENDORSEMENT
Attached to Policy No. __________
Issued by
BLANK TITLE INSURANCE COMPANY

1. The insurance for Advances added by Sections 2 and 3 of this endorsement is subject to the exclusions in Section 4 of this endorsement and the Exclusions in the Policy, except Exclusion 3(d), the provisions of the Conditions and the exceptions contained in Schedule B.
   a. “Agreement,” as used in this endorsement, shall mean the note or loan agreement, repayment of Advances under which is secured by the Insured Mortgage.
   b. “Advance,” as used in this endorsement, shall mean only an advance of principal made after the Date of Policy as provided in the Agreement, including expenses of foreclosure, amounts advanced pursuant to the Insured Mortgage to pay taxes and insurance, assure compliance with laws, or to protect the lien of the Insured Mortgage before the time of acquisition of the Title, and reasonable amounts expended to prevent deterioration of improvements, together with interest on those advances.
   c. “Changes in the rate of interest,” as used in this endorsement, shall mean only those changes in the rate of interest calculated pursuant to a formula provided in the Insured Mortgage or the Agreement at Date of Policy.

2. The Company insures against loss or damage sustained by the Insured by reason of:
   a. The invalidity or unenforceability of the lien of the Insured Mortgage as security for each Advance.
   b. The lack of priority of the lien of the Insured Mortgage as security for each Advance over any lien or encumbrance on the Title.
   c. The invalidity or unenforceability or lack of priority of the lien of the Insured Mortgage as security for the Indebtedness, Advances and unpaid interest resulting from (i) re-Advances and repayments of Indebtedness, (ii) earlier periods of no Indebtedness owing during the term of the Insured Mortgage, or (iii) the Insured Mortgage not complying with the requirements of state law of the state in which the Land is located to secure Advances, (iv) failure of the Insured Mortgage to state the term for Advances, or (v) failure of the Insured Mortgage to state the maximum amount secured by the Insured Mortgage.
   d. The invalidity or unenforceability of the lien of the Insured Mortgage because of the failure of the mortgagors to be at least 62 years of age at Date of Policy.

3. The Company also insures against loss or damage sustained by the Insured by reason of:
   a. The invalidity or unenforceability of the lien of the Insured Mortgage resulting from any provisions of the Agreement that provide for (i) interest on interest, (ii) changes in the rate of interest, or (iii) the addition of unpaid interest to the principal portion of the Indebtedness.
   b. Lack of priority of the lien of the Insured Mortgage as security for the Indebtedness, including any unpaid interest that was added to principal in accordance with any provisions of the Agreement, interest on interest, or interest as changed in accordance with the provisions of the Insured Mortgage, which lack of priority is caused by (i) changes in the rate of interest, (ii) interest on interest, or (iii) increases in the Indebtedness resulting from the addition of unpaid interest.
“Interest,” as used in this paragraph 3, shall include lawful interest based on appreciated value.

4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) resulting from:
   a. The invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage as security for any Advance made after a Petition for Relief under the Bankruptcy Code (11 U.S.C.) has been filed by or on behalf of the mortgagor;
   b. The lien of real estate taxes or assessments on the Title imposed by governmental authority arising after Date of Policy;
   c. The lack of priority of the lien of the Insured Mortgage as security for any Advance to a federal tax lien, which Advance is made after the earlier of (i) actual knowledge of the Insured that a federal tax lien was filed against the mortgagor, or (ii) the expiration, after notice of a federal tax lien filed against the mortgagor, of any grace period for making disbursements with priority over the federal tax lien provided in the Internal Revenue Code (26 U.S.C.);
   d. Any federal or state environmental protection lien; or
   e. Usury, or any consumer credit protection or truth-in-lending law. [; or
   f. Any mechanic’s or materialmen’s lien.]

5. The Indebtedness includes Advances.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: __________________________________________
   Authorized Signatory
RESIDENTIAL LIMITED COVERAGE JUNIOR LOAN POLICY

Issued By

BLANK TITLE INSURANCE COMPANY

Any notice of claim and any other notice or statement in writing required to be given to the Company under this Policy must be given to the Company at the address shown in Section 15 of the Conditions.

COVERED RISKS

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS AND THE CONDITIONS, and provided that the Land is a one-to-four family residence or condominium unit, Blank Title Insurance Company, a __________ corporation, the Company, insures, as of Date of Policy, against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of:

1. The Grantee not being the named grantee on the last document purporting to vest the Title recorded in the Public Records.

2. The description of the Land in Schedule A not being the same as that contained in the last document purporting to vest the Title recorded in the Public Records.

3. A Monetary Lien recorded in the Public Records.

4. Any ad valorem taxes or assessments of any governmental taxing authority that constitute a lien on the Title and that on Date of Policy appear in the official ad valorem tax records where the Land is located.

The Company will also pay the costs, attorneys’ fees and expenses incurred in defense of any matter insured against by this Policy, but only to the extent provided in the Conditions.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY: ________________________________ PRESIDENT

BY: ________________________________ SECRETARY
SCHEDULE A

Name and Address of Title Insurance Company:

Policy No. [Premium: $________.]

Amount of Insurance: $ Date of Policy:

Name of Insured:

Grantee:

The Land referred to in this policy is described as follows:

EXCEPTIONS

This policy does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees or expenses) which arise by reason of:

[TAX INFORMATION]
EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of:

1. Any invalidity, unenforceability or ineffectiveness of the Insured's Mortgage.

2. Defects, liens, encumbrances, adverse claims or other matters:
   a. created, suffered, assumed or agreed to by the Insured Claimant;
   b. known to the Insured Claimant whether or not disclosed in the Public Records;
   c. resulting in no loss or damage to the Insured Claimant; or
   d. recorded or filed in the Public Records subsequent to Date of Policy.
CONDITIONS

1. DEFINITION OF TERMS

The following terms when used in this policy mean:

(a) “Amount of Insurance”: The amount stated in Schedule A.

(b) “Date of Policy”: The date designated as “Date of Policy” in Schedule A.

(c) “Entity”: A corporation, partnership, trust, limited liability company, or other similar legal entity.

(d) “Grantee”: The Grantee designated in Schedule A.

(e) “Indebtedness”: The obligation if secured by the Insured’s Mortgage. Including one evidenced by electronic means authorized by law, and if that obligation is the payment of a debt, the Indebtedness is the sum of:

   (i) the amount of the principal disbursed if secured by the Insured’s Mortgage;
   (ii) interest on the loan;
   (iii) the prepayment premiums, exit fees, and other similar fees or penalties allowed by law;
   (iv) the expenses of foreclosure and any other costs of enforcement;

   but the Indebtedness is reduced by the total of all payments and by any amount forgiven by an Insured.

(f) “Insured”: The Insured named in Schedule A if it is the owner of the Indebtedness and each successor in ownership of the Indebtedness, except a successor who is an obligor, reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor Insured.

(g) "Insured Claimant": An Insured claiming loss or damage.

(h) "Insured’s Mortgage": The Mortgage described in JR1.

(i) "Knowledge" or "Known": Actual knowledge, not constructive knowledge or notice that may be imputed to an Insured by reason of the Public Records or any other records that impart constructive notice of matters affecting the Title.

(j) “Land”: The land described in Schedule A, and affixed improvements that by law constitute real property. The term “Land” does not include any property beyond the lines of the area described in Schedule A, nor any right, title, interest, estate, or easement in abutting streets, roads, avenues, alleys, lanes, ways, or waterways.

(k) "Mortgage": Mortgage, deed of trust, trust deed, or other security instrument, including one evidenced by electronic means authorized by law.

(l) "Monetary Lien": Any Mortgage, deed of trust, judgment lien or other lien affecting the Title securing the obligation to pay money, but not including any lien created in any easement, covenant, condition, restriction, or declaration of condominium or planned unit development, except to the extent that a separate notice of enforcement of a specific delinquent charge or assessment affecting the Title has been recorded in the Public Records.
(m) "Public Records": Records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without Knowledge.

(n) "Title": The estate or interest described in Schedule A.

2. CONTINUATION OF INSURANCE
The coverage of this policy shall continue in force as of Date of Policy in favor of an Insured after acquisition of the Title by an Insured through foreclosure of the lien of the Insured’s Mortgage or deed in lieu of foreclosure.

3. NOTICE OF CLAIM TO BE GIVEN BY INSURED CLAIMANT
The Insured shall notify the Company promptly in writing (i) in case of any litigation as set forth in Section 5 of these Conditions, (ii) in case Knowledge shall come to an Insured of any claim that might cause loss or damage for which the Company may be liable by virtue of this policy. If the Company is prejudiced by the failure of the Insured Claimant to provide prompt notice, the Company’s liability to the Insured Claimant under the policy shall be reduced to the extent of the prejudice.

4. PROOF OF LOSS
In the event the Company is unable to determine the amount of loss or damage, the Company may, at its option, require as a condition of payment that the Insured Claimant furnish a signed proof of loss. The proof of loss must describe the defect, lien, encumbrance, or other matter insured against by this policy that constitutes the basis of loss or damage and shall state, to the extent possible, the basis of calculating the amount of the loss or damage.

5. DEFENSE AND PROSECUTION OF ACTIONS
(a) Upon written request by the Insured, and subject to the options contained in Section 6 of these Conditions, the Company, at its own cost and without unreasonable delay, shall provide for the defense of an Insured in litigation in which any third party asserts a claim covered by this policy adverse to the Insured. This obligation is limited to only those stated causes of action alleging matters insured against by this policy. The Company shall have the right to select counsel of its choice (subject to the right of the Insured to object for reasonable cause) to represent the Insured as to those stated causes of action. It shall not be liable for and will not pay the fees of any other counsel. The Company will not pay any fees, costs, or expenses incurred by the Insured in the defense of those causes of action that allege matters not insured against by this policy.

(b) The Company shall have the right, in addition to the options contained in Section 6 of these Conditions, at its own cost, to institute and prosecute any action or proceeding or to do any other act that in its opinion may be necessary or desirable to prevent or reduce loss or damage to the Insured. The Company may take any appropriate action under the terms of this policy, whether or not it shall be liable to the Insured. The exercise of these rights shall not be an admission of liability or waiver of any provision of this policy. If the Company exercises its rights under this subsection, it must do so diligently.
(c) Whenever the Company brings an action or asserts a defense as required or permitted by this policy, the Company may pursue the litigation to a final determination by a court of competent jurisdiction, and it expressly reserves the right, in its sole discretion, to appeal any adverse judgment or order.

6. OPTIONS TO PAY OR OTHERWISE SETTLE CLAIMS; TERMINATION OF LIABILITY

In case of a claim under this policy, the Company shall have the following additional options:

(a) To Pay or Tender Payment of the Amount of Insurance or to Purchase the Indebtedness.

(i) To pay or tender payment of the Amount of Insurance under this policy together with any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment or tender of payment and that the Company is obligated to pay; or

(ii) To purchase the Indebtedness for the amount of the Indebtedness on the date of purchase, together with any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of purchase and that the Company is obligated to pay.

When the Company purchases the Indebtedness, the Insured shall transfer, assign, and convey to the Company the Indebtedness and the Insured Mortgage, together with any collateral security.

Upon the exercise by the Company of either of the options provided for in subsections (a)(i) or (ii), all liability and obligations of the Company to the Insured under this policy, other than to make the payment required in those subsections, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation.

(b) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

(i) To pay or otherwise settle with other parties for or in the name of an Insured Claimant any claim insured against under this policy. In addition, the Company will pay any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment and that the Company is obligated to pay; or

(ii) To pay or otherwise settle with the Insured Claimant the loss or damage provided for under this policy, together with any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment and that the Company is obligated to pay.

Upon the exercise by the Company of either of the options provided for in subsections (b)(i) or (ii), the Company's obligations to the Insured under this policy for the claimed loss or damage, other than the payments required to be made, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation.

7. DETERMINATION AND EXTENT OF LIABILITY

This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the Insured Claimant who has suffered loss or damage by reason of matters insured against by this policy.
(a) The extent of liability of the Company for loss or damage under this policy shall not exceed the least of
(i) the Amount of Insurance,
(ii) the Indebtedness,
(iii) the difference between the value of the Title without the matter insured against and the value of the Title subject to the matter insured against by this policy.

(b) In the event the Insured has acquired the Title in the manner described in Section 2 of these Conditions then the extent of liability of the Company shall continue as set forth in Section 7(a) of these Conditions.

(c) In addition to the extent of liability under (a) and (b), the Company will also pay those costs, attorneys' fees, and expenses incurred in accordance with Sections 5 and 7 of these Conditions. If the loss is caused by a lien insured against by this policy, the difference between the value of the estate or interest in the land encumbered by the insured's mortgage without the lien insured against and the value of that estate or interest subject to the lien insured against by this policy.

8. LIMITATION OF LIABILITY

(a) If the Company removes an alleged matter insured against by this policy in a reasonably diligent manner by any method, including litigation and the completion of any appeals, it shall have fully performed its obligations and shall not be liable for any loss or damage with respect to that matter.

(b) In the event of any litigation, including litigation by the Company or with the Company's consent, the Company shall have no liability for loss or damage until there has been a final determination by a court of competent jurisdiction, and disposition of all appeals, adverse to the Insured with respect to matters insured against by this policy.

(c) The Company shall not be liable for loss or damage to any insured for liability voluntarily assumed by the Insured in settling any claim or suit without the prior written consent of the Company.

9. REDUCTION OF INSURANCE; TERMINATION OF LIABILITY

(a) All payments under this policy, except payment made for costs, attorneys' fees and expenses, shall reduce the Amount of Insurance by the amount of the payment.

(b) The voluntary satisfaction or release of the Insured's Mortgage shall terminate all liability of the Company except as provided in Section 2 of these Conditions.

10. PAYMENT OF LOSS

When liability and the extent of loss or damage have been definitely fixed in accordance with these Conditions, the payment shall be made within 30 days.

11. RIGHTS OF RECOVERY UPON PAYMENT OR SETTLEMENT
(a) The Company's Right to Recover

Whenever the Company shall have settled and paid a claim under this policy, it shall be subrogated and entitled to all rights and remedies of the Insured Claimant in respect to the claim that the Insured Claimant has against any person or property to the extent of the amount of any loss, costs, attorneys’ fees, and expenses paid by the Company. If requested by the Company, the Insured Claimant shall execute documents to evidence the transfer to the Company of these rights and remedies. The Insured Claimant shall permit the Company to sue, compromise, or settle in the name of the Insured Claimant and to use the name of the Insured Claimant in any transaction or litigation involving these rights and remedies.

If a payment on account of a claim does not fully cover the loss of the Insured Claimant, the Company shall defer the exercise of its right to recover until after the Insured Claimant shall have recovered its loss.

(b) The Company's Rights Against Noninsured Obligors

The Company’s right of subrogation includes the Insured’s rights against non-insured obligors including the rights of the Insured to indemnities, guaranties, other policies of insurance, or bonds, notwithstanding any terms or conditions contained in those instruments that address subrogation rights.

The Company’s right of subrogation shall not be avoided by acquisition of the Insured Mortgage by an obligor who acquires the Insured Mortgage as a result of an indemnity, guarantee, other policy of insurance, or bond, and the obligor will not be an Insured under this policy.

12. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT

(a) This policy together with all endorsements, if any, attached to it by the Company is the entire policy and contract between the Insured and the Company. In interpreting any provision of this policy, this policy shall be construed as a whole.

(b) Any claim of loss or damage relating to the Covered Risks or any other matter shall be restricted to this policy.

(c) Any amendment of or endorsement to this policy must be in writing and authenticated by an authorized person, or expressly incorporated by Schedule A of this policy.

(d) Each endorsement to this policy issued at any time is made a part of this policy and is subject to all of its terms and provisions. Except as the endorsement expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsement, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.

13. SEVERABILITY

In the event any provision of this policy, in whole or in part, is held invalid or unenforceable under applicable law, the policy shall be deemed not to include that provision or such part held to be invalid, and all other provisions shall remain in full force and effect.

14. CHOICE OF LAW; FORUM

(a) Choice of Law: The Insured acknowledges the Company has underwritten the risks covered by this policy and determined the premium charged therefore in reliance upon the law affecting interests in real property and applicable to the interpretation, rights,
remedies, or enforcement of policies of title insurance of the jurisdiction where the Land is located.

Therefore, the court or an arbitrator shall apply the law of the jurisdiction where the Land is located to determine the validity of claims insured against by this policy and to interpret and enforce the terms of this policy. In neither case shall the court or arbitrator apply its conflicts of law principles to determine the applicable law.

(b)  Choice of Forum: Any litigation or other proceeding brought by the Insured against the Company must be filed only in a state or federal court within the United States of America or its territories having appropriate jurisdiction.

15.  NOTICES, WHERE SENT

All notices required to be given the Company and any statement in writing required to be furnished the Company shall include the number of this policy and shall be addressed to the Company, Attention: Claims Department.

[16.  ARBITRATION

Unless prohibited by applicable law, either the Company or the Insured may demand that the claim or controversy shall be submitted to arbitration pursuant to the Title Insurance Arbitration Rules of the American Land Title Association ("Rules"). Except as provided in the Rules, there shall be no joinder or consolidation with claims or controversies of other persons. Arbitrable matters may include, but are not limited to, any controversy or claim between the Company and the Insured arising out of or relating to this policy, any service in connection with its issuance or the breach of a policy provision, or to any other controversy or claim arising out of the transaction giving rise to this policy. All arbitrable matters when the Amount of Insurance is $2,000,000 or less shall be arbitrated at the option of either the Company or the Insured. All arbitrable matters when the Amount of Insurance is in excess of $2,000,000 shall be arbitrated only when agreed to by both the Company and the Insured. Arbitration pursuant to this policy and under the Rules shall be binding upon the parties. Judgment upon the award rendered by the Arbitrator(s) may be entered in any court of competent jurisdiction.]
RESIDENTIAL LIMITED COVERAGE JUNIOR LOAN POLICY

Issued By
BLANK TITLE INSURANCE COMPANY

Any notice of claim and any other notice or statement in writing required to be given to the Company under this Policy must be given to the Company at the address shown in Section 44-15 of the Conditions.

COVERED RISKS

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS AND THE CONDITIONS, and provided that the Land is a one-to-four family residence or condominium unit, Blank Title Insurance Company, a ______________ corporation, the Company, insures, as of Date of Policy, against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of:

1. The Grantee not being the named grantee on the last document purporting to vest the Title recorded in the Public Records.

2. The description of the Land in Schedule A not being the same as that contained in the last document purporting to vest the Title recorded in the Public Records.

3. A Monetary Lien recorded in the Public Records.

4. Any ad valorem taxes or assessments of any governmental taxing authority that constitute a lien on the Title and that on Date of Policy appear in the official ad valorem tax records where the Land is located.

The Company will also pay the costs, attorneys' fees and expenses incurred in defense of any matter insured against by this Policy, but only to the extent provided in the Conditions.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY: ________________________ PRESIDENT

BY: ________________________ SECRETARY
SCHEDULE A

Name and Address of Title Insurance Company:

Policy No. 

Amount of Insurance: $ 

Name of Insured:

Grantee:

The Land referred to in this policy is described as follows:

EXCEPTIONS

This policy does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees or expenses) which arise by reason of:

[TAX INFORMATION]
EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys' fees or expenses which arise by reason of:

1. Any invalidity, unenforceability or ineffectiveness of the Insured's Mortgage.

2. Defects, liens, encumbrances, adverse claims or other matters:
   a. created, suffered, assumed or agreed to by the Insured Claimant;
   b. known to the Insured Claimant whether or not disclosed in the Public Records;
   c. resulting in no loss or damage to the Insured Claimant; or
   d. recorded or filed in the Public Records subsequent to Date of Policy.
CONDITIONS

1. DEFINITION OF TERMS

The following terms when used in this policy mean:

(a) “Amount of Insurance”: The amount stated in Schedule A.
(b) “Date of Policy”: The date designated as “Date of Policy” in Schedule A.
(c) “Entity”: A corporation, partnership, trust, limited liability company, or other similar legal entity.
(d) “Grantee”: The Grantee designated in Schedule A.
(e) “Indebtedness”: The obligation if secured by the Insured’s Mortgage. Including one evidenced by electronic means authorized by law, and if that obligation is the payment of a debt, the Indebtedness is the sum of:
   (i) the amount of the principal disbursed if secured by the Insured’s Mortgage;
   (ii) interest on the loan;
   (iii) the prepayment premiums, exit fees, and other similar fees or penalties allowed by law;
   (iv) the expenses of foreclosure and any other costs of enforcement;
   but the Indebtedness is reduced by the total of all payments and by any amount forgiven by an Insured.
(f) “Insured”: The Insured named in Schedule A if it is the owner of the Indebtedness and each successor in ownership of the Indebtedness, except a successor who is an obligor, reserving, however, all rights and defenses as to any successor that the Company would have had against any predecessor Insured.
(g) "Insured Claimant": An Insured claiming loss or damage.
(h) "Insured’s Mortgage": The Mortgage described in JR1.
(i) "Knowledge" or "Known": Actual knowledge, not constructive knowledge or notice that may be imputed to an Insured by reason of the Public Records or any other records that impart constructive notice of matters affecting the Title.
(j) "Land": The land described in Schedule A, and affixed improvements that by law constitute real property. The term “Land” does not include any property beyond the lines of the area described in Schedule A, nor any right, title, interest, estate, or easement in abutting streets, roads, avenues, alleys, lanes, ways, or waterways.
(k) "Mortgage": Mortgage, deed of trust, trust deed, or other security instrument, including one evidenced by electronic means authorized by law.
(l) "Monetary Lien": Any Mortgage, deed of trust, judgment lien or other lien affecting the Title securing the obligation to pay money, but not including any lien created in any easement, covenant, condition, restriction, or declaration of condominium or planned unit development, except to the extent that a separate notice of enforcement of a specific delinquent charge or assessment affecting the Title has been recorded in the Public Records.
(m) "Public Records": Records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without Knowledge.

(n) "Title": The estate or interest described in Schedule A.

2. CONTINUATION OF INSURANCE
The coverage of this policy shall continue in force as of Date of Policy in favor of an Insured after acquisition of the Title by an Insured through foreclosure of the lien of the Insured’s Mortgage or deed in lieu of foreclosure.

3. NOTICE OF CLAIM TO BE GIVEN BY INSURED CLAIMANT
The Insured shall notify the Company promptly in writing (i) in case of any litigation as set forth in Section 5 of these Conditions, (ii) in case Knowledge shall come to an Insured of any claim that might cause loss or damage for which the Company may be liable by virtue of this policy. If the Company is prejudiced by the failure of the Insured Claimant to provide prompt notice, the Company’s liability to the Insured Claimant under the policy shall be reduced to the extent of the prejudice.

4. PROOF OF LOSS
In the event the Company is unable to determine the amount of loss or damage, the Company may, at its option, require as a condition of payment that the Insured Claimant furnish a signed proof of loss. The proof of loss must describe the defect, lien, encumbrance, or other matter insured against by this policy that constitutes the basis of loss or damage and shall state, to the extent possible, the basis of calculating the amount of the loss or damage.

5. DEFENSE AND PROSECUTION OF ACTIONS
(a) Upon written request by the Insured, and subject to the options contained in Section 6 of these Conditions, the Company, at its own cost and without unreasonable delay, shall provide for the defense of an Insured in litigation in which any third party asserts a claim covered by this policy adverse to the Insured. This obligation is limited to only those stated causes of action alleging matters insured against by this policy. The Company shall have the right to select counsel of its choice (subject to the right of the Insured to object for reasonable cause) to represent the Insured as to those stated causes of action. It shall not be liable for and will not pay the fees of any other counsel. The Company will not pay any fees, costs, or expenses incurred by the Insured in the defense of those causes of action that allege matters not insured against by this policy.

(b) The Company shall have the right, in addition to the options contained in Section 6 of these Conditions, at its own cost, to institute and prosecute any action or proceeding or to do any other act that in its opinion may be necessary or desirable to prevent or reduce loss or damage to the Insured. The Company may take any appropriate action under the terms of this policy, whether or not it shall be liable to the Insured. The exercise of these rights shall not be an admission of liability or waiver of any provision of this policy. If the Company exercises its rights under this subsection, it must do so diligently.
(c) Whenever the Company brings an action or asserts a defense as required or permitted by this policy, the Company may pursue the litigation to a final determination by a court of competent jurisdiction, and it expressly reserves the right, in its sole discretion, to appeal any adverse judgment or order.

6. **OPTIONS TO PAY OR OTHERWISE SETTLE CLAIMS; TERMINATION OF LIABILITY**

   In case of a claim under this policy, the Company shall have the following additional options:

   (a) To Pay or Tender Payment of the Amount of Insurance or to Purchase the Indebtedness.

      (i) To pay or tender payment of the Amount of Insurance under this policy together with any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment or tender of payment and that the Company is obligated to pay; or

      (ii) To purchase the Indebtedness for the amount of the Indebtedness on the date of purchase, together with any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of purchase and that the Company is obligated to pay.

      When the Company purchases the Indebtedness, the Insured shall transfer, assign, and convey to the Company the Indebtedness and the Insured Mortgage, together with any collateral security.

      Upon the exercise by the Company of either of the options provided for in subsections (a)(i) or (ii), all liability and obligations of the Company to the Insured under this policy, other than to make the payment required in those subsections, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation.

   (b) To Pay or Otherwise Settle With Parties Other Than the Insured or With the Insured Claimant.

      (i) to pay or otherwise settle with other parties for or in the name of an Insured Claimant any claim insured against under this policy. In addition, the Company will pay any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment and that the Company is obligated to pay; or

      (ii) to pay or otherwise settle with the Insured Claimant the loss or damage provided for under this policy, together with any costs, attorneys' fees, and expenses incurred by the Insured Claimant that were authorized by the Company up to the time of payment and that the Company is obligated to pay.

      Upon the exercise by the Company of either of the options provided for in subsections (b)(i) or (ii), the Company's obligations to the Insured under this policy for the claimed loss or damage, other than the payments required to be made, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation.

7. **DETERMINATION AND PAYMENT OF LOSS EXTENT OF LIABILITY**

   This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the Insured Claimant who has suffered loss or damage by reason of matters insured against by this policy.
(a) The extent of liability of the Company for loss or damage under this policy shall not exceed the least of
   (i) the Amount of Insurance,
   (ii) the Indebtedness, or
   (iii) the difference between the value of the Title without the matter insured against and the value of the Title subject to the matter insured against by this policy.

(b) In the event the Insured has acquired the Title in the manner described in Section 2 of these Conditions then the extent of liability of the Company shall continue as set forth in Section 7(a) of these Conditions.

(c) In addition to the extent of liability under (a) and (b), the Company will also pay those costs, attorneys' fees, and expenses incurred in accordance with Sections 5 and 7 of these Conditions. If the loss is caused by a lien insured against by this policy, the difference between the value of the estate or interest in the land encumbered by the insured's mortgage without the lien insured against and the value of that estate or interest subject to the lien insured against by this policy.

8. LIMITATION OF LIABILITY
   (a) If the Company removes an alleged matter insured against by this policy in a reasonably diligent manner by any method, including litigation and the completion of any appeals, it shall have fully performed its obligations and shall not be liable for any loss or damage with respect to that matter.

   (b) In the event of any litigation, including litigation by the Company or with the Company's consent, the Company shall have no liability for loss or damage until there has been a final determination by a court of competent jurisdiction, and disposition of all appeals, adverse to the Insured with respect to matters insured against by this policy.

   (c) The Company shall not be liable for loss or damage to any insured for liability voluntarily assumed by the Insured in settling any claim or suit without the prior written consent of the Company.

9. REDUCTION OF INSURANCE; TERMINATION OF LIABILITY
   (a) All payments under this policy, except payment made for costs, attorneys' fees and expenses, shall reduce the Amount of Insurance by the amount of the payment.

   (b) The voluntary satisfaction or release of the Insured's Mortgage shall terminate all liability of the Company except as provided in Section 2 of these Conditions.

10. PAYMENT OF LOSS
    When liability and the extent of loss or damage have been definitely fixed in accordance with these Conditions, the payment shall be made within 30 days.

11. RIGHTS OF RECOVERY UPON PAYMENT OR SETTLEMENT
(a) The Company's Right to Recover

Whenever the Company shall have settled and paid a claim under this policy, it shall be subrogated and entitled to all rights and remedies of the Insured Claimant in respect to the claim that the Insured Claimant has against any person or property to the extent of the amount of any loss, costs, attorneys' fees, and expenses paid by the Company. If requested by the Company, the Insured Claimant shall execute documents to evidence the transfer to the Company of these rights and remedies. The Insured Claimant shall permit the Company to sue, compromise, or settle in the name of the Insured Claimant and to use the name of the Insured Claimant in any transaction or litigation involving these rights and remedies.

If a payment on account of a claim does not fully cover the loss of the Insured Claimant, the Company shall defer the exercise of its right to recover until after the Insured Claimant shall have recovered its loss.

(b) The Company's Rights Against Noninsured Obligors

The Company’s right of subrogation includes the Insured’s rights against non-insured obligors including the rights of the Insured to indemnities, guaranties, other policies of insurance, or bonds, notwithstanding any terms or conditions contained in those instruments that address subrogation rights.

The Company’s right of subrogation shall not be avoided by acquisition of the Insured Mortgage by an obligor who acquires the Insured Mortgage as a result of an indemnity, guarantee, other policy of insurance, or bond, and the obligor will not be an Insured under this policy.

12. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT

(a) This policy together with all endorsements, if any, attached to it by the Company is the entire policy and contract between the Insured and the Company. In interpreting any provision of this policy, this policy shall be construed as a whole.

(b) Any claim of loss or damage relating to the Covered Risks or any other matter shall be restricted to this policy.

(c) Any amendment of or endorsement to this policy must be in writing and authenticated by an authorized person, or expressly incorporated by Schedule A of this policy.

(d) Each endorsement to this policy issued at any time is made a part of this policy and is subject to all of its terms and provisions. Except as the endorsement expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsement, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.

13. SEVERABILITY

In the event any provision of this policy, in whole or in part, is held invalid or unenforceable under applicable law, the policy shall be deemed not to include that provision or such part held to be invalid, and all other provisions shall remain in full force and effect.

14. CHOICE OF LAW; FORUM

(a) Choice of Law: The Insured acknowledges the Company has underwritten the risks covered by this policy and determined the premium charged therefore in reliance upon the law affecting interests in real property and applicable to the interpretation, rights,
remedies, or enforcement of policies of title insurance of the jurisdiction where the Land is located.

Therefore, the court or an arbitrator shall apply the law of the jurisdiction where the Land is located to determine the validity of claims insured against by this policy and to interpret and enforce the terms of this policy. In neither case shall the court or arbitrator apply its conflicts of law principles to determine the applicable law.

(b) Choice of Forum: Any litigation or other proceeding brought by the Insured against the Company must be filed only in a state or federal court within the United States of America or its territories having appropriate jurisdiction.

15. NOTICES WHERE SENT

All notices required to be given the Company and any statement in writing required to be furnished the Company shall include the number of this policy and shall be addressed to the Company, Attention: Claims Department.

16. ARBITRATION

Unless prohibited by applicable law, either the Company or the Insured may demand that the claim or controversy shall be submitted to arbitration pursuant to the Title Insurance Arbitration Rules of the American Land Title Association ("Rules"). Except as provided in the Rules, there shall be no joinder or consolidation with claims or controversies of other persons. Arbitrable matters may include, but are not limited to, any controversy or claim between the Company and the Insured arising out of or relating to this policy, any service in connection with its issuance or the breach of a policy provision, or to any other controversy or claim arising out of the transaction giving rise to this policy. All arbitrable matters when the Amount of Insurance is $2,000,000 or less shall be arbitrated at the option of either the Company or the Insured. All arbitrable matters when the Amount of Insurance is in excess of $2,000,000 shall be arbitrated only when agreed to by both the Company and the Insured. Arbitration pursuant to this policy and under the Rules shall be binding upon the parties. Judgment upon the award rendered by the Arbitrator(s) may be entered in any court of competent jurisdiction.]
Technical Corrections to Existing ALTA Forms

The ALTA Forms Committee announced technical corrections to existing ALTA forms. The corrections are effective immediately.

- **Endorsement 3.2-06 (Zoning – Land Under Development) Revised 04-02-12**: A slight change in language in paragraph 3 has been applied. The language originally published was unintentionally restrictive in terms of the timing of a zoning violation for future alterations or improvements.
- **Endorsement 9.8-06 (Covenants Conditions and Restrictions – Land Under Development – Owner’s Policy) Adopted 04-02-12**: Paragraph 4.d. of the published version was inadvertently included in the Form. The other forms in the series stop at paragraph 4.c. and the technical correction results in consistency across the 9 Series.
- **Endorsement 14.3-06 (Future Advance – Reverse Mortgage) Revised 2-3-11**: A capitalization error is corrected in paragraph 2.c.
- **ALTA Residential Limited Coverage Junior Loan Policy Revised 8-1-12**: The reference on page 1 of the policy to the notices provision is corrected to display the correct section number. Also, a correction is made to the title of the DETERMINATION AND EXTENT OF LIABILITY section and a comma is inserted in the NOTICES, WHERE SENT section later in the form.

These corrected versions are effective immediately and may be downloaded, along with redlines of the changes, from the ALTA Policy Forms page on the ALTA website.

Close Window

Copyright © 2004-2012 American Land Title Association. All rights reserved.
Mr. D. Lawrence Buggage, Associate Insurance Rate Analyst  
L.A. 3, Rate Filing Bureau, Rate Regulation Branch  
California Department of Insurance  
300 South Spring Street  
Suite 12705, South Tower  
Los Angeles, CA  90013

RE: FORM FILING REQUEST

Dear Mr. Buggage:

The CLTA, in its capacity as an advisory organization pursuant to Sections 12402-12402.2 of the Insurance Code, is making the following form filing on behalf of its member companies. Please accept the following to be effective 30 days from the date of this filing.

Revised POLICY / ENDORSEMENTS - The ALTA Forms Committee recommended minor technical changes to the following policy and three (3) endorsements. All forms will hold their original effective dates:

1. CLTA Form 100.2.8-06 (04-02-12) / ALTA Endorsement Form 9.8-06  
*Covenant Conditions and Restrictions – Land Under Development – Owner’s Policy*
Paragraph 4.d. of the published version was inadvertently included in the Form. The other forms in the series stop at paragraph 4.c. and the technical correction results in consistency across the 9 Series.

2. CLTA Form 111.14.3-06 (02-03-11 ) / ALTA Endorsement Form 14.3-06  
*Future Advance – Reverse Mortgage*
A capitalization error is corrected in paragraph 2.c.

3. CLTA Form 123.3-06 (04-02-12)  / ALTA Endorsement Form 3.2-06  
*Zoning – Land Under Development*
A slight change in language in paragraph 3 has been applied. The language originally published was unintentionally restrictive in terms of the timing of a zoning violation for future alterations or improvements.

4. ALTA Residential Limited Coverage Junior Loan Policy (08-01-12)
The reference on page 1 of the policy to the notices provision is corrected to display the correct section number. Also, a correction is made to the title of the DETERMINATION AND EXTENT OF LIABILITY section and a comma is inserted in the NOTICES, WHERE SENT section later in the form.

Upon receipt, I would appreciate your email reply acknowledging your receipt of this filing followed by the CDI File Number and filing acceptance date.

Sincerely,

Craig C. Page  
Executive Vice President and Counsel
December 20, 2012 – via email
Mr. D. Lawrence Buggage, Associate Insurance Rate Analyst
California Department of Insurance
RE: FORM FILING REQUEST
Page Two of Two

enclosure(s)

cc: Ken Allen, Chief, Rate Filing Bureau, Ca Department of Insurance
Roger Therien, CLTA Forms & Practices Committee Chair
Robert Cavallaro, CLTA Forms & Practices Committee Vice Chair
Paul Flores, CLTA Forms & Practices Committee, Title Forms Section Chair
Bill Burding, CLTA Legislative Committee Chair
Dear Craig Page,

Please be advised that California Land Title Association, filing CDI # 12-9286, was received on December 20, 2012 and have been accepted and closed on January 24, 2013. The filings carry an effective date of January 18, 2012. Please note that the Commissioner may at any time take any action allowed by law if it is determined that any portion of the filing application conflicts with any applicable law or regulation.

Please contact me if you have any questions regarding this filing.

Tina

Insurance Rate Analyst
California Department of Insurance
Rate Regulation Branch, RFLA3
Tel: 213-346-6795
Fax: 213-897-7241
ENDORSEMENT

Attached to Policy No.

Issued by

BLANK TITLE INSURANCE COMPANY

1. The insurance provided by this endorsement is subject to the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

2. The Company insures against loss or damage sustained by the Insured by reason of:
   a. any defect in the execution of the [Insert Title of Assignment of Rents or Leases Document] referred to in paragraph _____ [of Part II] of Schedule B; or
   b. any assignment of the lessor’s interest in any lease or leases or any assignment of rents affecting the Title and recorded in the Public Records at Date of Policy other than as set forth in any instrument referred to in Schedule B.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ______________________________________
    Authorized Signatory
ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

1. The insurance provided by this endorsement is subject to the exclusions in Sections 4 and 5 of this endorsement, the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

2. For the purposes of this endorsement only, “Mortgage Tax” means a recordation, registration or related tax or charge required to be paid when the Insured Mortgage is recorded in the Public Records.

3. Upon payment of any deficiency in the Mortgage Tax, including interest and penalties, by the Insured, the Company insures against loss or damage sustained by the Insured by reason of:
   a. the invalidity or unenforceability of the lien of the Insured Mortgage as security for the Indebtedness resulting from the failure to pay, at the time of recording, any portion of the Mortgage Tax; or
   b. the lack of priority of the lien of the Insured Mortgage as security for the Indebtedness resulting from the failure to pay, at the time of recording, any portion of the Mortgage Tax.

4. The Company does not insure against loss or damage (and the Company will not pay costs, attorneys' fees, or expenses) resulting from the failure of the Insured to pay the Mortgage Tax deficiency, together with interest and penalties.

5. The Company is not liable for the payment of any portion of the Mortgage Tax, including interest or penalties.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ______________________________

Authorized Signatory
SHORT FORM RESIDENTIAL LOAN POLICY
ONE-TO-FOUR FAMILY
Issued by
BLANK TITLE INSURANCE COMPANY
SCHEDULE A

Name and Address of Title Insurance Company:

[File No.: ]
Policy No.:
Loan No.:
Address Reference: Street Address:
County and State:

Amount of Insurance: $ [Premium: $ ]
Mortgage Amount: $ Mortgage Date:
Date of Policy: [at a.m. / p.m.]

Name of Insured:

Name of Borrower(s):

The estate or interest in the Land identified in this Schedule A and which is encumbered by the Insured Mortgage is fee simple and is, at Date of Policy, vested in the borrower(s) shown in the Insured Mortgage and named above.

The Land referred to in this policy is described as set forth in the Insured Mortgage.

This policy consists of [one] page(s), [including its reverse side,] unless an addendum is attached and indicated below:

_____ Addendum attached

The endorsements checked below, if any, are incorporated in this policy:

☐ ALTA ENDORSEMENT 4-06 (Condominium)
☐ ALTA ENDORSEMENT 4.1-06 (Condominium), if the Land or estate or interest is referred to in the Insured Mortgage as a condominium.
☐ ALTA ENDORSEMENT 5-06 (Planned Unit Development)
☐ ALTA ENDORSEMENT 5.1-06 (Planned Unit Development)
☐ ALTA ENDORSEMENT 6-06 (Variable Rate), if the Insured Mortgage contains provisions which provide for an adjustable interest rate.
☐ ALTA ENDORSEMENT 6.2-06 (Variable Rate-Negative Amortization), if the Insured Mortgage contains provisions which provide for both an adjustable interest rate and negative amortization.

☐ ALTA ENDORSEMENT 7-06 (Manufactured Housing), if a manufactured housing unit is located on the Land at Date of Policy.

☐ ALTA ENDORSEMENT 7.1-06 (Manufactured Housing – Conversion; Loan)

☐ ALTA ENDORSEMENT 8.1-06 (Environmental Protection Lien) – Paragraph b refers to the following state statute(s):

☐ ALTA ENDORSEMENT 9-06 (Restrictions, Encroachments, Minerals)

☐ ALTA ENDORSEMENT 14-06 (Future Advance – Priority)

☐ ALTA ENDORSEMENT 14.1-06 (Future Advance – Knowledge)

☐ ALTA ENDORSEMENT 14.3-06 (Future Advance – Reverse Mortgage)

☐ ALTA ENDORSEMENT 22-06 (Location) The type of improvement is a one-to-four family residential structure and the street address is as shown above.

☐ ALTA ENDORSEMENT 30-06 – (Shared Appreciation Mortgage)

[Witness clause optional]

BY: ___________________________ PRESIDENT

BY: ___________________________ SECRETARY

[bracketed material optional—one alternative must be chosen]

SUBJECT TO THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B BELOW, AND ANY ADDENDUM ATTACHED HERETO, BLANK TITLE INSURANCE COMPANY, A ______________ CORPORATION, HEREBIN CALLED THE "COMPANY," HEREBY INSURES THE INSURED IN ACCORDANCE WITH AND SUBJECT TO THE TERMS, EXCLUSIONS AND CONDITIONS SET FORTH IN THE AMERICAN LAND TITLE ASSOCIATION LOAN POLICY (6-17-06), ALL OF WHICH ARE INCORPORATED HEREIN. ALL REFERENCES TO SCHEDULES A AND B SHALL REFER TO SCHEDULES A AND B OF THIS POLICY.
SCHEDULE B
EXCEPTIONS FROM COVERAGE AND
AFFIRMATIVE INSURANCES

Except to the extent of the affirmative insurance set forth below, this policy does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) which arise by reason of:

1. Those taxes and assessments that become due or payable subsequent to Date of Policy. (This does not modify or limit the coverage provided in Covered Risk 11(b).)

2. Covenants, conditions, or restrictions, if any, appearing in the Public Records; however, this policy insures against loss or damage arising from:
   (a) the violation of those covenants, conditions, or restrictions on or prior to Date of Policy;
   (b) a forfeiture or reversion of Title from a future violation of those covenants, conditions, or restrictions, including those relating to environmental protection; and
   (c) provisions in those covenants, conditions, or restrictions, including those relating to environmental protection, under which the lien of the Insured Mortgage can be extinguished, subordinated, or impaired.

   As used in paragraph 2(a), the words “covenants, conditions, or restrictions” do not refer to or include any covenant, condition, or restriction (a) relating to obligations of any type to perform maintenance, repair or remediation on the Land, or (b) pertaining to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances, except to the extent that a notice of a violation or alleged violation affecting the Land has been recorded or filed in the Public Records at Date of Policy and is not referenced in an addendum attached to this policy.

3. Any easements or servitudes appearing in the Public Records; however, this policy insures against loss or damage arising from (a) the encroachment, at Date of Policy, of the improvements on any easement, and (b) any interference with or damage to existing improvements, including lawns, shrubbery, and trees, resulting from the use of the easements for the purposes granted or reserved.

4. Any lease, grant, exception, or reservation of minerals or mineral rights or other subsurface substances appearing in the Public Records; however, this policy insures against loss or damage arising from (a) any effect on or impairment of the use of the Land for residential one-to-four family dwelling purposes by reason of such lease, grant, exception or reservation of minerals or mineral rights or other subsurface substances, and (b) any damage to existing improvements, including lawns, shrubbery, and trees, resulting from the future exercise of any right to use the surface of the Land for the extraction or development of the minerals or mineral rights or other subsurface substances so leased, granted, excepted, or reserved. Nothing herein shall insure against loss or damage resulting from contamination, explosion, fire, fracturing, vibration, earthquake or subsidence.

