CALIFORNIA LAND TITLE ASSOCIATION
FORMS AND PRACTICES COMMITTEE

*****

AGENDA

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June 6-7, 2013

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

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

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1. Administrative Section (Elliot Smith)

A. Approval of the Minutes of the February 7-8, 2013 meeting.

See Exhibit 1A

2. Bankruptcy Section (Wayne Condict)

A. In re Cass (Daff v. Wallace)
Bankruptcy Appellate Panel – 9th Circuit (Central Dist. of California)

Filed 4-11-13

See Exhibit 2A

B. In re Reingold (Reingold v. Shaffer)
Bankruptcy Appellate Panel – 9th Circuit (Central Dist. of California)

Filed 3-19-13

See Exhibit 2B

C. In re Meruelo Maddux Properties (Mereulo v. MMP)
Bankruptcy Appellate Panel – 9th Circuit (Central Dist. of California)

Filed 4-9-13

See Exhibit 2C

D. In re Sui (Sui v. Marshack)
Bankruptcy Appellate Panel – 9th Circuit (Central Dist. of California)

Filed 4-4-13

See Exhibit 2D

E. In re Garcia (Orange County's Credit Union v. Garcia)
9th Circuit

Filed 3-5-13

See Exhibit 2E

F. In re Fitness Holdings Int'l (OCUC v. Hancock Park Capital)
9th Circuit

Filed 4-30-13

See Exhibit 2F-1, 2F-2 and 2F-3

G. In re Evans (Henderson v. Community Bank of Mississippi)
U.S. Bankruptcy Court – Southern Dist. Mississippi

Filed 4-26-13

See Exhibit 2G

H. In re Davis (Branigan v. Davis)
4th Circuit

Filed 5-10-13

See Exhibit 2H

I. In re Showalter (Showalter v. Hopper)
Bankruptcy Appellate Panel – 9th Circuit (Eastern Dist. of California)

Filed 4-11-13

See Exhibit 2I

3. Court Decisions Section (David Westcott)

A. Multani v. Witkin & Neal
Cal. App. 2nd Dist.

Filed 5-1-13

See Exhibit 3A

B. Jolley v. Chase Home Finance
Cal. App. 1st Dist.

Filed 2-11-13

See Exhibit 3B

C. Chanda v. Federal Home Loans Corp.
Cal. App. 4th Dist., Div. 1
Filed 4-19-13
See Exhibit 3C

D. Aguayo v. Amaro
Cal. App. 2nd Dist.
Filed 1-31-13
See Exhibit 3D

E. Hamilton Court v. East Olympic, L.P.
Cal. App. 2nd Dist.
Filed 4-16-13
See Exhibit 3E

F. Hutton v. Fidelity National Title Company
Cal.App. 5th Dist.
Filed 1-31-13
See Exhibit 3F

G. Hagman v. Meher Mount Corp.
Cal.App. 2nd Dist.
Filed 4-3-13
See Exhibit 3G

H. Windsor Pacific v. Samwood Co.
Cal.App. 2nd Dist.
Filed 1-30-13
See Exhibit 3H

I. Intengan v. BAC Home Loans Servicing
Cal.App. 1st Dist.
Filed 3-22-13
See Exhibit 3I

J. West v. JPMorgan Chase Bank
Cal.App. 4th Dist., Div. 3
Filed 3-18-13
See Exhibit 3J

K. Bock v. California Capital Loans, Inc.
Cal.App. 3rd Dist.
Filed 5-14-13
See Exhibit 3K

L. Scott v. JPMorgan Chase Bank
Cal.App. 1st Dist.

Filed 3-18-13

See Exhibit 3L

4. Closing Instructions Section (Terri Winchester)

Nothing Scheduled.

5. Governmental Regulations Section

Nothing Scheduled.

6. Subdivision and Land Use Section (Douglas Borchert)

A. Pacific Palisades Bowl Mobile Estates v. City of Los Angeles
California Supreme Court

Filed 11-29-12

See Exhibit 6A

B. Corrie v. Soloway
Cal.App. 1st Dist.

Filed 5/16/13

See Exhibit 6B

7. Legislation Section (Tim Reardon)

A. Redevelopment Agency update

See Exhibit 7A

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: CLTA's form filing to CA DOI dated March 4, 2013, approved on or about 4-4-13.**

Ex. 10.A.1: Form Filing Request Letter

Ex. 10.A.2: CLTA 104.6-06 (ALTA 37-06) (12-3-12)

Ex. 10.A.3: CLTA 105-06-06 (Rev. 2-8-13)

Ex. 10.A.4: ALTA Residential Short Form Residential Loan Policy (Rev. 12-3-12)

Ex. 10.A.5: ALTA U.S. Policy (Rev. 12-3-12)

Ex. 10.A.6: CLTA Guarantee Form 22.1 (2-8-13)

Ex. 10.A.7: CLTA Guarantee Form 22 (Rev. 2-8-13)

Ex. 10.A.8: DOI Acceptance Email 3-27-13

B. **Action Item:** Motion that Forms and Practices recommend that the Board of Governors authorize the staff to file the following ALTA forms Adopted or Revised as of 4-02-13 with the proposed CLTA Form numbers if appropriate, as noted below, with the CA DOI forthwith:

1. ALTA 9.6-06 (Private Rights-Loan Policy) **Rev.**
   CLTA 100.2.6-06 [Exhibit 10.B.1]
2. ALTA 9.9-06 (Private Rights-Owner's Policy) **NEW**
   CLTA Proposed 100.2.9-06 [Exhibit 10.B.2]
3. ALTA 9.10-06 (Restrictions, Encroachments, Minerals-Current Violations-Loan Policy) **NEW**
   CLTA Proposed 100.2.10-06 [Exhibit 10.B.3]
4. ALTA 12-06 (Aggregation-State Limits-Loan) **Rev.**
   CLTA 117-06 [Exhibit 10.B.4]
5. ALTA 12.1-06 (Aggregation-Loan) **NEW**
   CLTA Proposed 117.1-06 [Exhibit 10.B.5]
6. ALTA 28.2-06 (Encroachments-Boundaries & Easements-Described Improvements) **NEW**
   CLTA Proposed 103.15-06 [Exhibit 10.B.6]
7. ALTA 32.1-06 (Construction Loan-LOP-Direct Payment) **Rev.**
   CLTA 137.1-06 [Exhibit 10.B.7]
8. ALTA 32.2-06 (Construction Loan-LOP-Insured's Direct Payment) **Rev.**
   CLTA 137.2 -06 [Exhibit 10.B.8]
9. ALTA 39-06 (Policy Authentication) **NEW**
   CLTA Proposed 142-06 [Exhibit 10.B.9]
10. ALTA Short Form Residential Limited Coverage Jr. Loan Policy **Rev.**
    [Exhibit 10.B.10]

11. ALTA Policy Forms News [Exhibit 10.B.11]

C. **Action Item**: Two forms were pulled back by the ALTA Forms Committee after the comment period and are subject to further revision:

Exhibit 10.C.1: ALTA 11.2-06 Mortgage Modification with Additional Advance

Exhibit 10.C.2: ALTA 40-06 Tax Credit

MOTION: To authorize CLTA's Title Forms Committee Chair to submit a form filing request on behalf of Forms and Practices so that the CLTA Board of Governors authorizes the CLTA Staff to submit a form filing for those two forms only after the ALTA has adopted the two aforementioned forms. The CLTA form numbers would be as follows:

ALTA 11.2-06 – CLTA 110.11.2-06

ALTA 40-06 – CLTA 143-06

D. **Non-Action Item:** Abengoa (Unpublished) Decision in MO and CLTA's Guarantee No. 25.

Forms committee does ***not*** recommend that CLTA modify Guarantee No. 25 in light of the Abengoa case.

1. *Abengoa Bioenergy v. Chicago Title Insurance Co.* [Exhibit 10.D.1]
2. CLTA Guarantee Form No. 25 [Exhibit 10.D.2]

E. **Non-Action Items**: Carry over items re: CLTA's comments referred to ALTA through Paul Hammann about comments and proposed revisions to:

1. ALTA 28.1-06 – Comments made by Forms and Practices to modify 28.1-06 (Carried over from CLTA F & P Feb. 2013, per minutes, item no. 10.D)

   See Exhibits 10.E.1 and 10.E.2

2. CLTA/ALTA Homeowner's Policy – Proposed modification to CLTA/ALTA Homeowner's Policy by adding exclusion language paragraphs 5(d) and 5(e) from ALTA 9.7-06 (04-02-12). Carried over from CLTA F and P Nov. 2012, per minutes, item no. 10.C)

   See Exhibit 10.E.3

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

Nothing Scheduled.

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

A. Grand Canyon Skywalk Development v. Sa Nyu Wa Incorporated
9th Circuit

Filed 4-26-13

INDIANS: Plaintiff is required to exhaust its remedies in tribal court prior to proceeding with an action in federal court on its claims challenging the defendant Tribe's authority to condemn plaintiff's intangible property rights in a revenue-sharing contract between plaintiff and the Tribe. The bad faith exception to the exhaustion requirement did not apply because where a tribal court has asserted jurisdiction and is entertaining a suit, the tribal court must have acted in bad faith for exhaustion to be excused; bad faith by a litigant instituting the tribal court action will not suffice. Also, the evidence did not meet the narrow futility exception, which applies where exhaustion would be futile because of the lack of adequate opportunity to challenge the tribal court's jurisdiction.

See Exhibit 14A

B. Bourhis v. Lord
California Supreme Court

Filed 3-4-13

A corporation that files a notice of appeal while its corporate powers are suspended may proceed with the appeal after those powers have been revived, even if the revival occurs after the time to appeal has expired.

See Exhibit 14B

C. Cynergy v. First American Title Insurance Company
U.S. Court of Appeals – 11th Circuit

Filed 1-28-13

Where an insured had knowledge that the property did not have access, the policy exclusion for matters created, suffered, assumed or agreed to by the insured claimant applies to preclude coverage.

See Exhibit 14C

D. First National Bank of Layton v. Palmer
Utah Court of Appeals

Filed 1-28-13

The court refused to apply the doctrine of equitable subrogation where a deed of trust was modified after the lender obtained an erroneous title report that omitted an

intervening lien. The lender had knowledge of the intervening lien because it secured a seller carry-back loan in the transaction in which the lender made the initial loan.

See Exhibit 14D

E. Levy Gardens Partners v. Commonwealth Land Title Insurance Company
U.S. Court of Appeals – 5th Circuit

Filed 1-31-13

A zoning endorsement is not stand-alone coverage, so the meaning of "loss or damage" under the endorsement is defined by the policy provision stating that damages are limited to the difference between the value of the title as insured and the value of the title subject to the insured risk.

See Exhibit 14E

F. In re The Majestic Star Casino
U.S. Court of Appeals – 3rd Circuit

Filed 5-21-13

While the tax status of an S-corp was of value it was not property within Bankruptcy Code Section 541.

See Exhibit 14F

CLTA California Land Title Association
SINCE 1907

Bulletin 12/13 – 86
April 3, 2013

2013
Minutes of the Meeting
of the

CALIFORNIA LAND TITLE ASSOCIATION
FORMS AND PRACTICES COMMITTEE

Held at

Fairmont Newport Beach
4500 MacArthur Blvd, Newport Beach, CA 92660

February 7-8, 2013
Thursday: 1:00 PM - 5:00 PM
Friday: 9:00 AM - 1:00 PM

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

1. Administrative Section (Elliot Smith)

A. It was moved and seconded, and the motion unanimously passed, that the Minutes of the June 6-7 meeting be approved as written.

B. It was moved and seconded, and the motion unanimously passed, that the Minutes of the November 1-2 meeting be approved as written.

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

On appeal, McCoy did not dispute that the debtor held an interest in the property before McCoy's lien fixed. Nonetheless, McCoy contended that the debtor's conveyance of the property to Bayview Resources, LLC (Bayview) resulted in a termination of debtor's previous interest (even though debtor was a member of Bayview) and then, when the debtor reacquired the property from Bayview, the 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 the United States Supreme Court's opinion in *Farrey v. Sanderfoot*, 500 U.S. 291 (1991), which makes his lien unavoidable. As a result, McCoy argued that the bankruptcy court erred in relying on the holdings in *Stoneking* and *Chiu* for its decision.

The BAP agreed. In this case of first impression in the Ninth Circuit, the BAP held that because the debtor did not maintain a continuous interest in the property in question from the time the lien fixed until the petition date, he was not entitled to avoid McCoy's lien based on his homestead exemption. When the interest in real property once held by a debtor is entirely extinguished by transfer, voluntary or as a matter of law, a judicial lien which attached when the debtor had that interest cannot be avoided pursuant to Title 11 USC Section 522 when the debtor acquires a subsequent interest in the property and the interest held when the lien fixed is gone. When the debtor reacquires the property he acquires a different interest that is then subject to the judicial lien.

The case will be noted in the CLTA Manual, but there was no practice recommendation and the case was dropped.

B. TC Healthcare I, LLC v. Dupuis (In re Haven Eldercare, LLC)
U.S. Court of Appeals – 2nd Circuit

Filed 11-15-12

This is a summary order from the U.S. Court of Appeals for the Second Circuit affirming a judgment of the U.S. District Court of Connecticut.

At issue is whether a state court has jurisdiction to render a judgment against the purchaser of debtor's assets, purchased pursuant to 11 U.S.C. § 363, free and clear of any liens, claims, or encumbrances, on debtor's pre-bankruptcy contract with plaintiff. The court held that pursuant to 28 U.S.C. § 1334(b), the bankruptcy court has "original but not exclusive jurisdiction" over state claims pending

bankruptcy proceedings. The court affirmed a state court judgment against defendant for debtor's pre-bankruptcy liability notwithstanding purchase pursuant to a ("free and clear") § 363 order.

Here a Vermont small claims court had entered a judgment for plaintiff for $5,000. The appellate court held that the preclusive effect of the state's res judicata law applied to a prior judgment. The defendant failed to submit to the Vermont court admissible evidence of the pending bankruptcy Sale Order in order to effect a stay of the proceedings. In light of that fact, the Vermont court had proper subject matter jurisdiction and its judgment was final and enforceable.

There was no practice recommendation and the case was dropped.

C. <u>Mass Dept of Unemployment Asst. v. OPK Biotech, LLC (In re PBBPC, Inc.)</u>
Bankruptcy Appellate Panel – 1st Circuit (District of Mass.)

Filed 1-17-13

The Bankruptcy Appellate Panel for the First Circuit affirms the order of the U.S. Bankruptcy Court for the District of Massachusetts. This case addresses the scope of the meaning of "any interest" for sales free and clear under 11 U.S.C § 363(f). In this case, the court ruled that "any interest" includes future state employment tax obligations that attached to the sale of debtor's assets.

Prior to the sale of its assets pursuant to a Chapter 11 filing, debtor corporation had dismissed most of its employees. Accordingly, the Massachusetts Department of Unemployment (MDU) assessed a high "experience rate" against the company, resulting in a higher (tax) contribution rate against the debtor. Appellee purchased the company assets under § 363(f) free and clear of all encumbrances and claims. The MDU assessed a higher employment tax rate on appellee based on debtor's employee layoffs, than it would have on a new employer. Appellee claimed that debtor's liability followed the purchased assets and should be considered an "interest" under § 363.

The court noted that there is no concise definition in the Bankruptcy Code of the scope of the meaning of the term "any interest" within §363, and that prior court rulings had applied an ad hoc standard. The court concluded that when Congress included the term "any," that it intended an inclusive interpretation of the term "any interest" within § 363. In this case debtor's sale of assets was deemed to be free and clear of the debtor's "experience rating" and the higher employment tax obligation.

There was no practice recommendation and the case was dropped.

D. <u>Collect Access, LLC v. Hernandez (In re Hernandez)</u>
Bankruptcy Appellate Panel – 9th Circuit (So. District of California)

Filed 12-14-12

This case involved a Sheriff's levy of execution on a bank account of debtor Hernandez. Creditor Collect Access LLC (CAL) had obtained its judgment and pursuant to a writ of execution the Sheriff collected Hernandez' bank account balance ($712) before Hernandez filed his Ch. 7 petition. After the trustee's no distribution report, Hernandez moved for and obtained a bankruptcy court order requiring the Sheriff to turn over the collected funds. Immediately before service of the order the Sheriff transferred the funds to CAL. Hernandez obtained a new

turnover order directed at CAL. CAL filed its opposition and the bankruptcy court ruled in debtor's favor finding that the funds were property of the estate under section 541. It held that upon collection of the deposited funds by the Sheriff, CAL had only an execution lien on them and therefore the funds were property of the estate at the time of filing. CAL appealed, contending that California debt collection law conferred ownership on the creditor from the time the funds were collected by the Sheriff.

The 9th Circuit BAP affirmed the bankruptcy court's ruling but observed that the concept of ownership of the funds is not sufficiently precise under California law. Some cases have held that ownership transfers to the creditor upon levy unless there is a redemption right in debtor, some have held that the transfer occurs once the Sheriff releases funds to the creditor. The BAP affirmed on a different basis – namely that all of the funds in Hernandez' account were social security benefits and were therefore (under CA law) exempt from execution. So, the bankruptcy court had correctly ordered their return to the debtor as debtor's exempt property. Neither practice change recommendations nor manual changes were suggested.

There was no practice recommendation and the case was dropped.

E. Heritage Pacific Financial, LLC v. Machuca (In re Machuca)
Bankruptcy Appellate Panel – 9th Circuit (No. District of California)

Filed 12-14-12

This is a decision by the BAP for the Ninth Circuit affirming an award of attorney's fees by the bankruptcy court for the Northern District of California. The bankruptcy court made the fee award in favor of the debtor after he prevailed on summary judgment in an adversary proceeding brought by Heritage Pacific Financial (HPC) under Section 523(a)2(B). HPC sought to have the debt declared nondischargeable based on the submission of a false loan application. The court denied the motion and awarded the debtor's fees since there was no evidence that HPC relied on the application in making the loan.

There was no practice recommendation and the case was dropped.

F. Toye v. O'Donnell (In re O'Donnell)
Bankruptcy Appellate Panel – 1st Circuit (District of Maine)

Filed 12-5-12

This is a decision by the BAP for the First Circuit affirming a judgment by the U.S. Bankruptcy Court in Maine. The bankruptcy court entered a determination that a debt was nondischargeable under Section 523(a)(2)(B) as a result of the debtor's willful neglect in overseeing the completion and submission of financial information used to obtain credit. The court found the debtor's complete failure to oversee the acts of his agent in submitting the information was sufficient to meet the requirement of 523(a)(2)(B)(iv) that he caused the financial statement to be made with the intent to deceive.

There was no practice recommendation and the case was dropped.

G. <u>In re Barry L. Michael</u>
U.S. Court of Appeals – 3rd Circuit Filed 10-26-12

Under § 348(e) the Court of Appeal affirmed the bankruptcy court and district court decisions that any funds held by the trustee from the debtor when a Chapter 13 is converted to a Chapter 7 should be returned to the debtor. Under §1327(b) confirmation of the plan vests all property of the estate in the debtor and creates a new relationship between the creditors and the debtors in which the creditors forgo certain rights in return for the debtor's promise to make payments under the plan. Under §348 (e) the trustee's plan duties terminate post conversion and return of the debtor's funds is one of the trustee's remaining duties.

The case will be noted in the CLTA Manual, but there was no practice recommendation and the case was dropped.

H. <u>In re Miller</u>
Bankruptcy Appellate Panel – 6th Circuit (No. District of Ohio)
Filed 12-27-12

Cecil Miller deeded 3 parcels of real property to his daughter for zero consideration a few months before filing a Chapter 7 petition. The bankruptcy trustee filed an adversary proceeding to set aside those fraudulent transfers and an order doing so was entered. In the adversary proceeding, trustee also sought an order to sell the 3 properties but this request was denied because the parcels were valued at $29,000 but the SBA had mortgages on the land totaling more than $118,000. The court found no purpose in approving a sale after which no unsecured creditor would benefit.

The trustee later moved for an order to sell by auction process free and clear of liens. This approach was motivated by an agreement the trustee had made with the SBA that allowed $5000 of sale proceeds to be paid into the estate for administration costs and distributions. The SBA apparently saw this as an expedited way to get the properties on the market and avoid foreclosure costs and delays. Debtor died shortly after filing the petition but debtor's daughter objected to the motion to sell on the grounds that title was in her name of record and she wasn't served with a copy of the motion to sell. She also raised the issue of Debtor's widow not receiving notice of the motion to sell. The court granted the trustee's motion and debtor's daughter appealed.

On appeal, the 6th Circuit BAP affirmed, finding that Debtor's daughter had no standing to appeal because she could not show that she was aggrieved by the order. She was already divested of title by the 548 order so she had no interest in the property being sold. She was not the debtor but only the heir of the debtor. The 3 parcels were property of the bankruptcy estate. The debtor's probate estate had no interest in them. Moreover, they were so upside down that the debtor's heirs had no chance of receiving any distribution from the bankruptcy estate after payment in full of all creditors.

There was no practice recommendation and the case was dropped.

I. <u>Executive Benefits Ins. Agency v. Arkison (In re Bellingham Ins. Agency, Inc.)</u>
U.S. Court of Appeals – 9th Circuit

Filed 12-4-12

The bankruptcy trustee of Bellingham Insurance Agency (Bellingham) obtained a bankruptcy court judgment under section 548 setting aside as fraudulent transfers of around $373,000 from Bellingham's pre-filing receivables to a new entity set up by Bellingham's owners called Executive Benefits Insurance Agency (EBIA). EBIA was neither a creditor nor an investor in Bellingham. The district court affirmed the judgment.

On appeal to the 9th Circuit, EBIA raised the defense of lack of subject-matter jurisdiction by the bankruptcy court pursuant to the reasoning of *Stern v. Marshall*. The 9th Circuit affirmed the judgment because EBIA was held to have consented to the bankruptcy court's jurisdiction by failing to object until filing its brief on appeal. Nevertheless, the appellate court analyzed EBIA's *Stern* case argument and agreed that the bankruptcy judge, not being an Article III judge, had no jurisdiction to enter a judgment against a non-party to Bellingham's bankruptcy case even though the case was for the recovery of a fraudulent conveyance – an action listed as item H in the 16 core proceedings enumerated by Congress in 28 USC 157(b). The court cited *Northern Pipeline* for the holding that the only exceptions to the rule of Article III adjudication were territorial courts, military courts and cases involving public as opposed to private rights. Certain bankruptcy adjudications have been considered to fall within the public rights exception.

Congress presumed to address this (i.e. establish "core proceedings" as public rights) with its designation of 16 "core proceedings" in the Bankruptcy Amendments and Federal Judgeship Act of 1984 (28 USC 151, et seq.). However, the 9th Circuit, following the Supreme Court's 1989 fraudulent conveyance case of *Granfinanciera v. Nordberg*, disregarded the distinction in opining that even though fraudulent conveyance actions are "core proceedings", the bankruptcy judge, not being an Article III judge (with lifetime tenure and salary protection), could not enter a judgment of fraudulent transfer against a 3rd party to the bankruptcy case. While the judgment was upheld for failure to timely raise the defense, it continues the theme of *Stern* that even some "core proceedings" are not necessarily within the constitutional authority of bankruptcy courts if they adjudicate against non-parties to the bankruptcy. Concern was raised by the Committee about reliance on some bankruptcy orders purporting to bind 3rd parties when no opposition is filed.

The case will be noted in the CLTA Manual, but there was no practice recommendation and the case was dropped.

J. <u>Sundale, Ltd. v. Florida Assoc. Capital Enterprises, LLC (In re Sundale, Ltd.)</u>
U.S. Court of Appeals – 11th Circuit

Filed 11-29-12

This 11th Circuit case also dealt with the ruling in *Stern* and the "core proceedings" jurisdiction conferred by Congress on bankruptcy courts. Mortgage holder Florida Associates Capital Enterprises (FACE) sued in bankruptcy court to have its mortgage on debtor's (Sundale's) development declared valid and to establish the amount owed. Debtor denied that any money was owed and

counterclaimed to recoup an earlier pay-down of the “loan”. The bankruptcy court found the debt and mortgage to be valid and denied debtor’s recoupment claim. This judgment was affirmed (and, to help with the jurisdictional issues, adopted as its judgment) by the district court.

Debtor appealed to the 11th Circuit claiming lack of jurisdiction by the bankruptcy court to decide the recoupment claim. Judgment affirmed. The recoupment claim of Sundale was one of the 16 “core proceedings.” Counterclaims by the estate against persons filing claims against the estate is listed as item C (of A through P of 28 USC 157(b)) enumerated by Congress as within the jurisdiction of the bankruptcy court. Moreover, not only was Sundale a party to the bankruptcy (nothing less than the debtor itself) but, as the court stated, FACE’s creditor’s claim was inextricably linked to a determination of not only whether a debt was owed but also whether recoupment was owed. Here it was the debtor itself challenging the bankruptcy court’s jurisdiction to hear the debtor’s own recoupment action. The court responded by reminding debtor that the Stern decision was intended to have limited application.

There was no practice recommendation and the case was dropped.

K. Dill Oil Co., LLC v. Stephens (In re Stephens)
U.S. Court of Appeals – 10th Circuit Filed 1-15-13

Did Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”) (2005) repeal application of the absolute priority rule (APR) to individual Chapter 11 debtors? The APR bars junior claimants, including debtors, from retaining any interest in property when a dissenting class of senior creditors has not been paid in full. U.S. BAP for the 10th Circuit certified this case for direct appeal to the 10th Circuit Court of Appeals because they felt that the case involved a “matter of public importance” for which “there is no controlling decision” in the circuit. The court found that (1) The BAP for the 9th Cir and five Bankruptcy courts had taken the broad view that the BPCPA amendments adding section 1115 eliminated APR as to the entire estate. See: *In re Friedman*, 466 B.R. 471 (B.A.P. 9th Cir.2012); *SPCP Grp., LLC v. Biggins*, 465 B.R. 316 (M.D.Fla.2011), and (2) The 4th Circuit and 17 other Bankruptcy courts had taken the narrow view that the BPCPA amendments adding section 1115 had the effect of exempting certain post-petition property from application of APR, but did not eliminate APR from pre-petition property.

This court reversed the bankruptcy court, holding that no repeal could be inferred, based on the presumption against implied repeal. To infer repeal would require a finding of Congressional intent, but in this case, the statutory language and legislative history lacked any clear indication that Congress intended to repeal.

There was no practice recommendation and the case was dropped.

L. First American Title Ins. Co. v. Gaskill (In re Gaskill)
U.S Bankruptcy Court – Western District of Michigan)

Filed 9-18-12

A title insurer brought an adversary proceeding in the Chapter 13 case of one of the owner/corporate officers of a title agency to have a debt created by the title agency's failure to remit title premiums declared to be nondischargeable on the basis that the failure to remit the premiums constituted a defalcation while acting in a fiduciary capacity. Although the debtor was a 50% owner of the title agency and served as Vice President and Treasurer, she handled closings while the other co-owner of the title agency handled the business operations and was responsible for making the remittance payments. The court found the debtor was not responsible for implementing the title agency's fiduciary duties and that she did not cause or participate in the breach of those duties. In addition, debtor had no control over the funds from which the remittance amounts should have been paid. While she might have been more diligent in her role as a corporate officer her conduct was not "objectively reckless" so it did not constitute a defalcation. The debt owed to the title insurer is subject to discharge in this case.

There was no practice recommendation and the case was dropped.

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

[No summary submitted}

There was no practice recommendation and the case was dropped.

3. Court Decisions Section (David Westcott)

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

1. In order to be privileged under CC 47(b)(4), a lis pendens must a) identify a previously filed action and b) the previously filed action must be one that affects title or right of possession of real property. The court declined to add a third requirement that the plaintiff must make a showing of evidentiary merit.

2. The name of the beneficiary in a deed of trust was altered in an attempt by a loan broker to support an unrelated loan. The court held that since the deed of trust was materially altered after it was signed, it was a forgery and was therefore void *ab initio*.

There was no practice recommendation and the case was dropped.

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

The court held that defendant did not violate a subordination agreement pursuant to which plaintiff agreed to subordinate its deed of trust to a deed of trust in favor of defendant securing a loan in the amount of $4,006,600, even though defendant cross-collateralized the loan with two other loans for $11,227,500 and $5,912,750. To the extent defendant's trust deed secured a note in the amount of

$4,006,600, it was senior to plaintiff's trust deed. To the extent defendant's trust deed secured other notes it is junior to plaintiff's trust deed. Plaintiff could have protected its interest by tendering the amount necessary to cure the default under the $4,006,600 note alone.

There was no practice recommendation and the case was dropped.

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

This is a case of first impression in California. The weight of authority from other jurisdiction supports the trial courts conclusion that the omission of a trustee does not prevent enforcement of the deed of trust. The 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.

The case will be referenced in CLTA Manual Section 58.05.C, but there was no practice recommendation and the case was dropped.

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

The court held that an easement cannot be reduced in size on the basis that the reasonable use requirements of the easement, both presently and in the future, do not require the full size and scope of the original easement. Even though defendant had no apparent use for more than 15 feet of the 60-foot easement, an easement acquired by deed cannot be lost by mere non-user. The court distinguished *Scruby v. Vintage Grapevine, Inc.* (1995) 37 Cal.App.4th 697, in which the court permitted the servient tenement to maintain water tanks and grape vines in the easement area because such use did not interfere with the dominant tenements use of the remainder of the easement for ingress and egress. Scruby dealt with the scope of use of an easement, whereas here plaintiff sought to entirely terminate defendant's rights as to a portion of the easement.

There was no practice recommendation and the case was dropped.

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

A tripartite attorney-client relationship arises when a title insurer retains counsel to prosecute an action on behalf of an insured pursuant to a title policy. The privilege applies even where the insurer asserted a reservation of rights in a non-*Cumis* situation.

There was no practice recommendation and the case was dropped.

F. Pfeifer v. Countrywide Home Loans
Cal.App. 1st Dist. Filed 12-13-12

This case involved the pending foreclosure of a deed of trust whose beneficiary was the subject of FHA mortgage insurance. The subject deed of trust form was

a “FHA California Deed of Trust with MERS – 4/96” – apparently a commonly used form. The borrower - Alan Pfeifer and his mother Florence, who suffered from Alzheimer’s disease, sued to enjoin the foreclosure (and to recover resulting damages) based on the assertion that the trustee or others had violated certain provisions of the Code of Federal Regulations. Paragraph 9 of the deed of trust read 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...” The borrowers asserted a violation of the regulation that stated: “…The mortgagee must have a face-to-face interview with the mortgagor, or make a reasonable effort to arrange such a meeting…”. 24 CFR § 203.604(b). The court stated that the “face-to-face interview” was a condition precedent to the lender exercising the right of foreclosure under the deed of trust, and that, since the lender had not conducted such a face-to-face interview, the borrower could sue to enjoin the foreclosure.

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)

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.

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.

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

B. Redevelopment Agencies.

The recent meeting between CLTA representatives and the California Department of Finance was explained and discussed.

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

Nothing Scheduled.

9. Title Documents Section (Ed Rusky)

A. Electronic recording question.

The lack of progress of County Recorders adopting electronic recording systems, due to a combination of the recession and cost of implementation, was briefly discussed.

10. Title Forms Section (Paul Flores)

A. **Non-Action Item:** CLTA staff submitted, and the CA DOI accepted, a form filing re ALTA Technical corrections to the following ALTA endorsements and policy form:

ALTA 3.2-06
ALTA 9.8-06
ALTA 14.3-06
ALTA Res. Limited Coverage Jr. Loan Policy Rev. 8-1-12
ALTA Technical Correction Explanation
CLTA Form Filing Correspondence dated 12-20-12
CA DOI acceptance of 12-20-12 Form Filing by email dated 1-24-13

This item was briefly reviewed and discussed.

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:

ALTA 37-06 (CLTA 104.5-06)
ALTA 38-06 (CLTA 142-06)
Short Form Residential Loan Policy
U.S. Policy

After discussion, the motion was amended to refer to the following forms:

1. *ALTA 37-06 (CLTA 104.6-06) (instead of 104.5-06)*
2. *[Do not file the ALTA 38-06 because it is inapplicable in California]*
3. *Short Form Residential Loan Policy*
4. *U.S. Policy*

As amended it was then moved and seconded, and the motion unanimously passed.

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").

After discussion, it was moved and seconded, and the motion unanimously passed.

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

After discussion, it was decided to recommend the proposed changes to the ALTA Forms Committee. The item will be carried.

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.

After discussion, it was decided to carry this item in order to continue to monitor it.

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.

After discussion, it was moved and seconded to approve the proposed changes to the Informational Notes, but <u>NOT to include a new paragraph 4</u> pertaining to the Federal Debt Collection Procedures Act (28 USC 3001-3308). The motion unanimously passed to (1) recommend to the proposed changes to the CLTA Board of Governors and (2) request that CLTA file the amended TSG form with the California DOI on behalf of all member companies.

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.

After discussion, it was moved and seconded, and the motion unanimously passed.

11. <u>Special Sub-Committee - Electronic Recording and Signatures (Paul Flores)</u>

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

This item was briefly reviewed and discussed.

B. Roster of CLTA Electronic Recordation Task Force.

This item was briefly reviewed and discussed.

12. <u>Special Sub-Committee – Copyright Protection of CLTA Forms and Manual</u>

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.

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.

C. Maryland Transit Admin. v. Surface Transportation Board
U.S. Court of Appeals – 4th Circuit

Filed 11-21-12

Railroad right of way case.

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.

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.

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.

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.

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.

FILED

APR 11 2013

SUSAN M SPRAUL, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

1 NOT FOR PUBLICATION
2
3 **UNITED STATES BANKRUPTCY APPELLATE PANEL**
4 **OF THE NINTH CIRCUIT**

5 In re:)	BAP No. CC-12-1513-KiPaTa
6 CATHERINE Z. CASS,)	Bk. No. 12-16090-RK
7 Debtor.)	Adv. No. 12-1235-RK
8 9 CHARLES W. DAFF, Chapter 7 Trustee,)	
10 Appellant,)	
11 v.)	**M E M O R A N D U M**[1]
12 13 JAMES WALLACE; REBECCA WALLACE; GLORIA SUESS,)	
14 Appellees.)	

15 Argued and Submitted on March 22, 2013,
16 at Pasadena, California

17 Filed - April 11, 2013

18 Appeal from the United States Bankruptcy Court
for the Central District of California

19 Honorable Robert N. Kwan, Bankruptcy Judge, Presiding

20
21 Appearances: Ed Hays, Esq. of Marshack Hays LLP argued for appellant, Charles W. Daff, Chapter 7 Trustee;
22 David B. Dimitruk, Esq. of the Law Offices of David B. Dimitruk argued for appellees, James and Rebecca
23 Wallace and Gloria Suess.

24 Before: KIRSCHER, PAPPAS and TAYLOR, Bankruptcy Judges.
25
26
27 [1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th
28 Cir. BAP Rule 8013-1.

Appellant, chapter 7[2] trustee Charles W. Daff ("Trustee"), appeals a judgment from the bankruptcy court determining that the recorded abstract of judgment of appellees, James and Rebecca Wallace ("Wallaces") and Gloria Suess ("Suess")(collectively the "Judgment Creditors") attached to proceeds from the sale of debtor's residence even though it was recorded after the debtor had fraudulently transferred her interest in the residence to her daughter. The bankruptcy court published its decision. See Daff v. Wallace (In re Cass), 476 B.R. 602 (Bankr. C.D. Cal. 2012). We AFFIRM on the narrow basis that the debtor, despite the transfer, held an equitable interest in the Residence to which the Judgment Creditors' judgment lien attached. As a result, the sale proceeds are subject to the Judgment Creditors' claim. We express no opinion concerning the bankruptcy court's determination that under California law a transfer of property in fraud of creditors is "void ab initio" rather than merely "voidable."

I. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

A. The defamation lawsuit, the fraudulent transfer, the first bankruptcy case, the state court judgment and appeal, and the abstract of judgment

The facts of this case are undisputed. The Judgment Creditors are former next door neighbors of the deceased chapter 7 debtor, Catherine Z. Cass ("Cass"). After many years of Cass's daily harassment of her neighbors by posting of defamatory signs about them in her front yard, directing loud music at their homes, making other loud noises to disturb them throughout the night,

[2] Unless specified otherwise, all chapter, code and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

operating yard machines while they tried to enjoy their backyards, and leading her dogs to defecate on the Wallaces' front yard without picking up after them, Suess and the Wallaces sued Cass in state court for defamation and nuisance on April 22, 2004 ("Defamation Lawsuit"). At that time, Cass owned her residence located in Santa Ana, California ("Residence").

One day after filing her answer, Cass executed and recorded a grant deed purporting to transfer title of the Residence to her daughter, Christine Zeman ("Zeman"), and reserving a life estate for herself. Zeman provided no consideration for the transfer. Concurrent with the transfer, Zeman signed a letter agreement wherein she promised to "transfer the [Residence] back to [Cass] upon her request."

The trial in the Defamation Lawsuit was scheduled to begin on May 9, 2005, but was stayed once Cass filed a chapter 13 bankruptcy case on May 6, 2005. On July 5, 2007, the bankruptcy court dismissed Cass's chapter 13 case as a bad faith filing and enjoined her from filing any further bankruptcy petitions for 180 days.

After trial of the Defamation Lawsuit, on September 15, 2005, the state court announced its oral ruling against Cass. On October 28, 2005, the state court entered a judgment in favor of the Judgment Creditors on their nuisance and defamation claims for $320,000, which included an award of $75,000 for punitive damages and injunctive relief ("State Court Judgment"). Pursuant to the State Court Judgment, the court determined:

> Among other things, the punitive and exemplary damages are determined by the court to be appropriate based upon (1) the defendant's malicious and oppressive conduct

toward the plaintiffs, which conduct the court finds was established by clear and convincing evidence, (2) the net equity of the residence located at 2420 N. Fairmont Ave., Santa Ana, California 92706, which is effectively owned by Catherine Cass despite the purported transfer of title to her daughter Christine Zeman without consideration and agreements to support the transfer and which the court took into consideration in determining the amount of punitive and exemplary damages, and (3) the transfer of title to the residence was to avoid the possibility of a judgment that might affect her ability to hold on to the residence (emphasis added).

The Judgment Creditors recorded an abstract of the State Court Judgment ("Abstract") in Orange County, California on November 1, 2005.

Cass appealed the State Court Judgment. The California Court of Appeals affirmed the damages award but struck some of the injunctive provisions as unconstitutionally broad.

B. The fraudulent transfer lawsuit, the second bankruptcy case, removal of the fraudulent transfer lawsuit and the avoidance judgment

Immediately after the bankruptcy court dismissed Cass's chapter 13 bankruptcy case and, while the Defamation Lawsuit and appeal were pending, the Judgment Creditors filed another suit against Cass and Zeman in state court on July 8, 2005, seeking to avoid and set aside as fraudulent Cass's transfer of the Residence to Zeman ("Fraudulent Transfer Lawsuit") under CAL. CIV. CODE ("CCC") § 3439 et seq., the California Uniform Fraudulent Transfer Act ("CUFTA"). The Judgment Creditors asserted that, despite the transfer, Cass had retained exclusive use, possession and control of the Residence within the meaning of CCC § 3439.04(b)(2). The Residence, which was Cass's only asset, was believed to be worth $500,000 at the time of the transfer. The Judgment Creditors prayed for multiple remedies under California law, including an

order avoiding and setting aside the transfer and restoring title of the Residence to Cass, an attachment against the Residence or its proceeds, injunctive relief and the appointment of a receiver.[3]

The trial in the Fraudulent Transfer Lawsuit was scheduled to begin on January 8, 2007, but was stayed once Cass filed a chapter 7 bankruptcy case on January 5, 2007. Shortly thereafter, Trustee filed a Notice of Substitution of Bankruptcy Trustee as Plaintiff and Real Party in Interest in the state court and removed the Fraudulent Transfer Lawsuit to the bankruptcy court (now the "Fraudulent Transfer Adversary"). All activity in the Fraudulent Transfer Adversary was initially suspended while Cass pursued her appeal of the State Court Judgment.

At a status conference on May 27, 2008, Trustee announced that he, Zeman and the Judgment Creditors had negotiated a stipulation to undo the transfer of the Residence and restore title to Trustee and to dismiss Zeman from the Fraudulent Transfer Adversary. Cass opposed the stipulation. The bankruptcy court noted that because Cass was not a party to it, she could still pursue her appellate rights respecting the State Court Judgment with the California Supreme Court.

The Stipulation for Entry of Judgment Avoiding and Recovering Transfer of Real Property ("Stipulation") and separate judgment ("Avoidance Judgment") were filed on May 29, 2008. The Avoidance Judgment avoided and set aside the transfer of the Residence under

[3] Zeman apparently filed a cross-complaint in the Fraudulent Transfer Lawsuit, but we do not have a copy of it in the record, and it is not clear as to what claims she asserted.

CCC §§ 3439.04[4] and 3439.07,[5] recovered it for the benefit of the estate under § 550, and dismissed Zeman's cross-complaint and the Zeman Adversary[6] with prejudice. All claims against Zeman were now resolved and dismissed with prejudice.

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[4] CCC § 3439.04(a)(1), which is the relevant section here, provides:

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation as follows:
>
> (1) With actual intent to hinder, delay, or defraud any creditor of the debtor.

[5] CCC § 3439.07, which sets forth a creditor's remedies, provides in relevant part:

> (a) In an action for relief against a transfer or obligation under this chapter, a creditor, subject to the limitations in Section 3439.08, may obtain:
>
> (1) Avoidance of the transfer or obligation to the extent necessary to satisfy the creditor's claim.
>
> (2) An attachment or other provisional remedy against the asset transferred or its proceeds . . .
>
> (3) Subject to applicable principles of equity and in accordance with applicable rules of civil procedure, the following:
>
> (A) An injunction against further disposition by the debtor or a transferee, or both, of the asset transferred or its proceeds.
>
> (B) Appointment of a receiver to take charge of the asset transferred or its proceeds.
>
> (C) Any other relief the circumstances may require.
>
> (b) If a creditor has commenced an action on a claim against the debtor, the creditor may attach the asset transferred or its proceeds if the remedy of attachment is available in the action under applicable law and the property is subject to attachment in the hands of the transferee under applicable law.
>
> (c) If a creditor has obtained a judgment on a claim against the debtor, the creditor may levy execution on the asset transferred or its proceeds.

[6] In the Zeman Adversary (07-1094), the Judgment Creditors alleged claims to deny Cass's discharge and sought a determination that their lien rights in the Residence were superior to Zeman's.

Cass appealed the Stipulation and Avoidance Judgment to the Panel. She alternatively requested that the bankruptcy court reconsider its approval of the Stipulation and Avoidance Judgment. The bankruptcy court denied Cass's request to reconsider.

On June 11, 2008, the California Supreme Court denied Cass's petition for review of the appellate court's decision affirming the damages awarded in the State Court Judgment. The State Court Judgment was therefore final.

Cass died on February 7, 2009. On June 11, 2009, the Panel dismissed her appeal of the Stipulation and Avoidance Judgment for lack of prosecution.

C. Trustee's adversary proceeding against the Judgment Creditors

1. Pretrial events

a. Trustee's complaint, the Judgment Creditors' counterclaims, the homestead exemption order and the sale of the Residence

On January 27, 2010, Trustee filed a complaint against the Judgment Creditors seeking a declaratory judgment that the Abstract never attached to the Residence ("Declaratory Relief Adversary").[7] Specifically, Trustee contended that the Judgment Creditors had no judgment lien on the Residence, because Cass had transferred title to it to Zeman before they recorded the Abstract, and any lien against Cass's life estate had terminated upon her death.[8]

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[7] The Declaratory Relief Adversary was initially filed in Santa Ana and assigned case no. 10-1058. When it was transferred to the Los Angeles Division, it was renumbered 12-1235.

[8] Trustee had also asserted a claim under § 549, seeking to avoid, recover and preserve any lien that arose postpetition in (continued...)

The Judgment Creditors filed an answer and counterclaim seeking declaratory relief and injunction against Trustee. Specifically, the Judgment Creditors sought a determination that (a) Trustee had to apply the sale proceeds of the Residence to satisfy their claims against Cass, (b) the Abstract was superior to all claims of interest in the Residence and (c) Cass's transfer to Zeman was a fraudulent transfer that nullified and voided that transfer, including the life estate.

On May 6, 2010, the bankruptcy court entered an order on Trustee's objection to Cass's claimed homestead exemption ("Homestead Exemption Order"):

> IT IS HEREBY ORDERED that the Debtor's disputed claim of exemption in her life estate is rendered moot by her death. Upon the Debtor's death, the life estate terminated and no longer constituted property of bankruptcy estate which could be administered by the Trustee for the benefit of creditors. If and when the Trustee sells the Estate's rights in the real property commonly known as 2420 N. Fairmont Avenue, Santa Ana, California that were established pursuant to [the Avoidance Judgment] entered as Docket No. 155 on May 29, 2008, no portion of the proceeds of sale shall constitute proceeds of the sale of the Debtor's interest in her life estate.

On June 1, 2010, the bankruptcy court entered an order authorizing Trustee to sell the Residence free and clear of all liens, claims and interests for $321,000, with the caveat that the Judgment Creditors' disputed lien attached to the sale proceeds pending resolution of the Declaratory Relief Adversary.

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[8](...continued) favor of the Judgment Creditors upon entry of the Avoidance Judgment. Trustee later dropped this claim at trial after the Judgment Creditors conceded they never contended their judgment lien arose under such a theory. Therefore, we do not further discuss the § 549 claim.

Ultimately, Trustee received $292,730.95 in proceeds. After payment of interim compensation and reimbursement of costs for Trustee and his professionals in the amount of $92,371.66, Trustee held the balance of $193,459.29 in net sale proceeds.

b. The cross-motions for summary judgment, the order denying summary judgment and the appeal of that order

Trustee and the Judgment Creditors filed cross-motions for summary judgment in September 2010. The bankruptcy court denied the cross-motions, determining that certain genuine issues of material fact existed for trial. First, as to the parties' conflicting argument whether in California a fraudulent transfer is "voidable" or "void ab initio," the court observed that neither party had cited a California case holding one way or the other under the CUFTA, and the court had not located any such case. The court further determined that a genuine issue of material fact existed as to Cass's retention of control over the Residence after the transfer of the remainder interest to Zeman within the meaning of the CUFTA and the common law, which needed to be resolved at trial. Finally, the parties needed to address at trial the conflict between CAL. CODE CIV. P. ("CCP") § 697.340(a),[9] which contains an exception for property transfers before judgment is obtained, and case law holding that fraudulent transfers are void.

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[9] CCP § 697.340(a) provides:

> A judgment lien on real property attaches to all interests in real property in the county where the lien is created (whether present or future, vested or contingent, legal or equitable) that are subject to enforcement of the money judgment against the judgment debtor . . . at the time the lien was created, but does not reach . . . real property that is subject to an attachment lien in favor of the creditor and was transferred before judgment (emphasis added).

The parties timely filed cross-appeals of the interlocutory summary judgment order and motions for leave. On June 15, 2011, the Panel issued an order denying leave and dismissing the cross-appeals due to the parties' inability to establish the factors necessary to obtain leave to appeal.

2. The trial, the memorandum decision and the judgment in favor of the Judgment Creditors

In their filed Joint Pretrial Order ("Joint PTO") and Joint Compendium of Exhibits in support, the parties contended that no issues of material fact were in dispute and that the matter could be decided without any witness testimony. The bankruptcy court approved the Joint PTO on November 8, 2011.

On December 19, 2011, Trustee and the Judgment Creditors filed a second stipulation in the Fraudulent Transfer Adversary (the "December 19 Stipulation"), dismissing all remaining claims between the parties not previously dismissed without prejudice so that those claims could be adjudicated in the Declaratory Relief Adversary. Under the December 19 Stipulation, the parties agreed that dismissal of the Fraudulent Transfer Adversary would "not give rise to any adverse legal or other effect on any party or issue to be determined in [the Declaratory Relief Adversary]". The bankruptcy court entered an order on December 20, 2011, approving the December 19 Stipulation (the "December 20 Order").

Both parties submitted opening trial briefs, responses and replies in support. In short, Trustee contended that under CCP § 697.340(a) an abstract of judgment has no affect on previously transferred property. Because the Judgment Creditors recorded their Abstract after Cass transferred her remainder interest in

1 the Residence to Zeman, the Abstract attached only to Cass's life
2 estate, which lapsed upon her death and extinguished any existing
3 liens. He further argued that the state court had not determined
4 Cass had an interest in the Residence at the time the Abstract was
5 recorded. As a result, argued Trustee, the Judgment Creditors had
6 no secured claim against the remainder interest in the Residence.

7 The crux of Trustee's argument was that in California
8 fraudulent transfers are voidable, not void ab initio, because the
9 CUFTA superceded the common law that fraudulent transfers are void
10 with a specific provision that such transfers are subject only to
11 "avoidance." Therefore, contrary to the Judgment Creditors'
12 position, the fraudulent transfer of Cass's remainder interest was
13 not automatically void at the moment it occurred, which is the
14 only way the Abstract could have attached and provided the
15 Judgment Creditors with a secured judgment lien. In fact, argued
16 Trustee, the bankruptcy court's prior ruling in the Homestead
17 Exemption Order implicitly found that the transfer was not void,
18 based on its finding that Cass's only interest in the Residence as
19 of the petition date was a life estate; if the transfer had been
20 void, the court would have found that Cass still held a remainder
21 interest in the Residence despite the transfer to Zeman. Thus, it
22 was law of the case that the transfer was "avoided" and never
23 adjudicated to be "void."

24 Alternatively, Trustee argued that even if the transfer could
25 be declared "void," only he had standing to seek such a
26 determination. According to Trustee, because the Avoidance
27 Judgment avoided, recovered and preserved the transfer of the
28 remainder interest in the Residence and vested title in Trustee

for the benefit of the estate, the Judgment Creditors lost their right to launch a further attack to establish the transfer was void ab initio and obtain a claim superior to the estate. In addition, claim preclusion further barred the Judgment Creditors from asserting that the transfer was void because the Avoidance Judgment conclusively determined it was "avoidable."

The Judgment Creditors essentially argued that their Abstract attached to the Residence when it was filed on November 1, 2005, in one of two ways: (1) Cass was the owner or the equitable owner of the Residence when the Abstract was recorded, so it attached pursuant to CCP § 697.340(a); or (2) because Cass was guilty of a fraudulent transfer, such transfer was "void" and could be disregarded by creditors, so the Abstract attached to the Residence and then to the proceeds, and Trustee's subsequent acquisition of bare title could not defeat the prior recorded Abstract.

Specifically, the Judgment Creditors asserted that their Abstract attached to the Residence even though Cass had previously transferred title to it to Zeman because CCP § 697.340(a) dictated that their judgment lien, which they perfected by recording the Abstract, attached immediately to the Residence and subjected it to the satisfaction of the State Court Judgment. Therefore, the question was whether Cass had any interest in the Residence when the Abstract was recorded. The Judgment Creditors argued that the record, particularly the findings by the state court, established her ownership at that time.

The Judgment Creditors alternatively argued that the Abstract attached to the fee interest Cass attempted to fraudulently

transfer to Zeman because the transfer was void and as though it never occurred. They argued that, contrary to Trustee's position, the CUFTA, particularly CCC § 3439.07(a)(1) and its use of the terms "avoidance" and "avoid," did not displace or expressly supercede the long-established law in California that fraudulent transfers are considered "void." As a result, argued the Judgment Creditors, title and ownership to the Residence remained in Cass, the fraudulent grantor, and Trustee's subsequent acquisition of bare legal title from Zeman (who admitted the transfer was fraudulent by entering into the Stipulation) was subordinate to their prior recorded Abstract. As a result, they were entitled to the balance of the net sale proceeds.

The Judgment Creditors rejected Trustee's standing argument, contending that while he was the only party able to prosecute the fraudulent transfer claims, the result of setting aside the transfer did not necessarily invalidate their Abstract. They also rejected Trustee's argument that his recovery and preservation of the Residence for the estate terminated their competing claims, contending that when a trustee recovers fraudulently transferred property, the recovered property still remains subject to whatever secured liens were against it.

In response, Trustee contended that the Judgment Creditors were precluded from arguing Cass held an equitable interest in the Residence after the transfer because that argument was outside the scope of the Joint PTO, and therefore it had been waived. Trustee further argued that the issue of whether Cass retained a beneficial interest in the Residence other than a life estate was barred because the bankruptcy court had already ruled in the

Homestead Exemption Order that no portion of the sale proceeds were subject to Cass's claimed homestead exemption. Finally, Trustee argued that the Avoidance Judgment, which avoided, recovered and preserved the remainder interest in the Residence, clearly established that the Judgment Creditors' claims of any superior lien rights to Zeman were dismissed with prejudice.

The trial on Trustee's complaint and the Judgment Creditors' counterclaims was held on April 6, 2012. As an initial housekeeping matter, all exhibits in the Joint Compendium of Exhibits were admitted into evidence, and all stipulated facts in the Joint PTO were deemed established. After hearing oral argument from the parties, the bankruptcy court requested further briefing from the parties. The parties timely submitted the ordered post-trial briefs, and the trial was continued to June 12, 2012.

At the continued trial on June 12, 2012, the bankruptcy court announced that it was taking the matter under submission.

The bankruptcy court entered its Memorandum Decision in favor of the Judgment Creditors and dismissing Trustee's complaint on August 31, 2012. The court found that Cass retained an equitable interest in the Residence despite the fraudulent transfer to Zeman. Therefore, when the Judgment Creditors recorded their Abstract, they perfected a judgment lien under California law, which attached to Cass's equitable interest in the Residence. In re Cass, 476 B.R. at 608. This result was obtained whether a fraudulent transfer is void or void ab initio under state law. Id. Nevertheless, the court held that under California law, a fraudulent transfer is void ab initio, except to the extent that

the CUFTA has made it voidable for good faith purchasers for value. Id. Trustee had not established that the CUFTA changed the common law that fraudulent transfers are "void" as to the transferor's creditors. Id. at 617-18. Any cases relied upon by Trustee either were distinguishable on the facts or applied law of another state, which was substantively different from California. Id. at 616-19. Accordingly, Trustee was to apply the sale proceeds from the Residence to satisfy the Judgment Creditors' claims against Cass, except those interests superior to their November 1, 2005 judgment lien. Id. at 618-19.[10]

On October 5, 2012, the bankruptcy court entered an amended judgment against Trustee's complaint and in favor of the Judgment Creditors on their counterclaims (the "Declaratory Relief Judgment").[11]

Trustee timely appealed the Declaratory Relief Judgment on October 9, 2012. On that same date, he also filed a motion for stay pending appeal in the bankruptcy court. The Judgment Creditors opposed the motion. The bankruptcy court denied the motion for stay pending appeal for Trustee's failure to demonstrate that he would suffer irreparable injury. For these

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[10] The bankruptcy court rejected Trustee's contention that various preclusion doctrines barred litigation of the Judgment Creditors' claims that the Abstract attached to the Residence or that the transfer was void ab initio. In re Cass, 476 B.R. at 610-13.

[11] The original judgment was entered on October 4, 2012, but Trustee had lodged an objection to the form of that judgment because it included what he contended were impermissible findings that had been separately stated in the memorandum decision. The bankruptcy court agreed and entered the amended judgment, which had deleted all findings.

same reasons, the BAP motions panel denied Trustee’s emergency motion for stay pending appeal on November 9, 2012.

II. JURISDICTION

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

III. ISSUES

1. Could the Judgment Creditors seek a determination as to whether their judgment lien attached to the Residence?
2. Did the bankruptcy court abuse its discretion by not applying issue preclusion or judicial estoppel?
3. Did the bankruptcy court err in determining that Cass retained an equitable interest in the Residence to which their judgment lien attached despite the purported transfer of her remainder interest to Zeman?

IV. STANDARDS OF REVIEW

We review de novo the bankruptcy court’s conclusions of law and review for clear error its findings of fact. McDonald v. Checks-N-Advance, Inc. (In re Ferrell), 539 F.3d 1186, 1189 (9th Cir. 2008)(per curiam).

We review a bankruptcy court’s interpretation of California law de novo in order to determine if it correctly applied the substantive law. Kipperman v. Proulx (In re Burns), 291 B.R. 846, 849 (9th Cir. BAP 2003); Astaire v. Best Film & Video Corp., 116 F.3d 1297, 1300 (9th Cir. 1997)(issues of state law are reviewed de novo).

We review questions regarding the application of “res judicata, including issue and claim preclusion, de novo, as mixed

questions of law and fact in which legal questions predominate." Khaligh v. Hadaegh (In re Khaligh), 338 B.R. 817, 823 (9th Cir. BAP 2006), aff'd, 506 F.3d 956 (9th Cir. 2007)(citations omitted). "Once it is determined that preclusion doctrines are available to be applied, the actual decision to apply them is left to the trial court's discretion." Id. at 823 (citations omitted).

We review a bankruptcy court's application of judicial estoppel for abuse of discretion. Cheng v. K&S Diversified Invs., Inc. (In re Cheng), 308 B.R. 448, 452 (9th Cir. BAP 2004)(citing Hamilton v. State Farm Fire & Cas. Co., 270 F.3d 778, 782 (9th Cir. 1999)). Likewise, we review a bankruptcy court's interpretation of its own order for an abuse of discretion. Arenson v. Chi. Mercantile Exch., 520 F.2d 722, 725 (7th Cir. 1975). A bankruptcy court abuses its discretion if it applied the wrong legal standard or its findings were illogical, implausible or without support in the record. TrafficSchool.com, Inc. v. Edriver Inc., 653 F.3d 820, 832 (9th Cir. 2011).

V. DISCUSSION

A. The Judgment Creditors could seek a determination in the Declaratory Relief Adversary about whether their judgment lien attached to the Residence.

Under § 541(a)(1), as of the commencement of the bankruptcy case, a debtor's interest in property, whether a legal or an equitable interest, becomes property of the bankruptcy estate. Property of the estate also includes any interest in property recovered under § 550[12] and any interest in property that is

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[12] Section 550(a) provides:

(a) Except as otherwise provided in this section, to the (continued...)

preserved for the benefit of the estate under § 551.[13] Section 541(a)(3), (a)(4).

Section 550 allows the trustee to recover fraudulently transferred property for the benefit of the estate to the extent that a transfer is avoided as fraudulent under either §§ 544 or 548. Once a trustee recovers an asset for the estate through one of the enumerated transfer or lien avoidance provisions, § 551 automatically preserves the asset for the benefit of the estate. Heintz v. Carey (In re Heintz), 198 B.R. 581, 584 (9th Cir. BAP 1996)(citing The Retail Clerks Welfare Trust v. McCarty (In re Van De Kamp's Dutch Bakeries), 908 F.2d 517, 520 (9th Cir. 1990)); In re Schmiel, 319 B.R. 520, 529 (Bankr. E.D. Mich. 2005)(once the transfer of an asset is avoided, § 551 automatically returns that "stick" to the "bundle" that makes up estate property and preserves it for the benefit of the estate).

Facing an expired statute of limitations problem precluding an avoidance action under § 548, Trustee proceeded under § 544 to avoid Cass's fraudulent transfer of the Residence to Zeman.

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[12](...continued)
extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from--
(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
(2) any immediate or mediate transferee of such initial transferee.

[13] Section 551 provides:

Any transfer avoided under section 522, 544, 545, 547, 548, 549, or 724(a) of this title, or any lien void under section 506(d) of this title, is preserved for the benefit of the estate but only with respect to property of the estate.

Section 544 is what conferred standing to Trustee in place of the Judgment Creditors to prosecute the Fraudulent Transfer Adversary. See Gen. Elec. Capital Auto Lease, Inc. v. Broach (In re Lucas Dallas, Inc.), 185 B.R. 801, 804 (9th Cir. BAP 1995)(trustee lacks standing to assert independent state law created fraudulent transfer claims and can only do so by way of § 544(b)). Under § 544(b)(1), a trustee "may avoid any transfer of an interest of the debtor in property . . . that is voidable under applicable law" - i.e., state law. The transfer here was avoidable by Trustee as a fraudulent transfer under California law, specifically, the CUFTA, found in CCC §§ 3439 et seq. See Kupetz v. Wolf, 845 F.2d 842, 845 (9th Cir. 1988)(Section 544(b) permits a trustee to stand in a creditor's shoes to assert any state law claims that a creditor may have.).

Trustee argues that the bankruptcy court erred when it entered judgment in favor of the Judgment Creditors because their claims as to whether they held an interest in the Residence, that the transfer was void ab initio, or that their purported lien attached to the Residence were cut off once he avoided, recovered and preserved the Residence for the benefit of the estate under §§ 550 and 551. He further argues that because the Residence was preserved under § 551, their judgment lien disappeared. Trustee also argues that he was the only party with standing to seek avoidance of the fraudulent transfer and recovery of the Residence.

It is undisputed that Trustee was the only party with standing to prosecute what became the Fraudulent Transfer Adversary against Cass and Zeman. See Estate of Spirtos v. One

San Bernardino Cnty. Super. Ct., 443 F.3d 1172, 1776 (9th Cir. 2006); In re PWS Holding Corp., 303 F.3d 308 (3d Cir. 2002), cert. denied, 538 U.S. 924 (2003)(although individual creditors may be permitted to bring a fraudulent transfer action derivatively on behalf of the estate, they have no standing to prosecute such an action in their own right and for their own benefit, even if they would have had standing to do so outside of bankruptcy). However, Trustee fails to cite any authority supporting his contention that, because a trustee has avoided and recovered property initially subject to a secured creditor's fraudulent transfer lawsuit, such creditor loses all rights to any claims or defenses it may have. The bankruptcy court rejected this argument at trial. We disagree that Quarre v. Saylor (In re Saylor), 178 B.R. 209 (9th Cir. BAP 1995), aff'd 108 F.3d 219 (9th Cir. 1997) supports Trustee's position. Saylor did not address the lien rights of a judgment creditor, as that was not an issue in the case. Saylor merely held that a judgment creditor did not have standing to prosecute an exception to discharge claim under § 523(a)(6) based on an alleged fraudulent transfer of real property.

To the extent Trustee argues that the Judgment Creditors dismissed their claims by entering into the Stipulation and Avoidance Judgment, we reject this argument for the same reasons articulated by the bankruptcy court, which we explain in more detail below. As for Trustee's policy argument that recovered property is not intended to benefit just one creditor but is to be equitably shared by them all, this policy pertains to unsecured creditors, not secured ones. See generally §§ 507 and 726.

Trustee also fails to cite any authority holding that, once a fraudulently transferred property is avoided under state law and recovered and preserved under §§ 550 and 551, a secured creditor's perfected judgment lien (or other perfected security interest) disappears. Section 551 does not operate to somehow make a secured creditor's perfected lien disappear upon the trustee's later avoidance of the transfer. In re Mathiason, 129 B.R. 173, 177 (Bankr. D. Minn. 1991) aff'd, 16 F.3d 234 (8th Cir. 1994). That statute is intended to prevent junior lienholders from improving their position at the expense of the estate when a senior lien is avoided. Id. (citing S.Rep. No. 989, 95th Cong., 2d Sess. 91 (1978), U.S.Code Cong. & Admin.News 1978, p. 5787)). "It is not intended to strip from recovered property, interests equal or senior to the transfer avoided." Id. Assuming that the Judgment Creditors had a perfected senior lien in the Residence, which we believe they did, Trustee took the Residence subject to that senior lien. Trustee also offers no argument to counter California law that perfected judgment liens are extinguished only by the recording of an acknowledgment of satisfaction of the underlying judgment or by the judgment creditor's release of the lien. CCP § 697.400(a), (c).

Accordingly, the bankruptcy court did not err by allowing the Judgment Creditors to assert their claims against Trustee or raise any defenses thereto.

B. The bankruptcy court did not abuse its discretion when it determined that issue preclusion and judicial estoppel did not preclude the Judgment Creditors' claims.

Although Trustee asserted the doctrines of claim preclusion, issue preclusion, judicial estoppel, law of the case and election

of remedies before the bankruptcy court and in his statement of issues on appeal in his opening brief, he provides argument only as to the doctrines of issue preclusion and judicial estoppel. Therefore, we address only these two, as he has waived any right to assert the other doctrines. See McLain v. Calderon, 134 F.3d 1383, 1384 n.2 (9th Cir. 1998)(issue mentioned in statement of issues but not discussed in brief is considered waived).

1. Issue preclusion as to the Avoidance Judgment

"The preclusive effect of a federal court judgment is determined by federal common law, but the rule of decision differs depending upon whether the federal court's jurisdiction over the issue was based on diversity or federal question." Haliburton Energy Servs., Inc. v. McVay (In re McVay), 461 B.R. 735, 741 (Bankr. C.D. Ill. 2012)(citing Taylor v. Sturgell, 553 U.S. 880, 891 (2008)). "Under federal common law, a federal diversity judgment is to be accorded the same preclusive effect that would be applied by the state courts in the state in which the federal diversity court sits." Id. (citing Taylor, 553 U.S. at 891 n.4); Semtek Int'l Inc. v. Lockheed Martin Corp., 531 U.S. 497, 508 (2001)). "For judgments in federal question cases, federal common law supplies the rule of decision." Id. (citing Taylor, 553 U.S. at 891).

The bankruptcy court applied California issue preclusion law to the Avoidance Judgment, which avoided the fraudulent transfer of the Residence under California law by Trustee under § 544(b). Trustee recovered and preserved the Residence for the benefit of the estate under §§ 550 and 551. Both the Avoidance Judgment and Homestead Exemption Order were entered by the bankruptcy court.

Hence, we have two judgments entered by a federal court deciding what were ultimately federal questions, although rooted in state law. Therefore, we conclude that federal issue preclusion law should have been applied in this case. Nonetheless, whether federal or California issue preclusion law[14] applied, the result is the same. The Judgment Creditors were not precluded from seeking a determination that their judgment lien attached to the Residence.

Issue preclusion "bars 'successive litigation of an issue of fact or law that was actually litigated and resolved in a valid court determination essential to that prior judgment,' even if the issue recurs in the context of a different claim." Taylor, 553 U.S. at 892 (quoting New Hampshire v. Maine, 532 U.S. 742, 748-49 (2001)). As the party asserting issue preclusion, Trustee had the burden of establishing all elements required for its application. Palm v. Klapperman (In re Cady), 266 B.R. 172, 183 (9th Cir. BAP 2001)(citing Watson v. Shandell (In re Watson), 192 B.R. 739, 747 (9th Cir. BAP 1996); Berr v. FDIC (In re Berr), 172 B.R. 299, 306 (9th Cir. BAP 1994)). Under the federal standard, four elements must be met for issue preclusion to apply: (1) The issue sought to be precluded must be the same as that

[14] California issue preclusion law is virtually identical to federal law. In California, the party asserting issue preclusion must establish the following five elements: (1) the issue sought to be precluded from relitigation must be identical to that decided in a former proceeding; (2) this issue must have been actually litigated in the former proceeding; (3) it must have been necessarily decided in the former proceeding; (4) the decision in the former proceeding must be final and on the merits; and (5) the party against whom preclusion is sought must be the same as, or in privity with, the party to the former proceeding. Lucido v. Super. Ct., 51 Cal.3d 335, 341 (Cal. 1990)(citations omitted).

involved in the prior action; (2) the issue must have been actually litigated; (3) it must have been determined by a valid and final judgment; and (4) the determination must have been essential to the final judgment. Id. (citing In re Berr, 172 B.R. at 306).

Trustee argues that the bankruptcy court should have applied issue preclusion to the Avoidance Judgment and ruled that the Judgment Creditors were precluded from seeking a determination that the transfer was "void ab initio." Specifically, he contends the bankruptcy court erred in finding that the Avoidance Judgment did not adjudicate the same issues as the instant Declaratory Relief Adversary when the Avoidance Judgment established that the transfer occurred, was "avoided," and restored all ownership interests in the Residence to Trustee for the benefit of the estate.

In deciding that Trustee had not met his burden of establishing the elements for issue preclusion to the Avoidance Judgment, the bankruptcy court was interpreting its own order. We accord substantial deference to a court's interpretation of its own orders and will not overturn that interpretation unless we are convinced it amounts to an abuse of discretion. Marciano v. Fahs (In re Marciano), 459 B.R. 27, 35 (9th Cir. BAP 2011). See Hallett v. Morgan, 296 F.3d 732, 739-40 (9th Cir. 2002)(special consideration is given to the trial court's interpretation of its own orders); Colonial Auto Ctr. v. Tomlin (In re Tomlin), 105 F.3d 933, 941 (4th Cir. 1997)(the bankruptcy judge who has presided over a case from its inception is in the best position to clarify the court's rulings).

We are not convinced that the bankruptcy court's interpretation of the Avoidance Judgment was an abuse of discretion. It determined that the Avoidance Judgment did not address, let alone adjudicate, the issues related to the Judgment Creditors' claims of: (1) whether the judgment lien from the recorded Abstract attached to the Residence; (2) whether the judgment lien is superior to Trustee's interests; or (3) whether the transfer from Cass to Zeman was void or voidable. In re Cass, 476 B.R. at 610-11. It further found that the Avoidance Judgment did not eliminate the Judgment Creditors' rights to their claims for declaratory and injunctive relief. Id. at 611. To the contrary, the parties expressly agreed in the December 19 Stipulation that those claims would be dismissed without prejudice in the Fraudulent Transfer Adversary so they could be adjudicated in this action, and that the dismissal of those claims would not give rise to any adverse legal or other effect on any party or issue to be determined in this action. Id. Accordingly, Trustee had not established that the issue was actually and necessarily decided. We see no abuse of discretion in the bankruptcy court's decision.

For these same reasons, we also reject Trustee's argument that issue preclusion foreclosed the Judgment Creditors from claiming that the Abstract attached to any equitable interest in the Residence, other than Cass's life estate. Because the parties had agreed to dismiss the remaining claims between them so that those claims/issues could be decided in the Declaratory Relief Adversary, the Judgment Creditors could seek a determination of whether the Abstract attached to any interest Cass had at the time

it was recorded, equitable or otherwise.

2. Issue preclusion as to the Homestead Exemption Order

The bankruptcy court rejected Trustee's "flawed" contention that the Homestead Exemption Order precluded the Judgment Creditors from asserting they had perfected a judgment lien based on a post-transfer recordation of the Abstract. In re Cass, 476 B.R. at 612 n.3. To be precise, the court determined that issue preclusion did not apply because: (1) the Homestead Exemption Order was not a judgment on the merits because the court denied Cass's claimed exemption as moot in light of her death; and (2) the perfection issue was not actually litigated in the homestead exemption litigation and was not actually and necessarily decided in the court's denial of the claimed homestead exemption. Id.

Trustee argues that the Homestead Exemption Order necessarily determined Cass did not have an interest in the previously transferred remainder interest in the Residence because, if it had, such interest would have been subject to the homestead exemption. He fails to address the bankruptcy court's other finding that the perfection issue was not actually litigated in the context of the homestead exemption.

In deciding that Trustee had not met his burden of establishing the elements for issue preclusion to the Homestead Exemption Order, the bankruptcy court was interpreting its own order, and we give substantial deference to that interpretation. In re Marciano, 459 B.R. at 35. Again, Trustee has not convinced us that the bankruptcy court abused its discretion in determining the Homestead Exemption Order did not preclude the Judgment

Creditors from asserting they had perfected their judgment lien. We also note that, although it is not the basis for our decision, Trustee did not provide in the record any of the underlying documents filed in the homestead exemption matter to support his contention about what the bankruptcy court "necessarily decided." We further reject Trustee's contention that Cass's remainder interest would have been subject to a homestead exemption. A debtor who has voluntarily transferred property in fraud of creditors prepetition, which is later recovered, loses any exemption in that recovered property. Hitt v. Glass (In re Glass), 164 B.R. 759, 762 (9th Cir. BAP 1994); § 522(g).[15]

3. Judicial estoppel as to the Avoidance Judgment

"Judicial estoppel is an equitable doctrine that precludes a party from gaining an advantage by asserting one position, and then later seeking an advantage by taking a clearly inconsistent position." Hamilton, 270 F.3d at 782 (citing Rissetto v. Plumbers & Steamfitters Local 343, 94 F.3d 597, 600-01 (9th Cir. 1996)). The doctrine is aimed at not only preventing a party from gaining an advantage by asserting inconsistent positions, but also ensuring "the orderly administration of justice and . . . the

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[15] Section 522(g) provides:

> 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 such property by the debtor; and
> (B) the debtor did not conceal such property; or
> (2) the debtor could have avoided such transfer under subsection (f)(1)(B) of this section.

dignity of judicial proceedings," and to "protect against a litigant playing fast and loose with the courts." Russell v. Rolfs, 893 F.2d 1033, 1037 (9th Cir. 1990).

Trustee contends the Judgment Creditors were judicially estopped from asserting the inconsistent position that the fraudulent transfer was void and had never occurred when they sought a judgment in state court "avoiding" the transfer and restoring title to Cass, thereby admitting Cass had no equitable interest in the Residence and that her transferred interest had to be restored for their lien to attach. Trustee further argues that the Judgment Creditors failed to preserve in the Avoidance Judgment, which avoided the transfer under CCC §§ 3439.04 and 3439.07, the argument that the transfer could later be attacked as void ab initio under CCC § 3439.10.

The bankruptcy court determined that judicial estoppel did not apply because the Judgment Creditors had not taken inconsistent positions in the Fraudulent Transfer Adversary and in the Declaratory Relief Adversary. In re Cass, 476 B.R. at 613. We agree. First, judicial estoppel generally applies only to bar a party from making a factual assertion in a legal proceeding which directly contradicts an earlier assertion made in the same proceeding or a prior one. Russell, 893 F.2d at 1037. The Judgment Creditors' request for relief of "avoiding" and setting aside the fraudulent transfer is not a factual assertion, and their complaint did not admit that Cass had no equitable interest in the Residence. In fact, the Judgment Creditors alleged that the transfer was a "fraudulent transfer within the meaning of common law of fraudulent transfers and within the meaning of [CCC]

§§ 3439.04 and 3439.05, and should be avoided and set aside." California common law treats such transfers void as to creditors. Hence, their position was not inconsistent from the earlier suit. As for Trustee's second argument, the bankruptcy court found, and we agree, that the Judgment Creditors preserved their remaining claims in the December 19 Stipulation and December 20 Order.

Accordingly, the bankruptcy court properly declined to apply the doctrine of judicial estoppel in this case.

C. The bankruptcy court did not err when it determined that Cass had an equitable interest in the Residence to which the judgment lien attached upon recordation of the Abstract.

1. Governing California law

The CUFTA permits defrauded creditors to reach property in the hands of a transferee. Fidelity Nat'l Title Ins. Co. v. Schroeder, 179 Cal.App.4th 834, 840 (Cal. Ct. App. 2009)(citing Mejia v. Reed, 331 Cal.4th 657, 663 (Cal. 2003)). It is undisputed that Cass's transfer of the Residence to Zeman was a fraudulent transfer, and that Zeman was not a good faith transferee under CCC § 3439.08.[16] It is also undisputed that the transfer was avoided under CCC §§ 3439.04 and 3439.07.

A judgment lien on real property is created by recording an abstract of a money judgment with the county recorder. CCP § 697.310(a); Weeks v. Pederson (In re Pederson), 230 B.R. 158, 160 (9th Cir. BAP 1999)(in California the recording of an abstract of a money judgment in the county creates a judgment lien

[16] CCC § 3439.08(a) provides:

> A transfer or an obligation is not voidable under paragraph (1) of subdivision (a) of Section 3439.04, against a person who took in good faith and for a reasonably equivalent value or against any subsequent transferee or obligee.

on real property, which attaches to all debtor's interests in real property in the county). Under CCP § 697.340(a), a recorded judgment lien on real property attaches to all interests the judgment debtor has in real property in the county where the lien is created, including equitable interests, and subjects that property to enforcement of the money judgment.

2. Analysis

The bankruptcy court initially found "as a factual matter" that Cass had an equitable interest in the Residence after she made the transfer to which the Judgment Creditors' lien attached upon recording of the Abstract. In re Cass, 476 B.R. at 608. Elaborating on this point, the court explained that Cass retained an equitable interest in the Residence based on the agreement that Zeman would reconvey title to Cass upon demand:

> For all intents and purposes, the Residence was the Debtor's property. She continued to enjoy the right to use the property through her retention of the life estate in the property, and she continued to control Zeman's right to dispose of the property, as evidenced by the side agreement between Debtor and Zeman to re-convey the remainder interest. On this record, the court finds by a preponderance of the evidence that the Debtor retained an equitable interest in the Residence after she purportedly transferred a remainder interest to her daughter.

Id. at 616. The bankruptcy court then held that because Cass had at least an equitable interest in the Residence, despite the purported transfer of the remainder interest to Zeman, and because CCP § 697.340(a) provides that a judgment lien attaches to all interests in real property, including equitable interests, the Judgment Creditor's judgment lien attached to this interest when they recorded the Abstract per CCP § 697.310(a). Id. at 616-17.

Trustee contends that the Abstract did not attach under

CCP § 697.340(a), because it was not filed until after the transfer and, because the transfer was not avoided until May 29, 2008, the Abstract had nothing to which it could attach at the time of recordation in 2005 other than Cass's life estate, which lapsed upon her death. Trustee further argues that the Judgment Creditors did not plead a constructive or resulting trust in the Fraudulent Transfer Lawsuit, and the Avoidance Judgment did not establish a constructive or resulting trust based on any alleged equitable interest Cass retained in the Residence to which the Abstract could attach.

The bankruptcy court did not address the issue of constructive or resulting trusts in its decision. It determined, as a matter of fact, that Cass retained an equitable interest in the Residence because Zeman had agreed to reconvey the remainder interest to Cass upon demand. Trustee has not disputed this fact. He argues, however, in his reply brief, that the bankruptcy court failed to cite any authority to support its conclusion that Cass held an equitable interest in the Residence to which the Abstract could have attached. Although we are free to reject this argument because it was not raised in Trustee's opening brief, we exercise our discretion to address it. See Smith v. Marsh, 194 F.3d 1045, 1052 (9th Cir. 1999)(issues not raised in appellant's opening brief are deemed waived). We preface our discussion by noting that we apply California law to determine the nature and extent of a debtor's interest in property. See Butner v. United States, 440 U.S. 48, 54 (1979).

Under California law, a transferee of property transferred in fraud of creditors by the transferor holds only nominal or bare

legal title to the property conveyed; the transferor retains the beneficial and equitable interest in the conveyed property, which remains liable to the debts of creditors. Sasaki v. Kai, 56 Cal.App.2d 406, 410 (Cal. Ct. App. 1942)(citing McAlvay v. Consumer's Salt Co., 112 Cal.App. 383, 394 (Cal. Ct. App. 1931)); Alhambra Bldg. & Loan Assn. v. DeCelle, 47 Cal.App.2d 409, 412 (Cal. Ct. App. 1941)(grantee holds "mere naked legal title" of fraudulently conveyed property when he holds it in secret trust for the judgment debtor, who remains the beneficial owner of the property); 30 Cal. Jur. 3d ENFORCEMENT OF JUDGMENTS § 118 (2013) ("Where only nominal title is conveyed to a third party by the judgment debtor, the debtor's beneficial interest in the property is liable for the debts of subsequent creditors as well as those existing at the time of the transfer."). See also Breeden v. Smith, 120 Cal.App.2d 622, 664-66 (Cal. Ct. App. 1953)(although in the context of a homestead exemption, the court recognized that a judgment debtor who transfers his interest in property to the transferee to hold in secret trust in fraud of creditors but who remains in exclusive possession of that property retains full equitable interest in the property; transferee holds only bare legal title); and Putnam Sand & Gravel Co., Inc. v. Albers, 14 Cal.App.3d 722, 726 (Cal. Ct. App. 1971)(holding same); and Tarlesson v. Broadway Foreclosure Invs., LLC, 184 Cal.App.4th 931, 937 (Cal. Ct. App. 2010)(citing Breeden and Albers and holding same). This result is based on the principle that "one cannot be the equitable owner of property and still have it exempt from his debts." Sasaki, 56 Cal.App.2d at 410 (quoting McAlvay, 112 Cal.App. at 394).

Accordingly, we agree with the bankruptcy court that Cass retained an equitable interest in the Residence, despite the purported transfer. Because CCP § 697.340(a) provides that a perfected judgment lien attaches to all debtor's interests in real property, including equitable interests, the Judgment Creditor's judgment lien attached to this equitable interest when they recorded the Abstract per CCP § 697.310(a) on November 1, 2005.

As for Trustee's resulting trust theory, we fail to see where he raised this argument before the bankruptcy court. As such, we treat it as waived. See Ellsworth v. Lifescape Med. Assocs., P.C. (In re Ellsworth), 455 B.R. 904, 919 (9th Cir. BAP 2011)(failing to demonstrate that argument was properly raised to the bankruptcy court can result in waiver).[17]

We also disagree with Trustee that the bankruptcy court erred in considering the state court's comments that Cass "effectively owned" the Residence to conclude that Cass had an equitable interest in the Residence to which the Judgment Creditors' lien could attach. Because these comments by the state court in the

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[17] Even if we did address this issue, we disagree with Trustee that under Schroeder, supra at 29, which did not involve a CUFTA claim, the Judgment Creditors were required to plead a resulting trust cause of action if they wanted a ruling that the Abstract attached to any equitable interest created by the resulting trust. Schroeder did not hold that a creditor must plead a cause of action for a resulting (or constructive) trust in order for an abstract of judgment to attach to a fraudulent debtor's equitable interest in property. Further, even if the Judgment Creditors were required to plead this equitable remedy, because this case was tried on the merits, the bankruptcy court could have afforded such relief whether they requested it or not. See Am. Motorists Ins. Co. v. Cowan, 127 Cal.App.3d 875, 883 (Cal. Ct. App. 1982) (after a trial on the merits the court may afford any form of relief supported by the evidence and as to which the parties were on notice, whether requested in the pleadings or not)(citing CCP § 580 and 3 Witkin, Cal. Procedure PLEADING, §§ 374, 376, pp. 2038, 2039-40)(2d ed. 1971)).

Defamation Lawsuit were part of the undisputed facts in the Joint PTO, which were deemed established at trial, the bankruptcy court was well within its discretion to consider them. Further, nothing in the bankruptcy court's decision indicates that it relied solely on these comments to reach the conclusion that Cass owned an equitable interest in the Residence at the time the Abstract was recorded. To the contrary, the bankruptcy court reached this conclusion on its own findings and application of California law.

VI. CONCLUSION

We conclude that Cass held an equitable interest in the Residence at the time the Judgment Creditors recorded their Abstract, and that equitable interest was subject to attachment by her creditors. Because their perfected judgment lien attached to Cass's equitable interest in the Residence pursuant to CCP § 697.340(a), Trustee took the Residence subject to the Judgment Creditors' senior interest when he avoided and recovered it. As a result, the Declaratory Relief Judgment is AFFIRMED, and Trustee must apply the sale proceeds from the Residence to satisfy the Judgment Creditors' claims against Cass, except those interests superior to their November 1, 2005 judgment lien.

FILED

MAR 19 2013

SUSAN M SPRAUL, CLERK
U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP Nos. CC-12-1112-PaDKi CC-12-1141-PaDKi (Cross Appeals)
WILLIAM SPENCER REINGOLD and ALIDA ANN REINGOLD, Debtors.	Bankr. No. 10-24329-RN Adv. Proc. No. 10-01903-RN
WILLIAM SPENCER REINGOLD, Appellant and Cross-Appellee, v. SHARON SHAFFER, Appellee and Cross-Appellant.	**M E M O R A N D U M**[1]

Argued and Submitted on February 22, 2013,
at Pasadena, California

Filed - March 19, 2013

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

Honorable Charles E. Rendlen, III, Bankruptcy Judge, Presiding

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Appearances: Shai S. Oved argued for appellant William Spencer Reingold; Philip Dennis Dapeer argued for appellee Sharon Shaffer.

Before: PAPPAS, DUNN and KIRSCHER, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

Chapter 7[2] debtor William Spencer Reingold ("Reingold") appeals from a decision of the bankruptcy court determining that $76,000 of a total debt of $126,000 he owed to creditor Sharon Shaffer ("Shaffer") was excepted from discharge under § 523(a)(2)(A). Shaffer cross-appeals, arguing that the total debt should be excepted from discharge under § 523(a)(2)(A). We AFFIRM.

FACTS

Reingold is a contractor and real estate developer. In 2008, he hoped to purchase and rehabilitate a single-family residence in Santa Barbara that had been damaged by fire (the "Property"). At some point not clear in the record, but before having contact with or receiving any funds from Shaffer, Reingold withdrew money from his children's IRA accounts and made a deposit of $32,000 into escrow for the purchase of the Property.

Reingold did not have sufficient funds from his available resources to complete the acquisition of and work on the Property, nor to meet his other business expenses. Reingold enlisted Shaffer's financial aid.

On October 24, 2011, Shaffer gave Reingold a check for $50,000. Reingold cashed it and the check cleared the bank on October 28, 2011. Reingold asserts that the money given to him by Shaffer was intended to be a general purpose loan to support his business. Shaffer disputes this, and contends that the loan was

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[2] Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. The Federal Rules of Civil Procedure are referred to as Civil Rules.

intended solely for Reingold's use to acquire and improve the Property.

On October 31, 2011, Reingold and Shaffer signed a Loan Agreement and Promissory Note (the "Loan Agreement"), prepared by Reingold, containing, in part, the following terms:

> [SHAFFER] agrees to loan [REINGOLD] the sum of $126,000 dollars (Hereinafter, "the Loan Amount") to be used for purchase and rehabilitation of [the Property]. FOR VALUE RECEIVED, [REINGOLD] promises to pay to the order of [SHAFFER] the sum of $150,000 dollars within one year. . . . If the Loan Amount is not repaid within one year interest thereafter will accrue at a rate of 16% annually on any unpaid principal or interest. Upon acquisition of the [Property] [REINGOLD] grants [SHAFFER] an immediate secured interest in [the PROPERTY] as a secondary lienholder.

On November 17, 2008, Shaffer gave Reingold a second check, this one for $76,000. The check cleared the bank on November 25, 2011.

On April 20, 2009, Reingold canceled the escrow on the Property and the $32,000 deposit was refunded to him.

On July 21, 2009, Shaffer sued Reingold in state court for breach of contract and to collect on the promissory note. Shaffer conceded in the bankruptcy court that she did not assert a cause of action for fraud against Reingold in state court. The state court granted a default judgment against Reingold in favor of Shaffer on November 4, 2009, for $126,000 in damages, $12,047.00 interest, $43,069.00 attorney's fees, and $2,595.00 costs, for a total of $183,711.00.

Reingold and his wife filed a petition under chapter 7 on April 14, 2010.

Shaffer filed an adversary complaint against Reingold on May 24, 2010, and a First Amended Complaint ("FAC") on August 24,

2010. In the FAC, Shaffer sought a determination that the debt owed by Reingold[3] to her was excepted from discharge in bankruptcy under § 523(a)(2)(A). Specifically, Shaffer alleged that the representations made to her by Reingold in the Loan Agreement — that the loan proceeds would be used for the purchase and rehabilitation of the Property — were false and fraudulent at the time they were made; that Reingold was aware of that falsity; that Reingold made those representations with the intent to obtain the loan and to defraud Shaffer; and that Shaffer relied on those representations and was proximately damaged by them. Reingold filed an answer on September 21, 2010, admitting that he signed the promissory note and Loan Agreement, but generally denying the remaining allegations.

Shaffer submitted a trial brief to the bankruptcy court in which she argued that: (1) Reingold obtained the loan proceeds of $126,000 based on false statements, which were compounded by Reingold's concealment of material facts, such as his financial inability to acquire the Property and his intention to use the funds for purposes other than the Project; (2) Reingold never intended to use the loan proceeds for the purpose he represented to Shaffer; (3) Reingold did not use the proceeds for their intended purpose; (4) Shaffer was victimized by Reingold.

Reingold's trial brief acknowledged that he had defaulted on his contractual obligations under the Loan Agreement, but denied that he committed any fraud. Generally, Reingold asserted that he

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[3] In her First Amended Complaint, Shaffer asserted that Reingold's wife, Alida Ann Reingold, was also responsible for the debt. The parties agreed to dismiss Alida as a defendant with prejudice before the trial in the adversary began.

did not make any material misrepresentations, with knowledge of any falsity, upon which Shaffer relied and sustained injury.

The bankruptcy court conducted a trial on November 28, 2011. Shaffer and Reingold were represented by counsel. They were the only two witnesses, and both were subject to cross-examination. At the close of testimony, the court took the issues under advisement.

On January 9, 2012, the bankruptcy court announced its oral decision on the record. It found that the debt represented by the $76,000 check given by Shaffer to Reingold was excepted from discharge under § 523(a)(2)(A) because those loan proceeds were obtained by false pretenses and used for purposes other than as specifically represented in the Loan Agreement.

On the other hand, the bankruptcy court ruled that the debt represented by the $50,000 check could be discharged. The court found that the money represented a general purpose loan from Shaffer to Reingold for development of the Property. The court would later in its findings observe that a general purpose loan is that "for which the borrower could use the loan for any purpose."

The bankruptcy court entered a judgment in favor of Shaffer and against Reingold on February 16, 2012, for $76,000, which it declared to be excepted from discharge under § 523(a)(2)(A). Reingold timely appealed the judgment. Shaffer filed a timely cross-appeal.

JURISDICTION

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

ISSUES

Whether the bankruptcy court erred in determining that the debt represented by the $50,000 check was not excepted from discharge under § 523(a)(2)(A).

Whether the bankruptcy court erred in finding that the debt represented by the $76,000 check was excepted from discharge under § 523(a)(2)(A).

STANDARDS OF REVIEW

The question whether a claim is excepted from discharge under § 523(a)(2)(A) presents mixed issues of law and fact which we review de novo. Diamond v. Kolcum (In re Diamond), 285 F.3d 822, 826 (9th Cir. 2001). We review the bankruptcy court's findings of fact for clear error. Honkanen v. Hopper (In re Honkanen), 446 B.R. 373, 378 (9th Cir. BAP 2011).

DISCUSSION

Section 523(a)(2)(A) provides that: "A discharge . . . does not discharge an individual debtor from any debt . . . (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by — (A) false pretenses, a false representation, or actual fraud[.]" To demonstrate to the bankruptcy court that a debt should be excepted from discharge under § 523(a)(2)(A), a creditor must prove five elements: (1) misrepresentation, fraudulent omission or deceptive conduct by the debtor; (2) knowledge of the falsity or deceptiveness of his statement or conduct; (3) an intent to deceive; (4) justifiable reliance by the creditor on the debtor's statement or conduct; and (5) damage to the creditor proximately caused by its reliance on the debtor's statement or conduct.

Ghomeshi v. Sabban (In re Sabban), 600 F.3d 1219, 1222 (9th Cir. 2010); Oney v. Weinberg (In re Weinberg), 410 B.R. 19, 35 (9th Cir. BAP 2009). The creditor bears the burden of proving all five elements by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 291 (1991); In re Weinberg, 410 B.R. at 35.

This appeal focuses on whether Reingold made fraudulent representations to Shaffer to obtain the loans and, if so, when. Reingold argues that he never misrepresented his intent to Shaffer and, thus, the bankruptcy court erred in holding any portion of his debt to Shaffer excepted from discharge. Shaffer defends the decision of the bankruptcy court that the $76,000 she paid to Reingold on November 17 was excepted from discharge, but argues in her cross-appeal that the Loan Agreement signed on October 31, 2008, was an integrated contract and, therefore, the bankruptcy court was obliged to treat funds received both on October 24, 2008, and November 17, 2008, as a single transaction for purposes of measuring Reingold's entitlement to a discharge for purposes of § 523(a)(2)(A).

I.

The bankruptcy court did not err in determining that the debt represented by the $50,000 check was not excepted from discharge under § 523(a)(2)(A).

In resolving the issues, we must first examine the timing of the relevant events in this case. The parties hotly dispute whether there was a misrepresentation[4] and when it occurred.

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[4] The parties and the court have used the terms "misrepresentation," "false representation" and "false pretenses" interchangeably. Properly viewed, there are distinctions. A false representation is an express misrepresentation, while a (continued...)

Reingold acknowledged at trial that he signed the Loan Agreement on October 31, 2008.

> Q: [The Loan Agreement] has a date – that's your signature on page 1-21?
>
> REINGOLD: Yes, it is.
>
> Q: And it's dated October 31, 2008. Do you recall signing this at that time?
>
> REINGOLD: Yes, sir.

Trial Tr. 7:11-13. Shaffer then testified:

> Q: You signed [the Loan Agreement] on October 31, 2008, correct?
>
> SHAFFER: Yes, I did.
>
> Q: And Mr. Reingold signed it at the same time, correct?
>
> SHAFFER: Yes, he did.

Trial Tr. 63:11-14, November 28, 2011. Despite some later equivocation by Shaffer,[5] based on the evidence, the bankruptcy

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[4](...continued) false pretense refers to an implied misrepresentation or conduct intended to create and foster a false impression. See In re Young, 91 F.3d 1367, 1374 (10th Cir. 1996) (citing Itaparica, Ltd. v. Hargrove (In re Hargrove), 164 B.R. 768, 772 (Bankr. N.D. Okla. 1994) (recognizing that an implied representation constitutes "false pretenses" for purposes of § 523(a)(2)(A))). The parties have not raised any issue regarding the distinction between false representation and false pretense and so we will not examine the question. Smith v. Young (In re Young), 208 B.R. 189, 199 (Bankr. S.D. Cal. 1997) ("The conceptual difficulty attending such a fine differentiation, however, leads courts to typically ignore the negligible difference between the two phrases.")

[5] Shaffer would state under cross-examination that she gave Reingold the $50,000 check at the same time that she signed the Loan Agreement. Trial Tr. 70:2-6. She also indicated that they dated the Loan Agreement for October 31 because "I think silly on my end. I just wanted to extend that year – that year long period, span." However, she did not give any specific date other than October 24 for delivery of the check and October 31 for signing the Loan Agreement. And to the extent that this (continued...)

court could properly find that the Loan Agreement, with its alleged misrepresentation, was executed by the parties on October 31, 2008.

It was also established in the bankruptcy court as a matter of disputed fact that Shaffer gave Reingold the check for $50,000 on October 24 or, in other words, before the parties executed the Loan Agreement. The evidence in the record confirms that the check was dated and signed by Shaffer on October 24, and that the check was honored by the bank on October 28, 2008. The proof also showed that the second check for $76,000 was given by Shaffer to Reingold on November 17, 2008, after the Loan Agreement was signed.

Against this temporal sequence, the bankruptcy court found that: "[The $76,000] loan proceeds were to be used only for the development of the [Property]. Such representations were the inducement for Plaintiff Sharon Shaffer to make the loan to Defendant William Reingold. The specifics and restrictions, including the material representation that the $76,000 was to be used for this property were established on October 31st, 2008." H'rg Tr. 4:2-10, Jan. 9, 2012.

In her cross-appeal, Shaffer does not challenge the bankruptcy court's finding that Reingold's representation concerning his proposed use of the loan funds was made on

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[5](...continued)
contradicts both her earlier testimony and the testimony of Reingold, the bankruptcy court did not clearly err in accepting the dates on which both parties' testimonies agree, that is, October 24 for delivery of the $50,000 check and October 31, 2008, when both parties signed the Loan Agreement.

October 31 in the Loan Agreement. Instead, she argues that, as the Loan Agreement expressly provides, the parties' agreement was an integrated contract governing the terms of the total loan of $126,000. Under California contract law, since the parties' intent was that there was but a single loan, Shaffer argues that the bankruptcy court erred by its finding that there were, in fact, two loans made by Shaffer to Reingold. Because there was only one loan, and because that loan was conditioned on the terms in the Loan Agreement restricting Reingold's use of the loan proceeds to acquiring and developing the Property, Shaffer insists the total debt must be excepted from discharge under § 523(a)(2)(A).

Shaffer's argument misses the point. As it arises in the context of Reingold's bankruptcy case, this contest does not implicate state contract law, nor the interpretation of the terms of the Loan Agreement. Instead, the critical issue is if and when Reingold engaged in any fraud in connection with Shaffer's extension of credit to him, and the disposition of that question is through application of § 523(a)(2)(A).

There is no dispute that Reingold was indebted to Shaffer for $126,000 as evidenced by the Loan Agreement. Nor is it disputed that the Loan Agreement contains a clause that the loan proceeds were to be used for the purchase and development of the Property. What is disputed is whether that contract clause constituted a misrepresentation, known to be false by Reingold, that was intended to defraud Shaffer, and whether Shaffer relied on that representation and suffered a proximate injury as a result. Those concerns derive exclusively from federal bankruptcy law, not state

law. Grogan, 498 U.S. at 284.[6]

It is perhaps unfortunate that the bankruptcy court seemed to refer to the checks issued on October 24, 2008, and November 7, 2008, as independent loans. However, a fair review of the record indicates that the court was attempting to distinguish between the two payments by Shaffer to Reingold in relation to his representation about his intended use of the loan proceeds. In this respect, the bankruptcy court correctly noted that one payment was made by Shaffer before Reingold's actionable fraud under the bankruptcy law occurred, and the other afterwards.

In particular, the facts found by the bankruptcy court were that the $50,000 payment was made to Reingold on October 24, 2008. However, Reingold would not make the misrepresentation that the loan proceeds would be used solely to acquire and develop the Property until the Loan Agreement was presented to Shaffer on October 31, 2008. To except a debt from discharge under § 523(a)(2)(A), the critical misrepresentation must occur at or before the point where "the money was obtained." Campos v. Beck (In re Beck), 2012 WL 2127751 at *3 (Bankr. D. Ariz. June 11, 2012) ("The plaintiff must make an 'initial showing that the alleged fraud existed at the time of, and has been the methodology

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[6] Reingold also attempts to argue principles of contract law are applicable here. He suggests that this is a contest over a breach of contract, which he freely admits he committed, and he concedes that Shaffer holds a dischargeable claim against him for $126,000. But Reingold fails to appreciate the distinction between breach of contract and fraud. As our Court of Appeals explained the critical difference, breach of contract is the "failure to honor one's promise, but breaking a promise that one intends not to keep is fraud." United States v. Univ. of Phoenix, 461 F.3d 1166, 1172 (9th Cir. 2006)(citing United States ex rel. Main v. Oakland City Univ., 426 F.3d 914 (7th Cir. 2005).

by which, the money, property or services were obtained.'"), quoting Conn. Attys. Title Ins. Co. v Budnick (In re Budnick), 469 B.R. 158, 174 (Bankr. D. Conn. 2012); Aslakson v. Freese (In re Freese), 472 B.R. 907, 918 (Bankr. D.N.D. 2012); In re Woodall, 177 B.R. 517, 523-24 (Bankr. D. Md. 1995); In re Ethridge, 80 B.R. 581, 587 (Bankr. M.D. Ga. 1987). In other words, misrepresentations made by a debtor to a creditor after the credit has been extended have no effect upon the discharge of the debt.

Simply put, the target misrepresentation must have existed at the inception of the debt, and a creditor must prove that he or she relied on that misrepresentation. As the Panel has explained,

> For purposes of [§] 523(a)(2), however, the timing of the fraud and the elements to prove fraud focus on the time when the lender . . . made the extension of credit to the Debtor. . . . In other words, . . . the inquiry of whether a creditor justifiably relied on Debtor's alleged misrepresentations is focused on the moment in time when that creditor extended the funds to Debtor. See McClellan v. Cantrell, 217 F.3d 890, 896 (7th Cir. 2000)(Ripple, Circuit Judge, concurring) (noting Congress' use of "obtained by" in § 523(a)(2) "clearly indicates that fraudulent conduct occurred at the inception of the debt, i.e. the debtor committed a fraudulent act to induce the creditor to part with his money or property.").

New Falls Corp. v. Boyajian (In re Boyajian), 367 B.R. 138, 147 (9th Cir. BAP 2007) (citing Bombardier Capital, Inc. v. Dobek (In re Dobek), 278 B.R. 496, 508 (Bankr. N.D. Ill. 2002)). As a leading treatise explains, "if the property and services were obtained before the making of any false representation, subsequent misrepresentations will have no effect on dischargeability." 4 COLLIER ON BANKRUPTCY ¶ 523.08[1] (Alan N. Resnick & Henry J. Sommer, eds., 16th ed., 2012).

Here, the bankruptcy court found that the only representation made by Reingold to Shaffer in connection with the $50,000 check paid on October 24, 2008, was that it was to be a general purpose loan, to be used in conducting his business, which the court characterized as a "loan for which the borrower could use the loan proceeds for any purpose." H'rg Tr. 5:20-21. Moreover, the court found that Reingold "did use a portion of the $50,000, as well as personal effort and services, toward the project." H'rg Tr. 5:6-8.

Whether the debtor made a misrepresentation is a finding of fact reviewed for clear error. Candland v. Ins. Co. of N. Am. (In re Candland), 90 F.3d 1466 (9th Cir. 1996) (citing In re Lansford, 822 F.2d 902, 904 (9th Cir. 1987)). The bankruptcy court's finding that no misrepresentation was made by Reingold to Shaffer until October 31, 2008, a week after she gave him the initial $50,000 check, is supported by the record and was not clearly erroneous. Because no misrepresentation occurred at or before the time of the $50,000 payment, the Panel need not review whether the other elements for an exception to discharge under § 523(a)(2)(A) are present as to that payment. The bankruptcy court did not err in determining that the debt represented by the $50,000 check was not excepted from discharge under § 523(a)(2)(A).

II.

The bankruptcy court did not err in determining that the $76,000 payment was excepted from discharge under §523(a)(2)(A).

Reingold argues that the bankruptcy court erred when it decided that his debt to Shaffer for the $76,000 payment was

excepted from discharge. He contends that the entire $126,000 debt was dischargeable. At bottom, Reingold's position amounts to a challenge to the bankruptcy court's fact findings and lacks merit.

A. <u>Misrepresentation</u>. As discussed above, the bankruptcy court found that Reingold represented in the Loan Agreement that the $76,000 he received from Shaffer was to be specifically and solely used for acquisition of and work on the Property, and that he would account for his use of the funds to Shaffer. In particular, in the words of the bankruptcy court, through the Loan Agreement, "Debtor [represented that the] loan proceeds were to be used only for the development of the [Property]. Such representations were the inducement for Plaintiff Sharon Shaffer to make the loan to Defendant William Reingold. The specifics and restrictions . . . were established on October 31, 2008." Hr'g Tr. 4:8-10. The court then found that "the $76,000 loan was to be specifically used and accounted for by the Defendant. That the Defendant obtained the loan by false pretenses in that he failed to specifically account, keep the Plaintiff informed and utilize[d] the funds for purposes that can only be assumed for other than specifically intended on the development of the [Property]." H'rg Tr. 5:9-16. The court also found that, at the time he entered into the Loan Agreement, Reingold "concealed from [Shaffer] . . . [his] intention not to use the loan proceeds strictly in accordance with the purpose of the $76,000 loan contract." H'rg Tr. 6:1-3. Simply stated, the bankruptcy court found that Reingold intentionally concealed his intent to use the $76,000 in loan funds as specifically agreed in the Loan Agreement

1 for purposes other than acquisition and development of the
2 Property.
3 A debtor's silence or omission of a material fact can
4 constitute a false representation which is actionable under
5 § 523(a)(2)(A). Citibank (South Dakota), N.A. v. Eashai
6 (In re Eashai), 87 F.3d 1082, 1088-89 (9th Cir. 1996). Moreover,
7 "[t]he nature of a scheme to defraud by false representations can
8 be shown by accumulated evidence . . . and subsequent conduct."
9 United States v. Gibson, 690 F.2d 697, 701 (9th Cir. 1982). In
10 this case, Reingold's failure to account to Shaffer for the use of
11 the loan proceeds when she requested that he do so, and his
12 failure to adequately account to the court for the money, could
13 evidence Reingold's fraudulent intent.[7]
14 The bankruptcy court considered the testimony of the parties
15 on this topic from both Reingold and Shaffer. Reingold insisted
16 that he never concealed information from Shaffer with the intent
17 to defraud her. Indeed, Reingold testified that he specifically
18 told Shaffer that he would use the funds for purposes other than
19 the Project. Trial Tr. 117:8-10. Shaffer was equally adamant
20 that Reingold never told her that he would use the funds for
21 purposes other than the Project and she would not have provided
22
23
24 [7] Reingold argues that the bankruptcy court's findings that faulted him for his failure to account to Shaffer, or to the
25 court, for the use of the $76,000 demonstrates that the court conflated the elements for an exception to discharge for fraud or
26 defalcation by a fiduciary under § 523(a)(4) with those required to show actual fraud under § 523(a)(2)(A). This argument is
27 misplaced. Shaffer did not allege a claim for relief under § 523(a)(4). And as discussed above, Reingold's failure to
28 account for the loan funds was apparently viewed by the bankruptcy court as evidence of Reingold's intent to conceal his fraudulent conduct. The bankruptcy court did not err in this regard.

the funds to him had she known that Reingold would use them for a purpose outside the restrictions of the Loan Agreement. Trial Tr. 64:9-14. As noted above, whether there was a misrepresentation is a question of fact reviewed for clear error. In re Candland, 90 F.3d at 1466. "Where there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly erroneous."). Anderson v. City of Bessemer City, NC, 470 U.S. 564, 574, (1985). And we must defer to a bankruptcy court's findings based on testimonial evidence. Rule 8013.

Here, the bankruptcy court did not clearly err when it found that Reingold made a misrepresentation to Shaffer concerning his intended use of the $76,000 in loan proceeds.

B. Knowledge of the falsity or deceptiveness of a statement, or conduct and an intent to deceive. The bankruptcy court found that Reingold actively concealed his true purpose not to apply all the restricted funds to acquiring or developing the Property. Knowledge of the falsity or deceptiveness of a statement is a question of fact. Runnion v. Pedrazzini (In re Pedrazzini), 644 F.2d 756, 758 (9th Cir. 1981) (The existence of scienter is a question of fact, not to be reversed on appeal unless clearly erroneous.). The bankruptcy court had testimony from both parties and its ruling, again based on conflicting testimonial evidence, is not clearly erroneous.

Moreover, the bankruptcy court had evidence of Reingold's behavior subsequent to the Loan Agreement from which it could infer that Reingold did not intend to apply the funds solely to the Property. It is well established that courts can consider subsequent conduct in determining fraudulent intent as long as

1 that conduct provides an indication of the debtor's state of mind
2 at the time of the false representations. Williamson v. Busconi,
3 87 F.3d 602, 603 (1st Cir. 1996) (explaining that "subsequent
4 conduct may reflect back to the promisor's state of mind and thus
5 may be considered in ascertaining whether there was fraudulent
6 intent at the time the promise was made"); Strominger v. Giquinto
7 (In re Giquinto), 388 B.R. 152, 167 (Bankr. E.D. Pa. 2008)
8 (stating that "[a]n often employed indicia, especially with
9 respect to fraudulent actions under § 523(a)(2)(A), centers on a
10 debtor's subsequent conduct"); Siebanoller v. Rahrig
11 (In re Rahrig), 373 B.R. 829, 834 (Bankr. N.D. Ohio 2007) (same);
12 Stein v. Tripp (In re Tripp), 357 B.R. 544, 548 (Bankr. D. Ariz.
13 2006) (noting that a court "may consider subsequent conduct to the
14 extent that it provides an insight into the debtor's state of mind
15 at the time of the representations"); Lucas v. Lyle (In re Lyle),
16 334 B.R. 324, 334 (Bankr. D. Mass. 2005) (explaining that
17 "subsequent conduct can reflect a debtor's state of mind at the
18 time the representation is made"); Visotsky v. Woolley
19 (In re Woolley), 145 B.R. 830, 836 (Bankr. E.D. Va. 1991) (same);
20 Miller v. Krause (In re Krause), 114 B.R. 582, 606 (Bankr. N.D.
21 Ind. 1988) (same).
22 Shaffer testified that Reingold failed to communicate any
23 information regarding his efforts to acquire and rehabilitate the
24 Property. He provided no written accounting or other financial
25 statements regarding her investment. Trial Tr. 65:12. He did not
26 inform her that he had canceled escrow on the Property and taken
27 the funds back in his own name. Trial Tr. 65:24. Indeed, Shaffer
28 never found out about the canceled escrow until she filed her

state court lawsuit. Trial Tr. 66:20. Reingold did not dispute that testimony.

The only documentary evidence produced at trial concerning his use of the loan proceeds was Reingold's selection of checks that he alleged represented expenditures from Shaffer's funds on the Project. However, in his testimony, Reingold was unable to link the checks to the Property or establish that the funds were provided by Shaffer. For example: (1) Check 1033 for $2,000, for "taxes for IEG Corporation" for the period 2006-2007, well before Shaffer was involved with Reingold or the Project." Trial Tr. 33:3-5. (2) Check 1037, dated December 23, 2008, for $5,000, for "expenses and salary for subs." Reingold testified that he did not know what work was done for that $5,000. Trial Tr. 35:1. (3) Two checks not identified in Reingold's testimony totaling $23,000. Reingold was not able to state whether the $23,000 was partly or fully attributed to the Project. Trial Tr. 35:16-22. (4) Check 4157 for $5,187 to the California Franchise Tax Board for "state taxes." In testimony, Reingold admitted "I don't know if it had anything to do with [the Project]. Probably nothing." Trial Tr. 36:20-21. (5) Check 4176 for $3,000 to Natalia Avenegas. Reingold testified, "I don't remember who she was." Trial Tr. 38:4. (6) A check in October 2008 to IEG (a wholly owned corporation of Reingold) for $17,000 marked "Loan to IEG." Reingold testified that the $17,000 was for "construction projects that I had running at that time." Trial Tr. 38:20-21. In short, on their faces, the checks submitted by Reingold in discovery and then admitted in the bankruptcy court do not conclusively support his argument that the expenditures they represent were related in

full to the Project.

Moreover, Reingold never properly established the source of the funds for the checks. Reingold failed to provide in discovery or at trial the bank statements to trace the source of the funds for the checks. After testifying that he had lost or misplaced financial records following a fire and burglary at his home, Trial Tr. 52:8-22, this colloquy followed with counsel for Shaffer:

> COUNSEL: So, did you ever make any effort to get [the bank statements and missing checks] online or directly from the bank? Calling on the bank and asking for the copies of these — of the bank statements over this period of time so that I or Ms. Shaffer could do an accounting as to what money came in and out of the account to which you deposited her loan proceeds?
>
> REINGOLD: No, I just acquired the checks that we used to - that we spent to the money, that we could find.

Trial Tr. 52:22-53:4. Without the supporting bank statements, neither the parties nor the bankruptcy court could trace the funds from Shaffer to Reingold.

In sum, the bankruptcy court had testimonial evidence that Reingold withheld information from Shaffer about his work on the Project. He failed to inform Shaffer that he had stopped escrow on the Project and claimed the funds for himself. He was not able to provide documentary evidence that he had used Shaffer's funds for their intended purpose. And he was unable to provide adequate records related to either the Project or use of Shaffer's funds. Reingold's subsequent conduct, therefore, exhibited two badges of fraud as discussed in a recent bankruptcy court decision:

> For purposes of § 523(a)(2)(A), a common badge of fraud concerns whether a defendant made any effort to perform their obligation. Chase Bank v. Brumbaugh (In re Brumbaugh), 383 B.R. 907, 912 (Bankr. N.D. Ohio 2007). As this Court previously explained: "as a general rule,

> the greater the extent of a debtor's performance, the less likely it will be that they possessed an intent to defraud." Ewing v. Bissonnette (In re Bissonnette), 398 B.R. 189, 194 (Bankr. N.D. Ohio 2008).

Bartson v. Marroquin (In re Marroquin), 441 B.R. 586, 593 (Bankr. N.D. Ohio 2010). The Bartson court went on to identify "failure to keep adequate records" as another badge of fraud in a debtor's subsequent conduct that would show intent to defraud for § 523(a)(2)(A) purposes. Id.

Here, the bankruptcy court did not clearly err in finding that:

> The Court finds that the $76,000 loan was to be specifically used and accounted for by [REINGOLD]. That [REINGOLD] obtained the loan by false pretenses in that he failed to specifically account, keep [SHAFFER] informed and utilize the funds for purposes that can only be assumed for other than specifically intended on the development of the [PROPERTY].

Hr'g Tr. 5:11-16.

C. Justifiable reliance by the creditor on the debtor's statement or conduct. The bankruptcy court found that Shaffer relied on Reingold's misrepresentation and concealment. Whether Shaffer justifiably relied on Reingold's misrepresentation is a question of fact. Eugene Parks Law Corp. Defined Benefit Pension Plan v. Kirsh (In re Kirsh), 973 F.2d 1454, 1456 (9th Cir. 1982); Deitz v. Ford (In re Deitz), 469 B.R. 11, 34 (9th Cir. BAP 2012). There is nothing in the record to indicate a reason why Shaffer should not rely on the representation in the Loan Agreement that funds would be used on the Property. Shaffer testified that she was acquainted with Reingold from their mutual interest in surfing, that she was aware that Reingold was a contractor, and that she was given a prospectus concerning the Property by

Reingold before signing the Loan Agreement. There is nothing apparent in this record to indicate that Shaffer should not trust Reingold’s representations. It was not clearly erroneous for the bankruptcy court to conclude that Shaffer justifiably relied on the misrepresentations of Reingold.

D. Damage to the creditor proximately caused by the debtor's statement or conduct. The bankruptcy court found that Shaffer “was damaged in the amount which the court now determines to be [$]76,000 of the loan proceeds based upon defendant’s failure to account for the use and disposition of the Shaffer loan proceeds.” Hr’g Tr. 6:5-9. Determination of proximate cause and assessing damages under § 523(a) is a question of fact. Britton v. Price (In re Britton), 950 F.2d 602, 605 (9th Cir. 1991). The bankruptcy court did not clearly err in determining that Shaffer was proximately damaged in the amount of $76,000.

In sum, the record supports the bankruptcy court’s decision that the debt to Shaffer for the $76,000 arose as a result of Reingold’s fraudulent misrepresentation and is excepted from discharge under § 523(a)(2)(A).[8]

CONCLUSION

We AFFIRM the judgment of the bankruptcy court.

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[8] Reingold raises several issues regarding evidentiary rulings made by the bankruptcy court. However, Reingold does not specify the particular evidentiary rulings to which he objected, nor whether he raised the objections challenged on appeal in the bankruptcy court. Reingold does not explain how the bankruptcy court’s evidentiary rulings were prejudicial. We will not reverse even erroneous evidentiary rulings unless they are prejudicial. Allstate Ins. Co. v. Herron, 634 F.3d 1101, 1110 (9th Cir. 2011). We therefore decline to consider Reingold’s evidentiary challenges.

FILED

NOT FOR PUBLICATION

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OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re: MERUELO MADDUX PROPERTIES, INC., et al., Debtors.	BAP No. CC-12-1303-TaMoMk Bk. No. SV 09-13356-VK
BELINDA MERUELO, Appellant, v. MERUELO MADDUX PROPERTIES, INC., et al., Appellees.	**MEMORANDUM**[*]

Argued and Submitted On February 21, 2013
at Pasadena, California

Filed - April 9, 2013

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

Honorable Victoria Kaufman, Bankruptcy Judge, Presiding

Appearances: Gregory M. Salvato of Salvato Law Offices on behalf of Appellant Belinda Meruelo; Christopher E. Prince of Lesnick Prince & Pappas LLP on behalf of Evoq Properties, Inc. (formerly known as Meruelo Maddux Properties, Inc.) and Merco Group - 2001-2021 West Mission Boulevard, LLC

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[*]This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

Before: TAYLOR, MONTALI,[**] and MARKELL, Bankruptcy Judges.

INTRODUCTION

Belinda Meruelo, individually, as trustee of the Meruelo Living Trust u/d/t dated November 11, 1988 ("Trust"), and as representative of the Estate of Homer Meruelo (hereinafter in all capacities, "Belinda"[1]), filed a proof of claim in the chapter 11 bankruptcy case of Merco Group 2001-2021 West Mission Boulevard, LLC ("Merco Group"), case no. 09-13403.[2] Merco Group[3] objected

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[**]The Honorable Dennis Montali, Bankruptcy Judge for the Northern District of California, sitting by designation.

[1] An appeal filed by Belinda Meruelo's son Richard Meruelo was also submitted to this Panel on February 21, 2013 in BAP No. CC-12-1304. In order to avoid unnecessary confusion, the appellant here will be referred to as "Belinda." We intend no disrespect by this informality.

[2] We exercised our discretion and independently reviewed certain imaged documents from the bankruptcy court's electronic docket. See Rourke v. Seaboard Sur. Co. (In re E.R. Fegert, Inc.), 887 F.2d 955, 957-58 (9th Cir. 1989); Atwood v. Chase Manhattan Mortg. Co. (In re Atwood), 293 B.R. 227, 233 n.9 (9th Cir. BAP 2003). In so doing, we determined that on April 7, 2009, the bankruptcy court ordered joint administration of Merco Group's bankruptcy case with 53 related cases under case no. 09-13356, In re Meruelo Maddux Properties, Inc. ("MMPI")("Joint Administration Order"). The Joint Administration Order directed claimants to file proofs of claim in the case directly related to their claims and to use the caption and case number for that case when so doing. It also, however, directed use of the MMPI case number, caption, and docket in connection with all other filings in the jointly administered cases. As a result, the MMPI docket included more than 3700 entries at the time of our review; this significantly impeded our ability to independently identify relevant documents.

[3] On June 24, 2011, the bankruptcy court entered an order confirming a plan of reorganization. The post-confirmation Merco Group filed the motion for disallowance.

to the claim and moved for disallowance; the bankruptcy court granted the disallowance motion. Belinda appeals the bankruptcy court's order disallowing the claim. We AFFIRM.

FACTS[4]

Pre-Petition Sale of the Property.

In early 2005, Merco Group, as buyer, entered into a contract with Meruelo Pomona, LLC, as seller, to purchase improved real property located in Pomona, California (the "Property") for $20,000,000. Belinda and her late husband, Homer Meruelo, managed and owned the selling entity ("Seller"). Their son, Richard Meruelo, managed Merco Group.

When Seller and Merco Group executed the purchase agreement ("Purchase Agreement"), a deed of trust securing debt owed by Seller to PNL Pomona, L.P. ("PNL") encumbered the Property. PNL also held a written guaranty from Belinda ("Guaranty") guaranteeing repayment of its loan to Seller.

The sale transaction closed over two years later on or about July 27, 2007. On closing, Merco Group paid the sales price, in part, by assuming the obligation to repay the PNL loan which had a then outstanding balance of $8,763,304.85. The Purchase Agreement did not require a release of the Guaranty, and Belinda remained bound by the Guaranty after assumption.

Post-Petition Proceedings.

On or about March 27, 2009, Merco Group and 53 related entities filed voluntary petitions under chapter 11. The

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[4] The record on appeal reflects that the background facts are not in dispute.

Property became an asset of a bankruptcy estate. On September 24, 2009, Belinda filed the original proof of claim ("Original Claim"). The Original Claim stated that it was an indemnification claim and sought payment to the extent Belinda, in the future, incurred losses associated with Merco Group's failure to re-pay PNL.

Thereafter, PNL sued Belinda in an action seeking recovery on the Guaranty in Los Angeles Superior Court, PNL Pomona, L.P. v. Belinda Meruelo, et al., case number KC055493 ("Guaranty Action").[5] As a result, on December 6, 2011, Belinda filed an amendment to the Original Claim ("Amended Claim") and asserted a specific claim for $3,306,941.05 based on a proposed judgment dated October 20, 2011 in the Guaranty Action. In the Amended Claim, Belinda alleged that: (1) as a third party beneficiary to the Purchase Agreement, she may enforce the Purchase Agreement against Merco Group pursuant to California Civil Code section 1559 ("CC Section 1559");[6] and (2) she holds rights to reimbursement and indemnification under California law, including California Civil Code section 2847 ("CC Section 2847").[7]

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[5] It is not disputed that at some point thereafter, PNL foreclosed non-judicially against the Property.

[6] CC Section 1559 provides: "A contract, made expressly for the benefit of a third person, may be enforced by him at any time before the parties thereto rescind it."

[7] CC Section 2847 provides, in relevant part, that: "If a surety satisfies the principal obligation, or any part thereof, whether with or without legal proceedings, the principal is bound to reimburse what he has disbursed, including necessary costs and expenses. . . ."

On January 23, 2012, Merco Group filed its Motion for Order Disallowing Claim of [Belinda] ("Motion") and sought disallowance on two grounds. First, Merco Group argued that section 502(e)[8] of the Bankruptcy Code[9] bars recovery under the Amended Claim as Belinda had not yet paid the PNL judgment. Second, Merco Group asserted that section 580d of the California Code of Civil Procedure ("CCP Section 580d") barred recovery. Merco Group, citing Union Bank v. Gradsky, 265 Cal. App. 2d 40, 44-47 (1968), argued that just as this anti-deficiency statute protects a borrower from a lender's deficiency claim after a non-judicial foreclosure, it also protects a borrower from the guarantor's reimbursement claim.

Belinda filed an opposition to the Motion ("Opposition").[10]

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[8] Section 502(e) provides, in relevant part, that:

> [T]he court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor to the extent that (A) such creditor's claim against the estate is disallowed; (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution; or (C) such entity asserts a right to subrogation under section 509 of this title.

[9] Unless otherwise specified, 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.

[10] The Opposition initially sought a six month continuance of the hearing on the Motion on the grounds that the matter was not ripe, as Belinda alleged that damages were likely to increase. At that time, Belinda alleged out-of-pocket damages in (continued...)

In substance, Belinda argued that Merco Group's first basis for disallowance, section 502(e), did not apply, because Merco Group was not liable with Belinda on the Guaranty. Belinda noted that the confirmed plan allowed PNL to non-judicially foreclose, that this foreclosure eradicated PNL's deficiency rights against Merco Group by operation of California law, and that this left only Belinda liable to PNL.

The Opposition did not address Merco Group's second basis for disallowance, CCP Section 580d. Instead, Belinda argued that Merco Group breached the Purchase Agreement when, having agreed to assume the PNL debt, it failed to satisfy the PNL debt in full and thereby release Belinda from obligations under the Guaranty. Belinda alleged that Seller contracted with Merco Group for the "express purpose of relieving [Belinda's] mortgage debt through the assumption of the loan by [Merco Group]." Opposition at 54:19-21. Belinda asserted, therefore, that as the third party beneficiary of the Purchase Agreement, she had the right to compel Merco Group to perform its obligations under the Purchase Agreement. Belinda, thus, requested that the bankruptcy court infer that such contractual obligations included payment of all the alleged damages incurred, or to be incurred, as a result of the Guaranty Action and Merco Group's failure to pay PNL in full.

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[10](...continued)
the amount of $425,521.05, for attorney's fees incurred in defense of the Guaranty Action, but the proposed judgment in the Guaranty Action had not been entered. The bankruptcy court continued the initial hearing on the Motion, scheduled for March 15, 2012, to May 11, 2012, based on the parties' stipulation and order thereon. Neither the stipulation nor the order thereon, however, mentioned the ripeness argument.

The bankruptcy court heard oral argument on the Motion and Opposition on May 11, 2012. After hearing brief argument, the bankruptcy court granted the Motion, on the following stated grounds:

> The Court doesn't see her as a third-party beneficiary. They bought the property. The intention wasn't to relieve her of the debt, it was to acquire the property. And so the Court's going to - - and for the other grounds explained in the motion. So the objection is sustained. Okay.

Hr'g Tr. (May 11, 2012) at 3:19-24. The Court entered the order disallowing the Amended Claim on May 29, 2012 ("Order"). The Order, prepared by Merco Group's counsel, recites that it is based on the "Motion, the Opposition to the Motion, the Reply in support, the arguments presented at the hearing, and the pleadings and papers on file in this proceeding . . . ." Order, Dkt. 3768 at 2:6-7. Belinda filed a timely notice of appeal.

JURISDICTION

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. §§ 1334 and 157(b)(2)(B). We have jurisdiction under 28 U.S.C. § 158.

ISSUE

Did the bankruptcy court err in disallowing the Amended Claim?

STANDARD OF REVIEW

We review the bankruptcy court's legal conclusions de novo and its findings of fact for clear error. See Allen v. US Bank, NA (In re Allen), 472 B.R. 559, 564 (9th Cir. BAP 2012). We review the bankruptcy court's order disallowing the claim de novo. See Continental Ins. Co. v. Thorpe Insulation Co.

(In re Thorpe Insulation Co.), 671 F.3d 1011, 1020 (9th Cir. 2012), cert. denied, 133 S. Ct. 119 (2012). See also Varela v. Dynamic Brokers, Inc. (In re Dynamic Brokers, Inc.), 293 B.R. 489, 493 (9th Cir. BAP 2003) (issues related to disallowance are questions of law reviewed de novo). This case also involves contract interpretation; again, de novo review is appropriate. Simpson v. Burkart (In re Simpson), 366 B.R. 64, 70-71 (9th Cir. BAP 2007).

DISCUSSION

The Bankruptcy Code sets forth the grounds for disallowance of proofs of claim primarily in section 502(b). See Heath v. Am. Express Travel Related Servs. Co., Inc. (In re Heath), 331 B.R. 424, 426 (9th Cir. BAP 2005). Section 502(b)(1) provides for disallowance of a claim that "is unenforceable against the debtor and property of the estate, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured." The bankruptcy court's oral ruling articulated only one specific ground for disallowance; Belinda was not a third party beneficiary of the Purchase Agreement. Belinda disputes this conclusion, but she never addresses the bankruptcy court's general reference to other grounds set forth in the Motion and the resultant inclusion of CCP Section 580d as a basis for disallowance. We conclude, first, that the necessary application of CCP Section 580d is dispositive here. We then also conclude that the bankruptcy court correctly determined that Belinda was not a third party beneficiary of the Purchase Agreement entitled

to specific performance rights under California law.[11]

CCP Section 580d Requires Disallowance of the Amended Claim.

Merco Group cited CCP Section 580d in its Motion as grounds for disallowance. It argued that non-judicial foreclosure extinguished any indirect obligation it otherwise owed to Belinda on account of the Guaranty. Belinda did not respond directly to this argument prior to appeal either in writing or at oral argument.[12] The bankruptcy court, likely as a result, did not discuss this objection specifically in its oral ruling. But, it generally references the "other grounds explained in the motion" as a basis for its disallowance of the claim. Hr'g Tr. (May 11, 2012) at 3:23-24.

In her opening brief on appeal, Belinda addresses not CCP Section 580d, but her Guaranty's Gradsky waiver. In her reply brief, she responds more directly to Merco Group's CCP Section 580d argument, and states that she found no case authority providing that CCP Section 580d applies to the claim of a third party beneficiary. To the extent Belinda retained any right to dispute the CCP Section 580d basis for disallowance of the Amended Claim, these arguments fail to justify a reversal. Merco

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[11] To the extent that we misread the bankruptcy court's reference to other grounds as including CCP Section 580d, we note that we may affirm the bankruptcy court on any grounds supported by the record. Com-1 Info, Inc. v. Wolkowitz (In re Maximus Computers, Inc.), 278 B.R. 189, 194 (9th Cir. BAP 2002).

[12] Belinda may not argue the inapplicability of CCP Section 580d for the first time on appeal. Golden v. Chicago Title Ins. Co. (In re Choo), 237 B.R. 608, 613 (9th Cir. BAP 2002) (issues not raised at the trial court will not be considered for the first time on appeal).

Group argues that even if it "impliedly promised Belinda that it would pay the underlying debt, CCP Section 580d would still preclude her claim for reimbursement." Apl'e Brief at 10. We agree.

CCP Section 580d provides, in pertinent part, that:

> No judgment shall be rendered for any deficiency upon a note secured by a deed of trust or mortgage upon real property or an estate for years therein hereafter executed in any case in which the real property or estate for years therein has been sold by the mortgagee or trustee under power of sale contained in the mortgage or deed of trust.

And it is well settled that CCP Section 580d: "prevents both the creditor and the guarantor from obtaining any deficiency judgment against the debtor after nonjudicial sale of the security." Union Bank v. Gradsky, 265 Cal. App. 2d at 41. And as the Gradsky court further noted:

> The Legislature clearly intended to protect the debtor from personal liability following a nonjudicial sale of the security. No liability, direct or indirect, should be imposed upon the debtor following a nonjudicial sale of the security. To permit a guarantor to recover reimbursement from the debtor would permit circumvention of the legislative purpose in enacting [CCP Section 580d].

Id. at 46.

Thus, when PNL foreclosed, CCP Section 580d extinguished all PNL's claims against Merco Group. And concurrently, CCP Section 580d also barred any Guaranty-based claim by Belinda against Merco Group based on California laws such as CC Section 2847.

The Guaranty contains extensive waivers of defenses by the

1 guarantor, Belinda, and includes a "Gradsky waiver" wherein
2 Belinda acknowledged the impact of a non-judicial foreclosure on
3 any rights to recovery against the borrower and agreed to be
4 bound by her guarantee notwithstanding. Belinda asserts that she
5 never waived her right to reimbursement from Merco Group under
6 California law, despite the Gradsky and other suretyship waivers
7 contained in the Guaranty. Without citation to legal authority,
8 she argues that any waivers of reimbursement claims under the
9 Guaranty were extinguished as a result of the provision in Merco
10 Group's confirmed plan that allowed PNL to proceed to
11 non-judicial foreclosure in full satisfaction of its claim.
12 Belinda misses the point. The Guaranty's waivers are intended to
13 protect PNL from an argument that a non-judicial foreclosure
14 exonerates the Guaranty, precisely because foreclosure negatively
15 impacts Belinda's rights against Merco Group. Belinda did not
16 simply waive the right to assert suretyship defenses against PNL
17 in the Guaranty; in addition, she acknowledged that a non-
18 judicial foreclosure terminated all such rights. Again, non-
19 judicial foreclosure did not revitalize Belinda's rights to
20 recovery from PNL - it extinguished them. And as a result, the
21 bankruptcy court correctly disallowed the Amended Claim.

22 **The Bankruptcy Court Did Not Err In Disallowing The Claim**
23 **Notwithstanding Alleged Third Party Beneficiary Rights.**

24 Perhaps in recognition of the impact of CCP Section 580d on
25 her ability to recover against Merco Group after a non-judicial
26 foreclosure, Belinda also asserted rights to recovery as a third
27 party beneficiary of the Purchase Agreement. CC Section 1559
28 permits a third party beneficiary to enforce a contract "made

expressly" for its benefit. A court finds such express benefit where the contracting parties must have intended to benefit the third party and where such intent appears in the express terms of the contract. Bancomer, S.A. v. Superior Court, 44 Cal. App. 4th 1450, 1458 (1996) (citation omitted). Ascertaining the parties' intent is a question of contract interpretation. Hess v. Ford Motor Co., 27 Cal. 4th 516, 524 (2002). A third party bears the burden of proving that the contractual performance it seeks was actually promised. Garcia v. Truck Ins. Exchange, 36 Cal. 3d 426, 436 (1984).

Belinda argues on appeal that testimony and declarations establish that the parties to the Purchase Agreement intended her to benefit by Merco Group's assumption of the PNL debt and by having all obligations on the debt to PNL released. But, she cites to no part of the record on appeal for any such testimony or declaratory evidence. The Panel's review of the appellate record and its limited review of the extensive bankruptcy court docket also failed to uncover any such evidence. Thus, the Panel must conclude that the bankruptcy court necessarily based its ruling on its review and interpretation of the only evidence properly before it, the Purchase Agreement itself and the relevant closing statements.[13]

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[13] In her Opening Brief, Belinda states, without citation, that "the parties' testimony, including that of Richard Meruelo" established that the intent of the parties to the Purchase Agreement was to purchase the Property and to relieve Belinda of her "obligation on the Property otherwise owing to PNL." Apl't Opening Brief at 12. The record on appeal, however, contained no such testimony. At oral argument, Belinda acknowledged the
(continued...)

Belinda argues that the Purchase Agreement, augmented by the closing statements, provides that: "[Merco Group] assumed the entire liability for the indebtedness with the objective of eliminating Meruelo's liability." Apl't Opening Brief at 12. Our review reveals major flaws in Belinda's position.

The Purchase Agreement was a contract between Seller and Merco Group for the sale and purchase of the Property. On its face, it contemplated that Merco Group would obtain new financing for its acquisition of the Property. Paragraph 5, "Financing Contingency," allows Merco Group until the closing date to satisfy itself as to its ability to obtain financing. The Purchase Agreement, in contrast, never referenced PNL, the

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[13](...continued)
absence of such testimony in her designation of the record, and, further, never specified where on the docket such alleged testimony resides. The Panel conducted some appropriate docket review. But, it was not required to cull an unidentified piece of evidence from an undesignated and unidentified document; and this is particularly true given the fact that the docket here exceeds 3,700 entries. To the extent that this evidence exists, it is buried in the docket and must remain interred.

In particular, the Panel reviewed the docket and found no other hearing held on this matter (the first hearing was continued in advance on the parties' stipulation), including no evidentiary hearing. The transcript of the hearing contains no party testimony, only the short argument by counsel for Belinda and the bankruptcy court's terse ruling.

Thus, the record before us establishes that the only evidence submitted by Belinda to the bankruptcy court directly in support of her third party beneficiary claim is attached to the Amended Claim: a copy of the Purchase Agreement and the Seller's and Buyer's closing statements. Belinda's argument that the bankruptcy court also should have considered parol evidence, thus, must refer to the closing statements, which follow the copy of the Purchase Agreement attached to the Amended Claim; she discussed and provided nothing else.

existing PNL debt amount or loan terms, nor the Guaranty. Similarly, the due diligence documents listed in the incorporated exhibits to the Purchase Agreement do not include any documents associated with the existing PNL loan. Nor does the Purchase Agreement contain any mention of notice to, or request for consent to loan assumption from, PNL. Finally, Exhibit "C" to the Purchase Agreement, the "Standard Provisions", contains an integration clause and the requirement that all amendments be in writing. The only reference to existing financing, by logical inference, is the line item in the closing statements: "Assumption" and the amount credited toward the $20,000,000 purchase price: $8,763,304.85.

Obviously, Merco Group's acquisition of new financing and related retirement of the existing PNL debt on close of escrow would have satisfied Belinda's obligations to PNL. As Belinda alleges, however, and as the closing statements evidence, Merco Group, instead, took the Property subject to the existing PNL debt. The Purchase Agreement contained no provisions addressing Belinda's obligations to PNL under the Guaranty and no expressed intent to benefit Belinda directly. And the closing statements are similarly silent as to Belinda and the Guaranty. And there is no other evidence before us on appeal. On this record, there is no evidence of express intent to benefit Belinda directly and in her capacity as a guarantor. We, thus, determine that the bankruptcy court correctly found that Belinda did not meet her burden of proving third party beneficiary status in relation to the Purchase Agreement and for CC Section 1559 purposes.

But even if extra-contractual evidence of intent existed,

beneficiary status of the type that allows specific performance under CC Section 1559 does not exist here, because the Purchase Agreement itself is silent on this point. CC Section 1559 allows certain third party beneficiaries to compel specific enforcement of a contract between other parties. It does not provide enforcement rights to all third parties who derive some incidental benefit from a contract. The statute provides real party in interest status only for a narrow category of third party beneficiaries.

In order for a court to find third party beneficiary standing under CC Section 1559, the third party must be more than a party who derives some benefit from the contract; instead, it must be expressly clear from the face of the contract that the party is an intended beneficiary.[14] Expressly, for purposes of CC Section 1559 means: ". . . in an express manner; in direct or unmistakable terms; explicitly; definitely; directly." R.J. Cardinal Co. v. Ritchie, 218 Cal. App. 2d 124, 135 (1963). Here, the Purchase Agreement never mentions Belinda, and the bankruptcy court did not err in finding that there was no express intention to contract for her benefit. Put another way, the bankruptcy court correctly found that the express intent of the Purchase Agreement was to benefit the Seller through the sale and not to benefit Belinda through an assumption. The bankruptcy court, thus, correctly determined that CC Section 1559 does not

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[14] A classic example of a contract allowing third party beneficiary enforcement under CC Section 1559 is a will. The heirs, who are expressly named therein, may bring an action requiring specific performance. Sonnicksen v. Sonnicksen, 45 Cal. App. 2d 46, 53 (1941).

allow her to specifically enforce the Purchase Agreement.

Cases cited by Belinda do not require a different result. R.J. Cardinal Co. involved an oral contract wherein the defendants allegedly expressly promised to pay a debt owed to the plaintiff-third party creditor. 218 Cal. App. 2d at 133. Here, there is no evidence or even argument that the contract at issue included a direct obligation to pay Belinda or to make payment on her behalf. And, in any event, the appellate court in R.J. Cardinal Co. reversed based on the exclusion of evidence relevant to the alleged lack of consideration for the alleged third party contract. Id. at 137. The facts are clearly distinguishable, and the case fails to advance Belinda's position.

Ralph C. Sutro Co. v. Paramount Plastering, Inc., 216 Cal. App. 2d 433 (1963) involved a construction loan agreement. Belinda cites Sutro for the proposition that in determining third party beneficiary status a contract: "should be read in light of the circumstances under which it was entered." Apl't Opening Brief at 11. This Panel agrees, but does not find this unremarkable assertion helpful to Belinda here. The Sutro Co. court determined that it was clear that the construction loan agreement at issue was made for the benefit of not only the borrower, but also for the benefit of the laborers and materialmen who completed the construction, as it expressly conditioned loan advances on a showing that the laborers and materialmen were paid. Id. at 437. Again, the contract at issue in Sutro Co. expressly named the third party plaintiffs - at least by class; and this was sufficient. Id. Here, again, the

Purchase Agreement is silent.

Finally, Schauer v. Mandarin Gems of Cal., Inc., 125 Cal. App. 4th 949 (2005), involved an action by an ex-wife to recover for breach of a warranty in the contract between her ex-husband and a jeweler that arose in connection with the ex-husband's purchase of her engagement ring. The Schauer court echoed the definition of "expressly" used by the R.J. Cardinal Co. court, and added the requirement that the intent to create third party beneficiary status must be expressly manifested by the contracting parties. Id. at 957-58. The Schauer court then concluded that the promisor (in that case the jeweler) must have understood that a third party beneficiary with specific enforcement rights was intended and had no difficulty finding that a seller of engagement rings would understand that the buyer intended to gift the ring to his bride-to-be. Id. at 958. Here, there is no such logical leap that can or should be made to overcome the lack of a direct reference to Belinda or the Guaranty in the Purchase Agreement itself. Clearly, the Seller intended to benefit itself and to directly enjoy the benefits of the sale of the Property. Belinda's benefit, if any in relation to her status as Guarantor, was at best incidental. And the bankruptcy court correctly determined that this was not enough for CC Section 1559 purposes.

Finally, we note that the specific performance that Belinda desires - payment in full of the PNL loan – is not expressly required by the Purchase Agreement. Nothing in the Purchase Agreement or closing statements can reasonably be interpreted to require that the debt, once assumed, be paid off in full by Merco

Group as would be necessary to relieve Belinda of obligations under the Guaranty. Debt assumption is not the same as a promise to pay in full. Nothing contained in the Purchase Agreement would prevent Merco Group from subsequently selling the Property, as had the Seller, subject to the existing financing with PNL and without release of Belinda's obligations under the Guaranty.[15]

The bankruptcy court specifically disapproved Belinda's third-party-beneficiary theory, finding that the "intention wasn't to relieve [Belinda] of the debt, it was to acquire the property." Hr'g Tr. (May 11, 2012) at 3:21-22. The record before the bankruptcy court was sufficient for it to properly make this determination, as a matter of law and fact. Here, the contract at issue does not expressly state any intention to benefit Belinda. And, as noted above, there is no parol evidence available to the Panel to establish that this was the parties' intention. Even if it was, however, the argument would fail given contractual silence on this point. Parol evidence may be appropriate to determine the parties' intent, but CC Section 1559 requires that the contract be unambiguous on this point on its face. Here, silence leads inescapably to a determination of facial ambiguity on this point. And here, the reliance on CC Section 1559 appears to be nothing other than a less than subtle attempt to recover a deficiency from the borrower where such recovery is absolutely barred by CCP Section 580(d).

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[15] Belinda did not retain any rights limiting Merco Group's ability to reassign, and in the Guaranty she generally agreed that PNL could allow such assumption without exonerating the Guaranty.

Therefore, the bankruptcy court properly disallowed Belinda's claim to the extent based on this theory.

And having concluded that CCP Section 580d bars Belinda's claim against Merco Group, in any event, and finding no error in the bankruptcy court's conclusion that Belinda's claim based on alleged third party beneficiary standing also fails, we need not address Belinda's's remaining arguments on appeal.[16]

CONCLUSION

For all of the reasons set forth above, we hold that the bankruptcy court did not err when it disallowed Belinda's Amended Claim, and we AFFIRM.

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[16] Belinda argues that the bankruptcy court should have analyzed the allegedly paid attorneys' fees claims separately from the as yet unpaid indemnification claim amount. Any such error would be harmless in light of this disposition, and we generally ignore harmless error. See Van Zandt v. Mbunda (In re Mbunda), 484 B.R. 344, 2012 Bankr. LEXIS 5940 *20 (9th Cir. BAP 2012)(citing Litton Loan Serv'g, LP v. Garvida (In re Garvida), 347 B.R. 697, 704 (9th Cir. BAP 2006)).

In addition, Belinda dedicated a substantial part of her opening brief on appeal in response to Merco Group's argument, raised for the first time on reply before the bankruptcy court, that it should not be required to pay claims relating to work by Belinda's attorney due to a conflict of interest. Appellee Merco Group did the same. Merco Group also alleged that the bankruptcy court made findings on this issue, and it cited to multiple pages of the transcript of the hearing that was held on May 11, 2012, in support. This discussion, however, actually occurred in connection with another claim objection, which is the subject of a separate appeal heard by this Panel, in CC-12-1304. At oral argument, the parties confirmed that such citations were the result of confusion. The argument adds nothing to our analysis and conclusions here.

FILED

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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:

YAN SUI,

Debtor.

YAN SUI,

Appellant,

v.

RICHARD A. MARSHACK, Chapter 7 Trustee; AMRANE COHEN, Chapter 13 Trustee,

Appellees.

BAP Nos. CC-12-1223-KiPaD
CC-12-1366-KiPaD
CC-12-1367-KiPaD
(related appeals)

Bk. No. 8:11-20448-CB

M E M O R A N D U M[1]

Argued and Submitted on February 22, 2013,
at Pasadena, California

Filed - April 4, 2013

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

Honorable Catherine E. Bauer, Bankruptcy Judge, Presiding

Appearances: Appellant Yan Sui argued pro se; D. Edward Hays, Esq. argued for Appellee Richard A. Marshack, Chapter 7 Trustee.

Before: KIRSCHER, PAPPAS and DUNN, Bankruptcy Judges.

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[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

In these related appeals, debtor Yan Sui ("Sui") appeals three orders from the bankruptcy court: (1) the order allowing the former chapter 7[2] trustee's administrative claim for fees and expenses incurred while Sui's case was in chapter 7; (2) the order allowing the Goodrich Law Corporation's ("GLC") administrative claim for fees and expenses incurred while Sui's case was in chapter 7; and (3) the order reconverting Sui's chapter 13 bankruptcy case to chapter 7. We AFFIRM the order reconverting Sui's case to chapter 7. However, we DISMISS for lack of jurisdiction the appeal of the interlocutory orders allowing the administrative claims of the former trustee and GLC.

I. FACTUAL BACKGROUND AND PROCEDURAL HISTORY

A. Prepetition facts

In 2000, Sui and his non-debtor wife, Pei-Yu Yang ("Yang"), acquired a fee simple interest in a residence in Costa Mesa, California ("Residence"). In 2003, Sui and Yang executed a $207,000 promissory note and first deed of trust in favor of World Savings Bank against the Residence.

In July 2007, Sui sued his former attorney, Kenny K. Tan ("Tan"), for professional negligence. Tan prevailed against Sui in arbitration and, in October 2008, was awarded $7,329.40. After a hearing on June 10, 2009, the state court confirmed the arbitration award and awarded Tan an additional $2,365.00 for sanctions and costs of $40.00, for a total judgment against Sui of $9,734.40. The judgment was entered on June 25, 2009 ("Tan

[2] Unless specified otherwise, all chapter, code and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

Judgment”). Within minutes of the June 10 hearing, Sui filed and recorded a quitclaim deed conveying his entire interest in the Residence to Yang for little or no consideration.

Sui exhausted all of his appeals, and the Tan Judgment is final. As of the filing of his bankruptcy case, the Tan Judgment remained unpaid.

B. Sui's chapter 7 bankruptcy filing

Sui, pro se, filed a chapter 7 bankruptcy case on July 27, 2011. Richard A. Marshack was appointed to serve as trustee for Sui's chapter 7 bankruptcy estate (“Trustee” or “former Trustee”). Sui did not list any real property in his Schedule A or list any secured debts in his Schedule D. Sui claimed in his Schedule I that he was “separated” from Yang.

On August 22, 2011, Trustee sought an order approving the employment of GLC as his general counsel. According to the application, Trustee wished to employ GLC to pursue and recover what he believed was a fraudulent transfer by Sui of the Residence to Yang in 2009. Trustee believed that a substantial amount of equity was available to pay creditors based on a valuation of the Residence of at least $410,000 and a secured debt held by World Savings Bank of $220,000. Other services to be performed by GLC included (1) representing Trustee in any action where the rights of the estate or Trustee may be affected, (2) conducting examinations of Sui, witnesses, claimants or adverse parties and preparing and assisting in the preparation of reports, accounts, applications, motions, complaints and orders, and (3) performing any and all other legal services incident and necessary for the administration of the bankruptcy case. David M. Goodrich

(“Goodrich”) of GLC agreed to perform legal services at the hourly rate of $250.00. The application stated that GLC's compensation was subject to court approval under § 328, and that GLC would be paid for its legal services only if it recovered any money or property.

Also on August 22, 2011, Trustee filed an adversary proceeding against Yang seeking to avoid the alleged fraudulent transfer of Sui's interest in the Residence.

In a letter dated August 23, 2011, Goodrich informed Sui that Trustee had learned of Sui's involvement as plaintiff in a number of lawsuits pending before the state and federal court, and that Sui had filed pleadings in some of these cases postpetition. Goodrich informed Sui that Trustee had assumed all rights in any of Sui's litigation once his bankruptcy was filed, and that Sui was not authorized to file any further pleadings without Trustee's permission.

On September 1, 2011, Sui filed a combined opposition to GLC's employment application and a notice of dismissal. Sui contended that GLC was not a “disinterested” party because the firm rented an office in a building owned by Trustee. No action was taken on Sui's notice of dismissal.

On September 8, 2011, Trustee filed an amended application for the employment of GLC to disclose that GLC was a tenant of Marshack Hays, LLP, a law firm in which Trustee was a partner. Other than this disclosure, the terms of GLC's employment remained the same.

On September 19, 2011, Sui moved to dismiss his chapter 7 bankruptcy case. Sui contended that he was a party to four

lawsuits (three in state court and one in federal court) against the homeowners association for the community in which the Residence is located ("HOA"), as well as one federal court lawsuit against a party named Southside Towing, and he wanted to prosecute these cases without Trustee's interference. Sui also contended that he had voluntarily paid in full his two unsecured creditors, Capital One and American Express. Finally, Sui contended that Tan, a judgment creditor, did not meet the definition of "creditor" for the purpose of his bankruptcy case, and that Tan was mistakenly added to Sui's schedules. Therefore, argued Sui, dismissal was appropriate because his two creditors were now paid, and Tan was not technically a creditor. The bankruptcy court denied Sui's dismissal motion for failure to show cause, and because the motion was not properly noticed and set for hearing.

Sui filed a second motion to dismiss his chapter 7 case on October 11, 2011. This dismissal motion was essentially identical to the first. Trustee opposed dismissal, contending that Sui had failed to demonstrate cause, and that the best interests of creditors would be served by allowing Trustee to administer the case. Specifically, Trustee opposed dismissal because:

- Sui and Yang held at least $300,000 in equity in the Residence;
- Sui failed to disclose several pending lawsuits in his bankruptcy petition, including those filed against the HOA;
- Sui lived in the Residence with Yang despite his claim that he was separated;
- Sui failed to list any of Yang's assets as assets of the bankruptcy estate;
- Sui continued to prosecute disclosed and undisclosed litigation despite Goodrich's demands to cease such activity;

- after filing the chapter 7 case, Sui filed a new civil lawsuit for a potential claim that was not scheduled;
- Yang had filed a petition for dissolution of marriage, but no decree of separation or divorce had been entered;
- Sui claimed at the § 341(a) meeting of creditors that he was never legally married to Yang yet his tax returns indicated he was married to Yang, he affirmed his marriage to Yang in a recently filed lawsuit, and he was the respondent in Yang's petition for dissolution;
- Sui had allegedly paid over $8,000 in prepetition debt to two creditors after he filed his chapter 7 case;
- three cars were regularly seen at the Residence, but Sui had not scheduled any vehicles;
- Sui had paid the HOA $10,000 within 90 days of the bankruptcy filing, but this payment was not scheduled;
- one of Sui's creditors had obtained an order from the state court determining Sui to be a vexatious litigant;
- at least two creditors did not consent to dismissal and neither of these creditors were listed in Sui's schedules; and
- an undisclosed ownership interest in real property located in Manteca, California was transferred to Sui on July 5, 2011 - twenty-two days before he filed his chapter 7 case.[3]

The HOA, who Sui did not list as a creditor in his schedules, also opposed dismissal, contending that Sui owed the HOA approximately $18,000 in attorney's fees incurred in defending Sui's frivolous and duplicative lawsuits.

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[3] According to a motion for relief from stay filed by Wells Fargo Bank on October 14, 2011, borrowers Alberto and Patricia Valencia had defaulted under the terms of a note and deed of trust regarding certain property in Manteca, California. A trustee's sale was scheduled for August 10, 2011. On July 5, 2011, the Valencias purportedly conveyed an ownership interest in the property to Yan Sui, "a single woman," by grant deed. According to Wells Fargo, this "Yan Sui" was the debtor Yan Sui. Sui did not disclose an ownership interest in this property in his schedules. Wells Fargo contended that cause existed to terminate the stay because Sui's bankruptcy case was being used for an improper purpose to frustrate its efforts to foreclose upon the property.

After a hearing on Sui's second motion to dismiss and GLC's employment application, the bankruptcy court entered an order approving GLC's employment under § 327, stating that any compensation or reimbursement of costs would "only be paid upon application to and approval of the Court pursuant to 11 U.S.C. § 330." The bankruptcy court denied Sui's second motion to dismiss his chapter 7 case for failing to show cause to grant it.[4]

C. Sui's conversion to chapter 13, Trustee's and GLC's administrative claims and Sui's motion to dismiss the chapter 13 bankruptcy case

On January 9, 2012, Sui moved to convert his chapter 7 case to chapter 13. No opposition was filed. The bankruptcy court entered an order on January 30, 2012, converting Sui's case to chapter 13 under § 706(a).

Sui filed his chapter 13 plan on February 14, 2012. The plan proposed payments of $402.00 per month for 24 months, which would pay the Tan Judgment, Sui's alleged sole debt, in full. The plan proposed to pay $0.00 for fees of either the chapter 13 trustee or the former Trustee.[5] A confirmation hearing was set for April 12, 2012.

On February 28, 2012, GLC moved for an order allowing its administrative claim (claim #2) for fees and expenses incurred in Sui's chapter 7 case prior to the conversion. GLC contended that

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[4] Sui appealed the order approving GLC's employment and the order denying his second motion to dismiss his chapter 7 case on November 8, 2011. The Panel denied Sui's motion for leave to appeal the interlocutory orders and dismissed the appeal.

[5] Trustee and GLC filed a combined objection to Sui's chapter 13 plan on March 5, 2012. They opposed confirmation because the plan failed to provide for their administrative claims for preconversion fees and expenses.

its fees and expenses were directly related to the protracted investigation of a variety of undisclosed assets and avoidable fraudulent transfers. GLC contended that all of its services were necessary and benefitted the estate by proving significant assets existed that could be liquidated and/or recovered and liquidated to pay creditors. GLC further contended that its uncovering of assets forced Sui into chapter 13, whereby most, if not all, of his unsecured debt would now be paid. Therefore, argued GLC, its fees of $14,987.50 and expenses of $37.70 should be allowed as an administrative expense under § 503(b)(1)(A). GLC attached copies of detailed time and expense records for preconversion services provided in Sui's chapter 7 case between August 17, 2011 and December 27, 2011.

On March 6, 2012, the former Trustee filed a similar motion to allow his administrative claim (claim #3) for preconversion fees and expenses under § 503(b)(1)(A). Trustee essentially set forth the same basis for why his claim should be allowed as an administrative expense, adding that his (and his staff's) services were instrumental in the bankruptcy court's denials of Sui's multiple motions to dismiss the case. Trustee requested fees of $5,890.00, which were based on an hourly rate and time spent, and expenses of $64.08. Attached were copies of detailed time and expense records for services Trustee and his staff provided in Sui's chapter 7 case.

Sui opposed both motions to allow the administrative claims

1 for preconversion fees and expenses.[6] In his thirty-one page
2 objection to GLC's fees, Sui contended the claim should be
3 disallowed in its entirety because: (1) the fees were unreasonable
4 in light of the debt; (2) the services were not reasonably likely
5 to benefit the estate; (3) the services were duplicative with that
6 of Trustee's or consisted of tasks that should have been performed
7 by Trustee; (4) any fees incurred before GLC filed its amended
8 employment application on September 8, 2011, were unauthorized;
9 (5) Trustee's adversary action against Yang had no merit and would
10 fail; and (6) GLC was not entitled to compensation because of
11 various false statements made by Goodrich during Sui's case, and
12 because GLC caused Sui and Yang to lose two favorable default
13 judgments against Southside Towing and the HOA. Sui virtually
14 went through each of GLC's time entries, contending that it was
15 either "unnecessary," "unfounded," "unconvincing," "groundless,"
16 "duplicative," or a "secretarial" function that was charged at an
17 attorney rate.

18 Sui contended that the former Trustee's claim for fees should
19 also be disallowed because: (1) the fees were unreasonable;
20 (2) Trustee failed to explain to Sui how his fees were calculated
21 and documented; (3) some of Trustee's services were duplicative
22 with those of GLC; (4) Trustee's staff members were not authorized
23 by the court to assist him; and (5) Trustee was not entitled to
24 any compensation because he had caused Sui, his estate and Yang
25 damages in the Southside Towing and HOA cases.

26

27 [6] Sui did not file a claim objection but rather an opposition
to the former Trustee's and GLC's motions to allow their
administrative claims. Presumably, the bankruptcy court construed
28 Sui's opposition to be an objection to their proofs of claim.

On March 21, 2012, Sui moved to dismiss his chapter 13 case. Sui explained the reasons for why he quitclaimed his interest in the Residence and why he indicated that he was "separated" in his Schedule I. Sui contended that Trustee's actions or failures to act regarding the pending lawsuits caused him and his creditors damages. Sui also contended that Trustee and GLC were not entitled to any fees because they caused their own damages. Attached to Sui's motion were various court documents and emails from Sui to Tan attempting to work out a payment plan for the Tan Judgment.

The former Trustee and GLC opposed Sui's motion to dismiss, asserting essentially the same bases for denial of the motion as Trustee had asserted in his opposition to Sui's prior motions to dismiss his then chapter 7 case. In short, Trustee and GLC contended that Sui's acts had been in bad faith, and that it was in the best interests of creditors to deny Sui's motion to dismiss and reconvert his case to chapter 7. In his attached declaration, Goodrich stated that Sui had testified at the initial § 341(a) meeting of creditors in his chapter 13 case that his sole purpose for conversion was to seek dismissal of his case.

The matters of Sui's plan confirmation and motion to dismiss and the motions for allowance of Trustee's and GLC's administrative claims were heard by the bankruptcy court on April 12, 2012. At the outset, Goodrich, appearing for both GLC and the former Trustee, moved to reconvert Sui's case to chapter 7. Counsel for the chapter 13 trustee supported reconversion, noting that Sui had failed to make any plan payments or show any attempt to set forth a confirmable plan. After Sui

explained that he had paid his three creditors in full, the bankruptcy court announced its decision to deny the motion to dismiss and reconvert the case to chapter 7:

> The problem is that you used the bankruptcy system inappropriately. You filed documents that were untrue. And we can't allow that. You misused the Bankruptcy Court and all the people involved. That's why we can't let you dismiss this case because you caused a lot of people a lot of work. And you violated some federal laws. That's why we're not going to dismiss this case.
>
> I'm going to reconvert it to a Chapter 7. The Chapter 7 Trustee had to do a lot of work because of the inconsistencies between your statements in writing and orally. And had to do a lot of investigations to fine [sic] out that, frankly, there were lies involved in your bankruptcy case. And we can't run the system that way. So I am going to reconvert it back to a Chapter 7.
> . . . .
>
> So I'm not dismissing the bankruptcy case. That's denied.

Hr'g Tr. (Apr. 12, 2012) 2:10-23; 3:9-10.

The bankruptcy court then announced its decision to allow GLC's and the former Trustee's administrative claims for preconversion fees and expenses:

> I am going to allow the administrative claim of the Goodrich Law Firm because they had to do a lot of work on this case because of the way you abused the system.
> . . . .
>
> I am also going to allow the motion for the administrative claim of the Chapter 7 Trustee, who also had to do a lot of work because of your many inconsistent statements.

Id. at 3:10-13; 16-19. After Sui contended that he had been truthful in his bankruptcy case, the bankruptcy court further found:

> With all due respect I'm finding the opposite. Therefore, you need to understand that this is the end of the road. You can't keep coming here and trying to get rid of this bankruptcy case. You came here seeking the protection of the bankruptcy court, but you did not

> follow the rules. Yes, you are getting penalized for doing things you should not have done. That's where we are at at this point. Because we have to protect the integrity of this system.
>
> . . . .
>
> You came here voluntarily, sir. You cannot leave when we find out that you're abusing the system. And money has been spent by various parties in the bankruptcy system to bring out the fact that you have lied. They're entitled to be paid.

Id. at 4:9-17; 4:24-5:3. Based on the court's ruling, confirmation of the plan was denied. The court also denied Sui's request to file a new plan.

On April 13, 2012, the bankruptcy court entered an order allowing the former Trustee's administrative claim for preconversion fees of $5,980.00 and expenses of $64.08. On April 20, 2012, the bankruptcy court entered three more orders: (1) the order allowing GLC's administrative claim for preconversion fees of $14,987.50 and expenses of $37.70; (2) the order denying Sui's motion to dismiss the chapter 13 case; and (3) the order reconverting Sui's bankruptcy case to chapter 7.

Sui timely appealed the orders allowing the former Trustee's and GLC's administrative claims and the order reconverting the case to chapter 7.[7]

II. JURISDICTION

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

[7] Sui did not appeal the order denying his motion to dismiss the chapter 13 case. As for the three orders that are on appeal, although Sui filed only one notice of appeal for all of them, we entered an order on July 18, 2012, assigning each order its own appeal number: CC-12-1223 for the order allowing the former Trustee's administrative claim; CC-12-1366 for the order allowing GLC's administrative claim; and CC-12-1367 for the order reconverting the bankruptcy case to chapter 7.

order reconverting Sui's case to chapter 7 under 28 U.S.C. § 158. We address below our jurisdiction over the orders allowing the administrative claims of the former Trustee and GLC.

III. ISSUES

1. Did the bankruptcy court abuse its discretion when it reconverted Sui's case to chapter 7?

2. Do we have jurisdiction over the appeal of the orders allowing the former Trustee's and GLC's administrative claims for preconversion fees and expenses?

IV. STANDARDS OF REVIEW

We review for abuse of discretion the bankruptcy court's decision to deny a request for dismissal of a chapter 13 case under § 1307(b) and to convert a case from chapter 13 to chapter 7. Rosson v. Fitzgerald (In re Rosson), 545 F.3d 764, 771 (9th Cir. 2008). A bankruptcy court abuses its discretion if it applied the wrong legal standard or its findings were illogical, implausible or without support in the record. TrafficSchool.com, Inc. v. Edriver, Inc., 653 F.3d 820, 832 (9th Cir. 2011).

"Bad faith" is a finding of fact reviewed for clear error. Id. at 774 (citing Leavitt v. Soto (In re Leavitt), 171 F.3d 1219, 1222-23 (9th Cir. 1999); and Eisen v. Curry (In re Eisen), 14 F.3d 469, 470 (9th Cir. 1994)(per curiam)). A bankruptcy court's factual finding is clearly erroneous if it is illogical, implausible, or without support in the record. Retz v. Samson (In re Retz), 606 F.3d 1189, 1196 (9th Cir. 2010)(citing United States v. Hinkson, 585 F.3d 1247, 1261-62 & n.21 (9th Cir. 2009)(en banc)).

When a question regarding our jurisdiction exists, we are

"entitled to raise [that issue] sua sponte and [address it] de novo." Menk v. Lapaglia (In re Menk), 241 B.R. 896, 903 (9th Cir. BAP 1999).

V. DISCUSSION

A. The bankruptcy court did not abuse its discretion when it reconverted Sui's case to chapter 7.

Sui's brief on appeal spends a great deal of time discussing the alleged wrongful acts of the former Trustee and GLC rather than explaining how the bankruptcy court erred in its decision to reconvert his case to chapter 7. However, Sui appears to contend the bankruptcy court abused its discretion in reconverting his case to chapter 7 for abuse of process when his prepetition creditors had been paid in full prior to the hearing. Sui also appears to contend that his right to dismiss his chapter 13 case was absolute under § 1307(b).

Sections 1307(b) and 1307(c) provide, in relevant part:

> (b) On request of the debtor at any time, if the case has not been converted under section 706, 1112, or 1208 of this title, the court shall dismiss a case under this chapter.
>
> (c) [O]n request of a party in interest or the United States trustee and after notice and a hearing, the court may convert a case under [chapter 13] to a case under chapter 7 of this title, or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause . . . . (Emphasis added).[8]

Section 1307(c) establishes a two-step analysis for dealing with questions of conversion and dismissal. "First, it must be determined that there is 'cause' to act. Second, once a

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[8] Section 1307(c) provides a non-exhaustive list of acts and omissions that constitute "cause," none of which is directly applicable here.

determination of 'cause' has been made, a choice must be made between conversion and dismissal based on the 'best interests of the creditors and the estate.'" Nelson v. Meyer (In re Nelson), 343 B.R. 671, 675 (9th Cir. BAP 2006)(citations omitted).

Because Sui's case had already been converted under § 706,[9] the bankruptcy court was not required to dismiss Sui's case on his request. Further, even if Sui had not previously converted his case, the right to dismiss his chapter 13 case was not absolute. In reviewing the U.S. Supreme Court's holding in Marrama v. Citizens Bank of Mass. (In re Marrama), 549 U.S. 365 (2007), the Ninth Circuit held in In re Rosson that a "debtor's right of voluntary dismissal under § 1307(b) is not absolute, but is qualified by the authority of a bankruptcy court to deny dismissal on grounds of bad-faith conduct or 'to prevent an abuse of process.'" 545 F.3d at 774 (citing § 105(a))(other citations omitted). In other words, a bankruptcy court may dismiss or convert a chapter 13 case to chapter 7 for "cause," which courts have routinely interpreted to include bad faith conduct. In re Marrama, 549 U.S. at 373; In re Rosson, 545 F.3d at 774-75; In re Leavitt, 171 F.3d at 1224 (although not specifically listed, bad faith is a "cause" for dismissal under § 1307(c)); In re Eisen, 14 F.3d at 470 (chapter 13 case filed in bad faith may be dismissed "for cause").

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[9] Section 706(a) provides:

> The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable.

In determining whether a debtor has engaged in bad-faith conduct, the bankruptcy court must review the "totality of the circumstances." In re Eisen, 14 F.3d at 470 (quoting Goeb v. Heid (In re Goeb), 675 F.2d 1386, 1391 (9th Cir. 1982)). A bankruptcy court should consider:

> (1) whether the debtor misrepresented facts in his or her petition or plan, unfairly manipulated the Bankruptcy Code or otherwise filed the chapter 13 petition or plan in an inequitable manner;
>
> (2) the debtor's history of filings and dismissals;
>
> (3) whether the debtor's only purpose in filing for chapter 13 protection is to defeat state court litigation; and
>
> (4) whether egregious behavior is present.

In re Leavitt, 171 F.3d at 1224. A finding of bad faith does not require fraudulent intent by the debtor. Id.

It is undisputed that Sui failed to disclose several pending lawsuits in his bankruptcy schedules, and that he unlawfully continued to prosecute disclosed and undisclosed litigation in other courts while his case was in chapter 7. See Moneymaker v. CoBen (In re Eisen), 31 F.3d 1447, 1451 n.2 (9th Cir. 1994) (debtor's prepetition causes of action become property of the estate upon the bankruptcy filing and the trustee is the only party with standing to prosecute those actions). Sui also apparently owns or possesses at least three vehicles, none of which was ever scheduled. Sui claimed at the § 341(a) meeting of creditors that he was never legally married to Yang, yet in recent tax returns and pleadings filed in other courts, Sui has affirmatively represented that Yang is his wife. He also claimed in his Schedule I that he is "separated" from Yang. Further, Sui

admitted at the initial § 341(a) meeting of creditors in his chapter 13 case that his sole purpose for conversion was to seek dismissal of his case. Finally, although he disputes it, Sui may have obtained an ownership interest in real property located in Manteca, California just days before his bankruptcy filing, but he failed to disclose this interest in his schedules.

Based on these facts and more, the bankruptcy court found that Sui had filed untrue documents, violated federal law and abused the bankruptcy process. Therefore, under the totality of the circumstances, the bankruptcy court found that "cause" to convert had been established.

The bankruptcy court also determined that because of Sui's conduct, converting the case to chapter 7 was preferred to dismissing it. Although it did not expressly find that conversion was in the best interest of creditors as opposed to dismissal, the record supports the bankruptcy court's decision to reconvert the case. See Shanks v. Dressel, 540 F.3d 1082, 1086 (9th Cir. 2008) (we may affirm on any ground supported by the record). In their opposition to dismissal, both the former Trustee and GLC suggested conversion would be in the best interests of creditors because Sui had shown a pattern of avoiding paying his creditors, particularly Tan, and no assurances existed that he would pay his creditors outside of bankruptcy. For example, just moments after the state court announced its oral ruling in favor of Tan, Sui recorded a quitclaim deed conveying his entire interest in the Residence to Yang for little or no consideration. Sui also filed his chapter 7 bankruptcy case just one day before Tan was to conduct a scheduled debtor's examination on July 28, 2011. Moreover, it was quite

possible, based on the multitude of omissions in his schedules, that Sui had not listed all of his creditors. For certain, Sui did not list the HOA, with whom he had been in litigation for years prior to his bankruptcy filing.

Obviously, Sui's plan of filing a chapter 7 bankruptcy case to shield himself from his prepetition creditors backfired. It ended up, much to Sui's dismay, giving the former Trustee power over his prepetition claims and litigation. It also allowed the former Trustee to investigate Sui's undisclosed assets, as well as pursue and recover what might have been a fraudulent transfer of the Residence to Yang.

We see no clear error in the bankruptcy court’s finding of bad faith conduct. We also see no error in its apparent determination that conversion, as opposed to dismissal, was in the best interests of creditors. Accordingly, we conclude the bankruptcy court did not abuse its discretion when it reconverted Sui’s case to chapter 7.[10]

B. We lack jurisdiction over the appeal of the interlocutory orders allowing the former Trustee's and GLC's administrative claims for preconversion fees and expenses.

We conclude, on this record, that the orders allowing the former Trustee's and GLC's administrative claims for preconversion fees and expenses are interlocutory. Counsel for the former

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[10] Although Sui does not raise this issue, the former Trustee had standing to suggest the case be reconverted instead of dismissed. See In re Barnes, 275 B.R. 889, 892-93 (Bankr. E.D. Cal. 2002). Even if Trustee somehow lacked standing, the bankruptcy court had the authority to sua sponte convert Sui’s case. In re Rosson, 545 F.3d at 774 (bankruptcy court has authority to sua sponte dismiss or convert a case on its own motion under § 105(a) to prevent what it reasonably perceives as an abuse of process).

Trustee conceded as much at oral argument. We also decline to consider Sui's notice of appeal of these orders as a motion for leave to appeal under Rule 8003(c). As such, we must DISMISS these appeals for lack of jurisdiction.

Because Sui's case was reconverted to chapter 7, which the former Trustee is again administering, and because Sui never confirmed a chapter 13 plan allowing for the administrative claims of the former Trustee and GLC for preconversion fees and expenses, the orders at issue are, at best, interim fee awards under § 331. Interim awards under § 331 are interlocutory and are always subject to the court's reexamination and adjustment during the course of the case. Leichty v. Neary (In re Strand), 375 F.3d 854, 858 (9th Cir. 2004)(citations omitted).

Although we believe that this case should run its course and decline to exercise jurisdiction over the appeal of these orders under Rule 8003(c), we perceive considerable issues with the merits of the awarded fees and strongly suggest that the bankruptcy court revisit the awards upon the parties' final fee applications. We note, the bankruptcy court did not articulate upon what legal standard it was awarding fees and expenses for either the former Trustee or GLC, nor did it conduct any reasonableness analysis, even when reasonableness was questioned by Sui. The court also made no finding that Trustee's and GLC's services were likely to benefit the estate at the time rendered. Now that Sui's case has been reconverted to chapter 7, the former Trustee's fees would presumably be subject to § 326. As counsel

for Trustee employed under § 327(a),[11] GLC's fees were (and are) subject to a reasonableness determination under § 330(a).

VI. CONCLUSION

Based on the foregoing, we AFFIRM the order reconverting Sui's case to chapter 7. However, we DISMISS for lack of jurisdiction the appeal of the interlocutory orders allowing the former Trustee's and GLC's administrative claims for preconversion fees and expenses.

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[11] Although GLC's employment application expressly sought employment under § 328, the bankruptcy court's order approving GLC's employment, which was drafted by GLC, made no mention of § 328, and instead stated that any compensation or reimbursement was subject to court approval under § 330. Therefore, as GLC even seems to concede on appeal, its fees were subject to a reasonableness determination under § 330. See Appellee Response Brief at 8. We further note that GLC agreed to accept fees only if property or money is recovered. Other than the $5,000 Trustee recovered in a settlement with the HOA, we fail to see what other assets had been recovered prior to GLC being awarded nearly $15,000 in fees.

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

IN RE: ANGIE M. GARCIA, AKA Angel Garcia, AKA Angie Marie Garcia, *Debtor*,	No. 11-56076
ORANGE COUNTY'S CREDIT UNION, *Appellant*, v. ANGIE M. GARCIA, *Appellee*, UNITED STATES TRUSTEE and CHARLES W. DAFF, Chapter 7 Trustee, *Trustees*.	D.C. No. 8:10-cv-00985-JST OPINION

Appeal from the United States District Court
for the Central District of California
Josephine Staton Tucker, District Judge, Presiding

Submitted February 13, 2013*
Pasadena, California

Filed March 5, 2013

Before: Alex Kozinski, Chief Judge, Barry G. Silverman, Circuit Judge, and Jed S. Rakoff, Senior District Judge.**

Opinion by Judge Silverman

SUMMARY***

Bankruptcy

Affirming the district court's judgment in a bankruptcy case, the panel held that: (1) a motor vehicle may fall within California's "wildcard" or "grubstake" exemption; and (2) if an exempt vehicle is a tool of the debtor's trade and is secured by a nonpossessory, nonpurchase-money lien, then the debtor can avoid the lien pursuant to 11 U.S.C. § 522(f)(1)(B).

* The panel unanimously concludes this case is suitable for decision without oral argument. *See* Fed. R. App. P. 34(a)(2).

** The Honorable Jed S. Rakoff, Senior District Judge for the U.S. District Court for the Southern District of New York, sitting by designation.

*** This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

COUNSEL

Robert M. Dato and Joseph M. Welch, Buchalter Nemer, Irvine, California, for Creditor-Appellant.

Anerio V. Altman, Lake Forest, California, for Debtor-Appellee.

OPINION

SILVERMAN, Circuit Judge:

We hold today that a motor vehicle, even a Mercedes, may fall within California's so-called "wildcard" or "grubstake" exemption. Cal. Civ. Proc. Code § 703.140(b)(5). We also hold that if an exempt vehicle is a tool of the debtor's trade and is secured by a nonpossessory, nonpurchase-money lien, the debtor can avoid the lien pursuant to 11 U.S.C. § 522(f)(1)(B). The district court so ruled and remanded the case to the bankruptcy court to determine whether the vehicle in question, a 2001 Mercedes 320E sedan, was in fact a tool of the debtor's trade as a real estate agent, or just a sweet ride. The lien-holder appealed. We affirm.

I. FACTS

In November 2006, Angie Garcia, a real estate agent, borrowed $22,160 from Orange County's Credit Union and used her Mercedes as collateral. The credit union perfected a nonpossessory, nonpurchase-money lien on the vehicle.

Garcia filed for Chapter 7 bankruptcy and listed the outstanding balance of the loan as $12,715.50. She claimed that the car, valued at $5,350, was exempt from her bankruptcy estate under California Civil Procedure Code § 703.140(b)(5). That section allows a debtor to exempt up to $18,350 in "any property."[1] Garcia also moved to avoid the lien on the car pursuant to 11 U.S.C. § 522(f)(1)(B). That section allows debtors to avoid nonpossessory, nonpurchase-

[1] Cal. Civ. Proc. Code § 703.140(b) (2010) states:

> The following exemptions may be elected as provided in subdivision (a):
>
> (1) The debtor's aggregate interest, not to exceed seventeen thousand four hundred twenty-five dollars ($17,425) in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor.
>
> . . .
>
> (5) The debtor's aggregate interest, not to exceed in value nine hundred twenty-five dollars ($925) plus any unused amount of the exemption provided under paragraph (1), in any property.

On January 1, 2013, the amounts were increased to $24,060 and $1,280, respectively, and the burial plot reference was deleted.

money liens on exempt property that is a tool of the debtor's trade.[2]

The bankruptcy court ruled that the California wildcard exemption could not be used for vehicles like Garcia's because other sections of the California exemption statutes deal with them explicitly. It also ruled that Garcia could not use the lien avoidance provisions of 11 U.S.C. § 522(f)(1)(B) because motor vehicles were explicitly mentioned in other portions of the statute, (e.g., § 522(d)(2)), and because the legislative history behind § 522(f) did not support avoiding liens on luxury items.

The district court reversed. As for the California wildcard exemption, the district court ruled that "any property" means just that – any property – up to the statutory amount. Quoting *In re Taylor*, 861 F.2d 550, 553 (9th Cir. 1988), the court also

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[2] 11 U.S.C. § 522(f)(1) states:

> Notwithstanding any waiver of exemptions but subject to paragraph (3), the debtor may 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--
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> . . .
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> (B) a nonpossessory, nonpurchase-money security interest in any--
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> . . .
>
> (ii) implements, professional books, or tools, of the trade of the debtor or the trade of a dependent of the debtor.

ruled that "[l]ien avoidance on motor vehicles as tools of the debtor's trade . . . is generally allowed in situations where the vehicle is necessary to the debtor's trade, and the state has opted out of the federal laundry list." The court remanded the case to the bankruptcy court for further factual findings to determine whether Garcia's Mercedes is indeed a tool of her trade.

II. JURISDICTION AND STANDARD OF REVIEW

We have jurisdiction to hear appeals from a district court's ruling on a bankruptcy court's final order, judgment, or decree under 28 U.S.C. § 1291. Although the district court's order reversed and remanded to the bankruptcy court for further factual findings, we may exercise jurisdiction if the issues on appeal are legal "in nature and [their] resolution either (1) could dispose of the case or proceedings and obviate the need for factfinding; or (2) would materially aid the bankruptcy court in reaching its disposition on remand." *In re Scovis*, 249 F.3d 975, 980 (9th Cir. 2001) (citing *Lundell v. Anchor Constr. Specialists*, 223 F.3d 1035, 1038 (9th Cir. 2000)).

Here, the issues are purely legal. On appeal, we consider whether California Civil Procedure Code § 703.140(b)(5) permits the exemption of a motor vehicle and whether 11 U.S.C. § 522(f)(1)(B) permits lien avoidance on the same. As the district court noted, the bankruptcy court resolved these issues as a matter of law and made no factual findings.

We review de novo the district court's decision, *In re AFI Holding, Inc.*, 525 F.3d 700, 702 (9th Cir. 2008), and the bankruptcy court's interpretation of the Bankruptcy Code, *Blausey v. U.S. Trustee*, 552 F.3d 1124, 1132 (9th Cir. 2009).

III. DISCUSSION

Generally, when a debtor files Chapter 7 bankruptcy, all of the debtor's property becomes the property of the bankruptcy estate. 11 U.S.C. § 541. Federal law, however, provides avenues for the debtor to exempt certain property. 11 U.S.C. § 522(d). This exemption scheme can be supplanted by states that choose to provide their own menu of exemptions. 11 U.S.C. § 522(b)(2); *see also In re Granger*, 754 F.2d 1490, 1490, 1492 (9th Cir. 1985) ("[A] state that has opted out has considerable freedom in creating exemptions and eligibility requirements for those exemptions."). California is one such state, providing its own exemption scheme in California Civil Procedure Code §§ 703.130 and 703.140.

We agree with the district court that as a purely legal matter Garcia is not prevented from exempting a motor vehicle up to the maximum allowable amount under California Civil Procedure Code § 703.140(b)(5). Section 703.140(b)(5) permits a debtor to exempt her "aggregate interest, not to exceed in value nine hundred twenty-five dollars ($925) plus any unused amount of the exemption provided under paragraph (1), in *any property*." Cal. Civ. Proc. Code § 703.140(b)(5) (2010) (emphasis added). Paragraph (1) states that a debtor can exempt up to $17,425 in certain types of real or personal property. *Id.* § 703.140(b)(1) (2010). Thus, these two paragraphs combine to allow a debtor to exempt up to $18,350 in "any property." "Any" means *any*, and fancy cars are not excluded.

The final question is whether a lien on a motor vehicle can be avoided under 11 U.S.C. § 522(f)(1)(B) as a tool of the

debtor's trade. As the district court correctly ruled, the answer is "yes." *In re Taylor*, 861 F.2d at 553.

It remains to be seen whether Garcia's car qualifies as a tool of her trade. We affirm the district court's remand to the bankruptcy court for that factual determination, and likewise affirm the district court's ruling in all other respects.

AFFIRMED.

FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

In the Matter of: FITNESS HOLDINGS INTERNATIONAL, INC., *Debtor*,	No. 11-56677
OFFICIAL COMMITTEE OF UNSECURED CREDITORS, of the ESTATE OF FITNESS HOLDINGS INTERNATIONAL, INC., *Appellant*,	D.C. No. 2:10-cv-00647-AG
v.	
HANCOCK PARK CAPITAL II, L.P., a Delaware Limited Partnership; PACIFIC WESTERN BANK; KENTON VAN HARTEN; MICHAEL FOURTICQ, SR.; HANCOCK PARK ASSOCIATES, III; HANCOCK PARK ASSOCIATES, *Appellees*.	OPINION

Appeal from the United States District Court
for the Central District of California
Andrew J. Guilford, District Judge, Presiding

Argued and Submitted
February 4, 2013—Pasadena, California

Filed April 30, 2013

Before: Consuelo M. Callahan, Sandra S. Ikuta, and Andrew D. Hurwitz, Circuit Judges.

Opinion by Judge Ikuta

SUMMARY[*]

Bankruptcy

The panel vacated the district court's judgment affirming the bankruptcy court's dismissal of a complaint alleging that a debtor's pre-bankruptcy transfer of funds to its sole shareholder, in repayment of a purported loan, was a constructively fraudulent transfer under 11 U.S.C. § 548(a)(1)(B).

The panel held that a court has the authority to recharacterize a purported loan as an equity investment for purposes of § 548, and that a transaction creates a debt if it creates a "right to payment" under state law. Because the district court concluded that it lacked the authority to make this determination, the panel remanded the case for further proceedings.

[*] This summary constitutes no part of the opinion of the court. It has been prepared by court staff for the convenience of the reader.

COUNSEL

Richard D. Burstein and Robyn B. Sokol, Ezra Brutzkus Gubner, LLP, Woodland Hills, California; Larry W. Gabriel (argued), Jenkins Mulligan & Gabriel, LLP, Woodland Hills, California; David J. Richardson, The Creditors' Law Group, APC, Los Angeles, California, for Appellants.

David K. Eldan (argued), Parker, Milliken, Clark, O'Hara & Samuelian, Los Angeles, California; Ralph F. Hirschmann (argued) and Shane W. Tseng, Hirschmann Law Group, Los Angeles, California; Lawrence C. Barth and M. Lance Jasper (argued), Munger, Tolles & Olson, LLP, Los Angeles, California, for Appellees.

OPINION

IKUTA, Circuit Judge:

This case presents the question whether a debtor's pre-bankruptcy transfer of funds to its sole shareholder, in repayment of a purported loan, may be a constructively fraudulent transfer under 11 U.S.C. § 548(a)(1)(B). In order to answer this question, we must determine whether a bankruptcy court has the power to recharacterize the purported loan as an equity investment. We hold that a court has the authority to determine whether a transaction creates a debt or an equity interest for purposes of § 548, and that a transaction creates a debt if it creates a "right to payment" under state law. *See* 11 U.S.C. §§ 101(5), (12); *Butner v. United States*, 440 U.S. 48, 54 (1979) (noting that "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law"). Because the

district court concluded that it lacked authority to make this determination, we vacate the decision below and remand for further proceedings.[1]

I

Fitness Holdings International, Inc., the debtor in this bankruptcy case, was a home fitness corporation. Before declaring bankruptcy, the company received significant funding from two entities: Hancock Park, its sole shareholder, and Pacific Western Bank. Defendants Kenton Van Harten and Michael Fourticq both served on Fitness Holdings' board of directors. Fourticq was also a manager of Hancock Park.

Between 2003 and 2006, Fitness Holdings executed eleven separate subordinated promissory notes to Hancock Park for a total of $24,276,065. Each note required Fitness Holdings to pay a specified principal amount to Hancock Park, plus interest of ten percent per year, on or before the note's maturity date.[2]

In July 2004, Pacific Western Bank made a $7 million revolving loan and a $5 million installment loan to Fitness Holdings, both of which were secured by all of Fitness Holdings' assets. Hancock Park guaranteed these loans. Fitness Holdings and Pacific Western Bank amended the loan

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[1] In this opinion, we address only the trustee's claim for avoidance of a constructively fraudulent transfer under § 548(a)(1)(B) and his request for declaratory relief (claims 2 and 7 of the First Amended Complaint). We resolve the remaining claims in a memorandum disposition filed concurrently with this opinion.

[2] The maturity dates of the eleven notes were set for September 30, 2006, November 5, 2006, and October 1, 2009.

agreement multiple times. The amendments eased Fitness Holdings' obligations in various ways, for example, by extending the maturity dates on the revolving loan and waiving past breaches.

Finally, in June 2007, Fitness Holdings and Pacific Western Bank agreed to refinance Fitness Holdings' debt. Under the terms of the agreement, Pacific Western Bank made two loans to Fitness Holdings: a $17 million term loan, and an $8 million revolving line of credit. These loans were also secured by all of Fitness Holdings' assets. The loan agreement provided that upon closing, $8,886,204 would be disbursed to pay off Pacific Western Bank's original secured loan, and $11,995,500 would be disbursed to Hancock Park to pay off its unsecured promissory notes. The payoff of Pacific Western Bank's prior secured loan had the effect of releasing Hancock Park from its guarantee.

These attempts to save Fitness Holdings proved unsuccessful, and the company filed for Chapter 11 bankruptcy on October 20, 2008. A committee of unsecured creditors, acting on behalf of Fitness Holdings and its estate, filed a complaint against Hancock Park, Pacific Western Bank, Van Harten, and Fourticq to recover the payments made to Hancock Park as a result of the refinancing transaction with Pacific Western Bank. The complaint also requested declaratory relief, asking the court to characterize the financing Hancock Park provided to Fitness Holdings in connection with the promissory notes as equity investments in Fitness Holdings, rather than extensions of credit. As a result, the complaint alleged, the transfer of $11,995,500 to Hancock Park was constructively fraudulent.

On January 15, 2010, the bankruptcy court dismissed all claims against Hancock Park with prejudice. The case was subsequently converted to a Chapter 7 filing on April 6, 2010, *In re Fitness Holdings Int'l, Inc.*, No. 2:08-bk-27527-BR, Dkt. # 291 (Bankr. C.D. Cal. April 6, 2010). The following month, the bankruptcy court appointed a trustee for Fitness Holdings, who replaced the committee of unsecured creditors in the litigation.

The trustee appealed the bankruptcy court's dismissal of the complaint to the district court, which affirmed the bankruptcy court and dismissed the case for failure to state a claim. *In re Fitness Holdings Int'l, Inc. (Fitness I)*, No. CV 10-0647 AG, 2011 WL 7763674, *1 (C.D. Cal. Aug. 31, 2011). The district court held that, under longstanding precedent of the Ninth Circuit Bankruptcy Appellate Panel, Hancock Park's advances to Fitness Holdings were loans and, as a matter of law, it was barred from recharacterizing such loans as equity investments. *Id.* at *5 (citing *In re Pacific Express*, 69 B.R. 112, 115 (B.A.P. 9th Cir. 1986)).[3]

The trustee timely appealed, claiming that the district court should have: (1) recharacterized Hancock Park's payment of $11,995,500 to Fitness Holdings as a payment in satisfaction of an equity interest rather than a debt, and then (2) avoided Fitness Holdings' $11,995,500 transfer to Hancock Park as a constructively fraudulent transfer under § 548(a)(1)(B) of the Bankruptcy Code.

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[3] The district court erred in holding it was bound by a decision of the Bankruptcy Appellate Panel. *See Bank of Maui v. Estate Analysis, Inc.*, 904 F.2d 470, 472 (9th Cir. 1990) ("As article III courts, the district courts must always be free to decline to follow BAP decisions and to formulate their own rules within their jurisdiction.").

II

We have jurisdiction under 28 U.S.C. §§ 158(d)(1) and 1291. Because the district court dismissed the trustee's complaint for failure to state a claim, we review de novo. *Telesaurus VPC, LLC v. Power*, 623 F.3d 998, 1003 (9th Cir. 2010). In order to survive a motion to dismiss, a party must allege "'sufficient factual matter, accepted as true, to state a claim to relief that is plausible on its face.'" *Id.* (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009)). "A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at 678. In reviewing a dismissal for failure to state a claim, "[a]ll well-pleaded allegations of material fact in the complaint are accepted as true and are construed in the light most favorable to the non-moving party." *Faulkner v. ADT Sec. Servs. Inc.*, 706 F.3d 1017, 1019 (9th Cir. 2013).

A

We begin by setting forth the legal framework for fraudulent transfers under § 548(a)(1)(B) of the Bankruptcy Code.[4]

Filing a petition in bankruptcy creates an estate made up of the debtor's assets. *Schwab v. Reilly*, 130 S. Ct. 2652, 2657 (2010). In a Chapter 7 bankruptcy, a trustee is

[4] The trustee brought a "recharacterization" claim as a separate cause of action (claim 7 of the First Amended Complaint). We interpret this claim as a request for a determination that Fitness Holdings' transfer to Hancock Park was not made in repayment of a "debt" as that term is defined in the Code. 11 U.S.C. § 101(12).

appointed or elected to administer the estate. 11 U.S.C. §§ 701–04. In order to protect the interests of the estate, a bankruptcy trustee may bring an action to avoid a transfer made before the bankruptcy that is allegedly either intentionally fraudulent, 11 U.S.C. § 548(a)(1)(A), or constructively fraudulent, § 548(a)(1)(B); *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 535 (1994). A transfer is constructively fraudulent, and thus can be avoided by the trustee, 11 U.S.C. § 550, if the debtor made the transfer on or within two years before the date of filing the bankruptcy petition, the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation," § 548(a)(1)(B)(i), and one of four circumstances obtains.[5]

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[5] 11 USC § 548(a)(1)(B) (defining constructive fraudulent transfers) provides in pertinent part:

> (a)(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
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> . . . .
>
> (B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
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> (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

In construing the statutory requirement that the debtor "received less than a reasonably equivalent value in exchange for such transfer or obligation," § 548(a)(1)(B)(i), we must turn to a series of interlocking statutory definitions. The key phrase in § 548(a)(1)(B)(i), "reasonably equivalent value," is not defined in the Code. *BFP*, 511 U.S. at 535. "Value" is defined, however, and includes the "satisfaction or securing of a present or antecedent debt of the debtor." § 548(d)(2)(A). Under this definition, "[p]ayment of a pre-existing debt is value, and if the payment is dollar-for-dollar, full value is given." 5 Collier on Bankruptcy ¶ 548.03[5] (16th ed. 2012). Therefore, to the extent a transfer constitutes repayment of the debtor's antecedent or present debt, the transfer is not constructively fraudulent. *See Freeland v. Enodis Corp.*, 540 F.3d 721, 735 (7th Cir. 2008) (holding that there is "reasonably equivalent value" where "payment of the accrued interest constituted 'dollar-for-dollar forgiveness of

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> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;
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> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or
>
> (IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

a contractual debt.'") (quoting *In re Carrozzella & Richardson*, 286 B.R. 480, 491 (D. Conn. 2002)).

We next address the definition of the term "debt." The Bankruptcy Code defines "debt" to mean "liability on a claim." 11 U.S.C. § 101(12); *see also Johnson v. Home State Bank*, 501 U.S. 78, 84 n.5 (1991) (noting that "'debt . . . has a meaning coextensive with that of 'claim.'") (citing *Penn. Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 558 (1990)). "Claim" is defined, in relevant part, to mean "a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A). The Code thus broadly defines "debt" as liability on virtually any type of "right to payment."

Under these interlocking definitions, to the extent a transfer is made in satisfaction of a "claim" (i.e., a "right to payment"), that transfer is made for "reasonably equivalent value" for purposes of § 548(a)(1)(B)(i). And a determination that a transfer was made for "reasonably equivalent value" precludes a determination that it was constructively fraudulent under § 548(a)(1)(B). *See In re United Energy Corp.*, 944 F.2d 589, 595–96 (9th Cir. 1991).

B

This analysis raises the further question of how courts are to determine whether there is a "right to payment" that constitutes a "claim" under the Code. Supreme Court precedent establishes that, unless Congress has spoken, the nature and scope of a right to payment is determined by state

law.[6] The Supreme Court has "long recognized that the basic federal rule in bankruptcy is that state law governs the substance of claims, Congress having generally left the determination of property rights in the assets of a bankrupt's estate to state law." *Travelers Cas. & Sur. Co. of Am. v. Pac. Gas & Elec. Co.*, 549 U.S. 443, 450 (2007) (internal quotation marks omitted). This principle was given its clearest statement in *Butner*, 440 U.S. 48, which held that because "[p]roperty interests are created and defined by state law," *id.* at 55, "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.* This means that "when the Bankruptcy Code uses the word 'claim'—which the Code itself defines as a 'right to payment,'—it is usually referring to a right to payment recognized under state law." *Travelers*, 549 U.S. at 451 (internal citation omitted).

Relying on the *Butner* principle, the Supreme Court held in *Travelers* that a court should not use a federal rule to determine whether a pre-petition contract guaranteeing attorneys' fees created a "right to payment" giving rise to a "claim" under the Code. *Id.* at 446–47, 453–54. *Travelers* arose from a Ninth Circuit case in which we had relied on circuit precedent holding that attorneys' fees are not recoverable in bankruptcy "for litigating issues peculiar to federal bankruptcy law." *Id.* at 451 (internal quotation omitted). In a unanimous reversal, the Supreme Court criticized us for relying "solely on a rule of [our] own

[6] The term "state law" is often used "expansively . . . to refer to all nonbankruptcy law that creates substantive claims." *Grogan v. Garner*, 498 U.S. 279, 284 n.9 (1991). "We thus mean to include in this term claims that have their source in substantive federal law." *Id.*

creation." *Id.* According to the Court, because the creditor's contractual right to attorneys' fees could be enforceable under the law of California, the pre-petition contract could give rise to a "claim" in bankruptcy, and so the Ninth Circuit erred in holding that, as a per se rule, a right to attorneys' fees for litigating bankruptcy issues never gives rise to a claim in bankruptcy. *Id.* at 450–52; *see also Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 21 (2000) (holding that where there was "no sign that Congress meant to alter" a state substantive right, the *Butner* rule required a creditor's claim to be assessed in light of state law, including the allocation of the burden of proof).

Under the *Butner* principle, therefore, a court may not fashion a rule "solely of its own creation" in determining what constitutes a "claim" for purposes of bankruptcy. Rather, "subject to any qualifying or contrary provisions of the Bankruptcy Code," *Raleigh*, 530 U.S. at 20, a court must determine whether the asserted interest in the debtor's assets is a "right to payment" recognized under state law, *id.*

We now construe § 548(a)(1)(B) in light of the *Butner* principle. Because the Code defines debt as "liability on a claim," § 101(12), and defines "value" as including "satisfaction or securing of a . . . debt," § 548(d)(2)(A), we conclude that a transfer is for "reasonably equivalent value" for purposes of § 548(a)(1)(B)(i) if it is made in repayment of a "claim," i.e., a "right to payment" under state law. Therefore, in an action to avoid a transfer as constructively fraudulent under § 548(a)(1)(B), if any party claims that the transfer constituted the repayment of a debt (and thus was a transfer for "reasonably equivalent value"), the court must determine whether the purported "debt" constituted a right to payment under state law. If it did not, the court may

recharacterize the debtor's obligation to the transferee under state law principles.

Because we hold that a court may recharacterize an obligation that does not constitute "debt" under state law, we disagree with *In re Pacific Express, Inc.*, which held that the Code did not authorize courts to characterize claims as equity or debt, but limited courts to the statutory remedy of equitable subordination under 11 U.S.C. § 510. 69 B.R. 112, 115 (B.A.P. 9th Cir. 1986). This is incorrect, because "recharacterization and equitable subordination address distinct concerns." *In re SubMicron Sys.*, 432 F.3d 448, 454 (3d Cir. 2006). Under the Code, the statutory equitable subordination remedy allows a court, under equitable principles, to subordinate "all or part of an allowed claim to all or part of another allowed claim." § 510(c)(1). In contrast, a court considering a motion to avoid a transfer as constructively fraudulent under § 548(a)(1)(B) must determine whether the transfer is for the repayment of a "claim" at all. Therefore *Pacific Express* erred in holding that the "characterization of claims as equity or debt" is governed by § 510(c). 69 B.R. at 115.[7]

C

In concluding that the Bankruptcy Code gives courts the authority to recharacterize claims in bankruptcy proceedings, we join our sister circuits, which have reached the same conclusion. *See In re Lothian Oil*, 650 F.3d 539, 542–43 (5th Cir. 2011); *SubMicron*, 432 F.3d at 454; *In re Dornier*

[7] In this opinion, we do not address whether the trustee has adequately pleaded a claim for equitable subordination. We resolve this issue in the memorandum disposition filed concurrently with this opinion.

Aviation, 453 F.3d 225, 231 (4th Cir. 2006); *In re Hedged-Investments Associates, Inc.*, 380 F.3d 1292, 1298 (10th Cir. 2004); *In re Autostyle Plastics, Inc.*, 269 F.3d 726, 748 (6th Cir. 2001). But despite their broad agreement that the Code authorizes courts to recharacterize claims, the circuits have taken different approaches in identifying the legal framework for this recharacterization. *Compare Lothian Oil*, 650 F.3d at 543 (holding that, under the *Butner* principle, courts are required to define claims by reference to state law, and are thus required to recharacterize purported "debt" as equity where state law would treat the asserted interest as an equity interest) *with SubMicron*, 432 F.3d at 454–56 (holding that a court has the equitable authority to recharacterize a transaction and determine if it is more like "debt" or "equity") *and Autostyle Plastics*, 269 F.3d at 749–50 (announcing an eleven-factor test, derived from federal tax law, for determining whether a purported "debt" is in fact "equity").

We agree with the approach adopted by the Fifth Circuit in *Lothian Oil*, 650 F.3d at 543, which is consistent with the *Butner* principle. *Lothian Oil* considered two pre-bankruptcy loan agreements which stated that the debtor would repay the loan in the form of equity interests and royalties, and did not specify interest rates or maturity dates. 650 F.3d at 541. When the debtor asked the court to recharacterize the loans as equity interests, the court construed this as a request to disallow the lender's claim under 11 U.S.C. § 502 on the ground that the purported loans were "unenforceable against the debtor and property of the debtor, under any agreement or applicable law." *Id.* at 543 (quoting 11 U.S.C. § 502(b)(1)). Recognizing the Supreme Court's determination in *Butner* that "'applicable law' is *state* law," *id.* at 543, *Lothian Oil* looked to Texas law, which employed a multi-factor test to

"distinguish between debt and equity," *id.* at 544 (quoting *Arch Petrol., Inc. v. Sharp*, 958 S.W.2d 475, 477 n.3 (Tex. Ct. App. 1997)). Under Texas law, the interests created by the lender's agreements with the debtor constituted "common equity interests at best," and not debt. *Id.* Therefore, the court disallowed the claims and recharacterized them as equity interests. *Id.*

We believe the Fifth Circuit's approach is more consistent with Supreme Court precedent than that of the circuits that have fashioned a federal test for recharacterizing an alleged debt in reliance on their general equitable authority under 11 U.S.C. § 105(a).[8] *See, e.g.*, *Autostyle*, 269 F.3d at 749–50; *Hedged-Investments*, 380 F.3d at 1298–99. Such an equitable approach is inconsistent with Supreme Court precedent requiring us to determine whether a party has a "right to payment," i.e., a "claim," § 101(5), by reference to state law, *see Butner*, 440 U.S. at 55; *Travelers*, 549 U.S. at 451. Given the Supreme Court's direction, courts may not rely on § 105(a) and federal common law rules "of [their] own creation" to determine whether recharacterization is warranted. *Travelers*, 549 U.S. at 451; *cf.* James M. Wilton & Stephen Moeller-Sally, *Debt Recharacterization Under*

[8] 11 U.S.C. § 105(a) provides:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

State Law, 62 Bus. Law. 1257, 1278 (Aug. 2007) ("Federal courts, if they are to follow Supreme Court precedent, cannot create a separate legal standard for the enforceability of insider debt in bankruptcy and should follow the state law of debt recharacterization."). Therefore, we agree with *Lothian Oil* that in order to determine whether a particular obligation owed by the debtor is a "claim" for purposes of bankruptcy law, it is first necessary to determine whether that obligation gives the holder of the obligation a "right to payment" under state law.

III

We now consider the application of these principles to this case. The question before the district court was whether the trustee's complaint plausibly alleged that Fitness Holdings' transfer of $11,995,500 to Hancock Park was a constructively fraudulent transfer under § 548(a)(1)(B). As explained in our decision today, to survive a motion to dismiss, the trustee was required to plausibly allege that the interests created by Hancock Park's agreements with Fitness Holdings constituted equity investments (rather than debt) under applicable state law, and that therefore Hancock Park had no "right to payment" of $11,995,500 from Fitness Holdings. By making such allegations, the trustee could then claim that Fitness Holdings' transfer was not for reasonably equivalent value. *See* § 548(d)(2)(A).[9] Such allegations,

[9] The trustee also contends that Fitness Holdings did not receive "reasonably equivalent value" because it paid down unsecured pre-existing debt with newly acquired secured financing. We reject this argument, because it is not supported by either the Code or our case law. Section 548(d)(2)(A) defines "value" to include the "satisfaction or securing of a present or antecedent debt." Under this definition, a debtor who grants a security interest in its property in exchange for funds has

combined with plausible allegations of the other elements of a claim for a constructively fraudulent transfer under § 548(a)(1)(B), could potentially "nudge" the trustee's claims "across the line from conceivable to plausible," *Iqbal*, 556 U.S. at 680 (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570 (2006)), and show an entitlement to relief sufficient to withstand a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure.

The district court did not view the trustee's constructively fraudulent transfer claim through this lens. Because the court erroneously concluded that it was barred from considering whether the complaint plausibly alleged that the promissory notes could be recharacterized as creating equity interests rather than debt, it failed to apply the correct standard in considering whether the trustee's allegation that Fitness Holdings did not receive reasonably equivalent value for its transfer of $11,995,500 to Hancock Park plausibly gave rise to a claim for relief under § 548(a)(1)(B).

Analyzing the trustee's constructive fraudulent transfer claim under the proper legal framework requires the identification of the pertinent legal principles under applicable state law. Rather than ruling on these issues in the

---

received reasonably equivalent value, *see In re Northern Merch., Inc.*, 371 F.3d 1056, 1059 (9th Cir. 2004), as has a debtor who pays down pre-existing debt. We therefore see no basis for holding that a debtor who takes both actions simultaneously (obtaining a secured loan and simultaneously paying down pre-existing debt) has received something less than "reasonably equivalent value." The trustee's reliance on *In re Superior Stamp & Coin Co.*, 223 F.3d 1004, 1008 n.3 (9th Cir. 2000), is misplaced, because that case considered the circumstances that might give rise to a voidable preference under § 547(b), not whether the debtor obtained reasonably equivalent value under § 548.

first instance, *see Salmon Spawning & Recovery Alliance v. Gutierrez*, 545 F.3d 1220, 1230 n.6 (9th Cir. 2008), we vacate the district court's dismissal of the complaint's constructive fraudulent transfer claim and remand for further proceedings consistent with this opinion. Each party will bear its own costs on appeal.

VACATED AND REMANDED.

Unpublished Disposition
2013 WL 2151401
Only the Westlaw citation is currently available.
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NOTE: THIS OPINION WILL NOT APPEAR IN A PRINTED VOLUME. THE DISPOSITION WILL APPEAR IN A REPORTER TABLE.
United States Court of Appeals,
Ninth Circuit.

In the Matter of FITNESS HOLDINGS INTERNATIONAL, INC., Debtor,
Official Committee of Unsecured Creditors, of the Estate of Fitness Holdings International, Inc., Appellant,
v.
Hancock Park Capital II, L.P., a Delaware Limited Partnership; Pacific Western Bank; Kenton Van Harten; Michael Fourticq, Sr.; Hancock Park Associates, III; Hancock Park Associates, Appellees.

No. 11–56677. | Argued and Submitted Feb. 4, 2013. | Filed May 20, 2013.

Attorneys and Law Firms

David John Richardson, Richardson Buchanan, A Professional Corporation, Los Angeles, CA, Larry Wayne Gabriel, Esquire, Jenkins Mulligan & Gabriel, LLP, Richard D. Burstein, Esquire, Robyn B. Sokol, Ezra Brutzkus Gubner LLP, Woodland Hills, CA, for Appellant.

Lawrence Charles Barth, Esquire, Munger, Tolles & Olson LLP, David K. Eldan, Senior, Larry G. Ivanjack, Esquire, A Professional Organization, Ralph F. Hirschmann, Managing Senior Counsel, Hirschmann & Tseng LLP, Shane W. Tseng, Hirschmann & Tseng LLP, Derek J. Kaufman, Esquire, Bankruptcy Counsel, Munger, Tolles & Olson LLP, Los Angeles, CA, Lawrence Charles Barth, Esquire, Derek J. Kaufman, Esquire, Bankruptcy Counsel, for Appellees.

Appeal from the United States District Court for the Central District of California, Andrew J. Guilford, District Judge, Presiding. D.C. No. 2:10–cv–00647–AG.

Before CALLAHAN, IKUTA, and HURWITZ, Circuit Judges.

Opinion

ORDER

***1** Pacific Western Bank's Petition for Clarification or Rehearing is GRANTED IN PART AND DENIED IN PART. Its request for clarification is GRANTED. The clarifications are made in the amended memorandum disposition filed concurrently with this order. Its request for a rehearing is DENIED.

No further petitions for rehearing or rehearing en banc will be entertained.

AMENDED MEMORANDUM[*]

In this Chapter 7 bankruptcy case, the bankruptcy court dismissed all the trustee's claims against defendants under Rule 12(b)(6) of the Federal Rules of Civil Procedure. The bankruptcy court affirmed. We have jurisdiction under 28 U.S.C. §§ 158(d)(1) and 1291, and now affirm in part, reverse in part, and vacate and remand in part.[1]

As explained in our opinion in *In re Fitness Holdings Int'l,* the district court erred in concluding that the trustee's argument that Hancock Park's loan to Fitness Holdings should be recharacterized as equity was not cognizable as a matter of law. No. 11–56677, Slip op. at .... Because of this legal error, the district court failed to consider whether the trustee plausibly alleged that the $11,995,500 transfer from Hancock Park to Fitness Holdings should be recharacterized as creating an equity interest rather than debt. As a result, the district court failed to apply the correct standard in considering whether the trustee's allegations that Fitness Holdings made its transfer to Hancock Park without reasonably equivalent value plausibly gave rise to an entitlement to relief. *Fitness Holdings,* No. 11–56677, slip op. at .... Accordingly, we vacated the district court's dismissal of the 11 U.S.C. § 548(a)(1)(B) constructive fraudulent conveyance claim and remanded for further proceedings. *Fitness Holdings,* No. 11–56677, slip op. at ....

The district court's legal error also infected its analysis of many of the trustee's other claims. First, because the district court erred in failing to consider whether applicable state fraudulent conveyance law allowed a court to recharacterize a loan as an equity interest, it failed to apply the correct standard in considering whether the trustee's allegations that Fitness Holdings transferred $11,995,500 to Hancock Park without receiving

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reasonably equivalent value plausibly alleged a claim for relief under 11 U.S.C. § 544(b)(1), which incorporates applicable state law (claims 3, 4 and 5 of the First Amended Complaint).

Second, the district court's erroneous assumption that a court lacked authority to recharacterize Hancock Park's $11,995,500 as equity rather than debt prevented the court from properly evaluating the trustee's allegations (claim 1 of the First Amended Complaint) that Fitness Holdings' transfer of $11,995,500 to Hancock Park in return for an equity investment was actually fraudulent for purposes of 11 U.S.C. § 548(a)(1)(A).

Third, because the court failed to properly address the fraudulent transfer claims, it also did not properly address the claim for recovery of an avoided transfer under 11 U.S.C. § 550(a) (claim 6 of the First Amended Complaint).

***2** Finally, the court's erroneous assumption prevented it from properly evaluating the trustee's allegations that Hancock Park, Van Harten and Fourticq breached their fiduciary duties to Fitness Holdings (claim 9 of the First Amended Complaint), and that Pacific Western aided and abetted the alleged breach of fiduciary duties (claim 10 of the First Amended Complaint).

Because the district court did not review these claims (claims 1, 3, 4, 5, 6, 9, and 10 of the First Amended Complaint) under the correct standard, we vacate dismissal of these claims and remand them to the district court to consider them in the first instance. *See Salmon Spawning & Recovery Alliance v. Gutierrez,* 545 F.3d 1220, 1230 n.6 (9th Cir.2008). We likewise decline to reach the merits of Pacific Western's argument that the *in pari delicto* doctrine shields it from aiding and abetting liability, and leave it to the district court to consider this theory on remand.

We affirm the district court's dismissal of the trustee's claims that Fitness Holdings' transfer of a security interest in its assets to Pacific Western should be avoided as an actually fraudulent transfer (claims 10, 11, and 13 of the original complaint). The complaint asserts only that Fitness Holdings conveyed a security interest to Pacific Western in order to obtain a $25 million loan. We cannot reasonably infer that Fitness Holdings was attempting to "hinder, delay, or defraud" its creditors, § 548(a)(1)(A); Cal. Civ.Code § 3439.04(a)(1), simply because it took on secured debt to replace unsecured debt; borrowers regularly give security interests to obtain financing. Because the complaint fails to plausibly allege any other facts showing that the trustee has an entitlement to relief, the district court properly dismissed the claims alleging an actually fraudulent transfer to Pacific Western.

The district court also properly dismissed the trustee's claims that Fitness Holdings' transfer of a security interest in its assets to Pacific Western should be avoided as a constructively fraudulent transfer (claims 12 and 14 of the original complaint). Because the complaint alleges that Fitness Holding granted Pacific Western the security interest in exchange for a $25 million loan, and does not allege that the value of the security interest exceeded the value of the loan, the trustee failed to plausibly allege that the security interest was given for less than reasonably equivalent value, which is a necessary element of a claim for a constructively fraudulent transfer under both the Bankruptcy Code and state law. §§ 548(a)(1)(B)(i); 548(d)(2)(A)(i); § 544(b)(1); Cal. Civ.Code § 3439 .04(a)(2).

Because the district court properly dismissed the trustee's claims for constructively and actually fraudulent transfers, the dismissal of the trustee's claim for avoidance of these transfers (claim 15 of the original complaint) was also correct. *See* 11 U .S.C. § 550.

The trustee's allegations (in claim 8 of the First Amended Complaint) that insiders "contrived" to benefit themselves by knowingly funneling money to themselves out of a failing company plausibly alleged the elements of a claim for equitable subordination, namely: " '(1) that the [defendants] engaged in some type of inequitable conduct, (2) that the misconduct injured creditors or conferred unfair advantage on the claimant, and (3) that subordination would not be inconsistent with the Bankruptcy Code.' " *In re First Alliance Mortg. Co.,* 471 F.3d 977, 1006 (9th Cir.2006) (quoting *In re Lazar,* 83 F.3d 306, 309 (9th Cir.1996)). We therefore reverse the district court's dismissal of this claim. Each party will bear its own costs on appeal.

***3 AFFIRMED IN PART, REVERSED IN PART, VACATED IN PART, AND REMANDED.**

Footnotes

* This disposition is not appropriate for publication and is not precedent except as provided by 9th Cir. R. 36–3.

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[1] We address trustee's claim that the complaint sufficiently alleged that Fitness Holdings' transfer to Hancock Park was avoidable under 11 U.S.C. § 548(a)(1)(B) (Claims 2 and 7 of the First Amended Complaint) in an opinion filed concurrently with this disposition.

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Lenders Beware: Debt Can Now Be Recharacterized as Equity in the Ninth Circuit

May 22, 2013

For the last 27 years, bankruptcy courts in the Ninth Circuit consistently held that debt could not be recharacterized as equity unless the movant proved inequitable conduct by the debt holder. On April 30, 2013, the Ninth Circuit Court of Appeals rejected that precedent and joined other circuit courts in holding that bankruptcy courts do have the authority to recharacterize a loan as an equity investment to the extent allowed under state law even without inequitable conduct. This decision has obvious implications for loans whose repayment schedule, interest rate or other terms, among other things, are suspect.

The Fitness Holdings Background

Hancock Park, the sole shareholder of Fitness Holdings, made subordinated unsecured loans to Fitness Holdings totaling more than $24 million. Pacific Western Bank ("PWB") made a $7 million revolving loan and $5 million installment loan to Fitness Holdings secured by all of Fitness Holdings' assets and guaranteed by Hancock Park. In 2007, PWB agreed to refinance Fitness Holdings' debt. PWB issued Fitness Holdings a new $17 million term loan and an $8 million revolving line of credit, of which $8.8 million was used to pay off PWB's original secured loan, and $11.9 million was used to pay off Hancock Park's unsecured loans.

In October 2011, Fitness Holdings filed chapter 11 in the Central District of California. First, the Unsecured Creditors' Committee, and then after the bankruptcy case was converted to chapter 7, the bankruptcy trustee sued Hancock Park, PWB and Fitness Holdings' principals to recover the $11.9 million paid to Hancock Park on the grounds that the Hancock Park's debt was really equity. They argued the payment of $11.9 million for Hancock Park's "loans" was a fraudulent transfer and must be returned to the estate. Relying on the Ninth Circuit Bankruptcy Appellate Panel's decision in *In re Pacific Express, Inc.*, 69 B.R. 112 (B.A.P. 9th Cir. 1986), the bankruptcy court dismissed the complaint stating that Hancock Park's debt could not be recharacterized as equity. On appeal, the district court affirmed. The bankruptcy trustee appealed to the Ninth Circuit.

The Ninth Circuit Decision

The Ninth Circuit Court of Appeals vacated and remanded, holding that bankruptcy courts can recharacterize debt as an equity investment to the extent allowed under state law. *In re Fitness Holdings Int'l*, __ F.3d __, No. 11-56677 (9th Cir. 2013).

The claim asserted against Hancock Park was that the payment it received from the refinancing was a constructively fraudulent transfer. Under the Bankruptcy Code, a transfer by a debtor may be avoided and recovered for the estate's creditors if the debtor does not receive “reasonably equivalent value” in exchange for the transfer and the debtor is insolvent or undercapitalized at the time the transfer was made. Although the Bankruptcy Code does not define "reasonably equivalent value," it does define the term "value" as including the "satisfaction or securing of a present or antecedent debt of the debtor." Therefore, to the extent a transfer is repayment of the debtor’s debt, the transfer is not constructively fraudulent. The terms "debt" and "claim" are both defined under the Bankruptcy Code as a "right to payment." Thus, if a transfer is made in satisfaction of a debt, that is, the creditor's "right to payment," such as an outstanding loan, then the transfer is made for “reasonably equivalent value” and cannot be avoided. Following a Supreme Court ruling, the Ninth Circuit concluded that *state law* determines whether a transaction (*i.e.*, purported loan) gives rise to a "right to payment" and that therefore the fraudulent transfer claim should not have been dismissed.

In ruling that a bankruptcy court has authority to and should determine whether a purported loan actually constitutes a “right to payment” under state law, the Ninth Circuit rejected the Ninth Circuit Bankruptcy Appellate Panel’s *Pacific Express* decision and sided with the majority of other circuit courts (Third Circuit, Fourth Circuit, Fifth Circuit, Sixth Circuit, and Tenth Circuit), which previously determined that courts are authorized to recharacterize debt as an equity interest in the debtor.

The Ninth Circuit noted three different recharacterization analyses adopted by other circuits. The Ninth Circuit rejected two of these, which rely on various provisions of federal and/or tax law. The Ninth Circuit adopted the Fifth Circuit’s approach as set forth in *In re Lothian Oil*, 650 F.3d 539, 542-43, holding that claims must be defined under state law and that courts must recharacterize purported debt as equity investments where state law would do so. Rather than ruling on the recharacterization issue on the record before it, the Ninth Circuit vacated the district court’s dismissal of the trustee’s fraudulent transfer claim and remanded the matter back to the bankruptcy court for further proceedings.

Implications

Because *Fitness Holdings* confirms bankruptcy court authority to recharacterize debt as equity investments within the Ninth Circuit, we can expect that insider loans will now be subject to close scrutiny and recharacterization challenges by unsecured creditor committees and/or trustees. Since bankruptcy courts within the Ninth Circuit can and should now look to state

law to determine whether a loan may be an equity investment, insider lenders should consider choice of law in documenting financing transactions, in addition to making sure the borrower is adequately capitalized and their loans are on market terms.

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United States Bankruptcy Court,
S.D. Mississippi.
In re Jon Christopher EVANS, Debtor.
Derek A. Henderson, Trustee for Bankruptcy Estate of Jon Christopher Evans and Jointly Administered Related Cases, Plaintiff
v.
Community Bank of Mississippi, et al., Defendants.

Bankruptcy No. 09–03763–NPO.
Adversary No. 10–00005–NPO.
April 26, 2013.

Derek A. Henderson, Jackson, MS, pro se.

W. Lawrence Deas, Deas & Deas LLC, Tupelo, MS, Kristina M. Johnson, Jones Walker, William C. Brabec, Adams and Reese LLP, Mason E. Lowe, Mary Clay Morgan, Bradley Arant Boult Cummings LLP, William Liston, III, Gene D. Berry, Jackson, MS, Marshall H. Smith, Jr., Holmes County Bank & Trust Company, Lexington, MS, J. Mark Franklin, III, Thomas R. Hudson, Michael Scott Jones, Adams & Reese LLP, Ridgeland, MS, Barrett Blake Teller, Teller, Chaney, Hassell & Hopson LLP, Vicksburg, MS, Richard T. Phillips, Robert Ryan Revere, Smith Phillips Mitchell Scott & Nowak LL, Batesville, MS, Michael S. Macinnis, Jeff D. Rawlings, Rawlings & MacInnis, PA, Madison, MS, for Defendants.

MEMORANDUM OPINION AND ORDER ON CROSS–CLAIMS OF FIRST ALLIANCE BANK, FIRST STATE BANK, AND PATRIOT BANK AGAINST MISSISSIPI VALLEY TITLE INSURANCE COMPANY AND OLD REPUBLIC NATIONAL TITLE INSURANCE COMPANY RELATED TO THE WOODGREEN PROPERTY—PHASE TWO: DAMAGES

NEIL P. OLACK, United States Bankruptcy Judge.

The liability and uncontested damages phase (“Phase One”)[FN1] of the trial (the “Woodgreen Trial”) of this adversary proceeding (the “Adversary”) took place on February 21–22, 2012. In Phase One of the Woodgreen Trial, the Court found that Mississippi Valley **Title Insurance** Company and Old Republic National **Title Insurance** Company (the “Title Companies”) had breached the implied duty of good faith and fair dealing contained in the **title insurance** policies acquired by First Alliance Bank (“First Alliance”), First State Bank (“First State”), and Patriot Bank (“Patriot”). Together, First Alliance, First State, and Patriot are referred to as the Woodgreen Banks. *See* Memorandum Opinion and Order on Cross–Claims of First State Bank, First Alliance Bank, and Patriot Bank Against Mississippi Valley **Title Insurance** Company and Old Republic National **Title Insurance** Company Related to the Woodgreen Property–Phase One: Liability, *First Alliance Bank v. Mississippi Valley **Title Insurance** Company,* Adv. Proc. No. 10–00005–NPO, 2012 WL 2374237 (Bankr.S.D. Miss. June 22, 2012) (the “Liability Opinion”) (Adv.Dkt.490).[FN2]

FN1. With the consent of the parties, the Court bifurcated the bench trial into two phases: (1) liability and (2) damages.

FN2. Citations to docket entries in the Adversary are cited as “(Adv.Dkt.____)”; and citations to docket entries in other adversary proceedings and bankruptcy cases are cited to the proceeding or case number first, and then to the docket number.

The claims of the Woodgreen Banks, and the responses of the Title Companies, are asserted in the following pleadings: Crossclaim of Patriot Bank (Adv.Dkt.177) filed by Patriot; Crossclaim of First Alliance Bank (Adv.Dkt.178) filed by First Alliance; Amended Crossclaim of First State Bank (Adv.Dkt.188) filed by First State; Mississippi Valley **Title Insurance** Company and Old Republic National **Title Insurance** Company's Amended An-

swer and Affirmative Defenses to First Alliance Bank's Cross–Claim (Adv.Dkt.212) filed by the Title Companies; Mississippi Valley **Title Insurance** Company and Old Republic National **Title Insurance** Company's Amended Answer and Affirmative Defenses to First State Bank's Amended Cross–Claim (Adv.Dkt.213) filed by the Title Companies; and Mississippi Valley **Title Insurance** Company and Old Republic National **Title Insurance** Company's Amended Answer and Affirmative Defenses to Patriot Bank's Cross–Claim (Adv.Dkt.217) filed by the Title Companies. The damages phase (“Phase Two”) of the Woodgreen Trial took place on December 10–11, 2012. In Phase Two, William C. Brabec and Michael Scott Jones represented the Title Companies; William Liston, III and W. Lawrence Deas represented the Woodgreen Banks.

Prior to Phase Two of the Woodgreen Trial, the Woodgreen Banks filed a Motion *in Limine* to Exclude Opinions and Testimony of J. Walter Allen Filed by First Alliance Bank, First State Bank, and Patriot Bank (the “Motion *in Limine*”) (Adv.Dkt.512) and the Memorandum Brief in Support of Motion *in Limine* to Exclude Opinions and Testimony of J. Walter Allen Filed by First Alliance Bank, First State Bank, and Patriot Bank (Adv.Dkt.513). The Title Companies filed the Title Companies' Response in Opposition to Motion *in Limine* to Exclude Opinions and Testimony of J. Walter Allen (Adv.Dkt.519). The Court deferred ruling on the Motion *in Limine* until the Title Companies attempted to qualify J. Walter Allen (“Allen”) as an expert during Phase Two of the Woodgreen Trial. When that time arrived, the Court denied the Motion *in Limine* from the bench, accepted Allen as an expert in real estate appraisals, and allowed the introduction into evidence of Allen's appraisal report (the “Allen Report”) (MVT Ex. 84). The basis for the Court's denial of the Motion in *Limine* is discussed later in this Opinion.

On February 1, 2013, the Woodgreen Banks submitted the Memorandum Brief of the Woodgreen Banks on Issues Raised at Trial on Damages (Adv.Dkt.527), and the Title Companies submitted the Title Companies' Post–Trial Brief Regarding Damages (Adv.Dkt.528). Having considered the pleadings as well as the testimony, exhibits, and the arguments of counsel presented at Phase One and Phase Two of the Woodgreen Trial, the Court makes the following findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052: [FN3]

FN3. Specifically, the Court makes the following findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

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JURISDICTION

The Court has jurisdiction over the parties to and the subject matter of this case pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(K) and (O).[FN4] Notice of Phase Two of the Woodgreen Trial was proper under the circumstances.

FN4. This finding of core jurisdiction is undisputed. *See* Amended Pretrial Order at 2 (Adv.Dkt.515). The United States Supreme Court in *Stern v. Marshall,* 131 S.Ct. 2594 (2011), held that bankruptcy courts lack constitutional authority to enter a final judgment on a state-law, compulsory counterclaim that did not stem from the bankruptcy itself. *See* *Technical Automation Servs. Corp. v. Liberty Surplus Ins. Corp.,* 673 F.3d 399 (5th Cir.2012) (suggesting a narrow interpretation of *Stern* in holding that *Stern* does not, *sub silentio,* reach so far as to render unconstitutional the statutory powers of federal magistrate judges). In the event that a higher court disagrees that the Adversary involves “core” matters and/or otherwise determines that the Court lacks constitutional authority to enter a final judgment, the Court recommends that this Opinion be regarded as its proposed findings of fact and conclusions of law and further recommends that the District Court enter this Opinion as its own after due consideration, in accordance with 28 U.S.C. § 157(c)(1).

FACTS[FN5]

FN5. Hereinafter, the trial exhibits of the Woodgreen Banks are cited as “(WB Ex.

____)"; and the trial exhibits of the Title Companies are cited as "(MVT Ex. ____)".

Because the facts and history of this Adversary are unwieldy, the Court recounts only those facts and history that are pertinent to the damages issues. This Opinion assumes familiarity with the Court's Liability Opinion.

The Adversary involves 23.38 acres, or 1,018,433 square feet, of undeveloped land along Goodman Road in Southaven, DeSoto County, Mississippi. On August 5, 2004, the Woodgreen Development Corporation LLC, through Jon Christopher Evans ("Chris Evans"), purchased this property from James C. Henson and Cassandra E. Henson (the "Hensons") for $3.35 million. Since then, the property has become known as the Woodgreen Property.

Woodgreen Property

The Woodgreen Property is located on the north side of Goodman Road, approximately 1,965 feet east of where Goodman Road intersects Getwell Road. Its square shape is split in the middle by a drainage ditch that runs east to west. The ditch, in turn, runs into Nolehole Creek, which flows north to south along the eastern border of the Woodgreen Property. A separate branch of Nolehole Creek transverses the Woodgreen Property in an eastwardly direction. According to Allen, Nolehole Creek is "very deep, ... very wide, [and] very formidable" and wide enough for a pick-up truck. (2 Trial Tr. at 32).[FN6] There is an awkward slope, so that the topography of the Woodgreen Property resembles a piece of paper folded in the middle with the highest elevation along Goodman Road and the lowest elevation near Nolehole Creek. A contour map shows the severity of the elevation problem on both the northern and southern borders of the Woodgreen Property. The ditch, creek, and slope present problems for the commercial development of the Woodgreen Property. Allen described the Woodgreen Property as "below average functional utility." (Allen Rep. at 48).

FN6. Citations to the transcript of Phase One of the Woodgreen Trial are preceded by "Phase One". The transcript of Phase Two of the Woodgreen Trial is divided into two parts. The first transcript, which is a record of the proceedings that took place on December 10, 2012, is cited as "(1 Trial Tr. at ____)"; the second transcript, which is a record of the proceedings that took place on December 11, 2012, is cited as "(2 Trial Tr. at ____)".

Deeds of Trust

On the empty promise that he would develop the Woodgreen Property into a commercial subdivision, Chris Evans obtained loans from the Woodgreen Banks on behalf of various entities he controlled.[FN7] As part of his fraudulent scheme, Chris Evans arranged for a surveyor to prepare plats (the "Evans Plats") dividing the Woodgreen Property into seventeen (17) lots, each lot roughly one acre in size. Copies of the Evans Plats are attached to the Liability Opinion as Appendices 2–A, 2–B, and 2–C. Also attached to the Liability Opinion is Appendix 1, which is a survey of the Woodgreen Property depicting a subdivision of fifteen (15) lots, marked as Tracts 10A through 10O. To secure the loans, Chris Evans granted the Woodgreen Banks deeds of trust on six (6) of the fifteen (15) lots. These six (6) lots are Tracts 10E, 10F, 10G, 10H, 10J, and 10K. In connection with the original loan transactions consummated in 2004 and 2005, the Woodgreen Banks obtained appraisals of the six (6) lots. The values in those appraisals are shown in the following chart:

FN7. With respect to the loan transactions with the Woodgreen Banks, these other entities were Snowden Grove Investors LLC and Cedar Lake Investors LLC.

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Woodgreen Bank	Appraisal Date	Lot	Value
First Alliance	August 4, 2004	10E	$479,000.00
		10F	$479,000.00
	November 22, 2004	10E	$175,747.00
		10F	$175,747.00
First State	May 11, 2005	10G & 10H	$660,000.00
	June 17, 2005	10G	$103,691.00
		10H	$38,664.00
Patriot	November 18, 2004	10J	$310,000.00
		10K	$310,000.00
	July 22, 2005	10J	$87,873.00
		10K	$87,873.00

(MVT Exs. 50–51, 53, 55–56, 84).

The entities on whose behalf Chris Evans acted when he signed the deeds of trust did not actually own the six (6) lots that purportedly secured the loans, and, moreover, different entities (also controlled by Chris Evans) previously had granted other lenders senior liens on the same six (6) lots. In the words of Brian W. Pray ("Pray"), an expert witness for the Woodgreen Banks, the Evans Brothers tried to "flim-flam" the Woodgreen Banks. (1 Trial Tr. at 129).

Chris Evans was assisted in his fraudulent scheme by his brother, Charles H. Evans, Jr. ("Charles Evans," or together with Chris Evans, the "Evans Brothers"). Charles Evans was an attorney "approved" by the Title Companies to submit applications for **title insurance** policies, and his involvement was integral to the success of the *Ponzi* -like scheme.

When the loans went into default in late 2009, the Woodgreen Banks discovered that the defects in the liens prevented them from foreclosing their interests in the lots. The Woodgreen Banks are now the owners of the six (6) lots, but if they sell them, they will violate local law. The current plight of the Woodgreen Banks requires background information, beginning with the land-use regulations enacted by the City of Southaven.

City of Southaven

Under the Land Subdivision Ordinance (the "Subdivision Ordinance") (SOUTHAVEN, MISS., ORDINANCE No. 29, art. III) (WB Ex. 35), no person may subdivide land into lots of ten (10) acres or less unless a plat of the subdivision previously has been approved by Southaven's planning commission. Moreover, it is a criminal offense for any person to sell property that does not conform to this requirement. (*Id.*).

Policies

In connection with the loans involving the Evans Brothers, the Woodgreen Banks acquired policies of **title insurance** from the Title Companies in order to protect their interest in the lots. These policies were patterned after 1992 standardized American Land Title Association ("ALTA") forms and are identical to one another except for schedule A, where the description of the insured interest appears. (WB Exs. 38, 45, 53; MVT Ex. 10). The Court will sometimes refer to the **title insurance** policies issued to the Woodgreen Banks collectively as the "Policies." Each of the Policies is discussed in detail below.

First Alliance

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With respect to First Alliance, the Title Companies issued two policies of **title insurance** on December 2, 2004, which insured its interests in Tracts 10E and 10F as the holder of first deeds of trust. The parties stipulated that “[t]he amount of insurance stated in schedule A of both title policies issued to First Alliance Bank is $760,000.00” and “that the amount of its unpaid principal indebtedness secured by the insured mortgages, together with interest thereon, equaled $762,680.03.”(Pretrial Order at 92, Adv. Dkt. 515).

First State

The Title Companies issued a policy of **title insurance** to First State on June 23, 2005, which insured First State's interest in Tracts 10G and 10H as the holder of a first deed of trust. The parties stipulated that “[t]he amount of insurance stated in schedule A of the policy issued to First State Bank is $420,000.00” and “that the amount of its unpaid principal indebtedness secured by the insured mortgage, together with interest thereon, equaled $355,947.82.”(Pretrial Order at 92, Adv. Dkt. 515).

Patriot

On August 2, 2005, the Title Companies issued a policy of **title insurance** which insured Patriot's interest in Tracts 10J and 10K as the holder of a first deed of trust. The parties stipulated that “[t]he amount of insurance stated in schedule A of the policy issued to Patriot Bank is $500,000.00” and “that the amount of its unpaid principal indebtedness secured by the insured mortgage, together with interest thereon, equaled $342,044.41.”(Pretrial Order at 92, Adv. Dkt. 515).

Special Warranty Deeds

The Woodgreen Banks submitted claims to the Title Companies under the Policies due to the title defects. The Policies provided the Title Companies several options to satisfy their indemnity obligations. The Policies allowed them either to pay the “amount of insurance” (Policies ¶ 6(a)(i)), purchase the secured indebtedness (Policies ¶ 6(a)(ii)), or pay or otherwise settle with other parties or with the insured (Policies ¶ 6(b)(i), ¶ 6(b)(ii)). They chose the option that allowed them to institute any action “which in [their] opinion may be necessary or desirable to establish the title to the estate or interest or the lien of the insured mortgage, as insured, or to prevent or reduce loss or damage to the insured.”(Policies ¶ 4(b)). The Title Companies attempted to cure the title defects by purchasing the Woodgreen Property, paying off the senior lienholders, and conveying the six (6) lots, by Special Warranty Deeds (the “Special Warranty Deeds”), to the Woodgreen Banks on August 18, 2010. (*See* WB Exs. 9, 11, 13, 15, 16). Significantly, until these conveyances occurred on August 18, 2010, the Woodgreen Property had remained whole from the date of its original purchase from the Hensons on August 5, 2004.[FN8] The subdivision of the Woodgreen Property on August 18, 2010, *via* the Special Warranty Deeds, violated Southaven's Subdivision Ordinance and reduced or eliminated the value of the six (6) lots.

FN8. As discussed in detail in the Liability Opinion, the Title Companies did not purchase the Woodgreen Property or transfer the lots directly to the Woodgreen Banks but used a subsidiary, Mississippi Real Estate Dispositions, LLC, which they formed for this specific purpose. (Liability Op., at *12) (WB Exs. 8, 10, 12, 14). This middle step is immaterial to the damages issue.

Liability Opinion

In the Liability Opinion, the Court ruled that the Title Companies breached their implied duty to act in good faith in establishing the titles, as insured. In reaching this result, the Court relied on the Mississippi Supreme Court decision in *Cenac v. Murry,* 609 So.2d 1257 (Miss.1992). The *Cenac* Court declared, “Each party to a contract has a justified expectation that the other will act in a reasonable manner, and when one party acts outside of accepted commercial practices to deprive the other party of the benefit of the contract, the contract is breached. In an ‘ordinary’ contract situation, a breach of the covenant is a breach of the contract

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itself." *Id.* at 1273–74 (citation omitted); *see Unity Commc'ns, Inc. v. AT & T Mobility, LLC,* 643 F.Supp.2d 829, 841 (S.D.Miss.2009) (recognizing *Cenac* as "the leading case in Mississippi on the treatment of a claim for breach of good faith and fair dealing in a contractual setting").

The Court concluded that the Title Companies had prevented the Woodgreen Banks from enjoying the benefit of the indemnity provisions of the Policies and were liable to the Woodgreen Banks for breach of the duty of good faith and fair dealing. The Court found that it was unlikely that the Woodgreen Banks would have agreed to the loans if they had known in advance that the Policies allowed the Title Companies to cure the title defects in such a way as to reduce or eliminate the resale value of the lots. Among the options available to the Title Companies, the title defects could have been cured without violating the Subdivision Ordinance or the claims could have been paid. The Title Companies chose an option that created an obstacle to the marketability of the lots that did not exist on the dates the Policies were issued. They did so because they believed that *Seymour v. Evans,* 608 So.2d 1141 (Miss.1992), allowed them to cure the title defects by conveying the lots directly to the Woodgreen Banks. In *Seymour,* the Mississippi Supreme Court held that a sale of land was not void, although the conveyance violated an ordinance requiring approval of a subdivision. *Id.* at 1148.

Allen's Valuation Analysis

At Phase Two, Allen testified on behalf of the Title Companies as an expert in the field of real estate appraisals. Allen is the managing director of the Memphis office of Integra Realty Resources. He is licensed as a real estate appraiser in Mississippi, Tennessee, and Arkansas. He is a member of the Appraisal Institute and possesses the MAI designation. He has appraised real estate since 1979 and has performed over 17,000 appraisals. The Woodgreen Banks did not challenge Allen's qualifications, only the reliability of his testimony and report.

Allen valued each of the six (6) lots on at least three dates: (1) the dates of the loans orchestrated by the Evans Brothers in 2004 and 2005, (2) the dates the Woodgreen Banks submitted their claims to the Title Companies in 2009 and 2010, and (3) the date the Title Companies conveyed the lots to the Woodgreen Banks on August 18, 2010. In summary, Allen testified that the values of the six (6) lots on these multiple dates were, as follows:

Woodgreen Bank	Appraisal Date	Lots	Value
First Alliance	November 22, 2004	10E & 10F	$351,494.00
	December 9, 2009		$246,046.00
	August 18, 2010		$246,046.00
First State	June 17, 2005	10G & 10H	$142,355.00
	November 12, 2009		$99,648.00
	August 18, 2010		$99,648.00
Patriot	July 22, 2005	10J & 10K	$175,746.00
	March 1, 2010		$123,022.00
	August 18, 2010		$123,022.00

(Allen Rep. at 1). In Mississippi, the damages

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for breach of contract should put the insured party in the same position it would have occupied had the breaching party performed the contract. Therefore, the Court reviews Allen's valuation opinion in some detail as to the fair market value of the lots on August 18, 2010, just prior to the breach of the Policies. Although the Woodgreen Banks sustained losses when they funded the loans in 2004 and 2005, those losses were not causally related to the breach of the Policies.

There are three recognized methods for valuing real estate in Rule 1–4 of the Uniform Standards of Professional Appraisal Practice ("USPAP"). They are the sales comparison approach, the income capitalization approach, and the cost approach. (Allen Rep. at 6). Considered in isolation, these approaches generally do not establish the value of property; rather, value is "the product of a reconciliation of the indications yielded by the three approaches." *Rebelwood, Ltd. v. Hinds County,* 544 So.2d 1356, 1360 (Miss.1989).

With respect to the appraisal of the larger Woodgreen Property, Allen used the sales comparison approach and the income capitalization approach.[FN9] He did not engage in the cost approach because he concluded that there were no improvements that contributed value to the Woodgreen Property.

FN9. The Allen Report mistakenly indicates in the beginning paragraphs that Allen "use[d] only the sales comparison approach in developing an opinion of value for the subject."(Allen Rep. at 6). The Allen Report, however, applies both the sales comparison approach and the income capitalization approach. (*Id.* at 50).

The sales comparison approach is predicated upon prices actually paid in open market transactions for comparable properties. The sales comparison approach assumes that an informed purchaser would pay no more for a property than the cost of producing a substitute property with the same utility. (Allen Rep. at 50). The income capitalization approach involves discounting to present value the anticipated net income that the property is expected to generate over its usable life. The income capitalization approach assumes than an investor would pay no more than the present value of the anticipated net income of the property. (*Id.*)

After reconciling the indicated value of the larger Woodgreen Property based upon the sales comparison approach and the income capitalization approach, Allen used the principle of contribution to arrive at a value for each of the smaller six (6) lots. The principle of contribution states that "the value of a particular component is measured in terms of its contribution to the value of the whole property or as the amount that its absence would detract from the value of the whole [property]." (Allen Rep. at 97) (citations omitted). Allen used a ranking analysis to compare the characteristics of each lot to the characteristics of an ideal lot. He based the ranking criteria upon four physical characteristics: (1) access/exposure, (2) drainage, (3) shape, and (4) size.

Woodgreen Property: Sales Comparison Approach

In applying the sales comparison approach to the larger Woodgreen Property, Allen analyzed land sales using the following parameters: (1) location (DeSoto County); (2) size (greater than 5 acres); (3) use (commercial); and (4) transaction date. Allen excluded from his analysis the original sale of the Woodgreen Property by the Hensons to the Evans Brothers on the ground that the sales price of $3.35 million on August 5, 2004, was inconsistent with the market value of the Woodgreen Property. (Allen Rep. at 4). Apparently, Allen also excluded the later acquisition of the six (6) lots by the Title Companies on the ground they were not arms-length transactions.[FN10] (*Id.* at 3).

FN10. The Title Companies purchased the Woodgreen Property and paid the lenders holding first deeds of trust. *See* Liability Op., at *10–11. The details are irrelevant to

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the damages issues.

With respect to the appraisal date of August 18, 2010, Allen considered the most relevant land sales to be the following four (4) sales: (1) the November, 2008, sale of 25.20 acres (or 1,097,712 square feet) of land located in Southaven at “Airway Road Extended” at a total sales price of $2,850,000.00 or $2.60 per square foot; (2) the August, 2008, sale of 16.66 acres (or 725,710 square feet) of land located in Olive Branch on Pleasant Hill Road at a total sales price of $1,680,000.00 or $2.31 per square foot; (3) the April, 2008, sale of 13.19 acres (or 574,556 square feet) of land located in Olive Branch on Goodman Road at a total sales price of $2,105,000.00 or $3.66 per square foot; and (4) the January, 2008, sale of 26.36 acres (or 1,148,242 square feet) of land located in Olive Branch on Goodman Road at a total sales price of $2,650,000 .00 or $2.31 per square foot. (Allen Rep. at 73–76). Prior to any adjustments to the sales prices, he found a range of $2.31 to $3.66 per square foot. (*Id.* at 77).

Next, Allen adjusted these sale prices downwards in amounts ranging from twenty-five (25) percent to fifty (50) percent. Allen applied a –50 percent adjustment to all four (4) land sales because of the superior shape and topography of the land in relation to the Woodgreen Property. He also applied a –25 percent size-adjustment to two of the four (4) land sales because they were smaller than the Woodgreen Property and a smaller parcel of land will sell for more than a larger parcel. After making these adjustments, Allen arrived at a range of $1.04–$1.95 per square foot, with an average price of $1.41 per square foot. (*Id.* at 77). Then, he determined that the indicated value of the Woodgreen Property was $1.50 per square foot or approximately $1,530,000.00.[FN11] (Allen Rep. at 78).

FN11. $1,527,649.50 = $1.50 x 1,018,433 square feet.

Allen's valuation of the larger Woodgreen Property as of August 18, 2010, is significantly lower than his $2,040,000.00 valuation of the Woodgreen Property in 2004 and 2005 when the original loan transactions took place. (Allen Rep. at 57). Allen testified that beginning in 2007, the real estate market slid into a decline, as shown by the dramatic decrease in the number of land sales. For example, there were 61 comparable land sales in 2004, but only 17 in 2010. When new construction ended, so did the demand for new land. Rent stabilized, and lending criteria for undeveloped land changed.

Woodgreen Property: Subdivision Development Method

For the purpose of the income capitalization approach, Allen determined that the “highest and best use” of the Woodgreen Property was commercial development and estimated the Woodgreen Property's long-term future income by employing the subdivision development method. For that purpose, Allen used a conceptual site plan prepared by David Dichiara (“Dichiara”) with Guest Consultants, Inc. (the “Dichiara Plat”) (Allen Rep. at 40; MVT Ex. 85), a copy of which is attached to the end of this Opinion as Appendix 1. Dichiara is a Mississippi-licensed professional engineer.

Prior to the Diachiara Plat, the Title Companies had retained Guest Consultants, Inc. to prepare a plat depicting all of the various and overlapping interests in the Woodgreen Property granted by the Evans Brothers. That plat, known as the MVT Plat [FN12] (WB Ex. 87), is attached to the end of this Opinion as Appendix 2. The MVT Plat shows the same lots as the Evans Plats but differs from the Evans Plats in that the MVT Plat includes an easement that ends in a cove, rather than a circular drive. Dichiara did not prepare the MVT Plat, but he was aware of its existence, and to some degree, relied upon it. As with the Evans Plats, neither the Dichiara Plat nor the MVT Plat has ever been submitted to the City of Southaven for its approval.

FN12. In the Liability Opinion, the MVT Plat

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is referred to as the “Unofficial Plat.” (Liability Op., at *11).

The Dichiara Plat emulates the MVT Plat in that it carves out parcels of land approximately one-acre in size, and depicts the same exterior boundary lines for the Woodgreen Property. The Diachiara Plat and the MVT Plat differ in almost every other way. The Dichiara Plat shows twenty-six (26) lots; the MVT Plat shows seventeen (17) lots. The configurations of the lots are completely different. The MVT Plat does not account for the drainage ditch, Nolehole Creek, or the slope. The Dichiara Plat attempts to minimize these problems with the construction of two (2) bridges and two (2) water detention ponds.

Seven (7) of the twenty-six (26) lots in the Dichiara Plat are located along Goodman Road. These seven (7) lots contain 4.050 acres or 175,763 square feet of land. The remaining nineteen (19) lots are all interior lots; they do not abut Goodman Road. These nineteen (19) lots include 14.970 acres or 652,921 square feet of land. The total useable acreage shown in the Diachara Plat is 19.02 acres, which is less than the 23.88 acres that comprise the entire Woodgreen Property. According to Allen, this reduction in useable acreage is necessary to account for the topography and water issues as well as to comply with the Subdivision Ordinance.

In reaching his valuation appraisals based upon the subdivision development method, Allen made numerous critical assumptions. Allen assumed that the Woodgreen Banks and all other entities that held an interest in the Woodgreen Property would agree to the Diachiara Plat. Moreover, Allen assumed that all entities would agree to share the financial burden of developing the Woodgreen Property in the way depicted in the Diachiara Plat. Other assumptions by Allen included the approval of the Dichiara Plat by the City of Southaven and the future development of the Woodgreen Property as indicated in the Diachiara Plat.

With the Dichiara Plat in hand, Allen then calculated the potential cash flow of all twenty-six (26) lots. He considered the timing and cost for the approval and development of the subdivision as shown in the Dichiara Plat. He estimated a planning and design period of four (4) months and a construction period of seven (7) or eight (8) months. To complete the cost analysis, Allen relied upon a quantitative survey performed by Dichiara, who concluded that drainage ditches would have to be realigned, water detention ponds would have to be constructed, and concrete bridges would have to be built over Nolehole Creek. (1 Trial Tr. at 51–52). These improvements translated to construction costs, as of August 18, 2010, of $1,854,724.00, according to Dichiara. (Allen Rep. at 85). Other development costs, according to Allen, included “soft” costs and the developer's profit. “Soft” costs include bonds, interest, permit fees, legal and accounting fees, and appraisal fees, estimated at twelve (12) percent of the “hard” costs. Allen forecasted the developer's profit as fifteen (15) percent of gross sales revenue. Allen believed that all twenty-six (26) lots would sell in seven (7) years or, at a rate of 2.717 acres per year. (Allen Rep. at 86). He estimated that the average sales price for the lots that abut Goodman Road would be $15.00 per square foot, and for the interior lots, would be $8.25 per square foot, as derived from his sales comparison analysis. This resulted in an aggregate retail value of $8,020,000.00 or $1,145,714.00 per year. (Allen Rep. at 87). From these totals, Allen subtracted construction costs, “soft” costs, and the developer's profit. He then discounted the present cash value at a rate of fifteen (15) percent. Allen testified that the value of the Woodgreen Property as of August 18, 2010, was $1,370,000.00.

Six (6) Lots and their Contributory Value

As noted earlier, Allen's sales comparison approach yielded a value of $1,530,000.00 for the larger Woodgreen Property as of August 18, 2010, and his income capitalization approach, a value of $1,370,000.00, also as of August 18, 2010. The

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fact that these two numbers are only $160,000.00 apart, according to Allen, validated his valuation analysis. Allen reconciled these values to reach $1.4 million.

For determining the value of each of the six (6) lots as they appear in the Evans Plats, Allen used $1.4 million as a starting point for the value of the Woodgreen Property as a whole. He then determined the contributory value of each lot applying four criteria: (1) access/exposure, (2) drainage, (3) shape, and (4) size. (Allen Rep. at 94). For each of the criteria, he scored all seventeen (17) lots, with a score of ten (10) representing the most desirable feature and one (1) representing the least desirable feature. He then multiplied that number by the ranking number. A perfect score for an ideal lot would be 100 points (10x4 + 10x3 + 10x2 + 10x1). The sum of all seventeen (17) lots, as scored by Allen, was 1,138 points. The total score of each lot was then divided by 1,138 points to determine the specific lot's contribution to the overall value of the Woodgreen Property. (Allen Rep. at 98). The contribution was then multiplied by the value of the Woodgreen Property ($1.4 million) to arrive at the following values, as of August 18, 2010:

Woodgreen Bank	Lot	Value
First Alliance	10E	$123,023.00
	10F	$123,023.00
First State	10G	$72,583.00
	10H	$27,065.00
Patriot	10J	$61,511.00
	10K	$61,511.00

(Allen Rep. at 1).

DISCUSSION

In Phase Two of the Woodgreen Trial, the Woodgreen Banks seek an award of their expectation damages as a remedy for the breach by the Title Companies of their duty of good faith and fair dealing. *Theobald v. Nosser,* 752 So.2d 1036, 1042 (Miss.1999). Expectation damages are the conventional remedy for breach of contract. The Mississippi Supreme Court held in *Cenac* that the appropriate measure for breach of the covenant of good faith is the measure of expectancy type damages. *Cenac,* 609 So.2d at 1273.

> Each party to a contract has a justified expectation that the other will act in a reasonable manner, and when one party acts outside of accepted commercial practices to deprive the other party of the benefit of the contract, the contract is breached. In an ‘ordinary’ contract situation, a breach of the covenant is a breach of the contract itself, and contract damages are due.

Id. (citation omitted). Expectation damages are intended to “put the injured party in the position where she would have been but for the breach.” *Theobold,* 752 So.2d at 1042. The Mississippi Supreme Court has repeatedly held that “absolute certainty in the proof of damages is not required, [but] reasonable certainty is.” *Cenac,* 609 So.2d at 1274. As further explained by the Mississippi Supreme Court, “damages ... may be recovered only where and to the extent that the evidence removes their quantum from the realm of speculation and conjecture and transports it through the twilight zone and into the daylight of reasonable certainty.” *Wall v. Swilley,* 562 So.2d 1252, 1256 (Miss.1990).

The Policies consist of two main sections: (1)

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EXCLUSIONS FROM COVERAGE and (2) CONDITIONS AND STIPULATIONS. The parties agree that paragraph 7(a) of the CONDITIONS AND STIPULATIONS section of the Policies controls the method for determining the amount of damages due the Woodgreen Banks, but that is the extent of their agreement.

Paragraph 7, which is entitled "Determination and Extent of Liability," but is commonly known as the "Maximum Payment Provision," provides as follows:

> *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 damages 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, if applicable, the amount of insurance as defined in Section 2(c) of these Conditions and Stipulations.
>
> (ii) the amount of the unpaid principal indebtedness secured by the insured mortgage as limited or provided under Section 8 of these Conditions and Stipulations or as reduced under Section 9 of these Conditions and Stipulations, at the time the loss or damage insured against by this policy occurs, together with interest thereon; or
>
> (iii) 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.

Under the Maximum Payment Provision, the Title Companies pay "the least of" either: (1) the face amount of the policy; (2) the indebtedness secured by the insured mortgage; or (3) the difference between the value of the insured estate or interest, as insured, and the value of the insured estate or interest subject to any covered defects. It is the third option in paragraph 7(a)(iii), the difference between the value of the lots as insured and the value of the lots subject to the Subdivision Ordinance,[FN13] that has generated much of the dispute in Phase Two.

> FN13. The Woodgreen Banks point out that they bear the financial burden of property taxes, which they maintain renders the value of the lots subject to the Subdivision Ordinance less than zero.

The Woodgreen Banks calculate their damages to be the lesser of either the amount of insurance or the unpaid loan amount, as indicated in the chart below:

Woodgreen Bank	Lots	Date of Loan	Amount of Insurance ¶ 7(a)(i)	Unpaid Loan Amount ¶ 7(a)(ii)	Damages Claimed by Woodgreen Bank
First Alliance	10E & 10F	November 22, 2004	$760,000.00	$762,680.03	$760,000.00
First State	10G & 10H	June 17, 2005	$420,000.00	$355,947.82	$355,947.82
Patriot	10J & 10K	July 22, 2005	$500,000.00	$342,044.41	$342,044 .41

The Woodgreen Banks allege that with respect

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to First Alliance, the least amount is the amount of insurance under paragraph 7(a)(i), and with respect to First State and Patriot, the least amount is the outstanding loan amount under paragraph 7(a)(ii). Therefore, these amounts are the amount of their damages. The Woodgreen Banks purposefully presented no evidence to establish the amount under paragraph 7(a)(iii) because they contend that the value of the six (6) lots is incapable of adequate proof.

The Title Companies maintain that the Woodgreen Banks each own "the collateral intended as security for their respective loans with the Evans Brothers," and they are not entitled to recover any monetary damages. (MVT Br. at 16). They contend that the Woodgreen Banks did not seek rescission of the Special Warranty Deeds and, therefore, "they have elected damages as their sole remedy."(MVT Br. at 3). They cite the holding of the Mississippi Supreme Court in *Hudson v. Farrish Gravel Co.,* 279 So.2d 630 (Miss.1973), for the proposition that:

> [N]o recovery can be had where resort must be had to speculation or conjecture for the purpose of determining whether or not the damages resulted from the act of which complaint is made, or some other cause, or where it is impossible to say what of any portion of the damages resulted from the fault of the defendant.

Id. at 636.

In the alternative, the Title Companies contend that the Woodgreen Banks' damages are the least of: (1) the amount in paragraph 7(a)(iii) determined by subtracting the original value of the lots subject to certain uncovered defects and the present value of the lots or (2) the value of the lots on August 18, 2010, less their present value. (MVT Br. at 11). At a minimum, the Title Companies assert that they are entitled to a set off for the current value of the lots.

A. Whether the Woodgreen Banks bear the burden of proof

The Title Companies maintain that the Woodgreen Banks have failed to meet their burden of proving the full extent of their damages because they have not proved by a preponderance of the evidence the amounts of all the options in paragraph 7(a). (MVT Br. at 2). Although the amounts under paragraphs 7(a)(i) and 7(a)(ii) are undisputed, the Woodgreen Banks did not proffer any evidence as to the amounts under paragraph 7(a)(iii), that is, the difference between the value of the lots as insured and the value of the lots subject to the Subdivision Ordinance. According to the Title Companies, the failure of the Woodgreen Banks to produce evidence of the amounts due under paragraph 7(a)(iii) is fatal to their damages claim because the least amount is the only amount they are entitled to receive under the Policies. The Title Companies cite *Savage v. LaGrange,* 815 So.2d 485 (Miss.Ct.App.2002), where the Mississippi Court of Appeals held that the plaintiff bears the burden to prove "not only the *fact* of his injury, but the *extent* of the injury in order to support an award of monetary damages." *Id.* at 491 (emphasis added). Consequently, the Title Companies insist that the Woodgreen Banks have not met their burden of proving their damages by a reasonable degree of certainty, and, therefore, are not entitled to recover any damages whatsoever for the breach of the Policies.

In contrast, the Woodgreen Banks maintain that they have adequately proved the extent of their damages, and the Title Companies have the burden of proving the third option in paragraph 7(a)(iii), if they want to dispute their claim. Moreover, according to the Woodgreen Banks, the third option in paragraph 7(a)(iii) does not apply because the amount cannot be proved by the Title Companies with any degree of reasonable certainty, given that the term "value" is ambiguous. The Woodgreen Banks further contend that even if "value" in paragraph 7(a)(iii) is defined as the value of the lots as measured by a real estate appraisal, Allen's valuation opinions do not satisfy the Title

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Companies' burden of proof because his opinions are unreliable, speculative, and irrelevant. The amounts in paragraph 7(a)(i) and paragraph 7(a)(ii), according to the Woodgreen Banks, are undisputed and the least of those two amounts properly represent the measure of their damages.

The Woodgreen Banks further maintain that the Policies imposed upon them only one requirement with respect to proving the amount of their damages, that is, submitting a written "proof of loss or damage" stating the "basis of calculating the amount of the loss or damage."(Policies ¶ 5). The Woodgreen Banks assert that they submitted their claims to the Title Companies in accordance with this provision and have met their burden of proving the extent of their loss. In the alternative, the Woodgreen Banks insist that there is evidence in the record, which the Title Companies themselves introduced, of the appraised values of the six (6) lots as of the dates the loans were funded.

Woodgreen Bank	Appraisal Date	Lots	Value
First Alliance	August 4, 2004	10E & 10F	$958,000.00
First State	May 11, 2005	10G & 10H	$660,000.00
Patriot	November 18, 2004	10J & 10K	$620,000.00

(WB Br. at 20; *see* Pretrial Order ¶¶ 38(B)(2), (C)(17), & (D)(31); MVT Exs. 50, 51, 53, 55, 56). These appraisals do not include deductions for development costs or downward adjustments for size, shape, or topography. The Title Companies challenge these appraisals as unreliable because they rest on the false assumption that the Evans Brothers would lawfully subdivide the Woodgreen Property.

Both the Woodgreen Banks and the Title Companies recognize the difficulty in proving the difference in the value of the six (6) lots under paragraph 7(a)(iii), given that the Subdivision Ordinance prohibits their sale without an approved subdivision plat. The Title Companies attempt to use the difficulty in measuring the lots to their advantage.

In general, the insured has the burden of proving that coverage exists under an insurance policy. *See*17A Lee R. Russ & Thomas F. Segalla, Couch on Insurance § 254:11 (3d ed.2005)."Under Mississippi law a plaintiff has the burden of proving a right to recover under the insurance policy sued on," and this basic burden never shifts from the plaintiff. *Britt v. Travelers Ins. Co.,* 566 F.2d 1020, 1022 (5th Cir.1978). On the other hand, the insurer has the burden of proving the applicability of any exclusion or limitation. *Commercial Union Ins. Co. v. Byrne,* 248 So.2d 777, 782 (Miss.1971). The parties treat the dispute regarding the allocation of the evidentiary burden under paragraph 7(a)(iii) as requiring the Court to decide whether paragraph 7(a) is a "coverage" provision or an "exclusion" provision. Treating paragraph 7(a) like a coverage provision results in the Woodgreen Banks bearing the burden of proof; conversely, treating paragraph 7(a) like an exclusion provision results in the Title Companies bearing the burden of proof.

As stated previously, the Title Companies contend that the Woodgreen Banks have the burden of proving the difference between what they received (the lots subject to the Subdivision Ordinance) and what they were entitled to receive. The Title Companies point out that paragraph 7(a) appears under the "CONDITIONS AND STIPULATIONS" section of the Policies and not the "EXCLUSIONS FROM COVERAGE" section. According to the Title Companies, the Woodgreen Banks' interpretation would rewrite paragraph 7(a) to read, "The liability of the Title Companies under this policy shall not exceed

the least of whatever damage calculations the insured chooses."(MVT Br. at 18).*See* *Leonard v. Nationwide Mut. Ins. Co.,* 499 F .3d 419, 429 (5th Cir.2007) (quoting *State Auto. Mut. Ins. Co. v. Glover,* 176 So.2d 256, 258 (Miss.1965) ("No rule of construction requires or permits [the Court] to make a contract differing from that made by the parties themselves, or to enlarge an insurance company's obligations where the provisions of its policy are clear.")).

The Title Companies further maintain that the Policies are "named-peril" policies and that the Fifth Circuit and the Mississippi Supreme Court have drawn an important distinction between "named-peril" and "all-risk" policies. *See* *Tuepker v. State Farm Fire & Cas. Co.,* 507 F.3d 346, 356–57 (5th Cir.2007); *see also* *Lunday v. Lititz Mut. Ins. Co.,* 276 So.2d 696, 698 (Miss.1973). "All-risk" policies provide coverage for all risks except those risks that are specifically excluded, whereas "named-peril" policies provide coverage only if the damage is caused by a peril listed in the policy. *See*7 Lee R. Russ & Thomas F. Segalla, Couch on Insurance § 101:7 (3d ed.2005). The purpose of an "all-risk" policy is to insure a loss when the cause of the loss is uncertain. (*Id.*).

The Title Companies rely on *Broussard v. State Farm Fire & Casualty Company,* 523 F.3d 618 (5th Cir.2008), in support of their contention that the Woodgreen Banks bear the burden of proving paragraph 7(a)(iii) because the Policies are named-peril policies. In *Broussard,* the insureds, who lost their home during Hurricane Katrina in 2005, submitted a claim under their homeowners' insurance policy. The policy specifically excluded water-related losses from both its "named-peril" coverage for their personal property and its "open-peril" coverage for any "accidental direct loss" to their home. Both coverages were subject to an anti-concurrent cause clause. The insureds argued that their home was destroyed by tornadic winds prior to the arrival of the storm surge and that they were entitled to recover under their homeowners' insurance policy because the insurance company could not show that their losses were caused by water, an excluded peril, and not by wind. The expert for the insurance company testified at trial that he could not determine whether wind or water caused the damages to the home.

The Fifth Circuit acknowledged that "[t]he parties bear different burdens of proof under the personal property and dwelling coverages." *Id.* at 625.Under "named-peril" coverage, the Fifth Circuit ruled that the insured had the burden of proving that the peril insured in the policy caused the loss to their personal property. *Id.* Under "open-peril" coverage, the Fifth Circuit ruled that the insurer had the burden of proving that the excluded peril caused the loss to their home. The Title Companies compare the Maximum Payment Provision in paragraph 7(a) to the "named-peril" coverage provision at issue in *Broussard.*

The Woodgreen Banks contend that paragraph 7(a) is an exclusion provision because it limits the Title Companies' obligation to indemnify by excluding those damages incurred by the Woodgreen Banks that exceed certain amounts. The Woodgreen Banks further contend that even though paragraph 7(a) does not fall under the "EXCLUSIONS FROM COVERAGE" section of the Policies, it functions like a limitation on the liability of the Title Companies. According to the Woodgreen Banks, their view is consistent with the Fifth Circuit's decision in *Penthouse Owners Association, Inc. v. Certain Underwriters at Lloyds, London,* 612 F.3d 383 (5th Cir.2010), a case that like *Broussard* involved property losses sustained in 2005 during Hurricane Katrina. In *Penthouse Owners,* the insured owned a condominium complex in Pass Christian, Mississippi, that was completely destroyed during Hurricane Katrina. Certain underwriters at Lloyd's of London ("Underwriters") insured the condominiums under an "all-risk" policy. The Underwriters denied the insured's claim because an anti-concurrent cause clause in the policy

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excluded damage caused by water, regardless of any other event that may have contributed concurrently to the loss. The district court, however, interpreted an endorsement in the policy that defined a “Windstorm or Hail Deductible” as providing coverage regardless of whether the loss was caused by wind or water. In other words, the district court ruled that the policy endorsement rendered the anti-concurrent cause clause meaningless.

On appeal, the Fifth Circuit rejected the district court's interpretation of the endorsement in the policy and concluded that the “Windstorm or Hail Deductible” did not expand the policy's scope of coverage. Instead, it operated only in deciding whether the deductible applied. Of significance to the Adversary, the Fifth Circuit recognized in its discussion of insurance contract interpretation that “[e]xclusions and limitations are reviewed stringently; they must be clear and unambiguous. An insurer ‘bears the burden of showing that an exclusion applies and that it is not subject to some other reasonable interpretation that would afford coverage.’ “ *Id.* at 386 (quotations omitted); *see also* *Hankins v. Md. Cas. Co.,* 101 So.3d 645, 659 (Miss.2012) (to benefit from an exclusionary clause in an insurance contract, the insurer has the burden of showing that the exclusion applies and that no other reasonable interpretation of the policy would afford coverage)(dissenting opinion); *Miss. Phosphates Corp. v. Furnace & Tube Serv., Inc.,* No. 1:07CV1140, 2009 WL 1448967, at *4 (S.D.Miss. May 22, 2009) (under Louisiana law, insurer bears the burden of proving that a loss falls within a policy exclusion); *Mid–Continent Cas. Co. v. Bay Rock Operating Co,* 614 F.3d 105, 114 (5th Cir.2010) (under Texas law, the insurer bears the burden of proving that an exclusion or limitation applies).

The Woodgreen Banks argue that the Fifth Circuit in *Broussard* cited two decisions from the Mississippi Supreme Court that show that the Title Companies' reliance on *Broussard* is misplaced. In those two decisions, *Lititz Mutual Insurance Company v. Boatner,* 254 So.2d 765, 766 (Miss.1971), and *Grace v. Lititz Mututal Insurance Company,* 257 So.2d 217, 225 (Miss.1972), the Mississippi Supreme Court held that the insured had the burden of proving, as part of his *prima facie* case, that the losses he sustained during Hurricane Camille were caused by wind, a peril specified in his policy. The Mississippi Supreme Court, however, refused to shift the burden of proof back to the insured to show that the exclusion in the policy for water damage did not apply to negate coverage.

The Court finds that the Woodgreen Banks have satisfied their burden of producing evidence regarding the extent of their damages. Moreover, the Court agrees with the Woodgreen Banks that paragraph 7(a)(iii) functions as a third limitation on the Title Companies' liability, which is how it was described by James Partin, vice-president and senior counsel of the Title Companies. (1 Trial Tr. at 72; 2 Trial Tr. at 12).

The Court also finds that the Title Companies' citation of *Savage* for its holding that a plaintiff bears the burden of proving his damages is unpersuasive. *Savage* involved a tort claim arising out of a motor vehicle accident. Damages are an essential element of any tort claim. *Thomas v. Columbia Group, LLC,* 969 So.2d 849, 852 (Miss.2007). This proceeding, however, involves a breach of contract claim where the liability of the Title Companies has already been established.

Moreover, the argument of the Title Companies regarding the placement of paragraph 7(a) in the Policies would carry weight only if paragraph 7(a) appeared within the opening paragraphs of the Policies where the types of losses are defined, but it does not. Instead, there is only a reference to the CONDITIONS AND STIPULATIONS section in the opening paragraphs and paragraph 7(a) itself appears on the third page of the Policies. More important, unlike *Broussard,* coverage is not at issue here. The Policies covered any loss sustained because of eight (8) named perils, at least five (5) of which squarely apply to the losses alleged by the

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Woodgreen Banks.[FN14] Indeed, the Title Companies attempted to cure the defects in the liens held by the Woodgreen Banks on August 18, 2010, without a whiff of a coverage dispute.

FN14. These five (5) perils include: (1) title to the estate or interest described in Schedule A being vested other than as stated; (2) a defect in or lien or encumbrance on the title; (3) unmarketability of the title; (4) invalidity or unenforceability of the lien of the insured mortgage upon the title; and (5) priority of any lien or encumbrance over the lien of the insured mortgage. (Policies, at 1).

"One who violates his contract with another is liable for all the direct and proximate damages, which result from the violation." *Wells v. Nat'l Life Ass'n of Hartford,* 99 F. 222, 232 (5th Cir.1900). The purported conflict between this long-standing rule of law and the rule of law cited by the Title Companies that damages must be proved with reasonable certainty was resolved by the Mississippi Supreme Court in *Adams v. United States Homecrafters, Inc.,* 744 So.2d 736, 740 (Miss.1999)."The rule that damages, if uncertain, cannot be recovered applies to their nature, and not to their extent. If the damage is certain, the fact that its extent is uncertain does not prevent a recovery." *Id.* (quotation omitted); *see* 4 ENCYCLOPEDIA OF MISSISSIPPI LAW § 25:48, at 39 (2001). In Mississippi, "a party will not be permitted to escape liability because of the lack of a perfect measure of damages his wrong has caused." *J.K. v. R.K.,* 30 So.3d 290, 299 (Miss.2009) (quotation omitted). Given the special and unique facts in the Adversary, the Courts finds that the Woodgreen Banks have met their burden of proving that they sustained damages as a result of the breach of the Policies. *See* *Hawkins Hardware Co. v. Crews,* 169 So. 767, 769 (Miss.1936) ("When the cause of the damages is reasonably certain, recovery is not to be denied because the data in proof does not furnish a perfect measure thereof."). The Title Companies, therefore, bear the burden of proving that the losses shown by the Woodgreen Banks exceed the reasonable expectation of the parties under the third option under paragraph 7(a)(iii). Before turning to the merits of whether the Title Companies have succeeded in challenging the damages through Allen's valuation analysis, the Court considers certain preliminary arguments presented by the parties.

B. Whether "value" is an ambiguous term

The Woodgreen Banks contend that the amount in paragraph 7(a)(iii) cannot be proved by the Title Companies with reasonable certainty because the term "value" is ambiguous. The Woodgreen Banks insist that the Policies do not define the method for determining "value" and do not establish the date that should apply for determining "value." The Woodgreen Banks rely on this Court's decision in *G & B Investments, Inc. v. Henderson (In re Evans*), 460 B.R. 848 (Bankr.S.D.Miss.2011),[FN15] (*Heritage*), a separate adversary proceeding which arose from the same *Ponzi*-type scheme of the Evans Brothers but which involved commercial property located elsewhere. The Maximum Payment Provision in paragraph 8(a) of the **title insurance** policy at issue in *Heritage* is identical to paragraph 7(a) in the Policies. The Woodgreen Banks contend that the following rulings against the Title Companies in *Heritage* are relevant to the issue of ambiguity in this Adversary:

FN15. The Title Companies did not appeal *Heritage.*

1. The Title Companies drafted the Policies and any ambiguity must be interpreted against them. *Heritage,* 460 B.R. at 895–96.

2. The Policies do not define "value" in paragraph 8(a) and do not establish the method of valuation, or the time for determining valuation. *Heritage,* 460 B.R. at 895–96.

In *Heritage,* this Court ruled that "value" in the Maximum Payment Provision must be interpreted

as valuing the insured interest as of the date that the lender made its loan. The Woodgreen Banks assert that they too sustained their losses when they funded the loans because their respective borrowers, like those in *Heritage,* never actually held title to the lots. Therefore, according to the Woodgreen Banks, “value” must be determined as of the date they made their loans in 2004 and 2005. These dates favor the Woodgreen Banks because the real estate market did not begin its decline until 2007. As a result, the values of the lots, by any method, would yield a higher benefit for the Woodgreen Banks when the loans were made, than when the Title Companies breached the Policies on August 18, 2010.

In *Heritage,* the Title Companies paid Heritage Bank the fair market value of its collateral using a date that they believed Heritage Bank could have hypothetically brought a foreclosure action, which was well after the downfall of the real estate market. The Court found that the Title Companies had breached the **title insurance** policy by underpaying Heritage Bank's claim. The Court rejected the hypothetical foreclosure date embraced by the Title Companies and ruled that the Maximum Payment Provision, which was silent on this issue, was ambiguous both as to the date and method for valuation.

The facts underlying Heritage Bank's allegations are not analogous to those of the Woodgreen Banks. In *Heritage,* there was a factual dispute as to whether the Title Companies had attempted to cure the defect. Resolving this dispute, the Court found that no attempt to cure had been made by the Title Companies. This finding in *Heritage* was important because there was a specific provision in the **title insurance** policy that allowed the insured to choose the date to calculate its loss if the Title Companies unsuccessfully attempted to cure the defect. That dispute is not present here, because the Title Companies actually did attempt to cure the defects and because the Policies are based on a different ALTA form with different provisions. The Court declines the Woodgreen Banks' invitation to interpret *Heritage* as providing a definitive ruling on the date for measuring losses in all **title insurance** claims in Mississippi.

C. Whether the Woodgreen Banks reasonably expected the defects

The Title Companies maintain that the measure of damages for breach of the Policies is governed by the reasonable expectations of the parties arising from the language of the Policies. Tying the expectancy damages to the language of the Policies is necessary, according to the Title Companies, to ensure that any monetary “remedy ... be such that the breaching party is not charged beyond the trouble the breach caused.” *Univ. of S. Miss. v. Williams,* 891 So.2d 160, 176 (Miss.2004) (citing *Frierson v. Delta Outdoor, Inc.,* 794 So.2d 220, 225 (Miss.2001)).

According to the Title Companies, the Woodgreen Banks' only reasonable expectation regarding their indemnity obligations under the Policies was that the Woodgreen Banks could “take the collateral securing their loans.”(MVT Br. at 21). The Title Companies contend that it was unreasonable for the Woodgreen Banks to expect anything more than what they have already received because the Woodgreen Banks never had coverage for defects “created, suffered, assumed or agreed to by the insured” (Policies ¶ 3(a)) or defects arising out of the enforcement of “[a]ny law, ordinance or governmental regulation” (Policies ¶ 1(a)). Therefore, according to the Title Companies, the Woodgreen Banks willingly accepted the risk of these defects and are not entitled to monetary damages.

The Title Companies cite *Cynergy, LLC v. First American* ***Title*** ***Insurance*** *Company,* 706 F.3d 1321 (11th Cir.2013), in support of their argument. There, a group of investors formed a company to purchase land for the development of a residential subdivision. The investment company was aware when it purchased the land that the property did not abut a public road and lacked dedicated access to any public road. A year later, the invest-

ment company submitted a claim to its **title insurance** company for losses due to a "lack of a right of access to and from the land." *Id.* at 1329.The **title insurance** company denied the claim based on a provision in the policy that excluded coverage for matters "created, suffered, assumed or agreed to by the insured."The Eleventh Circuit affirmed the district court's award of summary judgment in favor of the **title insurance** company on the ground that any loss sustained by the investment company due to the "lack of a right of access" was excluded from the policy.

A **title insurance** policy, according to the Title Companies, "does not guarantee either that the mortgaged premises are worth the amount of the mortgage, or that the mortgage debt will be repaid ."*See* *Associated Bank, N.A. v. Stewart Title Guar. Co.,* 881 F.Supp.2d 1058, 1066 (D.Minn.2012) (citation omitted). In the same vein, the Title Companies insist that a diminution in value due to a decline in market conditions is not a covered risk in the Policies.

The Court finds no merit in the Title Companies' argument. The Woodgreen Banks not only reasonably expected the Title Companies to indemnify them for losses they incurred as a result of the defects covered in the Policies, but the Woodgreen Banks also reasonably expected the Title Companies to cure the covered defects in a way that would not render the lots unmarketable. Indeed, the unreasonable and unexpected manner in which the Title Companies chose to attempt to cure the defects in the lots is the gist of the Court's conclusion in the Liability Opinion that the Title Companies breached the duty of good faith and fair dealing. (Liability Op., at *28).

Notwithstanding their present posture, the Title Companies fostered the expectation that the six (6) lots could be sold prior to conveying the lots to the Woodgreen Banks. The Title Companies wrote the Woodgreen Banks a letter indicating their intent "to deed the properties to the [Woodgreen Banks] who hold the second position notes and deeds of trust. *The conveyance* will avoid the time and expense of a foreclosure for the banks and *will allow the immediate resale of these properties without title defect.*" (WB Ex. 20) (emphasis added). In a follow-up letter, the Title Companies wrote the Woodgreen Banks that "the Title Companies will cure any other title or access defects and then convey title to lenders holding second equitable liens."(WB Ex. 21).

The Eleventh Circuit's decision in *Cynergy,* which the Title Companies rely upon, is inapposite. In *Cynergy,* the lack of a right of access to the property existed, and was known to the insured, before the title policy was issued by the title company. Here, the unauthorized subdivision of the Woodgreen Property arose as a direct result of actions taken by the Title Companies, which occurred well after the Policies had been issued.

The expectation of the Woodgreen Banks that the lots would be marketable is consistent with paragraph 2(a) of the Policies, which provides that "coverage ... continue[s] in force ... in favor of (i) an insured who acquires all or any part of the estate or interest in the land by ... conveyance in lieu of foreclosure ."(Policies ¶ 2(a)). Similarly, paragraph 7(b) of the Maximum Payment Provision declares that "the liability of the Company shall continue" in the event the insured has acquired the estate or interest. (Policies ¶ 7(b)).

D. Whether the Woodgreen Banks sustained a loss

The Title Companies next contend that if the Subdivision Ordinance rendered the lots valueless, as alleged by the Woodgreen Banks, than the Woodgreen Banks did not sustain a loss as a result of the conveyances on August 18, 2010. If the value of the lots as insured in 2004 and 2005 was $0.00, according to the Title Companies, then the difference between the value as insured ($0.00) and the value of the lots subject to the same defect today ($0.00) remains the same ($0.00).

The Court again finds that the Title Companies'

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argument is misplaced. There was no violation of the Southaven Ordinance in 2004 and 2005 because the borrowers that purportedly signed the deeds of trust in favor of the Woodgreen Banks did not hold title to the six (6) lots. Moreover, the Subdivision Ordinance applied only to sales of land and, therefore, would not have applied to the deeds of trust even if the borrowers had held title to the six (6) lots. Consequently, the Woodgreen Property was not actually subdivided and, therefore, the violation of the Subdivision Ordinance did not actually occur until the Title Companies conveyed the six (6) lots on August 18, 2010. Thus, the Court rejects the Title Companies' contention that "[t]he Woodgreen Banks are in the exact same position they would have been in had their liens been enforceable."(MVT Br. at 25).

E. Whether the Woodgreen Banks' appraisals show no loss in value

The Title Companies compare the value of the lots before they were conveyed to the Woodgreen Banks on August 18, 2010, as appraised by Allen and the value of the lots after they were conveyed, as appraised by the Woodgreen Banks' appraisers. (WB Exs. 43, 50). They then declare that "none of the [Woodgreen] Banks suffered a loss."(MVT Br. at 27). The chart below shows that the appraisals obtained by the Woodgreen Banks immediately after the conveyances are higher than the pre-conveyance appraisals performed by Allen immediately before the conveyances:

Woodgreen Bank	Pre-conveyance Value	Post-conveyance	Value Losses
First Alliance	$246,046.00	unknown	$0.00
First State	$99,648.00	$192,900.00	$0.00
Patriot	$123,022.00	$168,600.00	$0.00

(WB Exs. 43, 50; MVT Ex. 84). Therefore, according to the Title Companies, none of the Woodgreen Banks suffered any loss because the lots are currently worth more.

The Title Companies' argument is misplaced for two main reasons. First, the appraisals obtained by the Woodgreen Banks did not address the impact of the Subdivision Ordinance and because unlike the Title Companies, the Woodgreen Banks were unaware at that time that the lots were unmarketable. Second, the appraisals were necessary for the Woodgreen Banks to classify the lots in their balance sheets as "other real estate owned" ("OREO"), which banking regulations required them to do. *See*12 C.F.R. § 34.87 (accounting treatment for OREO and sales of OREO). The appraisals were not obtained by the Woodgreen Banks to assess the diminution in value sustained as a result of the Subdivision Ordinance. (1 Trial Tr. at 108).

F. Whether the Woodgreen Banks failed to mitigate their damages

The Title Companies contend that the Woodgreen Banks failed to mitigate their losses and for that reason are precluded from recovering any monetary damages under Mississippi law. *Wall,* 562 So.2d at 1258 (plaintiffs are "charged with a duty of mitigating their damages"). In Mississippi, the burden of producing "facts which will operate to bring the mitigation into effect" rests on the defendant. *See Poteete v. City of Water Valley,* 42 So.2d 112, 113 (Miss.1949) (citations omitted). It is undisputed that the Woodgreen Banks did not make any effort to market or sell the six (6) lots or to seek a variance or exception from the City of Southaven. (1 Trial Tr. at 99–100, 202, 218). The Title Companies describe this failure as "curious" because the Woodgreen Banks and the City of Southaven share the same counsel. (1 Trial Tr. at

20, 22).

The Title Companies point out that Whitney Choat ("Choat"), planning director for the City of Southaven, testified in Phase One of the Woodgreen Trial that Southaven had not yet taken any action to enforce the Subdivision Ordinance with respect to the Woodgreen Property and had no plans to do so at that time. (Phase One, 1 Trial Tr. at 65–66). According to Choat, the City still viewed the Woodgreen Property as a "large tract of 20–plus acres."(Phase One, 1 Trial Tr. at 66). The Title Companies complain that in light of the City's wait-and-see attitude, the Woodgreen Banks could have attempted to sell the lots after August 18, 2010, to minimize their losses.

The Court finds the Title Companies' mitigation argument unfounded. Surely, the Woodgreen Banks were not required to prevent the Title Companies from conveying and subdividing the Woodgreen Property on August 18, 2010, and the Title Companies have not demonstrated how the Woodgreen Banks could have prevented the accumulation of damages after the conveyances. There is no evidence that the Woodgreen Banks benefitted from their alleged inactivity, even assuming that their actions would not have been futile.

G. Whether Allen's valuation analysis is credible

During Phase Two of the Woodgreen Trial, the Title Companies presented the testimony of Allen to prove the value of the insured lots before they were conveyed by the Title Companies to the Woodgreen Banks. The Woodgreen Banks asked the Court to exclude Allen's testimony and the Allen Report based upon Federal Rule of Evidence 702 and the requirements set forth by the U.S. Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals, Inc.,* 509 U.S. 579 (1993), for the admissibility of scientific testimony. *See also Kumho Tire Co. v. Carmichael,* 526 U.S. 137 (1999) (expanding *Daubert* analysis to include all expert testimony).Rule 702 of the Federal Rules of Evidence provides:

A witness who is qualified as an expert by knowledge, skill, experience, training or education may testify in the form of an opinion or otherwise if:

(a) the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;

(b) the testimony is based on sufficient facts or data;

(c) the testimony is the product of reliable principles and methods; and

(d) the expert has reliably applied the principles and methods to the facts of the case.

FED.R.EVID. 702.

In *Daubert,* the Supreme Court stressed the trial court's "gatekeeper" role in excluding unreliable evidence. The *Daubert* factors for evaluating expert testimony include "whether the theory or technique the expert employs is generally accepted; whether the theory has been subjected to peer review and publication; whether the theory can and has been tested; whether the known or potential rate of error is acceptable; and whether there are standards controlling the technique's operation." *Wells v. SmithKline Beecham Corp.,* 601 F.3d 375, 379 (5th Cir.2010) (citing *Daubert,* at 509 U.S. at 593). These factors are neither exclusive nor dispositive.

Appraisers fall within the scope of expert witnesses subject to the *Daubert* analysis and "[t]he essential elements of the real estate expert's competency include his knowledge of the property and of the real estate market in which it is situated, as well as his evaluating skill and experience as an appraiser." *Hidden Oaks Ltd. v. City of Austin,* 138 F.3d 1036, 1050 (5th Cir.1998) (quotation omitted).

As mentioned previously, the Court denied the Motion *in Limine* and accepted Allen as an expert

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in the field of real estate appraisals. In accepting Allen as an expert, the Court noted that its role as a gatekeeper for the admission of expert testimony is not as essential in bench trials. *Gibbs v. Gibbs,* 210 F.3d 491, 500 (5th Cir.2000). The Court reserved its decision on what evidentiary weight to afford Allen's testimony and the Allen Report, an issue to which the Court now turns.

The Woodgreen Banks contend that Allen's testimony was speculative and not credible. *See Boltar, L.L.C. v. Comm'r,* 136 T.C. 326, 338 (2011) (appraisal hypothesizing 174–unit condominium was speculative because project was too large for land and did not comply with zoning law). The Woodgreen Banks criticize Allen's testimony and the Allen Report for four (4) main reasons: (1) Allen did not actually appraise the six (6) lots; (2) Allen's adjustments were speculative; (3) Allen relied on cost projections that were uncertain and unsupported; and (4) Allen failed to analyze the original sale of the Woodgreen Property.

The Woodgreen Banks called Pray as an expert in the field of real estate appraisals. Pray was one of the first real estate appraisers licensed in Mississippi.[FN16] In 2001, he was certified by the Appraisal Qualifications Board to teach USPAP. (1 Trial Tr. at 115). He served as a commissioner on the Mississippi Real Estate Commission for eight (8) years. (1 Trial Tr. at 114). Unlike Allen, Pray is not a member of the Appraisal Institute and does not possess the MAI designation. Pray testified that he did not pursue the MAI designation because of his belief that it could conflict with his role as a real estate commissioner. Pray has performed over 400 appraisals and about 50 appraisal reviews. (1 Trial Tr. at 117).

FN16. Pray's general appraiser number is “GA–10.” (1 Trial Tr. at 112).

Pray did not prepare his own appraisal of the Woodgreen Property because he did not believe it was possible to provide a valuation opinion that conformed to USPAP standards. He testified that if he were asked to appraise the lots, “I would walk away from [the assignment].” (1 Trial Tr. at 158). His role as an expert, therefore, was limited to his review of the credibility of the Allen Report. (1 Trial Tr. at 125).

1. Whether Allen actually appraised the six (6) lots

With respect to Allen's subdivision development method, Pray testified on behalf of the Woodgreen Banks that Allen did not actually appraise the six (6) lots but instead appraised a “phoney baloney” subdivision of twenty-six (26) commercial lots, which Pray insisted did not bear any resemblance to the unapproved subdivision of the six (6) lots at issue. (1 Trial Tr. at 169).“None of the [Woodgreen] Banks loaned money against all 23 acres of [the] Woodgreen [Property] nor contracted to insure it.”(WB Br. at 10). Allen used sales figures and development costs based on a hypothetical subdivision of twenty-six (26) lots, whereas the Woodgreen Property in the Evans Plats depicts only seventeen (17) lots. Pray stated that it was pure speculation for Allen to assume that all the current owners[FN17] of the Woodgreen Property would voluntarily agree to develop the Woodgreen Property as a commercial subdivision and to share in the development costs. Allen did not communicate the Diachiara Plat to any of the property owners, and representatives from the Woodgreen Banks made it clear that they would never agree to bear the financial burden. (1 Trial Tr. at 91, 193, 209).

FN17. Other than the Woodgreen Banks, the owners of the Woodgreen Property include BankPlus, NFPS, Inc. (Wachovia Bank), Renasant Bank, Magna Bank, Synovus Bank (Trust One), and Mississippi Real Estate Dispositions, LLC, a subsidiary of the Title Companies. (Allen Rep. at 3).

The Woodgreen Banks point out that although USPAP standards may authorize the subdivision development method, an appraiser must follow certain requirements for employing that methodo-

logy. Under Standards Rule 1–2(g), a hypothetical condition may be used only if "use of the hypothetical condition results in a credible analysis." *See* 2012–13 USPAP Standards Rule 1–2(g) at U–18. USPAP defines "credible" as "worthy of belief" and comments that "credible assignment results require support, by relevant evidence and logic, to the degree necessary for the intended use."*Id.* at U–3.

The Woodgreen Banks also assert that Allen's use of the subdivision development method violated USPAP's "Jurisdictional Exception" rule, which they contend required Allen to reject any approach unauthorized by the State of Mississippi. *See* 2012–13 USPAP Standards at U–3. The Woodgreen Banks assert that the Mississippi Supreme Court in *Jackson County Development, Inc. v. Mississippi State Highway Commission,* 262 So.2d 416, 417–18 (Miss .1972), ruled that the subdivision development approach for valuing land is inherently unreliable.