NOTICES, WHERE SENT: Any notice of claim or other notice or statement in writing required to be given the Company under this policy must be given to the Company at the following address:

__________________________________________.
ADDENDUM TO SHORT FORM RESIDENTIAL LOAN POLICY

Addendum to Policy Number: _______________ [File Number: __________]

SCHEDULE B (Continued)

IN ADDITION TO THE MATTERS SET FORTH ON SCHEDULE B OF THE POLICY TO WHICH THIS ADDENDUM IS ATTACHED, THIS POLICY DOES NOT INSURE AGAINST LOSS OR DAMAGE (AND THE COMPANY WILL NOT PAY COSTS, ATTORNEYS’ FEES OR EXPENSES) THAT ARISE BY REASON OF THE FOLLOWING:
UNITED STATES OF AMERICA
POLICY OF TITLE INSURANCE
Issued by
BLANK TITLE INSURANCE COMPANY

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B AND THE CONDITIONS AND STIPULATIONS, BLANK TITLE INSURANCE COMPANY, a Blank corporation, herein called the Company, insures, as of Date of Policy shown in Schedule A, against loss or damage, not exceeding the Amount of Insurance stated in Schedule A, sustained or incurred by the insured by reason of:

1. Title to the estate or interest described in Schedule A being vested other than as stated therein;

2. Any defect in or lien or encumbrance on the title;

3. Unmarketability of the title;

4. Lack of a right of access to and from the land;

5. In instances where the insured acquires title to the land by condemnation, failure of the commitment for title insurance, as updated to the date of the filing of the lis pendens notice or the Declaration of Taking, to disclose the parties having an interest in the land as disclosed by the public records.

6. Title to the estate or interest described in Schedule A being vested other than as stated therein or being defective:
   (a) as a result of the avoidance in whole or in part, or from a court order providing an alternative remedy, of a transfer of all or any part of the title to or any interest in the land occurring prior to the transaction vesting title as shown in Schedule A because that prior transfer constituted a fraudulent or preferential transfer under federal bankruptcy, state insolvency, or similar creditors’ rights laws; or
   (b) because the instrument of transfer vesting title as shown in Schedule A constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors’ rights laws by reason of the failure of its recording in the public records
      (i) to be timely, or
      (ii) to impart notice of its existence to a purchaser for value or to a judgment or lien creditor.

The Company will also pay the costs, attorneys’ fees and expenses incurred in defense of the title, as insured, but only to the extent provided in the Conditions and Stipulations.

[Witness clause optional]
BLANK TITLE INSURANCE COMPANY

BY: ________________________________ PRESIDENT

BY: ________________________________ SECRETARY
EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys’ fees or expenses which arise by reason of:

1. (a) Any law, ordinance or governmental regulation (including but not limited to building and zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating to (i) the occupancy, use, or enjoyment of the land; (ii) the character, dimensions or location of any improvement now or hereafter erected on the land; (iii) a separation in ownership or a change in the dimensions or area of the land or any parcel of which the land is or was a part; or (iv) environmental protection, or the effect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.

(b) Any governmental police power not excluded by (a) above, except to the extent that a notice of the exercise thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.

2. Rights of eminent domain unless notice of the exercise thereof has been recorded in the public records at Date of Policy, but not excluding from coverage any taking which has occurred prior to Date of Policy which would be binding on the rights of a purchaser for value without knowledge.

3. Defects, liens, encumbrances, adverse claims or other matters:

(a) created, suffered, assumed or agreed to by the insured claimant;

(b) not known to the Company, not recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under the policy;

(c) resulting in no loss or damage to the insured claimant; or

(d) attaching or created subsequent to Date of Policy (however, this does not modify or limit the coverage provided under insuring provision 6).

4. This policy does not insure against the invalidity or insufficiency of any condemnation proceeding instituted by the United States of America, except to the extent set forth in insuring provision 5.
5. Any claim, which arises out of the transaction vesting in the Insured the estate or interest insured by this policy, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors’ rights laws, that is based on:

(a) the transaction creating the estate or interest insured by this policy being deemed a fraudulent conveyance or fraudulent transfer; or

(b) the transaction creating the estate or interest insured by this policy being deemed a preferential transfer except where the preferential transfer results from the failure:

(i) to timely record the instrument of transfer; or

(ii) of such recordation to impart notice to a purchaser for value or a judgment or lien creditor.

5. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors’ rights laws, that the transaction vesting the title as shown in Schedule A is:

(a) a fraudulent conveyance or fraudulent transfer; or

(b) a preferential transfer for any reason not stated in insuring provision 6.
SCHEDULE A

Name and Address of Title Insurance Company:

[File No. ] Policy No.

Amount of Insurance $

[Premium $ ]

Date of Policy_____

[at p.m.]

1. Name of Insured:

2. The estate or interest in the land which is covered by this policy is:

3. Title to the estate or interest in the land is vested in:

[4. The land referred to in this policy is described as follows:]

If Paragraph 4 is omitted, a Schedule C, captioned the same as Paragraph 4, must be used.
SCHEDULE B

[File No.    ]  Policy No.

EXCEPTIONS FROM COVERAGE

This policy does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) which arise by reason of:

1. [POLICY MAY INCLUDE REGIONAL EXCEPTIONS IF SO]

2. [DESIRED BY ISSUING COMPANY]

   [VARIABLE EXCEPTIONS SUCH AS TAXES, EASEMENTS, CC & Rs, ETC.]

3.

4.
CONDITIONS AND STIPULATIONS

1. DEFINITION OF TERMS.

   The following terms when used in this policy mean:

   (a) "Insured": the insured named in Schedule A, and, subject to any rights or defenses the Company
       would have had against the named insured, those who succeed to the interest of the named insured by
       operation of law as distinguished from purchase including, but not limited to, heirs, distributees, devisees,
       survivors, personal representatives, next of kin, or corporate or fiduciary successors.

   (b) "Insured claimant": an insured claiming loss or damage.

   (c) "Knowledge" or "Known": actual knowledge, not constructive knowledge or notice which may be
       imputed to an insured by reason of the public records as defined in this policy or any other records which
       impart constructive notice of matters affecting the land.

   (d) "Land": the land described or referred to in Schedule [A][C], and improvements affixed thereto
       which by law constitute real property. The term "land" does not include any property beyond the lines of the
       area described or referred to in Schedule [A][C], nor any right, title, interest, estate or easement in abutting
       streets, roads, avenues, alleys, lanes, ways or waterways, but nothing herein shall modify or limit the extent to
       which a right of access to and from the land is insured by this policy.

   (e) "Mortgage": mortgage, deed of trust, trust deed, or other security instrument.

   (f) "Public Records": records established under state statutes at Date of Policy for the
       purpose of imparting constructive notice of matters relating to real property to purchasers for value and without
       knowledge. With respect to Section 1(a)(iv) of the Exclusions From Coverage, "public records" shall also
       include environmental protection liens filed in the records of the clerk of the United States district court for the
       district in which the land is located.

   (g) "Unmarketability" of the Title: an alleged or apparent matter affecting the title
       to the land, not excluded or excepted from coverage, which would entitle a purchaser of the estate or interest
       described in Schedule A to be released from the obligation to purchase by virtue of a contractual condition
       requiring the delivery of marketable title.

2. CONTINUATION OF INSURANCE AFTER CONVEYANCE OF TITLE.

   The coverage of this policy shall continue in force as of Date of Policy in favor of an insured only so
   long as the insured retains an estate or interest in the land, or holds an indebtedness secured by a purchase
   money mortgage given by a purchaser from the insured, or only so long as the insured shall have liability by
   reason of covenants of warranty made by the insured in any transfer or conveyance of the estate or interest. This
   policy shall not continue in force in favor of any purchaser from the insured of either (i) an estate or
   interest in the land, or (ii) an indebtedness secured by a purchase money mortgage given to the insured.
3. NOTICE OF CLAIM TO BE GIVEN BY INSURED CLAIMANT.

The insured shall notify the Company promptly in writing (i) in case of any litigation as set forth in Section 4(a) below, (ii) in case knowledge shall come to an insured hereunder of any claim of title or interest which is adverse to the title to the estate or interest, as insured, and which might cause loss or damage for which the Company may be liable by virtue of this policy, or (iii) if title to the estate or interest, as insured, is rejected as unmarketable. If prompt notice shall not be given to the Company, then as to the insured all liability of the Company shall terminate with regard to the matter or matters for which prompt notice is required; provided, however, that failure to notify the Company shall in no case prejudice the rights of any insured under this policy unless the Company shall be prejudiced by the failure and then only to the extent of the prejudice.

4. DEFENSE AND PROSECUTION OF ACTIONS; DUTY OF INSURED CLAIMANT TO COOPERATE.

(a) Upon written request by the insured and subject to the options contained in Section 6 of these Conditions and Stipulations, the Company, at its own cost and without unreasonable delay, shall provide for the defense of an insured in litigation in which any third party asserts a claim adverse to the title or interest as insured, but only as to those stated causes of action alleging a defect, lien or encumbrance or other matter insured against by this policy. The Company shall have the right to select counsel of its choice (subject to the right of the insured to object for reasonable cause) to represent the insured as to those stated causes of action and shall not be liable for and will not pay the fees of any other counsel. The Company will not pay any fees, costs or expenses incurred by the insured in the defense of those causes of action which allege matters not insured by this policy.

(b) The Company shall have the right, at its own cost, to institute and prosecute any action or proceeding or to do any other act which in its opinion may be necessary or desirable to establish the title to the estate or interest, as insured, or to prevent or reduce loss or damage to the insured. The Company may take any appropriate action under the terms of this policy, whether or not it shall be liable hereunder, and shall not thereby concede liability or waive any provision of this policy. If the Company shall exercise its rights under this paragraph, it shall do so diligently.

(c) Whenever the Company shall have brought an action or interposed a defense as required or permitted by the provisions of this policy, the Company may pursue any litigation to final determination by a court of competent jurisdiction and expressly reserves the right, in its sole discretion, to appeal from any adverse judgment or order.

(d) In all cases where this policy permits or requires the Company to prosecute or provide for the defense of any action or proceeding, the insured shall secure to the Company the right to so prosecute or provide defense in the action or proceeding, and all appeals therein, and permit the Company to use, at its option, the name of the insured for this purpose. Whenever requested by the Company, the insured, at the Company's expense, shall give the Company all reasonable aid (i) in any action or proceeding, securing evidence, obtaining witnesses, prosecuting or defending the action or proceeding, or effecting settlement, and (ii) in any other lawful act which in the opinion of the Company may be necessary or desirable to establish the title to the estate or interest as insured. If the Company is prejudiced by the failure of the insured to furnish the required cooperation, the Company's obligations to the insured under the policy shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, with regard to the matter or matters requiring such cooperation.
(e) Notwithstanding Conditions and Stipulations Section 4(a-d), the Attorney General of the United States shall have the sole right to authorize or to undertake the defense of any matter which would constitute a claim under the policy, and the Company may not represent the insured without authorization. If the Attorney General elects to defend at the Government's expense, the Company shall, upon request, cooperate and render all reasonable assistance in the prosecution or defense of the proceeding and in prosecuting any related appeals. If the Attorney General shall fail to authorize and permit the Company to defend, all liability of the Company with respect to that claim shall terminate; provided, however, that if the Attorney General shall give the Company timely notice of all proceedings and an opportunity to suggest defenses and actions as it shall recommend should be taken, and the Attorney General shall present the defenses and take the actions of which the Company shall advise the Attorney General in writing, the liability of the Company shall continue and, in any event, the Company shall cooperate and render all reasonable assistance in the prosecution or defense of the claim and any related appeals.

5. PROOF OF LOSS OR DAMAGE.

In addition to and after the notices required under Section 3 of these Conditions and Stipulations have been provided the Company, a proof of loss or damage signed and sworn to by the insured claimant shall be furnished to the Company within 90 days after the insured claimant shall ascertain the facts giving rise to the loss or damage. The proof of loss or damage shall describe the defect in, or lien or encumbrance on the title, or other matter insured against by this policy which constitutes the basis of loss or damage and shall state, to the extent possible, the basis of calculating the amount of the loss or damage. If the Company is prejudiced by the failure of the insured claimant to provide the required proof of loss or damage, the Company's obligations to the insured under the policy shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, with regard to the matter or matters requiring such proof of loss or damage.

In addition, the insured claimant may reasonably be required to submit to examination under oath by any authorized representative of the Company and shall produce for examination, inspection and copying, at such reasonable times and places as may be designated by any authorized representative of the Company, all records, books, ledgers, checks, correspondence and memoranda, whether bearing a date before or after Date of Policy, which reasonably pertain to the loss or damage. Further, if requested by any authorized representative of the Company, the insured claimant shall grant its permission, in writing, for any authorized representative of the Company to examine, inspect and copy all records, books, ledgers, checks, correspondence and memoranda in the custody or control of a third party, which reasonably pertain to the loss or damage. All information designated as confidential by the insured claimant provided to the Company pursuant to this Section shall not be disclosed to others unless, in the reasonable judgment of the Company, it is necessary in the administration of the claim. Unless prohibited by law or governmental regulation, failure of the insured claimant to submit for examination under oath, produce other reasonably requested information or grant permission to secure reasonably necessary information from third parties as required in this paragraph shall terminate any liability of the Company under this policy as to that claim.
6. OPTIONS TO PAY OR OTHERWISE SETTLE CLAIMS; TERMINATION OF LIABILITY.

In case of a claim under this policy, the Company shall have the following additional options:

(a) **To Pay or Tender Payment of the Amount of Insurance.**

To pay or tender payment of the amount of insurance under this policy together with any costs, attorneys' fees and expenses incurred by the insured claimant, which were authorized by the Company, up to the time of payment or tender of payment and which the Company is obligated to pay.

Upon the exercise by the Company of this option, all liability and obligations to the insured under this policy, other than to make the payment required, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, and the policy shall be surrendered to the Company for cancellation.

(b) **To Pay or Otherwise Settle With Parties Other than the Insured or With the Insured Claimant.**

(i) Subject to the prior written approval of the Attorney General, to pay or otherwise settle with other parties for or in the name of an insured claimant any claim insured against under this policy, together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of payment and which the Company is obligated to pay; or

(ii) to pay or otherwise settle with the insured claimant the loss or damage provided for under this policy, together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of payment and which the Company is obligated to pay.

Upon the exercise by the Company of either of the options provided for in paragraphs 6(b)(i) or (ii), the Company's obligations to the insured under this policy for the claimed loss or damage, other than the payments required to be made, shall terminate, including any liability or obligation to defend, prosecute or continue any litigation. Failure of the Attorney General to give the approval called for in 6(b)(i) shall not prejudice the rights of the insured unless the Company is prejudiced thereby, and then only to the extent of the prejudice.

7. DETERMINATION AND EXTENT OF LIABILITY.

This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the insured claimant who has suffered loss or damage by reason of matters insured against by this policy and only to the extent herein described.

(a) The liability of the Company under this policy shall not exceed the least of:

(i) the Amount of Insurance stated in Schedule A; or

(ii) the difference between the value of the insured estate or interest as insured and the value of the insured estate or interest subject to the defect, lien or encumbrance insured against by this policy.

(b) The Company will pay only those costs, attorneys' fees and expenses incurred in accordance with Section 4 of these Conditions and Stipulations.
8. **APPORTIONMENT.**

If the land described in Schedule [A][C] consists of two or more parcels which are not used as a single site, and a loss is established affecting one or more of the parcels but not all, the loss shall be computed and settled on a pro rata basis as if the amount of insurance under this policy was divided pro rata as to the value on Date of Policy of each separate parcel to the whole, exclusive of any improvements made subsequent to Date of Policy, unless a liability or value has otherwise been agreed upon as to each parcel by the Company and the insured at the time of the issuance of this policy and shown by an express statement or by an endorsement attached to this policy.

9. **LIMITATION OF LIABILITY.**

(a) If the Company establishes the title, or removes the alleged defect, lien or encumbrance, or cures the lack of a right of access to or from the land, or cures the claim of unmarketability of title, all as insured, in a reasonably diligent manner by any method, including litigation and the completion of any appeals therefrom, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused thereby.

(b) In the event of any litigation, including litigation by the Company or with the Company’s consent, the Company shall have no liability for loss or damage until there has been a final determination by a court of competent jurisdiction, and disposition of all appeals therefrom, adverse to the title as insured.

(c) The Company shall not be liable for loss or damage to any insured for liability voluntarily assumed by the insured in settling any claim or suit without the prior written consent of the Company.

10. **REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY.**

All payments under this policy, except payments made for costs, attorneys’ fees and expenses, shall reduce the amount of the insurance pro tanto.

11. **LIABILITY NONCUMULATIVE.**

It is expressly understood that the amount of insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the insured has agreed, assumed, or taken subject, or which is hereafter executed by an insured and which is a charge or lien on the estate or interest described or referred to in Schedule A, and the amount so paid shall be deemed a payment under this policy to the insured owner.

12. **PAYMENT OF LOSS.**

(a) No payment shall be made without producing this policy or an accurate facsimile for endorsement of the payment unless the policy has been lost or destroyed, in which case proof of loss or destruction shall be furnished to the satisfaction of the Company.

(b) When liability and the extent of loss or damage has been definitely fixed in accordance with these Conditions and Stipulations, the loss or damage shall be payable within 30 days thereafter.
13. **SUBROGATION UPON PAYMENT OR SETTLEMENT.**

(a) The Company's Right of Subrogation.

Whenever the Company shall have settled and paid a claim under this policy, all right of subrogation shall vest in the Company unaffected by any act of the insured claimant.

The Company shall be subrogated to and be entitled to all rights and remedies which the insured claimant would have had against any person or property in respect to the claim had this policy not been issued. If requested by the Company, the insured claimant shall transfer to the Company all rights and remedies against any person or property necessary in order to perfect this right of subrogation. The insured claimant shall permit the Company to sue, compromise or settle in the name of the insured claimant and to use the name of the insured claimant in any transaction or litigation involving these rights or remedies.

If a payment on account of a claim does not fully cover the loss of the insured claimant, the Company shall be subrogated to these rights and remedies in the proportion which the Company's payment bears to the whole amount of the loss.

If loss should result from any act of the insured claimant, as stated above, that act shall not void this policy, but the Company, in that event, shall be required to pay only that part of any losses insured against by this policy which shall exceed the amount, if any, lost to the Company by reason of the impairment by the insured claimant of the Company's right of subrogation.

(b) The Company's Rights Against Non-insured Obligors.

The Company's right of subrogation against non-insured obligors shall exist and shall include, without limitation, the rights of the insured to indemnities, guaranties, other policies of insurance or bonds, notwithstanding any terms or conditions contained in those instruments which provide for subrogation rights by reason of this policy.

(c) No Subrogation to the Rights of the United States.

Notwithstanding the provisions of Conditions and Stipulations Section 13(a) and (b), whenever the Company shall have settled and paid a claim under this policy, the Company shall not be subrogated to the rights of the United States. The Attorney General may elect to pursue any additional remedies which may exist, and the Company may be consulted. If the Company agrees in writing to reimburse the United States for all costs, attorneys' fees and expenses, to the extent that funds are recovered they shall be applied first to reimbursing the Company for the amount paid to satisfy the claim, and then to the United States.

14. **ARBITRATION ONLY BY AGREEMENT.**

Arbitrable matters may include, but are not limited to, any controversy or claim between the Company and the insured arising out of or relating to this policy, any service of the Company in connection with its issuance or the breach of a policy provision or other obligation. All arbitrable matters shall be arbitrated only when agreed to by both the Company and the Insured.

The law of the United States, or if there be no applicable federal law, the law of the situs of the land shall apply to an arbitration under the Title Insurance Arbitration Rules.

A copy of the Rules may be obtained from the Company upon request.
15. **LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT.**

(a) This policy together with all endorsements, if any, attached hereto by the Company is the entire policy and contract between the insured and the Company. In interpreting any provision of this policy, this policy shall be construed as a whole.

(b) Any claim of loss or damage, whether or not based on negligence, and which arises out of the status of the title to the estate or interest covered hereby or by any action asserting such claim, shall be restricted to this policy.

(c) No amendment of or endorsement to this policy can be made except by a writing endorsed hereon or attached hereto signed by either the President, a Vice President, the Secretary, an Assistant Secretary, or validating officer or authorized signatory of the Company.

16. **SEVERABILITY.**

In the event any provision of the policy is held invalid or unenforceable under applicable law, the policy shall be deemed not to include that provision and all other provisions shall remain in full force and effect.

17. **NOTICES, WHERE SENT.**

All notices required to be given the Company and any statement in writing required to be furnished the Company shall include the number of this policy and shall be addressed to the Company at (fill in).

NOTE: Bracketed [] material optional
UNITED STATES OF AMERICA
POLICY OF TITLE INSURANCE
Issued by
BLANK TITLE INSURANCE COMPANY

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B AND THE CONDITIONS AND STIPULATIONS, BLANK TITLE INSURANCE COMPANY, a Blank corporation, herein called the Company, insures, as of Date of Policy shown in Schedule A, against loss or damage, not exceeding the Amount of Insurance stated in Schedule A, sustained or incurred by the insured by reason of:

1. Title to the estate or interest described in Schedule A being vested other than as stated therein;

2. Any defect in or lien or encumbrance on the title;

3. Unmarketability of the title;

4. Lack of a right of access to and from the land;

5. In instances where the insured acquires title to the land by condemnation, failure of the commitment for title insurance, as updated to the date of the filing of the lis pendens notice or the Declaration of Taking, to disclose the parties having an interest in the land as disclosed by the public records.

6. Title to the estate or interest described in Schedule A being vested other than as stated therein or being defective:
   
   (a) as a result of the avoidance in whole or in part, or from a court order providing an alternative remedy, of a transfer of all or any part of the title to or any interest in the land occurring prior to the transaction vesting title as shown in Schedule A because that prior transfer constituted a fraudulent or preferential transfer under federal bankruptcy, state insolvency, or similar creditors’ rights laws; or
   
   (b) because the instrument of transfer vesting title as shown in Schedule A constitutes a preferential transfer under federal bankruptcy, state insolvency, or similar creditors’ rights laws by reason of the failure of its recording in the public records
      
      (i) to be timely, or

      (ii) to impart notice of its existence to a purchaser for value or to a judgment or lien creditor.

The Company will also pay the costs, attorneys’ fees and expenses incurred in defense of the title, as insured, but only to the extent provided in the Conditions and Stipulations.

[Witness clause optional]
BLANK TITLE INSURANCE COMPANY

BY: ________________________________ PRESIDENT

BY: ________________________________ SECRETARY
EXCLUSIONS FROM COVERAGE

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorneys’ fees or expenses which arise by reason of:

1. (a) Any law, ordinance or governmental regulation (including but not limited to building and zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating to (i) the occupancy, use, or enjoyment of the land; (ii) the character, dimensions or location of any improvement now or hereafter erected on the land; (iii) a separation in ownership or a change in the dimensions or area of the land or any parcel of which the land is or was a part; or (iv) environmental protection, or the effect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.

(b) Any governmental police power not excluded by (a) above, except to the extent that a notice of the exercise thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.

2. Rights of eminent domain unless notice of the exercise thereof has been recorded in the public records at Date of Policy, but not excluding from coverage any taking which has occurred prior to Date of Policy which would be binding on the rights of a purchaser for value without knowledge.

3. Defects, liens, encumbrances, adverse claims or other matters:

(a) created, suffered, assumed or agreed to by the insured claimant;

(b) not known to the Company, not recorded in the public records at Date of Policy, but known to the insured claimant and not disclosed in writing to the Company by the insured claimant prior to the date the insured claimant became an insured under the policy;

(c) resulting in no loss or damage to the insured claimant; or

(d) attaching or created subsequent to Date of Policy (however, this does not modify or limit the coverage provided under insuring provision 6).

4. This policy does not insure against the invalidity or insufficiency of any condemnation proceeding instituted by the United States of America, except to the extent set forth in insuring provision 5.
5. Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors’ rights laws, that the transaction vesting the title as shown in Schedule A is:

(a) a fraudulent conveyance or fraudulent transfer; or

(b) a preferential transfer for any reason not stated in insuring provision 6.
SCHEDULE A

Name and Address of Title Insurance Company:

[File No. ] Policy No.

Amount of Insurance $
[Premium $ ]

Date of Policy [at p.m.]

1. Name of Insured:

2. The estate or interest in the land which is covered by this policy is:

3. Title to the estate or interest in the land is vested in:

[4. The land referred to in this policy is described as follows:]

If Paragraph 4 is omitted, a Schedule C, captioned the same as Paragraph 4, must be used.
SCHEDULE B

[File No. ] Policy No.

EXCEPTIONS FROM COVERAGE

This policy does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees or expenses) which arise by reason of:

1. [POLICY MAY INCLUDE REGIONAL EXCEPTIONS IF SO]

2. DESIRED BY ISSUING COMPANY]

[VARIABLE EXCEPTIONS SUCH AS TAXES, EASEMENTS, CC & Rs, ETC.]

3.

4.
CONDITIIONS AND STIPULATIONS

1. DEFINITION OF TERMS.

The following terms when used in this policy mean:

(a) "insured": the insured named in Schedule A, and, subject to any rights or defenses the Company would have had against the named insured, those who succeed to the interest of the named insured by operation of law as distinguished from purchase including, but not limited to, heirs, distributees, devisees, survivors, personal representatives, next of kin, or corporate or fiduciary successors.

(b) "insured claimant": an insured claiming loss or damage.

(c) "knowledge" or "known": actual knowledge, not constructive knowledge or notice which may be imputed to an insured by reason of the public records as defined in this policy or any other records which impart constructive notice of matters affecting the land.

(d) "land": the land described or referred to in Schedule [A][C], and improvements affixed thereto which by law constitute real property. The term "land" does not include any property beyond the lines of the area described or referred to in Schedule [A][C], nor any right, title, interest, estate or easement in abutting streets, roads, avenues, alleys, lanes, ways or waterways, but nothing herein shall modify or limit the extent to which a right of access to and from the land is insured by this policy.

(e) "mortgage": mortgage, deed of trust, trust deed, or other security instrument.

(f) "public records": records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge. With respect to Section 1(a)(iv) of the Exclusions From Coverage, "public records" shall also include environmental protection liens filed in the records of the clerk of the United States district court for the district in which the land is located.

(g) "unmarketability of the title": an alleged or apparent matter affecting the title to the land, not excluded or excepted from coverage, which would entitle a purchaser of the estate or interest described in Schedule A to be released from the obligation to purchase by virtue of a contractual condition requiring the delivery of marketable title.

2. CONTINUATION OF INSURANCE AFTER CONVEYANCE OF TITLE.

The coverage of this policy shall continue in force as of Date of Policy in favor of an insured only so long as the insured retains an estate or interest in the land, or holds an indebtedness secured by a purchase money mortgage given by a purchaser from the insured, or only so long as the insured shall have liability by reason of covenants of warranty made by the insured in any transfer or conveyance of the estate or interest. This policy shall not continue in force in favor of any purchaser from the insured of either (i) an estate or interest in the land, or (ii) an indebtedness secured by a purchase money mortgage given to the insured.
3. NOTICE OF CLAIM TO BE GIVEN BY INSURED CLAIMANT.

The insured shall notify the Company promptly in writing (i) in case of any litigation as set forth in Section 4(a) below, (ii) in case knowledge shall come to an insured hereunder of any claim of title or interest which is adverse to the title to the estate or interest, as insured, and which might cause loss or damage for which the Company may be liable by virtue of this policy, or (iii) if title to the estate or interest, as insured, is rejected as unmarketable. If prompt notice shall not be given to the Company, then as to the insured all liability of the Company shall terminate with regard to the matter or matters for which prompt notice is required; provided, however, that failure to notify the Company shall in no case prejudice the rights of any insured under this policy unless the Company shall be prejudiced by the failure and then only to the extent of the prejudice.

4. DEFENSE AND PROSECUTION OF ACTIONS; DUTY OF INSURED CLAIMANT TO COOPERATE.

(a) Upon written request by the insured and subject to the options contained in Section 6 of these Conditions and Stipulations, the Company, at its own cost and without unreasonable delay, shall provide for the defense of an insured in litigation in which any third party asserts a claim adverse to the title or interest as insured, but only as to those stated causes of action alleging a defect, lien or encumbrance or other matter insured against by this policy. The Company shall have the right to select counsel of its choice (subject to the right of the insured to object for reasonable cause) to represent the insured as to those stated causes of action and shall not be liable for and will not pay the fees of any other counsel. The Company will not pay any fees, costs or expenses incurred by the insured in the defense of those causes of action which allege matters not insured by this policy.

(b) The Company shall have the right, at its own cost, to institute and prosecute any action or proceeding or to do any other act which in its opinion may be necessary or desirable to establish the title to the estate or interest, as insured, or to prevent or reduce loss or damage to the insured. The Company may take any appropriate action under the terms of this policy, whether or not it shall be liable hereunder, and shall not thereby concede liability or waive any provision of this policy. If the Company shall exercise its rights under this paragraph, it shall do so diligently.

(c) Whenever the Company shall have brought an action or interposed a defense as required or permitted by the provisions of this policy, the Company may pursue any litigation to final determination by a court of competent jurisdiction and expressly reserves the right, in its sole discretion, to appeal from any adverse judgment or order.

(d) In all cases where this policy permits or requires the Company to prosecute or provide for the defense of any action or proceeding, the insured shall secure to the Company the right to so prosecute or provide defense in the action or proceeding, and all appeals therein, and permit the Company to use, at its option, the name of the insured for this purpose. Whenever requested by the Company, the insured, at the Company's expense, shall give the Company all reasonable aid (i) in any action or proceeding, securing evidence, obtaining witnesses, prosecuting or defending the action or proceeding, or effecting settlement, and (ii) in any other lawful act which in the opinion of the Company may be necessary or desirable to establish the title to the estate or interest as insured. If the Company is prejudiced by the failure of the insured to furnish the required cooperation, the Company's obligations to the insured under the policy shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, with regard to the matter or matters requiring such cooperation.
(e) Notwithstanding Conditions and Stipulations Section 4(a-d), the Attorney General of the United States shall have the sole right to authorize or to undertake the defense of any matter which would constitute a claim under the policy, and the Company may not represent the insured without authorization. If the Attorney General elects to defend at the Government's expense, the Company shall, upon request, cooperate and render all reasonable assistance in the prosecution or defense of the proceeding and in prosecuting any related appeals. If the Attorney General shall fail to authorize and permit the Company to defend, all liability of the Company with respect to that claim shall terminate; provided, however, that if the Attorney General shall give the Company timely notice of all proceedings and an opportunity to suggest defenses and actions as it shall recommend should be taken, and the Attorney General shall present the defenses and take the actions of which the Company shall advise the Attorney General in writing, the liability of the Company shall continue and, in any event, the Company shall cooperate and render all reasonable assistance in the prosecution or defense of the claim and any related appeals.

5. **PROOF OF LOSS OR DAMAGE.**

In addition to and after the notices required under Section 3 of these Conditions and Stipulations have been provided the Company, a proof of loss or damage signed and sworn to by the insured claimant shall be furnished to the Company within 90 days after the insured claimant shall ascertain the facts giving rise to the loss or damage. The proof of loss or damage shall describe the defect in, or lien or encumbrance on the title, or other matter insured against by this policy which constitutes the basis of loss or damage and shall state, to the extent possible, the basis of calculating the amount of the loss or damage. If the Company is prejudiced by the failure of the insured claimant to provide the required proof of loss or damage, the Company's obligations to the insured under the policy shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, with regard to the matter or matters requiring such proof of loss or damage.

In addition, the insured claimant may reasonably be required to submit to examination under oath by any authorized representative of the Company and shall produce for examination, inspection and copying, at such reasonable times and places as may be designated by any authorized representative of the Company, all records, books, ledgers, checks, correspondence and memoranda, whether bearing a date before or after Date of Policy, which reasonably pertain to the loss or damage. Further, if requested by any authorized representative of the Company, the insured claimant shall grant its permission, in writing, for any authorized representative of the Company to examine, inspect and copy all records, books, ledgers, checks, correspondence and memoranda in the custody or control of a third party, which reasonably pertain to the loss or damage. All information designated as confidential by the insured claimant provided to the Company pursuant to this Section shall not be disclosed to others unless, in the reasonable judgment of the Company, it is necessary in the administration of the claim. Unless prohibited by law or governmental regulation, failure of the insured claimant to submit for examination under oath, produce other reasonably requested information or grant permission to secure reasonably necessary information from third parties as required in this paragraph shall terminate any liability of the Company under this policy as to that claim.
6. OPTIONS TO PAY OR OTHERWISE SETTLE CLAIMS; TERMINATION OF LIABILITY.

In case of a claim under this policy, the Company shall have the following additional options:

(a) To Pay or Tender Payment of the Amount of Insurance.

To pay or tender payment of the amount of insurance under this policy together with any costs, attorneys' fees and expenses incurred by the insured claimant, which were authorized by the Company, up to the time of payment or tender of payment and which the Company is obligated to pay.

Upon the exercise by the Company of this option, all liability and obligations to the insured under this policy, other than to make the payment required, shall terminate, including any liability or obligation to defend, prosecute, or continue any litigation, and the policy shall be surrendered to the Company for cancellation.

(b) To Pay or Otherwise Settle With Parties Other than the Insured or With the Insured Claimant.

(i) Subject to the prior written approval of the Attorney General, to pay or otherwise settle with other parties for or in the name of an insured claimant any claim insured against under this policy, together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of payment and which the Company is obligated to pay; or

(ii) to pay or otherwise settle with the insured claimant the loss or damage provided for under this policy, together with any costs, attorneys' fees and expenses incurred by the insured claimant which were authorized by the Company up to the time of payment and which the Company is obligated to pay.

Upon the exercise by the Company of either of the options provided for in paragraphs 6(b)(i) or (ii), the Company's obligations to the insured under this policy for the claimed loss or damage, other than the payments required to be made, shall terminate, including any liability or obligation to defend, prosecute or continue any litigation. Failure of the Attorney General to give the approval called for in 6(b)(i) shall not prejudice the rights of the insured unless the Company is prejudiced thereby, and then only to the extent of the prejudice.

7. DETERMINATION AND EXTENT OF LIABILITY.

This policy is a contract of indemnity against actual monetary loss or damage sustained or incurred by the insured claimant who has suffered loss or damage by reason of matters insured against by this policy and only to the extent herein described.

(a) The liability of the Company under this policy shall not exceed the least of:

(i) the Amount of Insurance stated in Schedule A; or

(ii) the difference between the value of the insured estate or interest as insured and the value of the insured estate or interest subject to the defect, lien or encumbrance insured against by this policy.

(b) The Company will pay only those costs, attorneys' fees and expenses incurred in accordance with Section 4 of these Conditions and Stipulations.
8. **APPORTIONMENT.**

If the land described in Schedule [A][C] consists of two or more parcels which are not used as a single site, and a loss is established affecting one or more of the parcels but not all, the loss shall be computed and settled on a pro rata basis as if the amount of insurance under this policy was divided pro rata as to the value on Date of Policy of each separate parcel to the whole, exclusive of any improvements made subsequent to Date of Policy, unless a liability or value has otherwise been agreed upon as to each parcel by the Company and the insured at the time of the issuance of this policy and shown by an express statement or by an endorsement attached to this policy.

9. **LIMITATION OF LIABILITY.**

(a) If the Company establishes the title, or removes the alleged defect, lien or encumbrance, or cures the lack of a right of access to or from the land, or cures the claim of unmarketability of title, all as insured, in a reasonably diligent manner by any method, including litigation and the completion of any appeals therefrom, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused thereby.

(b) In the event of any litigation, including litigation by the Company or with the Company's consent, the Company shall have no liability for loss or damage until there has been a final determination by a court of competent jurisdiction, and disposition of all appeals therefrom, adverse to the title as insured.

(c) The Company shall not be liable for loss or damage to any insured for liability voluntarily assumed by the insured in settling any claim or suit without the prior written consent of the Company.

10. **REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY.**

All payments under this policy, except payments made for costs, attorneys’ fees and expenses, shall reduce the amount of the insurance pro tanto.

11. **LIABILITY NONCUMULATIVE.**

It is expressly understood that the amount of insurance under this policy shall be reduced by any amount the Company may pay under any policy insuring a mortgage to which exception is taken in Schedule B or to which the insured has agreed, assumed, or taken subject, or which is hereafter executed by an insured and which is a charge or lien on the estate or interest described or referred to in Schedule A, and the amount so paid shall be deemed a payment under this policy to the insured owner.

12. **PAYMENT OF LOSS.**

(a) No payment shall be made without producing this policy or an accurate facsimile for endorsement of the payment unless the policy has been lost or destroyed, in which case proof of loss or destruction shall be furnished to the satisfaction of the Company.

(b) When liability and the extent of loss or damage has been definitely fixed in accordance with these Conditions and Stipulations, the loss or damage shall be payable within 30 days thereafter.
13. **SUBROGATION UPON PAYMENT OR SETTLEMENT.**

   (a) **The Company's Right of Subrogation.**

      Whenever the Company shall have settled and paid a claim under this policy, all right of
subrogation shall vest in the Company unaffected by any act of the insured claimant.

      The Company shall be subrogated to and be entitled to all rights and remedies which the insured
claimant would have had against any person or property in respect to the claim had this policy not been
issued. If requested by the Company, the insured claimant shall transfer to the Company all rights and
remedies against any person or property necessary in order to perfect this right of subrogation. The
insured claimant shall permit the Company to sue, compromise or settle in the name of the insured
claimant and to use the name of the insured claimant in any transaction or litigation involving these rights
or remedies.

      If a payment on account of a claim does not fully cover the loss of the insured claimant, the
Company shall be subrogated to these rights and remedies in the proportion which the Company's
payment bears to the whole amount of the loss.

      If loss should result from any act of the insured claimant, as stated above, that act shall not void
this policy, but the Company, in that event, shall be required to pay only that part of any losses insured
against by this policy which shall exceed the amount, if any, lost to the Company by reason of the
impairment by the insured claimant of the Company's right of subrogation.

   (b) **The Company's Rights Against Non-insured Obligors.**

      The Company's right of subrogation against non-insured obligors shall exist and shall include,
without limitation, the rights of the insured to indemnities, guaranties, other policies of insurance or bonds,
notwithstanding any terms or conditions contained in those instruments which provide for subrogation
rights by reason of this policy.

   (c) **No Subrogation to the Rights of the United States.**

      Notwithstanding the provisions of Conditions and Stipulations Section 13(a) and (b), whenever
the Company shall have settled and paid a claim under this policy, the Company shall not be subrogated
to the rights of the United States. The Attorney General may elect to pursue any additional remedies
which may exist, and the Company may be consulted. If the Company agrees in writing to reimburse the
United States for all costs, attorneys’ fees and expenses, to the extent that funds are recovered they shall
be applied first to reimbursing the Company for the amount paid to satisfy the claim, and then to the
United States.

14. **ARBITRATION ONLY BY AGREEMENT.**

   Arbitrable matters may include, but are not limited to, any controversy or claim between the
Company and the insured arising out of or relating to this policy, any service of the Company in
connection with its issuance or the breach of a policy provision or other obligation. All arbitrable matters
shall be arbitrated only when agreed to by both the Company and the Insured.

   The law of the United States, or if there be no applicable federal law, the law of the situs of the
land shall apply to an arbitration under the Title Insurance Arbitration Rules.

   A copy of the Rules may be obtained from the Company upon request.
15. LIABILITY LIMITED TO THIS POLICY; POLICY ENTIRE CONTRACT.

(a) This policy together with all endorsements, if any, attached hereto by the Company is the entire policy and contract between the insured and the Company. In interpreting any provision of this policy, this policy shall be construed as a whole.

(b) Any claim of loss or damage, whether or not based on negligence, and which arises out of the status of the title to the estate or interest covered hereby or by any action asserting such claim, shall be restricted to this policy.

(c) No amendment of or endorsement to this policy can be made except by a writing endorsed hereon or attached hereto signed by either the President, a Vice President, the Secretary, an Assistant Secretary, or validating officer or authorized signatory of the Company.

16. SEVERABILITY.

In the event any provision of the policy is held invalid or unenforceable under applicable law, the policy shall be deemed not to include that provision and all other provisions shall remain in full force and effect.

17. NOTICES, WHERE SENT.

All notices required to be given the Company and any statement in writing required to be furnished the Company shall include the number of this policy and shall be addressed to the Company at (fill in).

NOTE: Bracketed [] material optional
[COURTESY/PUBLICATION/DATE DOWN] ENDORSEMENT  
Attached to Guarantee No.___________  
Issued by  
BLANK TITLE INSURANCE COMPANY

Charge:

The Company hereby assures that, subsequent to the date of the guarantee issued under the above number, no matters are shown by the Public Records which would affect the assurances in Schedule A of the guarantee other than the following:

[NO CHANGES or DOCUMENT DESCRIPTION RECORDED POST DATE OF GUARANTEE]

The total liability of the company under this guarantee and endorsement shall not exceed, in the aggregate, the liability amount stated in said guarantee.

This endorsement is made a part of the guarantee and is subject to the exceptions, exclusions from coverage, the limits of liability and the conditions, except as modified by the above-mentioned provisions.

BLANK TITLE INSURANCE COMPANY

Dated:

By______________________________
ENDORSMENT
Attached to Policy No. __________
Issued by
BLANK TITLE INSURANCE COMPANY

1. The insurance provided by this endorsement is subject to the exclusions in Section 4 of this endorsement; and the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

2. For purposes of this endorsement only, “Improvement” means an existing building, located on either the Land or adjoining land at Date of Policy and that by law constitutes real property.

3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. An encroachment of any Improvement located on the Land onto adjoining land or onto that portion of the Land subject to an easement, unless an exception in Schedule B of the policy identifies the encroachment;
   b. An encroachment of any Improvement located on adjoining land onto the Land at Date of Policy, unless an exception in Schedule B of the policy identifies the encroachment;
   c. Enforced removal of any Improvement located on the Land as a result of an encroachment by the Improvement onto any portion of the Land subject to any easement, in the event that the owners of the easement shall, for the purpose of exercising the right of use or maintenance of the easement, compel removal or relocation of the encroaching Improvement; or
   d. Enforced removal of any Improvement located on the Land that encroaches onto adjoining land.

4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) resulting from the encroachments listed as Exceptions ____________ of Schedule B.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ____________________________
Authorized Signatory
ENDORSEMENT

Attached to Policy No. ____________________.

Issued By

________________________ TITLE INSURANCE COMPANY

DELETE

1. The insurance provided by this endorsement is subject to the exclusions in Section 4 of this endorsement; and the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

ADD

1. The insurance provided by this endorsement is subject to the Exclusions from Coverage, the Exceptions from Coverage contained in Schedule B, and the Conditions in the policy.

2. For purposes of this endorsement only, “Improvement” means an existing building, located on either the Land or adjoining land at Date of Policy and that by law constitutes real property.

3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. An encroachment of any Improvement located on the Land onto adjoining land or onto that portion of the Land subject to an easement, unless an exception in Schedule B of the policy identifies the encroachment;
   b. An encroachment of any Improvement located on adjoining land onto the Land at Date of Policy, unless an exception in Schedule B of the policy identifies the encroachment;
   c. Enforced removal of any Improvement located on the Land as a result of an encroachment by the Improvement onto any portion of the Land subject to any easement, in the event that the owners of the easement shall, for the purpose of exercising the right of use or maintenance of the easement, compel removal or relocation of the encroaching Improvement except:
   d. Enforced removal of any Improvement located on the Land that encroaches onto adjoining land except:
4. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees, or expenses) resulting from the encroachments listed as Exceptions __________ of Schedule B.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

________________________ TITLE INSURANCE COMPANY

By: ________________________________

Authorized Signatory
ENDORSEMENT
Attached to Policy No.
Issued by
BLANK TITLE INSURANCE COMPANY

Notwithstanding exception _______ in Schedule B of the above referenced policy, the Company insures against loss or damage sustained or incurred by the Insured by reason of the lack of priority of the lien of the Insured Mortgage over any statutory lien for services, labor or material affecting the Title and arising from construction of a work of improvement on the Land, but only to the extent that such lien is for services provided, labor performed or materials furnished prior to ________________________.  