Moreover, the Woodgreen Banks challenge as a "meaningless mathematical computation" Allen's use of the contributory principle. (WB Br. at 11). They criticize Allen for allocating to each of the Woodgreen Banks a portion of land in which they never held an interest. "An appraiser must refrain from valuing the whole solely by adding together the individual values of the various estates or component parts," as set forth in Standards Rule 1–4(e).*See* 2012–13 USPAP Standards Rule 1–4(e). The Comment to Rule 1–4(e) explains:

> Although the value of the whole may be equal to the sum of the separate estates or parts, it also may be greater than or less than the sum of such estates or parts. Therefore, the value of the whole must be tested by reference to appropriate data and supported by an appropriate analysis of such data.
>
> A similar procedure must be followed when the value of the whole has been established and the appraiser seeks to value a part. The value of any such part must be tested by reference to appropriate data and supported by an appropriate analysis of such data.

2012–13 USPAP Standards Rule 1–4(e), Comment. According to the Woodgreen Banks, the contributory value approach watered down Allen's value conclusions by burdening the lots with problems that adversely affected lots other than the lots they own.

2. Whether Allen's adjustments were speculative

Pray testified that Allen's sales comparison approach was faulty because he adjusted some of the comparable sales downward by as much as 25 percent based upon the large size of the Woodgreen Property when none of the Woodgreen Banks actually owned more than three (3) acres. (1 Trial Tr. at 145–48; Allen Rep. at 57). Pray also testified that Allen's methodology failed because he determined the value of each of the Woodgreen Banks' lot based upon the square footage of the entire twenty-three (23) acres, although, paradoxically, he reduced the starting value due to the inverse relationship between size and price. Moreover, according to Pray, Allen's downward adjustments of –35 percent for size and –50 percent for shape and topography were so excessive as to be unreliable and rendered his alleged comparable sales approach irrelevant. (Allen Rep. at 57, 77). Pray criticized Allen for pulling the "adjustment numbers out of the air."(1 Trial Tr. at 183).

3. Whether Allen relied on unsupported costs

The Woodgreen Banks disagreed with Dichiara regarding the necessity for the construction of two concrete bridges to provide access to the Woodgreen Property. According to the Woodgreen Banks, development costs in excess of $300,000.00 for the construction of the bridges were unnecessary, given that the six (6) lots were not impacted.

4. Whether Allen failed to analyze the Henson sale

The original sale of the Woodgreen Property

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from the Hensons for $3.35 million took place on August 5, 2004, within approximately four (4) months of Allen's November, 2004, valuation of the Woodgreen Property. The Allen Report mentioned the fact that the Henson sale had taken place and that the land had sold for $3.35 million, followed by the statement that "[t]he historic sale price is not consistent with our estimated market value as of November 22, 2004."(Allen Rep. at 4). There was no further explanation, however, as to why the sales price was not used in the comparable sales analysis. Pray criticized the paucity of Allen's analysis of the Henson sale, comparing it to "something that my granddaughter could put in an appraisal report."(1 Trial Tr. at 142).

Pray testified that the USPAP required Allen to analyze any sale of the Woodgreen Property that occurred during the three-year period of time prior to the date of his value determination. Pray relied upon Standards Rule 1–5, which provides:

Standards Rule 1–5

> When the value opinion to be developed is market value, an appraiser must, if such information is available to the appraiser in the normal course of business:
>
> (a) analyze all agreements of sale, options, and listings of the subject property current as of the effective date of the appraisal; and
>
> (b) analyze all sales of the subject property that occurred within the three (3) years prior to the effective date of the appraisal.
>
> 2012–2013 USPAP, Standards Rule 1–5, at U20. Further, Pray referred to Advisory Opinion 1, which states:
>
> The requirement for the appraiser to analyze and report sales history and related information is fundamental to the appraisal process. Just as the appraiser must analyze pending and recent sales of comparable properties, the appraiser must take into account all pending and recent sales of the subject property itself. This is not to say that the agreed price in a pending or recent sale of the subject property is necessarily representative of value as defined in the report, but the appraiser's failure to analyze and report these facts may exclude important information from the sales comparison approach. Information pertaining to the current market status and the sales history of the subject property may also be useful information for the determination of highest and best use or the analysis of market trends.
>
> 2012–13 USPAP Advisory Opinion 1, at A1–A2. Pray also testified that Allen's failure to explain why he excluded the Henson sale from his valuations in 2004 and 2005 had a domino-like effect because Allen carried the values he reached throughout his analysis. The Woodgreen Banks argue that the omission is sufficient reason for the Court to reject his sales comparison approach in *toto.*

Against this onslaught of thoughtful criticisms, the Court cannot uphold the reliability of Allen's testimony or the Allen Report. The work of an appraiser is to provide an unbiased assessment of the value of property. That assessment may be used in various contexts and for different purposes. *Fin. Sec. Assurance Inc. v. T–H New Orleans Ltd. P'ship (In re T–H New Orleans Ltd. P'ship*), 116 F.3d 790, 797 (5th Cir.1997)."The value of collateral must be determined in light of the purpose of the valuation and of the proposed disposition or use of the collateral." *In re Gauthier,* No. 08–51002, 2009 WL 2226106, *1 (Bankr.W.D.La. July 16, 2009) (citing 11 U.S.C. § 506(a) and *Assoc. Comm. Corp. v. Rash,* 520 U.S. 953, 962 (1997)). Here, the purpose of Allen's testimony and the Allen Report was to determine the diminution in value of the lots after the conveyances. Needless to say, the valuation of the six (6) lots was complicated by the impact of the Subdivision Ordinance because it prohibited the "as is" sale of the six (6) lots.

The valuation process is not an exact science. *In re Grind Coffee & Nosh, LLC,* No. 11–50011,

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2011 WL 1301357, at *6 (Bankr.S .D. Miss. April 4, 2011). Because of the subjective nature of the valuation process, courts are often greeted with conflicting appraisal testimony which must be evaluated depending upon the credibility of the expert's analysis. *Anderson v. Mega Lift Sys., L.L.C. (In re Mega Lift Sys., L.L. C.)*, No. 04–6085, 2007 WL 1643182, at *8 (Bankr.E.D. Tex. June 4, 2007); *In re Brown,* 289 B.R. 235, 238 (Bankr.M.D.Fla.2003) ("Valuation of assets 'is not an exact science and has inherent vagaries.'") (quotation omitted). A court may accept an appraisal in its entirety, may choose to give weight only to portions of the appraisal, or may reject the appraisal altogether. *See Grind Coffee & Nosh,* 2011 WL 1301357, at *6. As explained by the bankruptcy court in *Brown,* "the better reasoned approach is to review all of the proposed comparables, including in its analysis only those that assist the Court in its determination." *Brown,* 289 B.R. at 238.

Commissioned by the Title Companies in anticipation of the Adversary, the Allen Report attempts to provide an estimation of the fair market value of the Woodgreen Property. Fair market value is consistently defined as the price that a willing buyer would pay a willing seller, both persons having reasonable knowledge of all relevant facts and neither person being under any compulsion to buy or to sell. *United States v. Cartwright,* 411 U.S. 546, 551 (1973); *Bear Creek Water Ass'n, Inc. v. Town of Madison,* 416 So.2d 399, 402 (Miss.1982). The concept of "highest and best use" is an element in the determination of fair market value, but it does not eliminate the requirement that a hypothetical willing buyer would purchase the subject property for the indicated value. "If a hypothetical buyer would not reasonably have taken into account ... [a] potential use in agreeing to purchase the property, such potential use should not be considered in valuing the property." *Stanley Works & Subsidiaries v. Comm'r,* 87 T.C. 389, 402 (1986) (citing *United States v. 320.0 Acres of Land,* 605 F.2d 762, 781 (5th Cir.1979)).

The highest and best use of the Woodgreen Property, according to the Allen Report, was its commercial development into twenty-six (26) lots. When asked by the Court how the lots had any market value when they could not be sold without violating the Subdivision Ordinance, Allen answered, "I'm not here to testify to that particular value."(2 Trial Tr. at 106). The Court finds Allen's response troubling.

The four (4) land sales relied upon by Allen were too dissimilar to the Woodgreen Property to provide a realistic market value for the lots. The adjustments that Allen made are so large as to render the comparisons of no assistance to the Court. Allen offered nothing to support his adjustment percentages and agreed with counsel for the Woodgreen Banks that the Court should "take [his] word for it that [his] judgment is accurate."(2 Trial Tr. at 93–94). A valuation that is unsupported by sufficient data is unreliable. *Gen. Elec. Co. v. Joiner,* 522 U.S. 136, 146 (1997). Courts must be wary of appraisals which contain unsupported but important assumptions, valuations which place property with a unique and extraordinary location on par with an ordinary lot, and comparable sales that are so dissimilar that they are of little use in supporting the opinion of value. *In re Belmont Realty Corp.,* 113 B.R. 118, 119–21 (Bankr.D.R.I.1990).

The Court finds instructive *Walters v. State Road Department,* 239 So.2d 878 (Fla.Dist.Ct.App.1970), in which the court excluded as speculative and conjectural the testimony of an appraiser who could not say how he arrived at numerical percentages for his adjustments. The appraiser testified that his adjustments were based on his judgment of numerous factors, like the effect of time, location, and size of the property. The Florida court ruled that his opinion was purely subjective due to the lack of any recognized standard or formula. *Id.* at 880;*see also* *Wang v. Dept. of Revenue, State of Oregon,* No. 3054, 1991 WL 176269 (Or. T.C. Aug. 21, 1991) (lack of market data to support a fifty (50) percent adjustment for site size

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rendered value opinion speculative); *Richfield 81 Partners II, LLC v. SunTrust Bank (In re Richfield 81 Partners II, LLC*), 447 B.R 653, 659 (Bankr.N.D.Ga.2011) (appraisal adjustment percentages which are not computed or supported by an objective standard are arbitrary); *Gulf South Pipeline Co., LP v. Pitre,* 35 So.3d 494, 497 (Miss.2010) (appraiser's opinion that property suffered a fifteen (15) percent diminution in value was not supported by comparable sales data or other evidence and was purely speculative).

In finding the sales comparison approach unreliable, the Court does not find Allen's omission of the Henson sale to be fatal to his analysis because the Evans Brothers undoubtedly were motivated by fraud to purchase the Woodgreen Property. Their fraudulent scheme vitiated treatment of the Henson sale as an arms-length transaction. Even so, Allen should have explained his reasons for excluding the Henson sale in the Allen Report.

The nature of the Woodgreen Property's future income was too indeterminate to provide a reasonable estimate of the market value of the Woodgreen Property. In finding the income capitalization approach unreliable, the Court does not interpret the Mississippi Supreme Court's decision in *Jackson County* as a blanket prohibition of the subdivision development method. There may be circumstances where the Mississippi Supreme Court would sanction the appraisal of land using the subdivision development method. The Woodgreen Bank's expert witness, Pray, did not testify that the methodology applied by Allen was fundamentally flawed. (1 Trial Tr. at 179). For example, Allen's use of the subdivision development method was not tantamount to use of a Ouija board to determine the value of the lots. Rather, Pray opined that in using the methodology, Allen made numerous mistakes, as outlined previously, that Pray described as unforgivable “cardinal sins,” unlike forgivable “venial sins.” (1 Trial Tr. at 144).

Moreover, the Court does not view Allen's compliance with USPAP standards as a determining factor as to the admissibility or reliability of his testimony. *Whitehouse Hotel Ltd. P'ship v. Comm'r,* 615 F.3d 321, 332 (5th Cir.2010). Compliance with USPAP Standards is not a substitute for a *Daubert* analysis. The nature and extent of Allen's deviations from the USPAP standards, however, weighed heavily against the credibility of his opinions, as discussed previously.

For these reasons, the Court finds that Allen's valuation analysis lacked credibility and did not satisfy the Title Companies' burden of proving the third option for measuring and limiting the damages of the Woodgreen Banks. The Court, therefore, finds that the extent of the Woodgreen Banks' damages is the least of the amount of insurance stated in schedule A or the amount of outstanding indebtedness.

H. Whether the Title Companies are entitled to a set off

The Title Companies seek a set off of the value of the lots, given that the Woodgreen Banks currently hold title to the lots. The Title Companies' request for a set off raises the same valuation issues previously addressed. What is the value of the lots subject to the Subdivision Ordinance? Given the absence of reliable evidence regarding the current value of the lots, the Court finds that in lieu of a set off, the Special Warranty Deeds (WB Exs. 9, 11, 13, 15) and the “Right–of–Way and Utility Easement” (WB Ex. 16) should be cancelled or rescinded in order to restore the parties to the *status quo* before the conveyances on August 18, 2010. Cancellation or rescission of the Special Warranty Deeds is consistent with paragraph 6(a)(ii), which provides that “[i]f the Company offers to purchase the indebtedness ..., the owner of the indebtedness shall transfer, assign, and convey the indebtedness and the insured mortgage, together with any collateral security, to the Company upon payment therefor.”(Policies 6(a)(ii)).

The Title Companies oppose rescission of the Special Warranty Deeds on the ground that the Woodgreen Banks chose monetary damages as

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their exclusive remedy for the breach of the Policies. (MVT Br. at 9). In Mississippi, "where rescission is not sought, the law seeks to place the victim in the economic position he would have enjoyed had he received what he bargained for." *Wall,* 562 So.2d at 1256. The Title Companies' argument confuses rescission of the Special Warranty Deeds with rescission of the Policies. A rescission of the Policies would bar monetary damages under the doctrine of "election of remedies." *Garris v. Smith's G & G, LLC,* 941 So.2d 228, 232 (Miss.Ct.App.2006) (citation omitted). It would require the Title Companies to return the premiums and would restore the parties to the *status quo* before the issuance of the Policies in 2004 and 2005. The rescission proposed by the Court, in contrast, leaves the Policies intact, is consistent with the "benefit of the bargain" rule and the "election of remedies" doctrine, and places the parties in *status quo* before the breach of the Policies on August 18, 2010.

CONCLUSION

In valuing the lots, the Title Companies asked Allen to assume there were no marketability problems, that is, that all owners of the Woodgreen Property would join together to sell the lots. In doing so, the Title Companies violated the fundamental concept of Mississippi law that a party who breaches a contract may not take advantage of its own wrong. *See Morris v. Macione,* 546 So.2d 969, 971 (Miss.1989). Allen's appraisal evaluated the Woodgreen Property under an impediment presented by the Subdivision Ordinance which did not exist when the Policies were issued and which the Title Companies themselves created by subdividing the Woodgreen Property. The Title Companies' own violation should not allow them to limit or reduce their obligations under the Policies.

The Court, therefore, concludes that the Woodgreen Banks are entitled to judgment against the Title Companies in an amount equal to the lesser of the amount of insurance stated in schedule A of the Policies or the amount of outstanding loan indebtedness, as follows:

1. Judgment in favor of First Alliance in the amount of $760,000 .00;

2. Judgment in favor of First State in the amount of $355,947.82; and

3. Judgment in favor of Patriot in the amount of $342,044.41.

In addition, the Woodgreen Banks are entitled to pre-judgment interest from August 18, 2010, and post-judgment interest calculated in accordance with 28 U.S.C. § 1961(a) from the date of the entry of final judgment until paid, and all costs of court. Upon payment in full of these amounts from the Title Companies to the Woodgreen Banks, the parties are restored to the positions they held before the conveyances on August 18, 2010. Toward that end, the Woodgreen Banks may mark the Special Warranty Deeds "cancelled" and return them to the Title Companies, so that the Title Companies remain the owners of the Woodgreen Property. The parties, however, are not precluded from implementing a different procedure so long as the effect is the same as a reconveyance of the Woodgreen Property to the Title Companies.

A separate final judgment shall be entered in accordance with Rules 7054 and 9021 of the Federal Rules of Bankruptcy Procedure.

SO ORDERED.

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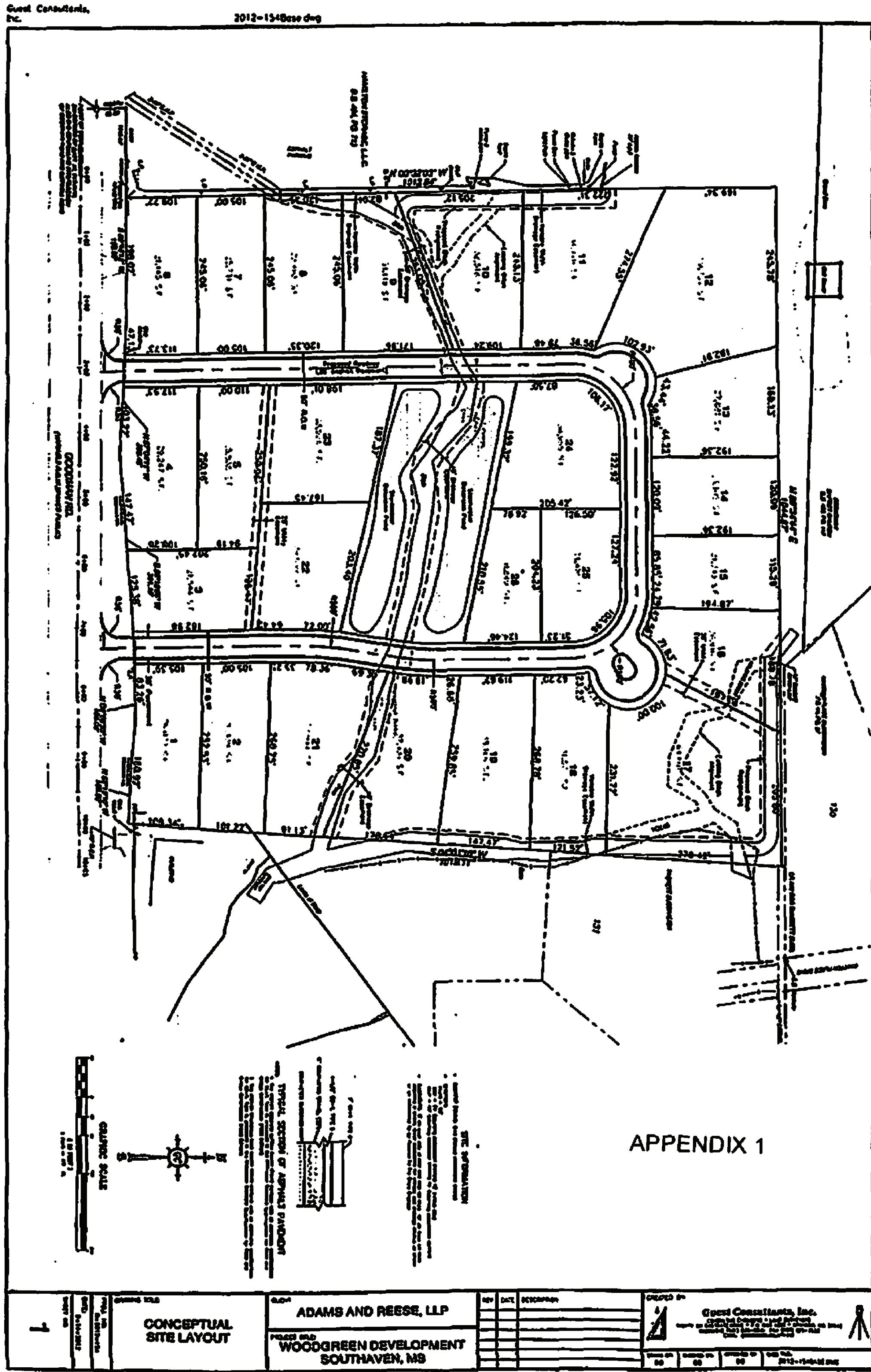

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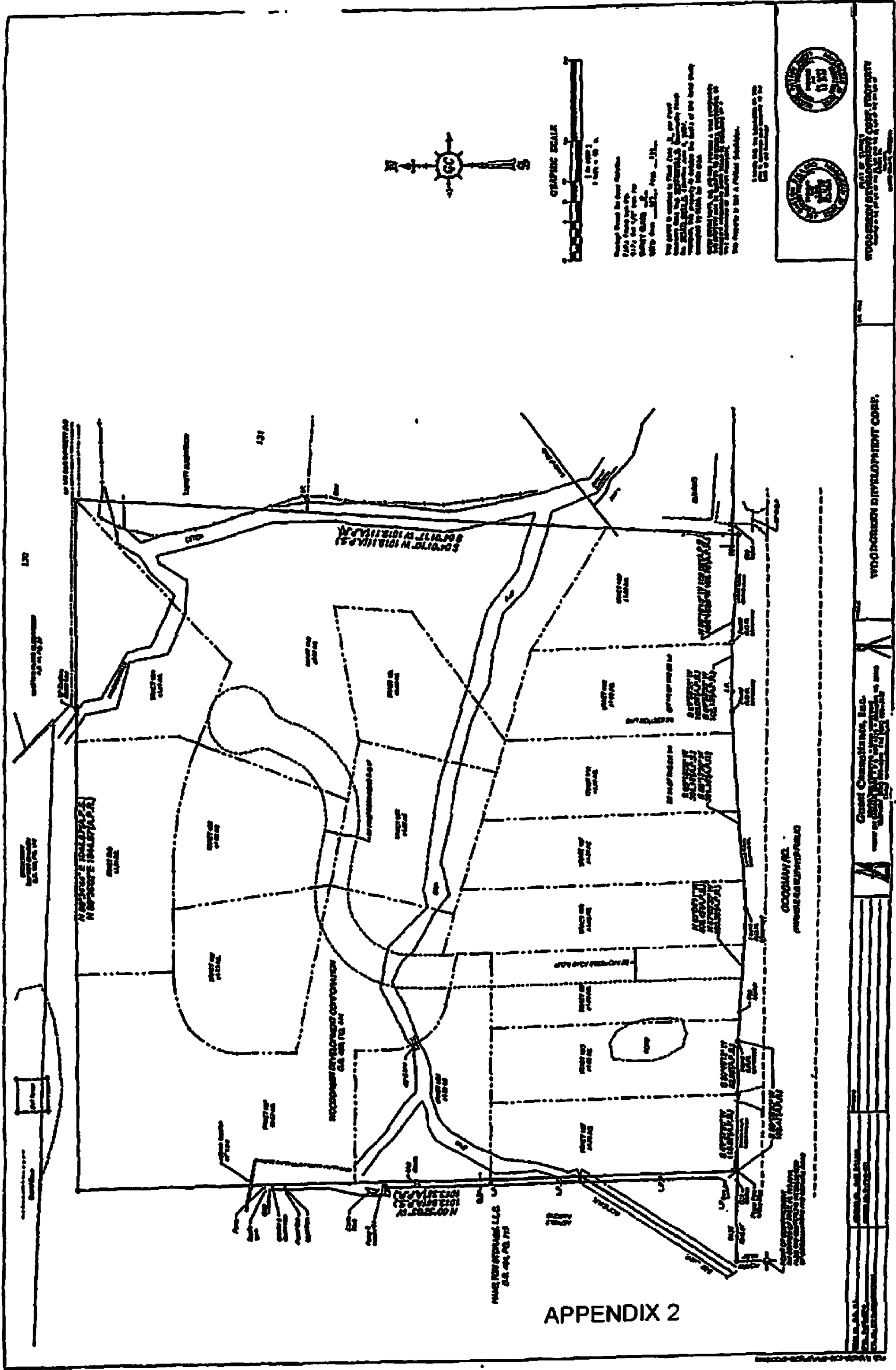
APPENDIX 2

Bkrtcy.S.D.Miss.,2013.
In re Evans
Slip Copy, 2013 WL 1788500 (Bkrtcy.S.D.Miss.)

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PUBLISHED

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

In re: BRYAN MATTHEW DAVIS; CARLA DENISE BRACEY-DAVIS; MARQUITA E. MOORE,
Debtors.

TIMOTHY P. BRANIGAN,
Plaintiff-Appellant,
and
TD BANK, N.A.,
Plaintiff,
v.
BRYAN MATTHEW DAVIS; CARLA DENISE BRACEY-DAVIS; MARQUITA E. MOORE,
Defendants-Appellees.

No. 12-1184

Appeal from the United States District Court
for the District of Maryland, at Greenbelt.
Peter J. Messitte, Senior District Judge.
(8:11-cv-01270-PJM; 8:11-cv-01718-PJM;
8:11-cv-01940-PJM)

Argued: December 4, 2012

Decided: May 10, 2013

Before NIEMEYER, KEENAN, and DIAZ, Circuit Judges.

Affirmed by published opinion. Judge Diaz wrote the majority opinion, in which Judge Niemeyer joined. Judge Keenan wrote a dissenting opinion.

COUNSEL

ARGUED: Timothy P. Branigan, LAW OFFICE OF TIMOTHY P. BRANIGAN, Laurel, Maryland, for Appellant. Seth W. Diamond, THE DIAMOND LAW GROUP, LLC, Silver Spring, Maryland, for Appellees. **ON BRIEF:** Laura J. Margulies, LAURA MARGULIES & ASSOCIATES, LLC, Rockville, Maryland, for Appellees Bryan Matthew Davis and Carla Denise Bracey-Davis; Morgan William Fisher, LAWRENCE & FISHER PLLC, Annapolis, Maryland, for Appellee Marquita E. Moore.

OPINION

DIAZ, Circuit Judge:

In this case, a Chapter 13 bankruptcy trustee, Timothy Branigan (the "Trustee"), challenges confirmation orders, entered by the bankruptcy court and affirmed by the district court, stripping off junior liens against debtors' residences. The Trustee argues that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") creates a per se rule barring lien-stripping in so-called "Chapter 20" cases.[1] BAPCPA, however, does not bar the orders entered by the bankruptcy court, and the stripping off of valueless liens—that is a lien secured by collateral without a single penny of value to support it—is otherwise consistent with the Bankruptcy Code. We therefore affirm.

[1]"Chapter 20" is a colloquial reference to a Chapter 13 bankruptcy filed within four years of a Chapter 7 bankruptcy that concluded with a discharge.

I.

We begin with a general overview of the relevant statutory framework, and then summarize the procedural history of the appeals.

A.

Chapter 7 of the Bankruptcy Code governs liquidation of a bankruptcy estate and "offer[s] debtors limited relief in return for the relinquishment of their nonexempt assets for ratable distribution among creditors." *Collier on Bankruptcy* ¶ 1300.02 (16th ed. 2012). For an individual debtor, this process involves the collection, liquidation, and distribution of nonexempt property. *See id.* ¶ 700.01. The process culminates in a discharge, which eliminates personal liability for debts not excepted from discharge, but leaves intact *in rem* claims. *Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991). In addition, the discharge serves as an injunction against efforts to collect discharged debts, unless the debtor has reaffirmed them. *See Collier on Bankruptcy* ¶ 700.05.

Chapter 13 of the Bankruptcy Code, "Adjustment of Debts of an Individual with Regular Income," on the other hand, is primarily focused on a plan of reorganization rather than liquidation. Unlike Chapter 7, Chapter 13 permits the debtor to "deal comprehensively with both unsecured and secured debts," particularly large secured claims. *Id.* ¶¶ 1300.01, 1300.02. In a Chapter 13 case, a debtor may propose a plan for paying creditors primarily out of the debtor's income. Thus, creditors receive ratable recoveries from future income, a protection not available to creditors in liquidation proceedings. The Chapter 13 plan "can provide for the payment of secured claims to permit the debtor to retain collateral for those claims and may provide for the cure of arrearages on long-term debts, such as home mortgages." *Id.* ¶ 1300.01. In addition, a Chapter 13 discharge excepts fewer types of debt than a Chapter 7 discharge. *Id.*

Congress enacted BAPCPA in 2005 "to correct perceived abuses of the bankruptcy system." *Milavetz, Gallop & Milavetz, P.A. v. United States*, 130 S. Ct. 1324, 1329 (2010). An overarching goal was to "help ensure that debtors who *can* pay creditors *do* pay them." *Ransom v. FIA Card Servs.*, 131 S. Ct. 716, 721 (2011). To that end, BAPCPA altered the Chapter 13 regime by adding

> new requirements to make payments to holders of domestic support obligations, requirements to file prepetition tax returns, changes in maximum plan length, protection for pension contributions and pension loan repayments, requirements for scheduling of the confirmation hearing, requirements for greater payments on many secured debts, new methods of calculating disposable income under section 1325(b), new requirements for preconfirmation payments, new requirements to obtain a discharge, including postpetition credit education in addition to the prepetition credit counseling briefing required for all debtors, new exceptions to the chapter 13 discharge, new limits on obtaining a chapter 13 discharge after a prior bankruptcy discharge and new provisions permitting plan modification to obtain health insurance.

Collier on Bankruptcy ¶ 1300.36[10] (footnotes omitted). Relevant to this appeal, BAPCPA provides additional protection for secured creditors. For example, creditors retain allowed secured claims until either payment of the underlying debt pursuant to nonbankruptcy law or discharge. Moreover, if a Chapter 13 case is dismissed or converted without completion of the bankruptcy plan, the holder of an allowed secured claim retains the lien to the extent recognized by applicable nonbankruptcy law. *See* 11 U.S.C. § 1325(a)(5)(B).

BAPCPA further provides that a debtor may not receive a Chapter 13 discharge within four years of filing a Chapter 7 petition that results in a discharge. 11 U.S.C. § 1328(f)(1).

Despite the discharge limitations imposed by BAPCPA, a Chapter 7 debtor may still wish to seek later relief under Chapter 13 "in order to cure a default through a plan, or simply to seek protection of the bankruptcy court and the automatic stay while paying debts in an orderly fashion through a plan." *Collier on Bankruptcy* ¶ 1328.06[1].

B.

On June 7, 2008, Bryan Matthew Davis and Carla Denise Bracey-Davis filed a Chapter 7 bankruptcy petition with the United States Bankruptcy Court for the District of Maryland. At the time, they ran a large monthly deficit, and Mrs. Bracey-Davis was unemployed. The Davises sought to discharge their unsecured debt, strip down[2] liens on their primary residence and a rental property, and obtain a loan modification to address mortgage arrears on the properties. After learning that lien-stripping was prohibited under Chapter 7, they nevertheless chose to proceed with their Chapter 7 case because they were ineligible to convert to a Chapter 13 case. They hoped, however, that their mortgage lenders would approve their pending loan modification applications. On September 17, 2008, they received a Chapter 7 discharge, which absolved them of personal liability on nonexempt debts but left their mortgage debt unchanged.

Thereafter, the Davises obtained gainful employment. They still had no savings, however, and large mortgage arrears, which they could not bring current, accrued. On September 4, 2009, they filed a Chapter 13 petition to reorganize their debts, repay mortgage arrears and consumer debt, and strip off junior liens. At the time, their principal home was valued at $270,000, and was encumbered by a first-priority lien with

[2]"In a 'strip off' the entire lien is removed, whereas in a 'strip down' a lien is bifurcated into secured and unsecured claims with only the unsecured claim component being removed." *Johnson v. Asset Mgmt. Group*, 226 B.R. 364, 365 n.3 (D. Md. 1998).

a balance of $275,373.59, a second-priority lien with a balance of $115,138.58, and a third-priority lien with a balance of $117,603.31.

On March 30, 2011, Bankruptcy Judge Wendelin I. Lipp granted the Davises' Amended Motion to Avoid Lien, which sought to strip off the third-priority lien on the Davises' home upon completion of the Chapter 13 plan. Judge Lipp reasoned that BAPCPA did not create a per se rule against lien-stripping in the Chapter 20 context. The court proceeded to consider, as it always does in any Chapter 13 case, whether the debtors filed their petition in good faith. Finding that the Davises had acted in good faith, Judge Lipp entered an order stripping off the third-priority lien on the Davises' home. J.A. 65-66. Judge Lipp subsequently entered orders stripping off the second and third liens on the Davises' rental property and confirming the Davises' bankruptcy plan. J.A. 67-72. Both the Trustee and the holder of the third-priority lien against the Davises' home, TD Bank, N.A., appealed to the district court, which affirmed.

C.

Marquita Moore filed a Chapter 7 petition on February 1, 2010, for which she received a discharge on October 20, 2010. One week later, Moore filed a Chapter 13 petition. Moore sought to pay an Internal Revenue Service priority claim and strip off a second lien, which had no value, on her principal home. The Trustee never contended that Moore filed her Chapter 13 petition in bad faith. On January 5, 2011, the bankruptcy court granted Moore's motion to strip off the second lien. Subsequently, the bankruptcy court confirmed Moore's plan and adopted Judge Lipp's rationale to overrule the Trustee's objection to the lien-stripping component of the confirmation order. The Trustee appealed, and the district court affirmed.[3]

[3]The district court consolidated these cases before affirming both without a written opinion.

We have jurisdiction to consider these appeals under 28 U.S.C. § 158(d).

II.

The question presented is whether BAPCPA precludes the stripping off of valueless liens by Chapter 20 debtors ineligible for a discharge. In a bankruptcy appeal, "we review the district court['s] decision de novo, effectively standing in its shoes to consider directly the findings of fact and conclusions of law by the bankruptcy court." *Morris v. Quigley (In re Quigley)*, 673 F.3d 269, 271 (4th Cir. 2012) (internal quotations omitted). "[W]e review legal conclusions by the bankruptcy court de novo and may overturn its factual determinations only upon a showing of clear error." *Id.* (internal quotations omitted).

A.

Before reaching the issue raised by the Trustee, we consider the threshold question of whether a bankruptcy court may strip off a valueless lien in a typical Chapter 13 proceeding. The answer, in the view of those circuits to have considered the question, is that a bankruptcy court may grant such relief. *See Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220 (9th Cir. 2002); *Lane v. W. Interstate Bancorp (In re Lane)*, 280 F.3d 663 (6th Cir. 2002); *Pond v. Farm Specialist Realty (In re Pond)*, 252 F.3d 122 (2d Cir. 2001); *Tanner v. FirstPlus Fin. (In re Tanner)*, 217 F.3d 1357 (11th Cir. 2000); *Bartee v. Tara Colony Homeowners Ass'n (In re Bartee)*, 212 F.3d 277 (5th Cir. 2000); *McDonald v. Master Fin. (In re McDonald)*, 205 F.3d 606 (3d Cir. 2000). We too have affirmed, albeit in unpublished opinions, the stripping off of valueless liens against principal residences in Chapter 13 cases. *See First Mariner Bank v. Johnson (In re Johnson)*, 407 F. App'x 713 (4th Cir. 2011); *Suntrust Bank v. Millard (In re Millard)*, 404 F. App'x 804 (4th Cir. 2010).

To exercise this authority, bankruptcy courts rely on sections 506 and 1322(b) of the Bankruptcy Code.[4] First, courts apply the valuation procedure in section 506(a):

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim.

In other words, a claim's status as secured or unsecured depends on the value of the collateral. Next, courts look to section 1322(b)(2), which provides that, subject to certain exceptions not relevant here, a Chapter 13 bankruptcy plan may

> modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims[.]

Applying this framework, a completely valueless lien is classified as an unsecured claim under section 506(a). Only then does a bankruptcy court consider the rights of lienholders under section 1322, which affords protection to holders of secured claims against principal residences. Section 1322, however, expressly permits modification of the rights of unsecured creditors. The end result is that section 506(a), which classifies valueless liens as unsecured claims, operates with section 1322(b)(2) to permit a bankruptcy court, in a Chapter 13 case, to strip off a lien against a primary residence with no

[4]All section references, unless otherwise indicated, are to the Bankruptcy Code, Title 11 of the United States Code.

value. *See, e.g.*, *Zimmer*, 313 F.3d at 1226-27; *Lane*, 280 F.3d at 668.

We recognize that the Supreme Court has interpreted section 1322(b)(2) as precluding a "strip down" of a partially secured lien against a principal residence in Chapter 13. That is, a debtor may not reduce an underwater mortgage to the value of the principal residence because partially secured lienholders are "holders of secured claims" protected against lien modification. *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 331-32 (1993). *Nobelman* notwithstanding, however, courts have generally permitted a "strip off" of completely valueless liens in Chapter 13 cases because, unlike the lienholder in *Nobelman*, holders of such liens are not "holders of secured claims" and, therefore, are not entitled to the protection of section 1322(b)(2).

We see no reason to depart from the conclusion of our sister circuits, as well as our own unpublished dispositions, on this issue. Accordingly, we hold that the Bankruptcy Code permits the stripping off of valueless liens in Chapter 13 proceedings.

B.

We are left with the question raised in this appeal: whether the 2005 enactment of BAPCPA precludes the stripping off of valueless liens by Chapter 20 debtors.

Under BAPCPA, after filing for Chapter 7 relief and receiving a discharge, a debtor is ineligible for a discharge in a Chapter 13 proceeding for four years. 11 U.S.C. § 1328(f)(1). As previously noted, following a Chapter 7 discharge, creditors may not seek a personal judgment against the debtor but may pursue recovery against the property securing the debt.

Notwithstanding the bar on discharges imposed by BAPCPA, we have held that a debtor may still take advantage of

the protections offered by Chapter 13 short of a discharge. *See Branigan v. Bateman (In re Bateman)*, 515 F.3d 272, 283 (4th Cir. 2008). In doing so, we said that "it is the ability to reorganize one's financial life and pay off debts, not the ability to receive a discharge, that is the debtor's 'holy grail.'" *Id.* We recognized that a debtor might pursue this course "to cure a mortgage, deal with other secured debts, or simply pay debts under a plan with the protection of the automatic stay." *Id.* (internal quotations omitted).

Bankruptcy courts are split on whether a debtor may strip off liens in a Chapter 20 case. *Compare In re Fisette*, 455 B.R. 177 (BAP 8th Cir. 2011) (concluding a Chapter 20 debtor may strip off liens), *and In re Dang*, 467 B.R. 227 (Bankr. M.D. Fla. 2012) (same), *and In re Okosisi*, 451 B.R. 90 (Bankr. D. Nev. 2011) (same), *and In re Tran*, 431 B.R. 230, 237 (Bankr. N.D. Cal. 2010) (same), *with In re Gerardin*, 447 B.R. 342 (Bankr. S.D. Fla. 2011) (holding that Chapter 20 debtors could not permanently strip off wholly unsecured junior liens), *and In re Victorio*, 454 B.R. 759 (Bankr. S.D. Cal. 2011) (same), *and In re Fenn*, 428 B.R. 494 (Bankr. N.D. Ill. 2010) (same), *and In re Jarvis*, 390 B.R. 600 (Bankr. C.D. Ill. 2008) (same).

The Trustee contends that lien-stripping is contingent on a debtor's ability to receive a Chapter 13 discharge. In support of this proposition, the Trustee points first to section 1325(a)(5)(B)(i)(I) of the Bankruptcy Code, which provides that a holder of a secured lien retains the lien until either the underlying debt is paid or there is a discharge. Because the debtors here are not eligible for a discharge, the Trustee contends that the liens must survive until paid in full. Next, the Trustee relies on section 1325(a)(5)(B)(i)(II)—which reinstates liens if the case is dismissed or converted without completion of the plan—for the proposition that Congress intended to preserve liens absent a discharge. *See also* 11 U.S.C. §§ 349(b)(1)(C) (providing that any lien stripped under section 506(d) is reinstated upon dismissal),

348(f)(1)(C)(i) (providing that a creditor holding security shall continue to be secured by that security unless the claims have been paid in full as of the date of conversion, notwithstanding any valuation). Finally, the Trustee contends that, under section 524, a discharge operates as an injunction against any action to enforce a debt. Absent this injunction, which is precluded in the Chapter 20 context by section 1328(f), the Trustee says there is no mechanism to enforce the stripping off of a lien.

The Trustee also urges that Supreme Court precedent reinforces his statutory argument. Specifically, the Trustee directs our attention to *Dewsnup v. Timm*, 502 U.S. 410 (1992), where, says the Trustee, petitioners were not allowed, in a Chapter 7 case, to strip down junior liens on claims that had been fully allowed pursuant to section 502, despite the fact that there was no equity in the collateral.

In *Dewsnup*, the Court considered whether section 506(d) (providing that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void") permits a Chapter 7 debtor to strip down a creditor's lien to the value of the collateral. *See* 502 U.S. at 411-12. The Court held that "§ 506(d) does not allow petitioner to 'strip down' [a creditor's] lien, because [the creditor's] claim is secured by a lien and has been fully allowed." *Id.* at 417. The Court noted that section 506 "and its relationship to other provisions of [the Bankruptcy] Code do embrace some ambiguities." *Id.* at 416. Given that ambiguity, the Court declined to give "allowed secured claim" the same meaning in section 506(d) as in section 506(a) and concluded that section 506 by itself is insufficient to effectuate lien-stripping.

The Trustee contends that the debtors are attempting an end run around *Dewsnup*'s prohibition of Chapter 7 lien-stripping and that construing sections 1325(a)(5) and 1328(f) to bar lien-stripping by Chapter 20 debtors is consistent with BAPCPA's goal of rebalancing the scales in favor of creditors.

The debtors respond that because BAPCPA left intact the operative lien-stripping provisions of the Code, Congress did not intend to alter the ability of bankruptcy courts to enter lien-stripping orders in Chapter 13 cases. And this is so regardless of the availability of a discharge. A discharge, the debtors say, extinguishes only *in personam* liability. *See Johnson*, 501 U.S. at 84 ("[A] bankruptcy discharge extinguishes only one mode of enforcing a claim—namely, an action against the debtor *in personam*—while leaving intact another—namely, an action against the debtor *in rem*."). Because the debtors here have already discharged their *in personam* liability in the prior Chapter 7 proceedings, they have no need for a discharge with respect to the liens. The debtors also say that once the bankruptcy court has entered an order stripping off liens, no provision of the Bankruptcy Code reinstates the liens once the plan is completed and the case closed. Thus, "the provisions of the plan become permanent [upon completion of the plan], and [a lien-stripping order] is, similarly, permanent." *Okosisi*, 451 B.R. at 100.

The debtors also contend that the provisions relied on by the Trustee are inapplicable. Specifically, section 1325(a)(5), which provides generally for the treatment of *allowed* secured claims, comes into play only after the claims have been valued under section 506(a), and is therefore irrelevant to the unsecured claims at issue here. Similarly, the debtors say that the Trustee improperly relies on other provisions of the Code that apply when a case is dismissed or converted without completion of the plan, such as sections 1325(a)(5)(B)(i)(II), 349(b)(1)(C), and 348(f)(1)(C)(i). In a successful Chapter 20 case, on the other hand, the plan is completed, and the case is closed administratively without dismissal or conversion.

C.

Although the Trustee's arguments are not insubstantial, we conclude that the Bankruptcy Code permits the result advanced by the debtors. The starting point for our analysis

is *Bateman*, where we held that a Chapter 13 debtor need not be eligible for a discharge in order to take advantage of the protections afforded by Chapter 13. 515 F.3d at 283. Therefore, if the Bankruptcy Code provides a mechanism for stripping off worthless liens absent a discharge, a debtor may avail himself of that relief.

We are satisfied that the Bankruptcy Code does provide such a mechanism. To begin with, the debtors' junior liens in this case are worthless and, therefore, unsecured claims under section 506(a). While *Dewsnup* admittedly requires that section 506 operate in tandem with another statutory provision to effectuate lien-stripping, section 506 has always operated in tandem with section 1322(b) to strip liens in Chapter 13 cases. BAPCPA did not amend sections 506 or 1322(b), so the analysis permitting lien-stripping in Chapter 20 cases is no different than that in any other Chapter 13 case.

Courts concluding to the contrary rely on section 1325(a)(5). *See, e.g.*, *Gerardin*, 447 B.R. at 346-48. But this provision applies only to an "allowed secured claim." We agree with the debtors that a court must first value the claim under section 506(a) before proceeding further. Because the liens in these cases have no value, they are wholly unsecured claims, which leaves no role in the analysis for section 1325(a)(5).

Relying on *Gerardin*, among other cases, the Trustee argues that any lien secured by real property, even if worthless, is a secured claim for purposes of section 1325. We, however, cannot square *Gerardin* and similar cases with the Supreme Court's opinion in *Nobelman*, which valued the claim in that case under section 506 before analyzing whether section 1322 barred its modification. *See* 508 U.S. at 328. If, as the Trustee insists, it were not necessary to first value the claim pursuant to section 506(a), the analysis in *Nobelman* would be superfluous. *See id.* Rather, the Court could have simply held that, because the lien was secured by a primary

residence, it falls within the anti-modification provision of section 1322(b), regardless of the value of the collateral.

We do not take lightly the Trustee's assertion that permitting lien-stripping in Chapter 20 cases creates an end run around *Dewsnup*'s bar to such relief in Chapter 7 cases. But the Trustee's premise ignores the equally reasonable view that Congress intended to leave intact the normal Chapter 13 lien-stripping regime where a debtor could otherwise satisfy the requirements for filing a Chapter 20 case. In that regard, the law already provides a mechanism for preventing abuse of the bankruptcy process without the creation of a per se rule against lien-stripping, as bankruptcy courts are bound to carefully scrutinize filings for good faith and dismiss cases where the debtor attempts to use a Chapter 20 procedure solely to strip off a lien. Likewise, creditors are also protected by section 349(b)(1)(C), which provides that a lien springs back if the case is dismissed.

Finally, the unavailability of a discharge in the Chapter 20 context is not determinative. It bears emphasizing that a bankruptcy discharge alters *in personam* rights, precluding an action against the debtor for personal liability. *Johnson*, 501 U.S. at 84. In contrast, the lien-stripping orders at issue here alter *in rem* liability where the creditor's lien has no value. For that reason we are persuaded that, upon completion of the plan, its provisions—including any orders stripping off valueless liens—become permanent, even in the absence of a discharge.

Our good colleague in dissent says that our holding creates a situation where unsecured creditors are treated more favorably than secured creditors. However, this conclusion does not acknowledge the distinction between *in rem* and *in personam* liability. While the dissent correctly notes that an unsecured creditor's *in personam* claim survives a Chapter 20 proceeding because of the absence of a discharge, the same is true for any *in personam* claim a secured creditor may have.

All *in personam* claims survive a Chapter 20 proceeding, and creditors are treated equally in that respect. We simply hold today that the bankruptcy court may strip the *in rem* component of a valueless lien. It is an apples-to-oranges comparison to posit that unsecured creditors, who have no *in rem* rights at all, are treated more favorably because a limited class of secured creditors are stripped of their *in rem* claims. Our dissenting colleague also overlooks the bankruptcy court's duty to dismiss Chapter 20 cases filed in bad faith, which we think alleviates much of the concern with lien stripping in this context.

III.

In sum, although BAPCPA clearly tipped the bankruptcy scales back in the direction of creditors, we find nothing in the Act to suggest that Congress intended to bar lien-stripping of worthless liens in Chapter 20 proceedings. This, we conclude, is the most sensible reading of a complex statutory scheme that admittedly "abounds with arbitrary distinctions." *Lane*, 280 F.3d at 669. We therefore affirm the judgment of the district court.

AFFIRMED

BARBARA MILANO KEENAN, Circuit Judge, dissenting:

I respectfully dissent. Under the majority's holding, a creditor whose rights are secured by real property with no present value to support the lien, is treated less favorably than a wholly unsecured creditor. I would conclude that this result is anomalous and is not permitted upon application of the BAPCPA amendments.

In my view, while the BAPCPA amendments to 11 U.S.C. § 1325(a)(5)(B)(i) and § 1328(f)[1] do not alter the statutory

[1]*See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, 80, 87.

provisions allowing a typical Chapter 13 debtor to strip off a secondary mortgage secured by property with no present value to support the lien (valueless junior mortgage), those amendments prevent a Chapter 20 debtor from eliminating a valueless junior mortgage. In particular, Section 1325(a)(5)(B)(i) operates to prohibit such Chapter 20 debtors, who file a Chapter 13 case within four years of filing a Chapter 7 case that resulted in a discharge, from entirely and permanently eliminating a valueless junior mortgage.

The provisions that permit a typical Chapter 13 debtor to strip off a valueless junior mortgage are 11 U.S.C. § 506(a), which allows bifurcation of a claim secured by property into secured and unsecured components based on value, and 11 U.S.C. § 1322(b)(2), which permits modification of rights of creditors holding certain secured claims and all unsecured claims. However, under Section 1325(a)(5)(B)(i), a Chapter 13 plan must provide that a holder of an "allowed secured claim" will retain its lien until the earlier of (1) full payment of the debt as determined under non-bankruptcy law or (2) discharge.

The majority determines that Section 1325(a)(5) is inapplicable, because the claims at issue are not "allowed secured claims" based on the valuation provision of Section 506(a). In my view, this is a flawed interpretation of the term "allowed secured claim." The term "allowed secured claim" in Section 1325(a)(5) is not defined by, or predicated on, an application of Section 506(a). *In re: Ballard*, 526 F.3d 634, 640-41 (10th Cir. 2008) (discussing application of Section 1325(a)(5) in the context whether the surrender of a motor vehicle under Section 1325(a)(5)(C) fully satisfied the claim). Instead, Section 506(a) provides a method for the judicial valuation of an allowed secured claim, without altering the secured status of a creditor. *See In re Price*, 562 F.3d 618, 623 (4th Cir. 2009); *see also Dewsnup v. Timm*, 502 U.S. 410, 417 (1992) (holding that the valuation permitted by § 506(a) does not determine the meaning of "allowed secured claim" in § 506(d)). There-

fore, the term "allowed secured claim" merely describes (1) a claim, which is a "right to payment" or a "right to an equitable remedy" as defined in 11 U.S.C. § 101(5); (2) that is "allowed," meaning "not objected to by an interested party" under 11 U.S.C. § 502(a); and (3) that is "secured."

The claims at issue in the present cases are allowed and are secured by the debtors' real property. The claims remained secured by the debtors' real property even after the debtors received Chapter 7 discharges removing the personal liability component of their debts. *See Johnson v. Home State Bank*, 501 U.S. 78, 83 (1991) ("A creditor's right to foreclose on the mortgage survives or passes through the bankruptcy") (citing 11 U.S.C. § 522(c)(2)). And, as the majority acknowledges, the in rem portion of the claims survived the debtors' Chapter 7 discharges. *See id.*

Because the present debtors' Chapter 13 plans must comply with Section 1325(a)(5), the junior mortgagee creditors in these cases have "allowed secured claims" against the debtors' bankruptcy estates. Under Section 1325(a)(5)(B)(i),[2] the debtors' Chapter 13 plans must provide that the junior mortgagee creditors retain their liens on the properties until the earlier of (1) full payment by the debtors in the context of non-bankruptcy law, or (2) discharge. Here, the debtors have not fully paid their outstanding debts to the junior mortgagee creditors, and the debtors are prevented by Section 1328(f) from obtaining a discharge in their Chapter 13 cases, given their recent Chapter 7 discharges. Therefore, the provisions in Section 1325(a)(5)(B)(i) and Section 1328(f) together prohibit Chapter 20 debtors from stripping off their valueless junior mortgages and require retention of the liens of the junior mortgagee creditors.

[2]Subsections 1325(a)(5)(A) and (C) are not relevant in the present cases because it is undisputed, with regard to paragraph (A), that the holders of the claims have not "accepted" the plans, and, with regard to paragraph (C), that the debtors have not surrendered the property securing the claims.

Contrary to the majority's contention, the Supreme Court's analysis in *Nobelman v. American Savings Bank*, 508 U.S. 324 (1993), supports, rather than impedes, the above interpretation of the term "allowed secured claim" in Section 1325(a)(5). *See Ante* at 13-14. In its opinion in *Nobelman*, the Court focused on the interplay between Section 506(a) and Section 1322(b)(2). The Court held that the valuation provided for in Section 506(a) did not automatically adjust downward the amount of a mortgage for treatment in a debtor's Chapter 13 plan, because Section 1322(b)(2) otherwise protected the bank's rights, which were secured by an interest in the debtor's principal residence. *Id.* at 328-29. The Court held that, therefore, the amount of the debt owed to the bank was unaffected by the earlier valuation of that claim under Section 506(a). *Id.*

In its analysis, the Court explained that although Section 506(a) provides for "a judicial valuation of the collateral to determine the status of the bank's secured claim," such valuation did not affect a secured creditor whose rights otherwise were protected by a different statute, in that case, Section 1322(b)(2). *Id.* Employing this analysis, I would conclude that, like the creditor in *Nobelman*, the rights of the creditors in the present cases are not altered by the valuation process of Section 506(a) for allowed secured claims, because Section 1325(a)(5)(B)(i) otherwise protects the rights of such holders by providing that they retain their lien until the earlier of "payment of the underlying debt as determined under non-bankruptcy law" or "discharge" under Section 1328. 11 U.S.C. § 1325(a)(5)(B)(i)(I)(aa), (bb). Thus, the liens of the creditors in the present cases are fully protected by Section 1325(a)(5)(B)(i), consistent with the definition of the term "allowed secured claim" applied by the Supreme Court in *Dewsnup*. *See* 502 U.S. at 417.

Congress enacted BAPCPA "to correct perceived abuses of the bankruptcy system." *Ransom v. FIA Card Servs., N.A.*, 131 S.Ct. 716 (2011) (addressing the "means test" adopted to

"ensure that debtors who can pay creditors do pay them")(emphasis omitted). The BAPCPA addition of Section 1328(f) curtails the relief available to serial-filing debtors. *See In re Victorio*, 454 B.R. 759, 779 (Bankr. S.D. Cal. 2011), *aff'd*, 470 B.R. 545 (S.D. Cal. 2012).

Additionally, Section 306 of the BAPCPA amendments, which added subsection (i)(I) to Section 1325(a)(5)(B), was entitled "Giving Secured Creditors Fair Treatment in Chapter 13." Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23, 80. The legislative history of this section demonstrates that Congress included these additions "to require – as a condition of confirmation – that a chapter 13 plan provide that a secured creditor retain its statutory lien until the earlier of when the underlying debt is paid or the debtor receives a discharge." H. R. Rep. No. 109-31, pt. 1 at 71-72 (2005).

The above construction of Section 1325(a)(5) and Section 1328(f), which prohibits Chapter 20 debtors from stripping off valueless junior mortgages, also makes practical sense when considering the effect of a Chapter 13 plan that does not conclude with a discharge. As this Court has explained, even though a Chapter 20 debtor is prohibited from obtaining a discharge in his Chapter 13 case under § 1328(f), he may file a Chapter 13 case and take advantage of the other protections available. *Branigan v. Bateman*, 515 F.3d 272, 283 (4th Cir. 2008) (explaining protections). However, upon completion of the Chapter 13 plan, when there is no accompanying discharge, the debtor's status with his creditors is returned to the status quo ante. *See Victorio v. Billingslea*, 470 B.R. 545, 556 (S.D. Cal. 2012) (citing *In re Victorio*, 454 B.R. at 779). As a result, any personal liability for the remaining balances on unsecured debt, such as debt accumulated on a personal credit card, is not eliminated by discharge and those unsecured creditors can seek payment on the outstanding debt upon plan completion, outside of bankruptcy. *See id.* In contrast, under the majority's holding, when there is no discharge upon com-

pletion of a Chapter 13 plan the creditors with security interests in real property are not returned to the status quo ante and cannot pursue in rem claims at the conclusion of the Chapter 13 plan.

While the majority suggests that the comparison between secured creditors and unsecured creditors in this context is akin to comparing apples and oranges, that is precisely the point. These types of creditors are distinct and are not treated equally under the Bankruptcy Code. The distinguishing factor between secured and unsecured creditors is that secured creditors have two methods of recouping debt: in personam liability against the debtor and in rem liability against the collateral. The majority's position would equalize the status of these creditors by eliminating the secured creditor's in rem claim.

Such a result turns on its head the basic bankruptcy principle that secured creditors are treated more favorably than unsecured creditors. *See In re Gerardin*, 447 B.R. 342, 351-52 (Bankr. S.D. Fla. 2011) (citing *Nobelman*, 508 U.S. at 329 and *Dewsnup*, 502 U.S. at 417). The result reached by the majority also undermines the Supreme Court's repeated respect for the bargained-for rights of mortgagors and their mortgagees as set forth in security instruments. *See Nobelman*, 508 U.S. at 329; *Dewsnup*, 502 U.S. at 417. Therefore, I would hold that the debtors' Chapter 13 plans were required to comply with the terms of Section 1325(a)(5), and that the debtors were not permitted to strip off the valueless junior mortgages. Accordingly, I would reverse the district court's judgment approving the Chapter 13 confirmation orders.

FILED

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OF THE NINTH CIRCUIT

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	BAP No. EC-12-1419-DJuMk
MICHAEL TRENT SHOWALTER, Debtor.	Bk. No. 12-22720
MICHAEL TRENT SHOWALTER, Appellant,	
v.	**MEMORANDUM**[1]
J. MICHAEL HOPPER, Chapter 7 Trustee, Appellee.	

Argued and Submitted on March 22, 2013
at Sacramento, California

Filed - April 11, 2013

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

Honorable Michael S. McManus, Bankruptcy Judge, Presiding

Appearances: Albert M. Kun, Esq., argued for Appellant Michael Trent Showalter; J. Luke Hendrix, Esq., argued for Appellee J. Michael Hopper, Trustee.

Before: DUNN, JURY, and MARKELL, Bankruptcy Judges.

[1] This disposition is not appropriate for publication. Although it may be cited for whatever persuasive value it may have (see Fed. R. App. P. 32.1), it has no precedential value. See 9th Cir. BAP Rule 8013-1.

The debtor Michael T. Showalter ("Debtor") appeals the bankruptcy court's order sustaining the chapter 7[2] trustee's ("Trustee") objection to the Debtor's homestead exemption claim in an undivided one-third interest in a single-family residence property located in Lecanto, Florida (the "Florida Property") pursuant to California Code of Civil Procedure ("C.C.P.") § 704.920. We AFFIRM.

FACTS

There is no material dispute between the parties as to the factual record in this appeal. Where they differ is in the implications from the facts in the record.

I. The History of the Debtor's Connections with the Florida Property

The Florida Property is about 4.76 acres, improved by a home, a shed and two pump houses. Debtor's mother and step-father bought the Florida Property in the 1960's. Debtor lived with his family at the Florida Property from the 1960's until some time during the 1970's. Debtor testified at his deposition that he lived at the Florida Property for "a couple years in there in the '80's." He further testified that he lived at the Florida Property for a period of months in the early 1990's. From 1994 to 2000, the Debtor lived at two different locations in Orlando, Florida with his wife and son. From 2000 through the date of his bankruptcy filing in 2012, the Debtor lived with his

[2] Unless otherwise indicated, all chapter and section references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532.

wife and son in a rental property in Vallejo, California (the "Vallejo Property"). After his bankruptcy filing and divorce, the Debtor moved to a different rental property in Vallejo, California.

The last time the Debtor visited the Florida Property was for a period of about three weeks in April 2008 after his mother passed away, when he stayed at the Florida Property with his sister and "some relatives." During that time, his wife and son remained at the Vallejo Property.

The Debtor inherited an undivided one-third interest in the Florida Property from his mother. There is no evidence in the record that Debtor has paid any utility bills or insurance for the Florida Property. The Debtor did testify that he had paid to reroof the residence on the Florida Property and shared in the payment of real property taxes.

On January 10, 2012, in Vallejo, California, the Debtor signed a Homestead Declaration ("Homestead Declaration") with respect to the Florida Property that was recorded in Florida on January 17, 2012. In the Homestead Declaration, the Debtor stated, based on his personal knowledge before a notary public, that: "The above declared homestead is my principal dwelling." He further stated that: "I am currently residing on that declared homestead." Id. Both statements were patently untrue.[3]

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[3] In his deposition, the Debtor stated that he talked about signing the Homestead Declaration with his siblings in November 2011. However, under the circumstances of this case, a reasonable assumption can be made that the signing and recording of the Homestead Declaration was part of the Debtor's (continued...)

II. Bankruptcy Proceedings

The Debtor filed his chapter 7 bankruptcy petition on February 13, 2012. The Trustee is the duly appointed trustee in the Debtor's chapter 7 case. In the petition, the Debtor gave his address as the Vallejo Property. In his Schedule A, he included his one-third interest in the Florida Property valued at $45,000. In his Schedule C, the Debtor claimed an exemption for his interest in the Florida Property for a value of $55,000 under C.C.P. § 704.910. He did not identify any personal property that he owned at the Florida Property on his Schedule B, and he did not claim an exemption in any such property on his Schedule C. In his Statement of Financial Affairs, in response to Item #15, the Debtor indicated that he had not resided in any property other than the Vallejo Property during the three years preceding his bankruptcy filing.

In the early stages of his chapter 7 case, the Debtor amended his claimed exemptions on Schedule C twice. In his first amended Schedule C ("First Amendment"), filed on April 11, 2012, he claimed an exemption in his interest in the Florida Property under C.C.P. § 704.910 and Article X, § 4 of the Florida Constitution. In his second amended Schedule C ("Second Amendment"), filed on May 11, 2012, he returned to his original position and claimed an exemption in his interest in the Florida

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[3](...continued) prebankruptcy planning, as at the upper left-hand corner of the Homestead Declaration, the recording officer is directed to mail the Homestead Declaration after recording to Albert Kun, Esq., 381 Bush Street, #200, San Francisco, CA 94104, the Debtor's bankruptcy counsel.

Property under C.C.P. § 704.910 only.

In the meantime, on April 18, 2012, the Trustee objected ("First Objection") to the Debtor's exemption claim for his interest in the Florida Property, arguing that the Debtor's Homestead Declaration was invalid because the Debtor did not reside on the Florida Property when the Homestead Declaration was recorded.

On May 21, 2012, the bankruptcy court heard argument on the First Objection, which by then applied with respect to the Second Amendment. Following the hearing, the bankruptcy court sustained the First Objection because C.C.P. § 704.910 is a definitional section of the California Code of Civil Procedure that includes no provision for a "debtor to claim an exemption in any property." The bankruptcy court made clear that its decision was without prejudice, but it was up to the Debtor to claim an appropriate exemption under applicable law. The bankruptcy court also decided not to address the First Objection to the extent that it referenced Article X, § 4 of the Florida Constitution, as in light of the Second Amendment, "the debtor is no longer asserting the exemption claim under the Florida Constitution." The bankruptcy court's decision on the First Objection was documented by a minute order entered on May 21, 2012. That order was not appealed.

On May 30, 2012, the Debtor amended his Schedule C a third time ("Third Amendment"), claiming an exemption in his interest

in the Florida Property under C.C.P. § 704.920.[4] C.C.P. § 704.920 provides:

> A dwelling in which an owner or spouse of an owner resides may be selected as a declared homestead pursuant to this article by recording a homestead declaration in the office of the county recorder of the county where the dwelling is located. From and after the time of recording, the dwelling is a declared homestead for the purposes of this article.

On June 25, 2012, the Trustee objected ("Second Objection") to the homestead exemption claim set forth in the Third Amendment. The Trustee argued that whether or not a homestead declaration was recorded, in order to have a valid homestead under California law, the Debtor had to reside on the subject property on the date of the declaration, and Debtor did not reside on the Florida Property when the Homestead Declaration was signed or recorded. In addition, the Trustee argued that even if the Homestead Declaration had any validity independent of the fact that the Debtor did not live on the Florida Property, under California law, a homestead by declaration would only apply with respect to a voluntary sale and was ineffective with respect to the Trustee's involuntary hypothetical judgment lien sale of the Debtor's interest in the Florida Property as of the bankruptcy petition date, citing Kelley v. Locke (In re Kelley), 300 B.R. 11, 19-20 (9th Cir. BAP 2003). Finally, the Trustee argued that Debtor's untrue statement in the Homestead Declaration that he currently was residing at the Florida Property demonstrated bad faith that should preclude allowance of the Debtor's homestead

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[4] The Debtor never claimed an exemption in any personal property at the Florida Property in any version of his Schedule C that he filed.

claim.

The Debtor responded that the Florida Property was his domicile, and his testimony was that the Florida Property was his family home, to which he intended to return with his son when his divorce was final. Debtor's response was supported by his Declaration.

The bankruptcy court heard the Second Objection on July 30, 2012 (the "Hearing"). During argument at the Hearing, the bankruptcy court confirmed its understanding that the property to which a valid claim of homestead would attach had to be the principal abode of the Debtor, and the Debtor did not reside at the Florida Property on the petition date or thereafter. The bankruptcy court further stated that it did not find the Debtor's statements credible that he intended to move back to the Florida Property to live. Ultimately, the bankruptcy court sustained the Second Objection. Its decision was memorialized in a minute order ("Minute Order") entered on July 30, 2012.

The Debtor timely appealed.

JURISDICTION

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

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ISSUE PRESENTED[5]

Did the bankruptcy court err in sustaining the Second Objection?

STANDARDS OF REVIEW

We review issues of statutory interpretation and conclusions of law de novo. Ransom v. MBNA Am. Bank, N.A. (In re Ransom), 380 B.R. 799, 802 (9th Cir. BAP 2007), aff'd, 577 F.3d 1026 (9th Cir. 2009), aff'd, 131 S. Ct. 716 (2011).

We review a bankruptcy court's fact findings for clear error. Honkanen v. Hopper (In re Honkanen), 446 B.R. 373, 378 (9th Cir. BAP 2011). A finding of fact is clearly erroneous if the appellate tribunal, after reviewing the entire record, has a definite and firm conviction that a mistake has been made. Hoopai v. Countrywide Home Loans, Inc. (In re Hoopai), 369 B.R. 506, 509 (9th Cir. BAP 2007). If the bankruptcy court's view of the evidence is plausible in light of the record considered in its entirety, we may not reverse even if we are convinced that we might have made different findings. Anderson v. City of Bessemer City, N.C., 470 U.S. 564, 574 (1985); Int'l Ass'n of Firefighters, Local 1186 v. City of Vallejo (In re City of Vallejo), 408 B.R. 280, 289 (9th Cir. BAP 2009). "When there are two permissible views of the evidence, the factfinder's choice

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[5] In Appellant's Opening Brief at 5, the Debtor states seven separate issues, most of which can be distilled into the single issue stated above. We deal with two of Debtor's stated issues infra, one of which reflects a misunderstanding by the Debtor and his counsel of the bankruptcy court's perception of Ninth Circuit authority and one of which is waived.

between them cannot be clearly erroneous." Anderson, 470 U.S. at 574. The bankruptcy court's credibility determinations further are entitled to heightened deference. See id. at 575.

In evaluating whether a 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 appropriate 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).

DISCUSSION

A. The Bankruptcy Court Did Not Ignore the Ninth Circuit's Decision in In re Arrol.

In his Opening Brief, Debtor's first argument is that the bankruptcy court abused its discretion by failing to follow the controlling Ninth Circuit authority of Arrol v. Broach (In re Arrol), 170 F.3d 934 (9th Cir. 1999). In Arrol, the debtor, Mr. Arrol ("Arrol"), owned a home in Michigan (the "Residence"). He experienced financial problems that ultimately resulted in his filing for bankruptcy protection under chapter 7. However, a bankruptcy filing presented a problem for Arrol in that he valued the Residence at $75,000, and the Michigan homestead exemption was only $3,500. Arrol solved that problem by moving temporarily to California, which had a $75,000 homestead exemption, in October 1994. He moved back to the Residence in Michigan in November 1996 and continued to reside there at all times relevant

to his bankruptcy case and the appeals that led to the Ninth Circuit's decision. Arrol filed his bankruptcy petition on January 9, 1997, claiming a $75,000 California homestead exemption in the Residence. In re Arrol, 170 F.3d at 935.

The trustee objected, arguing that under the Bankruptcy Code and California conflict of law principles, Arrol could claim no more than the $3,500 Michigan homestead exemption in the Residence. The bankruptcy court overruled the trustee's objection to Arrol's California homestead exemption claim, and its decision was affirmed by the district court and ultimately, by the Ninth Circuit. Id.

Two holdings of the Ninth Circuit in Arrol are relevant to this appeal: The Ninth Circuit interpreted § 522(b)(2)(A), which at the time of the Arrol decision provided in relevant part that a debtor could claim as exempt,

> any property that is exempt under . . . State or local law that is applicable on the date of the filing of the petition at the place in which the debtor's domicile has been located for the 180 days immediately preceding the date of the filing of the petition, or for a longer portion of such 180-day period than in any other place . . . .

Id. The Ninth Circuit first concluded that "[t]he plain language of section 522(b)(2)(A) points us to the state's exemption laws, not to its conflict of laws rules." The specific language of the statute allowed exemptions to be claimed under state laws applicable on the filing date. Since Arrol was domiciled in California for a longer portion of the 180 days preceding his bankruptcy filing than in Michigan, California homestead exemption law applied. Id. at 935-36.

Second, the Ninth Circuit held that since the California

homestead exemption law did not limit its application to homes within California, Arrol could properly claim his California homestead exemption as to the Residence in Michigan. Id. at 936-37.

Debtor argues that the bankruptcy court erred in this case in not applying Arrol. Appellant's Opening Brief at 7. However, in deciding the Second Objection, the bankruptcy court was fully cognizant of the Arrol decision. In fact, in the Minute Order, the bankruptcy court stated:

> The Ninth Circuit has determined that this California homestead statute is not limited in its application to California property. It may be claimed in a residence located outside of California. See In re Arrol, 170 F.3d 935 (9th Cir. 1999).

In addition, during colloquy at the Hearing, the bankruptcy court stated its awareness that exemption statutes are "supposed to be interpreted liberally in favor of the debtor." The bankruptcy court simply disagreed that the Debtor's circumstances tracked closely enough with Arrol's to mandate direct application of the second Arrol holding in this case.

Based on the record in this appeal, we conclude that the bankruptcy court did not abuse its discretion by applying an incorrect legal standard. The real dispute focuses on Debtor's arguments that the bankruptcy court clearly erred in its fact findings, which we discuss in Section C infra.

B. Debtor Raises No Issue As To the Bankruptcy Court's Interpretation of California Homestead Exemption Law.

California has opted out of the exemption scheme provided for in the Bankruptcy Code; so, in this California bankruptcy case, California exemption law applies. Orange County's Credit

Union v. Garcia (In re Garcia), 2013 WL 791544 (9th Cir. March 5, 2013).

As noted above, in the Third Amendment, the Debtor claimed an exemption in his interest in the Florida Property under C.C.P. § 704.920. In the Minute Order, after quoting C.C.P. § 704.920, the bankruptcy court discussed its interpretation as follows:

> "The Article 5 exemption requires that a party record a declaration stating that the residence is the 'principal dwelling' of the declarant or his or her spouse." Kelley v. Locke (In re Kelley), 300 B.R. 11, 17-18 (B.A.P. 9th Cir. 2003) (citing [C.C.P.] § 704.930(a)(3)).
>
> "Pursuant to California law, the factors a court should consider in determining residency for homestead purposes are physical occupancy of the property and the intention with which the property is occupied." Kelley at 21 (citing Ellsworth v. Marshall, 196 Cal. App. 2d 471, 474 (1961)).
>
> "The Ninth Circuit Court of Appeals has determined that a debtor is not automatically entitled to the protections provided in the Article 4 automatic homestead exemption [C.C.P.] §§ 704.710 et al. upon showing a valid declaration of homestead under Article 5 [C.C.P.] §§ 704.910 et al. Understanding this distinction is imperative, as the Article 4 exemption protections are applicable in a forced sale context (as here, where Debtor has filed his bankruptcy petition) whereas the Article 5 protections only apply in voluntary sales."
>
> "In the context of bankruptcy . . . Debtor's declaration of homestead helps him not at all, as the additional benefits conferred in Article 5 would benefit him only in the situation of a voluntary sale." Kelley at 19, 21 (citing Redwood Empire Prod. Credit Ass'n v. Anderson (In re Anderson), 824 F.2d 754, 757-59 (9th Cir. 1987)).

Minute Order.

Nowhere in Appellant's Opening Brief, either in the Statement of Issues presented on Appeal or anywhere in the Argument, does Debtor contest the bankruptcy court's interpretation of California exemption law. Accordingly, any

such issues are waived. Arpin v. Santa Clara Valley Transp. Agency, 261 F.3d 912, 919 (9th Cir. 2001) (issues not specifically and distinctly raised and argued in opening brief are waived).

As noted in the Minute Order, the exemption provided by the recording of a declaration of homestead, the only exemption claimed in the Third Amendment, gives the Debtor no protection at all in this bankruptcy proceeding. The declaration of homestead, a C.C.P. Article 5 exemption, only exempts an interest in property in a voluntary sale context. In re Kelley, 300 B.R. at 19, 21. In a forced sale situation, as bankruptcy is interpreted, only C.C.P. Article 4 exemptions apply, in this instance, the automatic exemption of C.C.P. § 704.710, et seq. Since the Debtor never claimed the Florida Property as exempt under C.C.P. § 704.710, he arguably has no relevant exemption claim at all, and the bankruptcy court's ruling could be affirmed on this alternative ground.

In re Kelley is a published opinion of this Panel that has not been overruled. We follow the rule that absent a change in the law, we are bound by our prior precedential opinions. See, e.g., Gaughan v. The Edward Dittlof Revocable Trust (In re Costas), 346 B.R. 198, 201 (9th Cir. BAP 2006); Ball v. Payco-Gen'l Am. Credits, Inc. (In re Ball), 185 B.R. 595, 597 (9th Cir. BAP 1995). In this appeal, we follow the conclusion of the Panel in In re Kelley, 300 B.R. at 21, as did the bankruptcy court, that under California law, the primary factors a bankruptcy court should consider in determining residency for homestead exemption purposes are physical occupancy of the claimed domicile and the

intent with which the property is occupied.

C. The Bankruptcy Court Did Not Clearly Err In Its Fact Findings.

Debtor argues from multiple angles that the bankruptcy court clearly erred in finding that the Debtor was not temporarily absent from the Florida Property and had no credible intent to return to live at the Florida Property. The Debtor does not (and cannot) contend that he actually occupied the Florida Property as his residence on the date that his Homestead Declaration was recorded or on the petition date or thereafter. "Whether or not [Debtor] actually or physically resided on the [Florida Property] at the time he filed his bankruptcy petition is not significant." Appellant's Opening Brief at 10. Debtor does argue that the Florida Property was his domicile, his family home, his "stomping grounds," to which he planned to return with his son when his divorce was finalized, based on his statements in his deposition and in his declaration filed in opposition to the Second Objection.

The bankruptcy court was aware of those statements and addressed them at the Hearing. "I know the words came out of his mouth. I don't believe it." The bankruptcy court's findings that the Debtor was not temporarily absent from the Florida Property and did not intend to live there were based on the following evidence in the record.

From the Debtor's own testimony, he had not resided at the Florida Property from 1994 forward. When last he lived in Florida, between 1994 and 2000, he had lived with his family in Orlando, and from 2000 through the date of his bankruptcy filing,

he and his family had lived at the Vallejo Property. Subsequent to his bankruptcy filing, the Debtor had moved, but he was still living in Vallejo. The last time he even visited the Florida Property was for a period of three weeks in 2008 after his mother's death. During that time, his wife and son remained at the Vallejo Property. In his Statement of Financial Affairs, the Debtor confirmed under penalty of perjury that he had not resided anywhere other than the Vallejo Property during the three years preceding his bankruptcy filing. The Debtor testified at his deposition that his brother currently was occupying the residence on the Florida Property; so, it was not even vacant for him to reoccupy.

In addition, the Debtor had called his own credibility into question by declaring before a notary public in the Homestead Declaration 1) that the Florida Property was his principal dwelling, and 2) that he currently was residing on the Florida Property, both of which statements clearly were not true. As argued by the Trustee in the Second Objection, those express misrepresentations raise real "concerns about the Debtor's veracity in this matter."

In light of the foregoing evidence that was before the bankruptcy court when it decided to sustain the Second Objection, we cannot find that the bankruptcy court clearly erred in determining that the Debtor did not reside on the Florida Property at the time of his bankruptcy filing and had no credible intent to return to the Florida Property to reside there in the future. "When there are two permissible views of the evidence, the factfinder's choice between them cannot be clearly

erroneous." Anderson, 470 U.S. at 574.

D. The Debtor Waived Any Argument That His Interest In the Florida Property Is Exempt Under the Florida Constitution.

As noted by the bankruptcy court in deciding the First Objection, although the Debtor claimed an exemption in his interest in the Florida Property under Article X, § 4 of the Florida Constitution in the First Amendment, he abandoned that exemption claim in the Second Amendment. He did not renew it in the Third Amendment. He further did not argue it in his opposition to the Trustee's Second Objection and did not raise it as an issue at the Hearing. An argument that was not raised before the trial court generally is deemed waived for purposes of appeal. "Absent exceptional circumstances, we generally will not consider arguments raised for the first time on appeal, although we have discretion to do so." El Paso v. America West Airlines, Inc. (In re America West Airlines, Inc.), 217 F.3d 1161, 1165 (9th Cir. 2000).

The Debtor argues, particularly in his Reply Brief, that even if the application of Florida Constitution Article X, § 4 was not raised before the bankruptcy court, we should consider it as a matter of discretion because "[t]he issue raised here is constitutional and constitutional issues can be raised any time, even for the first time on appeal." Appellant's Reply Brief at 3. However, the issue does not arise under the United States Constitution, it relates to a provision of the Florida Constitution, and it is here where the first holding in In re Arrol is particularly relevant.

As discussed above, the Ninth Circuit held in Arrol that

under § 522(b)(2)(A), exemption claims may be made under the particular state laws applicable on the filing date.

Section 522(b) has been amended substantially subsequent to the decision in Arrol. Under the currently effective version of § 522(b)(3)(A), applicable exemption laws are those of the state or locality where "the debtor's domicile has been located for the 730 days immediately preceding the date of the filing of the petition . . . ." The uncontroverted evidence before the bankruptcy court was that the Debtor resided at the Vallejo Property for the entire 730 days preceding his bankruptcy filing. In light of the record before us in this appeal, and consistent with the bankruptcy court's findings based on that record, we conclude that the applicable exemption laws in this case, as in Arrol, are the exemption laws of California. Consequently, Florida exemption law, whether constitutional or statutory, is not applicable, and we will not consider Debtor's argument with respect to Article X, § 4 of the Florida Constitution.

CONCLUSION

For the reasons discussed, we AFFIRM.

Filed 5/1/13

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SEVEN

AFSHAN MULTANI et al. Plaintiffs and Appellants, v. WITKIN & NEAL et al. Defendants and Respondents.	B237295 (Los Angeles County Super. Ct. No. GC044440)

APPEAL from a judgment of the Superior Court of Los Angeles County, C. Edward Simpson, Judge. Reversed.

Law office of Gary Kurtz and Gary Kurtz for Plaintiffs and Appellants.

Richardson Harman Ober, Kelly G. Richardson and Brian D. Moreno for Defendants and Respondents.

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INTRODUCTION

The Castle Green Homeowners Association notified Afshan and Rahim Multani that they were delinquent in paying their monthly assessment fees. After the Multanis disputed the debt, the Association conducted a nonjudicial foreclosure sale of their condominium unit. The Multanis sued to set aside the foreclosure alleging irregularities in the sale notices and procedure. They further alleged that the Association and its agents had committed tortious acts during the foreclosure process.

The defendants filed a motion for summary judgment or adjudication arguing that the court should dismiss the foreclosure claims because plaintiffs had actual knowledge of the foreclosure proceedings and failed to exercise their post-sale right of redemption. The defendants also argued that plaintiffs' tort claims were untimely and predicated on privileged conduct related to the foreclosure process. The court granted the motion.

We reverse the trial court's dismissal of plaintiffs' claims seeking to set aside the foreclosure sale, concluding that defendants failed to demonstrate that they notified the plaintiffs of their right of redemption as required by Code of Civil Procedure section 729.050.

FACTUAL AND PROCEDURAL BACKGROUND

A. Summary of Plaintiffs' Complaint

1. Plaintiffs' factual allegations

In January of 2010, plaintiffs Afshan and Rahim Multani filed a complaint against the Castle Green Homeowners Association (the Association) and numerous other parties arising from a foreclosure of the Multanis' condominium unit.[1] The complaint alleged that, in 1998, plaintiffs had purchased a condominium unit in the "Castle Greens" building in Pasadena, California. Plaintiffs obtained financing to purchase the unit from Chase Bank, who later transferred the loan to Indymac Bank.

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1 This factual summary is predicated on the allegations in plaintiffs' second amended complaint, which was filed on June 28, 2010.

In 2005, Rahim Multani returned from an overseas trip and was informed by the Association and its agents, LB Property Management and SBS Lien Services, that he was delinquent in paying his homeowner assessment fees. Although Multani paid the delinquent fees, he received a letter from SBS in August of 2005 alleging that he still owed approximately $2,000 in fees and costs. Multani met with SBS and issued a payment of $743.16 that was never credited to his account. In October, Multani attempted to pay the Association his monthly assessment but was told that the account had been referred to SBS "for collection." One month later, the Association, acting through SBS, recorded a notice of delinquent assessment against the property in the amount of $3,317, which consisted of $2,229 in unpaid assessments and an additional $1,087 in attorney's fees, costs, late fees and interest.

Throughout 2006, Multani and the Association continued to "disput[e] the validity of the amount . . . owed . . ." In February of 2007, Multani received a notice of sale informing him that the Association "intended to enforce the lien created by the November . . . recording of the Notice of Assessment by selling the Subject Property on March 27, 2007." The Association alleged that Multani now owed almost $12,000 in assessment fees and costs. Although Multani disputed the Association's accounting, he agreed to pay the full amount and the Association released the assessment lien.

Shortly after the lien was released, Multani contacted the Association and "requested that his account be given . . . credit f[or] . . . previously non-credited payments." Between April and July of 2007, Multani continued to make his "required monthly assessment payments, but was never given the credit due on the account." In February of 2008, the Association recorded a second notice of delinquent assessment lien against the property and, in June, recorded a "Notice of Default and Lien." Six months later, on December 5, 2008, the Association and its trustee, Witkin & Neal, "set a sale date of the property to take place on January 27, 2009." Multani "sent a letter disputing the validity of the amount owed" and requested alternative dispute resolution. The Association did not respond.

On January 5, 2009, "Indymac [Bank], the lender and beneficiary of the senior deed of trust [on the condominium unit], mistakenly instructed their [sic] trustee to foreclose . . . on the property." Plaintiffs immediately filed a wrongful foreclosure action and Indymac agreed to issue a notice of rescission of foreclosure, which was recorded on April 28, 2009. Plaintiffs contended that Indymac's actions had effectively "extinguish[ed] [the Association's] lien and its Notice of Trustee's Sale," thereby requiring the Association to reinitiate the foreclosure process by recording a new lien.

The Association, however, elected to proceed and directed Witkin & Neil to record the notice of trustee sale set for January 27, 2009. In May of 2009, Multani informed the president of the Association, Randy Banks, that he "ha[d] been trying for some time to correct and rectify what seemed an impossible task of getting a [sic] accurate accounting on Plaintiffs' account and getting the proper credits that were due." Banks told Multani that he was unaware of the accounting discrepancies and would "provide assistance . . . with the outstanding issues regarding the [improper] Association assessments."

Despite these assurances, on May 21, 2009, the Association placed a notice on the door of the Multanis' condominium stating that they owed $13,640 for delinquent assessments and costs. Shortly after the notice was posted, the Multanis' tenants informed them that the locks on the condominium unit had been changed. When Multani arrived at Castle Green to investigate the matter, he was met by Banks, who said that he had contacted the police and that Multani would be arrested if he did not leave the premises. Although Multani informed the responding officers that he was the legal owner of the condominium, he was forced to leave the building. Between May and October of 2009, Banks and other Association members continued to "harass[] Plaintiffs' tenants," causing them to vacate the condominium.

On July 23, 2009, the Association conducted a foreclosure sale of the Multanis' condominium, which was purchased by ProValue Properties. Although the "property was estimated to be valued at approximately $400,000," ProValue paid only $20,400, subject to Indymac Bank's $75,000 deed of trust. The Association and its trustee never

notified the Multanis that the sale had been postponed from January 27 to July 23, nor did they provide any notice after the sale was completed.

In October of 2009, the Multanis signed a lease with new tenants who moved into the condominium. However, on November 19, the Multanis received a courtesy copy of an unlawful detainer complaint from the Los Angeles Superior Court stating that: (1) a nonjudicial foreclosure of the condominium had occurred on July 23, 2009; (2) although originally scheduled to occur on January 27, 2009, the Association's trustee had "from time to time postponed" the sale until July 23; and (3) a trustee deed of sale had been recorded on October 24, 2009, which was 90 days after the plaintiffs' "right to redemption" had expired. Prior to receiving the unlawful detainer complaint, the plaintiffs were unaware of the foreclosure sale.

In November and December of 2009, ProValue repeatedly changed the locks on the condominium unit. Multani and his tenants had several disputes with ProValue, culminating in an altercation on December 17, 2009. Based on misrepresentations made by ProValue, the Pasadena police told Multani that he had to vacate the condominium by the end of the weekend or he would be arrested for trespassing. After being repeatedly harassed and threatened with arrest, Multani finally relinquished possession of the unit and elected to file a lawsuit against the Association, its agents – Witkin & Neal, SBS Lien Services and LB Property Management – and numerous other parties, including ProValue.

2. Summary of plaintiffs' claims

The Multanis' complaint asserted numerous claims seeking to set aside the foreclosure, including: quiet title, wrongful foreclosure, rescission and declaratory relief. The Multanis alleged that the foreclosure was improper because the Association and its agents (collectively defendants) had failed to properly serve the notice of trustee sale or comply with other procedural requirements mandated under Civil Code section 2924*, et seq*. Plaintiffs also alleged that the defendants had failed to comply with "Civil Code section 1367 *et seq*.," which imposes additional procedural requirements on nonjudicial

foreclosures conducted by homeowner associations for delinquent assessment fees. More specifically, plaintiffs alleged that the defendants "failed to provide alternate dispute resolution as required by [Civil Code section 1367.4]." The Multanis further asserted that all of the defendants' foreclosure notices had been "effectively voided" when "Indymac Bank . . . conducted their non-judicial foreclosure sale of January 2009 and recorded the Deed Upon Sale."

In addition to the foreclosure claims, the complaint alleged several tort claims based on the defendants' actions during the foreclosure process. Plaintiffs asserted claims for fraud, breach of fiduciary duty and intentional infliction of emotional distress alleging that the defendants had: (1) "intentionally mixed up the accounting of Plaintiffs' dues, imposed unwarranted dues and other charges, and confused Plaintiffs as to what was actually going on by repeated filings of notices, liens, and releases of liens by Defendants"; (2) "intentionally did not properly credit Plaintiffs' account so as to further extract additional monies in the form of collections costs, attorneys fees and late penalties"; and (3) "conspired to conduct a [nonjudicial foreclosure] sale without any notice to prevent Plaintiffs from opposing such sale."

The complaint also asserted claims for interference with contractual relations and interference with prospective economic advantage, which were predicated on the defendants' harassment of the plaintiff's condominium tenants. The complaint listed numerous additional statutory claims based on similar conduct, including violation of the Unruh Civil Rights Act (Civ. Code, §§ 51 *et seq*.), violation of the Fair Debt Collection Practices Act (Civ. Code, §§ 1788 *et seq*.), violation of the federal Racketeer Influence and Corrupt Organization Act (18 U.S.C §§ 1961 *et seq*.) (RICO) and unfair business practices.

B. ***Defendants' Motion for Summary Judgment or Summary Adjudication***

1. Defendants' motion and supporting evidence

a. Summary of motion for summary judgment or adjudication

In June of 2011, the Association and its agents filed a motion for summary judgment or, alternatively, summary adjudication. First, defendants asserted that the undisputed evidence showed the Multanis had "violated the 'tender rule' by failing to tender the full amount before the foreclosure sale." Second, defendants argued that they had provided evidence demonstrating substantial compliance with all statutory notice requirements. Third, defendants contended that plaintiffs were not harmed by any alleged procedural irregularity because they had actual notice that the foreclosure sale was scheduled to occur on January 27, 2009. Fourth, defendants argued that, pursuant to Civil Code section 1058.5, Indymac Bank's rescinded January 5th foreclosure had no effect on the Association's foreclosure.[2]

As to plaintiffs' tort claims, the defendants argued that all of the conduct alleged in the complaint was related to the "processing of [a] . . . foreclosure" and was therefore "covered by the Civil Code Section 47(b) absolute privilege." The Association also argued that the allegations in the complaint demonstrated that plaintiffs' interference claims were time barred.

The Association's agents, Witkin & Neil and LB Management, separately argued that all of the tort claims asserted against them should be dismissed because they were entitled to qualified immunity under Civil Code section 2924, subdivision (b) and defendants had "failed to articulate the alleged bad acts committed by [them]."

b. Summary of evidence filed in support of defendants' motion

In support of their motion, the defendants submitted a declaration from the chief operating officer of Witkin & Neal summarizing the actions the trustee had taken during

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2 Civil Code section 1058.5, subdivision (b) states, in relevant part: "Where a trustee's deed is invalidated by a pending bankruptcy or otherwise, recordation of a notice of rescission of the trustee's deed . . . shall restore the condition of record title to the real property described in the trustee's deed and the existence and priority of all lienholders to the status quo prior to the recordation of the trustee's deed upon sale . . . ."

the foreclosure proceedings. According to the declaration, on April 21, 2008, Witkin & Neal mailed the plaintiffs a "pre-notice" of default letter informing them that a notice of delinquent assessment had been recorded against the property and that the current amount due on the account was $4,206.40. The letter further stated that the plaintiffs had the right to "dispute the assessment debt by submitting a written request for dispute resolution." A declaration of mailing indicated that the letter was sent to the Multanis' condominium unit and a Pasadena post office box numbered "82341."

The declaration also stated that, on June 23, 2008, Witkin & Neal mailed the plaintiffs a notice of default and election to sell stating that the amount currently due totaled $5,494.73 and would continue to "increase until [the] account bec[a]me current." A declaration of mailing indicated that the notice was sent to the same two addresses as the "pre-notice" letter and to a second Pasadena post office box numbered "92341." On January 9, 2009, Witkin & Neal sent the plaintiffs a notice of trustee's sale informing them that: (1) the sale was scheduled to occur on January 27, 2009; (2) the total unpaid balance was currently $10,267.62; and (3) the foreclosure sale was subject to a 90-day redemption period during which the owners could reclaim the property. A declaration of mailing indicated that the notice was sent to the same three addresses as the notice of default.

The declaration further alleged that, "at the time and place fixed in the Notice of Trustee's Sale, [Witkin & Neal] did, by public announcement, and in a manner provided by law, postpone the sale date from time to time thereafter until July 23, 2009, when [Witkin & Neal] sold the Subject unit to ProValue Properties . . . for the sum of $20,200." On July 31, 2009, defendants recorded a certificate of sale confirming that that the property was sold to ProValue and that the sale was subject to a 90-day "right of redemption." According to the declaration, plaintiffs "made no attempt to tender the full amount before the foreclosure sale date" and "failed to redeem the Subject Property during the 90-day right of redemption period." At the expiration of the 90-day redemption period, Witkin & Neal recorded a Trustee's Deed Upon Sale, dated November 6, 2009.

The defendants also submitted excerpts from Rahim Multani's deposition in which he admitted that he stopped paying his assessment fees because he "felt that [a] claim of overpayment was not being handled correctly." According to Multani, "no one gave [him] a correct accounting or breakdown of what the actual outstanding amount was owed." Multani alleged that, in 2008, he had tried to pay the amount that he believed he owed but the Association rejected his payments. Thereafter, Multani made a "conscious decision" not to pay the "entire asserted balance" because he believed it was incorrect and was "always a moving target." Multani also testified that, prior to December 16, 2009, he was unaware that the Association had actually held a foreclosure sale.

2. *Plaintiffs' opposition and supporting documentation*

On August 10, 2011, plaintiffs submitted an opposition arguing that there were disputed issues of material fact as to whether the defendants had complied with all of the mandated procedural requirements. Plaintiffs argued, in relevant part, that: (1) "[d]efendants failed to provide notice to Plaintiffs for the secret sale [that occurred on July 23, 2009]"; (2) defendant failed to respond to Rahim Multani's letter dated December 2008, in which he specifically requested alternative dispute resolution; and (3) Indymac's subsequently rescinded foreclosure "extinguished" any prior notices the Association had issued in relation to their own foreclosure. The plaintiffs also argued that they were excused from complying with the tender rule because they had disputed "the validity of the underlying debt."

As to the tort claims, plaintiffs asserted that their complaint alleged numerous forms of non-communicative conduct that were not privileged under Civil Code section 47 subdivision (b), including allegations that the defendants had unlawfully harassed Multani and his tenants and repeatedly changed the locks on the condominium unit.

In support of their opposition, plaintiffs submitted a 14-page declaration from Rahim Multani that contained a detailed discussion of the accounting dispute that preceded the Association's recording of the delinquency lien. Multani asserted that, in June of 2007, he paid the Association almost $12,000 to resolve a prior payment dispute

that had begun in 2005, but that the defendants failed to properly credit him for two prior payments totaling approximately $1,500 and then began to intentionally inflate their monetary claims. Multani alleged that, on December 22, 2008, he sent the Association board a letter in which he disputed the amount that he owed and requested alternate dispute resolution. The Association, however, never responded to the letter.

Multani's declaration admitted that he knew defendants had scheduled a foreclosure sale for January 27, 2009, but asserted that he was led to believe the sale had been cancelled. Multani explained that, one day prior to the scheduled sale date, his attorney informed Witkin & Neal that Indymac Bank had foreclosed on the property two weeks earlier. In response, Witkin & Neal allegedly stated "if that was the case, then there would be no sale taking place the next day." According to Multani, Witkin & Neal never indicated that it might postpone the foreclosure sale, but then "surreptitious[ly]" sold the property to ProValue on July 23, 2009. Multani further stated that, after this "secret" sale occurred, the defendants failed to provide him a notice of his right to redemption as required under Code of Civil Procedure section 729.050.[3]

Multani also asserted that, during the foreclosure sale, the defendants committed numerous "criminal acts by changing the locks on the Subject property . . . ; calling the Pasadena Police Department on more than one occasion to attempt to prevent [him] from [entering the subject property]; improperly having [him] detained; and attempt[ing] to place [him] under citizen's arrest for trespassing . . ."[4]

C. The trial court's ruling

At the hearing, the plaintiffs argued that defendants had sent many of the foreclosure notices to the wrong address. According to the plaintiffs' attorney, Rahim

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3 Unless otherwise noted, all further statutory citations and references are to the Code of Civil Procedure.

4 The defendants filed objections to numerous aspects of Rahim Multani's deposition. The record, however, does not indicate whether the court ruled on the objections, and defendants have not asserted there were any erroneous evidentiary rulings.

Multani's proper mailing address was post office box number 92341, but the defendants had sent several of the notices to post office box number 82341. Plaintiffs counsel further argued that the proper address had been on file with the Association but, "at some point[,] the homeowners association started sending it to the wrong P.O. box."

In response, defendants' attorney argued that they had submitted several recordation of mailings in support of their motion showing that most of the notices had in fact been sent to post office box 92341. Counsel also argued that it was irrelevant whether the defendants had mailed the notices to the correct address because plaintiffs had admitted they "had actual knowledge of the [foreclosure] process." After the court informed the parties that it was going to take the matter under submission, the following exchange occurred:

PLAINTIFFS' COUNSEL: Your honor, can I just ask the court to take a look at [section] 729.050.

COURT: And what is it?

PLAINTIFFS' COUNSEL: That talks about the requirements. Their certificate of sale.

COURT: Oh yeah, I'm going to look at that.

On August 23, 2011, the trial court filed an order granting judgment in favor of Witkin & Neal and LB Property Management and granting the Association judgment on twelve of the fifteen remaining claims pleaded against it.[5] The court concluded that the defendants were entitled to judgment on each of the four claims seeking to set aside the foreclosure because plaintiffs had admitted that they "failed to tender the amount of the debt prior to the sale or exercise [their] right[s] of redemption after the sale."[6]

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5 The record indicates that, several months prior to the hearing on the motion for summary judgment or adjudication, the trial court had sustained a demurrer to plaintiffs' claims alleging violations of the Fair Debt Collection Practices Act and RICO. Appellants do not challenge that ruling.

6 Plaintiffs sought to set aside the foreclosure in four separate claims: declaratory relief, quiet title, wrongful foreclosure and rescission. We refer collectively to these four claims as the "foreclosure claims" or as "claims seeking to set aside the foreclosure."

In addition, the court concluded that the following evidence demonstrated that plaintiffs were not "prejudice[ed]" by any "procedural irregularity" in the foreclosure proceedings: (1) prior to recording the notice of delinquent assessment, the Association sent plaintiffs a letter advising them of their right to alternative dispute resolution; (2) Witkin & Neal's declaration demonstrated that defendants had properly complied with all statutory requirements when postponing the foreclosure sale from January 27, 2009 to July 23; 2009; and (3) plaintiffs admitted they had "actual knowledge of the foreclosure proceedings" and, "[d]espite such knowledge, [had] failed to exercise their 90-day statutory right of redemption."

The trial court also concluded that the defendants' evidence showed that four notices had been sent to the plaintiffs' condominium unit and post office box 82341: (1) a notice to pay or lien, dated December 27, 2007; (2) a notice of delinquent assessment liens, which had been sent on February 28, 2008 and again on April 21, 2008; (3) a notice of default and election to sell, dated June 13, 2008; and (4) a notice of trustee's sale, dated October 31, 2009. The latter two items were also sent to post office box 92341, which Multani had alleged to be his proper mailing address. The court further noted that plaintiffs had never specifically alleged that they did not receive any of these four items.

On the tort-based claims, the court ruled that the defendants were entitled to dismissal of the fifth cause of action (fraud), eighth cause of action (breach of fiduciary duty) ninth cause of action (intentional infliction of emotional distress) and the eighteenth cause of action (unfair business practices) because each of those claims was predicated on "actions . . . subject to immunities set forth in [Civil Code sections] 47 and 2924(b)." In addition, the court ruled that plaintiffs' thirteenth through sixteenth claims, which alleged interference with contractual relations and prospective economic advantage, were "time-barred."

The court entered judgment in favor of Witkin & Neal and LB Property Management on September 12, 2011. Three claims, however, remained pending against

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Plaintiffs also pleaded a claim for cancellation of deed against ProValue, which is not a party to this appeal.

the Association: violation of the Unruh Civil Rights Act, forcible detainer and a request for an accounting.

On September 23, the Association moved for judgment on the pleadings seeking dismissal "of these remaining claims . . . such that judgment [may be] entered in favor of the Association." The trial court granted the motion on October 19, 2011 and entered a final judgment in favor of the Association on November 9, 2011. Plaintiffs filed a timely appeal of the trial court's judgment and order granting the defendants' motion for summary judgment or adjudication.[7]

DISCUSSION

A. *Standard of Review*

"'The standard for deciding a summary judgment motion is well-established, as is the standard of review on appeal.' [Citation.] 'A defendant moving for summary judgment has the burden of producing evidence showing that one or more elements of the plaintiff's cause of action cannot be established, or that there is a complete defense to that cause of action. [Citation.] The burden then shifts to the plaintiff to produce specific facts showing a triable issue as to the cause of action or the defense. [Citations.] Despite the shifting burdens of production, the defendant, as the moving party, always bears the ultimate burden of persuasion as to whether summary judgment is warranted. [Citations.]' [Citation.]." (*Hypertouch, Inc. v. ValueClick, Inc*. (2011) 192 Cal.App.4th 805, 817 (*Hypertouch*).)

"'On appeal, we review de novo an order granting summary judgment. [Citation.] The trial court must grant a summary judgment motion when the evidence shows that there is no triable issue of material fact and the moving party is entitled to judgment as a

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7 Plaintiffs' notice of appeal and portions of their appellate brief also allude to the trial court's order granting the Association's motion for judgment on the pleadings. As discussed in more detail below, however, the brief contains insufficient legal analysis of any of the three claims dismissed in that order. Plaintiffs have therefore abandoned any claim of error regarding the trial court's order granting defendants' motion for judgment on the pleadings. (*Reyes v. Kosha* (1998) 65 Cal.App.4th 451, 466, fn. 6 (*Reyes*).)

matter of law. [Citations.] In making this determination, courts view the evidence, including all reasonable inferences supported by that evidence, in the light most favorable to the nonmoving party. [Citations.]' [Citation.]" (*Hypertouch, supra*, 192 Cal.App.4th at p. 818.) "The same standards apply to motions for summary adjudication." (*Id*. at p. 817, fn. 3.)

B. *Defendants Failed to Satisfy Their Initial Burden of Production on Plaintiffs' Foreclosure Claims*

The plaintiffs argue that the trial court erred in dismissing each of their claims seeking to set aside the foreclosure sale because there are triable issues of fact as to whether defendants complied with numerous procedures required under the Civil Code and the Code of Civil Procedure. We reverse the trial court's dismissal of the foreclosure claims, concluding that defendants failed to demonstrate that they notified plaintiffs of their right to redemption or the applicable redemption period as required under section 729.050.[8]

1. The post-sale right to redemption in nonjudicial foreclosures by a homeowner association for delinquent assessment fees

Special procedures govern nonjudicial foreclosures initiated by a homeowner association for the collection of delinquent assessment fees. Under the Davis-Stirling Common Interest Development Act (see Civ. Code, § 1350 *et seq*.) (the Act), which governs common interest developments (CID) in California,[9] the amount of any unpaid association assessment, plus the reasonable costs of collection, late charges, and interest, constitutes a "debt of the owner of the separate interest." (Civ. Code, § 1367.1, subd. (a); Civ. Code, § 1366, subds. (e)(1)-(3).) After complying with various notice requirements

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8 The plaintiffs raise numerous additional arguments as to why we should reverse the trial court's dismissal of their foreclosure claims. Because we reverse the dismissal of those claims based on defendants' failure to provide evidence demonstrating compliance with section 729.050, we need not address plaintiffs' additional arguments.

9 The parties do not dispute that the Multanis' condominium unit was part of a common interest development governed by the Act.

(see Civ. Code, § 1367.1, subds. (a)-(c)), an association may record a lien of delinquent assessment against the property (see Civ. Code, § 1367.1, subd. (e)) and then enforce the lien through a nonjudicial foreclosure "conducted in accordance with [Civil Code] [s]ections 2924, 2924b and 2924c applicable to the exercise of powers of sale in mortgages and deeds of trust." (Civ. Code, § 1367.1, subd. (g).)

As a general rule, the debtor in a nonjudicial foreclosure may avoid the loss of the property by "pay[ing] all amounts due at any time prior to the sale . . ." (*Knapp v. Doherty* (2004) 123 Cal.App.4th 76, 86-87 (*Knapp*).) However, "[o]nce the sale is completed, the trustor has no further rights of redemption." (*Id*. at p. 831.) Prior to 2006, these same rules applied to nonjudicial foreclosures by an association for delinquent assessments.

In 2005, however, the Legislature adopted S.B. 137 (2005 Stats., c. 452 (S.B. 137), § 5), which placed numerous limitations on an association's ability to utilize foreclosure as a means to collect assessments. The legislative history indicates that S.B. 137 was intended to "institute . . . important procedural . . . requirements to protect CID homeowners" from the "extreme hammer of non-judicial foreclosure in order to collect relatively small amounts of overdue assessments." (California Bill Analysis, S.B. 137 Assembly Fl. (2005-2006 Reg. Sess.) September 1, 2005.) Supporters of the Bill argued that there had been "too many instances" in which "CID associations [had] . . . initiated [foreclosures] for relatively small amounts . . ., [and then] sold [the property] for an all-too-often shockingly small fraction of its actual value." (*Ibid*.) The bill sought to avoid similar outcomes in the future by providing "CID homeowners" additional "due process protections." (*Ibid*.)

S.B. 137 added Civil Code section 1367.4, which prohibits (with certain exceptions) the use of foreclosure to collect delinquent assessments that total less than $1,800. (Civ. Code, § 1367.4, subd. (b).) Although the statute permits an association to "use . . . nonjudicial foreclosure" for delinquent assessments exceeding $1,800 (see Civ. Code, § 1367.4, subd. (c)), section 1367.4, subdivision (c)(4) requires that the association provide CID owners a right to redeem the property within 90 days after the sale: "A

nonjudicial foreclosure by an association to collect upon a debt for delinquent assessments shall be subject to a right of redemption. The redemption period within which the separate interest may be redeemed from a foreclosure sale under this paragraph ends 90 days after the sale. . . ." A similar provision appears in section 729.035, which was also added as part of S.B. 137: "Notwithstanding any provision of law to the contrary, the sale of a separate interest in a common interest development is subject to the right of redemption within 90 days after the sale if the sale arises from a foreclosure by the association of a common interest development pursuant to subdivision (g) of Section 1367.1 of the Civil Code, subject to the conditions of Section 1367.4 of the Civil Code."[10]

The redemption process, which is normally available only in the context of judicial foreclosure, is governed by requirements set forth in the Code of Civil Procedure.[11] Section 729.040 mandates that, following a foreclosure subject to a right of redemption, the trustee must deliver a "certificate of sale" to the purchaser and record a duplicate of the certificate in the office of the county recorder. Under section 729.050,

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10 Civil Code section 1367.4 imposes various other conditions on an association's use of nonjudicial foreclosure. First, "prior to initiating the foreclosure," the association must "offer the owner and, if so requested by the owner, participate in" various, enumerated forms of alternative dispute resolution, including binding arbitration. (Civ. Code, § 1367.4, subd. (c)(1).) Second, the statute requires that the decision to initiate foreclosure must be made by the association's board of directors in an open vote. (Civ. Code, § 1367.4, subd. (c)(2).) Third, the board must provide the owner notice of its decision. (Civ. Code, § 1367.4, subd. (c)(3).)

11 A judicial foreclosure involves significant "court oversight" (*Arabia v. BAC Home Loans Servicing, L.P*. (2012) 208 Cal.App.4th 462, 470) and provides the creditor and the debtor certain rights that are generally not available in nonjudicial foreclosure: "In a judicial foreclosure, if the property is sold for less than the amount of the outstanding indebtedness, the creditor may seek a deficiency judgment, or the difference between the amount of the indebtedness and the fair market value of the property, as determined by a court, at the time of the sale. [Citation.] However, the debtor has a statutory right of redemption . . . for a period of time after foreclosure. [Citation.]" (*Alliance Mortgage Co. v. Rothwell* (1995) 10 Cal.4th 1226, 1236 (*Alliance*).) By contrast, in a nonjudicial foreclosure, there "is no oversight by a court, . . . the debtor has no postsale right of redemption[,] . . . and the creditor may not seek a deficiency judgment." (*National Enterprises, Inc. v. Woods* (2001) 94 Cal.App.4th 1217, 1226.)

the trustee must also promptly notify the debtor of his redemption rights: "If property is sold subject to the right of redemption, promptly after the sale the levying officer or trustee who conducted the sale shall serve notice of the right of redemption on the judgment debtor. Service shall be made personally or by mail. The notice of the right of redemption shall indicate the applicable redemption period."

Sections 729.060-729.090 describe how the debtor may redeem his or her property following the foreclosure sale. "[S]ection 729.060, subdivision (a) requires '[a] person who seeks to redeem the property [to] deposit the redemption price with the levying officer who conducted the sale before the expiration of the redemption period.' Subdivision (b) of this statute defines the redemption price as 'the total of the following amounts . . . . [¶] (1) The purchase price at the sale. [¶] (2) The amount of any assessments or taxes and reasonable amounts for fire insurance, maintenance, upkeep, and repair of improvements on the property. [¶] (3) Any amount paid by the purchaser on a prior obligation secured by the property to the extent that the payment was necessary for the protection of the purchaser's interest. [¶] (4) Interest on the amounts described in paragraphs (1), (2), and (3) . . . .' In addition, subdivision (c) of . . . section 729.060 authorizes an offset to the redeeming party for '[r]ents and profits from the property paid to the purchaser or the value of the use and occupation of the property to the purchaser . . . .'" (*Barry v. OC Residential Properties* (2011) 194 Cal.App.4th 861, 866 (*Barry*).)

Section 729.070 establishes "a procedure allowing one 'seeking to redeem the property [who] disagree[s with the purchaser's claimed] redemption price' to petition 'the court for an order determining the redemption price . . .' [Citation.]" (*Barry, supra,* 194 Cal.App.4th at pp. 866-867.) If the debtor does not deposit the redemption price or otherwise file a petition challenging the redemption price within the applicable redemption period, the trustee must deliver an executed trustee's deed to the purchaser and provide the debtor notice that the trustee sale has occurred. (§ 729.080, subd. (a).) If, however, the debtor tenders "the redemption price determined by court order or agreed upon by the purchaser . . . the effect of the sale is terminated and the person who

redeemed the property is restored to the estate therein sold at the sale." (§ 729.080, subd. (b).)

2. Defendants failed to make a prima facie showing that plaintiffs cannot establish the elements necessary to set aside the foreclosure sale

Plaintiffs contend that the trial court erred in dismissing their foreclosure claims because the defendants failed to notify them of their right of redemption as required under section 729.050.

a. Defendants have waived any argument regarding plaintiffs' failure to plead a violation of section 729.050

Before addressing the merits of this argument, we assess defendants' contention that we should "disregard[]" this "alleged [procedural] violation" because it "is outside the scope of the Second Amended Complaint."

Generally, "[a] defendant moving for summary judgment need address only the issues raised by the complaint; the plaintiff cannot bring up new, unpleaded issues in his or her opposing papers. [Citation.]" (*Government Employees Ins. Co. v. Superior Court* (2000) 79 Cal.App.4th 95, 98, fn. 4.) Defendants assert that, in this case, plaintiffs' "allegation that [the Association and its trustee] somehow violated . . . [s]ection 729.050 . . . . does not exist in the [second amended complaint]," which prohibits them from raising the issue on appeal.

Plaintiffs' complaint, however, alleges that the defendants "conducted the foreclosure proceedings unlawfully in that they did not follow the California non-judicial foreclosure sale procedures prescribed by . . . Civil Code § 2924 and 1367." The complaint also alleges violation of "§ 1367 *et seq*." As discussed above, Civil Code section 1367.4, subdivision (c)(4) requires the association to provide CID owners a 90-day period to redeem the property, which triggers the trustee's notice requirements under section 729.050.

In any event, defendants have forfeited this issue. When a plaintiff opposes a motion for summary judgment or adjudication by raising an "unpleaded issue," the

defendant's failure to "object to [the] injection of [the] unpleaded theory . . . [constitutes a] waive[r]." (*Knapp, supra,* 123 Cal.App.4th at p. 90; see also *Stalnaker v. Boeing Co*. (1986) 186 Cal.App.3d 1291, 1302.) The purpose of this objection requirement is to ensure that, if the objection is sustained, the plaintiff has an opportunity to request leave to amend the pleading to raise the unpleaded theory. (See *Stalnaker, supra,* 186 Cal.App.3d at p. 1302.)

In the trial court, plaintiffs' opposition papers included a declaration from Rahim Multani in which he alleged that defendants did not comply with section 729.050's notice requirements. Although the defendants objected to numerous statements in Multani's declaration on the ground that they introduced issues outside the pleadings, defendants did not raise this objection in regards to Multani's statements about section 729.050. Moreover, during oral argument, the plaintiffs' attorney specifically requested that the trial court review section 729.050 and determine whether defendants had demonstrated compliance with its requirements. The defendants did not object to this request and the trial court agreed that it would consider the issue. Under these circumstances, "we deem waived defendants' objection to plaintiffs' . . . mode of pleading and argument." (*Stalnaker, supra*, 186 Cal.App.3d at p. 1302, fn. 7 [finding waiver where "the newly introduced theory was . . . presented to the trial court, without defendants' objection"].)

b. Defendants failed to make a prima facie showing that they were entitled to dismissal of plaintiffs' claims seeking to set aside the foreclosure

As the party moving for summary adjudication of plaintiffs' foreclosure claims, the defendants had the "'initial burden of production to make a prima facie showing" that "one or more elements of the plaintiff's cause of action cannot be established." (*Hypertouch, supra,* 192 Cal.App.4th at p. 838.)

"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.) "Because nonjudicial foreclosure is a 'drastic sanction' and a 'draconian remedy' [citation], '"[t]he

statutory requirements must be strictly complied with, and a trustee's sale based on statutorily deficient notice of default is invalid."' [Citations]." (*Ung v. Koehler* (2005) 135 Cal.App.4th 186, 202-203; see also *Holland v. Pendleton Mortg. Co*. (1943) 61 Cal.App.2d 570, 573-574 [foreclosure sale invalid where trustee fails to comply with statutory notice procedures]; 4 Miller & Starr, Cal. Real Est. (3d ed. 2011) § 10:210 ["A sale of the collateral by an exercise of the power of sale in violation of the statutory limitations on the power is invalid"].)

To set aside a foreclosure, a plaintiff must generally establish three elements: "(1) the trustee . . . caused an illegal, fraudulent, or willfully oppressive sale of real property pursuant to a power of sale in a mortgage or deed of trust; (2) the party attacking the sale . . . was prejudiced or harmed; and (3) in cases where the trustor . . . challenges the sale, the trustor . . . tendered the amount of the secured indebtedness or was excused from tendering." (*Lona v. Citibank, N.A.* (2011) 202 Cal.App.4th 89, 104 (*Lona*).) The defendants argue that their moving papers made a prima facie showing that plaintiffs cannot establish any of these three elements.

i. Defendants introduced no evidence that they complied with section 729.050

"Justifications . . . which satisfy the first element [to set aside a foreclosure] include the trustee's . . . failure to comply with the statutory procedural requirements for the notice or conduct of the sale." (*Lona, supra*, 202 Cal.App.4th at p. 104.) Although there is generally no "postsale right of redemption" in nonjudicial foreclosure proceedings (*Alliance, supra,* 10 Cal.4th at p. 1236), a nonjudicial foreclosure by an association for delinquent assessments is "subject to the right of redemption within 90 days after the sale." (§ 729.035; see also Civ. Code, § 1367.4, subd. (c)(4).) As a result, the trustee who conducts the sale must "promptly . . . serve notice of the right of redemption on the judgment debtor," which "shall indicate the applicable redemption period." (§ 729.050.)

Defendants have failed to provide any evidence that they complied with this statutory requirement. In support of their motion for summary adjudication, the

defendants submitted evidence that they mailed the Multanis the following notices regarding the foreclosure proceedings: (1) a “pre-notice of Default letter,” mailed April 21, 2008; (2) a “Notice of Default and Election to Sell,” mailed June 23, 2008; (3) a “Notice of Board Decision to Foreclose and Notice of Default,” mailed October 7, 2008; and (4) a “Notice of Trustee’s Sale,” mailed January 9, 2009. The defendants also submitted evidence that, following the foreclosure sale, the trustee recorded a “Certification of Sale” on July 31, 2009 and then recorded the “Trustee’s Deed Upon sale . . . [a]fter the 90-day right of redemption period expired.”

Defendants, however, have cited no evidence in the record – and we have located none – demonstrating that it mailed the Multanis a notice of right to redemption as required under section 729.050. Instead, defendants contend that they had no burden to present evidence that they complied with section 729.050 because “[a] nonjudicial foreclosure sale is accompanied by a common law presumption that it ‘was conducted regularly and fairly.’ [Citations.]” (*Lona, supra*, 202 Cal.App.4th at p. 105.) Defendants appear to assert that this presumption was, standing alone, sufficient to “‘to make a prima facie showing’” (*Hypertouch, supra,* 192 Cal.App.4th at p. 839) that plaintiff could not demonstrate any procedural irregularity in the foreclosure proceedings.

The defendants have not cited any authority indicating that this common law presumption of regularity applies to the postsale redemption procedures at issue here. All of the cases they cite applied the presumption in the context of standard nonjudicial foreclosures that were not subject to statutory redemption. Even if the common law presumption were to apply to redemption procedures, however, a defendant moving for summary adjudication of claims seeking to set aside a foreclosure may not discharge his or her initial burden of production by merely referencing the presumption. The presumption, which is rebuttable (see *6 Angels, Inc. v. Stuart-Wright Mortgage, Inc*. (2001) 85 Cal.App.4th 1279, 1284), merely requires that the party “attacking the sale . . . [must] ‘plead[] and prove[] an improper procedure and resulting prejudice’ [Citation.]” (*Knapp, supra,* 123 Cal.App.4th at p. 86, fn. 4.) Thus, the plaintiff has the burden to

allege in its pleading that a prejudicial irregularity occurred and then to prove that allegation at trial.

For the purposes of summary judgment or adjudication, however, defendants still must make a prima facie showing that plaintiffs could not prove that any irregularity occurred. This initial burden required defendants here to "present evidence" that they complied with the statutory procedures applicable to this foreclosure. (*Hypertouch, supra*, 192 Cal.App.4th at p. 838.) Their failure to do so means that they failed to "conclusively negate[]" the first element of plaintiffs' foreclosure claims. (*Ibid*.)

ii. Defendants did not make a prima facie showing that plaintiffs suffered no harm from the procedural defect

The second element necessary to set aside a foreclosure requires the plaintiff to show that he or she was "prejudiced or harmed" by defendants' failure to comply "with the procedural requirements for the foreclosure sale." (See *Lona, supra,* 202 Cal.App.4th at p. 104 ["to challenge a sale successfully there must be evidence of a failure to comply with the procedural requirements for the foreclosure sale that caused prejudice to the person attacking the sale"].)

Section 729.050's notification requirement serves two purposes. First, it ensures that the debtor is aware that the property may still be redeemed. Second, it informs the debtor the date on which his or her redemption rights expire. Presumably, a debtor who has not received such notice has been harmed or prejudiced by the fact that they were not informed of those rights. (See *Residential Capital v. Cal-Western Reconveyance Corp*. (2003) 108 Cal.App.4th 807, 822 (*Residential Capital*) ["The inquiry is whether . . . there is a . . . defect in the statutory procedure that is prejudicial to the interests of the trustor and claimants"].)

Defendants, however, contend that no such prejudice occurred here because plaintiffs were provided enough information to independently calculate when their redemption period was set to expire. In support, defendants cite evidence indicating that, prior to the foreclosure sale, they provided plaintiffs a statutorily-required notice of intent

to sell stating that: (1) the foreclosure sale was scheduled to occur on January 27, 2009; and (2) the sale would be subject to a right of redemption that would end 90 days after the sale date. Defendants assert that, based on this information, plaintiffs could have determined when their right to redemption ended and therefore were not harmed by the trustee's failure to comply with section 729.050.

For the purposes of this appeal, we assume that defendants did in fact make a prima facie showing that they properly notified plaintiffs that the foreclosure sale was originally scheduled to occur on January 27 and that the sale would be subject to a 90-day right of redemption.[12] Such evidence, however, is insufficient to demonstrate that plaintiffs suffered no prejudice or harm from defendants' failure to comply with the notice requirements of section 729.050. Defendants' argument is predicated on the assumption that a debtor has an independent duty to calculate the applicable redemption period based on information received during the foreclosure process. Section 729.050, however, specifically relieves the debtor of any such burden by requiring the trustee to provide notice of the applicable redemption period promptly after the foreclosures sale.

This post-sale notice requirement is of heightened importance where, as here, the trustee postponed the original sale date without individualized notice to the debtor. Civil Code section 2924g permits a trustee to postpone a foreclosure sale for up to a year by making a public announcement "at the time and place last appointed for sale. . . . No other notice of postponement need be given." (Civ. Code, § 2924g, subd. (d).)[13] Although the foreclosure in this case was originally scheduled for January 27, 2009, the defendants' moving papers state that "[a]t the time and place fixed in the [notice of sale,

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12 Plaintiffs argue that the notice of sale was ineffective because there is a triable issue of fact as to whether defendants sent it to the correct address. For the purpose of our analysis, however, we need not resolve that dispute.

13 The Civil Code has since been amended to require that, as of January 1, 2011, "whenever a sale is postponed for a period of at least 10 business days pursuant to Section 2924g, a mortgagee, beneficiary, or authorized agent shall provide written notice to a borrower regarding the new sale date and time, within five business days following the postponement." (Civ. Code, § 2924, subd. (a)(5).)

the trustee] did, by public announcement . . . postpone the sale date from time to time . . . until July 23." Defendants provided no evidence that they gave plaintiffs any notice regarding the postponements beyond the public announcement requirements described in Civil Code section 2924g. Thus, without the section 729.050 notice, plaintiffs could have only determined their applicable redemption period by attending each of the scheduled sale dates or otherwise researching when, exactly, the sale occurred. Again, section 729.050 relieved them of any such obligation.

Defendants' argument would also permit homeowner associations to ignore section 729.050 without consequence. The defendants were statutorily required to send the pre-sale notice that contained the information they now contend remedied any harm from their subsequent failure to comply with section 729.050. The Civil Code requires that, before conducting a foreclosure sale predicated on delinquent assessment fees, the association must provide a notice of sale that includes the date of the sale and a statement "that the property is being sold subject to the right of redemption." (Civ. Code, §§ 1367.4, subd. (c)(4); 2924b, subd. (b) and 2924f.) Thus, defendants are essentially arguing that a trustee who complies with this pre-sale notice requirement need not comply with section 729.050's post-sale notice requirement. This argument is the antithesis of the statutory scheme, which imposes a duty to provide a pre-sale notice referencing the right to redemption *and* a post-sale notice stating the applicable redemption period. The Legislature plainly concluded that, for the purpose of protecting a CID owner's due process rights, both forms of notice are necessary.

The primary authority defendants cite in support of their assertion that plaintiffs cannot establish harm is *Knapp, supra,* 123 Cal.App.4th 76, which held that "a slight deviation from statutory notice requirements" does not always require a court to "invalidate a foreclosure sale, where the trustee otherwise complies fully with the Civil Code." (*Id*. at p. 93.) The plaintiff in *Knapp* provided evidence that the defendant had served a notice of sale prematurely. Under the Civil Code, the trustee was required to comply with multiple timing requirements when serving the notice of sale: Civil Code section 2924 required the trustee to serve the notice no earlier than "'three months'

following recordation of the notice of default" (*id*. at p. 92), while section 2924b required that the trustee serve "the notice at least 20 days prior to the sale." (*Id*. at p. 88.) The court explained that the evidence showed the trustee "served the [s]ale [n]otice on . . . a date that was slightly less than three months after recordation of the [d]efault [n]otice," but 29 days prior to the sale date. (*Id*. at p. 92.) "Thus, while the [s]ale [n]otice did not comply fully with the three-month requirement under section 2924, it provided more than the 20 days notice mandated under section 2924b . . ." (*Ibid*.)

The court ruled that, under such circumstances, the foreclosure need not be set aside, concluding: "[T]he slight procedural irregularity in the service of the [s]ale [n]otice did not cause any injury to [b]orrowers. They had notice of the original sale date; the trustee's sale did not go forward until almost *one year after* the date noticed. There was no *prejudicial* procedural irregularity." (*Knapp, supra*, 123 Cal.App.4th at p. 94.) In the court's view, the "[b]orrowers' objection to the premature notice [wa]s, in effect, a criticism that the trustee provided *too much* notice of the sale. There [wa]s no evidence that they were prejudiced by the premature mailing of the notice. Given the fact that the trustee's sale did not occur until almost a year after service of the Sale Notice, it is difficult to imagine how Borrowers could claim any prejudice." (*Id.* at p. 96.)

In reaching its holding, the court specifically differentiated prior decisions setting aside foreclosure sales in which the debtor had been denied a "'substantial statutory right'" that was likely to result in prejudice. (*Knapp, supra*, 123 Cal.App.4th at p. 94.) According to the court, "no such substantial statutory right was abridged by trustee's premature mailing of the Sale Notice, which otherwise gave [b]orrowers adequate and timely notice of the trustee's sale." (*Ibid*.)

The facts in *Knapp* bear little resemblances to the facts in this case. The defendants' failure to comply with section 729.050 was not "a slight deviation from statutory notice requirements." (*Knapp, supra*, 123 Cal.App.4th at p. 93.) Defendants did not, as in *Knapp*, send a statutorily-required notice "slightly" prematurely; instead, the evidence suggests that they completely failed to send the notice required under section 729.050. Moreover, unlike in *Knapp*, defendants have provided no evidence that

plaintiffs were not harmed by the procedural defect. Nothing in the defendants' moving papers demonstrates that, despite the lack of section 729.050 notice, plaintiffs were actually aware of the date on which their redemption rights were set to expire but elected not to redeem. At most, defendants have shown that plaintiffs might have been able to calculate when their redemption rights expired based on information that was provided in other statutorily-mandated pre-sale notices.

In sum, the defendants have failed to make a prima facie showing that their failure to comply with section 729.050 was not "prejudicial to the interests of the . . . claimants." (*Residential Capital, supra,* 108 Cal.App.4th at p. 822.) Because the defendants have provided no evidence that plaintiffs were notified, or were otherwise aware of the actual date on which their right to redemption expired, we cannot conclude that plaintiffs suffered no prejudice.[14]

iii. Defendants failed to establish that the tender rule precluded plaintiffs from seeking to set aside the foreclosure sale

The defendants argue that plaintiffs cannot satisfy the third element necessary to set aside a foreclosure sale, which requires a showing that "the trustor . . . tendered the amount of the secured indebtedness or was excused from tendering." (*Lona*, *supra*, 202 Cal.App.4th at p. 104.) Defendants assert that plaintiffs have admitted they never offered

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14 Defendants also argue that plaintiffs were not harmed by the trustee's failure to comply with section 729.050 because, shortly after the foreclosure sale, the trustee recorded a certificate of sale referencing the date of the sale and the 90 day redemption period. According to defendants, the trustee's recording of the certificate provided plaintiffs "constructive notice of the right to redemption." This argument fails for the same reasons discussed above. First, the argument presumes that plaintiffs had a duty to monitor whether a certificate of sale was recorded against their property. The Legislature relieved CID owners of any such duty by requiring that the trustee provide notice of the redemption period promptly after the sale pursuant to section 729.050. Second, the trustee's act of recording a certificate of sale that included the sale date and a statement regarding the right to redemption was statutorily mandated under section 729.040. Thus, defendants argue that a trustee who complies with section 729.040's recording requirements need not comply with section 729.050's post-sale notice requirements. Such an outcome would be inconsistent with the legislative scheme.

to pay the full amount of the debt and are therefore precluded from challenging the foreclosure sale.

The tender requirement is rooted in the equitable nature of an action to set aside a nonjudicial foreclosure. "Because the action is in equity, a defaulted borrower who seeks to set aside a trustee's sale is required to do equity before the court will exercise its equitable powers. [Citation.] Consequently, as a condition precedent to an action by the borrower to set aside the trustee's sale on the ground that the sale is voidable because of irregularities in the sale notice or procedure, the borrower must offer to pay the full amount of the debt for which the property was security. [Citation.] '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].' [Citation.]" (*Lona*, *supra*, 202 Cal.App.4th at p. 112.)

There are, however, several exceptions to the requirement. "First, if the borrower's action attacks the validity of the underlying debt, a tender is not required since it would constitute an affirmation of the debt. [Citation.] [¶] Second, a tender will not be required when the person who seeks to set aside the trustee's sale has a counter-claim or setoff against the beneficiary. In such cases, it is deemed that the tender and the counter claim offset one another, and if the offset is equal to or greater than the amount due, a tender is not required. [Citation.] [¶] Third, a tender may not be required where it would be inequitable to impose such a condition on the party challenging the sale [Citation.] . . . . [¶] Fourth, no tender will be required when the trustor is not required to rely on equity to attack the deed because the trustee's deed is void on its face. [Citation.]" (*Lona*, *supra*, 202 Cal.App.4th at pp. 112-113.)

As discussed above, a nonjudicial foreclosure by an association predicated on delinquent assessment fees is unique in that the CID owner is entitled to a post-sale right of redemption. (See Civ. Code, § 1367.4, subd. (c)(4); § 729.035.) Under these redemption rights, the property owner is entitled to receive notice of the applicable redemption period and then pay the redemption price or contest the redemption price through a judicial proceeding. (See §§ 729.050 -729.080.) Therefore, unlike most forms

of nonjudicial foreclosure, CID owners are provided an opportunity to avoid the loss of their property either by tendering the amount of the debt prior to the sale or paying the applicable redemption price – which consists of the purchase price and various other costs – after the sale.

Defendants assume, without discussion, that the tender requirement applies where, as here, the debtor is seeking to set aside a nonjudicial foreclosure subject to a statutory, post-sale right of redemption. Although we have found no authority analyzing the issue, we conclude that a debtor is properly excused from complying with the tender requirement where the nonjudicial foreclosure is subject to a statutory right of redemption and the trustee has failed to provide the notice required under section 729.050.

Applying the tender rule under such circumstances would be inconsistent with the statutory scheme. CID owners who were denied their statutory right to be notified of the redemption process could only challenge the denial of that right by offering to tender the amount of the secured debt. In other words, CID owners could only challenge an association's failure to provide notice of the redemption process by offering to forego the redemption process. Such an outcome would be neither logical nor equitable.

Defendants argue that even if plaintiffs were not required to tender the amount of the secured debt as a condition of bringing their suit, they were nonetheless required to tender the redemption price, thereby ensuring that they could have redeemed the property had section 729.050 been properly followed. Defendants' argument overlooks the fact that, under the statutory framework governing redemption, if the debtor and the purchaser disagree on the proper redemption price, the debtor may seek a judicial determination of the appropriate price. (See § 729.070.) Under defendants' theory, however, CID owners would have to affirm the purchaser's claimed redemption price through an offer of tender – thereby effectively waiving their right to seek a judicial determination of the redemption price – as a condition of challenging an association's failure to comply with section 729.050. Given that the tender rule is inapplicable where the debtor's action attacks the validity of the underlying debt, the rule should not be applied in a manner that

would require a CID owner who never received notice of his redemption rights to forego any challenge to the redemption price.

Because defendants failed to make a prima facie showing that plaintiffs cannot establish any of the three elements necessary to set aside the foreclosure, it is not entitled to summary adjudication on plaintiffs second, third, sixth or seventh causes of action.

C. *Plaintiffs Have Forfeited Any Claim of Error Regarding Additional Causes of Action Pleaded in the Second Amended Complaint*

In addition to their four claims seeking to set aside the foreclosure, plaintiffs' second amended complaint asserts thirteen tort and statutory-based claims arising from various acts that defendants allegedly committed during the foreclosure process. The trial court dismissed all thirteen of these additional claims at various points in the proceedings. The court sustained a demurrer without leave to amend on two of the claims – violation of the Fair Debt Collection Practices Act and RICO – prior to the hearing on the motion for summary adjudication. The trial court's order granting defendants' motion for summary adjudication dismissed five of the claims – fraud, breach of fiduciary duty, intentional infliction of emotional distress and unfair business practices – on the basis that each claim was predicated on "actions . . . subject to immunities set forth in [Civil Code sections] 47 and 2924(b)." The summary adjudication order also dismissed plaintiffs' four interference claims, concluding that they were "time barred." Finally, the court dismissed the remaining three claims for violation of the Unruh Act, accounting and forcible detainer pursuant to an order granting defendants' motion for judgment on the pleadings.

Although a large majority of plaintiffs' 60-page brief argues that we should reinstate their foreclosure claims because there is evidence defendants committed various procedural irregularities, the final five pages of the brief asserts that their "claims for wrongful closure are not based on a communicative act" and are therefore not precluded under the "litigation privilege." (See Civ. Code, § 47, subd. (b).) In the course of this discussion, plaintiffs allude to various other claims in their complaint. Specifically,

plaintiffs assert that Civil Code "[s]ection 47(b)(2), does not bar Plaintiffs' cause of action for intentional interference with contractual relations because it is based upon an alleged tortious course of conduct. While the isolated act of filing a notice of lien was communicative, it was only one act in the overall course of conduct alleged in Appellant's eight through twentieth causes of action." This five-page section of the brief does not include a single citation to the record.

For the purposes of this appeal, we need not assess whether the litigation privilege applies to plaintiffs' claims seeking to set aside the foreclosure sale. The trial court's order granting the motion for summary adjudication demonstrates that it dismissed those particular claims based on its finding that that plaintiffs had not complied with the tender rule and had not been prejudiced by any "procedural irregularity," not because the claims were precluded under the litigation privilege. For the reasons discussed above, we have reversed the trial court's dismissal of those claims.

As to the remaining causes of action set forth in the second amended complaint, plaintiffs have forfeited any claim of error. "[I]t is appellant's burden to affirmatively show error. [Citation.] To demonstrate error, appellant must present meaningful legal analysis supported by citations to authority and citations to facts in the record that support the claim of error. [Citations.]" (*In re S.C.* (2006) 138 Cal.App.4th 396, 408 (*S.C.*).) "Mere suggestions of error without supporting argument or authority other than general abstract principles do not properly present grounds for appellate review." (*Department of Alcoholic Beverage Control v. Alcoholic Beverage Control Appeals Bd.* (2002) 100 Cal.App.4th 1066, 1078.) "Hence, conclusory claims of error will fail." (*S.C., supra,* 138 Cal.App.4th at p. 408.)

Plaintiffs' conclusory assertions that the litigation privilege does not apply to their "cause of action for intentional interference with contractual relations" or their "eight through twentieth causes of action"[15] does not constitute "adequate factual or legal analysis." (*Placer County Local Agency Formation Com. v. Nevada County Local*

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15 Although plaintiffs' brief reference their "eight through twentieth causes of action," the second amended complaint only contains eighteen claims.

Agency Formation Com. (2006) 135 Cal.App.4th 793, 814.) The record demonstrates that most of these claims were not dismissed pursuant to the litigation privilege. The trial court dismissed the plaintiffs' thirteenth through sixteenth claims, which allege interference with contract relations and prospective economic advantage, based on the statute of limitations. The tenth and eleventh claims for violation of the Fair Debt Practices Act and RICO were dismissed pursuant to an order sustaining a demurrer that is not in the record and was not appealed by plaintiffs. The plaintiffs' twelfth and seventeenth claims for forcible detainer and an accounting were dismissed pursuant to an order granting defendants' motion for judgment on the pleadings. Plaintiffs, however, provide no independent legal analysis of that motion or the resulting order.

Plaintiffs' discussion of the litigation privilege consists of little more than a summary of general abstract principles that is devoid of a single citation to the record. (See generally *Metzenbaum v. Metzenbaum* (1950) 96 Cal.App.2d 197, 199 ["An appellate court cannot be expected to search through a voluminous record to discover evidence on a point raised by appellant when his brief makes no reference to the pages where the evidence on the point can be found in the record"].) Although plaintiffs' brief summarizes various holdings pertaining to different aspects of the litigation privilege, it fails to adequately explain how those holdings relate to the non-foreclosure claims asserted in the complaint.

In sum, to the extent plaintiffs were requesting that we reverse the trial court's dismissal of any claims beyond those seeking to set aside the foreclosure sale, they failed "to provide meaningful legal analysis and record citations for [their] complaints." (*S.C., supra,* 138 Cal.App.4th at p. 408.)[16] These claims have therefore been abandoned. (*Reyes, supra,* 65 Cal.App.4th at p. 466, fn. 6)

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16 The final paragraph of plaintiffs' brief asserts that "Respondents were awarded attorneys' fees as prevailing parties" and requests that the "award of costs and attorney's fees . . . be vacated." This portion of the brief does not contain any citation to legal authority or the record. Moreover, the plaintiffs failed to include a copy of the order awarding fees and costs in the appellate record. Without such materials, we have no basis

DISPOSITION

The trial court's judgment is reversed and the case is remanded for further proceedings. The trial court's order granting defendants' motion for summary judgment, or, in the alternative, summary adjudication is reversed to the extent it dismisses plaintiffs' second, third, sixth and seventh claims. The trial court's order granting defendants' motion for judgment on the pleadings is affirmed. Each party shall its own costs.

ZELON, J.

We concur:

PERLUSS, P. J.

JACKSON, J.

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to review the order. (*Buckhart v. San Francisco Residential Rent Etc., Bd.* (1988) 197 Cal.App.3d 1032, 1036 ["The appellant must affirmatively demonstrate error by an adequate record"].)

Filed 2/11/13

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION TWO

SCOTT CALL JOLLEY, Plaintiff and Appellant, v. CHASE HOME FINANCE, LLC et al., Defendants and Respondents.	A134019 (Marin County Super. Ct. No. CIV1002039)

Plaintiff Scott Call Jolley and Washington Mutual Bank (WaMu) entered into a construction loan agreement in 2006, which eventually encountered problems due to alleged failures by WaMu to properly disburse construction funds. As Jolley was continuing to attempt to salvage the transaction, WaMu went into receivership with the Federal Deposit Insurance Corporation (FDIC), and in September 2008 JP Morgan Chase[1] (Chase) bought WaMu's assets through a purchase and assumption agreement (Agreement or P&A Agreement). Jolley soon stopped making payments on the loan, and in late 2009 Chase took steps to foreclose.

Two days before the scheduled foreclosure sale, Jolley sued Chase and California Reconveyance Company (CRC), the trustee, alleging eight causes of action, including misrepresentation, breach of contract, and negligence. Defendants jointly moved for summary judgment or, in the alternative, summary adjudication, Chase's position based in large part on the theory that under the P&A Agreement Chase had not assumed the liabilities of WaMu. The Agreement was put before the court only in a request for

[1] J.P. Morgan Chase is the successor corporation to both Chase Home Finance LLC and California Reconveyance Company (CRC). We refer to the Chase entities collectively as "Chase."

judicial notice, which Agreement, an expert witness for Jolley declared, was not complete. Without addressing the expert's testimony, the trial court granted the request for judicial notice and, rejecting all of Jolley's arguments, granted summary judgment for both defendants.

Jolley appeals, arguing that there are triable issues of material fact relating to the financing debacle, not just limited to the claimed inauthenticity of the Agreement but also as to misconduct by Chase itself. We agree, and we reverse the summary judgment for Chase, concluding that six causes of action must proceed against it, all but the causes of action for declaratory relief and accounting. We affirm the summary judgment for CRC.

BACKGROUND

The Underlying Facts

In January 2006 Jolley entered into a construction loan agreement with WaMu through which he borrowed $2,156,000 to renovate a house to be used as a rental property in Tiburon, a property he had earlier purchased with a loan from WaMu, having put down $330,000 on the $1,650,000 purchase price. After the construction loan agreement was signed, WaMu disbursed the money to pay off its own first mortgage, approximately $1.3 million. Jolley understood that approximately $1 million would be available to cover construction costs for the renovation.

Jolley claims WaMu lost the loan documents, which held up construction financing for approximately eight months. Construction went forward nonetheless, with Jolley incurring at least $100,000 in construction expense. Jolley testified that WaMu made false representations, including that amounts prepaid for construction ($328,308.79) would be reimbursed to him. He further claims there were significant irregularities in the loan disbursements, with the result that WaMu claimed it had disbursed more of the money than he had actually received, which errors caused delays in construction that resulted in financial losses.

Jolley retained an attorney to assist him, and by May 2006 the attorney had written to WaMu to try to straighten out these problems. In August 2006 Jolley retained Jeffrey Thorne, a former WaMu employee, to review implementation of the agreement and to

facilitate its modification. Thorne went through the files and concluded that Jolley had not received approximately $350,000 due him under the loan agreement. Thorne wrote a detailed memorandum to WaMu explaining the problems, which memorandum recommended that the loan amount be increased to $2,485,000.

WaMu "eventually agreed to the modification . . ." and on October 5, 2006 WaMu and Jolley executed a loan modification based on an expansion of the original construction project from 2500 square feet to 5000. This was done at WaMu's insistence, as Jolley was told that increasing the size and scope of the project would qualify him for a higher loan amount. Even at that time, Thorne warned that the loan amount needed to be increased by $400,000 to complete the enlarged project. The modification agreement itself does not specify a new maximum amount to be disbursed, but indicates the new principal amount would be "Variable: new principal amount." And WaMu "promised that if [Jolley] increased the square footage and scope of the work that [WaMu] would supply the additional funds needed to complete the construction . . . ."

The modified agreement called for completion of construction by July 1, 2007, and required Jolley to make monthly interest and principal payments of $16,181.12 beginning August 1.[2] Exactly what transpired from October 2006 to September 2008 is somewhat hazy from the record, but construction apparently continued, with Jolley continuing to make interest payments. If we read Chase's documents correctly, the last disbursement was in June 2008.

On September 25, 2008, WaMu was closed by the Office of Thrift Supervision, and the FDIC was appointed receiver. (U.S. Dept. of the Treasury, Office of Thrift Supervision Order No. 2008-36 (Sep. 25, 2008); 12 U.S.C. § 1821(c).) On the same date,

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[2] Payments on the construction loan were interest only during construction and varied in amount depending on the status of funding. Once construction had been completed, the balance of the loan was to be rolled over into a fully amortized mortgage on the home. A reserve was included to pay the interest payments during construction. Because the reserve was calculated based on the predicted length of construction, it proved to be insufficient to cover interest payments during the extended construction period.

Chase acquired certain assets of WaMu, including all loans and loan commitments. According to Chase, the acquisition was pursuant to the P&A Agreement, which agreement was between the FDIC as receiver and Chase.

Section 2.1 of the Agreement specified the liabilities Chase was assuming: "Subject to Sections 2.5 and 4.8, the Assuming Bank expressly assumes at Book Value (subject to adjustment pursuant to Article VIII) and agrees to pay, perform, and discharge, all of the liabilities of the Failed Bank which are reflected on the Books and Records of the Failed Bank as of Bank Closing, including the Assumed Deposits and all liabilities associated with any and all employee benefit plans, except as listed on the attached Schedule 2.1, and as otherwise provided in this Agreement (such liabilities referred to as 'Liabilities Assumed'). Notwithstanding Section 4.8, the Assuming Bank specifically assumes all mortgage servicing rights and obligations of the Failed Bank." Jolley contends Chase assumed liability for WaMu's failures in servicing Jolley's loan as part of its "mortgage servicing . . . obligations."

Section 2.5 of the Agreement expressly provided, however, that Chase would assume no liabilities associated with borrower claims arising out of WaMu's lending activities: "Notwithstanding anything to the contrary in this Agreement, any liability associated with borrower claims for payment of or liability associated with borrower claims for payments of or liability to any borrower for monetary relief, or that provide for any other form of relief to any borrower, whether or not such liability is reduced to judgment, liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, legal or equitable, judicial or extra-judicial, secured or unsecured, whether asserted affirmatively or defensively, related in any way to any loan or commitment to lend made by the failed Bank prior to the failure, or to any loan made by a third party in connection with a loan which is or was held by the Failed Bank, or otherwise arising in connection with the Failed Bank's lending and loan purchase activities are specifically not assumed by the assuming Bank." As will be seen, this paragraph played a central role in the trial court's decision granting summary judgment.

According to Jolley's testimony, "Once Chase had taken over the operations of [WaMu], they continued in the construction loan department with the same people that I had been dealing with when [Wamu] still owned the loan. I had dealt with Mabette Del Rosario, Neil Lampert, and Jed Sonstrom in the legal department . . . . After the takeover by Chase, Mabette Del Rosario continued to run the construction disbursement department. I was led to believe that because Chase had taken over the loan from [Wamu], it was still going to honor the original agreement which said in the addendum Construction/Permanent Loan Part One: 'When all conditions prior to rollover are met as described in the construction loan agreement, the loan will rollover to a fully amortized loan.' " Another Chase employee with whom Jolley would come to deal was Andrew North.

In November 2008, shortly after Chase had entered the picture, Jolley made his last monthly payment on the loan, claiming he was forced to default thereafter by WaMu's breaches and negligence in the funding of the construction loan. The total amount owing on the loan by the time of Jolley's default, according to Chase's records, was $2,426,650.00. At the time of Jolley's default, construction had not been completed, but was allegedly completed sometime between April 2009 and April 2010.

After Chase's involvement Jolley tried to secure a loan modification, with Thorne continuing to advocate on Jolley's behalf that he would need an additional $400,000 to complete construction. Thorne and Jolley both told Chase "in great detail" about the prior problems with the loan.

As indicated, the original construction loan contained a rollover provision. Chase claims it was not obligated to honor it because Jolley was in default and construction had not been completed when he went into default, and thus "all conditions prior to rollover" had not been met.

But, Jolley testified, he was encouraged on many occasions by North that, in light of the history of problems with WaMu, there was a "high probability" that Chase "would be able to modify the loan so as to avoid the foreclosure." North said the "likelihood was good," that it was "likely" when construction was complete he could roll the construction

loan into a fully amortized conventional loan. Jolley further testified that as a result of these representations he was induced to complete construction at a cost of $100,000, borrowing from family and friends to do so. In addition to other damages, Jolley claims the construction delays and "inordinate delay" during the loan modification negotiations prevented him from selling the property before the housing market collapsed.

Ultimately, instead of agreeing to a loan modification, Chase demanded payment of the loan in full.[3] On December 29, 2009, CRC, as trustee, recorded a notice of default, and on March 30, 2010, recorded and served a notice of sale.

On April 5, 2010 North sent Jolley an email saying he had requested the Chase foreclosure department to hold off on its planned foreclosure, "which means any future sale dates will be postpone [*sic*] to give us the opportunity to see if we can modify the collateral property." Chase refused.

The Proceedings Below

The Complaint

On April 19, 2010, two days before the scheduled foreclosure sale, Jolley filed this lawsuit. It named Chase Home Finance LLC and CRC, and alleged eight causes of action: (1) fraud and deceit—intentional misrepresentation;[4] (2) fraud and deceit—negligent misrepresentation; (3) breach of contract/promissory estoppel; (4) negligence; (5) violation of Business and Professions Code section 17200 et. seq.; (6) declaratory relief; (7) accounting; and (8) reformation. Though CRC was named as a defendant, no specific wrongdoing was alleged with respect to it.

On April 20, 2010, Jolley obtained a temporary restraining order prohibiting Chase from going forward with the trustee's sale. And on August 20, 2010, a preliminary injunction was issued, with Jolley putting up a $50,000 bond.

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[3] Documents submitted by Chase show the outstanding principal owing at default in December 2008 was $2,426,650, increased to $2,632,066.99 when the notice of default was recorded. By the time the motion was filed in August 2011, Chase calculated it was owed $3,019,693.29.

[4] Jolley's complaint referred to both WaMu and Chase collectively as "the Bank," making it difficult to ascertain which conduct was alleged with respect to which entity.

Meanwhile, an answer was filed on behalf of Chase and CRC jointly.

Jolley's lawsuit rested in part on the theory that Chase was the successor in interest to WaMu and therefore had "stepp[ed] into the shoes" of WaMu and was liable for any misrepresentation, negligence, or breach of contract on its part under California law and under the construction contract he had signed with WaMu. Jolley relied on language in paragraph 13 of his agreement with WaMu that made "the covenants and agreements" binding on "the successors and assigns of [WaMu]." Jolley also relied on Civil Code section 1589, which requires one who takes the benefit of a transaction to also assume its liabilities.[5]

The Motion and the Request for Judicial Notice

On August 25, 2011, Chase[6] filed a motion for summary judgment or, in the alternative, summary adjudication, fundamentally claiming that it had no liability for borrower claims based on WaMu's conduct prior to the FDIC receivership. It relied on federal law relating to the powers of the FDIC as receiver and on the terms of the P&A Agreement, specifically that it had acquired only the assets of WaMu in its purchase from the FDIC, not the liabilities. This contention was based on section 2.5 of the Agreement quoted above, which had also been asserted as an affirmative defense in Chase's answer. The motion was set for hearing on November 15, 2011.

Simultaneously with filing its motion, Chase filed a request for judicial notice that requested "the Court to take judicial notice pursuant to California Evidence Code Sections 450-460" of five facts, the first of which was as follows:

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[5] That section reads: "A voluntary acceptance of the benefit of a transaction is equivalent to a consent to all the obligations arising from it, so far as the facts are known, or ought to be known, to the person accepting." (Civ. Code, § 1589.)

[6] The motion was actually filed on behalf of both named defendants, Chase, and CRC. As noted, no charging allegations were made in Jolley's complaint against CRC, and his opposition to the motion said essentially nothing about it. Thus, the focus of the proceedings below, and here, is on Chase, and for ease of discussion we refer to Chase as the moving party.

"1. On September 25, 2008, Washington Mutual Bank, _.A. ("WaMu") was closed by the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation (FDIC) was named Receiver for WaMu pursuant to its authority under the Federal Deposit Insurance Act, 12 U.S.C. § 1821(d). Pursuant to the Purchase and Assumption Agreement between the FDIC as Receiver for WaMu, and Chase, dated September 25, 2008, Chase acquired certain of the assets of WaMu, including all loans and loan commitments of WaMu. A copy of that Purchase and Assumption Agreement is attached hereto as Exhibit A and can be found on the FDIC's website at http://www.fdic.gov/about/freedom/Washington_Mutual_P_and _A.pdf."[7] The attached copy was 39 pages, including exhibits. No separate points and authorities accompanied Chase's request for judicial notice.

Jolley's Opposition

Jolley filed opposition to the motion. He also objected to the request for judicial notice as to the P&A Agreement, and filed points and authorities supporting his position, most fundamentally disputing that the 39-page Agreement was the complete document governing Chase's purchase of WaMu. Thorne, who at one time worked at the FDIC as an independent contractor, filed a declaration stating he had seen and read a 118-page P&A Agreement for the Chase purchase of WaMu. Thorne claimed the longer document had never been made public and its provision governing assumption of liability was different.

In November 2011, Jolley began trying to secure a copy of the 118-page agreement referred to in Thorne's declaration. His counsel requested a copy from the FDIC, and also apparently served a subpoena duces tecum seeking production of it. According to Jolley's counsel, the FDIC refused to produce the document unless all parties to the litigation signed a confidentiality agreement. On November 9, 2011, six days before the motion was to be heard, Jolley requested that counsel for Chase sign a

[7] The remaining "facts" were four paragraphs attaching what were claimed to be "certified" or "true and correct" copies of documents recorded in Marin County.

confidentiality agreement. She refused to do so.[8] On or about November 14, 2011, Jolley filed an ex parte application seeking to continue the motion, to keep discovery open, and to continue the trial date so that further efforts could be made to obtain the longer agreement.[9]

Meanwhile, Chase had filed a reply to Jolley's opposition, which included 62 objections to Jolley's evidence, 40 of which objected to particular testimony in Thorne's declaration or his deposition.

The Ruling on the Motion

Argument on the motion was heard on November 15, most of which focused on Thorne's declaration, at the conclusion of which the matter was taken under submission. On December 1, the court entered its order granting summary judgment, which order reads in pertinent part as follows:

"The Court affirms its tentative ruling which stated as follows:

"The undisputed evidence establishes that Defendant Chase Home Finance, LLC (Chase) is not liable for the alleged intentional and negligent misrepresentations (causes of action nos. 1 & 2), made to Plaintiff by employees of the Washington Mutual Bank in relation to the Construction Loan issued to Plaintiff, pursuant to the Purchase and Assumption Agreement through which Chase acquired Washington Mutual from the FDIC on September 25, 2008.

"Under that Agreement, Chase expressly did not assume liability for borrower's claims 'related in any way to any loan or commitment to lend made by the Failed Bank prior to failure, . . .' or 'otherwise arising in connection with [WaMu's] lending or loan purchase activities . . . .' (Request to Take Judicial Notice, Ex. 1, P&A Agreement ¶ 2.5) [¶] . . . [¶]

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[8] We cast no aspersions on Chase's counsel for her position, as the confidentiality agreement prepared by Jolley's counsel did not specify the documents requested.

[9] We find no express ruling on Jolley's ex parte application for a continuance, but it was effectively denied by the grant of summary judgment.

“The third cause of action for Breach of Contract/Promissory Estoppel also fails, as the undisputed evidence shows that Defendants never promised to modify the Washington Mutual Construction, or to issue Plaintiff any additional funds to complete the Project. No enforceable promise or loan modification agreement was created by Chase’s conduct.

“Chase’s employee Mr. North’s representations to Plaintiff that approval of his loan modification application was “likely”, “highly probable”, and “looks good”, are all opinions of Mr. North, which do not create a binding commitment to modify a loan, nor do they represent the fact that the loan has been approved.

“These hopes or expectations expressed by North do not constitute either: a clear and unambiguous promise to approve the application; nor do they evidence any terms to create an enforceable contract. (See *Laks v. Coast Fed. Sav. & Loan Assn.* (1976) 60 Cal.App.3d 885, 891, 893 [agreement to make construction loan was expressly conditional, and lacked essential terms of the loan, and could not support a cause of action for promissory estoppel].)

“Also, there is no evidence to suggest that Mr. North had authority to approve a loan modification either by himself, or with the consent of others.

“A borrower’s ‘understanding or expectation that the Bank would extend a loan is not sufficient to establish an agreement to make a loan. [Citation.]’ (*Conrad v. Bank of America* (1996) 48 Cal.App.4th 133, 156.) ‘To be enforceable, a promise must be definite enough that a court can determine the scope of the duty and the limits of performance must be sufficiently defined to provide a rational basis for the assessment of damages. [Citations.]’ (*Ladas v. California State Auto. Assn.* (1993) 19 Cal.App.4th 761, 770.) ‘When the evidence clearly shows that the only (and the complete) subject matter that is under consideration is left for further negotiation and agreement, there is no contract, not for vagueness or indefiniteness of terms but for lack of any terms. [Citation.]’ (*Kruse v. Bank of America* (1988) 202 Cal.App.3d 38, 59.)

“The motion is granted on the fourth cause of action for Negligence.

“ ‘Under California law, a lender does not owe a borrower or third party any duties beyond those expressed in the loan agreement, except those imposed due to special circumstance.’ (*Sipe v. Countrywide Bank* (E.D.Cal. 2010) 690 F.Supp.2d 1141, 1153, citing *Nymark v. Heart Fed. Savings & Loan Assn.,* (1991) 231 Cal.App.3d 1089, 1096.) . . . .

“The undisputed evidence shows that Chase and Plaintiff engaged in the typical lender/borrower relationship. Plaintiff has not presented evidence of special circumstances on which to impose a general duty of due care. (See *Sipe v. Countrywide Bank* (E.D.Cal. 2010) 690 F.Supp.2d 1141, 1153.)

“Moreover, the complaint does not allege, and there is no evidence to establish, that Chase committed a negligent act after acquiring Plaintiff’s loan.”

Then, after disposing of the other four causes of action, the order concludes with this: “Defendants’ Request to Take Judicial Notice is granted. (Evid. Code § 452(c)(d)).”

No ruling was made on any of the evidentiary objections.

Judgment was thereafter entered accordingly, from which Jolley filed a timely notice of appeal.

DISCUSSION

1. <u>Summary Judgment Law and the Standard of Review</u>

We collected and confirmed the applicable law in *Nazir v. United Airlines, Inc.* (2009) 178 Cal.App.4th 243, 253-254:

“Code of Civil Procedure section 437c, subdivision (c) provides that summary judgment is properly granted when there is no triable issue of material fact and the moving party is entitled to judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c).) As applicable here, moving defendants can meet their burden by demonstrating that ‘a cause of action has no merit,’ which they can do by showing that ‘[o]ne or more elements of the cause of action cannot be separately established.’ (§ 437c, subd. (*o*)(1); see also *Romano v. Rockwell Internat., Inc.* (1996) 14 Cal.4th 479, 486-487.) Once defendants meet this burden, the burden shifts to plaintiff to show the existence of a triable issue of material fact. (§ 437c, subd. (p)(2).)

"On appeal '[w]e review a grant of summary judgment de novo; we must decide independently whether the facts not subject to triable dispute warrant judgment for the moving party as a matter of law. [Citations.]' (*Intel Corp. v. Hamidi* (2003) 30 Cal.4th 1342, 1348.) Put another way, we exercise our independent judgment, and decide whether undisputed facts have been established that negate plaintiff's claims. (*Romano v. Rockwell Internat., Inc., supra*, 14 Cal.4th at p. 487.) As we put it in *Fisherman's Wharf Bay Cruise Corp. v. Superior Court* (2003) 114 Cal.App.4th 309, 320: '[W]e exercise an independent review to determine if the defendant moving for summary judgment met its burden of establishing a complete defense or of negating each of the plaintiff's theories and establishing that the action was without merit.' (Accord, *Certain Underwriters at Lloyd's of London v. Superior Court* (2001) 24 Cal.4th 945, 972.)

"But other principles guide us as well, including that '[w]e accept as true the facts . . . in the evidence of the party opposing summary judgment and the reasonable inferences that can be drawn from them.' (*Morgan v. Regents of University of California* (2000) 88 Cal.App.4th 52, 67.) And we must ' "view the evidence in the light most favorable to plaintiff[] as the losing part[y]" and "liberally construe plaintiff['s] evidentiary submissions and strictly scrutinize defendant['s] own evidence, in order to resolve any evidentiary doubts or ambiguities in plaintiff['s] favor." ' (*McDonald v. Antelope Valley Community College Dist.* (2008) 45 Cal.4th 88, 96–97.)"

2. <u>The P&A Agreement: Judicial Notice, the Law, and Thorne's Testimony</u>

As noted, Chase requested judicial notice of the P&A Agreement attached to the declaration of its counsel who represented that it was a copy of the agreement found on the FDIC website. The declarant was not a custodian of records, was not a party to the Agreement, gave no indication she was involved in negotiating or drafting it, and provided no background as to how she acquired knowledge of the document. Indeed, she did not even aver it was a true and complete copy.

We also note that the request was for judicial notice of the fact that on September 25, 2008, "Chase acquired certain of the assets of WaMu, including all loans and loan commitments of WaMu." The papers did *not* request judicial notice that Chase

did *not* assume liabilities based on borrower claims. Unquestionably, the trial court below used the Agreement for a much broader purpose, namely to prove that Chase did not assume liability for WaMu's alleged misdeeds with respect to Jolley's loan.

We conclude this was error, and that the content and legal effect of the P & A Agreement could not properly be determined on judicial notice under California law. And certainly not here.

Judicial notice, of course, may be utilized on a motion for summary judgment. (Code Civ. Proc., § 437c, subd. (b)(1); *Herrera v. Deutsche Bank National Trust Co.* (2011) 196 Cal.App.4th 1366, 1374.) But only to the extent authorized by our state statutes. (Evid. Code, § 450.)

As noted above, Chase's request for judicial notice requested it, however unhelpfully, "pursuant to . . . Evidence Code sections 450-460." As also noted, the order granting summary judgment ended with the ruling that Chase's request for judicial notice was also granted, citing Evidence Code section 452, subdivisions (c) & (d).

The Evidence Code section cited by the trial court allow for permissive judicial notice respectively of "(c) Official acts of the legislative, executive, and judicial departments of the United States and of any state of the United States" and "(d) Records of (1) any court of this state or (2) any court of record of the United States or of any state of the United States." (Evid. Code, § 452, subds. (c) & (d).)

Certainly the P&A Agreement does not come within subdivision (d), as it is not a record of any court. And while it is true that subdivision (c) "enables courts in California to take notice of a wide variety of official acts. . . . [and] an expansive reading must be provided to certain of its phrases [and] included in 'executive' acts are those performed by administrative agencies. . . ." (Simons, California Evidence Manual (2012) Judicial Notice § 7:11, p. 544), we do not understand a contract with a private bank to come within that subdivision.

Apparently satisfied itself that the two subdivisions cited in the trial court's order are unsupportive, Chase's brief cites two different subdivisions, and asserts that "judicial notice may be taken of the following:

"(g) Facts and propositions that are of such common knowledge within the territorial jurisdiction of the court that they cannot reasonably be the subject of dispute.

"(h) Facts and propositions that are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy."

In claimed support, Chase first cites some cases clearly inapposite, such as cases dealing with State Bar records (*In re White* (2004) 121 Cal.App.4th 1453) and the "definition of 'mass transportation.' " (*Shaw v. People ex rel. Chiang* (2009) 175 Cal.App.4th 577). Chase then goes on: "[s]imilarly, under federal law the information on government agency websites has often been treated as a proper subject for judicial notice by numerous circuits (*See, e.g., Paralyzed Veterans of Am. v. McPherson*, No. C 06-4670 SBA, 2008 WL 4183981, at p. *5 (N.D. Cal. Sept. 9, 2008) (and cases cited therein).) [¶] Here, the P&A Agreement is available on a public Web site maintained by the FDIC. It is not reasonably subject to dispute and is capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy. The taking of judicial notice of the terms of the P&A Agreement was not in error."[10] (Fn. omitted.) Chase then concludes as follows: "Chase and CRC sought the

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[10] The referenced footnote says that "Federal Courts have taken judicial notice of the P&A Agreement and similar agreements with the FDIC. (*Allen v. United Fin. Mortgage Corp.*, 660 F.Supp.2d 1089, 1093 (N.D. Cal. 2009) (judicial notice taken of the P&A Agreement even though a few pages missing from that offered by defendant, because the Agreement is available online, from the FDIC's web site; *In re Sharp*, Case No. 09-13980 A P. No. 10-1032 (N. D. Cal. Bk.); *Jarvis v. JP Morgan Chase Bank*, *N.A.*, 2010 WL 2927276, at *1, (C.D. Cal. July 23, 2010); *see also Yeomalakis v. F.D.I.C.*, 562 F.3d 56, 60 (1st Cir. 2009.) (Resp. App. 86-89.)"

Some federal courts have taken judicial notice of the same or similar purchase and assumption agreements, frequently without discussion or analysis, either because they were deemed "public records" or because their contents could be "accurately and readily determined from sources whose accuracy cannot reasonably be questioned." (Fed. Rules Evid., rule 201(b)(2); *Rosenfeld v. JPMorgan Chase Bank, N.A.* (N.D.Cal. 2010) 732 F.Supp.2d 952, 958-960 [dismissing claims against Chase despite claim that it engaged in loan modification negotiations with plaintiff]; *McCann v. Quality Loan Service Corp.* (W.D.Wash. 2010) 729 F.Supp.2d 1238, 1241-1242 [in context of claims

taking of judicial notice of a document which is not hearsay, but which itself contains admissible evidence."

Maybe some federal cases might allow this. California law does not. (*Searles Valley Minerals Operations, Inc. v. State Bd. Of Equalization* (2008) 160 Cal.App.4th 514, 519 [taxpayers who produced and sold electricity to California requested judicial notice of materials contained on website pages of American Coal Foundation and United States Department of Energy under Evidence Code section 452, subdivision (h). Held: request was properly denied, as though "it might be appropriate to take judicial notice of *the existence* of the Web sites, the same is not true of their factual content"].)

Chase makes much of the fact that the P&A Agreement is posted on the FDIC Web site, which it calls an "official governmental agency," apparently believing this fact alone makes the legal significance of the Agreement subject to judicial notice. While there may be federal cases that adopt this approach, frequently without analysis (see fn. 10, *ante*), we know of no "official Web site" provision for judicial notice in California. (See *L.B. Research & Education Foundation v. UCLA Foundation* (2005) 30 Cal.App.4th 171, 180, fn. 2.) "Simply because information is on the Internet does not mean that it is not reasonably subject to dispute." (*Huitt v. Southern California Gas Co.* (2010) 188 Cal.App.4th 1586, 1605, fn. 10.)

In typically scholarly fashion, Witkin has an elaborate exposition of the law of judicial notice in 1 California Evidence (5th ed. 2012), Judicial Notice, ch. 2, beginning

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relating to WaMu refinance transaction, collecting cases holding Chase not liable for WaMu's conduct]; *Cassese v. Washington Mutual et al.* (E.D.N.Y. Dec. 22, 2008 No. 05 CV 2724) 2008 U.S. Dist. Lexis 111709, at pp. *6-7, 2009 [same, including claims of fraud and breach of contract]**;** *Moncrief v. Washington Mutual* (S.D.Cal. June 28, 2010 No. 10CV350) 2010 U.S. Dist. Lexis 64100 at pp.*6-7 [same for claims filed after Chase acquired WaMu's assets].)

Some cases have found the language of section 2.1 of the P&A Agreement creates a degree of uncertainty about whether Chase assumed specific liabilities depending on whether it acted as lender, loan servicer, or both. (See *Hayes-Boman v. J.P. Morgan Chase Bank* (D.Minn. 2010) 724 F.Supp.2d 1003, 1015; *Punzalan v. FDIC* (W.D.Tex. 2009) 633 F.Supp.2d 406, 414 & fn. 5; *In re Pena* (Bankr. S.D.Tex. 2009) 409 B.R. 847, 859-862.)

at page 109. Beginning at section 32, the author discusses "matters commonly known or readily determinable," and goes on for several sections with descriptions of cases and "illustrations" of such facts. One looks in vain for any case remotely supporting Chase's position here. In sum, we hold that judicial notice was not properly taken of the content of the P&A Agreement even if there was no dispute about its authenticity. A fortiori here, where the very authenticity of the Agreement was in dispute.

As described above, Jolley's opposition included a declaration from Thorne, who had been a "senior construction loan consultant" with WaMu until July of 2006, having been in charge of construction lending in 38 states since May 2005. He was an "asset manager for the FDIC" at the time he signed the declaration (October 2011), and was "intimately familiar with the procedures for taking over a failed bank." And he testified: "Pursuant to the public part of the agreement with the FDIC, of which were approximately 36 pages, the balance of the contract and the complete agreement with the FDIC and Chase bank is 118 pages long which has not been made public. I am familiar with this agreement, I read it." Though somewhat ungrammatical, the declaration fairly clearly recites the existence of a nonpublic agreement (or portion of an agreement) that could affect the outcome of this case. In short, Thorne testified that the P&A Agreement submitted by Chase was not the full agreement entered between Chase and the FDIC, but rather a longer version exists, the terms of which are different from the version of which the court below took judicial notice.

Thorne also made certain representations about the content of the missing pages, claiming the FDIC guaranteed 80 percent of any failed WaMu loans, while Chase assumed only 20 percent of potential losses on the loans by receiving an 80 percent discount on WaMu's assets. In his deposition Thorne not only referred to the P&A Agreement being 118 pages long, but also testified that it obligated Chase "to work directly with the customers to do as much as possible to modify any loans . . . so that no foreclosures are made and borrowers are kept in their homes." The missing part of the document "spells out an agreement between the purchasing institution and the FDIC as to how they are to handle the customers upon the purchase of the bank; i.e., how the

foreclosures are to be handled, work out agreements that they're supposed to make. . . . They just can't go in and just start foreclosing on everybody that's not paying."

Chase filed 62 objections to Jolley's evidence, including 33 objections to particular aspects of Thorne's declaration and seven objections to particular statements in his deposition. We are concerned primarily with Objections 5 and 60, objecting to Thorne's statements that a 118-page purchase and assumption agreement exists, objections based on the best evidence rule, lack of foundation, and lack of competency. [11]

As noted, the trial court did not rule on these, or any other, evidentiary objections, and Jolley preliminarily contends that the objections cannot be maintained here. He is wrong, as specifically held in *Reid v. Google, Inc.* (2010) 50 Cal.4th 512, 534, a case involving objections made in a summary judgment proceeding. The Supreme Court held that if the objections were not ruled upon in the trial court, the objections are presumed overruled and are preserved for appeal. We thus turn to the merits of Chase's objections, and find there is none.

Chase questions the competency of Thorne's declaration because he is not a lawyer, was not employed at WaMu at the time of the P&A Agreement, and was never employed by Chase. This, the argument runs, fails to establish personal knowledge or expertise sufficient to opine about the contents of the purported nonpublic agreement. Chase also points out that while his declaration says Thorne was an independent contractor at the FDIC at the time he signed the declaration, it fails to show he worked there at the time of the WaMu receivership.

But that is no basis for rejecting Thorne's testimony on the narrow point that a 118-page agreement exists, one that he had personally read. We view his testimony on this point as that of a percipient witness, not an expert.

We may agree with Chase for purposes of argument that Thorne's statements about the contents of the longer agreement were not admissible. But we need not credit

[11] Chase also argues on appeal that Jolley's testimony is barred by the parol evidence rule and as hearsay. These objections were not made in the trial court, and are thus inappropriate here.

those statements in order to conclude that a factual issue has been raised. The judgment in this case rests squarely on the terms of a much shorter, disputed version of the P&A Agreement submitted by Chase. This was wrong. Since Jolley has presented evidence that a longer agreement exists, the court below resolved a disputed issue of fact by resting its decision on the terms of the shorter agreement. Put otherwise, the court did not view the evidence favorably to Jolley. (See *Gould v. Maryland Sound Industries, Inc.* (1995) 31 Cal.App.4th 1137, 1145-1146 [existence of a written contract could not be judicially noticed where the opposing party claimed that an oral contract governed the relationship].)

It may be true that in some extreme circumstances "a trial court may weigh the credibility of a declaration submitted in opposition to a summary judgment motion and grant the motion 'where the declaration is facially so incredible as a matter of law that the moving party otherwise would be entitled to summary judgment.' " (*People v. Schlimbach* (2011) 193 Cal.App.4th 1132, 1142, fn. 9, quoting *Estate of Housley* (1997) 56 Cal.App.4th 342, 359–360.) This is not such a case.

Thorne's declaration certainly raises significant issues *vis a vis* Chase and the FDIC, with testimony that is hardly run of the mill. But that testimony is not so incredible that it could be ignored or rejected as untruthful on summary judgment, especially given the FDIC's response here, which not only did not deny the existence of the longer agreement, but suggested there were documents to be produced if there were a confidentiality agreement.

3. Summary Adjudication Was Improperly Granted On The First, Second, Third, Fourth, Fifth, And Eighth Causes Of Action

A. <u>The First And Second Causes Of Action, For Misrepresentation</u>

The conclusion that Chase was not liable for WaMu's conduct presupposes acceptance of the P&A Agreement submitted by Chase as the full and complete contract governing its assumption of liabilities. Since, as discussed above, the Agreement was not properly utilized here, on that basis alone the summary adjudication of first and second causes of action was improper. In addition to the alleged misrepresentations by WaMu,

Jolley alleges misstatements by Chase after the receivership, which would render summary adjudication improper for an additional reason if there are triable issues of material fact with respect to such misrepresentations. We find such issues here.

The elements of fraud, which give rise to the tort action for deceit, are (a) misrepresentation; (b) knowledge of falsity; (c) intent to defraud, i.e., induce reliance; (d) justifiable reliance; and (e) damage. (*Lovejoy v. AT&T Corp.* (2001) 92 Cal.App.4th 85, 93; see also, *Lazar v. Superior Court* (1996) 12 Cal.4th 631, 638.) "The tort of negligent misrepresentation, a species of the tort of deceit [citation], does not require intent to defraud but only the assertion, as a fact, of that which is not true, by one who has no reasonable ground for believing it to be true." (*Conroy v. Regents of University of California* (2009) 45 Cal.4th 1244, 1255.)

Jolley testified that Chase representative North told him in various ways—that it was "highly probable," and "likely," and "look[ed] good"—that a modification of the loan agreement would be approved and the construction loan rolled over into a conventional loan. The trial court concluded there was no evidence of a misstatement of *fact*, but at most an overoptimistic *opinion* upon which Jolley could not reasonably have relied. We disagree.

To begin with, it is well settled that an opinion may be actionable when it is made by a party who "possess[es] superior knowledge." (*Pacesetter Homes v. Brodken* (1970) 5 Cal.App.3d 206, 211.) As one Court of Appeal put it almost ninety years ago, "[W]hen one of the parties possesses, or assumes to possess, superior knowledge or special information regarding the subject matter of the representation, and the other party is so situated that he may reasonably rely upon such supposed superior knowledge or special information, a representation made by the party possessing or assuming to possess such knowledge or information, though it might be regarded as but the expression of an opinion if made by any other person, is not excused if it be false." (*Haserot v. Keller* (1924) 67 Cal.App. 659, 670; *Cohen v. S & S Construction Co.* (1983) 151 Cal.App.3d 941, 946; see generally Rest.2d Torts § 542; CACI No. 1904.)

Equally well recognized is that there may be liability for an opinion where it is "expressed in a manner implying a factual basis which does not exist." (*Pacesetter Homes, Inc. v. Brodkin*, *supra*, 5 Cal.App.3d at p. 211; see generally, *Crandall v. Parks* (1908) 152 Cal. 772, 776; Civ. Code, § 1572; Rest.2d Torts, § 525, com. f.) Witkin explains how this rule is often applied to statements about future events, describing it this way: "(3) *Future Events.* As pointed out above . . . , predictions or representations as to what will happen in the future are normally treated as opinion; but sometimes they may be interpreted as implying knowledge of facts that make the predictions probable. If the defendant does not know of these facts, the statement is an actionable misrepresentation. . . . The same is true where an agent states that his or her principal will advance money to harvest a crop, or where a corporation agent represents that the corporation will lease certain property or locate a plant in a certain city. (See *Eade v. Reich* (1932) 120 Cal.App. 32, 35 [discussing holdings to this effect].)" (5 Witkin, Summary of California Law (10th ed. 2005) Torts, § 776, p. 1126; also see *Apollo Capital Fund LLC v. Roth Capital Partners, LLC* (2007) 158 Cal.App.4th 226, 241 [broker-dealer's oral representations concerning offering of company's bridge notes, that preferred stock offering was "done deal" and that early prepayment of notes was "guaranteed," were actionable statements of facts, rather than opinion or prediction].)

Jolley testified that North told him he was "from the executive offices of Chase," causing Jolley to think he "was dealing with the decision makers at the highest level of Chase Bank." Beyond that, the very assessment of probabilities of a loan modification may have implied that North had discussed the matter with those who actually would make the decision or that he possessed facts from which he could reasonably assess the probabilities. In any event, the matter should have been left to the trier of fact, not determined on summary judgment: "[W]here there is a reasonable doubt as to whether a particular statement is an expression of opinion or the affirmation of a fact, the determination rests with the trier of the facts." (*Willson v. Municipal Bond Co.* (1936) 7 Cal.2d 144, 151.)

Jolley presented evidence that he in fact relied upon these statements, expending additional sums to complete the construction,   that the promising statements by North induced him to borrow from other sources to finish the renovation. These consequences were entirely foreseeable in light of the history of the construction loan, the unfinished status of the underlying project, and the encouraging statements by North that the loan would likely be rolled over into a conventional loan once construction was completed. Whether Jolley's reliance was justified in the circumstances is a factual question for a jury, not one for summary judgment.

Price v. Wells Fargo Bank (1989) 213 Cal.App.3d 465 (*Price*), overruled on other grounds in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association* (2013) 55 Cal.4th 1169, 1182, relied on by Chase, is not to the contrary. There, the ranch owner plaintiffs took out three loans totaling $370,000 from Wells Fargo to pay off preexisting loans to other banks. (*Id.* at p. 471.) The notes for two of the loans called for repayment within approximately eight months; the third loan documents were less clear but appeared to call for payment at the same time. Testimony by bank officers, however, tended to support plaintiffs' argument that the parties intended the loans to be paid off over a five-year period. (*Ibid.*) After seeing the early due date in the notes, plaintiffs discussed the matter with the same bank representative who had helped them with the original loans, who promised to "redo" the loans to reflect the five-year repayment period. (*Price*, *supra*, 213 Cal.App.3d at p. 472.) Plaintiffs let the eight-month maturity date pass without repaying any principal. When the bank began sending past due letters, plaintiffs did not insist that the loans be rewritten, but sought a restructuring of the repayments. For a period of time the bank negotiated with plaintiffs and established alternate repayment terms. However, when the repayment schedule was not kept, the bank initiated foreclosure proceedings. (*Id.* at pp. 472-473.)

Plaintiffs were able to pay off the loans before a foreclosure sale was conducted, and then sued the bank, claiming that in order to pay off the loans they were forced to sell other assets at distressed prices. (*Id.* at pp. 473-474.) They alleged several theories based fundamentally on the bank's having taken a "hard line" during negotiations regarding

repayment of the loans. (*Id*. at p. 479.) Summary judgment was granted for the bank, which was affirmed on appeal.

Chase points particularly to the statement in *Price* to the effect that the bank would "redo" the loans or "work with" the borrowers, and draws a parallel between those representations and the statements made by North here. We find the analogy unpersuasive. The *Price* plaintiffs admitted in discovery that they understood their obligations under the original notes and never disputed that the amounts claimed by the bank were in fact owed to it. (*Price*, *supra*, 213 Cal.App.3d at pp. 472, 480-481.) And the alleged promise to "redo" the contract was never asserted during loan renegotiation as a basis for loan modification. (*Id*. at pp. 480-481.) In short, the plaintiffs' own actions undermined any claim of reliance on the misstatement. This is not the situation here.

Chase also cites *Conrad v. Bank of America* (1996) 45 Cal.App.4th 133, which held that a postbankruptcy fraud claim against a bank was precluded by failure of the borrowers to list that claim in the original bankruptcy filing. (*Id*. at pp. 145-155.) As a second ground for denying relief, the Court of Appeal held that no fraudulent statement had been shown. (*Id*. at pp. 155-156.) The borrower's testimony showed only that he told the banker his company "might need some loans and that it intended to go forward utilizing liquid assets and that kind of thing before talking" further to the bank about loans. The banker reportedly said "No problem." (*Id*. at p. 156.) The court observed "[t]hat exchange establishes nothing more than a willingness to consider future loan applications and does not establish a fraudulent promise to make a loan. [Citation.]" (*Conrad*, *supra*, 45 Cal.App.4th at p. 156.) The court went on that the borrower's "understanding or expectation that the Bank would extend a loan is not sufficient to establish an agreement to make a loan. [Citation.] And his testimony is otherwise lacking in specificity." (*Conrad*, *supra*, 45 Cal.App.4th at p. 156.)

Here we have more specificity as to a predicted outcome of the loan modification process and the likelihood of its occurrence, as Jolley continued discussions with North into the days immediately preceding the proposed trustee's sale. Indeed, there is documentary evidence that North continued to represent that he would ask the

"Foreclosure Department to hold [its] processes," thus making the alleged promises more certain—and more central to the loan renegotiation efforts. And not only did Jolley not act inconsistently with a claim of reliance, he in fact relied, investing additional funds into completing the construction in anticipation that the loan would be rolled into a conventional loan.

While there may not be any direct showing of an intention to defraud, it is clear that Chase would benefit from Jolley's further investment in the construction project. This is so because the bank could ultimately foreclose on a newly renovated property instead of a stalled construction project, making its ability to realize on the asset more fruitful. In addition, prolonging the loan modification process allowed Chase's investment in the property to mount while Jolley's equity, if any, was consumed in a declining real estate market. Drawing all inferences in favor of the nonmoving party, as we must (*Nazir v. United Airlines, Inc.*, *supra*, 178 Cal.App.4th at p. 254), we conclude that prolonged communication—perhaps more accurately, miscommunication—about a possible loan modification raises a triable issue of fact of intent by Chase to profit by misleading Jolley about his loan modification prospects, a showing sufficient to withstand summary adjudication.

B. The Third Cause of Action, for Breach Of Contract/Promissory Estoppel

On the third cause of action, styled breach of contract/promissory estoppel, Chase claims there was no evidence of a breach by it of WaMu's loan agreement, again claims the P&A Agreement relieves it of any liability for any breach by WaMu, and claims its own conduct toward Jolley in the form of North's promising forecast of a loan modification did not create a contract or amount to an estoppel. We, of course, disagree as to the P&A Agreement. We also find a triable issue of material fact regarding Chase's own conduct.

Jolley obviously complains that WaMu failed to timely disburse funds in accordance with the loan agreement, but he also appears to claim the failure to fully fund the loan continued through the Chase period. Jolley stated as a disputed fact, "Even with the Modification Agreement, further delays in disbursements as a result of WaMu made it

effectively impossible for Jolley to complete the project and commence payments as of August 1, 2007." He also asserted in his declaration, "Chase continued in WaMu's refusal to disburse portions of the construction loan due and to modify the loan to provide necessary funding." And he said, "Chase . . . had an obligation to carry out the terms of the Washington Mutual loan which was to provide adequate funds to complete the modified construction plans after which, Chase . . . [was] responsible for rolling the loan into a permanent financing loan."

Thorne testified that after he got involved on Jolley's behalf, Jolley "received disbursements on the work that had been completed based on the inspection that had been made." The trial court construed that statement as follows: "Plaintiff's expert, Jeffrey Thorne, . . . testified that Plaintiff ultimately received the disbursements for the work Plaintiff had completed." And the court concluded, "[t]he undisputed evidence shows Chase fulfilled all of its obligations under the Construction Loan Agreement." We read the record differently.

To begin with, this was not specified as an undisputed fact in Chase's moving papers, and Jolley did not admit any such fact as undisputed. It cannot be said that the undisputed facts show no controversy on this point.

Jolley contends "Chase . . . had a direct continuing responsibility to provide necessary funding to see that the project was finished . . . ." We understand this to mean that Jolley believes Chase was obligated to disburse, but failed to disburse, additional funds under his preexisting agreement with WaMu. The fact that Thorne may have believed the loan had been fully funded by WaMu prior to the receivership (if his statement is properly so construed) does not bind Jolley to that same conclusion.

Turning to the paperwork, Thorne's memorandum to WaMu in approximately September 2006 recommended a modified loan amount of $2,485,000. As far as we can tell, the amount actually disbursed as of September 25, 2008, was $2,426,650. This also suggests that further disbursements may have been due under the modified agreement. We are also not able to say with confidence that the dispute about the $350,000 that Thorne found to be "in limbo" was ever resolved. In sum, there appear to be disputed

facts concerning whether WaMu, succeeded by Chase, ever fully funded the loan, factual disputes relating to whether the lender's obligations under the modified loan agreement ever were fulfilled.

Chase also argues it was under no obligation to disburse further funds or to roll over the construction loan because Jolley was in default on the loan payments beginning in December 2008. True, the loan contract conditioned the loan rollover provision on the borrower's compliance with the terms of the loan agreement. But there was a two-month period postreceivership—and prior to Jolley's default—during which it seems possible that funds were due to be disbursed, at least under Jolley's interpretation of the loan agreement.

Jolley also argues that the frequent reassurances by North that a modification was forthcoming induced him to rely, and as a result he "borrowed from friends and family to finish the construction." The effect of this is a triable issue of fact whether Chase has potential liability for its own conduct under a theory of promissory estoppel.

" 'A promise which the promisor should reasonably expect to induce action or forbearance of a definite and substantial character on the part of the promisee and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.' " (*C&K Engineering Contractors v. Amber Steel Co.* (1978) 23 Cal.3d 1, 6.) The elements of promissory estoppel are: " ' "(1) a promise clear and unambiguous in its terms; (2) reliance by the party to whom the promise is made; (3) [the] reliance must be both reasonable and foreseeable; and (4) the party asserting the estoppel must be injured by the party's reliance." ' " (*Joffe v. City of Huntington Park* (2011) 201 Cal.App.4th 492, 513.)

The Fourth Cause Of Action, For Negligence

The trial court granted summary adjudication on the fourth cause of action, for negligence, essentially finding no duty. The order read as follows: " 'Under California law, a lender does not owe a borrower or third party any duties beyond those expressed in the loan agreement, except those imposed due to special circumstance.' (*Sipe v. Countrywide Bank* (E.D.Cal. 2010) 690 F.Supp.2d 1141, 1153, citing *Nymark v. Heart*

Fed. Savings & Loan Assn., (1991) 231 Cal.App.3d 1089, 1096.) . . ." We conclude there was a triable issue of material fact as to a duty of care to Jolley, which potentially makes Chase liable for its own negligence.

We acknowledge that we deal with an ordinary duty of reasonable care, not a fiduciary duty. We further acknowledge the frequent observation that lenders and borrowers operate at arm's length. (*Oaks Management Corp. v. Superior Court* (2006) 145 Cal.App.4th 453, 466-467; *Nymark v. Heart Fed. Savings & Loan Assn., supra,* 231 Cal.App.3d at p. 1093 (*Nymark*).) And we finally acknowledge that "as a general rule, a financial institution owes no duty of care to a borrower when the institution's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender of money." (*Nymark*, *supra*, 231 Cal.App.3d at p. 1096; see also *Fox & Carskadon Financial Corp. v. San Francisco Fed. Sav. & Loan Assn.* (1975) 52 Cal.App.3d 484, 488, 489; *Ragland v. U.S. Bank National Association* (2012) 209 Cal.App.4th 182, 206.)

Such "general rule" has often been repeated, including in federal cases involving the takeover by Chase of WaMu's loans[12] and cases decided in the context of loan modification applications.[13] It was primarily on the basis of this general rule that the trial court below, without further analysis, granted summary adjudication of the negligence

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[12] *Rosenfeld.*, *supra*, 732 F.Supp.2d at p. 969 [claim for breach of fiduciary duty]; *Argueta v. J.P. Morgan Chase* (E.D.Cal. June 30, 2011 No. CIV. 2:11-441) 2011 U.S. Dist. Lexis 70756, at p. *12; *Sullivan v. JP Morgan Chase Bank, NA* (E.D.Cal. 2010) 725 F.Supp.2d 1087, 1094 ["Plaintiffs' allegations that Defendant misrepresented to them that a permanent loan modification would be put into place are insufficient to form the basis of a negligence claim"].)

[13] *Becker v. Wells Fargo Bank, N.A., Inc.* (E.D.Cal. Mar. 22, 2011 No. 2:10-cv-02799) 2011 U.S. Dist. Lexis 29687, at pp.*67-71 [allegations about loan modification application process did not give rise to duty]; *Dooms v. Fed. Home Loan Mortgage Corporation* (E.D.Cal. Mar. 31, 2011 No. CV F 11-0352) 2011 Dist. Lexis 38550, at pp. *25-28; *DeLeon v. Wells Fargo Bank, N.A.* (N.D.Cal. Oct. 22, 2010 No. 10-CV-01390) 2010 U.S. Dist. Lexis 112941, at p. *12 [defendant did not have a duty "to complete the loan modification process"].)

claim. And Chase relies upon such general rule here, contending it owed Jolley no duty of care. Such reliance is misplaced.

When considered in full context, the cases show the question is not subject to black-and-white analysis—and not easily decided on the "general rule." We conclude here, where there was an ongoing dispute about WaMu's performance of the construction loan contract, where that dispute appears to have bridged the FDIC's receivership and Chase's acquisition of the construction loan, and where specific representations were made by a Chase representative as to the likelihood of a loan modification, a cause of action for negligence has been stated that cannot be properly resolved based on lack of duty alone.

In *Connor v. Great Western Sav. & Loan Assn.* (1968) 69 Cal.2d 850, 856-858 (*Connor*), a lender was involved in developing tract housing which proved to be faulty because the builders poured slab foundations on adobe soil, and the foundations cracked in subsequent rainstorms. (*Id.* at pp. 856-857.) The lender provided the money for the purchase of the land and for construction loans, and ultimately offered homebuyers long-term loans on the homes. (*Id.* at p. 858.) The Supreme Court held the bank was not liable as a joint venturer (*id.* at pp. 862-863), but further held that its role as "an active participant in a home construction enterprise" imposed upon it a duty of ordinary care to the purchasers of the homes (*id.* at p. 864)—a holding reached by applying the six factors identified in *Biakanja v. Irving* (1958) 49 Cal.2d 647, 650 (the "*Biakanja* factors").[14] (*Connor, supra,* 69 Cal.2d at p. 865.)

Perhaps the *Biakanja* factors must be applied here too. (See *Auto Equity Sales v. Superior Court* (1962) 57 Cal.2d 450, 455.) But even if not, they are certainly appropriate for consideration, which consideration compels a conclusion for Jolley.

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[14] *Connor* held there was lender liability to the homeowners who bought into the housing tract. The Legislature subsequently enacted Civil Code section 3434 to restrict such liability, and to that extent *Connor* has been superseded by statute. (*Anthony v. Kelsey-Hayes Co.* (1972) 25 Cal.App.3d 442, 454, fn. 5.)

The *Biakanja* factors are six nonexhaustive factors: (1) the extent to which the transaction was intended to affect the plaintiff, (2) the foreseeability of harm to the plaintiff, (3) the degree of certainty that the plaintiff suffered injury, (4) the closeness of the connection between the defendant's conduct and the injury suffered, (5) the moral blame attached to the defendant's conduct, and (6) the policy of preventing future harm. (*Biakanja v. Irving*, *supra*, 49 Cal.2d at p. 650.)

We begin by identifying the specific conduct by Chase that Jolley claims was negligent so as to limit our analysis "to the specific action the plaintiff claims the particular [defendant] had a duty to undertake in the particular case." (*Vasquez v. Residential Investments, Inc.* (2004) 118 Cal.App.4th 269, 280.) As we see it, Jolley claims Chase had an obligation to investigate the history of the loan and to make additional disbursements, to review his loan modification request in good faith, and to conform to standards of conduct in the industry to protect him against further losses associated with the loan. Chase allegedly acted unreasonably by failing to review Jolley's request for a loan modification in good faith, having decided in advance it would extend no further monies in connection with WaMu's loans.[15] Jolley also complains about specific misstatements, false assurances given by Chase personnel about the prospects for a loan modification, while different personnel at Chase—the actual decision makers—were bent on foreclosure.

The first factor, the extent to which the transaction was intended to affect the plaintiff, hardly needs discussion. Jolley was the person in direct negotiation, and contractual privity, with the loan originator (WaMu), from which Chase took over. Jolley specifically brought to Chase's attention his dissatisfaction with WaMu's funding of the loan. To the extent Chase undertook a reassessment of the propriety of past

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[15] We agree with Chase that no admissible evidence was submitted to support the assertion that Chase had decided in advance not to further fund any WaMu loans. The only evidence on this point was Thorne's declaration, which lacked foundation. However, regardless whether the decision was made in advance, if it were made without due care to avoid further injury to Jolley, then Chase is potentially liable for its own negligence.

disbursements, it obviously did so for Jolley's benefit. And North's representations were made directly to Jolley, and were certainly likely to, if not intended to, affect his decisionmaking.

Likewise, it was certainly foreseeable that harm to Jolley could ensue in the event of Chase's negligence. Jolley began missing payments shortly after Chase bought WaMu's assets. That his credit rating would be adversely affected if Chase failed to negotiate with him in good faith was foreseeable, making it more difficult for him to secure alternative financing to cure the default. Given North's encouragement, it was also foreseeable that Jolley would sink more of his own money into the project, thereby suffering further injury.

There is also no doubt that Jolley was in fact injured. He invested $100,000 in finishing construction on the property shortly before foreclosure proceedings were initiated. As to the closeness of the connection between Chase's acts and Jolley's injury, the upbeat prediction of the availability of a loan modification and the rollover of the loan into a conventional mortgage was almost certainly a primary factor in causing this particular injury. Had Jolley known that Chase would ultimately foreclose on the property, he would have had no incentive to invest an additional $100,000 in its completion.

While it is not possible to tell at this point how blameworthy Chase's conduct may prove to be, this is not a case such as *Nymark*, where the borrower was in a better position to protect his own interests. To the contrary, Jolley's ability to protect his own interests in the loan modification process was practically nil. Chase held all the cards. The fact that Chase benefited from prolonging the loan renegotiation period and encouraging Jolley to complete construction certainly lends itself to a blameworthy interpretation. And a fair reading of the evidence here includes that Jolley was subjected to "dual tracking," which as discussed below has now been made illegal, illegality that tends to reinforce the view that Chase's conduct was blameworthy.

The policy of preventing future harm also favors imposing a duty of care on an entity in Chase's position. When a bank acquires from the FDIC loans from a failed bank

part of what it acquires is the history of the loan. Even if acquiring banks are not liable for breaches, fraud, or negligence of the failed bank under their purchase and assumption agreements—an issue we do not decide—simple good business practices dictate that they take into account the position in which the borrower has been placed prior to their acquisition of the loan. Where there is a long running dispute whether the failed bank properly disbursed monies due under the loan, the acquiring bank owes a duty of care to investigate the history of the loan and take that into account in negotiating with the borrower for a loan modification. Particularly so here.

We note that we deal with a construction loan, not a residential home loan where, save for possible loan servicing issues, the relationship ends when the loan is funded. By contrast, in a construction loan the relationship between lender and borrower is ongoing, in the sense that the parties are working together over a period of time, with disbursements made throughout the construction period, depending upon the state of progress towards completion. [16] We see no reason why a negligent failure to fund a construction loan, or negligent delays in doing so, would not be subject to the same standard of care.

Even when the lender is acting as a conventional lender, the no-duty rule is only a general rule. (*Osei v. Countrywide Home Loans* (E.D.Cal. 2010) 692 F.Supp.2d 1240, 1249.) As a recent federal case put it: "*Nymark* does not support the sweeping conclusion that a lender never owes a duty of care to a borrower. Rather, the *Nymark* court explained that the question of whether a lender owes such a duty requires 'the balancing of the "*Biakanja* factors." ' " (*Newson v. Countrywide Home Loans, Inc*. (N.D.Cal. Nov. 30, 2010 No. C 09–5288) 2010 U.S. Dist. Lexis 126383, at p. *15.) Or, in the words of

[16] Such a loan more readily gives rise to a cause of action for negligence in that contractual disbursements must be made with due care. "A lender that enters into a loan agreement to disburse the loan funds according to the terms of the loan documents, assumes a duty of care to act reasonably to abstain from injuring the borrower by its disbursal of funds. A lender may be liable to the borrower who is damaged as a result of the lender's negligent disbursal of the loan funds." (12 Miller & Starr, California Real Estate (3d ed. 2011) § 36:6, fns. omitted.)

an even more recent case, in each case where the general rule was applied to shield a lender from liability, "the plaintiff sought to impose upon the lender liability for activities *outside* the scope of the lender's conventional role in a loan transaction. It is against this attempt to expand lender liability (to that of, e.g., an investment advisor or construction manager) that the court in *Nymark* found a financial institution owes no duty of care to a borrower when its involvement in the loan transaction 'does not exceed the scope of its conventional role as a mere lender of money.' *Nymark*, 231 Cal.App.3d at 1096. *Nymark* and the cases cited therein do not purport to state a legal principle that a lender can never be held liable for negligence in its handling of a loan transaction within its conventional role as a lender of money." (*Ottolini v. Bank of America* (N.D.Cal. Aug. 19, 2011 No. C-11–0477) 2011 U.S. Dist. Lexis 92900, at p. *16.) We agree with these observations.

Chase relies upon the historical truism that a bank as lender is entitled to pursue its own economic interest in dealing with a borrower, citing *Kruse v. Bank of America* (1988) 202 Cal.App.3d 38, 67. We live, however, in a world dramatically rocked in the past few years by lending practices perhaps too much colored by short-sighted self-interest. We have experienced not only an alarming surge in the number of bank failures, but the collapse of the housing market, an avalanche of foreclosures,[17] and

[17] We quote the California Legislature: "California is still reeling from the economic impacts of a wave of residential property foreclosures that began in 2007. From 2007 to 2011 alone, there were over 900,000 completed foreclosure sales. In 2011, 38 of the top 100 hardest hit ZIP Codes in the nation were in California, and the current wave of foreclosures continues apace. All of this foreclosure activity has adversely affected property values and resulted in less money for schools, public safety, and other public services. In addition, according to the Urban Institute, every foreclosure imposes significant costs on local governments, including an estimated nineteen thousand two hundred twenty-nine dollars ($19,229) in local government costs. And the foreclosure crisis is not over; there remain more than two million 'underwater' mortgages in California.

"It is essential to the economic health of this state to mitigate the negative effects on the state and local economies and the housing market that are the result of continued foreclosures by modifying the foreclosure process to ensure that borrowers who may

related costs borne by all of society.[18] There is, to be sure, blame enough to go around. And banks are hardly to be excluded.

Due to the ongoing financial crisis, the federal government has adopted a voluntary incentive-based program designed to encourage lenders and borrowers to work together in the event of the borrower's default, by establishing a home loan modification program. (See U.S. Dept. of Treasury, Supplemental Directive No. 09-01 (Apr. 5, 2009). Similarly, the California Legislature has expressed a strong preference for fostering more cooperative relations between lenders and borrowers who are at risk of foreclosure, so that homes will not be lost.[19] (Civ. Code, §§ 2923.5 & 2923.6.) These provisions,

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qualify for a foreclosure alternative are considered for, and have a meaningful opportunity to obtain, available loss mitigation options. These changes to the state's foreclosure process are essential to ensure that the current crisis is not worsened by unnecessarily adding foreclosed properties to the market when an alternative to foreclosure may be available. Avoiding foreclosure, where possible, will help stabilize the state's housing market and avoid the substantial, corresponding negative effects of foreclosures on families, communities, and the state and local economy." (Assem. Bill No. 278 (2011-2012 Reg. Sess.), § 1 (subdivisions designations omitted).)

[18] The legislative history of Assembly Bill No. 278 recognized extensive " 'spillover' costs" of "the foreclosure epidemic": "By some estimates the foreclosure crisis will strip neighboring homeowners of $1.9 trillion in equity as foreclosures drain value from homes located near foreclosed properties by 2012. . . . Meanwhile, state and local governments continue to be hit hard by declining tax revenues coupled with increased demand for social services. In fact, the Urban Institute estimates that a single foreclosure costs $79,443 after aggregating the costs borne by financial institutions, investors, the homeowner, their neighbors, and local governments." (Sen. Rules Com., Off. Of Sen. Floor Analyses, Conference Report on Assem. Bill No. 278 (2011-2012 Reg. Sess.) June 27, 2012, pp. 14-15.)

[19] "When a borrower is in danger of defaulting, a commonsense approach under a traditional mortgage would be for the lender and borrower to mutually agree to modify the terms of the loan . . . . [¶] Despite the apparent mutual interest of loan holders and borrowers, many distressed homeowners report obstacles when trying to obtain a loan modification or short-sale approval. (See e.g. 'Loan Modifications Elude Local Homeowners,' Sacramento Bee (January 17, 2011).) . . . . [¶] . . . [¶] Some analysts and leading economists have cited a failure by banks to provide loan modifications as a single reason that the foreclosure crisis continues to drag on." (Sen. Floor Analysis of Assem. Bill No. 278 at pp. 15-16.)

enacted in 2008, require lenders to negotiate with borrowers in default to seek loss mitigation solutions. As discussed hereafter, existing law will soon be supplemented by amendments enacted as part of the "California Homeowner Bill of Rights." (Assem. Bill No. 278; Sen. Bill No. 900 (2011-2012 Reg. Sess.).)

Granted, these ameliorative efforts have been directed primarily at aiding resident homeowners at risk of losing their homes. (Civ. Code, §§ 2923.5, subd. (f); Assem. Bill No. 278, § 18, adding Civ. Code, § 2924.15.) We also understand there is no express duty on a lender's part to grant a modification under state or federal loan modification statutes. And until the new legislation takes effect, no private right of action for damages is granted under the statutes. (See *Hamilton v. Greenwich Investors XXVI, LLC* (2011) 195 Cal.App.4th 1602, 1616; *Mabry v. Superior Court* (2010) 185 Cal.App.4th 208, 214; *Pantoja v. Countrywide Home Loans, Inc.* (N.D.Cal.2009) 640 F.Supp.2d 1177, 1188.) We do not cite any of these legislative measures in reliance upon their provisions, nor do we suggest their provisions were violated in the present case. Rather, we refer to the existence—and recent strengthening—of these legislative measures because they demonstrate a rising trend to require lenders to deal reasonably with borrowers in default to try to effectuate a workable loan modification. In short, these measures indicate that courts should not rely mechanically on the "general rule" that lenders owe no duty of care to their borrowers.

Existing state statutes relating to loan modifications will soon be supplemented by stiffer restrictions on the conduct of lenders and loan servicers during the loan modification process. Even as this case has been pending before us, on July 2, 2012, the California Legislature passed Assembly Bill No. 278 and Senate Bill No. 900, which have since been signed into law by the Governor. These provisions address more pointedly the foreclosure crisis in our state through even greater encouragement to lenders and loan servicers to engage in good faith loan modification efforts.

One of the targets of the legislation is a practice that has come to be known as "dual tracking." Dual tracking refers to a common bank tactic. When a borrower in default seeks a loan modification, the institution often continues to pursue foreclosure at

the same time." (Alejandro Lazo, *Banks Are Foreclosing While Homeowners Pursue Loan Modifications*, Los Angeles Times, (Apr. 14, 2011); see also Sen. Floor Analysis of Assem. Bill No. 278 at p. 3.) The result is that the borrower does not know where he or she stands, and by the time foreclosure becomes the lender's clear choice, it is too late for the borrower to find options to avoid it. "Mortgage lenders call it 'dual tracking,' but for homeowners struggling to avoid foreclosure, it might go by another name: the double-cross."[20] (Lazo, *Banks Are Foreclosing*.) As we understand the pleadings and proof here, this is precisely one of Jolley's claims.[21]

The recent California legislation attempts over time to eliminate the practice of dual tracking and to ameliorate its effects, by requiring lenders and loan servicers to designate a "single point of contact" for each borrower in default. (Assem. Bill No. 278, § 7, amending Civil Code § 2923.6, subd. (c) [prohibiting dual tracking by higher volume lenders and mortgage servicers], Assem. Bill No. 278, § 9, adding Civil Code, § 2923.7 [single point of contact], Assem. Bill No. 278, § 15, adding Civil Code, § 2924.11 [prohibiting dual tracking by all lenders and mortgage servicers effective January 1, 2018].) The single point of contact provision, like the dual-tracking provision, is intended to prevent borrowers from being given the run around, being told one thing by one bank employee while something entirely different is being pursued by another.

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[20] According to the legislative history, "borrowers can find their loss-mitigation options curtailed because of dual-track processes that result in foreclosures even when a borrower has been approved for a loan modification." (Sen. Floor Analysis of Assem. Bill No. 278, pp. 20-21.)

[21] Jolley alleged, inter alia, that he was told a "workable loan modification was in the works" and "[f]oreclosure proceedings would be suspended pending the outcome of the loan modification process." He further alleged the true facts were that "a loan modification was not in the works" and "foreclosure proceedings were ongoing." Beyond the mere allegations, Jolley testified that because of "inordinate delay" by Chase in responding to his initial contact regarding a loan modification, he "borrowed heavily from friends and family" to complete construction. And further, that had the loan modification been granted and the construction loan converted to a conventional loan, the permanent financing would have been at a "favorable rate," making the "payments substantially less" and he "could have afforded to pay them."

Under the legislation, the single point of contact must be responsible for, among other things, "[h]aving access to current information and personnel sufficient to timely, accurately, and adequately inform the borrower of the current status of" his loan modification request and "[h]aving access to individuals with the ability and authority to stop foreclosure proceedings when necessary." (Assem.Bill No. 278, § 9, adding Civ. Code, § 2923.7.)

The same legislation provides homeowners who are facing foreclosure or whose homes have actually been lost to foreclosure with a remedy if the lender or loan servicer materially violated the provisions of the Act intentionally, recklessly, or through "willful misconduct." (Assem. Bill No. 278, §§ 16 & 17, adding Civil Code, § 2924.12): those facing foreclosure may seek an injunction, while those who have lost their homes may seek treble actual damages or statutory damages of $50,000, whichever is greater.

Of course, these provisions do not apply to our case. The question for our purposes is whether the new legislation sets forth policy considerations that should affect the assessment whether a duty of care was owed to Jolley at that time. We think it does.

We find support for our conclusion in recent federal district court cases that have found a duty of care in particular circumstances surrounding loan modification negotiations. *Ansanelli v. JP Morgan Chase Bank, N.A.* (N.D. Cal. Mar. 28, 2011 No. C 10-03892) 2011 U.S. Dist. Lexis 32350, p. *21, is illustrative. There, the court found a duty of care had properly been pleaded in a negligence action where the bank offered plaintiffs a trial loan modification plan, then reneged on a promise to modify the loan. The bank reported the loan as past due despite the fact that plaintiffs had made proper payments under the trial modification, thereby damaging their credit rating. (*Id*. at pp. *2-3.)

Similarly, *Robinson v. Bank of America* (N.D. Cal. May 29, 2012 No. 12-CV-00494-RMW) 2012 U.S. Dist. Lexis 74212, p. *21, decided on a motion to dismiss, held that a bank went beyond its role as a "silent" lender in its dealings with plaintiff during loan modification negotiations. There, the bank was "alleged to have executed and breached the modification agreement, then engaged in a series of

contradictory and somewhat misleading communications with plaintiff—in person, in writing, and by phone—regarding the status of his loan. Under such circumstances, it was entirely foreseeable that [the bank's] conduct could result in damage to plaintiff's credit rating or a decrease in the value of his home." (*Ibid*.; see also *Crilley v. Bank of America, N.A.* (D.Haw. Apr. 26, 2012 No. 12–00081) 2012 U.S. Dist. Lexis 58469 at pp. *5-12, 26 [duty of care owed where plaintiff and bank engaged in substantial negotiations regarding loan modification, finding potential liability based in part on "delays in the loan modification process"]; *Watkinson v. MortgageIT, Inc.* (S.D.Cal. June 1, 2010 No. 10-CV–327) 2010 U.S. Dist. Lexis 53540, pp. *23-24 [duty of care found where bank knowingly misstated borrower's income and value of property on loan application, and where borrower sought but was denied a loan modification]; *Garcia v. Ocwen Loan Servicing, LLC* (N.D.Cal. May 6, 2010 No. C-10-0290) 2010 U.S. Dist. Lexis 45375 at pp. *7-11 [plaintiff's allegations about loan modification application process sufficiently pled a duty under *Biakanja* factors]; but see, *Ottolini v. Bank of America, supra,* 2011 Dist. Lexis 92900 at pp. *18-19 [distinguishing *Ansanelli, supra,* 2011 U.S. Dist. Lexis 32350 where "the application for loan modification had not progressed to a concrete stage and . . . there is no indication of the likelihood that such an application would have been granted"].)

We conclude that the determination that Chase owed no duty to Jolley was error. Thus, the summary adjudication on the negligence cause of action must be reversed, as it was in *Laabs v. Southern California Edison Co.* (2009) 175 Cal.App.4th 1260, 1269 where the Court of Appeal held as follows: "We note, however, that we do not hold that SCE owed Laabs a duty of care as a matter of law; rather, we hold that triable issues of fact exist as to the relevant considerations underlying duty in this case, and that SCE failed to establish that it was entitled to judgment as a matter of law. While we recognize that the issue of duty is a matter for the trial court, it is nonetheless a factually oriented inquiry. As stated in *Burger v. Pond* (1990) 224 Cal.App.3d 597, 603, ' "Foreseeability" and "policy considerations" are not determined in a vacuum, but rather depend . . . upon the particular circumstances in which the purported wrongful conduct occurred.' "

C. <u>The Fifth Cause Of Action, Violation Of Business And Professions Code Section 17200</u>

Jolley claims Chase violated the unfair competition law (UCL) (Bus. & Prof. Code, § 17200), but does not specify which acts violated that provision or the nature of the violation. Again, he bases his theory of liability on the premise that Chase "must stand squarely in the shoes of WaMu for all of its criminal, fraudulent, negligent and otherwise 'unfair' practices perpetrated against Appellant and the world economy . . . ." He further claims, without specificity, that Chase is equally liable for such wrongdoing on its own part.

The UCL is broad in scope, prohibiting any "unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising," as well as any act specifically prohibited under Business and Professions Code section 17500 et seq. The statute is meant to forbid not only anti-competitive practices but also " ' " 'the right of the *public* to protections from fraud and deceit.' " ' " (*Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 209.) An "unlawful" activity is any business activity that is forbidden by law. (*Saunders v. Superior Court* (1994) 27 Cal.App.4th 832, 838-839.) A "fraudulent" activity includes any act or practice likely to deceive the public, even if no one is actually deceived. (*Committee on Children's Television, Inc. v. General Foods Corp.*, *supra*, 35 Cal.3d at p. 211.)

There is a split of authority on what constitutes an "unfair" practice. (*Bardin v. DaimlerChrysler Corp.* (2006) 136 Cal.App.4th 1255, 1260-1261.) Some cases hold an "unfair" practice is one that offends established public policy, that is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers, or that has an impact on the victim that outweighs defendant's reasons, justifications, and motives for the practice. (*Pastoria v. Nationwide Ins.* (2003) 112 Cal.App.4th 1490, 1498; *Smith v. State Farm Mutual Automobile Ins. Co.* (2001) 93 Cal.App.4th 700, 718-719; *Podolsky v. First Healthcare Corp.* (1996) 50 Cal.App.4th 632, 647.) Others, including at least one from our district (*Gregory v. Albertson's, Inc.* (2002) 104 Cal.App.4th 845, 853-854), hold that the public policy which is a predicate to a claim under the "unfair" prong of the UCL

must be tethered to specific constitutional, statutory, or regulatory provisions. (See also, *Scripps Clinic v. Superior Court* (2003) 108 Cal.App.4th 917, 938.) Either way, unfairness is independently sufficient to state a claim under the statute. (*Allied Grape Growers v. Bronco Wine Co.* (1988) 203 Cal.App.3d 432, 451; see *Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163, 180 [indicating that conduct may be "unfair" without being "unlawful"].)

Granting summary adjudication on the fifth cause of action, the trial court concluded that "the undisputed evidence shows that Chase has not violated any law, or committed a deceptive or fraudulent act/misrepresentation to fall within § 17200." There was no reference to "unfair" conduct.

With respect to Chase's own conduct, we have already decided that North's statements may be construed as misstatements of fact, with possible liability for such conduct left to the trier of fact. That raises a triable issue as to "fraudulent." We have also concluded that dual tracking has been alleged and supported by Jolley's declaration. And while dual tracking may not have been forbidden by statute at the time, the new legislation and its legislative history may still contribute to its being considered "unfair" for purposes of the UCL. Summary adjudication of Jolley's fifth cause of action was improper.

E. <u>The Eighth Cause Of Action, For Reformation</u>

Civil Code section 3399 provides the authority upon which a contract may be reformed: "When, through fraud or a mutual mistake of the parties, or a mistake of one party, which the other at the time knew or suspected, a written contract does not truly express the intention of the parties, it may be revised, on the application of a party aggrieved, so as to express that intention, so far as it can be done without prejudice to rights acquired by third persons, in good faith and for value." (See generally, 5 Witkin, Cal. Procedure (5th ed. 2008) Pleading, § 806, pp. 221-222.)

The "intention of the parties," as stated in Civil Code section 3399, refers to "a single intention which is entertained by both parties." (*Shupe v. Nelson* (1967) 254 Cal.App.2d 693, 700.) "The essential purpose of reformation is to reflect the intent

of the parties." (*Jones v. First American Title Ins. Co.* (2003) 107 Cal.App.4th 381, 389.) " 'Although a court of equity may revise a written instrument to make it conform to the real agreement, it has no power to make a new contract for the parties . . . .' " (*American Home Ins. Co. v. Travelers Indemnity Co.* (1981) 122 Cal.App.3d 951, 963.)

The facts are undisputed that Chase and Jolley never signed a contract to modify the WaMu loan or reached agreement on any specific terms for a loan modification. However, Jolley pled, and testified, that the original loan agreement with WaMu was marred by either fraud or mutual mistake in that he was promised that prepaid construction costs would be reimbursed to him. Jolley's basis for this claim is a written document entitled "Construction Items Prepaid at Closing" signed in December 2005, before the actual loan was finalized. Jolley evidently wishes to reform the written agreement to incorporate this reimbursement provision, and there is a triable issue of fact whether he can. Summary adjudication on this cause of action must be reversed. (See *Jensen v. Quality Loan Services Corp* (E.D.Cal. 2010) 702 F.Supp.2d 1183, 1197, fn. 5 [Chase may be subject to reformation of WaMu's loan based on its acquisition of the loan].)

4. Summary Adjudication Was Properly Granted On The Sixth and Seventh Causes Of Action

A. <u>The Sixth Cause Of Action, For Declaratory Relief</u>

Code of Civil Procedure section 1060 authorizes actions for declaratory relief under a "written instrument" or "contract." Declaratory relief generally operates prospectively to declare future rights, rather than to redress past wrongs. (*Babb v. Superior Court* (1971) 3 Cal.3d 841, 848; *Gafcon, Inc. v. Ponsor & Associates* (2002) 98 Cal.App.4th 1388, 1403 (*Gafcon*).) It serves to set controversies at rest before they lead to repudiation of obligations, invasion of rights or commission of wrongs. In short, the remedy is to be used in the interests of preventive justice, to declare rights rather than execute them. (*Ibid.*)

"To qualify for declaratory relief, [a party] would have to demonstrate its action presented two essential elements: '(1) a proper subject of declaratory relief, and (2) an actual controversy involving justiciable questions relating to [the party's] rights or obligations.' " (*Wilson & Wilson v. City Council of Redwood City* (2011) 191 Cal.App.4th 1559, 1582.)

The trial court did not state any reason for granting summary adjudication on the declaratory relief cause of action, but simply recited in conclusory fashion that Jolley was not entitled to such relief, citing *Gafcon*, *supra*, 98 Cal.App.4th at pages 1401-1402. Citation of that case suggests the ruling was premised on the notion that Jolley has, if anything, a fully matured cause of action against Chase, and not one appropriate for declaratory relief. With this we agree.

The undisputed facts show that loan modification negotiations did not result in a written instrument or contract under which the parties' rights need to be declared. While there may be a controversy about past conduct, we see no reason why money damages would not be an adequate remedy. (See *Gafcon*, *supra*, 98 Cal.App.4th at pp. 1403-1404.) Moreover, this cause of action is redundant of Jolley's other claims, and declaratory relief may be denied "where its declaration or determination is not necessary or proper at the time under all the circumstances." (Code Civ. Proc., § 1061.) Where, as here, Jolley has a fully matured cause of action for money, he must seek damages, and not pursue a declaratory relief claim. (*Gafcon*, *supra*, 98 Cal.App.4th at pp. 1403-1404; *Jackson v. Teachers Ins. Co.* (1973) 30 Cal.App.3d 341, 344.) Summary adjudication of the sixth cause of action was proper.

F. The Seventh Cause Of Action, For Accounting

An action for an accounting may be brought to compel the defendant to account to the plaintiff for money or property (1) where a fiduciary relationship exists between the parties, or (2) where, even though no fiduciary relationship exists, the accounts are so complicated that an ordinary legal action demanding a fixed sum is impracticable. (5 Witkin, Cal. Procedure, *supra,* Pleadings, § 819, p. 236.) "A cause of action for an accounting requires a showing that a relationship exists between the plaintiff and

defendant that requires an accounting, and that some balance is due the plaintiff that can only be ascertained by an accounting." (*Teselle v. McLoughlin* (2009) 173 Cal.App.4th 156, 179.)

Chase contends that Jolley's cause of action for an accounting is subject to summary adjudication because Jolley makes no claim that money was due him under the contract with WaMu, and no independent contract was ever entered into with Chase. The trial court found "no evidence that Defendants owe [Jolley] any money under the Construction Loan Agreement that requires an accounting." It further concluded, "[Jolley] makes no effort to identify where in the payment record he is owed any money" with the consequence that "no grounds for an accounting exist." Jolley's efforts aside, there are disputed facts with respect to whether the modified construction loan had been fully funded prior to Chase's acquisition of the loan.

That said, we find an accounting remedy uncalled for in this case. There was no fiduciary relationship between the parties and we detect no proof of any other special relationship that would give rise to an accounting remedy, nor a specification of amounts due so complicated that it cannot be determined in a legal action for damages. Summary adjudication of the seventh cause of action was proper.

5. Summary Judgment for CRC Was Proper

CRC acted solely as trustee in the present case. None of Jolley's allegations of wrongdoing pertains to CRC, and no factual support has been offered with respect to any claim against it. The summary judgment is therefore affirmed insofar as it is in favor of CRC. (See *Moncrief v. Washington Mutual, supra,* 2010 U.S. Dist. Lexis 64100, at p. *8.)

DISPOSITION

The summary judgment in favor of CRC is affirmed, as are the summary adjudications in favor of Chase of the sixth and seventh causes of action. The summary judgment for Chase is reversed. Both sides shall bear their respective costs on appeal.

____
Richman, J.

We concur:

____
Haerle, Acting P.J.

____
Lambden, J.

Trial Court:	Marin County Superior Court
Trial Judge:	Honorable Lynne Duryee
Attorney for Plaintiff and Appellant:	Law Offices of Vernon Bradley, Vernon Bradley
Attorneys for Defendants and Respondents:	Law Offices of Sohnen & Kelly, Harvey Sohnen, Patricia M. Kelly

Filed 4/19/13

CERTIFIED FOR PUBLICATION

COURT OF APPEAL, FOURTH APPELLATE DISTRICT

DIVISION ONE

STATE OF CALIFORNIA

BRYAN CHANDA et al., Cross-complainants and Respondents, v. FEDERAL HOME LOANS CORPORATION, Cross-defendant and Appellant.	D059976 (Super. Ct. No. ECU03970)

APPEAL from a judgment of the Superior Court of Imperial County, Jeffrey B. Jones, Judge. Reversed and remanded.

Deuprey & Associates and Dan H. Deuprey for Cross-defendant and Appellant.

Meylan Davitt Jain & Arevian and Vincent J. Davitt; Fidelity National Law Group and Kevin R. Broersma for Cross-complainants and Respondents.

Private lenders sued a private mortgage broker for negligence and breach of fiduciary duty after it was discovered that a loan they had financed had been obtained through fraud and forgery. In this case, the trial court excluded evidence of title insurance procured by the private mortgage broker as part of the lending transaction to

protect the lenders from fraud and forgery as barred by the collateral source rule and refused to instruct the jury on superseding cause. We conclude the trial court prejudicially abused its discretion in excluding this evidence because it was relevant to liability. We also conclude the trial court properly declined to instruct the jury on superseding cause. The judgment is reversed and matter is remanded for a new trial.

FACTUAL AND PROCEDURAL BACKGROUND

Federal Home Loans Corporation (FHLC) is a private mortgage broker that did equity lending, meaning that the loans originated through it were primarily based upon the value of the property, with loan to value ratios much lower than a traditional banking institution. Canizalez Associates, Inc. (Canizalez) and Valley Family Practice Medical Associates, Inc. (VFPM, together the Property Owners) each own a one-half interest in real property on which an office building is located in El Centro, California (the Property). Marcella Barker is a notary public and the former office manager for Canizalez.

In June 2006, Barker contacted FHLC and requested a loan on behalf of the Property Owners in the amount of $165,000.00 (Loan 1). Johanna Rivera, a loan officer at FHLC, went to meet with Dr. Jorge Robles, the authorized representative of VFPM and Alejandro Calderon, the authorized representative of Canizalez, for execution of the loan documents. After Barker represented that one of the owners was not available, Rivera accepted a proposal made by Barker that Barker would get the loan documents signed, including the notarized signatures of Dr. Robles and Calderon. Rivera found there was nothing out of the ordinary in dealing solely through Barker in

connection with originating the loan and gathering the documents needed. Thereafter, the promissory note for $165,000 and the accompanying deed of trust to secure the note were apparently duly signed by Dr. Robles and Calderon with each signature personally notarized by Barker. Barker, however, obtained Loan 1 by forging these signatures. Following the close of escrow, the monthly interest-only payments on Loan 1 were timely made.

About six months later, Barker requested a larger replacement loan from FHLC in the amount of $480,000.00 secured by the Property (Loan 2). FHLC brokered Loan 2 through individual lenders, Bryan and Khema Chanda (the Chandas), as an investment. Barker again forged the necessary signatures to acquire Loan 2.

When the Property Owners learned of the fraud, they sued FHLC, the Chandas and other parties to cancel the fraudulently obtained trust deeds. The Chandas then filed a cross-complaint against the Property Owners and others for, among other things, equitable subrogation. The Chandas amended their cross-complaint and sued FHLC alleging causes of action for negligence and breach of fiduciary duty.

Ultimately, all parties settled except for the Chandas' causes of action against FHLC. The Chandas' claims against FHLC proceeded to trial and a jury found that FHLC had breached fiduciary duties owed to the Chandas and that FHLC had acted with malice, fraud or oppression. The jury awarded the Chandas $590,469.51 in compensatory damages and later awarded them $62,500 in punitive damages. FHLC timely appealed.

DISCUSSION

I. *Collateral Source Rule*

A. Facts

Before trial, the Chandas moved in limine to exclude (1) all evidence relating to any title insurance policy, (2) any compensation provided to the Chandas under any insurance policy, and (3) any claims or claim information exchanged between the Chandas and the title insurer. The Chandas argued that any such evidence was irrelevant to any issue to be tried and inadmissible under the collateral source rule. FHLC opposed the motion, arguing that the collateral source rule did not apply. Assuming the collateral source rule did apply, FHLC argued that evidence of title insurance it obtained on behalf of the Chandas was relevant to defend against the Chandas' breach of fiduciary duty allegations. After hearing argument from counsel, the trial court concluded that the collateral source rule applied. It granted the motion to preclude the jury from hearing about any payments the Chandas may have received under the title insurance policy, but denied the motion to the extent it sought to exclude *any* reference to title insurance, stating, "I don't see how we avoid reference to insurance, particularly title insurance, because that's part of the transaction."

The trial court's ruling on the matter evolved during trial. It later clarified that "[t]he purpose of the title insurance is irrelevant. What is admissible is that the title insurance is required by the escrow, it was obtained and the premium was paid, so [FHLC] did what [it was] supposed to do." The trial court explained that it did not know what the title insurance policy covered and concluded that evidence regarding

what a title policy is, what the policy covered and the named insured was not relevant; however, evidence that FHLC obtained title insurance in conformity with the escrow instructions was "fine."

FHLC later filed a motion in limine for an order allowing admission of evidence regarding insurance coverage. FHLC again argued that the collateral source rule did not apply. It also asserted that the Chandas had " 'opened the door' " to the issue of insurance coverage when counsel for the Chandas requested emotional distress damages during opening statements. Before the court issued its tentative ruling on the motion, the Chandas withdrew any claim they had for general damages. After hearing argument from counsel, the court denied the motion. It explained that application of the collateral source rule excluded evidence of title insurance coverage and application of Evidence Code section 352 excluded evidence of "all the stuff" that FHLC did correctly, such as getting title insurance, as this evidence was not relevant to the case. (Undesignated statutory references are to the Evidence Code.) It again clarified that the fact FHLC obtained title insurance as part of the transaction was admissible.

The trial court later modified its ruling, deciding it would not allow any mention of title insurance based on potential prejudice having the jury know there was title insurance, but not knowing if there was coverage. It also noted the "inordinate amount of time" spent by counsel trying to draw attention to this item. FHLC unsuccessfully attempted to change the court's decision to bar all reference to title insurance, noting it could present evidence the title company did not require any

special category of notaries and that FHLC followed its custom of using any notary, including one that worked for the borrowers. The court heard argument, including FHLC's offer of proof that it sought to call a number of title company witnesses that would testify they had never heard of a notary who had forged signatures of people and then notarized the signatures. The trial court barred this testimony under section 352 as redundant of FHLC's expert witness.

Finally, after the jury returned its verdict in phase one, FHLC moved in limine to admit evidence of title insurance coverage to guide the jury in determining the amount of any punitive damages, arguing the evidence was relevant to the degree of reprehensibility and likelihood of harm. The trial court denied the request, essentially finding such evidence was not relevant.

B. Analysis

FHLC contends the trial court erred in excluding evidence of title insurance under the collateral source rule because this evidence was relevant to defend against the Chandas' claims of breach of fiduciary duty, rebut claims of emotional distress, and resolve punitive damages questions in both phases of the trial. As we shall explain, it was not necessary for the trial court to decide whether the collateral source rule applied in order to rule on the admissibility of the title insurance evidence. Accordingly, the trial court abused its discretion in applying the collateral source rule to exclude evidence of title insurance and we find this ruling was prejudicial, requiring that the judgment be reversed and the matter remanded for a new trial.

In determining tort damages, the collateral source rule provides "that if an

injured party receives some compensation for his injuries from a source wholly independent of the tortfeasor, such payment should not be deducted from the damages which the plaintiff would otherwise collect from the tortfeasor." (*Helfend v. Southern Cal. Rapid Transit Dist.* (1970) 2 Cal.3d 1, 6.) The collateral source rule "operates both as a substantive rule of damages and as a rule of evidence." (*Arambula v. Wells* (1999) 72 Cal.App.4th 1006, 1015.) As part of the law of damages, the collateral source rule dictates that "[i]f an injured plaintiff gets some compensation for the injury from a collateral source such as insurance, that payment is, under the collateral source doctrine, not deducted from the damages that the plaintiff can collect from the tortfeasor. [Citation.]" (*Lund v. San Joaquin Valley Railroad* (2003) 31 Cal.4th 1, 8.) "As a rule of evidence, it precludes the introduction of evidence of the plaintiff being compensated by a collateral source unless there is a 'persuasive showing' that such evidence is of 'substantial probative value' for purposes other than reducing damages." (*Arambula v. Wells*, *supra*, 72 Cal.App.4th at p. 1015.)

Nevertheless, "'[i]t has always been the rule that the existence of insurance may properly be referred to in a case if the evidence is otherwise admissible.' [Citation.] The trial court must then determine, pursuant to Evidence Code section 352, whether the probative value of the other evidence outweighs the prejudicial effect of the mention of insurance. [Citations.]" (*Blake v. E. Thompson Petroleum Repair Co.* (1985) 170 Cal.App.3d 823, 831 (*Blake*).)

At the time of trial, the Chandas had not yet received any compensation under the title insurance policy, with the Chandas' counsel stating he was not coverage

counsel and did not know coverage issues. Thus, the question presented was not whether any payment from the title insurer could be deducted from any damages received by the Chandas. For this reason, there was no need for the parties to argue application of the collateral source rule or for the trial court to rule on this issue at this stage of the litigation.

The narrow question before the court was whether the jury should have been allowed to hear that the Chandas harm was *potentially* covered by title insurance. On this issue, FHLC submitted an offer of proof that it complied with industry standards to request title insurance while handling the escrow for the loan and that the title insurance policy covered fraud and forgery. Based on this offer of proof, the trial court initially decided it would allow reference to title insurance because it was part of the transaction. Ultimately, however, it excluded all mention of title insurance based on potential prejudice having the jury know there was title insurance, but not knowing if there was coverage. It also noted the "inordinate amount of time" spent by counsel trying to draw attention to this item.

Here, evidence of title insurance was relevant to FHLC's liability. Namely, FHLC presented an offer of proof that industry standards required it to obtain title insurance covering fraud and forgery for the loan transaction. Because the title insurance evidence was relevant, the admissibility of this evidence turned on whether its probative value outweighed the prejudicial effect of the mention of insurance. (*Blake*, *supra*, 170 Cal.App.3d at p. 831.)

We conclude that the probative value of the evidence outweighed its prejudicial

effect because any risk of prejudice could have been eliminated by instructing the jury (1) to only consider the evidence for purposes of deciding whether FHLC was negligent or had breached its fiduciary duties, and (2) to not consider any potential recovery under the title insurance policy in assessing damages as this is a matter for the court to address after the jury renders its verdict. Proceeding in this manner would have addressed the trial court's concern of potential prejudice having the jury know there was title insurance but not knowing if there was coverage, and having FHLC spend an "inordinate amount of time" trying to draw attention to this item through multiple witnesses. Accordingly, we turn to whether exclusion of this evidence prejudiced FHLC.

A party challenging discretionary rulings on motions in limine must demonstrate the court's " 'discretion was so abused that it resulted in a manifest miscarriage of justice. [Citation.]' " (*Hernandez v. Paicius* (2003) 109 Cal.App.4th 452, 456; § 354.) A " 'miscarriage of justice' " will be declared only when the reviewing court, after examining the entire case, concludes that " 'it is reasonably probable that a result more favorable to the appealing party would have been reached in the absence of the error.' [Citation.]" (*Cassim v. Allstate Ins. Co.* (2004) 33 Cal.4th 780, 800.)

We conclude that exclusion of the title insurance evidence was prejudicial to FHLC in that it is reasonably probable a result more favorable to it would have been reached absent the error. The Chandas tried this case on the theory that FHLC did nothing to mitigate against the risk of fraud or forgery. At the beginning of trial, the

Chandas' counsel told the jury that the evidence would show that FHLC had no policies, procedures or practice manuals to cover "how their clients or investors might be protected." It informed the jury that the Chandas lost their entire investment based on FHLC's conduct and that punitive damages were appropriate because FHLC acted willfully, intentionally and fraudulently.

During cross-examination, FHLC's defense expert stated that a broker has a duty to mitigate the risks of possible loan fraud. FHLC, however, was prevented from eliciting testimony on redirect regarding the role of title insurance against fraud and forgery applicable to such mitigation. The record shows that FHLC's defense expert sought permission from the court to mention title insurance during his testimony, but was barred from doing so. Additionally, during closing argument, the Chandas' counsel repeatedly asserted that FHLC did nothing to protect against potential fraud. Excluding title insurance evidence prejudiced FHLC by preventing it from defending against the entire theme of the case, including the assertion that it acted with malice, fraud or oppression justifying an award of punitive damages. Thus, the judgment must be reversed and the matter remanded for a new trial. (To the extent the Chandas argue the error was not prejudicial because the jury could have found in their favor based on misrepresentation, this contention is belied by the fact the only theory presented to the jury in the special verdict form was breach of fiduciary duty.)

On remand, it is possible that the status of any claim under the title insurance policy could still be unresolved. However, even if the Chandas obtained recovery under the policy, we believe any jury confusion or potential prejudice can be avoided

by instructing the jury that it is not to consider any recovery under the title insurance policy in assessing damages as this is a matter for the court to address after the jury renders its verdict. (See *Blake*, *supra*, 170 Cal.App.3d at p. 831 ["[E]vidence of a plaintiff's own insurance coverage tends to diminish his chance of recovery, just as evidence of the defendant's coverage tends to enhance it."].) Should the jury render a verdict in favor of the Chandas, and the Chandas obtained compensation under the policy, then the issue whether the collateral source rule applied would be ripe for resolution to determine whether FHLC is entitled to an offset based on the compensation that the Chandas obtained under the title insurance policy.

II. *Superseding Cause*

A. Facts

As an affirmative defense to the operative complaint, FHLC alleged that any recovery against it was barred by Barker's superseding acts. At trial, FHLC requested CACI Nos. 432 and 433 and two special instructions on the subject of superseding cause. FHLC also requested a special verdict form containing a specific interrogatory on the issue of superseding cause. The trial court rejected the argument that Barker's actions constituted a superseding cause, declined to instruct the jury on this issue and rejected FHLC's proposed verdict form.

B. General Legal Principles

Upon request, a party is entitled to nonargumentative and correct instructions on every theory advanced by that party if the theory is supported by substantial evidence. (*Soule v. General Motors Corp.* (1994) 8 Cal.4th 548, 572 (*Soule*).) We

review the evidence most favorable to the applicability of the requested instruction, since a party is entitled to that instruction if that evidence could establish the elements of the theory presented. (*Scott v. Rayhrer* (2010) 185 Cal.App.4th 1535, 1540.) "'A judgment will not be reversed for error[] in jury instructions unless it appears reasonably probable that, absent the error, the jury would have rendered a verdict more favorable to the appellant. [Citation.]' [Citation.]" (*Ibid.*)

CACI Nos. 432 and 433 pertain to third-party conduct or intentional/criminal conduct as a superseding cause. These instructions state that to avoid responsibility, the defendant must establish four factors: the other party's conduct occurred after the defendant's, the subsequent conduct was highly unusual, the defendant had no reason to expect such wrongful conduct, and the resulting harm was different from that which could be expected from the defendant's own conduct. (CACI Nos. 432 & 433)

"[T]he defense of 'superseding cause[]' . . . absolves [the original] tortfeasor, even though his conduct *was* a substantial contributing factor, when an independent event [subsequently] intervenes in the chain of causation, producing harm of a kind and degree so far beyond the risk the original tortfeasor should have foreseen that the law deems it unfair to hold him responsible." (*Soule*, *supra*, 8 Cal.4th at p. 573, fn. 9.) In criminal cases, intervening causes are typically described as either dependent or independent. (*People v. Schmies* (1996) 44 Cal.App.4th 38, 49.) "A dependent intervening cause will not absolve a defendant of criminal liability while an independent intervening cause breaks the chain of causation and does absolve the defendant. [Citation.]" (*Ibid.*)

To determine whether an independent intervening act was reasonably foreseeable, we look to the act and the nature of the harm suffered. (*Hardison v. Bushnell* (1993) 18 Cal.App.4th 22, 27.) To qualify as a superseding cause so as to relieve the defendant from liability for the plaintiff's injuries, both the intervening act and the results of that act must not be foreseeable. (*Pappert v. San Diego Gas & Electric Co.* (1982) 137 Cal.App.3d 205, 210.) Significantly, "what is required to be foreseeable is the general character of the event or harm . . . not its precise nature or manner of occurrence." (*Bigbee v. Pacific Tel. & Tel. Co.* (1983) 34 Cal.3d 49, 57–58.) Whether an intervening force is superseding or not generally presents a question of fact, but becomes a matter of law where only one reasonable conclusion may be reached. (*Brewer v. Teano* (1995) 40 Cal.App.4th 1024, 1035.)

C. Analysis

FHLC contends the trial court prejudicially erred in refusing to give CACI Nos. 432 and 433 because the evidence supported these instructions. In making this argument, FHLC focused exclusively on whether Barker's conduct was foreseeable, asserting that foreseeability presented a factual question to be decided by the jury. Specifically, FHLC made an offer of proof that FHLC, FHLC's retained broker expert, and title company officers have never encountered a situation where a notary personally forged the signatures to be authenticated and that Barker's act of forgery was not reasonably foreseeable. We requested and received further briefing on whether evidence existed to prove the first factor listed under CACI Nos. 432 and 433 regarding superseding cause, i.e., whether Barker's superseding conduct occurred after

the conduct of FHLC. We conclude the trial court properly refused to instruct on superseding cause.

To absolve FHLC of liability, Barker must have acted subsequent to FHLC's acts and her actions must qualify as an unforeseeable independent event that produced an unforeseeable result. (*Soule*, *supra*, 8 Cal.4th at p. 573, fn. 9.) In their supplemental briefing, the parties point to evidence that some of Barker's acts of malfeasance occurred before FHLC's acts and some after. Among other things, the parties cite to the events surrounding Loan 1 and Barker's act of intercepting loan documents mailed to the Property Owners after the closing of Loan 2. This evidence shows us that Barker's and FHLC's actions were intertwined temporally, not independent of each other and contributed to the harm ultimately suffered by the Chandas. In other words, this case presents a situation of concurrent or contributory causation where the wrongful acts of Barker and FHLC contributed to the Chandas' harm.

To the extent FHLC argues it was unforeseeable that a notary would commit forgery, we agree with the Chandas that FHLC is viewing the facts too narrowly. The general character of the event, the submission of forged loan documents was highly foreseeable. (*Bigbee v. Pacific Tel. & Tel. Co.*, *supra*, 34 Cal.3d at pp. 57–58.) The fact a notary committed the forgery, a notary's cohort committed the forgery, or a notary negligently authenticated a forged signature, are details that do not change the general character of the event—the submission of forged loan documents. Finally, the result of that event, the Chandas' loss of their investment, was also highly foreseeable.

Accordingly, there was no factual issue on superseding cause for the jury to consider and the trial court properly declined to present this issue to the jury.

DISPOSITION

The judgment is reversed and the matter is remanded for a new trial. Appellant is entitled to its costs on appeal.

McINTYRE, Acting P. J.

WE CONCUR:

O'ROURKE, J.

IRION, J.

Filed 1/31/13 (received from court 2/14/13)

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION THREE

SOFIA AGUAYO, Plaintiff and Appellant, v. MICHELLE AMARO, as Special Administrator, etc., Defendant and Respondent.	B231194 (Los Angeles County Super. Ct. Nos. BC319770 and BP089151)

APPEAL from a judgment of the Superior Court of Los Angeles County, Michael I. Levanas, Judge. Affirmed.

Ronald E. Wiksell; Law Offices of James T. Duff and James T. Duff for Plaintiff and Appellant.

Kenneth G. Campion for Defendant and Respondent.

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INTRODUCTION

Sofia Aguayo appeals a judgment against her and in favor of Michelle Amaro, the special administrator of the Estate of Isabel Infante. Sofia[1] and Amaro both sought to quiet title to real property located at 3665 Gillig Avenue in Los Angeles (the property). After a bench trial, the court determined that the property belonged to the estate on the ground that Sofia was barred from asserting adverse possession of the property under the doctrine of unclean hands.

The primary issues on appeal are whether unclean hands can serve as a defense to adverse possession by claim of right and, if so, whether the trial court abused its discretion in applying the defense in this case. We shall conclude that the trial court has discretion to apply the defense of unclean hands when a party claiming adverse possession engages in deceitful interference with the true owner's ability to defeat the claim, and that the trial court did not abuse its discretion here.

FACTUAL AND PROCEDURAL BACKGROUND

1. *The Infante Family Home*

Herman Infante and Isabel Infante acquired the property by grant deed in 1946. The property served as the family home for Herman and Isabel and their two children, Alfred Infante and Richard Infante. Richard's biological daughter, Michelle Amaro, was raised on the property until she was adopted by a different family when she nine years old. According to Amaro, she was adopted because her father Richard was a heroin addict who could not take care of her.

Herman passed away in 1969. Isabel died intestate in 1993. After their parents died, Alfred and Richard continued to reside at the property, though probate proceedings regarding the Estate of Isabel Infante did not commence for many years.

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[1] We refer to certain individuals in this case by their first name for the sake of clarity and not out of disrespect to the individuals.

2. *Jesus and Sofia Aguayo's Efforts to Take the Property Through Adverse Possession*

Sofia's husband, Jesus Duran Aguayo, claims he is in the "business" of acquiring properties by adverse possession. He contends he has filed about 10 actions seeking to quiet title on real property through adverse possession. Jesus has acquired an expertise in the practice. Working with Jesus, Sofia is engaged in the same occupation.

In 1995, Sofia sent a letter addressed to Isabel Infante at 3665 Gillig Avenue in Los Angeles, inquiring whether she could purchase the property. Isabel was deceased at the time.

Sofia contends that Alfred responded to the letter and engaged in discussions with Jesus regarding the sale of Alfred's contingent interest in the property. She further contends that Alfred orally agreed he would sell his interest for $25,000. In July 1995, Jesus allegedly gave Alfred $2,000 cash in exchange for Alfred's promise to commence probate proceedings. Alfred, however, did not commence such proceedings. In 2001, Alfred died intestate.

On January 2, 1999, Jesus placed a sign on the property stating, "No Trespassing." The sign also indicated that Sofia was the "owner" of the property. Jesus and Sofia also allegedly changed the locks to the front door of the house, placed a fence around the property, and made electrical, plumbing and drywall repairs.

On April 24, 1999, Jesus allegedly loaned $2,000 cash to Richard. The loan was allegedly memorialized with a hand-written document signed by Richard (loan agreement).

On January 1, 2000, "Jesus Aguayo" and Richard allegedly entered into a written agreement entitled "Part Sale & Rental Agreement" (sale and rental agreement). Under this agreement, drafted by Jesus, Richard rented the property from Jesus for $400 a month.[2] The sale and rental agreement further allegedly provided that Richard would

[2] The record does not indicate why Richard would rent the property *from Jesus* at a time when the property belonged to the Estate of Isabel Infante.

"transfer" his rights to the property in exchange for the $2,000 in cash he was given on April 24, 1999, and 54 months of future rent ($21,600), for a total of $23,600.

From 1999 to 2004, Richard resided at the property, except for numerous stints in the county jail. During this time period, Jesus and Sofia maintained their "No Trespassing" sign. Jesus visited the property on a weekly basis.

3. *The Aguayos Record a Wild Deed and Pay Property Taxes*

On April 27, 2000, Jesus and Sofia recorded a quitclaim deed (the quitclaim deed) which purported to transfer the property from "Jesus Duran" to Jesus Aguayo and Sofia Aguayo. This was a "wild" deed because it was recorded outside the chain of title. (*Far West Savings & Loan Assn. v. McLaughlin* (1988) 201 Cal.App.3d 67, 73.)

The quitclaim deed stated that tax statements should be should be mailed to Sofia Aguayo, P.O. Box 39965, Downey, CA 90239. After the deed was recorded, the Los Angeles County Registrar-Recorder's office mailed all tax bills to Sofia's post office box in Downey. Members of the Infante family did not have access to this post office box. Sofia paid all tax bills due from 2000 through 2006, as well as back taxes due from 1993 through 1999.

4. *Pleadings in the Civil Action*

On August 9, 2004, Sofia filed a verified complaint to quiet title to the property. (*Aguayo v. Infante et al.* (Super. Ct. L.A. County, 2004, No. BC319770) (the civil action).) The complaint sought a judgment that the property belonged to Sofia under the doctrine of adverse possession. Amaro, as special administrator of the Estate of Isabel Infante, filed a cross-complaint against Sofia and Jesus for quiet title and other causes of action she did not pursue at trial.[3]

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[3] On or about November 23, 2004, Richard assigned his interest in the property to Amaro. On November 24, 2004, Amaro was appointed special administrator in *Estate of Isabel Infante* (Super. Ct. L.A. County, 2004, No. BP089151) (the probate action).

5. *Trial*

On August 17, 2006, the superior court held a bench trial on the competing quiet title causes of action of Sofia and Amaro. Pursuant to the parties' stipulation, the trial court adjudicated the dispute over the ownership of the property in both the civil action and probate action.

Only two witnesses were called at trial: Jesus and Amaro. At the end of trial, the court took the matter under submission.

6. *Statement of Decision*

On November 20, 2006, the trial court issued its statement of decision. The court found, inter alia, that Sofia took possession of the property by claim of right and color of title. We shall discuss both kinds of adverse of possession *post*. The court further found that although Sofia met the "technical requirements" of adverse possession, her quiet title action "must fail as she proceeded with unclean hands in asserting her adverse interest in this property."

The court based its ruling on Amaro's unclean hands defense on Sofia's act of recording the quitclaim deed. The court stated: "The evidence at trial showed that recording of a 'wild deed' caused the property tax bills to be sent to the Aguayos and not the legal owner. The court is convinced that this 'wild deed' was recorded to insure the legal owners would not receive tax bills and thereby be reminded that property taxes were due." Additionally, the court found that "[t]he act of diverting property tax bills from the true owner was a deceitful act intended to insure the legal owner would not pay their property taxes and also appears to be a criminal act per Penal Code section 115.5."

7. *Criminal Proceedings Against the Aguayos*

Pursuant to Sofia's request, we take judicial notice of certain documents in *People v. Aguayo* (Super. Ct. L.A. County, 2008, No. BA320295) (the criminal action). (Evid. Code, §§ 452, subd. (d), 453, 459.) On October 26, 2006, Jesus and Sofia were indicted on 22 counts for conduct associated with their adverse possession "business." The Aguayos were charged with grand theft of personal property, burglary, filing false or

forged instruments, forgery, vandalism, unauthorized entry of a dwelling house, theft from an elder or dependent adult, and conspiracy to commit crime. There were numerous alleged victims of their alleged crimes, including Richard Infante.

Seven of the counts related to the property which is the subject of this appeal. Count 7 charged Jesus and Sofia with filing a false or forged document, namely the quitclaim deed, in violation of Penal Code section 115, subdivision (a). On March 29, 2007—after the statement of decision in the civil action and probate action was entered—the superior court dismissed Count 7 in the criminal action on the grounds the People presented misleading arguments and instructions to the grand jury.[4]

8. *Judgment and Appeal*

On December 7, 2010, the trial court entered judgment in the civil action and the probate action.[5] The judgment stated that the property was owned by the Estate of Isabel Infante. Sofia filed a timely notice of appeal.

CONTENTIONS

Sofia makes two main arguments on appeal. She first contends the trial court erroneously ruled that the doctrine of unclean hands applies to defeat a quiet title cause of action based on adverse possession by claim of right. Unclean hands, Sofia argues, is "unavailable" as a defense to this cause of action. Alternatively, assuming the defense is available, Sofia argues the trial court abused its discretion in applying the defense of unclean hands under the facts of this case.

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[4] On August 15, 2008, the jury convicted Jesus and Sofia of, inter alia, vandalizing the subject property (Pen. Code, § 594, subd. (a)), entering the subject property without authorization (Pen. Code, § 602.5, subd. (a)), and conspiracy to commit a crime (Pen. Code, § 182, subd. (a)(1)). The jury, however, acquitted Jesus and Sofia of forgery in connection with the sale and rental agreement and the loan agreement. The Aguayos's convictions were affirmed on appeal. (*People v. Aguayo* (June 10, 2010, B212334) [nonpub. opn.].)

[5] The record does not indicate why the trial court waited more than four years after it entered its statement of decision to enter its judgment.

Amaro does not argue that the trial court erroneously found that Sofia satisfied all of the requirements of adverse possession. The issue of whether all of the elements of adverse possession were satisfied was not briefed and is not before us. Accordingly, except as otherwise stated, we assume for purposes of this appeal that the requirements of adverse possession were satisfied.

DISCUSSION

1. *Standard of Review*

We review the trial court's decision to apply Amaro's unclean hands defense for abuse of discretion. (*Farahani v. San Diego Community College Dist.* (2009) 175 Cal.App.4th 1486, 1495 (*Farahani*).) We review the trial court's factual findings under the substantial evidence test. (*Fladeboe v. American Isuzu Motors, Inc.* (2007) 150 Cal.App.4th 42, 56.) "We presume the trial court's factual findings are supported by the evidence, and it is the appellant's burden to show that they are not." (*Estates of Collins & Flowers* (2012) 205 Cal.App.4th 1238, 1246.)

2. *The Defense of Unclean Hands*

A quiet title action is equitable in nature except when it takes on the character of an ejectment proceeding to recover possession of real property. (*Estate of Phelps* (1990) 223 Cal.App.3d 332, 340.) In this case, neither party sought possession of the property under an ejectment theory. The trial court therefore adjudicated the matter as a chancellor in equity.

The doctrine of unclean hands is a defense to an equitable action, including an action to quiet title. (*Estates of Collins & Flowers*, *supra*, 205 Cal.App.4th at p. 1247-1248.) It rests on the maxim that " ' "he who comes into equity must come with clean hands." ' " (*Farahani*, *supra*, 175 Cal.App.4th at p. 1495) "The doctrine demands that a plaintiff act fairly in the matter for which he seeks a remedy. He must come into court with clean hands, and keep them clean, or he will be denied relief, regardless of the merits of his claim." (*Kendall-Jackson Winery, Ltd. v. Superior Court* (1999)

76 Cal.App.4th 970, 978 (*Kendall-Jackson*).) Whether the doctrine of unclean hands applies is a question of fact. (*Ibid.*)

Not all wrongful conduct constitutes unclean hands. Only if the misconduct is directly related to the cause at issue can a defendant invoke the doctrine. (*Kendall-Jackson*, *supra*, 76 Cal.App.4th at p. 979; accord *Farahani*, *supra*, 175 Cal.App.4th at p. 1495 [the conduct must be relative to the matter in which the plaintiff seeks relief].) The misconduct, however, "need not be a crime or an actionable tort. Any conduct that violates conscience, or good faith, or other equitable standards of conduct is sufficient cause to invoke the doctrine." (*Kendall-Jackson*, at p. 979; accord *Estates of Collins & Flowers*, *supra*, 205 Cal.App.4th at p. 1247 [" 'Unconscientious conduct in the transaction may give rise to the defense' "].) "Whether the defense applies in particular circumstances depends on the analogous case law, the nature of the misconduct, and the relationship of the misconduct to the claimed injuries." (*Dickson, Carlson & Campillo v. Pole* (2000) 83 Cal.App.4th 436, 447.)

3. *Unclean Hands May Be a Defense to Adverse Possession by Claim of Right*

The elements of adverse possession are as follows: "(1) Possession must be by actual occupation under such circumstances as to constitute reasonable notice to the owner. (2) It must be hostile to the owner's title. (3) The holder must claim the property as his own, *under either color of title, or claim of right*. (4) Possession must be continuous and uninterrupted for five years. (5) The holder must pay all the taxes levied and assessed upon the property during the period." (*Dimmick v. Dimmick* (1962) 58 Cal.2d 417, 421 (Italics added.)

Adverse possession under color of title is based on a written instrument, judgment, or decree which purports to convey real property but is for some reason defective. (*Estate of Williams* (1977) 73 Cal.App.3d 141, 147 (*Williams*); *Safwenberg v. Marquez* (1975) 50 Cal.App.3d 301, 309 (*Safwenberg*).) Adverse possession under color of title is

codified by Code of Civil Procedure sections 322 and 323.[6] (See *Sorensen v. Costa* (1948) 32 Cal.2d 453, 458 (*Sorensen*).) "The good faith of the occupant, in relying on a defective instrument, is a crucial element to establishing adverse possession based upon color of title." (*Williams*, at p. 147.)

"Adverse possession under a claim of right is not founded on a written instrument, judgment or decree." (*Safwenberg*, *supra*, 50 Cal.App.3d at p. 309.) Claim of right adverse possession is codified by sections 324 and 325.[7] (Cf. *Sorensen*, *supra*, 32 Cal.2d at p. 458.) There is no good faith requirement for adverse possession based on a claim of right. (See *Safwenberg,* at pp. 309-310; *Buic v. Buic* (1992) 5 Cal.App.4th 1600, 1604.)

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[6] Except as otherwise stated, all future statutory references are to the Code of Civil Procedure. Section 322 provides: "When it appears that the occupant, or those under whom he claims, entered into the possession of the property under claim of title, exclusive of other right, founding such claim upon a written instrument, as being a conveyance of the property in question, or upon the decree or judgment of a competent court, and that there has been a continued occupation and possession of the property included in such instrument, decree, or judgment, or of some part of the property, under such claim, for five years, the property so included is deemed to have been held adversely . . . ." Section 323 describes what constitutes adverse possession by any person claiming a title founded upon a written instrument, judgment or degree.

[7] Section 324 provides: "Where it appears that there has been an actual continued occupation of land, under a claim of title, exclusive of any other right, but not founded upon a written instrument, judgment, or decree, the land so actually occupied, and no other, is deemed to have been held adversely." Section 325, subdivision (a) provides: "For the purpose of constituting an adverse possession by a person claiming title, not founded upon a written instrument, judgment, or decree, land is deemed to have been possessed and occupied in the following cases only: [¶] (1) Where it has been protected by a substantial enclosure. [¶] (2) Where it has been usually cultivated or improved." Section 325, subdivision (b), which applies to both color of title and claim of right adverse possession, provides: "In no case shall adverse possession be considered established under the provision of any section of this code, unless it shall be shown that the land has been occupied and claimed for the period of five years continuously, and the party or persons, their predecessors and grantors, have timely paid all state, county, or municipal taxes that have been levied and assessed upon the land for the period of five years during which the land has been occupied and claimed. Payment of those taxes by the party or persons, their predecessors and grantors shall be established by certified records of the county tax collector."

A claim of right can be founded on either a deliberate trespass, or a mistake if the claimant intends to claim the area occupied as his or her land. (*Safwenberg,* at p. 310.)

Sofia argues that because adverse possession under claim of right necessarily involves the wrongful occupancy of real property, unclean hands cannot be asserted as a defense to adverse possession as a matter of law. We disagree.

It is correct that the wrongful act of trespass cannot be the basis for an unclean hands defense to adverse possession by claim of right. This is because if such a defense existed, adverse possession by claim of right would not be possible. (*Brown v. Berman* (1962) 203 Cal.App.2d 327, 329-330 (*Brown*).)

In *Brown*, the plaintiff sought to quiet title to land pursuant to adverse possession based on a claim of right. The defendant argued "that the clean hands doctrine bars recovery by a plaintiff who is a mere trespasser or intruder." (*Brown*, *supra*, 203 Cal.App.2d at p. 329.) The court, however, rejected the defendant's argument and held: "This contention overlooks the fact that title by adverse possession is not limited to those who claim under color of title, but is available also to those who merely make a claim of right [citation]. One entering under a claim of right is a mere intruder or trespasser [citation], without any bona fide belief in his title [citation]. To hold that one who meets the stringent possession requirements of section 325 cannot gain any prescriptive title under mere claim of right would defeat entirely the application of adverse possession to all save those claiming under color of title. No authority is cited for defendant's contention. Obviously none can be, since it is the antithesis of the historical doctrine which permits one who takes by 'bow and spear,' and defends against all comers, to acquire title on expiration of the statutory period." (*Id.* at pp. 329-330.)

The present case is distinguishable from *Brown* because the basis for Amaro's unclean hands defense was not Sofia's trespass on the property. Rather, it was her deceitful act of recording a wild deed for the purpose of diverting tax bills to her address.

The trial court found that the sole purpose of recording the wild deed was to interfere with the true owner's payment of property taxes. Had the true owner paid the property taxes, Sofia would not have satisfied one of the five elements of adverse possession. There was substantial evidence supporting the trial court's finding, including evidence that Sofia and Jesus were sophisticated parties knowledgeable about the requirements of adverse possession, and Jesus's failure to provide a credible explanation for the wild deed and the use of the name "Jesus Duran" as the grantor on the deed. We hold that where, as here, a party claiming adverse possession engages in deceitful interference with the true owner's ability to defeat the claim, the trial court may in its discretion apply the defense of unclean hands.

Sofia's reliance on *Le Fevre v. Borwick* (1953) 116 Cal.App.2d 786 (*Le Fevre*) is misplaced. In *Le Fevre*, the court rejected the defendants' unclean hands defense because there was no evidence that the plaintiffs acted inequitably toward them. (*Id.* at pp. 789-790.) The same is not true here. *Le Fevre* is thus distinguishable from this case.

Sofia also cites *Treager v. Friedman* (1947) 79 Cal.App.2d 151 (*Treager*). In *Treager*, a property owner, Dr. Friedman, recorded a fraudulent deed of trust in favor of the plaintiffs in order to protect the property against claims by third party creditors. (*Id.* at pp. 156-157.) The defendant, Dr. Friedman's wife, purchased the property at a foreclosure sale. (*Id.* at pp. 162-163.) Subsequently, the defendant sought to quiet title to the property pursuant to adverse possession. The plaintiffs argued that the defendant's claim was barred under the doctrine of unclean hands. (*Id.* at p. 173.) The court, however, rejected this argument on the ground that Dr. Friedman's original fraudulent transactions did not directly relate to the defendant's adverse possession claim. (*Ibid.*)

The present case is distinguishable from *Treager*. Sofia's wrongful conduct related directly to her adverse possession claim. By filing a wild deed with the intention

of diverting tax bills away from the true owner of the property, Sofia managed to satisfy one of the essential elements of adverse possession, namely paying all of the taxes due on the property for the period of five years during which the land had been occupied and claimed. (§ 325, subd. (b).)

4. *The Trial Court Did Not Abuse Its Discretion in Applying Unclean Hands in This Case*

We hold that the trial court did not abuse its discretion by ruling that the doctrine of unclean hands barred Sofia's adverse possession claim. The court found that Jesus and Sofia knew the quitclaim deed was "false" because "Jesus Duran" did not have "title to or ownership of the property to transfer on April 27, 2000." The court further found that Jesus and Sofia, as individuals knowledgeable about adverse possession, knew they did not need to record the quitclaim deed in order to satisfy the requirements of adverse possession, and that they recorded that wild deed for the sole purpose of diverting the tax bills away from the true owner of the property. This is the kind of bad faith, unconscionable conduct that a trial court, sitting as a court of equity, can reasonably conclude is sufficient to invoke the doctrine of unclean hands. (See *Estate of Collins & Flowers*, *supra*, 205 Cal.App.4th at p. 1242 [unclean hands doctrine barred a party from challenging a forged deed]; *DeRosa v. Transamerica Title Ins. Co.* (1989) 213 Cal.App.3d 1390, 1396-1397 [plaintiff who accepted title to property in order to permit the true owner to defraud his creditors was barred by the unclean hands doctrine from maintaining a malicious prosecution action against a title insurance company]; *Potter v. Boisvert* (1953) 117 Cal.App.2d 688, 690 [plaintiff who placed title to real property in a third party's name in order to avoid the possible loss of the property to his wife was barred by the unclean hands doctrine from claiming an interest in the property].)

In addition to finding that the Sofia committed a "deceitful act" by recording the quitclaim deed, the trial court also noted that this conduct "appears to be a criminal act per Penal Code section 115.5."[8] Sofia argues that because she was acquitted of violating Penal Code section 115 in the criminal action, the trial court erroneously concluded she committed a crime. Whether Sofia violated Penal Code section 115 or the related statute, Penal Code section 115.5, however, is not relevant to our analysis because the wrongful act which constitutes unclean hands need not be a crime, or even an actionable tort.[9] (*Kendall-Jackson*, *supra*, 76 Cal.App.4th at p. 979.)

Sofia argues that because the trial court found in its statement of decision that she took possession of the property under color of title, we must imply that it also found she acted in good faith. This implied finding, Sofia contends, precludes a finding of unclean hands. We reject this argument.

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[8] Penal Code section 115.5, subdivision (a) provides in part: "Every person who files any false or forged document or instrument with the county recorder which affects title to . . . real property consisting of a single-family residence . . . with knowledge that the document is false or forged, is punishable, in addition to any other punishment, by a fine not exceeding seventy-five thousand dollars ($75,000)." This statute is "a more specific application of the general statute (§ 115) and the purposes behind both statutes are the same—namely, to preserve the integrity and reliability of public documents." (*People v. Gangemi* (1993) 13 Cal.App.4th 1790, 1795-1796.)

[9] A *prior* acquittal in a criminal proceeding does not have res judicata effect in a civil proceeding in light of the different standards of proof. (*In re Coughlin* (1976) 16 Cal.3d 52, 58.) A fortiori, Sofia's *subsequent* acquittal in the criminal action had no effect on the trial court's findings in the civil action and probate action.

It is true that the trial court's finding that Sofia took possession under color of title appears to contradict its finding that she acted in bad faith because good faith is a requirement of adverse possession under color of title. But this ostensible contradiction is not ground to reverse the judgment. At most, it indicates the trial court may have misunderstood the elements of color of title in Sofia's favor.[10]

A judgment is presumed correct and all presumptions are indulged to support it on matters as to which the record is silent. (*Yu v. University of La Verne* (2011) 196 Cal.App.4th 779, 787.) Because we review the correctness of the judgment, and not the court's reasons, we must affirm the judgment if it can be supported on any legal theory, even if the trial court misapplied or misunderstood the law. (*Hoover v. American Income Life Ins. Co.* (2012) 206 Cal.App.4th 1193, 1201.)

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[10] The only document that could have possibly served as the basis for Sofia's color of title claim was the quitclaim deed. This deed purported to transfer title from "Jesus Duran" to Sofia and Jesus Aguayo. Sofia contends that "Jesus Duran" acquired title to the property pursuant to the sale and rental agreement. There was substantial evidence, however, from which the trial court could have concluded that Sofia did not in good faith believe the quitclaim deed transferred title to her. The sale and rental agreement did *not* transfer Richard's contingent interest in the property to "Jesus Duran"; it purported to transfer Richard's interest, if any, to Jesus Aguayo. Jesus conceded at trial that his legal name was not Jesus Duran. Moreover, the sale and rental agreement on its face appears to have unconscionable terms. Jesus purportedly acquired a house in the City of Los Angeles for the astonishingly low price of $2,000, plus 54 months of rent forbearance. Further, the document itself is highly suspicious. It consists primarily of a printed rental agreement form. On the side the agreement, in Jesus's handwriting, it states: "I Richard Infante, transfer, all of my rights, titles, & interest to: Jesus & Sofia Aguayo, in consideration [of] $2,000 given on 4-24-99 & credit of 54 months of rent, total $23,600.00." This written statement was not dated or initialed or signed by Richard.

Nowhere in its statement of decision did the trial court expressly find that Sofia and Jesus acted in good faith. Instead, the court stated that the Aguayos's act of recording a wild deed was conduct "beyond . . . bad faith" and, in fact, was "criminal in nature." In light of the court's express findings and the rule that all presumptions are indulged in support of the judgment, we cannot imply the trial court made a finding that Sofia acted in good faith.

DISPOSITION

The judgment is affirmed. Respondent Michelle Amaro is awarded costs on appeal.

CERTIFIED FOR PUBLICATION

KITCHING, J.

We concur:

KLEIN, P. J.

ALDRICH, J

Filed 4/16/13

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION FIVE

HAMILTON COURT, LLC, et al., Plaintiffs, Cross-Defendants and Respondents, v. EAST OLYMPIC, L.P., et al., Defendants, Cross-Complainants and Appellants.	B240052 (Los Angeles County Super. Ct. No. BC437727)

APPEAL from a judgment of the Superior Court of Los Angeles County. Susan Bryant-Deason, Judge. Reversed and remanded with instructions.

TroyGould, Jeffrey W. Kramer, Annmarie Mori for Defendants, Cross-Complainants and Appellants.

Vivoli Saccuzzo, Michael W. Vivoli for Plaintiffs, Cross-Defendants and Respondents.

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Defendants East Olympic, L.P., a California limited partnership ("East Olympic"), and its general partner, Jack Wilder, appeal the judgment quieting title to an easement on certain commercial real property in favor of plaintiffs Hamilton Court, LLC ("Hamilton Court") and 3650 Olympic, L.P. ("3650 Olympic"). Defendants contend that the trial court erred in applying the doctrine of merger of title to the facts of this case. We agree, and so reverse the judgment.

FACTUAL AND PROCEDURAL BACKGROUD

Prior to 1983, East Olympic owned an entire city block on East Olympic Boulevard in Los Angeles. The block, consisting of multiple subdivided lots, contained several buildings and parking lots; one of the buildings, referred to at trial as the "Three Story Building," sat on two of these lots, straddling a lot line.

In January 1983, East Olympic sold the majority of the city block, including the Three Story Building, to Angelus Building Partnership; the parties refer to this as the "Angelus Property." East Olympic retained the southwest portion of the block, on which stood a one-story building, a two-story building, and an adjacent yard and shed. The parties refer to this as the "Wilder Property."

The division of the city block into two separately owned properties presented a predicament. The Three Story Building belonging to Angelus Building Partnership, and the yard and shed belonging to East Olympic, occupied portions of Lots 35 and 36. The owners intended to each own fee title in a portion of Lots 35 and 36, but a legal lot split was never completed to effectuate this intent. As a consequence, the East Olympic yard and shed encroached on the Angelus Property's Lot 35, while the Three Story Building encroached on the Wilder Property's Lot 36. In order to address this situation, in 1994, East Olympic and Angelus Building Partnership entered into an Easement Agreement in "lieu of entering into lot splits with respect to Lot 35 and Lot 36 at this time, . . . to provide for mutual easements with respect to such encroachments . . . ." The area of Lots 35 and 36 where East Olympic's yard and shed encroached on the Angelus Property was termed the "East Olympic Easement." The portion of the two lots where the Angelus

Property's Three Story Building encroached on the Wilder Property was described as the "AGPV Easement."

The Easement Agreement provides, with respect to the land within the boundaries of the East Olympic Easement, that East Olympic has the exclusive use of the easement area and may use the easement area for any lawful purpose; that East Olympic has the exclusive right to "alter, improve, develop, demolish and construct improvements" on the easement area;" that East Olympic is responsible for paying all taxes on the easement area; that East Olympic has the right to obtain fee title to the easement area at any time "without any additional consideration, as provided for under the [1983] Purchase Agreement;" and that Angelus must pay half of the cost of converting the easement to fee title. The Easement Agreement contains similar provisions regarding the AGPV Easement.

On March 29, 2005, the Angelus Property was conveyed by grant deed to plaintiffs Hamilton Court and 3650 Olympic as tenants in common.

At that time, East Olympic was in escrow to sell the Wilder Property with seller financing. That sale, vesting title to the Wilder Property in Hamilton Court and Venice National Group, LLC ("Venice National") as tenants in common, was consummated on May 16, 2005, for a purchase price of $3.8 million, consisting of $800,000 in cash and a $3 million, non-recourse promissory note (the "Note") payable to East Olympic. The purchasers executed a first deed of trust (the "Deed of Trust") in favor of East Olympic, which created a security interest in the Wilder Property and the East Olympic Easement. Just prior to the close of escrow, at the purchasers' request, East Olympic approved adding language to the Note and Deed of Trust permitting Venice National to transfer its interest in the property to 3650 Olympic "if such transfer is made subject to the Trustor's promissory note and this Deed of Trust and does not affect the priority of this Deed of Trust in any manner whatsoever." This proviso appears in both the Note and the Deed of Trust.

Venice National quitclaimed its interest in the Wilder Property to 3650 Olympic in July 2005. Upon that transfer, Hamilton Court and 3650 Olympic, as tenants in common, held record title to both the Angelus Property and the Wilder Property.

In late 2008, plaintiffs ceased making payments as they became due under the Note. East Olympic foreclosed under the Deed of Trust, and reacquired the Wilder Property at a foreclosure sale in June 2009.

By this lawsuit, plaintiffs seek to establish that East Olympic did not reacquire the East Olympic Easement at the foreclosure sale. That is to say, they sued for quiet title, contending that, pursuant to the doctrine of merger, the East Olympic Easement was extinguished in July 2005 when the record title to the Angelus Property and the Wilder Property were both held by plaintiffs as tenants in common.

Trial was to the court, which ruled in favor of plaintiffs. Defendants timely appealed the judgment subsequently entered.

STANDARD OF REVIEW

"The interpretation of an easement that does not depend on conflicting extrinsic evidence is a question of law. (*Van Klompenburg v. Berghold* (2005) 126 Cal.App.4th 345, 349; *McCann v. City of Los Angeles* (1978) 79 Cal.App.3d 112, 115, fn. 2.) We apply independent review to questions of law. (*Kellogg v. Garcia* (2002) 102 Cal.App.4th 796, 802-803.) To the extent that resolution of the appeal turns on factual findings made by the trial court, we review such findings under a substantial evidence standard." (*Beyer v. Tahoe Sands Resort* (2005) 129 Cal.App.4th 1458, 1470.)

DISCUSSION

Civil Code section 811 provides, "A servitude is extinguished: [¶] 1. By the vesting of the right of the servitude and the right to the servient tenement in the same person; . . ." while section 805 of the same code states: "A servitude thereon cannot be held by the owner of the servient tenement." The rationale for these statutes is "to avoid nonsensical easements – where they are without doubt unnecessary because the owner

owns the estate." (*Beyer v. Tahoe Sands Resort*, *supra*, 129 Cal.App.4th at p. 1475.) Plaintiffs argue that, pursuant to Civil Code section 811, the moment Venice National conveyed its interest in the Angelus Property to 3650 Olympic, so that the Angelus Property and the Wilder Property were vested "in the same persons," the East Olympic Easement was extinguished as a matter of law.

Though a simple reading of the Civil Code would support plaintiffs' position, "[t]he union of a lesser and greater estate does not always result in a merger. The doctrine of merger is applied only where it prevents an injustice and serves the interests of the person holding the two estates, in the absence of evidence of a contrary intent. It is not applied where it results in an injustice, injury, or prejudice to a third person. [¶] . . . [¶] Whether or not there has been a merger depends on the actual or presumed intention of the parties and is a question of fact. A stipulation between the parties that there will not be a merger usually is respected and enforced. There will be no merger if it would be inequitable. If inequitable, it is presumed that there is no merger, but this presumption can be overcome by evidence that the parties intended a merger upon the union of the estates." (4 Miller & Starr, Cal. Real Estate (3d ed. 2006) § 10:41, fns. omitted.)

Defendants contend that the "general rule" of merger does not apply to the facts of this case because, among other reasons, the parties agreed otherwise. By way of the Deed of Trust, Hamilton Court and Venice National pledged the East Olympic Easement as security for the Note. In addition, Venice National obtained East Olympic's permission to transfer its interest in the Wilder Property to 3650 Olympic by agreeing that, in so doing, it would not jeopardize the collateral securing its loan. Specifically, the Deed of Trust granted Venice National permission to transfer its interest in the Wilder Property to 3650 Olympic "if such transfer is made subject to the Trustor's promissory note and this Deed of Trust and does not affect the priority of this Deed of Trust in any manner whatsoever."

Plaintiffs contend that extinguishing the East Olympic Easement has no effect on the priority of the Deed of Trust, and hence does not violate the parties' agreement. We

cannot agree. In the absence of a merger, East Olympic would have had a first priority security interest in the land covered by the East Olympic Easement. If as plaintiffs' maintain, the East Olympic Easement were extinguished by operation of law in July 2005 when they acquired title to both properties, East Olympic thereafter had no security interest at all in the East Olympic Easement, because it was no longer extant. We agree with defendants that this result – going from first priority to no priority – is inconsistent with the parties' agreement that any transfer would "not affect the priority of this Deed of Trust in any manner whatsoever." In short, by agreeing (1) to burden the East Olympic Easement with a security interest in favor of East Olympic, and (2) that any transfer to 3650 Olympic would be subject to the Deed of Trust and would not affect the priority of that security interest, plaintiffs in effect stipulated that there would be no merger under Civil Code section 811 so long as the Deed of Trust remained in effect.

DISPOSITION

The judgment is reversed. The matter is remanded to the trial court with instructions to quiet title to the East Olympic Easement in defendant East Olympic. Defendants are to recover their costs of appeal.

CERTIFIED FOR PUBLICATION

ARMSTRONG, J.

I concur:

TURNER, P. J.

MOSK, J., Concurring

I concur.

Although the deed of trust refers to "priority," which could be viewed as just referring to a priority over other liens, I agree with the majority's view.

There is another ground that should support the judgment: That is, there is or should be a so-called mortgage—in this case, deed of trust—exception to the merger doctrine. There is no authority in this state on that point. But as one authority has written, "it has been held that an easement is not terminated by merger when the dominant tenement is encumbered by a deed of trust or a mortgage at the time ownership of the servient and dominant tenement is united in the same party. Preventing merger in such case equitably preserves the mortgagee's security." (Ely and Bruce, The Law of Easements & Licenses in Land (2013) § 10:27 (fn. omitted); see *Pergament v. Loring Properties, Ltd.* (Minn. 1999) 599 N.W.2d 146, 149-151; *Lewitz v. Porath Family Trust* (Col.App. 2001) 36 P.3d 120; *Heritage Communities of N.C., Inc. v. Powers, Inc.* (1980) 272 S.E.2d 399; 2 Rest.3d Property, Servitudes, § 7.5, com. d; Stolpman, *Property Law—To Merge or Not To Merge: Determining the Scope of Mortgage; The Mortgage Exception to the Merger Doctrine Pergament v. Loring Properties, Limited, 599 N.W.2d 146 (Minn. 1999)* (2000) 27 Wm. Mitchell L. Rev. 1331).

To extinguish the interest of the beneficiary of a deed of trust or mortgage security by merger would "jeopardize, if it did not wholly destroy, the stability of every [such] security." (*Duval v. Becker* (Md. 1895) 32 A. 308, 310.) In this case and most such cases, the holder of the security is not a party to the transaction giving rise to the merger doctrine. It would be inequitable under the circumstances here to extinguish the security

rights of such a beneficiary of the deed of trust when that security holder has no control over the transaction upon which extinguishment of the easement by the merger doctrine is claimed.

MOSK, J.

Filed 1/31/13

CERTIFIED FOR PARTIAL PUBLICATION*

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIFTH APPELLATE DISTRICT

BRENT HUTTON,

Plaintiff and Appellant,

v.

FIDELITY NATIONAL TITLE COMPANY,

Defendant and Respondent.

F063318/F063922

(Super. Ct. Nos. CV-269732 & CV-269733)

OPINION

APPEAL from a judgment of the Superior Court of Kern County. Sidney P. Chapin, Judge.

R. Rex Parris Law Firm, R. Rex Parris, Alexander R. Wheeler, Jason P. Fowler, Kitty Szeto, Douglas Han, John M. Bickford; Dake, Braun & Monje, Stephen M. Dake and Craig N. Braun for Plaintiff and Appellant.

Hahn Loeser & Parks and Michael J. Gleason for Defendant and Respondent.

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* Pursuant to California Rules of Court, rules 8.1105(b) and 8.1110, this opinion is certified for publication with the exception of part III.

Plaintiff Brent Hutton sued defendant Fidelity National Title Company, the escrow company used in plaintiff's refinance of his home loan, for allegedly charging a notary fee in excess of the amount permitted by Government Code section 8211.[1] Under that statute, a notary may charge only $10 per signature for "taking an acknowledgment."[2] Since only two acknowledgments were taken by the notary in connection with plaintiff's loan refinance (with only one signature notarized as to each acknowledgement), plaintiff asserted that defendant violated the statute by charging him $75 for services performed by the notary.[3] Based on the supposed overcharge for notary services, plaintiff's complaint set forth causes of action for violation of California's unfair competition law (Bus. & Prof. Code, § 17200 et seq.; the UCL) and unjust enrichment. The complaint was styled as a statewide, multi-year class action on behalf of plaintiff and all others who used defendant's escrow services in real estate or loan refinance transactions and were allegedly overcharged for notary services.

After conducting discovery but before class certification, defendant moved for summary judgment on two principal grounds: (1) The $75 fee was not a violation of section 8211 because that section only limited fees for certain services (e.g., taking acknowledgments) and the notary involved in this case performed many *other* services

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1 Unless otherwise indicated, all further statutory references are to the Government Code.

2 For convenience, we refer to a "notary public" as simply a notary. The relevant portion of section 8211 states: "Fees charged by a notary public for the following services shall not exceed the fees prescribed by this section. [¶] (a) For taking an acknowledgment or proof of a deed, or other instrument, to include the seal and the writing of the certificate, the sum of ten dollars ($10) for each signature taken."

3 The complaint alleged the fee was $125, but that was merely an estimated amount in a preclosing statement. It was undisputed that the actual amount charged was $75. It was also undisputed that two acknowledgements were taken by the notary, one for a deed of trust and another for an interspousal transfer deed, each document having a single notarized signature.

(i.e., traveling to location of signing, presenting multiple documents for signature, showing where to sign or initial each document, answering questions, etc.) and (2) The $75 fee was charged and retained by a third party independent contractor, not by defendant, even though defendant as escrow holder disbursed the funds for such services. The trial court granted defendant's motion for summary judgment on both grounds. Plaintiff appeals from the resulting judgment. We find the first ground noted above to be dispositive and conclude on that basis that the trial court properly granted summary judgment.[4] Plaintiff also appeals from the trial court's postjudgment order granting an award of attorney fees to defendant pursuant to a contractual provision in the escrow instructions. Plaintiff contends that said provision should not have been enforced because it was unconscionable. We agree with plaintiff on that issue and reverse the trial court's order granting attorney fees. In all other respects, the judgment below is affirmed.

FACTS AND PROCEDURAL HISTORY

Plaintiff's Complaint

On February 26, 2010, plaintiff filed his complaint against defendant to obtain remedies for alleged violation of the UCL and unjust enrichment. According to the complaint, section 8211 made it unlawful for defendant to charge in excess of $10 for each notarized signature on a deed or deed of trust. In providing escrow services in connection with plaintiff's loan refinance, defendant allegedly billed a predetermined notary charge that exceeded the amount prescribed in section 8211. That same practice by defendant allegedly resulted in other persons (class members) being overcharged by defendant for notary services in connection with other real estate or loan refinance transactions. The complaint explained further: "The law could not be simpler.

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4 Since the first ground is dispositive, we find it unnecessary to address the second ground (i.e., the notary's independent contractor status).

California Government Code Section 8211 sets a cap on notarization fees. Under Section 8211[, subdivision](a), it is illegal to charge more than $10 per notarized signature on each deed or deed of trust used in a specific Real Estate Transaction. [¶] … [Defendant] charged … more than $10 per signature. Thus, [Defendant] violated the law." Based on these core facts, plaintiff alleged a first cause of action labeled as unfair business practices (elsewhere more specifically identified by plaintiff as a UCL cause of action) and a second cause of action for unjust enrichment. Both causes of action were explicitly premised upon defendant's alleged overcharge for notary fees in violation of section 8211.

Defendant's Motion for Summary Judgment

On December 23, 2010, defendant filed its motion for summary judgment. We have already summarized above the grounds upon which that motion was made. In support of the first ground for the motion (i.e., that section 8211 was not violated), defendant presented, among other evidence, the declaration of the individual notary who was involved in the document signing in this case—namely, Lauri E. Kilpatrick (Kilpatrick). In her declaration, Kilpatrick described a variety of services that she typically provided in connection with the signing of loan refinance documents in her capacity as a notary and a "certified signing agent" (or CSA). As a CSA, she is familiar with the various documents necessary in the loan closing process and is able to answer questions. Her declaration stated: "Generally, during a loan closing, I will (a) present all of the loan documents to the borrower which generally consists of about 60 to 150 pages, (b) make all necessary disclosures required by those loan documents, (c) explain the purpose of each loan document, (d) answer any questions the borrower may have about the loan documents or the loan closing process in general, (e) indicate where the borrower must sign each loan document, and (f) take an acknowledgment of the borrower's signature when necessary. *I provided these services for Mr. Hutton's 2007 refinance closing*. [¶] … The majority of my loan signings are mobile loan signings

where I will travel to the borrower's home, the lender's office, or the escrow holder's office." (Italics added.) Of the services mentioned by Kilpatrick, the taking of acknowledgments (or the notarizing of signatures) was merely one minor part. Defendant's motion noted plaintiff's testimony in which he (plaintiff) recalled that "a lady" (Kilpatrick) came to his home to conduct the signing of plaintiff's 2007 loan refinance papers, but he recalled little else about it.[5] Defendant's motion also pointed out that the $75 charge, as it appeared in the closing statement (the HUD-1 form), included an explicit reference to the fact that Kilpatrick was also a CSA. Specifically, the HUD-1 form stated: "Notary to Lauri Kilpatrick, APN & CSA."

In support of the second ground for the motion, defendant presented evidence that Kilpatrick was an independent contractor who charged and retained the entire fee, and that she was not an agent or employee of defendant.[6] Preliminarily, defendant asserted that as an escrow company, it frequently made use of third party mobile notaries (like Kilpatrick) for loan closings. Defendant did so for several reasons, including that it freed up their escrow officers for other critical tasks since loan signings may take one to two hours, and because loan signings often involved travel to the borrower's residence and often occurred outside of normal business hours to accommodate a borrower's schedule. Defendant disbursed a check to Kilpatrick for $75 after she submitted an invoice for a "loan signing." Defendant's evidence showed that Kilpatrick was an independent contractor doing business since 2005 as "A Good Deed Document & Notary Service." Kilpatrick was on defendant's approved list of third party notaries for closing loans,

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5 Plaintiff testified the signing occurred at his house, while Kilpatrick recalled that it took place at the escrow company. Either way, she was traveling from her own business office to a suitable place to perform the signing.

6 Defendant's motion was also made on a third ground to the effect that the dispute should have been referred to the Secretary of State. That contention is not before us in this appeal.

based in part on her completion of a "Notary Approval Request" packet that included an "Independent Contractor Status Test." Defendant further asserted that Kilpatrick had her own business office, had other clients besides defendant, made her services available to other escrow companies, set her own hours and did not take instructions from defendant on how to perform her essential work. At a typical loan signing, Kilpatrick's practice was to disclose to the borrower that she was an independent contractor and was not an employee of the lender or the escrow holder.

Plaintiff filed opposition to the motion for summary judgment, arguing that the fees charged were unlawful under section 8211 even if other services were provided because, allegedly, the only essential *notary* function performed was the taking of two acknowledgments and the HUD-1 described the fee as "Notary to Lauri Kilpatrick, APN & CSA." Plaintiff's opposition further argued that even if the fees were not unlawful, they were potentially *unfair* or *fraudulent* under the UCL because (1) defendant did not itemize or disclose the various services being provided and (2) Kilpatrick's answering of questions would constitute the unauthorized practice of law. According to plaintiff, since defendant's motion did not negate these other potential theories, defendant did not meet its initial burden as the moving party. Additionally, plaintiff's opposition argued that there were triable issues of fact whether Kilpatrick was defendant's agent, based in part on defendant's guidelines regarding its approved notaries, which guidelines may, according to plaintiff, indicate a degree of control over the manner of performing services. For these and other reasons, plaintiff argued that the motion for summary judgment should be denied.

Defendant's reply in support of its motion responded that *all* of plaintiff's claims were premised on violation of section 8211 and that no other theories were alleged in the complaint. Since in summary judgment proceedings the material issues are framed and limited by the pleadings, defendant's reply insisted it was not necessary for defendant to negate theories that were not pled. Additionally, defendant argued that the material facts

showing Kilpatrick to be an independent contractor were not in dispute and, therefore, that issue could properly be decided as a matter of law.

The hearing of the motion for summary judgment was held on March 14, 2011. Following oral argument, the trial court took the matter under submission. On May 13, 2011, the trial court issued its written order granting the motion for summary judgment. The court granted the motion because "no overcharge occurred as … [section] 8211 only sets a price for taking an acknowledgment," and it "does not limit what notaries can charge for services which are not listed in that statute." Secondly, the trial court concluded that Kilpatrick was a third party independent contractor and, therefore, defendant was not liable even if there was an overcharge. On June 17, 2011, the trial court entered judgment in favor of defendant. Plaintiff timely appealed from that judgment.

Defendant's Motion for Attorney Fees

The judgment entered below made defendant the prevailing party in the action. On August 8, 2011, defendant moved for an award of attorney fees based on a provision in the escrow instructions. Defendant's motion requested $266,801 in attorney fees. Defendant argued that this sum, though large, was reasonable in light of the fact that plaintiff had aggressively litigated and engaged in extensive and wide-ranging discovery, which treated the case as a multi-year, statewide class action, even though there had been no class certification. Defendant substantiated the actual amount of time spent in defending the litigation by submitting declarations and copies of billing statements or invoices.

Plaintiff objected to the enforcement of the attorney fees provision, contending it was so oppressive and one-sided that it was unconscionable. Plaintiff also objected that the amount of attorney fees requested was unreasonable. The motion was heard on September 1, 2011, and following oral argument the trial court took the matter under submission. On October 21, 2011, the trial court granted the motion and awarded

defendant attorney fees in the sum of $266,801. Plaintiff then separately appealed from the order granting attorney fees, and the two appeals were consolidated by this court.

DISCUSSION

I. Summary Judgment Law and Standard of Review

We begin with the summary judgment motion. Summary judgment is appropriate when all of the papers submitted show there is no triable issue of material fact and the moving party is entitled to a judgment as a matter of law. (Code Civ. Proc., § 437c, subd. (c).) "The purpose of the law of summary judgment is to provide courts with a mechanism to cut through the parties' pleadings in order to determine whether, despite their allegations, trial is in fact necessary to resolve their dispute." (*Aguilar v. Atlantic Richfield Co*. (2001) 25 Cal.4th 826, 843.)

A defendant may move for summary judgment if it is contended that the action has no merit. (Code Civ. Proc., § 437c, subd. (a).) A defendant moving for summary judgment has the initial burden of showing a cause of action is without merit. A defendant meets that burden by showing that one or more elements of the cause of action cannot be established, or that there is a complete defense thereto. (*Id*., subd. (p)(2).) If the defendant makes such a showing, the burden shifts to the plaintiff to produce evidence demonstrating the existence of a triable issue of material fact. (*Ibid*.; *Aguilar v. Atlantic Richfield Co*., *supra*, 25 Cal.4th at p. 849.)

The pleadings play a key role in a summary judgment motion. "'The function of the pleadings in a motion for summary judgment is to delimit the scope of the issues'" and to frame "the outer measure of materiality in a summary judgment proceeding." (*FPI Development, Inc. v. Nakashima* (1991) 231 Cal.App.3d 367, 381.) As our Supreme Court has explained it: "The materiality of a disputed fact is measured by the pleadings [citations], which 'set the boundaries of the issues to be resolved at summary judgment.' [Citations.]" (*Conroy v. Regents of University of California* (2009) 45 Cal.4th 1244, 1250 (*Conroy*).) Accordingly, the burden of a defendant moving for summary judgment

only requires that he or she negate plaintiff's theories of liability *as alleged in the complaint*; that is, a moving party need not refute liability on some theoretical possibility not included in the pleadings. (*Id*. at pp. 1254-1255; *County of Santa Clara v. Atlantic Richfield Co*. (2006) 137 Cal.App.4th 292, 332; *Lockhart v. County of Los Angeles* (2007) 155 Cal.App.4th 289, 304; see also *Melican v. Regents of University of California* (2007) 151 Cal.App.4th 168, 182 ["We do not require [defendant] to negate elements of causes of action plaintiffs never pleaded."].)