This endorsement is issued as part of the policy.  Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance.  To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls.  Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

BLANK TITLE INSURANCE COMPANY

Dated: By______________________________

CLTA 122.1A-06 (11-04-11)
ALTA - Lender

[NOTE: Add General ML exception to preliminary report or title commitment and Schedule B of loan policy covering initial disbursement of advance; subsequent advances covered by issuance of CLTA 122.1B-06 require a separate Schedule B exception re Mechanics’ Lien Coverage Cut-Off Date Definition and Pending Disbursement Schedule B exception in the preliminary report or title commitment and loan policy of title insurance ]
Any statutory lien for services, labor, or material which arises from service provided, labor performed, or material or equipment furnished on or after ______________________ (the “Mechanics’ Lien Coverage Cut-Off Date.”) [This Schedule B exception needs to be added in the preliminary report or title commitment and policy if there is an initial loan draw to be covered by the loan policy that has a general mechanics’ lien exclusion in tandem with the issuance of the CLTA 122.1A-06 endorsement form and and our underwriting gets us comfortable insuring a “gap” between (A) the date as of which we have satisfactory documentary evidence that everyone has been paid current – presumably including lien waivers from all appropriate parties, and (B) the Date of Policy].
ENDORSEMENT
Attached to Policy No.
Issued by
BLANK TITLE INSURANCE COMPANY

Based upon the representation of the Insured that the Insured has made an advance in the sum of $[__________] (the “Advance”), [for a cumulative total Advance of [__________]] which is a portion of the Indebtedness, the Company hereby (a) increases the Mechanics’ Lien Coverage Liability Limit (defined in paragraph ___ of Schedule B) by the amount of the Advance, to a total Mechanics’ Lien Coverage Liability Limit of $[__________], and (b) extends the Mechanics’ Lien Coverage Cut-Off Date (defined in paragraph ___ of Schedule B) to [__________].

The Company also insures against loss or damage sustained or incurred by the Insured by reason of:

1. Any lien, encumbrance or other matter affecting the Title and recorded in the Public Records subsequent to Date of Policy, to the date of this endorsement, except:

2. Any subsisting tax or assessment lien which is prior to the lien of the Insured Mortgage, as of the date of issuance of this endorsement, except:

3. Title being vested as of the date of issuance of this Endorsement other than as shown in Schedule A according to the Public Records;

4. The failure of the Advance to be secured by the Insured Mortgage;

5. Lack of priority of the lien of the Insured Mortgage with respect to the Advance over any lien, encumbrance or other matter affecting the Title and recorded in the Public Records subsequent to Date of Policy and as of the date of issuance of this Endorsement, except:

6. Lack of priority of the lien of the Insured Mortgage over any statutory lien for services, labor or materials arising out of the work of improvement under construction or completed, but only to the extent that such lien is for services provided, labor performed or materials furnished prior to [__________________________].

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

BLANK TITLE INSURANCE COMPANY

Dated: ____________________________

By ________________________________

CLTA 122.1B-06 (11-04-11)
ALTA - Lender

[NOTE: Add to the preliminary report or title commitment and loan policy of title insurance a separate Schedule B exception re Mechanics’ Lien Coverage Cut-Off Date Definition and Pending Disbursement for subsequent]
advances]
Notwithstanding the Amount of Insurance stated in Schedule A, the liability of the Company under the policy (the “Mechanics’ Lien Coverage Liability Limit”) for loss or damage by reason of the lack of priority of the lien of the Insured Mortgage upon the Title over any statutory lien for services, labor or material is limited as of the Date of Policy to $__________, being the amount of the Indebtedness actually disbursed at Date of Policy. The Mechanics’ Lien Coverage Liability Limit may only be increased and the Mechanics’ Lien Coverage Cut-Off Date may only be brought forward by the Company’s issuance of its CLTA Form 122.1B-06 Endorsement which expressly (a) increases the Mechanics’ Lien Coverage Liability Limit (to the aggregate amount represented by the Insured as actually paid and disbursed by the Insured at the date of the 122.1B-06 Endorsement) and (b) brings forward the Mechanics’ Lien Coverage Cut-Off Date.
ENDORSEMENT
Attached to Policy No. __________
Issued by
BLANK TITLE INSURANCE COMPANY

1. Covered Risk 11(a) of this policy is deleted.

2. The insurance [for Construction Loan Advances] added by Section 3 of this endorsement is subject to the exclusions in Section 4 of this endorsement and the Exclusions from Coverage in the Policy, the provisions of the Conditions, and the exceptions contained in Schedule B. For the purposes of this endorsement and each subsequent Disbursement Endorsement:
   a. “Date of Coverage”, is [________________________] [Date of Policy] unless the Company sets a different Date of Coverage by an ALTA 33-06 Disbursement Endorsement issued at the discretion of the Company.
   b. “Construction Loan Advance,” shall mean an advance that constitutes Indebtedness made on or before Date of Coverage for the purpose of financing in whole or in part the construction of improvements on the Land.
   c. “Mechanic’s Lien,” shall mean any statutory lien or claim of lien, affecting the Title, that arises from services provided, labor performed, or materials or equipment furnished.

3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. The invalidity or unenforceability of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage;
   b. The lack of priority of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage, over any lien or encumbrance on the Title recorded in the Public Records and not shown in Schedule B; and
   c. The lack of priority of the lien of the Insured Mortgage, as security for each Construction Loan Advance made on or before the Date of Coverage over any Mechanic’s Lien, if notice of the Mechanic’s Lien is not filed or recorded in the Public Records, but only to the extent that the charges for the services, labor, materials or equipment for which the Mechanic’s Lien is claimed were designated for payment in the documents supporting a Construction Loan Advance disbursed by or on behalf of the Insured on or before Date of Coverage.
4. This policy does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees or expenses) by reason of any Mechanic’s Lien arising from services, labor, material or equipment:

   a. furnished after Date of Coverage; or

   b. not designated for payment in the documents supporting a Construction Loan Advance disbursed by or on behalf of the Insured on or before Date of Coverage.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: _______________________________________

Authorized Signatory
ENDORSEMENT
Attached to Policy No. __________

Issued by
BLANK TITLE INSURANCE COMPANY

1. Covered Risk 11(a) of this policy is deleted.

2. The insurance [for Construction Loan Advances] added by Section 3 of this endorsement is subject to the exclusions in Section 4 of this endorsement and the Exclusions from Coverage in the Policy, the provisions of the Conditions, and the exceptions contained in Schedule B. For the purposes of this endorsement and each subsequent Disbursement Endorsement:
   a. “Date of Coverage”, is [__________________________] [Date of Policy] unless the Company sets a different Date of Coverage by an ALTA 33-06 Disbursement Endorsement issued at the discretion of the Company.
   b. “Construction Loan Advance,” shall mean an advance that constitutes Indebtedness made on or before Date of Coverage for the purpose of financing in whole or in part the construction of improvements on the Land.
   c. “Mechanic’s Lien,” shall mean any statutory lien or claim of lien, affecting the Title, that arises from services provided, labor performed, or materials or equipment furnished.

3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. The invalidity or unenforceability of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage;
   b. The lack of priority of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage, over any lien or encumbrance on the Title recorded in the Public Records and not shown in Schedule B; and
   c. The lack of priority of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage over any Mechanic’s Lien if notice of the Mechanic’s Lien is not filed or recorded in the Public Records, but only to the extent that direct payment to the Mechanic’s Lien claimant has been made by the Company or by the Insured with the Company’s written approval.
4. This policy does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) by reason of any Mechanic's Lien arising from services, labor, material or equipment:

   a. furnished after Date of Coverage; or

   b. to the extent that the Mechanic's Lien claimant was not directly paid by the Company or by the Insured with the Company's written approval.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ________________________________

Authorized Signatory
ENDORSEMENT
Attached to Policy No. __________ 
Issued by
BLANK TITLE INSURANCE COMPANY

1. Covered Risk 11(a) of this policy is deleted.

2. The insurance [for Construction Loan Advances] added by Section 3 of this endorsement is subject to the exclusions in Section 4 of this endorsement and the Exclusions from Coverage in the Policy, the provisions of the Conditions, and the exceptions contained in Schedule B. For the purposes of this endorsement and each subsequent Disbursement Endorsement:
   a. “Date of Coverage,” is [Date of Policy] unless the Company sets a different Date of Coverage by an ALTA 33-06 Disbursement Endorsement issued at the discretion of the Company.
   b. “Construction Loan Advance,” shall mean an advance that constitutes Indebtedness made on or before Date of Coverage for the purpose of financing in whole or in part the construction of improvements on the Land.
   c. “Mechanic’s Lien,” shall mean any statutory lien or claim of lien, affecting the Title, that arises from services provided, labor performed, or materials or equipment furnished.

3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. The invalidity or unenforceability of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage;
   b. The lack of priority of the lien of the Insured Mortgage as security for each Construction Loan Advance made on or before the Date of Coverage, over any lien or encumbrance on the Title recorded in the Public Records and not shown in Schedule B; and
   c. The lack of priority of the lien of the Insured Mortgage, as security for each Construction Loan Advance made on or before the Date of Coverage over any Mechanic’s Lien, if notice of the Mechanic’s Lien is not filed or recorded in the Public Records, but only to the extent that direct payment to the Mechanic’s Lien claimant has been made by the Insured or on the Insured’s behalf on or before Date of Coverage.
4. This policy does not insure against loss or damage (and the Company will not pay costs, attorneys’ fees or expenses) by reason of any Mechanic’s Lien arising from services, labor, materials or equipment:

   a. Furnished after Date of Coverage; or
   
   b. To the extent that the Mechanic’s Lien claimant was not directly paid by the Insured or on the Insured’s behalf.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ______________________________________
    Authorized Signatory
ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

1. The Date of Coverage is amended to ________________________.

   [a. The current disbursement is: $________________________ ]

   [b. The aggregate amount, including the current disbursement, recognized by the Company as
      disbursed by the Insured is: $______________________]

2. Schedule A is amended as follows:

3. Schedule B is amended as follows:

   [Part I]

   [Part II]

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any
of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of
Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous
endorsement is inconsistent with an express provision of this endorsement, this endorsement controls.
Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior
endorsements.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: _________________________________
TRUSTEE’S SALE GUARANTEE

SUBJECT TO THE EXCLUSIONS FROM COVERAGE AND THE CONDITIONS ATTACHED HERETO AND MADE A PART OF THIS GUARANTEE,

BLANK TITLE INSURANCE COMPANY
a corporation, herein called the Company

GUARANTEES
the Assured named in Schedule A of this Guarantee

against loss or damage not exceeding the liability amount stated in Schedule A sustained by the Assured by reason of any incorrectness in the assurances set forth in Paragraph 3 of Schedule A.

DATED:

BY: ____________________

AUTHORIZED SIGNATURE
BLANK TITLE INSURANCE COMPANY

SCHEDULE A

Guarantee No: ____________________  Liability: $ ____________________

Date of Guarantee: _______________  Fee: $ ____________________

1. Name of Assured:

2. The estate or interest in the Land that is the subject of this Guarantee is:

3. Assurances:

   According to the Public Records as of the Date of Guarantee,

   a. Title to the estate or interest is vested in:

   b. Title to the estate or interest is subject to defects, liens or encumbrances shown in Schedule B which are not necessarily shown in the order of their priority.

   c. The Land referred to in this Guarantee is situated in the State of California, County of ______________________, and is described as follows:

   d. Relative to the Mortgage shown in Paragraph ______ of Schedule B:

      i. For the purposes of California Civil Code Section 2924b (b) and (d), the address of the trustor or mortgagor as shown in the Mortgage is:

         [If none, insert “NONE”]

      ii. The names and addresses of all persons who have recorded requests for a copy of notice of default and for a copy of notice of sale as provided by California Civil Code §§ 2924b (a), (b) and (d) are:

      iii. The names and addresses of all additional persons who are entitled to receive a copy of notice of default and a copy of notice of sale as provided by California Civil Code §§ 2924b (c) (1), (2) and (3) are:

      iv. The names and addresses of all associations defined in California Civil Code § 1351 (a) that have recorded a request for notice that are entitled to receive a
copy of any trustee’s deed upon sale as provided by California Civil Code § 2924b (f) are:

v. The names and addresses of all state taxing agencies that are entitled to receive a copy of notice of sale as provided by California Civil Code § 2924b (c) (3) are:

vi. The address of the Internal Revenue Service to which a copy of notice of sale is to be mailed as provided by California Civil Code § 2924b (c) (4) is:

vii. The name of each city in which the Land is located is:

If not in a city, each judicial district in which the Land is located is:

viii. The name of a newspaper of general circulation for the publication of a notice of sale as required by California Civil Code § 2924f (b) (1) is:
BLANK TITLE INSURANCE COMPANY

SCHEDULE B

[VARIABLE MATTERS SUCH AS TAXES, EASEMENTS, CC&R's, ETC.]
EXCLUSIONS FROM COVERAGE

1. Except to the extent of the assurances set forth in Paragraph 3 of Schedule A, the Company assumes no liability for loss or damage by reason of any law, ordinance, governmental regulation or any other police power adopted or promulgated by any federal or state government authority purporting to regulate nonjudicial foreclosures or any related duties, whether or not disclosed by the Public Records at the Date of Guarantee.

2. Notwithstanding any assurances set forth in Paragraph 3 of Schedule A, the Company assumes no liability for loss or damage by reason of the following:

   a. Defects, liens, encumbrances, adverse claims or other matters affecting the title to any property beyond the lines of the Land expressly described in the description set forth in Schedule A of this Guarantee, or title to streets, roads, avenues, lanes, ways or waterways to which such Land abuts, or the right to maintain therein vaults, tunnels, ramps or any structure or improvements; or any rights or easements therein, unless such property, rights or easements are expressly and specifically set forth in said description.

   b. Defects, liens, encumbrances, adverse claims or other matters, whether or not shown by the Public Records (1) that are created, suffered, assumed or agreed to by one or more of the Assureds; (2) that result in no loss to the Assured; or (3) that do not result either in the invalidity of any nonjudicial proceeding to foreclose the lien of the Mortgage or the failure of any such nonjudicial foreclosure proceeding to divest a lien, estate or interest subordinate or subject to the lien of the Mortgage.

   c. Defects, liens, encumbrances, adverse claims or other matters against the title, not shown by the Public Records.

   d. The identity of any party shown or referred to in Schedule A.

   e. The validity, legal effect or priority of any matter shown or referred to in this Guarantee.

   f. Any law, ordinance, governmental regulation or any other police power adopted or promulgated by any county, city, or any other local government authority purporting to regulate nonjudicial foreclosures or any related duties, whether or not disclosed by the Public Records at the Date of Guarantee.

   g. (1) Taxes or assessments of any taxing authority that levies taxes or assessments on real property; or, (2) proceedings by a public agency which may result in taxes or assessments, or notices of such proceedings, whether or not the matters excluded under (1) or (2) are shown by the records of the taxing authority or by the Public Records.

   h. (1) Unpatented mining claims; (2) reservations or exceptions in patents or in Acts authorizing the issuance thereof; (3) water rights, claims or title to water, whether or not the matters excluded under (1), (2) or (3) are shown by the Public Records.
CLTA Guarantee Form No. 22 (02-___-2013)
Trustee's Sale Guarantee

BLANK TITLE INSURANCE COMPANY

INFORMATIONAL NOTES

No assurances as set forth in Paragraph 3 of Schedule A are provided in connection with the following information and the Company assumes no liability for any inaccuracies in or omissions from the information. This information is not intended to be comprehensive and does not necessarily include all laws and regulations that might affect the contemplated foreclosure.

1. Attention is called to California Civil Code Sections 2920 et. seq., through 2924l, inclusive, and any amendments thereto, that govern the actions of mortgagees, beneficiaries, mortgage servicers, trustees, and those of their agents with respect to non-judicial foreclosures. (i) prior to initiation of a proceeding to nonjudicially foreclose a deed of trust or mortgage by power of sale, (ii) during initiation and pendency of such a foreclosure proceeding, (iii) when conducting a foreclosure auction and sale, and (iv) when causing issue of a trustee's deed or otherwise discharging post sale activities.

   [Further language to be considered:]

   Depending upon the character of the trustor/borrower/owner in question and that of the real property encumbered by a deed of trust or mortgage with power of sale to be foreclosed, one or more of such sections may restrain the right to commence nonjudicial foreclosure, to record required notices of default or sale, or to conduct a trustee's sale. Similarly and likewise dependent, one of more of such laws may dictate that a required notice of default include a declaration that the mortgage servicer (as defined therein) has contacted the borrower, has tried with due diligence to contact the borrower as required by law, or that no contact was required because the individual did not meet the definition of “borrower” set forth in these laws.

   EDITING NOTE: New paragraph 1 would replace former paragraphs 4, 5, and 6.

2. Attention is called to the Servicemembers Civil Relief Act (Appendix 50 USC §§501 et seq.), and any amendments thereto, and the Military Reservist Relief Act of 1991 (California Military and Veterans Code §§ 800 et seq.), and Military and Veterans Code § 408, and any amendments to any of the foregoing statutes, that contain restrictions against the sale of land under a deed of trust or mortgage if the owner is entitled to the benefits of those Acts.

   EDITING NOTE: Indicated changes mandated by passage of AB 2475 (2012) (Chapter 204, Statutes of 2012) amending § 408 Mil. & Vet. Code effective January 1, 2013, that applies to a deed of trust or mortgage with power of sale executed by a service member and that is a lien on such member's real property at the time of the member's entry into military service and that is still so owned by the member at commencement of (i) judicial foreclosure (court may stay such proceedings or otherwise limit the prosecution of such action) and (ii) judicial and nonjudicial foreclosure, then no such foreclosure is valid if made during the period of military service or within nine months thereafter, except as otherwise provided for in § 408.

2. Attention is called to the Federal Tax Lien Act of 1966 (26 USC §§ 6321 et seq.), and any amendments thereto, that, among other things, provides for the giving of written notice of sale in a specified manner to the Secretary of Treasury or his or her delegate as a requirement for the discharge or divestment of a Federal Tax Lien in a nonjudicial sale, and establishes with respect to that lien a right in the United States to redeem the property within a period of 120 days from the date of the sale.
3. 3.4.
4. [see Exhibit 10.C.2 for proposed language and 5 options]
5. Attention is called to California Government Code § 16187, and any amendments thereto, that, among other things, provides for the giving of written notice of sale in a specified manner to the Controller of the State of California necessary for the discharge or divestment in a nonjudicial sale of a Notice of Lien for Postponed Property Taxes recorded in the public records subsequent to the recording of a notice of default.

4. Attention is called to California Civil Code § 2923.5, and any amendments thereto, that applies to loans made from January 1, 2003 to December 31, 2007 secured by deeds of trust on owner-occupied residential property and that, among other things, states that a notice of default may not be recorded pursuant to California Civil Code § 2924 until 30 days after initial contact with the borrower of a prescribed and detailed nature is made or after satisfying certain due diligence requirements. A special declaration with respect to the initial contact must be attached to or made a part of a notice of default. Reference is made to the statute for particulars.

5. Attention is called to California Civil Code § 2924.8, and any amendments thereto, that applies to notes secured by deeds of trust on residential real property, if the billing address for the mortgage note is different than the property address, and that, among other things, requires the posting of a prescribed notice of impending foreclosure in several designated languages and the mailing of that notice in a prescribed manner, which posting and mailing are to occur concurrently with posting and mailing of notice of sale pursuant to California Civil Code § 2924f. A copy of that notice may be obtained from the State of California Department of Financial Institutions. Reference is made to the statute for particulars.

6. Attention is called to California Civil Code § 2924b (d), and any amendments thereto, that requires alternative notice procedures if the mortgage or deed of trust does not contain a mailing address of the trustor or mortgagor.

[The inclusion, arrangement and language of the matters shown in the above Informational Notes to be in accordance with the practices of the issuing member company.]
TRUSTEE’S SALE GUARANTEE CONDITIONS

1. Definition of Terms.

The following terms when used in the Guarantee mean:

a. the "Assured": (i) the party or parties named as the Assured in Schedule A, or on a supplemental writing executed by the Company, (ii) the duly substituted trustee of the Mortgage and (iii) the owner of the indebtedness or other obligation secured by the Mortgage.

b. "Land": the Land described or referred to in Schedule A, and improvements affixed thereto which by law constitute real property. The term "Land" does not include any property beyond the lines of the area described or referred to in Schedule A, nor any right, title, interest, estate or easement in abutting streets, roads, avenues, alleys, lanes, ways or waterways.

c. "Mortgage": the mortgage, deed of trust, trust deed, or other security instrument set forth in Paragraph 3.d. of Schedule A.

d. "Public Records": those records established under California statutes at Date of Guarantee for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge.

e. "Date of Guarantee": the Date of Guarantee set forth in Schedule A

2. Notice of Claim to be Given by Assured.

The Assured shall notify the Company promptly in writing in case knowledge shall come to the Assured of any assertion of facts, or claims of title or interest that are contrary to the assurances set forth in Paragraph 3 of Schedule A and that might cause loss or damage for which the Company may be liable under this Guarantee. If prompt notice shall not be given to the Company, then all liability of the Company shall terminate with regard to the matter or matters for which prompt notice is required; provided, however, that failure to notify the Company shall in no case prejudice the rights of the Assured under this Guarantee unless the Company shall be prejudiced by the failure and then only to the extent of the prejudice.

3. No Duty to Defend or Prosecute.

The Company shall have no duty to defend or prosecute any action or proceeding to which the Assured is a party, notwithstanding the nature of any allegation in such action or proceeding.

4. Company’s Option to Defend or Prosecute Actions; Duty of Assured to Cooperate.

Even though the Company has no duty to defend or prosecute as set forth in Paragraph 3 above:

a. The Company shall have the right, at its sole option and cost, to institute and prosecute any action or proceeding, interpose a defense, as limited in Paragraph 4.b. or to do any other act which in its opinion may be necessary or desirable to establish the correctness of the assurances set forth in Paragraph 3 of Schedule A or to prevent or reduce loss or damage to the Assured including, but not limited to, repeating the trustee’s sale
b. If the Company elects to exercise its options as stated in Paragraph 4.a., the Company shall have the right to select counsel of its choice (subject to the right of the Assured to object for reasonable cause) to represent the Assured and shall not be liable for and will not pay the fees of any other counsel, nor will the Company pay any fees, costs or expenses incurred by the Assured in the defense of those causes of action which allege matters not covered by this Guarantee.

c. Whenever the Company shall have brought an action or interposed a defense as permitted by the provisions of this Guarantee, the Company may pursue any litigation to final determination by a court of competent jurisdiction and expressly reserves the right, in its sole discretion, to appeal from an adverse judgment or order.

d. In all cases where this Guarantee permits the Company to prosecute or provide for the defense of any action or proceeding, the Assured shall secure to the Company the right to so prosecute or provide for the defense of any action or proceeding, and all appeals therein, and permit the Company to use, at its option, the name of the Assured for this purpose. Whenever requested by the Company, the Assured, at the Company's expense, shall give the Company all reasonable aid in any action or proceeding, securing evidence, obtaining witnesses, prosecuting or defending the action or lawful act which in the opinion of the Company may be necessary or desirable to establish the correctness of the assurances set forth in Paragraph 3 of Schedule A. If the Company is prejudiced by the failure of the Assured to furnish the required cooperation, the Company's obligations to the Assured under the Guarantee shall terminate.

5. Proof of Loss or Damage.

a. In addition to and after the notices required under Section 2 of these Conditions have been provided to the Company, a proof of loss or damage signed and sworn to by the Assured shall be furnished to the Company within ninety (90) days after the Assured shall ascertain the facts giving rise to the loss or damage. The proof of loss or damage shall describe the matters covered by this Guarantee which constitute the basis of loss or damage and shall state, to the extent possible, the basis of calculating the amount of the loss or damage. If the Company is prejudiced by the failure of the Assured to provide the required proof of loss or damage, the Company's obligation to the Assured under the Guarantee shall terminate.

b. The Company may reasonably require the Assured to submit to examination under oath by any authorized representative of the Company and to produce for examination, inspection, and copying, at such reasonable times and places as may be designated by the authorized representative of the Company, all records, in whatever medium maintained, including books, ledgers, checks, memoranda, correspondence, reports, e-mails, disks, tapes, and videos whether bearing a date before or after Date of Guarantee, that reasonably pertain to the loss or damage. Further, if requested by any authorized representative of the Company, the Assured shall grant its permission, in writing, for any authorized representative of the Company to examine, inspect, and copy all of these records in the custody or control of a third party that reasonably pertain to the loss or damage. All information designated as confidential by the Assured provided to the Company pursuant to this Section shall not be disclosed to others unless, in the reasonable judgment of the Company, it is necessary in the administration of the claim. Failure of the Assured to submit for examination under oath, produce any reasonably requested information, or grant permission to secure reasonably necessary information
from third parties as required in this subsection, unless prohibited by law or governmental regulation, shall terminate any liability of the Company under this Guarantee as to that claim.

6. Options to Pay or Otherwise Settle Claims: Termination of Liability.

In case of a claim under this Guarantee, the Company shall have the following additional options:

a. To Pay or Tender Payment of the Amount of Guarantee or to Purchase the Indebtedness.

i. To pay or tender payment of the full amount of this Guarantee together with any costs, attorneys’ fees, and expenses incurred by the Assured that were authorized by the Company up to the time of payment or tender of payment and that the Company is obligated to pay; or

ii. To purchase the indebtedness secured by the Mortgage for the amount owing thereon, together with any costs, attorneys’ fees, and expenses incurred by the Assured that were authorized by the Company up to the time of purchase and that the Company is obligated to pay.

When the Company so purchases such indebtedness, the owner thereof shall transfer, assign, and convey to the Company the indebtedness and the Mortgage, together with any collateral security.

Upon the exercise by the Company of either of the options provided for in Paragraphs 6.a.i. or 6.a.ii., all liability and obligations of the Company to the Assured under this Guarantee, other than to make the payment required in those paragraphs, shall terminate, including any duty to continue any and all litigation initiated by Company pursuant to Paragraph 4.

b. To Pay or Otherwise Settle With Parties Other Than the Assured or With the Assured.

i. To pay or otherwise settle with other parties for or in the name of an Assured any claim assured against under this Guarantee. In addition, the Company will pay any costs, attorneys’ fees, and expenses incurred by the Assured that were authorized by the Company up to the time of payment and that the Company is obligated to pay; or

ii. To pay or otherwise settle with the Assured the loss or damage provided for under this Guarantee, together with any costs, attorneys’ fees, and expenses incurred by the Assured that were authorized by the Company up to the time of payment and that the Company is obligated to pay.

Upon the exercise by the Company of either of the options provided for in Paragraphs 6.b.i. or 6.b.ii., the Company’s obligations to the Assured under this Guarantee for the claimed loss or damage, other than the payments required to be made, shall terminate, including any duty to continue any and all litigation initiated by Company pursuant to Paragraph 4.

7. Limitation of Liability.

This Guarantee is a contract of Indemnity against actual monetary loss or damage sustained or incurred by the Assured who has suffered loss or damage by reason of reliance upon the assurances set forth in Paragraph 3 of Schedule A and only to the extent herein described, and subject to the Exclusions From Coverage and Conditions of this Guarantee.
a. The liability of the Company under this Guarantee to the Assured shall not exceed the least of:

i. the amount of liability stated in Schedule A;

ii. the amount of the unpaid principal indebtedness secured by the Mortgage as limited or as reduced under Paragraph 8 of these Conditions at the time the loss or damage assured against by this Guarantee occurs, together with interest thereon; or

iii. the difference between the value of the estate or interest set forth in Schedule A and the value of the estate or interest subject to any defect, lien, encumbrance or other matter assured against by this Guarantee.

b. If the Company or the Assured under the direction of the Company at the Company’s expense establishes the title, or removes the alleged defect, lien or, encumbrance or cures any other matter assured against by this Guarantee in a reasonably diligent manner by any method, including litigation and the completion of any appeals therefrom, it shall have fully performed its obligations with respect to that matter and shall not be liable for any loss or damage caused thereby.

c. In the event of any litigation by the Company or with the Company's consent, the Company shall have no liability for loss or damage until there has been a final determination by a court of competent jurisdiction, and disposition of all appeals therefrom.

d. The Company shall not be liable for loss or damage to the Assured for liability voluntarily assumed by the Assured in settling any claim or suit without the prior written consent of the Company.

8. Reduction of Liability or Termination of Liability.

All payments under this Guarantee, except payments made for costs, attorneys’ fees and expenses pursuant to Paragraph 4 shall reduce the amount of liability pro tanto.


a. No payment shall be made without producing this Guarantee for endorsement of the payment unless the Guarantee has been lost or destroyed, in which case proof of loss or destruction shall be furnished to the satisfaction of the Company.

b. When liability and the extent of loss or damage has been definitely fixed in accordance with these Conditions the loss or damage shall be payable within thirty (30) days thereafter.

10. Subrogation Upon Payment or Settlement.

Whenever the Company shall have settled and paid a claim under this Guarantee, all right of subrogation shall vest in the Company unaffected by any act of the Assured.

The Company shall be subrogated to and be entitled to all rights and remedies which the Assured would have had against any person or property in respect to the claim had this Guarantee not been issued. If requested by the Company, the Assured shall transfer to the Company all rights and remedies against any person or property necessary in order to perfect this right of subrogation. The Assured shall permit the Company to sue, compromise or settle in the name of
the Assured and to use the name of the Assured in any transaction or litigation involving these rights or remedies.

If a payment on account of a claim does not fully cover the loss of the Assured the Company shall be subrogated to all rights and remedies of the Assured after the Assured shall have recovered its principal, interest, and costs of collection.

11. Arbitration.

Either the Company or the Assured may demand that the claim or controversy shall be submitted to arbitration pursuant to the Title Insurance Arbitration Rules of the American Land Title Association (“Rules”). Except as provided in the Rules, there shall be no joinder or consolidation with claims or controversies of other persons. Arbitrable matters may include, but are not limited to, any controversy or claim between the Company and the Assured arising out of or relating to this Guarantee, any service in connection with its issuance or the breach of a Guarantee provision, or to any other controversy or claim arising out of the transaction giving rise to this Guarantee. All arbitrable matters when the amount of liability in Schedule A is $2,000,000 or less shall be arbitrated at the option of either the Company or the Assured. All arbitrable matters when the amount of liability in Schedule A is in excess of $2,000,000 shall be arbitrated only when agreed to by both the Company and the Assured. Arbitration pursuant to this Guarantee and under the Rules shall be binding upon the parties. Judgment upon the award rendered by the Arbitrator(s) may be entered in any court of competent jurisdiction.

12. Liability Limited to This Guarantee; Guarantee Entire Contract.

a. This Guarantee together with all endorsements, if any, attached hereto by the Company is the entire Guarantee and contract between the Assured and the Company. In interpreting any provision of this Guarantee, this Guarantee shall be construed as a whole.

b. Any claim of loss or damage, whether or not based on negligence, or any action asserting such claim, shall be restricted to this Guarantee.

c. No amendment of or endorsement to this Guarantee can be made except by a writing endorsed hereon or attached hereto signed by either the President, a Vice President, the Secretary, an Assistant Secretary, or validating officer or authorized signatory of the Company.


All notices required to be given the Company and any statement in writing required to be furnished the Company shall include the number of this Guarantee and shall be addressed to the Company at ________________________________________. 
Guarantee No. 22, Information Notes Section:

Proposed paragraph no. 4 as follows:

Option 1

Attention is called to the Federal Debt Collection Procedures Act (28 USC 3001-3308) and the provisions of 28 USC 2410 (actions affecting property on which United States has a lien) which, among other things, may provide for written notice to be given to the United States, may provide for the discharge of the property from the mortgage or other lien held by the United States, and may provide that the United States shall have one year from the date of sale within which to redeem.

Option 2

Attention is called to the Federal Debt Collection Procedures Act (28 USC 3001-3308) and the provisions of 28 USC 2410 (actions affecting property on which United States has a lien) which, among other things, may provide for written notice to be given to the United States, may provide for the discharge of the property from the mortgage or other lien held by the United States, and may provide that the United States shall have one year from the date of sale within which to redeem.

Option 3

Attention is called to the Federal Debt Collection Procedures Act (28 USC 3001-3308) and the provisions of 28 USC 2410 (actions affecting property on which United States has a lien) which, among other things, may provide for written notice to be given to the United States, may provide for the discharge of the property from the mortgage or other lien held by the United States.

Option 4

Omit paragraph altogether
Paragraph 10 of the Covered Risks of the policy which reads:

"The lack of priority of the lien of the Insured Mortgage upon the Title over any other lien or encumbrance."

is deleted, and there is substituted in lieu thereof the following:

10. (1) The lack of priority of the lien of the Insured Mortgage, referred to in subparagraph (a) of paragraph 4 of Schedule A, upon the Title over any other lien or encumbrance, or

(2) The lack of priority of the lien of the Insured Mortgage, referred to in subparagraph (b) of paragraph 4 of Schedule A, upon the Title over any other lien or encumbrance, except the Insured Mortgage referred to in subparagraph (a) of paragraph 4 of Schedule A;

Except where used in this endorsement, the term "Insured Mortgage" wherever used in the policy shall be construed as referring to both of the mortgages described in Schedule A.

The Company insures that, except as stated in Part I of Schedule B, there are no matters affecting the priority of the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A which have intervened between the time of the recording of the Insured Mortgage shown in subparagraph (a) of paragraph 4 of Schedule A and the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A.
There is added to Section 11 of the Conditions the following:

"Loss under this policy shall be payable first to the owner of the Indebtedness secured by the Insured Mortgage referred to in subparagraph (a) of paragraph 4 of Schedule A, and if such ownership vests in more than one, payment shall be made ratably as their respective interests may appear, and thereafter, any loss shall be payable to the owner of the Indebtedness secured by the Insured Mortgage referred to in subparagraph (b) of paragraph 4 of Schedule A, and if more than one, then to such Insureds ratably as their respective interests may appear.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

BLANK TITLE INSURANCE COMPANY

Date:

By______________________________

CLTA Form 105-06 (03-09-07)
ALTA - Lender
ENDORSEMENT
Attached to Policy No.
Issued by
BLANK TITLE INSURANCE COMPANY

Paragraph 10 of the Covered Risks of the policy which reads:

"The lack of priority of the lien of the Insured Mortgage upon the Title over any other lien or encumbrance."

is deleted, and there is substituted in lieu thereof the following:

10. (1) The lack of priority of the lien of the Insured Mortgage, referred to in subparagraph (a) of paragraph 4 of Schedule A, upon the Title over any other lien or encumbrance, or

(2) The lack of priority of the lien of the Insured Mortgage, referred to in subparagraph (b) of paragraph 4 of Schedule A, upon the Title over any other lien or encumbrance, except the Insured Mortgage referred to in subparagraph (a) of paragraph 4 of Schedule A;

Except where used in this endorsement, the term "Insured Mortgage" wherever used in the policy shall be construed as referring to both of the mortgages described in Schedule A.

The Company insures that, except as stated in Part I of Schedule B, there are no matters affecting the priority of the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A which have intervened between the time of the recording of the Insured Mortgage shown in subparagraph (a) of paragraph 4 of Schedule A and the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A.
The Company insures against loss or damage sustained by the Insured by reason of there being any defects, lien, encumbrances, adverse claims or other matters, except as stated in Part I of Schedule B, affecting the priority of the lien of the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A that have intervened between the time of recording of (1) the Insured Mortgage shown in subparagraph (a) of paragraph 4 of Schedule A, and (2) the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A.

There is added to Section 11 of the Conditions the following:

"Loss under this policy shall be payable first to the owner of the Indebtedness secured by the Insured Mortgage referred to in subparagraph (a) of paragraph 4 of Schedule A, and if such ownership vests in more than one, payment shall be made ratably as their respective interests may appear, and thereafter, any loss shall be payable to the owner of the Indebtedness secured by the Insured Mortgage referred to in subparagraph (b) of paragraph 4 of Schedule A, and if more than one, then to such Insureds ratably as their respective interests may appear.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

BLANK TITLE INSURANCE COMPANY

Date:

By______________________________
ENDORSEMENT
Attached to Policy No.
Issued by
BLANK TITLE INSURANCE COMPANY

Paragraph 10 of the Covered Risks of the policy which reads:

"The lack of priority of the lien of the Insured Mortgage upon the Title over any other lien or encumbrance."

is deleted, and there is substituted in lieu thereof the following:

10. (1) The lack of priority of the lien of the Insured Mortgage, referred to in subparagraph (a) of paragraph 4 of Schedule A, upon the Title over any other lien or encumbrance, or

(2) The lack of priority of the lien of the Insured Mortgage, referred to in subparagraph (b) of paragraph 4 of Schedule A, upon the Title over any other lien or encumbrance, except the Insured Mortgage referred to in subparagraph (a) of paragraph 4 of Schedule A;

Except where used in this endorsement, the term "Insured Mortgage" wherever used in the policy shall be construed as referring to both of the mortgages described in Schedule A.

The Company insures against loss or damage sustained by the Insured by reason of there being any defects, lien, encumbrances, adverse claims or other matters, except as stated in Part I of Schedule B, affecting the priority of the lien of the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A that have intervened between the time of recording of (1) the Insured Mortgage shown in subparagraph (a) of paragraph 4 of Schedule A and (2) the Insured Mortgage shown in subparagraph (b) of paragraph 4 of Schedule A.
There is added to Section 11 of the Conditions the following:

"Loss under this policy shall be payable first to the owner of the Indebtedness secured by the Insured Mortgage referred to in subparagraph (a) of paragraph 4 of Schedule A, and if such ownership vests in more than one, payment shall be made ratably as their respective interests may appear, and thereafter, any loss shall be payable to the owner of the Indebtedness secured by the Insured Mortgage referred to in subparagraph (b) of paragraph 4 of Schedule A, and if more than one, then to such Insureds ratably as their respective interests may appear.

This endorsement is issued as part of the policy. Except as it expressly states, it does not (i) modify any of the terms and provisions of the policy, (ii) modify any prior endorsements, (iii) extend the Date of Policy, or (iv) increase the Amount of Insurance. To the extent a provision of the policy or a previous endorsement is inconsistent with an express provision of this endorsement, this endorsement controls. Otherwise, this endorsement is subject to all of the terms and provisions of the policy and of any prior endorsements.

BLANK TITLE INSURANCE COMPANY

Date:

By______________________________
TITLE 11. DEPARTMENT OF JUSTICE

NOTICE FOR PROPOSED AMENDMENTS TO THE DEPARTMENT OF JUSTICE REGULATIONS PERTAINING TO ELECTRONIC RECORDING DELIVERY SYSTEM

The Department of Justice (DOJ)/Electronic Recording Delivery System (ERDS) program under the authority of the Electronic Recording Delivery Act of 2004 (ERDA), AB 578 (Chapter 621, Statutes of 2004), as amended, is requesting approval to amend six (6) of the nine (9) Articles of the ERDS regulations, CCR, Title 11, Division 1, Chapter 18, Articles 1-9.

The DOJ is requesting to amend regulations sections 121 through 223 to provide clearer guidance to the Counties and the individuals that use an ERDS.

Public Hearing Dates, Time and Place:

No public hearing has been scheduled for the proposed regulatory action; however, any interested person or his or her duly authorized representative may request, no later than 15 days prior to the close of the written comment period, a public hearing pursuant to the Administrative Procedures Act, Government Code section 11346.8.

Written Comment Period:

Any interested person, or his or her authorized representative, may submit written comments relevant to the proposed regulatory action to the contact person(s) listed below. The written comment period closes on March 18, 2013 at 5 p.m. Only written comments received by that time shall be considered.

Contact Person(s):

Any requests for or questions regarding the regulations package should be directed to:

Michelle N. Mitchell, Field Representative
California Department of Justice
California Justice Information Services Division
Electronic Recording Delivery System
P.O. Box 160526
Sacramento, CA 95816-0526
Telephone: (916) 227-1127
Christina Rogers, Assistant Bureau Chief
California Department of Justice
California Justice Information Services Division
Electronic Recording Delivery System
P.O. Box 160526
Sacramento, CA 95816-0526
Telephone: (916) 227-3059

Authority and Reference

The Department is authorized to adopt these regulations pursuant to the Governemnt Code section 12586(b) and to implement, interpret, and make specific the provisions of Governemnt Code Section 12580 et seq. Authority Cited: Sections 27392(a), 27393, 27393(b), 27393(b)(6), 27394(a), 27394(b), 27394(c), 27395(a), 27395(b), 27395(c), 27395(d) and 27395(e), 27396(a), 27396(b), 27396(b)(1), Government Code. Reference: Sections 27390(b)(2), 27390(b)(8), 27391, 27391(a), 27391(b), 27391(e), 27392, 27392(a), 27392(b), 27393(b), 27393(b)(2), 27393(b)(3), 27393(b)(6), 27393(b)(7), 27393(b)(9), 27393(b)(10), 27393(b)(12), 27393(c), 27394, 27394(a), 27394(b), 27394(c), 27394(d), 27394(e), 27394(f), 27395, 27395(a), 27395(b), 27396, 27396(a), 27396(b), 27396(b)(1), 27397(a), 27397(b), 27397.5, 27397.5(d)(2) and 27396 Government Code; and Sections 1203.4, 11105 and 11105.2, Penal Code.

INFORMATIVE DIGEST/POLICY STATEMENT OVERVIEW

Existing Laws and Regulation

Existing law generally specifies that the recorder of any county may, in lieu of a written paper, accept for recording a digitized image of a recordable instrument, subject to specified conditions. AB 578 enacted the Electronic Recording Delivery Act of 2004, to authorize a county recorder, upon approval by resolution of the board of supervisors and system certification by the Attorney General, to establish an electronic recording delivery system for the delivery for recording of specified digitized and digital electronic records, subject to specified conditions, including system certification, regulation, and oversight by the Attorney General. It authorizes a county recorder to include in its electronic recording delivery system a secure method for accepting for recording a digital or digitized electronic record that is an instrument of reconveyance, substitution of trustee, or assignment of deed of trust, subject to specified conditions. It requires participating counties to pay for the direct cost of regulation and oversight by the Attorney General, and authorizes those counties to impose fees to cover those costs.
Anticipated Benefits of the Proposed Regulation:

The DOJ concludes that the benefits of this program will ensure the safety and security of the documents being transmitted electronically and that all California citizens’ personal information is also being transmitted securely. The background check conducted on individuals participating within the program promotes fairness and social equity for all California citizens. The proposed regulatory action will benefit the general welfare of California by ensuring the conservation, maintenance, and utilization of the sustainable living resources.

The DOJ concludes that the non-monetary benefits of this program will ensure the protection of safety and the environment, prevention of discrimination, and security for all California citizens.

The DOJ is unaware of any inconsistencies or incompatibilities with existing state regulations.