Furthermore, "'"'[t]he [papers] filed in response to a defendant's motion for summary judgment may not create issues outside the pleadings and are not a substitute for an amendment to the pleadings.'"' [Citation.]" (*County of Santa Clara v. Atlantic Richfield Co*., *supra*, 137 Cal.App.4th at p. 332.) An opposing party's separate statement is not a substitute for amendment of the complaint. (*Lackner v. North* (2006) 135 Cal.App.4th 1188, 1201-1202, fn. 5.) Similarly, "'"[d]eclarations in opposition to a motion for summary judgment 'are no substitute for amended pleadings.' … If the motion for summary judgment presents evidence sufficient to disprove the plaintiff's claims, … the plaintiff forfeits an opportunity to amend to state new claims by failing to request it."' [Citations.]" (*Conroy*, *supra*, 45 Cal.4th at p. 1254.)

On appeal from a summary judgment, our task is to independently determine whether an issue of material fact exists and whether the moving party is entitled to summary judgment as a matter of law. (*Brantley v. Pisaro* (1996) 42 Cal.App.4th 1591, 1601.) "We independently review the parties' papers supporting and opposing the motion, using the same method of analysis as the trial court. Essentially, we assume the role of the trial court and apply the same rules and standards." (*Kline v. Turner* (2001) 87 Cal.App.4th 1369, 1373.) We apply the same three-step analysis required of the trial court. First, we identify the issues framed by the pleadings since it is these allegations to which the motion must respond. Second, we determine whether the moving party's showing has established facts which negate the opponent's claim and justify a judgment

in the moving party's favor. When a summary judgment motion prima facie justifies a judgment, the third and final step is to determine whether the opposition demonstrates the existence of a triable issue of material fact. (*Hamburg v. Wal-Mart Stores, Inc*. (2004) 116 Cal.App.4th 497, 503; *Chevron U.S.A., Inc. v. Superior Court* (1992) 4 Cal.App.4th 544, 548.) In so doing, we liberally construe the opposing party's evidence, strictly construe the moving party's evidence, and resolve all doubts in favor of the opposing party. (*Johnson v. American Standard, Inc*. (2008) 43 Cal.4th 56, 64; *Saelzler v. Advanced Group 400* (2001) 25 Cal.4th 763, 768.)

II. Summary Judgment Was Properly Granted

A. Defendant's Burden as Moving Party Was Satisfied

In this case, the trial court acknowledged that plaintiff's narrowly framed causes of action limited the issues that had to be addressed by defendant's summary judgment motion. According to the trial court, the *only* theory of liability alleged in the complaint was that defendant overcharged plaintiff for notary services and retained the benefits thereof. That is, plaintiff's entire complaint was premised on the assumption that section 8211, subdivision (a), was violated in this case when plaintiff was charged $75 for Kilpatrick's services. When defendant's motion presented evidence showing that Kilpatrick provided many other services at the loan signing besides merely taking two acknowledgments, the trial court concluded that plaintiff's causes of action were without merit based on that showing *and* the clear language of the statute. According to the trial court, section 8211 does not limit what may be charged "for services which are not listed in that statute." We agree with that analysis.

In the discussion that follows, we shall break down defendant's (and the trial court's) reasoning into three logical steps: (1) the meaning of section 8211, (2) the limited scope of plaintiff's pleading, and (3) defendant's evidentiary showing as the moving party successfully defeating the causes of action as pled. When each step is

considered, it will serve to highlight that defendant met its initial burden as the moving party. Afterwards, we will address the matters presented in plaintiff's opposition.

1. Section 8211

Section 8211 states, in relevant part, that "[f]ees charged by a notary public *for the following services* shall not exceed the fees prescribed by this section." (Italics added.) Included in the list of services regulated by section 8211 is the fee "[f]or taking an acknowledgment." (*Id*., subd. (a).)[7] It is plain on the face of the statute that it sets fees only for certain types of services performed by a notary—namely those services listed in the statute. Conversely, the statute does not regulate fees for any services not mentioned in the statute.[8] "'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.]'" (*Mutual Life Ins. Co. v. City of Los Angeles* (1990) 50 Cal.3d 402, 412.) We conclude the trial court correctly recognized the clear meaning of this statute.

2. The Pleadings

Throughout plaintiff's complaint, the sole basis for liability was the claim that defendant violated section 8211 and thus overcharged plaintiff. For example, in the introductory general allegations, plaintiff's complaint alleged that section 8211 "adopts a specific regulatory scheme which establishes specific limits on the amount of fees that

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[7] Section 8211, subdivision (a), states: "For taking an acknowledgment or proof of a deed, or other instrument, to include the seal and the writing of the certificate, the sum of ten dollars ($10) for each signature taken."

[8] As noted by defendant, current materials produced by the California Secretary of State's Office, entitled "Notary Public Disciplinary Guidelines," indicated in a hypothetical example relating to application of section 8211 that a notary may charge for travel expenses, as long as he or she actually did travel. (Cal. Sec. of State, Notary Public Disciplinary Guidelines (Nov. 2012) p. 19.) Travel is not among the charges expressly listed in section 8211.

can be charged for notarizing documents." Allegedly, plaintiff was charged a predetermined notary fee that was contrary to section 8211. As to plaintiff's loan transaction, defendant allegedly charged a predetermined fee of $125 "even though only [two] signature[s were] notarized in Plaintiff's Real Estate Transaction."[9] According to the complaint, defendant "violated California law by overcharging Plaintiff more than $100 for notarizing the deed of trust which Plaintiff signed," and defendant thereby "engaged in unlawful business practices and unjustly enriched [itself] by overcharging" plaintiff. Based on these allegations of fact, the complaint goes on to specify the common question of law involved in the case: "The law could not be simpler. California Government Code Section 8211 sets a cap on notarization fees. Under Section 8211[, subdivision](a), it is illegal to charge more than $10 per notarized signature on each deed or deed of trust used in a specific Real Estate Transaction. [¶] … [Defendant] charged … more than $10 per signature. Thus, [Defendant] violated the law."

Further, as to the first cause of action (the UCL claim labeled as "Unfair Business Practices"), the complaint alleged that the basis for that claim was as follows: "[Defendant] engaged in unlawful, unfair or fraudulent business acts and practices. *Namely, [Defendant] overcharged Plaintiff* … by assessing and collecting set Notary Fees in each Real Estate Transaction irrespective of the number of signatures actually notarized. Plaintiff … [was] *charged more than California law allowed*, and thus lost money due to [Defendant's] *unlawful* business practices." (Italics added.) As to the second cause of action (for "Unjust Enrichment"), the complaint alleged that the basis for that claim was as follows: "California Government Code Section 8211[, subdivision](a) sets a cap on notarization fees. *Under Section 8211[, subdivision](a), it is illegal to*

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9 Actually, the amount charged to plaintiff was $75; the $125 amount was set forth in a preliminary estimated statement of closing fees. This correction was brought to light in the summary judgment motion, and was not disputed.

charge more than $10 per notarized signature. [Defendant], *through violating California law*, unjustly enriched [itself] at the expense of Plaintiff ….” (Italics added.)

We conclude from these allegations that plaintiff's entire complaint was founded on one, and only one, theory of liability: that defendant overcharged plaintiff for notary services under the provisions of section 8211, subdivision (a). As the trial court correctly held, "[b]ased on the causes of action *alleged*, Plaintiffs *only* make a claim that [defendant] overcharged them for the notary fees." (Italics added.) Since that was the exclusive theory of liability pleaded by plaintiff, it was all that had to be addressed by defendant's motion for summary judgment. (*County of Santa Clara v. Atlantic Richfield Co.*, *supra*, 137 Cal.App.4th at pp. 332-333 [theories not pleaded by plaintiff need not be addressed in defendant's motion under Code Civ. Proc., § 437c].)

3. Defendant's Factual Showing

As noted above, in meeting the issue of the alleged overcharge under section 8211, defendant's motion demonstrated that Kilpatrick, who was both a notary and a CSA, provided a number of signing services in connection with plaintiff's loan refinance in addition to merely taking the two acknowledgements. Among other things, it was shown that Kilpatrick presented the various loan documents for signature, read the mandatory disclosures, explained the purpose of loan documents, indicated where the borrower must sign on each document, and answered questions. In short, she traveled to the place of the signing (which plaintiff recalled was his home) and facilitated the closing of the loan by obtaining the necessary signatures on all of the documents in a careful, step-by-step process, including answering questions. While the assistance and service provided by Kilpatrick included the taking of two acknowledgments (each with one notarized signature), her performance of that intrinsically notarial act was merely one part of the overall signing services she provided.

More than that, Kilpatrick's deposition testimony and her official notary journal evidenced that when she took the two acknowledgements in connection with plaintiff's

loan refinance signing, she recorded in her notary journal the fee of $10 per notarized signature. Further, Kilpatrick's testimony made clear that she understood $10 per notarized signature was all she could charge for that particular function, notwithstanding the fact that the total fee she billed for the entirety of her signing services was a flat fee of $75, which was not broken down or itemized.[10] A reasonable inference may be drawn from this evidence that plaintiff was charged only $10 per signature for the two acknowledgments, as set forth in Kilpatrick's notary journal, and that the total signing fee of $75 was attributable to the fact that many other services were performed by Kilpatrick.[11]

In conclusion, because section 8211 only limited fees for the services specifically listed therein and did not prohibit remuneration for other services rendered, defendant's evidentiary showing was sufficient to prima facie negate plaintiff's claim that defendant allegedly violated the statute by charging $75. Plaintiff's complaint assumed that the $75 charged was for taking two acknowledgments, but defendant showed that it was instead for a variety of loan signing services provided by Kilpatrick. We conclude that defendant met its burden as the moving party.

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10 We may consider this evidence in deciding whether defendant's burden was met, even though it was submitted in plaintiff's opposition. (See *Villa v. McFerren* (1995) 35 Cal.App.4th 733, 749-751 [in determining whether the defendant's burden of production was met, the court may consider evidence supplied by the plaintiff's opposition that filled a gap in the defendant's showing]; *Laabs v. City of Victorville* (2008) 163 Cal.App.4th 1242, 1267 [same]; Code Civ. Proc., § 437c, subd. (c) ["all" the papers considered].)

11 In defendant's reply, defendant noted Kilpatrick's deposition testimony that during the signing of the loan documents, plaintiff's wife (who was also a notary) asked about the fee being more than $10, and Kilpatrick explained that it was not a mere notarization but a loan signing, which was different.

B. Plaintiff's Opposition

Plaintiff argued in his opposition to the motion, as he does on appeal, that even if defendant negated plaintiff's claim for violation of section 8211, defendant nevertheless failed to meet its burden as the moving party since there were other potential theories of liability available to plaintiff that defendant's motion did not address. Plaintiff also asserted that evidence referenced in his opposition was sufficient to create a triable issue of material fact. We now address these arguments.[12]

1. Other Theories Were Not Pled

In arguing that defendant did not address certain *other* potential causes of action, plaintiff's appeal emphasizes that the UCL has three separate grounds of liability. That is a correct statement of the law. (See Bus. & Prof. Code, § 17200.) "Since section 17200 is in the disjunctive, it establishes three separate types of unfair competition. The statute prohibits practices that are either 'unfair,' or 'unlawful,' or 'fraudulent.' [Citation.]" (*Pastoria v. Nationwide Ins*. (2003) 112 Cal.App.4th 1490, 1496.) Plaintiff argues that it stated a cause of action for potential *unfair* or *fraudulent* practices because (1) the HUD-1 form or other documents provided by defendant did not itemize and disclose the specific services that were billed for notary or CSA services performed by Kilpatrick and (2) Kilpatrick's conduct of answering questions about loan documents constituted the unlawful practice of law. Whatever we may think about the viability of such theories, the problem for plaintiff at this stage is that no such claim or cause of action was ever alleged.

In an effort to persuade us that these theories were somehow pled, plaintiff notes that the first cause of action included a statement that defendant's conduct was "unlawful,

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[12] Plaintiff also argued that section 8211 had an itemization requirement, but the language of that section plainly does not say anything about itemization, and we decline to insert a duty that is not in the statute.

unfair or fraudulent." But that was a bare conclusion, not the factual basis of a cause of action. Moreover, we cannot ignore that the next sentence of the complaint made it unmistakably clear that the first cause of action was based solely on "unlawful" conduct. It stated, as we previously noted above, as follows: "*Namely*, [Defendant] *overcharged* Plaintiff … by assessing and collecting set Notary Fees in each Real Estate Transaction irrespective of the number of signatures actually notarized. Plaintiff … [was] *charged more than California law allowed*, and thus lost money due to [Defendant's] *unlawful* business practices." (Italics added.) Likewise, the second cause of action for unjust enrichment was premised exclusively on the identical unlawful conduct—that is, on the claim that defendant charged more than what section 8211 permitted, and "through violating [that] California law, unjustly enriched [itself] …." Plainly then, the actionable wrongdoing for which relief was sought in the complaint was not a failure to disclose or itemize, nor a notary's unauthorized practice of law, but that of overcharging plaintiff by exceeding the amount permitted under section 8211.

Finally, plaintiff tries to make something of the fact that the concept of itemization was briefly mentioned in the complaint. That is, the complaint alleged that defendant did not compute notary fees based on an itemization of the total number of notarized signatures taken in a transaction, but instead defendant billed a predetermined "block" amount. But that allegation was simply a description of the process by which defendant allegedly *overcharged* plaintiff under section 8211, with the overcharge itself being the sole basis of the cause of action in the pleading. In conclusion, nothing in the allegations of the complaint indicated that insufficient disclosure or itemization, or unauthorized practice of law by a notary, constituted the actionable wrongdoing on defendant's part for which relief was sought. No such causes of action were alleged.

What we said at the outset of our discussion bears repeating here: For purposes of a summary judgment motion, the pleadings set the boundaries of the issues to be resolved. (*Conroy*, *supra*, 45 Cal.4th at p. 1250.) Defendant, therefore, met its burden as

the moving party when it negated the sole basis of plaintiff's claims—namely, the alleged excessive notary fee under section 8211. It was not incumbent on defendant to refute liability on some theoretical possibilities not included in the pleadings. (*Conroy*, *supra*, at p. 1254; *County of Santa Clara v. Atlantic Richfield Co*., *supra*, 137 Cal.App.4th at p. 332.) Each of the suggested *other* grounds for liability argued by plaintiff were simply theoretical possibilities that were not included in the pleadings. Finally, plaintiff cannot use his opposition papers as a substitute for an amended pleading, and his failure to seek an amendment below forfeits the issue. (*Conroy*, *supra*, at p. 1254; *County of Santa Clara v. Atlantic Richfield Co*., *supra*, at pp. 333; *Lackner v. North*, *supra*, 135 Cal.App.4th at pp. 1201-1202, fn. 5.)

2. No Triable Issue of Fact

Nothing in plaintiff's opposition papers created a triable issue of fact on the present ground for the motion. Indeed, most of the opposition evidence went to the separate issue of whether or not Kilpatrick was an agent of defendant, or to show purported theories of liability that were not alleged in the pleadings. Since defendant met its burden as the moving party, and plaintiff failed to demonstrate the existence of a triable issue of fact, we conclude that summary judgment was properly granted. (Code Civ. Proc., § 437c, subd. (c) & (p)(2).)[13]

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[13] Plaintiff's appeal also claims the trial court erred when it did not sustain his evidentiary objections to certain statements in two of the declarations submitted by defendant. Plaintiff has failed to adequately demonstrate error, since a party's understanding of the nature of his or her employment relationship would not be irrelevant to that issue (*Lara v. Workers' Comp. Appeals Bd*. (2010) 182 Cal.App.4th 393, 399), and other facts and circumstances were provided to support that understanding. Therefore, no bare conclusions as to Kilpatrick's independent contractor status were made. In any event, the particular statements to which plaintiff objected did not impact the ground upon which we have affirmed the summary judgment.

III. Attorney Fees Provision Was Unconscionable*

Defendant, as prevailing party, moved for recovery of its attorney fees pursuant to a provision in the parties' escrow instructions. Plaintiff objected to enforcement of that provision on the ground that it was unconscionable. In its written order following the hearing, the trial court granted the motion and awarded to defendant the sum of $266,801 as a recovery of its attorney fees. We treat the trial court's order granting the motion as an implicit rejection of plaintiff's contention that the attorney fees provision was unconscionable.[14] Plaintiff's appeal argues the trial court erred on that issue. We agree.

A. Standard of Review

"Unconscionability is ultimately a question of law for the court." (*Flores v. Transamerica HomeFirst, Inc*. (2001) 93 Cal.App.4th 846, 851, citing Civ. Code, § 1670.5.) "However, numerous factual issues may bear on that question. [Citation.] Where the trial court's determination of unconscionability is based upon the trial court's resolution of conflicts in the evidence, or on the factual inferences which may be drawn therefrom, we consider the evidence in the light most favorable to the court's determination and review those aspects of the determination for substantial evidence. [Citations.]" (*Gutierrez v. Autowest, Inc.* (2003) 114 Cal.App.4th 77, 89.) To the extent that there are no material conflicts in the evidence bearing on the issue of unconscionability, our review is de novo. (*Higgins v. Superior Court* (2006) 140 Cal.App.4th 1238, 1250.)

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* See footnote, *ante*, page 1.

14 The order did not mention the issue of unconscionability.

B. The Contract Provision and Other Evidence

The subject attorney fees provision, which was set forth in paragraph 14 of the general provisions of the escrow instructions, stated as follows:

> "In the event that a suit is brought by any party or parties to these escrow instructions to which the Escrow Holder is named as a party which results in a judgment in favor of the Escrow Holder and against a principal or principals herein, the principals or principals' agent agree to pay said Escrow Holder all costs, expenses and reasonable attorney's fees which it may expend or incur in said suit, the amount thereof to be fixed and judgment therefore to be rendered by the court in said suit."

In opposing the motion for attorney fees, plaintiff's declaration described the circumstances of signing the escrow instructions on February 5, 2007. He stated that he "did not personally choose to use [defendant]" as the escrow company for the loan refinance, nor was he given any other options. He signed "all" of the loan paperwork in front of the notary selected by defendant, who presented "approximately forty (40) standard loan forms to sign." The forms were presented for signature in order for plaintiff to obtain his loan refinance, and were presented to him by the notary for "quick signature." As form after form was put forward for plaintiff's signature, plaintiff did not attempt a detailed review of each document, nor did he believe there was sufficient time to do so. Moreover, plaintiff did not believe he could "pick and choose which forms to sign" or "cross out any pre-printed paragraphs that [he] did not agree with." Rather, he believed that in order to obtain his loan refinance, he had to sign all of the documents presented to him, including the escrow instructions. Defendant never told him otherwise, nor did defendant indicate that any of the preprinted general provisions in the escrow instructions were negotiable. Further, plaintiff's declaration stated that he had no idea the escrow instructions contained a paragraph that required him to "pay all of [defendant's] attorneys' fees for whatever type of claim I may have against it." He asserted that had he known about that provision, he would never have signed the escrow instructions.

Defendant's reply in support of its attorney fees motion argued that the matters asserted in plaintiff's declaration were too conclusory to adequately support a finding of unconscionability. Defendant noted that, contrary to plaintiff's declaration, plaintiff had testified previously that he did not recall whether the notary had offered to answer questions or whether she had explained any documents to him. Defendant's reply also referred to Kilpatrick's declaration (utilized by defendant in the summary judgment motion), indicating that Kilpatrick had summarized the nature of the documents to be signed and offered to answer questions. Additionally, in arguing against unconscionability, defendant claimed that Civil Code section 1717 would make the one-sided attorney fees provision mutual.

The trial court's order did not expressly address the issue of unconscionability, but simply stated: "[Defendant's] motion is hereby granted. [Defendant] is contractually entitled to be recompensed for attorney fees and expenses. [Defendant] reasonably incurred $266,801 in attorney's fees and expenses. Hence, Plaintiff or his agents shall recompense [Defendant] $266,801 in attorneys' fees and expenses …."

C. Overview of Law of Unconscionability

A court may deny enforcement of a contractual provision that is determined to be unconscionable. "If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result." (Civ. Code, § 1670.5, subd. (a).)

Our Supreme Court recently summarized the law of unconscionability in *Pinnacle Museum Tower Assn. v. Pinnacle Market Development (US), LLC* (2012) 55 Cal.4th 223 (*Pinnacle*), as follows: "Unconscionability consists of both procedural and substantive elements. The procedural element addresses the circumstances of contract negotiation and formation, focusing on oppression or surprise due to unequal bargaining power.

[Citations.] Substantive unconscionability pertains to the fairness of an agreement's actual terms and to assessments of whether they are overly harsh or one-sided. [Citations.] A contract term is not substantively unconscionable when it merely gives one side a greater benefit; rather, the term must be 'so one-sided as to "shock the conscience."' [Citation.]" (*Id*. at p. 246; see also *Little v. Auto Stiegler, Inc*. (2003) 29 Cal.4th 1064, 1071 (*Little*) [procedural unconscionability "generally takes the form of a contract of adhesion"]; *Armendariz v. Foundation Health Psychcare Services, Inc*. (2000) 24 Cal.4th 83, 113-114 (*Armendariz*).)[15]

"Both procedural unconscionability and substantive unconscionability must be shown, but 'they need not be present in the same degree' and are evaluated on '"a sliding scale."' [Citation.] '[T]he more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.' [Citation.]" (*Pinnacle*, *supra*, 55 Cal.4th at p. 247, citing *Armendariz, supra*, 24 Cal.4th at p. 114.)

D. Application

We now consider whether the attorney fees provision at issue was unconscionable and, therefore, unenforceable. We do so by evaluating whether plaintiff showed both the procedural and the substantive elements of unconscionability.

1. Procedural Unconscionability

As indicated above, procedural unconscionability requires either *oppression* or *surprise*. """Oppression occurs where a contract involves lack of negotiation and

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[15] The procedural/substantive approach was first given clear articulation in the case of *A&M Produce Co. v. FMC Corp*. (1982) 135 Cal.App.3d 473, 485-493 (*A&M Produce*), and was viewed as an alternative to the approach taken previously in *Graham v. Scissor-Tail, Inc*. (1981) 28 Cal.3d 807, 817-820. (See *Morris v. Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1316-1320 [summarizing development of two analytical approaches to unconscionability].)

meaningful choice, surprise where the allegedly unconscionable provision is hidden within a prolix printed form.'" [Citation.]" (*Pinnacle*, *supra*, 55 Cal.4th at p. 247.) Procedural unconscionability, and in particular "'oppression,'" generally entails a *contract of adhesion*; that is, "'a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'" (*Armendariz*, *supra*, 24 Cal.4th at p. 113; see also *Walnut Producers of California v. Diamond Foods, Inc*. (2010) 187 Cal.App.4th 634, 645-646.) "'[S]urprise'" typically involves a provision """hidden""" within the prolixness of a preprinted form contract drafted by the party having superior bargaining strength. (*Baker v. Osborne Development Co*. (2008) 159 Cal.App.4th 884, 895; *A&M Produce*, *supra*, 135 Cal.App.3d at p. 486; *Armendariz*, *supra*, at p. 114.)

Here, we conclude that procedural unconscionability existed based on *surprise* created by defendant escrow company. Preliminarily, we agree with plaintiff that in his situation as an individual homeowner or consumer seeking to refinance his home loan, the lender-approved escrow company handling the signing and escrow settlement process (i.e., defendant) was in a superior bargaining position. (See *Akin v. Business Title Corp*. (1968) 264 Cal.App.2d 153, 157 [recognizing escrow company generally has superior bargaining strength over customers needing its services].) Further, the escrow instructions were, to a significant extent, adhesive in the sense that they were set forth in a form contract imposed on plaintiff, the weaker party, and the disputed attorney fees provision was neither known to nor negotiated by plaintiff.[16] (See *Morris v. Redwood*

16 On the issue of adhesion, plaintiff's declaration was conclusory in asserting his inability to negotiate or cross out preprinted terms on the standardized form. He believed he could not do so, at least not without risking the loss of his refinancing, but he never affirmatively tested that belief by inquiring or attempting to negotiate. Nevertheless, we believe the attending circumstances were such that plaintiff reasonably understood that the preprinted documents were presented for his signature in a take it or leave it fashion. That is, the preprinted forms were submitted to plaintiff as what he would need to sign,

Empire Bancorp, *supra*, 128 Cal.App.4th at p. 1319, applying *Armendariz*, *supra*, 24 Cal.4th at p. 113.)

As to the specific issue of surprise, plaintiff demonstrated that the attorney fees provision was hidden or obscured in more than one way. First, there was the signing process itself. The record showed that during the signing event (conducted by the notary selected by defendant), plaintiff was presented in one sitting with approximately 40 preprinted forms for his signature in order to complete his loan refinance transaction, and the escrow instructions were but one document among that multitude of preprinted forms. We believe the quantity of loan and escrow documents that plaintiff was asked to sign at one time—each one of which would presumably have its own assortment of fine print or boilerplate provisions—was relevant to the issue of surprise. It is not unreasonable to expect that a single provision contained in one document may get missed or overlooked when the signing party must also work through and sign a large number of other preprinted form documents at the same time. But that was not all that was involved here. The provision was also hidden within the escrow instructions themselves. In our observation of the escrow instructions, the entirety of which were printed in a relatively small font size, the attorney fees provision was inconspicuously buried in the prolixness of the densely packed, harder to read boilerplate "GENERAL PROVISIONS" section of the last part of that form document. (See, e.g., *Pardee Construction Co. v. Superior Court* (2002) 100 Cal.App.4th 1081, 1090 (*Pardee*) [surprise shown where disputed provision was buried in the preprinted form contracts supplied by party with superior bargaining

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then and there, for his loan refinance and escrow to proceed to closure. To all appearances, it was the time for final signature(s) to be obtained on those forms. Most people would reasonably assume under such conditions (unless informed otherwise) that they would have to sign, as written, the standardized legal documents presented by a large financial institution or escrow company if they wanted the underlying transaction to be consummated. And as it conspicuously stated at the top of the escrow instructions, plaintiff was being asked to merely "SIGN AND RETURN" that document.

strength, and were difficult to read due to format and font]; *Gutierrez v. Autowest, Inc*., *supra*, 114 Cal.App.4th at p. 89 [surprise shown where disputed clause was "printed in eight-point typeface on the opposite side of the signature page of the lease" and lessee was "never informed that the lease contained an arbitration clause"].) The above described conditions were sufficient, by themselves, to adequately show surprise for purposes of procedural unconscionability.

We note further that there was nothing in the escrow instructions or otherwise that would have drawn plaintiff's attention to the specific fact that the prolixness of the preprinted, standardized form included a highly unexpected or irregular term that had never been discussed by the parties: that is, a one-sided attorney fees provision that encompassed all types of claims and exclusively benefitted defendant.[17] Although the party asserting unconscionability has the burden of proving that defense (*Woodside Homes of Cal., Inc. v. Superior Court* (2003) 107 Cal.App.4th 723, 728), it has also been held that the party who prepared and submitted a form contract containing unexpected or harsh terms has the burden of showing that the other party had notice of them (*Ellis v. McKinnon Broadcasting Co*. (1993) 18 Cal.App.4th 1796, 1804). That did not occur here.

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17 Under the circumstances as described, it would be easy to miss or misread one or more of the general provisions, notwithstanding the fact that above the signature block of the escrow instructions it stated that a party's signature "SIGNIFIES" that he or she read and understood the general provisions. The provision at issue did have a heading that read "REIMBURSEMENT ATTORNEY FEES/ESCROW HOLDER," the presence of which was one factor on the issue of surprise. (See *Pardee*, *supra*, 100 Cal.App.4th at p. 1090.) The existence of that heading arguably diminishes the overall strength of plaintiff's showing of procedural unconscionability in this case, but it is insufficient to undo it. We note further that nothing in that ordinary heading would alert the reader that the standardized provision was extreme or unusual in its content.

On this record, we conclude that plaintiff adequately established grounds for surprise as a matter of law. Therefore, the element of procedural unconscionability was satisfied and the trial court's implied finding to the contrary was in error.

2. Substantive Unconscionability

The substantive element of unconscionability "pertains to the fairness of an agreement's actual terms and to assessments of whether they are overly harsh or one-sided. [Citations.]" (*Pinnacle*, *supra*, 55 Cal.4th at p. 246.) This includes consideration of the extent to which the disputed term is outside the reasonable expectation of the nondrafting party and/or unduly oppressive. (*Gutierrez v. Autowest, Inc.*, *supra*, 114 Cal.App.4th at p. 88.) "Substantively unconscionable terms may take various forms, but may generally be described as *unfairly one-sided*." (*Little*, *supra*, 29 Cal.4th at p. 1071, italics added.) "A contract term is not substantively unconscionable when it merely gives one side a greater benefit; rather, the term must be 'so one-sided as to "shock the conscience."' [Citation.]" (*Pinnacle*, *supra*, at p. 246.) Unconscionability is measured as of the time the contract was entered. (Civ. Code, § 1670.5, subd. (a).)

We agree with plaintiff that the attorney fees provision was unfairly one-sided and well beyond the expectations of plaintiff, as the nondrafting party. This was not a *standard* attorney fees provision providing a mutual right to attorney fees to the prevailing party in an action. Rather, the provision gave to defendant alone a right to recover its attorney fees and, furthermore, that one-sided attorney fees remedy in defendant's favor extended to any type of suit or action. A customer presented with standardized escrow instructions would not reasonably expect an attorney fees provision that was *both* completely one-sided (i.e., only allowing defendant to recover its fees) and all-encompassing (i.e., including claims independent of the contractual escrow instructions, such as for alleged violations of statute or fraudulent conduct). Moreover, such one-sided attorney fees provisions imposed in adhesive contracts by the stronger party have been routinely described as oppressive by our case law. (See, e.g., *Reynolds*

Metals Co. v. Alperson (1979) 25 Cal.3d 124, 128 [noting that Civ. Code, § 1717 was enacted to prevent oppression caused by one-sided fee agreements]; *Coast Bank v. Holmes* (1971) 19 Cal.App.3d 581, 596-597 [one-sided fee provisions puts weaker party at unfair disadvantage and often used as instruments of oppression].)

For example, the unfairness or oppression created by such one-sided fee provisions was summarized in *International Billing Services, Inc. v. Emigh* (2000) 84 Cal.App.4th 1175. In that case, the Court of Appeal discussed the issue in the context of the reciprocity provision of Civil Code section 1717, as follows: "Absent the reciprocity provision, contracting parties with superior economic bargaining power would routinely insert one-sided fees provisions in contracts. In the event of a dispute, and regardless of the merits *vel non* of the disputant's claims, the drafting party would have an unfair litigation advantage from the outset: Even if it lost, it would only have to pay contract damages; if it won, the weaker party would also have to pay fees. 'One-sided attorney's fees clauses can thus be used as instruments of oppression to force settlements of dubious or unmeritorious claims. [Citations.] Section 1717 was obviously designed to remedy this evil.'" (*International Billing Services, Inc.*, *supra*, at pp. 1187-1188.) Similarly, in *Coast Bank v. Holmes*, *supra*, 19 Cal.App.3d 581, the appellate court explained: "[P]arties with superior bargaining power, especially in 'adhesion' type contracts," frequently impose unilateral "attorney fee clauses for their own benefit." (*Id.* at p. 596.) "This places the other contracting party at a distinct disadvantage. Should he lose in litigation, he must pay legal expenses of both sides and even if he wins, he must bear his own attorney's fees. One-sided attorney's fees clauses can thus be used as instruments of oppression ...." (*Id.* at pp. 596-597.)

We find the attorney fees provision in this case was substantively unconscionable at the time the contract was entered. It was unfairly one-sided, oppressive, and outside the reasonable expectations of the nondrafting party at that time, not only because of the unilateral advantage that it afforded to defendant, but also because it extended that one-

sided advantage to apply to all types of claims, no matter how egregious the alleged wrongdoing might be. These factors, considered on a sliding scale with the relatively strong showing on the procedural element of surprise, lead us to conclude in this case that the attorney fees provision was unconscionable and cannot be enforced.

Defendant contends the attorney fees clause is salvageable because, by virtue of Civil Code section 1717's reciprocity provision, the clause will automatically be treated as bilateral and mutual. We disagree. Section 1717 states, in relevant part, as follows: "*In any action on a contract*, where the contract specifically provides that attorney's fees and costs, *which are incurred to enforce that contract*, shall be awarded either to one of the parties or to the prevailing party, then the party who is determined to be *the party prevailing on the contract*, whether he or she is the party specified in the contract or not, shall be entitled to reasonable attorney's fees in addition to other costs." (*Id*., subd. (a), italics added.)[18] By its clear terms, section 1717 applies to actions that are based on a contract (*Federal Deposit Ins. Corp. v. Dintino* (2008) 167 Cal.App.4th 333, 357), or to claims that "sound in contract" (*Silverado Modjestka Recreation & Park Dist. v. County of Orange* (2011) 197 Cal.App.4th 282, 310), where the contract expressly provides for recovery of attorney fees. "In determining whether an action is 'on the contract' under section 1717, the proper focus is not on the nature of the remedy, but on the basis of the cause of action." (*Kachlon v. Markowitz* (2008) 168 Cal.App.4th 316, 347.) In that sense, the term "'on the contract'" is broadly construed. (*Turner v. Schultz* (2009) 175 Cal.App.4th 974, 979; see also *Douglas E. Barnhart, Inc. v. CMC Fabricators, Inc*. (2012) 211 Cal.App.4th 230, 240-241 [digesting cases construing term "'on the contract.'"].)

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18 It is not clear that Civil Code section 1717 may be used by the party responsible for drafting and imposing an unconscionable provision to salvage its enforceability against the weaker party. We do not reach that issue here, since we hold section 1717 does not apply.

Here, even broadly construed, plaintiff's actions for unfair competition and unjust enrichment were based exclusively on enforcement of a distinct statutory regulation (i.e., Gov. Code, § 8211) concerning how much a notary, as such, may charge in fees for certain services. That statute, as a regulation upon notaries for the services they perform in that capacity, comprised a duty that was independent of the parties' contract for escrow services. The escrow relationship and the contract on which that relationship was based were merely incidental to plaintiff's claims. Since plaintiff's action was not "on the contract" for purposes of Civil Code section 1717, that section did not apply here. Therefore, defendant's contention that the unconscionable attorney fees provision was fixed by section 1717 fails.

DISPOSITION

The trial court's order granting defendant's motion for attorney fees and costs is reversed. In all other respects, the judgment is affirmed. Each party shall bear their own costs.

____
Kane, J.

WE CONCUR:

____
Gomes, Acting P.J.

____
Franson, J.

Filed 4/3/13

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION SIX

MAJ I. HAGMAN, as Trustees, etc., Plaintiff and Respondent, v. MEHER MOUNT CORPORATION, Defendant and Appellant.	2d Civil No. B239014 (Case No. 56-2011-00393722-CU-OR-VTA) (Ventura County)

In this boundary dispute, one neighbor seeks to quiet title by adverse possession to an adjoining piece of his neighbor's land that he inadvertently fenced in and later improved. The unusual twist is that the neighboring land on which the adverse possession took place belongs to a nonprofit religious organization. We hold that a nonprofit religious organization's status as a "public benefit corporation" does not make it a "public entity" immune from adverse possession under Civil Code section 1007. We further hold that a nonprofit religious organization's "welfare exemption" from property taxes (see Rev. & Tax. Code, § 214) means that no such taxes were "levied and assessed" on the property during the years it qualified for the exemption. Under the plain and binding language of Code of Civil Procedure Code section 325, the adverse possessor is consequently excused from the usual requirement that he pay taxes on the disputed land for five years. (*Id.*, subd. (b).)

FACTS AND PROCEDURAL HISTORY

Larry Hagman or his trust (Hagman) owns a 30-acre parcel of land in Ojai, California. In 1987, one of the fences marking the boundary of his property was built in the wrong place. Since then, Hagman has been occupying and improving a .44-acre portion of the 173-acre parcel owned by his adjoining neighbor, the Meher Mount Corporation (Meher Mount).[1] Meher Mount is a religious group whose "primary purpose" is to "provide for the betterment of mankind by implementing the teachings of Meher Baba." The land it owns is irrevocably dedicated to that purpose.

Between 1999 and 2004, Meher Mount applied and qualified for a welfare exemption as a religious organization using its property for educational purposes. (See Rev. & Tax Code, §§ 214, 271.) Accordingly, it did not pay Ventura County property taxes during those years. It did, however, pay the Mosquito Control and Vector Borne Disease Prevention Assessment (mosquito assessment) levied on its land, which amounted to $12.08 for all five years. Hagman did not pay any taxes or assessments on Meher Mount's property for those years.

In early 2011, Hagman sued Meher Mount to quiet title to the disputed half acre on the theory that he had acquired title by adversely possessing that parcel between 1999 and 2004. Hagman moved for summary judgment. Meher Mount answered, opposed summary judgment and filed a cross-complaint for trespass and ejectment. In those filings, Meher Mount argued that (1) tax-exempt religious organizations are public entities immune from adverse possession under Civil Code section 1007; and (2) Hagman did not prove, as a prerequisite to adverse possession under Code of Civil Procedure section 325, that he paid either the yearly property taxes or the mosquito assessment on Meher Mount's land between 1999 and 2004.

The trial court granted summary judgment for Hagman. The court ruled that Civil Code section 1007 limits immunity from adverse possession to "public

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[1] Although Hagman passed away during the pendency of this appeal, the property issues remain live.

utilities" and "public entities." Meher Mount was neither. The court further noted that the only contested element of adverse possession was the requirement that Hagman pay all taxes levied and assessed on the property for the five years of alleged adverse possession.[2] (Code Civ. Proc., § 325, subd. (b).) The court accepted Hagman's argument that no property taxes had been assessed or levied on Meher Mount's property by virtue of its welfare exemption. Relying on *San Marcos Water District v. San Marcos Unified School District* (1986) 42 Cal.3d 154 (*San Marcos Water Dist.*), superseded on other grounds by Government Code section 54999 et seq., the court further ruled that the mosquito assessment was not a "tax." The court reasoned that the assessment was levied to "clearly benefit specific real property" and not to raise "general revenue." Because it was not a tax, Hagman was not required to pay it under Code of Civil Procedure section 325.

DISCUSSION

A party is entitled to summary judgment only if he proves there are no triable issues of material fact and that he is entitled to judgment as a matter of law. (*Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 850.) We review de novo a trial court's conclusion that a party has carried his burden. (*Winchester Mystery House, LLC v. Global Asylum, Inc.* (2012) 210 Cal.App.4th 579, 587.)

I. *Meher Mount's Property Is Not Immune From Adverse Possession*

In California, title to property owned by a public entity cannot be obtained by another through adverse possession.[3] (Civ. Code, § 1007; *Marin Healthcare Dist. v. Sutter Health* (2002) 103 Cal.App.4th 861, 867 (*Marin Healthcare Dist.*) [no adverse possession against state property]; *Hoadley v. City and County of*

[2] The undisputed facts established the other four elements of adverse possession: Hagman possessed the half acre under a claim of right; his possession was open and notorious enough to give reasonable notice; it was hostile and exclusive; and it was continuous and uninterrupted for five years.

[3] Civil Code section 1007 also reaches property owned by the State or "dedicated to a public use by a public utility." Meher Mount does not claim to be the State or a public utility.

San Francisco (1875) 50 Cal. 265, 274-276 [same]; cf. *Guerra v. Packard* (1965) 236 Cal.App.2d 272, 287-288 [adverse possession permissible against privately owned land].) Meher Mount offers arguments based on statutory language, policy, and precedent as to why a "public benefit corporation" like itself is a "public entity."

Meher Mount's statutory argument is a tidy syllogism: "Public benefit corporations" (Corp. Code, § 5060) are "public corporations" (Evid. Code, § 200), and "public corporations" are "public entities"; ergo, "public benefit corporations" must be "public entities." We reject this argument for two reasons.

First, public benefit corporations are not public corporations. The term "public corporation" is a term of art used to designate certain entities that exercise governmental functions. (See Cal. Const. art. VI, § 9 [State Bar is a "public corporation"]; Bus. & Prof. Code, § 6001 [same]; *People ex rel. Post v. San Joaquin Valley Agr. Assn.* (1907) 151 Cal. 797, 799, 803-04 [district agricultural associations are "public corporations"]; Gov. Code § 6300 [defining "public corporation" to include only governmental entities]; accord *Bettencourt v. Industrial Accident Comm.* (1917) 175 Cal. 559, 561.) Our Legislature knows how to designate an entity as a "public corporation," and it has not so designated "public benefit corporations." That the terms "public corporation" and "public benefit corporation" happen to share two of the same words does not make them synonymous.

Second, public benefit corporations are not public entities. "Public entity" is not defined in Civil Code section 1007, but is defined elsewhere throughout the California Codes. (E.g., Evid. Code, § 200; Gov. Code, § 811.2; Civ. Proc. Code, §§ 481.200, 871.7, subd. (a), 1235.190; Health & Saf. Code, §§ 13050.1, 103660; Pub. Contract Code, §§ 1100, 5100, 7200, subd. (a)(2), 20671, subd. (b); Ins. Code, § 130, subd. (h); Pub. Resources Code, § 5800; Veh. Code, § 17000, subd. (c); Unemp. Ins. Code, § 135, subd. (a)(3); Wat. Code, § 371, subd. (e).) In every instance, the entities listed as public entities—from traditional bodies like counties and cities to more recent innovations like public authorities and public corporations—have one thing in common: Each is vested with some degree of sovereignty. (*Vallas v. City of Chula*

Vista (1976) 56 Cal.App.3d 382, 387, disapproved on other grounds in *Peterson v. Long Beach* (1979) 24 Cal.3d 238, 245, fn.5, superseded by Evid Code, § 669 [so noting with Evid. Code, § 200]; *Lawson v. Super. Ct.* (2010) 180 Cal.App.4th 1372, 1396 [so noting with Gov. Code, § 811.2].)

Public benefit corporations lack any element of sovereignty. They are not created by the government, even though they may require governmental approval to qualify as a public benefit corporation. They are not owned or operated by the government. They do not possess any of the traditional incidents of sovereign authority such as the power to tax or to condemn property. They do not serve a governmental purpose, although they may serve altruistic purposes that benefit society. (Accord Civ. Proc. Code, § 1235.155 [for condemnation purposes, distinguishing property owned by tax-exempt nonprofit organizations from property owned by public entities].)

Meher Mount's policy argument is also unpersuasive. Meher Mount argues that granting immunity from adverse possession to public benefit corporations makes good policy sense because they provide a valuable public service and should not have to fend off land-hungry encroachers. That may be so, but the Legislature could reasonably choose to recognize the contribution of public benefit corporations by exempting them from property taxes while simultaneously conclude that they are more akin to private land owners than to governmental entities when it comes to immunity from adverse possession. Government property is immune from adverse possession "because there may be little incentive for a public entity to be aware of who is using public property or take steps to interfere with a potential adverse possessor. [Citation.]" (*Hayes v. Vanek* (1989) 217 Cal.App.3d 271, 286.) Public benefit corporations ostensibly have different incentives. They include a diverse array of organizations from religious schools to cemeteries to water cooperatives; such entities have a far greater incentive than cities or counties to police their own property for trespassers and to take action to eject them. Because, "as a court, we must defer to the Legislature's judgment on which . . . policies to adopt," (*Marin Healthcare Dist.*,

supra, 103 Cal.App.4th at p. 872), Meher Mount's request that we strike a different balance among these competing policy considerations is better addressed to the Legislature than to us.

Meher Mount lastly contends that *Mosk v. Summerland Spiritualist Association* (1964) 225 Cal.App.2d 376, requires us to rule in its favor. In *Mosk*, the plaintiff sought to adversely possess land owned by a religious trust. The court held that the plaintiff had failed to prove his entitlement to adverse possession, but made the following observation: "It seems to us that property held under a charitable trust would have the same immunity" to adverse possession as the government. (*Id.*, at p. 381.) Tellingly, no court has cited *Mosk* for its observation in the intervening 49 years. We go further, and express our view that *Mosk's* observation is incorrect. *Mosk* contained no statutory analysis. Instead, it reasoned that charitable trusts are imbued with a "public" character because, at that time, only the Attorney General could enforce such trusts. (*Ibid.*) That premise is no longer valid, as the Attorney General's authority is no longer exclusive. (See Prob. Code, § 24, subd. (d) [trust beneficiaries have standing]; Gov. Code, § 12598, subd. (a) [Attorney General also has authority over charitable trusts and public benefit corporations]; Corp. Code., § 9230 [Attorney General has fewer powers over "religious corporations"].) More to the point, nothing in *Mosk* undermines our analysis of Civil Code section 1007's text or policy. We decline to follow *Mosk.*

Accordingly, we conclude that Meher Mount is not a public entity immune from adverse possession.

II. *Hagman Need Not Pay Property Taxes Never Levied And Assessed*

To obtain title, an adverse possessor is required to prove that he or she "timely paid all state, county, or municipal taxes that have been levied and assessed upon the land for [a] period of five years . . . ." (Civ. Proc. Code, § 325, subd. (b); *Gilardi v. Hallam* (1981) 30 Cal.3d 317, 326 (*Gilardi*); *Glatts v. Henson* (1948) 31 Cal.2d 368, 372; *Main Street Plaza v. Main LLC* (2011) 194 Cal.App.4th 1044, 1054 [applying requirement to separately assessed prescriptive easements].) Meher Mount

argues that Hagman has failed to comply with this requirement for two reasons: (1) he never paid the property taxes on the disputed half acre; and (2) he never paid the mosquito assessments. Hagman admits he paid no taxes, but responds that (1) no property taxes were ever levied or assessed on the property due to Meher Mount's tax-exempt status; and (2) the mosquito assessment is not a tax. The meaning of the terms "levy," "assess," and "tax" are all issues of law we review de novo. (*Sinclair Paint Co. v. State Bd. of Equalization* (1997) 15 Cal.4th 866, 873-874 (*Sinclair Paint Co.*); *People ex rel. Lockyer v. Shamrock Foods Co.* (2000) 24 Cal.4th 415, 432.)

A. *Property Taxes Were Not Assessed Or Levied On Meher Mount's Property*

Because Code of Civil Procedure Code section 325 does not use its own definition for when taxes have been "levied" and "assessed," we look to the general definitions. (See *Allen v. McKay & Co.* (1898) 120 Cal. 332, 334.) A tax is assessed when the county assessor prepares the roll listing all properties subject to taxation and their assessed value. (Rev. & Tax. Code, §§ 401, 109, 601.) This occurs annually. (*Id.*, § 405, subd. (a).) A tax is levied when the county's board of supervisors fixes the tax rate and orders that the taxes be paid "in specific sums in terms of the rates so accepted." (Gov. Code, §§ 29100, 29101.)

For each tax year pertinent in this case, Meher Mount applied and qualified for the welfare exemption on that property. (See Rev. & Tax Code, § 214.) Once these exemptions were granted, the property became "exempt from taxation." (*Id.*, subd. (a).) The question then becomes: Does the grant of the welfare exemption from property taxes preclude a county from assessing and levying taxes on the exempt property? As discussed below, the exemption precludes both assessment and levy.

The grant of the welfare exemption precludes the assessment of property taxes. Assessment requires both valuation of the property and its placement on the roll. Meher Mount notes that property will often be valued before a welfare exemption is granted. This is true, but valuation is only the first portion of assessment. Under the statutorily prescribed deadlines, exemption applications are due before property is placed on the roll. (Rev. & Tax Code, §§ 254.5 [exemption applications due February

15]; 616, 617 [certified assessor's roll due to auditor on July 1].) This ensures that property qualifying for the welfare exemption—whether or not already valued—is not placed on the roll and consequently not assessed any property tax. However, even if property is placed on the roll, a subsequently granted exemption voids any prior assessment of property tax on that land. (*Id.*, §§ 271, subd. (a)(1); 272 [requiring assessor's roll to be corrected if welfare exemption is approved after roll is completed]; 201 [exempt property not "subject to taxation"]; *Hollister v. Sherman* (1883) 63 Cal. 38, 39 [attempts to assess exempt property are void].)

The welfare exemption also precludes any levy of property taxes. Levy presupposes assessment. If, due to the exemption, no tax is assessed, there can be no subsequent levy. Even if a tax is levied, the levy is canceled by a later-granted exemption. (See *Mountain Club v. Pinney* (1924) 67 Cal.App. 225, 248-249 [holding that adverse possessor need not pay later-canceled tax].)

Meher Mount argues that excusing Hagman from the statutory duty to pay property taxes on the disputed parcel, just because Meher Mount is excused, is bad public policy. Meher Mount posits that the exemption is meant to benefit the public-minded property owner, and should therefore apply only to the owner and not the adverse possessor. Meher Mount also anticipates that our rule will make it easier to adversely possess the land of tax-exempt organizations. Be that as it may, these are policy arguments we are not free to follow when faced with statutes that dictate a different result.

We therefore conclude that no property taxes were assessed or levied on Meher Mount's property during the years it qualified for the welfare exemption. Hagman is accordingly not required to pay property taxes on that land under Code of Civil Procedure section 325, subdivision (b).[4] (See *Allen v. Allen* (1911) 159 Cal. 197, 200 [if no taxes are levied or assessed, adverse possessor need not pay taxes].)

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[4] In light of our ruling, we need not reach Hagman's further argument that he already paid the property taxes on the disputed half acre because he openly improved that land. (See *Gilardi*, *supra*, 30 Cal.3d at p. 327.)

B. *The Mosquito Assessment Is Not a "Tax"*

In determining whether the mosquito assessment is a tax, we start with the generic definition. "[T]axes are imposed for revenue purposes, rather than in return for a specific benefit conferred or privilege granted. [Citations.]" (*Sinclair Paint Co.*, *supra*, 15 Cal.4th at p. 874; *San Marcos Water Dist.*, *supra*, 42 Cal.3d at p. 162; *Pajaro Valley Water Management Agency v. Amrhein* (2007) 150 Cal.App.4th 1364, 1381.) To be sure, the Legislature and voters have adopted different definitions of "tax" tailored to specific purposes. (*Sinclair Paint Co.*, *supra*, at p. 874 [the term "tax" has "no fixed meaning"]; see also *Richmond v. Shasta Community Servs. Dist.* (2004) 32 Cal.4th 409, 421 (*Richmond*) [defining "tax" vis-à-vis "assessment" in determining voter enactment requirements]; *San Marcos Water Dist.*, *supra*, at pp. 160-162 [defining taxable "fee" vis-à-vis exempt "special assessment" for purposes of public entity's exemption from taxes]; *United Business Com. v. City of San Diego* (1979) 91 Cal.App.3d 156, 165 [defining "tax" vis-à-vis "fee" for purposes of determining municipality's power to levy tax].)

There is no policy-driven reason to depart from this generic definition when defining the term "taxes" under Code of Civil Procedure section 325 because the policy served by the taxation requirement in this context is a relatively weak one. An adverse possessor is required to pay taxes to put the record owner on notice of the adverse possessor's interest in the property. Notice is surely important, but the notice imparted by the payment of taxes is "entirely insignificant" when compared to notice imparted by the adverse possessor's open and notorious possession of the land itself. (*Cavanaugh v. Jackson* (1893) 99 Cal. 672, 674.) The notice arising from payment of taxes borders on trivial in this case, where the assessment ranged from $1.12 to $7.60 per year.

The mosquito assessment is not a tax under the generic definition. The assessment does not raise general revenues for the county or any other public entity. To the contrary, the environmental health division that administers this program is limited to monitoring, abating and preventing mosquitos (Gov. Code, § 53750, subd.

(l)), and may only seek assessments for this program if its revenues are not enough to meet the costs of providing these services (Health & Saf. Code, §§ 2080, 2082, subd. (a)). We therefore agree with the trial court that the mosquito assessment is not a tax. Hagman was not required to pay it in order to perfect his claim of adverse possession.

Meher Mount contends that the mosquito assessment is not an "assessment" under California Constitution, article XIIID section 2(b),[5] and is instead a "special tax" under article XIIIC section 1(d); as such, it is a tax. These constitutional provisions do not use the generic definition we have adopted. Accordingly, how the mosquito assessment is classified under their rubric is irrelevant. (*Richmond*, *supra*, 32 Cal.4th at p. 422.)

We decline to consider Meher Mount's further challenge to the enactment of the mosquito assessment under article XIIID section 4. As an initial matter, this challenge comes eight years too late. (Code Civ. Proc., § 329.5 [challenges to validity of assessments must be brought within 30 days of levy]; *Barratt American, Inc. v. City of San Diego* (2004) 117 Cal.App.4th 809, 812 [applying Code Civ. Proc., § 329.5 to art. XIIID].) More to the point, our resolution of this argument will have no impact on the outcome of this case. If we conclude that the mosquito assessment is an "assessment" within the meaning of article XIIID section 2(b), it is by Meher Mount's reasoning *not* a "tax," and Hagman was not obligated to pay it. On the other hand, if we conclude that the mosquito assessment was actually a "special tax" that was not enacted under the more onerous enactment procedures of article XIIIC section 2(d), the assessment is void and hence no longer "levied." Hagman would accordingly not be required to pay it. Either way, Hagman would not be required to pay the mosquito assessment.

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[5] All further references to Articles are to the California Constitution.

DISPOSITION

The judgment quieting title to Hagman is affirmed. Costs on appeal are awarded to Hagman.

CERTFIED FOR PUBLICATION.

HOFFSTADT, J.*

We concur:

GILBERT, P. J.

YEGAN, J.

* Assigned by the Chairperson of the Judicial Council.

Henry J. Walsh, Judge

Superior Court County of Ventura

____

SM Sanders Law Group and Stephen M. Sanders for Defendant and Appellant.

Terrance B. Rodsky for Plaintiff and Respondent.

Filed 1/30/13

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SECOND APPELLATE DISTRICT

DIVISION THREE

WINDSOR PACIFIC LLC, Plaintiff and Appellant, v. SAMWOOD CO., INC., Defendant and Respondent; SHADOW PINES, LLC, Defendant and Appellant.	B233514 (Los Angeles County Super. Ct. No. PC046686)

APPEALS from a judgment and an order of the Superior Court of Los Angeles County, Michael S. Mink, Jr., Judge. Judgment affirmed. Order reversed and remanded with directions.

McLeod, Moscarino, Witham & Flynn and John P. Flynn for Plaintiff and Appellant.

Joseph Di Giulio; and Howard Posner for Defendant and Respondent.

Michelman & Robinson, Eric J. Rans, Robin James and Stephen R. Isbell for Defendant and Appellant.

Windsor Pacific LLC (Windsor) seeks to establish a prescriptive easement over two access roads on undeveloped land in northern Los Angeles County owned by Samwood Co., Inc. (Samwood), and Shadow Pines, LLC (Shadow). Windsor used the roads for several years with Shadow's permission and pursuant to a written easement agreement with Shadow. The trial court, after a nonjury trial, granted judgment in favor of both Shadow and Samwood, holding that Windsor's use of the roads did not create a *prescriptive* easement over either the Samwood property or the Shadow property because Windsor's use of those roads was expressly authorized by a prior *permissive* easement granted to Windsor. In a post-judgment order, the trial court denied Shadow's motion for an award of attorney fees pursuant to a contractual attorney fee provision included in the written agreement that had led to creation of the aforesaid permissive easement. Windsor appealed from the judgment only with respect to the denial of a prescriptive easement over the *Samwood* property. Shadow has appealed from the order denying the requested attorney fee award.

Windsor contends that the permissive easement granted by its written agreement with Shadow applied only to use of the access roads on Shadow's property. Such easement agreement, Windsor argues, does not apply to use of the access roads on Samwood's property because Shadow did not have the authority to grant such an easement to Windsor. We reject that argument and hold, under the undisputed facts in this case, that Windsor is equitably estopped to deny or question Shadow's authority to grant an easement over the Samwood property. In view of this conclusion, we will affirm the judgment.

Shadow's appeal argues that the attorney fee provision in the easement agreement with Windsor authorizes a fee award in this case. We agree and hold that an attorney fee clause providing for a fee award to the prevailing party in "any action or proceeding to enforce or interpret" a contract applies not only where the plaintiff's allegations in the complaint seek to enforce or interpret the contract, but also where the defendant seeks to do so by asserting an affirmative defense raised in its answer. We will therefore reverse the post-judgment order denying Shadow's motion for an award of attorney fees and remand with directions to grant the motion and determine the amount of the award.

FACTUAL AND PROCEDURAL BACKGROUND

1. *Factual Background*

Windsor owns 80 acres of undeveloped land in the Canyon Country area of northern Los Angeles County. Windsor acquired the property in August and November 2003. Allen Hubsch, a real estate attorney, is Windsor's principal.

Samwood owns 160 acres of undeveloped land adjoining and immediately south of the Windsor property. Samwood acquired the property prior to 2003. Shadow owns more than 160 acres of undeveloped land immediately south of the Samwood property. Shadow acquired the property in three separate acquisitions beginning in 2006.

Tick Canyon Road traverses the Shadow property and the southeast corner of the Samwood property where Tick Canyon Road intersects with Trash Canyon Road. From that intersection, Trash Canyon Road leads north through the Samwood property toward the Windsor property. Both roads are unpaved. Hubsch began using the two roads by

car in late 2002 or early 2003 when he first visited the area looking for investment property. He traveled the two roads on numerous occasions thereafter. A surveyor, a geologist and others hired by Hubsch also traveled the two roads on numerous occasions.

Samwood entered into a written agreement with Synergy, a Land & Development Company (Synergy) in April 2003 granting Synergy an option to purchase the Samwood property during a specified term. Samwood also granted Synergy "a license . . . to enter upon the Property . . . for the purpose of inspections and tests, and generally in connection with its investigation of the Property and its prospects for development . . . . " The option agreement also stated that Synergy was "entitled to full access to and entry upon the Property at all times convenient to it and may allow its representatives and contractually retained independent contractors to enter in aid of Buyer's prospective development plans." The option agreement was later assigned to another company and then to Shadow, and its term was extended. Samwood and Shadow later amended the option agreement and further extended its term.

Windsor and Shadow entered into a written Agreement Regarding Easements (ARE) in March 2006. The ARE stated that Shadow owned the Shadow property and held options to purchase the Samwood property. It provided that Windsor would execute two written agreements granting easements to Shadow over the Windsor property upon the satisfaction of certain conditions, including the approval of a tentative map and a conditional use permit for development of the Samwood and Shadow properties. It stated that Shadow could terminate the ARE at any time prior to the

Windsor's delivery to Shadow of such easements, and that upon such termination Shadow would deliver to Windsor a signed agreement, known as the Termination Easement, granting Windsor an easement over the Samwood and Shadow properties. It also stated that Windsor could terminate the ARE if Shadow's options expired and were not timely renewed, if Shadow failed to timely obtain an approved tentative map satisfying certain requirements and in other circumstances.

Section 19.5 of the ARE stated that if either party exercised its right to terminate the ARE, "then . . . neither Party shall have any further obligation to the other Party other than (i) pursuant to Section 17 and Section 3.3 for acts or occurrences prior to the date of termination, and (ii) pursuant to this Section." The two referenced sections related to indemnification. Section 19.5 went on to state that within 30 days after the termination of the ARE Shadow must execute in favor of Windsor a quitclaim of any easements provided to Shadow by Windsor.

Under the heading "General Provisions" and the subheading "Governing Law," the ARE included a provision for an award of attorney fees to the prevailing party "[i]n any action or proceeding to enforce or interpret the provisions of this Agreement."[1]

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[1] The attorney fee clause stated in full: "In any action or proceeding to enforce or interpret the provisions of this Agreement, the prevailing party (as determined by the court, arbitrators, agency or other authority before which such suit, arbitration or proceeding is commenced) shall, in addition to such other relief as may be awarded, be entitled to its reasonable attorneys' fees, expenses, and costs of investigation incurred in connection therewith (including, without limitation, attorneys' fees, expenses and costs of investigation incurred in appellate proceedings, costs incurred in establishing the right to indemnification, or in any action or participation in, or in connection with, any case or proceeding under Chapter 7, 11 or 13 of the Bankruptcy Code, 11 United States Code Sections 101 et seq., or any successor statutes)."

The conditions for Windsor's execution of the two easement agreements relating to Shadow's use of the Windsor property were never satisfied, and the easements were never executed. Shadow gave notice of its termination of the ARE pursuant to the termination provision in a letter to Windsor dated August 11, 2006. Shadow provided Windsor a signed Termination Easement at that time, granting Windsor a nonexclusive easement over the two access roads on the Samwood and Shadow properties, Tick Canyon Road and Trash Canyon Road, "as such roadways may reasonably be relocated from time-to-time by Grantor [Shadow]." The Termination Easement stated further that the exact location of the easement area could change in accordance with the requirements and conditions for approval of the proposed development.

Windsor claimed a prescriptive easement over the two access roads on the Samwood property for the first time in February 2009.

2. *Trial Court Proceedings*

Windsor filed a complaint against Samwood and Shadow in October 2009 alleging counts for (1) quiet title, seeking to quiet title to a prescriptive easement over Tick Canyon Road and Trash Canyon Road for private or public use; (2) ejectment, alleging that the defendants have obstructed Windsor's use of the two roads and seeking to restore such use; and (3) declaratory relief, seeking a declaration as to the rights and obligations of the parties with respect to the two roads.

A nonjury trial in January 2011 resulted in a judgment in favor of the defendants. The trial court filed a Memorandum of Decision in February 2011 stating, "This Memorandum of Decision shall constitute a Statement of Decision, if one is so

requested, unless within the time period provided by law, additional requests are made by a party in conformity with statutory procedures and the Rules of Court." No party requested a statement of decision.

The Memorandum of Decision stated that Windsor and Shadow began to negotiate the ARE in mid-2005 and orally agreed at that time that each had permission to travel over the other's property. It stated that the ARE executed in March 2006 expressly granted such permission and that the Termination Easement later delivered to Windsor granted Windsor a permissive easement over the two access roads. It stated that Windsor's use of the roads therefore was permissive beginning no later than mid-2005 and that Windsor had failed to prove by clear and convincing evidence that its use of the roads was adverse for a five-year period, as necessary to establish a prescriptive easement. The trial court entered a judgment in March 2011, awarding Windsor no relief on its complaint against either defendant. Windsor timely appealed the judgment.

Shadow moved for an attorney fee award in April 2011 based on the attorney fee provision in the ARE and Civil Code section 1717. Windsor argued in opposition that this was not an action "to enforce or interpret the provisions of [the ARE]" within the meaning of the attorney fee provision and that this was not an "action on a contract" (Civ. Code, § 1717, subd. (a)). Windsor also argued that the amount of fees requested was unreasonable. The trial court denied the motion "[f]or all the reasons stated in the Plaintiff's Opposition." Shadow timely appealed the order.

CONTENTIONS

Windsor challenges the judgment in favor of Samwood on the count for quiet title. Windsor contends (1) its use of the two roads was adverse to Samwood for a period in excess of five years because Samwood never consented to Windsor's use; (2) the trial court erred by placing the burden of proof of adverse use for a period of five years on Windsor rather than requiring Samwood to prove that Windsor's use was permissive; and (3) the court erred by requiring that such proof be made by clear and convincing evidence.

Shadow challenges the denial of its motion for an attorney fee award, contending this is an action "to enforce or interpret the provisions of [the ARE]" within the meaning of the attorney fee provision.

DISCUSSION

1. *Windsor Is Not Entitled to a Prescriptive Easement*

a. *Prescriptive Easement and Adverse Use*

A prescriptive easement is established by use of land that is (1) open and notorious, (2) continuous and uninterrupted, and (3) adverse to the true owner, and that is all of these things (4) for a period of five years. (*Warsaw v. Chicago Metallic Ceilings, Inc.* (1984) 35 Cal.3d 564, 570; *Gilardi v. Hallam* (1981) 30 Cal.3d 317, 321-322; Civ. Code, § 1007; Code Civ. Proc., § 321 [five-year period].) Periods of prescriptive use by successive owners of the dominant estate can be "tacked" together if the first three elements are satisfied. (*Miller v. Johnston* (1969) 270 Cal.App.2d 289,

295; see Rest.3d Property, Servitudes, § 2.17.) Whether each of these elements is satisfied is a question of fact. (*Warsaw*, *supra*, 35 Cal.3d at p. 570.)

The term “adverse” in this context is essentially synonymous with “hostile” and “under a claim of right.” (*Aaron v. Dunham* (2006) 137 Cal.App.4th 1244, 1252; *Felgenhauer v. Soni* (2004) 121 Cal.App.4th 445, 450.) A claimant need not believe that his or her use is legally justified or expressly claim a right of use for the use to be adverse.[2] (*Aaron*, *supra*, at p. 1252; *Felgenhauer*, *supra*, at p. 450.) Instead, a claimant’s use is adverse to the owner if the use is made without any express or implied recognition of the owner’s property rights. (*Sorensen v. Costa* (1948) 32 Cal.2d 453, 459; See 6 Miller & Starr, California Real Estate (3d ed. 2012) Easements, § 15:35, p. 15-133.) In other words, a claimant’s use is adverse to the owner if it is wrongful and in defiance of the owner’s property rights. (See Bruce & Ely, *supra*, § 5:8, p. 5–28.)

Use with the owner’s permission, however, is not adverse to the owner. (*Aaron v. Dunham*, *supra*, 137 Cal.App.4th at p. 1252; *Richmond Ramblers Motorcycle Club v. Western Title Guaranty Co.* (1975) 47 Cal.App.3d 747, 754; see Rest.3d Property, Servitudes, § 2.16, com. f, p. 228.) To be adverse to the owner a claimant’s use must give rise to a cause of action by the owner against the claimant. (See 6 Miller & Starr, California Real Estate, *supra*, § 15.29, p. 15-111; 12 Witkin, Summary of Cal. Law

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[2] For this reason, the term “claim of right” is imprecise and potentially misleading when used in this context. (See Bruce & Ely, The Law of Easements and Licenses in Land (2012) Creation of Easements by Prescription, § 5:8, pp. 5–28 to 5–30 [“Adverse use is sometimes characterized as a use made under a claim of right, but such a description is imprecise because a claim need not be formally asserted, nor must the use be made with the belief that it is lawful”].)

(10th ed. 2005) Real Property, § 403, p. 472.) This ensures that a prescriptive easement can arise only if the owner had an opportunity to protect his or her rights by taking legal action to prevent the wrongful use, yet failed to do so. (See Bruce & Ely, The Law of Easements and Licenses in Land, *supra*, § 5:8, p. 5–32; 2 American Law of Property (1952) Easements, § 8.53, p. 269, fn. 1.)

b. *Windsor Is Equitably Estopped from Claiming A Prescriptive Easement*

Windsor used the two access roads on the Samwood property with the express permission of Shadow under the terms of the Termination Easement beginning in August 2006 at the latest. The Termination Easement stated that Shadow owned an interest in both the Shadow property and the Samwood property and granted Windsor a nonexclusive easement to use the access roads on the two properties. In our view, Windsor's continued use of the two access roads in these circumstances precludes its claim that its use of the roads was adverse to Samwood as owner of the Samwood property. We believe that this is true irrespective of whether or not Shadow actually had the authority to grant Windsor an easement over the Samwood property. As we explain, we hold that Windsor is equitably estopped to deny the existence of such authority.

"The doctrine of equitable estoppel is founded on concepts of equity and fair dealing. It provides that a person may not deny the existence of a state of facts if he intentionally led another to believe a particular circumstance to be true and to rely upon such belief to his detriment. The elements of the doctrine are that (1) the party to be

estopped must be apprised of the facts; (2) he must intend that his conduct shall be acted upon, or must so act that the party asserting the estoppel has a right to believe it was so intended; (3) the other party must be ignorant of the true state of facts; and (4) he must rely upon the conduct to his injury. [Citation.]" (*Strong v. County of Santa Cruz* (1975) 15 Cal.3d 720, 725.) The detrimental reliance must be reasonable. (*Waller v. Truck Ins. Exchange, Inc.* (1995) 11 Cal.4th 1, 35; *Berkeley Police Assn. v. City of Berkeley* (1977) 76 Cal.App.3d 931, 938.)

The determination of equitable estoppel ordinarily is a question of fact for the trier of fact, unless the facts are undisputed and can support only one reasonable conclusion as a matter of law. (*Platt Pacific, Inc. v. Andelson* (1993) 6 Cal.4th 307, 319; *Albers v. County of Los Angeles* (1965) 62 Cal.2d 250, 266.) In this case, the evidence compels the conclusion, as a matter of law, that each of the essential elements is satisfied and that Windsor is estopped to deny that Shadow had the authority to grant Windsor an easement over the two access roads on the Samwood property.[3]

The first element is satisfied because the evidence clearly shows that Windsor (acting through Hubsch) had, sometime after mid-2005, formed the intent to claim a prescriptive easement over the two access roads on both the Shadow and Samwood properties, yet it failed to disclose such intention to either Shadow or Samwood.

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[3] Shadow alleged estoppel as an affirmative defense in its answer, but neither defendant argued equitable estoppel at trial. Nonetheless, we may consider the issue for the first time on appeal because it involves a question of law based on facts established by the record and does not require the resolution of conflicting evidence. (*California Horse Racing Bd. v. Workers' Comp. Appeals Bd.* (2007) 153 Cal.App.4th 1169, 1173.)

Windsor was well aware such a prescriptive easement was totally inconsistent with its permissive use of the property. Nonetheless, Windsor at no time before February 2009 ever (1) questioned or disputed Shadow's authority to grant permission to Windsor to use the two access roads on the Samwood property or (2) asserted any claim for a *prescriptive* easement.

Regarding the second element, Windsor and Shadow entered into the ARE in March 2006, including the provision that Shadow would grant Windsor an easement to use the access roads on *both* the Shadow and Samwood properties upon Shadow's termination of the ARE. This shows the parties' understanding that Shadow did have the authority to grant Windsor an easement over the Samwood property. Moreover, when issues arose as to the condition or use of the Samwood property, Windsor contacted Synergy (Shadow's predecessor in interest) and later Shadow, rather than Samwood, suggesting that Windsor recognized Synergy's and Shadow's authority with respect to use of the Samwood property. This evidence compels the conclusion that Shadow and Samwood had a right to rely on the appearance created by Windsor's conduct that its use of the access roads on the Samwood property was permissive and was not adverse to Samwood, which satisfies the second element.

The third element is satisfied because Samwood and Shadow were unaware until February 2009 that Windsor intended to claim a prescriptive easement based on its use of the access roads on the Samwood property. Finally, the fourth element is also satisfied because both Samwood and Shadow would be injured if, after Windsor had negotiated for and agreed to receive a *permissive* easement, its continued use of the two

access roads were held to give rise to a *prescriptive* easement. Both Samwood and Shadow were entitled to rely on their understanding that Windsor's use of the two access roads on the Samwood property was permissive, until the time that Windsor claimed otherwise.

We therefore hold that the essential elements of equitable estoppel are satisfied as a matter of law and that Windsor therefore may not deny Shadow's authority to grant Windsor an easement over the two access roads on the Samwood property. Windsor's use of the roads on the Samwood property was permissive and thus not adverse to Samwood. The trial court correctly concluded that Windsor is not entitled to a *prescriptive* easement.[4]

2. *Shadow Is Entitled to a Contractual Attorney Fee Award*

a. *Standard of Review*

Shadow contends it is entitled to a fee award pursuant to the attorney fee clause in the ARE. Whether a contractual attorney fee clause provides for a fee award in a particular case is a question of contract interpretation. We interpret a contract de novo if the interpretation does not turn on the credibility of extrinsic evidence, as here. (*City of Manhattan Beach v. Superior Court* (1996) 13 Cal.4th 232, 238; *Kalai v. Gray* (2003) 109 Cal.App.4th 768, 777.)

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[4] In light of our conclusion, we need not address Windsor's contentions that the trial court improperly placed the burden of proof of adverse use for a period of five years on Windsor or that the court improperly required Windsor to prove such adverse use by clear and convincing evidence.

b. *Shadow Is the Prevailing Party in an Action to Enforce or Interpret the ARE*

An attorney fee clause can provide for an attorney fee award in an action on the contract or, if worded more broadly, can provide for a fee award in any litigation between the parties. (*Santisas v. Goodin* (1998) 17 Cal.4th 599, 608.) Civil Code section 1717 governs a fee award in an action on a contract. (*Id.* at p. 615.) Civil Code section 1717 is inapplicable, however, to noncontract claims. (*Santisas*, *supra*, at p. 619; *Moallem v. Coldwell Banker Com. Group, Inc.* (1994) 25 Cal.App.4th 1827, 1832-1833.)[5]

Our goal in interpreting a contract is to give effect to the mutual intention of the contracting parties at the time the contract was formed. (Civ. Code, § 1636.) We ascertain that intention solely from the written contract if possible, but also consider the circumstances under which the contract was made and the matter to which it relates. (*Id.*, §§ 1639, 1647.) We consider the contract as a whole and interpret its language in context so as to give effect to each provision, rather than interpret contractual language in isolation. (*Id.*, § 1641.) We interpret words in accordance with their ordinary and popular sense, unless the words are used in a technical sense or a special meaning is given to them by usage. (*Id.*, § 1644.) If contractual language is clear and explicit and does not involve an absurdity, the plain meaning governs. (*Id.*, § 1638.)

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[5] Neither party has raised any issue with respect to the application of Civil Code section 1717 and we therefore have no reason to discuss it further. The dispositive issue presented here with respect to the award of attorney fees is whether this is "an action to enforce or interpret" the ARE within the meaning of that agreement's attorney fee clause.

The attorney fee clause in the ARE provides for an attorney fee award to the prevailing party "[i]n any action or proceeding to enforce or interpret the provisions of this Agreement." In our view, this action does involve the interpretation of the ARE with respect to the meaning of this provision. We have interpreted the ARE in determining that the provision requiring Shadow to grant an easement in favor of Windsor over both the Shadow and the Samwood properties upon the termination of the ARE shows the parties' understanding that Shadow had the authority to grant Windsor an easement over the Samwood property. Such determination was necessary to our conclusion that Windsor is equitably estopped from claiming that its use of the roads on the Samwood property was adverse to Samwood, precluding a prescriptive easement.

Thus, we believe that this action is an "action or proceeding to . . . interpret the provisions of this Agreement" within the meaning of the ARE whether Windsor seeks to enforce or interpret the ARE in its complaint or Shadow seeks to do so in its answer. Put another way, it does not matter whether such interpretation has been sought by the allegations of a complaint or by affirmative defenses in an answer. We understand the words "action or proceeding," used in accordance with their ordinary and popular sense, to encompass the entire action or proceeding, including both the complaint and any responsive pleading, such as an answer. (*Palmer v. Agee* (1978) 87 Cal.App.3d 377, 387; see Black's Law Dict. (9th ed. 2009) p. 32, col. 2 [defining "action" as, inter alia, "A civil or criminal judicial proceeding"].) In our view, an action in which a party seeks to enforce or interpret a contract in connection with either a claim alleged in the complaint or a defense alleged in an answer will constitute an action to "enforce or

interpret" the contract. There is, however, case law that arguably supports a contrary conclusion.

Exxess Electronixx v. Heger Realty Corp. (1998) 64 Cal.App.4th 698 and *Gil v. Mansano* (2004) 121 Cal.App.4th 739 held that whether the attorney fee clauses at issue in those cases authorized a fee award in favor of the prevailing party depended on the nature of the claims alleged in the complaint or cross-complaint, irrespective of the defenses raised. *Exxess* involved a clause in a lease providing for an attorney fee award to the prevailing party " '[i]f any Party or Broker brings an action or proceeding to enforce the terms hereof or declare rights hereunder.' " (*Exxess*, *supra*, 64 Cal.App.4th at p. 702.) The lessee filed a cross-complaint against its real estate broker alleging contract and tort claims. The case was settled before trial, and the cross-complaint was dismissed with prejudice. (*Id.* at p. 704.) The Court of Appeal assumed for purposes of argument that the cross-defendant was the prevailing party. (*Id.* at p. 712.) *Exxess* stated that even if the cross-defendant effectively enforced the terms of the lease by asserting a defense based on an "as-is" clause, asserting a defense was not "bringing" an action or proceeding within the meaning of the attorney fee clause. (*Ibid.*)

Exxess also distinguished an "action" from a "defense," stating in essence that the word "action" refers to the complaint and does not encompass a defense. (*Exxess*, *supra*, 64 Cal.App.4th at p. 712, fn. 15, citing primarily Black's Law Dictionary.) *Exxess* therefore concluded that the cross-defendant was not entitled to a contractual attorney fee award by virtue of its assertion of the defense. (*Ibid.*) *Exxess* noted that the attorney fee clause at issue was very narrowly drawn. (*Ibid.*)

Gil v. Mansano, *supra*, 121 Cal.App.4th 739, involved a clause in a release providing for an attorney fee award to the prevailing party " '[i]n the event action is brought to enforce the terms of this [Release].' " (*Id.* at p. 742.) The defendant asserted the release as a defense to the plaintiff's complaint for fraud and successfully moved for summary judgment. (*Ibid.*) The majority opinion in *Gil* stated that even if the assertion of the defense based on a contractual release had the effect of enforcing the contract, the assertion of a defense was not the "bringing" of an action within the meaning of the attorney fee clause. (*Id.* at pp. 743-744, citing *Exxess*, *supra*, 64 Cal.App.4th at p. 712.) The majority in *Gil* also quoted the discussion in *Exxess*, *supra*, 64 Cal.App.4th at page 712, footnote 15, distinguishing an "action" from a "defense." (*Gil*, *supra*, 121 Cal.App.4th at p. 744.)[6] As in *Exxess*, the majority in *Gil* also noted that the attorney fee clause at issue was very narrowly drawn. (*Gil*, *supra*, 121 Cal.App.4th at p. 745.)

Justice Armstrong in a dissenting opinion in *Gil* stated to the contrary that the word "action," in ordinary usage, encompassed the entire judicial proceeding, including the answer, and that an action in which the defendant asserted a defense based on a release was an action brought to enforce the terms of the release within the meaning of

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[6] See also *Salawy v. Ocean Towers Housing Corp.* (2004) 121 Cal.App.4th 664, 670-674, in which a majority of the same court, over a dissent by Justice Armstrong, construed in a similar manner a statutory provision authorizing an attorney fee award to the prevailing party in an "action . . . to enforce the governing documents" (Civ. Code, § 1354, former subd. (f)).

the attorney fee clause. (*Gil*, *supra*, 121 Cal.App.4th at pp. 746-747 (dis. opn. of Armstrong, J.)

Both *Exxess*, *supra*, 64 Cal.App.4th 698, and the majority opinion in *Gil v. Mansano*, *supra*, 121 Cal.App.4th 739, seemed to regard the word "brings" or "brought" as narrowing the scope of the attorney fee clause. Such words, however, are not present in the attorney fee clause here at issue, so *Exxess* and *Gil* are distinguishable on this basis. More importantly, however, we believe that the analysis in Justice Armstrong's dissent in *Gil* is correct. To the extent that either *Exxess* or *Gil* suggests, or can be read to support the proposition, that the word "action" does not encompass a defense, we disagree. As did Justice Armstrong in his dissenting opinion in *Gil*, we regard the word "action" used in this context as encompassing the entire judicial proceeding, *including any defenses asserted*.

Accordingly, we conclude that this action is "an action to interpret" the ARE within the meaning of the attorney fee clause in that agreement. Shadow is the prevailing party because it successfully asserted the affirmative defense of equitable estoppel and obtained a judgment in its favor denying Windsor any relief on its complaint. Shadow therefore is entitled to a contractual attorney fee award in an amount to be determined by the trial court on remand.

c. *The Termination of the ARE Did Not Negate the Attorney Fee Clause*

Windsor further contends that Shadow's termination of the ARE relieved the parties of any obligation to pay attorney fees pursuant to the attorney fee clause. We disagree.

We construe the term "obligation" as used in the termination clause, quoted *ante*, as referring to the parties' performance obligations under the ARE. Thus, the parties agreed that their respective performance obligations under the ARE would be terminated upon the termination of the ARE. In our view, the term "obligation" in this context does not encompass the parties' nonperformance obligations under the general provisions of the contract. Provisions regarding notices, choice of law, venue and the like appear in the ARE under the heading "General Provisions." Such general provisions alone impose no affirmative obligations on the parties with respect to accomplishing the purposes of the contract. Instead, the general provisions concern subsidiary matters relating to contract performance and dispute resolution. The attorney fee clause is such a general provision. Absent a provision expressly stating otherwise, we conclude that the parties intended the general provision of the ARE to survive the termination of the contract so as to apply mainly in the event of a later dispute. We therefore hold that the termination of the ARE did not negate the attorney fee clause.

DISPOSITION

The judgment is affirmed. The post-judgment order denying an attorney fee award is reversed and the matter is remanded with directions to (1) grant Shadow's motion for an award of attorney fees and (2) conduct further proceedings to determine the reasonable amount of fees to be awarded. Samwood and Shadow are entitled to recover their costs on appeal.

CERTIFIED FOR PUBLICATION

CROSKEY, J.

WE CONCUR:

KLEIN, P. J.

ALDRICH, J.

Filed 3/22/13

CERTIFIED FOR PARTIAL PUBLICATION*

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

ARDEN M. INTENGAN, **Plaintiff and Appellant,** **v.** **BAC HOME LOANS SERVICING LP, et al.,** **Defendants and Respondents.**	**A135782** **(San Mateo County Super. Ct. No. CIV 505111)**

Arden M. Intengan (Intengan) appeals from a judgment of dismissal entered after the court sustained the demurrer to her third amended complaint without leave to amend. Essentially, Intengan sought to preclude respondents from foreclosing on her property, contending they lack authority to do so under the relevant deed of trust and notice of default. In this appeal, Intengan argues that the demurrer should not have been sustained because she alleged facts sufficient to state a cause of action, including a claim based on respondents' alleged failure to contact her or attempt with due diligence to contact her before recording the notice of default (Civ. Code, § 2923.5). She also contends the court should have ruled on her motion to strike the demurrer.

We will reverse the judgment. In the published portion of our opinion, we conclude that judicial notice could not be taken of respondents' compliance with Civil Code section 2923.5, and Intengan's allegations that respondents did not comply with the statute were sufficient to state a cause of action for wrongful foreclosure. In the

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* Pursuant to California Rules of Court, rules 8.1105(b) and 8.1110, this opinion is certified for publication with the exception of parts II.A.2 through II.A.10, II.B and II.C.

unpublished portion of the opinion, we conclude that Intengan failed to state any other cause of action and the court did not err in denying leave to amend.

I. FACTS AND PROCEDURAL HISTORY

On June 26, 2006, Intengan borrowed $696,500 from Countrywide Bank, N.A. (Countrywide). The loan was secured by a deed of trust on Intengan's real property in Daly City. Under the deed of trust, the beneficiary was Mortgage Electronic Registration Systems, Inc. (MERS), the trustee was respondent ReconTrust Company, N.A. (ReconTrust), and BAC Home Loans Servicing LP (BAC) serviced the note. BAC's successor is respondent Bank of America, N.A.

On or about December 28, 2010, MERS assigned its beneficial interest in Intengan's deed of trust to "The Bank of New York Mellon fka The Bank of New York, as Successor Trustee to JPMorgan Chase Bank, N.A., as Trustee for the Holders of SAMI II Trust 2006-AR7, Mortgage Pass-Through Certificates, Series 2006-AR7" (Bank of New York).

On December 28, 2010, ReconTrust, as agent for the beneficiary under the deed of trust, recorded a notice of Intengan's default on Intengan's loan; the Notice of Default and Election to Sell Under Deed of Trust indicated that she was more than $46,000 in arrears.

Purportedly accompanying the notice of default was a declaration by Samantha Jones, "MLO Loan Servicing Specialist of BAC Home Loans Servicing, LP," in which she states under penalty of perjury that Bank of America "tried with due diligence to contact the borrower in accordance with California Civil Code Section 2923.5." The declaration does not provide any facts to support this conclusion, such as the specifics of any attempt to contact Intengan.

A Notice of Trustee's Sale was recorded by ReconTrust on April 5, 2011, setting a sales date of April 26, 2011. Intengan does not allege that the sale occurred, and the respondents' brief represents that no sale took place and that Intengan has been in possession of the property for nearly two years without making payments on her loan.

A. *Original, First Amended, and Second Amended Complaints*

On April 25, 2011 – the day before the scheduled foreclosure sale – Intengan filed a complaint against defendants including BAC and ReconTrust, asserting causes of action for declaratory relief, injunctive relief, and an accounting. Before any defendant responded, Intengan filed a first amended complaint and then a second amended complaint.

BAC and RinconTrust filed a demurrer to Intengan's second amended complaint. The court sustained their special demurrer to the first and second causes of action, with leave to amend in order to state a violation of Civil Code section 2923.5. The court also sustained their general demurrer to the third cause of action for an accounting, without leave to amend.

B. *Third Amended Complaint*

Intengan filed her third amended complaint in January 2012 against BAC, ReconTrust, and others. This time, she purported to assert causes of action for wrongful foreclosure, fraud, intentional misrepresentation, breach of contract, breach of the implied covenant of good faith and fair dealing, slander of title, quiet title, declaratory relief, violation of Business and Professions Code section 17200, unjust enrichment, and injunctive relief seeking to enjoin the pending foreclosure sale.

In February 2012, respondents filed a demurrer to the third amended complaint. Although the demurrer is central to the issues on appeal, neither Intengan nor respondents include the demurrer in the record. The record does contain, however, respondents' request for judicial notice in support of their demurrer, by which they sought judicial notice of the deed of trust on Intengan's property, the notice of default, the assignment of the deed of trust to Bank of New York, and the notice of trustee's sale.

In June 2012, Intengan filed an opposition and "motion to strike" the demurrer, "on the grounds that Defendants Bank of America's Demurrer does not state facts sufficient to constitute a demurrer, is uncertain, is ambiguous, is unintelligible, is irrelevant, is false, contains improper matters and/or is not drawn or filed in conformity with the laws of California." She urged that the demurrer misstated facts and ignored the

law, and therefore it should be stricken or denied. The purported motion was not accompanied by a notice of hearing.

The court granted respondents' request for judicial notice and sustained their demurrer to the third amended complaint without leave to amend. A judgment of dismissal was entered on June 15, 2012.

This appeal followed.

II. DISCUSSION

As mentioned, Intengan argues that the court erred in sustaining the demurrer and further erred in failing to rule on her motion to strike the demurrer.

A. *Demurrer*

In our de novo review of an order sustaining a demurrer, we assume the truth of all facts properly pleaded in the complaint or reasonably inferred from the pleading, but not mere contentions, deductions, or conclusions of law. (*Buller v. Sutter Health* (2008) 160 Cal.App.4th 981, 985-986 (*Buller*).) We then determine if those facts are sufficient, as a matter of law, to state a cause of action under any legal theory. (*Aguilera v. Heiman* (2009) 174 Cal.App.4th 590, 595.)

In making this determination, we also consider facts of which the trial court properly took judicial notice. (E.g., *Avila v. Citrus Community College Dist.* (2006) 38 Cal.4th 148, 165, fn. 12.) A demurrer may be sustained where judicially noticeable facts render the pleading defective (*Evans v. City of Berkeley* (2006) 38 Cal.4th 1, 6), and allegations in the pleading may be disregarded if they are contrary to facts judicially noticed. (*Hoffman v. Smithwoods RV Park, LLC* (2009) 179 Cal.App.4th 390, 400 (*Hoffman*); see *Fontenot v. Wells Fargo Bank, N.A*. (2011) 198 Cal.App.4th 256, 264-265 (*Fontenot*) [in sustaining demurrer, court properly took judicial notice of recorded documents that clarified and to some extent contradicted plaintiff's allegations].)

In order to prevail on appeal from an order sustaining a demurrer, the appellant must affirmatively demonstrate error. Specifically, the appellant must show that the facts pleaded are sufficient to establish every element of a cause of action and overcome all legal grounds on which the trial court sustained the demurrer. (*Cantu v. Resolution Trust*

Corp. (1992) 4 Cal.App.4th 857, 879-880.) We will affirm the ruling if there is any ground on which the demurrer could have been properly sustained. (*Debro v. Los Angeles Raiders* (2001) 92 Cal.App.4th 940, 946 (*Debro*).)

1. *Wrongful Foreclosure (First Cause of Action)*

The first purported cause of action in Intengan's third amended complaint is for "wrongful foreclosure." Intengan alleges there was "an unauthorized Trustee, document irregularities, improper signatories, and [a] defective Notice of Default;" she further alleges that "due to the chain of assignments, it is now unknown and doubtful who is the current lender/beneficiary/assignee with legal authority and standing regarding the mortgage on [the] subject property." Intengan also claims that BAC and ReconTrust failed to comply with a number of Civil Code sections regulating nonjudicial foreclosures, including the requirement of contacting the borrower, or attempting to do so with due diligence, under Civil Code section 2923.5.

a. *Failure to tender*

As a general rule, a plaintiff may not challenge the propriety of a foreclosure on his or her property without offering to repay what he or she borrowed against the property. (*Karlsen v. American Sav. & Loan Ass'n* (1971) 15 Cal.App.3d 112, 117 [judgment on the pleadings properly granted where plaintiff attempted to set aside trustee's sale for lack of adequate notice, because "[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 *United States Cold Storage v. Great Western Savings & Loan Assn.* (1985) 165 Cal.App.3d 1214, 1222-1223 ["the law is long-established that a *trustor* or his successor must tender the obligation in full as a prerequisite to [a] challenge of the foreclosure sale"]; *FPCI RE-HAB 01 v. E&G Investments, Ltd*. (1989) 207 Cal.App.3d 1018, 1021-1022 [tender rule is based on "the equitable maxim that a court of equity will not order a useless act performed . . . if plaintiffs could not have redeemed the property had the sale procedures been proper, any irregularities in the sale did not result in damages to the plaintiffs"].)

Intengan's third amended complaint alleges her willingness "to tender the appropriate and reasonable mortgage payments." That allegation, however, is plainly insufficient. A valid tender of performance must be of the full debt, in good faith, unconditional, and with the ability to perform. (Civ. Code, §§ 1486, 1493, 1494, 1495.)

Intengan's third amended complaint also asserts that "tender is not required inasmuch as there is [a] void foreclosure, not a voidable one." (Citing *Dimock v. Emerald Properties* (2000) 81 Cal.App.4th 868, 877-878.) However, Intengan does not allege that she was fraudulently induced into the loan; nor does she otherwise attack the validity of the debt. Nor do her allegations indicate a defect in the foreclosure procedure that would render a resulting sale void *on its face*, particularly when considered in light of the documents that were judicially noticed. On the other hand, as we shall discuss *post*, Intengan has alleged a defect in the foreclosure procedure – the failure to comply with Civil Code section 2923.5 – which, if true, would render the foreclosure either void or voidable. Whether or not this would remove the need to allege tender is an issue we need not address, since an allegation of tender is unnecessary for another reason.

According to the allegations of the third amended complaint – as well as representations in the respondents' brief – no foreclosure sale had occurred as of the time of the ruling on the demurrer. While the tender requirement may apply to causes of action to *set aside* a foreclosure sale, a number of California and federal courts have held or suggested that it does not apply to actions seeking to *enjoin* a foreclosure sale – at least where the lenders had allegedly not complied with a condition precedent to foreclosure. (See, e.g., *Pfeifer v. Countrywide Home Loans, Inc*. (2012) 211 Cal.App.4th 1250, 1280-1281 [failure to allege tender of full amount owed did not bar declaratory relief or injunctive relief based on wrongful foreclosure, where lenders had not yet foreclosed and borrowers alleged that lenders had not complied with servicing regulations that were a condition precedent to foreclosure]; *Mabry v. Superior Court* (2010) 185 Cal.App.4th 208, 225 [borrower not required to tender full amount of indebtedness in seeking to enjoin foreclosure sale based on alleged failure to comply with Civ. Code, § 2923.5] (*Mabry*); *Barrionuevo v. Chase Bank, N.A*. (N.D. Cal. Aug. 6, 2012) 885 F.Supp.2d 964,

2012 U.S. Dist. LEXIS 109935, at pp. *12-13 & fn. 4 [no tender requirement where foreclosure sale had not yet occurred, in case where noncompliance with Civ. Code, § 2923.5 was alleged] (*Barrionuevo*).)

b. *Wrongful foreclosure theories*

Intengan contends that the foreclosing beneficiary under the deed of trust, Bank of New York, has not been shown to have standing to foreclose. She alleges: "Defendants made transfers, assignments of the subject loan and that due to the chain of assignments, it is now unknown and doubtful who is the current lender/beneficiary/assignee with legal authority and standing regarding the mortgage on the subject property."

Intengan fails to allege wrongful foreclosure on this ground. The records of which the court took judicial notice, without Intengan's objection, identify the foreclosing beneficiary to be the Bank of New York. Specifically, the recorded deed of trust names MERS as the original beneficiary, the recorded assignment of the deed of trust assigns all beneficial interest under the deed of trust from MERS to Bank of New York as the new beneficiary, and the notice of trustee sale was dated and recorded after Bank of New York became the beneficiary. (See *Fontenot, supra*, 198 Cal.App.4th at pp. 264-265 [court may take judicial notice of the fact of the existence and legal effect of legally operative documents, such as the identity of the beneficiary designated in the deed of trust, where not subject to reasonable dispute]; *Scott v. JP Morgan Chase Bank, N.A*. (Mar. 18, 2013) 2013 Cal.App. LEXIS 211.) While Intengan's pleading includes the unsupported conclusion that there was no assignment of the deed of trust in favor of "The Bank of New York Mellon fka The Bank of New York as Trustee," the recorded assignment of which the court took judicial notice shows there was, and Intengan neither alleges nor argues facts from which the assignment might be inferred to be invalid. (See *Fontenot, supra*, at pp. 264-265.) Under these circumstances, the judicially noticed facts contradict the conclusory allegations of the third amended complaint, and those

allegations may be disregarded. (*Id*. at p. 265; *Hoffman, supra*, 179 Cal.App.4th at p. 400.)[1]

Similarly, Intengan alleges that respondents could not provide a valid "chain of assignments" from previous lenders including Countrywide. From the outset, however, MERS (not Countrywide) was the beneficiary under the deed of trust, and the assignment of the deed of trust shows that MERS assigned its interest to Bank of New York. (See *Fontenot, supra*, 198 Cal.App.4th at pp. 264-265.)

Intengan also alleges the conclusion that the notice of trustee's sale arose from an "unauthorized Trustee, document irregularities, [and] improper signatories." Although she alleges that the substitution of ReconTrust as trustee was not recorded until February 17, 2011, the records of which the court took judicial notice – including the original deed of trust – show that ReconTrust was the trustee from the beginning and throughout the date of the notice of default and notice of trustee sale. (See *Fontenot, supra*, 198 Cal.App.4th at pp. 264-265.) Furthermore, both beneficiaries and trustees – and their agents – may record notices of default. (Civ. Code, § 2924, subd. (a)(1).) Thus, ReconTrust was authorized to record the notice of default as the trustee, and it was also authorized to record the notice of default as the agent of the beneficiary. Intengan's allegations fail to state facts from which it may be inferred that the notice of default or the notice of trustee's sale was invalid on this ground.

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[1] Accord, *Herrera v. Deutsche Bank National Trust Co*. (2011) 196 Cal.App.4th 1366, 1375 (*Herrera*). In *Herrera*, the court held that judicial notice could not be taken of the fact that a foreclosing bank was the beneficiary under a deed of trust where the judicial notice was to be based on a disputed hearsay statement in a *substitution of trustee* form that the bank was the beneficiary (as opposed to the original deed of trust or an assignment that actually made the bank the beneficiary) and a disputed hearsay statement in an assignment of the deed of trust that the *predecessor* bank was successor to the original beneficiary (which was a hearsay statement that could not establish a chain of title without independent proof). Here, by contrast, the legally operative effect of the deed of trust is that MERS was the beneficiary, and the legally operative effect of the assignment from MERS to Bank of New York is that Bank of New York became the new beneficiary.

Intengan further alleges that respondents did not comply with the requirements of Civil Code sections 2823.6, 2923.5, or 2923.6, before proceeding with the foreclosure. There is no Civil Code section 2823.6. Her allegations as to Civil Code section 2923.6 are unavailing, but her allegation as to Civil Code section 2923.5 suffice to state a cause of action.

In January 2012, when Intengan's third amended complaint was filed, and June 2012, when it was dismissed, Civil Code section 2923.6 provided: "It is the intent of the Legislature that the mortgagee, beneficiary, or authorized agent offer the borrower a loan modification or workout plan if such a modification or plan is consistent with its contractual or other authority." (Civ. Code, § 2923.6, subd. (b).)[2] Intengan alleged that, pursuant to Civil Code section "2823.6" — which we take to mean "2923.6" — "Defendants are now contractually bound to implement the loan modification as provided therein." But Civil Code section 2923.6 does not grant a right to a loan modification. To the contrary, it "merely expresses the hope that lenders will offer loan modifications on certain terms" and "conspicuously does not require lenders to take any action." (*Mabry, supra,* 185 Cal.App.4th at p. 222 & fn. 9.) In other words, "[t]here is no 'duty' under Civil Code section 2923.6 to agree to a loan modification." (*Hamilton v. Greenwich Investors XXVI, LLC* (2011) 195 Cal.App.4th 1602, 1617.)

Civil Code section 2923.5 precludes a trustee (like respondent ReconTrust) or mortgage servicer (such as BAC / respondent Bank of America) from recording a notice of default until 30 days after the loan servicer has made initial contact with the borrower to assess the borrower's financial situation and explore options for avoiding foreclosure, or has satisfied the due diligence requirements of the statute. (Civ. Code, § 2923.5, subd. (a)(1).) Due diligence requires sending a letter by first class mail, making three attempts to contact the borrower by telephone, and sending a certified letter if no

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[2] Stats. 2012, chs. 86, § 7 and 87, § 7, effective January 1, 2013, amended Civil Code section 2923.6, subdivision (b) by substituting "mortgage servicer" for "mortgagee, beneficiary, or authorized agent."

response is received within two weeks of the telephone attempts. (Civ. Code, § 2923.5, subd. (e).)

Intengan expressly alleged in her third amended complaint that respondents "*did not comply* with such contact and due diligence requirements pursuant to Civil Code section 2923.5." (Italics added.) In support of their demurrer, respondents sought judicial notice of the notice of default, including the attached declaration of Samantha Jones, which averred that Bank of America "tried with due diligence to contact [Intengan] in accordance with California Civil Code Section 2923.5." But in her opposition to the demurrer, Intengan argued that she had never spoken with Jones in person or over the telephone, heard any recording from Jones "over the telephone or any other method recorded by 'Ms. Jones', Defendants Bank of America or Mr. Julian," or "communicated with 'Ms. Jones' by any method of communication whatsoever nor received any communication whatsoever from 'Ms. Jones' other than by the 'Ms. Jones' Declaration Defendants Bank of America and Mr. Julian have provided."

Construing the allegations of the third amended complaint broadly (as we must on demurrer), we conclude that Intengan stated a cause of action for wrongful foreclosure based on respondents' alleged noncompliance with Civil Code section 2923.5. Intengan alleged that defendants did not contact her or attempt to contact her with due diligence as required by the statute. Although respondents sought judicial notice of Jones' declaration regarding compliance with the statute, Intengan disputed the truthfulness of Jones' declaration by denying that she was ever contacted or received any telephone message. She also argued at the demurrer hearing that it was inappropriate to turn the hearing into an evidentiary hearing – in other words, that a demurrer may not be sustained by resolving a conflict in the evidence. And in this appeal Intengan argues that, while judicial notice may be taken of the existence of a document such as a declaration, accepting the truth of its *contents* presents an entirely different matter.

Intengan is correct. Civil Code section 2923.5 requires not only that a declaration of compliance be attached to the notice of default, but that the bank actually perform the underlying acts (i.e., contacting the borrower or attempting such contact with due

diligence) that would constitute compliance. While judicial notice could be properly taken of the *existence* of Jones' declaration, it could not be taken of the facts of compliance asserted *in* the declaration, at least where, as here, Intengan has alleged and argued that the declaration is false and the facts asserted in the declaration are reasonably subject to dispute. (See, e.g., *Joslin v. H.A.S. Ins. Brokerage* (1986) 184 Cal.App.3d 369, 374-376 [facts disclosed in a deposition and not disputed could be considered in ruling on a demurrer, but facts disclosed in the deposition that were disputed could not be, since " 'judicial notice of matters upon demurrer will be dispositive only in those instances where there is not or cannot be a factual dispute concerning that which is sought to be judicially noticed.' "(*Joslin*)].) Indeed, respondents only sought judicial notice of the documents attached to its request, not the underlying fact of its attempt to contact Intengan.

Taking judicial notice that the bank actually performed certain acts that might constitute compliance with its statutory obligations, based solely on a declaration that avers compliance in a conclusory manner, would of course be vastly different than merely taking judicial notice that the declaration was signed and attached to the notice of default (or, as discussed *ante*, from taking judicial notice of the legal effect of a legally operative deed of trust that names its beneficiary). At least in this case, what the bank actually did to comply with the statute is reasonably subject to dispute and cannot be judicially noticed, even though the existence of the declaration (and the legal effect of a deed of trust) is not reasonably subject to dispute and can be judicially noticed. (See *Skov v. U.S. Bank* (2012) 207 Cal.App.4th 690, 696 [where bank sought judicial notice of a notice of default declaration stating compliance with Civ. Code, § 2923.5, whether the bank "complied with section 2923.5 is the type of fact that is reasonably subject to dispute, and thus, not a proper subject of judicial notice" (*Skov*)].)

Furthermore, even if the "facts" stated in Jones' declaration *could* be the subject of judicial notice, the declaration contains only a conclusory assertion that Bank of America complied with the statute: nowhere does it state when, how, or by whom the elements of

due diligence were accomplished, or how the declarant knew if they were.[3] More importantly, the most these averments could do is create a factual dispute as to whether respondents complied with the statute. (See *Mabry, supra*, 185 Cal.App.4th at p. 235-236 [competing accounts as to possibility of compliance with Civ. Code, § 2923.5 created conflict in the evidence].) A demurrer is " 'simply not the appropriate procedure for determining the truth of disputed facts.' " (*Joslin, supra*, 184 Cal.App.3d at p. 374; see *Skov, supra*, 207 Cal.App.4th at pp. 696-697 [assuming the truth of the plaintiff's allegations, a disputed issue of compliance with Civ. Code, § 2923.5 cannot be resolved at the demurrer stage]; see also *Barrionuevo, supra*, 885 F.Supp.2d 964, 2012 U.S. Dist. LEXIS 109935 at *34-35 [borrowers' allegation that bank did not contact them before filing the notice of default was sufficient to state a violation of Civ. Code, § 2923.5, despite judicial notice taken of declaration in notice of default that asserted statutory compliance]; *Argueta v. J.P. Morgan Chase* (E.D. Cal. 2011) 787 F.Supp.2d 1099, 1107 [despite judicial notice of Notice of Default including declaration of compliance with Civ. Code, § 2923.5, plaintiff's allegations were sufficient to preclude dismissal where plaintiffs alleged that they did not receive phone calls, phone messages, or letters before the Notice of Default was recorded] (*Argueta*).)

On this basis, Intengan stated a cause of action for wrongful foreclosure based on the purported failure to comply with Civil Code section 2923.5 before recordation of the notice of default. For this reason, it was error to sustain the demurrer.[4]

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[3] This detail might not be necessary for the *declaration* to meet the requirements of the statute. (*Mabry, supra*, 185 Cal.App.4th at p. 235.) But at issue here is not the sufficiency of the declaration's form, but whether it can be said, as a matter of law, that respondents complied with the requirement that the loan servicer contacted the borrower or made the necessary efforts to do so.

[4] We note, however, the well-established rule that there is no remedy for violation of Civil Code section 2923.5 except a delay of the foreclosure sale pending compliance with the statute. (*Mabry, supra*, 185 Cal.App.4th at p. 223; *Stebley v. Litton Loan Servicing, LLP* (2011) 202 Cal.App.4th 522, 525-526 (*Stebley*); *Argueta, supra*, 787 F.Supp.2d at p. 1107.)

2. *Fraud and Intentional Misrepresentation (Second and Third Causes of Action)*

Intengan's second and third causes of action are for fraud and intentional misrepresentation. The trial court sustained the demurrer as to both of these causes of action on the ground they were not alleged with specificity.

To state a cause of action for fraud or intentional misrepresentation, a plaintiff must allege: a misrepresentation of fact (false statement, concealment or nondisclosure); the defendant's knowledge of the representation's falsity; the defendant's intent to induce reliance; the plaintiff's justifiable reliance; and resulting damage. (*Anderson v. Deloitte & Touche* (1997) 56 Cal.App.4th 1468, 1474.) Moreover, fraud must be alleged with specificity: "The requirement of specificity in a fraud action against a corporation requires the plaintiff to allege the names of the persons who made the allegedly fraudulent representations, their authority to speak, to whom they spoke, what they said or wrote, and when it was said or written." (*Tarmann v. State Farm Mut. Auto Ins. Co*. (1991) 2 Cal.App.4th 153, 157.)

The second cause of action for fraud alleges that respondents "committed fraud and [are] continually doing so when they know that they do not have the legal authority to act on the subject loan and to prematurely foreclose, and yet proceeded to represent themselves with such authority." Intengan also alleges that respondents "represented themselves as lender(s)/assignee(s)/trustee(s) of the subject loan and property with no legal authority to act and foreclose." To the extent these allegations assert that respondents misrepresented their standing to foreclose (in the sense of being the beneficiary and trustee), the allegations of the third amended complaint do not state facts from which it can be inferred that BAC or ReconTrust did *not* have standing to foreclose (see *ante*). Accordingly, no fraud claim can be stated on this ground.

Intengan argues that respondents committed fraud by denying Intengan's efforts to modify the loan. As a matter of law, however, respondents had no duty to modify the loan (see *ante*), and Intengan does not specifically allege that she was promised a modification, let alone when and by whom such a promise was made. The allegations of

the third amended complaint do not assert facts from which Intengan's conclusions of fraud can be inferred on this basis.

Intengan alleges that respondents changed the terms of the loan by assessing exorbitant fees and charges and falsely indicating they were part of the loan, and she further points to respondents' "obfuscating or misrepresenting the later steep monthly payments and interest rate increases on the loan after deceptively marketing risky loans with their primary purpose to sell the loans to the secondary market." But Intengan does not allege the specific BAC or ReconTrust employee who made these purportedly false representations, describe the employee's authority to do so, or identify when the statement was made. Nor does she allege the purported misrepresentations with the specificity necessary to state a fraud claim.

Lastly, Intengan alleges that respondents committed fraud by misrepresenting that the assignment, disclosures, and foreclosure documents, such as the notice of default, were proper, when they were not. As discussed *ante*, the allegations of her pleading for the most part do not state facts from which it can be inferred that the documents were improper, particularly in light of the judicially noticed documents. The one exception to this arises as to the notice of default and compliance with Civil Code section 2923.5, but even on that basis Intengan fails to allege a fraud claim.

Intengan argues that ReconTrust committed fraud by falsely representing that BAC and ReconTrust complied with their Civil Code 2923.5 requirements. Although Intengan does not clearly allege when, where, and by whom this representation of compliance with Civil Code section 2923.5 occurred, she does allege that the fraud arose upon the signing of the notice of default; moreover, those factual details are provided by the declaration attached to the notice of default, which respondents themselves brought to the attention of the trial court: on December 4, 2010, Jones represented, on behalf of BAC, that "Bank of America . . . tried with due diligence to contact the borrower in accordance with California Civil Code Section 2923.5." Intengan alleges that this representation is untrue.

The problem, however, is that Intengan does not sufficiently allege the elements of fraud as to this representation, particularly with respect to justifiable reliance. Although she does allege in general terms that she relied justifiably on "[t]hese misrepresentations . . . by Defendants," she fails to allege facts or offer any argument as to how she could justifiably rely on a representation that she knows to be false. If, as she now insists, she did not receive a communication from respondents before the notice of default as required by Civil Code section 2923.5, she could not have justifiably relied on the representation accompanying the notice of default that she did. The court did not err in sustaining the demurrer as to Intengan's second cause of action for fraud.

Intengan's third cause of action for intentional misrepresentation was based on respondents' alleged refusal to modify the loan and their assessment of purportedly exorbitant fees and charges. For the reasons stated *ante* with respect to the fraud claim, Intengan fails to allege an intentional misrepresentation claim based on these allegations. Accordingly, the demurrer was properly sustained as to Intengan's third cause of action for intentional misrepresentation.

3. *Breach of Contract (Fourth Cause of Action)*

The fourth cause of action alleges breach of the deed of trust by transferring Intengan's loan, securitizing her loan, and imposing charges and fees without disclosure.

As to transfer and securitization, Intengan does not point to any provision in the deed of trust that precludes assignment or transfer of either the loan or the beneficiary interest in the deed of trust. To the contrary, the deed of trust provides in paragraph 20: "The Note or a partial interest in the Note (together with this Security Instrument) can be sold one or more times without prior notice to Borrower." Furthermore, Intengan provides no legal authority for the proposition that a lender's transfer of a note or associated deed of trust – including a transfer for the purpose of securitization – breaches a contract between the lender and the borrower. (See *Badger v. Mortgage Electronic Registration Systems, Inc.* (D. Ariz. July 27, 2010) No. CV-11-08094-PCT-NVW, 2011 U.S. Dist. LEXIS 82998 *2 [rejecting breach of contract claim based on theory that "loan documents do not authorize anyone to assign the note, securitize the debt, and so forth"];

see also *Robinson v. Countrywide Home Loans, Inc*. (2011) 199 Cal.App.4th 42, 46 [no cause of action for wrongful initiation of foreclosure or declaratory relief based on lack of standing to foreclose due to securitization] (*Robinson*); *Gomes v. Countrywide Home Loans, Inc*. (2011) 192 Cal.App.4th 1149, 1154-1157 (*Gomes*).)

As to the charges and fees purportedly assessed without disclosure, there is no allegation as to the contractual provision precluding or limiting charges or fees or requiring disclosures, or any allegations detailing the charges or fees purportedly assessed. Intengan alleges nothing more than a legal conclusion, which is insufficient to state a cause of action.

4. *Breach of Implied Covenant of Good Faith (Fifth Cause of Action)*

The fifth cause of action alleges breach of the implied covenant of good faith and fair dealing. Intengan asserts that BAC and ReconTrust breached the covenant by failing to modify her loan.

The implied covenant of good faith and fair dealing prevents one contracting party from depriving the other contracting party of the benefits of the agreement actually made. (*Guz v. Bechtel National, Inc*. (2000) 24 Cal.4th 317, 349.) However, "[i]It cannot impose substantive duties or limits on the contracting parties beyond those incorporated in the specific terms of their agreement." (*Id*. at pp. 349-350.)

No express or implied term of the promissory note or deed of trust entitled Intengan to a loan modification on her default. Accordingly, Intengan fails to state a cause of action for breach of the implied covenant of good faith and fair dealing. (See *Wienke v. IndyMac Bank FSB* (N.D. Cal. Jun. 29, 2011) No. CV 10-4082 NJV, 2011 U.S. Dist. LEXIS 69717 *8 [dismissing clam for breach of the implied covenant based on the lender's refusal to provide a "feasible loan modification"].)

5. *Slander of Title (Sixth Cause of Action)*

Intengan alleges that "Defendants have not shown clearly and convincingly any proper chain of assignments originally from COUNTRYWIDE HOME LOANS, as they could not establish legal standing as specified and set forth herein this Complaint and

fails to render effective the California Civil Code Sec 2924 foreclosure laws." Essentially, she argues that respondents had no *standing* to foreclose.

For reasons explained *ante*, the documents judicially noticed by the court indicate the standing necessary both for recordation of the notice of default and for the notice of trustee's sale. Intengan does not allege facts that give rise to a contrary conclusion. Moreover, a borrower cannot file a preemptive suit seeking damages or declaratory relief based on the allegation that the foreclosing party lacks standing. (*Robinson, supra,* 199 Cal.App.4th at p. 46 & fn. 5 [preemption suit not allowed, although action to enjoin the foreclosure may be pursued]; see *Gomes, supra,* 192 Cal.App.4th at pp. 1154-1157.)

Furthermore, Intengan's allegations do not state a slander of title claim. Slander of title is "a tortious injury to property resulting from unprivileged, false, malicious publication of disparaging statements regarding the title to property owned by plaintiff, to plaintiff's damage." (*Southcott v. Pioneer Title Co*. (1962) 203 Cal.App.2d 673, 676; see *Manhattan Loft, LLC v. Mercury Liquors, Inc*. (2009) 173 Cal.App.4th 1040, 1051.) A disparaging statement is one intended to "cast doubt" on the "existence or extent" of another's property interest. (*Glass v. Gulf Oil Corp*. (1970) 12 Cal.App.3d 412, 423.) To be actionable, the disparaging statement must be relied upon by a third party and cause the property owner pecuniary loss. (*Appel v. Burman* (1984) 159 Cal.App.3d 1209, 1214.) Intengan's allegations in her claim for slander of title do not identify an unprivileged, false, malicious publication of a statement intended to cast doubt on her property interest, on which a third party relied, causing Intengan pecuniary loss.

6. *Quiet Title (Seventh Cause of Action)*

Intengan alleges that "Defendants have no estate, right, title or interest on the subject property when they acted . . . as foreclosing entities." But she has no quiet title cause of action as a matter of law, for two reasons.

First, the purpose of a quiet title action is to establish one's title against adverse claims to real property. Intengan does not allege any facts demonstrating that respondent ReconTrust or BAC claims any interest adverse to her title: ReconTrust is the trustee,

and BAC is the loan servicer. On this basis, Intengan fails to state a quiet title cause of action.

Second, to state a cause of action to quiet title, Intengan had to allege facts demonstrating that she is the rightful owner of the property; that is, that she has satisfied her obligations under the deed of trust. (*Lane v. Vitek Real Estate Indus. Group* (E.D. Cal. 2010) 713 F. Supp. 2d 1092, 1103.) Thus, a borrower cannot quiet title to secured property without alleging that he or she paid the debt secured by the property. (E.g., *Miller v. Provost* (1994) 26 Cal.App.4th 1703, 1707 ["a mortgagor of real property cannot, without paying his debt, quiet his title against the mortgagee"]; *Aguilar v. Bocci* (1974) 39 Cal.App.3d 475, 477.) It would be inequitable to quiet title in a property owner's name without requiring the owner to repay the secured loan that he or she used to purchase the property in the first place. (See *Stebley, supra,* 202 Cal.App.4th 522, 526.)

Here, Intengan has not alleged a tender of the outstanding indebtedness or even her willingness and ability to do so. As discussed *ante*, her allegation that she was willing to tender the reasonable mortgage payments is insufficient. A valid tender of performance must be of the full debt, in good faith, unconditional, and with the ability to perform. (Civ. Code, §§ 1486, 1493, 1494, 1495.)

7. *Declaratory Relief (Eighth Cause of Action)*

Intengan seeks declaratory relief regarding the parties' "respective rights and duties concerning the terms of the subject loan," and particularly a judicial declaration that defendants "do not have the authority to foreclose prematurely" and that defendants are "not the proper parties with legal standing on the subject loan."

Declaratory relief is available where there is an "actual controversy relating to the legal rights and duties of the respective parties." (Code Civ. Proc., § 1060.) It is not an independent cause of action, but a form of equitable relief. (*Batt v. City and County of San Francisco* (2007) 155 Cal.App.4th 65, 82; see also *California Ins. Guarantee Assn. v. Superior Court* (1991) 231 Cal.App.3d 1617, 1623-1624 [declaratory relief statute

provides a form of relief to the plaintiff, not a second cause of action for determination of issues that are the subject of another claim] (*California*).)

Because Intengan's wrongful foreclosure cause of action will address the rights and duties of the parties with respect to Civil Code section 2923.5, and because she might obtain relief under that cause of action upon proof of her allegations, she has not alleged any need for declaratory relief with respect to Civil Code section 2923.5. (*California, supra*, 231 Cal.App.3d at p. 1624.) Furthermore, because Intengan fails to state any other cause of action as a matter of law, there is no other basis for a declaratory relief claim to adjudicate a purported controversy. (*Ball v. FleetBoston Financial Corp*. (2008) 164 Cal.App.4th 794, 800.) The trial court did not err in sustaining the demurrer to the cause of action for declaratory relief.

8. *Unfair Competition (Ninth Cause of Action)*

Intengan's ninth cause of action alleges that BAC and ReconTrust engaged in unfair competition in violation of Business and Professions Code section 17200 (UCL).

Intengan alleges that respondents engaged in unfair business practices by: (1) assessing improper or excessive fees; (2) "improperly characterizing Plaintiff accounts towards premature foreclosure proceedings to generate unwarranted fees"; (3) misapplying or failing to apply payments; (4) failing to provide adequate monthly statement information regarding the account status, payments owed, and the basis for fees assessed; (5) collecting or attempting to collect fees, costs, and charges that were not due; (6) mishandling mortgage payments and failing to timely or properly credit payments received, resulting in the imposition of fees; (7) and failing to disclose the costs, fees, and charges assessed under the mortgage. "Moreover, the foreclosing Defendants engage in a uniform pattern and practice of unfair and overly aggressive servicing that result in the assessment of unwarranted and unfair fees against California consumers, and execute premature foreclosure proceedings."

Intengan's UCL claim fails because none of the matters on which she expressly bases her claim state a viable cause of action. (See *Krantz v. BT Visual Images* (2001) 89

Cal.App.4th 164, 178 [holding that a UCL claim stands or falls with the antecedent substantive causes of action].)

In any event, Intengan fails to state a cause of action under the UCL because she has not alleged the elements of the violation with reasonable particularity. (*Khoury v. Maly's of California, Inc*. (1993) 14 Cal.App.4th 612, 619 ["A plaintiff alleging unfair business practices under [the UCL] must state with reasonable particularity the facts supporting the statutory elements of the violation"].)

9. *Unjust Enrichment (Tenth Cause of Action)*

Intengan's tenth cause of action is for unjust enrichment. The elements of an unjust enrichment claim are receipt of a benefit and unjust retention of the benefit at the expense of another. (*Peterson v. Cellco Partnership* (2008) 164 Cal.App.4th 1583, 1593.)

Intengan fails to allege facts showing what benefits BAC or ReconTrust received from Intengan, or why it would be unjust for BAC or ReconTrust to retain them. Her conclusory allegation that, "[b]y their wrongful acts and omissions, the foreclosing Defendants have been unjustly enriched at the expense of Plaintiffs and thus Plaintiffs have been unjustly deprived," is insufficient to state a cause of action.

10. *Injunctive Relief (Eleventh Cause of Action)*

Injunctive relief is a remedy rather than an independent cause of action. (See *McDowell v. Watson* (1997) 59 Cal.App.4th 1155, 1159; *Shell Oil Co. v. Richter* (1942) 52 Cal.App.2d 164, 168.) While Intengan might obtain injunctive relief if she proves her allegations of respondents' noncompliance with Civil Code section 2923.5, she has not stated a separate cause of action. The trial court did not err in sustaining the demurrer as to her purported cause of action for injunctive relief.

11. *Intengan's Other Arguments*

Intengan contends that the court's ruling on the demurrer "is partial and therefore inconsistent with California statutory and case law," "amounts to a constructive tax" in violation of her constitutional rights, violates her constitutional right to be free from illegal takings, resulted from a misapplication of law and ignorance of the facts, and

violates her "Constitutional Right to separation of powers." She contends that "[n]o evidence exists in the record that Judge Swope had any probable cause to institute any forfeiture action against Appellant Intengan by the Wrongful Demurrer Ruling resulting in the loss of Appellant Intengan's lawsuit." She asserts that the "refusals" of Bank of America and the trial court "resemble an Orwellian conundrum." She "further requests that this Court piece together Appellant Intengan's Constitutional Right that Judge Swope and Respondents Bank of America shattered Humpty Dumpty-like due to their acts of partiality, misapplication of law, ignorance of facts and unconstitutionality and by their refusals to contemplate the gravity of their decisionmaking before proceeding contrary to law." Intengan additionally refers us to Lewis Carroll's *Alice's Adventures in Wonderland*. And she urges us to do justice and mercy in this case, providing numerous quotations from the Bible.

We have fully considered all of Intengan's arguments in arriving at our disposition of her appeal. We conclude: the trial court erred in sustaining the demurrer to the third amended complaint, only in that Intengan adequately alleged a violation of Civil Code section 2923.5, which might be pursued under her theory of wrongful foreclosure. Accordingly, the judgment of dismissal must be reversed, and the order sustaining the demurrer to the third amended complaint must be reversed solely as to her purported cause of action for wrongful foreclosure, based exclusively on the alleged violation of Civil Code section 2923.5, potentially providing relief only in the form of a postponement of the foreclosure sale.

B. *Denial of Leave to Amend*

As to the causes of action to which the demurrer was properly sustained, we must next consider whether leave to amend should have been granted. We review a denial of leave to amend for an abuse of discretion. (*Debro, supra*, 92 Cal.App.4th at p. 946.) To prevail on appeal, an appellant must usually demonstrate a reasonable possibility that the defects in the complaint can be cured by amendment. (E.g., *Schifando v. City of Los Angeles* (2003) 31 Cal.4th 1074, 1081; see *Vaca v. Wachovia Mortgage Corp*. (2011) 198 Cal.App.4th 737, 743.) Thus, Intengan must show how her third amended complaint

could further be amended and how, as so amended, the pleading would state a cause of action. (*Buller, supra,* 160 Cal.App.4th at p. 992.)

Intengan fails to demonstrate how she could amend her third amended complaint to state a cause of action. She has had multiple opportunities in the trial court to allege facts sufficient to state a cause of action, and even now she fails to show what amendment she would make or why it would cure her pleading's deficiencies.

At the demurrer hearing, Intengan asked defense counsel to stipulate to her amending the third amended complaint to add Jones – the person who signed the declaration accompanying the notice of default – as a defendant. That proposed amendment, however, would not cure any of the pleadings' defects discussed *ante*. Accordingly, Intengan has not demonstrated any reasonable possibility that the defects of her pleading can be cured by amendment, and the court did not abuse its discretion in denying her further leave to amend.

C. *Intengan's Motion to Strike the Demurrer*

Intengan contends that the court erred by ignoring her motion to strike respondents' demurrer, which she included with her memorandum in opposition to the demurrer. Her motion to strike was not properly brought, however, since it was not separately presented and did not include a notice of hearing or separate memorandum of points and authorities. (Cal. Rules of Court, rule 3.1112.) Moreover, Intengan's points and authorities provided no substantive basis for the motion apart from her opposition to the demurrer, so the court at least implicitly denied her motion when it sustained the demurrer. At any rate, Intengan could not have received greater relief under her motion to strike the demurrer than we provide her in this appeal. Accordingly, she fails to establish reversible error in this regard.

III. DISPOSITION

The judgment of dismissal is reversed. The order sustaining the demurrer is reversed, solely as to a cause of action for wrongful foreclosure based on allegations that respondents did not comply with Civil Code section 2923.5. Appellant shall recover her costs on appeal.

NEEDHAM, J.

We concur.

JONES, P. J.

BRUINIERS, J.

(A135782)

Intengan v. BAC Home Loans Servicing LP et al., A135782

Trial court:	San Mateo County Superior Court
Trial judge:	Hon. V. Raymond Swope

Arden M. Intengan, in pro. per. for Plaintiff and Appellant.

Severson & Werson, Jan T. Chilton and M. Elizabeth Holt for Defendants and Respondents.

Filed 3/18/13

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FOURTH APPELLATE DISTRICT

DIVISION THREE

GENEVIEVE WEST, Plaintiff and Appellant, v. JPMORGAN CHASE BANK, N.A., as Receiver, etc., Defendant and Respondent.	G046516 (Super. Ct. No. 30-2010-00425322) O P I N I O N

Appeal from a judgment of the Superior Court of Orange County, Gregory Munoz, Judge. Affirmed in part, reversed in part, and remanded.

Genevieve West, in pro. per., for Plaintiff and Appellant.

AlvaradoSmith, John M. Sorich, S. Christopher Yoo, Yunnie Youn Ahn and Jenny L. Merris for Defendant and Respondent.

*   *   *

INTRODUCTION

As authorized by Congress, the United States Department of the Treasury implemented the Home Affordable Mortgage Program (HAMP) to help homeowners avoid foreclosure during the housing market crisis of 2008. "The goal of HAMP is to provide relief to borrowers who have defaulted on their mortgage payments or who are likely to default by reducing mortgage payments to sustainable levels, without discharging any of the underlying debt." (*Bosque v. Wells Fargo Bank, N.A.* (D.Mass. 2011) 762 F.Supp.2d 342, 347.)

After her home loan went into default, plaintiff Genevieve West agreed to a trial period plan (TPP), a form of temporary loan payment reduction under HAMP, from defendant JPMorgan Chase Bank, N.A. (Chase Bank),[1] which had acquired her loan from the original lender. West complied with the terms of the TPP, and timely made every reduced monthly payment on her loan during the trial period and afterwards. Nonetheless, Chase Bank denied West a permanent loan modification, and West's home was sold at a trustee's sale just two days after Chase Bank told her, so West alleged, that no foreclosure sale was scheduled.

West brought this lawsuit alleging fraud, breach of written contract, promissory estoppel, and other causes of action, against Chase Bank. The trial court sustained without leave to amend Chase Bank's demurrer to the third amended complaint, and West appealed from the subsequent judgment. We hold that West stated causes of action for fraud, negligent misrepresentation, breach of written contract, promissory estoppel, and unfair competition, and therefore reverse the judgment on those

[1] Chase Bank appeared as JPMorgan Chase Bank, N.A., as acquirer of certain assets and liabilities of Washington Mutual Bank from the Federal Deposit Insurance Commission, acting as receiver for Washington Mutual Bank.

causes of action. We affirm only on the causes of action for conversion, to set aside or vacate void trustee sale, for slander of title, and to quiet title.

In holding that West stated a cause of action for breach of written contract, we agree with the analysis and interpretation of HAMP presented in the recent opinion of the United States Court of Appeals for the Seventh Circuit in *Wigod v. Wells Fargo Bank, N.A.* (7th Cir. 2012) 673 F.3d 547, 556-557 (*Wigod*). Core to our decision is the court's conclusion in *Wigod*, *supra*, 673 F.3d at page 557, that when a borrower complies with all the terms of a TPP, and the borrower's representations remain true and correct, the loan servicer must offer the borrower a permanent loan modification. As a party to a TPP, a borrower may sue the lender or loan servicer for its breach. (*Id.* at p. 559, fn. 4.) Because West complied with all the terms of the TPP, Chase Bank had to offer her a permanent loan modification.

HAMP

To explain HAMP, we quote extensively from *Wigod*, *supra*, 673 F.3d at pages 556-557:

"In response to rapidly deteriorating financial market conditions in the late summer and early fall of 2008, Congress enacted the Emergency Economic Stabilization Act, P.L. 110-343, 122 Stat. 3765. The centerpiece of the Act was the Troubled Asset Relief Program (TARP), which required the Secretary of the Treasury, among many other duties and powers, to 'implement a plan that seeks to maximize assistance for homeowners and . . . encourage the servicers of the underlying mortgages . . . to take advantage of . . . available programs to minimize foreclosures.' 12 U.S.C. § 5219(a). Congress also granted the Secretary the authority to 'use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures.' *Id.*

"Pursuant to this authority, in February 2009 the Secretary set aside up to $50 billion of TARP funds to induce lenders to refinance mortgages with more favorable

interest rates and thereby allow homeowners to avoid foreclosure. The Secretary negotiated Servicer Participation Agreements (SPAs) with dozens of home loan servicers . . . . Under the terms of the SPAs, servicers agreed to identify homeowners who were in default or would likely soon be in default on their mortgage payments, and to modify the loans of those eligible under the program. In exchange, servicers would receive a $1,000 payment for each permanent modification, along with other incentives. The SPAs stated that servicers 'shall perform the loan modification . . . described in . . . the Program guidelines and procedures issued by the Treasury . . . and . . . any supplemental documentation, instructions, bulletins, letters, directives, or other communications . . . issued by the Treasury.' In such supplemental guidelines, Treasury directed servicers to determine each borrower's eligibility for a modification by following what amounted to a three-step process:

"First, the borrower had to meet certain threshold requirements, including that the loan originated on or before January 1, 2009; it was secured by the borrower's primary residence; the mortgage payments were more than 31 percent of the borrower's monthly income; and, for a one-unit home, the current unpaid principal balance was no greater than $729,750.

"Second, the servicer calculated a modification using a 'waterfall' method, applying enumerated changes in a specified order until the borrower's monthly mortgage payment ratio dropped 'as close as possible to 31 percent.'

"Third, the servicer applied a Net Present Value (NPV) test to assess whether the modified mortgage's value to the servicer would be greater than the return on the mortgage if unmodified. The NPV test is 'essentially an accounting calculation to determine whether it is more profitable to modify the loan or allow the loan to go into foreclosure.' [Citation.] If the NPV result was negative—that is, the value of the modified mortgage would be lower than the servicer's expected return after foreclosure—the servicer was not obliged to offer a modification. If the NPV was positive, however,

the Treasury directives said that 'the servicer MUST offer the modification.' Supplemental Directive 09-01. [¶] . . . [¶]

"Where a borrower qualified for a HAMP loan modification, the modification process itself consisted of two stages. After determining a borrower was eligible, the servicer implemented a Trial Period Plan (TPP) under the new loan repayment terms it formulated using the waterfall method. The trial period under the TPP lasted three or more months, during which time the lender 'must service the mortgage loan . . . in the same manner as it would service a loan in forbearance.' Supplemental Directive 09-01. After the trial period, if the borrower complied with all terms of the TPP Agreement—including making all required payments and providing all required documentation—and if the borrower's representations remained true and correct, *the servicer had to offer a permanent modification.* See Supplemental Directive 09-01 ('If the borrower complies with the terms and conditions of the [TPP], the loan modification will become effective on the first day of the month following the trial period. . . .')." (Fourth ellipsis & italics added, fn. omitted.)

In *Wigod, supra,* 673 F.3d at pages 576-586, the Seventh Circuit Court of Appeals concluded HAMP does not preempt or otherwise displace state law causes of action. The court also recognized a borrower may assert state law claims, such as breach of contract, based directly on a TPP agreement because the borrower is in direct privity with the lender or loan servicer. (*Wigod*, *supra*, at p. 559 & fn. 4.) We do not address whether HAMP creates a private right of action because West has asserted only California state law claims.

ALLEGATIONS

West's third amended complaint alleged the following facts.

West obtained an adjustable rate home loan in the sum of $645,000, secured by a deed of trust on her home. The deed of trust, which was recorded in

September 2006, named Washington Mutual Bank, F.A. (Washington Mutual), as the lender and beneficiary, California Reconveyance Company as the trustee, and West as the borrower. In 2008, Chase Bank acquired Washington Mutual and purchased certain of its assets, including West's loan.

West failed to make payments on the home loan. As a consequence, a notice of default and election to sell under the deed of trust was recorded in March 2009. According to the notice of default, West was $17,795.91 in arrears as of March 17, 2009.

In April 2009, a substitution of trustee was recorded. It named Quality Loan Service Corporation (QLSC) as trustee in place of California Reconveyance Company.

In July 2009, Washington Mutual informed West she had been approved for a TPP, which Washington Mutual called a "Trial Plan Agreement." The approval letter stated: "Since you have told us you're committed to pursuing a stay-in-home option, you have been approved for a Trial Plan Agreement. If you comply with all the terms of this Agreement, we'll consider a permanent workout solution for your loan once the Trial Plan has been completed." In August 2009, West entered into the Trial Plan Agreement with Washington Mutual. The Trial Plan Agreement required West to make an initial payment of $1,931.86 by August 1, 2009, and additional payments in that amount on September 1 and October 1. The Trial Plan Agreement stated: "If you do not make your payments on time, or if any of your payments are returned for nonsufficient funds, this Agreement will be in breach and collection and/or foreclosure activity will resume."

West made all three payments under the Trial Plan Agreement and continued thereafter to make monthly payments in the required amount. In January 2010 and again in March 2010, Chase Bank confirmed receipt of documents that West had submitted in support of her request for a permanent loan modification under HAMP. In

the letters confirming receipt of those documents, Chase Bank advised West to "continue to make your trial period payments on time."

By letter dated April 5, 2010, Chase Bank notified West that "we have determined that you do not qualify for a modification through the Making Home Affordable ('MHA') modification program or through other modification programs offered by Chase at this time." Chase Bank's determination was based on a calculation of West's "Net Present Value" (NPV) under a formula developed by the Department of the Treasury. The letter stated: "If we receive a request from you within thirty (30) calendar days from the date of this letter, we will provide you with the date the NPV calculation was completed and the input values noted below. If, within thirty (30) calendar days of receiving this information you provide us with evidence that any of these input values are inaccurate, and those inaccuracies are material, for example a significant difference in your gross monthly income or an inaccurate zip code, we will conduct a new NPV evaluation. While there is no guarantee that a new NPV evaluation will result in the owner of your Loan approving a modification, we want to ensure that the NPV evaluation is based on accurate information."

On April 8, 2010, West "and or" her representative contacted Chase Bank, informed the bank it had used outdated financial information, and requested a "re-evaluation" (boldface & underscoring omitted) using updated financial information. Chase Bank did not send West the NPV data and input values that she had requested.

On May 24, 2010, West again informed Chase Bank that it had used outdated financial information and that she would submit "updated financial information, and any other information necessary to make the input data accurate." West alleged: "On or about May 24, 2010, [West] and or her representative conducted a conference call with the loan modification department of CHASE BANK, who [*sic*] agreed and promised [West] that [she] could resubmit her updated financial data for re-evaluation for HAMP

modification solutions, and that there was no foreclosure sale date or sale scheduled."[2] (Boldface & underscoring omitted.)

Also on May 24, West made her 10th reduced payment of $1,931.86, which Chase Bank rejected and returned to her.

Although Chase Bank had told West no foreclosure sale had been scheduled, her home was sold at a trustee's sale conducted on May 26, 2010. "In violation of its promises and said letter, and HAMP rules (and Supplemental Directives), two (2) days later, CHASE BANK secretly, sold [West]'s home, on May 26,[]2010 during the re-evaluation period. CHASE BANK issued letters dated May[]20, 2010, received May 24, 2010, rejecting [West]'s 10th payment . . . , made pursuant to the continuing forbearance agreement."

A trustee's deed upon sale was recorded on June 10, 2010. The deed identified Green Island Holdings, LP, as the grantee, and recited, "[s]aid property was sold by said Trustee at public auction on 5/26/2010 at the place named in the Notice of Sale . . . ."

On May 28, 2010, two days after the trustee's sale, Chase Bank's Homeownership Preservation Office sent West a letter telling her: "More and more Americans are struggling to keep up with their mortgage payments. If you are experiencing financial difficulty, you have a variety of options that might help you get back on track, and keep you out of foreclosure." The letter invited West to meet with "specialists from Chase" at a "local event" to "work out the best solution to your current needs."

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[2] West also asserts that during the conference call, she was told "not to worry, that her 'payments would be going down $200 from $1931.86 to about $1731.86.'" (Italics omitted.) That assertion is based on a declaration West submitted in opposition to Chase Bank's demurrer to the third amended complaint, which did not allege Chase Bank represented that West's payments would be reduced.

On August 18, 2010, nearly three months after the trustee's sale, the "Chase Fulfillment Center" sent West information about the Home Affordable Foreclosure Alternatives (HAFA) program. The letter stated: "HAFA is a United States Treasury program providing financial incentives to servicers and eligible borrowers working together on foreclosure alternatives, such as a short sale or deed-in-lieu. These alternatives may provide a more favorable outcome than a foreclosure sale by avoiding extended vacancy periods and costly foreclosures. [¶] If you are interested in the requirements for participating in HAFA, please sign the enclosed Borrower Request for HAFA Consideration and return it to the following address or fax number . . . ."

PROCEDURAL HISTORY

West filed the initial complaint in November 2010. A series of demurrers and amendments resulted in the third amended complaint, which asserted these causes of action: fraud (first cause of action); negligent misrepresentation (second cause of action); conversion (third cause of action); set aside or vacate void trustee sale (fourth cause of action); unfair business practices under Business and Professions Code section 17200 et seq. (fifth cause of action); slander of title (sixth cause of action); breach of written contract (seventh cause of action); verified quiet title (10th cause of action); and promissory estoppel (11th cause of action).

Chase Bank demurred to the third amended complaint on the ground none of the causes action stated facts sufficient to state a cause of action. Chase Bank filed a request for judicial notice in support of its demurrer. West opposed the demurrer and also filed a request for judicial notice.

The trial court sustained Chase Bank's demurrer in its entirety without leave to amend. The court granted West's request for judicial notice, and, while no ruling on Chase Bank's request for judicial notice appears in the record, the court cited Chase Bank's request in the minute order sustaining the demurrer. In that minute order, the trial

court noted: "This case has now been pending for over one year and . . . West has had four opportunities to properly state a claim and has failed to do so, despite the Court specifically pointing out the same or similar problems with the Complaint on previous Demurrers." An order sustaining the demurrer without leave to amend, and a judgment against West and in favor of Chase Bank, were entered on January 3, 2012.

STANDARD OF REVIEW

"On appeal from a judgment dismissing an action after sustaining a demurrer without leave to amend, . . . [w]e give the complaint a reasonable interpretation, reading it as a whole and its parts in their context. [Citation.] Further, we treat the demurrer as admitting all material facts properly pleaded, but do not assume the truth of contentions, deductions or conclusions of law." (*City of Dinuba v. County of Tulare* (2007) 41 Cal.4th 859, 865.) We independently review a ruling on a demurrer to determine whether the pleading alleges facts sufficient to state a cause of action. (*McCall v. PacifiCare of Cal., Inc.* (2001) 25 Cal.4th 412, 415.)

DISCUSSION

I.

Fraud and Negligent Misrepresentation Causes of Action

West asserted fraud in the first cause of action and negligent misrepresentation in the second cause of action. In the fraud cause of action, West alleged that starting on August 6, 2009, Chase Bank made false representations in the Trial Plan Agreement and "verbally" that she was granted "a continuing Making Home Affordable (HAMP) Trial Modification, and or forbearance agreement, during the re-evaluation of the HAMP Modification." She alleged that Chase Bank concealed from her "the fact that there was a foreclosure sale date pending against the subject Property, and that it did intend to [foreclose] during the re-evaluation period."

The elements of fraud are (1) the defendant made a false representation as to a past or existing material fact; (2) the defendant knew the representation was false at

the time it was made; (3) in making the representation, the defendant intended to deceive the plaintiff; (4) the plaintiff justifiably relied on the representation; and (5) the plaintiff suffered resulting damages. (*Lazar v. Superior Court* (1996) 12 Cal.4th 631, 638.) The elements of negligent misrepresentation are the same except for the second element, which for negligent misrepresentation is the defendant made the representation without reasonable ground for believing it to be true. (*Wells Fargo Bank, N.A. v. FSI, Financial Solutions, Inc.* (2011) 196 Cal.App.4th 1559, 1573; *National Union Fire Ins. Co. of Pittsburgh, PA v. Cambridge Integrated Services Group, Inc.* (2009) 171 Cal.App.4th 35, 50.)

Chase Bank argues the trial court was correct to sustain the demurrer to those causes of action without leave to amend because West did not allege (1) fraud with the required particularity, (2) justifiable reliance, and (3) causation.

A. *Specificity*

Fraud must be pleaded with specificity rather than with "'general and conclusory allegations.'" (*Small v. Fritz Companies, Inc.* (2003) 30 Cal.4th 167, 184.) The specificity requirement means a plaintiff must allege facts showing how, when, where, to whom, and by what means the representations were made, and, in the case of a corporate defendant, the plaintiff must allege the names of the persons who made the representations, their authority to speak on behalf of the corporation, to whom they spoke, what they said or wrote, and when the representation was made. (*Lazar v. Superior Court*, *supra*, 12 Cal.4th at p. 645.)

We enforce the specificity requirement in consideration of its two purposes. The first purpose is to give notice to the defendant with sufficiently definite charges that the defendant can meet them. (*Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 216.) The second is to permit a court to weed out meritless fraud claims on the basis of the pleadings; thus, "the pleading should be

sufficient '"to enable the court to determine whether, on the facts pleaded, there is any foundation, prima facie at least, for the charge of fraud."'" (*Id.* at pp. 216-217.)

West met that specificity requirement. She alleged quite specifically that Chase Bank made misrepresentations in the Trial Plan Agreement, in the April 5, 2010 letter, and in telephone conferences on April 8 and May 24, 2010. Both the Trial Plan Agreement and the April 5 letter were attached to the third amended complaint. The Trial Plan Agreement was sent to West on July 24, 2009 by a Washington Mutual loan workout specialist identified as Russell Buelna.

West alleged that, in the April 5, 2010 letter, Chase Bank falsely represented that it would reevaluate her case and send her the NPV input data if she so requested within 30 days. The April 5 letter is from the Chase Fulfillment Center and, though the letter does not identify the preparer, West did not have to plead that information because it was uniquely within Chase Bank's knowledge. (*Committee on Children's Television, Inc. v. General Foods Corp.*, *supra*, 35 Cal.3d at p. 217; see also *Boschma v. Home Loan Center, Inc.* (2011) 198 Cal.App.4th 230, 248 ["'While the precise identities of the employees responsible . . . are not specified in the loan instrument, defendants possess the superior knowledge of who was responsible for crafting these loan documents'"].)

West alleged that on April 8, 2010, she spoke with a supervisor in the loan modification department of Chase Bank, and, on May 24, 2010, spoke with someone in that department. She specifically described the misrepresentations allegedly made during those conferences and alleged the misrepresentations were communicated by telephone. She alleged that, in a telephone call on May 24, 2010, a Chase Bank representative told her she "could resubmit her updated financial data for re-evaluation for HAMP modification solutions, and that there was no foreclosure sale date or sale scheduled." (Boldface & underscoring omitted.) Her allegation of the persons who made the alleged misrepresentations was sufficient to give notice to Chase Bank of the charges. The

identification of the Chase Bank employees who spoke with West on those dates is or should be within Chase Bank's knowledge.

B. *Justifiable Reliance*

"'Besides actual reliance, [a] plaintiff must also show "justifiable" reliance, i.e., circumstances were such to make it *reasonable* for [the] plaintiff to accept [the] defendant's statements without an independent inquiry or investigation.' [Citation.] The reasonableness of the plaintiff's reliance is judged by reference to the plaintiff's knowledge and experience. [Citation.] '"Except in the rare case where the undisputed facts leave no room for a reasonable difference of opinion, the question of whether a plaintiff's reliance is reasonable is a question of fact." [Citations.]' [Citation.]" (*OCM Principal Opportunities Fund, L.P. v. CIBC World Markets Corp.* (2007) 157 Cal.App.4th 835, 864-865.) "Reliance can be proved in a fraudulent omission case by establishing that 'had the omitted information been disclosed, [the plaintiff] would have been aware of it and behaved differently.'" (*Boschma v. Home Loan Center, Inc.*, *supra*, 198 Cal.App.4th at pp. 250-251.)

West alleged in the third amended complaint that she "justifiably relied [on] the representations made by CHASE BANK, on the phone, and in its letters" and, "[a]t all related times, Defendants knew or should have known that Plaintiff would justifiably rely on its representations made in writing, and on the phone."

Chase Bank argues those allegations did not satisfy the justifiable reliance requirement because (1) the Trial Plan Agreement makes no promise of a permanent loan modification agreement and (2) the April 5, 2010 letter informed West that Chase Bank had determined she did not qualify for a permanent loan modification.

The Trial Plan Agreement represented only that Chase Bank would reevalute West's application for a permanent loan modification if West made all payments as scheduled. But the April 5, 2010 letter stated that Chase Bank would provide West with the NPV input values if she requested them within 30 days and that

Chase Bank would conduct a new evaluation if West provided evidence that any of those input values were inaccurate. West could justifiably rely on those representations, and she alleged she asked for those input values on April 8 and on May 24, 2010. Chase Bank never sent them to her before foreclosing.

West also alleged that from the time of the Trial Plan Agreement, Chase Bank concealed the fact it was pursuing foreclosure and that on May 24, a Chase Bank representative told West that no trustee's sale was scheduled. West could have justifiably relied on that representation too, particularly considering she was requesting a reevaluation of Chase Bank's decision to deny her a permanent loan modification.

C. *Causation*

Chase Bank argues West has not pleaded, and cannot plead, her reliance on the alleged misrepresentations caused her to suffer damages; that is, she did not "'establish a complete causal relationship' between the alleged misrepresentations and the harm claimed to have resulted therefrom." (See *Mirkin v. Wasserman* (1993) 5 Cal.4th 1082, 1092.)

West alleged that in reliance on the representations and Chase Bank's alleged concealment of the foreclosure sale, she suffered damages "including loss of mortgage payments made under false pretenses, attorney fees, legal costs, personal injuries, pain and suffering, anxiety, humiliation, fear, extreme emotional distress, and physical injuries." As Chase Bank argues, West already owed the mortgage payments and was obligated to make them notwithstanding the alleged misrepresentations. West also alleged, however, that Chase Bank "lull[ed]" her into "a false sense of security, so she would not hire an attorney to protect her rights," and then pursued the foreclosure sale despite telling her, on May 24, 2010, that no foreclosure sale had been scheduled.

The third amended complaint, read as a whole, may be reasonably construed to allege that West's reliance on Chase Bank's alleged misrepresentations caused West to forego taking legal action to stop the foreclosure sale. Under the

allegations of the third amended complaint, West likely would have been successful in taking legal action to stop the sale. In the April 5, 2010 letter denying a loan modification, Chase Bank offered to conduct a new NPV evaluation if West made a timely request for input values and provided evidence those values were inaccurate. West alleged she timely requested the input values, but Chase Bank never provided her the information. In January 2010 and again in March 2010, Chase Bank advised West to "continue to make your trial period payments on time." She made all of her payments.

II.

Breach of Written Contract Cause of Action

In the seventh cause of action for breach of written contract, West alleged the Trial Plan Agreement constituted a written contract, which Chase Bank breached by denying her a permanent loan modification after "secretly" selling her home. We conclude the third amended complaint stated a cause of action for breach of written contract.

Chase Bank does not dispute the Trial Plan Agreement constituted a written contract. Many federal courts have concluded a trial loan modification under HAMP constitutes a valid, enforceable contract under state law, at least at the pleading stage of litigation. (E.g., *Wigod*, *supra*, 673 F.3d at pp. 560-561 [valid contract under Illinois law]; *Gaudin v. Saxon Mortgage Services, Inc.* (N.D.Cal. 2011) 820 F.Supp.2d 1051, 1053-1054 [valid contract]; *Bosque v. Wells Fargo Bank, N.A.*, *supra*, 762 F.Supp.2d at pp. 352-353 [valid contract under Massachusetts law]; *Sutcliffe v. Wells Fargo Bank, N.A.* (N.D.Cal. 2012) 283 F.R.D. 533, 550 [valid contract under California law]; *Turbeville v. JPMorgan Chase Bank* (C.D.Cal., Apr. 4, 2011, No. SA CV 10-01464 DOC (JCGx)) 2011 U.S.Dist. Lexis 42290, pp. *8-*12 [valid contract under California law].) Chase Bank does not argue lack of offer and acceptance, consideration, certain terms, or any element necessary to create an enforceable contract.

Instead, Chase Bank argues it did not as a matter of law breach the terms of the Trial Plan Agreement because the exhibits to the third amended complaint establish that Chase Bank did reevaluate West's application for a permanent loan modification. Chase Bank relies on the term of the Trial Plan Agreement stating, "[i]f all payments are made as scheduled, we will reevaluate your application for assistance and determine if we are able to offer you a permanent workout solution to bring your loan current." Attached to the third amended complaint was Chase Bank's letter, dated April 5, 2010, notifying West that Chase Bank had determined she did not qualify for a loan modification based on a calculation of her NPV under a formula developed by the Department of the Treasury.

This argument ignores Chase Bank's obligations under HAMP and the express and implied obligations under the Trial Plan Agreement. When Chase Bank received public tax dollars under the Troubled Asset Relief Program,[3] it agreed to offer TPP's and loan modifications under HAMP according to guidelines, procedures, instructions, and directives issued by the Department of the Treasury. (*Wigod*, *supra*, 673 F.3d at p. 556.) Under the United States Department of the Treasury, HAMP Supplemental Directive 09-01 (Apr. 6, 2009) (Directive 09-01), if the lender approves a TPP, and the borrower complies with all the terms of the TPP and all of the borrower's representations remain true and correct, the lender *must offer* a permanent loan modification. (*Wigod*, *supra*, at p. 557.) Directive 09-01, *supra*, at page 18, states: "If

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[3] The Emergency Economic Stabilization Act of 2008, title 12 United States Code section 5201 et seq., gave the Secretary of the Treasury the power to establish the Troubled Asset Relief Program to purchase, make, and fund commitments to purchase troubled assets from any financial institution, on such terms and conditions as set by the Secretary. (12 U.S.C. § 5211(a)(1).) The Emergency Economic Stabilization Act of 2008 defines a "troubled asset" as a financial instrument the purchase of which is necessary to promote financial stability. (12 U.S.C. § 5202(9)(B).)

the borrower complies with the terms and conditions of the [TPP], the loan modification will become effective on the first day of the month following the trial period . . . ."[4]

In *Wigod*, *supra,* 673 F.3d at page 558, the defendant bank issued the plaintiff a four-month TPP. The TPP stated that if the plaintiff was in compliance with the plan and her representation on which the plan was issued continued to be true, then the defendant "'will provide me with a [permanent] Loan Modification Agreement.'" (*Ibid.*) The plaintiff alleged she made all the payments required under the TPP, but the defendant bank improperly reevaluated her eligibility and declined to offer her a permanent loan modification. (*Ibid.*) The Seventh Circuit Court of Appeals concluded the plaintiff adequately pleaded causes of action under Illinois law for breach of contract, promissory estoppel, and fraudulent misrepresentations against the defendant bank. (*Id.* at p. 559.) The court held the TPP constituted a valid and enforceable contract under Illinois law and the defendant bank breached the express terms of the contract by declining to offer the plaintiff a permanent loan modification. (*Id.* at pp. 561-566.) Under HAMP guidelines, the defendant bank had "some limited discretion to set the precise terms of an offered permanent modification" if "[the plaintiff] fulfilled the TPP's conditions." (*Id.* at p. 565.) Nonetheless, the defendant bank was required to offer "*some* sort of good-faith modification to [the plaintiff] consistent with HAMP guidelines." (*Ibid.*)

Unlike the TPP in *Wigod*, the Trial Plan Agreement signed by West, and prepared by Chase Bank, did not expressly include the proviso that Chase Bank would offer a permanent loan modification if she complied with that agreement's terms. But such a proviso is imposed by the United States Department of the Treasury through Directive 09-01, *supra*, page 18 (see *Wigod*, *supra*, 673 F.3d at p. 557), and a contract must be interpreted in a way to make it lawful (Civ. Code, § 1643). To make the Trial

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[4] Construction of the United States Department of the Treasury directives is a question of law for the court to decide. (*Wigod*, *supra*, 673 F.3d at p. 580.)

Plan Agreement lawful, it must be interpreted to include the proviso imposed by Directive 09-01. In addition, HAMP guidelines "informed the reasonable expectations of the parties to [the Trial Plan Agreement]." (*Wigod*, *supra*, at p. 565.)

Thus, in light of Directive 09-01 and HAMP guidelines, the reasonable interpretation of the Trial Plan Agreement—and the one necessary to make it lawful and in compliance with HAMP—is that Chase Bank's reevaluation upon completion of the trial period would be limited to determining whether West complied with the terms of the Trial Plan Agreement and whether West's original representations remained true and correct. Applying *Wigod* to this case, "[a]lthough [Chase Bank] may have had some limited discretion to set the precise terms of an offered permanent modification, it was certainly required to offer *some* sort of good-faith permanent modification to [West] consistent with HAMP guidelines. It has offered none." (*Wigod*, *supra*, 673 F.3d at p. 565.)

In addition, Chase Bank stated in its April 5, 2010 letter that, upon timely request from West, it would provide her with the input values used to calculate her NPV and, if within 30 days of receiving that information, West provided Chase Bank with evidence that any of the input values were inaccurate, and those inaccuracies were material, Chase Bank would conduct a new NPV evaluation. As a matter of contract law, the import of this letter is twofold. First, under Chase Bank's interpretation of the Trial Plan Agreement, the April 5, 2010 letter constituted a modification of that agreement. A modification of a contract is a change in the obligations of a party by a subsequent mutual agreement of the parties. (1 Witkin, Summary of Cal. Law (10th ed. 2005) Contracts, § 964, p. 1055.) A contract in writing may be modified by a contract in writing. (Civ. Code, § 1698, subd. (a).) Though not signed by anyone at Chase Bank, the April 5, 2010 letter bears the Chase Bank letterhead, which suffices as a signature. (Rest.2d Contracts, § 134.)

Second, to the extent the Trial Plan Agreement is ambiguous, the April 5, 2010 letter is relevant under the practical construction doctrine in determining Chase Bank's intent. "'[W]hen a contract is ambiguous, a construction given to it by the acts and conduct of the parties with knowledge of its terms, before any controversy has arisen as to its meaning, is entitled to great weight, and will, when reasonable, be adopted and enforced by the court. [Citation.] The reason underlying the rule is that it is the duty of the court to give effect to the intention of the parties where it is not wholly at variance with the correct legal interpretation of the terms of the contract, and a practical construction placed by the parties upon the instrument is the best evidence of their intention.'" (*Employers Reinsurance Co. v. Superior Court* (2008) 161 Cal.App.4th 906, 921.) The April 5, 2010 letter, which was drafted before a controversy arose over the Trial Plan Agreement, shows that Chase Bank intended, at the very least, to give West the option and ability—before any foreclosure sale—to challenge the decision to deny her a permanent loan modification.

Thus, as alleged in the third amended complaint, the Trial Plan Agreement required Chase Bank to offer West a permanent loan modification because she had complied with the terms of that agreement. In addition, West alleged she was entitled to challenge Chase Bank's decision to deny her a permanent loan modification by providing information to support a different NPV calculation. She is correct. The third amended complaint alleged Chase Bank breached the Trial Plan Agreement in these two ways, and therefore stated a cause of action for breach of written contract.

III.

Conversion and Slander of Title Causes of Action

The third cause of action of the third amended complaint was for conversion, and the sixth cause of action was for slander of title. In her opening brief, West does not offer any argument or authority in support of those causes of action, a point stressed by Chase Bank in the respondent's brief. In the reply brief, West argues

the third amended complaint stated causes of action for conversion and slander of title. We deem the arguments made for the first time in the reply brief to be waived. (*Chicago Title Ins. Co. v. AMZ Ins. Services, Inc.* (2010) 188 Cal.App.4th 401, 427-428; *Employers Mutual Casualty Co. v. Philadelphia Indemnity Ins. Co.* (2008) 169 Cal.App.4th 340, 349-350; *Cold Creek Compost, Inc. v. State Farm Fire & Casualty Co.* (2007) 156 Cal.App.4th 1469, 1486 ["Arguments cannot properly be raised for the first time in an appellant's reply brief, and accordingly we deem them waived in this instance"].)

IV.

Set Aside or Vacate Void Trustee Sale Cause of Action

In the fourth cause of action, West alleged Chase Bank failed to comply with statutory foreclosure procedures and, on that basis, she sought to set aside or vacate the trustee's sale as wrongful.[5] We conclude the fourth cause of action did not state a claim.

"After a nonjudicial foreclosure sale has been completed, the traditional method by which the sale is challenged is a suit in equity to set aside the trustee's sale. [Citation.] Generally, a challenge to the validity of a trustee's sale is an attempt to have the sale set aside and to have the title restored." (*Lona v. Citibank, N.A.* (2011) 202 Cal.App.4th 89, 103.) The elements of a cause of action to set aside a foreclosure sale are (1) the trustee or mortgagee caused an illegal, fraudulent, or willfully oppressive sale of real property pursuant to a power of sale in a mortgage or deed of trust; (2) the party attacking the sale suffered prejudice or harm; and (3) the trustor or mortgagor tenders the amount of the secured indebtedness or was excused from tendering. (*Id.* at p. 104.)

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[5] Chase Bank argues West waived her challenge to the dismissal of the fourth cause of action by not addressing it in her opening brief. That is not correct. West addressed the fourth cause of action at pages 31-40 of her opening brief and argued she "adequately alleged a claim for wrongful foreclosure."

The first element may be satisfied by allegations that (1) the trustee or beneficiary failed to comply with the statutory procedural requirements for the notice or conduct of the sale; (2) the trustee did not have the power to foreclose; (3) the trustor was not in default, no breach had occurred, or the lender waived the breach; or (4) the deed of trust was void. (*Lona v. Citibank, N.A.*, *supra*, 202 Cal.App.4th at pp. 104-105.)

In the fourth cause of action, West alleged the trustee's sale was void under either of two theories: (1) QLSC, which issued the notice of default and notice of trustee's sale, and conducted the nonjudicial foreclosure sale, did not have authority to act as trustee under the deed of trust or (2) "[d]efendants failed to give plaintiff[] notice of the foreclosure sale and the actual foreclosure date" (underscoring omitted).[6] In her opening brief, West asserts several other procedural irregularities not alleged in the third amended complaint. She argues Chase Bank failed to comply with Civil Code section 2923.5 by recording the notice of default before the mandatory 30-day wait period, the notice of default does not state the correct amount due under the note and deed of trust, and Chase Bank failed to mail her a copy of the recorded notice of default in the manner required by Civil Code section 2924b, subdivision (c)(1).

We consider only those theories presented in the third amended complaint in determining whether the trial court erred by sustaining without leave to amend Chase Bank's demurrer to the fourth cause of action. West had several opportunities to amend her complaint in the trial court and on appeal has not asked for leave to amend.

The first theory asserted in the third amended complaint is incorrect based on documents which may be judicially noticed. In support of its demurrer to the third amended complaint, Chase Bank requested the trial court take judicial notice of several

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[6] West also alleged she was entitled to an injunction to stay the trustee's sale due to Chase Bank's violations of Civil Code section 2923.5. The trustee's sale had been conducted when the third amended complaint was filed. West's claim for injunctive relief therefore was moot from the outset.

documents and instruments, including (1) the notice of default and election to sell, recorded on March 18, 2009, and (2) the substitution of trustee, recorded on April 30, 2009. If a substitution of trustee is effected after recordation of a notice of default but before recordation of the notice of sale, the beneficiary or its agent must cause a copy of the substitution to be mailed to all persons to whom a notice of default is required to be mailed under Civil Code section 2924b. (Civ. Code, § 2934a, subd. (c).) "Once recorded, the substitution shall constitute conclusive evidence of the authority of the substituted trustee or his or her agents to act pursuant to this section." (*Id.*, § 2934a, subd. (d).) Here, the substitution of trustee was recorded and therefore constitutes conclusive evidence that QLSC had authority to conduct the trustee's sale.

West also contends the notice of default was void because it was signed by QLSC and recorded before it became trustee. A notice of default may be filed for record by the beneficiary, trustee, or their authorized agents. (Civ. Code, § 2924, subd. (a)(1).) The notice of default in this case was signed and filed for record by QLSC "as agent for beneficiary" (capitalization omitted).

The second theory alleged in the third amended complaint was "[d]efendants failed to give plaintiff[] notice of the foreclosure sale and the actual foreclosure date" (underscoring omitted). No details supporting this theory were alleged in the body of the third amended complaint. Attached to that complaint as exhibit 2 is a notice of trustee's sale, recorded on June 24, 2009, stating the sale would be conducted on July 13, 2009 at 12:00 p.m. The trustee's deed upon sale, attached as exhibit 3 to the third amended complaint, recites that the sale was conducted on May 26, 2010. A reasonable implication is that West is alleging Chase Bank failed to comply with the notice requirements of Civil Code section 2924g, subdivision (d) for postponing a trustee's sale.[7]

[7] Civil Code section 2924g, subdivision (d) reads, in relevant part: "The notice of each postponement and the reason therefor shall be given by public declaration by the trustee

An allegation of tender of the indebtedness is necessary when the person seeking to set aside the foreclosure sale asserts the sale is voidable due to irregularities in the sale notice or procedure. (*Lona v. Citibank, N.A.*, *supra*, 202 Cal.App.4th at p. 112; *Abdallah v. United Savings Bank* (1996) 43 Cal.App.4th 1101, 1109.) "'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].'" (*Lona v. Citibank, N.A.*, *supra*, at p. 112.)

West did not allege she tendered or could tender the full amount of the indebtedness. She argues instead an allegation of tender was not required: "While a tender may be required when a plaintiff alleges a procedural irregularity, West alleges the theory that the process, sale and trustee[']s deed upon sale w[ere] void for failure to comply with California statutory law [citation]. Under these facts, an offer, or tender to pay the debt, is <u>not required</u>, (where it would be inequitable), such as where plaintiffs <u>have a legal right to avoid the sale</u> [citation]."

The third amended complaint alleged only procedural irregularities in the sale notice and procedure. The trustee's deed upon sale recites that the trustee complied with the deed of trust and all applicable statutory requirements of the State of California. No inconsistent recitals appear on the face of the trustee's deed. Thus, any notice defects are deemed voidable, not void. (*Dimock v. Emerald Properties* (2000) 81 Cal.App.4th 868, 877.) West therefore was required to allege tender of the indebtedness to seek to set aside the trustee's sale. The trial court did not err by sustaining without leave to amend the demurrer to the fourth cause of action.

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at the time and place last appointed for sale. A public declaration of postponement shall also set forth the new date, time, and place of sale and the place of sale shall be the same place as originally fixed by the trustee for the sale. No other notice of postponement need be given."

V.

Quiet Title Cause of Action

In the 10th cause of action, West sought to quiet title against Chase Bank, Washington Mutual, and QLSC on the ground Chase Bank failed to comply strictly with the statutory nonjudicial foreclosure procedures. Chase Bank argues the quiet title cause of action is defective for several reasons, among which is that Chase Bank no longer holds title to the property. This argument has merit.

An element of a cause of action for quiet title is "[t]he adverse claims to the title of the plaintiff against which a determination is sought." (Code Civ. Proc., § 761.020, subd. (c).) West did not satisfy this element because none of the defendants to the third amended complaint has adverse claims to title. In support of the demurrer to the third amended complaint, Chase Bank requested the trial court take judicial notice of the recorded trustee's deed upon sale issued to Green Island Holdings, LP, as grantee. A court may take judicial notice of a recorded deed. (*Ragland v. U.S. Bank National Assn.* (2012) 209 Cal.App.4th 182, 194.) The trustee's deed upon sale includes a recitation that "[t]he grantee herein WASN'T the foreclosing beneficiary." (Original capitalization.)

Thus, based on the third amended complaint and the documents judicially noticed, none of the defendants named in the third amended complaint had adverse claims to title. West did not name Green Island Holdings, LP, or any subsequent purchasers as a defendant in the third amended complaint. Accordingly, the trial court did not err by sustaining without leave to amend the demurrer to West's quiet title cause of action. Nothing we say precludes West from seeking leave to amend to allege quiet title based on other facts or theories.

VI.

Promissory Estoppel Cause of Action

In the cause of action for promissory estoppel, West alleged Chase Bank made various promises to induce her to enter into the Trial Plan Agreement. Chase Bank

argues the promissory estoppel cause of action is defective because West failed to allege the promises with clarity and specificity and failed to allege detrimental reliance.

The elements of promissory estoppel are (1) a promise, (2) the promisor should reasonably expect the promise to induce action or forbearance on the part of the promisee or a third person, (3) the promise induces action or forbearance by the promisee or a third person (which we refer to as detrimental reliance), and (4) injustice can be avoided only by enforcement of the promise. (*Kajima/Ray Wilson v. Los Angeles County Metropolitan Transportation Authority* (2000) 23 Cal.4th 305, 310; see Rest.2d Contracts, § 90, subd. (1).)

"'[A] promise is an indispensable element of the doctrine of promissory estoppel. The cases are uniform in holding that this doctrine cannot be invoked and must be held inapplicable in the absence of a showing that a promise had been made upon which the complaining party relied to his prejudice . . . .' [Citation.] The promise must, in addition, be 'clear and unambiguous in its terms.' [Citation.]" (*Garcia v. World Savings, FSB* (2010) 183 Cal.App.4th 1031, 1044.) For a promise to be enforceable, it need only be "'definite enough that a court can determine the scope of the duty[,] and the limits of performance must be sufficiently defined to provide a rational basis for the assessment of damages.' [Citations.]" (*Bustamante v. Intuit, Inc.* (2006) 141 Cal.App.4th 199, 209.)

In the promissory estoppel cause of action, West alleged: "Defendant made clear, definite and certain promises to Plaintiff to induce her to enter into oral executed and written HAMP agreements, including promises not to sell during the HAMP reevaluation, that there was no foreclosure date pending, that it would send Plaintiff the NPV input data, that Plaintiff would have 60 days to obtain a reevaluation for a HAMP permanent modification, all of which were false causing Plaintiff to forbear from taking legal action against it, to relinquish mortgage payments (under false pretenses), and incur damages and personal injuries."

Read in isolation, this allegation did not clearly and specifically allege a promise made by Chase Bank. But we do not read passages from a complaint in isolation; in reviewing a ruling on a demurrer, we read the complaint "as a whole and its parts in their context." (*City of Dinuba v. County of Tulare*, *supra*, 41 Cal.4th at p. 865.) Read as a whole, the third amended complaint clearly and specifically alleged these promises meeting the requirements for promissory estoppel: (1) in the Trial Plan Agreement, Chase Bank promised West that it had offered her a trial loan modification under the HAMP guidelines and, during the trial modification period, Chase Bank would not pursue foreclosure; (2) the April 5, 2010 letter promised West that Chase Bank would reevaluate the denial of a permanent loan modification if she timely submitted evidence the NPV input values used by Chase Bank were inaccurate; (3) on May 24, 2010, a Chase Bank representative promised West she could resubmit her updated financial data for reevaluation for HAMP modification; and (4) on the same day, the Chase Bank representative promised West there was no foreclosure sale date or sale scheduled. The promises alleged are "'definite enough'" for us to determine "'the scope of the duty'" imposed by them. (*Bustamante v. Intuit, Inc.*, *supra*, 141 Cal.App.4th at p. 209.)

On the requirement of detrimental reliance, the promissory estoppel cause of action itself alleged: "Plaintiff relied upon such promises to her detriment. Plaintiff's reliance was justified and reasonable. Plaintiff has been injured by such reliance." Read in isolation, this allegation in insufficient. But the third amended complaint, read as a whole, may be reasonably interpreted to allege that West's reliance on Chase Bank's alleged misrepresentations caused West not to take legal action to stop the trustee's sale. In her opening brief, West also claims that, if she had known Chase Bank would not offer her a permanent loan modification, "she would have pursued other options, including possibly selling her home, retaining counsel earlier, and/or finding a co-signer to save her home."

In *Wigod*, the Seventh Circuit Court of Appeals held the plaintiff's cause of action for promissory estoppel alleged a "sufficiently clear promise" and detrimental reliance: "[The plaintiff] asserts that Wells Fargo made an unambiguous promise that if she made timely payments and accurate representations during the trial period, she would receive an offer for a permanent loan modification calculated using the required HAMP methodology." (*Wigod*, *supra*, 673 F.3d at p. 566.) The court concluded the plaintiff relied on that promise to her detriment by foregoing the opportunity to use other remedies to save her home and by devoting her resources to making the lower monthly payments under the TPP rather than attempting to sell her home or defaulting. (*Ibid.*) In *Turbeville v. JPMorgan Chase Bank*, *supra*, 2011 U.S.Dist. Lexis 42290 at pages *17-*18, the plaintiffs alleged that in reliance on the defendant bank's promise, they made the trial plan payments rather than pursue other opportunities to cure the default. The court concluded that allegation was sufficient for detrimental reliance. (*Id.* at p. *18.) West's third amended complaint adequately alleges promissory estoppel under these authorities.

VII.

Unfair Competition Cause of Action

In the fifth cause of action, West alleged violations of the California unfair competition law (UCL), Business and Professions Code section 17200 et seq. She alleged: "In furtherance of Defendants' common plan and scheme, as alleged, including but not limited to obtaining mortgage payment money by false pretenses, false representations regarding HAMP modification re-evaluation acts, deadlines and other promises, and concealing the true trustee . . . in its notices, s[ale] and trustee's deed upon sale, Defendants, and each of them, committed an unlawful, unfair, deceptive or fraudulent business practice."

The UCL permits civil recovery for "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising . . . ." (Bus. & Prof. Code, § 17200.) "'Because Business and Professions Code section 17200

is written in the disjunctive, it establishes three varieties of unfair competition—acts or practices which are unlawful, or unfair, or fraudulent. . . . '" (*Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.* (1999) 20 Cal.4th 163, 180.)

By defining "unfair competition" to include any unlawful act or practice, the UCL permits violations of other laws to be treated as independently actionable as unfair competition. (*Cel-Tech Communications, Inc. v. Los Angeles Cellular Telephone Co.*, *supra*, 20 Cal.4th at p. 180.) Several definitions of "unfair" under the UCL have been formulated. They are:

1. "An act or practice is unfair if the consumer injury is substantial, is not outweighed by any countervailing benefits to consumers or to competition, and is not an injury the consumers themselves could reasonably have avoided." (*Daugherty v. American Honda Motor Co., Inc.* (2006) 144 Cal.App.4th 824, 839.)

2. "'[A]n "unfair" business practice occurs when that practice "offends an established public policy or when the practice is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers." [Citation.]' [Citation.]" (*Smith v. State Farm Mutual Automobile Ins. Co.* (2001) 93 Cal.App.4th 700, 719.)

3. An unfair business practice means "'the public policy which is a predicate to the action must be "tethered" to specific constitutional, statutory or regulatory provisions.'" (*Scripps Clinic v. Superior Court* (2003) 108 Cal.App.4th 917, 940.)

A fraudulent practice under the UCL "require[s] only a showing that members of the public are likely to be deceived" and "can be shown even without allegations of actual deception, reasonable reliance and damage." (*Daugherty v. American Honda Motor Co., Inc.*, *supra*, 144 Cal.App.4th at p. 838.)

We conclude the third amended complaint stated a cause of action under the UCL based on unfair or fraudulent practices. Liberally construed, the third amended complaint alleged Chase Bank engaged in a practice of making TPP's that did not comply

with HAMP guidelines and the United States Department of the Treasury directives; made misrepresentations regarding a borrower's right and ability to challenge the bank's calculation of the NPV; made misrepresentations about pending foreclosure sales; and wrongfully had trustee's sales conducted when the borrower was in compliance with a TPP. Under such allegations, Chase Bank engaged in unfair business practices under any of the three definitions. Chase Bank concedes that West's cause of action under the UCL "depends on the viability of the underlying claims," and the claims for fraud, negligent misrepresentation, breach of written contract, and promissory estoppel are viable.

DISPOSITION

The judgment is affirmed as to the causes of action for conversion, to set aside or vacate void trustee sale, for slander of title, and to quiet title. In all other respects, the judgment is reversed and the matter remanded for further proceedings. West shall recover costs incurred on appeal.

FYBEL, J.

WE CONCUR:

O'LEARY, P. J.

MOORE, J.

Filed 5/14/13

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

THIRD APPELLATE DISTRICT

(Nevada)

GREGORY W. BOCK, as Trustee, etc., Plaintiff and Appellant, v. CALIFORNIA CAPITAL LOANS, INC. et al., Defendants and Respondents.	C069863 (Super. Ct. No. 76151)

APPEAL from a judgment of the Superior Court of Nevada County, Sean P. Dowling, Judge. Affirmed.

John J. Hartford; Wilson & Wilson and Donald A. Wilson for Plaintiff and Appellant.

Jay-Allen Eisen Law Corporation, Jay-Allen Eisen, Aaron S. McKinney; The Law Offices of Kirk S. Rimmer and Kirk S. Rimmer for Defendant and Respondent.

In California, a loan secured by a lien on real property is exempt from the constitutional prohibition on usury if the loan is made or arranged by a licensed real estate broker. (Cal. Const., art. XV, § 1; Civ. Code,[1] § 1916.1.) Section 1916.1 explains

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[1] All further section references are to the Civil Code unless otherwise noted.

that "a loan . . . is arranged by a person licensed as a real estate broker when the broker . . . acts for compensation or in expectation of compensation for soliciting, negotiating, or arranging the loan for another."

In this case, we conclude that even when the lender on such a loan is a corporation that is wholly owned by the arranging broker, the broker can still be found to have arranged the loan "for another" for purposes of section 1916.1. We also conclude that in such a situation, the broker may be found to have arranged the loan "in expectation of compensation" even if the only compensation the broker will receive is the profit his wholly owned corporation reaps from the interest on the loan. Based on these conclusions, we affirm the judgment here.

FACTUAL AND PROCEDURAL BACKGROUND

When plaintiff Gregory W. Bock, trustee of the Bock Family Trust, needed a loan, a third party put him in contact with defendant Leo Speckert, a licensed real estate broker and the sole shareholder of defendant California Capital Loans, Inc. (California Capital). Speckert told Bock what the terms of the loan would be and made out disclosure statements regarding the loan. California Capital loaned Bock $1.2 million secured by a deed of trust on certain real property the trust owned. Speckert did not take a commission on the transaction.

The promissory note for the loan provided for an interest rate of 15 percent, with monthly interest-only payments to commence in April 2009 and to continue until March 2012, when the entire loan principal was to be repaid. When Bock defaulted on the loan payments, California Capital foreclosed and purchased the trust's property at a trustee's sale under the deed of trust in April 2010. In May 2010, Bock filed suit against California Capital and Speckert, claiming (among other things) that the interest rate on the loan exceeded the maximum allowed by the California Constitution and therefore the trustee's sale was void. Ultimately, a brief court trial was held in August 2011 on Bock's claim of usury. The trial court found the note was exempt from the constitutional usury

prohibition under section 1916.1, which applies to “any loan . . . made or arranged by any person licensed as a real estate broker by the State of California, and secured, directly or collaterally, in whole or in part by liens on real property.” Accordingly, the trial court entered judgment in favor of defendants.[2] Following the denial of his motion for a new trial, Bock timely appealed.

DISCUSSION

On appeal, Bock contends section 1916.1 did not apply here because the loan was made by California Capital, not Speckert, and Speckert cannot be deemed to have arranged the loan within the meaning of the statute because: (1) he did not act in expectation of receiving a commission on the transaction; and (2) he did not arrange the loan “for another” because the lender was his wholly owned corporation. Finding no merit in these arguments, we affirm.

Section 1 of article XV of the California Constitution imposes certain limitations on the amount of interest that can be charged on a loan. That provision also contains an exemption for “any loans made or arranged by any person licensed as a real estate broker by the State of California and secured in whole or in part by liens on real property.” As relevant here, section 1916.1 implements that exemption by specifying that “a loan . . . is arranged by a person licensed as a real estate broker when the broker . . . acts for compensation or in expectation of compensation for soliciting, negotiating, or arranging the loan for another.”

Under the part of section 1916.1 at issue here, then, a licensed real estate broker can be deemed to have arranged a loan only if the broker “act[ed] for compensation or in

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2 Defendants have requested that we take judicial notice of the complaint and judgment in an unlawful detainer proceeding that California Capital commenced against Bock following the judgment in this case. As those documents are irrelevant to our resolution of this appeal, we deny that request.

expectation of compensation" and the broker "solicit[ed], negotiat[ed], or arrang[ed] the loan for another." (See *Green v. Future Two* (1986) 179 Cal.App.3d 738, 742–743 ["a loan is arranged by a person licensed as a real estate broker only if two things occur. One is that the broker acts for another or others, not for himself. The other is that he receives or expects to receive compensation"].)

I

Arranging A Loan "For Another"

Taking Bock's second argument first, the question is whether a real estate broker can be deemed to have arranged a loan "for another" when the lender is a corporation that is wholly owned by the broker. Like the trial court, we conclude the answer to that question is "yes."

First, Bock himself qualifies as "another" person separate and apart from Speckert for whom Speckert can be deemed to have arranged the loan. The evidence was that when Bock needed a loan, a third party put Bock in contact with Speckert, and Speckert told Bock what the terms of the loan would be and made out disclosure statements regarding the loan. As we explain, the statutory provisions governing those disclosure statements support the conclusion that Speckert arranged the loan for Bock within the meaning of section 1916.1.

"Business and Professions Code section 10240 requires a real estate broker to provide [a mortgage loan disclosure statement] to a borrower on a secured loan negotiated by the broker." (*Stoneridge Parkway Partners, LLC v. MW Housing Partners III* (2007) 153 Cal.App.4th 1373, 1377.) By its terms, Business and Professions Code section 10240 applies to "[e]very real estate broker. . . acting within the meaning of subdivision (d) of Section 10131." In turn, subdivision (d) of Business and Professions Code section 10131 provides that "[a] real estate broker within the meaning of this part is a person who, for a compensation or in expectation of a compensation, regardless of the form or time of payment" "[s]olicits borrowers or lenders for or negotiates loans or

collects payments or performs services for borrowers or lenders or note owners in connection with loans secured directly or collaterally by liens on real property or on a business opportunity." (See *Stickel v. Harris* (1987) 196 Cal.App.3d 575, 583 ["Given unmistakable parallels of language, it is both logical and appropriate for section 1916.1 to be construed in light of Business and Professions Code section 10131"].)

Business and Professions Code section 10131 makes clear that a real estate broker can perform services for both lenders *and borrowers* in connection with loans secured by liens on real property. Bock points to no authority suggesting that a broker can only be deemed to have performed such services for either the lender or the borrower and not for both sides in the transaction. Thus, on the facts here, even if Speckert can be deemed to have arranged the loan for his wholly owned corporation, California Capital, he can also be deemed to have arranged the loan for Bock, who certainly qualifies as "another."

Second, even if we were to look only at the relationship between Speckert and California Capital in addressing this issue, we would still conclude that Speckert arranged the loan "for another" within the meaning of section 1916.1. "It is fundamental that a corporation is a legal entity that is distinct from its shareholders." (*Grosset v. Wenaas* (2008) 42 Cal.4th 1100, 1108.) Thus, California Capital qualifies as "another" for purposes of the loan Speckert arranged, even though Speckert was the sole shareholder of the corporation.

Bock argues that under the case law, "a broker [can] 'arrange' a loan for a business he [i]s a part of only if there [is] some other person who also benefit[s] from the transaction." In Bock's view, because only Speckert -- as the sole shareholder of California Capital -- would have benefited from the loan his corporation made, Speckert cannot be deemed to have arranged the loan "for another."

The case law does not support Bock's argument. In *Stoneridge*, this court concluded that "an officer and employee of the managing company of a limited liability company, which was the manager of another limited liability company, which was the

general partner of the lender" "negotiated and arranged the . . . loan as a third party intermediary, or as the statute reads, 'for another' " because he "was not negotiating solely on his own behalf." (*Stoneridge Parkway Partners, LLC v. MW Housing Partners III*, *supra*, 153 Cal.App.4th at pp. 1379, 1381.) The same is true here. Even if Speckert was, indirectly, the only individual who would benefit from the loan because he was the sole shareholder of the lending corporation, he still was -- like the individual in *Stoneridge* -- "not negotiating solely on his own behalf" because he and his corporation are *distinct legal entities*, and therefore he was necessarily acting "for another" in negotiating the loan for his corporation.[3]

None of the four other cases Bock cites -- all of which this court discussed in *Stoneridge* -- is any more helpful to him. As this court explained in *Stoneridge*, the court in *Winnett v. Roberts* (1986) 179 Cal.App.3d 909 "determined a loan was not exempt from the usury prohibition where the only broker involved in the transaction was the borrower." (*Stoneridge Parkway Partners, LLC v. MW Housing Partners III*, *supra*, 153 Cal.App.4th at p. 1380.) Obviously, that holding has no application here because Speckert was neither the borrower nor the lender in the transaction at issue. As we have noted, Speckert and California Capital are legally distinct from each other and therefore Speckert cannot be treated as the lender simply because he was the sole shareholder in the corporation that loaned the money to Bock.

As for *Green v. Future Two*, *supra*, 179 Cal.App.3d at page 738, which "concerned a loan made to a partnership, the general partner of which was a licensed

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[3] We note that Bock made no attempt here to use the alter ego doctrine to pierce the corporate veil and thereby establish that for purposes of this transaction Speckert and California Capital should be treated as one and the same. (See *Mesler v. Bragg Management Co.* (1985) 39 Cal.3d 290, 300 [describing circumstances in which the courts "will disregard the corporate entity and will hold the individual shareholders liable for the actions of the corporation"].)

broker," the *Stoneridge* court concluded that on this particular point *Green* was "not persuasive authority" because "[t]he *Green* court reached its conclusion ipse dixit, without analyzing the broker's efforts on behalf of the partnership." (*Stoneridge Parkway Partners, LLC v. MW Housing Partners III*, *supra*, 153 Cal.App.4th at p. 1380.) Thus, we find no guidance in *Green*.

In *Stickel v. Harris*, *supra*, 196 Cal.App.3d at page 575, "the First Appellate District determined the exemption for loans negotiated by licensed real estate brokers applied to a loan made to a partnership and a joint venture even though a licensed broker who solicited and negotiated the loan was one of the partners" because "[t]he broker 'was not acting exclusively as a borrower; he was simultaneously acting as an agent soliciting the loan on behalf of others, conduct for which a license was required . . . .' " (*Stoneridge Parkway Partners, LLC v. MW Housing Partners III*, *supra*, 153 Cal.App.4th at p. 1381, quoting *Stickel*, at p. 587.) Here, because Speckert and California Capital are distinct legal entities, Speckert was not acting as the lender in the transaction at all; he was, at best, acting as an agent *for* his corporation and thus was acting "for another."

Finally, in *Park Terrace Limited v. Teasdale* (2002) 100 Cal.App.4th 802, "the Fourth Appellate District determined a licensed broker who was a general partner in five limited partnerships arranged loans to the partnerships, and thus the loans were exempt from the usury limitation" because the broker " 'negotiated the loans for each partnership's benefit, not merely for his own.' " (*Stoneridge Parkway Partners, LLC v. MW Housing Partners III*, *supra*, 153 Cal.App.4th at p. 1381, quoting *Park Terrace*, at p. 807.) A similar conclusion applies here: Speckert negotiated the loan for the benefit of his corporation -- a separate legal entity -- not merely for his own benefit.

Based on the foregoing analysis, we reject Bock's argument that Speckert could not be deemed to have acted "for another" in arranging the loan from California Capital to Bock.

II

Arranging A Loan "In Expectation Of Compensation"

Bock's other argument on appeal is that Speckert cannot be deemed to have arranged the loan within the meaning of section 1916.1 because he did not act in expectation of receiving a commission on the transaction. We find no merit is this argument either.

As we have noted, under the part of section 1916.1 at issue here a broker must have "act[ed] for compensation or in expectation of compensation" for the exception from the constitutional usury provision to apply. According to Bock, the interest that the lender, California Capital, was to have earned on the loan but cannot be considered compensation to Bock for purposes of the section 1916.1, even though Bock was the sole shareholder of the corporation, and since Speckert did not take a commission on the transaction, Speckert did not act for compensation or in expectation of compensation in arranging the loan.

Bock's argument is inconsistent with decisional law under the statute that we find persuasive. In *Stickel*, the licensed real estate broker whose actions were at issue (Butticci) was a member of a joint venture and of a partnership that were the borrowers on the loans in question. (*Stickel v. Harris, supra*, 196 Cal.App.3d at pp. 579-580.) There, the appellate court noted that "[p]recisely what constitutes 'compensation' for purposes of section 1916.1 is a question of first impression." (*Stickel*, at p. 584.) The court then continued as follows: "Within the context of other statutes, compensation is a concept which has received an extremely broad definition sufficient to encompass the receipt of just about any form of monetary or tangible benefit that is not self-bestowed. [Citations.] '[T]he nature of compensation . . . is as variable as the particular facts involved.' [Citation.] The term 'interest' has been treated with a similar expansiveness. [Citations.]

"Whether a payment, advantage, benefit, or other form of consideration amounts to compensation has traditionally been regarded as an issue to be decided by the trier of fact. [Citations.] In usury cases the trier of fact is vested with the power to resolve many issues attending and including the ultimate question of whether a particular transaction is usurious. [Citations.] By parity of reasoning, it follows that the issue of whether Butticci 'arranged' a nonusurious loan within the meaning of section 1916.1 was likewise committed to the trier of fact unless, as a matter of law, a given transaction failed to meet the two-prong test cited previously. The only task confronting us is to decide if the trial court's determination that the loan was exempt can claim the support of substantial evidence considered by the trial court in its capacity as the trier of fact. [Citations.]

"[I]t is undisputed that [Butticci] was not soliciting the loan for himself, but as the intermediary for the partnership and the joint venture. Butticci did not forfeit this status solely because he became a member of these entities. Butticci testified that he expected to be compensated when the profits generated by sale of the condominiums were paid to the partners at the conclusion of the project. By obtaining the financial wherewithal which would enable the partnership and the joint venture to operate, he was providing a vital service from which all involved would benefit. Those benefits would accrue to all of the partners and joint venturers, who would each obtain a pro rata share of the ultimate profits. The fact that Butticci's reward would be deferred until a later time is of no moment. Anticipated profits qualify as compensation. [Citations.] Accordingly, substantial evidence supports the trial court's finding that Butticci solicited the loan with an expectation of compensation. This finding in turn supports the court's determination that the loan was exempted by section 1916.1 from the interest limitations of the usury law." (*Stickel v. Harris, supra*, 196 Cal.App.3d at pp. 584-585; see also *Park Terrace Limited v. Teasdale*, *supra*, 100 Cal.App.4th at pp. 806-808 [following *Stickel* on this point].)

Applying the reasoning of *Stickel* here, there was substantial evidence on which the trial court could have found that Speckert "act[ed] . . . in expectation of compensation" in arranging the loan from California Capital to Bock because, as the sole shareholder of California Capital, Speckert could have expected to reap the benefits of the interest his corporation was supposed to earn on the loan: 15 percent per year for three years on a loan principal of $1.2 million -- i.e., $540,000. There is no logical reason to require Speckert to have earned, or expected to earn, compensation solely in the form of a commission from his corporation for section 1916.1 to apply here. Whether he took his compensation for the deal by drawing a dividend from the corporation or by receiving a commission from the corporation makes no difference under *Stickel*. The profit his corporation expected to reap from the interest payments on the loan was sufficient to satisfy the "compensation" requirement of the statute just as the profits Butticci's joint venture and partnership expected to reap from the sale of the condominiums they were going to build on the property they purchased with the loan proceeds was sufficient to satisfy that requirement in *Stickel*.

This conclusion is bolstered by the provision in subdivision (d) of Business and Professions Code section 10131, discussed above, that refers to a broker acting "for a compensation or in expectation of a compensation, *regardless of the form or time of payment*." (Italics added.) We have noted already that "it is both logical and appropriate for section 1916.1 to be construed in light of Business and Professions Code section 10131." (*Stickel v. Harris*, *supra*, 196 Cal.App.3d at p. 583.) The italicized language of Business and Professions Code section 10131, subdivision (d) emphasizes that we are not to draw fine distinctions between various forms of compensation -- i.e., a commission versus a corporate dividend -- in determining whether a licensed real estate broker has acted in his or her licensed capacity. Accordingly, under the reasoning of *Stickel*, there was substantial evidence to support the trial court's implied finding here that Speckert

acted in expectation of compensation in brokering the loan from California Capital to Bock.

Ignoring *Stickel* on this point, Bock relies on two cases to support his contention that the expectation that California Capital would earn interest on the loan did not satisfy the "compensation" requirement of section 1916.1. He first cites *In re Lara* (9th Cir. 1984) 731 F.2d 1455. In *Lara*, a licensed real estate broker (Zager) and his friend (Pion) loaned money to the Laras secured by a deed of trust on their home. (*Id.* at pp. 1457-1458.) The Ninth Circuit concluded that "the portion of the loan funded by Zager [wa]s exempt [from the constitutional usury prohibition under section 1916.1] because it was 'made' by a licensed real estate broker." (*Lara*, at p. 1462.) As for the portion of the loan funded by Pion, the question for the court was whether that portion of the loan was "arranged" by a licensed real estate broker. (*Ibid.*) The court concluded that it was not "[b]ecause Zager did not receive a commission for soliciting Pion's participation in the loan." (*Id.* at p. 1463.) "Zager and Pion argue[d] that [the court] define[d] the term 'compensation' too narrowly. Zager claim[ed] that he was 'compensated' for soliciting a lender inasmuch as he would not have undertaken the loan, and would have received no interest from the Laras, absent Pion's participation." (*Ibid.*) The Ninth Circuit disagreed, concluding as follows: "The fact that Zager would profit if Pion agreed to undertake the loan . . . does not imply that Zager was acting for compensation. Under California law, a broker is not acting in his licensed capacity unless he receives compensation for acting on behalf of someone else. [Citation.] A broker who realizes a profit from participating in a real estate transaction on his own behalf does not act for 'compensation.' [Citations.] It follows that Zager did not receive compensation for bringing Pion into the transaction, and we hold, therefore, that Pion's portion of the loan was not 'arranged' by a licensed real estate broker." (*Ibid.*)

We do not find *Lara* persuasive on this point for two reasons. First, it was noted in *In re Hein* (Bankr. S.D.Cal. 1986) 60 B.R. 769, 775 that "Business and Professions

Code [section] 10131 was amended in 1984, after *In re Lara*, to add the emphasized portion of the introductory paragraph, as follows: [¶] " 'A real estate broker within the meaning of this part is a person who, for a compensation or in the expectation of a compensation, *regardless of a form or time of payment*, does or negotiates to do one or more of the following acts or acts for another or others . . . .' " Thus, in reaching its conclusion, the *Lara* court did not have the benefit of the statutory language that we have found persuasive here (see above).

Second, *Lara* is distinguishable on its facts, inasmuch as the Ninth Circuit treated the part of the loan Zager made on his own behalf separately from the part of the loan Pion made. The Ninth Circuit essentially concluded that the interest Zager expected to receive on the part of the loan he made could not be considered, at the same time, to be compensation that he expected to receive for "arranging" the part of the loan Pion made. No such issue arises here. Here, there was only one loan -- made by California Capital to Bock -- and the only compensation Speckert expected to receive for brokering that single loan was the profit he would reap from the interest his corporation earned on the loan. As we have explained, that profit gave the trial court a substantial evidentiary basis for finding that Speckert acted with the expectation of compensation in arranging the loan.

The second case on which Bock relies is *Creative Ventures, LLC v. Jim Ward & Associates* (2011) 195 Cal.App.4th 1430, which he contends "is squarely on fours with the present case." As the court explained in that case, "[p]laintiffs Creative Ventures, LLC (Creative), and Arden 2002, LLC (Arden), borrowed nearly $3 million from defendant Jim Ward & Associates (JWA), a California Corporation, to finance two real property development projects. The loans were evidenced by four promissory notes

secured by deeds of trust on the real property. Each of the notes called for interest payments in excess of the maximum permitted by the California Constitution. (Cal. Const., art. XV, § 1.) The interest charges would have been lawful if the loans had been 'made or arranged' by a licensed real estate broker (Civ. Code, § 1916.1), as JWA held itself out to be. As it happened, JWA was not so licensed." (*Creative Ventures*, at p. 1435.) The trial court found JWA liable for usury, and the appellate court found the evidence sufficient to support that ruling. (*Id.* at pp. 1435-1436.)

On appeal, JWA argued the loans were "exempt from the usury law because, as a corporation, it could only act through its directors, officers, or other agents and the loans were actually arranged by [Jim] Ward, who was licensed." (*Creative Ventures, LLC v. Jim Ward & Associates*, *supra*, 195 Cal.App.4th 1442-1443.) The appellate court explained that "although the parties argue over the evidence of Ward's role in the negotiations, the arguments miss the point. The question is not what Ward did but whether he was acting on behalf of the corporation or in his individual interest when he did it. As to that factual question, the trial court implicitly found that, to the extent Ward was involved, he was acting on behalf of JWA. There is ample evidence to support the finding." (*Id.* at p. 1443.) In particular, the court noted that (1) "the promissory notes . . . specifie[d] that the loans were being arranged by a licensed broker and identifie[d] the broker as JWA"; (2) the managing member of the borrowers (Schink) "thought JWA was the broker arranging the loans because that is what Lee [the attorney who helped Ward form JWA] told him and that is what he read in the loan documents"; (3) "[t]hat Lee and Ward believed the transaction was conducted on behalf of the corporation is evidenced by their mutual belief that the corporation was licensed; licensing the corporation was a concern only if the loans were to be arranged on behalf of the corporation"; (4) "Lee's

understanding that the individuals were acting on behalf of the corporation is further evidenced by his describing lending practices not in terms of what Ward did, but in terms of what the company did." (*Id.* at pp. 1436, 1443-1444.) The appellate court concluded that "[t]his is substantial evidence to support the trial court's conclusion that the parties' true intent was that JWA arranged the loans; Ward, Lee, and Locker acted on behalf of JWA. Since JWA was not licensed, the loans are not exempt from the usury laws. The trial court did not err in declaring the interest terms null and void and finding JWA liable for usury." (*Id.* at p. 1444.)

The reason *Creative Ventures* is of no assistance to Bock here is that in this case the trial court impliedly found that Speckert arranged the loan at issue by acting in his individual capacity as a licensed real estate broker, and the question on appeal is simply whether there was substantial evidence to support *that* finding. We have concluded already that there was. The fact that different evidence in *Creative Ventures* -- namely, the evidence that the licensed individual was acting on behalf of the corporation rather than in his individual capacity -- led to the appellate court affirming a different trial court finding in that case, namely, that the loan was arranged by the unlicensed corporation rather than the licensed individual -- simply has no logical bearing on the outcome of Bock's appeal here.

For the foregoing reasons, substantial evidence supports the trial court's finding that section 1916.1 applied here, and there was no trial court error on this point. [4]

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[4] Because we uphold the judgment on this basis, we do not address defendant's alternate argument that the appeal is barred by res judicata.

DISPOSITION

The judgment is affirmed. Defendants shall recover their costs on appeal. (Cal. Rules of Court, rule 8.278(a)(1).)

ROBIE, Acting P. J.

We concur:

MURRAY, J.

DUARTE, J.

Filed 3/18/13

CERTIFIED FOR PARTIAL PUBLICATION*

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

MICHAEL D. SCOTT, **Plaintiff and Appellant,** **v.** **JPMORGAN CHASE BANK, N.A., et al.,** **Defendants and Respondents.**	**A132741** **(Solano County Super. Ct. No. FCS033424)**

Michael D. Scott (Scott) appeals from an order sustaining a demurrer to his second amended complaint without leave to amend. He contends he alleged facts sufficient to state a cause of action against respondent JPMorgan Chase Bank, N.A. (JPMorgan), primarily because JPMorgan allegedly did not have standing to foreclose on his property. He further alleges that the trial court erred in taking judicial notice of facts in a contract between JPMorgan and the federal government, by which JPMorgan claims to have obtained a beneficial interest under the deed of trust on Scott's property without assuming related liabilities.

Because a direct appeal cannot be taken from an order sustaining a demurrer, we exercise our discretion to review the trial court's decision as an appealable final judgment of dismissal. In the published portion of our opinion, we conclude that the trial court properly took judicial notice of the fact and legal effect of the government's contract with JPMorgan, since Scott made no showing in the trial court that the contract was not authentic or otherwise argued it was reasonably subject to dispute. We also conclude

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* Pursuant to California Rules of Court, rules 8.1105(b) and 8.1110, this opinion is certified for publication with the exception of parts II.C. and II.D.

that, based on the allegations of the second amended complaint, and in light of the facts the court judicially noticed, the court did not err in sustaining the demurrer. In the unpublished portion of our opinion, we conclude that the court did not err in denying further leave to amend. The judgment will be affirmed.

I. FACTS AND PROCEDURAL HISTORY

Scott received title to certain real property in February 2005. The following August, he obtained from First Magnus Financial Corporation (Magnus) a $975,000 construction loan, secured by a deed of trust on the property. In November 2007, Magnus assigned its interest under the deed of trust to Washington Mutual Bank (WaMu).

A. *JPMorgan Becomes Beneficiary Under the Deed of Trust and Forecloses*

According to documents judicially noticed by the trial court, the federal government's Office of Thrift Supervision (OTS) issued an order on September 25, 2008, appointing the Federal Deposit Insurance Corporation (FDIC) as the receiver of WaMu. As set forth in a Purchase and Assumption Agreement between the FDIC and respondent JPMorgan dated as of September 25, 2008 (P&A Agreement), the FDIC then sold to JPMorgan "all of the assets" of WaMu (with specified exceptions), but not WaMu's liabilities for claims by borrowers.

Scott defaulted on his loan, and in January 2009 the California Reconveyance Company (CRC), as trustee under the deed of trust, caused the recording of a Notice of Default and Election to Sell the property. At the time, Scott purportedly owed $1,046,708.52 under the corresponding note. In April 2009, CRC caused a notice of trustee's sale to be recorded, providing notification that the property would be sold in May 2009.

B. *Scott's Complaint and First Amended Complaint*

In April 2009, Scott filed a complaint in this case against JPMorgan (and perhaps others), but the complaint is not in the appellate record. A first amended complaint, filed in June 2009, asserted numerous causes of action against JP Morgan, WaMu, Magnus,

and Cobs Homes, essentially seeking relief on the ground that Scott had been fraudulently induced to enter into a subprime loan with Magnus.

JPMorgan filed a motion for judgment on the pleadings, arguing that, under the P&A Agreement, it did not assume any of WaMu's liabilities related to Scott's loan, JPMorgan complied with applicable provisions of the Civil Code, and Scott did not tender the amount owed under the note and deed of trust.

In support of its motion, JPMorgan sought judicial notice of: (1) a copy of the grant deed by which Scott obtained title to the property; (2) a copy of the deed of trust on the property, recorded August 18, 2005, identifying Magnus as the beneficiary; (3) a copy of the assignment of the deed of trust from Magnus to WaMu, recorded on November 5, 2007; (4) the OTS order appointing the FDIC as receiver of WaMu; (5) a copy of the P&A Agreement (attaching excerpts from the agreement and asserting the availability of its entirety at the FDIC Web site); (6) the notice of default and election to sell, recorded on or about January 14, 2009; and (7) the notice of trustee's sale, recorded on or about April 20, 2009. Judicial notice was sought under Evidence Code sections 451, subdivision (f), and 452, subdivisions (d), (g), and (h).

Of particular relevance to this appeal are the provisions of the P&A Agreement regarding the sale of WaMu's assets to JPMorgan. Section 3.1 of the P&A Agreement provided that the Assuming Bank (JPMorgan) purchased from the Receiver (FDIC) "all right, title, and interest of the Receiver in and to *all of the assets* (real, personal, and mixed, wherever located and however acquired) . . . of the Failed Bank [WaMu] whether or not reflected on the books of the Failed Bank as of Bank Closing [September 25, 2008]." (Italics added.) Although Section 3.5 of the P&A Agreement provided that JPMorgan did "not purchase, acquire or assume, or (except as otherwise expressly provided in this Agreement) obtain an option to purchase, acquire or assume under this Agreement the assets or Assets listed on the attached Schedule 3.5," Schedule 3.5 sets forth assets not relevant here.

As to WaMu's liabilities, Section 2.5 of the P&A Agreement provided that JPMorgan did not assume liability for borrower claims related to loans, or commitments

to lend, made by WaMu, held by WaMu, or purchased by WaMu. Specifically, Section 2.5 reads: "**Borrowers' Claims.** Notwithstanding anything to the contrary in this Agreement, any liability associated with borrower claims for payment of or liability to any borrower for monetary relief, or that provide for any other form of relief to any borrower, whether or not such liability is reduced to judgment, liquidated or unliquidated, fixed or contingent, matured or unmatured, disputed or undisputed, legal or equitable, judicial or extra-judicial, secured or unsecured, whether asserted affirmatively or defensively, related in any way to any loan or commitment to lend made by the Failed Bank [WaMu] prior to failure [September 25, 2008], or to any loan made by a third party in connection with a loan which is or was held by the Failed Bank, or otherwise arising in connection with Failed Bank's lending or loan purchase activities are specifically not assumed by the Assuming Bank [JPMorgan]."

Scott filed an opposition to JPMorgan's motion and boilerplate objections to its request for judicial notice, asserting generally that the documents did not fall within the cited Evidence Code provisions. He did not dispute that the P&A Agreement attached to the judicial notice request and published on the FDIC's Web site was authentic, accurate, and complete.

In November 2010, the trial court granted JPMorgan's motion for judgment on the pleadings, with leave to amend.

C. *Scott's Second Amended Complaint*

Later in November 2010, Scott filed his second amended complaint against JPMorgan and the other defendants sued in the first amended complaint. He asserted essentially the same causes of action, but added some allegations as to JPMorgan, contending: the assignment of the deed of trust from Magnus to WaMu was invalid because the notary had no record of notarizing it; JPMorgan did not complete the transfer of the "[WaMu] assets from the FDIC to [JPMorgan]," so JPMorgan had no interest in the property; and yet JPMorgan employees spoke with Scott before and after JPMorgan "acquired the certain assets and liabilities of [WaMu] from the FDIC."

1. *Scott's Causes of Action*

The vast majority of Scott's purported causes of action are expressly based on fraud and other wrongdoing allegedly perpetrated to induce Scott to enter into the loan in August 2005, before JPMorgan obtained an interest in the property. By cause of action, Scott alleges: (1) violation of Business and Professions Code section 17200, based on defendants' untrue or misleading statements (regarding the terms and payment obligations, prepayment penalty, home value and ability to refinance, and nonreceipt of kickbacks and the like) and their failure to consider Scott's ability to pay; (2) violation of Financial Code section 4973 ("predatory lending") by acts perpetrated by Magnus, including approving construction loans to uninformed buyers, encouraging the use of false documentation to qualify unqualified borrowers for a loan, and making false statements; (3) fraud, based on statements made to Scott "in the origination of the [loan]" regarding the loan terms and value of his property; (4) breach of the implied covenant of good faith and fair dealing in the negotiation of the loan; (5) conversion, by inducing Scott to agree to the loan and inflating the value of his property to justify a larger mortgage and compel unjust monthly payments; (6) quiet title, seeking invalidation of the deed of trust due to fraud and undue influence employed to get Scott to take out the loan; (7) fraud in the inducement, based on promises made to induce Scott to agree to the loan; (8) unfair business practices, based on "fraudulent acts, business model or change of underwriting standards"; (9) breach of mortgage brokers' fiduciary duties in connection with Scott's entry into the loan; (12) "civil conspiracy" in the origination of the loan ; (13) "aiding and abetting," in that all defendants knew and encouraged what every other defendant did in regard to the origination of the loan; (14) unlawful joint venture, in an agreement to originate, purchase, assign, sell and transfer the loan; and (16) racial discrimination in regard to the financing Scott was provided .

The tenth cause of action – entitled "Wrongful Foreclosure" – contends that the foreclosure proceedings should be stopped (even though the property had already been sold) due to the defendants' "reprehensible conduct throughout this transaction." More particularly, Scott alleges that the foreclosure was wrongful in two respects. First, in

paragraph 104, he contends JPMorgan had no right to foreclose because there was no valid loan due to the alleged fraud in the origination process. Second, in paragraphs 105 through 107, he alleges JPMorgan had no right to foreclose because the "Notice of Default was defective," the amount stated as due and owing in the Notice of Default was incorrect, and interest was overcharged.

Lastly, the fifteenth cause of action for injunctive relief, and the eighteenth cause of action for unjust enrichment (there is no eleventh or seventeenth cause of action), seek specified remedies based on the foregoing claims.

2. *JPMorgan's Demurrer*

JPMorgan filed a demurrer to the second amended complaint, contending it was a rehash of Scott's earlier pleading, JPMorgan could not be liable for any of Magnus' loan origination acts because it did not assume this liability under the P&A Agreement, and the wrongful foreclosure claim failed because JPMorgan complied with its statutory notice requirements and Scott failed to tender amounts owing under the loan.

JPMorgan did not file a new request for judicial notice in connection with its demurrer, but the parties and the trial court proceeded as if the earlier request for judicial notice could be considered in ruling on the demurrer. Although JPMorgan's demurrer represented incorrectly that a "request for judicial notice" was being submitted concurrently, it also provided that its "motion" would be based on the "request for judicial notice" as well as "all documents, records, and pleadings on file."

Scott filed an opposition to the demurrer, urging that the court must accept as true his allegation that "defendants' notice of default was defective and in violation of Civil Code [section] 2924." He also argued that it would be inequitable to require a tender, in light of his allegations that JPMorgan's fraudulent acts had increased Scott's costs and risk and inflated the value of his home; alternatively, he proposed, the court should allow him to make the tender *after* entry of judgment. As to the materials JPMorgan had sought to be judicially noticed, Scott did not object to the absence of a new or separate request for judicial notice, but relied instead on his boilerplate objections to the earlier one and argued that the materials could not be considered in ruling on the demurrer.

In addition, Scott sought leave to amend in case the demurrer was sustained, based on the following "offer of proof:" "Plaintiff submits to the court that the discovery responses adduced in this case clearly demonstrate the active involvement of JPMorgan Chase's representatives with this transaction after the acquisition by JPMorgan Chase of Washington Mutual (again, however, plaintiff reasserts his objection to defendant's use and previous Request for Judicial Notice)."

3. *Court's Ruling*

After a hearing on May 5, 2011, the trial court affirmed its tentative ruling by a written order entered on May 20, 2011, sustaining the demurrer to the second amended complaint without leave to amend.

The court noted that JPMorgan's "Request for Judicial Notice of RJN Exhibits 1 through 7 was previously granted by Order filed herein in November 4, 2010." It then explained its decision on the demurrer as follows: "JPMorgan Chase acquired the assets of Washington Mutual from the Federal Deposit Insurance Corporation (FDIC) by purchase agreement dated September 25, 2008 ('Agreement') but did not assume any borrower liabilities. (RJN Ex. 4, 5). [Citations.] Plaintiff's SAC, at [¶] 49, alleges JP Morgan Chase acquired the assets of Washington Mutual. [¶] On November 7, 2007, First Magnus assigned its interest under the Deed of Trust to Washington Mutual. (RJN, Ex. 3). Proof or acknowledgement of an instrument by an out of state notary is authorized by Civil Code § 1182. The certificate of acknowledgement is prima facie evidence of the facts recited in the certificate, and the genuineness of the signature of each person by whom the writing purports to have been signed. Evidence Code [sections] 1451, 1452; 1453." The court also noted, relying on the documents judicially noticed, that Scott defaulted on his loan payments, a notice of default was recorded, as was a notice of trustee's sale. And, in another proceeding consolidated with this one, "the Complaint indicates JP Morgan Chase purchased the subject property at trustee's sale on May 7, 2009."

In addition, the court observed: "Plaintiff has failed to allege tender, or make an offer to tender a sum sufficient to cure the default, and therefore has not met the requirements to obtain relief for wrongful foreclosure. [Citations.]"

This appeal followed.

II. DISCUSSION

In our de novo review of an order sustaining a demurrer, we assume the truth of all facts properly pleaded in the complaint or reasonably inferred from the pleading, but not mere contentions, deductions, or conclusions of law. (*Buller v. Sutter Health* (2008) 160 Cal.App.4th 981, 985-986 (*Buller*).) We then determine if those facts are sufficient, as a matter of law, to state a cause of action under any legal theory. (*Aguilera v. Heiman* (2009) 174 Cal.App.4th 590, 595.)

In making this determination, we also consider facts of which the trial court properly took judicial notice. (E.g., *Avila v. Citrus Community College Dist.* (2006) 38 Cal.4th 148, 165, fn. 12.) Indeed, a demurrer may be sustained where judicially noticeable facts render the pleading defective (*Evans v. City of Berkeley* (2006) 38 Cal.4th 1, 6), and allegations in the pleading may be disregarded if they are contrary to facts judicially noticed. (*Hoffman v. Smithwoods RV Park, LLC* (2009) 179 Cal.App.4th 390, 400; see *Fontenot v. Wells Fargo Bank, N.A*. (2011) 198 Cal.App.4th 256, 264-266 (*Fontenot*) [in sustaining demurrer, court properly took judicial notice of recorded documents that clarified and to some extent contradicted plaintiff's allegations].)

In order to prevail on appeal from an order sustaining a demurrer, the appellant must affirmatively demonstrate error. Specifically, the appellant must show that the facts pleaded are sufficient to establish every element of a cause of action and overcome all legal grounds on which the trial court sustained the demurrer. (*Cantu v. Resolution Trust Corp*. (1992) 4 Cal.App.4th 857, 879-880.) We will affirm the ruling if there is any ground on which the demurrer could have been properly sustained. (*Debro v. Los Angeles Raiders* (2001) 92 Cal.App.4th 940, 946 (*Debro*).)

We begin our analysis with whether the trial court erred in taking judicial notice.

A. *Judicial Notice*

In ruling on the demurrer to the second amended complaint, the court took judicial notice of several documents (and facts therein), including the federal government's appointment of FDIC as WaMu's receiver and the P&A Agreement, which provides that the FDIC transferred to JPMorgan assets of WaMu, but not certain liabilities, as of September 25, 2008, after Scott had obtained his loan and before JPMorgan foreclosed. Although JPMorgan had not submitted a formal request for judicial notice in connection with the demurrer, the court and parties acknowledged JPMorgan's prior request, Scott had the opportunity to object, and, in any event, the court may take judicial notice on its own volition. (See Evid. Code, § 455, subd. (a); *Joslin v. H.A.S. Ins. Brokerage* (1986) 184 Cal.App.3d 369, 374 (*Joslin*) [reviewing propriety of judicial notice in ruling on demurrer, even though record did not contain request for judicial notice].)

Scott contends that the court should not have taken judicial notice of the P&A Agreement or the facts therein. At least two subdivisions of Evidence Code section 452, however, provided authority for the judicial notice taken in this case. (Except where otherwise indicated, all statutory references hereafter are to the Evidence Code.)

First, section 452, subdivision (c) provides that judicial notice may be taken of "[o]fficial acts of the legislative, executive, and judicial departments of the United States and of any state of the United States." This subdivision "enables courts in California to take notice of a wide variety of official acts. . . . [and] an expansive reading must be provided to certain of its phrases[;] included in 'executive' acts are those performed by administrative agencies." (Simons, California Evidence Manual (2013) Judicial Notice § 7:11, p. 558.) Scott does not dispute that official acts of the FDIC may be subject to judicial notice under section 452, subdivision (c). As JPMorgan argues, the FDIC's official acts of seizing WaMu's assets and publishing the P&A Agreement are judicially noticeable. Moreover, as explained *post*, the FDIC's official act of transferring certain WaMu assets (but not certain liabilities) to JPMorgan as of September 25, 2008 – as

evinced by the P&A Agreement – is an official act subject to judicial notice under section 452, subdivision (c) under the circumstances of this case.[1]

Second, section 452, subdivision (h) provides that judicial notice may be taken of "[f]acts and propositions that are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy." In this case, the fact of the P&A Agreement and the fact of the transfer to JPMorgan of WaMu assets, but not liabilities for borrower's claims, are not reasonably subject to dispute and are capable of ready determination, particularly since Scott did not question with specificity the authenticity, completeness, or legal effect of the P&A Agreement posted on the official FDIC Web site. Numerous federal courts have taken judicial notice of the P&A Agreement on a similar basis.[2]

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[1] In its respondent's brief, JPMorgan criticizes Scott for not addressing subdivision (c) of section 452. This is ironic, since JPMorgan did not *seek* judicial notice in the trial court based on subdivision (c) of section 452, but on subdivisions (d), (g), and (h), along with section 451, subdivision (f). Nonetheless, JPMorgan's failure to rely on subdivision (c) in the trial court does not compel us to find the court's grant of judicial notice erroneous, for three reasons. First, Scott's appellate briefs do not make this argument. Second, the trial court's ruling will be affirmed if there is any lawful ground to support it. (*Hendy v. Losse* (1991) 54 Cal.3d 723, 742; see also *StorMedia Inc. v. Superior Court* (1999) 20 Cal.4th 449, 457, fn. 9 [in reviewing demurrer ruling, appellate court may consider facts judicially noticed by the trial court or those which the trial court properly could have noticed] (*StorMedia*); Evid. Code, § 459.) Third, as stated in the text, we agree with JPMorgan that judicial notice was also proper under section 452, subdivision (h), a ground JPMorgan *did* cite. We need not and do not decide whether judicial notice would have also been proper under section 451, subdivision (f) [universally known facts] or section 452, subdivision (g) [common knowledge within the jurisdiction].

[2] Rule 201(b) of the Federal Rules of Evidence, which permits judicial notice of a fact that is "not subject to reasonable dispute because it . . . can be accurately and readily determined from sources whose accuracy cannot reasonably be questioned," is akin to California Evidence Code section 452, subdivision (h), which permits judicial notice of "[f]acts and propositions that are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy." Under the federal rule, courts have taken judicial notice of the P&A Agreement. (*Argueta v. JPMorgan Chase* (E.D. Cal. 2011) 787 F.Supp.2d 1099, 1103 [judicial notice taken of P&A Agreement]; *Rosenfeld v. JPMorgan Chase Bank, N.A.*

Scott argues that judicial notice was improper because, while judicial notice may be taken of public records, it may not be taken of the facts asserted within them. (E.g., *Herrera v. Deutsche Bank National Trust Co.* (2011) 196 Cal.App.4th 1366, 1375 ["While courts take judicial notice of public records, they do not take notice of the truth of matters stated therein"] (*Herrera*); *Joslin, supra,* 184 Cal.App.3d at p. 374 ["Taking judicial notice of a document is not the same as accepting the truth of its contents or accepting a particular interpretation of its meaning"]; see *Mangini v. R.J. Reynolds Tobacco Co*. (1994) 7 Cal.4th 1057, 1063-1065 [court could not take judicial notice of the truth of conclusions within a report from the United States Surgeon General regarding the health effects of smoking or the truth of matters reported in a newspaper article] (*Mangini*), overruled on other grounds in *In re Tobacco Cases II* (2007) 41 Cal.4th 1257, 1262, 1276.)

The distinction that Scott draws, however, is immaterial to this case. Where, as here, judicial notice is requested of a *legally operative* document – like a contract – the court may take notice not only of the fact of the document and its recording or publication, but also facts that clearly derive from its *legal effect*. (*Fontenot, supra,* 198 Cal.App.4th at p. 265.) Moreover, whether the fact derives from the legal effect of a

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(N.D. Cal. 2010) 732 F.Supp.2d 952, 959 [judicial notice taken of the P&A Agreement, as a matter of public record]; *McCann v. Quality Loan Service Corp.* (W.D. Wash. 2010) 729 F.Supp.2d 1238, 1241 ["the Court takes judicial notice of the P&A Agreement because it is a public record and not the subject of reasonable dispute"]; *Allen v. United Fin. Mortgage Corp*. (N.D. Cal. 2009) 660 F.Supp.2d 1089, 1093 [judicial notice taken of the P&A Agreement, even though several pages were missing from the submission by defendant, because the entire P&A Agreement is available online from the FDIC's Web site]; *Coward v. JP Morgan Chase Bank*, 2013 U.S. Dist. LEXIS 22412, (E.D. Cal. Feb. 19, 2013) at *7-9 [judicial notice taken of P&A Agreement]; *In re Sharp*, Case No. 09-13980, A. P. No. 10-1032, 2011 Bankr. LEXIS 2841, at *3, fn. 1 (N.D. Cal. Bk. Jul. 19, 2011) [same]; *Jarvis v. JP Morgan Chase Bank, N.A*., 2010 WL 2927276, at *1, 2010 U.S. Dist. LEXIS 84958, at *3 (C.D. Cal. July 23, 2010) [judicial notice taken of OTS Order and P&A Agreement, which were available on government Web sites]; *Molina v. Wash. Mut. Bank*, No. 09-CV-00894-IEG (AJB), 2010 U.S. Dist. LEXIS 8056, at *8 (S.D. Cal. Jan. 29, 2010) [judicial notice taken of P&A Agreement].)

document or from a statement within the document, the fact may be judicially noticed where, as here, the fact is not reasonably subject to dispute.

Judicial notice of the legal effect of legally operative documents was discussed at length by our Division One colleagues in *Fontenot*. There, the court explained: "[C]ourts have taken judicial notice not only of the existence and recordation of recorded documents but also a variety of matters that can be deduced from the documents. In *Poseidon* [*Development, Inc. v. Woodland Lane Estates, LLC* (2007) 152 Cal.App.4th 1106, 1117], for example, the court affirmed the trial court's taking judicial notice, in sustaining a demurrer, of the parties, dates, and legal consequences of a series of recorded documents relating to a real estate transaction. [Citation.] Although the court recognized that it would have been improper to take judicial notice of the truth of statements of fact recited within the documents, the trial court was permitted to take judicial notice of the legal effect of the documents' language when that effect was clear. [Citation.]" (*Fontenot, supra*, 198 Cal.App.4th at p. 265.) After giving additional examples, the court in *Fontenot* continued: "Strictly speaking, a court takes judicial notice of facts, not documents. (Evid. Code, § 452, subds. (g), (h).) When a court is asked to take judicial notice of a document, the propriety of the court's action depends upon the nature of the facts of which the court takes notice from the document. . . . Taken together, the decisions discussed above establish that a court may take judicial notice of the fact of a document's recordation, the date the document was recorded and executed, the parties to the transaction reflected in a recorded document, and the document's legally operative language, assuming there is no genuine dispute regarding the document's authenticity. From this, the court may deduce and rely upon the legal effect of the recorded document, when that effect is clear from its face." (*Ibid.*)

Accordingly, *Fontenot* ruled, the trial court did not err at the demurrer stage in taking judicial notice of the identity of the beneficiary of a deed of trust, based on the designation of the beneficiary in the deed of trust, "since its status was not a matter of fact existing apart from the document itself." (*Fontenot, supra*, 198 Cal.App.4th at p. 266.) The deed of trust, as a legally operative document, designated the beneficiary,

and therefore the identity of the beneficiary was not reasonably subject to dispute. (*Ibid*.) Other matters noticed by the trial court could be inferred from the text or legal effect of the documents as well. (*Ibid*.)

Here, in line with *Fontenot*, the trial court in this case did not abuse its discretion in taking judicial notice of the OTS Order, the P&A Agreement, *and* the legal effect of those documents in transferring to JPMorgan the stated assets of WaMu, but none of its liabilities for borrowers' claims, as of September 25, 2008. The P&A Agreement expressly provided that this was the intent of the parties to the agreement, and that was its legal effect. These facts therefore derive from the legal effect of the documents themselves, rather than any disputed hearsay statement of fact within them. Moreover, there is no allegation in the second amended complaint that the P&A Agreement is not authentic, and its authenticity is buttressed by its posting on the official FDIC Web site.[3]

None of the cases on which Scott relies is inconsistent with our conclusion that judicial notice can be taken of the legal effect of the P&A Agreement. In *Herrera*, for example, the court merely held that judicial notice could not be taken of the fact that a foreclosing bank was the beneficiary under a deed of trust, where the judicial notice was to be based on disputed hearsay statements *within* a substitution of trustee form and an assignment of the deed of trust: it was improper to take judicial notice based on the substitution of trustee form, because the recital in the document that the bank "is the

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[3] Scott's sole objection in the trial court was the boilerplate objection that "this document" was not the type of document of which judicial notice may be taken. Scott belatedly argues *in this appeal* that JPMorgan did not sufficiently authenticate the documents attached to its request for judicial notice, because we should not accept a financial entity's representation that documents are in fact true copies of the originals. However, the request for judicial notice averred, under penalty of perjury, that the copies were "true and correct," and Scott provides no authority that an assertion under penalty of perjury should be disregarded merely because it is made by someone on behalf of a bank. While the request for judicial notice does not explicitly state the factual foundation for this representation, it does refer to a link on the FDIC Web site, by which the authenticity of the document can be verified. In the absence of any indication in the record that the document has been falsified, or any specific objection in the trial court, the averment of authentication and the independent means of verification were sufficient.

present beneficiary" was hearsay and disputed; it was improper to take judicial notice based on the assignment of the deed of trust, because, even though the document recited that the bank was assigned all beneficial interest under the deed of trust by a predecessor bank, its recital that the *predecessor* bank was successor to the original beneficiary was hearsay, so the overall truthfulness of the assignment of the deed of trust remained subject to dispute as well. (*Herrera, supra,* 196 Cal.App.4th at p. 1375.)

Thus, *Herrera* did not hold that judicial notice cannot be taken of the legal effect of a legally operative document (like the assignment of the deed of trust, or, here, the P&A Agreement); it simply held that it could not be done in *that* case, because the vitality of the assignment was reasonably subject to dispute without independent proof that the party assigning the interest had the authority to do so. (*Herrera, supra,* 196 Cal.App.4th at p. 1375; see *Fontenot, supra*, 198 Cal.App.4th at pp. 266-267 & fn. 7 [distinguishing *Herrera* on this ground].) Here, by contrast, Scott fails to show any reasonable dispute that WaMu held the beneficial interest in Scott's deed of trust when the FDIC transferred WaMu's relevant assets to JPMorgan: to the contrary, Scott alleges that after Magnus became insolvent WaMu notified him that WaMu "retained custody" of his loan, and he does not allege any well-pleaded facts from which the invalidity of the assignment might reasonably be inferred.[4] *Herrera* poses no barrier to taking judicial notice of facts deriving from the legal effect of the P&A Agreement.

Similarly distinguishable is *Fremont Indemnity Co. v. Fremont General Corp.* (2007) 148 Cal.App.4th 97, in which the court held that judicial notice could not be taken

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[4] In his opening brief, Scott says the second amended complaint alleges "fatal holes in the chain of title from [Magnus's] transfer of the Deed of Trust to WaMu, due to what amounts to be an unprovable (false) notarization, and substitution of the original first page of the Deed of Trust." His pleading, however, merely alleges that Scott "contends" the assignment of the deed of trust from Magnus to WaMu was invalid because the notary had no record of notarizing it, and the first page of the deed of trust was different. An allegation of what Scott "contends" is not an allegation of fact, and there is no factual allegation explaining any difference in the substituted page that would nullify the assignment. Moreover, Scott provides no legal authority for the proposition that either the absence of a notarization record or the substitution of a page of the deed of trust, under the facts alleged, would render the assignment void.

of the meaning or enforceability of a letter, where the parties disputed whether the letter memorialized or constituted a contract, and the meaning and enforceability of the letter was reasonably subject to dispute. (*Id*. at pp. 114-116.) Because judicial notice could not be taken of the meaning of the letter based on the document alone, the court could not take judicial notice of the proper interpretation of the letter submitted in support of a demurrer. (*Id*. at p. 115.)

In the matter before us, however, neither the enforceability of the P&A Agreement nor its meaning is reasonably subject to dispute. The second amended complaint does not allege that the P&A Agreement is unenforceable, or that it did not transfer WaMu's assets (but not liabilities) to JPMorgan as of September 25, 2008. Nor is there any specific factual allegation from which we might infer that the P&A Agreement is unenforceable or susceptible of a different meaning.[5] Moreover, the P&A Agreement has already been the subject of judicial interpretation by multiple courts, which have reached the conclusion that the P&A Agreement is enforceable, precludes JPMorgan's liability for borrowers' claims, and justifies dismissal of borrowers' claims at the pleading stage. (E.g., *Hanaway v. JPMorgan Chase Bank, N.A*. (C.D. Cal. Feb. 15, 2011) 2011 U.S. Dist. LEXIS 21374 at *8-9 [dismissing claims against JPMorgan related to borrower's loan transaction with WaMu, and citing numerous other federal decisions reaching the same conclusion] (*Hanaway*); see *Yeomalakis v. FDIC* (1st Cir. 2009) 562 F.3d 56, 60 [because JPMorgan's P&A Agreement retained for the FDIC any liability associated with borrower claims for relief, the FDIC rather than JPMorgan is the appropriate party in interest] (*Yeomalakis*); see also § 451, subd. (a) [trial court shall take judicial notice of federal decisional law].) Under these circumstances, the court did not abuse its discretion

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[5] Scott alleged in vague conclusory terms that JPMorgan had not "completed" the FDIC's transfer of WaMu's assets to JPMorgan and, on that basis, JPMorgan had no beneficial interest in his property. He offered no factual basis for that conclusion, and it is inconsistent with his other allegations. At any rate, his contention does not dispute the enforceability or interpretation of the P&A Agreement. To the extent it is germane to his other arguments, we address it *post*.

in taking judicial notice of the P&A Agreement and its transfer of WaMu's assets to JPMorgan without transferring WaMu's relevant liabilities.

Also inapposite is *Joslin, supra,* 184 Cal.App.3d 369. There, the question was whether deposition testimony could be considered in ruling on a demurrer. (*Id*. at p. 373.) The court, noting that "[t]aking judicial notice of a document is not the same as accepting the truth of its contents or accepting a particular interpretation of its meaning," ruled that "the trial judge could accept the truth of the facts stated in the . . . deposition only to the extent they were not or could not be disputed." (*Id*. at pp. 374-375.) Thus, facts disclosed by the deposition and not disputed were properly considered in ruling on the demurrer, and facts disclosed by the deposition that were disputed could not be. (*Id*. at pp. 375-376.)

Joslin is distinguishable, since it dealt with facts asserted by parties in a deposition, not facts deriving from the independent legal significance of a contract. In any event, just as facts that were not disputed in *Joslin* could be considered in ruling on a demurrer, the facts that are not disputed or not reasonably subject to dispute in this case – the existence, enforceability, and legal effect of the P&A Agreement – were properly considered in ruling on JPMorgan's demurrer.[6]

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[6] In *Mangini, supra,* 7 Cal.4th 1057, it was ruled that the court could not judicially notice the truth of conclusions within a report from the United States Surgeon General regarding the health effects of smoking or the truth of matters reported in a newspaper article. (*Id*. at pp. 1063-1065.) *Mangini* did not, however, address legally operative documents, such as a recorded assignment or contract. In *StorMedia, supra,* 20 Cal.4th 449, the court cited *Joslin* for the proposition that "[w]hen judicial notice is taken of a document, however, the truthfulness and proper interpretation of the document are disputable." (*StorMedia,* at p. 457, fn. 9.) The court *granted* an implicit request for judicial notice that was unopposed, without applying the principle. (*Ibid*.) In *Searles Valley Minerals Operations, Inc. v. State Bd. of Equalization* (2008) 160 Cal.App.4th 514, at page 519, the court ruled that judicial notice could not be taken of "materials contained on Web site pages" of the American Coal Foundation and the United States Department of Energy pursuant to section 452, subdivision (h), where no legal authority was cited for taking judicial notice from the Web sites and, "although it might be appropriate to take judicial notice of the existence of the Web sites, the same is not true of their factual content." (Italics omitted.) As we explain in the text, the rule against

Nor is the federal district court's decision in *Mena v. JPMorgan Chase Bank* (N.D. Cal. Sept. 7, 2012) 2012 U.S. Dist. LEXIS 128585 (*Mena*), on which Scott also relies, contrary to our conclusion. In *Mena*, the plaintiffs had two loans from WaMu, secured by deeds of trust naming WaMu as the original lender/beneficiary. Plaintiffs alleged that WaMu then transferred its interests to a third party, based on certain SEC filings. JPMorgan, however, argued that WaMu's interests had instead been transferred to JPMorgan by the FDIC pursuant to the P&A Agreement. (*Id*. at *3-4 & fn. 10.) After foreclosure proceedings were commenced based on JPMorgan's purported interest under the deed of trust (and transfer of that interest to third parties), the plaintiffs sued, asserting claims including wrongful foreclosure. (*Id*. at *4-6.) JPMorgan moved for dismissal, seeking judicial notice of documents including the P&A Agreement. (*Id*. at *9.) In deciding whether the plaintiffs had stated a claim based on JPMorgan's unlawful initiation of the nonjudicial foreclosure process, the court concluded that it could take judicial notice of the P&A Agreement, but it could not take judicial notice that the effect of the agreement was to transfer the beneficial interest under the deed of trust to JPMorgan, due to the *specific* allegations in the complaint (supported by SEC filings) that WaMu's interest had been transferred to a third party before the FDIC transferred WaMu's assets to JPMorgan. (*Id*. at *24.)[7]

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judicial notice of the content of a document is inapplicable here, where we are concerned with judicial notice of the undisputed legal effect of a legally operative document.

[7] The court in *Mena* stated: "And although the court notices the September 2008 Purchase and Assumption Agreement between Chase and the FDIC Receiver of WaMu's assets, [footnote] the court may not notice, as undisputed fact, that the effect of this agreement was to transfer to Chase the beneficial interest in question, that interest already having been 'spun off' according to the Complaint. It is not clear from the Complaint or the noticed documents whether Chase properly owned the beneficial interest that it purported to transfer in the first and second Assignment of DOT. [Footnote.] The allegations of false signatures to which Defendants have not responded further strengthen Plaintiffs' allegation of wrongful conduct." (*Mena, supra,* 2012 U.S. Dist. LEXIS 128585, at *24.) Elsewhere the court explained: "The court agrees with the premise . . . that judicial action may be used to challenge a nonjudicial foreclosure process where the *specific* facts alleged in the complaint, taken as true at the pleading stage, demonstrate a

Mena is readily distinguishable from the matter at hand. In *Mena*, the plaintiffs had alleged specific facts to support the inference that JPMorgan did not obtain WaMu's interest in the deed of trust under the P&A Agreement. Here, by contrast, Scott alleges no specific facts, resorting to a mere conclusory assertion that JPMorgan had no interest in the deed of trust securing the property. It was not an abuse of discretion for the trial court in this case to take judicial notice of the obvious legal effect of the P&A Agreement – to transfer to JPMorgan the assets of WaMu that included its interests in deeds of trust.

In sum, whether the fact to be judicially noticed is the document or record itself (e.g. the existence of the P&A Agreement), the legal effect of the document (its transfer of assets but not liabilities to JPMorgan), a fact asserted within the document (the transfer), or an act by a government agency (the transfer by the FDIC), the essential question is whether the fact to be judicially noticed is not reasonably subject to dispute. Here, the court did not abuse its discretion in concluding that the fact of the FDIC's transfer to JPMorgan of "all of" WaMu's assets, but not its liabilities for borrower's claims, as of September 25, 2008, was not reasonably subject to dispute in light of the face of the P&A Agreement, its posting on the official FDIC Web site, the allegations (or lack thereof) in Scott's second amended complaint, the arguments of the parties, and the numerous federal judicial decisions accepting that fact in the context of motions to dismiss.[8]

Finally, our ruling today is consistent with the very recent decision of our Division Two colleagues in *Jolley v. Chase Home Finance, LLC* (2013) 213 Cal.App.4th

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failure to effect a valid transfer of beneficial interest in a manner than renders void the initiation of nonjudicial foreclosure." (*Id*. at *11, italics added.)

[8] Indeed, section 452, subdivision (c) permits judicial notice of official government *acts*. This is not a situation where the statutory provision permits judicial notice only of a record or document, and the question becomes whether statements of fact *within* the document are worthy of judicial notice as well. The question is simply whether the fact of the government's action (transferring WaMu's assets but not its liabilities to JPMorgan) has been sufficiently evinced by the document that was submitted to establish that fact (the P&A Agreement). It has been in this case, since the authenticity and effect of the P&A Agreement cannot reasonably be disputed, for reasons discussed *ante*.

872 (*Jolley*). In *Jolley*, defendant Chase Home Finance, LLC (Chase) had sought summary judgment on claims brought by the plaintiff borrower. In support of its motion, Chase requested judicial notice of its acquisition of some of WaMu's assets based on the P&A Agreement, attaching a purported copy of the P&A Agreement to its attorney's declaration and referencing the FDIC Web site on which the agreement is posted. (*Id*. at pp. 882-883.) Unlike Scott in this case, the plaintiff in *Jolley* objected to the judicial notice request on the specific ground that the document attached to the declaration was *not* the complete document governing Chase's purchase of WaMu assets, and submitted a declaration explaining that this belief was based on personal knowledge of a longer version, which the FDIC refused to produce. (*Id*. at p. 883.) The appellate court in *Jolley* concluded it was error for the trial court to take judicial notice of the P&A Agreement and Chase's acts of acquiring WaMu's assets but not its liabilities: "the content and legal effect of the P&A Agreement could not properly be determined on judicial notice under California law. . . . [a]nd certainly not here." (*Id*. at p. 887.)

Jolley is obviously distinguishable on its facts from the matter at hand. In *Jolley*, the P&A Agreement and its legal effect were reasonably subject to dispute because the opposing party insisted that the copy attached to the attorney's declaration was *not the actual P&A Agreement*, based on personal knowledge as set forth in a declaration under penalty of perjury. In our case, by contrast, Scott did not dispute in the trial court that the copy attached to counsel's declaration and on the FDIC Web site is the actual P&A Agreement. Since Scott on appeal fails to show that the P&A Agreement (or even its legal effect) was reasonably subject to dispute on this or any other basis in the trial court, he fails to show that the court erred in taking judicial notice.

Indeed, in our view, the overarching theme of both *Jolley* and this case are in accord: judicial notice can be taken of matters not reasonably subject to dispute, but cannot be taken of matters shown to be reasonably subject to dispute. As *Jolley* notes, the mere fact that a statement appears on a web page does not mean that it is not reasonably subject to dispute. (*Jolley, supra*, 213 Cal.App.4th at p. 889; *Huitt v. Southern California Gas. Co*. (2010) 188 Cal.App.4th 1586, 1605, fn. 10.) And if the

information on the Web site is reasonably disputed by the parties, it is not subject to judicial notice. (*Jolley,* at p. 889; *L.B. Research & Education Foundation v. UCLA Foundation* (2005) 130 Cal.App.4th 171, 180, fn. 2 [where the parties submitted dueling requests for judicial notice "comprised of printouts from various Web sites maintained by UCLA and the University of California," the information is not subject to judicial notice because it is subject to interpretation].) But based on the record in the case before us, the fact of the FDIC's act of transferring assets (but not liabilities) to JPMorgan, as evinced by the P&A Agreement attached to the request for judicial notice and published to the public on the official FDIC Web site, was not shown by Scott to be subject to reasonable dispute in the trial court.[9]

The trial court in this case did not err in taking judicial notice of the fact that the FDIC transferred assets, but not liabilities, of WaMu as of September 25, 2008, to JPMorgan, as set forth in the provisions of the P&A Agreement.

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[9] *Jolley* also acknowledged the broad scope of section 452, subdivision (c) pertaining to judicial notice of official government acts, but did not "understand a contract with a private bank to come within that subdivision." (*Jolley, supra*, at p. 887.) We need not and do not decide whether every contract between a government agency and a private entity will be subject to judicial notice. On the record before us, the P&A Agreement was not just any contract: it was the official disposition of the assets and liabilities of a savings bank unable to pay its obligations to creditors and depositors, pursuant to a federal government order of receivership for the purpose of liquidation under a federal statute, published on the FDIC Web site to give vital and reliable notice to the public. Furthermore, we focus not on the contractual form of the document, but on the undisputed nature of the official *act* of transfer that it *evinces*, to bring section 452, subdivision (c) into play. In any event, we do not rely solely on subdivision (c) to uphold the judicial notice in this case. On another note, *Jolley* stated: "In sum, we hold that judicial notice was not properly taken of the content of the P&A Agreement *even if there was no dispute* about its authenticity. A fortiori here, where the very authenticity of the Agreement was in dispute." (*Jolley,* at p. 889, italics added.) The seemingly broad brush of this comment is limited by its factual context, however; certainly *Jolley* did not decide the propriety of judicial notice under circumstances that were not before it, but are now before us.

B. *Legal Significance of the Facts Judicially Noticed*

Having concluded that the court properly took judicial notice of the facts that (1) JPMorgan received "all right, title, and interest of the Receiver in and to all of the assets (real, personal and mixed, wherever located and however acquired) . . . of [WaMu]" (except for certain assets not germane here, as set forth *ante*) in September 2008 and (2) JPMorgan did not assume liability for borrower claims related to loans, or commitments to lend, made or held by WaMu, as of September 25, 2008, we now consider how those facts affect whether Scott has stated a cause of action.

Scott purported to assert 16 causes of action in his second amended complaint, each of which we discussed *ante*. Many of these purported "causes of action" are really just alternative legal theories, or requests for a particular remedy (injunctive relief) or imposition of joint liability (aiding and abetting, conspiracy, joint venture), rather than a distinct cause of action. Giving Scott's pleading the broadest construction to which it is entitled at the demurrer stage, we conclude that Scott sought relief against JPMorgan on the following bases.

1. *Wrongdoing by Others in Loan Negotiation and Origination*

The second amended complaint seeks recovery against JPMorgan in part for the fraud and other wrongdoing perpetrated *by Magnus and others* in connection with Scott's entry into the loan agreement, based on the fact that JPMorgan is a successor to WaMu's interest in the deed of trust. We agree with JPMorgan and the trial court that this liability is foreclosed as a matter of law by the legal effect of the P&A Agreement, which provided that JPMorgan did not assume liability for borrower claims related to loans or loan commitments made by WaMu, or made by a third party (like Magnus) and purchased or held by WaMu.

There is no dispute that the FDIC, as conservator or receiver, may sell the assets of a failed bank while retaining its related liabilities. (See, e.g., *Kennedy v. Mainland Sav. Ass'n* (5th Cir. 1994) 41 F.3d 986, 990-991; *Payne v. Security Sav. & Loan Assn., F.A.* (7th Cir. 1991) 924 F.2d 109, 111 ["This design facilitates the sale of a failed institution's assets (and thus helps to minimize the government's financial exposure) by allowing the

[FDIC] to absorb liabilities itself and guarantee potential purchasers that the assets they buy are not encumbered by additional financial obligations"].) Furthermore, in examining the same provision in the P&A Agreement that is at issue in this case, federal courts have concluded that JPMorgan has no liability as a matter of law. (E.g., *Ansanelli v. JPMorgan Chase Bank, N.A*. (N.D. Cal. Mar. 28, 2011) 2011 U.S. Dist. LEXIS 32350, at *6 ["Chase is not responsible for any liability of *WaMu* related to loans made by WaMu prior to September 25, 2008, the date of assumption . . . ."]; *Javaheri v. JPMorgan Chase Bank, N.A.* (C.D. Cal. Jan. 11, 2011) 2011 U.S. Dist. LEXIS 4249, at *8-9 ["[B]ecause JPMorgan expressly disclaimed assumption of liability arising from borrower claims against WaMu, those actions which predate the P&A Agreement cannot be brought against JPMorgan"].) Rather, the FDIC "was and remains the appropriate party in interest." (*Yeomalakis, supra,* 562 F.3d at p. 60.)

2. *JPMorgan's Own Acts Prior to Foreclosure*

Scott also suggests that JPMorgan could be liable for its *own acts* in connection with his entry into the loan agreement. The second amended complaint, however, does not allege any particular act by JPMorgan in this regard. Scott points us instead to his boilerplate allegations that all "defendants" are responsible for the acts of all the other "defendants," as well as his conspiracy, aiding and abetting, and joint venture contentions as to the "defendants." The pleading's conclusory statements as to all "defendants" are insufficient to state a cause of action against JPMorgan, in light of the allegations and judicially noticed documents indicating that the loan was negotiated on behalf of Magnus, without any mention of JPMorgan. In other words, the only inference from the allegations of Scott's pleading *and* the facts properly subject to judicial notice is that JPMorgan was not involved in the negotiation and origination of the loan.

Similarly, Scott contends JPMorgan could be liable for its own acts after the loan origination, but prior to foreclosure. In paragraph 49 of his second amended complaint, Scott alleged: "Plaintiff had specific discussions with employees of JPMorgan Chase prior to the time JPMorgan Chase acquired the certain assets and liabilities of Washington Mutual from the FDIC in which the representatives and employees of

JPMorgan Chase, both prior to its acquisition of Washington Mutual from the FDIC and subsequent to its acquisition of Washington Mutual, made representations that if plaintiff spent his own funds to bring the house to the point of obtaining a final building inspection, JPMorgan Chase would provide reimbursement of the balance of the construction funds and permanent financing. As a result of those representations, plaintiff did expend in excess of $400,000.00 of his personal funds, including, but not limited to, borrowing from his pension plan to comply with the conditions set forth by JPMorgan Chase."

These allegations, however, are not sufficiently specific to support a claim for fraud: they do not allege with particularity who made the statements, when they were made, what was actually stated, or why they were false. (See *Lazar v. Superior Court* (1996) 12 Cal.4th 631, 645; *Tarmann v. State Farm Mut. Auto Ins. Co*. (1991) 2 Cal.App.4th 153, 157 ["The requirement of specificity in a fraud action against a corporation requires the plaintiff to allege the names of the persons who made the allegedly fraudulent representations, their authority to speak, to whom they spoke, what they said or wrote, and when it was said or written"].) Nor has Scott, in the trial court or in his appellate briefs, articulated any other cause of action that could be based on JPMorgan's purported statements. Scott has failed to show that his allegations allege a cognizable cause of action.

3. *Wrongful Foreclosure: JPMorgan's Lack of Standing to Foreclose*

Turning to Scott's wrongful foreclosure claim, Scott contends that JPMorgan lacked *standing* to foreclose on his property, because it had no beneficial interest under the deed of trust on his property. Although this assertion about standing reigns paramount in Scott's appellate briefs, the allegation does not actually appear in his purported cause of action for wrongful foreclosure; instead, it is found in paragraph 40, which is merely incorporated by reference into the cause of action and reads: "Plaintiff contends that defendant JP Morgan Chase has not completed the transfer of the Washing [*sic*] Mutual assets from the FDIC to JP Morgan Chase. Plaintiff further contends that as

a result, defendant JP Morgan Chase has no rights in plaintiff's real property and that any foreclosure actions proceeded wrongfully."

Scott's lack-of-standing theory is precluded by the allegations of the second amended complaint and the facts judicially noticed by the court: the original beneficiary under the deed of trust was Magnus; Magnus transferred its beneficiary interest to WaMu; and, as demonstrated by the P&A Agreement, WaMu's assets were transferred by the FDIC to JPMorgan as of September 25, 2008. Therefore, JPMorgan had WaMu's beneficial interest in the deed of trust on Scott's property, and the power to foreclose with respect to Scott's loan on the date that JPMorgan initiated the foreclosure proceedings against Scott for default.[10]

Scott argues that JPMorgan did not establish the chain of assignment or ownership of the beneficial interest in the deed of trust from Magnus to WaMu. As explained *ante*, however, Scott himself alleges that WaMu notified him that it "retained custody" of his loan after Magnus became insolvent, the assignment judicially noticed by the court reflects the transfer of the beneficial interest to WaMu, and the second amended complaint contains no well-pleaded facts from which the invalidity of the assignment may be inferred. Based on the allegations of Scott's pleading and the facts judicially noticed, the only reasonable inference is that WaMu held the beneficial interest under the deed of trust on Scott's property as of the time WaMu's assets were transferred to JPMorgan.

Scott further argues (but did not allege in his second amended complaint) that JPMorgan failed to establish that the assets transferred to it from WaMu included the beneficial interest in the deed of trust. However, the P&A Agreement states that JPMorgan is receiving "*all* right, title, and interest of the Receiver in and to *all of the assets* (real, personal and mixed, wherever located and however acquired) . . . of the Failed Bank [WaMu] whether or not reflected on the books of the Failed Bank as of Bank Closing [September 25, 2008]." (Italics added.) Indeed, Scott admits in his second

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[10] There is no dispute that the FDIC had legal authority to transfer WaMu's assets to JPMorgan. (See generally 12 U.S.C. § 1821(d)(2).)

amended complaint that JPMorgan acquired "certain assets" of WaMu from the FDIC and, before and after that time, discussed the loan with Scott. Based on the allegations of Scott's pleading and the facts arising from the legal effect of the P&A Agreement, the only inference is that JPMorgan received the beneficial interest under the deed of trust on Scott's property, and thus had standing to foreclose.

4. *Wrongful Foreclosure: Procedural Irregularities*

In his wrongful foreclosure claim, Scott alleged that the "Notice of Default was defective," the amount stated as due and owing in the Notice of Default was incorrect, and interest was overcharged. In this appeal, however, Scott insists that his wrongful foreclosure claim is *not* based on procedural irregularities, but exclusively on JPMorgan's purported lack of standing to foreclose. Scott fails to establish a cause of action based on his conclusory allegations of the deficiencies in the notice of default or other aspects in the foreclosure process.

5. *Wrongful Foreclosure: Loan Unenforceable*

In his wrongful foreclosure claim, Scott alleges in paragraph 104 that "[d]efendants had no right to foreclose at the time foreclosure proceedings were commenced," because fraud was perpetrated "in the loan origination process," such that there was no valid loan on the property and "therefore no possibility of default." In essence, Scott alleges, it was wrong for JPMorgan to sell his property (to which he had obtained title before taking on the loan) for nonpayment on a loan that should be voided ab initio, and if he can prove his claim of fraud in the inducement he should be able to void the loan and receive clear title to his property.

This claim is also precluded by JPMorgan's nonassumption of liability in section 2.5 of the P&A Agreement. The P&A Agreement expressly extends to borrower's claims for "legal *or* equitable" relief, whether asserted "affirmatively *or* defensively." And agreements like the P&A Agreement, which further important public policy (see *Payne, supra,* 924 F.2d at p. 111), do not leave the borrower without recourse, since the borrower may seek relief from the FDIC (*Yeomalakis, supra,* 562 F.3d at p. 60).

Moreover, even if this claim were not precluded by the P&A Agreement, it would be precluded because the allegations of the second amended complaint are insufficient to state a claim for fraud in the inducement. Fraud must be pleaded with specificity. (See *Lazar, supra,* 12 Cal.4th at p. 645.) Scott has pleaded in generalities, without identifying the specific persons who made the misrepresentations, the precise statements made, or the dates on which they were made.

In sum, as a matter of law based on Scott's allegations (which we assume to be true if well-pleaded, unless indisputably rebutted by facts judicially noticed) and facts that were the proper subject of judicial notice, none of Scott's theories of liability are tenable. Scott has therefore failed to show any cognizable basis for the causes of action he asserted in his second amended complaint, or any other cause of action. The court did not err in sustaining JPMorgan's demurrer to Scott's second amended complaint.

C. *Other Arguments of the Parties*

1. *Scott's Failure to Tender*

When asserting a cause of action to quiet title or wrongful foreclosure, a plaintiff must usually allege tender of the amount of the secured debt. (See, e.g., *Miller v. Provost* (1994) 26 Cal.App.4th 1703, 1707 ["a mortgagor of real property cannot, without paying his debt, quiet his title against the mortgagee"]; *Karlsen v. American Sav. & Loan Assn.* (1971) 15 Cal.App.3d 112, 117 [judgment on the pleadings properly granted where plaintiff attempted to set aside trustee's sale for lack of adequate notice, because "[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"]; *United States Cold Storage v. Great Western Savings & Loan Assn.* (1985) 165 Cal.App.3d 1214, 1222-1223 ["the law is long-established that a *trustor* or his successor must tender the obligation in full as a prerequisite to challenge of the foreclosure sale"]; *FPCI RE-HAB 01 v. E&G Investments, Ltd*. (1989) 207 Cal.App.3d 1018, 1021 [tender rule is based on the equitable maxim that a court of equity will not order a useless act performed; "if plaintiffs could not have redeemed the property had the sale procedures been proper, any irregularities in the sale did not result in damages to the plaintiffs"].)

Scott argues that there is no tender requirement where the borrower challenges the foreclosure sale as void ab initio. (Citing *Dimock v. Emerald Properties* (2000) 81 Cal.App.4th 868, 874-876 [foreclosure void and deed void on its face, where trustee who gave notice and sold the property had been divested of all authority, as a matter of law, to take those actions, in light of a recorded substitution of trustees]; *Lona* v. C*itibank, N.A.* (2011) 202 Cal.App.4th 89, 112-113 [tender requirement inapplicable where deed is void on its face, the borrower's action attacks the validity of the underlying debt, the person who seeks to set aside the trustee's sale has a counterclaim or setoff against the beneficiary, or it would otherwise be inequitable to impose such a condition].)

Scott's bases for claiming that the foreclosure sale is void, however, are his assertions that the loan was procured by fraud in the first place, and that JPMorgan had no standing to foreclose because it received no beneficial interest in the deed of trust. As we have explained *ante*, while Scott claims the loan was procured by fraud, he has not alleged fraudulent inducement with sufficient specificity. Furthermore, even if JPMorgan's purported lack of standing could render the sale void (as opposed to voidable) – a matter we do not decide – we have already determined that JPMorgan *did* have standing to foreclose as a matter of law, based on the allegations and the facts judicially noticed by the trial court.

Lastly, Scott argues that he should not be required to tender because banks are not trustworthy. We are not persuaded that the tender rule should be jettisoned simply because a borrower says he distrusts the bank that foreclosed on his property. Scott's failure to allege tender establishes an alternative ground for sustaining the demurrer to his wrongful foreclosure and quiet title claims, as well as to all claims seeking relief from foreclosure or "implicitly integrated" with foreclosure. (*Abdallah v. United Savings Bank* (1996) 43 Cal.App.4th 1101, 1109; *Arnolds Management Corp. v. Eischen* (1984) 158 Cal.App.3d 575, 577-580 [demurrer properly sustained without leave to amend as to junior lienor, who sought to set aside a nonjudicial foreclosure sale *and* obtain damages for a defect in the notice based on a wrongful foreclosure claim, as well as damages for

fraud and negligence, where the junior lienor had not alleged that it tendered the full amount to the senior lienor].)

2. *Effect of Verification of Pleading*

Scott argues that because he verified his second amended complaint, the court must give greater weight to the facts he alleges than the facts judicially noticed based on the P&A Agreement. He provides no authority for this novel proposition, or for his related argument that the court must accept his contentions, deductions, and legal conclusions. Nor is the argument persuasive: averring that a conclusion of law is true of one's own personal knowledge does not make a conclusion of law more lawful or less conclusory.

Scott fails to establish that the court erred in sustaining JPMorgan's demurrer to the second amended complaint in its entirety.

D. *Denial of Leave to Amend*

We review a denial of leave to amend for an abuse of discretion. (*Debro, supra*, 92 Cal.App.4th at p. 946.) To prevail on appeal, an appellant must usually demonstrate a reasonable possibility that the defects in the complaint can be cured by amendment. (E.g., *Schifando v. City of Los Angeles* (2003) 31 Cal.4th 1074, 1081; see *Vaca v. Wachovia Mortgage Corp*. (2011) 198 Cal.App.4th 737, 743.) Thus, Scott must show how the second amended complaint could further be amended and how, as so amended, the pleading would state a cause of action. (*Buller, supra,* 160 Cal.App.4th at p. 992.)

Scott fails to show how he could further amend his complaint to state a cause of action. He has had prior opportunities in the trial court to allege facts sufficient to state a cause of action, and he fails to explain what specific factual amendment he would make or why it would cure the deficiencies of his pleading.

In the trial court, Scott sought leave to amend based on the following: "Plaintiff submits to the court that the discovery responses adduced in this case clearly demonstrate the active involvement of JPMorgan Chase's representatives with this transaction after the acquisition by JPMorgan Chase of Washington Mutual." This proffer is patently

insufficient, in that it fails to set forth any specific facts that Scott could allege to cure the deficiencies of his pleading and state a cause of action.

In light of Scott's vague and nonspecific proffer, as well as the allegations of the second amended complaint, Scott's prior opportunity to amend, and the arguments in his appellate brief, Scott has not demonstrated any reasonable possibility that the defects of his pleading can be cured by amendment. The court did not abuse its discretion in denying him further leave to amend.[11]

III. DISPOSITION

The order sustaining JPMorgan's demurrer to Scott's second amended complaint without leave to amend, which we deem to constitute the judgment of dismissal in the trial court, is affirmed.

____

NEEDHAM, J.

We concur:

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SIMONS, Acting P. J.

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BRUINIERS, J.

[11] At oral argument in this appeal, Scott requested leave to amend in order to add claims for breach of contract and negligence based on JPMorgan's conduct after it became the beneficiary under his deed of trust. He also urged that the allegations of his pleading were like those in *Jolley* – including an alleged breach of contract and wrongful foreclosure for failing to provide Scott additional funds under his loan. Even on this basis, however, he fails to demonstrate that he can state a cognizable cause of action or that the trial court abused its discretion.

Scott v. JPMorgan Chase et al., A132741

Trial court:	Solano County Superior Court
Trial judge:	Hon. Scott L. Kayes

Michael D. Scott, in pro. per.; Terry J. Thomas and Nelson Goodell for Plaintiff and Appellant.

AlvaradoSmith, Theodore E. Bacon and T. Matthew Hansen for Defendants and Respondents.

Filed 11/29/12

IN THE SUPREME COURT OF CALIFORNIA

PACIFIC PALISADES BOWL MOBILE ESTATES, LLC,	
Plaintiff and Appellant,	S187243
v.	Ct.App. 2/4 B216515
CITY OF LOS ANGELES,	Los Angeles County
Defendant and Appellant.	Super. Ct. No. BS112956

We hold here that the requirements of the California Coastal Act of 1976 (Pub. Resources Code, § 30000 et seq.; hereafter Coastal Act) and the Mello Act (Gov. Code, §§ 65590, 65590.1) apply to a proposed conversion, within California's coastal zone, of a mobilehome park from tenant occupancy to resident ownership. In so holding, we reject the argument that such a conversion is not a "development" for purposes of the Coastal Act, and further reject the argument that Government Code section 66427.5, a provision of the Subdivision Map Act (Gov. Code, §§ 66410-66499.37), exempts such conversions from the need to comply with other state laws, or precludes local governmental agencies from exercising state-delegated authority to require compliance with state laws such as the Coastal Act or the Mello Act.

We therefore affirm the Court of Appeal's judgment overturning a grant of mandamus relief to Pacific Palisades Bowl Mobile Estates, LLC (Palisades Bowl).

BACKGROUND

The present controversy arose after the City of Los Angeles (the City) refused to accept Palisades Bowl's application to convert its 170-unit mobilehome park from tenant occupancy to resident ownership because Palisades Bowl had failed to include applications for a coastal development permit or for Mello Act approval. Palisades Bowl declined to provide the applications, instead filing in the superior court a petition for writ of mandate and a complaint for injunctive and declaratory relief. Palisades Bowl argued that the proposed conversion was not a development subject to the Coastal Act, and that the City's action was in any event barred by Government Code section 66427.5, a provision that states substantive and procedural requirements for obtaining map approval for conversions of mobilehome parks from tenant occupancy to resident ownership. The trial court agreed with Palisades Bowl. It therefore issued a peremptory writ of mandamus commanding the City to vacate its decision finding Palisades Bowl's application incomplete, to deem the application complete, and to evaluate the application for approval without considering whether it complied with either the Coastal Act or the Mello Act.

The Court of Appeal reversed, reasoning that the policy considerations behind the Coastal Act and the Mello Act are more extensive than those behind Government Code section 66427.5, and section 66427.5 therefore could not preclude the City from imposing conditions and requirements mandated by those acts on a subdivider seeking to convert to resident ownership a mobilehome park located in the coastal zone. It therefore entered judgment directing the trial court to vacate its peremptory writ of mandamus and enter judgment in favor of the City. We granted review.

DISCUSSION

I.

We are concerned with the interplay between three separate statutory schemes, each furthering important state interests and each in some manner regulating development within California's coastal areas.

A. ***Coastal Act (Pub. Resources Code, § 30000 et seq.)***

The Coastal Act "was enacted by the Legislature as a comprehensive scheme to govern land use planning for the entire coastal zone of California. The Legislature found that 'the California coastal zone is a distinct and valuable natural resource of vital and enduring interest to all the people'; that 'the permanent protection of the state's natural and scenic resources is a paramount concern'; that 'it is necessary to protect the ecological balance of the coastal zone' and that 'existing developed uses, and future developments that are carefully planned and developed consistent with the policies of this division, are essential to the economic and social well-being of the people of this state . . . .' ([Pub. Resources Code,] § 30001, subds. (a) and (d).)" (*Yost v. Thomas* (1984) 36 Cal.3d 561, 565.) The Coastal Act is to be "liberally construed to accomplish its purposes and objectives." (Pub. Resources Code, § 30009.) Under it, with exceptions not applicable here, any person wishing to perform or undertake any development in the coastal zone must obtain a coastal development permit "in addition to obtaining any other permit required by law from any local government or from any state, regional, or local agency . . . ." (*Id*., § 30600, subd. (a).)

The Coastal Act expressly recognizes the need to "rely heavily" on local government "[t]o achieve maximum responsiveness to local conditions, accountability, and public accessibility . . . ." (Pub. Resources Code, § 30004, subd. (a).) As relevant here, it requires local governments to develop local coastal programs, comprised of a land use plan and a set of implementing ordinances

designed to promote the act's objectives of protecting the coastline and its resources and of maximizing public access. (*Id.*, §§ 30001.5, 30500-30526; *Landgate, Inc. v. California Coastal Com.* (1998) 17 Cal.4th 1006, 1011.) Once the California Coastal Commission certifies a local government's program, and all implementing actions become effective, the commission delegates authority over coastal development permits to the local government. (Pub. Resources Code, §§ 30519, subd. (a), 30600.5, subds. (a), (b), (c).) Moreover, "[p]rior to certification of its local coastal program, a local government may, with respect to any development within its area of jurisdiction, . . . establish procedures for the filing, processing, review, modification, approval, or denial of a coastal development permit." (*Id.*, § 30600, subd. (b)(1).) An action taken under a locally issued permit is appealable to the commission. (*Id.*, § 30603.) Thus, "[u]nder the Coastal Act's legislative scheme, . . . the [local coastal program] and the development permits issued by local agencies pursuant to the Coastal Act are not solely a matter of local law, but embody state policy." (*Charles A. Pratt Construction Co., Inc. v. California Coastal Com.* (2008) 162 Cal.App.4th 1068, 1075.) "In fact, a fundamental purpose of the Coastal Act is to ensure that state policies prevail over the concerns of local government." (*Ibid.*) Moreover, in certain areas, sometimes referred to as dual permit jurisdictions, an applicant must obtain a permit from the local entity and after obtaining the local permit, a second permit from the commission. (Pub. Resources Code, §§ 30600, 30601; Cal. Code Regs., tit. 14, § 13301, subd. (a).) Palisades Bowl's mobilehome park is located in a dual permit jurisdiction.

The Coastal Act does not specifically recite that it requires a permit for mobilehome park conversions, and Palisades Bowl contends it does not. We disagree. The act requires a coastal development permit for "any development" in the coastal zone. (Pub. Resources Code § 30600.) As relevant here, a

"development" means a "change in the density or intensity of use of land, including, but not limited to, subdivision pursuant to the Subdivision Map Act . . . , and any other division of land, including lot splits, except where the land division is brought about in connection with the purchase of such land by a public agency for public recreational use." (*Id.*, § 30106.) The Subdivision Map Act defines "subdivision" as "the division, by any subdivider, of any unit or units of improved or unimproved land, or any portion thereof . . . ." (Gov. Code, § 66424.) It specifically refers to the conversion of a rental mobilehome park to resident ownership as a form of "subdivision" (*id.*, § 66427.5), and refers to the applicant seeking to subdivide the property on which the park is located as the "subdivider" (*id.*, §§ 66423, 66427.4, 66427.5). A mobilehome park conversion thus is a "subdivision" under the Subdivision Map Act and for that reason is also a "development" subject to the Coastal Act's permit requirements.

Palisades Bowl argues, however, a conversion of a mobilehome park is not a "development" for purposes of the Coastal Act because it does not alter the density or intensity of use of the land. But by introducing a list of projects, including "subdivision," with the phrase "including, but not limited to," the Legislature in Public Resources Code section 30106 has explained that each listed project *is* a change in the intensity of use for purposes of the act, and by means of the list illustrates various species of changes in land use against which other unspecified projects may be measured so it may be determined whether they, too, require coastal permits. (See *People v. Arias* (2008) 45 Cal.4th 169, 181 [recognizing "the proviso 'including, but not limited to' 'connotes an illustrative listing, one purposefully capable of enlargement' "].) *Any* subdivision under the Subdivision Map Act thus is, *by definition*, a species of change in the density or intensity of use of land and is a "development." Palisades Bowl also seems to assume the Coastal Act is concerned only with preventing an *increase* in density

or intensity of use, but Public Resources Code section 30106, by using the word "change," signals that a project that would *decrease* intensity of use, such as by limiting public access to the coastline or reducing the number of lots available for residential purposes, is also a development. We observe, further, that other portions of Public Resources Code section 30106 define "development" to include uses that may not or will not have any effect on the density or intensity of use.[1] In addition, the statutory reference to "other division[s] of land, including lot splits" (Pub. Resources Code, § 30106), which need not result in a change in density or intensity of use, further suggests the Legislature intended "development" to include all listed uses *and* all changes in density or intensity of use whether or not the specific use was among those listed.

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1 Public Resources Code section 30106 recites in full: " 'Development' means, on land, in or under water, the placement or erection of any solid material or structure; discharge or disposal of any dredged material or of any gaseous, liquid, solid, or thermal waste; grading, removing, dredging, mining, or extraction of any materials; change in the density or intensity of use of land, including, but not limited to, subdivision pursuant to the Subdivision Map Act (commencing with Section 66410 of the Government Code), and any other division of land, including lot splits, except where the land division is brought about in connection with the purchase of such land by a public agency for public recreational use; change in the intensity of use of water, or of access thereto; construction, reconstruction, demolition, or alteration of the size of any structure, including any facility of any private, public, or municipal utility; and the removal or harvesting of major vegetation other than for agricultural purposes, kelp harvesting, and timber operations which are in accordance with a timber harvesting plan submitted pursuant to the provisions of the Z'berg-Nejedly Forest Practice Act of 1973 (commencing with Section 4511).

"As used in this section, 'structure' includes, but is not limited to, any building, road, pipe, flume, conduit, siphon, aqueduct, telephone line, and electrical power transmission and distribution line."

An expansive interpretation of "development" is consistent with the mandate that the Coastal Act is to be "liberally construed to accomplish its purposes and objectives." (Pub. Resources Code, § 30009.) It thus has been held that "development" is not restricted to physical alteration of the land. (*DeCicco v. California Coastal Com.* (2011) 199 Cal.App.4th 947, 951 [Rejecting a claim that a subdivision is not a land use and explaining, "[a]lthough a subdivision may not be a use of land, it is quite clearly a 'development' within the meaning of the Coastal Act. Section 30106 expressly defines 'development' to include 'subdivision.' "].) Similarly, it has been recognized that the Coastal Act's definition of "development" goes beyond "what is commonly regarded as a development of real property" (*Gualala Festivals Committee v. California Coastal Com.* (2010) 183 Cal.App.4th 60, 67) and is not restricted to activities that physically alter the land or water (*id.* at p. 68).

That the act extends to conversions is further demonstrated by Public Resources Code section 30610, which exempts specified projects, including conversion of a multiple-unit residential structure to a time-share project, from the coastal permit requirement. Subdivision (h) of section 30610 explains that the conversion of a residential structure into condominiums is not a time-share project and thus does not qualify for this exemption. If the conversion of a residential structure into condominiums were not a "development" because it does not increase the density or intensity of use, the explanation would be unnecessary.

Finally, the Legislature laid to rest any argument that conversions from tenant occupancy to resident ownership are not subject to the provisions of the Coastal Act by its response to a trial court's ruling that a stock cooperative conversion was not subject to the act because it was not a "development." At the time of the trial court's ruling, Government Code section 66424, which generally

lists the projects defined as "subdivisions" under the Subdivision Map Act, did not expressly refer to stock cooperative conversions. The trial court, reasoning a stock cooperative conversion was neither a defined "subdivision" nor a division of land, concluded it could not be a "development" for purposes of the Coastal Act. (*California Coastal Com. v. Quanta Investment Corp.* (1980) 113 Cal.App.3d 579, 595.) The Legislature responded by amending Government Code section 66424 to specifically recite " 'Subdivision', includes . . . the conversion of five or more existing dwelling units to a stock cooperative . . ." (Gov. Code, § 66424, as amended by Stats. 1979, ch. 1192, § 1, pp. 4691-4692; *Quanta*, at pp. 600-605 [quoting statute]), thus ensuring that stock cooperative conversions would be defined subdivisions and therefore would also be "developments" subject to the Coastal Act.

In short, *all* subdivisions, including mobilehome park conversions, are "developments" for purposes of the Coastal Act.

We also reject the notion that an owner seeking to convert a mobilehome park to resident ownership can avoid the reach of the Coastal Act by asserting that its particular conversion will have no impact on the density or intensity of land use. In the first place, that a conversion might not immediately alter use of land does not preclude the possibility it will lead to an increase in the density or intensity of use. Additionally, a conversion might lead to problematic design features as owners express their individuality by decorating or adding to their mobile homes. Nor is it impossible that owners would block public access to coastal areas or increase the number of residents in their units. In any event, the act accounts for the possibility a proposed project may not affect coastal resources by conferring authority on the executive director of the coastal commission, after a public hearing, to issue "waivers from coastal development permit requirements for any development that is de minimus." (Pub. Resources Code, § 30624.7.) As

explained in *Gualala Festivals Committee v. California Coastal Com.*, *supra*, 183 Cal.App.4th at pages 69-70: "Construing the Act to provide the Commission with both expansive jurisdiction to control even limited . . . development and the authority to exempt from the permit process development that does not have 'any *significant* adverse impact upon coastal resources' provides the Commission the necessary flexibility to manage the coastal zone environment so as to accomplish the statutory purposes." That a project specifically recognized as a "development" by the act is unlikely to affect density or intensity of land use may warrant a grant of exemption from the act's permit requirements, but it does not except the project from the act's jurisdiction.

We conclude the Coastal Act applies to all mobilehome park conversions to resident ownership.

B. *The Mello Act (Gov. Code, §§ 65590, 65590.1)*

The Legislature, as part of the housing elements law (Gov. Code, §§ 65580-65589.8), has declared that the "availability of housing is of vital statewide importance," and "decent housing and a suitable living environment for every Californian . . . is a priority of the highest order." (*Id.*, § 65580, subd. (a).) Further, "[t]he provision of housing affordable to low- and moderate-income households requires the cooperation of all levels of government." (*Id.*, subd. (c).) Each local government therefore is required to adopt a "housing element" as a component of its general plan. (*Id.*, § 65581, subd. (b).) The housing element "shall consist of an identification and analysis of existing and projected housing needs and a statement of goals, policies, quantified objectives, financial resources, and scheduled programs for the preservation, improvement, and development of housing. The housing element shall identify adequate sites for housing, including rental housing, factory-built housing, mobilehomes, and emergency shelters, and

shall make adequate provision for the existing and projected needs of all economic segments of the community." (*Id.*, § 65583.)

The Mello Act supplements the housing elements law, establishing minimum requirements for housing within the coastal zone for persons and families of low or moderate income. (Gov. Code, § 65590, subds. (b), (k); *Venice Town Council, Inc. v. City of Los Angeles* (1996) 47 Cal.App.4th 1547, 1552-1553.) It does not require local governments to adopt individual ordinances or programs to ensure compliance with its provisions (Gov. Code, § 65590, subd. (h)(3)), but it prohibits local governments from authorizing "[t]he conversion or demolition of existing residential dwelling units occupied by persons and families of low or moderate income, . . . unless provision has been made for the replacement of those dwelling units with units for persons and families of low or moderate income." (*Id.*, subd. (b); *Venice Town Council, Inc.*, at p. 1553.)

The Mello Act expressly applies to most conversions of residential units within the coastal zone, and also expressly applies to the conversion of a mobilehome or mobilehome lot to a condominium, cooperative, or similar form of ownership. (Gov. Code, § 65590, subds. (b), (g)(1).)

C. *The Subdivision Map Act* (*Gov. Code, §§ 66410-66499.37*)

"The Subdivision Map Act is 'the primary regulatory control' governing the subdivision of real property in California." (*Gardner v. County of Sonoma* (2003) 29 Cal.4th 990, 996.) It has three principal goals: "to encourage orderly community development, to prevent undue burdens on the public, and to protect individual real estate buyers." (*van't Rood v. County of Santa Clara* (2003) 113 Cal.App.4th 549, 563-564.) It "seeks 'to encourage and facilitate orderly community development, coordinate planning with the community pattern established by local authorities, and assure proper improvements are made, so that

the area does not become an undue burden on the taxpayer.' " (*Gardner*, at pp. 997-998.)

To accomplish its goals, the Subdivision Map Act sets suitability, design, improvement, and procedural requirements (e.g., Gov. Code, §§ 66473 et seq., 66478.1 et seq.). It also allows local governments to impose supplemental requirements of the same kind (e.g., *id.*, §§ 66475 et seq., 66479 et. seq.). (*The Pines v. City of Santa Monica* (1981) 29 Cal.3d 656, 659.) Further, "[t]he Act vests the '[r]egulation and control of the design and improvement of subdivisions' in the legislative bodies of local agencies, which must promulgate ordinances on the subject." (*Gardner v. County of Sonoma*, *supra*, 29 Cal.4th at p. 997, fn. omitted.) The local entity's enforcement power is directly tied to its power to grant or withhold approval of a subdivision map. Thus, "[o]rdinarily, subdivision under the Act may be lawfully accomplished only by obtaining local approval and recordation of a tentative and final map pursuant to section 66426, when five or more parcels are involved, or a parcel map pursuant to section 66428 when four or fewer parcels are involved." (*Ibid.*)

The subdivision process begins with submission to the city or county of an application, including a map depicting the proposed lots. The application and map are first reviewed for completeness. They are next reviewed for technical feasibility, which may require consultation with other agencies. (Dittman, *Map Quest: The Subdivision Map Act may be the most heavily litigated statute in land use law* (Jan. 2007) 29 L.A. Law. 23, 24-25.) The process typically involves one or more hearings. Thus, "[g]enerally, a public hearing is scheduled and conducted only after city and county staff have deemed the map complete, approved the technical feasibility of the map, and prepared an appropriate environmental analysis. The public hearing may be before an advisory agency that is authorized to approve, conditionally approve, or disapprove tentative maps . . . . After the

required public hearing or hearings, the tentative map can be approved." (*Id.* at p. 25, citing Gov. Code, §§ 66452.1, subds. (a), (b), 66452.2, subd. (b); see also *Horn v. County of Ventura* (1979) 24 Cal.3d 605, 616.)

The Subdivision Map Act cites a number of circumstances that require denial of a map; most relate to whether the proposed project and its design are appropriate to the community or to the site, the project's impact on the environment, or issues of health and safety.[2]

The Subdivision Map Act expressly applies to mobilehome park conversions. (Gov. Code, §§ 66427.4, 66427.5, 66428.1.)

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[2] Government Code section 66474 recites that "A legislative body of a city or county shall deny approval of a tentative map, or a parcel map for which a tentative map was not required, if it makes any of the following findings:

"(a) That the proposed map is not consistent with applicable general and specific plans . . . .

"(b) That the design or improvement of the proposed subdivision is not consistent with applicable general and specific plans.

"(c) That the site is not physically suitable for the type of development.

"(d) That the site is not physically suitable for the proposed density of development.

"(e) That the design of the subdivision or the proposed improvements are likely to cause substantial environmental damage or substantially and avoidably injure fish or wildlife or their habitat.

"(f) That the design of the subdivision or type of improvements is likely to cause serious public health problems.

"(g) That the design of the subdivision or the type of improvements will conflict with easements, acquired by the public at large, for access through or use of, property within the proposed subdivision. In this connection, the governing body may approve a map if it finds that alternate easements, for access or for use, will be provided, and that these will be substantially equivalent to ones previously acquired by the public. This subsection shall apply only to easements of record or to easements established by judgment of a court of competent jurisdiction and no authority is hereby granted to a legislative body to determine that the public at large has acquired easements for access through or use of property within the proposed subdivision."

II.

Palisades Bowl does not dispute that, as a general rule, developments within the coastal zone are subject not only to the provisions of the Subdivision Map Act (Gov. Code, §§ 66410-66499.37), but also to all other applicable state laws, including the Coastal Act (Pub. Resources Code, § 30000 et seq.) and the Mello Act (Gov. Code, §§ 65590, 65590.1). Nor does it dispute that, as a general rule, a local agency may or must reject an application that does not comply with the Coastal Act or the Mello Act, even if the application satisfies the requirements of the Subdivision Map Act. In this case, for example, Palisades Bowl sought a vesting tentative map. The approval of a vesting tentative map confers a vested right to proceed with the development in substantial compliance with the ordinances, policies, and standards described by the Subdivision Map Act. (Gov. Code, § 66498.1, subd. (b).) But a local agency may condition or deny a permit if "[t]he condition or denial is required in order to comply with state or federal law." (*Id*., subd. (c)(2).) Further, nothing in the chapter on vesting tentative maps "removes, diminishes, or affects the obligation of any subdivider to comply with the conditions and requirements of any state or federal laws, regulations, or policies and [the chapter] does not grant local agencies the option to disregard any state or federal laws, regulations, or policies." (*Id.*, § 66498.6, subd. (b).)[3]

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[3] Palisades Bowl at times argues or suggests the City acted improperly, procedurally, by requiring it to file applications for a coastal permit and Mello Act clearance in connection with its application for a tentative map. But a combined application appears to be authorized by Public Resources Code section 30600, subdivision (b)(1), which authorizes local governments to "establish procedures for the filing, processing, review, modification, approval, or denial of a coastal development permit," and specifies that "[t]hose procedures may be incorporated and made a part of the procedures relating to any other appropriate land use development permit issued by local government." In addition, Government Code section 66498.1, subdivision (c)(2), part of the Subdivision Map Act, by

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But Palisades Bowl contends Government Code section 66427.5, a provision of the Subdivision Map Act, exempts mobilehome park conversions to resident ownership from other state laws, regulations, or policies, and prohibits local governmental entities from enforcing compliance with any state law requirements except for those imposed by the section itself.

Government Code section 66427.5 creates a mandatory procedure to "avoid the economic displacement of all nonpurchasing residents." Under it, the subdivider must (1) offer each existing tenant the option to purchase that tenant's unit or to continue residency as a tenant (*id.*, subd. (a)), (2) file a report on the impact of the conversion project upon residents (*id.*, subd. (b)), (3) make a copy of the report available to residents at least 15 days prior to the advisory agency's hearing on the map (*id.*, subd. (c)), and (4) obtain a survey of the residents' support for the proposed conversion (*id.*, subd. (d)(1)). Subdivision (d)(5) of section 66427.5 recites that the results of the survey "shall be submitted to the local agency upon the filing of the tentative or parcel map, to be considered as part of the subdivision map hearing prescribed by subdivision (e)." Subdivision (e) recites: "The subdivider shall be subject to a hearing by a legislative body or advisory agency, which is authorized by local ordinance to approve, conditionally approve, or disapprove the map. *The scope of the hearing shall be limited to the issue of compliance with this section.*" (Italics added.) Subdivision (f) states a formula and timeline for increasing the rent of nonpurchasing residents to the

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conferring authority on local governmental agencies to deny or condition a permit to ensure compliance with state law, necessarily contemplates a showing of compliance with state law before or as part of the map application process.

market rate and limits the increases that may be charged lower-income nonpurchasing residents.[4]

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[4] Government Code section 66427.5 recites in full: "At the time of filing a tentative or parcel map for a subdivision to be created from the conversion of a rental mobilehome park to resident ownership, the subdivider shall avoid the economic displacement of all nonpurchasing residents in the following manner:

"(a) The subdivider shall offer each existing tenant an option to either purchase his or her condominium or subdivided unit, which is to be created by the conversion of the park to resident ownership, or to continue residency as a tenant.

"(b) The subdivider shall file a report on the impact of the conversion upon residents of the mobilehome park to be converted to resident owned subdivided interest.

"(c) The subdivider shall make a copy of the report available to each resident of the mobilehome park at least 15 days prior to the hearing on the map by the advisory agency or, if there is no advisory agency, by the legislative body.

"(d)(1) The subdivider shall obtain a survey of support of residents of the mobilehome park for the proposed conversion.

"(2) The survey of support shall be conducted in accordance with an agreement between the subdivider and a resident homeowners' association, if any, that is independent of the subdivider or mobilehome park owner.

"(3) The survey shall be obtained pursuant to a written ballot.

"(4) The survey shall be conducted so that each occupied mobilehome space has one vote.

"(5) The results of the survey shall be submitted to the local agency upon the filing of the tentative or parcel map, to be considered as part of the subdivision map hearing prescribed by subdivision (e).

"(e) The subdivider shall be subject to a hearing by a legislative body or advisory agency, which is authorized by local ordinance to approve, conditionally approve, or disapprove the map. The scope of the hearing shall be limited to the issue of compliance with this section.

"(f) The subdivider shall be required to avoid the economic displacement of all nonpurchasing residents in accordance with the following:

"(1) As to nonpurchasing residents who are not lower income households, as defined in Section 50079.5 of the Health and Safety Code, the monthly rent, including any applicable fees or charges for use of any preconversion amenities, may increase from the preconversion rent to market levels, as defined in an appraisal conducted in accordance with nationally recognized professional appraisal standards, in equal annual increases over a four-year period.

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In Palisades Bowl's view, by limiting the scope of the hearing prescribed by Government Code section 66427.5, subdivision (e) to the issue of compliance with "this section," the Legislature defined the full extent of a local governmental entity's obligation and power to review an application to convert a mobilehome park to resident ownership. Thus, according to Palisades Bowl, the City lacked authority to deny its application for the failure to comply with the Coastal Act or the Mello Act and for that reason also lacked authority to reject its application for failing to include applications for a coastal development permit and for Mello Act clearance. The City asserts, to the contrary, that Government Code section 66427.5, even if read to limit local regulation of mobilehome park conversions, need not and should not be construed to prevent local agencies from enforcing compliance with state laws such as the Coastal Act or the Mello Act.

As we are concerned here only with the application of Coastal Act and Mello Act requirements, we need not also determine whether Government Code section 66427.5 limits local regulation of mobilehome park conversions. We find that irrespective of any effect section 66427.5 has on local regulation of mobilehome park conversions or on the number or subject matter of any hearings required or permitted by the Subdivision Map Act, it does not affect the responsibility of local governmental agencies to ensure compliance with the

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"(2) As to nonpurchasing residents who are lower income households, as defined in Section 50079.5 of the Health and Safety Code, the monthly rent, including any applicable fees or charges for use of any preconversion amenities, may increase from the preconversion rent by an amount equal to the average monthly increase in rent in the four years immediately preceding the conversion, except that in no event shall the monthly rent be increased by an amount greater than the average monthly percentage increase in the Consumer Price Index for the most recently reported period."

Coastal Act and the Mello Act and does not deprive local agencies of the power to hold hearings or impose such conditions as are necessary to ensure compliance with those acts.

III.

" 'As in any case involving statutory interpretation, our fundamental task here is to determine the Legislature's intent so as to effectuate the law's purpose.' " (*In re C.H.* (2011) 53 Cal.4th 94, 100.) " 'If the statute's text evinces an unmistakable plain meaning, we need go no further.' " (*Ibid.*) But where, as here, a statute's terms are unclear or ambiguous, "we may 'look to a variety of extrinsic aids, including the ostensible objects to be achieved, the evils to be remedied, the legislative history, public policy, contemporaneous administrative construction, and the statutory scheme of which the statute is a part.' " (*In re M.M.* (2012) 54 Cal.4th 530, 536.)

Significant state policies favor an interpretation of Government Code section 66427.5 that does not deprive the Coastal Act and the Mello Act of jurisdiction over land use within the coastal zone. As we observed earlier, the Coastal Act specifically recites that "existing developed uses, and future developments that are carefully planned and developed consistent with the policies of [the act] are essential to the economic and social well-being of the people of this state . . . ." (Pub. Resources Code, § 30001, subd. (d).) Moreover, as the Court of Appeal recognized, the Coastal Act explains that the "permanent protection of the state's natural and scenic resources is a *paramount* concern to present and future residents of the state and nation." (Pub. Resources Code, § 30001, subd. (b), italics added.) The housing elements law, which the Mello Act supplements, similarly responds to a concern "of vital statewide importance." (Gov. Code, § 65580, subd. (a).)

Palisades Bowl, however, claims a different state policy mandates its interpretation of Government Code section 66427.5. That section was enacted in 1991 (Stats. 1991, ch. 745, § 2, p. 3324), several years after the Legislature enacted the Mobilehome Park Resident Ownership Program (Health & Saf. Code, §§ 50780 et seq., 50781, subd. (j), added by Stats. 1984, ch. 1692, § 2, pp. 6115-6119; hereafter MPROP), in which it articulated its concern that manufactured housing and mobilehome parks, a significant source of affordable housing for California residents, were being threatened by increases in costs, physical deterioration, and pressures to convert the parks to other uses. (Health & Saf. Code, § 50780, subd. (a).) The MPROP was enacted "to encourage and facilitate the conversion of mobilehome parks to resident ownership or ownership by qualified nonprofit housing sponsors or by local public entities, to protect low-income mobilehome park residents from both physical and economic displacement, to obtain a high level of private and other public financing for mobilehome park conversions, and to help establish acceptance for resident-owned, nonprofit-owned, and government-owned mobilehome parks in the private market." (Health & Saf. Code, § 50780, subd. (b).)[5]

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[5] Health and Safety Code section 50780 provides in full: "(a) The Legislature finds and declares as follows:

"(1) That manufactured housing and mobilehome parks provide a significant source of homeownership for California residents, but increasing costs of mobilehome park development and construction, combined with the costs of manufactured housing, the costs of financing and operating these parks, the low vacancy rates, and the pressures to convert mobilehome parks to other uses increasingly render mobilehome park living unaffordable, particularly to those residents most in need of affordable housing.

"(2) That state government can play an important role in addressing the problems confronted by mobilehome park residents by providing supplemental financing that makes it possible for mobilehome park residents to acquire the mobilehome parks in which they reside and convert them to resident ownership.

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In Palisades Bowl's view, it follows that when the Legislature enacted Government Code section 66427.5, it did so not only to provide a uniform statewide procedure for protecting nonpurchasing residents against economic displacement, but also to promote conversions of mobilehome parks to resident or nonprofit ownership by simplifying the procedures for what it asserts is little more than a change in title. (See also *Sequoia Park Associates v. County of Sonoma* (2009) 176 Cal.App.4th 1270, 1295 [taking the view that because tenant-occupied mobilehome parks are subject to a myriad of laws and regulations, local review of mobilehome park conversions is unnecessary].)

We do not agree. Although the MPROP reflects a state policy favoring conversions of mobilehome parks to resident ownership, nothing in it, and nothing in Government Code section 66427.5, suggests a belief by the Legislature that this policy is of more importance than and overrides the "paramount" and "vital"

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"(3) That a significant number of older mobilehome parks exist in California, the residents of which may collectively lack the experience or other qualifications necessary to successfully own and operate their parks; that these parks provide low-cost housing for their residents that would be difficult to replace if the parks were converted to other uses; that these parks are more likely than other parks to be threatened by physical deterioration or conversion to other uses; and that it is, therefore, appropriate to use the resources of the fund pursuant to this chapter to transfer these parks to ownership by qualified nonprofit housing sponsors or by local public entities for the purpose of preserving them as affordable housing.