Description of the Effect of the Proposed Action

The following items outline the proposed amendments:

- These amendments include the DOJ’s reorganization information which required amendments to all ERDS forms, which is incorporated herein by reference.
- The re-fingerprinting process was eliminated due to the DOJ having subsequent arrest authority.
- The amendments allow secure access users to bundle Type 1 and Type 2 instruments within the same ERDS payloads.
- Amendments have been made to ensure that the ERDS are utilizing the latest final NIST/FIPS publications, and a timeframe was added for updates, which is incorporated herein by reference.
- Removed the word staff and replaced it with representative.
- Removed items that are not technically feasible to audit.
- Title changed Form # ERDS 0002 from: Application for DOJ Computer Security Auditor Approval to: Application for Computer Security Auditor Approval, which is incorporated herein by reference.
- Title changed Form # ERDS 0004 from: Attachment to ERDS 0002 Computer Security Auditor Significant Experience Reference(s) to: Reference(s) for ERDS Computer Security Auditor, which is incorporated herein by reference.
- Amended the minimum requirements to become an ERDS Auditor.
- Amended timeline for inspecting sub-counties.
- Added language for local inspections to be all-inclusive.
- Inspection letters to be mailed out 30 days instead of 10 days to allow for follow up questions.
Section 999.121 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
- Proof of Fingerprinting was eliminated due to the DOJ having subsequent arrest authority under Government Code section 27395(c)(3).

Section 999.133 is amended as follows:

- The ERDS payload structure was amended so that secure access authorized users can include both Type 1 and Type 2 instruments within the same payload.

Section 999.137 is amended as follows:

- Amendments were made so that the ERDS users are utilizing the latest final publications of NIST/FIPS guidelines as required and to include a timeline as to when those updates must be implemented, which is incorporated herein by reference.

Section 999.139 is amended as follows:

- Amendments were made so that the ERDS users are utilizing the latest final publications of NIST/FIPS guidelines as required and to include a timeline as to when those updates must be implemented, which is incorporated herein by reference.

Section 999.141 is amended as follows:

- Amendments were made so that the ERDS users are utilizing the latest final publications of NIST/FIPS guidelines as required and to include a timeline as to when those updates must be implemented, which is incorporated herein by reference.

Section 999.143 is amended as follows:

- Amendments were made so that the ERDS users are utilizing the latest final publications of NIST/FIPS guidelines as required and to include a timeline as to when those updates must be implemented, which is incorporated herein by reference.
Section 999.144 is amended as follows:

- Amendments were made so that the ERDS users are utilizing the latest final publications of NIST/FIPS guidelines as required and to include a timeline as to when those updates must be implemented, which is incorporated herein by reference.

Section 999.145 is amended as follows:

- Language was amended from staff to representative.

Section 999.146 is amended as follows:

- Auditable events, incidents, and reporting requirements not feasible to audit were removed.

Section 999.165 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.166 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.168 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.171 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.172 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
Section 999.173 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.174 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.176 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.178 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.179 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.190 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
- Form # ERDS 0002 title was changed from Application for DOJ Computer Security Auditor Approval to Application for Computer Security Auditor Approval, which is incorporated herein by reference.
- Form # 0004 title was changed from Attachment to ERDS 0002 Computer Security Auditor Significant Experience Reference(s) to Reference(s) for ERDS Computer Security Auditor, which is incorporated herein by reference.
- The minimum requirements to become an Approved Computer Security Auditor have been amended.
Section 999.192 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
- Form # ERDS 0002 title was changed from Application for DOJ Computer Security Auditor Approval to Application for Computer Security Auditor Approval, which is incorporated herein by reference.

Section 999.193 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
- Form # ERDS 0002 title was changed from Application for DOJ Computer Security Auditor Approval to Application for Computer Security Auditor Approval, which is incorporated herein by reference.

Section 999.195 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
- Form # ERDS 0002 title was changed from Application for DOJ Computer Security Auditor Approval to Application for Computer Security Auditor Approval, which is incorporated herein by reference.
- Form # 0004 title was changed from Attachment to ERDS 0002 Computer Security Auditor Significant Experience Reference(s) to Reference(s) for ERDS Computer Security Auditor, which is incorporated herein by reference.
- The minimum requirements to become an Approved Computer Security Auditor have been amended.

Section 999.203 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.204 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
Section 999.206 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.207 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.209 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.210 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.211 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.217 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
- The timeframe for local inspections of sub counties were changed due to the fact that lead counties are inspected every two years and have control over the ERDS.
- Language was amended from staff to representative.

Section 999.219 is amended as follows:

- The timeframe for local inspections of sub counties were changed due to the fact that the lead counties are inspected every two years and have control over the ERDS.
- The inspections were also amended to include hardware, software, workstations, and network devices comprising the ERDS, including those located at the office of an
Authorized Submitter and/or their agents; this allows the DOJ inspections to be all inclusive.

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
- Turn around time for the inspection letters to be mailed to the county recorder increased from 10 days to 30 days, due to follow up items.

Section 999.220 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.221 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.

Section 999.223 is amended as follows:

- The ERDS forms were amended to accurately reflect changes due to the DOJ’s reorganization, which are incorporated herein by reference.
Disclosures of Proposed Action:

The DOJ Has Made the Following Initial Determinations:

Mandate on local agencies and school districts: None.

Cost or saving to any state agency: None.

Cost to any local agency or school district which must be reimbursed in accordance with Government Code sections 17500 through 17630: None.

Other nondiscretionary cost or saving imposed on local agencies: None.

Cost or savings in federal funding to the state: None.

Cost impacts on a representative private person or businesses: The DOJ is not aware of any cost impact that a private person or business would necessarily incur in reasonable compliance with the proposed action.

Significant effect on housing cost: None.

Significant statewide adverse economic impact directly affecting businesses, including ability of California businesses to compete with businesses with other states: None. The DOJ believes there is no adverse economic impact directly affecting businesses within California or out of state, this program is on a voluntary basis.

Results of the economic impact analysis:

Elimination of jobs/businesses, creation of jobs/businesses, or expansion of jobs/businesses: This rulemaking will assist the County Recorders within California, in lieu of a written paper, in accepting for recording a digitized image of a recordable instrument, subject to specified conditions. This regulatory action will not eliminate, create or cause expansion to any businesses in California or out of state.

Benefits of the Proposed Regulation:

This rulemaking will assist the County Recorders within California, in lieu of a written paper, in accepting for recording a digitized image of a recordable instrument, subject to specified conditions. For additional benefits, please see page 3 under “Anticipated Benefits of the Proposed Regulation..
Small Business Reporting requirement: The Department has determined that the proposed amendments will not affect small businesses due to the program being voluntary.

Consideration of Alternatives:

In accordance with Government Code section 11346.5(a)(13), the DOJ must determine that no reasonable alternative considered by the DOJ or that has otherwise been identified and brought to its attention would be more effective in carrying out the purpose for which the action is proposed, would be as effective and less burdensome to affected private persons than the proposed action, or would be more cost-effective to affected private persons and equally effective in implementing the statutory policy or other provision of law. The DOJ invites interested persons to present statements or arguments with respect to alternatives to the proposed amendment to existing regulations during the written comment period.

Availability of Statements:

The DOJ has prepared an Initial Statement of Reasons for the proposed amendments to existing regulations and a listing of the exact regulations being proposed.

Copies of the exact language of the Initial Statement of Reasons and of the Text of the Proposed Amendments to existing regulations, and any other information may be obtained from the DOJ contact person(s) shown in the notice. Copies of the exact language of the Initial Statement of Reasons and of the Text of the Proposed Amendments to existing regulations may also be obtained through the Office of the Attorney General’s website at: [http://oag.ca.gov/erds](http://oag.ca.gov/erds).

With the exception of any non-substantive technical or grammatical changes, the full text of any amended proposal will be available for 15 days prior to its adoption to all persons who submit written comments during the public comment period and all persons who request notification.

Availability of Changed or Amended Text:

After the DOJ analyzes all timely and relevant comments received during the comment period, the DOJ will either adopt the amendments to the existing regulations as described in the notice, or make modifications based on the comments. If the DOJ makes modifications which are sufficiently related to the original text of the proposed amendments to existing regulations, the amended text, with the changes clearly indicated, will be made available to the public for at least 15 days before the DOJ adopts the revised amendments to the existing regulations. The DOJ will accept written comments on the amended regulations for 15 days after the date on which they are made available.
Availability of Final Statement of Reasons:

Once the Final Statement of Reasons has been prepared, it will be made available through the contact person(s) shown in this notice and the Office of the Attorney General’s website at: http://oag.ca.gov/erds.
Incorporated by Reference Documents:

ERDS Forms
ERDS 0001A: Application for System Certification (Rev. 05/2011)
ERDS 0001B: Application for Sub-County System Certification (Rev. 05/2011)
ERDS 0002: Application for Computer Security Auditor Approval (Rev. 05/2011)
ERDS 0003: Application for Vendor of ERDS Software Certification (Rev. 05/2011)
ERDS 0004: Reference(s) for ERDS Computer Security Auditor (Rev. 05/2011)
ERDS 0006: Request for Replacement of Certificate and/or Documents (Rev. 05/2011)
ERDS 0007: FAX Transmission Cover Sheet (Rev. 05/2011)
ERDS 0008: Change of ERDS Role (Rev. 05/2011)
ERDS 0009: Reference(s) for Vendor of ERDS Software Certification (Rev. 05/2011)
ERDS 0010: Application for Withdrawal (Rev. 05/2011)
ERDS 0011: Statement of Understanding (Rev. 05/2011)
ERDS 0012: Acknowledgment of Responsibilities (Rev. 05/2011)
ERDS 0013: Request for Approval of Substantive Modification(s) (Rev. 05/2011)

Publications
California County Information Services Directors Association “Best Practices”  
(Pub. 03/2002)
FIPS PUB 140-2: Security Requirements for Cryptographic Modules (Rev. 12/02)
FIPS PUB 180-3: Secure Hash Standard (Pub. 10/08)
FIPS PUB 197: Advanced Encryption Standard (AES) (Pub.11/01)
FIPS PUB 198-1: The Keyed-Hash Message Authentication Code (HMAC) (Pub. 07/08)
NISTSP 800-63-1: Electronic Authentication Guideline (Pub. 12/11)
NISTSP 800-70: National Checklists Program for IT Products-Guidelines for Checklist Users and Developers (Pub. 02/11)
NISTSP 800-88: Guidelines for Media Sanitization (Pub. 09/06)
## CLTA Electronic Recordation Task Force - Formed in October, 2007 (updated March 5, 2012)

<table>
<thead>
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<th>Email Contacts Grouped:</th>
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<tbody>
<tr>
<td><a href="mailto:cp@clta.org">cp@clta.org</a>; <a href="mailto:aj@clta.org">aj@clta.org</a>; <a href="mailto:Paul.Flores@fnf.com">Paul.Flores@fnf.com</a>; <a href="mailto:Brian.Maughan@fnf.com">Brian.Maughan@fnf.com</a>; <a href="mailto:lwilson@firstam.com">lwilson@firstam.com</a>; <a href="mailto:phammann@firstam.com">phammann@firstam.com</a>; <a href="mailto:kpearson@firstam.com">kpearson@firstam.com</a>; <a href="mailto:danbuchanan@firstam.com">danbuchanan@firstam.com</a>; <a href="mailto:gaalseth@firstam.com">gaalseth@firstam.com</a>; <a href="mailto:rtherien@ortc.com">rtherien@ortc.com</a>; <a href="mailto:jhwiley@octitle.com">jhwiley@octitle.com</a>; <a href="mailto:jtyler@placertitle.com">jtyler@placertitle.com</a>; <a href="mailto:rcavalla@stewart.com">rcavalla@stewart.com</a></td>
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IN THE COURT OF APPEALS OF THE STATE OF OREGON

SERA ARCHITECTS, INC.,
an Oregon corporation,
Plaintiff-Appellant,
Cross-Respondent,

v.

KLAHOWYA CONDOMINIUM, LLC,
dba Klahowya, LLC,
an Oregon limited liability company,
Defendant-Respondent,

and

SHOREBANK PACIFIC CORPORATION,
dba Shorebank Pacific, a Delaware corporation,
Defendant-Respondent
Cross-Appellant,

and

CARL GATZKE,
and dba Klahowya, LLC;
SUSAN MIKOLASY,
individually, and dba Klahowya, LLC;
and BOOCO CONSTRUCTION, INC.,
an Oregon corporation,
Defendants.

BOOCO CONSTRUCTION, INC.,
an Oregon corporation,
Plaintiff,

v.

KLAHOWYA CONDOMINIUM, LLC,
dba Klahowya, LLC,
an Oregon limited liability company;
and SHOREBANK PACIFIC
Defendants.

SERA ARCHITECTS, INC., an Oregon corporation,
Plaintiff-Appellant,
v.

KLAHOWYA CONDOMINIUM, LLC,
dba Klahowya, LLC,
an Oregon limited liability company;
SHOREBANK PACIFIC CORPORATION,
dba Shorebank Pacific,
a Delaware corporation,
Defendants-Respondents,

and

CARL GATZKE,
individually, and dba Klahowya, LLC;
SUSAN MIKOLASY,
individually, and dba Klahowya, LLC;
and BOOCO CONSTRUCTION, INC.,
an Oregon corporation,
Defendants.

BOOCO CONSTRUCTION, INC.,
an Oregon corporation,
Plaintiff,

v.

KLAHOWYA CONDOMINIUM, LLC,
dba Klahowya, LLC,
an Oregon limited liability company;
and SHOREBANK PACIFIC
Defendants.

Clackamas County Circuit Court
CV07100715, CV07120131
A140946 (Control)
A142185

Steven L. Maurer, Judge.
John K. Lowe, Judge.
Robert R. Selander, Judge.

Argued and submitted on May 04, 2011.

James N. Westwood argued the cause for appellant-cross-respondent SERA Architects, Inc. With him on the briefs were Christine A. Kosydar and Stoel Rives LLP.

Daniel L. Steinberg argued the cause for respondent-cross-appellant Shorebank Pacific
Corporation. With him on the briefs were M. Elizabeth Duncan and Greene & Markley, P.C.

No appearance for respondent Klahowya Condominium, LLC.

Before Ortega, Presiding Judge, and Brewer, Judge, and Sercombe, Judge.*

ORTEGA, P. J.

On appeal, limited judgment reversed and remanded; on cross-appeal, affirmed; supplemental judgment affirmed on cross appeal.

*Brewer, J., *vice* Rosenblum, S. J.
This appeal involves a dispute over priority by two creditors of Klahowya
Condominium, LLC, (Klahowya), the developer of a failed property development. The
trial court concluded that trust deeds held by defendant Shorebank Pacific Corporation
(Shorebank) had priority over an architect's lien filed by plaintiff SERA Architects, Inc.
(SERA) and entered a limited judgment to that effect. The trial court's decision had two
aspects: first, that Shorebank's trust deed had priority under the Construction Lien Law,
ORS 87.005 - 87.060, and second, that, under the doctrine of equitable subrogation,
Shorebank's trust deed was substituted to the first position of a prior mortgagee whose
loan had been paid off from the proceeds of Shorebank's loan. SERA appeals the limited
judgment, assigning error to the trial court's determination of priority. Shorebank cross-
appeals the limited judgment, challenging trial court rulings related to the validity of
SERA's lien. Shorebank also cross-appeals the supplemental judgment that awarded
attorney fees to SERA from Klahowya, arguing that SERA was not entitled to the full
amount of fees awarded because a large percentage of those fees were incurred in SERA's
failed attempt to establish priority over Shorebank.

Ultimately, we conclude that SERA's lien had priority over Shorebank's
trust deed under the Construction Lien Law and that the trial court erred by subrogating
Shorebank's trust deed to first position. Accordingly, we reverse and remand the limited
judgment on appeal. Given our resolution of SERA's appeal, we also affirm the
supplemental judgment, which Shorebank cross-appeals.
The following facts are undisputed. In January 2006, Klahowya purchased property in Government Camp (the development property) with a loan of $1,300,000 from Triangle Holdings II, LLC (Triangle) to build a mixed-use development. The Triangle loan was secured by a trust deed on the development property from Klahowya, which Triangle recorded on January 30, 2006. On March 28, 2006, SERA and Klahowya entered into a contract for SERA to provide architectural services for the development; SERA commenced work on the plans that March and held a workshop for consultants, owners, and other interested parties early in April. Shorebank's representatives attended the workshop. In July 2006, the contractor, BooCo Construction, Inc. (BooCo), began preparing the property for construction by demolishing existing cabins and clearing trees. BooCo stopped work at the site in October 2006 without commencing construction.

In November 2006, Shorebank provided Klahowya with a line of credit, secured by a trust deed on the development property, in the amount of $1,462,000, from which Klahowya paid off the $1,425,000 balance of the Triangle loan. Shorebank recorded the trust deed on the development property on November 15, 2006. Shorebank also extended an additional line of credit for $250,000 to Klahowya, which was secured by a trust deed on land abutting Blossom Trail (the Blossom Trail property). Shorebank

___

1 Carl Gatzke and Susan Mikolasy were named as individual defendants jointly doing business as Klahowya. For ease of reference, we refer to all three parties as Klahowya.

2 The principal balance had increased from the original loan amount because of accrued interest on the loan.
recorded that trust deed on February 9, 2007.\textsuperscript{3} Finally, Shorebank extended an additional $250,000 under its original line of credit, and Shorebank and Klahowya executed a modification of the trust deed on the development property to reflect a new principal balance of $1,712,000 and an increase in the interest rate on the original note. Shorebank recorded the modification of the trust deed on May 29, 2007.

Klahowya paid SERA for services rendered until sometime in early 2007, at which point it stopped making payments. SERA recorded a claim of lien on the property on June 29, 2007, asserting a lien for $375,598, plus interest.

In October 2007, SERA sued Klahowya and Shorebank for foreclosure of its construction lien, alleging that Klahowya owed it a balance of $375,598, together with fees and interest, for work performed under the contract.\textsuperscript{4} SERA also alleged that any "right, title or interest in the [development property]" claimed by Shorebank "is junior and subordinate to SERA's." Two months later, BooCo filed suit against Klahowya and Shorebank for breach of contract and foreclosure of a construction lien filed by BooCo. Eventually, the trial court consolidated the cases.

Shorebank answered SERA's complaint and raised several affirmative

\textsuperscript{3} According to Shorebank, the promissory note related to the trust deed on the Blossom Trail property was satisfied and is no longer relevant to this appeal. SERA does not dispute that characterization of the record, and we, therefore, do not address any priority issue with the Blossom Trail trust deed in this appeal.

\textsuperscript{4} SERA also brought breach of contract and quantum meruit claims against Klahowya, neither of which is relevant to this appeal. SERA later amended its complaint to add BooCo as a defendant; SERA's claims as to BooCo are not relevant to this appeal.
defenses, including that Shorebank's trust deed had priority over SERA's lien by virtue of the Construction Lien Law and that, regardless, Shorebank was equitably subrogated to the first lien position of Triangle's trust deed to the extent that Shorebank's loan proceeds were used to pay off the Triangle loan. Shorebank also brought a counterclaim against Klahowya to foreclose Shorebank's trust deed.

After the parties engaged in extensive pretrial motion practice, the trial court conducted a bench trial on SERA's lien claims as to the amount due SERA by Klahowya and the priority issue between SERA and Shorebank. At the close of trial, the court ruled that Shorebank's trust deed on the development property had priority over SERA's lien. The court later entered a limited judgment in favor of SERA against Klahowya for the amount of the lien, but establishing the priority of Shorebank's trust deed over SERA's lien.5

After trial, SERA petitioned for attorney fees from Klahowya pursuant to ORS 87.060 and its contract with Klahowya. Shorebank opposed the petition, contending that, to the extent that SERA sought attorney fees related to its "claim of foreclosure against Shorebank," such fees were improper because SERA did not prevail on that claim. Accordingly, Shorebank argued that $74,745 of the fees sought were unavailable because they pertained to SERA's unsuccessful litigation with Shorebank over priority. The trial court entered a supplemental judgment awarding SERA the full

5 The court entered a general judgment in the case granting Shorebank a money award and a lien on the development property.
amount of fees it had sought.

SERA appeals from the limited judgment. Shorebank cross-appeals from the limited judgment and the supplemental judgment awarding attorney fees. We begin with Shorebank's cross-appeal of the limited judgment because of its potential to be dispositive and conclude that it does not provide a basis for reversal.

Exhaustive detail of the proceedings and legal arguments that underlie Shorebank's cross-appeal would not benefit the bench, bar, or public, but we briefly describe the context for our decision to affirm the trial court's ruling that Shorebank challenges. Shorebank made a motion at the close of SERA's case that has been alternatively characterized as a motion for reconsideration of an earlier summary judgment order or a motion for directed verdict. Shorebank sought a ruling that SERA's lien--which the trial court had already ruled was valid in the context of earlier proceedings in which Shorebank chose not to participate--was untimely under ORS 87.035 and was therefore invalid. The trial court, without reaching the merits, declined to reconsider its prior summary judgment order as to the validity of SERA's lien and denied Shorebank's motion based on the stage of the proceedings at which Shorebank raised it and the circumstances that preceded it. We conclude that the trial court did not err in so ruling. We also reject Shorebank's second assignment of error on cross-appeal without further discussion.

ORS 87.035 requires, among other things, a lien claimant to perfect the lien by filing a claim of lien within a specified time frame.
We proceed to address SERA's appeal from the limited judgment, challenging the trial court's ruling that Shorebank's trust deed had priority over SERA's lien. At trial, SERA argued that, under the Construction Lien Law, its lien had priority over Shorebank's trust deed. Shorebank countered that the lien law supported Shorebank's claim of priority and, alternatively, that the doctrine of equitable subrogation placed Shorebank's trust deed in the same position as Triangle's trust deed, thus giving Shorebank priority.

The trial court concluded that Shorebank's trust deed on the development property would hold the same priority position as Triangle's trust deed by equitable subrogation—at least as to the amount of the Shorebank loan that was used to pay off the Triangle loan. Because there remained a question of priority of the additional Shorebank loans ($250,000 related to the modification of the trust deed on the development property and $250,000 related to the separate note secured by the trust deed on the Blossom Trail property), the court also analyzed the relevant statutes and determined that Shorebank's trust deeds, as to those additional amounts, had priority over SERA's lien. We conclude that the trial court was incorrect in both of those conclusions.

Although the trial court first addressed the issue of equitable subrogation and then analyzed the priority issue under the relevant statutes, we begin with the statutory issue because of its potential to dispose of the entire appeal. That is, if Shorebank's trust deed has priority under the Construction Lien Law, then all amounts
secured by its trust deed would have priority over SERA's lien, thereby obviating the need to address whether the trial court erred by applying equitable subrogation in this case.

In preparation for our examination of the Construction Lien Law, we begin with a general common-law rule that operates in the background of the governing statutes--the "first in time is first in right" rule. See Director of Veterans' Affairs v. Vickery, 299 Or 315, 318, 702 P2d 1070 (1985) (recognizing that rule in the context of determining if a mortgage lien had priority over a city's nuisance abatement lien). Stated simply, that rule provides that an earlier lien is entitled to satisfaction before a subsequent lien. See Rankin v. Scott, 25 US (12 Wheat) 177, 179, 6 L Ed 192 (1827) ("The principle is believed to be universal, that a prior lien gives a prior claim, which is entitled to prior satisfaction, out of the subject it binds, unless the lien be intrinsically defective, or be displaced by some act of the party holding it, which shall postpone him in a court of law or equity to a subsequent claimant.").

That general rule, however, is subject to legislative action that restructures the normal priorities. Vickery, 299 Or at 319. Construction liens are, to some extent, an example of such legislative action. Although they were unknown at common law, as far back as 1864, the legislature granted construction liens priority over both prior and subsequently recorded mortgages. See General Laws of Oregon, Civ Code, ch XXVII,

7 It is undisputed that Shorebank's trust deed and the modification of the trust deed were recorded before SERA recorded its claim of lien.
title I, §§ 2, 7, pp 763-65 (Deady 1845-1864); see also Hickey v. Polacheck, 63 Or App 784, 786, 666 P2d 294 (1983) (noting that later versions of lien statutes granted construction liens priority). The construction lien laws are "designed to protect laborers and materialmen who expend their labor and materials upon the buildings of others."

Lemire v. McCollum, 246 Or 418, 426, 425 P2d 755 (1967). Accordingly, in some circumstances, the legislature has "restructured the normal priorities" and granted "super-priority" to certain types of construction liens. In those instances, "even when a construction lien is perfected after another encumbrance was recorded, the construction lien has superior rights in the event of a foreclosure." Evergreen Pacific, Inc. v. Cedar Brook Way, LLC, 251 Or App 194, 199, 284 P3d 509 (2012).

With that background in mind, we turn to the applicable statutes. ORS 87.010 sets forth a number of categories of construction-related liens, one of which is the architect's lien that is at issue in this case. Specifically, ORS 87.010(5) provides:

"An architect, landscape architect, land surveyor or registered engineer who, at the request of the owner or an agent of the owner, prepares plans, drawings or specifications that are intended for use in or to facilitate the construction of an improvement or who supervises the construction shall have a lien upon the land and structures necessary for the use of the plans, drawings or specifications so provided or supervision performed."

ORS 87.035 provides the process for perfecting a construction lien, which is done by timely filing a claim of lien with the county recording officer.8

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8 ORS 87.035, in part, states:

"(1) Every person claiming a lien created under ORS 87.010(1) or (2) shall perfect the lien not later than 75 days after the person has ceased to
ORS 87.025 establishes specific rules that address priority of construction
liens in various circumstances. The following provisions of that statute are relevant to
our analysis:

"(1) A lien created under ORS 87.010(2) or (6) and perfected under ORS 87.035 upon any lot or parcel of land shall be preferred to any lien, mortgage or other encumbrance which attached to the land after or was unrecorded at the time of commencement of the improvement.

"(2) Except as provided in subsections (3) and (6) of this section, a lien created under ORS 87.010(1), (4) or (5) and perfected under ORS 87.035 upon any improvement shall be preferred to all prior liens, mortgages or other encumbrances upon the land upon which the improvement was constructed. To enforce such lien the improvement may be sold separately from the land; and the purchaser may remove the improvement within a reasonable time thereafter * * *

"(3) No lien for materials or supplies shall have priority over any recorded mortgage or trust deed on either the land or improvement unless the person furnishing the material or supplies [gives notice to the mortgagee].

"* * * * *

provide labor, rent equipment or furnish materials or 75 days after completion of construction, whichever is earlier. Every other person claiming a lien created under ORS 87.010 shall perfect the lien not later than 75 days after the completion of construction. All liens claimed shall be perfected as provided by subsections (2) to (4) of this section.

"(2) A lien created under ORS 87.010 shall be perfected by filing a claim of lien with the recording officer of the county or counties in which the improvement, or some part thereof, is situated.

"(3) [listing the items that a claim of lien must contain].

"(4) The claim of lien shall be verified by the oath of the person filing * * * subject to the criminal penalties for false swearing * * *."
"(7) The perfection of a lien under ORS 87.035 relates to the date of commencement of the improvement as defined in ORS 87.005. Except as provided in subsection (3) of this section, the date of creation of the lien under ORS 87.010 and the date of perfection of the lien under ORS 87.035 do not affect the priorities under this section, the equal priority of perfected lien claimants, or the distribution of proceeds to perfected lien claimants under ORS 87.060(6)." 

SERA's argument at trial and on appeal is straightforward. SERA contends that ORS 87.010(5) authorizes its lien on the land and structures necessary for the use of the plans, drawings, or specifications it prepared. ORS 87.035(2) provides that the lien must be perfected by recording a claim of lien. ORS 87.025(7) states, in part, that "[t]he perfection of lien under ORS 87.035 relates to the date of commencement of the improvement as defined in ORS 87.005." SERA asserts that its lien relates back to the date that BooCo began work on the development property in July 2006 because "commencement of the improvement" is defined in ORS 87.005(1) as the "first actual preparation or construction upon the site * * * of such substantial character as to notify interested persons that preparation or construction upon the site has begun or is about to begin[,]" and ORS 87.005(9) provides that "[p]reparation' means excavating, surveying, landscaping, demolishing or detaching existing structures or leveling, filling in or otherwise making land ready for construction." According to SERA, because BooCo's

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ORS 87.060(6) provides:

"In case the proceeds of any sale under ORS 87.001 to 87.060 * * * are insufficient to pay all lienholders claiming under such statutes, the liens of all persons shall be paid pro rata. Each claimant is entitled to execution for any balance due the claimant after the distribution of the proceeds, and that execution shall be issued by the clerk of the court * * *."
site preparation began in July 2006—before Shorebank recorded its trust deed—SERA's lien has priority over Shorebank's trust deed.

Shorebank counters that, because its trust deed was recorded before SERA filed its claim of lien in June 2007, Shorebank's trust deed has priority under the first in time is first in right rule. That is, Shorebank's position is that priority of SERA's lien is requested for purposes of the first in time is first in right rule by the date that SERA filed its claim of lien, not the "commencement of the improvement." Shorebank also notes that although ORS 87.025(2) grants priority to certain liens over prior recorded interests, that statute is not applicable here because it operates to grant superpriority only when an improvement has been constructed. See Bratzel v. Stafford, 140 Or 661, 664-65, 14 P2d 454 (1932) (concluding that predecessor statute to ORS 87.025 was intended to prioritize construction liens only over the improvement). Accordingly, Shorebank notes that although SERA had a lien upon the land, ORS 87.025(2) did not grant that lien any priority.10

Shorebank also disputes SERA's assertion that ORS 87.025(7) grants all construction liens priority as to the date of the "commencement of the improvement." Shorebank maintains that the second sentence of ORS 87.025(7) "expressly states that it does not [a]ffect priorities." Accordingly, Shorebank argues that ORS 87.025(7), by its plain terms, does not change the priority rule in ORS 87.025(2) and that because ORS

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10 Shorebank does not argue on appeal that the lack of improvement on the development property defeated the validity of SERA's lien.
87.025(2) only grants priority to liens perfected on an improvement, Shorebank has
priority under the first in time is first in right rule.

Properly framed, the parties' fundamental disagreement reduces to a dispute
over the date that SERA's lien on the development property should be measured for
purposes of the first in time is first in right rule. SERA asserts that its lien encumbered
the development property before Shorebank's trust deed was recorded, while Shorebank
argues that SERA's lien did not encumber the development property until the claim of
lien was recorded--which was after Shorebank recorded its trust deed.

Accordingly, the outcome of this case depends largely on the meaning of
ORS 87.025(7) and how it operates in the context of this case and the other relevant
statutes. To make that determination, we must ascertain the legislature's intent by
examining the text, context, and any relevant legislative history of the statutes, resorting
if necessary to maxims of statutory construction. State v. Gaines, 346 Or 160, 171-72,
206 P3d 1042 (2009).

Initially, we agree with SERA that ORS 87.010(5) establishes that, once
SERA prepared plans, drawings, or specifications intended for use in the construction of
an improvement to Klahowya, SERA had "a lien upon the land and structures necessary
for the use of the plans, drawings or specifications." That lien was then inchoate and was
not enforceable until SERA perfected it by complying with ORS 87.035. Once it did so,
however, ORS 87.025(7) provides that the lien "relates to the date of commencement of
the improvement as defined in ORS 87.005." Therefore, the statute appears to
contemplate that the lien attaches to the property at the "commencement of the improvement." Because it is undisputed that BooCo commenced the improvement in July 2006, SERA's lien would relate to that date for purposes of establishing priority unless the remainder of ORS 87.025(7) precludes that construction of the statutory scheme.

As noted, ORS 87.025(7) provides:

"The perfection of a lien under ORS 87.035 relates to the date of commencement of the improvement as defined in ORS 87.005. Except as provided in subsection (3) of this section, the date of creation of the lien under ORS 87.010 and the date of perfection of the lien under ORS 87.035 do not affect the priorities under this section, the equal priority of perfected lien claimants, or the distribution of proceeds to perfected lien claimants under ORS 87.060(6)."

Added to the Construction Lien Law in 1987, Or Laws 1987, ch 662, § 3, as part of Senate Bill (SB) 356 (1987), its legislative history reveals that ORS 87.025(7) was not intended to alter existing law as to priorities. Instead, it was intended to make explicit that a lien created under ORS 87.010 and perfected under ORS 87.035 relates back to the commencement of the improvement as that term was defined in the statute. Exhibit A, House Committee on Judiciary, Subcommittee 4, SB 356, June 10, 1986 (summary of amendments by Oregon Bankers Association, Construction Industry Committee, Associated General Contractors, Oregon Land Title Association, and Home Builders

Senate Bill 356, in addition to adding ORS 87.025(7), reduced the time period within which to perfect liens from 90 days to 75 days after a triggering event, changed certain notice requirements, and provided a cause of action against lien claimants in certain circumstances.
Association). The legislative history also indicates that the statute was intended to clarify
that, if a lien was created under ORS 87.010 before a party filed a bankruptcy petition,
but the claim of lien was filed under ORS 87.035 after the party filed its bankruptcy
petition, the lien would have priority over the bankruptcy trustee. Id. Most importantly
to our analysis, the legislative history is clear that the bill was "not intended to alter
existing law as to priorities, alter the equal priority of a perfected lien claimant's liens or
the distribution of proceeds to them under ORS 87.060(6)." Id.; see also Minutes, House
Committee on Judiciary, Subcommittee 4, June 10, 1987, 2.

Accordingly, we must inquire as to the law of priorities in construction
liens at the time that the legislature enacted ORS 87.025(7). At that time, the law was
that a construction lien, if perfected by filing a claim of lien, related to and encumbered
the property as of the beginning of construction or the delivery of materials. See
Evergreen, 251 Or App at 199-200 (noting that, although a construction lien "remains
inchoate until a claim is filed, as a practical matter, it effectively encumbers the property
as soon as the contractor begins work").

In Hickey, 63 Or App at 786, which preceded SB 356 by four years, we
concluded, under slightly different circumstances, that a construction lien perfected by
filing a claim of lien related back to the beginning of the work. There, the defendant
delivered materials to a construction site from December 1977 through February 1979
and recorded a construction lien in March 1979. In the meantime, two mortgages had
been recorded after the date that materials were first delivered by the defendant but
before the defendant recorded its lien. In resolving the priority dispute, we noted that it was the "long-standing and clearly-established law that a construction lien * * * attaches when materials are first furnished but remains inchoate until the lien is filed, at which time it relates back to the beginning of the work." *Id.* Accordingly, for purposes of determining priority, the construction lien attached when materials were first delivered to the property. *Id.* Our conclusion in *Hickey* is consistent with a century of Oregon cases. See *Auld v. Starbard*, 89 Or 284, 289, 173 P 664 (1918) (noting that a "laborer's" or "materialman's" lien relates to the beginning of the work); *Henry v. Hand*, 36 Or 492, 498, 59 P 330 (1899) (interpreting predecessor lien statutes and concluding that "the lien shall attach at the time of the commencement of the structure"). Accordingly, the principle that a construction lien encumbers the property on the date that site work begins or materials are delivered, and not the date that the claim of lien is filed, has remained consistent.

Therefore, we conclude that SERA's lien was created under ORS 87.010(5) when SERA began work on the project and, when it perfected its lien under ORS 87.035, the lien related back to July 2006 when BooCo "commenc[ed] the improvement" as that term is defined in ORS 87.005. For purposes of measuring priority, the lien related back to July 2006, and Shorebank recorded its trust deeds subsequently. Accordingly, the trial court erred when it concluded that Shorebank's trust deed had priority over SERA's lien under the Construction Lien Law.

Having concluded that SERA's lien had priority over Shorebank's trust
deed, we must resolve the question of whether that trust deed, at least as to the portion of
the loan proceeds used to pay off the Triangle loan, can be equitably subrogated to the
position of Triangle's trust deed. If so, then Shorebank would be in first lien position as
compared to the SERA lien, because Triangle's trust deed was recorded several months
before BooCo began preparation of the development property.

Shorebank raised equitable subrogation as an affirmative defense, and we
review such defenses according to their character. See Burt, Vetterlein & Bushnell, P.C.

Accordingly, our review of the facts is de novo.\(^\text{12}\) Nevertheless, the parties do not dispute
the facts that underlie the trial court's application of equitable subrogation, and we review
the trial court's determination in light of those undisputed facts.

The doctrine of equitable subrogation, in this context, has been described as
follows:

"If the holder of a mortgage take[s] a new mortgage as a substitute
for a former one, and cancel[s] and release[s] the latter in ignorance of the
existence of an intervening lien upon the mortgaged premises, although
such lien be of record, equity will, in the absence of the intervening rights
of third parties, restore the lien of the first mortgage and give it its original
priority."\(^\text{13}\)

\(^{12}\) The notice of appeal in this case was filed before the effective date of the
legislative change to ORS 19.415(3) that made de novo review in most equity cases
discretionary. See Or Laws 2009, ch 231, § 2. Accordingly, we apply the 2007 version
of the statute, under which de novo review is required.

\(^{13}\) We have also applied the doctrine when a lender did not take a new mortgage as a
substitute for a former mortgage, but instead released funds to a party on the condition
that those funds be used to pay off prior trust deeds. See Dimeo, 164 Or App at 571;

On appeal, the parties focus their arguments on whether Shorebank was in fact ignorant of SERA's lien and, if so, whether that ignorance was excusable. As we have previously explained in Dimeo, equitable subrogation does not apply unless the lender "proves that it was ignorant of the existence of the intervening lien and that its ignorance was not a result of inexcusable negligence." 164 Or App at 571.

SERA contends that Shorebank failed to demonstrate that it was ignorant of SERA's intervening lien or that any ignorance was excusable. In support, SERA points to the following facts: (1) Shorebank attended, in the role of "banker," the April 2006 workshop hosted by SERA at which site preparation plans were discussed and a timeline for construction was assembled; (2) actual site preparation occurred between July 2006 and October 2006; (3) Shorebank and Klahowya's loan negotiations in October 2006 included discussions of SERA's work. In light of those facts, and the fact that Shorebank is a commercial lender, SERA asserts that Shorebank was, in fact, aware of SERA's lien on the property and equitable subrogation cannot apply.

Shorebank does not dispute those facts, but argues that equitable subrogation is proper because it reasonably believed that SERA had no lien when Shorebank recorded its trust deed in November 2006. Shorebank explains that SERA's claim of lien was not recorded until June 2007, and Shorebank specifically asked
Klahowya whether it had paid SERA in full before completing the refinancing in November 2006. Shorebank asserts that SERA never informed it that Klahowya was not paying its bills. Shorebank reasons that, as a result, as of the date that it recorded its trust deed, it had no grounds to believe that SERA had a lien on the development property and that, therefore, its ignorance of SERA's lien was excusable. Also implicit in Shorebank's argument is that its understanding of the law—that Shorebank had priority because it recorded its trust deed before SERA filed a claim of lien—contributed to Shorebank's ignorance of SERA's lien.

As a general matter, actual ignorance of the intervening lien is required, *Dimeo*, 164 Or App at 571, but constructive knowledge of an intervening lien is not necessarily a bar to application of the doctrine. For example, in *Rusher v. Bunker*, 99 Or App 303, 309, 782 P2d 170 (1989), we declined to adopt a *per se* rule that constructive notice from recording is incompatible with an equitable subrogation claim. See also *Pearce*, 22 Or at 33 (concluding that relief was available even though the intervening lien was recorded). Nevertheless, we recognized in *Rusher* that a lender's failure to search the record may weigh against application of equitable subrogation. 99 Or App at 309. Furthermore, constructive notice of an intervening lien may be "excused" if the lender proceeded with the transaction based on misrepresentations, fraud, or misleading information provided by another. *Pearce*, 22 Or at 30-31 (a lender released a former mortgage in favor of a new mortgage based on the mortgagor's misrepresentation that there were no other intervening encumbrances).
For example, in *Metropolitan Life Ins. Co. v. Craven*, 164 Or 274, 101 P2d 237 (1940), the lender advanced money to pay off a prior encumbrance in ignorance of a recorded intervening lien. The Supreme Court ultimately granted equitable relief because the lender's ignorance was induced by a misrepresentation by the property owner that no junior liens existed, and the lender obtained an abstract of title from a title company that failed to reveal the junior lien. *Id.* at 283; *see also Rusher*, 99 Or App at 305-06, 309 (equitable subrogation was appropriate where the lender relied on misinformation from a title company that no intervening liens had been filed between the time of the preliminary title report and the lender's recording of its trust deed); *cf. High v. Davis*, 283 Or 315, 333-34, 584 P2d 725 (1978) (where the lender had notice of membership agreements creating hunting and fishing rights and proceeded without further investigation, the equities were not sufficient to subrogate the lender to the rights of prior lienors).

Shorebank's position requires us to accept that its ignorance of construction lien law is tantamount to ignorance of SERA's lien or, second, that even though SERA's lien encumbered the property as of July 2006, because that lien was inchoate and Klahowya was current in payments to SERA until well after Shorebank recorded its trust deed, Shorebank was ignorant of the lien and that ignorance was excusable. Neither of those positions supports the application of equitable subrogation.

Shorebank had actual notice of the facts that led to the creation of SERA's lien--that is, Shorebank was aware that Klahowya had contracted with SERA to perform architectural services for the project and that SERA was in fact providing those services.
Shorebank was aware of the construction timeline that indicated that site preparation would begin in mid-2006, and BooCo began preparation according to that plan. In that sense, Shorebank had actual notice of SERA's lien. Moreover, this case is unlike any other in which equitable subrogation was used to prevent manifest injustice. Shorebank's "ignorance" in this case was not induced by misrepresentations or negligence of others, but rather was due to its misunderstanding of the law. We decline to extend the doctrine of equitable subrogation to the circumstances presented here.

Finally, we address Shorebank's cross-appeal of the supplemental judgment awarding SERA $120,144.56 in attorney fees against Klahowya under an attorney fees provision in their contract and ORS 87.060. Shorebank challenged SERA's attorney fees petition before the trial court on the basis that over $74,000 of the fees sought were related to SERA's attempts to secure priority over Shorebank's trust deeds. On cross-appeal, Shorebank reiterates that argument, contending that the trial court abused its discretion in awarding the full amount because SERA did not prevail in foreclosing its lien against Shorebank.

In light of our resolution of SERA's appeal, Shorebank's argument that SERA did not prevail in foreclosing its lien against Shorebank is no longer valid. Accordingly, we affirm the supplemental judgment awarding attorney fees to SERA. On appeal, limited judgment reversed and remanded; on cross-appeal, affirmed; supplemental judgment affirmed on cross-appeal.
IN THE SUPREME COURT OF THE STATE OF OREGON

HOPE PRESBYTERIAN CHURCH
OF ROGUE RIVER, a domestic
nonprofit corporation,

Petitioner on Review,

v.

PRESBYTERIAN CHURCH (U.S.A)
and PRESBYTERY OF THE CASCADES,
a domestic nonprofit corporation,

Respondents on Review.

(CC 07-2707-E2; CA A139430; SC S059584)

On review from the Court of Appeals.*

Argued and submitted March 5, 2012, at Lewis and Clark Law School.

James Dole of Dole, Sorenson, Ransom & Ferguson, Grants Pass, argued the
cause and filed the brief for petitioner on review.

Christopher J. Cox of Weil, Gotshal & Manges LLP, Redwood Shores, California,
argued the cause for respondents on review. James A. Wallan of Hornecker, Cowling,
Hassen & Heysell, LLP, Medford, and Yen P. Nguyen of Weil, Gotshal & Manges LLP
filed the brief.

W. Michael Gillette of Schwabe, Williamson & Wyatt P.C., Portland, argued the
case and filed the brief for amicus curiae Presbyterian Lay Committee. With him on the
brief were Jill S. Gelineau and Sara Kobak of Schwabe, Williamson & Wyatt P.C. and
Forrest A. Norman of Gallagher Sharp, Cleveland, Ohio.

Paul A. Dakopolos and Joan W. Reese of Garrett Hemann Robertson P.C., Salem,
filed the brief for amicus curiae Episcopal Diocese of Oregon.

Before Balmer, Chief Justice, and Durham, De Muniz, Kistler, Walters, and
Linder, Justices.**
BALMER, C. J.

The decision of the Court of Appeals is affirmed. The judgment of the circuit court is reversed, and the case is remanded to the circuit court for entry of a judgment in favor of Presbyterian Church (U.S.A.).