"(b) Therefore, it is the intent of the Legislature, in enacting this chapter, to encourage and facilitate the conversion of mobilehome parks to resident ownership or ownership by qualified nonprofit housing sponsors or by local public entities, to protect low-income mobilehome park residents from both physical and economic displacement, to obtain a high level of private and other public financing for mobilehome park conversions, and to help establish acceptance for resident-owned, nonprofit-owned, and government-owned mobilehome parks in the private market."

concerns of the Coastal Act and the Mello Act. In addition, the Subdivision Map Act's deference to other state or federal laws, regulations, or policies; the other interests at stake; and the absence of any language in section 66427.5 expressly excepting mobilehome park conversions from those laws, regulations, or policies strongly suggest the section, like the other provisions of the Subdivision Map Act, is intended to operate in conjunction with other state laws.

General principles of statutory interpretation also favor a construction of Government Code section 66427.5 that does not cause it to displace the Coastal Act or the Mello Act. "A court must, where reasonably possible, harmonize statutes, reconcile seeming inconsistencies in them, and construe them to give force and effect to all of their provisions. [Citations.] This rule applies although one of the statutes involved deals generally with a subject and another relates specifically to particular aspects of the subject." (*Hough v. McCarthy* (1960) 54 Cal.2d 273, 279.) Thus, when " 'two codes are to be construed, they "must be regarded as blending into each other and forming a single statute." [Citation.] Accordingly, they "must be read together and so construed as to give effect, when possible, to all the provisions thereof." [Citation.]' " (*Mejia v. Reed* (2003) 31 Cal.4th 657, 663.) Further, " ' "[a]ll presumptions are against a repeal by implication. [Citations.]" [Citation.] Absent an express declaration of legislative intent, we will find an implied repeal "only when there is no rational basis for harmonizing two potentially conflicting statutes [citation], and the statutes are 'irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation.' " [Citation.]' " (*Merrill v. Navegar, Inc.* (2001) 26 Cal.4th 465, 487; accord, *Schatz v. Allen Matkins Leck Gamble & Mallory LLP* (2009) 45 Cal.4th 557, 573.)

Government Code section 66427.5 can be construed to require a hearing devoted exclusively to the issue of economic displacement of tenants *in addition*

to the procedures and hearings required by other state laws. Such a construction is consistent with the general application of the Subdivision Map Act *and* the Coastal Act and the Mello Act to developments within the coastal zone, harmonizing the provisions of all three acts. This construction is consistent as well with the Mello Act's express mandate that its provisions apply to mobilehome park conversions within the coastal zone. (Gov. Code, § 65590, subds. (b), (g)(1).) A contrary construction of section 66427.5, one that denies enforcement of the Coastal Act and the Mello Act in connection with mobilehome park conversions within the coastal zone, not only fails to harmonize the section with those acts but, by overriding their provisions, also effects an implied partial repeal of them. (See *Schatz v. Allen Matkins Leck Gamble & Mallory LLP*, *supra*, 45 Cal.4th at p. 573.) We would adopt it only if no other construction were feasible.

That Government Code section 66427.5, like the Mello Act, seeks to preserve affordable housing within the coastal zone does not render the statutes fatally incompatible. Section 66427.5 establishes specific measures to avoid the economic displacement of all nonpurchasing mobilehome park residents through notice, an opportunity to purchase, and measured rent increases. Nothing requires either the subdivider or the purchasing residents to maintain or provide any low- or moderate-income housing stock. In contrast, the Mello Act requires a developer to provide replacement low- and moderate-income housing in order to maintain a variety of housing stock within the coastal zone. (Gov. Code, § 65590.) The statutes thus address different subjects: one protects current residents, the other maintains adequate low- and moderate-income housing stock in the coastal zone for future residents. There is no conflict between them.

We recognize that requiring compliance with the Mello Act and the Coastal Act may slow down the conversion process. But that result, even if not fully consistent with the Legislature's expressed desire, in the MPROP, to encourage or

facilitate conversions, does not create so serious a repugnancy between statutory schemes as to justify a construction of Government Code section 66427.5 that effects an implied repeal of the Coastal Act and the Mello Act.

Nor is it by any means certain the Legislature would have assumed compliance with the Coastal Act or the Mello Act would pose significant obstacles to mobilehome park conversions. The goals of those acts are not incompatible with Government Code section 66427.5 or with a desire to protect mobilehome parks as a source of affordable housing, and Palisades Bowl has not shown that requiring a coastal permit or Mello Act compliance will unreasonably burden conversions to resident ownership. To the contrary, if, as Palisades Bowl insists, its conversion will have no effect on the interests protected by the Coastal Act, it may be able to obtain an exemption from the necessity of obtaining a coastal permit. (Pub. Resources Code, § 30624.7). In addition, although requiring compliance with the Mello Act may delay the conversion process, Government Code section 66427.5, subdivision (e), by creating a uniform statewide procedure for protecting nonpurchasing residents against economic displacement, streamlines the process by addressing the issue most likely to create a stumbling block to conversion. The Legislature reasonably may have concluded such a procedure provides an adequate response to the desire to encourage and facilitate conversions.

Finally, a related provision of the Subdivision Map Act also argues against Palisades Bowl's interpretation. Government Code section 66427.5 generally refers to the conversion of a rental mobilehome park to resident ownership. Government Code section 66428.1 governs conversions when at least two-thirds of the park's tenants sign a petition indicating their intent to purchase the park for purposes of converting it to resident ownership. Section 66428.1 states a general rule requiring waiver of the requirement for a parcel map or a tentative and final

map for tenant-initiated conversions, but excepts from that rule conversions where design or improvement requirements are necessitated by significant health or safety concerns (*id*., subd. (a)(1)), the local agency determines there is an exterior boundary discrepancy that requires recordation of a new parcel or tentative and final map (*id*., subd. (a)(2)), the existing parcels were not created by a recorded parcel or final map (*id*., subd. (a)(3)), or the conversion would result in the creation of more condominium units or interests than the number of tenant lots or spaces that existed prior to conversion (*id*., subd. (a)(4)). Accordingly, despite the Legislature's expressed interest, in the MPROP, of promoting mobilehome park conversions to resident ownership, section 66428.1 contemplates some form of local scrutiny for the purpose of determining whether or not waiver is warranted, and by specifying conditions that preclude waiver, it further implies that the agency charged with the obligation to review map applications has the authority to address those conditions when determining whether to approve, conditionally approve, or disapprove the map. That the Legislature did not intend to prevent all review even of tenant-initiated conversions to address local concerns argues against a construction of Government Code section 66427.5 that prevents review of owner-initiated conversions for compliance with state law.

For the reasons we have stated, we find a construction of Government Code section 66427.5 that does not exempt residential conversions from the Coastal Act and the Mello Act to be consistent with the language of the section and its context, and finds significant support in the rules of statutory construction disfavoring implied repeal of laws and favoring harmony between code provisions. Palisades Bowl argues, however, that the legislative history of the section reveals that the Legislature intended to exempt conversions from the requirements of other state laws. That history has been chronicled in other cases (see, e.g., *Colony Cove Properties, LLC v. City of Carson* (2010) 187 Cal.App.4th 1487, 1497-1504;

Sequoia Park Associates v. County of Sonoma, *supra*, 176 Cal.App.4th at pp. 1282-1287; *El Dorado Palm Springs, Ltd. v. City of Palm Springs* (2002) 96 Cal.App.4th 1153, 1166-1174 (*El Dorado*)), and because little in the history prior to the 2002 amendment of section 66427.5 sheds light on the meaning of section 66427.5, subdivision (e), it need not be described in great detail here. Palisades Bowl cites it chiefly for the Legislature's response to the decision in *El Dorado.* We find, to the contrary, the Legislature did no more than signal its intent to bar local governmental entities from imposing their own conditions for the protection of tenants on conversions to resident ownership.

An understanding of *El Dorado* begins with an earlier case, *Donohue v. Santa Paula West Mobile Home Park* (1996) 47 Cal.App.4th 1168. There, the Second District rejected an argument that provisions of Government Code section 66427.5 allowing for increases in rent after conversion (*id*., former subd. (d)(1), now subd. (f)(1)) take effect when a subdivider files a tentative map as the first step toward conversion to resident ownership. The court held that the provisions do not take effect until conversion occurs (*Donohue*, at p. 1173), observing that a contrary conclusion would mean "every park owner could purchase a lifetime exemption from local rent control for the cost of filing a tentative map, even if park residents have no ability to purchase and even if local government disapproves the tentative map. Park residents could then be economically displaced by unregulated rent increases. This is the very circumstance section 66427.5 was enacted to prevent." (*Id.* at p. 1175.)

The decision in *Donohue* did not render it impossible to use Government Code section 66427.5 to avoid local rent control. For example, an owner could obtain approval for a conversion, take the steps necessary to "convert" the park so as to exempt it from local rent control, but make no further effort to transfer ownership of the newly created lots to residents, thereby enabling the owner to

continue to rent the units to tenants without the burden of local rent control. In *El Dorado*, *supra*, 96 Cal.App.4th 1153, the City of Palm Springs had responded to that possibility by making its approval of a proposed conversion subject to conditions designed to ensure the conversion was bona fide. One condition would delay conversion, and thus the force of section 66427.5's rent increase provisions, until escrow had closed on approximately one-third of the units. The Fourth District held the conditions violated section 66427.5. It found a park is converted to resident ownership when the first unit is sold (*El Dorado*, at p. 1166), thus confirming it would be possible for a park owner to avoid local rent control by means of a "sham" conversion. The court expressed concern that section 66427.5 therefore could be used to avoid local rent control by means of "sham transactions," suggesting the Legislature might wish to broaden the authority of local entities to regulate conversions. (*El Dorado*, at p. 1165.) But it held that section 66427.5, in what was then subdivision (d), "provides that 'The scope of the hearing shall be limited to the issue of compliance with this section.' Thus, the City lacks authority to investigate or impose additional conditions to prevent sham or fraudulent transactions at the time it approves the tentative or parcel map." (*El Dorado*, at p. 1165.)

In 2002, the Legislature responded to the decision in *El Dorado* by amending Government Code section 66427.5, moving the section's hearing requirements to a new subdivision (e) and adding a new subdivision (d), which imposes on the subdivider the obligation to obtain a survey of tenants to determine tenant support for a conversion and submit the results of the survey to the local agency "to be considered as part of the subdivision map hearing prescribed by subdivision (e)." (Gov. Code, § 66427.5, subd. (d)(5), added by Stats. 2002, ch. 1143, § 1, p. 7399.) The Legislature also enacted, but did not include in the code amendments, language reciting: "It is the intent of the Legislature to address

the conversion of a mobilehome park to resident ownership that is not a bona fide resident conversion, as described by the Court of Appeal in El Dorado . . . . It is, therefore, the intent of the Legislature in enacting this act to ensure that conversions pursuant to Section 66427.5 of the Government Code are bona fide resident conversions." (Stats. 2002, ch. 1143, § 2, pp. 7399-7400.)[6] But the Legislature rejected a proposal that would have granted local agencies authority to impose "any additional conditions of approval that the local legislative body or advisory agency determines are necessary to preserve affordability or to protect nonpurchasing residents from economic displacement." (Sen. Amend. to Assem. Bill No. 930 (2001-2002 Reg. Sess.) June 26, 2002, § 1, p. 3, italics omitted.)

Palisades Bowl asserts the Legislature's failure to adopt provisions conferring additional authority on local agencies proves the Fourth District in *El Dorado*, *supra*, 96 Cal.App.4th 1153, correctly interpreted Government Code section 66427.5 as precluding local governmental agencies from investigating or imposing additional conditions on mobilehome park conversions to prevent sham or fraudulent transactions. It reasons, further, that the Legislature's limited response to that decision and its expressed interest in promoting mobilehome park conversions to resident ownership lead inexorably to the conclusion the Legislature intended to prevent local agencies from denying conversion applications for any reason besides noncompliance with section 66427.5. But the Fourth District in *El Dorado* was concerned only with conditions that had been

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6 This language is part of what is known as a " 'plus section' " of a bill: a provision "that is not intended to be a substantive part of the code section or general law that the bill enacts, but [expresses] the Legislature's view on some aspect of the operation or effect of the bill." (*People v. Allen* (1999) 21 Cal.4th 846, 858-859, fn. 13.)

imposed on a conversion by a local entity to protect tenants, and neither its holding nor the Legislature's response to it can reasonably be read to support an argument neither addresses: whether section 66427.5, even if it precludes local regulation to prevent sham conversions, also bars state-mandated local review of conversions for compliance with other state laws.

For the same reason, we find little if any support for Palisades Bowl's position in two appellate court cases that, like the present case, were decided after the 2002 amendments to Government Code section 66427.5. In *Sequoia Park Associates v. County of Sonoma*, *supra*, 176 Cal.App.4th 1270, the First District invalidated a local ordinance that specified the actions a subdivider was required to take to prove a proposed conversion was "a bona fide resident conversion" (*id.* at p. 1274). The court reasoned that the Legislature has expressly and impliedly preempted all local regulation of mobilehome park conversions to resident ownership. (*Id.* at pp. 1275, 1297-1300.) The following year, the Second District issued its opinion in the present case, and on the same day also decided *Colony Cove Properties, LLC v. City of Carson*, *supra*, 187 Cal.App.4th 1487. It found there that, "[w]hen it overhauled sections 66427.4 and 66427.5 in 1995, the Legislature deprived local entities and agencies of the authority to 'enact[] more stringent measures' regulating conversions of mobilehome parks to resident ownership, thereby conveying its intent to prevent localities from unduly impeding resident conversions." (*Id.* at p. 1506.) The court further observed that the Legislature's later rejection of the proposal to authorize local agencies to impose additional conditions of approval "demonstrates that it continues to oppose local deviation from or addition to the statutory criteria." (*Ibid.*)

Although broadly stating that Government Code section 66427.5 precludes local regulation of mobilehome park conversions to resident ownership, neither *Sequoia Park* nor *Colony Cove* considered the specific issues presented by this

case: whether the section exempts conversions from other state laws, such as the Coastal Act and the Mello Act, or bars local agencies from exercising the authority delegated to them by the Coastal Act and the Mello Act to require compliance with those acts and to reject or deny applications that do not establish compliance. They do not, accordingly, provide authority supporting either argument.

CONCLUSION

We hold that Government Code section 66427.5, which states a uniform, statewide procedure for protecting nonpurchasing residents against economic displacement, does not exempt conversions of mobilehome parks to resident ownership from the requirements of the Coastal Act (Pub. Resources Code, § 30000 et seq.) or the Mello Act (Gov. Code, §§ 65590, 65590.1), which also apply to such conversions, and has no effect on the authority those acts delegate to local entities to enforce compliance with their provisions. Local agencies therefore are not precluded from establishing such procedures and holding such hearings as are appropriate to fulfill their responsibilities to ensure compliance with the Coastal Act and the Mello Act.

The judgment of the Court of Appeal is affirmed.

WERDEGAR, J.

WE CONCUR:

CANTIL-SAKAUYE, C. J.
CHIN, J.
CORRIGAN, J.
LIU, J.
KLINE, J.*

***** Presiding Justice, Court of Appeal, First Appellate District, Division Two, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

DISSENTING OPINION BY KENNARD, J.

Government Code section 66427.5 (section 66427.5) sets forth requirements for subdividing a mobilehome park for the purpose of converting it to resident ownership — that is, a mobilehome park in which the residents own, rather than rent, the parcels on which their mobilehomes are situated. The majority holds that when a mobilehome park is located within the coastal zone, a person or entity seeking to convert the park to resident ownership must comply not only with section 66427.5 but also with the California Coastal Act of 1976 (Pub. Resources Code, § 30000 et seq.; hereafter Coastal Act) and the Mello Act (Gov. Code, § 65590).

I disagree. Because subdividing a mobilehome park to convert it to resident ownership does not involve a change in the density or intensity of the property's use, it is not a "development" within the meaning of the Coastal Zone Act, and therefore it is not subject to regulation under that act. Nor does the Mello Act apply. The plain language of section 66427.5's subdivision (e) shows that the Legislature intended section 66427.5 to displace other state laws such as the Mello Act.

I

Plaintiff Pacific Palisades Bowl Mobile Estates, LLC (Palisades Bowl) owns a mobilehome park with more than 170 units. The park is in the coastal

zone across Pacific Coast Highway from Will Rogers State Beach in the City of Los Angeles (the City). In November 2007, after various discussions with City's planning officials, Palisades Bowl attempted to file an application to convert its mobilehome park to resident ownership. City officials refused to accept the application, insisting it was incomplete because it did not include, among other things, a coastal development permit and a Mello Act affordable housing determination.

In January 2008, Palisades Bowl filed in superior court a petition for writ of mandate together with a complaint for declaratory and injunctive relief. Palisades Bowl alleged, among other things, that the City had improperly refused to accept its subdivision application and that the City lacks discretion to impose any requirements other than those set forth in section 66427.5. Palisades Bowl requested a writ or injunction commanding the City to accept its application, deem it complete, and make a decision either approving or denying it.

The superior court issued a peremptory writ of mandate commanding the City to vacate its decision finding Palisades Bowl's application incomplete, deem it complete, and evaluate it without regard to whether it complied with either the Coastal Act or the Mello Act. On the City's appeal, the Court of Appeal reversed with directions to vacate the peremptory writ and enter judgment for the City. This court granted review.

II

This case presents issues of statutory construction. In construing statutes, a court aims "to ascertain the intent of the enacting legislative body so that we may adopt the construction that best effectuates the purpose of the law." (*Hassan v. Mercy American River Hospital* (2003) 31 Cal.4th 709, 715; accord, *Klein v. United States of America* (2010) 50 Cal.4th 68, 77; *Chavez v. City of Los Angeles* (2010) 47 Cal.4th 970, 986.) To achieve this goal, a court begins by looking to the

words of the statute, "because the statutory language is generally the most reliable indicator of legislative intent." (*Hassan v. Mercy American River Hospital*, *supra*, at p. 715; accord, *Klein v. United States of America*, *supra*, at p. 77; *Chavez v. City of Los Angeles*, *supra*, at p. 986.) If the statutory language is not ambiguous, its plain meaning governs. (*In re Ethan C.* (2012) 54 Cal.4th 610, 627; *People v. Toney* (2004) 32 Cal.4th 228, 232.)

The Coastal Act does not expressly require a permit for mobilehome park conversions to resident ownership, but it does require a permit for any "development." (Pub. Resources Code, § 30600.) The issue, then, is whether a mobilehome park conversion to resident ownership is a "development" within the Coastal Act's definition of that term as, among other things, a "change in the density or intensity of use of land, including, but not limited to, subdivision pursuant to the Subdivision Map Act . . . and any other division of land, including lot splits, except where the land division is brought about in connection with the purchase of such land by a public agency for public recreational use" (Pub. Resources Code, § 30106). Under the plain meaning of this definition, a mobilehome park conversion to resident ownership is not a "development" because it does not change the density or intensity of use of the land, but merely changes the form of its ownership. After the conversion, the same number of mobilehomes will remain in the same locations, each occupied by a single household.

The majority concludes otherwise. It reasons that "by introducing a list of projects, including 'subdivision,' with the phrase 'including, but not limited to,' the Legislature in Public Resources Code section 30106 has explained that each listed project *is* a change in the intensity of use for purposes of the act . . . ." (Maj. opn., *ante*, at p. 5.) The majority states: "*Any* subdivision under the Subdivision Map Act thus is, *by definition*, a species of change in the density or intensity of use

of land and is a ‘development.’ ” (*Ibid.*; see also *id.* at p. 8 [“In short, *all* subdivisions, including mobilehome park conversions, are ‘developments’ for purposes of the Coastal Act.”].)

The majority’s approach leads to statutory constructions that the Legislature is unlikely to have intended. For example, if a statute defined “antique American car” as “any car manufactured in the United States before 1940, including, but not limited to, a Ford, Chevrolet, or Chrysler,” the majority’s approach would mean that *every* Ford, Chevrolet, and Chrysler *by definition* is an “antique American car,” regardless of where or when it was made. Such a construction would be nonsensical because it nullifies important elements in the statutory definition. I would construe this hypothetical statutory definition to mean that a Ford, Chevrolet, or Chrysler is an “antique American car” if, but only if, it was manufactured in the United States before 1940.

Another example, involving an actual statutory definition, is provided by *People v. Arias* (2008) 45 Cal.4th 169 (*Arias*). At issue there was the meaning of Health and Safety Code section 11366.8, making it a crime to possess a “false compartment” in a vehicle. The statute defines “false compartment” as “any box, container, space, or enclosure that is intended for use or designed for use to conceal, hide, or otherwise prevent discovery of any controlled substance within or attached to a vehicle, including, but not limited to, . . . [¶] . . . [¶] . . . [o]riginal factory equipment of a vehicle that is modified, altered, or changed. . . .” (Health & Saf. Code, § 11366.8, subd. (d).) This court construed that provision as “exclud[ing] from its definition of ‘false compartment’ a vehicle’s original factory equipment that has not been modified, altered, or changed in any way.” (*Arias*, *supra*, at pp. 173-174.)

The majority here cites *Arias*, *supra*, 45 Cal.4th 169, for the proposition that whenever a statutory definition contains a list introduced by the phrase

"including, but not limited to," then every item on the list necessarily must, in every instance, fall within the statutory definition. (Maj. opn., *ante*, at p. 5.) The flaw in that reasoning becomes apparent if it is applied to the statutory definition at issue in *Arias*. Under the majority's reasoning, as applied to Health and Safety Code section 11366.8, *any* modification of a vehicle's original factory equipment *by definition* produces a false compartment, regardless of whether the modification meets the statute's requirement of being intended or designed for use to conceal a controlled substance. Surely this cannot be what the Legislature contemplated. I would construe the statute in *Arias* as meaning that modified original factory equipment is a "false compartment" if, but only if, it is "intended for use or designed for use to conceal, hide, or otherwise prevent discovery of any controlled substance within or attached to a vehicle" (Health & Saf. Code, § 11366.8, subd. (d)). By the same token, a subdivision or other division of land qualifies as a "development" under the Coastal Act if, but only if, it will result in a "change in the density or intensity of use of land" (Pub. Resources Code, § 30106). As this court explained in *Arias*, in construing a statutory definition, a court must be careful not to "render nugatory the qualifiers that the Legislature purposefully included . . . ." (*Arias*, *supra*, 45 Cal.4th at p. 181.)

To summarize: Because subdividing a mobilehome park under section 66427.5 for the purpose of converting it to resident ownership involves no change in the density or intensity of the land's use, it is not a development under the Coastal Act, no coastal permit is required, and no conflict exists between section 66427.5 and the Coastal Act.

This leaves the Mello Act, which establishes housing requirements within the coastal zone for persons and families with low or moderate incomes. In particular, it prohibits authorizing the conversion or demolition of existing residential units occupied by persons and families of low or moderate income

unless provision has been made for replacement with other similar units. The Mello Act expressly applies to the conversion of a mobilehome or mobilehome lot in a mobilehome park lot "to a condominium, cooperative, or similar form of ownership." (Gov. Code, § 65590, subd. (g)(1).)

Section 66427.5 contains its own safeguards to avoid economic displacement of nonpurchasing tenants with low or moderate incomes. The subdivider (usually the mobilehome park's owner) must offer each tenant the option to continue renting the space rather than buying it. (§ 66427.5, subd. (a).) If the tenant chooses to continue renting, section 66427.5 limits rent increases. (§ 66427.5, subd. (f).) For lower income households, increases cannot exceed the rise in the Consumer Price Index. (§ 66427.5, subd. (f)(2).) The subdivider also must survey all the tenants to find out if they favor the conversion to resident ownership and give copies of the survey results to the local agency as part of the subdivision application. (§ 66427.5, subd. (d).)

For mobilehome park conversions to resident ownership, application of the Mello Act is precluded by section 66427.5's subdivision (e), which reads: "The subdivider shall be subject to a hearing by a legislative body or advisory agency, which is authorized by local ordinance to approve, conditionally approve, or disapprove the map. *The scope of the hearing shall be limited to the issue of compliance with this section*." (Italics added.) By limiting the issues at the hearing on the subdivision application to compliance with section 66427.5 itself, the plain language of this provision bars application of other state laws such as the Mello Act.

Reaching a different conclusion, the majority states that the language of section 66427.5's subdivision (e) "can be construed to require a hearing devoted exclusively to the issue of economic displacement of tenants *in addition* to the procedures and hearing required by other state laws." (Maj. opn., *ante*, at pp. 20-

21.) But nothing in the statutory language suggests that the Legislature intended such a cumbersome and inefficient system, mandating multiple hearings for piecemeal consideration of overlapping and redundant statutory requirements before a subdivision map may be approved. To subdivide a mobilehome park for conversion to resident ownership, section 66427.5 requires a single application and a single hearing limited to the question of compliance with section 66427.5, to be followed by approval or disapproval. Thus, section 66427.5 alone governs the subdivision map approval.

For the reasons stated above, I conclude that irrespective of whether a mobilehome park is located within the coastal zone, the person or entity seeking to convert the park to resident ownership must comply only with section 66427.5 and need not also comply with either the Coastal Act or the Mello Act. Therefore, I would reverse the judgment of the Court of Appeal and direct that court to affirm the superior court's judgment.

KENNARD, J.

See next page for addresses and telephone numbers for counsel who argued in Supreme Court.

Name of Opinion Pacific Palisades Bowl Mobile Estates, LLC v. City of Los Angeles

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Unpublished Opinion
Original Appeal
Original Proceeding
Review Granted XXX 187 Cal.App.4th 1461
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Judge: James C. Chalfant

Counsel:

Bien & Summers, Elliot L. Bien, Amy E. Margolin; Blum Collins and Craig M. Collins for Plaintiff and Appellant.

Bien & Summers, Elliot L. Bien and Amy E. Margolin for Western Manufactured Housing Communities Association as Amicus Curiae on behalf of Plaintiff and Appellant.

Hart, King & Coldren, Robert S. Coldren, C. William Dahlin and Boyd L. Hill for Laguna Terrace Park, LLC, as Amicus Curiae on behalf of Plaintiff and Appellant.

R. S. Radford for Pacific Legal Foundation as Amicus Curiae on behalf of Plaintiff and Appellant.

Gilchrist & Rutter, Richard H. Close, Thomas W. Casparian and Yen N. Hope for Carson Harbor Village, Ltd., as Amicus Curiae on behalf of Plaintiff and Appellant.

Carmen A. Trutanich, City Attorney, Jeri L. Burge, Assistant City Attorney, Kenneth T. Fong and Amy Brothers, Deputy City Attorneys, for Defendant and Appellant.

Kirkland & Ellis, Robyn E. Bladow and Vidhya Ragunathan for Western Center on Law and Poverty as Amicus Curiae on behalf of Defendant and Appellant.

Law Office of William J. Constantine and William J. Constantine for Golden State Manufactured-Home Owners League as Amicus Curiae on behalf of Defendant and Appellant.

Kamala D. Harris, Attorney General, Manuel M. Medeiros, State Solicitor General, John A. Saurenman, Assistant Attorney General, and Jamee Jordan Patterson, Deputy Attorney General, for California Coastal Commission as Amicus Curiae on behalf of Defendant and Appellant.

Richards, Watson & Gershon, Rochelle Browne and Ginetta L. Giovinco for League of California Cities as Amicus Curiae on behalf of Defendant and Appellant.

Aleshire & Wynder, William W. Wynder, Sunny K. Soltani and Jeff M. Malawy for Palisades Bowl Residents' Association, Inc., and City of Carson as Amici Curiae on behalf of Defendant and Appellant.

Counsel who argued in Supreme Court (not intended for publication with opinion):

Elliot L. Bien
Bien & Summers
23 Palomino Road
Novato, CA 94947
(415) 898-2900

Amy Brothers
Deputy City Attorney
700 City Hall East
200 North Main Street
Los Angeles, CA 90012
(213) 978-8069

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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION ONE

SIDNEY J. CORRIE, JR., Plaintiff and Appellant, v. ELIZABETH SOLOWAY, as Trustee, etc., et al., Defendants and Respondents.	A135963 (Contra Costa County Super. Ct. No. P09-01129)

Appellant Sidney J. Corrie, Jr., petitioned the probate court to enforce an option he held to purchase a portion of a property owned by the Armand Borel Trust Dated June 20, 1994, as Amended and Restated in 2008 (Borel Trust or the trust). Respondents, successor trustee, Elizabeth Soloway, and trust beneficiary, the East Bay Regional Park District (the District), objected to the petition on the grounds that Corrie's option agreement with the trust was void and unenforceable for illegality in that it failed to comply with the Subdivision Map Act, Government Code[1] section 66410 et seq. (SMA). Following a separate trial on the issue, the trial court ruled in favor of respondents, finding that amendments to the option agreement executed by Corrie and a previous trustee to cure the illegality were ineffectual.

Corrie contends the trial court erred as a matter of law in holding that no subsequent acts by the parties could revive the option agreement. We agree, and will reverse the trial court's orders on this issue.

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[1] All statutory references are to the Government Code unless otherwise indicated.

I. BACKGROUND

Armand Borel was the settler and trustee of the Armand Borel Trust Dated June 20, 1994, a revocable trust. On June 14, 2004, Borel and Corrie entered into a "Real Property Option and Purchase Agreement" (the Option Agreement) pertaining to a 16.65-acre parcel of real property Borel owned in Danville, California (the Danville property). The Option Agreement granted Corrie a five-year exclusive and irrevocable option to purchase up to seven acres of the Danville property at a price of $500,000 per acre. In return for the purchase option, Corrie was required to pay Borel a nonrefundable option fee of $100,000 up front, plus another $5,000 per month during the option period. The Option Agreement provided that if the option was exercised, "Buyer shall purchase and Seller shall sell the Property on the terms and conditions set forth in this Agreement," and it included detailed provisions specifying buyer's and seller's covenants and conditions precedent to closing the sale, the deposits required to be made into escrow by buyer and seller, and the title company's duties at the closing. The Option Agreement also gave Corrie a right of first refusal to purchase "the balance of the [Danville property] that is not part of this Option Agreement." No language in the Option Agreement expressly conditioned a future sale of property subject to the option on compliance with the SMA.[2]

As required by the Option Agreement, Borel, individually and as trustee, and Corrie executed a "Memorandum of Option," incorporating the Option Agreement by reference, which was recorded on August 3, 2004.

On July 14, 2008, Borel executed a revised trust instrument, creating the Borel Trust. The Borel Trust provided that upon Borel's death the Danville property would be

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[2] "The [SMA] 'generally requires all subdividers of property to design their subdivisions in conformity with applicable general and specific plans and to comply with all of the conditions of applicable local ordinances. [Citation.]' [Citation.] '. . . [T]he Act aims to "control the design of subdivisions for the benefit of adjacent landowners, prospective purchasers and the public in general." ' " (*Trinity Park, L.P. v. City of Sunnyvale* (2011) 193 Cal.App.4th 1014, 1028.) With certain exceptions, the SMA prohibits the sale of any parcel of real property for which a map is required, until a map in full compliance with its provisions has been filed. (§ 66499.30, subds. (a), (b).)

distributed to the District "so long as it used [*sic*] as and for an agricultural park." In the event the District could not create and operate such a park, the Borel Trust provided that the property would go to the City of San Ramon or the Town of Danville to create and operate the park.

In July 2008, Corrie was contemplating exercising the option. On July 24, 2008, Borel wrote a letter to the Town of Danville's planning director authorizing Corrie to proceed with a tentative parcel map application and the creation of a second parcel on the Danville property for all or any portion of the seven acres covered by Corrie's option. The 2008 transaction did not proceed, and Corrie continued to make option payments. On March 25, 2009, Borel and Corrie amended the Option Agreement to (1) extend the option period by one year to June 14, 2010; (2) increase the option fees from $5,000 per month to $10,000 per month; and (3) give Corrie the option to extend the option period to June 14, 2011, by payment of an additional $100,000 to Borel, which would count toward the purchase price of the property if Corrie exercised the option (Amendment No. 1). Corrie timely made the $100,000 payment required for extension of the option period until June 14, 2011.

In March 2009, Borel and Corrie entered into and recorded an agreement with a lender entitled "Subordination, Nondisturbance and Attornment Agreement Regarding Option and Right of First Refusal" (the subordination agreement). The subordination agreement recited that the lender had conditionally agreed to make a $1.4 million loan to Borel as trustee of the Borel Trust, secured in part by a deed of trust on the Danville property. The agreement generally addressed the relative rights and duties of Corrie, the lender, and the foreclosure purchaser in the event of a future foreclosure sale pertaining to the Danville property. A promissory note for $1.4 million secured by the property was recorded on April 14, 2009.

Borel died on April 19, 2009, and Noelle Flanagan became the successor trustee of the Borel Trust. At the end of April 2010, Corrie and Flanagan (as trustee) signed a writing, in the form of a letter addressed to Flanagan, stating: "The option agreement provides that the parties will fully cooperate with each other during the term of the

option. In order to facilitate our parcel map application with the Town of Danville, we both need to acknowledge that the terms and conditions of the Option Agreement are incorporated . . . herein and allow Sidney Corrie, Jr. to proceed with an application for a parcel map, while the Borel Trust remains the record owner of the Property. *Corrie and the Borel Trust also acknowledge that the obligations of each expressed in the Option Agreement are conditioned upon the approval and filing of a final subdivision map or parcel map as required pursuant to Government Code sections 66410 et seq.*" (Italics added.)

On November 16, 2010, Flanagan and Corrie executed a document captioned "Amendment #2 to Real Property Option and Purchase Agreement" (Amendment No. 2). The amendment recited that the Option Agreement had been amended on March 25, 2009 (Amendment No. 1) and on March 1, 2010 (the March 2010 letter agreement). Amendment No. 2 extended the option period to June 14, 2013, in return for Corrie making "advance principal payments" totaling $500,000 over the succeeding five months, as well as continuing to pay monthly option fees, not applicable to the purchase price, at the higher rate of $14,286 per month, instead of $10,000 per month, until the option was exercised. Further, Amendment No. 2 gave Corrie an option to purchase "an additional adjacent three acres" at $500,000 per acre, "thus bringing the total property subject to an option to purchase to ten acres." Finally, Amendment No. 2 stated: "All other terms and conditions of the Agreement and its amendments remain the same. Seller and Buyer again acknowledge that the obligations of each expressed in the Agreement and its amendments are conditioned upon the approval and filing of a final subdivision map or parcel map . . . ."

In April 2011, the District, as a beneficiary of the restated Borel Trust, filed a probate petition to have Flanagan removed as trustee. With Flanagan's authorization, Corrie filed a parcel map application with the Town of Danville on September 27, 2011. In November 2011, he applied to the probate court for an order authorizing and instructing the trustee to join in the application and to execute a deed conveying the seven acres covered by the application, as the Town of Danville was requiring. The District

opposed the application, stating that sale of the seven acres subject to the option at a below-market price would undermine or destroy its ability to operate and maintain an agricultural park on the Danville property by reducing the net monetary inheritance it would receive along with the land.

Flanagan died in December 2011, and in January 2012, Elizabeth Soloway was appointed as successor trustee of the Borel Trust. Soloway filed an objection to Corrie's petition shortly after becoming trustee. She requested a separate trial be held on the issue of whether the Option Agreement was void for failing to condition sale of the property on compliance with the SMA, and the District joined in that request. The trial court decided to proceed on that basis.

Following briefing and argument, the trial court ruled the Option Agreement was void and unenforceable. The court held (1) the agreement was void at its inception because it permitted the sale of a parcel of real property before the filing of a final subdivision or parcel map and without being expressly conditioned upon the approval and filing of such a map; and (2) subsequent acts by the parties, such as Amendment No. 2, were ineffective to revive its validity. The trial court denied Corrie's motion for a new trial, and this appeal followed.[3]

II. DISCUSSION

Corrie contends the trial court erred in finding Amendment No. 2 and the March 2010 letter agreement ineffective to cure the original agreement's noncompliance with the SMA. Because the material facts are undisputed, the trial court's ruling presents a pure question of law which we review de novo. For the reasons discussed *post*, we agree with Corrie.

A. *Applicable Statutory Law*

As relevant here, the SMA generally prohibits the *sale* of any parcel of real property for which a map is required, unless a map compliant with its provisions has been

[3] The orders are appealable under Probate Code section 1300, subdivisions (a) and (k).

filed: "No person shall sell, lease, or finance any parcel or parcels of real property or commence construction of any building for sale, lease or financing thereon, except for model homes, or allow occupancy thereof, for which a final map [or parcel map] is required by this division or local ordinance, until the final map [or parcel map] thereof in full compliance with this division and any local ordinance has been filed for record by the recorder of the county in which any portion of the subdivision is located." (§ 66499.30, subds. (a), (b).)[4]

Notwithstanding the foregoing prohibition, the SMA permits parties to offer or enter into contracts for the future sale of divided portions of land without first filing subdivision maps as long as such contracts are expressly conditioned on compliance with the SMA before the close of escrow: " 'Nothing contained in [section 66499.30,] subdivisions (a) and (b) shall be deemed to prohibit *an offer or contract to sell*, lease, or finance real property . . . where the sale, lease, or financing . . . is expressly conditioned upon the approval and filing of a final subdivision map or parcel map, as required under this division.' " (*Black Hills, supra,* 146 Cal.App.4th at p. 891, italics omitted; italics added.) Thus, under section 66499.30, subdivision (e) (section 66499.30(e)), " '[e]ven though a final map or parcel map has not been recorded, a subdivider can enter into a contract to sell, lease, or finance, . . . on . . . a portion of a larger parcel of land *if the contract is conditioned expressly on the future approval and recordation of a final map or parcel map prior to the close of any escrow* . . . .' " (*Black Hills,* at p. 891, quoting 9 Miller & Starr, Cal. Real Estate (3d ed. 2001) § 25:147, p. 361, italics added.) The SMA does not specify how such an express condition must be designed or phrased.

The principal purposes of the SMA include protection of both real estate buyers and the general public: " 'The [SMA] has three principal goals: to encourage orderly

[4] " 'A final (subdivision) map is generally required for subdivisions of five or more parcels. [Citations.] A parcel map is generally required for the creation of four or fewer parcels.' " (*Black Hills Investments, Inc. v. Albertson's, Inc.* (2007) 146 Cal.App.4th 883, 890 (*Black Hills*), quoting *van't Rood v. County of Santa Clara* (2003) 113 Cal.App.4th 549, 564.)

community development, to prevent undue burdens on the public, and to protect individual real estate buyers. [Citations.]' [Citation.] 'By generally requiring local review and approval of all proposed subdivisions, the [SMA] aims to "control the design of subdivisions for the benefit of adjacent landowners, prospective purchasers and the public in general." [Citation.] More specifically, the [SMA] seeks "to encourage and facilitate orderly community development, coordinate planning with the community pattern established by local authorities, and assure proper improvements are made, so that the area does not become an undue burden on the taxpayer." ' " (*Black Hills, supra*, 146 Cal.App.4th at p. 890.)

B. *Preliminary Issues*

"An option is an offer by which a promisor binds himself in advance to make a contract if the optionee accepts upon the terms and within the time designated in the option." (*Simons v. Young* (1979) 93 Cal.App.3d 170, 182.) As a type of offer to sell real property, an option contract comes within the literal terms of section 66499.30(e). Since no subdivision map was filed when the Option Agreement was created in this case, the agreement was therefore subject to section 66499.30(e) *if* it contemplated any subdivision of the Danville Property.[5] Nonetheless, both sides put forward arguments they assert would allow this court to decide the appeal in their favor *without* reaching the issue of illegality. We address those threshold arguments first.

Corrie contends the trial court lacked jurisdiction to enter an order finding the Option Agreement and the subsequent amendments void because of the absence of a necessary party, Fremont Bank (Fremont), which held an unspecified security interest of some nature in Corrie's option. Fremont's motion for leave to intervene and for a new

[5] We note that subdivisions (a) and (b) of section 66499.30 by their terms only prohibit the *sale* of real property taking place before a map complying with the SMA has been filed; they do not literally prohibit the making of offers or contracts to sell real property before such maps are filed. However, viewed in conjunction with section 66499.30(e) it may be implied that the SMA prohibits the making of contracts and offers to sell unless expressly conditioned on SMA compliance before the sale is completed.

trial, filed *after* the court entered the subject order, was denied. We agree with the trial court that Fremont failed to demonstrate this was a proper case for intervention, its motion was untimely, and it was estopped by its prior conduct in expressing its willingness to waive notice from belatedly changing its position.

Corrie further contends the Option Agreement is ambiguous and could be construed to give him an option to purchase the entire Danville property, in which case SMA requirements might not apply to it. We are not persuaded. The first operative sentence of the agreement, entitled, "Grant of Option," states: "Subject to the terms and conditions of this Agreement [including certain recitals], Seller grants to Buyer an exclusive and irrevocable option . . . to purchase seven (7) acres of the Property for the Purchase Price set forth in Section 2 below." The agreement specifies no other purchase option. It does grant Corrie a right of first refusal to purchase the rest of the Danville property as follows: "Seller grants to Buyer a Right of First Refusal on the balance of the Property described in Exhibit A *that is not part of this Option Agreement*."[6] (Italics added.) The option grant and right of first refusal clause demonstrate unequivocally that the Option Agreement limited Corrie's purchase option to seven acres. Amendment No. 2 confirms the parties interpreted the original option as covering only seven acres. It gave Corrie an option to purchase "an additional adjacent three acres" at $500,000 per acre, "thus bringing the total property subject to an option to purchase to ten acres." An option to purchase an adjacent three acres would be unnecessary if Corrie already had an option to purchase the entire property. Although the Option Agreement sometimes used the defined term "Property" carelessly to refer both to the seven acres subject to the option and to the entire Danville property, we do not find the agreement as a whole is reasonably susceptible to the interpretation that it grants an option to purchase the entire property.

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[6] A right of first refusal is not the same as an option contract. (See 1 Miller & Starr, Cal. Real Estate (3d ed. 2000) § 2:10, p. 39.)

On very different grounds, respondents also maintain we need not reach the issues pertaining to illegality. According to respondents, we need not consider the potential curative effect of Amendment No. 2 because the amendment is void as a matter of trust law. Respondents assert (1) Flanagan breached her duties as trustee by executing Amendment No. 2; (2) the evidence shows Corrie was aware of the breach and was therefore not protected as an innocent party by Probate Code section 18100; and (3) the amendment must therefore be considered void under Probate Code section 16420, subdivision (a)(9). (See *Vournas v. Fidelity Nat. Tit. Ins. Co.* (1999) 73 Cal.App.4th 668, 673 [Prob. Code, § 18100 excuses third parties who deal with the trustee from investigating the trustee's powers except where they have actual knowledge of a breach of the trust]; Prob. Code, § 16420, subd. (a)(9) [authorizing trust beneficiaries to commence a proceeding to trace and recover property conveyed in breach of the trust].)

Amendment No. 2 included an indemnity clause in which Corrie promised to indemnify and hold the Borel Trust harmless "for matters arising out of this Agreement." Respondents insist the presence of this clause showed Corrie's knowledge that Amendment No. 2 "constituted a breach of trust that would deprive the [District] of its bequest." Respondents reason that Corrie's actual knowledge of this fact would void "[t]he purported conveyance of interest in real property as set forth in Amendment #2." We disagree. First, the clause does not demonstrate Corrie knew as a fact that Amendment No. 2 was a breach of trust. An indemnity agreement is not an admission of fault or liability. It shows at most Corrie was aware the District might object to and seek to litigate the option extension. There had certainly been no adjudication of such a claim. Moreover, the Borel Trust specifically confers broad powers on the successor trustee, including the power to grant options for the sale or exchange of trust property for any purpose, with or without prior court authorization. It is not clear why Corrie was required to ignore that express power. In fact, respondents make no showing based on the facts in the record before us that enforcement of Amendment No. 2 would in fact deprive the District of its bequest, or otherwise breach the trust. Without prejudice to the District's position in any further proceedings on this point, there is no basis in the present

record for this court to decide the breach of trust issue in favor of the District on this appeal.

C. ***Is the Option Void for Illegality?***

" 'The illegality of contracts constitutes a vast, confusing and rather mysterious area of the law.' " (*McIntosh v. Mills* (2004) 121 Cal.App.4th 333, 344, quoting Strong, *The Enforceability of Illegal Contracts* (1961) 12 Hastings L.J. 347.)

The trial court held the March 2010 letter agreement and the parties' subsequent agreement reflected in Amendment No. 2 could not "revive" the illegal contract. In support of its holding, the court quoted the following language from *Stonehocker v. Cassano* (1957) 154 Cal.App.2d 732 (*Stonehocker*): "The subsequent conduct of the parties does not give validity to the sale made in violation of the law. If an agreement grows immediately out of an illegal act, a court will not lend its aid to enforce it." (*Id.* at p. 736.)[7] The trial court continued as follows: "In [*Black Hills*], a vendor's belated recordation of a parcel map after execution of the contract but before closing did not revive a void contract. Similarly here, an acknowledgement letter or amendment executed approximately six years after the execution of a contract would not revive a void contract. This latter conclusion follows from the established principle that the issue of legality or illegality is properly assessed at the time of sale. (*People v. Sidwell* (1945) 27 Cal.2d 121, 127.) A contrary conclusion would allow the SMA and its underlying public policies to be circumvented with ease."

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[7] In *Stonehocker*, the plaintiff made a partial payment toward the purchase of escrowed stock in violation of the Corporation Commissioner's permit prohibiting the receipt of any consideration for the stock until the commissioner consented to such transaction. (*Stonehocker, supra*, 154 Cal.App.2d at pp. 733–734.) After the consent was obtained, the plaintiff deposited promissory notes for the balance due in escrow, which the defendants sought to enforce by way of cross-complaint in the plaintiff's action to rescind the stock purchase for illegality. (*Ibid.*) The defendants contended the delivery of the promissory notes after the commissioner consented to the transfer constituted an independent, valid purchase of the shares, making the notes enforceable. (*Id.* at p. 734.) The Court of Appeal rejected that argument, finding that the latter transaction grew "immediately out of an illegal act." (*Id.* at p. 736.)

The three cases cited by the trial court are distinguishable. In *Stonehocker*, unlike here, the parties took no action to correct the illegality of their original transaction such as by returning the initial payments and restructuring their agreement to condition payment of consideration on consent from the Corporation Commissioner to the sale. In *Black Hills*, although one party unilaterally and voluntarily recorded the necessary map before the sale closed, there was no attempt to rewrite the contract to meet the statutory requirement that recordation be an express condition of the contract. *People v. Sidwell* merely held that the test of the legality or illegality of the sale of a security cannot be the ultimate success or failure of the venture as determined after the sale. It does not stand for any general principle that legality or illegality is properly assessed at the time of sale. If it did exist, such a principle would work in favor of Corrie's position since there had been no sale nor even a contract of sale prior to the execution of Amendment No. 2, because Corrie had not yet exercised his option to purchase at that point.

With regard to the trial court's policy concerns, it is not at all clear that allowing parties to correct a technical violation in their option agreement by mutual consent would allow the SMA and its underlying public policies to be easily circumvented. Certainly no public policy forbids parties from abandoning a void, illegal contract, and entering a new, enforceable contract covering the same subject matter. (See *Boloyan v. Contente* (1952) 113 Cal.App.2d 439, 442 [direct purchase of property negotiated after an illegal straw purchase by a third party was abandoned did not carry any taint from the prior transaction]; *Wise v. Radis* (1925) 74 Cal.App. 765, 781 [recognizing doctrine that if the parties make a new, lawful contract settling their rights as between themselves after an illegal contract has been executed, the new contract is enforceable]; *In re Estate of Jackson* (1986) 508 N.Y.S.2d 671 [parties abandoned usurious contract and entered new, enforceable contract for the same loan amount on nonusurious terms].)

There is no bright line rule that the parties' subsequent conduct cannot save their intended transaction from illegality. In *Robbins v. Pacific Eastern Corp.* (1937) 8 Cal.2d 241 (*Robbins*), a seller and buyer of stock entered into an illegal executory contract for the sale of the stock in violation of the Corporate Securities Act. The California Supreme

Court nonetheless held that the subsequent issuance and sale of the stock in New York, where the transaction was legal, was not void: "[E]ven if it be assumed that the executory contract, so far as the seller . . . is concerned, was illegal, nevertheless, the performance and execution of the contract in New York, being legal there, and being complete in themselves, stand independently of the prior illegality." (*Robbins*, at p. 277.) The court further stated: "[I]t does not impair the validity of a sale when made that the prior contract to make it was illegal. This is so because the sale or executed contract may legally stand on its own feet, independent of the prior executory contract. [¶] These principles are well settled." (*Id.* at p. 279.)

Moore v. Moffatt (1922) 188 Cal. 1 (*Moore*), discussed with approval in *Robbins, supra*, 8 Cal.2d at pages 281–283, upheld the validity of a stock sale made pursuant to a stock subscription agreement that was deemed void at its inception for lack of a permit from the Corporation Commissioner. The permit had been granted before the stock was issued and sold. (*Moore*, at pp. 5–6.) The *Moore* court stated: "[T]he parties to the transaction could not, nor did they, as a matter of law, by their adoption of the [subscription] agreement ratify and thereby validate as of the time of its original making or any time thereafter an agreement which may have been void in the first instance. But the parties could, and we think they did, when the bar of the statute to the making and acceptance of a valid agreement had been removed, elect to adopt and accept and stand upon the subscription agreement already signed as embodying—even though it may have been ineffectual at the time it was signed—the terms and conditions of a new agreement by which their future dealings were to be governed." (*Id.* at pp. 6–7.)

Waring v. Pitcher (1933) 135 Cal.App. 493 (*Waring*), also discussed with approval in *Robbins*, involved shares of stock subscribed and paid for before a permit was secured, but delivered to the buyer after the permit was obtained. The court held: "[P]rior to the time of receiving and accepting the certificate appellant could have demanded the return of her money. . . . [H]owever, . . . as the corporation was in existence when the certificate was delivered to plaintiff and held a valid permit to issue stock at that time, appellant's act of accepting and retaining the certificate had the same

legal effect as a new and independent contract for the sale of the stock as of the time of such delivery." (*Waring*, at pp. 496–497.)

It is admittedly hard to reconcile *Robbins*, *Moore*, and *Waring* with *Stonehocker* and other cases that have taken a similarly expansive view of the effect of illegality. (See, e.g., *Bourke v. Frisk* (1949) 92 Cal.App.2d 23; *Miller v. California Roofing Co.* (1942) 55 Cal.App.2d 136.) Perhaps the best formulation of the approach courts should take in considering defenses based on illegality is found in *Norwood v. Judd* (1949) 93 Cal.App.2d 276 (*Norwood*)—a formulation that was cited with approval and applied by the California Supreme Court in *Tri-Q, Inc. v. Sta-Hi Corp.* (1965) 63 Cal.2d 199. (*Id.* at pp. 218–219 [recognizing *Norwood* had been followed in a long line of other Supreme Court and appellate cases].) *Norwood* states: "The rule that the courts will not lend their aid to the enforcement of an illegal agreement or one against public policy is fundamentally sound. The rule was conceived for the purposes of protecting the public and the courts from imposition. It is a rule predicated upon sound public policy. But the courts should not . . . blindly extend the rule to every case where illegality appears somewhere in the transaction. The fundamental purpose of the rule must always be kept in mind, and the realities of the situation must be considered. Where, by applying the rule, the public cannot be protected because the transaction has been completed, where no serious moral turpitude is involved, where the defendant is the one guilty of the greatest moral fault, and where to apply the rule will be to permit the defendant to be unjustly enriched at the expense of the plaintiff, the rule should not be applied." (*Id.* at pp. 288–289.)[8]

The "realities of the situation" in this case convince us the option agreement between Corrie and the Borel Trust that is currently in effect is enforceable notwithstanding its relationship to the original 2004 Option Agreement which did not

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[8] For recent cases applying this formulation see *Carter v. Cohen* (2010) 188 Cal.App.4th 1038, 1048–1049; *Schaffter v. Creative Capital Leasing Group, LLC* (2008) 166 Cal.App.4th 745, 754–755; *Maudlin v. Pacific Decision Sciences Corp.* (2006) 137 Cal.App.4th 1001, 1013–1014.

comply with section 66499.30(e). First, we find the parties' transactions in this case consisted in substance of two or possibly three severable option agreements, the last of which—reflected in Amendment No. 2—was not unlawful under section 66499.30(e). Although drafted as an amendment to the original 2004 Option Agreement, and incorporating its terms, Amendment No. 2 established a different option period than either the Option Agreement or Amendment No. 1, exacted a higher price for maintaining the option, added new option terms, and made additional property subject to the option. It was in substance a new and different option agreement relative to those reflected in the Option Agreement and Amendment No. 1. In our view, the parties created a "new and independent" option contract (*Waring, supra*, 135 Cal.App. at p. 496) that stood on its own feet independently of the prior illegality (*Robbins, supra*, 8 Cal.2d at pp. 277, 279). As more fully discussed below, the option agreement created by Amendment No. 2 satisfied the requirements of section 66499.30(e) notwithstanding that it incorporated the terms of the original option.

We believe this result is consistent with the *Norwood* criteria. First, no moral turpitude is implicated in this case. There is no evidence either party intended at any time to circumvent the law or that their transactions had an unlawful purpose. In fact, the parties first began the approval process for subdivision of the property before any contract of sale was formed, when Borel wrote a letter to the planning director in 2008 authorizing Corrie to proceed with a tentative parcel map application. The parties' failure to condition the original Option Agreement or the further option created by Amendment No. 1 on SMA compliance was nothing but a drafting oversight to which no moral opprobrium attached.

Second, neither the option created in 2004, nor the new option created by Amendment No. 1 in 2009, were ever exercised. No contract of sale or sale ever occurred under these instruments, no interest in the property was created or transferred, and no subdivision of the property—legal or illegal—ever took place. (See *Schmidt v. Beckelman* (1960) 187 Cal.App.2d 462, 468 [absent exercise or attempted exercise of an option, no binding agreement to convey an interest in real property comes into existence];

1 Miller & Starr, Cal. Real Estate (3d ed. 2000) § 2:7 [an option is not a transfer of the title or any estate in the property].) By their express terms, the original Option Agreement expired in June 2009, and Amendment No. 1 expired in June 2011. Although both option agreements may have been illegal under section 66499.30(e), both are completed transactions fully performed on both sides in the sense that the buyer paid all option fees required to be paid and the seller held the offer open for the full option period. As indicated in *Norwood*, it is difficult to see how the public would be protected by declaring that these completed transactions taint the option agreement Corrie is seeking to enforce.

Third, there is no question the trust will be unjustly enriched if Amendment No. 2 is not enforced. Corrie's option payments have significantly enriched the trust, to the tune of $1,327,860, and we find nothing in the trial court's ruling to indicate Corrie would have a claim against the trust for the return of any part of this. "In compelling cases, illegal contracts will be enforced in order to 'avoid unjust enrichment to a defendant and a disproportionately harsh penalty upon the plaintiff.' " (*Asdourian v. Araj* (1985) 38 Cal.3d 276, 292.)

Finally, concerning the "moral fault" criterion in *Norwood*, neither side can be held guilty of greater fault than the other for the deficiency in the Option Agreement and Amendment No. 1. It was an error in drafting for which both sides are equally responsible, at least as far as can be shown on the record before us. However, the Borel Trust, by granting potentially inconsistent rights concerning the property to Corrie and the District, and by acting erratically in first cooperating with Corrie to correct the deficiency in the earlier agreements, inducing him to expend more money on the option, and then repudiating his option rights, does bear greater fault than Corrie for the current litigation and for the harm to Corrie if the option is declared void.

In our view, the fundamental purpose of the rule barring the enforcement of illegal agreements would not be advanced by its application here. In 2010, recognizing their earlier option agreements were legally defective, the parties mutually agreed to add a condition to their option agreement for the period beginning on June 14, 2011, intended

to correct the problem. No discernible purpose of the SMA would be served by precluding them from doing so. (Cf. *Stirlen v. Supercuts, Inc.* (1997) 51 Cal.App.4th 1519, 1535–1536 [a party's *unilateral*, *unaccepted* offer to modify a contract cannot resuscitate a legally defective contract].) While the parties may also have thought they could fix the problem retroactively to cover the earlier option terms that ran from June 14, 2004 until June 14, 2011, we do not believe the law permits that result. We merely hold that the illegality of the former option agreements does not taint the option that came into effect on the latter date.

Notwithstanding the condition of SMA compliance the parties agreed to in Amendment No. 2, respondents maintain Amendment No. 2 was ineffective to create a lawful option agreement because it incorporated the terms of the original Option Agreement, which include certain waiver provisions that nullify the condition. Clauses permitting waiver of SMA map requirements were found to invalidate real property purchase agreements in *Black Hills*, *supra*, 146 Cal.App.4th at pages 893–894, and in *Sixells, LLC v. Cannery Business Park* (2008) 170 Cal.App.4th 648 (*Sixells*) at pages 653–654, notwithstanding that the contracts in both cases otherwise purported to require SMA compliance as a condition of the sale.

We find both cases distinguishable. The fatal clause in *Black Hills* required the seller to comply with the SMA but then provided the seller the option of *either* satisfying that condition *or* waiving it in writing, without liability. (*Black Hills, supra*, 146 Cal.App.4th at p. 893.) In *Sixells,* the contract allowed the purchaser to complete the contract if, at its election, a final map was recorded or it waived the recording. (*Sixells, supra*, 170 Cal.App.4th at p. 653.) The contract therefore allowed the sale to go through before any final map had been recorded. (*Ibid.*) The Option Agreement in this case contains no such right to waive SMA compliance. The first waiver clause respondents point to in the Option Agreement, section 5.3, gives the buyer specified rights to either waive or obtain monetary consideration at closing for certain title exceptions set forth in the preliminary title report or otherwise discovered. This language cannot reasonably be construed to encompass SMA compliance, which is not a title issue.

The second waiver clause respondents cite, section 7.3 of the Option Agreement, allows the buyer to waive one or more of the following "Buyer's Conditions" specified in section 7.2: (1) a material adverse development causing the seller's representations and warranties to be untrue at the time of closing; (2) a default in the seller's performance of its obligations under the Option Agreement; (3) the title company's reservation of any right not to issue a title policy; and (4) the pendency as of the time of closing of any litigation, appeal, or governmental proceeding materially affecting the buyer's proposed development of the property. In our view, this waiver clause does not in any way qualify or nullify the condition of SMA compliance required by Amendment No. 2. Unlike the waiver clauses in issue in *Black Hills* and *Sixells*, the presence of this clause would not permit a closing to occur without prior compliance with the SMA. Amendment No. 2 makes such compliance an express condition of *both parties'* entire obligations under the agreement. Under its language, there would be no effective option agreement absent compliance with the SMA. Such compliance is therefore not a "buyer's condition" like those specified in section 7.2 of the Option Agreement. It is also not one of the seller's representations and warranties which are enumerated in another part of the Option Agreement, nor can it be construed as an obligation of the seller. It is a condition of both parties' obligations, not a promise of performance by the seller. Obviously the SMA condition has nothing to do with the willingness of the title insurer to issue a title policy. Finally, although a "governmental proceeding" is required to obtain an approved map for recording, Amendment No. 2 conditions both parties' obligations on the approval and filing of such a map, which means no transfer of the property can occur as long as proceedings to obtain a recordable map are still pending. Section 8 of the Option Agreement makes closing of the sale "[s]ubject to the conditions set forth in this Agreement," which would include the SMA compliance condition created by Amendment No. 2. We find no provision of the agreement that would allow either party to waive that condition.

Section 66499.30(e) does not specify a particular form of words required to expressly condition a sale of real property on compliance with the SMA. We decline to

construe it as a trap for the unwary. The parties in this case used language obviously designed to track and comply with section 66499.30(e), not to evade it. "A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties." (Civ. Code, § 1643.) We therefore find that the option agreement created by Amendment No. 2 satisfied the requirements of section 66499.30(e).

Respondents further contend Amendment No. 2 is unenforceable because Corrie and Borel stipulated and agreed they would not modify the Option Agreement without the lender's written consent, and evidently no such approval was obtained. We do not believe the District or the successor trustee have standing to assert contract rights belonging to the lender. In any event, we do not read the clause in issue as giving the lender a right to have Amendment No. 2 declared unenforceable. At best, the lender could claim damages for breach.

For these reasons, we find the trial court erred by finding the option agreement in effect at the time of trial void and unenforceable. We reverse and remand the matter to the trial court for entry of a new order resolving the issue of enforceability in favor of Corrie. We imply no judgment as to any other issues and defenses raised by the successor trustee or the District.

III. DISPOSITION

The orders appealed from are reversed, and the matter is remanded to the trial court with directions to enter a new order finding the option agreement as amended on November 16, 2010 was not void or unenforceable on grounds of illegality, and for further proceedings consistent with the views expressed in this opinion.

____
Margulies, Acting P.J.

We concur:

____
Dondero, J.

____
Jenkins, J*

A135963
Corrie v. Soloway

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* Associate justice of the Court of Appeal, First Appellate District, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

Trial Court: Contra Costa County Superior Court

Trial Judge: Hon. John H. Sugiyama

Counsel:

Gagen, McCoy, McMahon, Koss, Markowitz & Raines and Gregory L. McCoy for Plaintiff and Appellant.

Doyle Low, Michael J. Low, Jaime B. Herren for Defendant and Respondent Elizabeth Soloway.

Gordon, Watrous, Ryan, Langley, Bruno & Paltenghi, Bruce C. Paltenghi and Richard S. Bruno for Defendant and Respondent East Bay Regional Park District.

Exhibit 7A

From Craig Page's email
5/29/13

I am following up to see what steps you'd like CLTA to take next. Rather than getting responses from the group simultaneously, I'll defer to Dan B and Greg H for a response as our de facto chair and vice chair.

However, if any of the rest of you feel strongly about how to best proceed and would like to weigh in at this time, please feel free to forward comments directly to me or to the group at large.

I understand that we may want to proceed with legislation to address some concerns but do not know if that is an emergency, or on a "whenever we can get something" basis. Obviously, legislation gets tricky and if we need something quickly I'll need to shop now to deal with deadlines, finding a vehicle, etc.

From Craig Page's email
6/3/13

(1) It is late in the session and all deadlines for bills getting out of their house of origin has come and gone. Thus, we would have to find a "dead" bill that moved out of its house of origin but has died or has been dropped by the author and they are willing to relinquish the bill as a possible vehicle for legislation.

(2) The only chance of moving such a bill would be that the DOF, Controllers Office, and RDA groups and leadership in both houses would have to be on board. Given the controversial nature of this issue, that would be a heavy lift to accomplish this year. Not impossible, but a heavy lift.

(3) The above issues are easier to address if the changes you potentially seek are strongly supported and needed by the parties. I am assuming the issues are more title specific, but will know when we talk.

(4) If this is something that could wait for next year, that would be ideal… but I am assuming there is a sense of urgency to this?

CLTA California Land Title Association
SINCE 1907

March 4, 2013 – *via email*

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. On behalf of the CLTA Forms and Practices Committee recommendation and approval by CLTA's Board of Governors, the CLTA is requesting the following forms be filed at this time. Please accept the following to be effective 30 days from the date of this filing.

The following revised CLTA / ALTA ENDORSEMENTS are being filed:

1. **CLTA Form 104.6-06 (12-03-12)**/ALTA Form 37-06 *(Assignments of Rents or Leases)*

   Customers often request an endorsement similar to the Assignments of Rents or Leases Endorsement in commercial transactions, such as office, shopping center, or similar properties. The previous version of the CLTA 104.6-06 has been completely revised by substituting the language from the new ALTA 37-06 for consistency and uniformity as the coverage between the two forms are nearly identical. Adoption of the revised CLTA 104.6-06 will provide the commercial marketplace with a uniform, predictable form that insures against (1) any defect in the execution of the Assignment and (2) any assignment of rents recorded in the Public Records, unless excepted in Schedule B.

2. **CLTA Form 105-06 (02-08-13**) *(Multiple Mortgages in One Policy)*

   The current version of the CLTA Form 105-06 is being revised in order to put the insuring clause into true "indemnity" language. The clause, as it stands in the existing endorsement, suffers from the absence of the important phrase "against loss or damage" and, instead, reads a bit more like a representation of fact: "The Company insures that, except as stated in Part I of Schedule B, there are no matters affecting the priority . . ."

   The subject provision is the third (unnumbered) paragraph of the referenced endorsement. The revision reads as follows:

   > "The Company insures against loss or damage sustained by the Insured by reason of there being any defects, liens, 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."

The following revised ALTA POLICIES are being filed:

1. **ALTA Short Form Residential Loan Policy (12-03-12)**

   The ALTA Short Form Loan Policy is widely issued and, with some minor variations, is available in all jurisdictions. Some discrepancies exist in the use of the Policy because of various options for incorporation of

endorsements – either by automatic incorporation or by specific selection. Because of changes that have been made to the coverage regarding minerals in the ALTA Endorsement 9 and 35 series, additional modifications were needed with respect to the Short Form coverage in Schedule B. The proposed revised ALTA Short Form Loan Policy deletes options for automatic incorporation of endorsements, since the ALTA Form then had two basic alternate versions of the Policy. Each endorsement shown on the Policy can be incorporated if requested. The Policy also covers damage because of development of minerals and other subsurface substances, much like the ALTA 9-06 Endorsement.

2. ALTA U.S. Policy Form (12-03-12)

After a review of the existing policy, it was discovered that unlike most ALTA policies, this form did not include a creditors' rights exclusion. The revised policy now includes a creditors' rights exclusion as Exclusion 5. This exclusion is like the creditors' rights exclusion that has been included in other ALTA policies since 1992 and relates to the vesting transaction. No other change is being made to the U.S. Policy Form.

The following new and revised CLTA GUARANTEE's are being filed:

1. **CLTA Guarantee Form 22 (02-08-13)** *(Trustee's Sale Guarantee) -- REVISED*

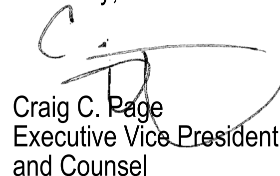
   Guarantee Form No. 22 includes an information section for trustees. Over the past decade the state legislature has adopted numerous changes to the non-judicial foreclosure process that has no bearing on the assurances provided by this product. Paragraphs 1 and 4 thru 6 of the Informational Notes section of Guarantee form, as noted, provide specific reference to California statutes that govern the actions of mortgagees, beneficiaries, mortgage servicers, trustees and their agents with respect to non-judicial foreclosures. Revised paragraph 1 provides a generic reference to the body of California law which will enable the CLTA to avoid amending the aforementioned paragraphs after each legislative session.

2. **CLTA Guarantee Form 22.1 (02-08-13)** *([Courtesy/Publication/Date Down] Endorsement) -- NEW*

   Guarantee Form No. 22.1 is the standard date down endorsement form used for courtesy, publication and sale date downs for the trustee and/or beneficiary under a deed of trust. The form is specific to Guarantee Form No. 22. It has also been revised because the date down form had not been modified to conform to the changes made to the Guarantee Form No. 22 when initially revised in 2011.

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

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 Hammann, CLTA Forms & Practices Committee Vice Chair
Paul Flores, CLTA Forms & Practices Committee, Title Forms Section Chair
Bill Burding, CLTA Legislative Committee Chair

CLTA Form 104.6-06 (12-03-12)
ALTA Endorsement Form 37-06
ALTA – Lender

Assignment of Rents or Leases

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

Dated: By________________________________

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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, liens, 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____________________________________

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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.

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☐ 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]

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SUBJECT TO THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B BELOW, AND ANY ADDENDUM ATTACHED HERETO, BLANK TITLE INSURANCE COMPANY, A ___________ CORPORATION, HEREIN 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: ____.

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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:

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AMERICAN LAND TITLE ASSOCIATION

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

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AMERICAN LAND TITLE ASSOCIATION

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.

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SCHEDULE A

Name and Address of Title Insurance Company:

[File No.] Policy No.

Amount of Insurance $
[Premium $]

Date of Policy_____ [at a.m. 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.

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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.

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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.

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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.

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(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.

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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.

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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.

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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.

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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

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[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_______________________________

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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

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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:

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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:

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BLANK TITLE INSURANCE COMPANY

SCHEDULE B

[VARIABLE MATTERS SUCH AS TAXES, EASEMENTS, CC&R's, ETC.]

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BLANK TITLE INSURANCE COMPANY

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.

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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 Article I commencing with California Civil Code Sections 2920 et. seq, of Chapter 2, Title 14, Part 4, Division 3, that govern the actions of mortgagees, beneficiaries, mortgage servicers, trustees, and their agents with respect to non-judicial foreclosures.

2. Attention is called to the Servicemembers Civil Relief Act *(Appendix 50 USC §§501 et seq.),* the Military Reservist Relief Act of 1991 *(California Military and Veterans Code §§ 800 et seq.),* and Military and Veterans Code § 408, 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 laws.

3. Attention is called to the Federal Tax Lien Act of 1966 *(26 USC §§ 6321 et seq.),* 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.

4. Attention is called to *California Government Code § 16187*, 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.

[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.]

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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 proceeding. The Company may take any appropriate action under the terms of this Guarantee, whether or not it shall be liable hereunder, and shall not thereby concede liability or waive any provision of this Guarantee. If the Company shall exercise its rights under this paragraph, it shall do so diligently.

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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.

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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:

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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.

9. Payment of Loss.

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.

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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.

13. 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 Guarantee and shall be addressed to the Company at ____.

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From: Heather Starkey
To: Flores, Paul
Subject: FW: Filing for California Land Title Association
Date: Wednesday, March 27, 2013 3:34:32 PM

Paul. Here is the form filing acceptance letter.
Heather

From: Zhao, Tianhong [mailto:Tianhong.Zhao@insurance.ca.gov]
Sent: Wednesday, March 27, 2013 1:33 PM
To: 'MAIL@CLTA.ORG'
Cc: Buggage, Dwayne
Subject: Filing for California Land Title Association

Dear Craig Page,

Please be advised that California Land Title Association, filing CDI # 13-1737, was received on March 4, 2013 and have been accepted and closed on March 27, 2013. The filings carry an effective date of April 2, 2013. 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 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 recorded in the Public Records at Date of Policy.
   b. "Private Right" means (i) a private charge or assessment; (ii) an option to purchase; (iii) a right of first refusal; or (iv) a right of prior approval of a future purchaser or occupant.
3. The Company insures against loss or damage sustained by the Insured under this Loan Policy if enforcement of a Private Right in a Covenant affecting the Title at Date of Policy (a) results in the invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage, or (b) causes a loss of the Insured's Title acquired in satisfaction or partial satisfaction of the Indebtedness.
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. any Covenant relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances[; or
   d. any Private Right in an instrument identified in Exceptions ( ) 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

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SHORT FORM RESIDENTIAL LIMITED COVERAGE

JUNIOR LOAN POLICY

Issued By

BLANK TITLE INSURANCE COMPANY

Subject to the Exceptions below and in any Addendum attached, BLANK TITLE INSURANCE COMPANY, a ____________ Corporation, (the "Company,") insures the Insured as of Date of Policy against loss or damage, not exceeding the Amount of Insurance, as provided by and subject to the terms, Exclusions from Coverage and Conditions set forth in the American Land Title Association Residential Limited Coverage Junior Loan Policy (8-1-12), all of which are incorporated by reference.

Name and Address of Title Insurance Company:

Policy No. [Premium: $]

Amount of Insurance: $ Date of Policy: [at a.m./p.m.]

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:]

___ Addendum containing additional exceptions attached.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY:_____________________________________ **PRESIDENT**

BY:_____________________________________ **SECRETARY**

NOTICES WHERE SENT. All notices required to be given the Company and any statement in writing required to be furnished to the Company shall include the number of this policy and shall be addressed to the Company, Attention: Claims Department, ___________________________________.

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ADDENDUM TO SHORT FORM RESIDENTIAL

LIMITED COVERAGE JUNIOR LOAN POLICY

File No: Addendum to Policy No.

EXCEPTIONS (CONTINUED)

In addition to the matters set forth as Exceptions on the Short Form Residential Limited Coverage Loan Policy to which this addendum is attached, this policy does not insure against loss or damage by reason of the following:

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AMERICAN LAND TITLE ASSOCIATION

Exhibit 10.B.11

We are more than technology providers, we are title industry experts. Simply put: WE KNOW TITLE.

Policy Forms Online

Policy Forms News!

The ALTA® Board of Governors approved recommendations to adopt 7 new endorsements, 4 revised endorsements, and a revised Short Form Residential Limited Coverage Junior Loan Policy during a meeting on February 21, 2013. These forms bear a publication date of April 2, 2013, and more detail appears below. Any prior version(s) of revised forms which may exist will be archived and decertified effective April 2, 2013.

The ALTA Forms Committee has also announced a Technical Correction to the ALTA Facultative Reinsurance Agreement (6-17-06).

You may download and review the subject forms in the "Recently Approved Forms - For Comment" section in the Policy Forms Online. If you have comments or concerns, please forward them to the staff liaison for the Forms Committee, Kelly Romeo.

As always, the forms have been developed by the ALTA® Forms Committee and approved by the ALTA® Board. An opportunity to review and comment is extended to ALTA® Members, Policy Forms Licensees, and industry customers before final publication. The forms, in general, are made available for customer convenience. The parties are free in each case to agree to different terms, and the use of these forms is voluntary, unless required by law.

ALTA Endorsement 9.6-06 (Private Rights – Loan Policy): Revised Form

ALTA Endorsement 9.6-06 was recently adopted. However, there is a new endorsement in this series, the ALTA 9.9-06 (Private Rights – Owner's Policy), which is the result of requests that have been made by customers for coverage similar to the ALTA 9.6-06. During development of the 9.9-06, minor inconsistencies with the existing version of the ALTA 9.6-06 became apparent, such as in the definition of Covenants and an optional exception provision to remove coverage as to a particular "Private Right."

The revised ALTA 9.6-06 would incorporate minor changes that appear in the new ALTA 9.9-06, such as a definition of Covenants that refers to such instruments recorded in the Public Records, and an additional Section 4.d that would authorize removal from the coverage of the endorsement of a particular Private Right identified in that Section. This change will facilitate a more efficient method of modifying the endorsement.

ALTA Endorsement 9.9-06 (Private Rights – Owner's Policy): New Form

ALTA Endorsement 9.6-06 (Private Rights – Loan Policy) was recently adopted in order to provide coverage similar to that litigated in the Nationwide case. That endorsement insures against invalidity, unenforceability or loss of priority of the lien of the Insured Mortgage because of Private Rights, which were defined as private charges and assessments, options to purchase, right of first refusal and right of prior approval of a sale or lease.

The new ALTA 9.9-06 (Private Rights – Owner's Policy) provides an endorsement similar to the existing ALTA 9.6-06 for a Loan Policy. It insures against loss of title based on a transfer of Title on or before Date of Policy caused by enforcement of a Private Right. A Private Right, for purposes of this endorsement means an option to a purchaser, a right of first refusal, or a right of prior approval of a buyer or occupant. Like the revised ALTA 9.6-06, this endorsement would include Section 4.d, which would allow the Company to remove from the coverage a particular identified "Private Right."

ALTA Endorsement 9.10-06 (Restrictions, Encroachments, Minerals – Current Violations – Loan Policy): New Form

The ALTA Endorsements in the 9 series include the existing ALTA 9-06, which insures against extinguishment or invalidity or lack of priority of the lien of the Insured Mortgage because of an existing or future violation of a Covenant. However, the ALTA 9 series has not included an endorsement that would simply insure against the effect of a violation at Date of Policy of a Covenant. In contrast, the ALTA 4.1-06 (Condominium) and ALTA 5.1-06 (PUD) provide coverage against existing violations, and do not insure against future violations.

The new ALTA 9.10-06 (Restrictions, Encroachments, Minerals – Current Violations – Loan Policy) provides flexibility to the customer to secure an endorsement where the Covenants do not state, such as by a subordination provision, that enforcement of future violations will not affect the Insured Mortgage. The only difference between the ALTA 9-06 and ALTA 9.10-06 is that Section 3.a. of the ALTA 9.10-06 insures with respect to a violation at Date of Policy.

ALTA Endorsement 11.2-06 (Mortgage Modification with Additional Amount of Insurance): New Form

The existing ALTA Endorsements 11-06 and 11.1-06 insure with respect to modifications of mortgages but do not address modifications that include additional advances or create additional indebtedness. This type of modification occurs in the marketplace and is currently addressed by proprietary endorsements or by other commonly used forms, such as the CLTA 110.10 -06 (Modification and Additional Advance).

The new ALTA 11.2-06 (Mortgage Modification with Additional Amount of Insurance) responds to an existing need in the marketplace by an additional Modification Endorsement that: (1) increases the Amount of Insurance, (2) insures against the invalidity or unenforceability of the Insured Mortgage because of the Modification, (3) insures against the lack of priority of the Insured Mortgage because of the Modification (subject to any listed exceptions), and (4) insures that stated liens are subordinate to the Insured Mortgage. The endorsement does not otherwise down date the policy, such as with respect to coverage by other endorsements. The endorsement, like the other Modification Endorsements, includes a creditors' rights exception.

ALTA Endorsement 12-06 (Aggregation – Loan): Revised Form

The ALTA Endorsement 12-06 (Aggregation – Loan) has not clearly addressed payment issues in the Conditions, including the amount payable under Section 7(a), the extent of liability under Section 8(a) and 8(b), and reduction of the amount of insurance.

The revised ALTA 12-06 clarifies the endorsement in a number of respects: (1) it uses a defined term, Aggregate Amount of Insurance, (2) it amends Section 7(a) of the Conditions and states that the amount that may be paid will be the lesser of the value of the Title as insured at the date the claim was made or the Aggregate Amount of Insurance, (3) it amends Section 8(a) and Section 8(b) to refer to the Aggregate Amount of Insurance, and (4) it amends Section 10 to refer to the Aggregate Amount of Insurance. This endorsement is clearly designed only for a Loan Policy because of reference to the provisions of such policy in the endorsement.

ALTA Endorsement 12.1-06 (Aggregation – State Limits - Loan): New Form

The ALTA Endorsement 12-06 (Aggregation – Loan) has not provided any standard option for a title insurer to establish lower aggregate liability limits for particular jurisdictions, such as those where a lower single risk limit is established, and a higher limit for other jurisdictions where such limits were not applicable.

The new ALTA 12.1-06 establishes two alternative definitions of "Aggregate Amount of Insurance" in paragraph 3. The Aggregate Amount of Insurance may be a stated amount such as the total amount of insurance under all policies, or may be a separate lower limit in listed states, such as a statutory single risk limit. This endorsement does not establish the procedure or requirements for completing paragraph 3; that would be decided by each title insurer issuing the endorsement.

The new ALTA 12.1-06 also includes the clarifications that are established in the proposed revision of the ALTA 12-06: (1) it uses a defined term, Aggregate Amount of Insurance (with an optional separate limit for listed states), (2) it amends Section 7(a) of the Conditions and states that the amount that may be paid will be the lesser of the value of the Title as insured at the date the claim was made or the Aggregate Amount of Insurance, (3) it amends Section 8(a) and Section 8(b) to refer to the Aggregate Amount of Insurance for the State where the Land is located, and (4) it amends Section 10 to refer to the Aggregate Amount of Insurance and to address reduction in the Aggregate Amount of Insurance in states listed in paragraph 3 of the endorsement. This endorsement is clearly designed only for a Loan Policy because of reference to the provisions of such policy in the endorsement.

ALTA Endorsement 28.2-06 (Encroachments – Boundaries and Easements – Described Improvements): New Form

The existing ALTA Endorsement 28.1-06 insures with respect to encroachments onto adjoining land or an easement, encroachments from adjoining land onto the Land, enforced removal of encroachments of Improvements onto an easement, and enforced removal of encroaching Improvements onto adjoining land. Each of these coverages can be removed by exception in Schedule B or in the endorsement as applicable. However, the definition of Improvements means "an existing building" and does not include other improvements, and some customers have expressed interest in having an alternative endorsement that would differently define Improvements to include other items that are important to use of the Land.

The new ALTA 28.2-06 (Encroachments – Boundaries and Easements – Described Improvements) provides coverage similar to the existing ALTA 28.1-06, but defines Improvement as "each improvement on the Land or adjoining land at Date of Policy, itemized below" so that the definition would be a list of applicable improvements; this format is similar to the minerals coverage in the ALTA 35.2-06 and allows the title insurer the flexibility to provide coverage tailored to the particular transaction.

ALTA Endorsement 32.1-06 (Construction Loan – Loss of Priority – Direct Payment): Revised Form

and

ALTA Endorsement 32.2-06 (Construction Loan – Loss of Priority – Insured's Direct Payment): Revised Form

The ALTA 32 series endorsements provide certain coverage to a construction lender with respect to unrecorded mechanic's liens. There were minor inconsistencies in the wording of paragraph 3.c of the ALTA 32-06 and both the 32.1-06 and 32.2-06 that would be preferable to correct.

Revised ALTA Endorsements 32.1-06 and 32.2-06 add the following phrase in paragraph 3c: "for the charges for the services, labor, materials or equipment for which the Mechanic's Lien is claimed." This change has no substantive effect upon either endorsement, which provides limited coverage with respect to claims by persons who were directly paid by the Insured or the Company in accordance with the endorsement.

ALTA Endorsement 39-06 (Policy Authentication): New Form

In recent years, commercial customers have frequently requested an "Electronic Execution" or similar endorsement recognizing that a policy and endorsements are not invalid simply because electronically generated without wet signatures. The concern of customers has been based upon the following provision in the Conditions of the Owner's Policy (at Section 15(c)) and of the Loan Policy (at Section 14(c)): "(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."

The new ALTA Endorsement 39-06 (Policy Authentication) is consistent with the endorsements currently requested in the market, but more precisely addresses the issue of authentication (essentially approval, as may be done by electronic signatures or other means) by acknowledging that the title insurer will not deny liability solely because the policy or endorsements were issued electronically or lack signatures. The new endorsement does not insure or agree that any form bearing the name of the Company will necessarily be treated as valid, if there are other bases for which issues of validity may remain (such as counterfeit forms).

ALTA Endorsement 40-06 (Tax Credit): New Form

In recent years, commercial customers have requested a Tax Credit Endorsement to an Owner's Policy where a motivation for investment in the land has been an available tax credit, such as for low income housing under federal law. However, these endorsements have been inconsistent in their wording and in some cases have not adequately addressed the concerns of the customer, who may have been an insured or a separate investor.

The new ALTA Endorsement 40-06 (Tax Credit) will provide a consistent, predictable and favorable endorsement for the customer when motivated by available tax credits. Although the proprietary endorsements previously issued have focused exclusively on tax credits under federal law, this endorsement is more broadly worded to encompass any tax credit under federal or state law. The endorsement provides for a partial assignment of right to payment under the policy, like the ALTA 16-06 (Mezzanine Endorsement), and like that endorsement recognizes that the title insurer may interplead where necessary.

ALTA Short Form Residential Limited Coverage Junior Loan Policy: Revised Form

The ALTA Board approved a revised ALTA Residential Limited Coverage Junior Loan Policy, with an effective date of August 1, 2012, which updated the Junior Loan Policy to be consistent with the terminology of the 2006 Loan Policy. Customers often prefer a short form version, for ease of review and retention. However, the existing version of the Short Form Junior Loan Policy was designed to incorporate the prior Junior Loan Policy and was inconsistent with the existing ALTA Junior Loan Policy.

The revised ALTA Short Form Residential Limited Coverage Junior Loan Policy incorporates the recently adopted Junior Loan Policy and provides the customer with the option of securing the coverage and terms of the most recently adopted Junior Loan Policy in a short form format. This revised form satisfies the need of customers for a short form that provides the most current coverage.

ALTA Facultative Reinsurance Agreement (6-17-06): Technical Correction

The ALTA Forms Committee has announced a technical correction to the ALTA Facultative Reinsurance Agreement bearing a publication date of 6-17-06. The revision adds SCHEDULE A at the end of the form. SCHEDULE A was inadvertently omitted in the publication version of the Form.

Questions? Comments?

You may download and review the subject forms in the "Recently Approved Forms - For Comment" section in the Policy Forms Online. If you have comments or concerns, please forward them to the staff liaison for the Forms Committee, Kelly Romeo.

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Washington, DC 20036-5104
P. 202.296.3671 F. 202.223.5843
www.alta.org
service@alta.org

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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 the purposes of this endorsement only:
   a. "Covenant" means a covenant, condition, limitation or restriction in a document or instrument recorded in the Public Records at Date of Policy.
   b. "Private Right" means (i) an option to purchase; (ii) a right of first refusal; or (iii) a right of prior approval of a future purchaser or occupant.

3. The Company insures against loss or damage sustained by the Insured under this Owner's Policy if enforcement of a Private Right in a Covenant affecting the Title at Date of Policy based on a transfer of Title on or before Date of Policy causes a loss of the Insured's Title.

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;
   c. any Covenant relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances; or
   d. any Private Right in an instrument identified in Exception(s) ______ 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

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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 5 of this endorsement; and 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:
   a. "Covenant" means a covenant, condition, limitation or restriction in a document or instrument in effect at Date of Policy.
   b. "Improvement" means an improvement, including any lawn, shrubbery, or trees, affixed to either the Land or adjoining land at Date of Policy that by law constitutes real property.
3. The Company insures against loss or damage sustained by the Insured by reason of:
   a. A violation at Date of Policy of a Covenant that:
      i. divests, subordinates, or extinguishes the lien of the Insured Mortgage,
      ii. results in the invalidity, unenforceability or lack of priority of the lien of the Insured Mortgage, or
      iii. causes a loss of the Insured's Title acquired in satisfaction or partial satisfaction of the Indebtedness;
   b. A violation on the Land at Date of Policy of an enforceable Covenant, unless an exception in Schedule B of the policy identifies the violation;
   c. Enforced removal of an Improvement located on the Land as a result of a violation, at Date of Policy, of a building setback line shown on a plat of subdivision recorded or filed in the Public Records, unless an exception in Schedule B of the policy identifies the violation; or
   d. 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.

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4. The Company insures against loss or damage sustained by reason of:
   a. An encroachment of:
      i. an Improvement located on the Land, at Date of Policy, onto adjoining land or onto that portion of the Land subject to an easement; or
      ii. an Improvement located on adjoining land onto the Land at Date of Policy

         unless an exception in Schedule B of the policy identifies the encroachment otherwise insured against in Sections 4.a.i. or 4.a.ii.;
   b. A final court order or judgment requiring the removal from any land adjoining the Land of an encroachment identified in Schedule B; or
   c. Damage to an Improvement located on the Land, at Date of Policy:
      i. that is located on or encroaches onto that portion of the Land subject to an easement excepted in Schedule B, which damage results from the exercise of the right to maintain the easement for the purpose for which it was granted or reserved; or
      ii. resulting from the future exercise of a right to use the surface of the Land for the extraction or development of minerals or any other subsurface substances excepted from the description of the Land or excepted in Schedule B.
5. 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;
   c. except as provided in Section 3.d, any Covenant relating to environmental protection of any kind or nature, including hazardous or toxic matters, conditions, or substances;
   d. contamination, explosion, fire, fracturing, vibration, earthquake or subsidence; or
   e. negligence by a person or an Entity exercising a right to extract or develop minerals or other subsurface 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: ____

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ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

1. The following policies are issued in conjunction with one another:

POLICY NUMBER:	STATE:	AMOUNT OF INSURANCE:
		$
		$
		$

2. The amount of insurance available to cover the Company's liability for loss or damage under this policy at the time of payment of loss shall be the Aggregate Amount of Insurance defined in Section 3 of this endorsement.

3. Subject to the limits in Section 4 of this endorsement, the Aggregate Amount of Insurance under these policies is $ ______________________.

4. Section 7(a)(i) of the Conditions of this policy is amended to read:

7. 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 lesser of the value of the Title as insured or the Aggregate Amount of Insurance applicable under this policy at the date the claim was made by the Insured Claimant, or to purchase the Indebtedness.

(i) to pay or tender payment of the lesser of the value of the Title as insured at the date the claim was made by the Insured Claimant, or the Aggregate Amount of Insurance applicable under this policy together with any cost, attorneys' fees, and costs 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

5. Section 8(a) and 8(b) of the Conditions of this policy are amended to read:

8. 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

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(i) the Aggregate Amount of Insurance,

(ii) the Indebtedness,

(iii) the difference between the value of the Title as insured and the value of the Title subject to the risk insured against by this policy, or

(iv) if a government agency or instrumentality is the Insured Claimant, the amount it paid in the acquisition of the Title or the Insured Mortgage in satisfaction of its insurance contract or guaranty.

(b) If the Company pursues its rights under Section 5 of these Conditions and is unsuccessful in establishing the Title or the lien of the Insured Mortgage, as insured, the Insured Claimant shall have the right to have the loss or damage determined either as of the date the claim was made by the Insured Claimant or as the date it is settled and paid.

6. Section 10 of the Conditions of this policy is amended to read:

10. REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY

(a) All payments under this policy, except payments made for costs, attorneys' fees, and expenses, shall reduce the Aggregate Amount of Insurance by the amount of the payment.

(b) However, any payments made prior to the acquisition of Title as provided in Section 2 of these Conditions shall not reduce the Aggregate Amount of Insurance afforded under this endorsement except to the extent that the payments reduce the Indebtedness.

(c) The voluntary satisfaction or release of the Insured Mortgage shall terminate all liability of the Company under this policy, except as provided in Section 2 of these Conditions, but it will not reduce the Aggregate Amount of Insurance for the other policies identified in Section 1 of this endorsement.

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]

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By: ______________________________________
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ENDORSEMENT

Attached to Policy No. __________

Issued by

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1. The following policies are issued in conjunction with one another:

POLICY NUMBER:	STATE:	AMOUNT OF INSURANCE:
		$
		$
		$

2. The amount of insurance available to cover the Company's liability for loss or damage under this policy at the time of payment of loss shall be the Aggregate Amount of Insurance defined in Section 3 of this endorsement.

3. The Aggregate Amount of Insurance under this policy is either:

   a. $ ______________________; or.

   b. If the Land is located in one of the states identified in this subsection, then the Aggregate Amount of Insurance is restricted to the amount shown below:

STATE	AGGREGATE AMOUNT OF INSURANCE
	$
	$

4. Section 7(a)(i) of the Conditions of this policy is amended to read:

   7. 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 lesser of the value of the Title as insured or the Aggregate Amount of Insurance applicable under this policy at the date the claim was made by the Insured Claimant, or to purchase the Indebtedness.

   (i) To pay or tender payment of the lesser of the value of the Title as insured at the date the claim was made by the Insured Claimant, or the Aggregate Amount of Insurance applicable under this policy, together with any cost, attorneys' fees, and costs and expenses incurred by the

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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

5. Section 8(a) and 8(b) of the Conditions of this policy are amended to read:

8. 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 Aggregate Amount of Insurance for the State where the Land is located,

(ii) the Indebtedness,

(iii) the difference between the value of the Title as insured and the value of the Title subject to the risk insured against by this policy, or

(iv) if a government agency or instrumentality is the Insured Claimant, the amount it paid in the acquisition of the Title or the Insured Mortgage in satisfaction of its insurance contract or guaranty.

(b) If the Company pursues its rights under Section 5 of these Conditions and is unsuccessful in establishing the Title or the lien of the Insured Mortgage, as insured, the Insured Claimant shall have the right to have the loss or damage determined either as of the date the claim was made by the Insured Claimant or as the date it is settled and paid.

6. Section 10 of the Conditions of this policy is amended to read:

10. REDUCTION OF INSURANCE; REDUCTION OR TERMINATION OF LIABILITY

(a) All payments under this policy, except payments made for costs, attorneys' fees, and expenses, shall reduce the applicable Aggregate Amount of Insurance by the amount of the payment.

(b) If this policy insures the Title to Land located in a state identified in Section 3 b. of this endorsement:

(i) all payments under this policy, except payments made for costs, attorneys' fees, and expenses, shall reduce the Aggregate Amount of Insurance by the amount of the payment; but

(ii) a payment made for loss or damage on Land insured in one of the policies identified in Section 1 on Land located outside this state shall not reduce the Aggregate Amount of Insurance in Section 3.b. of this endorsement until the Aggregate Amount of Insurance in Section 3.a. is reduced below the Aggregate Amount of Insurance in Section 3.b .

(c) However, any payments made prior to the acquisition of Title as provided in Section 2 of these Conditions shall not reduce the Aggregate Amount

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of Insurance afforded under this endorsement except to the extent that the payments reduce the Indebtedness.

(d) The voluntary satisfaction or release of the Insured Mortgage shall terminate all liability of the Company under this policy, except as provided in Section 2 of these Conditions, but it will not reduce the Aggregate Amount of Insurance for the other policies identified in Section 1 of this endorsement.

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]

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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, "Improvement" means each improvement on the Land or adjoining land at Date of Policy, itemized below:
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. Sections 3.c. and 3.d. of this endorsement do not insure against loss or damage (and the Company will not pay costs, attorneys' fees, or expenses) resulting from the following Exceptions, if any, listed in Schedule B: __________

   [The Company may list any Exceptions appearing in Schedule B for which it will not provide insurance pursuant to Section 3.c.or Section 3.d. The Company may insert "None" if it does not intend to limit the 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

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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 for the charges for the services, labor, materials or equipment for which the Mechanic’s Lien is claimed has been made by the Company or by the Insured with the Company's written approval.

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AMERICAN LAND TITLE ASSOCIATION

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

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AMERICAN LAND TITLE ASSOCIATION

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 for the charges for the services, labor, materials or equipment for which the Mechanic's Lien is claimed has been made by the Insured or on the Insured's behalf on or before Date of Coverage.

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AMERICAN LAND TITLE ASSOCIATION

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

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AMERICAN LAND TITLE ASSOCIATION

American Land Title Association

Exhibit 10.B.9
Endorsement 39-06
(Policy Authentication)
Adopted 04-02-13

ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

When the policy is issued by the Company with a policy number and Date of Policy, the Company will not deny liability under the policy or any endorsements issued with the policy solely on the grounds that the policy or endorsements were issued electronically or lack signatures in accordance with the Conditions.

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

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AMERICAN LAND TITLE ASSOCIATION

ENDORSEMENT

Attached to Policy No. __________

Issued by

BLANK TITLE INSURANCE COMPANY

As used in this endorsement, "Modification" means the agreement between _______ and ________ dated ________ and recorded _________ as document number _______.

The Amount of Insurance is increased to $_________.

1. Subject to the Exclusions from Coverage, the Exceptions contained in Schedule B and the Conditions contained in the policy, or any exclusion or exception in any prior endorsement, 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 upon the Title at Date of Endorsement as a result of the Modification;

   b. the lack of priority of the lien of the Insured Mortgage, at Date of Endorsement, over defects in or liens or encumbrances on the Title, except: [*Specify additional exceptions, if any*]; and

   c. the following matters not being subordinate to the lien of the Insured Mortgage: [*Specify matters to be insured as subordinate, if any*].

2. This endorsement does not insure against loss or damage, and the Company will not pay costs, attorneys' fees, or expenses, by reason of any claim that arises out of the transaction creating the Modification by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws that is based on:

   a. the Modification being deemed a fraudulent conveyance or fraudulent transfer; or

   b. the Modification 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 to a judgment or lien creditor.

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.

Date of Endorsement: ______________________

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[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

By: ____
Authorized Signatory

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AMERICAN LAND TITLE ASSOCIATION

CLTA Guarantee Form No. 25 (Revised 6-6-92)
Property Owner's Notice Guarantee

SCHEDULE A
Property Owner's Notice Guarantee

Order No. _________ Liability ___________ Fee $_________ [Guarantee No. ________]

1. Name of Assured:

2. Date of Guarantee:

The assurances referred to on the face page hereof are:

1. That, according to the last equalized Assessment Roll ("Assessment Roll") in the office of

   a. The persons listed below as "Assessed Owner" are shown on the Assessment Roll as owning real property within [300] feet of the land identified on the Assessment Roll as Assessor's Parcel Number(s):

   b. The Assessor's Parcel Number (APN) and any addresses shown below are as shown on the Assessment Roll.

2. That, according to the Company's property records (but without examination of those company records maintained or indexed by name), there have been no documents recorded subsequent to ___________________ purporting to transfer title to any of the properties listed below, except as indicated.

APN	ASSESSED OWNER
(Assessor's Tax Parcel Number and property address, if shown)	(Name of assessed owner and mailing address, shown)

By document recorded _____________________ the land was purportedly transferred to:

____.

Mailing Address:____.

CLTA Guarantee Form No. 25 (Revised 6-6-92)

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In the Missouri Court of Appeals Eastern District

DIVISION ONE

ABENGOA BIOENERGY U.S. HOLDING, INC.,	)	No. ED97555
Plaintiff/Respondent,	)	Appeal from the Circuit Court of St. Louis County
vs.	)	
CHICAGO TITLE INSURANCE CO.,	)	Honorable Richard C. Bresnahan
Defendant/Appellant.	)	FILED: July 17, 2012

Before Clifford H. Ahrens, P.J., Roy L. Richter, J., and Gary M. Gaertner, Jr., J.

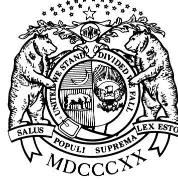
PER CURIAM

ORDER

Defendant Chicago Title Insurance Co. ("Chicago Title") appeals from the trial court's judgment, following a jury trial, awarding Plaintiff Abengoa Bioenergy U.S. Holding, Inc. ("Abengoa") damages sustained by Abengoa when Chicago Title performed a radius search and negligently failed to include seven property owners in a certified list of property owners who were legally entitled to notice of Abengoa's proposal to rezone property to build an ethanol plant.

We have reviewed the briefs of the parties and the record on appeal and find no error of law. No jurisprudential purpose would be served by a written opinion. However, the parties have been furnished with a memorandum for their information only, setting forth the facts and reasons for this order.

The judgment is affirmed pursuant to Rule 84.16(b).



In the Missouri Court of Appeals
Eastern District

DIVISION ONE

ABENGOA BIOENERGY U.S. HOLDING, INC.,	)	No. ED97555
	)	
Plaintiff/Respondent,	)	Appeal from the Circuit Court of St. Louis County
vs.	)	
	)	
CHICAGO TITLE INSURANCE CO.,	)	Honorable Richard C. Bresnahan
	)	
Defendant/Appellant.	)	FILED: July 17, 2012

Before Clifford H. Ahrens, P.J., Roy L. Richter, J., and Gary M. Gaertner, Jr., J.

MEMORANDUM SUPPLEMENTING ORDER
AFFIRMING JUDGMENT PURSUANT TO RULE 84.16(b)

This memorandum is for the information of the parties and sets forth the reasons for our order affirming the judgment.

THIS STATEMENT DOES NOT CONSTITUTE A FORMAL OPINION OF THIS COURT. IT IS NOT UNIFORMLY AVAILABLE. IT SHALL NOT BE REPORTED, CITED, OR OTHERWISE USED IN UNRELATED CASES BEFORE THIS COURT OR ANY OTHER COURT. IN THE EVENT OF THE FILING OF A MOTION TO REHEAR OR TRANSFER TO THE SUPREME COURT, A COPY OF THIS MEMORANDUM SHALL BE ATTACHED TO ANY SUCH MOTION.

Defendant Chicago Title Insurance Co. ("Chicago Title") appeals from the trial court's judgment, following a jury trial, awarding Plaintiff Abengoa Bioenergy U.S. Holding, Inc. ("Abengoa") damages sustained by Abengoa when Chicago Title performed a radius search and negligently failed to include seven property owners in a certified list of property owners who were legally entitled to notice of Abengoa's proposal to rezone property to build an ethanol plant. We affirm.

I. BACKGROUND

The parties are familiar with the facts and we need not recite them here. We will discuss the facts as they relate to our analysis of the points on appeal.

II. DISCUSSION

Chicago Title raises five points on appeal, arguing that it is entitled to judgment as a matter of law, or a new trial, based on alleged errors made by the trial court. Chicago Title's first and second points allege errors with regard to the trial court's refusal to enforce a limitation of liability clause, eliminated from evidence through the grant of a motion in limine. Chicago Title's third point contests Abengoa's standing. Its fourth point argues error in admitting Abengoa's expert testimony. Finally, Chicago Title's fifth point argues the damages awarded were not proximately caused by Chicago Title. For the reasons below, we deny each of these points on appeal.

Points I and II: Trial Court did not Err in Refusing to Enforce Limitation Clause

In its first point, Chicago Title alleges the trial court erred in refusing to amend the judgment to enforce the limitation of liability clause set forth by Chicago Title, limiting its liability to the $500 that Abengoa paid for the certificate. Chicago Title argues the clause was part of the parties' contract in that Abengoa accepted that term by

its conduct in paying without protest and in using the certificate to obtain rezoning. Chicago Title asserts that the contract between Abengoa and Chicago Title was not formed on the day Abengoa telephoned Chicago title requesting the radius search and certificate, May 18, 2006. Instead, it argues that conversation was just prior oral discussions. Chicago Title contends the last writing, which was the invoice that included a limitation of liability clause, provided on the same day as the requested certificate, May 25, 2006, nonetheless prevails. In its second point, Chicago Title alleges the trial court erred in determining the enforceability of the limitation of liability on a motion in limine, because such a motion cannot dispose of an entire defense in that only a proper summary judgment motion can resolve such a defense. We cannot agree with Chicago Title's allegations in either of these two points.

Standard of Review

In each of these points, Chicago Title is claiming error in a pretrial ruling on a motion in limine, which excluded evidence presented as an affirmative defense to Chicago Title's liability. The trial court memorialized its ruling in an Order dated August 10, 2011, which states: "Defendants may not raise the limitation clause at trial because the Court finds, as a matter of law, that the clause was not part of the parties' contract, which was formed when the telephone call was made between the parties." Accordingly, we first review the interpretation of a contract, which is a question of law, de novo. G.H.H. Investments, L.L.C. v. Chesterfield Mgmt. Assocs., L.P., 262 S.W.3d 687, 691 (Mo. App. E.D. 2008).

The correct standard when reviewing a trial court's ruling on a motion in limine is whether the trial court "clearly erred" or committed "plain error" in its ruling because a

ruling on a motion in limine "is merely a preliminary expression of the court's opinion as to the admissibility of the evidence." English v. Empire Dist. Elec. Co., Inc., 220 S.W.3d 849, 854 (Mo. App. S.D. 2007) (internal quotation omitted). As such, the court can change its interlocutory ruling anytime during the trial if presented with proper circumstances. Id. "It is incumbent upon the party seeking to preserve the excluded evidence for purposes of appeal to make an offer of proof at trial demonstrating why the evidence is relevant and admissible." Id. Without a specific and definite offer of proof, appellate courts will not generally review excluded evidence except for plain error. Frank v. Envtl. Sanitation Mgmt., Inc., 687 S.W.2d 876, 883 (Mo. banc 1985). Here, Chicago Title made no offer of proof and submitted no instruction regarding the limitation of liability clause excluded by the plaintiffs' motion in limine. Thus, we are left only with plain error review.

Plain error review triggers the commencement of a two-step analysis by an appellate court. State v. Campbell, 122 S.W.3d 736, 740 (Mo. App. S.D. 2004). The first step of this analysis is to determine whether the asserted claim of plain error facially establishes substantial grounds for believing a manifest injustice or miscarriage of justice has occurred. Id. If facially substantial grounds are found to exist, the appellate court should secondly engage in plain error review to determine whether manifest injustice or a miscarriage of justice has actually occurred. Id. If facially substantial grounds are absent, however, the appellate court should decline to exercise its discretion to review the claim of plain error pursuant to Rule 30.20. Id. To find manifest injustice, this Court must find that the trial court's error was outcome determinative. State v. Baxter, 204 S.W.3d 650, 652 (Mo. banc 2006).

Analysis

Having made several admissions in its pleadings and at trial that it entered into and breached a contract with the plaintiffs, Chicago Title seeks, in vague terms, to treat the written limitation of liability clause as a modification of the contract, which plaintiffs accepted by paying for the certificate and using it to obtain the initial rezoning. We disagree.

"The basic elements of a contract are offer, acceptance of that offer, and consideration to support the contract." U.S. Bank v. Lewis, 326 S.W.3d 491, 495 (Mo. App. S.D. 2010). The offer must be sufficiently specific on the terms of the contract that, upon its acceptance, a court may enforce the contract so formed. Around the World Importing, Inc. v. Mercantile Trust Co., N.A., 795 S.W.2d 85, 90 (Mo. App. E.D. 1990). A modification of a contract constitutes the making of a new contract and such new contract must be supported by consideration. Gross v. Diehl Specialties Intern., Inc., 776 S.W.2d 879, 883 (Mo. App. E.D. 1989). Where a contract has not been fully performed at the time of the new agreement, the substitution of a new provision that results in modification of *both* sides' obligations for a provision in the old contract, still unperformed, is sufficient consideration for the new contract. Id. Conversely, a promise to carry out an already existing contractual duty does not constitute consideration. Id. Acceptance of a unilateral demand in the absence of consideration does not bind the acceptor contractually. State v. Nationwide Life Ins. Co., 340 S.W.3d 161, 190 (Mo. App. W.D. 2011).

Here, Abengoa's Assistant General Counsel Jeff Jones ("Jones") and Chicago Title's corporate representative Sharon Dains ("Dains") spoke on the telephone on May

18, 2006, at which time Jones hired Chicago Title for the radius search job and gave the due date for the certified list. On the same day, following Dains's request for the legal description, Jones emailed her a copy of the purchase option on the proposed building site, which contained a legal description of the 120-acre tract. At that time, the terms of the contract were sufficiently specific such that Dains knew and Chicago Title later admitted to its formation. Dains knew that the job was supposed to be complete by noon on May 25, 2006. She sent an urgent fax to her local agent on May 24 stating that "we need a radius report before noon on 5/25/2006 in order to meet the deadline." However, Chicago Title now claims that the certificate sent to plaintiffs on May 25, 2006, contained an unambiguous term limiting Chicago Title's liability to the $500 that plaintiffs paid for the certificate.

The record is clear that the contract was fully performed, albeit inaccurately, at the time Chicago Title introduced its attempt for modification of the contract. Consideration was not involved in the supposed amendment to the contract. We find the radius search at issue separate from the issuance of a title insurance policy, see Fidelity Nat. Title Ins. Co. v. Tri-Lakes Title Co. Inc., 968 S.W.2d 727, 730 (Mo. App. S.D. 1998), and thus, it was not subject to the procedures used for memorializing oral agreements and issuing detailed insurance policies in writing. Contrary to Chicago Title's argument, Abengoa's payment and use of the certificate only fulfilled the contractual obligations agreed to on May 18, 2006. Abengoa did not accept a modification of the contract, acquiescing to a limitation of liability clause, by tendering payment for, and using, the certificate ordered on May 18, 2006.

Furthermore, upon review of the trial court's Order, we find that it prohibited evidence of the limitation clause at trial. Without one single offer of proof or even an instruction for the jury regarding the elimination of Chicago Title's entire defense, we find Chicago Title's claim does not facially establish substantial grounds for believing a manifest injustice has occurred. Offers of proof made by Chicago Title may have preserved the issue otherwise in the context of "choking off an entire claim" or an affirmative defense, but we decline to comment on such a hypothetical situation here. See Cass Bank & Trust Co. v. Mestman, 888 S.W.2d 400, 404 (Mo. App. E.D. 1994) (detailing numerous offers of proof, which ultimately resulted in the grant of a new trial). Chicago Title has left nothing more for our review than the trial court's Order eliminating prejudicial evidence irrelevant to the contract at issue. In this, we find no manifest injustice.

Chicago Title's first and second points are denied.

Point III: Abengoa had Standing to Recover Damages

In its third point, Chicago Title alleges the trial court erred in entering judgment for Abengoa because Abengoa had no standing to recover the damages the jury awarded. Chicago Title argues that only Abengoa's subsidiaries incurred those damages.

Standard of Review

Standing is a threshold issue. State ex rel. St. Louis Retail Group v. Kraiberg, 343 S.W.3d 712, 715 (Mo. App. E.D. 2011). A party cannot waive lack of standing. Id. The court may consider the issue of standing sua sponte at any time. Id. Standing is a question of law that we review de novo. Id. The issue is determined based on the petition and any other non-contested facts of the case. Id.

Analysis

Chicago Title argues that Missouri courts have long recognized that "[s]tanding is an aspect of justiciability, which focuses on the party rather than the issues." Buchanan v. Kirkpatrick, 615 S.W.2d 6, 13 n.8 (Mo. banc 1981). Here, however, Chicago Title focuses not on the parties, but the issue of damages. In determining whether a party has standing, we ask "whether the persons seeking the relief have the right to do so." Bannum, Inc. v. City of St. Louis, 195 S.W.3d 541, 545 (Mo. App. E.D. 2006) (citing State ex rel. Twenty-Second Circuit v. Jones, 823 S.W.2d 471, 475 (Mo. banc 1992)). Parties to a contract and third-party beneficiaries of a contract have standing to enforce a contract. Andes v. Albano, 853 S.W.2d 936, 942 (Mo. banc 1993).

Chicago Title argues Sequa Corp. v. Cooper, 128 S.W.3d 69 (Mo. App. E.D. 2003), supports its argument against standing. Sequa owned 100 percent of all shares of stock in its subsidiary, SESI, and lacked standing to sue for the defendants' alleged misconduct, and damages suffered as a result. Id. at 75. However, unlike the situation here where Chicago Title acted with negligence directly to Abengoa rather than its subsidiaries, the defendants in Sequa committed the alleged misconduct against SESI rather than Sequa. Id.

In this case, the undisputed evidence was that Abengoa, through its assistant general counsel, entered into a contract with Chicago Title. Chicago Title admitted to negligently breaching the contract with Abengoa. As a party to the contract, for whom Chicago Title negligently failed in performing, Abengoa had standing to sue in tort and, accordingly, collect damages. The trial court did not err in entering judgment for Abengoa based on standing. Chicago Title's third point is denied.

Point IV: No Error in Admitting Abengoa's Expert Opinions

Fourth, Chicago Title argues the trial court erred in allowing Michael Lewis's ("Lewis") opinions about lost cash flow for the Kansas subsidiary, because lost cash flow is not a proper measure of damages in that it does not consider expenses such as depreciation, and Lewis's opinions lacked foundation in that they were dependent on the opinions of a non-testifying expert.

Standard of Review

While Chicago Title argues that the review of the admissibility of expert testimony is de novo, that standard applies to the determination of whether the testimony constitutes *expert* testimony and whether that *expert* testimony should be admitted into trial as Section 490.065[1] is applied. Adkins v. Hontz, 337 S.W.3d 711, 719 (Mo. App. W.D. 2011). If the evidence on the record supports the satisfaction of the statute's requirements for the admission of the evidence, then the decision whether to admit the evidence is a matter of discretion for the trial court. Scott v. Blue Springs Ford Sales, Inc., 215 S.W.3d 145, 173 (Mo. App. W.D. 2006). If the trial court finds that the expert is qualified "by knowledge, skill, experience, training, or education," that the expert's testimony will assist the trier of fact, and that the facts or data the expert uses are reasonably relied on by experts in the field and otherwise reasonably reliable, the trial court must admit his or her testimony, and if not, it must be excluded. Kivland v. Columbia Orthopaedic Group, LLP, 331 S.W.3d 299, 311 (Mo. banc 2011). In deciding whether the facts and data on which the expert relies are otherwise reasonably reliable, the circuit court "independently assess[es] their reliability." Id.

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[1] All statutory citations are to RSMo 2000 as updated through the most recent cumulative supplement, unless otherwise indicated.

Analysis

This Court found in CADCO that "loss of profits" referred to the amount of net profits the plaintiff would have realized had its clients not been lost as a result of the defendant's actions. CADCO, Inc. v. Fleetwood Enters., Inc., 220 S.W.3d 426, 434 (Mo. App. E.D. 2007). Lost profits are recoverable in a variety of breach of contract and tort cases. Ameristar Jet Charter, Inc. v. Dodson Intern. Parts, Inc., 155 S.W.3d 50, 55 (Mo. banc 2005). A party seeking an award of lost profits must introduce evidence that provides an adequate basis for estimating the lost profits with reasonable certainty. Id. at 54. While an estimate of anticipated profits must be based on more than mere speculation, uncertainty regarding the amount of profits that would have been made does not prevent a recovery. Id. at 54-55. In calculating lost profits, the Missouri Supreme Court held that "variable expenses, not fixed expenses, should be deducted from estimated lost revenues." Id. at 56. "Fixed expenses are the continuous expenses of the business that are incurred regardless of the loss of a portion of the business." Id. at 55. Variable expenses are "costs directly linked to the volume of business," and *may* include depreciation. Id. (emphasis added).

Abengoa's expert Lewis testified that his damages construction model reflected the total capital costs, including the total amount of Abengoa's equity and money it contributed, plus the amounts borrowed from banks, and interest paid on the amounts borrowed from the banks as the plan was being constructed. He further stated depreciation should not be taken out because the model already takes into consideration capital costs. Lewis explained that depreciation is taken over many years, so is therefore an "allocation tool" and a non-cash charge where the company has taken the money up

front to buy equipment. Depreciation, therefore, is not included with the cost to build the plants, so as to prevent a "double dipping" in the model, Lewis explained. Lewis testified that the economic damage model is derived from the cash flow. During his testimony, Lewis pointed out that he and Chicago Title's expert, Thomas Hilton, differed on whether to include depreciation in their analyses. Both sides had the opportunity to cross-examine the expert witnesses on this point. Accordingly, we find the trial court did not err in admitting the expert's testimony regarding Abengoa's lost cash flow analysis, which accounted for depreciation.

Furthermore, regarding Chicago Title's objection to Lewis's testimony because it used "future forecasts of commodity prices" as pricing inputs for his model, upon which he bases his opinions, Abengoa argued at trial that the report relied upon by expert Lewis was simply "industry forecasts." The forecast data, done by economist Steven Harris ("Harris") and reported by Informa Economics, were "of the type reasonably relied upon by experts in the field of forming opinions or inferences upon a subject and must be otherwise reasonably reliable," Abengoa argued.

In CADCO, Inc. v. Fleetwood Enters., Inc., 220 S.W.3d 426, 435 (Mo. App. E.D. 2007), a lost profits case, the appellant challenged testimony from an expert witness Kevin Carlie based on insufficiently reliable opinions. The appellant argued that there was no foundation on which the expert could base his assumptions. Id. at 433. The expert had examined corporate tax returns, financial statements, expense and income statements, sales records, and industry forecasts, among other information. Id. at 435. This Court found no plain error, as the evidentiary foundation was sufficiently reliable

and adequately supported his opinion on lost profits, and the expert was extensively cross-examined regarding the basis of his opinion. Id.

Although the plain error review in CADCO required a showing of manifest injustice or miscarriage of justice, an error here need not rise to such a level. However, even under an abuse of discretion standard of review, we cannot find the trial court erred in admitting Lewis's testimony based on the industry forecast data he used. The evidence showed that Informa Economics is an agricultural industry economist which tracks and projects pricing and supply and demand for raw materials. The Informa report used historical data to then forecast ethanol and grain markets. The Informa report was not only relied upon by Lewis, but also by Abengoa, an accountant expert, and the banks financing the new ethanol plant, which required the report. The Informa report, including Harris's data, is reasonably reliable in an economist's field. The trial court did not err in deferring to Lewis's assessment of reliability in using the data and admitting his expert testimony. Chicago Title's fourth point is denied.

Point V: Court did not Plainly Err in Submitting Case on Proximate Cause

In its fifth and final point, Chicago Title alleges the trial court plainly erred in allowing evidence of damages allegedly incurred by the subsidiaries after February 2007, because Chicago Title's error was not the proximate cause of such damages in that they flowed directly from the actions of other persons and entities. We disagree.

Standard of Review

Plain error review involves a two-step analysis by an appellate court. State v. Campbell, 122 S.W.3d 736, 740 (Mo. App. S.D. 2004). We use the same two-step analysis as outlined, supra, in points I and II.

Analysis

The general test for proximate cause is whether an injury is the natural and probable consequence of the defendant's negligence. Stanley v. City of Independence, 995 S.W.2d 485, 488 (Mo. banc 1999). Each case is decided on its own facts. Id. Proximate cause cannot be based on pure speculation and conjecture. Id. "The test for proximate cause is whether the negligence sets in motion a chain of circumstances leading to the injury." Jones v. Trittler, 983 S.W.2d 165, 168 (Mo. App. E.D. 1998).

Here, assuming that Chicago Title was negligent in this case based on its admissions, its negligence must also be the proximate cause of the delay in building a new plant in a new location, and the resulting damages thereof. During trial, the evidence showed that in May 2007, a second lawsuit challenging the zoning for the new ethanol plant was filed, which would not have occurred but for Chicago Title's negligence and the resulting failure to notify certain individuals. Although Abengoa could have waited for the lawsuit to end, or built the plant regardless of the lawsuit, it realized the grave risks involved and decided to delay the project, and then build elsewhere. Chicago Title argues that the chain of causation was broken by Abengoa's own voluntary conduct in making its business decision or by the improper motives of the plaintiffs in the second lawsuit. We disagree. Chicago Title's negligence could foreseeably result in lawsuits filed by hostile residents who had reason to believe that Abengoa was trying to deceive them in zoning land without the required notice. When lawsuits are filed, they force parties to assess risks and make strategic decisions based on those risks. That is precisely what Abengoa did here.

Finding the element of causation present here, we hold the trial court did not err in allowing into evidence the damages incurred by subsidiaries after February 2007. Further, the verdict director for negligence was appropriately posited to the jury to find for the plaintiff, Abengoa, if "such negligence directly caused or directly contributed to cause damage to plaintiff." Based on the evidence, the jury found this true. Chicago Title's fifth point is denied.

III. Conclusion

The judgment of the trial court is affirmed pursuant to Rule 84.16(b).

PER CURIAM.

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 5 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. The Tax Credit Investor is: __________________________.
   b. "Available Tax Credits" means the tax credits, if any, available to the Tax Credit Investor under the applicable section of the Internal Revenue Code or other applicable law in effect as of Date of Policy with respect to the Land.
3. In the event of a claim resulting from a defect, lien, encumbrance or other matter insured against by the policy that causes loss or damage to the Tax Credit Investor by the reduction in the amount of Available Tax Credits:
   a. the Insured assigns to the Tax Credit Investor the right to receive any payment or portion of a payment for loss or damage otherwise payable to the Insured under Section 12 of the Conditions, but only to the extent of the reduction in the amount of Available Tax Credits; and
   b. the Insured acknowledges that any payment made by the Company to the Tax Credit Investor under this endorsement shall reduce the Amount of Insurance as provided in Section 10 of the Conditions.
4. The Company reserves all rights and defenses as to the Tax Credit Investor that the Company has against the Insured, and has no obligation to pay a loss to the Tax Credit Investor until:
   a. its liability and the extent of a loss insured against by the policy have been definitely fixed in accordance with the Conditions; and
   b. the Tax Credit Investor provides evidence of the reduction in the amount of Available Tax Credits
5. This endorsement does not insure against loss or damage (and the Company will not pay costs, attorneys' fees or expenses) incurred in defending or establishing:
   a. the eligibility of the Tax Credit Investor or the Land for the Available Tax Credit;
   b. that the Tax Credit Investor or the Land is entitled to any Available Tax Credit; or
   c. the existence, ownership or amount of any Available Tax Credit.
6. The provisions of Sections 4 and 5 of this endorsement shall not diminish the rights of the Insured under any other endorsement to the policy; however, in the calculation of loss or damage, the Company shall not be liable for duplicate recoveries for loss or damage to the Insured and Tax Credit Investor.
7. If the Insured, the Tax Credit Investor or others have conflicting claims to all or a part of the loss payable under the Policy, the Company may interplead the amount of the loss into Court. The

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Insured and the Tax Credit Investor shall be jointly and severally liable for the Company's reasonable costs for the interpleader and subsequent proceedings, including attorneys' fees. The Company shall be entitled to payment for the sums for which the Insured and Tax Credit Investor are liable under the preceding sentence from the funds deposited into Court, and it may apply to the Court for their payment.

This endorsement is issued as part of the policy. Except to the extent expressly stated, 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]

Agreed and Consented to:

____
Insured

BLANK TITLE INSURANCE COMPANY

By: ____
Authorized Signatory

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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, "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

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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:**

DELETE

~~**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

HOMEOWNER'S POLICY OF TITLE INSURANCE

For a one-to-four family residence

Issued By

BLANK TITLE INSURANCE COMPANY

OWNER'S INFORMATION SHEET

Your Title Insurance Policy is a legal contract between You and Us.

It applies only to a one-to-four family residence and only if each insured named in Schedule A is a Natural Person. If the Land described in Schedule A of the Policy is not an improved residential lot on which there is located a one-to-four family residence, or if each insured named in Schedule A is not a Natural Person, contact Us immediately.

The Policy insures You against actual loss resulting from certain Covered Risks. These Covered Risks are listed beginning on page of the Policy. The Policy is limited by:

- Provisions of Schedule A
- Exceptions in Schedule B
- Our Duty To Defend Against Legal Actions On Page _____
- Exclusions on page __
- Conditions on pages __ and __.

You should keep the Policy even if You transfer Your Title to the Land. It may protect against claims made against You by someone else after You transfer Your Title.

IF YOU WANT TO MAKE A CLAIM, SEE SECTION 3 UNDER CONDITIONS ON PAGE __.

The premium for this Policy is paid once. No additional premium is owed for the Policy.

This sheet is not Your insurance Policy. It is only a brief outline of some of the important Policy features. The Policy explains in detail Your rights and obligations and Our rights and obligations. Since the Policy--and not this sheet--is the legal document,

YOU SHOULD READ THE POLICY VERY CAREFULLY.

If You have any questions about Your Policy, contact:

BLANK TITLE INSURANCE COMPANY
____
____

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HOMEOWNER'S POLICY OF TITLE INSURANCE

For a one-to-four family residence

Issued By

BLANK TITLE INSURANCE COMPANY

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HOMEOWNER'S POLICY OF TITLE INSURANCE

For a one-to-four family residence

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BLANK TITLE INSURANCE COMPANY

As soon as You Know of anything that might be covered by this Policy, You must notify Us promptly in writing at the address shown in Section 3 of the Conditions.

OWNER'S COVERAGE STATEMENT

This Policy insures You against actual loss, including any costs, attorneys' fees and expenses provided under this Policy. The loss must result from one or more of the Covered Risks set forth below. This Policy covers only Land that is an improved residential lot on which there is located a one-to-four family residence and only when each insured named in Schedule A is a Natural Person.

Your insurance is effective on the Policy Date. This Policy covers Your actual loss from any risk described under Covered Risks if the event creating the risk exists on the Policy Date or, to the extent expressly stated in Covered Risks, after the Policy Date.

Your insurance is limited by all of the following:

- The Policy Amount
- For Covered Risk 16, 18, 19 and 21, Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A
- The Exceptions in Schedule B
- Our Duty To Defend Against Legal Actions
- The Exclusions on page
- The Conditions on pages and .

COVERED RISKS

The Covered Risks are:

1. Someone else owns an interest in Your Title.
2. Someone else has rights affecting Your Title because of leases, contracts, or options.
3. Someone else claims to have rights affecting Your Title because of forgery or impersonation.
4. Someone else has an Easement on the Land.
5. Someone else has a right to limit Your use of the Land.

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6. Your Title is defective. Some of these defects are:

   a. Someone else's failure to have authorized a transfer or conveyance of your Title.
   b. Someone else's failure to create a valid document by electronic means.
   c. A document upon which Your Title is based is invalid because it was not properly signed, sealed, acknowledged, delivered or recorded.
   d. A document upon which Your Title is based was signed using a falsified, expired, or otherwise invalid power of attorney.
   e. A document upon which Your Title is based was not properly filed, recorded, or indexed in the Public Records.
   f. A defective judicial or administrative proceeding.

7. Any of Covered Risks 1 through 6 occurring after the Policy Date.

8. Someone else has a lien on Your Title, including a:

   a. lien of real estate taxes or assessments imposed on Your Title by a governmental authority that are due or payable, but unpaid;
   b. Mortgage;
   c. judgment, state or federal tax lien;
   d. charge by a homeowner's or condominium association; or
   e. lien, occurring before or after the Policy Date, for labor and material furnished before the Policy Date.

9. Someone else has an encumbrance on Your Title.

10. Someone else claims to have rights affecting Your Title because of fraud, duress, incompetency or incapacity.

11. You do not have actual vehicular and pedestrian access to and from the Land, based upon a legal right.

12. You are forced to correct or remove an existing violation of any covenant, condition or restriction affecting the Land, even if the covenant, condition or restriction is excepted in Schedule B. However, You are not covered for any violation that relates to:

    a. any obligation to perform maintenance or repair on the Land; or
    b. environmental protection of any kind, including hazardous or toxic conditions or substances

    unless there is a notice recorded in the Public Records, describing any part of the Land, claiming a violation exists. Our liability for this Covered Risk is limited to the extent of the violation stated in that notice.

13. Your Title is lost or taken because of a violation of any covenant, condition or restriction, which occurred before You acquired Your Title, even if the covenant, condition or restriction is excepted in Schedule B.

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14. The violation or enforcement of those portions of any law or government regulation concerning:

    a. building;
    b. zoning;
    c. land use;
    d. improvements on the Land;
    e. land division; or
    f. environmental protection,

    if there is a notice recorded in the Public Records, describing any part of the Land, claiming a violation exists or declaring the intention to enforce the law or regulation. Our liability for this Covered Risk is limited to the extent of the violation or enforcement stated in that notice.

15. An enforcement action based on the exercise of a governmental police power not covered by Covered Risk 14 if there is a notice recorded in the Public Records, describing any part of the Land, of the enforcement action or intention to bring an enforcement action. Our liability for this Covered Risk is limited to the extent of the enforcement action stated in that notice.

16. Because of an existing violation of a subdivision law or regulation affecting the Land:

    a. You are unable to obtain a building permit;
    b. You are required to correct or remove the violation; or
    c. someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.

    The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

17. You lose Your Title to any part of the Land because of the right to take the Land by condemning it, if:

    a. there is a notice of the exercise of the right recorded in the Public Records and the notice describes any part of the Land; or
    b. the taking happened before the Policy Date and is binding on You if You bought the Land without Knowing of the taking.

18. You are forced to remove or remedy Your existing structures, or any part of them - other than boundary walls or fences - because any portion was built without obtaining a building permit from the proper government office. The amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

19. You are forced to remove or remedy Your existing structures, or any part of them, because they violate an existing zoning law or zoning regulation. If You are required to remedy any portion of Your existing structures, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

20. You cannot use the Land because use as a single-family residence violates an existing zoning law or zoning regulation.

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21. You are forced to remove Your existing structures because they encroach onto Your neighbor's land. If the encroaching structures are boundary walls or fences, the amount of Your insurance for this Covered Risk is subject to Your Deductible Amount and Our Maximum Dollar Limit of Liability shown in Schedule A.

22. Someone else has a legal right to, and does, refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it because Your neighbor's existing structures encroach onto the Land.

23. You are forced to remove Your existing structures which encroach onto an Easement or over a building set-back line, even if the Easement or building set-back line is excepted in Schedule B.

24. Your existing structures are damaged because of the exercise of a right to maintain or use any Easement affecting the Land, even if the Easement is excepted in Schedule B.

25. Your existing improvements (or a replacement or modification made to them after the Policy Date), including lawns, shrubbery or trees, are damaged because of the future exercise of a right to use the surface of the Land for the extraction or development of minerals, water or any other substance, even if those rights are excepted or reserved from the description of the Land or excepted in Schedule B.

26. Someone else tries to enforce a discriminatory covenant, condition or restriction that they claim affects Your Title which is based upon race, color, religion, sex, handicap, familial status, or national origin.

27. A taxing authority assesses supplemental real estate taxes not previously assessed against the Land for any period before the Policy Date because of construction or a change of ownership or use that occurred before the Policy Date.

28. Your neighbor builds any structures after the Policy Date -- other than boundary walls or fences -- which encroach onto the Land.

29. Your Title is unmarketable, which allows someone else to refuse to perform a contract to purchase the Land, lease it or make a Mortgage loan on it.

30. Someone else owns an interest in Your Title because a court order invalidates a prior transfer of the title under federal bankruptcy, state insolvency, or similar creditors' rights laws.

31. The residence with the address shown in Schedule A is not located on the Land at the Policy Date.

32. The map, if any, attached to this Policy does not show the correct location of the Land according to the Public Records.

OUR DUTY TO DEFEND AGAINST LEGAL ACTIONS

We will defend Your Title in any legal action only as to that part of the action which is based on a Covered Risk and which is not excepted or excluded from coverage in this Policy. We will pay the costs, attorneys' fees, and expenses We incur in that defense.

We will not pay for any part of the legal action which is not based on a Covered Risk or which is excepted or excluded from coverage in this Policy.

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We can end Our duty to defend Your Title under Section 4 of the Conditions.

THIS POLICY IS NOT COMPLETE WITHOUT SCHEDULES A AND B.

[Witness clause optional]

BLANK TITLE INSURANCE COMPANY

BY:____________________________________
PRESIDENT

BY:____________________________________
SECRETARY

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EXCLUSIONS

In addition to the Exceptions in Schedule B, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

1. Governmental police power, and the existence or violation of those portions of any law or government regulation concerning:

    a. building;
    b. zoning;
    c. land use;
    d. improvements on the Land;
    e. land division; and
    f. environmental protection.

    This Exclusion does not limit the coverage described in Covered Risk 8.a., 14, 15, 16, 18, 19, 20, 23 or 27.

2. The failure of Your existing structures, or any part of them, to be constructed in accordance with applicable building codes. This Exclusion does not limit the coverage described in Covered Risk 14 or 15.

3. The right to take the Land by condemning it. This Exclusion does not limit the coverage described in Covered Risk 17.

4. Risks:

    a. that are created, allowed, or agreed to by You, whether or not they are recorded in the Public Records;
    b. that are Known to You at the Policy Date, but not to Us, unless they are recorded in the Public Records at the Policy Date;
    c. that result in no loss to You; or
    d. that first occur after the Policy Date - this does not limit the coverage described in Covered Risk 7, 8.e., 25, 26, 27 or 28.

5. Failure to pay value for Your Title.

6. Lack of a right:

    a. to any land outside the area specifically described and referred to in paragraph 3 of Schedule A; and
    b. in streets, alleys, or waterways that touch the Land.

    This Exclusion does not limit the coverage described in Covered Risk 11 or 21.

7. The transfer of the Title to You is invalid as a preferential transfer or as a fraudulent transfer or conveyance under federal bankruptcy, state insolvency, or similar creditors' rights laws.

8. **Contamination, explosion, fire, vibration, fracturing, earthquake or subsidence.** This Exclusion does not limit the coverage described in Covered Risks 12, 14 or 15

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9. **Negligence by a person or an Entity exercising a right to extract or develop minerals or other subsurface substances.** This Exclusion does not limit the coverage described in Covered Risks 12, 14 or 15.

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HOMEOWNER'S POLICY OF TITLE INSURANCE

For a one-to-four family residence

Issued By

BLANK TITLE INSURANCE COMPANY

CONDITIONS

1. DEFINITIONS

   a. Easement - the right of someone else to use the Land for a special purpose.

   b. Estate Planning Entity - a legal entity or Trust established by a Natural Person for estate planning.

   c. Known - things about which You have actual knowledge. The words "Know" and "Knowing" have the same meaning as Known.

   d. Land - the land or condominium unit described in paragraph 3 of Schedule A and any improvements on the Land which are real property.

   e. Mortgage - a mortgage, deed of trust, trust deed or other security instrument.

   f. Natural Person - a human being, not a commercial or legal organization or entity. Natural Person includes a trustee of a Trust even if the trustee is not a human being.

   g. Policy Date - the date and time shown in Schedule A. If the insured named in Schedule A first acquires the interest shown in Schedule A by an instrument recorded in the Public Records later than the date and time shown in Schedule A, the Policy Date is the date and time the instrument is recorded.

   h. Public Records - records that give constructive notice of matters affecting Your Title, according to the state statutes where the Land is located.

   i. Title - the ownership of Your interest in the Land, as shown in Schedule A.

   j. Trust - a living trust established by a Natural Person for estate planning.

   k. We/Our/Us - Blank Title Insurance Company.

   l. You/Your - the insured named in Schedule A and also those identified in Section 2.b. of these Conditions.

2. CONTINUATION OF COVERAGE

   a. This Policy insures You forever, even after You no longer have Your Title. You cannot assign this Policy to anyone else.

   b. This Policy also insures:
      (1) anyone who inherits Your Title because of Your death;

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(2) Your spouse who receives Your Title because of dissolution of Your marriage;

(3) the trustee or successor trustee of a Trust or any Estate Planning Entity to whom You transfer Your Title after the Policy Date;

(4) the beneficiaries of Your Trust upon Your death; or

(5) anyone who receives Your Title by a transfer effective on Your death as authorized by law.

c. We may assert against the insureds identified in Section 2.b. any rights and defenses that We have against any previous insured under this Policy.

3. HOW TO MAKE A CLAIM

a. Prompt Notice Of Your Claim

(1) As soon as You Know of anything that might be covered by this Policy, You must notify Us promptly in writing.

(2) Send Your notice to **Blank Title Insurance Company**, , Attention: Claims Department. Please include the Policy number shown in Schedule A , and the county and state where the Land is located. Please enclose a copy of Your policy, if available.

(3) If You do not give Us prompt notice, Your coverage will be reduced or ended, but only to the extent Your failure affects Our ability to resolve the claim or defend You.

b. Proof Of Your Loss

(1) We may require You to give Us a written statement signed by You describing Your loss which includes:

(a) the basis of Your claim;

(b) the Covered Risks which resulted in Your loss;

(c) the dollar amount of Your loss; and

(d) the method You used to compute the amount of Your loss.

(2) We may require You to make available to Us records, checks, letters, contracts, insurance policies and other papers which relate to Your claim. We may make copies of these papers.

(3) We may require You to answer questions about Your claim under oath.

(4) If you fail or refuse to give Us a statement of loss, answer Our questions under oath, or make available to Us the papers We request, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.

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4. OUR CHOICES WHEN WE LEARN OF A CLAIM

   a. After We receive Your notice, or otherwise learn, of a claim that is covered by this Policy, Our choices include one or more of the following:

      (1) Pay the claim;

      (2) Negotiate a settlement;

      (3) Bring or defend a legal action related to the claim;

      (4) Pay You the amount required by this Policy;

      (5) End the coverage of this Policy for the claim by paying You Your actual loss resulting from the Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay;

      (6) End the coverage described in Covered Risk 16, 18, 19 or 21 by paying You the amount of Your insurance then in force for the particular Covered Risk, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay;

      (7) End all coverage of this Policy by paying You the Policy Amount then in force, and those costs, attorneys' fees and expenses incurred up to that time which We are obligated to pay;

      (8) Take other appropriate action.

   b. When We choose the options in Sections 4.a. (5), (6) or (7), all Our obligations for the claim end, including Our obligation to defend, or continue to defend, any legal action.

   c. Even if We do not think that the Policy covers the claim, We may choose one or more of the options above. By doing so, We do not give up any rights.

5. HANDLING A CLAIM OR LEGAL ACTION

   a. You must cooperate with Us in handling any claim or legal action and give Us all relevant information.

   b. If You fail or refuse to cooperate with Us, Your coverage will be reduced or ended, but only to the extent Your failure or refusal affects Our ability to resolve the claim or defend You.

   c. We are required to repay You only for those settlement costs, attorneys' fees and expenses that We approve in advance.

   d. We have the right to choose the attorney when We bring or defend a legal action on Your behalf. We can appeal any decision to the highest level. We do not have to pay Your claim until the legal action is finally decided.

   e. Whether or not We agree there is coverage, We can bring or defend a legal action, or take other appropriate action under this Policy. By doing so, We do not give up any rights.

AMERICAN LAND TITLE ASSOCIATION

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6. LIMITATION OF OUR LIABILITY

   a. After subtracting Your Deductible Amount if it applies, We will pay no more than the least of:

      (1) Your actual loss;

      (2) Our Maximum Dollar Limit of Liability then in force for the particular Covered Risk, for claims covered only under Covered Risk 16, 18, 19 or 21; or

      (3) the Policy Amount then in force.

      and any costs, attorneys' fees and expenses that We are obligated to pay under this Policy.

   b. If We pursue Our rights under Sections 4.a.(3) and 5.e. of these Conditions and are unsuccessful in establishing the Title, as insured:

      (1) the Policy Amount then in force will be increased by 10% of the Policy Amount shown in Schedule A, and

      (2) You shall have the right to have the actual loss determined on either the date the claim was made by You or the date it is settled and paid.

   c. (1) If We remove the cause of the claim with reasonable diligence after receiving notice of it, all Our obligations for the claim end, including any obligation for loss You had while We were removing the cause of the claim.

      (2) Regardless of 6.c.(1) above, if You cannot use the Land because of a claim covered by this Policy:

         (a) You may rent a reasonably equivalent substitute residence and We will repay You for the actual rent You pay, until the earlier of:

            (i) the cause of the claim is removed; or

            (ii) We pay You the amount required by this Policy. If Your claim is covered only under Covered Risk 16, 18, 19 or 21, that payment is the amount of Your insurance then in force for the particular Covered Risk.

         (b) We will pay reasonable costs You pay to relocate any personal property You have the right to remove from the Land, including transportation of that personal property for up to twenty-five (25) miles from the Land, and repair of any damage to that personal property because of the relocation. The amount We will pay You under this paragraph is limited to the value of the personal property before You relocate it.

   d. All payments We make under this Policy reduce the Policy Amount then in force, except for costs, attorneys' fees and expenses. All payments We make for claims which are covered only under Covered Risk 16, 18, 19 or 21 also reduce Our Maximum Dollar Limit of Liability for the particular Covered Risk, except for costs, attorneys' fees and expenses.

   e. If We issue, or have issued, a Policy to the owner of a Mortgage that is on Your Title and We have not given You any coverage against the Mortgage, then:

      (1) We have the right to pay any amount due You under this Policy to the owner of

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the Mortgage, and any amount paid shall be treated as a payment to You under this Policy, including under Section 4.a. of these Conditions;

(2) Any amount paid to the owner of the Mortgage shall be subtracted from the Policy Amount then in force ; and

(3) If Your claim is covered only under Covered Risk 16, 18, 19 or 21, any amount paid to the owner of the Mortgage shall also be subtracted from Our Maximum Dollar Limit of Liability for the particular Covered Risk.

f. If You do anything to affect any right of recovery You may have against someone else, We can subtract from Our liability the amount by which You reduced the value of that right.

7. TRANSFER OF YOUR RIGHTS TO US

a. When We settle Your claim, We have all the rights and remedies You have against any person or property related to the claim. You must not do anything to affect these rights and remedies. When We ask, You must execute documents to evidence the transfer to Us of these rights and remedies. You must let Us use Your name in enforcing these rights and remedies.

b. We will not be liable to You if We do not pursue these rights and remedies or if We do not recover any amount that might be recoverable.

c. We will pay any money We collect from enforcing these rights and remedies in the following order:

(1) to Us for the costs, attorneys' fees and expenses We paid to enforce these rights and remedies;

(2) to You for Your loss that You have not already collected;

(3) to Us for any money We paid out under this Policy on account of Your claim; and

(4) to You whatever is left.

d. If You have rights and remedies under contracts (such as indemnities, guaranties, bonds or other policies of insurance) to recover all or part of Your loss, then We have all of those rights and remedies, even if those contracts provide that those obligated have all of Your rights and remedies under this Policy.

8. THIS POLICY IS THE ENTIRE CONTRACT

This Policy, with any endorsements, is the entire contract between You and Us. To determine the meaning of any part of this Policy, You must read the entire Policy and any endorsements. Any changes to this Policy must be agreed to in writing by Us. Any claim You make against Us must be made under this Policy and is subject to its terms.

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9. <u>INCREASED POLICY AMOUNT</u>

The Policy Amount then in force will increase by ten percent (10%) of the Policy Amount shown in Schedule A each year for the first five years following the Policy Date shown in Schedule A, up to one hundred fifty percent (150%) of the Policy Amount shown in Schedule A. The increase each year will happen on the anniversary of the Policy Date shown in Schedule A.

10. <u>SEVERABILITY</u>

If any part of this Policy is held to be legally unenforceable, both You and We can still enforce the rest of this Policy.

11. <u>ARBITRATION</u>

a. If permitted in the state where the Land is located, You or We may demand arbitration.

b. The law used in the arbitration is the law of the state where the Land is located.

c. The arbitration shall be under the Title Insurance Arbitration Rules of the American Land Title Association ("Rules"). You can get a copy of the Rules from Us.

d. Except as provided in the Rules, You cannot join or consolidate Your claim or controversy with claims or controversies of other persons.

e. The arbitration shall be binding on both You and Us. The arbitration shall decide any matter in dispute between You and Us.

f. The arbitration award may be entered as a judgment in the proper court.

12. <u>CHOICE OF LAW</u>

The law of the state where the Land is located shall apply to this policy.