**Landau, J., did not participate in the consideration or decision of this case.
BALMER, C. J.

This case requires us to decide whether a local church or the national church from which it seeks to separate owns certain church property. Hope Presbyterian Church of Rogue River (Hope Presbyterian) is the name of a church congregation and a related nonprofit corporation. The congregation has been affiliated with a national Presbyterian Church organization since its founding in 1901, most recently affiliating with the Presbyterian Church (U.S.A.) (PCUSA), and its regional presbytery, the Presbytery of the Cascades. In 2007, the congregation voted to disaffiliate from PCUSA. The corporation then initiated this lawsuit, seeking to quiet title to certain church property and to obtain a declaration that PCUSA and the Presbytery of the Cascades have no claim or interest in any of the real and personal property in Hope Presbyterian’s possession. On cross-motions for summary judgment, the trial court quieted title in favor of Hope Presbyterian and declared that PCUSA and the Presbytery of the Cascades had no beneficial interest in any of Hope Presbyterian’s property. The Court of Appeals reversed, holding that Hope Presbyterian held the property in trust for PCUSA. Hope Presbyterian v. Presbyterian Church (USA), 242 Or App 485, 255 P3d 645 (2011). For the reasons that follow, we affirm the decision of the Court of Appeals.

FACTS

The Court of Appeals described in detail the relevant history of both Hope
Presbyterian, the local congregation, and PCUSA, the national denomination. We take the facts necessary to our decision from the Court of Appeals' opinion and the summary judgment record. Hope Presbyterian was established as a congregation in 1901 and was affiliated with predecessor organizations to PCUSA from that time until 1983, when it began over 20 years of affiliation with PCUSA. In 1930, Hope Presbyterian formally incorporated as "Hope Presbyterian Church of Rogue River." In the 1950s, Hope Presbyterian moved to its current location in Rogue River and began to use property that is now disputed. The Trustees of the Presbytery of Southwest Oregon, the regional presbytery of which Hope Presbyterian was a part at the time -- and which was, in turn, a part of a predecessor to PCUSA -- had acquired legal title to the property in 1955. In 1961, the Trustees of the Presbytery of Southwest Oregon transferred title to "The Hope Community Presbyterian Church, Rogue River, Ore[.]" by warranty deed. The deed makes no reference to the property being held in trust for PCUSA or its predecessor. Hope Presbyterian acquired an additional parcel of real property from a third party in 2001 by warranty deed. As with the first deed, the deed to the property acquired in 2001 makes no reference to PCUSA or to the property being held in trust. PCUSA does not dispute that Hope Presbyterian holds legal title to the property at issue.

1 Hope Presbyterian argues that the acts of the congregation could not bind the corporate entity, which is the plaintiff in this lawsuit, because the congregation and the corporation are distinct entities. As explained below, we conclude that, for purposes of this case, the actions of both the congregation and the corporation are relevant and often overlap. Therefore, we distinguish between the congregation and the corporation only where necessary.
PCUSA is the largest Presbyterian denomination in the United States and was formed in 1983 when the Presbyterian Church in the United States and the United Presbyterian Church in the United States of America (UPCUSA) merged. Similarly to its predecessors, PCUSA is organized hierarchically, with an individual local church being governed in ascending order by the "session," composed of leaders from the local church; the regional "presbytery," which oversees local churches in the same geographical area; the "synod," which oversees presbyteries within a geographic region; and ultimately, by the "General Assembly," the national governing body.

*The Book of Confessions* and the *Book of Order* are the governing documents that form the constitution of PCUSA. The *Book of Order* addresses, among other topics, how real and personal property are held within the organization. Chapter VIII, section G-8.0201, of the *Book of Order* provides:

> "All property held by or for a particular church, a presbytery, a synod, the General Assembly, or the Presbyterian Church (U.S.A.), whether legal title is lodged in a corporation, a trustee or trustees, or an unincorporated association, and whether the property is used in programs of a particular church or of a more inclusive governing body or retained for the production of income, is held in trust nevertheless for the use and benefit of the Presbyterian Church (U.S.A.)."

That provision of the *Book of Order* is almost identical to a provision in the constitution of one of PCUSA's predecessors, UPCUSA, with which Hope Presbyterian was affiliated before joining PCUSA. UPCUSA had amended its constitution in 1981 to include an express trust provision, and the Presbytery of the Cascades, which Hope Presbyterian belonged to at the time, was one of the presbyteries that approved that amendment.

When PCUSA was formed in 1983, two members of Hope Presbyterian
were present at the meeting approving the merger of UPCUSA with another Presbyterian
denomination and adopting the PCUSA Book of Order, which included the express trust
provision. Soon after the merger, Hope Presbyterian amended the congregation's bylaws
to state:

"This church being a part of the Presbytery of the Cascades, the Synod of
the Pacific, and the Presbyterian Church, U.S.A., is governed in all its
provisions by the Constitution of the Presbyterian Church, U.S.A."

(Underscoring in original.) Around the same time as that amendment to the
congregation's bylaws, the president and secretary of the corporation, as well as a third
person, signed an amendment to the articles of incorporation of "Hope 'Community' or
'United' Presbyterian Church." The document states:

"This corporation is a church congregation of and holds all property as
trustee for the Presbyterian Church (U.S.A.)."

The amendment was approved at a congregational meeting on October 23, 1983, and at a
meeting of the board of trustees on November 1, 1983. The amendment, however, was
never filed with the Secretary of State.

In 2007, the members of Hope Presbyterian's congregation voted to
disaffiliate from PCUSA. The Book of Order places the presbytery in control of the
disaffiliation process: "The relationship to the Presbyterian Church (U.S.A.) of a
particular church can be severed only by constitutional action on the part of the
presbytery. (G-11.0103i)[.]") Book of Order § G-8.0601 (2007). In fact, the Book of
Order lists the disaffiliation process, and actions involving real property, as part of the
presbytery's key responsibilities:
"The presbytery is responsible for the mission and government of the church throughout its geographical district. It therefore has the responsibility and power

"* * * *

"i. to divide, dismiss, or dissolve churches in consultation with their members; [and]

"* * * *

"y. to consider and act upon requests from congregations for permission to take the actions regarding real property as described in G-8.0000[.]

Id. § G-11.0103. In accordance with those provisions of the Book of Order, members of Hope Presbyterian met with representatives from the Presbytery of the Cascades regarding disaffiliation. Before the presbytery's disaffiliation process was complete, however, Hope Presbyterian brought this action to determine the ownership of the real and personal property in its possession, seeking to quiet title in its favor and to obtain a declaratory judgment that it is the sole owner of all real and personal property in its possession.

The Court of Appeals summarized the proceedings in the trial court:

"Both sides moved for summary judgment. Defendants asserted that, under the First Amendment to the United States Constitution, civil courts are authorized to resolve disputes between churches and their denominations only in limited circumstances. According to defendants, long-standing United States Supreme Court case law -- coincidentally, involving the Presbyterian Church -- requires civil courts to defer to the determinations of the highest governing body of 'hierarchical' churches. In this case, defendants contended, because the PCUSA clearly is such a hierarchical church, this dispute is conclusively resolved by reference to the Book of Order, which unambiguously provides that all property is held in trust for the denomination. In response, Hope Presbyterian argued that the PCUSA is not actually 'hierarchical' in nature and so is not subject to the analysis for which defendants contended. In any event, it argued, under
more recent case law, the preferred approach is to resolve disputes under 'neutral principles' of law, without regard to evidence relating to church doctrine or polity. Under those neutral principles, Hope Presbyterian argued, its title to the property in dispute is conclusive, as there is no evidence that a trust was created in accordance with the requirements of Oregon trust law.

"The trial court sided with Hope Presbyterian. The court explained that the case should be resolved on the basis of 'neutral secular principles' of law. The court then said:

"My way of understanding the neutral secular principles doctrine is that this Court must look at legal documents and must disregard purely church documents such as the Constitution of the Presbyterian Church (USA), statements of ecclesiastical doctrine and church polity, and the Book of Order. That means this court's analysis of this civil dispute about ownership of property, in this civil law court, is based entirely upon legal documents such as deeds and any trust documents that have been appropriately executed according to Oregon law.'

"The trial court did not consider the Book of Order or Hope Presbyterian's amended articles of incorporation, both of which declare that the disputed property is held in trust for the PCUSA. Instead, the court based its decision exclusively on any documents of conveyance or title that the parties submitted to the court. Finding no documents of written conveyance to the PCUSA or any other evidence of a trust, the court concluded that Hope Presbyterian's title in the property was conclusive."

242 Or App at 492-93.

The Court of Appeals reversed. The court traced the United States Supreme Court's approach to church property disputes, in light of the provision of the First Amendment to the United States Constitution, which states that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof[.]" We discuss that case law in detail below, but for present purposes it is sufficient to note that the Supreme Court has stated that states may adopt any one of
various approaches to resolving church property disputes, as long as the approach involves no consideration of doctrinal matters, and the Court expressly has approved two general approaches. In Watson v. Jones, 80 US 679, 20 L Ed 666 (1871), the Supreme Court adopted what is commonly known as the "hierarchical deference" approach. Under that approach, in disputes arising in churches with a hierarchical structure,

"whenever the questions of discipline, or of faith, or ecclesiastical rule, custom, or law have been decided by the highest of these church judicatories to which the matter has been carried, the legal tribunals must accept such decisions as final, and as binding on them, in their application to the case before them."

Id. at 727. In contrast, when considering disputes arising in independent congregations, rather than hierarchically organized churches, the "hierarchical deference" approach applies "the ordinary principles which govern voluntary associations[,]" including the church's "principle[s] of government[,]" and upholds the actions of "congregation[al] officers *** who adhere to the acknowledged organism by which the body is governed * * *." Id. at 725. The Court also has held that states may adopt the "neutral principles" approach described in Jones v. Wolf, 443 US 595, 604, 99 S Ct 3020, 61 L Ed 2d 775 (1979). Under that approach, courts resolve church property disputes by examining "the language of the deeds, the terms of the local church charters, the state statutes governing the holding of church property, and the provisions in the constitution of the general church concerning the ownership and control of church property" in the context of generally applicable neutral principles of law, such as trust and property law. Id. at 603. After discussing the hierarchical deference and neutral principles of law approaches to resolving church property disputes, the Court of Appeals addressed the few
Oregon cases that have grappled with the issue. In *Presbytery of Willamette v. Hammer*, 235 Or 564, 385 P2d 1013 (1963), a case also involving the Presbyterian Church, after a local congregation had dissolved, a regional presbytery sought to quiet title to property to which the local church held legal title. In affirming the trial court's decision to quiet title in the presbytery's favor, the court did not refer to *Watson* or hierarchical deference. The court did, however, cite cases from other states that relied specifically on *Watson* or generally on a theory of hierarchical deference in similar situations. More importantly, the court relied on evidence that "under the constitution of the United Presbyterian Church[,] when a member church is dissolved the property falls under the control of the Presbytery" and that, within the Presbyterian form of church governance, the presbyteries "hold ultimate title to all of the properties." *Id.* at 568-69 (quoting testimony of secretary-treasurer of plaintiff presbytery). In determining whether the presbytery held title to the property, the court did not rely on documents or evidence that would create a trust in circumstances not involving a church.

In describing *Presbytery of Willamette*, the Court of Appeals in this case stated:

"[T]he Oregon Supreme Court resolved a church property dispute by deferring to the provisions of the national Presbyterian Church constitution, supported by citations of authority to cases expressly invoking the hierarchical-deference approach that the United States Supreme Court required for so long under *Watson*."

*Hope Presbyterian*, 242 Or App at 509. Because no subsequent Oregon Supreme Court decisions suggested that the court had adopted any rule other than hierarchical deference, the Court of Appeals applied that methodology to resolve the parties' property dispute.
After determining that PCUSA is a hierarchical church, the Court of Appeals looked to the declaration in the *Book of Order* that all property held by a local church is held in trust for PCUSA. The court also noted that Hope Presbyterian's bylaws stated that the local church was governed by PCUSA's constitution, which includes the *Book of Order*. Because one of PCUSA's governing documents declared the existence of a trust in PCUSA's favor, following *Presbytery of Willamette*, the court deferred to PCUSA's imposition of a trust over Hope Presbyterian's property. *Id.* at 509-10.

The Court of Appeals went on, however, to analyze the dispute under the neutral principles approach as well -- having noted earlier that, following *Jones*, 443 US 595, the trend in the case law seemed to be toward that approach -- and concluded that PCUSA prevailed under that approach as well. *Id.* at 504, 512-14. Examining neutral principles of Oregon trust law, the court noted that, "[u]nder ORS 130.150(1)(b), a trust to titled property may be created 'by declaration by the owner of property that the owner holds identifiable property as trustee.'" *Id.* at 513 (alteration in *Hope Presbyterian*). The court then concluded that evidence in the summary judgment record demonstrated that Hope Presbyterian intended to create a trust over the property in its possession for the benefit of PCUSA. That evidence included the *Book of Order*, which declared an express trust in favor of PCUSA; the bylaws of the congregation of Hope Presbyterian, which declared that the congregation was governed by the PCUSA constitution; and Hope Presbyterian's declaration in the Articles of Amendment that, "[t]his corporation is a church congregation of and holds all property as trustee" for PCUSA. *Id.* at 514. For those reasons the Court of Appeals reversed and remanded the case for entry of a
judgment declaring the property to be held in trust for PCUSA.

On review, Hope Presbyterian contends that the Court of Appeals erred in holding that Oregon follows the hierarchical deference approach rather than the neutral principles of law approach. Under the neutral principles approach, Hope Presbyterian argues, no trust was created as matter of law and, if a trust had been created, the congregation's decision to disaffiliate from PCUSA would have revoked that trust.

*Amicus curiae* Presbyterian Lay Committee supports Hope Presbyterian, arguing that Oregon should adopt the neutral principles approach for resolving church property disputes.

PCUSA responds that the Court of Appeals was correct to apply hierarchical deference and resolve the property dispute in PCUSA's favor. PCUSA also asserts that it should prevail even if this court adopts the neutral principles approach because, it argues, under the Supreme Court's decision in *Jones*, an express trust provision in the denominational church's constitution is dispositive, and PCUSA's constitution contains an express trust provision. *Amicus curiae* Episcopal Diocese of Oregon filed a brief in support of PCUSA, arguing that hierarchical deference is the

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2 The parties -- and other courts -- generally identify the two approaches discussed in the text as the "hierarchical deference" approach and the "neutral principles" approach. We do so as well. As our discussion below of decisions from other states demonstrates, however, notwithstanding the nomenclature, states actually apply a variety of approaches, some of which are more deferential to church governance decisions and some of which focus more on generally applicable principles of state property, contract, and trust law.
appropriate approach to resolving church property disputes. Episcopal Diocese of
Oregon also argues that, even if the neutral principles approach is adopted, PCUSA
should prevail because the express trust clause in PCUSA's constitution, to which
Episcopal Diocese of Oregon contends that Hope Presbyterian subscribed through its
conduct, shows the parties' intent to create a trust as required by *Jones*.

**FIRST AMENDMENT PRINCIPLES IN CHURCH PROPERTY DISPUTES**

The First Amendment to the United States Constitution provides, in part,
that "Congress shall make no law respecting an establishment of religion, or prohibiting
the free exercise thereof[.]" The First Amendment is applicable to the states through the
Fourteenth Amendment. The limitations imposed by the religion clauses of the First
Amendment "'severely circumscribe[] the role that civil courts may play in resolving
church property disputes'" and "prohibit[] civil courts from resolving church property
disputes on the basis of religious doctrine and practice." *Jones*, 443 US at 602 (quoting
*Presbyterian Church v. Hull Church*, 393 US 440, 449, 89 S Ct 601, 21 L Ed 2d 658
(1969)).

The United States Supreme Court first dealt with how to resolve church
property disputes in *Watson*, 80 US 679. In that case, certain members of a local
congregation of the Presbyterian Church split from the denominational church over the
issue of slavery, with the dissenting members opposing the emancipation of slaves and
the denominational church supporting emancipation. The dissenting members, however,
wished to continue to possess and use the local church's property. The General
Assembly, the governing body of the denominational church, declared that intermediate
governing bodies, such as synods and presbyteries, that shared the dissenting faction's beliefs had departed from the faith and asserted that those who adhered to the General Assembly's beliefs were the true and lawful bodies of the church.

The Supreme Court in *Watson* began by stating:

"Religious organizations come before us in the same attitude as other voluntary associations for benevolent or charitable purposes, and their rights of property, or of contract, are equally under the protection of the law, and the actions of their members subject to its restraints."

80 US at 714.

The Supreme Court then classified religious organizations as being either organized around independent congregations or organized hierarchically. The Court described the different approaches for resolving congregational and hierarchical disputes. For independent congregations, the rights of competing factions to use and possess church property "must be determined by the ordinary principles which govern voluntary associations." *Id.* at 725. For hierarchical churches, however, the Court stated that it was "bound to look at the fact that the local congregation is itself but a member of a much larger and more important religious organization, and is under its government and control, and is bound by its orders and judgments." *Id.* at 726-27. In hierarchical churches, like the Presbyterian Church, the Court rejected the notion that civil courts could second-guess the resolution of internal disputes by the governing church body. The Court stated:

"All who unite themselves to such a body do so with an implied consent to this government, and are bound to submit to it. But it would be a vain consent and would lead to the total subversion of such religious bodies, if any one aggrieved by one of their decisions could appeal to the secular
courts and have them reversed. It is of the essence of these religious
unions, and of their right to establish tribunals for the decision of questions
arising among themselves, that those decisions should be binding in all
cases of ecclesiastical cognizance, subject only to such appeals as the
organism itself provides for.”

Id. at 729.

To resolve property disputes within hierarchical churches, the Supreme
Court held that "whenever the questions of discipline, or of faith, or ecclesiastical rule,
custom, or law have been decided by the highest of these church judicatories to which the
matter has been carried, the legal tribunals must accept such decisions as final, and as
binding on them, in their application to the case before them." Id. at 727. In that case,
the Court concluded that the Presbyterian Church was a hierarchical church, and, as
noted, the General Assembly -- the highest governing body of the Presbyterian Church --
had declared that the dissenting members of the local church were no longer operating
according to church doctrine. The Court deferred to that declaration and thus determined
that the dissenting members had no claim to church property.

For more than 100 years, so-called "hierarchical deference" was the only
methodology that the Supreme Court endorsed under the First Amendment to resolve
property disputes arising out of a schism in a hierarchically organized denomination. In
Jones v. Wolf, however, the Court held that a state may adopt "'any one of various
approaches for settling church property disputes so long as it involves no consideration of
doctrinal matters, whether the ritual and liturgy of worship or the tenets of faith.'" 443
US at 602 (quoting Md. & Va. Churches v. Sharpsburg Ch., 396 US 367, 368, 90 S Ct
Churches). Like Watson, Jones involved a schism within a Presbyterian denomination.

The Georgia Supreme Court resolved the property dispute by applying "neutral principles of law" rather than deferring to the decision of the denominational church. Id. at 599.

The United States Supreme Court endorsed the Georgia Supreme Court's adoption of the "neutral principles" approach to resolving church property disputes as one constitutionally acceptable alternative to the hierarchical deference approach. Id. at 604.

In applying the neutral principles approach, a court resolves church property disputes by relying on "objective, well-established concepts of trust and property law familiar to lawyers and judges," rather than automatically deferring to all decisions of the governing body of a hierarchical church. Id. at 603. To determine the ownership of church property, courts may examine "the language of the deeds, the terms of the local church charters, the state statutes governing the holding of church property, and the provisions in the constitution of the general church concerning the ownership and control of church property." Id. In addition to state statutes governing the holding of church property, courts may also examine other relevant state statutes. See id. at 600 (citing neutral principles cases where the Georgia Supreme Court considered state statutes dealing with implied trusts). In examining church documents, however, courts "must take special care to scrutinize the document[s] in purely secular terms" and thereby avoid "entanglement in questions of religious doctrine, polity, and practice." Id. at 603-04. The Court nevertheless recognized that there might be circumstances in which "the deed, the corporate charter, or the constitution of the general church incorporates religious concepts in the provisions relating to the ownership of property." Id. at 604. In
those circumstances, if the interpretation of the documents would "require the civil court
to resolve a religious controversy, then the court must defer to the resolution of the
doctrinal issue by the authoritative ecclesiastical body." *Id.*

The dissent in *Jones* criticized the majority for failing to defer to church
tribunals regarding the ownership of disputed property. The dissent argued that
defERENCE to the decision of the hierarchical church ensured that religious freedom was
protected from government interference. *Id.* at 616-17 (Powell, J., dissenting). The
majority responded,

"At any time before the dispute erupts, the parties can ensure, if they so
desire, that the faction loyal to the hierarchical church will retain the church
property. They can modify the deeds or the corporate charter to include a
right of reversion or trust in favor of the general church. Alternatively, the
constitution of the general church can be made to recite an express trust in
favor of the denominational church. The burden involved in taking such
steps will be minimal. And the civil courts will be bound to give effect to
the result indicated by the parties, provided it is embodied in some legally
cognizable form."

*Id.* at 606. State courts have focused on that statement in *Jones* when applying the
neutral principles approach.

State courts faced with church property disputes are left with the Supreme
Court's holding in *Jones* that, under the First Amendment, states may resolve church
property disputes using any approach that does not involve consideration of doctrinal
matters. As noted, without foreclosing other approaches, the Court expressly has
approved both the hierarchical deference approach, which involves deference to the
judgment of the governing body of a hierarchical church, and the neutral principles
approach, which involves applying neutral principles of law to determine ownership, as
long as any church documents are analyzed in a secular manner.

Just as the federal constitution does not mandate application of a particular approach to resolving church property disputes, neither party argues that the Oregon Constitution requires the application of the hierarchical deference approach, the neutral principles approach, or any other approach; neither do the parties argue that the Oregon Constitution prohibits any particular approach. Instead, the parties focus their arguments on this court's prior case law involving church property disputes.

As noted, the Court of Appeals relied on *Presbytery of Willamette*, 235 Or 564, to hold that Oregon follows the hierarchical deference approach, and, on review, the parties expend considerable energy debating whether *Presbytery of Willamette* and subsequent cases mandate applying hierarchical deference in this case. We need not decide whether *Presbytery of Willamette* adopted hierarchical deference or whether the methodology used in that case is binding on us now. When *Presbytery of Willamette* was decided, hierarchical deference, as described in the Supreme Court's *Watson* decision, was the only permissible approach under the First Amendment for resolving church property disputes within hierarchical churches. When the Court in *Jones* later authorized states to choose any approach, including the neutral principles approach, that did not consider doctrinal matters -- more than a decade after this court decided *Presbytery of Willamette* -- it created a new legal context for evaluating church property disputes under the First Amendment. That change in the legal context reduces the significance of *Presbytery of Willamette* and provides ample reason for this court to reexamine the proper methodology for resolving church property disputes in Oregon. See *Farmers Ins.*
Co. v. Mowry, 350 Or 686, 698, 261 P3d 1 (2011) ("[T]his court is willing to reconsider cases when the legal or factual context has changed in such a way as to seriously undermine the reasoning or result of earlier cases.").

Although courts must decide, when presented, property disputes (and other civil law matters) in which churches or other religious organizations are parties, First Amendment principles require that they do so without becoming involved in matters of church doctrine. Because both the hierarchical deference approach articulated in Watson and the neutral principles approach described in Jones defer to church decisions on matters of doctrine, thereby avoiding entangling courts in doctrinal disputes, we conclude that either approach is permissible in this case, which involves a property dispute within a hierarchical church. In Jones, the Supreme Court -- while not overruling Watson -- suggested that the neutral principles approach might be preferable to hierarchical deference:

"The primary advantages of the neutral-principles approach are that it is completely secular in operation, and yet flexible enough to accommodate all forms of religious organization and polity. The method relies exclusively on objective, well-established concepts of trust and property law familiar to lawyers and judges. It thereby promises to free civil courts completely from entanglement in questions of religious doctrine, polity, and practice."

443 US at 603.

We agree that the neutral principles approach has advantages over the hierarchical deference approach, even though the neutral principles approach does not free the courts from examining and potentially giving legal effect to church documents. We think that "[o]n balance * * * the promise of nonentanglement and neutrality inherent
in the neutral-principles approach more than compensates for what will be occasional
problems in application." *Id.* at 604. To avoid those occasional problems, the Supreme
Court in *Jones* emphasized that civil courts "must take special care to scrutinize the
[church] document[s] in purely secular terms, and not to rely on religious precepts in
determining whether the document[s] indicate[] that the parties have intended to create a
trust." *Id.* At the same time, if the interpretation of church documents would involve the
court in resolving a doctrinal controversy, then the court must defer to the resolution of
that doctrinal issue by the church's governing authority. *Id.* In that way, courts can give
effect to the relevant church documents, while avoiding prohibited religious
entanglement. For those reasons, we apply here the neutral principles approach for
resolving church property disputes.3

APPLICATION OF NEUTRAL PRINCIPLES

Since *Jones* opened the door for states to apply neutral principles of law to
resolve church property disputes under the First Amendment, hierarchical churches have
been on notice that state courts no longer are required to defer to the denominational
church's decision in a property dispute. Instead, under the neutral principles approach,
courts may examine deeds, local church charters, state statutes, and the denominational
church's constitution. *Jones*, 443 US at 600, 603. Moreover, as *Jones* stated, any time

3 We note that the majority of states that have examined the issue of church
property disputes since *Jones* have adopted the neutral principles approach. *See, e.g., In
S Ct 179 (2009); *Presbytery of Ohio Valley v. OPC*, 973 NE2d 1099, 1107 (Ind 2012).
before a dispute occurs, the parties can express their intent regarding the disposition of property. *Id.* at 606. A hierarchical church can ensure that property will remain with the faction loyal to the denominational church by modifying "the deeds or the corporate charter to include a right of reversion or trust in favor of the general church." *Id.* Alternatively, the constitution of the denominational church can be made "to recite an express trust in favor of the denominational church[]," *id.*, as PCUSA's constitution did when it was adopted in 1983 after *Jones*. Civil courts are bound to recognize the existence of a trust in the denominational church's favor, "provided it is embodied in some legally cognizable form." *Id.*

Although *Jones* provides a general framework for the neutral principles approach, state courts have applied that approach in different ways. Most courts examine the documents listed in *Jones*, including the denominational church's constitution. As the Court of Appeals noted, courts rarely deem the denominational church's constitution irrelevant and disregard it, as the trial court did in this case. *Hope Presbyterian*, 242 Or App at 504-05. Courts have disagreed, however, over the legal implications of an express trust provision in the denominational church's constitution.

Some courts have found an express trust provision in the denominational church's constitution dispositive and have ruled in favor of the denominational church, even in the absence of other supporting documents. *See, e.g.*, *Episcopal Diocese of Rochester v. Harnish*, 11 NY3d 340, 351, 899 NE2d 920, 924-25 (2008) (finding express trust provision in denominational church constitution dispositive after finding no support for creation of a trust in deeds, certificate of incorporation, or state law). A few courts
have analyzed the denominational church's constitution under principles of state law and
found an express trust clause to have little meaning. See, e.g., All Saints Parish
Waccamaw v. Protestant Episcopal Church in Diocese of South Carolina, 385 SC 428,
express trust provision in church constitution could not have created a trust over the local
church's property because, without legal title to the property, denominational church
could not declare that the property was held in trust). Many courts, however, have
examined the denominational church's constitution -- in some cases giving weight to the
local church's assent to that constitution -- along with deeds, local church charters, and
state statutes, to determine the outcome under neutral principles of law. See, e.g., In re
Episcopal Church Cases, 45 Cal 4th 467, 489, 493, 198 P3d 66, 81-82, 84 (2009) (ruling
in favor of denominational church after examining deeds, local church's corporate
documents, state statutes governing religious property, and denominational church
constitution, giving particular weight to the fact that the local church "agreed from the
beginning of its existence to be part of a greater denominational church and to be bound
by that greater church's governing instruments"). Thus, state courts, even those applying
"neutral principles," have not adopted a uniform approach for interpreting express trust
provisions in denominational church constitutions.

Here, PCUSA contends that the recitation of an express trust in favor of the
denominational church, as contained in the Book of Order, necessarily creates an express
trust under the neutral principles approach, regardless of the existence of documents from
the local church indicating any intent to create such a trust. PCUSA claims that Jones
requires that result. In addition to relying on the statement in *Jones* that "the constitution of the general church can be made to recite an express trust in favor of the denominational church[,]" PCUSA relies on the Supreme Court's statement that "[t]he burden involved in taking such steps will be minimal." 443 US at 606. PCUSA argues that, if it is required to comply with the trust laws of all 50 states where it has congregations, rather than merely amending its constitution, it will face an "enormous burden" and not a minimal one. Therefore, PCUSA argues, in light of *Jones*, the trust was created when it adopted its constitution containing the express trust clause.

In our view, however, the express trust provision in PCUSA's constitution cannot be dispositive, because *Jones* went on to state that the denominational church may ensure that church property remains with the loyal faction by reciting an express trust, "provided it is embodied in some legally cognizable form." *Id.* Whatever the exact contours of the phrase "legally cognizable," because there is no federal law governing the creation of trusts, that phrase must include at least the trust laws of the 50 states. In fact, one of the primary advantages of the neutral principles approach, according to *Jones*, is that "[t]he method relies exclusively on objective, well-established concepts of trust and property law familiar to lawyers and judges." *Id.* at 603. Moreover, looking to only the church constitution, as PCUSA argues we should do, would detract from the advantages of the neutral principles approach and essentially would be a *de facto* application of hierarchical deference. See *Presbytery of Ohio Valley v. OPC*, 973 NE2d 1099, 1106 n 7 (Ind 2012) (stating that a rule requiring imposition of a trust based solely on a trust provision in the church constitution "would result in *de facto* compulsory deference").
Thus, under the neutral principles approach, the denominational church may ensure that property remains with the loyal faction in the event of a schism by reciting an express trust in its favor, provided that the recitation is embodied in a legally cognizable form in the state where the controversy arose. Here, as discussed, PCUSA's constitution declares an express trust in favor of the denominational church for property, the legal title to which is in the name of the local church.

We now turn to the principles of Oregon trust law and the facts of this case to determine whether a trust exists over Hope Presbyterian's property in favor of PCUSA under Oregon law. Oregon adopted the Uniform Trust Code in 2005, and it provides a nonexclusive list of ways to create an express trust.\(^4\) See ORS 130.150; *The Oregon Uniform Trust Code and Comments*, 42 Willamette L Rev 187, 246 (2006) [hereinafter *Oregon UTC & Comments*] (noting list of methods for creating a trust is not exclusive).

Although Hope Presbyterian holds legal title to the property at issue, "[a] trust may be created \(* * * [b]y declaration by the owner of property that the owner holds identifiable property as trustee[]." ORS 130.150(1)(b). When an "'owner of property declares himself trustee of the property, a trust may be created without a transfer of title to the property.'" *Winters v. Winters*, 165 Or 659, 667, 109 P2d 857 (1941) (quoting 1

\(^4\) Although PCUSA argues that it formerly had an interest in local church property under a theory of implied trust, it argues the present case under a theory of express trust pursuant to *Jones*. We do not address whether an implied trust arose in this case.
Restatement of the Law of Trusts § 17 comment a (1935). Although a transfer of title is not required to create a trust by declaration, the statutory requirements for creating a trust must be satisfied: (1) the settlor must have capacity to create a trust; (2) the settlor must indicate an intention to create the trust; (3) the trust must have a definite beneficiary; (4) the trustee must have duties to perform; and (5) the same person cannot be the sole trustee and the sole beneficiary. ORS 130.155(1). Here, the focus of the parties' dispute is on the second element: whether the intent requirement was met.

The first issue, then, is whether Hope Presbyterian, as the owner of the property, declared that it held the property as trustee for PCUSA. The second issue is whether Hope Presbyterian subsequently revoked that purported trust.

PCUSA asserts that two documents approved by Hope Presbyterian shortly after the 1983 adoption of the Book of Order demonstrate Hope Presbyterian's intent to create a trust over church property for PCUSA's benefit. In apparent response to Jones, PCUSA declared in the Book of Order:

"All property held by or for a particular church, * * * whether legal title is lodged in a corporation, a trustee or trustees, or an unincorporated association, and whether the property is used in programs of a particular church or of a more inclusive governing body or retained for the production of income, is held in trust nevertheless for the use and benefit of the Presbyterian Church (U.S.A.)."

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5 We cite to both the statutes and Oregon case law on trusts because, although Oregon has adopted the Uniform Trust Code, the common law remains relevant: "The common law of trusts and principles of equity supplement this chapter [ORS chapter 130], except to the extent modified by this chapter or other law." ORS 130.025.
After PCUSA adopted that express trust provision, Hope Presbyterian, as previously stated, amended the congregation's bylaws to state:

"This church being a part of the Presbytery of the Cascades, the Synod of the Pacific, and the Presbyterian Church, U.S.A., is governed in all its provisions by the Constitution of the Presbyterian Church, U.S.A."

(Underscoring in original.) In addition, members of Hope Presbyterian and the board of trustees for the church corporation approved an amendment to the articles of incorporation declaring:

"This corporation is a church congregation of and holds all property as trustee for the Presbyterian Church (U.S.A.)."

The amendment was signed by the corporation's president and secretary, as well as a third party, under the statement, "We, the undersigned, declare under penalties of perjury that we have examined the foregoing and to the best of our knowledge and belief, it is true, correct and complete." As noted, that document was never filed with the Secretary of State.

Hope Presbyterian argues that what appears to be an expression of intent by the congregation and the corporation to "hold[] all property as trustee" for PCUSA was not, in fact, sufficient to create a trust because that intent was expressed at most by the congregation. It maintains that the congregation is a separate entity that cannot bind the corporation and that the corporation holds legal title to the property. Hope Presbyterian also argues that, even if there is no meaningful distinction between the entities, the Articles of Amendment, which declare the trust, contain numerous defects, including that they were never filed with the Secretary of State. Moreover, Hope Presbyterian asserts
that the purported trust fails to satisfy the statute of frauds.

We begin by addressing Hope Presbyterian's argument that the congregation is a separate entity that cannot bind the corporation because some of the acts that may be indicative of intent to create a trust were taken by members of the congregation. Hope Presbyterian focuses on the corporation's status as the plaintiff in this case, and as the holder of legal title to the property, and notes its lack of ties to PCUSA. Although the corporation was "affiliated" with PCUSA, Hope Presbyterian argues, the corporation could not have been a "member" of PCUSA because corporations cannot be members of PCUSA. Because it was not a member, Hope Presbyterian argues that the corporation was never bound by the Book of Order and, in fact, was never required to remain affiliated with any Presbyterian denomination.

PCUSA responds that the corporation and the congregation are intertwined. The Book of Order contemplates formation of a corporation and extends the express trust provision to property where the "legal title is lodged in a corporation[.]" § G-8.0201. In addition, PCUSA notes that the congregation's bylaws state that church members are entitled to vote on matters affecting corporate affairs and that the board of trustees, which "fulfill[s] the requirements of civil law with respect to the church corporation," must consist of church elders and be approved at a congregational meeting.

We agree that, for purposes of creation of the trust, there is no meaningful distinction between the nonprofit corporation, Hope Presbyterian Church of Rogue River, and the church congregation of the same name. The congregation existed for nearly 30 years before the members created the corporation, and the record makes it plain that the
corporation was created to help the congregation carry out its functions. The corporation's articles of incorporation state that the board of trustees will be elected at the annual congregational meeting. As noted, the congregation's bylaws require that the trustees be appointed by the session from a group of elders and approved at an annual congregational meeting. Moreover, the congregation's bylaws state that the church membership is "entitled at all meetings of the congregation to vote * * * on all matters affecting the corporate affairs, unless otherwise provided by the laws of the State of Oregon."

Having concluded that the acts of both the congregation and the corporation are relevant in determining whether Hope Presbyterian intended to hold its property in trust for the benefit of PCUSA, we turn to the requirements for expressing intent to create a trust and the acts of Hope Presbyterian that PCUSA claims expressed the necessary intent. Generally, a trust, including the settlor's manifestation of intent to create a trust, "need not be evidenced by a trust instrument[,]" unless required by statute, such as the statute of frauds. ORS 130.180. Evidence of intent to create a trust can include "written or spoken words or * * * conduct." Restatement (Third) of Trusts § 13 comment b (2003). Moreover, "[a]lthough the grantor's intent at the time of making the conveyance determines the nature of the interest created, it is permissible to look at the conduct of the parties after the conveyance in ascertaining that intent." Belton v. Buesing, 240 Or 399, 408, 402 P2d 98 (1965); see also Oregon UTC & Comments, 42 Willamette L Rev at 213-14 (citing Restatement (Second) of Trusts § 4 comment a (1959)); Restatement (Second) of Trusts § 4 comment a (1959) ("The intention of the settlor at the time of the
creation of the trust may ** be shown by facts occurring after that time to the extent that evidence of such facts is admissible to show such intention under the rules of evidence."). Here, the amendment to the articles of incorporation, the amendment to the congregation's bylaws, and the relationship between the parties leading up to and following the adoption of the PCUSA constitution demonstrate Hope Presbyterian's intent to hold its property in trust for PCUSA.

As noted, the board of trustees and the members of the congregation adopted a document entitled Articles of Amendment in 1983. That document states,

"This corporation is a church congregation of and holds all property as trustee for the Presbyterian Church (U.S.A.)."

Hope Presbyterian notes several alleged deficiencies in that document that would have prevented it from being accepted by the Secretary of State, including that it uses a different name for the corporation than the name that was on record with the Secretary of State. Notwithstanding those deficiencies, we conclude, as did the Court of Appeals, that the document shows that both the board of trustees of the corporation and the members of the congregation approved a document that recited the intent to hold Hope Presbyterian's property in trust for PCUSA.

Moreover, the statement in the Articles of Amendment is not the only

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6 Hope Presbyterian argues that it has never used the name "Hope 'Community' or 'United' Presbyterian Church," the name used on the Articles of Amendment. However, multiple deeds in the record convey property to Hope Community Presbyterian Church, which indicates that that is a name that the church used in some instances.
evidence of Hope Presbyterian's intent. Hope Presbyterian was a member of the
Presbytery of the Cascades when the Presbytery voted in 1980 to approve an amendment
to include an express trust provision in the constitution of PCUSA's predecessor. Hope
Presbyterian remained a member of the Presbytery of the Cascades after that vote, and
three years later, two members of Hope Presbyterian attended the meeting where the
Presbytery voted to approve the adoption of PCUSA's constitution, which also included
an express trust provision. The congregation subsequently amended its bylaws in 1983 to
state its intent to be "governed in all its provisions by the Constitution of the Presbyterian
Church, U.S.A." (Underscoring in original.) Then, for more than 20 years after Hope
Presbyterian's bylaw amendment, the congregation's conduct showed that Hope
Presbyterian remained affiliated with PCUSA and subject to its constitution. For
example, Hope Presbyterian continued to send representatives to Presbytery meetings and
sought approval from the Presbytery when buying or selling property, in accordance with
the Book of Order. That lengthy history of conduct provides additional insight into Hope
Presbyterian's intent to hold its property in trust for PCUSA

Based on Hope Presbyterian's conduct, PCUSA's constitution cannot be
irrelevant, as Hope Presbyterian contends -- even though it is not dispositive, as PCUSA
contends. By voluntarily associating with the denominational church when Hope
Presbyterian first organized in 1901 -- and remaining associated with the denominational
church for over 100 years until 2007 -- Hope Presbyterian demonstrated that it intended
to be bound by the governing documents of the church, including the constitution
containing the express trust provision. In applying the neutral principles approach, we do
not treat as dispositive the "orders and judgments" of the denominational church in
resolving church property disputes, as the Supreme Court did in *Watson*, 80 US 679, but
we cannot ignore Hope Presbyterian's long history of voluntary association with PCUSA
(and its predecessors) and its express assent to the *Book of Order* in 1983. *See In re
Episcopal Church Cases*, 45 Cal 4th at 493, 198 P3d at 84 (adopting neutral principles
approach, but finding for the denominational church in part because the documents at
issue "show[ed] that the local church agreed and intended to be part of a larger entity and
to be bound by the rules and governing documents of that greater entity"). Hope
Presbyterian's affiliation with PCUSA both before and after the adoption of the express
trust provision demonstrates that it intended to hold its property in trust for PCUSA.

Hope Presbyterian argues that, even if there is evidence of intent, the trust
fails under the statute of frauds. As noted, although ORS 130.180 states that a trust does
not generally need to be evidenced by a trust instrument, ORS 130.180 also
acknowledges that a trust instrument might be required by statutes other than the Uniform
Trust Code, such as the statute of frauds. Here, Hope Presbyterian argues that the trust
does not meet the standard set forth in ORS 93.020(1):

"No estate or interest in real property, other than a lease for term not
exceeding one year, nor any trust or power concerning such property, can
be created, transferred or declared otherwise than by operation of law or by
a conveyance or other instrument in writing, subscribed by the party
creating, transferring or declaring it * * * and executed with such
formalities as are required by law."

ORS 93.020(1) is a codification of the statute of frauds as it relates to real property, in
addition to the statute of frauds set forth in ORS 41.580. *See, e.g.*, *Smiley v. King*, 278 Or
While the Articles of Amendment may lack some of the formalities of a typical trust instrument, "'[a]ny writing, however informal, is sufficient to satisfy the statute [of frauds], if it contain[s] a complete statement of the trust, and is signed or subscribed by the proper party.'" *Heitkemper v. Schmeer*, 130 Or 644, 656, 275 P 55, *on reh'g*, 281 P 169 (1929) (quoting George Gleason Bogert, *Handbook of the Law of Trusts* § 20, 54 (1921)); see also Austin Wakeman Scott, William Franklin Fratcher & Mark L. Ascher, 1 *Scott and Ascher on Trusts* § 6.5, 292 (5th ed 2006) ("[T]he writing required by the statute of frauds may be anything written, formal or informal, signed by the proper party."). Here, the Articles of Amendment contain a statement that Hope Presbyterian will hold all property as trustee for the benefit of PCUSA, and the document was signed by both the corporation's president and secretary, who presumably had authority to act on behalf of the corporation. Thus, there is a writing declaring the trust that is signed by the proper parties, satisfying the requirements of ORS 93.020(1) and creating the trust.

Hope Presbyterian argues that, even if a trust was created, it was free to, and did, revoke that trust. Hope Presbyterian relies on ORS 130.505(1) for its authority to revoke the trust. ORS 130.505(1) provides:

"Unless the terms of a trust expressly provide that the trust is irrevocable, the settlor of the trust may revoke or amend the trust."

As noted, the Uniform Trust Code, of which ORS 130.505(1) is a part, was enacted in 2005. That particular provision, however, does not apply to trusts created before the effective date of Oregon's Uniform Trust Code. Or Laws 2005, ch 348, § 47, compiled as
a note after ORS 130.505 (2011) ("Section 46 (1) of this 2005 Act [ORS 130.505 (1)] does not apply to a trust created under an instrument executed before the effective date of this 2005 Act [January 1, 2006]."). The choice not to make the revocability provision retroactive appears to be based in part on the fact that that provision changed Oregon's common law of trusts. See Oregon UTC & Comments, 42 Willamette L Rev at 307 (noting change to Oregon common law); David M. English, Reporter, Uniform Trust Code (2000), The Uniform Trust Code (2000): Significant Provisions and Policy Issues, 67 Mo L Rev 143, 187 (2002) ("Because the Code's presumption of revocability will reverse the rule in most jurisdictions, the presumption applies only to trust instruments executed on or after the date of enactment."). Therefore, for trusts created before January 1, 2006, the common law applies to determine whether the trust is revocable. See ORS 130.025 ("The common law of trusts and principles of equity supplement this chapter, except to the extent modified by this chapter or other law."). Under Oregon common law, a trust was irrevocable "unless the settlor reserve[d] the power of revocation * * *."

Stipe v. First National Bank, 208 Or 251, 268, 301 P2d 175 (1956). In this case, the parties agree that if a trust was created, it was created in 1983. Therefore, because the trust was created before 2006, the common law applies, and the trust is irrevocable unless the settlor, Hope Presbyterian, reserved the power of revocation.

In the absence of an express provision declaring the trust revocable, a settlor may reserve the power of revocation if the settlor uses words from which a right to revoke can be inferred or if the settlor demonstrates the intent for the trust to be revocable through extrinsic evidence. Austin Wakeman Scott, William Franklin Fratcher & Mark
L. Ascher, 5 Scott and Ascher on Trusts § 35.1, 2278-79 (5th ed 2008). Hope Presbyterian, however, argues only that it has the right to revoke the trust under ORS 130.505(1). Hope Presbyterian argued to the trial court that imposing an irrevocable trust would be "unjust" because the church has been "self-supporting" throughout its history. However, because consideration is not required for the formation of a trust, and the presence or absence of consideration does not bear on the revocability of a trust, support provided or not provided by PCUSA is immaterial to the determination of revocability. Stipe, 208 Or at 266-68 (no consideration required for creation of trust and mere absence of consideration does not make trust revocable).

Moreover, nothing in the record indicates that Hope Presbyterian intended the express trust to be revocable, rather than irrevocable. Although the Articles of Amendment were never filed with the Secretary of State, they were approved, without reserving any right of revocation, by both the congregation and the board of trustees. Nothing in the text of either the Articles of Amendment or the bylaws -- or in any other document in the record -- states or suggests that Hope Presbyterian reserved the power of revocation.

Although a settlor generally cannot unilaterally revoke an irrevocable trust, ORS 130.200(1) allows for modification or termination of an irrevocable trust with approval of the court "upon consent of the settlor and all beneficiaries[.]") Here, beneficiary PCUSA did not consent to termination of the trust. The Presbytery of the Cascades, the regional presbytery, had begun meeting with Hope Presbyterian regarding disaffiliation before the disaffiliation vote, in accordance with the provision in the Book
of Order granting the presbytery the authority to dismiss local churches, and those meetings continued after the vote. Although that process may have offered a means for obtaining the beneficiary's consent to the revocation of the trust, the process was essentially halted when Hope Presbyterian filed its motion for summary judgment. Modification or termination of a trust can also take place without the consent of the beneficiary if the court finds that "[t]he interests of any beneficiary who does not consent will be adequately protected." ORS 130.200(5)(b). That is not the case here, of course, because termination would eliminate PCUSA's interest and the protections it is entitled to as a beneficiary. Because ORS 130.200 does not apply, Hope Presbyterian did not have a right to unilaterally revoke the trust.

For the foregoing reasons, we agree with the Court of Appeals that, under the neutral principles approach to resolving church property disputes, Hope Presbyterian held its property in trust for the benefit of PCUSA.

The decision of the Court of Appeals is affirmed. The judgment of the circuit court is reversed, and the case is remanded to the circuit court for entry of a judgment in favor of Presbyterian Church (U.S.A.).

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7 Hope Presbyterian raises several additional legal arguments concerning the creation -- and alleged revocation -- of the trust. We reject those arguments without discussion. Hope Presbyterian also identifies other facts that, it asserts, support its legal position on those issues. However, nothing in the record demonstrates any genuine dispute as to any fact that would be material to the dispositive legal issues. Indeed, both parties moved for summary judgment in their favor in the trial court and, in briefing and argument in the Court of Appeals and in this court, neither party sought a remand to the trial court for further development of the factual record.
PUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

MARYLAND TRANSIT ADMINISTRATION,

Petitioner,

v.

SURFACE TRANSPORTATION BOARD;
UNITED STATES OF AMERICA,

Respondents.

On Petition for Review of an Order of the Surface Transportation Board. (32609)

Argued: September 19, 2012
Decided: November 21, 2012

Before NIEMEYER and DIAZ, Circuit Judges, and Max O. COGBURN, Jr., United States District Judge for the Western District of North Carolina, sitting by designation.

Petition for review denied by published opinion. Judge Niemeyer wrote the opinion, in which Judge Diaz and Judge Cogburn joined.
COUNSEL


OPINION

NIEMEYER, Circuit Judge:

The Maryland Transit Administration ("MTA"), as the owner of the railroad right-of-way running between Clayton, Delaware, and Easton, Maryland, applied to the Surface Transportation Board ("STB" or "Board") (formerly, the Interstate Commerce Commission) to abandon freight transportation use of the right-of-way and to convert it to a recreational trail, as authorized by the National Trails System Act ("the Trails Act"), 16 U.S.C. § 1247. The Trails Act authorizes owners of railroad rights-of-way to enter into agreements with entities, called sponsors, under which the sponsors agree to convert the right-of-way into recreational trails, so long as they agree to reserve to the railroad the right to return the right-of-way to railroad use. As part of the application for conversion to trail use, the sponsors must agree to "assume full responsibility . . . for any legal liability arising out of such . . . use" or agree to indemnify the railroad for "any potential liability" and assume responsibility for the payment of all taxes assessed with respect to the right-of-way. 16 U.S.C. § 1247(d); 49 C.F.R. § 1152.29(a).
The MTA submitted to the STB interim user agreements it had reached with two sponsoring governmental agencies, in which the sponsors agreed to indemnify the MTA for potential liability, subject to limitations of state sovereign immunity and to future legislative appropriations. The STB rejected the MTA’s application, concluding that instead of assuming full responsibility for legal liability or indemnifying the MTA for any potential liability, the proposed sponsors conditioned their undertakings by subjecting them to sovereign immunity and to future state legislative appropriations. The STB explained that instead of assuming "full responsibility," the proposed sponsors "offer[ed] the possibility of no" responsibility.

The MTA filed this petition for review, contending (1) that the conditions imposed by the sponsors do "not narrow the scope of the indemnity" that would be undertaken and that the limitations of sovereign immunity and legislative appropriations were necessary; (2) that by requiring an unqualified indemnity clause, the STB’s regulation is, in any event, "an unreasonable and impermissible construction of the Trails Act because it infringes on state sovereignty without clear expression of congressional intent to do so"; and (3) that the STB inappropriately refused to exercise its duty to evaluate the substance of the sponsors’ undertakings by interpreting its responsibilities to be only ministerial.

For the reasons we give herein, we find the MTA’s arguments unpersuasive, especially in light of its burden to demonstrate that the STB acted arbitrarily and capriciously. See 5 U.S.C. § 706(2). Accordingly, we affirm the decision of the STB and deny the MTA’s petition for review.

I

The MTA acquired the 54.1-mile railroad right-of-way between Clayton, Delaware, and Easton, Maryland, from the trustees of the Penn Central Transportation Company in 1982 and later, for several years, tried to use it as a railroad through
an operations agreement with the Chesapeake Railroad Company. After the Chesapeake Railroad Company failed, however, the MTA filed a notice with the STB that it intended to abandon the use of the right-of-way for railroad transportation and to convert the right-of-way to a recreational trail. As required by the Trails Act and regulations under it, the MTA, at the time also acting as a potential trail sponsor, included in its notice a "statement of willingness" to assume "full responsibility" for any legal liability arising out of the recreational trail use and for the payment of any taxes that might be assessed against the right-of-way.

The STB duly issued a "certificate of interim trail use" ("CITU") to the MTA in January 2006, thus giving MTA 180 days to negotiate a trail use agreement. Under the STB’s regulations, any sponsor was required "to assume full responsibility . . . for any legal liability arising out of the use of the right-of-way (unless the user is immune from liability, in which case it need only indemnify the railroad against any potential liability)" and "for the payment of all taxes assessed against the right-of-way." 49 C.F.R. § 1152.29(a)(2).

After several extensions, in September 2008, the MTA shifted course. Rather than assume direct responsibility as a trail sponsor, the MTA submitted two new interim trail use agreements to the STB, one with the Delaware Department of Natural Resources and Environmental Control and one with the Maryland Department of Natural Resources. The MTA asked the Board to vacate the existing CITU and issue new CITUs reflecting the new sponsors’ assumption of responsibility. In each agreement the sponsor conditioned its undertaking to indemnify the MTA from liability. The agreement between the MTA and the Delaware sponsor provided:

Notwithstanding the requirements of subsection (a) [providing for indemnity and liability], nothing contained in this Agreement shall constitute or be deemed to constitute an obligation of future appro-
mpriations by the Delaware General Assembly. MTA acknowledges that Licensee must obtain appropriations prior to payment of any damages. A lack of funds to perform any aspect of this Agreement due to insufficient appropriation by the Delaware General Assembly shall not constitute a breach of this Agreement.

(Emphasis added). In its "statement of willingness to assume financial responsibility" submitted with the agreement, the Delaware Department of Natural Resources reiterated the limitation of its undertaking, stating that it "is entitled to sovereign immunity, and accordingly, will indemnify MTA against any potential liability provided that such indemnification shall not constitute or be deemed to constitute an obligation of future appropriations by the Delaware General Assembly."

The agreement between the MTA and the Maryland sponsor provided similarly:

In order to establish interim trail use and rail banking under 16 USC 1247(d) and 49 CFR 1152.29, Lessee is willing to assume, under the provisions of the Maryland Tort Claims Act, responsibility for . . . any legal liability arising out of the Lessee's use of the Area as a public recreation rail trail.

* * *

Subject to appropriations by the Maryland General Assembly and to the extent permitted by law (if at all), Lessee shall protect, indemnify, defend and hold harmless . . . Lessor . . . against and with respect to any and all liabilities arising out of or in any way connected with (a) the exercise or performance by Lessee . . ., (b) the use or operation by Lessee . . ., or (c) work performed by or on behalf of the Lessee upon the Trail.
At the first level of review, the STB’s Acting Director of the Office of Proceedings denied the MTA’s application to convert the right-of-way to a trail because the sponsors failed to comply with the undertakings required by Regulation 1152.29(a)(2). The Acting Director noted that subjecting the sponsors’ agreements to indemnify the MTA to future appropriations and making any liability subject to sovereign immunity could negate the required indemnification.

On appeal to the STB, the Board affirmed the Acting Director. The Board noted that under the Trails Act, prospective trail sponsors are required to assume full responsibility for “any legal liability” arising out of the use of the right-of-way as a trail or, as authorized by regulation, to indemnify the railroad for “any potential liability.” It explained, “[r]ecognizing that many States and their subdivisions enjoy sovereign immunity, the Board’s regulations allow them to satisfy the Trails Act by agreeing to indemnify the railroad against ‘any potential liability.’” (Quoting 49 C.F.R. § 1152.29(a)(2)). The Board noted, however, that the Delaware and Maryland sponsors “did not satisfy the requirements of the Trails Act and [the STB’s] regulations.” With respect to the Delaware sponsor’s undertaking, the Board pointed out that the sponsor’s willingness to indemnify the MTA was “subject to the requirements of Delaware law” and that the Delaware General Assembly “might not provide funds in sufficient amounts to discharge [the sponsor’s] obligations.” And with respect to the Maryland sponsor’s undertaking, the Board identified similar conditions, pointing out that the Maryland sponsor would indemnify the MTA only “under the provisions of the Maryland Tort Claims Act” and “subject to appropriations by the Maryland General Assembly.” Further, the Maryland sponsor included the qualification that it would indemnify the MTA only “to the extent permitted by law (if at all).” Finally, the Board noted that the Maryland sponsor failed to include any undertaking to pay taxes
that might be assessed against the right-of-way. In conclusion, the Board explained that both sponsors "offer[ed] the possibility of no indemnification for the abandoning railroad" and accordingly found that their undertakings did not comply with the Trails Act and Regulation 1152.29(a)(2).

From the decision of the Board, dated February 24, 2011, the MTA filed this petition for review. See 28 U.S.C. § 2344.

II

The MTA argues first that it satisfied the requirements of the Trails Act and Regulation 1152.29(a)(2) insofar as it included in its agreements with the two sponsors "indemnity clauses that indemnified MTA for any legal liability MTA might face due to the use of the right-of-way as a trail." It asserts that the clauses did so in "plain language." But as quickly as the MTA makes this assertion, it acknowledges, as it must, that its agreements included "language to make clear that the obligations of the [sponsors] were subject to the availability of funds pursuant to an appropriation from the legislature." It asserts that such language was "necessary to reflect state constitutional limits." And it concludes:

Being unable to commit to a future payment does not reduce the scope of the indemnity provision, nor does it reduce [the sponsors’] liability under the indemnity agreement. At most, the reservation means that there may be a time in the future when [the sponsors] would have to wait for a future appropriation before [they] could pay MTA’s indemnity claim. But [the sponsors] have still undertaken to indemnify MTA for any potential legal liability, as the Trails Act requires. The limitations regarding the ability to pay any indemnity claim are not inconsistent with the Trails Act requirement that a trail sponsor assume responsibility for any "legal liability."
It can hardly be argued that a requirement demanding that a party assume full responsibility for any liability or indemnify the railroad for any potential liability is satisfied by a promise to indemnify only if the principles of sovereign immunity so allow or if the money becomes available pursuant to future appropriations. As the Maryland sponsor candidly provided in its undertaking, its promise was "subject to appropriations by the Maryland General Assembly and to the extent permitted by law (if at all)." (Emphasis added).

We cannot conclude that the STB acted arbitrarily and capriciously in concluding that the MTA user agreements, which included qualifications to the undertakings, did not satisfy the statutory and regulatory obligations that the sponsors assume full responsibility for any liability or indemnify the MTA for any potential liability.

III

As an alternative position, the MTA contends that "the STB’s construction of the Trails Act would result in an impermissible requirement that States waive their sovereign immunity." As it explains, "[T]he STB’s construction of the Trails Act would require states to modify, waive, or ignore sovereign limits on their authority, as well as sovereign immunity . . . . [T]he STB would require state agencies to execute an unqualified indemnity provision even if doing so would violate state constitutional limits." The MTA argues that Regulation 1152.29, but not the Trails Act itself, requires the States to waive sovereign immunity by including the alternative that States and state agencies give unqualified indemnity. Therefore, it maintains, the regulation is an unreasonable application of the Trails Act.

The Trails Act provides that a sponsor must "assume full responsibility . . . for any legal liability" arising from the use of the right-of-way as a trail. 16 U.S.C. § 1247(d). The statute thus conditions participation on the trail sponsor’s agreement
to *fully protect* the railroad from liability arising from the use of the right-of-way as a recreational trail. The STB, through its Regulation 1152.29, found that the statutory requirement could, for sponsors having immunity, be satisfied by the sponsor’s indemnifying the railroad for "any potential liability." 49 C.F.R. § 1152.29(a)(2). The indemnity agreement effectively limits any state agency’s undertaking to a contractual obligation, much like the contractual undertaking a state agency would make in any agreement into which it enters to rent office space. Contrary to the MTA’s suggestion, the regulation’s indemnity option is not an additional, more burdensome condition; it addresses no more than the statute requires—the full-protection of the railroad. The language of both the statute and the regulation requires state sponsors to protect the railroads. If anything, the indemnity option is more friendly to agencies having immunity than is the Trails Act, because the Act, standing alone, would require a state to assume tort liability directly. The regulation’s indemnity option thus implements, in a reasonable manner, the Trails Act’s requirement that railroads be fully protected while also softening the statute’s impact on sovereign immunity. Accordingly, we reject the MTA’s claim that the regulation is unreasonable.

More importantly, however, the requirement to protect the railroad does not, as the MTA suggests, impose on a sponsoring state agency an unconstitutional requirement to waive its sovereign immunity. That requirement is made a condition of a federal benefit or gift that the state agency voluntarily elects to receive, and we have long recognized that a state may be required to "waive its sovereign immunity by accepting from Congress a ‘gift’ or a ‘gratuity,’ the receipt of which is made conditional on the State’s waiver of immunity." *Bell Atl. Md., Inc. v. MCI WorldCom, Inc.*, 240 F.3d 279, 291 (4th Cir. 2001), vacated on other grounds sub nom. *Verizon Md., Inc. v. Pub. Serv. Comm’n of Md.*, 535 U.S. 635 (2002); see also *MCI Telecomm. Corp. v. Bell Atl.-Pa.*, 271 F.3d 491, 505 (3d Cir. 2001).
In the case of the Trails Act, Congress created the voluntary federal rails-to-trails program, authorizing but not requiring railroad right-of-way owners and recreational trail sponsors to agree to convert railroad rights-of-way into recreational trails. For those electing to participate in the program, the Act provides two main benefits. First, through the application of federal law, the Act prevents reversionary property interests from vesting, as it normally would following the abandonment of the railroad use, thus preserving the right-of-way for a trail use. See Preseault v. I.C.C., 494 U.S. 1, 8 (1990). Second, by authorizing the conversion, albeit on a temporary basis, the federal government, not the States, remains potentially liable to land owners for takings challenges based on the delayed vesting of reversionary interests involved in railroad rights-of-way. See Nat’l Ass’n of Reversionary Prop. Owners v. S.T.B., 158 F.3d 135, 139 (D.C. Cir. 1998). Because Congress had no obligation to bestow these benefits on the States but made them available to the States on a voluntary basis, they qualify as a federal gift. See Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 686 (1999) ("Congress has no obligation to use its Spending Clause power to disburse funds to the States"). Indeed, the MTA has acknowledged the voluntary basis of the program in its brief, stating that "participation in the Trails Act program and its decision to enter into trail use agreements with [the sponsors] are strictly voluntary."

In short, even if the MTA is correct in its understanding that the Trails Act and Regulation 1152.29 mandate a waiver of sovereign immunity, the waiver would only be required as a condition of participating in the rails-to-trails program, a voluntary program in which no State—and indeed, no railroad—is forced to participate. See Nat’l Wildlife Fed’n v. I.C.C., 850 F.2d 694, 696 (D.C. Cir. 1988) (upholding a regulation that interpreted the Trails Act as requiring all transfers of rights-of-way to be voluntary).
Finally, the MTA contends that the STB improperly discharged its duties under the Trails Act by functioning only ministerially, refusing to evaluate the substance of its proffered indemnity provisions in the light of applicable state law. It relies on the STB’s explanation of its role given in its decision to deny the MTA’s application, where the STB stated:

To fulfill our ministerial role under the Trails Act, we need not parse the intricacies of Maryland and Delaware immunity law. Rather, we merely verify that the prospective trail sponsor has submitted the required documentation to comport with the statute and regulations.

(Emphasis added).

But the STB did not function as mechanically as the MTA claims. In its 11-page opinion, the Board, in some detail, expressed not only its reasons for concluding that the MTA did not satisfy the requirements of the Trails Act and Regulation 1152.29, but it explained the various policies underlying the requirements and making them important. In addition, the Board considered separately each of the MTA’s arguments and explained why it found the arguments to be unpersuasive. To be sure, the Board did explain that it was functioning ministerially, but it said so in the context of recognizing that it could not alter the plain requirements of the Trails Act and Regulation 1152.29. In reviewing the Board’s thorough decision, we conclude that the MTA’s argument is not well taken.

Moreover, there would be nothing to render illegal an agency’s adoption of regulations that restrain the degree of discretion it exercises. See Am. Hosp. Ass’n v. NLRB, 499 U.S. 606, 612 (1991) ("[E]ven if a statutory scheme requires individualized determinations, the decisionmaker has the authority to rely on rulemaking to resolve certain issues of general appli-
cability unless Congress clearly expresses an intent to withhold that authority”). If the agency, through rulemaking, decides to remove discretion from its determinations, then it appropriately relegates to itself a ministerial role. See Swan v. Clinton, 100 F.3d 973, 977 (D.C. Cir. 1996) ("A ministerial duty is one that admits of no discretion, so that the official in question has no authority to determine whether to perform the duty") (citing Mississippi v. Johnson, 71 U.S. (4 Wall.) 475, 498 (1866)).

Here, in promulgating 49 C.F.R. § 1152.29, the Board parroted the language of the Trails Act but included, as an alternative to assuming full responsibility for any liability, the right of a state sponsor to indemnify the railroad for any potential liability. The need for assuming full financial responsibility by either means was, however, demanded by the Act. Thus, when the Board made the individualized decision in this case, it simply confined its role to verifying the trail sponsors’ undertakings and concluding that because the trail sponsors qualified their indemnifications of the railroad, they did not provide the railroad with the protection required by the Trails Act. We cannot conclude that this decision manifested an improper discharge of the agency’s duties.

For the reasons given, we affirm the decision of the STB and deny the MTA’s petition for review.

*IT IS SO ORDERED.*
IN THE COURT OF APPEALS
STATE OF ARIZONA
DIVISION ONE

BRIMET II, LLC, an Arizona limited liability company,
Plaintiff/Appellee,
v.
DESTINY HOMES MARKETING, LLC, an Arizona limited liability company,
Defendant/Appellant.

Appeal from the Superior Court in Maricopa County
Cause No. CV2009-015587
The Honorable John A. Buttrick, Judge (Retired)

REVERSED AND REMANDED WITH INSTRUCTIONS

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OROZCO, Judge
Destiny Homes Marketing, LLC (Destiny) appeals the grant of summary judgment in favor of Brimet II, LLC (Brimet). For the reasons stated below, we reverse the grant of summary judgment and remand to the trial court with instructions to enter summary judgment in favor of Destiny.

FACTUAL AND PROCEDURAL BACKGROUND

First Horizon Home Loan Corporation (First Horizon) loaned Destiny Holdings II, LLC (the Borrower) $438,750 to purchase real property comprised of eighteen undeveloped lots (acquisition loan). The loan was secured by a blanket deed of trust on the property, which was recorded in first position. Destiny and the Borrower entered into an option contract (Option). Destiny recorded the Option (in a Memorandum of Option Agreement) in second position behind the acquisition loan.

First Horizon then extended a new loan to the Borrower for construction on the property (construction loan). The construction loan was also secured by a blanket deed of trust on the property which was recorded after the Option. The first $442,296.12\(^1\) of the construction loan was used to pay off the

\(^1\) This amount represents the principal and accrued interest on the acquisition loan.
acquisition loan. The Borrower eventually paid First Horizon $652,500 of the construction loan.

¶4 The following year, Northern Trust, N.A. (Northern) loaned the Borrower approximately $1.5 million to refinance the construction loan (refinance loan). The refinance loan was secured by a blanket deed of trust on twelve of the original eighteen lots and was recorded after the Option. The Borrower used the refinance loan to pay off the balance of the construction loan.

¶5 The Borrower defaulted on the refinance loan. Northern foreclosed and purchased the property at a trustee’s sale with a credit bid of $496,706.11. Northern filed this quiet title action seeking judicial confirmation that the trustee’s sale extinguished the Option. While this lawsuit was pending, Northern sold the property to Brimet.2 As a result, Brimet became the real party in interest to pursue the quiet title action.

¶6 Brimet moved for partial summary judgment and Destiny cross-moved for summary judgment. The trial court held that Brimet was entitled to summary judgment because “the doctrines of replacement and equitable subrogation apply here and

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2 Brimet, in turn, sold lots 10 and 16 to ME 12, LLC. ME 12, LLC was substituted in as the real party in interest as to those two lots. An order granting a stay of the litigation pending resolution of the appeal was entered as to ME 12, LLC.
collectively have the legal effect of wiping out Destiny’s option upon Northern Trust’s foreclosure of its priority lien position.” Destiny timely appealed. We have jurisdiction under Arizona Revised Statutes (A.R.S.) section 12-2101.A.1 (Supp. 2011).

DISCUSSION

Standing

¶ 7 Destiny maintains that Brimet does not have standing to maintain this quiet title action. Pursuant to A.R.S. § 12-1101.A. (2003), anyone having or claiming an interest in real property may bring an action to quiet title against any person claiming an adverse interest in the property.

¶ 8 Brimet claims that it owns the real property at issue free and clear of Destiny’s Option. Destiny, however, claims that Northern’s trustee’s sale did not extinguish the Option. Which party is correct depends on whether Northern’s lien was equitably subrogated to First Horizon’s first lien in connection with the acquisition loan.

¶ 9 Brimet does not claim that it is entitled to equitable subrogation, only that if Northern was equitably subrogated to the acquisition loan, then it purchased the property free and clear of Destiny’s Option. Because this is a defense on the merits to Destiny’s lien, rather than a technical defense to
avoid the lien, Brimet, as Northern’s grantee, may maintain a quiet title action to determine whose lien had priority at the time of the foreclosure. See Cosper v. Valley Bank, 28 Ariz. 373, 374-75, 237 P. 175, 176 (1925) (holding grantee entitled to assert grantor’s meritorious defense to judgment lien that lien was invalid as a matter of fact and law in quiet title action). Therefore, Brimet has standing in this quiet title action.

Replacement and Equitable Subrogation


¶11 Under the doctrine of replacement, “if a senior mortgage is released of record and, as part of the same transaction, is replaced with a new mortgage, the latter mortgage retains the same priority as its predecessor.” Restatement (Third) of Property § 7.3 (a) (1997). Replacement is not available when the terms of the new loan change the terms of the underlying debt such that it is materially prejudicial to
a junior lienholder’s interest in the real property. *Cont’l Lighting*, 227 Ariz. at 387, ¶ 16, 258 P.3d at 205. Because an intervening lienholder maintains the same position it had before the replacement lender satisfied the pre-existing obligation, it suffers no prejudice. *Id.* at 388, ¶ 20, 258 P.3d at 206.

¶12 The doctrine of equitable subrogation is similar to that of replacement in that a later lender can pay off the first and superior loan, allowing the later lender to be substituted into the priority position of the primary lienholder, regardless of the existence of a recorded intervening lien. *Id.* at 385, ¶ 9, 258 P.3d at 203. However, the second lender must be different than the first lender, “because, by definition, one cannot be subrogated to one’s own previous deed of trust.” *Id.* at ¶ 10. When the lenders are of the same identity, priorities are determined under replacement and not equitable subrogation. *Id.* at 386, ¶ 11, 258 P.3d at 204.

¶13 In the present case, the First Horizon construction loan that replaced the First Horizon acquisition loan had priority over the Option, in the amount of the balance owed on the senior loan, $442,296.12. *Id.* at 388, ¶ 22, 258 P.2d at 206. During the term of the construction loan, the Borrower paid $652,500 towards the balance of the loan. Thereafter, Northern refinanced the construction loan, and paid in full the
balance owed under the construction loan. Northern recorded a blanket deed of trust on the property securing the refinance loan after the Option.

¶14 Brimet maintains that Northern’s lien, filed after the Option, has priority over the Option under the doctrine of equitable subrogation. Equitable subrogation permits “a subsequent lender who supplies funds used to pay off a primary and superior encumbrance to be substituted into the priority position of the primary lienholder, despite the recording of an intervening lien.” Id. at 385, ¶ 9, 258 P.3d at 203 (citation omitted). To avoid prejudice to junior lienholders, however, replacement and equitable subrogation only exist up to the amount paid to release the senior lien. Id. at 388-89, ¶ 23, 258 P.3d at 206-07.

¶15 In this case, the construction loan had priority over the Option in the amount of $442,296.12, the balance owed on the acquisition loan and paid by the construction loan. The Borrower’s payment of $652,500 on the construction loan to First Horizon extinguished the priority lien in the amount of $442,296.12 which was senior to the Option. After the lien was extinguished, the Option had priority followed by the lien for the balance owed under the construction loan. In other words,
when Northern extended the refinance loan to the Borrower, Destiny’s Option was already in first position.³

¶16 Brimet argues, under an apportionment theory, that the balance paid to release the acquisition loan of $442,296.12 should be apportioned among each of the eighteen lots in the parcel secured by the deed of trust. Under the apportionment theory, a refinancing lender could obtain priority over the Option in the amount of $24,572 per lot. Brimet further argues that each lump sum payment the Borrower made to release a lot from the construction deed of trust should be applied only to that particular lot, not to the balance owed on the construction loan in general.⁴ Under Brimet’s theory, despite the Borrower’s payments in excess of the amount of the original senior lien, Northern would nonetheless be entitled to claim equitable subrogation in the amount of $294,864.


³ Northern would have become equitably subrogated for the balance of the amount it paid to satisfy the construction loan, to the extent any intervening liens had been placed on the property after the recording of the deed of trust securing the construction loan, but no such intervening liens were recorded.

⁴ Lot 18 was released for the lump sum payment of $112,500; while lots 12, 17, 11, and 3, were released upon receipt of a lump sum payment of $135,000 each.
contractor with a mechanics’ lien on a fifty-two lot development could not assert its entire lien amount against four lots in which it had priority. Id. at 169, 883 P.2d at 406. The court further held that each lot in the development would be deemed to have benefitted equally from the contractor’s improvements, for purposes of apportioning the contractor’s mechanics’ lien among lots in the subdivision, unless the contractor could prove that a lot was improved in a disproportionate amount. Id.

¶18 It is appropriate to apportion a mechanics’ lien per lot because, by statute, the legislature intended a mechanics’ lien to correspond to improvements made to the specific lot on which the lien is placed. Id. at 168, 883 P.2d at 405. There is no similar rationale, however, for apportioning an acquisition loan secured by a blanket deed of trust on one parcel among individual lots. To do so, contrary to the holding in CS & W, would allow Northern (and Brimet) “to resurrect an extinguished lien and obtain a priority to which it is not entitled.” Id. at 169, 883 P.2d at 406.

¶19 The original lender, First Horizon, could have made eighteen separate loans in the amount of $24,572 each, secured by eighteen separate deeds of trust, but it did not. Instead First Horizon chose to provide one loan secured by a blanket deed of trust on the entire property. Similarly, Northern’s
deed of trust is a blanket deed of trust covering the entire property. Although Northern had the right to foreclose on “all or any part of the Real Property,” Northern held just one trustee’s sale on the entire property. Additionally, ¶ 2.5 of the construction loan agreement provides that all payments or amounts received by Lender with respect to the Loan shall be applied: (i) first, to interest, (ii) second, to late fees and (iii) last, to the unpaid principal balance of the Loan.

¶20 The Schedule to the Loan Agreement sets forth the payment required to obtain a lot release. It does not provide that any such payment is applied in any manner other than as is set forth in ¶ 2.5 of the loan agreement. Nor did First Horizon apportion the payments. The principal balance sheet demonstrates that each lot release payment received was a pay down of the loan in general. In accordance with ¶ 2.5 of the loan agreement, of the $652,500 the Borrower repaid under the construction loan, First Horizon applied $118,629.72 to accrued interest and fees and $533,870.28 to the principal balance.

¶21 In sum, the construction loan had priority over the Option under the doctrine of replacement in the amount of $442,296.12. On June 1, 2006, the Borrower paid more than that amount towards the loan balance and the priority ceased to exist. Therefore, Destiny’s Option became the senior lien on
the property. Northern extended its refinancing loan in July 2006. At that time, there was no lien senior to the Option under which Northern could be equitably subrogated. Destiny’s Option was not extinguished when Northern foreclosed on its deed of trust and purchased the property at the trustee’s sale. Therefore, Brimet did not acquire title to the property free and clear of the Option and the Option remains as a senior encumbrance on the property.

**Attorney Fees**

¶22 Destiny seeks an award of attorney fees under A.R.S. § 12-341.01. This was a statutory quiet title action that turned on the application of the equitable doctrines of replacement and subrogation; it did not arise out of contract. Therefore, Destiny is not entitled to an award of its attorney fees. As the successful party on appeal, Destiny is entitled to its costs upon compliance with Rule 21 of the Arizona Rules of Civil Appellate Procedure.
CONCLUSION

§23 We reverse and remand to the trial court with instructions that summary judgment be entered in favor of Destiny.

/S/

___________________________________
PATRICIA A. OROZCO, Judge

CONCURRING:

/S/

____________________________________
MAURICE PORTLEY, Presiding Judge

/S/

____________________________________
RANDALL M. HOWE, Judge
IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FOURTH APPELLATE DISTRICT
DIVISION TWO

TWENTY-NINE PALMS ENTERPRISES CORPORATION,

Plaintiff and Respondent,

v.

PAUL BARDOS,

Defendant and Appellant.

E051769
(Super.Ct.No. CIVRS908132)
OPINION

APPEAL from the Superior Court of San Bernardino County. Martin A. Hildreth, Judge. (Retired judge of the San Bernardino Mun. Ct., West Valley Div., assigned by the Chief Justice pursuant to art. VI, § 6 of the Cal. Const.) Affirmed.

Lambert & Rogers and Michael Rogers for Defendant and Appellant.

Plaintiff and respondent Twenty-Nine Palms Enterprises Corporation (Palms), a tribal corporation, sued defendant and appellant Cadmus Construction Co. (Cadmus), a sole proprietorship wholly owned and operated by Paul Bardos (Bardos) (1) to recover money paid to Cadmus, because it alleged Cadmus was an unlicensed contractor (Bus. & Prof. Code, § 7031),¹ and (2) for unfair competition, in that Cadmus allegedly performed work requiring a contractor’s license while unlicensed (§ 17200). The trial court granted summary judgment in favor of Palms.

Cadmus raises six contentions on appeal. First, Cadmus asserts section 7031 does not apply to contracts made with a tribal corporation for work done on tribal land. Second, Cadmus asserts the trial court erred by sustaining Palms’s objections to Cadmus’s evidence “en masse.” Third, Cadmus asserts there is a triable issue of fact as to whether it held a valid license. Fourth, Cadmus contends that if it was not properly licensed, then there is a triable issue of fact as to whether it satisfies the substantial compliance requirements. (§ 7031, subd. (e).) Fifth, Cadmus contends Palms is estopped from seeking recovery pursuant to the unlicensed contractor statute (§ 7031). We affirm the judgment.

FACTUAL AND PROCEDURAL HISTORY

A. COMPLAINT

The facts in this subsection are taken from Palms’s complaint. Twenty-Nine Palms Band of Mission Indians (the tribe) is a federally recognized Indian tribe. The

¹ All subsequent statutory references will be to the Business and Professions Code, unless otherwise indicated.
tribe is sovereign, residing on its reservation in the Coachella area. Palms is a tribal corporation wholly owned and operated by the tribe. (25 U.S.C. § 477.) Palms owns and operates the Spotlight 29 casino (the casino). Palms and the casino are on the tribe’s land in the Coachella area.

On or about March 12, 2007, Cadmus submitted a written bid proposal to construct a temporary access road and parking lot for the casino. The bid was in the amount of $751,995. Palms accepted Cadmus’s bid. Cadmus performed the work on the tribe’s land, where the casino is located. Cadmus finished its work and was paid in full around May 2007; Palms paid Cadmus $751,995. Cadmus first received its contractor’s license in October 2007. When Cadmus entered into the construction contract and performed the construction work, it was not a licensed contractor. Palms sought to have Cadmus disgorge the $751,995.

B. ANSWER

In Cadmus’s answer it denied the allegations and raised 14 affirmative defenses, such as substantial compliance, consent, waiver, and unclean hands. Cadmus’s answer is primarily legal assertions, without facts.

C. MOTION FOR SUMMARY JUDGMENT

Palms filed a motion for summary judgment on April 1, 2010. Palms argued the undisputed evidence reflected Cadmus acted as a contractor, but was not licensed when it performed the construction work at the casino, and therefore, Palms should prevail, and Cadmus should be required to disgorge the $751,995.
The declaration of Darrell Mike (Mike), a member of the Palms Board of Directors was attached to Palms’s motion for summary judgment. Mike declared Palms contracted with Cadmus in March 2007 for construction work related to a temporary access road and parking lot. Mike stated, “A substantial portion of this work took place on an approximately 47 acre lot adjacent to the Tribe’s reservation (the ‘Adjacent Lot’).” Mike denied that the adjacent lot was ever part of the tribe’s federally approved reservation land. Mike believed Palms held a temporary easement over the adjacent lot.

Palms also lodged various exhibits in support of its motion for summary judgment. One of the exhibits was a transcript of Bardos’s deposition. In the deposition, Bardos stated Cadmus was a general contracting company, and in 2007 it was operating as a general contractor. Cadmus filed its fictitious business name statement with San Bernardino County on April 6, 2007. Cadmus entered into the contract with Palms on March 12, 2007. Bardos believed Cadmus completed its work around the end of June 2007. The State of California issued a contractor’s license to Cadmus on October 26, 2007 (license No. 905717).

Cadmus has always been a sole proprietorship, and Bardos has always been the 100 percent owner. Bardos asserted that from April to October 2007 Cadmus was operating under the contractor’s license issued to Bardos Construction, Inc. (BCI) (license No. 505220). In 1983, Bardos applied for a contractor’s license as an individual doing business as BCI. When asked if Bardos informed anyone at Palms that he was operating under BCI’s license, Bardos responded, “I had no obligation to do that. [¶] . . . [¶] I didn’t need to. They had private investigators.”
Also lodged as an exhibit was the contract between Cadmus and “Spotlight 29 Casino.” Term No. 23 of the contract provided, “License: Pursuant to legal requirements, notice is hereby given that contractors are required by law to be licensed and are regulated by the Contractors State License Board. Any questions concerning a contractor may be referred to the Registrar of the Board [w]hose address is . . . .”

Other exhibits included invoices from Cadmus to Palms, and checks from Palms to Cadmus. A fictitious business name statement reflected Bardos filed for Cadmus’s fictitious business name on April 6, 2007. The application for Cadmus’s contractor’s license was dated June 25, 2007, and signed by Bardos. Cadmus’s contractor’s license reflected an issue date of October 26, 2007. An online printout related to BCI reflected it had an active class B general building contractor’s license, which was issued in February 1987.

D. **OPPOSITION TO MOTION FOR SUMMARY JUDGMENT**

1. **DECLARATION**

In a declaration, Bardos asserted he had been a licensed general contractor in California since 1980. In February 2007, Palms hired Bardos to be its representative in regard to the construction of a parking structure near the casino. As the representative, Bardos would help Palms with the selection of architects and engineers; review completed plans; prepare schedules and budgets; interface with local officials to expedite the permit process; assist with drafting and negotiating contracts with contractors, subcontractors, or suppliers; inspect work as it progressed; and review contractor pay applications.
Bardos asserted that during his time as Palms’s construction representative, he learned “the Tribe always took the position that California licensing and/or regulatory laws do not apply to the Tribe and/or work being performed on Tribal lands,” which was why local building inspectors did not inspect the construction work and Palms hired BCI to inspect the work.

In his declaration, Bardos explained that Worth Group had been hired as the general contractor for the parking structure project. Palms asked BCI to prepare a bid for the temporary parking lot and access road, in order to replace Worth Group who prepared a bid $1,000,000 higher than BCI’s bid. Bardos declared Palms asked BCI to perform the work under a different name, to hide the fact that Bardos—Palms’s representative—was performing the construction work, i.e. self-dealing. Bardos created Cadmus to hide his dual role. Bardos said Palms was “fully informed” BCI’s contractor’s license would be used for the work on the temporary parking lot and access road, through conversations with Bardos. Mike told Bardos construction work on tribal land was exempt from state licensing requirements.

Bardos declared Palms made payments to Cadmus, which Bardos then funneled to BCI, in order to pay subcontractors. Bardos explained that he did not immediately seek a contractor’s license for Cadmus because he relied on Palms’s representation Cadmus did not need a license for work done on tribal land.

Bardos further declared the written agreement between Cadmus and Palms only encompassed a portion of the work performed, because at the time the written contract was created Palms was still trying to gain an easement across the adjacent lot.
According to Bardos, the written agreement had two parts: the first part concerned constructing the access road, while the second part concerned construction of the temporary parking lot. Bardos declared that, at the time of signing the written contract, the tribe had not yet acquired a temporary easement across the adjacent lot, so the access road could be built. Thus, Mike struck out the first part of the contract, only agreeing to the second part related to the parking lot. Bardos stated the work related to the access road was eventually completed pursuant to collateral oral agreements.

2. **OPPOSITION**

Cadmus filed its corrected opposition to Palms’s motion for summary judgment on June 4, 2010. In the opposition, Cadmus set forth its version of the facts. Cadmus asserted the general contractor on the casino renovation project was Worth Group. Palms asked BCI how much it would charge to perform the work on the temporary access road and parking lot. BCI responded that it could perform the work for less money than Worth Group. Palms then asked Bardos, the managing officer and sole shareholder of BCI “to perform the [construction] work under a different name so that Worth [Group] would not discover that BCI . . . was the one performing the work.” In order to accommodate Palms, Bardos created the fictitious business name “‘Cadmus Construction Company.’” The fictitious business name was designed to conceal BCI’s identity from Worth, so Worth would not object to BCI’s dual role as Palms’s representative on the project and as a contractor on the project.
Cadmus asserted Palms performed an extensive background check on Bardos including a status review of BCI’s contractor’s license. Further, Cadmus argued Palms “expressly and impliedly approved of BCI’s licensure as being sufficient to support its purported agreement with Cadmus. [Citation.] [Palms] even went so far as to represent to Cadmus that it did not require Cadmus to have its own contractor’s license, but that the work could be performed under BCI’s license because it was being performed on the Tribe’s land.” Cadmus alleged Palms knew BCI would be performing the work, but insisted BCI and Bardos maintain the illusion Cadmus was performing the work, so Worth Group would not discover BCI’s dual role. Cadmus argued Palms should be barred from recovering disgorged profits due to the doctrine of unclean hands.

Further, Cadmus asserted the written contract did not cover all of the construction work. Cadmus argued some of the work was performed subject to oral agreements between Palms and BCI. Cadmus argued the checks for the construction work were made payable to Cadmus solely for Palms’s convenience, and to maintain the illusion that Cadmus was performing all the work. Cadmus argued summary judgment should not be granted because some of the money was earned by BCI pursuant to the oral agreements.

Further, Cadmus asserted civil regulatory laws do not apply on tribal lands. (28 U.S.C. § 1360.) Cadmus reasoned the state trial court lacked jurisdiction to decide the issue, if section 7031 is determined to be a civil-regulatory statute, as opposed to a criminal statute. Cadmus then argued that section 7031 is a civil-regulatory law because it is a regulatory licensing rule. Additionally, Cadmus asserted a triable issue of fact
existed as to whether Palms waived the licensing requirement, which it could do pursuant to its sovereign immunity.

Finally, Cadmus argued the motion for summary judgment should be denied because additional facts exist, and Cadmus should be permitted to conduct further discovery. Cadmus asserted it did not have a reasonable opportunity to conduct discovery because after Cadmus filed its answer, but before the summary judgment motion was filed, Cadmus’s insurance company disclaimed Cadmus’s coverage, which caused Cadmus to spend time evaluating whether it would keep the insurance company’s attorney or retain new counsel. Cadmus contended it could produce additional evidence related to triable issues of fact if given more time for discovery.

3. **EXHIBITS**

Cadmus lodged a variety of exhibits in support of its opposition to the motion for summary judgment. One of the exhibits was a Contractor’s State License Board Certification of Records reflecting Bardos Construction Company (BCC) was issued a class B general contractor’s license in 1980.

Another exhibit was the “Consulting Services Agreement” (the consulting agreement) between Palms and “Paul Bardos, dba Bardos Construction, Inc.,” dated February 1, 2007. The consulting agreement provided BCI would act as Palms’s representative for (1) the development and construction of a Kampgrounds of America facility, (2) the development and construction of a parking structure adjacent to the casino, and (3) renovations to the casino related to the parking structure. The representative position included assisting in the selection of architects and engineers;
reviewing completed plans; preparing schedules and budgets; interfacing with local officials to expedite the permit process; assisting with drafting and negotiating contracts with contractors, subcontractors, or suppliers; inspecting work as it progressed; and reviewing contractor’s pay applications.

Included in the exhibits was a City of Coachella building permit for work done on the temporary road and parking lot taken in the name of “Bardos Construction” in April 2007. Also included was an agreement between BCI and Laird Construction, for Laird to perform subcontracting work on the temporary road and parking lot. The agreement listed the general contractor as BCI. The subcontracting agreement reflected Laird would construct the temporary access road and parking lot for $396,649.

E.  REPLY TO THE OPPOSITION TO SUMMARY JUDGMENT

In Palms’s reply to Cadmus’s opposition, it raised a variety of arguments. First, Palms contended Bardos’s declaration contradicted his deposition testimony. Specifically, Bardos contradicted himself by declaring that part one of the contract, related to the access road, was not part of the written agreement. Palms asserted that during Bardos’s deposition, he testified the written contract was the only agreement for construction between Palms and Cadmus. Bardos testified, “Cadmus Construction Company completed its scope of work under this agreement,” referring to the written contract. Palms further argued the evidence reflected payments for the road construction corresponded exactly to those set forth in the written contract. Palms also argued Bardos contradicted himself by claiming he had conversations with tribal members about using BCI’s license to perform the construction work. In Bardos’s
deposition, when asked if he ever informed a tribal representative that Cadmus was using BCI’s license, Bardos responded, “I had no obligation to do that.”

Second, Palms asserted Cadmus failed to produce evidence that it was a licensed contractor when it performed the construction work. Third, Palms argued the written contract encompassed all the work performed, so there were no collateral agreements with BCI. Fourth, Palms contended the trial court found it had jurisdiction over the case during the demurrer stage of the proceedings, so Cadmus should not be permitted to reargue the jurisdiction issue.

Fifth, as to waiver, Palms argued Cadmus provided no authority that Palms could waive state licensing requirements. Palms asserted section 7031 was criminal in nature and therefore “may be enforced on the Tribe’s reservation, without regard to the Tribe’s wishes. [Citation.]” Palms further argued the express terms of the written contract reflected contractors must be properly licensed. Palms concluded Cadmus’s case law did not support the application of affirmative defenses in situations involving unlicensed contractors, e.g. unclean hands, estoppel, waiver, and fraud.

Sixth, in regard to Cadmus’s request for more time to conduct discovery, Palms argued Cadmus did not meet the statutory requirements for a continuance. Palms argued Cadmus failed to provide a declaration explaining why the discovery was not previously conducted—the explanation was in the opposition, but not a declaration. Further, Palms asserted Cadmus had not conducted any discovery as of June 2010, despite being served with the complaint in October 2009. Palms asserted Cadmus was
only trying to delay the proceedings by requesting more time for discovery. Palms filed 39 objections to the evidence Cadmus provided in support of its opposition.

F. SURREPLY TO THE REPLY IN SUPPORT OF THE MOTION FOR SUMMARY JUDGMENT

Cadmus filed a surreply to Palms’s reply. Cadmus asserted Bardos never testified that the written agreement covered all the construction work performed. Further, Cadmus asserted Bardos testified that members of the tribe asked Bardos to conceal the fact that BCI was performing the construction, and Bardos supplemented his testimony after the deposition to reflect that he spoke to tribal members about Cadmus using BCI’s license. Additionally Cadmus argued that the written contract showed Mike wrote “‘Part II only’” above the signature lines, indicating that part one was deleted from the written contract. Cadmus asserted the motion for summary judgment should not be granted because the written agreement did not cover all of the construction work, so some work was done directly between Palms and BCI.

G. HEARING

On June 17, 2010, the trial court held a hearing on Palms’s summary judgment motion. At the hearing, Palms argued its motion was primarily based on Bardos’s testimony, and invoices reflecting Cadmus was paid in the exact amounts set forth in the written agreement. Palms asserted the burden was on Cadmus to show it had a contractor’s license during the period of construction, and Cadmus had not provided proof of a license.
Cadmus argued the written agreement did not cover all the construction work performed. Cadmus further asserted Palms paid Cadmus, as opposed to BCI, because Palms chose to conceal BCI’s identity from Worth Group. Cadmus argued it was “unbelievable” for Palms to argue Cadmus was wrong to perform the construction work without a license, because Palms, Cadmus, BCI, and Bardos all agreed to conceal Bardos’s and BCI’s dual roles. Further, Cadmus asserted a contractor’s license was not required to perform the construction work on the tribe’s land.

The trial court found Cadmus did not have a contractor’s license at the time it performed the construction work, and therefore, Palms was entitled to a judgment against Cadmus in the amount of $751,995. As to substantial compliance, the trial court explained there was no evidence of sharing BCI’s license, and “using such [a] license is legally barred as a basis for substantial compliance.”

As to who performed the work, the trial court pointed out (1) Cadmus submitted the construction bid; (2) Palms accepted the bid without any changes; (3) Cadmus hired Laird to perform the construction work; (4) Cadmus completed the work within the scope of the contract by the end of June 2007; (5) Cadmus invoiced Palms for the entire written contract amount; (6) Palms paid Cadmus the full contract price; and (7) Cadmus was not issued a contractor’s license until October 26, 2007.

The trial court cited the rule that a party cannot create a triable issue of fact by contradicting its own prior discovery responses. Thus, the trial court reasoned Bardos’s declaration must be rejected in favor of Bardos’s deposition testimony. As a result, the trial court concluded Cadmus had not disputed any of Palms’s facts. The trial court also
found Cadmus had not contradicted any of Palms’s legal authority related to licensing laws, disgorgement laws, and the unavailability of substantial compliance. The trial court concluded Cadmus had not provided any legal authority for its arguments related to waiver, estoppel, or unclean hands. The court found Cadmus’s request for additional time failed because the request was not supported by affidavits or declarations.

As to Palms’s objections to Cadmus’s evidence, the trial court said, “The Court is sustaining [Palms’s] objections to defendant’s evidence.” Cadmus responded, “Your Honor indicated that the Court was sustaining [Palms’s] objections to Cadmus’ evidence. All of the objections?” The court said, “Yes.” The trial court granted Palms’s motion for summary judgment.

**DISCUSSION**

A.  **SECTION 7031**

Cadmus asserts the unlicensed contractor statute (§ 7031) is not enforceable in a contract made with a tribal entity for work done on tribal land. We disagree because Cadmus cannot assert Palms’s sovereign immunity.

Cadmus’s contention is purely legal; therefore, we apply the independent standard of review. (*Ferguson v. City of Cathedral City* (2011) 197 Cal.App.4th 1161, 1167 [Fourth Dist., Div. Two].)

In *Three Affiliated Tribes v. Wold Engineering* (1984) 467 U.S. 138, 148 (*Three Tribes*), the United States Supreme Court concluded the situation of an Indian suing a non-Indian in state court is “very different” from a non-Indian suing an Indian in state court for events occurring on tribal land. The United States Supreme Court explained,
“As a general matter, tribal self-government is not impeded when a State allows an Indian to enter its courts on equal terms with other persons to seek relief against a non-Indian concerning a claim arising in Indian country.” (Id. at pp. 148-149.)

In State of Arizona v. Zaman (1997) 190 Ariz. 208 (Zaman), a mother, who was a member of the Navajo tribe, brought an action in Arizona state court against her child’s father (Zaman), who was not a member of an Indian tribe. (Id. at p. 209.) The mother sought to have Zaman adjudged the child’s father and ordered to pay child support. (Ibid.) Zaman argued the trial court lacked jurisdiction. The trial court found in favor of the mother, but the intermediate appellate court reversed. The intermediate court held, the trial court “lacked subject matter jurisdiction because ‘state action [would] infringe[e] on the right of reservation Indians to make their own laws and be ruled by them.’” [Citation.]” (Ibid.)

The Arizona Supreme Court vacated the intermediate appellate court’s decision. (Zaman, supra, 190 Ariz. at p. 213.) The Arizona Supreme Court reasoned, “Zaman, a non-Indian, seeks to use a protection afforded Indians to defeat the claim of an Indian who chooses the state forum. This attempt to clothe oneself in the immunity afforded another has already been rejected by the Supreme Court. [Three Tribes, supra], 467 U.S. at 148.” (Zaman, supra, 190 Ariz. at p. 210.)

Zaman and Three Tribes reflect that the sovereign immunity defense is reserved for the tribe and its entities. Thus, if a tribe or a tribal entity seeks to sue a non-tribal entity in state court, then the non-tribal entity cannot assert a sovereign immunity defense. As the United States Supreme Court explained, a tribal entity selecting a state
forum is “very different” from a tribal entity being brought as a defendant to a state forum. (*Three Tribes, supra,* 467 U.S. at p. 148.) The difference, as identified in *Zaman,* is that the sovereign immunity defense is only available to the tribe and its entities.

Since the sovereign immunity defense is only available to the tribe and the tribal entities, the defense was not available to Cadmus—a non-tribal entity. Thus, Cadmus cannot rely on the defense theory that section 7031 was not enforceable in a contract made with a tribal entity for work done on tribal land, because that defense relies on principles of sovereign immunity. For example, in Cadmus’s opening brief, it argues, “[I]t is also well established that building and zoning codes are not operative on Tribal property because of sovereignty interference . . . .” Cadmus further argues, “The interference with Indian sovereignty of licensing requirements is illustrated in this case: Had Cadmus been forced to obtain a new license prior to commencing work, [then] the Tribe would have had to choose between selecting another contractor or delaying the start of construction . . . .” Cadmus is asserting the tribe’s sovereign immunity to prevent the tribe from pursuing an action against him in state court. Cadmus cannot do this—the sovereign immunity defense is reserved for the tribe and tribal entities. Accordingly, we conclude the trial court did not err.

Cadmus does not provide a detailed explanation as to why it is authorized to assert tribal sovereign immunity as a defense. In Cadmus’s opening brief, it writes, “Palms seeks disgorgement of monies paid to Cadmus for work done on Indian property . . . .” It appears Cadmus is asserting the following theory: Section 7031
simply was not the law in the jurisdiction where the contract performance took place. The problem with this argument is that it relies on principles of sovereign immunity. Cadmus is arguing a particular state law does not apply on tribal lands—Cadmus does not have the authority to assert this defense, only the tribe or its entities may assert such a defense. Cadmus cannot raise tribal immunity simply because the contract was performed on tribal land—the defense of sovereign immunity is personal to the tribe and its entities. (Zaman, supra, 190 Ariz. at p. 210; Three Tribes, supra, 467 U.S. at p. 148.) Accordingly, we find Cadmus’s argument to be unpersuasive.

Cadmus provides an argument as to whether section 7031 is civil in nature or criminal in nature. Cadmus asserts the statute is a civil regulatory statute and therefore does not apply on tribal land. Since we have concluded Cadmus cannot rely on the sovereign immunity defense, we do not address the merits of Cadmus’s sovereign immunity argument.2

B. EVIDENTIARY OBJECTIONS

Cadmus contends the trial court erred by summarily sustaining all of Palms’s 39 evidentiary objections, because some of the objections were unreasonable and it appears the trial court did not consider the individual objections. We agree.

2 On December 12, 2011, Cadmus requested this court take judicial notice of the “‘Tribal-State Compact between the State of California and the Twenty-Nine Palms Band of Mission Indians,’” related to casino gambling. The Compact was intended to support Cadmus’s sovereign immunity argument. Since we are not addressing the merits of Cadmus’s sovereign immunity argument, we deny Cadmus’s request for judicial notice.
We apply the abuse of discretion standard when reviewing the trial court’s rulings on evidentiary objections. (Powell v. Kleinman (2007) 151 Cal.App.4th 112, 122.) Summarily ruling on multiple evidentiary objections “has been criticized by many [appellate] courts.” (Tilley v. CZ Master Assoc. (2005) 131 Cal.App.4th 464, 479.) When a trial court issues a blanket ruling on numerous evidentiary objections without providing any reasoning, there “is hardly a ruling, as it could not provide any meaningful basis for review.” (Nazir v. United Airlines, Inc. (2009) 178 Cal.App.4th 243, 255.) When a trial court issues such a ruling, the “appellate court [is] left with the nebulous task of determining whether the ruling that was purportedly made was within the authority and discretion of the trial court and was correct.” (Sambrano v. City of San Diego (2001) 94 Cal.App.4th 225, 235.)

Although summarily ruling on numerous evidentiary rulings is a common labor-saving practice in law and motion courts, the objections in this case needed individual attention. (See Sambrano v. City of San Diego, supra, 94 Cal.App.4th at p. 235 [“common practice”].) Bardos submitted a seven-page declaration, excluding the signature and proof of service pages. Palms submitted 33 objections to that seven-page declaration, and the 33 objections were 48 pages in length. The objections were often to large sections of the deposition—multiple lines long—and were based on a variety of alleged problems, such as lack of foundation, vagueness, speculation, and lack of personal knowledge.
For example, Objection No. 1 was based on the following paragraph from Bardos’s declaration: “On or about August 1980, I personally became a licensed “B” General Building Contractor in the State of California doing business as the sole owner and proprietor of [BCC], contractor’s license number 392817. A true and correct copy of the certification of licensure for [BCC] is lodged concurrently herewith as Exhibit “A.” Since 1980, I have been at all times and without interruption, a licensed General Building Contractor in California. At the present time I currently hold active licenses for both Cadmus Construction, Inc. [(CCI)] (issued October 26, 2007) and [BCI] (issued February 6, 1987) under license numbers 905717 and 505220. True and correct copies of the certification of licensure for [CCI] and [BCI] are lodged concurrently herewith as Exhibits “B” and “C” respectively. Both licenses have always been active and in good standing without ever lapsing and without any disciplinary action taken against them. [Citation.]” (Boldface omitted.)

Palms objected to the foregoing paragraph on the bases of (1) irrelevance, (2) lack of foundation, and (3) misstating the evidence. Palms argued that BCI and CCI “are not parties to this case and their licensure is irrelevant.” First, as to relevancy, it is unclear how the evidence would be irrelevant, since (1) Palms raised the substantial compliance issue in its motion for summary judgment, specifically arguing about Cadmus’s use of BCI’s license, and (2) Cadmus could try to use the various other licenses to prove substantial compliance. Second, as to lack of foundation, it appears

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3 The appellant in this case is Cadmus Construction Co., not Cadmus Construction, Inc.
the paragraph is attempting to lay the foundation for the various licenses being lodged as evidence, so it is unclear exactly what foundation is missing for the testimony. Third, as to misstating the testimony, Palms points out that BCC’s license has been inactive since 1988. The problem with this objection is that Bardos declared BCI’s and CCI’s licenses have always been active—not BCC’s license. So there does not appear to be a misstatement of the evidence. In sum, it appears unreasonable for the trial court to have sustained this objection.

Objection Nos. 34 through 39 related to Cadmus’s exhibits. Palms asserted the various documents Cadmus presented were problematic, mostly due to the exhibits being irrelevant. For example, in Objection No. 34, Palms objected to BCC’s certificate of licensure on the basis of irrelevancy. Palms argued the certificate was irrelevant because BCC was not a party to this case. Contrary to Palms’s assertion, BCC’s license is relevant to Cadmus trying to establish substantial compliance with the licensing statutes. As will be explained in greater detail post, with BCC’s license, Cadmus could try to prove Bardos, and therefore, Cadmus (as a sole proprietorship) had been duly licensed as a contractor in this state prior to the performance of the act or contract. Thus, it was not reasonable to sustain the objection on the basis of the exhibit being irrelevant.

Given the sweeping nature of the objections (48 pages of objections to a seven-page declaration, numerous lines of the declaration being used in almost every objection, and multiple bases for each objection), and the problematic nature of some of the objections, as set forth ante, we conclude the trial court’s blanket ruling sustaining
all the objections, without reasoning, was an abuse of discretion. (See *Nazir v. United Airlines, Inc.*, *supra*, 178 Cal.App.4th at p. 257 [“order sustaining all but one of defendants’ objections was a manifest abuse of discretion.”].) Thus, the objected-to-evidence will be used in reviewing the trial court’s ruling on the summary judgment motion. (*Ibid.*)

In regard to whether the evidentiary ruling was harmless, an erroneous evidentiary ruling requires reversal only if “there is a reasonabl[e] probability that a result more favorable to the appealing party would have been reached in the absence of the error. [Citation.]” (*Robertson v. Fleetwood Travel Trailers of California, Inc.* (2006) 144 Cal.App.4th 785, 815; Evid. Code, § 354.) In the instant case, the error in the trial court’s evidentiary rulings would not change the outcome on the summary judgment motion because Cadmus failed to present any evidence creating a triable issue of fact, as will be explained post.

C. LICENSE

Cadmus asserts the trial court erred by granting summary judgment because there is evidence Cadmus was licensed.

“We review a grant of summary judgment de novo. [Citation.] We assume the role of the trial court and redetermine the merits of the motion. In doing so, we must strictly scrutinize the moving party’s papers so that all doubts as to whether any material, triable issues of fact exist are to be resolved in favor of the party opposing summary judgment. [Citation]” (*Calemine v. Samuelson* (2009) 171 Cal.App.4th 153, 160-161.)
The Contractors’ State License Law, “section 7000 et seq., requires contractors to be licensed unless they are exempt from licensure. (§§ 7026, 7031 & 7040 et seq.)” 

(Ball v. Steadfast-BLK (2011) 196 Cal.App.4th 694, 700 (Ball).) Section 7031, subdivision (a), requires a person to be “a duly licensed contractor at all times during the performance of the act or contract,” when “engaged in the business or acting in the capacity of a contractor.” Section 7031, subdivision (b), provides that an unlicensed contractor must disgorge all compensation earned under a contract. Section 7059.1, subdivision (b), provides, “A licensee shall not conduct business under more than one name for each license.”

However, “[a] sole owner is a sole proprietorship and a sole proprietorship is not a legal entity separate from its individual owner.” So, for example, if “Smith Heating” is a sole proprietorship owned by Smith, then Smith Heating cannot hold a contractor’s license independent from Smith. Smith Heating would not be a distinct legal entity—it is the individual, Smith, who is the licensee, and under that license Smith can perform work under the name Smith Heating. (Ball, supra, 196 Cal.App.4th at p. 701.)

Cadmus has always been a sole proprietorship, and Bardos has always been the 100 percent owner. Bardos asserts his role as the Responsible Managing Officer of BCI makes BCI’s license the equivalent of an individual license for Bardos, and thus, allows Bardos to perform work under Cadmus’s name.4 The problem with Cadmus’s argument

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4 The following is the law related to responsible managing officers. Former section 7068, subdivision (a), provided, “The board shall require an applicant to show such degree of knowledge and experience in the classification applied for, and such

[footnote continued on next page]
is that BCI, a corporation, is a separate legal entity from Bardos and Cadmus. (See
distinct legal entity, separate from its shareholders and officers.’”].) The fact that
Bardos is the Responsible Managing Officer for BCI does not dissolve BCI’s corporate
status—BCI is its own legal entity. (Ibid.) Thus, Bardos did not hold an individual
license, under BCI’s name, such that he could perform work under the name Cadmus.

Cadmus contends the corporate identity of BCI should be disregarded via the
alter ego doctrine or piercing the corporate veil. Palms contends Cadmus waived the
alter ego argument by not raising it below. “The appellate court can deem an argument
raised in an appeal from a grant of summary judgment waived if it was not raised below
and requires consideration of new factual questions.” (Zimmerman, Rosenfeld, Gersh &
Leeds LLP v. Larson (2005) 131 Cal.App.4th 1466, 1488.) We agree that the argument
is waived for failure to raise it below. (Misk v. D’Arco (2011) 197 Cal.App.4th 1065,

[footnote continued from previous page]

general knowledge of the building, safety, health, and lien laws of the state and of the
administrative principles of the contracting business as the board deems necessary for
Former section 7068, subdivision (b)(3), provided, “An applicant shall qualify in regard
to his or her experience and knowledge in one of the following ways: ¶ . . . ¶ (3) If
a corporation, or any other combination or organization, it shall qualify by the
appearance of a responsible managing officer or responsible managing employee who is
qualified for the same license classification as the classification being applied for.”
(Eff. Jan. 1, 2005, through Dec. 31, 2010.) Former section 7068, subdivision (e),
provided, “Except in accordance with Section 7068.1, no person qualifying on behalf of
an individual or firm under paragraph . . . (3) of subdivision (b) shall hold any other
active contractor’s license while acting in the capacity of a qualifying individual
pursuant to this section.” (Eff. Jan. 1, 2005, through Dec. 31, 2010.)
The determination of whether a corporation is an alter ego of an individual is ordinarily a question of fact.

Cadmus contends “the words ‘alter ego’ may not have been uttered in the trial court, [but] the idea certainly was. The idea that Appellant’s existing licensed corporation could not be used to do the work because the Tribe wanted to hide its identity was argued ad nauseum.” The problem with this argument is that the alter ego doctrine requires consideration of numerous factors, so a discussion of a general idea is not sufficient. For example, a few of the factors that must be considered are (1) whether there was commingling of funds; (2) whether the individual treated corporate assets as his own; and (3) whether the individual held himself out as being personally liable for the debts of the corporation. *(Greenspan v. LADT, LLC* (2010) 191 Cal.App.4th 486, 512-513 [listing 14 factors] *(Greenspan)*.) There is a lengthy list of other factors to be considered when deciding whether the corporate veil should be pierced, so a general discussion will not suffice as having raised the issue below.

Another threshold issue to discuss is the equitable nature of the alter ego doctrine. “‘[I]t has long been settled that “the courts may not resort to equitable considerations in defiance of section 7031.” [Citation.]’” *(Montgomery Sansome LP v. Rezai* (2012) 204 Cal.App.4th 786, 794; see also *MW Erectors, Inc. v. Niederhauser Ornamental and Metal Works Co., Inc.* (2005) 36 Cal.4th 412, 423 *(MW Erectors)*.) The alter ego doctrine is equitable in nature. *(Greenspan, supra, 191 Cal.App.4th at p. 508.* Thus, using the alter ego doctrine to allow Cadmus to borrow BCI’s license would be improper, because it is an equitable doctrine.
Despite the foregoing, we will address the merits of Cadmus’s contention. “The alter ego doctrine arises when a plaintiff comes into court claiming that an opposing party is using the corporate form unjustly and in derogation of the plaintiff’s interests . . . . In certain circumstances the court will disregard the corporate entity and will hold the individual shareholders liable for the actions of the corporation: “As the separate personality of the corporation is a statutory privilege, it must be used for legitimate business purposes and must not be perverted. When it is abused it will be disregarded and the corporation looked at as a collection or association of individuals, so that the corporation will be liable for acts of the stockholders or the stockholders liable for acts done in the name of the corporation.” . . .” (Greenspan, supra, 191 Cal.App.4th at pp. 510-511.)

Cadmus is trying to pierce the corporate veil of BCI to obtain BCI’s contractor’s license, in order to circumvent the state’s licensing statutes. The alter ego doctrine was not created to circumvent regulatory requirements; it was founded on equitable principles and designed to prevent an injustice. (Greenspan, supra, 191 Cal.App.4th at p. 512.) In the instant case, Cadmus admits its corporate form was created by Bardos for the purpose of self-dealing. Bardos was entrusted with hiring contractors and overseeing their work, and he hired himself in the form of Cadmus. Cadmus worked without a license, and now wants to pierce the corporate veil of BCI to borrow its contractor’s license. We fail to see how equity requires the piercing of BCI’s corporate veil in order to remedy an injustice in this case, because Cadmus is only trying to pierce BCI’s corporate veil to further Bardos’s self-dealing. (See Dickson, Carlson &
Campillo v. Pole (2000) 83 Cal.App.4th 436, 446 [“One who comes into equity must come with clean hands.”].

D. SUBSTANTIAL COMPLIANCE

Cadmus contends that if it was not properly licensed, then there is evidence it fulfilled the substantial compliance requirements. We disagree.

Palms contends Cadmus waived the substantial compliance argument by not raising it at the trial court. Cadmus asserts it can argue the theory on appeal, because in Palms’s motion for summary judgment, Palms argued “any attempt by Cadmus . . . to utilize the doctrine of substantial compliance is without merit.” Since the issue was raised in the motion for summary judgment we will address the merits of the contention.

“Section 7031, subdivision (e), provides the sole exception to the contractor’s licensure requirements.” (WSS Industrial Construction, Inc. v. Great West Contractors, Inc. (2008) 162 Cal.App.4th 581, 588.) It permits a court to find there has been “substantial compliance with licensure requirements . . . if it is shown at an evidentiary hearing that the person who engaged in the business or acted in the capacity of a contractor (1) had been duly licensed as a contractor in this state prior to the performance of the act or contract, (2) acted reasonably and in good faith to maintain proper licensure, (3) did not know or reasonably should not have known that he or she was not duly licensed when performance of the act or contract commenced, and (4) acted promptly and in good faith to reinstate his or her license upon learning it was invalid.” (§ 7031, subd. (e).)
As to the first factor, Cadmus was not licensed in the State of California prior to the construction. However, Cadmus was a sole proprietorship, and Bardos was the 100 percent owner. “[A] sole proprietorship is not a legal entity separate from its individual owner.” So, an individual’s contractor’s license can be used to perform work in the name of the sole proprietorship. (Ball, supra, 196 Cal.App.4th at p. 701.) BCC was a sole proprietorship owned by Bardos. BCC was issued a contractor’s license in 1981; however, the license became inactive in 1988. Since Bardos previously had a contractor’s license in the name of BCC, a sole proprietorship, then he arguably had been licensed prior to the work performed for Palms.

As to the second factor—acting reasonably and in good faith to maintain proper licensure—there is nothing indicating Cadmus tried to maintain or obtain a proper license until the end of the construction. The construction contract was dated March 12, 2007. The construction was completed around the end of June 2007. Cadmus applied for a contractor’s license in its name on June 25, 2007. Cadmus entered into a contract and was nearing completion of the contract before it applied for a license. Thus, it appears the second requirement is not satisfied because Cadmus did not reasonably and in good faith maintain a proper license—it waited until construction was nearly completed to submit an application for a license.

Cadmus contends it satisfied the second requirement because BCI maintained an active license and Palms told Cadmus it did not need a contractor’s license to perform work on tribal land. The problem with Cadmus’s argument is that BCI is its own distinct legal entity. Therefore, the fact that BCI held a license does not show Cadmus
was acting reasonably and in good faith to maintain proper licensure—they are two separate entities.

Further, Bardos’s evidence that Palms informed him a license was not needed is contradicted by Bardos’s testimony and Cadmus’s license application. (Guthrey v. State of California (1998) 63 Cal.App.4th 1108, 1120 [A party cannot evade summary judgment by creating its own contradictions in the evidence.].) At his deposition, when Bardos was asked if he informed anyone at Palms that he was operating under BCI’s license, he responded, “I had no obligation to do that. [¶] . . . [¶] I didn’t need to. They had private investigators.” Bardos’s testimony reflects Cadmus’s license status was not a topic of conversation. Bardos’s assertion is further contradicted by his license application dated June 25, 2007. Bardos stated Cadmus was created solely for the sake of hiding his self-dealing from Worth Group, and Cadmus has only ever performed work for Palms. Thus, Cadmus’s application for a license reflects a belief that a license was needed for work on tribal land, because Cadmus never worked for anyone other than Palms. Accordingly, Bardos’s own statements and Cadmus’s license application contradict Cadmus’s assertion that it acted in good faith because it did not believe it needed a license.

In the third factor, it must be shown that the contractor “did not know or reasonably should not have known that he or she was not duly licensed when performance of the act or contract commenced.” (§ 7031, subd. (e).) Bardos stated that he knew Cadmus did not have the appropriate license, and he believed Cadmus was operating under BCI’s license. Thus, Cadmus was aware it did not have a license,
because it was attempting to share a license with a different entity—BCI. Accordingly, the third factor is not satisfied, because it requires Cadmus to not know that it was unlicensed; in this case, Cadmus knew it was unlicensed.

Cadmus sets forth the following argument related to the third factor: “[Cadmus] was operating under the reasonable belief that a license was not required for this work. If a license was not required, then he was duly licensed.” Cadmus is missing the thrust of the third requirement, which is, did the contractor not know it was unlicensed? The evidence reflects Cadmus knew it was unlicensed prior to commencing work for Palms. In Bardos’s declaration, he explained he did not seek a license for Cadmus prior to starting the construction work because Palms requested Cadmus “immediately commence work.” Given the evidence, we are not persuaded Cadmus was unaware that it was unlicensed.

The fourth factor is concerned with whether Cadmus acted promptly and in good faith to reinstate its license upon learning it was invalid. (§ 7031, subd. (e).) Cadmus’s construction contract is dated March 12, 2007. The construction was completed around the end of June 2007. Cadmus applied for a contractor’s license in its name on June 25, 2007. Cadmus knew when it began performing the construction work that it was unlicensed, but it waited for months and until the construction work was nearly completed to apply for a license. Thus, the evidence reflects Cadmus did not act promptly to obtain its license.
Cadmus asserts it acted promptly by trying to reactivate BCC’s license. In Bardos’s declaration, he declared, “I submitted an application to extend the active license for [BCC] to create a new license for Cadmus . . . prior to June 25, 2007.” A “Certification of Records” related to BCC’s contractor’s license, covering the period from January 1, 1983, through January 12, 2010, reflects BCC’s license became inactive in 1988 and remained inactive through January 12, 2010. There is nothing indicating that BCC’s license was reactivated in 2007. Thus, it is unclear exactly when Cadmus tried to activate a license, if not June 25, 2007. Accordingly, we find Cadmus’s argument to be unpersuasive.

In sum, there is not a triable issue of fact on the issue of substantial compliance. There is not a triable issue of fact related to the second factor because there is nothing indicating Cadmus acted reasonably and in good faith to maintain proper licensure. There is not a triable issue of fact related to the third factor because the evidence reflects Cadmus knew it was unlicensed. There is not a triable issue of fact for the fourth factor because the evidence reflects Cadmus did not act promptly to obtain its license.

E. ESTOPPEL

Cadmus contends Palms should be estopped from relying on section 7031, because Palms told Cadmus state licensing laws did not apply to their transaction. We disagree.

Cadmus relies on the following rule: “Whenever a party has, by his own statement or conduct, intentionally and deliberately led another to believe a particular thing true and to act upon such belief, he is not, in any litigation arising out of such
statement or conduct, permitted to contradict it.”  (Evid. Code, § 623.)  The foregoing rule is a codified portion of the equitable estoppel doctrine.  (Superior Dispatch, Inc. v. Insurance Corp. of New York (2010) 181 Cal.App.4th 175, 186-187.)  As set forth ante, equitable principles may not be used to circumvent Business and Professions Code section 7031.  (Montgomery Sansome LP v. Rezai, supra, 204 Cal.App.4th at p. 794; see also MW Erectors, supra, 36 Cal.4th at p. 423.)  As a result, Cadmus may not rely on the codified equitable estoppel doctrine to defeat summary judgment.

Nevertheless, if Cadmus could rely on equitable estoppel, we would disagree with the merits of the argument.  Cadmus contends Palms informed Cadmus it did not need a contractor’s license due to the tribe’s sovereign immunity.  The flaw in Cadmus’s argument is that the conflict in the evidence on this point is created by Bardos himself.  (See Guthrey v. State of California, supra, 63 Cal.App.4th at p. 1120 [A party cannot evade summary judgment by creating its own contradictions in the evidence.].)

At his deposition, when Bardos was asked if he informed anyone at Palms that he was operating under BCI’s license, he responded, “I had no obligation to do that.  [¶]  I didn’t need to.  They had private investigators.”  This evidence contradicts an assertion that Cadmus’s license was a topic of conversation.  The claim is further contradicted by the evidence that Cadmus applied for a contractor’s license on June 25, 2007.  Bardos stated Cadmus was created solely for the sake of hiding his self-dealing from Worth Group, and Cadmus has only ever performed work for Palms.  If Cadmus only ever performed work for Palms, then Cadmus had to know a license was needed to work for Palms, otherwise it would not have applied for a license since Cadmus only
existed to hide Bardos’s self-dealing while working for Palms. Thus, the evidence reflects there is not a triable issue related to equitable estoppel because the contradictions in the evidence were created by Bardos and Cadmus.

DISPOSITION

The judgment is affirmed. Twenty-Nine Palms Enterprises Corporation is awarded its costs on appeal.

MILLER J.

We concur:

RICHLI Acting P. J.

KING J.
IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
FOURTH APPELLATE DISTRICT
DIVISION TWO

TWENTY-NINE PALMS ENTERPRISES CORPORATION,

Plaintiff and Respondent,

v.

PAUL BARDOS,

Defendant and Appellant.

E051769
(Super.Ct.No. CIVRS908132)

The County of San Bernardino

THE COURT

A request having been made to this court pursuant to California Rules of Court, rule 8.1105, for publication of a nonpublished opinion filed in the above entitled matter on October 11, 2012, and it appearing that the opinion meets the standard for publication as specified in California Rules of Court, rule 8.1105(c),

IT IS ORDERED that said opinion be certified for publication pursuant to California Rules of Court, rule 8.1105(b).

CERTIFIED FOR PUBLICATION

MILLER

We concur:

RICHLI

Acting P. J.

KING
CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

RICHARD ALLEN,

   Plaintiff and Appellant,

v.

EDITH MARLYNNE STODDARD, as
Administrator, etc.,

   Defendant and Respondent.

G046460

(Super. Ct. No. 30-2011-00501331)

OPINION


Law Offices of Joel J. Loquvam & Associates and Joel J. Loquvam for Plaintiff and Appellant.

This case of first impression requires us to directly confront the issue of whether Probate Code section 9353 irreconcilably conflicts with Code of Civil Procedure section 366.3.¹ We determine they do conflict on the very narrow point of how much time a claimant against an estate has to file suit based on a promise to make a distribution from the estate, such as a contract to make a will. Section 9353 gives claimants 90 days from rejection of the claim by the estate to file suit; section 366.3 gives them a year from decedent’s death to file suit. Under the longstanding rule of construction that newer and more specific statutes take precedence over older and more general statutes, we conclude it is section 366.3’s time limit that controls.

The practical effect of our determination is that plaintiff Richard Allen’s suit for breach of contract to make a will, filed 91 days after rejection by the estate of his creditor’s claim but within a year of the decedent’s death, is not time-barred. The judgment of dismissal in favor of the estate, predicated solely on the application of section 9353’s 90-day time frame to file suit, must therefore be reversed.

FACTS

This case comes to us on a judgment of dismissal after the defendant’s demurrer was sustained without leave to amend, so we accept as true all facts pled in the complaint. (Guzman v. County of Monterey (2009) 46 Cal.4th 887, 894; Marshall v. Gibson, Dunn & Crutcher (1995) 37 Cal.App.4th 1397, 1403.) We also accept as true other relevant, judicially-noticeable facts outside the complaint. (Jocer Enterprises, Inc. v. Price (2010) 183 Cal.App.4th 559.) In this case, the relevant, judicially-noticeable

¹ Undesignated references to any section 9000 through 9353 in this opinion are to the Probate Code. Any undesignated references to section 366.3 or to section 366.2 are to the Code of Civil Procedure.
facts we accept as true concern the nature, presentation and ultimate rejection of a creditor’s claim presented by plaintiff Richard Allen.

James Humpert died October 29, 2010. Humpert had been in a stable, long-term committed relationship with plaintiff Richard Allen, and during that relationship Humpert had promised Allen he “would be taken care of” should “anything happen” to Humpert. It is undisputed Humpert died intestate, and there is no evidence Allen and Humpert ever registered as domestic partners, or married during that brief period in 2008 when same-sex couples could marry.  

Allen filed a petition with the probate court to be appointed administrator of Humpert’s estate, but Humpert’s sister, Edith Marlynne Stoddard, filed an opposing petition, and she prevailed. Hence, as administrator of Humpert’s estate she is the named defendant in this case.

In April 2011, a little more than five months after Humpert died, Allen filed a creditor’s claim against Humpert’s estate based on the “would be taken care of” promise made by Humpert. (There is no issue of late notice in making this claim on the estate.) The next month, on May 19, 2011, the estate sent a formal notice of rejection of Allen’s claim.

Allen filed this action on August 18, 2011, which, given the 31 days that hath both May and July, ended up being exactly 91 days from May 19, 2011.  

Stoddard,  

There was a 143-day window in 2008 during which same sex couples could marry, extending from the effective date of our Supreme Court’s decision in In re Marriage Cases (2008) 43 Cal.4th 757 (Marriage Cases) to the passage of Proposition 8 in November of the same year. (See Perry v. Brown (9th Cir. 2012) 671 F.3d 1052, 1079.) This case, however, raises no issue of equal protection based on Humpert and Allen’s legal inability to marry under California law until the effective date of the Marriage Cases decision. The nature of Allen’s claim is solely contractual, based on Humpert’s promise to insure Allen would be “taken care of” after Humpert’s death.

This is perhaps an example of the misleading effect of a mandatory Judicial Council rejection form (DE-174), noted by the Rutter Group Probate Treatise to be a “trap for the unwary.” (See Ross & Moore, Cal. Practice Guide: Probate (The Rutter Group 2011) ¶ 8:98.4, p. 8-49 (Rutter Group Probate Treatise).) The rejection form states that the claimant has “three months” – as distinct from 90 days – to file suit. (Ibid.)
as estate administrator, successfully demurred to the complaint based on it being untimely under section 9353, subdivision (a)(1). A judgment of dismissal ensued, and Allen timely filed this appeal.

DISCUSSION

Preliminarily, we note a small matter not raised by either party. The entire battle at the trial level concerned the operation of section 9353, and specifically whether the time to file a suit might be extended for five days since the notice of rejection was served by mail. (Cf. Code Civ. Proc., § 1013.) Even though the suit was clearly filed within a year of Humpert’s death, the possible application of section 366.3 rather than section 9353 was not raised at the trial level at all. However, section 366.3 is the sole issue on appeal. 4

Since the effect of section 366.3 on this case presents a pristine issue of law, and since the estate makes no attempt to show any prejudice, we exercise our discretion to address the section 366.3 issue. (See People v. Rosas (2010) 191 Cal.App.4th 107, 115 [“appellate courts regularly use their discretion to entertain issues not raised at the trial level when those issues involve only questions of law based on undisputed facts”].)

A. Applicability of Section 366.3

Section 366.3 gives persons who have claims against estates based on promises to make a distribution after death (such as contracts to make a will) a full year from the date of the decedent’s death to file suit. If section 366.3 governed Allen’s claim against Humpert’s estate, his suit was timely. 5

4 Allen has abandoned any argument Code of Civil Procedure section 1013 gave him an extra five days to file this action.
5 “(a) If a person has a claim that arises from a promise or agreement with a decedent to distribution from an estate or trust or under another instrument, whether the promise or agreement was made orally or in writing,
The estate argues section 366.3 doesn’t apply at all. That is an argument readily disposed of. The gravamen of Allen’s suit is what is often called a “Marvin claim” (after Marvin v. Marvin (1976) 18 Cal.3d 660), which is an express or implied enforceable contract between two nonmarital partners, usually arising out of some sort of domestic arrangements between those partners. Marvin claims sometimes manifest themselves as breaches of contracts to make a will or other disposition from an estate when one of the nonmarital partners dies. (E.g., McMackin v. Ehrheart (2011) 194 Cal.App.4th 128, 131; see also Byrne v. Laura (1997) 52 Cal.App.4th 1054, 1064.)

The text of section 366.3 (“... a promise or agreement with a decedent to distribution from an estate ...”) squarely fits claims based on contracts, including Marvin contracts, by a decedent to provide for someone after the decedent’s death or make some other distribution of an estate. This point has been readily confirmed by case law. (McMackin, supra, 194 Cal.App.4th at pp. 136-139 [Marvin claim]; see also Estate of Ziegler (2010) 187 Cal.App.4th 1357, 1365 [claim to receive home on decedent’s death]; Stewart v. Seward (2007) 148 Cal.App.4th 1513, 1519 [claim based on promise to execute will leaving partial interest in property to claimant]; Embree v. Embree (2004) 125 Cal.App.4th 487, 492 [claim based on provision in marital settlement agreement to establish a trust or annuity to pay spousal support after decedent’s death].)

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an action to enforce the claim to distribution may be commenced within one year after the date of death, and the limitations period that would have been applicable does not apply.

“(b) The limitations period provided in this section for commencement of an action shall not be tolled or extended for any reason except as provided in Sections 12, 12a, and 12b of this code, and former Part 3 (commencing with Section 21300) of Division 11 of the Probate Code, as that part read prior to its repeal by Chapter 174 of the Statutes of 2008.

“(c) This section applies to actions brought on claims concerning persons dying on or after the effective date of this section.”
B. Applicability of Section 9353

The estate also argues that section 9353 does apply, and therefore its 90-day-from-date-of-rejection time limit bars Allen’s suit. This argument is not so readily disposed of.

We first review the formidable array of Probate Code statutes bearing on the requirement imposed on persons with claims on estates to file creditor’s claims with those estates. (Cf. generally Rutter Group Probate Treatise, supra, ¶¶ 8:1-8:11.2, pp. 8-1 through 8-13.)

Section 9000, subdivision (a)(1) defines claim to mean “a demand for payment for any of the following, whether due, not due, accrued or not accrued, or contingent, and whether liquidated or unliquidated: (1) Liability of the decedent, whether arising in contract, tort or otherwise.” (Italics added.)

Section 9000, subdivision (c) defines creditor to mean “a person who may have a claim against an estate.” Claims that are not filed with estates as provided in Part 4 of the Probate Code are “barred.” (§ 9002.)

Section 9002 provides that creditors who have claims against estates must, unless otherwise excused by statute, file those claims as provided in the Probate Code.6

Section 9351 precludes suit against an estate unless a claim has first been filed with the estate and the claim has been rejected in whole or part.7

These requirements then culminate in section 9353. Section 9353 says, plainly, that regardless of any other statute of limitations, any claimant against an estate has 90 days after notice of rejection of the claim by the estate to file suit.

6 “Except as otherwise provided by statute: [¶] (a) All claims shall be filed in the manner and within the time provided in this part. [¶] (b) A claim that is not filed as provided in this part is barred.” (Italics added.)

7 “An action may not be commenced against a decedent’s personal representative on a cause of action against the decedent unless a claim is first filed as provided in this part and the claim is rejected in whole or in part.” (Italics added.)
It is not surprising, then, that a claim for breach of an agreement to make a distribution from an estate has been squarely held to be a “claim” within the meaning of section 9000, and therefore a creditor’s claim was required before the claimant could state a cause of action in a lawsuit on that claim. (Wilkison v. Wiederkehr (2002) 101 Cal.App.4th 822, 829, 832.8)

And there is no basis in the texts of sections 9000, 9002, 9051 and 9053 to say that claims against estates based on promises by decedents to make wills are not within those statutes. Allen suggests that section 9000, subdivision (b) somehow removes such claims (which include Marvin claims) from the ambit of the word “claim” as defined in subdivision (a), but that argument is unavailing. The text just doesn’t fit. Subdivision (b) provides: “Claim’ does not include a dispute regarding title of the decedent to specific property alleged to be included in the decedent’s estate.” (Italics added.) There is nothing in a general promise to “take care” of a domestic partner after one’s death which implicates “title” to “specific property.”

In short, if section 9353, rather than section 366.3, controls the date of the filing of Allen’s suit, affirmance is required.

C. The Anomaly

So, does or does not, section 366.3 conflict with section 9353? The answer is: It does, but section 366.3 does not necessarily conflict with the sections of the Probate Code governing claims against estates involving matters other than the statute of limitations involving contracts to make a will. But to explain why, we must confront and resolve an anomaly that has arisen in the case law. The anomaly is this: Under Wilkison, a claim based on a contract to make a will is a claim within the meaning of section 9000 and therefore section 9353 should govern the statute of limitations, but Stewart says a

8 Wilkison’s thinking was the claimant had an adequate remedy at law for breach of the contract by filing a claim with the estate, and in the absence of such a filed claim, he could not maintain a legal action based on the contract breach. (Wilkison, supra, 101 Cal.App.4th at pp. 833-834.)
claim based on a contract to make a will is not a claim against the estate at all,\(^9\) and thus implies section 9353 has nothing to do with the statute of limitations on suits against estates based on contracts to make a will. And here’s the real problem: The conflict cannot be solved simply by saying *Wilkison* was decided before section 366.3 was applicable, because section 366.3 ushered in no change in the language of the Probate Code sections – particularly section 9000 which defines claims and creditors – that plainly apply to claims against estates based on contracts to make a will. And furthermore, the actual text of section 366.3 does not include any language that allows one to say suits based on contracts to make a will are not otherwise governed by the Probate Code sections. The text of section 366.3 doesn’t say anything to the effect that claims against estates based on contracts to make a will are not claims within the meaning of section 9000.\(^{10}\)

The anomaly is only resolved by recognizing that *Stewart’s* comment that the claimant there “was not a creditor of the estate” was simply dicta. The central point of the *Stewart* case was that the claim there fell within the meaning of section 366.3, not section 366.2. The point was important because the claimant’s only hope was to fit her claim within 366.2, which has tolling provisions section 366.3 doesn’t have.\(^{11}\) Because

\(^9\) The language: “We reject Stewart’s theory she was a ‘creditor’ of the estate of Wilmer Koontz (Wilmer) and that, following the administrator’s rejection of her ‘creditor’s claim,’ the cause of action came within the tolled or extended statute of limitations of section 366.2. The trial court properly determined Stewart’s action arose, not from her status as a ‘creditor,’ but from Wilmer’s alleged breach of a ‘promise or agreement with a decedent to distribution from an estate’ within the meaning of section 366.3, subdivision (a) and, accordingly, that statute’s one-year statute of limitations applied.” (*Stewart, supra*, 148 Cal.App.4th at p. 1515.)

In fact, based on this language, the Rutter Probate Treatise has opined that claims covered by section 366.3 are outside of the Probate Code claim-filing provisions altogether. (Rutter Probate Treatise, *supra*, ¶ 8:98.3, p. 8-49, citing *Stewart, supra*, 148 Cal.App.4th at p. 1515 [“a plaintiff suing on a cause of action within the purview of § 366.3 is not even a ‘creditor’ subject to the Probate Code claim-filing provisions”].)

\(^{10}\) The first part of section 366.3 says if you have a claim based on a promise to make a will you’ve got one year from the decedent’s death to sue. The second part is inapplicable to the present case – it provides for a tiny amount of tolling and extension for mechanical, computational reasons, or involving now-outdated will contest rules. And the third part merely makes section 366.3 applicable to death dates after 2001.

\(^{11}\) The claim in *Stewart* was under consideration by the estate for a week. She was two days late in filing suit under section 366.3. If the tolling provisions of section 366.2 had applied, the claimant would have found those two days and a few more to spare. (See *Stewart, supra*, 148 Cal.App.4th at pp. 1521-1523.)
her claim fell “squarely” within section 366.3, and section 366.3 allows for virtually no
tolling at all, her suit was time-barred. (Stewart, supra, 148 Cal.App.4th at pp. 1522-
1523.) The court could have reached that determination without adding the thought,
contained in the introductory part of the opinion but otherwise never developed, that the
plaintiff never was a “creditor” in the first place.

A statutory scheme in which “claims” within the scope of section 366.3 are
not held to be “claims” within section 9000 is inconsistent with all applicable statutes and
at least one prior Court of Appeal decision. 12 We therefore part company with the
redoubtable Rutter Group Probate Treatise when, relying on Stewart, it says claims
within section 366.3 are not claims “subject to the claim-filing requirements” of the
Probate Code. (Cf. Rutter Group Probate Treatise, supra, ¶ 8:11:5, p. 8-13 with ¶ 8:98.3,
p. 8-49.)

But we must take one more step. No case of which we are aware has
applied section 366.3 to countermand the competing 90-day statute of limitations in
section 9353. 13 We now take that step.

Insofar as section 9353 and section 366.3 provide for different times within
which a claimant must file suit on a claim within section 366.3, the two statutes cannot be
reconciled. Section 9353 begins with the words, “Regardless of whether the statute of

12 But note that sections 366.2 and section 366.3 do nicely dovetail with each other. Section 366.2 is
written to apply to claims that clearly arise before a decedent’s death, while section 366.3 is written so that it can
only apply to claims that arise on or after a decedent’s death.

13 A line of cases, of which Stewart is one, have, up to now, applied section 366.3 to bar lawsuits
filed more than a year after the decedent’s death. (See Stewart, supra, 148 Cal.App.4th at pp. 1516, 1519-1523
[decedent died October 26, 2004, claimant filed suit October 28, 2005, held: section 366.3 applied, there was no
tolling, and the suit was time-barred under section 366.3]; Ziegler, supra, 187 Cal.App.4th at pp. 1361, 1366
[decedent died January 15, 2006, claimant filed petition in September 2007, held: section 366.3 applied and time-
barred claim filed in probate]; McMackin, supra, 194 Cal.App.4th at pp. 131, 139 [decedent died October 1, 2004,
suit against estate filed January 13, 2010, held: section 366.3 applied and time-barred suit]; Embree, supra, 125
was covered by section 366.3 and time-barred].)

One case, Ferraro v. Camarlinghi (2008) 161 Cal.App.4th 509, 554-559, has expressly held a
civil action to be timely under section 366.3 because it was filed just three months after decedent stepmother’s
death.
limitations otherwise applicable to a claim will expire before or after the following times . . . ,” while section 366.3 affirmatively declares that an action “to enforce the claim to distribution may be commenced within one year after the date of death, and the limitations period that would have been applicable does not apply.”

The precise conflict can be resolved for purposes of this case by the well-established rule that where statutes are in irreconcilable conflict, a specific and later enacted statute trumps a general and earlier one. (See Collection Bureau of San Jose v. Rumsey (2000) 24 Cal.4th 301, 310 [“If conflicting statutes cannot be reconciled, later enactments supersede earlier ones . . . and more specific provisions take precedence over more general ones”].)

Section 9353 is a general statute. It applies on its face to all claims. Section 366.3 is a specific statute, applying only to a narrow class of claims. Section 9353 was enacted in 1991, about a decade earlier than section 366.3. (Compare Stats 1990, ch. 79, p. 794 and West’s Cal. Leg. Service, 2000, ch. 17, p. 54.) Thus, if they cannot be reconciled, section 366.3 prevails over section 9353. (Collection Bureau of San Jose v. Rumsey (2000) 24 Cal.4th 301, 310 [“If conflicting statutes cannot be reconciled, later enactments supersede earlier ones . . . and more specific provisions take precedence over more general ones”].)

We hold the two statutes cannot be reconciled on the narrow point of when suit must be filed. But we do not go beyond that. This case involves a claimant who filed a timely claim with the estate pursuant to sections 9002 and 9353, but who did not file a timely suit under section 9353. Since the suit was timely under section 366.3 and section 366.3 trumps section 9353 on the topic of suits, the suit here is timely.

We need not take the step in this case of trying to articulate a unified theory of the relationship between the Probate Code claim-filing requirements and section
366.3.  We only decide the case before us. (See Lawson v. Management Activities, Inc. (1999) 69 Cal.App.4th 652, 655.) And we recognize that by deciding only the case before us we may leave the relationship between sections 9351 and 366.6, to use the argot of science fiction, a bit wibbly wobbly in certain particulars. For example, we do not deal with the case where a suit might be timely under section 366.3, but there has been no claim to the estate, and thus no compliance with section 9351 at all. (Cf. Wilkison, supra, 101 Cal.App.4th 822 [no suit allowed because no creditor’s claim filed with estate at all].) Nor do we deal with the obvious problem of a estate that somehow tries to run out the clock on section 366.3. (Cf. Stewart, supra, 148 Cal.App.4th at p. 1524 [rejecting argument that reliance by estate on mandatory judicial council form constituted some form of waiver of right to assert 366.3’s one-year statute of limitations].) It may be there are still unexplored circumstances where section 9351 simply cannot be reconciled with section 366.3.

But those are tomorrow’s cases. Sufficient unto this case are its own complexities. Perhaps the Legislature will make things clearer in the meantime. For now, this suit was timely.

DISPOSITION

The judgment is reversed. Because this court’s reversal of the dismissal based on a statute of limitations is, in essence, an interlocutory determination – the estate may yet prevail on the merits of Allen’s claim – we exercise our discretion to not award appellate costs to the winner of this early round. Rather, the trial judge will have the discretion, when the final judgment is entered, to accord the appellate costs in this

14 One virtue of the Stewart dicta is that it does imply a bright line theory of claims against estates based on contracts to make a will – they simply are outside the universe of sections 9000 et seq. of the Probate Code. But saying so is a step we will leave to the Legislature. After all, does the Legislature really want all estates to remain open to possibly unknown claims a year after the decedent’s death, no matter how diligent an executor or administrator might be in giving notice to creditors? (Cf. Prob. Code, §§ 9050 et seq.) If so, it is for the Legislature to say so.
proceeding to the ultimately prevailing party. (See Root v. American Equity Specialty

BEDSWORTH, J.

WE CONCUR:

RYLAARSDAM, ACTING P. J.

MOORE, J.
In this quiet title action, plaintiff Kelly C. Wooster sought to establish that property he owns in Calaveras County is free and clear of a conservation easement recorded on the property over 30 years ago either because the Department of Fish and Game (the department) failed to post no hunting and no trespassing signs on the property as required by the conservation easement deed and agreement or because the grant of hunting rights to the department was void from the outset. The trial court sustained the department’s demurrer without leave to amend and dismissed the action.

On Wooster’s appeal, we agree with the trial court that Wooster is not entitled to the relief he seeks. Even if the department failed to comply with its obligation to post signs on the property, that failure did not extinguish the conservation easement or give
Wooster a basis for rescinding the easement. Furthermore, the grant of hunting rights to the department, so that the department could prohibit all hunting on the property, was entirely legal and consistent with the statutes governing conservation easements. Accordingly, we will affirm the judgment of dismissal.

FACTUAL AND PROCEDURAL BACKGROUND

Taking the factual allegations in Wooster’s second amended and supplemental complaint as true, Wooster owns approximately 4,535 acres of real property in Calaveras County, consisting of the Ranch Mine and the Stackpole (jointly the property). In 1981, the prior owners of the property and the department executed and recorded a conservation easement deed and agreement (the deed) with respect to the property. The declarations in the deed specified that the owners and the department “desire[d] to preserve and protect [the property], for wildlife conservation purposes . . . and to prevent, in accordance with the terms contained [in the deed], said property from degradation of fish and wildlife habitat due to residential, industrial or other uses detrimental to such purposes.” The declarations further specified that the owners would be able to continue using the land for grazing livestock, which was compatible with wildlife preservation, and would be able to develop the mineral rights on the property in the future.

Following these declarations, the deed granted to the department “full development and hunting rights in the form of a conservation easement over the . . . property subject to [certain] conditions” thereafter set forth. Five paragraphs then described rights retained by the owners. The sixth and seventh paragraphs described rights to access and to make improvements that were granted to the department. The eighth paragraph clarified that the department’s access rights did not include “the right of access for the general public over any portion of the . . . property.” The ninth paragraph then specified that the department “shall post the property at all points of entry to inform the public that said property is a State wildlife area and that no trespassing or hunting is
allowed.”¹ The 10th paragraph made clear that the department was under no obligation to make any improvements or repairs or perform any maintenance “other than signing as noted in Clause 9 of this agreement.” Finally, the 11th paragraph dealt with indemnity.

The department did not keep the property posted as required by the deed. In the absence of the required signs, people trespassed on the Ranch Mine, and it appeared that a marijuana growing operation was set up there.

In May 2009, Wooster acquired the Ranch Mine portion of the property. In January 2010, Wooster commenced this action against the department by filing a complaint to quiet title, for rescission and cancellation, and for declaratory relief. Wooster sought to rescind the deed because the department did not comply with the posting requirement. Wooster also claimed the department was “not authorized to accept a grant of ‘full hunting rights’” and such a grant was “inconsistent with the purposes of a conservation easement.”

The department demurred. The trial court sustained the demurrer with leave to amend as to the cause of action for rescission and cancellation of the deed on the ground there were “insufficient allegations of fraud or undue influence to support [such] a cause of action.”

The parties subsequently agreed Wooster could file a supplemental complaint alleging that Wooster had, since the filing of the original complaint, acquired the Stackpole portion of the property. Thereafter, in June 2010, Wooster filed a first amended and supplemental complaint. Again, the department demurred. This time, the trial court sustained the demurrer as to all causes of action with leave to amend.

In October 2010, Wooster filed his second amended and supplemental complaint. The department demurred again. The department also filed a motion to strike each of the

¹ We will refer to this as the posting requirement.
causes of action in the complaint. This time, the trial court sustained the demurrer without leave to amend as to the first five causes of action. On the cause of action for nonperformance of a condition, the trial court concluded Wooster had failed to allege sufficient facts to show that the posting requirement was a condition subsequent to requiring forfeiture of the department’s interest in the property. On the illegal contract cause of action, the court concluded Wooster had failed to allege sufficient facts to demonstrate that the conveyance of full development and hunting rights to the department was an illegal conveyance. On the two rescission causes of action, the trial court concluded Wooster had failed to sufficiently allege undue influence, fraud, or illegality in the creation of the conservation easement. Finally, the court concluded the quiet title cause of action failed because it was “solely dependent upon [Wooster] establishing the preceding four causes of action.” As to the remaining cause of action for declaratory relief, the trial court ruled the action could proceed on that cause of action because a “request for a declaration as to the respective rights of the parties under the conservations easement is appropriate.” The court also denied the motion to strike.

In February 2011, the department moved to strike the cause of action for declaratory relief on the ground that the only controversies alleged involved the same contentions asserted in the causes of action as to which the court had sustained the department’s demurrer without leave to amend. Wooster opposed the motion to strike but acknowledged that, depending on the basis for the court’s ruling as to the illegal contract cause of action, the motion might be well taken. Noting that the time for a motion for reconsideration had passed, the trial court denied the motion to strike.

In April 2011, the department tried again, filing a motion for reconsideration or, in the alternative, a renewed motion to strike. This time, in an attempt to clarify its original ruling overruling the demurrer on the declaratory relief cause of action, the trial court granted the motion to strike that cause of action in part, striking certain portions of the cause of action so that all that remained was the allegation that “[a] judicial determination
and declaration is appropriate and necessary in order that the parties may ascertain their respective rights and duties with respect to the Property.”

Recognizing that the trial court’s ruling had gutted the sole remaining cause of action, the department prepared a formal order that acknowledged that the court’s ruling left “no remaining controversy alleged in the sixth cause of action . . . that would support the rendering of a declaratory judgment” and which provided that the declaratory relief cause of action was “stricken in its entirety.” Wooster’s attorney approved the order, and the court signed it.

Thereafter, in June 2011, the trial court entered a judgment of dismissal. Wooster timely appealed.

DISCUSSION

I

Conservation Easements

“Conservation easements are negative easements that impose specific restrictions on the use of the property” they cover. (Johnston v. Sonoma County Agricultural Preservation & Open Space Dist. (2002) 100 Cal.App.4th 973, 976.) By statute, a conservation easement is “any limitation in a deed, will, or other instrument in the form of an easement, restriction, covenant, or condition, which is or has been executed by or on behalf of the owner of the land subject to such easement and is binding upon successive owners of such land, and the purpose of which is to retain land predominately in its natural, scenic, historical, agricultural, forested, or open-space condition.” (Civ.

2 Most significant was the fact that following the “partial” granting of the motion to strike, there no longer remained any allegation in the declaratory relief cause of action that there was an actual controversy between the parties, which is a necessity for such a cause of action. (See Code Civ. Proc., § 1060 [providing that an action for declaratory relief may be brought “in cases of actual controversy relating to the legal rights and duties of the respective parties”].)

5
Code, § 815.1.) “A conservation easement is an interest in real property voluntarily created and freely transferable in whole or in part for the purposes stated in Section 815.1 by any lawful method for the transfer of interests in real property in this state.” (Id., § 815.2, subd. (a).) “A conservation easement shall be perpetual in duration” (id., subd. (b)) and “shall not be deemed personal in nature and shall constitute an interest in real property notwithstanding the fact that it may be negative in character” (id., subd. (c)). “The particular characteristics of a conservation easement shall be those granted or specified in the instrument creating or transferring the easement.” (Id., subd. (d).)

A state agency may acquire a conservation easement “if otherwise authorized to acquire and hold title to real property and if the conservation easement is voluntarily conveyed.” (Civ. Code, § 815.3, subd. (b).)

II

Condition Subsequent Or Covenant?

On appeal, Wooster contends that, contrary to the trial court’s ruling, the posting requirement was a condition subsequent to the granting of the conservation easement, such that the department’s failure to comply with that requirement resulted in the department’s forfeiture of the easement. We disagree.

“A condition subsequent is one referring to a future event, upon the happening of which the obligation becomes no longer binding upon the other party, if he chooses to avail himself of the condition.” (Civ. Code, § 1438.) With respect to interests in real estate in particular, “[c]onditions subsequent are those which in terms operate upon an estate conveyed and render it liable to be defeated for breach of the conditions. Such conditions are not favored in law because they tend to destroy estates, and no provision in a deed relied on to create a condition subsequent will be so interpreted if the language of the provision will bear any other reasonable construction. While no precise form of words is necessary to create a condition subsequent, still it must be created by express terms or by clear implication.” (Hawley v. Kafitz (1905) 148 Cal. 393, 394; see also Civ.
Code, § 1442 [“A condition involving a forfeiture must be strictly interpreted against the party for whose benefit it is created”].

Like other interests in real property, “[a]n easement may be conveyed subject to conditions subsequent and extinguished if they occur.”  (City of Manhattan Beach v. Superior Court (1996) 13 Cal.4th 232, 260 (conc. & dis. opn. of Mosk, J.).)  Here, the deed granting the conservation easement to the department provided, as one of many “conditions,” that the department was to post the property with no trespassing and no hunting signs.  The question is whether this provision was intended to operate as a condition subsequent, such that the department’s failure to comply with the posting requirement would result in the extinguishment of the conservation easement, or instead was intended to operate only as a covenant, the breach of which could give rise to a cause of action for breach of contract but would not result in extinguishment of the easement.

Referring to the passage in Hawley, quoted above, Wooster argues as a threshold matter that the rule of strict construction against conditions subsequent does not apply here because “the reason for [that rule] is that [such] conditions ‘tend to destroy estates,’ ” and here “[a]ll defendants will lose is an easement,” which “‘is not an estate in land.’ ”  We are not persuaded.  The rule against construing language in a deed as a condition subsequent is merely a specific application of the more general rule that “[t]he law abhors forfeitures.”  (Lamont v. Ball (1949) 93 Cal.App.2d 291, 294.)  It does not matter that what would be forfeited here would be a conservation easement, rather than an “estate.”  As our Supreme Court said long ago, it is “the settled policy of the law not to enforce a forfeiture in the absence of a clear statement to that effect.”  (Universal Sales Corp. v. Cal. etc. Mfg. Co. (1942) 20 Cal.2d 751, 771.)  That rule applies no matter what is subject to the alleged forfeiture.

 Turning to the substantive issue, Wooster asserts the posting requirement was intended as a condition subsequent because the deed specifically included the
requirement in the list of “conditions” to which the easement was subject. For at least
two reasons, however, that argument is not persuasive.

First, the mere use of the word “condition” does not necessarily connote a
condition subsequent. (See Gramer v. City of Sacramento (1935) 2 Cal.2d 432, 438-
439.) As we have noted, the deed of the conservation easement here included 11
paragraphs in its list of “conditions,” but, as the department points out, “[m]ost of those
clauses address rights reserved to the Grantors or conveyed to the grantee in addition to
the development and hunting rights conveyed in the granting clause, and obviously are
not intended to be conditions subsequent, the breach of which forfeits the easement.”
Just as in Gramer, here “[i]t cannot be seriously contended that the reservation[s] . . .
sought to be expressed [in these other clauses] w[ere] such by virtue of the use of the
word ‘condition’ as to create a condition subsequent.” (Gramer, at p. 439.) In other
words, it makes little sense to interpret the posting requirement as a condition subsequent
just because it appears in a list of “conditions,” when the other terms that also appear in
that list cannot be reasonably interpreted as conditions subsequent. Thus, California
Supreme Court precedent significantly undercuts Wooster’s position that, without
exception, “a grant ‘subject to’ certain conditions is a grant subject to a condition
subsequent.”

Second, the cases on which Wooster relies do not support his contention that
language in a deed making a grant “subject to” a specific “condition” necessarily creates
a condition subsequent. For example, Wooster cites Firth v. Marovich (1911) 160 Cal.
257 in support of this proposition, but in Firth the deed also specifically provided,
following the conditional language, “[t]hat any breach of the foregoing conditions, or
any of them, occurring after the delivery of this deed, shall have the effect of forfeiting
the title of the grantee and his assigns, and thereupon the title to said real property shall
revert to the grantor.” (Id. at p. 258.) In other words, the deed in Firth specifically
provided for forfeiture of title upon failure of the condition. There was no similar language in the deed here.

Wooster contends that “express language of forfeiture or reversion” is not necessary to create a condition subsequent. While that may well be true, for the posting requirement here to be reasonably construed as a condition subsequent rather than simply a covenant, there would have to be something more than the inclusion of that requirement in a list of “conditions,” most of which consist of reserved rights that can in no way be construed as establishing conditions subsequent. Wooster, however, does not (and cannot) point to any other language in the deed supporting his construction of the posting requirement as a condition subsequent.

Wooster contends that “[t]he law provides that a condition subsequent is created in situations, such as here, where damages from breach are difficult or impossible to establish.” In support of this argument, he cites *Downing v. Rademacher* (1901) 133 Cal. 220, which involved the conveyance of a mine in exchange for “one third of the gross proceeds obtained by working the mine.” (*Id.* at pp. 224-225.) We find *Downing* of little use because we do not understand that case to involve the determination of whether particular language in a deed creates a condition subsequent. In any event, even if the principal Wooster purports to derive from *Downing* was correct, it does not govern here, because damages for the department’s (alleged) breach of the posting requirement are ascertainable. Specifically, Wooster could prove his damages by proving how much it would cost to “post the property at all points of entry to inform the public that said property is a State wildlife area and that no trespassing or hunting is allowed.” That is the value of the performance Wooster was denied when the department failed to post the property as required.

To the extent Wooster posits that it would be difficult or impossible to prove consequential damages from the department’s breach -- that is, damages from trespasses that may have occurred because the department did not satisfy the posting requirement --
that problem does not support construing the posting requirement as a condition subsequent. First, it is unclear to what extent Wooster would even be entitled to claim such damages, because he could have mitigated any harm flowing from the department’s alleged breach by himself posting the signs the department was supposed to have put up. (See Valle de Oro Bank N.A. v. Gamboa (1994) 26 Cal.App.4th 1686, 1691 [“The doctrine of mitigation of damages holds that ‘[a] plaintiff who suffers damage as a result of either a breach of contract or a tort has a duty to take reasonable steps to mitigate those damages and will not be able to recover for any losses which could have been thus avoided’ ”].) Second, even assuming he might be entitled to some consequential damages that would be difficult to determine, Wooster identifies no authority supporting his contention that the difficulty in proving consequential damages supports construing language in a deed as a condition subsequent. In other words, Wooster points to no case that supports construing the language in the deed as a condition subsequent because Wooster might find it difficult or impossible to prove that the department’s failure to put up the required signs was a cause of one or more trespasses that damaged his property.

In summary, we reject Wooster’s argument that the posting requirement constituted a condition subsequent. The trial court correctly concluded that the requirement is merely a covenant, and no forfeiture of the conservation easement resulted from the department’s alleged breach of that covenant.

III

Rescission For Breach Of The Posting Requirement

Wooster contends his complaint stated a valid cause of action for rescission based on the department’s breach of the posting requirement. We disagree.

“It is settled that a deed without fraud in its inception conveys the title, and is not void for any failure of consideration, either in whole or in part. [Citation.] Acts done subsequent to the execution and delivery of a deed cannot affect its integrity, and a subsequent failure of consideration or breach of a personal covenant not amounting to a
condition, will not avoid the deed, if there was no fraud or false representation.”  (*Lavely v. Nonemaker* (1931) 212 Cal. 380, 383.) “To hold that a vendor of real property could, for a failure to pay the purchase money or other consideration, repudiate his deed and recover the land, would render real estate titles dangerously uncertain, and would result in the most serious consequences.”  (*Id.* at p. 385.)

Echoing his argument about the rule of strict construction against conditions subsequent (discussed above), Wooster contends the foregoing rule “does not apply here” because the reason for the rule is to avoid rendering real estate titles “‘dangerously uncertain,’” and here “[t]here is no issue about uncertainty of real estate titles” because “[t]he covenant . . . is in the deed itself, and, obviously, may be discovered by a title search.”

Wooster’s attempt to distinguish this case from cases like *Lavely* is without merit. It is true that in *Lavely* the breached promises upon which the plaintiff based his action to set aside the deed he had given his daughter were oral promises (see *Lavely v. Nonemaker*, *supra*, 212 Cal. at pp. 381-382), while the promise at issue here appears in the recorded deed. The rule the court applied in *Lavely* did not turn on the oral nature of the promise, however. In other words, the law does not provide that a deed cannot be rescinded based on the breach of an oral promise, but *can* be rescinded based on the breach of a written promise contained in a recorded deed. Instead, the law is that “a deed without fraud in its inception . . . is not void for any failure of consideration,” period. (*Id.* at p. 383, italics added.) This is so because the uncertainty the rule seeks to avoid is not uncertainty regarding whether a deed was based on a promise, but rather uncertainty regarding whether the consideration for a deed was, in fact, conveyed as promised. Such uncertainty would exist here as much as in any other case, because in no case can someone tell from a mere title search whether a particular covenant for which the conveyance was given has or has not been fulfilled. Here, for example, one could not determine from searching the title to the Ranch Mine and the Stackpole whether the
department had fulfilled its obligation to post no hunting and no trespassing signs on the property. Thus, allowing the breach of that promise to serve as a basis for rescission of the easement would render the conservation easement as “dangerously uncertain” as any other interest in real property subject to rescission for failure of consideration.

In short, the conservation easement here was not subject to rescission based on failure of consideration.

IV

Legality Of The Grant Of Hunting Rights

Wooster contends that to the extent the deed granted the hunting rights on the property to the department so that the department could prevent those rights from being exercised by anyone, the grant was “illegal, and unenforceable.” According to Wooster, such a grant “offends the statutory regulatory framework, as well as the policies of the law to provide for hunting opportunities” and “takes the Agreement outside the legitimization of the conservation easement statutes.” Taking each of Wooster’s arguments in turn, we reject them all.

A

Public Policy

Wooster first argues that the grant of hunting rights to the department, which amounts to a permanent ban on hunting, violates the policy of the state, which is to maintain hunting opportunities and control them by regulation. We are not persuaded.

Citing a variety of provisions from the Fish and Game Code, Wooster attempts to extract from those provisions, via selective quotations, a “public policy to control the taking of game through duly promulgated regulations.” In his view, a permanent ban on hunting “through a deed or contract” is contrary to that policy and therefore illegal.

To refute Wooster’s argument, we need only point to a few provisions that he has ignored. For example, take Fish and Game Code section 1801. Wooster emphasizes that one of the objectives expressed in that statute is “[t]o provide for the beneficial use . . . of
wildlife by all citizens of the state.” (Fish & G. Code, § 1801, subd. (b).) He further notes that another of the objectives expressed in the statute is “[t]o maintain diversified recreational uses of wildlife, including the sport of hunting.” (Id., subd. (e).) Focusing on these provisions in isolation, Wooster tries to cobble together a public policy in favor of hunting that, in his view, is contravened by the hunting ban that resulted from the conservation easement here.

Read in its entirety, however, Fish and Game Code section 1801 supports, rather than forbids, the creation of areas where wildlife can be safe from depredation by hunters. For example, the opening paragraph of the statute provides that “[i]t is hereby declared to be the policy of the state to encourage the preservation, conservation, and maintenance of wildlife resources under the jurisdiction and influence of the state.” (Fish & G. Code, § 1801.) Indeed, all of the objectives thereafter set forth in the statute are but parts of this overarching policy. Certainly, creating pockets of land where wildlife cannot be legally hunted assists in “the preservation, conservation, and maintenance of wildlife resources” and thus in no way can be considered contrary to the public policy expressed in section 1801.

As another example, Fish and Game Code section 314 provides that the Fish and Game Commission “at any time may close to the taking of any species or subspecies of bird or mammal . . . any area where, in the judgment of the commission, added protection for birds or mammals is needed to properly conserve the birds or mammals, for such time as the commission may designate.” By accepting a grant of the hunting rights on the property at issue here, so as to prevent anyone from exercising those rights in perpetuity, the department essentially has done nothing more than exercise the power granted by Fish and Game Code section 314. Again, this shows how the department’s action of accepting the conservation easement at issue here was consistent with, not contrary to, the public policy underlying the Fish and Game Code.
We need not consider this argument further. Suffice it to say that in no way does the Fish and Game Code establish a public policy that forbids the department from accepting a conservation easement for the purpose of creating an area, comparable to a game refuge, in which no hunting is allowed.3

B

Board Acquisition Of Property

Wooster next argues that a grant of hunting rights to the department is contrary to the purposes for which the department can acquire property under the Wildlife Conservation Law of 1947 (Fish & G. Code, § 1300 et seq.) (the 1947 law). Again, we disagree.

The 1947 law begins by noting that “[t]he preservation, protection and restoration of wildlife within the State is an inseparable part of providing adequate recreation for our people in the interest of public welfare.” (Fish & G. Code, § 1301.) Thereafter, the 1947 law repeatedly refers to both preservation and recreation as interrelated. (E.g., id., §§ 1345, 1347.) From this, Wooster draws the inference that the department could not accept a grant of hunting rights in order to prevent hunting because doing so “destroy[s] the main recreational use of the property.”

Wooster’s reading of the 1947 law is too narrow, however. While the law does inextricably tie preservation to recreation, it does not do so in a way that precludes the department from acquiring land, or, as here, an easement, for the purpose of preventing all hunting on that land. For example, Fish and Game Code section 1346 expressly provides that the Wildlife Conservation Board “shall . . . ascertain what lands are suitable for providing cover for the propagation and rearing in a wild state of waterfowl, shore

3 To the extent Wooster suggests in passing that the Legislature’s power to create game refuges (see Fish & G. Code, §§ 10500, 10820-10843) is exclusive, he cites no authority for that proposition, and we therefore reject it.
birds, and upland birds, and the possibilities of acquiring easements on such lands to provide such cover.” This provision authorizes just the sort of action the department took here in acquiring the hunting rights to what became Wooster’s property -- acquiring property rights to provide wildlife a “safe harbor” in which to propagate.

What Wooster’s argument ignores is the self-evident fact that creating pockets of land in which wildlife can be safe from hunting actually does serve to increase the recreational use of wildlife, including as objects of the sport of hunting. This is so because wildlife populations that can increase in the protected areas will inevitably move to unprotected areas where they can be hunted. In this manner, wildlife is preserved, protected, and restored, while at the same time the opportunities for the recreational use of that wildlife are increased.

For the foregoing reasons, there is no inconsistency between the 1947 law and the department’s acceptance of a grant of hunting rights.

C

The Civil Code

Wooster next contends that a grant of hunting rights to the department is void under certain provisions of the Civil Code involving the ownership of property. Again, Wooster is wrong.

Civil Code section 669 provides that “[a]ll property has an owner, whether that owner is the state, and the property public, or the owner an individual, and the property private.” Civil Code section 656 provides that “[a]nimals wild by nature are the subjects of ownership, while living, only when on the land of the person claiming them, or when tamed, or taken and held in possession, or disabled and immediately pursued.” Wooster contends the grant of hunting rights to the department amounts to the “extinguishment or perpetual abatement of the right to own animals on th[e] land” involved here, which “surely cannot be done under these Civil Code provisions.”
This argument has no merit. An agreed-upon ban on hunting does not extinguish, destroy, or perpetually abate anyone’s right of ownership. Under Civil Code section 656, Wooster can still claim ownership of the wild animals on his property. Under the terms of the conservation easement, however, neither he nor anyone else can lawfully hunt those animals.

Wooster contends that a hunting ban of the sort at issue here is “similar to a restrictive covenant” that “burdens, but does not benefit, the land,” and such covenants “do not run with the land” “[u]nless they fall within Civil Code [section] 1468, which [this one] does not.” In other words, he contends that because the hunting ban is not appurtenant to other property, the ban is unenforceable against him. He acknowledges that “restrictions falling within the conservation easement statutes are an exception” to this rule, but he contends the extinguishment of hunting rights has no place in a conservation easement. We turn to that issue.

D

Consistency With The Conservation Easement Statutes

As we have previously noted, by statute the purpose of a conservation easement “is to retain land predominantly in its natural, scenic, historical, agricultural, forested, or open-space condition.” (Civ. Code, § 815.1.) Wooster contends that “[p]reventing hunting does not retain land in a ‘condition’ ” and therefore the conservation easement here was not valid. We disagree. The “natural” and “historical,” not to mention “scenic,” condition of land can easily be understood as land teeming with wildlife -- as it was before the advent of men, women, and firearms. Using a conservation easement to ban hunting most certainly does help retain land in this sort of unspoiled condition. As such, a hunting ban is unquestionably a legitimate aspect and aim of a conservation easement.
V

Rescission Based On Mistake

Wooster contends his complaint stated a valid cause of action for rescission based on mistake because “the parties to the Agreement understood that the purported grant of hunting rights was legal and valid, but it was not, and the Agreement was [therefore] entered into through mistake.” (Fn. omitted.) Our conclusion above that the grant of hunting rights was legal leaves this argument bereft of any support.

For all of the foregoing reasons, we find no error in the trial court’s sustaining of the department’s demurrer without leave to amend.

DISPOSITION

The judgment is affirmed. The department shall recover its costs on appeal. (Cal. Rules of Court, rule 8.278(a)(1).)

ROBIE, J.

We concur:

RAYE, P. J.

HULL, J.
THE COURT:

The opinion in the above-entitled matter filed November 26, 2012, was not certified for publication in the Official Reports. For good cause it appears now that the opinion should be published in the Official Reports and it is so ordered.

BY THE COURT:

_________________________, P. J.
RAYE

_________________________, J.
HULL

_________________________, J.
ROBIE
EDITORIAL LISTING

APPEAL from a judgment of the Superior Court of Calaveras County, John E. Martin, Judge. Affirmed.

Christopher D. Williams, for Plaintiff and Appellant.

Kamala D. Harris, Attorney General, Kathleen A. Kenealy, Assistant Attorney General, Sara J. Russell, Supervising Deputy Attorney General, Randy L. Barrow, Deputy Attorney General, for Defendants and Respondents.
IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION ONE

LESTER J. KNISPEL, as Trustee, etc.,
Plaintiff and Appellant,
v.

TRANSNATION TITLE INSURANCE COMPANY,
Defendant and Appellant.

B223870
(Los Angeles County
Super. Ct. No. BC393347)

APPEAL from a judgment and orders of the Superior Court of Los Angeles County. Zaven V. Sinanian, Judge. Reversed with directions.

Garrett & Tully, P.C., Ryan C. Squire, and Michael K. Dewberry for Defendant and Appellant.

Leodis C. Matthews, APC, Leodis C. Matthews, and Dick P. Sindicich for Plaintiff and Appellant.
Transnation Title Insurance Company (Transnation) appeals from a judgment entered against it in an insurance bad faith action. We reverse with directions to enter judgment in favor of Transnation.

BACKGROUND

In 2004, Dale Wilson offered to buy from Menasha Log Co. LLC approximately 3,000 acres of land located in Curry County, Oregon, for a purchase price of $3,000,000. The seller made a counteroffer to sell the property to Wilson for $5,285,000, and Wilson accepted. The purchase agreement states the following: “Buyer acknowledges that Buyer has not received or relied upon any oral or written statements, made by Seller or any real estate licensee, which are not expressly contained in this Agreement.” Wilson assigned the contract to Golden Gate Trust (Golden Gate); Wilson’s daughter, Bridgette Wilson Sampras, was the beneficiary, and her business manager, Lester J. Knispel, was the trustee.¹

The offer and counteroffer described the land as “all property owned by Menasha Log Co. LLC. (Menasha) recorded on the following Curry County maps,” which were then listed by numbers that referred to tax assessor maps.² The record contains no evidence that any maps were attached to the agreement. It is undisputed that some of the property depicted on the listed maps was owned by Menasha and that some was not.

¹ We note that the record contains unsworn statements by Wilson that the Golden Gate Trust does not exist, that Golden Gate “is an L.L.C. with Trustee,” and that the deed and title policy should be corrected accordingly. The first amended complaint, however, refers to “Golden Gate Trust, dated December 19, 2001, d/b/a Golden Gate Properties, LLC, a California Limited Liability Company.” (Block capitals omitted.) The issue is of no consequence to our opinion. We shall refer to the buyer entity, whatever it may be, as “Golden Gate.”

² Wilson’s offer identified the seller as “Menasha Log Co. LLC,” and the property description attached to the offer also used that name. The counteroffer identified the seller as “Menasha Log Co. LLC or Menasha Forest Products Corp.” and used the same attached property description as Wilson’s offer. We will refer to the seller entity as “Menasha.”
Depicted on one of the listed maps was a 40-acre parcel of land that Menasha had previously owned but had sold to R. Scott Knox and Karen Knox in 2003 (“the Knox parcel”), before entering into the purchase agreement with Wilson. It is consequently undisputed that Menasha did not own the Knox parcel when Wilson and Menasha entered into the purchase agreement in 2004.

The title officer who prepared the preliminary title report for the Menasha-Wilson transaction, however, erroneously included the Knox parcel in the legal description of the property that Wilson was purchasing. The same erroneous legal description was used in both the warranty deed and the title insurance policy, which was issued by Transnation.

After escrow closed, when Wilson was developing the property, a surveyor he hired to assist with the development informed him that Menasha had previously transferred the Knox parcel to the Knoxes. On that basis, Golden Gate filed a claim under the title insurance policy in April 2006. Transnation accepted the claim under a reservation of rights.

In February 2007, Menasha filed a claim in arbitration against Golden Gate, seeking to have the deed to Golden Gate corrected to exclude the Knox parcel; the claim also sought resolution of another dispute that is not at issue in the present litigation. Golden Gate filed a counterclaim, alleging that the Knox parcel was part of the sale and seeking damages for Menasha’s failure to deliver title to that parcel. In November 2007, the arbitrator issued an award in favor of Menasha, directing that the deed be reformed accordingly.

In June 2008, Golden Gate filed suit against Transnation in Los Angeles County Superior Court. The operative first amended complaint alleged claims for breach of contract, breach of the implied covenant of good faith and fair dealing, unfair competition, and declaratory relief. Golden Gate later chose to proceed on only the bad faith claim.

On July 22, 2009, the jury returned a special verdict in favor of Golden Gate on the bad faith claim, awarding $120,000 in compensatory damages. Because the jury found that Transnation acted with malice, oppression, or fraud, the trial continued to a
punitive damages phase. On July 23, 2009, the jury awarded Golden Gate $3,488,100 in punitive damages. On Golden Gate’s motion, the court also awarded attorney fees of $299,654.14 and prejudgment interest of $40,427.22.

The court entered judgment on January 28, 2010. Transnation moved for judgment notwithstanding the verdict and for new trial. By order dated March 29, 2010, the court denied the motion for judgment notwithstanding the verdict but granted the new trial motion as to the punitive damages award, unless Golden Gate agreed to reduce the punitive damages award to $240,000. It appears that Golden Gate did not agree to the reduction. Transnation appealed from the judgment and the orders on the posttrial motions. Golden Gate cross-appealed from the order conditionally granting a new trial as to punitive damages. Transnation then filed a “protective cross-appeal” as well, “out of an abundance of caution,” while recognizing that “a cross-appeal is not necessary in view of [Transnation’s] appeal from the judgment.”

DISCUSSION

Transnation argues that because the Knox parcel was not included in the property to be sold under the Menasha-Wilson purchase agreement, Golden Gate never acquired an insurable interest in the Knox parcel and consequently never suffered an insured loss. We agree.

“If the insured has no insurable interest, the contract is void.” (Ins. Code, § 280.) “Every interest in property, or any relation thereto, or liability in respect thereof, of such a nature that a contemplated peril might directly damnify the insured, is an insurable interest.” (Ins. Code, § 281.) “A mere contingent or expectant interest in anything, not founded on an actual right to the thing, nor upon any valid contract for it, is not insurable.” (Ins. Code, § 283.) Thus, if Golden Gate never had an actual right, contractual or otherwise, to the Knox parcel, then Golden Gate never held an insurable
interest in that parcel, and the title insurance policy was void insofar as it purported to apply to that parcel.³

“We independently review the trial court’s interpretation of a contract, including the resolution of any ambiguity, unless the interpretation depends on the trial court’s resolution of factual questions concerning the credibility of extrinsic evidence.”

(Dowling v. Farmers Ins. Exchange (2012) 208 Cal.App.4th 685, 694.) Golden Gate does not contend that the Menasha-Wilson purchase agreement is ambiguous. *A fortiori,* Golden Gate does not rely on extrinsic evidence to show the existence of an ambiguity or the manner in which the ambiguity should be resolved. Accordingly, the interpretation of the purchase agreement is an issue subject to de novo review.

Under the purchase agreement, Wilson contracted to buy, and Menasha contracted to sell, all of the property that Menasha owned that was shown on certain maps. At the time of Wilson’s offer and Menasha’s counteroffer, Menasha did not own the Knox parcel. Menasha therefore did not contract to sell the Knox parcel to Wilson (and Wilson did not offer to buy it from Menasha). Golden Gate consequently never held an insurable interest in the Knox parcel, so the title insurance policy is void insofar as it purports to apply to that parcel.

Golden Gate presents no arguments to the contrary. Transnation’s opening brief on appeal argues that Golden Gate never held an insurable interest in the Knox parcel, but Golden Gate’s respondent’s brief never addresses the issue. Instead, Golden Gate argues that “it is undisputed that the Knox parcel was insured under the title policy” (apparently because the title policy included the title company’s erroneous legal description of the covered property), and Golden Gate cites evidence purporting to show Menasha’s “intent to convey the 40-acre Knox parcel” (for example, an agent of Menasha signed both the

³ Transnation contends that Oregon law does not differ from California law on this point, citing Or. Rev. Stat. section 742.011 and Avrit v. Forest Industries Ins. Exch. (Or. Ct. App. 1984) 696 P.2d 583, 585-586. Although Golden Gate’s briefs discuss choice of law, they do not address the issue of insurable interest. We agree with Transnation that Oregon law does not differ from California law on this point, so we need not decide which state’s law governs.
preliminary title report and the warranty deed on Menasha’s behalf). (Bold and capitalization omitted.) Neither point is of any consequence. The purchase agreement is unambiguous, and Golden Gate does not contend otherwise. Under the agreement, Menasha contracted to sell to Wilson all of the property that Menasha owned that was depicted on the listed maps. Menasha did not then own the Knox parcel, so Menasha did not contract to sell it to Wilson. The title policy’s legal description of the property does not render the purchase agreement ambiguous or alter its meaning, and neither does the cited evidence of Menasha’s alleged intent to sell the Knox parcel to Wilson.

Because Golden Gate did not hold an insurable interest in the Knox parcel, the title policy was void as to that parcel. Transnation’s failure to provide benefits on Golden Gate’s claim as to that parcel therefore did not constitute a breach of the insurance contract. Golden Gate’s bad faith claim—the only claim on which Golden Gate proceeded to trial—consequently fails as a matter of law. (Waller v. Truck Ins. Exchange, Inc. (1995) 11 Cal.4th 1, 36.)

DISPOSITION

The judgment is reversed, and the superior court is directed to enter judgment in favor of Transnation. Transnation shall recover its costs of appeal.

NOT TO BE PUBLISHED.

ROTHSCHILD, Acting P. J.

We concur:

CHANLEY, J.

JOHNSON, J.