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HOMEOWNER'S POLICY OF TITLE INSURANCE

For a one-to-four family residence

Issued By

BLANK TITLE INSURANCE COMPANY

SCHEDULE A

Name and Address of Title Insurance Company:

Policy No.: [Premium: $_______________] Policy Amount: $ Policy Date [and Time]:

Deductible Amounts and Maximum Dollar Limits of Liability
For Covered Risk 16, 18, 19 and 21:

	Your Deductible Amount	Our Maximum Dollar Limit of Liability
Covered Risk 16:	% of Policy Amount Shown in Schedule A or $ (whichever is less)	$
Covered Risk 18:	% of Policy Amount Shown in Schedule A or $ (whichever is less)	$
Covered Risk 19:	% of Policy Amount Shown in Schedule A or $ (whichever is less)	$
Covered Risk 21:	% of Policy Amount Shown in Schedule A or $ (whichever is less)	$

Street Address of the Land:

1. Name of Insured:
2. Your interest in the Land covered by this Policy is:
3. The Land referred to in this Policy is described as:

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HOMEOWNER'S POLICY OF TITLE INSURANCE

For a one-to-four family residence

Issued By

BLANK TITLE INSURANCE COMPANY

SCHEDULE B

EXCEPTIONS

In addition to the Exclusions, You are not insured against loss, costs, attorneys' fees, and expenses resulting from:

AMERICAN
LAND TITLE
ASSOCIATION

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FOR PUBLICATION

UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

GRAND CANYON SKYWALK DEVELOPMENT, LLC, a Nevada limited liability company, *Plaintiff-Appellant*, v. 'SA' NYU WA INCORPORATED, also named as 'Sa' Nyu Wa: a tribally-charted corporation established under the laws of the Hualapai Indian Tribe; GRAND CANYON RESORT CORPORATION, a tribally-chartered corporation established under the laws of the Hualapai Indian Tribe; RICHARD WALERMA, SR.; WYNONA SINYELLA; RUBY STEELE; CANDIDA HUNTER; BARNEY ROCKY IMUS; WAYLON HONGA; CHARLES VAUGHN, SR., each individuals and members of the Hualapai Tribal Council; WANDA EASTER; JACI DUGAN, each individuals and Hualapai Indian Tribe employees; DUANE YELLOWHAWK, Honorable, individual and judge of the Hualapai Tribe Court, *Defendants-Appellees*.	No. 12-15634 D.C. No. 3:12-cv-08030-DGC OPINION

Appeal from the United States District Court
for the District of Arizona
David G. Campbell, District Judge, Presiding

Argued and Submitted
October 19, 2012—San Francisco, California

Filed April 26, 2013

Before: Raymond C. Fisher, Richard C. Tallman,
and Consuelo M. Callahan, Circuit Judges.

Opinion by Judge Tallman

SUMMARY[*]

Tribal Court Jurisdiction

Affirming the district court's judgment in an action concerning a dispute over a revenue-sharing contract between a Nevada corporation and a tribally chartered corporation of the Hualapai Indian Tribe for the building and operation of the Grand Canyon Skywalk, the panel held that the Nevada corporation must exhaust tribal court remedies before proceeding in federal court on its claims challenging the Tribe's authority to condemn its intangible property rights in the contract.

[*] 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 concluded that the bad faith and futility exceptions to the exhaustion requirement did not apply. It held that where a tribal court has asserted jurisdiction and is entertaining a suit, the tribal court must have acted in bad faith for exhaustion to be excused; bad faith by a litigant instituting the tribal court action will not suffice. The panel held that the submitted evidence did not establish that the tribal court operated in bad faith or was controlled by the tribal council in its decision making. The panel also affirmed the district court's conclusion that the evidence did not meet the narrow futility exception, which applies where exhaustion would be futile because of the lack of adequate opportunity to challenge the tribal court's jurisdiction.

The panel held inapplicable the exhaustion exception for cases in which the tribal court plainly lacks jurisdiction. The panel stated that the main rule of *Montana v. United States*, 450 U.S. 544 (1981), that generally Indian tribes lack civil authority over the conduct of nonmembers on non-Indian land within a reservation, was unlikely to apply to the facts of this case. The panel held that the district court correctly relied upon *Water Wheel Camp Recreation Area, Inc. v. LaRance*, 642 F.3d 802 (9th Cir. 2011), which recognizes that a tribe's inherent authority over tribal land may provide for regulatory authority over non-Indians on that land without the need to consider *Montana.* Moreover, even if the tribal court were to apply *Montana*'s main rule, the Nevada corporation's consensual relationship with the tribal corporation, or the financial implications of their agreement, likely would place the case squarely within one of *Montana*'s exceptions and allow for tribal jurisdiction.

COUNSEL

Troy A. Eid (argued) and Jennifer Weddle, Greenberg Traurig, LLP, Denver, Colorado; Tami Denise Cowden and Mark Tratos, Greenberg Traurig, LLP, Las Vegas, Nevada; and Pamela Overton, Greenberg Traurig, LLP, Phoenix, Arizona, for Plaintiff-Appellant.

Jeffrey David Gross (argued), Paul Kipp Charlton, Glen Hallman and Christopher W. Thompson, Gallagher & Kennedy, P.A., Phoenix, Arizona, for Defendants-Appellees.

OPINION

TALLMAN, Circuit Judge:

We must once again address the subject of tribal court jurisdiction over disputes arising when non-Indians choose to do business in Indian country. Underlying this jurisdictional question is a multi-million dollar development contract involving the building and operation of a tourist destination overlooking one of the world's great wonders, the Grand Canyon. The Skywalk is a glass-bottomed viewing platform suspended 70 feet over the rim of the Grand Canyon with the Colorado River flowing thousands of feet below.

Grand Canyon Skywalk Development, LLC ("GCSD"), a Nevada corporation, entered into a revenue-sharing contract with Sa Nyu Wa ("SNW"), a tribally chartered corporation of the Hualapai Indian Tribe. When a dispute arose over the contract, GCSD sued SNW in Hualapai Tribal Court to compel arbitration. While arbitration proceeded, the Hualapai Tribal Council exercised eminent domain and

condemned GCSD's intangible property rights in the contract, which practically speaking left SNW, as a tribal corporation, in contract with the Hualapai Tribe.

GCSD responded by filing suit against SNW in the United States District Court for the District of Arizona seeking declaratory judgment that the Hualapai Tribe lacked the authority to condemn its intangible property rights and injunctive relief. The district court denied the temporary restraining order ("TRO") to enjoin SNW based on the principle of comity and required GCSD to exhaust all possible tribal court remedies before proceeding in federal court. The district court relied on our decision in *Water Wheel Camp Recreational Area, Inc. v. LaRance*, 642 F.3d 802 (9th Cir. 2011), and also concluded there was not a sufficient basis to apply the bad faith or futility exceptions. For the same reasons cited by the district court, we affirm.

I

On December 31, 2003, GCSD and SNW entered into a revenue-sharing "Development and Management Agreement" to establish a glass bridge tourist overlook and related facilities known as the Skywalk on remote tribal land. In addition, GCSD agreed to provide shuttle services from locations outside the reservation to the Skywalk. The parties signed an amended agreement on September 10, 2007, and later created a trust to manage the shared revenues on March 10, 2010.

GCSD filed a complaint in Hualapai Tribal Court on February 25, 2011, seeking to compel SNW to engage in arbitration pursuant to their agreement's dispute resolution clause. SNW objected, but nonetheless participated, and on

February 1, 2012, an American Arbitration Association arbitrator set deadlines for a joint prehearing schedule and resolution of any outstanding discovery disputes, including depositions and subpoenas.

As arbitration proceeded, the Hualapai Tribal Council passed Resolution No. 20-2011 on April 4, 2011, enacting § 2.16 of the Hualapai Law and Order Code, which codified the Tribe's power to invoke eminent domain to condemn property for public use. On February 7, 2012, acting under § 2.16, the tribal council passed Resolution No. 15-2012 to acquire "GCSD's contractual interest in the Skywalk Agreement under the power of eminent domain and to do all things necessary to accomplish th[at] purpose." The Hualapai Tribal Court followed by issuing a TRO against GCSD, and SNW filed a Declaration of Taking with the tribal court.

GCSD responded on two fronts: it filed an expedited motion for a TRO in district court to stop the eminent domain proceedings, and it opposed the taking in Hualapai Tribal Court. After multiple hearings, the district court denied GCSD's TRO by invoking the principles of comity and ordered GCSD to exhaust tribal court remedies prior to review in federal court. GCSD timely appealed on March 22, 2012.

II

We have jurisdiction under 28 U.S.C. § 1292(a)(1) as an appeal from denial of injunctive relief. Although TROs are not typically appealable interlocutory orders, we may review a TRO that "possesses the qualities of a preliminary injunction" where the "district court holds an adversary hearing and the basis for the court's order was strongly

challenged." *Serv. Emps. Int'l Union v. Nat'l Union of Healthcare Workers*, 598 F.3d 1061, 1067 (9th Cir. 2010). We review questions of tribal court jurisdiction and exhaustion of tribal court remedies de novo and factual findings for clear error. *Smith v. Salish Kootenai Coll.*, 434 F.3d 1127, 1130 (9th Cir. 2006); *Philip Morris USA, Inc. v. King Mountain Tobacco Co.*, 569 F.3d 932, 938 n.1 (9th Cir. 2009).[1]

III

SNW argues, for the first time on appeal, that collateral estoppel bars GCSD from raising similar jurisdictional questions on appeal that it raised before the district court in an earlier case dismissed without prejudice. Because GCSD's argument fails on the merits, we need not consider either whether SNW waived this argument by failing to raise it in the district court or whether collateral estoppel applies here.

IV

Federal law has long recognized a respect for comity and deference to the tribal court as the appropriate court of first impression to determine its jurisdiction. *See Nat'l Farmers Union Ins. Cos. v. Crow Tribe of Indians*, 471 U.S. 845, 856–57 (1985); *Iowa Mut. Ins. Co. v. LaPlante*, 480 U.S. 9, 15–16 (1987); *Burlington N. R.R. Co. v. Crow Tribal Council*, 940 F.2d 1239, 1244–47 (9th Cir. 1991). As support for this

[1] While appellate review of a district court's denial of a TRO is typically for an abuse of discretion, the question of tribal jurisdiction and exhaustion of tribal remedies takes priority in this case and provides the appropriate standard of review.

premise, the Supreme Court cites: (1) Congress's commitment to "a policy of supporting tribal self-government and self-determination;" (2) a policy that allows "the forum whose jurisdiction is being challenged the first opportunity to evaluate the factual and legal bases for the challenge;" and (3) judicial economy, which will best be served "by allowing a full record to be developed in the Tribal Court." *Nat'l Farmers*, 471 U.S. at 856.

We have interpreted *National Farmers* as determining that tribal court exhaustion is not a jurisdictional bar, but rather a prerequisite to a federal court's exercise of its jurisdiction. *Crow Tribal Council*, 940 F.2d at 1245 n.3. "Therefore, under *National Farmers*, the federal courts should not even make a ruling on tribal court jurisdiction . . . until tribal remedies are exhausted." *Stock West, Inc. v. Confederated Tribes of the Colville Reservation*, 873 F.2d 1221, 1228 (9th Cir. 1989). However, there are four recognized exceptions to the requirement for exhaustion of tribal court remedies where:

> (1) an assertion of tribal jurisdiction is motivated by a desire to harass or is conducted in bad faith; (2) the action is patently violative of express jurisdictional prohibitions; (3) exhaustion would be futile because of the lack of adequate opportunity to challenge the court's jurisdiction; or (4) it is plain that no federal grant provides for tribal governance of nonmembers' conduct on land covered by *Montana*'s main rule.

Burlington N. R.R. Co. v. Red Wolf, 196 F.3d 1059, 1065 (9th Cir. 1999) (citations omitted). GCSD raises bad faith,

futility, and plain lack of tribal governance in support of its position. We review each of these exceptions in turn but ultimately conclude that none offers a sufficient basis to avoid exhaustion of tribal court remedies in this case.

V

The Supreme Court has suggested that a federal court need not wait until tribal remedies have been exhausted to consider a case if "an assertion of tribal jurisdiction is motivated by a desire to harass or is conducted in bad faith." *Nat'l Farmers*, 471 U.S. at 856 n.21 (internal citation omitted). *Black's Law Dictionary* defines bad faith as "[d]ishonesty of belief or purpose." 149 (9th ed. 2009). *National Farmers* used the passive voice and neither we, nor the Supreme Court, have expressly stated *who* must act in bad faith for it to apply. We now hold that where, as here, a tribal court has asserted jurisdiction and is entertaining a suit, the tribal court must have acted in bad faith for exhaustion to be excused. Bad faith by a litigant instituting the tribal court action will not suffice.

A

The source of the bad faith exception in the tribal court context is *National Farmers*, 471 U.S. at 856 n.21, which imported it from *Juidice v. Vail*, 430 U.S. 327, 338 (1977). In *Juidice*, the state court issued a commitment order, and the defendant was arrested after he failed to attend a deposition, appear for a hearing, and pay a fine. *Id*. at 329–30. Rather than appeal his case in state court, he filed a 42 U.S.C. § 1983 claim in district court. *Id*. at 328–30. Upon review, the Supreme Court held that a federal court must abstain from making a determination during a state proceeding based on

the principle of comity unless the proceeding was motivated by a desire to harass or was conducted in bad faith. *See id*. at 334–38. The Court looked to the *proceeding* and the court overseeing that proceeding to make its determination. *See id.* at 338 (holding that the bad faith exception "may not be utilized unless it is alleged and proved that [the State Courts] are enforcing the contempt procedures in bad faith or are motivated by a desire to harass"). The defendant there alleged bad faith by the plaintiffs, which the Court explicitly held insufficient to trigger the exception. *See id.* (holding that the exception was not triggered because "[w]hile some paragraphs of the complaint could be construed to make [bad faith] allegations as to the creditors, there are no comparable allegations with respect to appellant justices who issued the contempt orders"). Analogizing to this case, it must be the Hualapai Tribal Court that acts in bad faith to avoid the requirement to exhaust tribal court remedies.

Additionally, a broader interpretation would unnecessarily deprive tribal courts of jurisdiction and violate the principles of comity that underlie the exhaustion requirement. A party would need only allege bad faith by the opposing party, or a third party, to remove the case to federal court. Comity principles require that we trust that our tribal court counterparts can identify and punish bad faith by litigants as readily as we can. GCSD's proposed reading of the exception would swallow the rule and undermine the Supreme Court's general principle of deference to tribal courts.

GCSD points to two Ninth Circuit cases in support of its broader interpretation of who may act in bad faith to trigger the exception, but neither is dispositive of the issue. In *A&A Concrete, Inc. v. White Mountain Apache Tribe*, the

appellants argued that enforcement of a statutory scheme had been in bad faith. 781 F.2d 1411, 1417 (9th Cir. 1986). We rejected the argument because there was no evidence of bad faith in the record. *See id.* Similarly, in *Atwood v. Fort Peck Tribal Court Assiniboine*, we considered and rejected the bad faith exception in a single sentence by stating that "[t]here has been no showing that [the defendant] asserted tribal jurisdiction in bad faith or that she acted to harass [the plaintiff]." 513 F.3d 943, 948 (9th Cir. 2008). Although both of these decisions looked beyond the tribal court for their bad faith analysis, the topic received only a cursory review and was quickly dismissed. Neither case defined the scope of bad faith, and more importantly, neither case applied the bad faith exception. Ultimately, where a tribe has an established judicial system as here, the interpretation most faithful to *National Farmers* is that it must be the tribal court that acts in bad faith to exempt the party from exhausting available tribal court remedies.

B

The facts of this case do not support a finding of bad faith on the part of the tribal court. GCSD urges us to determine that the *Hualapai Tribal Court Evaluation*,[2] the proffered testimony of its author, Executive Director Joseph Myers, and other evidence proved that the tribal court and tribal council were inextricably intertwined such that bad faith by the tribal council could be imputed to the tribal court. However, the proffered evidence does not conclusively support that claim. The majority of the statements in the *Evaluation* are broad generalizations or guiding principles. Two specific findings

[2] The tribal council commissioned the *Evaluation* prepared by the National Indian Justice Center.

directly refute GCSD's contentions: (1) "no interviewee stated that there was any direct interference in court matters by tribal council members;" and (2) "[t]he judiciary is separate and apart from the tribal council." Additionally, the tribal council's act of bringing in an external auditing organization lends credibility to the tribal court system as a whole.

GCSD challenges the district court's refusal to hear testimony from the *Evaluation*'s author, Mr. Myers. "A district court's evidentiary rulings should not be reversed absent clear abuse of discretion and some prejudice." *S.E.C. v. Jasper*, 678 F.3d 1116, 1122 (9th Cir. 2012) (citation and internal quotation marks omitted). "For us to reverse a decision as an abuse of discretion, we must have a definite and firm conviction that the district court committed a clear error of judgment in the conclusion it reached." *United States v. Comprehensive Drug Testing, Inc.*, 621 F.3d 1162, 1175 (9th Cir. 2010) (citation and internal quotation marks omitted).

The district court did not abuse its discretion when it denied GCSD's request to introduce Mr. Myers' testimony. GCSD requested an emergency evidentiary hearing but failed to notify the court of its intention to introduce witness testimony. As a result, SNW did not have an opportunity to subpoena defense witnesses. Out of fairness to SNW and due to the urgency of a TRO proceeding, the court accepted only Mr. Myers' written report. The court reviewed the published *Evaluation* and left open the possibility of an additional evidentiary hearing if necessary.

Ultimately, the court's denial of the admission of his actual testimony was not an abuse of discretion because the

Evaluation documented Mr. Myers' findings and provided a balanced review of the Hualapai judiciary. When considered together, the submitted evidence does not establish that the tribal court operated in bad faith or is controlled by the tribal council in its decision making.

VI

Futility is also a recognized exception to the requirement to exhaust court tribal remedies. Where "exhaustion would be futile because of the lack of adequate opportunity to challenge the court's jurisdiction," a party is excused from exhausting claims in tribal court. *Red Wolf*, 196 F.3d at 1065. Generally, this exception applies narrowly to only the most extreme cases. *See Johnson v. Gila River Indian Cmty.*, 174 F.3d 1032, 1036 (9th Cir. 1999) (two-year delay called into question the possibility of tribal court remedies); *Krempel v. Prairie Island Indian Cmty.*, 125 F.3d 621, 622 (8th Cir. 1997) (exhaustion not required where there was no functioning tribal court).

GCSD has failed to show that the Hualapai Tribal Court does not offer an adequate and impartial opportunity to challenge jurisdiction. Although Hualapai Law and Order Code § 2.16(K) originally precluded a judge pro tem from hearing condemnation cases, the tribal court remedied this separation of powers issue by invalidating that section and appointing a neutral pro tem judge to hear this case. The Hualapai adjudicatory process has continued, as evidenced by submitted tribal court and tribal court of appeals orders. Both

parties to this appeal are participating in those proceedings.[3] The tribal court determined it has jurisdiction to review the condemnation act under the catchall section of the Hualapai Law and Order Code, § 3.1(d), which states: "the Tribal Court may be guided by common law as developed by other Tribal, federal or state courts" where no law is directly on point. Even the *Evaluation* offered as evidence by GCSD as proof of futility includes statements such as, "[t]he Hualapai Tribal Court is a functional, established system with court procedures" and "[t]he judiciary is separate and apart from the tribal council."

The submitted evidence supports the district court's finding that the tribal court operates independently from the tribal council and the evidence presented does not meet the narrow futility exception. GCSD is actively litigating its case in Hualapai Tribal Court, contradicting its argument that it has not had an "adequate opportunity to challenge the court's jurisdiction." *Red Wolf*, 196 F.3d at 1065.

VII

Finally, we turn to the third issue raised on appeal, whether the tribal court plainly lacked jurisdiction over this case. The Supreme Court stated in *Strate v. A-1 Contractors* that where "it is plain that no federal grant provides for tribal governance of nonmembers' conduct on land covered by *Montana*'s main rule, it will be equally evident that tribal courts lack adjudicatory authority over disputes arising from

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[3] Appellees' outstanding Second Motion to Supplement the Record, Oct. 5, 2012, ECF No. 38, and Appellant's outstanding Motion to Supplement the Record, Oct. 15, 2012, ECF No. 39, are granted. Submitted materials have been reviewed and were considered in this decision.

such conduct." 520 U.S. 438, 459 n.14 (1997) (*Montana* "described a general rule that, absent a different congressional direction, Indian tribes lack civil authority over the conduct of nonmembers on non-Indian land within a reservation." *Id*. at 446). We hold that this *Strate* exception does not apply here to deny the tribal court of its initial jurisdiction.

The tribal court does not plainly lack jurisdiction because *Montana*'s main rule is unlikely to apply to the facts of this case. Furthermore, the district court correctly relied upon *Water Wheel*, which provides for tribal jurisdiction without even reaching the application of *Montana*. Even if the tribal court were to apply *Montana*'s main rule, GCSD's consensual relationship with SNW or the financial implications of the agreement likely place it squarely within one of *Montana*'s exceptions and allow for tribal jurisdiction.[4]

A

Montana v. United States, 450 U.S. 544 (1981), is "the pathmarking case concerning tribal civil authority over nonmembers." *Strate*, 520 U.S. at 445. But as the district court properly determined, a tribe's inherent authority over tribal land may provide for regulatory authority over non-Indians on that land without the need to consider *Montana*. *See Water Wheel*, 642 F.3d at 804–05. As a starting point, we

[4] Although GCSD raises *mobilia sequuntur personam* as another means to preclude tribal jurisdiction in the first instance, its argument conflates the interlocutory jurisdictional question with the merits of the condemnation action. This opinion focuses on the jurisdictional question, and we need not determine the situs of the contract to render our decision.

recognize "the long-standing rule that Indian tribes possess inherent sovereign powers, including the authority to exclude, unless Congress clearly and unambiguously says otherwise." *Id.* at 808 (citation omitted).

In *Water Wheel*, a non-Indian corporation entered into a lease agreement with a group of tribes for the development and operation of a recreational park and marina on tribal land along the Colorado River. *Id.* at 805. Under the contract Water Wheel collected fees from users and made payments to the tribes. *Id.* After a dispute arose, Water Wheel stopped making payments and refused to vacate the premises after the lease ended. *Id.* The tribes filed suit in tribal court, and Water Wheel moved to dismiss the case, arguing the court did not have jurisdiction under *Montana*. *Id.* at 805–06. We held that "where the non-Indian activity in question occurred on tribal land, the activity interfered directly with the tribe's inherent powers to exclude and manage its own lands, and there are no competing state interests at play, the tribe's status as landowner is enough to support regulatory jurisdiction without considering *Montana*," *id.* at 814, and unless a limitation applies, adjudicatory jurisdiction, as well. *Id.* at 814–17.

Despite GCSD's attempts to distinguish *Water Wheel*, the factual differences do not diminish the reasoning or the application of the decision here. Just as in *Water Wheel*, GCSD agreed to develop and manage a tourist location on tribal land in exchange for a fee. It is the impressive beauty of the tribal land's location that is the valuable centerpiece of this controversy. Tourists visit the Skywalk because it provides unparalleled viewing of the Grand Canyon, a location to which the Tribe has the power to limit access through its inherent sovereignty and the right to exclude.

Water Wheel is instructive because there, just as here, it was access to the valuable tribal land that was the essential basis for the agreement.

Although this case involves an intangible property right within a contract, rather than a leasehold as in *Water Wheel*, the contract in this case equally interfered with the Hualapai's ability to exclude GCSD from the reservation. The dispute between GCSD and SNW over the management of the Skywalk property resulted in the Hualapai taking drastic measures: passing an ordinance to condemn GCSD's property rights, purporting to substitute the Tribe in the place of GCSD to carry out the management of the overlook, and spending more than two years in litigation. With the power to exclude comes the lesser power to regulate. *South Dakota v. Bourland*, 508 U.S. 679, 689 (1993). Where a tribe has regulatory jurisdiction and interests, such as those at stake here, it is also likely to have adjudicatory jurisdiction as the district court concluded. *See Water Wheel*, 642 F.3d at 814–16.

GCSD argues the Tribe waived its inherent sovereignty when it established SNW to manage the Skywalk contract, but that is not the case. *Merrion v. Jicarilla Apache Tribe* cautioned against conflating a tribe's agreement to contract with a waiver of tribal sovereignty. 455 U.S. 130, 144–48 (1982). "To presume that a sovereign forever waives the right to exercise one of its sovereign powers unless it expressly reserves the right to exercise that power in a commercial agreement turns the concept of sovereignty on its head . . . ." *Id.* at 148. GCSD relies on *Merrion* where the Court stated "[w]hen a tribe grants a non-Indian the right to be on Indian land, the tribe agrees not to exercise its ultimate power to oust the non-Indian as long as the non-Indian

complies with the initial conditions of entry." *Id.* at 144. But that argument goes to the merits of the condemnation action and not to the jurisdictional question before us now. Read in its entirety, *Merrion* holds that unless expressly waived "in unmistakable terms" within the contract, a tribe retains its inherent sovereignty, and as such, the tribe may have jurisdiction. *Id.* at 148.

B

Furthermore, although the main rule in *Montana v. United States* is that a tribal court lacks regulatory authority over the activities of non-Indians unless one of its two exceptions apply, this case is not *Montana*. *Montana*, 450 U.S. at 565–66. *Montana* considered tribal jurisdiction over nonmember activities on *non-Indian* land, *held in fee simple*, within a reservation. *Id.* at 547, 565–66. The land underlying this case, however, is federal Indian land held in trust for the Hualapai Tribe. The dispute arose out of an agreement related to the development, operations, and management of the Skywalk, an asset located in Indian country.

With the exception of *Nevada v. Hicks*, 533 U.S. 353 (2001), the Supreme Court has applied *Montana* "almost exclusively to questions of jurisdiction arising on non-Indian land or its equivalent." *Water Wheel*, 642 F.3d at 809. When deciding whether a tribal court has jurisdiction, land ownership may sometimes prove dispositive, but when a competing state interest exists courts balance that interest against the tribe's. *See Hicks*, 533 U.S. at 360, 370. Here, as the dispute centers on Hualapai trust land and there are no obvious state interests at play, the *Hicks* exception is unlikely to require *Montana*'s application. At the very least, it cannot be said that the tribal court plainly lacks jurisdiction.

C

Even if *Montana* applied, either of its two recognized exceptions could also provide for tribal jurisdiction in this case. The first exception allows "Indian tribes [to] retain inherent sovereign power to exercise some forms of civil jurisdiction over non-Indians on their reservations" where nonmembers enter into "consensual relationships with the tribe or its members, through commercial dealing, contracts, leases, or other arrangements." 450 U.S. at 565. The second exception exists where the conduct of a non-Indian "threatens or has some direct effect on the political integrity, the economic security, or the health or welfare of the tribe." *Id.* at 566. Additionally, tribal laws may be fairly imposed on nonmembers if the nonmember consents, either expressly or through his or her actions. *See Plains Commerce Bank v. Long Family Land & Cattle Co.*, 554 U.S. 316, 337 (2008).

GCSD voluntarily entered into a contract with SNW by signing an agreement to develop and manage the Skywalk and both parties were represented by counsel. The scope of the agreement was extensive, lasting more than eight years at the time the case was filed in the district court, and with agreed upon possible damages of up to $50 million for early termination. The parties reviewed and signed an amended agreement and entered into a subsequent trust years later. While the agreement was between GCSD and SNW, and not the Tribe directly, the first exception applies equally whether the contract is with a tribe or its members. *Montana*, 450 U.S. at 565. Given the consensual nature of the relationship between the parties and the potential economic impact of the agreement, the tribal court could conclude it has jurisdiction over SNW's dispute with GCSD under either of *Montana*'s exceptions.

Moreover, GCSD should have reasonably anticipated being subjected to the Tribe's jurisdiction. *See Plains Commerce*, 554 U.S. at 338. Article 2, § 2.1 of the original GCSD/SNW agreement specifies that the "Manager [GCSD] hereby accepts its appointment as the developer and manager of the Project and agrees to develop, supervise, manage, and operate the Project . . . in compliance with all applicable federal, [*Hualapai*] *Nation*, state, and local laws, ordinances, rules, and regulations, including all employment laws and regulations." (emphasis added). Thus, the necessary corollary would be that if GCSD operated in violation of the Tribe's laws, it could be subjected to its jurisdiction. GCSD consented to be bound by this language when it signed the agreement with SNW.

VIII

The judgment of the district court requiring exhaustion of tribal court remedies prior to proceeding with the action in federal court is **AFFIRMED**.

Filed 3/4/13

IN THE SUPREME COURT OF CALIFORNIA

DANIELLE BOURHIS et al.,	
Plaintiffs and Appellants,	S199887, S199889
v.	Ct.App. 1/2 A132136, A133177
JOHN LORD et al.,	Marin County
Defendants and Respondents.	Super. Ct. No. CIV060796

If a corporation fails to pay its taxes, the state may suspend its corporate powers. The state may later revive those powers when the corporation pays its taxes. We must decide whether a corporation that files notices of appeal while its corporate powers are suspended may proceed with the appeals after those powers have been revived, even if the revival occurs after the time to appeal has expired. Two opinions from this court in the 1970's held that revival of corporate powers validates an earlier notice of appeal. (*Rooney v. Vermont Investment Corp.* (1973) 10 Cal.3d 351 (*Rooney*); *Peacock Hill Assn. v. Peacock Lagoon Constr. Co.* (1972) 8 Cal.3d 369 (*Peacock Hill*).) We adhere to those decisions due to principles of stare decisis. Accordingly, these appeals may proceed.

I. PROCEDURAL HISTORY

Danielle Bourhis and others, including Brown Eyed Girl, Inc. (Brown Eyed Girl), a California corporation, filed the underlying lawsuit for property damage against John Lord and others. Before trial, defendants learned that the state had

suspended Brown Eyed Girl's corporate powers for nonpayment of taxes. They moved in the superior court to preclude it from offering any evidence at trial. The court denied the motion contingent on the corporation's reviving its corporate powers. After it granted a motion for a nonsuit in favor of some defendants, and a jury returned a verdict in favor of another defendant, the court entered judgment in favor of all defendants on April 5, 2011. Notice of entry of judgment was served the next day. Plaintiffs, including Brown Eyed Girl, filed a notice of appeal from that judgment on May 26, 2011. On August 30, 2011, the court entered an order after judgment awarding costs and attorney fees, which was entered and served the same day. On September 13, 2011, plaintiffs, including Brown Eyed Girl, filed a notice of appeal from that order.

On December 1, 2011, defendants filed separate motions in the Court of Appeal to strike Brown Eyed Girl's notices of appeal and to dismiss those appeals because its corporate powers were still suspended. In opposition, Brown Eyed Girl presented documentation showing that its corporate powers had been revived on December 8, 2011. It argued that this revival validated its previous notices of appeal, thus making the appeal effective.

On December 29, 2011, the Court of Appeal filed orders denying both motions. Both orders included these citations: "(*Rooney v. Vermont Investment Corp.* (1973) 10 Cal.3d 351, 359; *Peacock Hill Assn. v. Peacock Lagoon Constr. Co.* (1972) 8 Cal.3d 369, 373-374; see *ABA Recovery Services, Inc. v. Konold* (1988) 198 Cal.App.3d 720, 725, fn. 2.)"

Defendants filed separate petitions for review of the orders denying the motions to dismiss the appeals. (See Cal. Rules of Court, rule 8.500(a)(1) [interlocutory order of the Ct. App. is subject to review].) We granted both petitions and subsequently consolidated the matters.

DISCUSSION

With exceptions not relevant here, "the corporate powers, rights and privileges of a domestic taxpayer may be suspended, and the exercise of the corporate powers, rights, and privileges of a foreign taxpayer in this state may be forfeited," if a corporation fails to pay its taxes. (Rev. & Tax. Code, § 23301; see also *id*., § 23301.5 [similar provision regarding the failure to file a tax return].) (All further statutory references are to the Rev. & Tax. Code.) A corporation whose powers have been suspended may apply with the Franchise Tax Board for reinstatement after satisfying its obligations. (§ 23305.) If the statutory requirements are met, the Franchise Tax Board issues a "certificate of revivor." (§ 23305.) "Upon the issuance of the certificate [of revivor] by the Franchise Tax Board the taxpayer therein named shall become reinstated but the reinstatement shall be without prejudice to any action, defense or right which has accrued by reason of the original suspension or forfeiture . . . ." (§ 23305a.)

Brown Eyed Girl purported to file notices of appeal while its corporate powers were suspended. In general, a "corporation may not prosecute or defend an action, nor appeal from an adverse judgment in an action while its corporate rights are suspended for failure to pay taxes." (*Reed v. Norman* (1957) 48 Cal.2d 338, 343.) Thus, the notices of appeal were invalid when filed. However, Brown Eyed Girl later received a certificate of revivor. When that certificate is received, as one court put it, "[t]he legal rights of a suspended corporation are then revived, as an unconscious person is revived by artificial respiration." (*Benton v. County of Napa* (1991) 226 Cal.App.3d 1485, 1490.) "In a number of situations the revival of corporate powers by the payment of delinquent taxes has been held to validate otherwise invalid prior action." (*Peacock Hill*, *supra*, 8 Cal.3d at p. 371.) We must decide whether the revival of corporate powers in this case validated the earlier notices of appeal.

If revival of corporate powers occurs while a valid appeal can still be taken, the question appears easy; the revival would validate a prior notice of appeal and permit the appeal to proceed. The appeal would be timely, and little purpose would be served by requiring the corporation to file another, essentially identical, notice of appeal. But appeals are subject to jurisdictional time limits. A notice of appeal must be filed within 60 days after service of the notice of entry of judgment. (Cal. Rules of Court, rule 8.104(a).) "The time to file notice of appeal, both in civil and criminal cases, has always been held jurisdictional in California." (9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 614, p. 689.) As to both appeals at issue here, this time had expired before Brown Eyed Girl's corporate powers were revived. Should the later revival validate the earlier invalid notice of appeal in this circumstance?

When it denied the motions to dismiss the appeals, the Court of Appeal cited *Rooney*, *supra*, 10 Cal.3d 351, and *Peacock Hill*, *supra*, 8 Cal.3d 369. In *Peacock Hill*, the Peacock Hill Association moved to dismiss the appeal of Peacock Lagoon Construction Co. (Construction) on the ground that Construction's corporate powers had been suspended. We refused to dismiss the appeal. Citing cases in which "it was held that the purpose of section 23301 of the Revenue and Taxation Code is to put pressure on the delinquent corporation to pay its taxes," we said that "that purpose is satisfied by a rule which views a corporation's tax delinquencies, after correction, as mere irregularities." (*Peacock Hills*, *supra*, 8 Cal.3d at p. 371.) We added that "[t]here is little purpose in imposing additional penalties after the taxes have been paid." (*Ibid.*)

Peacock Hill relied in part on *Traub Co. v. Coffee Break Service, Inc.* (1967) 66 Cal.2d 368, where a party had moved to set aside a final judgment in favor of a corporation whose corporate status had been suspended. The *Traub* court had "concluded that the trial court was correct in its view that a final

judgment is immune from the collateral attack attempted." (*Peacock Hill*, *supra*, 8 Cal.3d at p. 372.) We explained that "[i]n *Traub* we cited with approval several Court of Appeal decisions in which the corporate plaintiff was allowed to maintain a lawsuit even though it had been suspended at the time it filed its complaint. In each case, the corporation had secured reinstatement prior to the date set for trial, but after the defendant had brought the suspension to the attention of the trial court. The appellate courts reasoned that the plea of lack of capacity of a corporation because of its suspension for failure to pay taxes, is a plea in abatement which is not favored in law and must be supported by the facts at the time of the plea. In each case it was held that revival of the corporate powers before trial was sufficient to permit the corporation to maintain its action." (*Ibid.*)

The *Peacock Hill* court concluded that "as to matters occurring prior to judgment the revival of corporate powers has the effect of validating the earlier acts and permitting the corporation to proceed with the action. We are satisfied that the same rule should ordinarily apply with respect to matters occurring subsequent to judgment. . . . [¶] In the instant case, the corporate powers of Construction have been revived by the payment of taxes, and it may proceed with its appeal." (*Peacock Hill*, *supra*, 8 Cal.3d at pp. 373-374.)

Justice Mosk dissented. He agreed with the majority that section 23301's purpose was to put pressure on a delinquent corporation to pay its taxes, but, he argued, "that purpose is frustrated by permitting a delinquent corporation, merely through tardy payment of taxes, to validate all of the actions taken during its period of suspension. Under that concept the stick becomes a carrot; all incentive to avoid punitive disabilities dissolves. Upon exposure of its delinquency the corporation suffers little more than fleeting embarrassment, and, indeed, it is then rewarded by authentication of all its previous illegal acts. [¶] In the present case, for example, Construction's powers had been suspended prior to trial and

remained in that status until after judgment and the filing of the notice of appeal. It was not until plaintiff brought the suspension to the attention of the appellate court by its motion to dismiss the appeal that Construction at long last paid its delinquent taxes. Presumably, if plaintiff had not moved to dismiss Construction's appeal, the latter simply could have continued in its suspended status until the appeal had been decided and for an indefinite period thereafter, depending upon whether or not it was advantageous to obtain revival of its corporate powers. How the majority's holding validating the revival of all acts of this suspended corporation taken after judgment will in the future impose any significant 'pressure' upon a corporation to pay its franchise taxes is difficult to comprehend." (*Peacock Hill*, *supra*, 8 Cal.3d at p. 374 (dis. opn. of Mosk, J.).)

Justice Mosk also cited section 23305a's provision that "reinstatement shall be without prejudice to any action, defense or right which has accrued by reason of the original suspension or forfeiture . . . ." He argued that "no rights could have accrued *to* the suspended corporation during the period of original suspension — it could not lawfully function for any purpose — so that the clause necessarily refers to rights accruing *against* the suspended corporation." (*Peacock Hill*, *supra*, 8 Cal.3d at p. 376 (dis. opn. of Mosk, J.).)

In *Rooney*, this court cited *Peacock Hill*, *supra*, 8 Cal.3d 369, for the proposition that "[t]he revival of corporate powers validated the procedural steps taken on behalf of the corporation while it was under suspension and permitted it to proceed with the appeal." (*Rooney*, *supra*, 10 Cal.3d at p. 359.)

Defendants argue that *Rooney*, *supra*, 10 Cal.3d 351, and *Peacock Hill*, *supra*, 8 Cal.3d 369, are distinguishable. They correctly note that neither opinion provides precise dates or expressly states whether the revival came before or after the time limit in which to appeal had expired. Thus, defendants argue, the revival in those cases might have occurred while there was still time to appeal, which

would mean the court did not decide the question presented here. In both cases, however, it appears the revival came after the time limit to appeal had expired. In *Rooney*, this court stated that the revival had occurred "20 days after the suspension had been called to defendants' attention by the filing of plaintiffs' brief." (*Rooney*, *supra*, at p. 359.) Because the plaintiffs were the respondents on appeal, the court was referring to the filing of the respondents' brief. Normally, that brief would be filed well after the time limit in which to file a notice of appeal had expired, and the opinion gives no suggestion the appeal was so expedited as to make it an exception to the norm. The timing of the revival relative to the time limits is even less clear in *Peacock Hill*. There, this court merely stated that one party had moved to dismiss Construction's appeal on the ground Construction's corporate powers had been suspended, that Construction had filed a declaration opposing the motion stating it had applied for a certificate of revivor, and that, "[s]ubsequently," Construction filed a certificate of revivor that the Franchise Tax Board had issued. (*Peacock Hill*, *supra*, at p. 371.) It is possible, although it seems unlikely, that all of these events had occurred before the time in which to file a valid notice of appeal had expired.

Although the scope of *Peacock Hill* and *Rooney* is thus not entirely clear, it appears both opinions intended the rule favoring revival to be unqualified. If the revival of either case had occurred while a valid appeal could still be taken, which would have made it an easy question, surely the opinion would have so indicated. In dissent, Justice Mosk cited section 23305a's language that revival must not prejudice an "action, defense or right" that had already accrued. This citation would be relevant only if the revival had occurred after it was too late to appeal; otherwise, the appellant could simply have filed a new notice of appeal. Justice Mosk's dissent thus strongly implies that the revival came after the time limit to appeal had expired. The majority opinion in *Peacock Hill* did not specifically

respond to Justice Mosk's argument regarding section 23305a, but it appears the majority implicitly concluded that the section did not invalidate the appeal even if the corporate revival occurred after it was too late to appeal. Accordingly, *Peacock Hill* and *Rooney* govern.

The doctrine of stare decisis teaches that a court usually should follow prior judicial precedent even if the current court might have decided the issue differently if it had been the first to consider it. This doctrine is especially forceful when, as here, the issue is one of statutory construction, because the Legislature can always overturn a judicial interpretation of a statute. The doctrine of stare decisis is not absolute, and sometimes it is appropriate to overrule prior precedent, even precedent interpreting a statute. Nevertheless, a court should be reluctant to overrule precedent and should do so only for good reason. (*People v. Latimer* (1993) 5 Cal.4th 1203, 1212-1213.)

We see no good reason to overrule *Rooney*, *supra*, 10 Cal.3d 351, and *Peacock Hill*, *supra*, 8 Cal.3d 369. The rule stated in those cases has existed for four decades. It does not appear the rule has proven unworkable or has unduly hampered the state's ability to collect its taxes. If the rule does create serious problems, the Legislature may change it any time it wishes, something it has not done. On the other hand, good reason exists not to overrule those cases. The Revenue and Taxation Code statutes at issue here "apply to a host of factual situations involving different" kinds of corporate actions. (*People v. Latimer*, *supra*, 5 Cal.4th at p. 1214.) In the years after we decided *Rooney* and *Peacock Hill*, appellate courts have cited those cases in resolving a variety of issues concerning the suspension of corporate powers, often holding that revival of those powers validated prior actions. (E.g., *Center for Self-Improvement & Community Development v. Lennar Corp.* (2009) 173 Cal.App.4th 1543, 1552-1553; *Benton v. County of Napa*, *supra*, 226 Cal.App.3d at pp. 1490-1492.) We cannot foresee

exactly what effect overruling *Peacock Hill* and *Rooney* today would have in other contexts, but the effect might be substantial. In this circumstance, we believe that the Legislature should modify the rule if it is to be modified.

When the Court of Appeal denied the motions to dismiss the appeals, in addition to citing *Rooney*, *supra*, 10 Cal.3d 351, and *Peacock Hill*, *supra*, 8 Cal.3d 369, it added, "see *ABA Recovery Services, Inc. v. Konold* (1988) 198 Cal.App.3d 720, 725, fn 2." Why the court did so is apparent. A line of Court of Appeal cases has held that the running of a statute of limitations is a substantive defense that may not be prejudiced by later revival of corporate powers. (*Friends of Shingle Springs Interchange, Inc. v. County of El Dorado* (2011) 200 Cal.App.4th 1470, 1486-1487, and cases cited.) As one court explained, "The statute of limitations was a substantive defense which accrued by its running during that period of appellant's suspension, and cannot be prejudiced by revival of the suspended corporation." (*Welco Construction, Inc. v. Modulux, Inc.* (1975) 47 Cal.App.3d 69, 74.)

In *ABA Recovery Services, Inc. v. Konold*, *supra*, 198 Cal.App.3d at pages 724-725, the Court of Appeal applied the rule that revival of corporate powers does not affect the running of the statute of limitations. But the court also compared the rule regarding statutes of limitations with the rule regarding appeals: "We question why the timely filing of a notice of appeal, which is jurisdictional and cannot be waived, is a procedural act unaffected by a corporation's suspension, while the statute of limitations, which is not jurisdictional and can be waived, is a substantive defense fatal to a suspended corporation's cause of action. However, we leave the resolution of this apparent inconsistency to the Supreme Court." (*Id*. at p. 725, fn. 2.)

We acknowledge the tension between the rule articulated in the cases above regarding statutes of limitations (no retroactive revival) and the rule we are

affirming today regarding notices of appeal (retroactive revival). But without addressing the propriety of the statute of limitations cases, an issue not presented in this case, we believe the two approaches can be reconciled. As noted, section 23305a provides that revival "shall be without prejudice to any action, defense or right which has accrued by reason of the original suspension or forfeiture . . . ." The cases concerning statutes of limitations explain that those statutes provide a substantive defense that later revival of corporate powers cannot prejudice. But *Rooney*, *supra*, 10 Cal.3d 351, and *Peacock Hill*, *supra*, 8 Cal.3d 369, implicitly concluded that the expiration of the time to file a valid notice of appeal does not provide an "action, defense or right" within the meaning of section 23305a. This conclusion finds support in *Schwartz v. Magyar House, Inc.* (1959) 168 Cal.App.2d 182, 190, which held that being "in a position to file a default judgment" against a suspended corporation "is not a 'right' within the contemplation of" section 23305a. (See also *Center for Self-Improvement & Community Development v. Lennar Corp.*, *supra*, 173 Cal.App.4th at pp. 1553-1554 [citing *Schwartz* with approval on this point].) Similarly, being in a position to move to dismiss an untimely appeal is not a "right" under that statute. Thus interpreted, the two rules — one concerning appeals, the other concerning statutes of limitations — can coexist.

As the concurring and dissenting opinion notes, filing a timely notice of appeal is a jurisdictional requirement. Although *Rooney*, *supra*, 10 Cal.3d 351, and *Peacock Hill*, *supra*, 8 Cal.3d 369, do not discuss this point expressly, it appears the court believed that what is jurisdictionally required is that the notice of appeal be timely, not that it be filed by an active corporation. Here, the notices of appeal were timely even if invalid when filed. The *Rooney* and *Peacock Hill* court implicitly concluded that the corporation's later reinstatement made the earlier, invalid but *timely*, notices of appeal valid and still timely.

III. CONCLUSION

We adhere to *Rooney*, *supra*, 10 Cal.3d 351, and *Peacock Hill*, *supra*, 8 Cal.3d 369. Accordingly, we affirm the Court of Appeal's orders denying the motions to dismiss the appeals.

CHIN, J.

WE CONCUR:

CANTIL-SAKAUYE, C. J.
BAXTER, J.
WERDEGAR, J.
CORRIGAN, J.
LIU, J.

CONCURRING AND DISSENTING OPINION BY KENNARD, J.

A corporation may not "appeal from an adverse judgment in an action while its corporate rights are suspended for failure to pay taxes." (*Reed v. Norman* (1957) 48 Cal.2d 338, 343.) According to the majority, that rule does not apply when, after expiration of the appeal period, the corporation's suspension is lifted. The majority reasons that the reinstatement retroactively validates a notice of appeal that the suspended corporation filed during the appeal period. I disagree. As an appellate court's jurisdiction is wholly dependent upon the *timely* filing of a *valid* notice of appeal, the consequence should be dismissal of the appeal.

In support of its holding, the majority cites two 40-year-old decisions of this court, one of them with a vigorous dissent by Justice Stanley Mosk. In my view, those two decisions were wrong then, are wrong now, and should be overruled. Because, however, those decisions may have led to some reliance by the bench and bar, I would apply the rule I propose to future cases only. This is the sole reason for my agreement with the majority's disposition.

I. APPELLATE JURISDICTION

A party seeking to appeal must file a notice of appeal within 60 days after it is served with a notice of entry of either a judgment or an appealable order, or within 180 days after entry of judgment, whichever is earlier. (Cal. Rules of Court, rule 8.104(a)(1), (c).) Here, one of the plaintiffs, Brown Eyed Girl, Inc., filed a timely notice of appeal. But that notice was filed during suspension of the

corporation's powers, rights, and privileges for not paying its taxes. As this court said 55 years ago, a corporation whose rights have been suspended "for failure to pay taxes" may not appeal from an adverse judgment in a court action. (*Reed v. Norman*, *supra*, 48 Cal.2d at p. 343.) Thus, here plaintiff's notice of appeal, filed during the corporation's suspension, was invalid.

After expiration of the appeal period, the corporation paid the delinquent taxes and was reinstated. Should the rule be that the reinstatement retroactively validates the corporation's invalid notice of appeal? The majority's answer is "yes." My answer is "no," as explained below.

The filing of a timely and valid notice of appeal is a "prerequisite to the exercise of appellate jurisdiction." (*Hollister Convalescent Hosp., Inc. v. Rico* (1975) 15 Cal.3d 660, 670.) The lack of such notice deprives the reviewing court of "all power to consider the appeal on its merits," and dismissal is the consequence. (*Id.* at p. 674; *Maynard v. Brandon* (2005) 36 Cal.4th 364, 372-373; *In re Chavez* (2003) 30 Cal.4th 643, 650; see 9 Witkin, Cal. Procedure (5th ed. 2008) Appeal, § 601, pp. 677-678.) That rule is also embodied in our court rules. (Cal. Rules of Court, rules 8.60(d) [appellate court may not relieve a party from the failure to file a timely notice of appeal], 8.104(b) [appellate court must dismiss the appeal if the notice of appeal is filed late].) "In the absence of statutory authorization, neither the trial nor appellate courts may extend or shorten the time for appeal [citation], even to relieve against mistake, inadvertence, accident, or misfortune [citations]." (*Estate of Hanley* (1943) 23 Cal.2d 120, 123.) No statute authorizes appellate courts to extend the appeal period for suspended corporations.

No good reason appears why a corporation's notice of appeal filed during suspension, and thus invalid, should become valid when, after expiration of the appeal period, the corporate powers are reinstated. To allow this is to vest the appellate court with jurisdiction that it lacked during the appeal period when an

invalid notice was filed. Such an outcome is generally unavailable irrespective of any mistake, inadvertence, or misfortune. (*Estate of Hanley*, *supra*, 23 Cal.2d at p. 123.)

II. THIS COURT'S PRECEDENTS

The majority's decision relies on two 40-year-old decisions of this court: *Peacock Hill Assn. v. Peacock Lagoon Constr. Co.* (1972) 8 Cal.3d 369 (*Peacock Hill*), and *Rooney v. Vermont Investment Corp.* (1973) 10 Cal.3d 351 (*Rooney*). Those two decisions were wrong then, are wrong now, and should be overruled.

As the majority notes, both *Peacock Hill*, *supra*, 8 Cal.3d 369 and *Rooney*, *supra*, 10 Cal.3d 351, implicitly held that an *invalid* notice of appeal filed by a corporation suspended for failure to pay taxes is, upon reinstatement of the corporation, retroactively validated. (See maj. opn., *ante*, at pp. 6-8.) Not at all considered by the *Peacock Hill* majority, however, was this core appellate rule: The filing of a timely and valid notice of appeal is a prerequisite for appellate jurisdiction. Instead, the majority there simply cited certain cases as holding that in "a number of situations" a suspended corporation's reinstatement served to validate "otherwise invalid prior action." (*Peacock Hill*, *supra*, at p. 371.) The cited cases, none of which involved appellate court subject matter jurisdiction, are: *Traub Co. v. Coffee Break Service, Inc.* (1967) 66 Cal.2d 368, *Diverco Constructors, Inc. v. Wilstein* (1970) 4 Cal.App.3d 6, *A. E. Cook Co. v. K S Racing Enterprises, Inc.* (1969) 274 Cal.App.2d 499, and *Duncan v. Sunset Agricultural Minerals* (1969) 273 Cal.App.2d 489. (*Peacock Hill*, *supra*, at p. 371.)

The decision in *Rooney*, *supra*, 10 Cal.3d 351, came a year after *Peacock Hill*, *supra*, 8 Cal.3d 369, which *Rooney*, without any analysis, cited with approval for the proposition that reinstatement of a suspended corporation "permitted it to proceed with the appeal." (*Rooney*, *supra*, at p. 359.)

Because the filing of a timely and valid notice of appeal is necessary to give the appellate court jurisdiction over the appeal, failure to file such a notice results in an irrevocable forfeiture of the litigant's right to appeal. In my view, this forfeiture cannot be vacated or cured by later events, such as reinstatement of corporate powers by payment of delinquent taxes, and I would therefore overrule the two decisions of this court — *Peacock Hill*, *supra*, 8 Cal.3d 369 and *Rooney*, *supra*, 10 Cal.3d 351 — that held to the contrary. But because those decisions may have been relied on by the bench and bar, I would, for reasons of fairness, apply the rule I propose to future cases only. (See, e.g., *Smith v. Rae-Venter Law Group* (2002) 29 Cal.4th 345, 372; *Woods v. Young* (1991) 53 Cal.3d 315, 330.) Solely on this basis, I agree with the majority's disposition here.

KENNARD, J.

See next page for addresses and telephone numbers for counsel who argued in Supreme Court.

Name of Opinion Bourhis v. Lord

Unpublished Opinion
Original Appeal
Original Proceeding
Review Granted XXX no opn. filed
Rehearing Granted

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Judge: James R. Ritchie

Counsel:

Bourhis & Mann, Ray Bourhis, Lawrence Mann; Smith & McGinty, Daniel U. Smith and Valerie T. McGinty for Plaintiffs and Appellants.

Brydon Hugo & Parker, Edward R. Hugo, Heidi K. Hugo and Jeffrey Kaufman for Defendants and Respondents.

Counsel who argued in Supreme Court (not intended for publication with opinion):

Edward R. Hugo
Brydon Hugo & Parker
135 Main Street, Suite 2000
San Francisco, CA 94105
(415) 808-0300

[PUBLISH]

IN THE UNITED STATES COURT OF APPEALS

FOR THE ELEVENTH CIRCUIT

No. 12-10495

D.C. Docket No. 1:10-cv-00068-JRH-WLB

CYNERGY, LLC,
as successor in interest to Farmers State Bank,

Plaintiff - Appellant,

versus

FIRST AMERICAN TITLE INSURANCE COMPANY,

Defendant - Appellee.

Appeal from the United States District Court
for the Southern District of Georgia

(January 28, 2013)

Before MARCUS and PRYOR, Circuit Judges, and FRIEDMAN,* District Judge.

FRIEDMAN, District Judge:

In this appeal, we are asked to review the district court's interpretation of an exclusion in a title insurance policy issued by the appellee, First American Title

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* Honorable Paul L. Friedman, United States District Judge for the District of Columbia, sitting by designation.

Insurance Company, to a Georgia bank, Farmers State Bank, and the district court's decision that First American was entitled to summary judgment based on that exclusion. We affirm the district court in all respects.

I. BACKGROUND

A. Factual Background

This dispute arises from a land development project that failed to go according to plan. The essential facts are as follows. A group of real estate investors formed a company — the Retreat at Lake Thurmond, LLC — to purchase an undeveloped parcel of land in Lincoln County, Georgia, and turn it into a residential subdivision. The Retreat took out a short-term purchase loan from a local institution, Farmers State Bank, to finance only the acquisition of the land; the costs of development were to be funded later from a separate source. The Bank, to protect itself from risks associated with the loan it was extending, also obtained personal guarantees from two of the Retreat's principal investors, Tommy Lee and Dean Antonakos, and secured debt on real property owned by individual Retreat investors as additional collateral for the loan. It also took out a title insurance policy with First American Title Insurance Company. Such policies insure "owners of real property or others having an interest in such real property . . . against loss by encumbrance, defective titles, invalidity, adverse claim to title,

or unmarketability of title by reason of encumbrance or defects not excepted in the insurance contract." Ga. Code Ann. § 33-7-8.

Using the funds it borrowed from the Bank, the Retreat purchased the parcel of land in September 2006. Although it promptly commenced preliminary construction operations, clearing and grading the property, its development plans did not proceed as anticipated. Among the issues with which the Retreat contended was that the property did not abut a public road and lacked dedicated access to any public road. The previous owner, Emily Hester, had accessed the property through a neighboring lot with the permission of its owners. Permissive access was also available via a gravel road situated on adjacent land owned by the United States Army Corps of Engineers, but the property had no legally enforceable right of access. Although the Retreat was aware of this condition before it purchased the property and had intended to obtain an easement across the Army Corps of Engineers land, it abandoned this plan after deeming it too expensive.

The title insurance policy that First American issued to the Bank covered, among other things, loss or damage incurred due to a "lack of a right of access to and from the land." A year after the Retreat purchased the property, it sent a letter to First American purporting to file a claim under this provision of the insurance

policy. First American denied the claim because the Bank, not the Retreat, was the insured party.

The Retreat attempted to solve its dedicated access problem by purchasing an adjoining tract of land in 2008 that contained a road leading to the highway. Progress continued to lag, however, due to the Retreat's inability to secure funding for development. Meanwhile, interest on the Retreat's purchase loan from the Bank continued to accrue, while the loan's maturity date approached. In an attempt to reach a mutually beneficial resolution to the Retreat's difficulty in paying back the purchase loan to Farmers State Bank, the Bank and the Retreat began to negotiate about a possible extension of the loan with modified terms. In October 2008, a principal investor behind the Retreat, Dean Antonakos, sent a letter to the Bank acknowledging that while the Retreat originally planned to fund the development of the property through other sources, "due to the financial climate of the over all economy, especially in the banking sector, those original development sources have dried up." Antonakos suggested, among other options, that the Retreat could complete preliminary improvements of the property in tandem with work on the newly purchased adjacent property, with the aim of selling the two together as a single subdivision that could be developed later — an endeavor that would require additional funding from the Bank.

Antonakos wrote to the Bank again the next month, acknowledging an "impasse" in their discussions and suggesting some alternative courses of action. In this letter, Antonakos drew the Bank's attention to its title insurance policy with First American and encouraged the Bank to file a claim under the provision that offered coverage for losses incurred due to the lack of a right of access to and from the land.

In March 2009, the Bank's executive vice president, J. Bruce Turner, wrote to Antonakos, declining Antonakos' invitation to make a claim against First American for the insurance proceeds and proposing two options for extending and modifying the loan. In this letter, Turner also stated: "When we originally made this loan, we knew that there was no designated access to the property, but it was in your plans to create one" from the nearby highway.

No agreement was reached with respect to extending the loan. Once the loan went into default, the Bank indicated that it might seek to recover on the personal guarantees that were made at the time of the loan by Antonakos and another Retreat investor, Tommy Lee. To extricate the Retreat from its debt to the Bank, Antonakos, Lee, and others formed a new company — Cynergy, LLC, the appellant here — to raise additional funds from third parties and purchase the Retreat's promissory note from the Bank. This newly formed company acquired

the note at full price in May 2009, essentially purchasing the Bank's loan. Through this transaction, Cynergy became the successor in interest to the Bank under the insurance policy.[1]

Four days after acquiring the Retreat note, Cynergy submitted to First American an insurance claim premised on the Retreat property's lack of dedicated access. First American retained counsel who conducted an investigation into the matter, after the completion of which First American denied the claim. It based this denial on one of the exclusions in the policy, a provision excluding coverage for matters "assumed or agreed to" by the insured. First American explained in its denial letter that, according to the results of its investigation, the Bank extended the loan with full awareness that the land had no dedicated right of access. Therefore, in First American's view, the property's lack of dedicated access was a condition "assumed or agreed to" by the Bank.

After First American refused a subsequent demand for payment, Cynergy filed suit in state court, seeking damages for breach of contract along with bad-faith penalties. First American removed the case to federal court, and the parties

[1] We pause to note that Antonakos and Lee therefore appear in this narrative in two different roles. Acting on behalf of the Retreat, they initially secured the loan from the Bank and negotiated the purchase of the land. After that loan went into default, acting on behalf of Cynergy they acquired the loan, stepping into the Bank's shoes.

filed cross-motions for summary judgment on the issue of First American's liability under the policy.

B. The District Court's Decision

The district court granted summary judgment to First American. The court first agreed with Cynergy's interpretation of the term "right of access" in the title insurance policy, concluding that the policy covers losses resulting from the lack of a dedicated, legally enforceable right of access to the property. It rejected First American's argument that the scope of the policy is limited to situations in which the claimant also lacks permissive access. Applying the established principle under Georgia law that ambiguity in insurance contracts should be resolved in favor of coverage, the court construed the phrase "lack of a right of access to and from the land" to mean the lack of legally enforceable access rights, even where, as here, the property owner has never lacked permissive access to the land. The court further found that the Retreat property did not have a legally enforceable right of access. The court therefore determined that Cynergy's claim fell within the scope of the insurance policy.

The court then turned to the next question: whether coverage nevertheless was defeated by the policy exclusion negating coverage for losses arising from

"defects, liens, encumbrances, adverse claims or other matters" that were "created, suffered, assumed or agreed to by the insured claimant."

Drawing on common definitions of the word "assume," along with the meaning that the word has been given in title insurance policies and in the analogous tort context of assumption of risk, the court concluded that the word, as used in the policy, "means that the Bank must have had actual, subjective knowledge of the access issue and appreciated its effect." No party before us disagrees with that definition.

Applying this standard, the district court found that "the evidence and undisputed facts show that the lack of dedicated access was indeed an 'assumed' condition." In reaching this conclusion, the court relied primarily on the sworn affidavit of George C. Leverett III, the Bank's former president and the officer who personally handled the Retreat loan. In his affidavit, Leverett states that at the time of the loan application, "I was aware that the tract appeared to be landlocked, but I was told by Tommy Lee of Retreat LLC that he was pursuing and expected to obtain an access easement to Highway 378 for their future development plans." The affidavit further explains that because the Bank was not financing the planned development of the property, but was only issuing a short-term loan for the purchase of the land, "obtaining adequate collateral on the loan

was more important to [the Bank] than the issue of how the property would be accessed for purposes of Retreat LLC's planned development."

The district court determined that Leverett's affidavit, along with a number of corroborating circumstances lending credence to his statements, demonstrated both the Bank's knowledge of the lack of access and its appreciation of the significance of that condition. It was precisely because the Bank knew that the property lacked dedicated access, Leverett attests, that the Bank "required additional collateral" for the loan beyond the security deed to the property itself, including personal guarantees from Antonakos and Lee as well as security deeds to properties owned by individual Retreat members. The court further observed that the Bank itself never filed an insurance claim with First American based on the property's lack of access, even when pressed to do so by Antonakos — an additional circumstance indicating that the Bank knowingly acquiesced to the lack of dedicated access when it issued the loan. Based on the evidence, the court found, the "only reasonable inference available" was that the Bank "assumed" the Retreat property's lack of dedicated access when it financed the purchase of the property and that "Leverett understood the implications of the issue and accounted for it by securing ample collateral." And Cynergy, the district court stated, presented "no evidence" to rebut this testimony and evidence.

Instead, Cynergy presented two legal arguments. First, Cynergy took issue with the interpretation of the insurance policy and its exclusions summarized above. In Cynergy's view, reading the policy to exclude conditions, like a lack of dedicated access, that were "assumed" by the insured party would "eviscerate" coverage under the policy. The district court quicky dispensed with this argument, which Cynergy revives before this Court and which is discussed below. Second, Cynergy contended that George Leverett's affidavit was inadmissible as hearsay and barred from consideration by Rule 56(c)(4) of the Federal Rules of Civil Procedure. The district court, acknowledging the dispositive effect of the affidavit on its ruling, engaged in a lengthy analysis of this point, finding the affidavit to be admissible under Rule 807 of the Federal Rules of Evidence and, contrary to Cynergy's arguments, in no way barred from consideration by Rule 56(c)(4). Having rejected these legal arguments, and finding no genuine issues of material fact in dispute, the court granted summary judgment to First American.

II. JURISDICTION AND STANDARD OF REVIEW

We have jurisdiction over this appeal pursuant to 28 U.S.C. § 1291. This Court reviews a district court's grant of summary judgment de novo. Kernel Records Oy v. Mosley, 694 F.3d 1294, 1300 (11th Cir. 2012). Summary judgment is appropriate "if the movant shows that there is no genuine dispute as to any

material fact and the movant is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(a). A genuine factual dispute exists only if a reasonable factfinder "could find by a preponderance of the evidence that the plaintiff is entitled to a verdict." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 252, 106 S. Ct. 2505 (1986). "Once the movant adequately supports its motion, the burden shifts to the nonmoving party to show that specific facts exist that raise a genuine issue for trial." Dietz v. Smithkline Beecham Corp., 598 F.3d 812, 815 (11th Cir. 2010).

The district court's evidentiary rulings are reviewed for abuse of discretion and will be reversed only "if an erroneous ruling resulted in 'substantial prejudice.'" Conroy v. Abraham Chevrolet-Tampa, Inc., 375 F.3d 1228, 1232 (11th Cir. 2004) (quoting Piamba Cortes v. Am. Airlines, Inc., 177 F.3d 1272, 1305 (11th Cir. 1999)). This Court will affirm such rulings "unless the district court has made a 'clear error of judgment' or has applied an 'incorrect legal standard.'" Id. (quoting Piamba Cortes, 177 F.3d at 1306).

III. DISCUSSION

A. Interpretation of the Insurance Policy

Cynergy maintains that the district court's interpretation of the policy exclusion under which it granted summary judgment to First American is unduly broad and inconsistent with Georgia law. As Cynergy reads it, the insurance

policy guarantees coverage without exception for losses incurred due to a property's lack of dedicated access. Any knowledge that the Bank may have had about the Retreat property's lack of access is therefore irrelevant in Cynergy's view. We find no merit to Cynergy's arguments.

The title insurance policy covers, among other matters, "loss or damage . . . sustained or incurred . . . by reason of . . . lack of a right of access to and from the land." Among the losses and damages excluded from coverage, however, are those arising from "defects, liens, encumbrances, adverse claims or other matters . . . created, suffered, assumed or agreed to by the insured claimant" (emphasis added). As discussed above, the district court construed these provisions as excluding coverage if the insured "assumed" the lack of a right of access, which the court interpreted to mean that the insured was aware of the lack of access when the policy was issued and appreciated its effect. The district court's assumption of risk analogy, quoting Vaughn v. Pleasent, 471 S.E.2d 866, 868 (Ga. 1996) (emphasis in original), is to the same effect: "In its simplest and primary sense, assumption of the risk means that the plaintiff, in advance, has given his consent to relieve the defendant of an obligation of conduct toward him, and to take his chance of injury from a known risk arising from what the defendant is to do or leave undone." Cynergy argues that, properly read, the policy does not actually

exclude coverage under this scenario — or, in the alternative, that any such purported exclusion is impermissible under Georgia law.

In support of its position, Cynergy first maintains as a matter of textual interpretation that the phrase “other matters” cannot include the lack of a right of access, because the policy fails to list that specific condition alongside “defects, liens, encumbrances, [and] adverse claims.” As Cynergy puts it: “Had First American wanted to list an additional exclusion for lack of access that is assumed, it could have written the policy differently to include that event among those specifically enumerated.” But of course, the phrase “other matters” would have no meaning if it did not refer to anything beyond the four examples that precede it. Cynergy’s reading of this provision, which would limit the matters covered by the exclusion to the four enumerated examples, therefore is untenable. The plain language of the policy is clear: losses of any type arising from matters that have been “assumed” by the insured claimant are not covered. While these matters include defects, liens, encumbrances, and adverse claims, they are not limited to those examples.

Cynergy next objects that under the district court’s interpretation of the exclusion, as Cynergy sees it, the policy purports to cover losses caused by the lack of dedicated access while simultaneously negating coverage for those same

losses under the "other matters" exclusion. But that is the nature of an exclusion — to exclude things that otherwise would be covered, when certain conditions are met. The policy does not exclude all losses stemming from a lack of dedicated access, merely those that were assumed by the insured. The exclusion therefore does not "eviscerate" coverage under the policy, as Cynergy asserts, and this case is unlike the decisions that Cynergy cites in which exclusions were found to impermissibly subsume a policy's affirmative grant of coverage. Those decisions simply recognize that, under Georgia law, an insurance policy may not purport to offer coverage that inevitably will be defeated by one of the policy's exclusions — in other words, the policy may not offer coverage that is chimerical. See Hooters of Augusta, Inc. v. Am. Global Ins. Co., 272 F. Supp. 2d 1365, 1378 (S.D. Ga. 2003) ("Read fairly, the Endorsement completely abrogates the coverage provided in the same document because every advertisement would be excluded by it. . . . When an exclusion completely nullifies the coverage provided in a policy, that exclusion has no effect[.]" (citing Isdoll v. Scottsdale Ins. Co., 466 S.E.2d 48, 50 (Ga. Ct. App. 1995))) (emphasis added); Transp. Ins. Co. v. Piedmont Const. Group, LLC., 686 S.E.2d 824, 828 (Ga. Ct. App. 2009) ("Transportation's proposed interpretation of the business-risk exclusion 'would make coverage for such actions merely illusory, despite the fact that such coverage is expressly

provided for in the policy.'" (quoting Isdoll, 466 S.E.2d at 50)) (emphasis added). In contrast to the provisions addressed in those cases, this dispute involves a policy exclusion that exempts certain claims from coverage — no more and no less. Cynergy's unhappiness that the exclusion is triggered by the undisputed facts underlying this particular case does not transform the provision into anything else.

Taking a different tack, Cynergy next argues that contrary to the district court's reasoning, the Bank's knowledge and appreciation of the access issue is "irrelevant" to the coverage question, "because First American gave written assurances there was access." What Cynergy appears to mean by this is that First American, when issuing the policy, was obliged to comply with a Georgia statute providing that title insurance contracts "shall be written only upon evidence or opinion of title obtained and preserved by the insurer." Ga. Code Ann. § 33-7-8. First American satisfied that obligation, however, by relying on evidence of title supplied by its issuing agent, James Roberts, and the validity of title has never been an issue in this case. Contrary to Cynergy's suggestion, Section 33-7-8 of the Georgia Code speaks only to evidence of title and imposes no requirements

regarding the accuracy of an insurer's understanding about a property's dedicated access, easements, and other such matters.[2]

Further to its argument under the Georgia Code, Cynergy analogizes this case to a Georgia decision, Fid. Nat. Title Ins. Co. v. Matrix Fin. Servs. Corp., 567 S.E.2d 96 (Ga. Ct. App. 2002), in which an identical policy exclusion was held inapplicable. The analogy fails. In Matrix, a lender sought to recover on a title insurance policy after defects in the title of the property came to light. Id. at 99. Among the insurer's many unavailing arguments against coverage was its contention that the lender "assumed, or agreed to" the loss that it incurred. Id. at 100. Specifically, the insurer argued that if the lender had "properly investigated" and "performed an adequate property title search," it would have discovered the defects in the title before it closed the loan. Id. at 101. According to the insurer, the lender "should never have closed" the loan, and "by doing so, it created its own loss." Id. In sum, the insurer contended that the lender "negligently created

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[2] Cynergy complains that an authorization request form completed by Roberts's firm for First American erroneously indicated that the Retreat property had dedicated access. But Cynergy has not explained how the mistake made by Roberts's firm has any bearing on the validity or interpretation of the exclusions in the title insurance policy. It was not illogical for First American to have issued this policy while knowing that the property lacked dedicated access, so long as the title was valid. Nor has Cynergy pointed to any rule prohibiting First American from doing so.

its own title problems and cannot legally or equitably seek coverage under the policy." Id.

The Court of Appeals of Georgia rejected this argument. It stated that the insurer was simply second-guessing the wisdom of the lender's business decisions, and that, regardless of what circumstances may have existed at the time of the loan to raise the lender's suspicions about the title, these circumstances did not affect the insurer's promise to insure the lender's interest in the property. Fid. Nat. Title Ins. Co., 567 S.E.2d at 101. The court went on to note that under Section 33-7-8 of the Georgia Code, the insurer, not the lender, "was responsible for obtaining the evidence to support its title opinion." Id. The lender's "failure to discover" the evidence of a title defect before closing therefore had no bearing on the insurer's obligations. Id.

Here, by contrast, First American does not allege that the Bank, with proper diligence, would have discovered the property's lack of dedicated access before extending the loan or that the Bank was obligated to undertake such an investigation. Instead, it alleges (and furnishes evidence) that the Bank actually knew about the lack of access and fully understood the effect of this fact on the property's value before it made the loan. Although Section § 33-7-8 puts the onus on insurers to obtain evidence of the validity of title before issuing a policy,

Cynergy identifies no similar obligation requiring First American to obtain evidence that the land did or did not have a dedicated right of access, or anything prohibiting First American from issuing the policy unless such access existed.

The district court correctly interpreted the terms of the title insurance contract. Accordingly, we move on to the question of whether genuine issues of material fact preclude summary judgment in First American's favor.

B. Summary Judgment

As the preceding discussion establishes, First American is not liable under the terms of the title insurance policy if Farmers State Bank was aware of the Retreat property's lack of a dedicated right of access and appreciated its effect when the Bank extended the loan and took out the insurance policy. The district court found that the evidence conclusively demonstrated that the Bank indeed had such knowledge and understood its significance. There being no genuine disputes of fact about this, the court concluded that summary judgment for First American was appropriate. Having reviewed the matter de novo, we agree.

1. Admissibility of the Leverett Affidavit

In the district court's reckoning, as in ours, the critical piece of evidence demonstrating that the Bank "assumed" the Retreat property's lack of dedicated access is the affidavit of George C. Leverett III, the Bank's former president and

the officer who originated the Retreat loan. Given the significance of the affidavit to the outcome of this case, we must address Cynergy's contention that the affidavit would have been inadmissible at trial and therefore should not have been considered by the district court at summary judgment. As an evidentiary ruling, the district court's determination is reviewed for abuse of discretion and should be affirmed unless the court made a "clear error of judgment" or applied an "incorrect legal standard." Conroy, 375 F.3d at 1232 (quoting Piamba, 177 F.3d at 1306).

Leverett's affidavit, which was executed at First American's request, was signed on October 1, 2009, at which point First American was investigating Cynergy's policy claim but had not yet denied it. At the time, Leverett was still the Bank's president, but he was undergoing treatment for cancer. He died in early April 2010, before the affidavit was ever produced in discovery for this lawsuit. Cynergy argued to the district court that the affidavit constituted inadmissible hearsay. The court disagreed, concluding after careful analysis that the affidavit was admissible under Rule 807 of the Federal Rules of Evidence. This "catch-all exception to the hearsay rule" permits admission of a hearsay statement "if it is particularly trustworthy; it bears on a material fact; it is the most probative evidence addressing that fact; its admission is consistent with the rules of evidence and advances the interests of justice; and its proffer follows adequate

notice to the adverse party." United States v. Rodriguez, 218 F.3d 1243, 1246 (11th Cir. 2000); see Fed. R. Evid. 807.

Cynergy does not challenge any part of the district court's Rule 807 analysis. Instead, Cynergy argues that the court failed to make one of the findings that it was required to make under the Rule — that the affidavit "is more probative on the point for which it is offered than any other evidence that the proponent can obtain through reasonable efforts." Fed. R. Evid. 807(a)(3). This contention is belied by the district court's discussion of the affidavit, during which the court separately addressed each prong of Rule 807(a) and stated that the affidavit speaks "directly and comprehensively" to "a key issue for which very little alternative evidence exists," further observing that "the need for the statements is great because the Bank's knowledge is the fulcrum upon which liability turns, but evidence on this point is scant." We conclude that the district court made the necessary finding under Rule 807(a)(3), and we agree that the criterion established by that provision is satisfied here.

Cynergy also maintains that the district court's consideration of the Leverett affidavit violated Rule 807(b), which permits a hearsay statement to be admitted "only if, before the trial or hearing, the proponent gives an adverse party reasonable notice of the intent to offer the statement and its particulars, including

the declarant's name and address, so that the party has a fair opportunity to meet it." Fed. R. Evid. 807(b). According to Cynergy, it was impermissible for the district court to consider the affidavit because First American did not provide notice to Cynergy before Leverett's death of its intent to offer the affidavit.[3]

First American disputes Cynergy's interpretation of Rule 807(b), arguing that it supplied notice of its intent to rely on the affidavit well before any "trial or hearing," as required by the Rule, and that First American had no obligation to ensure that such notice was provided before Leverett passed away. Indeed, First American scarcely could have done so, because Leverett was already deceased by the time that Cynergy filed this lawsuit in late April 2010. Cynergy offers no authority (and we are aware of none) precluding the district court's consideration of the affidavit for the purposes of summary judgment based on a lack of notice under these circumstances. Cynergy was provided with the affidavit months before briefing on the dispositive motions took place.[4] The notice requirement "is

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[3] First American maintains that Cynergy waived this argument by failing to raise it in the district court. But it was not until First American's reply brief in support of its motion for summary judgment that it first suggested, in response to Cynergy's hearsay objection, that the affidavit could be admitted under Rule 807. No hearing was held on the motion for summary judgment during which Cynergy could have countered with its notice argument. We therefore do not regard the argument as waived.

[4] The affidavit was used as an exhibit during the depositions of Antonakos and Lee six months before First American moved for summary judgment.

intended to afford the party against whom the statement is offered sufficient opportunity to determine its trustworthiness in order to provide a fair opportunity to meet the statement." United States v. Evans, 572 F.2d 455, 489 (5th Cir. 1978) (discussing predecessor Rule 803(24)); see also United States v. Munoz, 16 F.3d 1116, 1122 (11th Cir. 1994). It does not create a categorical ban on the admission of statements made by deceased persons. Nor does it impose what in this case would be the functional equivalent: a requirement that a defendant supply notice of its intent to offer a statement at trial before the plaintiff has even filed suit.

The district court's conclusion that the affidavit would be admissible at trial was not an abuse of discretion.

2. Genuine Issues of Material Fact

The evidence demonstrates that Farmers State Bank was fully aware of the Retreat property's lack of dedicated access when it extended the purchase loan and took out the insurance policy from First American. No reasonable factfinder could conclude otherwise. Because there are no genuine issues of material fact in dispute, and because First American is entitled to judgment as a matter of law, summary judgment was appropriate.

The sworn affidavit of former Bank president George Leverett leaves no doubt that the Bank understood the Retreat property to lack a dedicated right of

access and appreciated the impact of this condition on the land's marketability. The statements made in Leverett's affidavit are supported by attendant circumstances surrounding the loan — most notably that the Bank required additional collateral for the loan, beyond the deed to the property itself, to offset the potentially diminished resale value of the land. Leverett's statements derive further credence from overwhelming evidence showing that the principal investors in the Retreat were aware of the lack of access before purchasing the land but — just as Leverett attests — had planned on surmounting this obstacle by obtaining an easement over adjacent property. Leverett's affidavit, supported by these indicia of reliability, is uncontradicted by any other evidence.

The key portion of Leverett's affidavit reads as follows:

> At the application stage of this land acquisition loan, Mr. Tommy Lee made a presentation to me about his future property development plans. At that time I was aware that the tract appeared to be landlocked, but I was told by Tommy Lee of Retreat LLC that he was pursuing and expected to obtain an access easement to Highway 378 for their future development plans.

Cynergy depicts this passage as "vague and equivocal" because it states only that the tract "appeared to be landlocked," but we do not accept this characterization. As the affidavit's next paragraph makes clear, a conclusive determination about

the property's access was unnecessary to the Bank, as it was extending only a short-term purchase loan for the land, not for its development:

> FSB was not financing the planned development on the Property; the FSB loan was strictly for the acquisition of the Property. Thus, obtaining adequate collateral on the loan was more important to FSB than the issue of how the property would be accessed for purposes of Retreat LLC's planned development.

What mattered to the Bank, in other words, was not whether or not the property truly lacked dedicated access, as it appeared, but that the Bank obtain adequate security for its loan.

That is exactly what the Bank did. Not satisfied with a promissory note and a deed to the property itself, the Bank required additional security as collateral from the principal investors in the Retreat: personal guarantees from Antonakos and Lee, along with deeds to a residential property owned by Lee and a commercial property owned by other Retreat members. As the district court observed, the Bank's insistence on these terms is an attendant circumstance indicating that the Bank knowingly acquiesced to the property's lack of dedicated access and took the precautions necessary to safeguard its interests in light of this consideration.

Were there any doubt about how to interpret the statements made in Leverett's affidavit, it would be dispelled by notes that the Bank's vice president,

Maria Bradford, took to memorialize a telephone conversation she had with Leverett two months before the affidavit was executed. At the time of this conversation, First American was conducting its investigation into Cynergy's policy claim; Leverett, although still the Bank's president, was not coming into the office every day because of his illness, and so Bradford acted as a "messenger" to relay to him the inquiries that were being made about the Retreat loan. Bradford's notes of her conversation with Leverett — which were taken for her own future reference — describe Leverett as saying, in substance, that "since we had other collateral securing this loan and this loan was to be a short term 6 month acquisition loan only, the final outcome of public access to the property was not our primary concern."

In her deposition, Bradford explained why the Bank would have been willing to extend the loan despite the property's lack of access: the Bank had "our major collateral . . . the collateral was Tommy's home, a second mortgage on Tommy Lee's home and acreage. We had other collateral." As the closing attorney for the sale, James Roberts, stated in his own deposition, such an arrangement to secure a loan for land that lacked dedicated access was hardly

noteworthy, because banks issue such loans "if they feel that they have adequate collateral."[5]

Further support for Leverett's attestations comes from evidence showing that the investors behind the Retreat — or at least Tommy Lee, who was tasked with responsibility over the matter — were well aware of the property's lack of a right of access before their purchase. Although the knowledge held by the Bank, not the Retreat, is the dispositive issue under the insurance policy, the Retreat's undeniable knowledge lends credence to Leverett's account of having been apprised by Lee both of the access problem and how the Retreat was planning to solve that problem through an easement.

The previous owner of the Retreat property, Emily Hester, has attested to the fact that the primary reason she sold the property was because it lacked a dedicated right of access. She further stated that this issue was discussed among

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[5] Additional documentary support for the account set forth in Leverett's affidavit can, perhaps, be found in a letter written under his supervision in March 2009 to Dean Antonakos. In this letter, the Bank's executive vice president, J. Bruce Turner, told Antonakos: "When we originally made this loan, we knew that there was no designated access to the property, but it was in your plans to create one from Highway 378." Cynergy points out, however, that portions of Turner's deposition suggest that Turner was referring here not to the Bank's knowledge about the legal question of whether the property had a dedicated right of access, but rather to the logistical matter of creating a usable entrance to the property, which was being discussed by the Bank and the Retreat as they negotiated an extension of the loan. Because Turner's letter is — at most — simply one additional piece of corroborating evidence confirming the account set forth in Leverett's affidavit, our conclusion would be the same even if we gave no weight to Turner's March 2009 letter.

the parties prior to the sale, that the Retreat used this fact during negotiations to obtain a lower purchase price, and that an agent of the Retreat told her before the closing that the lack of access was not an issue because the Retreat could get an easement across the Army Corps of Engineers' adjacent land. The seller's real estate agent, Irma Conrad, likewise testified that she discussed the lack of access with the Retreat's real estate agent, Clay Turner; that the lowered purchase price reflected the property's lack of access; and that the Retreat was not concerned due to its plans to obtain an easement. Clay Turner himself has attested: "I was aware that the Property was landlocked with no road frontage or easement access and discussed this fact with Mr. Lee and Mr. Antonakos when they were considering purchasing the property." Confirming these accounts, Mr. Turner wrote a letter to the seller listing several "obstacles that have to be considered with the purchase of this property" which, according to the letter, justified the price and terms offered by the Retreat. The first of the "concerns" listed in Turner's letter is that "the property is currently land locked with no right of way for access. This is an issue that we feel confident that we could resolve given an appropriate option period of 180 days for which we have asked."

Indeed, Tommy Lee has admitted that he was told by Clay Turner about the property's lack of access and that although he had heard "rumors" of an existing

easement, no one from the Retreat ever determined before the sale whether or not these rumors were true. Upon being informed by Turner that the property appeared to lack access, however, Lee, in his own words, "told him to use that to try to get the price reduced." This evidence firmly supports Leverett's account of his own understanding, before the loan was made, about the property's lack of dedicated access and of his discussions with Lee about the matter.

All of the evidence in this case tells a consistent story, and in light of this evidence, no reasonable factfinder could doubt that the Bank was aware of the Retreat property's lack of dedicated access and appreciated its significance. The Bank therefore "assumed" that condition, within the meaning of the title insurance policy, and First American is entitled to summary judgment. Because we affirm the district court on the same grounds upon which it relied, we have no need to address First American's many alternative arguments for affirmance.

AFFIRMED.

2013 UT App 50

THE UTAH COURT OF APPEALS

FIRST NATIONAL BANK OF LAYTON,

Plaintiff and Appellee,

v.

RAY WM. PALMER,

Defendant and Appellant.

Opinion
No. 20110338-CA
Filed February 28, 2013

Seventh District, Monticello Department
The Honorable Lyle R. Anderson
No. 090700136

Craig C. Halls, Attorney for Appellant
Matthew C. Barneck and Wayne Z. Bennett, Attorneys for Appellee

JUDGE GREGORY K. ORME authored this Opinion,
in which JUDGE WILLIAM A. THORNE JR.
and JUDGE J. FREDERIC VOROS JR. concurred.

ORME, Judge:

¶1 Ray Palmer and First National Bank of Layton dispute the priority of their competing lien interests in a parcel of commercial real estate. The district court certified this issue as final pursuant to rule 54(b) of the Utah Rules of Civil Procedure, and Palmer appeals the court's grant of First National's motion for partial summary judgment and simultaneous denial of his cross-motion for partial summary judgment. We reverse.

BACKGROUND

¶2 In July 2003, Palmer agreed to sell a parcel of commercial real estate to JDJ Holdings, Inc. for a purchase price of $1,950,000. JDJ paid $190,000 cash as a down payment and obtained two loans to finance the remainder of the purchase price. The first loan was from First National for $1,025,000 and was secured by a note and trust deed, with the deed being properly recorded on December 12, 2003. First National's loan was guaranteed by the United States Department of Agriculture (USDA) and a number of other individual guarantors.

¶3 JDJ obtained a second loan for $780,000 from Palmer as seller-funded financing, which was similarly secured by a note and trust deed. Palmer's trust deed was recorded immediately after First National's trust deed, placing it in second priority position. At the time of the transaction, First National was fully aware that Palmer was providing seller financing, and both parties intended and understood that First National's lien was to be in first priority position.

¶4 Just two months later, USDA informed First National that it had only agreed to guarantee $975,000 of First National's loan and that the recorded $1,025,000 trust deed needed to be broken down into two trust deeds—one for $975,000 and one for the remaining $50,000—to be consistent with that agreement.[1] Before reconveying the $1,025,000 deed, First National ordered an updated title report from the same title company that had previously recorded both First National's and Palmer's trust deeds. Unbeknownst to First National, the title company prepared an incorrect title report, which showed First National's trust deed as the only outstanding lien on the property even though Palmer's trust deed was properly

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1. USDA agreed to guarantee only the money being loaned for use as purchase money. The other $50,000 was apparently to be used for business operations.

recorded. Despite its awareness that Palmer had provided financing to JDJ, First National did not take any additional action to inquire about the potential existence of Palmer's outstanding lien after receiving and reviewing the title report. Relying solely on the erroneous title report, First National reconveyed its trust deed on March 8, 2004, and immediately recorded a new trust deed reflecting the $975,000 guaranteed by USDA.

¶5 Nearly five years later, JDJ defaulted on the loans. Up to that point in time, neither party was aware that, because of First National's 2004 reconveyance, Palmer's trust deed had been elevated into and currently sat in first priority position. In May 2009, however, Palmer performed a title search of the property and discovered the change in priority. He subsequently informed First National of his discovery and stated his intention to begin foreclosure proceedings on the property.

¶6 In response, First National brought this action in July 2009 asking for, inter alia, equitable reinstatement and/or "subrogation" of its trust deed back into first priority position. First National and Palmer filed cross-motions for partial summary judgment, and in November 2010 the district court granted First National's motion, denied Palmer's, and reinstated First National's trust deed to first priority position. The district court reasoned that First National took sufficient care to discover any other outstanding liens and thereby "preserve[d] its entitlement to equitable reinstatement." Pursuant to the grant of partial summary judgment and the resulting reinstatement, First National initiated foreclosure proceedings and sold the property. Palmer now appeals.

ISSUE AND STANDARD OF REVIEW

¶7 Palmer contends that there are disputed issues of material fact and that, in any event, First National was not entitled to judgment as a matter of law because First National reconveyed its trust deed in negligent disregard of Palmer's outstanding lien. He

maintains that despite its blind reliance on the erroneous title report, First National's failure to inquire further about the potential existence of Palmer's junior lien—especially given First National's knowledge of Palmer's seller financing—precludes equitable relief.[2] "Summary judgment is appropriate when there is no issue as to any material fact and the moving party is entitled to judgment as a matter of law." *Dairyland Ins. v. State Farm Mut. Auto. Ins. Co.*, 882 P.2d 1143, 1144 (Utah 1994). On appeal, we "give[ ] no deference to the lower court's legal conclusions and review[ ] the issues presented under a correctness standard. Factual disputes are viewed in the light most favorable to the nonmoving party." *Emergency Physicians Integrated Care v. Salt Lake Cnty.*, 2007 UT 72, ¶ 8, 167 P.3d 1080 (internal citations omitted).

ANALYSIS

¶8 Palmer asserts that the district court's repositioning of First National's trust deed back into first priority position constituted an improper exercise of both equitable subrogation and equitable reinstatement. He argues that because it actually knew that Palmer had so recently provided seller financing, First National had an obligation to do more than simply rely on a title report that showed no other outstanding liens before reconveying its trust deed. In doing otherwise, Palmer insists, it did so at its peril. First National argues that the court's equitable powers are broad enough to put the parties back into the priority positions they intended, especially because First National reconveyed its trust deed based on a mistake of fact. Moreover, First National believes that allowing Palmer's lien to remain in first priority position will provide Palmer an

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2. First National believes that this issue is moot in light of the completed foreclosure sale. We, however, are not persuaded and decline to dismiss this appeal on that basis. The parties are still before the court, and it appears that the rights of the parties can be adjusted as appropriate.

unexpected and undeserved windfall. Palmer replies that because any windfall to him is a result of First National's negligent failure to take reasonable steps to discover his trust deed, equity should not be too quick to come to First National's rescue.

I. Equitable Subrogation

¶9 Palmer contends that the district court essentially subrogated First National's trust deed into first position, even though the court styled its remedy as a "reinstatement." We do not believe, however, that the doctrine of equitable subrogation has any application here and conclude that First National's trust deed cannot be returned to first priority position via this doctrine.

¶10 Although there is a relative dearth of subrogation case law in the context of real estate mortgages in Utah, our longstanding precedent recognizes two forms of equitable subrogation: legal subrogation and conventional subrogation. *See Martin v. Hickenlooper*, 59 P.2d 1139, 1141 (Utah 1936). Legal subrogation "arises 'where the person who pays the debt of another stands in the situation of a surety or is compelled to pay to protect his own right or property.'" *Id.* (quoting *Bingham v. Walker Bros., Bankers*, 283 P. 1055, 1063 (Utah 1929)). This form of subrogation is commonplace in insurance litigation, where an insurer will step into the shoes of its insured to bring an action against a tortfeasor. *See, e.g.*, *State Farm Mut. Auto. Ins. Co. v. Northwestern Nat'l Ins. Co.*, 912 P.2d 983, 985 (Utah 1996) ("Utah law clearly recognizes an insurer's right to bring a subrogation action on behalf of its insured against a tortfeasor."). Legal subrogation is not applicable here because First National is not a surety and has not stepped into the shoes of another party. First National was not compelled to pay to protect its rights, and there are not, in fact, any shoes, other than its own, for First National to step into.

¶11 Conventional subrogation is also not an appropriate mechanism for placing First National's trust deed back into first priority position. Conventional subrogation "occurs where the one

who is under no obligation to make . . . payment, and who has no right or interest to protect, pays the debt of another under an agreement, express or implied, that he will be subrogated to [the] rights of the original creditor." *Bingham*, 283 P. at 1063. First National did not advance any money to pay off the original trust deed with the understanding or agreement that its new trust deed would be subrogated to first priority position. Instead, First National merely released its trust deed and subsequently recorded a new trust deed reflecting a different loan amount. No money changed hands and none of the already existing liens were paid off. By definition, First National's trust deed cannot move to first priority position on a theory of conventional subrogation because the money secured by the second trust deed was not used to pay off the released and reconveyed first trust deed. Because First National is not aiming to stand in the shoes of another and did not pay off a prior lien with the expectation of subrogating to the prior lien's priority position, we conclude that First National's trust deed is incapable of being elevated to first priority position through the doctrine of equitable subrogation. Thus, we decline to view the relief ordered by the district court as premised on a theory of subrogation and turn to consider the stated basis for the district court's disposition.

II. Equitable Reinstatement

¶12 It is a well-accepted principle that when a mortgage is released by accident, mistake, or in ignorance of intervening lien rights, a court can equitably reinstate that mortgage to its original priority position. *See* 59 C.J.S. *Mortgages* §§ 323, 631 (2009); 55 Am. Jur. 2d *Mortgages* §§ 417, 1129 (2009); 2 Baxter Dunaway, *Law of Distressed Real Estate* § 26:41 (2010); *Badger Coal & Lumber Co. v. Olsen*, 167 P. 680, 682 (Utah 1917) ("When a new mortgage is substituted in ignorance of an intervening lien, the mortgage, released through mistake, may be restored in equity and given its original priority as a lien.") (citation and internal quotation marks omitted); *Home Fed. Sav. & Loan Ass'n v. Citizens Bank of Jonesboro*, 861 S.W.2d 321, 323 (Ark. Ct. App. 1993) ("[W]here a senior

mortgagee in good faith and without culpable negligence satisfied the lien of his mortgage on the record in ignorance of the existence of an intervening mortgage on the same premises and took a second mortgage as a substitute, equity will restore the lien of the first mortgage, provided it can be done without working hardship or injustice on innocent parties.").[3] Equitable reinstatement will be denied, however, if the party seeking reinstatement was negligent in failing to discover the lien that elevated to senior position. *See* 59 C.J.S. *Mortgages* § 323 ("A failure to exercise diligence and discover the existence of the record constitutes sufficient negligence to bar relief on the ground of mistake."); 55 Am. Jur. 2d *Mortgages* § 417 ("[I]n particular cases, the circumstances may be such as to justify the denial of the reinstatement of the mortgage because of the negligence of the mortgagee in connection with the release or discharge."). *See also Badger Coal*, 167 P. at 682 (observing that a party seeking equitable reinstatement did not substitute its

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3. We are aware that section 7.3(a) of the Restatement (Third) of Property states,

> 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, except (1) to the extent that any change in the terms of the mortgage or the obligation it secures is materially prejudicial to the holder of a junior interest in the real estate, or (2) to the extent that one who is protected by the recording act acquires an interest in the real estate at a time that the senior mortgage is not of record.

Restatement (Third) of Property: Mortgages § 7.3(a) (1997). This particular section of the Restatement, however, was not raised below by either party, nor has it been briefed on appeal. Moreover, we are unaware of any decision that has specifically adopted section 7.3(a) as part of Utah's common law. Consequently, we decline to address the rationale of 7.3(a) or include it in our analysis.

mortgage in ignorance of an intervening lien because "[h]e could easily have ascertained just what the facts were . . . , but he did not take the trouble to ask [either of the intervening lienholders]"). Negligence in this context "is an omission of something that a prudent and honest person would do." 59 C.J.S. *Mortgages* § 323.

¶13 Given its possession of documents stating that a "second trust deed [was to be] held by the seller," we conclude that First National was at the very least on inquiry notice of Palmer's trust deed and was, consequently, negligent in failing to inquire about the potential existence of Palmer's outstanding lien after the title report did not disclose it. In determining whether a party is on inquiry notice, we first perform "a subjective inquiry to determine what actual knowledge" the subsequent party in interest had. *See Pioneer Builders Co. v. KDA Corp.*, 2012 UT 74, ¶ 26, 292 P.3d 672. We then "conduct an objective inquiry to determine whether those facts would lead a reasonable person to inquire further." *Id.*

¶14 It is a long-standing practice in the real estate industry for sellers to secure any financing they extend with a recorded trust deed against the property being sold, and the facts here would not prompt a reasonably prudent party in First National's position to conclude that Palmer planned to secure his loan any differently or, even less likely, to be content with an unsecured promise to pay. The record is replete with documents evidencing First National's awareness of the financing provided by Palmer. Most notably, the HUD settlement statement from the initial loan closing and the commercial credit summary, the latter of which was prepared on First National stationary, both clearly state that Palmer would provide $780,000 in seller financing. Simply put, First National had actual knowledge of Palmer's loan and, at a minimum, it should have known of the substantial likelihood that a trust deed securing that financing would be recorded.[4]

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4. Palmer cites to twenty documents as evidence that First National had *actual* notice of Palmer's trust deed and not just the loan he

(continued...)

¶15 Under more typical circumstances, a lender's sole reliance on a title report might not be considered negligent. For example, a title report issued two decades later and showing no interest of record in favor of the seller would not be noteworthy. One would readily assume that the indebtedness secured by the seller's trust deed had been retired. But when a title report following so soon on the heels of the original transaction does not list a trust deed the lender would expect to see, the lender cannot simply turn a blind eye to what it knows, has reason to know, or has a duty to inquire about further. Accordingly, when the title report showed nothing but First National's $1,025,000 lien, it should have immediately piqued First National's attention and prompted further investigatory effort. A simple phone call to the real estate agent or to Palmer would have almost certainly revealed Palmer's outstanding lien, and it is likely that such a phone call would have averted this problem altogether. Instead, First National ignored what should have been an obvious problem and negligently failed to act. In our view, First National's decision to sweep its knowledge of Palmer's seller financing under the rug and proceed in blind reliance on what proved, not surprisingly, to be an erroneous title report was negligent and is the proximate cause of First National

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4. (...continued)
extended. We do not see anything within those twenty documents to indicate that First National actually knew about the recordation of Palmer's trust deed. Of those documents, only three were generated after Palmer's trust deed was recorded. Two of the three are the erroneous title commitment and ensuing title policy. The third is a letter from USDA informing First National about the discrepancy in the first trust deed and the actual amount that USDA agreed to guaranty. That letter says nothing of Palmer's second trust deed. Regardless, though, of whether First National had actual notice of the recorded trust deed, many of the documents demonstrate that First National had ample reason to know of the likelihood that Palmer's loan would be secured by a trust deed recorded against the property.

losing its first lien position. Such negligence forecloses equitable reinstatement.

CONCLUSION

¶16 Equitable subrogation is not applicable to the circumstances of this case. First National was on inquiry notice, requiring it to go beyond the deficient title report and to investigate the potential existence of Palmer's lien. Because it negligently failed to do anything other than rely on the erroneous title report, First National is not entitled to equitable relief. We consequently reverse the district court's grant of partial summary judgment to First National and remand for further proceedings consistent with this opinion.

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

United States Court of Appeals
Fifth Circuit

FILED
January 31, 2013

Lyle W. Cayce
Clerk

No. 12–30010

LEVY GARDENS PARTNERS 2007, L.P.,

Plaintiff – Appellant

v.

COMMONWEALTH LAND TITLE INSURANCE COMPANY,

Defendant – Appellee

LEVY GARDENS PARTNERS 2007, L.P.,

Plaintiff – Appellant Cross-Appellee

COMMONWEALTH LAND TITLE INSURANCE COMPANY,

Defendant – Appellee Cross-Appellant

Appeals from the United States District Court
for the Eastern District of Louisiana

Before STEWART, Chief Judge, and GARZA and ELROD, Circuit Judges.

EMILIO M. GARZA, Circuit Judge:

Levy Gardens Partners 2007, L.P. ("Levy Gardens") appeals the district court's decision following a bench trial ordering Commonwealth Land Title Insurance Company ("Commonwealth") to pay Levy Gardens $605,000 pursuant to Levy Gardens's title insurance policy with Commonwealth. Levy Gardens asserts it is entitled to over $7 million under the insurance policy.

Commonwealth cross-appeals the district court's grant of any relief to Levy Gardens, asserting the insurance policy does not insure against any of Levy Gardens's losses. We AFFIRM.

I

This case arises out of a failed Levy Gardens multi-family housing project in New Orleans. In November of 2007, the City of New Orleans, Department of Safety and Permits sent Levy Gardens a letter stating the zoning determination of its property was "R.O.," which permits multi-family housing. The City then issued Levy Gardens four building permits for the property. The City's law department subsequently sent Levy Gardens an opinion letter originally prepared for a city councilmember, advising that its proper zoning designation was R.O. Afterward, Levy Gardens purchased title insurance from Commonwealth in connection with this project on October 7, 2008. Section 8 under the "Conditions" heading in this insurance policy reads in relevant part:

> 8. 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
>> . . .
>> (iii) the difference between the value of the Title as insured and the value of the Title subject to the risk insured against by this policy
>> . . .

Section 3 under the same heading requires the insured to give the insurer notice of claims, stating:

> 3. NOTICE OF CLAIM TO BE GIVEN BY INSURED CLAIMANT
> The insured shall notify the Company promptly in writing . . . in case of any litigation as set forth in

> Section 5(A) of these Conditions. . . . 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.

This insurance policy also includes a "zoning endorsement" that reads:

> 1. The Company insures against loss or damage sustained by the insured in the event that, at the Date of Policy,
>   a. According to applicable zoning ordinances and amendments, the Land is not classified Zone RO (as to that portion of Lot L that was Lot 3A-6-1A-1) & B2 (as to that portion of Lot L that was Lot 3A-6-1A-2C);
>   b. The following use or uses are not allowed under that classification: multifamily housing (as to that portion of Lot L that was Lot 3A-6-1A01); parking (as to that portion of Lot L that was Lot 3A-6-1A-2C).
> 2. There shall be no liability under this endorsement based on
>   a. Lack of compliance with any conditions, restrictions, or requirements 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.a. does not modify or limit the coverage provided in Covered Risk 5.
>   b. 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.
>   c. 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.

The insurance policy limit is $18,323,070.

The East New Orleans Neighborhood Advisory Commission ("ENONAC"), a state body, filed suit in state court seeking a writ of mandamus, and on November 12, 2008 the state civil district court ordered the City to determine which parts of Levy Gardens's property were properly designated R.O. (the "2008 judgment"). The City complied with the mandamus order by filing an affidavit from the director of the Department of Safety and Permits that found all of Levy Gardens's property was properly designated R.O.

After the 2008 judgment, the City Council of New Orleans passed an ordinance that required enforcement of the most restrictive regulations that apply to Levy Gardens's property (the "2008 ordinance"). ENONAC then brought another suit in state civil district court seeking a preliminary injunction based on the 2008 ordinance. The state court held Levy Gardens's desired use was prohibited under an ordinance passed in 1985 (the "1985 ordinance"). The state court held the 1985 ordinance was not overridden by the Comprehensive Zoning Ordinance passed in 1995 (the "1995 CZO"), which, were it not for the 1985 ordinance, would have allowed Levy Gardens's desired use. The state court applied the 1985 ordinance over the 1995 CZO for two reasons. First, the 1995 CZO states in part, "Whenever these regulations contain an actual, implied, or apparent conflict, the more restrictive regulation shall apply unless specified otherwise." Second, the 2008 ordinance, like the 1995 CZO, requires application of the most restrictive regulations to Levy Gardens's property. Because the 1985

ordinance is more restrictive than the 1995 CZO, and because the 1995 CZO does not expressly repeal the 1985 ordinance, the state court held the 1995 CZO and the 2008 ordinance require application of the 1985 ordinance to Levy Gardens's property. Therefore, the state court issued a preliminary injunction enjoining Levy Gardens from building unless Levy Gardens successfully underwent a "conditional use process" to secure special permission from the city council to be exempt from zoning regulations (the "2009 judgment").

Levy Gardens then notified Commonwealth of the litigation, but referenced the incorrect policy number in its letter. Levy Gardens appealed the decision, and the Louisiana Fourth Circuit Court of Appeal affirmed the trial court. The Louisiana Supreme Court denied certiorari.

Levy Gardens then resumed contacting Commonwealth, at first using the incorrect policy number again. Levy Gardens and Commonwealth exchanged many letters, mostly sent by Levy Gardens, but Levy Gardens did not actually review the policy until later. Levy Gardens ultimately instituted the instant action in state court, then, after a non-diverse defendant was dismissed, removed it to federal district court. The district court first granted summary judgment to Levy Gardens, finding the insurance policy provided Levy Gardens with coverage. The district court then held a bench trial on the amount of damages. The district court issued its judgment in an oral decision, making five findings: (1) Levy Gardens is entitled to only the diminution in value of the property as a result of the application of the 1985 ordinance; (2) the meaning of "loss or damage" in the zoning endorsement is defined by Section 8 of the policy to mean loss in value of the title because the policy is not ambiguous in this regard; (3) the zoning endorsement is not stand-alone coverage; (4) Commonwealth's conduct does not warrant statutory penalties; and (5) Levy Gardens is entitled to $605,000, which is the difference in value between the title

of its insured property with and without the 1985 ordinance zoning encumbrance.

Levy Gardens appealed, asserting the policy covers all of its losses resulting from the application of the 1985 ordinance, including the money it spent on preparing for development. Levy Gardens also asserts the district court should have imposed penalties on Commonwealth. Commonwealth cross-appealed, asserting Levy Gardens is not entitled to any coverage under the policy.

II

We review grants of summary judgment de novo on appeal, applying the same standards as the district court. *Burge v. Parish of St. Tammany*, 187 F.3d 452, 464 (5th Cir. 1999). "[T]he party moving for summary judgment must 'demonstrate the absence of a genuine issue of material fact . . . .'" *Little v. Liquid Air Corp.*, 37 F.3d 1069, 1075 (5th Cir. 1994) (quoting *Celotex v. Catrett*, 477 U.S. 317, 323 (1986)). A dispute is "genuine" if the evidence is sufficient for a reasonable jury to return a verdict for the non-moving party. *Hamilton v. Segue Software, Inc.*, 232 F.3d 473, 477 (5th Cir. 2000). A fact issue is "material" if its resolution could affect the outcome of the action. *Id.* When reviewing summary judgment decisions, we construe all facts and inferences in the light most favorable to the non-moving party. *Cooper Tire & Rubber Co. v. Farese*, 423 F.3d 446, 454 (5th Cir. 2005). We review bench trial findings of fact for clear error. *Water Craft Management LLC v. Mercury Marine*, 457 F.3d 484, 488 (5th Cir. 2006).

We review interpretations of state law de novo, *Bayou Steel Corp. v. Nat'l Union Fire Ins. Co. Of Pittsburgh, Pa.*, 642 F.3d 506, 509 (5th Cir. 2011), "resolving questions of Louisiana law the way the Louisiana Supreme Court would interpret the statute based upon prior precedent, legislation, and relevant commentary." *Commerce & Indus. Inc. Co. v. Grinnell Corp.*, 280 F.3d 566, 570

(5th Cir. 2002) (internal quotation marks and citation omitted). Under Louisiana law, we read insurance policies as a whole, construing them strictly in favor of the insured. *Coleman v. Sch. Bd. of Richland Parish*, 418 F.3d 511, 517–18 (5th Cir. 2005). Where there is ambiguity, we construe insurance policies according to what a reasonable policy purchaser would expect at the time of purchase, and where the policy is clear, we interpret it as written. *Id.*

III

Commonwealth asserts Levy Gardens's losses are not covered by its title insurance policy primarily because at the date of the policy, October 7, 2008, the land was zoned to allow multi-family housing, and the insurance policy only covers adverse zoning *on the date of the policy*. In support, Commonwealth asserts the adverse 2009 judgment by the state court does not mean the property was not favorably zoned on October 7, 2008, despite the 2009 judgment's application of the 1985 ordinance that was in effect before the date of the policy. Commonwealth concludes zoning was favorable on the date of the policy, October 7, 2008, because the state court judgment came later. The district court disagreed and, citing the reasoning of the state court, held the 1985 ordinance prohibited multi-family housing on the property on October 7, 2008 despite the fact that the 1985 ordinance was overlooked by the City and the parties on that date. The district court's conclusion is correct because the state court judgment applied the 1985 ordinance and the 1995 CZO, in effect long before October 7, 2008.

In addition, Commonwealth makes two state law arguments. First, Commonwealth asserts the 1985 ordinance does not apply to Levy Gardens's property and is superceded by the 1995 CZO, despite the holdings of the state court in the 2009 judgment and the district court in the instant case. Second, Commonwealth asserts the City of New Orleans is the only entity with state statutory authority to make zoning determinations, and therefore the letters

from City employees and the building permits issued by the City prior to October 7, 2008 conclusively establish that the property was zoned favorably on that date.

The principle that state courts are the final arbiters of state law is well-settled. *See, e.g., Bell v. State of Md.*, 378 U.S. 226, 237 (1964) ("It is not for us, however, to decide this question of Maryland law, or to reach a conclusion as to how the Maryland Court of Appeals would decide it. Such a course would be inconsistent with our tradition of deference to state courts on questions of state law."). Commonwealth's state-law contentions have already been addressed by the Louisiana courts. *East New Orleans Neighborhood Advisory Comm'n v. Levy Gardens Partners 2008, LLC*, 20 So.3d 1131 (La. App. Ct. 2009) ("*ENONAC*"), *cert. denied*, 22 So.3d 169 (La. 2009). Commonwealth is mistaken to think the role of this federal court is to make an independent determination of state law where state courts have already decided the matter. The state courts already determined the 1985 ordinance applies to Levy Gardens's property and is not superceded by the 1995 CZO. *Id.* The Louisiana Fourth Circuit Court of Appeal affirmed the state trial court holding, and the Louisiana Supreme Court denied certiorari. *Id.* Although not necessary, the district court found the reasoning of the state courts persuasive and made the same holding independently on summary judgment. The district court reasoned that it was not bound by the state court judgment, presumably because the state court judgment determined a zoning matter, not coverage under the insurance policy. Because the district court also determined the 1985 ordinance prevented multi-family housing on the property, it found Levy Gardens had coverage under the policy. The district court did not need to make an independent holding that the 1985 ordinance applies to Levy Gardens's property, however, because the state courts had already decided on the applicability of that particular state law to that particular property. *Id.* Neither do we need to make an independent holding to the same

effect. *Bell*, 378 U.S. at 237. Though we decide whether Levy Gardens has coverage under the insurance policy, coverage that is affected by the state law zoning determination, as a federal court we should not hold state law provides a favorable zoning determination where state courts have held state law provides an unfavorable zoning determination. *Id.* Rather, we need determine only whether the property was zoned for multi-family housing on the date of the policy, October 7, 2008. As discussed above, the state courts applied the 1985 ordinance and the 1995 CZO, in effect long before the date of the policy; therefore, the property was not zoned for multi-family housing on the date of the policy.

Whether state law requires the *City* to make zoning determinations is likewise a matter for the state courts. *Id.* We do not hold the City's zoning determination is given precedence under state law where the state courts have concluded otherwise. *Id.* Whether we agree with the reasoning of the 2009 judgment is irrelevant: a state appellate court affirmed a trial court decision holding that the 1985 ordinance prevents multi-family housing on Levy Gardens's property. *ENONAC*, 22 So.3d at 1137. The state court did not determine the previous City decisions should be given precedence under state law. *Id.* Commonwealth is mistaken to assert this federal court should make a contrary determination. *See generally Bell*, 378 U.S. at 237.

Next, Commonwealth asserts there is no coverage because the failure of Levy Gardens's project was not caused by the zoning determination. This conclusion is incorrect. The basis for the insured-against loss in the endorsement is the reduction in value of the property's title due to unfavorable zoning. This reduction occurred because of the unfavorable zoning determination. Commonwealth may be correct that not *all* the losses of the project were caused by the zoning determination, but certainly the reduction in the *title's* value due to zoning was caused by the zoning determination. *See* 15

AM. JUR. TRIALS 467 (1968–date) ("Title insurance may be briefly defined as an agreement whereby the insurer, for a valuable consideration, agrees to indemnify the insured in a specified amount against loss of, or defect in, *title* to real estate . . . .") (emphasis added).

Lastly, Commonwealth asserts Levy Gardens is not entitled to coverage because Levy Gardens did not comply with three policy conditions. First, the zoning endorsement requires "a final decree of a court of competent jurisdiction adjudicating the invalidity, the effect of which is to prohibit the use or uses." Commonwealth asserts the issuance of the preliminary injunction by the state courts cannot be a "final decree;" rather, a *permanent* injunction is required to fulfill this condition. This is a plausible assertion. The plain reading of the condition, however, only requires a "final decree," which ordinarily means an appealable as opposed to interlocutory decree. *See, e.g., Gloria S. S. Co. v. Smith*, 376 F.2d 46, 47 (5th Cir. 1967) ("Gloria had the choice of appealing from that order within fifteen days or of awaiting a final decree, for all interlocutory orders are reviewable on appeal from the final decree."); *accord Loa-Herrera v. Trominski*, 231 F.3d 984, 991 (5th Cir. 2000). Construing the policy in favor of the insured, *Coleman*, 418 F.3d at 517–18, we hold the Louisiana Fourth Circuit Court of Appeal decision affirming the trial court judgment and the denial of certiorari by the Louisiana Supreme Court satisfy the "final decree" requirement.

Second, Commonwealth asserts Levy Gardens did not comply with the Section 3 notice requirement of the insurance policy, which reduces liability to the extent of prejudice caused by Levy Gardens's failure to notify Commonwealth of litigation. Unlike the other issues that determine whether Commonwealth owes Levy Gardens any coverage at all, the district court did not decide this issue on summary judgment; rather, it decided this issue after the bench trial. Therefore, unlike the de novo standard we use in reviewing the

other issues in this section, we review the factual findings of the district court in this issue for clear error. *Water Craft Mgmt. LLC*, 457 F.3d at 488.

After the bench trial, the district court found, "Levy Gardens did not comply with the notice requirements set forth in [Section] 3." The district court chose not to reduce Levy Gardens's damages, however, implying any prejudice caused by Levy Gardens's non-compliance was insignificant. The evidence in the record shows the district court did not clearly err in finding the prejudice to Commonwealth did not warrant any reduction in damages. The district court found Commonwealth prejudiced by not being able to choose its own counsel to represent Levy Gardens in the state court litigation, but also found the ability of the counsel who did represent Levy Gardens "considerable." Furthermore, Levy Gardens did notify Commonwealth of the adverse 2009 judgment, but Commonwealth chose not to participate in either the appeal to the Louisiana Fourth Circuit Court of Appeal or the application for a writ of certiorari from the Louisiana Supreme Court. Therefore, the district court's finding that any prejudice to Commonwealth should not reduce Levy Gardens's damages is not clearly erroneous.

Third, Commonwealth asserts the failure of Levy Gardens to complete the conditional use process ordered by the 2009 judgment precludes liability because the zoning endorsement specifically voids liability where there is a "[l]ack of compliance with any conditions, restrictions, or requirements 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." The conditional use process ordered by the 2009 judgment cannot, however, be what is contemplated by the endorsement's requirement to "secure necessary consents." Otherwise, Commonwealth would be shielded from paying out for insurance coverage every time there is an adverse zoning determination before or as a result of the conditional use process. Levy Gardens did at first "secure

necessary consents" by obtaining building permits from the City, but the adverse 2009 judgment voided those consents. As the district court found:

> The entire point of [Levy Gardens] purchasing title insurance and paying extra for a zoning endorsement was so it would not have to go through the conditional use process. It was assured and insured that multi-family housing was a permitted use, making the need to undergo the conditional use permit process unnecessary.

We do not disturb this finding because undergoing the conditional use process *does not guarantee* "secur[ing] necessary consents." Following Commonwealth's logic, on one hand Commonwealth would not have to pay insurance proceeds to Levy Gardens had Levy Gardens undergone the conditional use process but nevertheless been denied "necessary consents." The endorsement states Levy Gardens must "secure necessary consents," not only "*try* to secure necessary consents," so undergoing the conditional use process unsuccessfully would not satisfy the requirement. On the other hand, had Levy Gardens successfully undergone the conditional use process and received an exemption from the city council for the property, the property would not have been encumbered by zoning regulations. In other words, under Commonwealth's reading of "secure necessary consents," Commonwealth would never be liable. In any event, the purpose of purchasing title insurance is to avoid such processes that allow for special exemptions from zoning regulations. Therefore, reading the insurance policy in favor of Levy Gardens, we hold the insurance policy does not require Levy Gardens to undergo the conditional use process.

Therefore, we hold the district court did not err in concluding Levy Gardens has coverage under the insurance policy. Furthermore, we hold the district court did not err in concluding Levy Gardens did not violate the conditions of the policy in a manner prejudicial to Commonwealth.

IV

Turning to damages, Levy Gardens asserts it is entitled to all losses derived from preparing the property for development, not only the reduction in value of the title to the property that resulted from the zoning encumbrance. Commonwealth asserts Section 8 of the policy unambiguously restricts liability to the difference in the value of the title with and without the zoning encumbrance. Levy Gardens counters in three primary ways: 1) Commonwealth waived any use of Section 8 because it did not specifically include that section in its answer to Levy Gardens's complaint; 2) Section 8 is ambiguous and therefore must be construed to include all losses resulting from use of the property, not only loss in the value of the title; and 3) the zoning endorsement is stand-alone coverage that insures use of the property regardless of any other language in the insurance policy. Levy Gardens is mistaken in all three contentions. The title insurance policy insures against only the diminution in value of the property's title.

First, Levy Gardens contends that Commonwealth failed to allege Section 8 as an affirmative defense. Federal Rule of Civil Procedure 8(c) does require a defendant to "affirmatively state any avoidance or affirmative defense." "Louisiana appellate courts have for decades required that exclusions to insurance contracts be specifically pleaded as affirmative defenses." *Sher v. Lafayette Ins. Co.*, 988 So. 2d 186, 204 (La. 2008). "[A]n affirmative defense raises a new matter, which assuming the allegations in the petition are true, constitutes a defense to the action." *Id.*

Commonwealth did not, however, waive the contention that Section 8 defines the losses Levy Gardens is entitled to. Levy Gardens relies on *Aunt Sally's Praline Shop, Inc. v. United Fire & Cas. Co., Inc.*, 418 F. App'x 327, 330 (5th Cir. 2011), for the proposition that "[m]erely pleading the terms and conditions of an insurance policy is not sufficient to raise affirmative defenses

under the policy." Unlike here, *Aunt Sally's* addressed a failure to plead specific policy exclusions. Levy Gardens asserts Section 8 is an affirmative defense, and therefore should be treated as an exclusion. It is mistaken, however, because Section 8 is the only section available for determining the extent of liability—it is not an affirmative defense in the way an exclusion is an affirmative defense. It does not "raise[] a new matter, which assuming the allegations in the petition are true, constitutes a defense to the action." *Sher*, 988 So. 2d at 204. It is not a defense to liability; rather, it is a description of the extent of liability, as defined in the policy, for the loss or damage once liability is found.

Furthermore, "a technical failure to comply precisely with Rule 8(c) is not fatal." *Aunt Sally's*, 418 F. App'x at 330 (citing *Allied Chemical Corp. v. Mackay*, 695 F.2d 854, 855 (5th Cir. 1983)). "Rather, it is left up to the discretion of the trial court to determine whether the party against whom the unpleaded affirmative defense has been raised has suffered prejudice or unfair surprise. [*Allied Chemical Corp.*, 695 F. 2d at 855]. Thus, we review the district court's decision . . . for abuse of discretion." *Aunt Sally's*, 418 F. App'x at 330. Even if Section 8 were an "affirmative defense," the district court could not have abused its discretion because, the entire principal policy being only four pages long, Levy Gardens could not have been prejudiced or unfairly surprised. Section 8, the only section describing the extent of liability, could not be hidden away only to be pulled out later in a surprising or prejudicial manner. Therefore, Levy Gardens could not have "suffered prejudice or unfair surprise" when Commonwealth used Section 8 to determine the extent of liability. *Id.*

Second, Levy Gardens asserts Section 8 is ambiguous, so we should construe the section to include all loss or damage arising from the failed housing project. Levy Gardens relies on our opinion in *First American Bank v. First American Transport Title Ins. Co.*, 585 F.3d 833 (5th Cir. 2009), for the proposition that "title insurers take different approaches to the application of

Section 8(a)," concluding the section must be ambiguous. This reliance is misplaced. *First American Bank* held the same language that is used in Levy Gardens's insurance policy limits the insurer's liability to "the difference between the value . . . when unencumbered and the value . . . subject to the [encumbrance]." *First American Bank*, 585 F. 3d at 838. *First American Bank* recognized the difference between those values cannot be determined only by looking at the price resulting from a foreclosure sale. *Id.* That is clearly different from holding the language itself is ambiguous. In *First American Bank*, we remanded for proper valuation, asking the district court to take into account market data other than the foreclosure price; we did not rely on ambiguity to expand coverage beyond anything other than the value of title. *Id.*

Levy Gardens asserts the phrase "loss or damage" in Section 8 is also ambiguous, citing a number of out-of-state cases. It does not, however, present any alternative way to read the phrase "loss or damage." Section 8 is very clear in defining "loss or damage" as the lesser of the amount of insurance or the difference in value between the title with and without the zoning encumbrance. There is no reason to interpret "loss or damage" other than with the clear definition in Section 8. Section 8 is simply unambiguous: the loss or damage is the difference in value; neither the phrase "loss or damage" nor the word "value" is subject to any competing definition.

Third, Levy Gardens asserts the zoning endorsement is stand-alone coverage that should be read without the benefit of Section 8. Levy Gardens asserts that because the endorsement provides coverage in the event certain "use" of the land is prohibited, it must insure the use of the property, not the value. It also cites commentators who describe zoning endorsements as insuring against loss in the event property is "not zoned for a specified use or uses." This logic is misguided because the zoning endorsement insures the value of the title in the event certain use is not allowed (here, multi-family housing), therefore the

word "use" is a necessary term in describing the coverage it provides. That does not transform it into stand-alone coverage insuring against any loss related to any use of the property apart from the value of the property's title.

In addition, Levy Gardens asserts the zoning endorsement is stand-alone coverage because it modifies and conflicts with the policy. The endorsement does modify, or conflict with, the policy: it simply excepts the policy's exclusion for zoning, but no more. Levy Gardens relies on *Bozeman v. Commonwealth Land Title Ins. Co.*, 470 So. 2d 465 (La. App. Ct. 1985), for the proposition that an insurer cannot use an endorsement to insure for a known risk and then rely on a contrary exclusion to avoid liability. Commonwealth, however, is not relying on any zoning exclusion in the policy. *Bozeman* does not transform zoning endorsements into stand-alone coverage; it only prevents insurers from using exclusions to disregard endorsements they issue. 470 So. 2d at 467 ("[A]n exclusion may not be used to defeat coverage where the insurer was informed of the defect in the title and agreed to insure against loss occasioned by such defect."). Therefore, Levy Gardens cannot show the zoning endorsement is stand-alone coverage based on the fact that the endorsement modifies or conflicts with the policy's zoning exclusion.

Lastly, Levy Gardens asserts the zoning endorsement is stand-alone coverage because enforcing the terms of Section 8 would subvert the coverage provided by the endorsement. This reasoning simply assumes the answer. Section 8 would limit the coverage provided by the endorsement if the endorsement were stand-alone coverage, but this does not mean the endorsement is in fact stand-alone coverage. When the insurance policy is read as a whole, it is clear that Section 8 describes the extent of liability and the zoning endorsement excepts the zoning exclusion in the principal policy in order to cover loss to the value of the title in the event of a zoning encumbrance. It does not, contrary to Levy Gardens's assertions, transform this title insurance

policy into one that covers all losses, whether or not they are related to the value of the title. Therefore, we hold the district court did not err in concluding the insurance policy provides coverage for only the diminution in value of title to the property resulting from the zoning encumbrance.

V

Levy Gardens asserts the district court committed manifest error by declining to impose penalties on Commonwealth. Louisiana law provides for penalties in LA. REV. STAT. 22:1892 and 22:1973. Section 22:1892 reads in relevant part:

> A. (1) All insurers . . . shall pay the amount on any claim due any insured within thirty days after receipt of satisfactory proofs of loss from the insured or any party in interest. . . .
> . . .
> (4) All insurers shall make a written offer to settle any property damage claim . . . within thirty days after receipt of satisfactory proofs of loss of that claim.
> B. (1) Failure to make such payment within thirty days after receipt of such satisfactory written proofs and demand therefor or failure to make a written offer to settle any property damage claim . . . , when such failure is found to be arbitrary, capricious, or without probable cause, shall subject the insurer to a penalty
> . . . .

LA. REV. STAT. 22:1892(A)(1), (A)(2), (B)(1). 22:1973 reads in relevant part:

> A. An insurer . . . owes to his insured a duty of good faith and fair dealing. The insurer has an affirmative duty to adjust claims fairly and promptly and to make a reasonable effort to settle claims with the insured or the claimant, or both. Any insurer who breaches these duties shall be liable for any damages sustained as a result of the breach.
> . . .
> C. In addition to any general or special damages to which a claimant is entitled for breach of the imposed

> duty, the claimant may be awarded penalties assessed against the insurer . . . .

LA. REV. STAT. 22:1973(A), (C).

"A cause of action for penalties . . . requires a showing that (1) an insurer has received satisfactory proof of loss, (2) the insurer fails to tender payment within thirty days of receipt thereof, and (3) the insurer's failure to pay is arbitrary, capricious or without probable cause." *Louisiana Bag Co., Inc. v. Audubon Indem. Co.*, 999 So. 2d 1104, 1112–13 (La. 2008). "The phrase 'arbitrary, capricious, or without probable cause' . . . describe[s] an insurer whose willful refusal of a claim is not based on a good-faith defense." *Id.* at 1114. Under Louisiana law, "penalties should be imposed only when the facts negate probable cause for nonpayment," not "when the insurer has a reasonable basis to defend the claim and acts in good-faith reliance on that defense." *Id.* (quotation marks and citation omitted). "[W]hen there are substantial, reasonable and legitimate questions as to the extent of an insurer's liability or an insured's loss, failure to pay within the statutory time period is not arbitrary, capricious or without probable cause." *Id.* On the other hand, "an insurer cannot stonewall an insured simply because the insured is unable to prove the exact extent of his damages. Where the exact extent of the damages is unclear, an insurer must tender the reasonable amount which is due." *Id.* at 1115 (quotation marks and citation omitted). In *Louisiana Bag*, the Louisiana Supreme Court found the trial court committed manifest error when it did not impose penalties where the insurer did not dispute that it received proof of loss and delayed making payment on the undisputed portion of the claim to the insured. *Id.* at 1114–15, 1122.

"Whether or not a refusal to pay is arbitrary, capricious, or without probable cause depends on the facts known to the insurer at the time of its action . . . . Because the question is essentially a factual issue, the trial court's

finding should not be disturbed on appeal absent manifest error." *Reed v. State Farm Mut. Auto. Ins. Co.*, 857 So. 2d 1012, 1021 (La. 2003).

Levy Gardens asserts the district court manifestly erred in declining to impose penalties on Commonwealth because Commonwealth "stonewalled" Levy Gardens. Commonwealth responds that its position, asserting Levy Gardens did not have any coverage, was taken in good faith, even if ultimately wrong. The district court made five findings related to penalties: (1) Levy Gardens hampered negotiations by refusing to entertain questions about coverage and not reading the policy; (2) Levy Gardens did not provide Commonwealth sufficient proof of loss or notice of the claim because it used the incorrect policy number; (3) Commonwealth should have been clearer in its communications to Levy Gardens about its position; (4) Commonwealth's position on coverage was taken in good faith; and (5) Commonwealth's actions were not "so" arbitrary and capricious as to warrant penalties.

Levy Gardens places much emphasis on the word "so," asserting that any arbitrary and capricious action by Commonwealth would mandate the imposition of penalties. This disregards the discretion of the trial court to determine whether conduct by Commonwealth is "arbitrary and capricious" under the statute. The use of the word "so" by the trial court—in an oral ruling, no less—cannot be given so much weight as to hold the district court committed manifest error by declining to impose penalties. Rather, the district court simply did not find Commonwealth's conduct arbitrary and capricious under the penalty statutes. *See Guillory v. Lee*, 16 So.3d 1104, 1127 (La. 2009) ("[T]he question of arbitrary and capricious behavior [under the penalty statutes] is essentially a factual issue, and the trial court's finding should not be disturbed on appeal absent manifest error."). The record is replete with evidence supporting both positions. Levy Gardens used the incorrect policy number and did not provide proof of loss or notice, and Commonwealth was not clear in its communications

with Levy Gardens. Neither party acted perfectly, but Commonwealth did assert in good faith that there was no coverage at all, so it should not be penalized for not paying anything because there was no undisputed amount of damages. *Louisiana Bag*, 999 So. 2d at 1114-15. The district court's findings that Commonwealth's actions were not arbitrary and capricious and Commonwealth made its assertions in good faith are reasonable and supported by the record. Therefore, we hold the district court did not manifestly err by declining to impose penalties on Commonwealth.

VI

For these reasons, we AFFIRM.

PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 12-3200/3201

In Re: The Majestic Star Casino, LLC, et al,
Debtors

The Majestic Star Casino, LLC, et al.

v.

Barden Development, Inc;
United States of America on behalf
of the Internal Revenue Service; State of Indiana
Department of Revenue; John M. Chase, Jr., as
Personal Representative of Don H. Barden

United States of America on behalf
of the Internal Revenue Service,
Appellant No. 12-3200

Barden Development, Inc and
John M. Chase, Jr., as Personal
Representative of Don H. Barden,
Appellants No. 12-3201

On Appeal from the United States Bankruptcy Court
for the District of Delaware
(B.C. No. 10-56238)
Bankruptcy Judge: Hon. Kevin Gross

Argued
February 19, 2013

Before: AMBRO, JORDAN, and VANASKIE, *Circuit Judges*.

(Filed: May 21, 2013)

Kathryn Keneally
Thomas J. Clark
Ivan C. Dale [ARGUED]
Tax Division
Department of Justice
P.O. Box 502
Washington, DC 20044

Melissa L. Dickey
United States Department of Justice
Tax Division
P.O. Box 227
Ben Franklin Station
Washington, DC 20044

Charles M. Oberly
United States Attorney
1007 N. Orange Street
Wilmington, DE 19801
Counsel for Appellants
The United States of America

Steven D. Carpenter
100 North Senate Avenue
Indianapolis, IN 46204
Counsel for Appellant
Indiana Department of Revenue

Mary F. Caloway
Buchanan Ingersoll & Rooney
1105 N. market St. - #1900
Wilmington, DE 19801

Gerald M. Gordon [ARGUED]
Erika Pike Turner
Gordon Silver
3960 Howard Hughes Pkwy – 9th Fl.
Las Vegas, NV 89169

Anthony Ilardi, Jr.
Katherine Murphy
William Lentine
Dykema Gossett, PLLC
39577Woodward Avenue - #300
Bloomfield Hills, MI 48304
Counsel for Barden Appellants

Lauren O. Casazza [ARGUED]
Warren Haskel
Kirkland & Ellis
601 Lexington Avenue
New York, NY 10022

Kathleen P. Makowski
James E. O'Neill, III
Pachulski Stang Ziehl & Jones
919 N. Market Street – 17th Fl.
Wilmington, DE 19801
Counsel for Appellees

OPINION OF THE COURT

JORDAN, *Circuit Judge*.

This case arises from a corporate reorganization under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (the "Code"), and puts at issue whether a non-debtor company's decision to abandon its classification as an "S" corporation for federal tax purposes, thus forfeiting the pass-through tax benefits that it and its debtor subsidiary had enjoyed, is void as a postpetition transfer of "property of the bankruptcy estate," or is avoidable, under §§ 362, 549, and 550 of the Code. This appears to be a question of first impression in the federal Courts of Appeals.

Barden Development, Inc. ("BDI"), John M. Chase, as the personal representative of the estate of Don H. Barden[1] (together with BDI, the "Barden Appellants"), and the Internal Revenue Service (the "IRS") appeal an order of the United States Bankruptcy Court for the District of Delaware granting summary judgment to The Majestic Star Casino, LLC and certain of its subsidiaries and affiliates (collectively "Majestic" or the "Debtors") on their motion to avoid BDI's termination of its status as an "S" corporation (or "S-corp"), an entity type that is not subject to federal taxation. In November 2009, the Debtors, which had been controlled by Barden, filed petitions for relief under Chapter 11 of the Code. After the bankruptcy filing, Barden, as sole shareholder of BDI, successfully petitioned the IRS to revoke BDI's S-corp status. Under the Internal Revenue Code ("I.R.C."), that revocation also caused Majestic Star Casino II, Inc. ("MSC II"), an indirect and wholly-owned BDI subsidiary and one of the Debtors, to lose its status as a qualified subchapter S subsidiary (or "QSub"), which meant that it, like BDI, became subject to federal taxation.

The Debtors were by then effectively controlled by their creditors and, naturally, did not agree with shouldering a new tax burden. They filed an adversary complaint asserting that the revocation of BDI's S-corp status caused an unlawful postpetition transfer of property of the MSC II bankruptcy estate. The Bankruptcy Court agreed and ordered the Barden Appellants and the IRS to reinstate both BDI's status as an S-

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[1] Don H. Barden died on May 19, 2011. His personal representative was substituted for him in this action in July 2011. For simplicity, Don H. Barden and Mr. Chase are referred to in this opinion as "Barden."

corp and MSC II's status as a QSub. The case was certified to us for direct appeal. For the reasons that follow, we will vacate the Bankruptcy Court's January 24, 2012 order and remand this matter to the Court with directions to dismiss the complaint.

I. BACKGROUND

A. *Facts*

1. *The Parties*

Defendant-Appellant BDI is an Indiana corporation with its headquarters in Detroit, Michigan. Defendant-Appellant Barden was, at all pertinent times, the sole shareholder, chief executive officer, and president of BDI. At the time of the complaint, BDI qualified as a "small business corporation" under I.R.C. § 1361(b), and, presumably at Barden's direction, had elected under I.R.C. § 1362(a) to be treated as an S-corp for purposes of federal income taxation. As an S-corp, BDI was not subject to federal taxation, *see* I.R.C. § 1363(a),[2] or state taxation.[3] Rather, its income and

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[2] The Internal Revenue Code presumes that a business entity incorporated under any federal or state statute is taxable as a "C" corporation, the letter designation having reference to the subchapter of the I.R.C. which governs the tax treatment of various corporate transactions and interests. *See, e.g.*, I.R.C. §§ 331-346 (covering corporate liquidations); *id.* §§ 351-368 (corporate organizations and reorganizations); *id.* § 385 (treatment of corporate interests as stock or indebtedness); Treas. Reg. § 301.7701-2(a), (b) (defining a business entity that is "recognized for federal tax purposes").

losses were passed through to its shareholder, Barden, who was required to report BDI's income on his individual tax returns. *See* I.R.C. §§ 1363(b), 1366(a).[4]

Subchapter S of the I.R.C. creates an exception for a business entity that qualifies as a "small business corporation" and whose shareholder or shareholders elect S-corp status for that entity. *See* I.R.C. § 1361(a) (providing that any corporation is a taxable C-corporation unless it qualifies for, and elects, S-corp status); *id.* § 1362(a) (providing for the "S" election). To qualify as a small business corporation, the business entity must be a domestic corporation that does not have more than 100 shareholders, has only individual persons as shareholders, does not have a nonresident alien as a shareholder, and has only a single class of stock. *Id.* § 1361(b). As discussed in more detail *infra*, an S-corp is a "disregarded entity" for federal tax purposes and is not taxed on its income. *Id.* § 1363(a); *see also* Treas. Reg. § 301.7701-3(c)(v)(C) (providing that an entity that elects S-corp status is treated as an "association" rather than as a corporation for tax purposes so that only its shareholders are taxed on the entity's income).

[3] Indiana follows the federal entity classification rules for state tax purposes, so that an entity classified as an S-corp for federal tax purposes is automatically classified as such for Indiana state tax purposes. Ind. Code Ann. § 6-3-2-2.8(2). BDI was therefore treated as a disregarded entity by Indiana tax authorities as well.

[4] An S-corp is sometimes referred to as a "pass-though" or "flow-through" entity because the entity itself pays no tax but its income, deductions, losses, and credits flow-through to its shareholders, who must report those amounts in their personal income tax returns. *United States v.*

Plaintiff-Appellee MSC II is a Delaware corporation that owns and operates the Majestic Star II Casino and the Majestic Star Hotel in Gary, Indiana. MSC II generates income from those operations. BDI acquired MSC II in 2005 and was, at all times relevant to this dispute, the ultimate owner of 100 percent of its stock.[5] Prior to the Debtors' bankruptcy petition, BDI elected to treat MSC II as a QSub for federal tax purposes, pursuant to I.R.C. § 1361(b)(3)(B).[6]

Tomko, 562 F.3d 558, 576 n.14 (3d Cir. 2009) (en banc).

[5] MSC II was a wholly-owned subsidiary of The Majestic Star Casino, LLC, which in turn was wholly-owned by Majestic Holdco, LLC. BDI owned 100 percent of the stock of Majestic Holdco, LLC. Due to the 100 percent tiered ownership of Majestic Holdco, LLC and The Majestic Star Casino, LLC, those intermediate subsidiaries are treated as "disregarded entities" for federal income tax purposes, *see* Treas. Reg. § 307.7701-3(b)(ii), and BDI is treated as the owner of MSC II.

[6] The 1996 amendments to the I.R.C. enacted as part of the Small Business Job Protection Act of 1996, Pub. L. No. 104-188, 110 Stat. 1755, introduced QSubs as a new tax entity. An S-corp may elect QSub status for its subsidiary if (1) the S-corp parent holds 100 percent of the subsidiary's stock, (2) the subsidiary is otherwise eligible to qualify as an S-corp on its own, but for the fact that it has a corporate shareholder, and (3) the S-corp parent makes the appropriate election on IRS Form 8869. *See generally* The S Corporation Handbook § 2:6 (Peter M. Fass & Barbara S. Gerrard, eds. 2012). Treasury regulations provide that a QSub is generally not treated as a corporation separate from its S-corp parent.

That meant that MSC II was not treated as a separate tax entity from BDI, but rather that all of its assets, liabilities, and income were treated for federal tax purposes as the assets, liabilities, and income of BDI. *See id.* § 1361(b)(3)(A). As a result, MSC II paid no federal taxes and all of its income and losses flowed through to Barden (through BDI), and he was required to report them on his individual tax returns. *See* Treas. Reg. § 1.1366-1(a). BDI was able to elect to treat MSC II as a QSub because the latter met the statutory requirement that it was wholly owned by an S-corp, ultimately BDI. *See* I.R.C. § 1361(b)(3)(B); *supra* notes 5 and 6.

2. *The Majestic Bankruptcy and the Revocation of MSC II's QSub Status*

On November 23, 2009 (the "Petition Date"), MSC II and the other Debtors filed voluntary petitions for bankruptcy relief under the Code, and the Bankruptcy Court subsequently ordered that their Chapter 11 cases be jointly administered. The Debtors became debtors-in-possession of their respective

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Treas. Reg. § 1.1361-4(a)(1). If an S-corp makes a valid QSub election with respect to an existing subsidiary, as in this case, the subsidiary is deemed to have liquidated into the parent under I.R.C. §§ 332 and 337. Treas. Reg. § 1.1361-4(a)(2). If a subsidiary ceases to qualify as a QSub – for example, because its corporate parent is no longer an S-corp – the subsidiary is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) from the parent S-corp immediately before termination, in exchange for stock of the new subsidiary corporation, under I.R.C. § 351. I.R.C. § 1361(b)(3)(C); Treas. Reg. § 1.1361-5(b).

bankruptcy estates, and thus had, with limited exceptions not relevant here, all of the powers and duties of a bankruptcy trustee in a Chapter 11 case. At the Petition Date, both BDI and MSC II retained their status as, respectively, an S-corp and a QSub. Barden and BDI did not file bankruptcy petitions, nor did they participate as debtors in any of the petitions at issue in this case.

In addition to certain events that automatically revoke an entity's election to be treated as an S-corp,[7] that tax status may also be revoked if more than half of the corporation's shareholders consent to the revocation. I.R.C. § 1362(d)(1)(B). If S-corp status is revoked, the entity cannot elect such status again within five years of the revocation without the consent of the Secretary of the Treasury. *Id.* § 1362(g).[8]

Sometime after the Petition Date, Barden, BDI's sole shareholder, caused and consented to the revocation of BDI's

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[7] Those events include the purchase of the company's stock by more than 100 shareholders, by a shareholder who is not a natural person, or by a shareholder who is a nonresident alien, I.R.C. § 1361(b)(1)(A)-(C), or the company's issuance of more than one class of stock, *id.* § 1361(b)(1)(D). Any of those events cause the S-corp to lose its required status as a "small business corporation."

[8] Like an S-corp that elects to revoke or otherwise loses its S-corp status, *see* I.R.C. § 1362(g), a QSub that loses its QSub status is not eligible for that status again for five years, without the consent of the Secreatary or the IRS, *id.* § 1361(b)(3)(D); Treas. Reg. § 1.1361-5(c)(1).

status as an S-corp, and BDI filed a notice with the IRS to that effect. The revocation was retroactively effective to January 1, 2010, the first day of BDI's taxable year.[9] As a result, MSC II's QSub status was automatically terminated as of the end of the prior tax year (the "Revocation"), because it no longer met the requirement that it be wholly owned by an S-corp. Thus, both BDI and MSC II became C-corporations as of January 1, 2010. As a consequence of becoming a C-corporation, MSC II became responsible for filing its own tax returns and paying income taxes on its holdings and operations.

Neither BDI nor Barden sought or obtained authorization from the Debtors or from the Bankruptcy Court for the Revocation. The Debtors did not learn of the Revocation until July 19, 2010, which is believed to be at least four months after Barden and BDI filed the S-corp revocation with the IRS. *See supra* note 9. The Debtors allege that, because MSC II was not informed of the Revocation, it was unaware that it had a new obligation to report and pay income taxes. They also allege that, due to the change in MSC II's tax status, MSC II had to pay approximately $2.26 million in estimated income tax to the Indiana Department of Revenue for 2010 that it otherwise

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[9] It is not clear from the record at what point during the pendency of the Majestic bankruptcy proceedings BDI revoked its S-corp status. However, it presumably did so before March 15, 2010, because the revocation was effective on the first day of 2010 and would otherwise have been effective on the first day of 2011. *See* I.R.C. § 1362(d)(1)(C) (setting forth the effective dates for revocation of S-corp status).

would not have had to pay. However, as of April 2011 (the first date federal taxes would have been due following the Revocation), the Debtors had paid no federal income taxes as a result of the Revocation.

3. *Confirmation of the Majestic Plan and Its Effect on MSC II*

On December 10, 2010, prior to the Debtors' filing of the adversary complaint that initiated this action, the Bankruptcy Court issued an order permitting the Debtors to convert MSC II from a Delaware corporation to a Delaware limited liability company ("LLC"). On March 10, 2011, the Court entered an order confirming the Debtors' Second Amended Plan of Reorganization (the "Plan"). Pursuant to the Plan, as of December 1, 2011 (the "Effective Date"), new membership interests representing all of the equity interests in MSC II were to be issued to holders of certain senior secured debt. On November 28, 2011, just prior to the Effective Date, the Debtors went ahead and caused MSC II to convert to an LLC. That conversion meant that MSC II would no longer have qualified for QSub status, even if the Revocation had not already occurred. *See* I.R.C. § 1361(b)(3)(B) (requiring that a QSub be a "domestic corporation").[10] Also, as part of the

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[10] An LLC may opt to elect to be taxed as a partnership, *see* Treas. Reg. § 301.7701-3(c), so the conversion of MSC II to an LLC effectively reinstated its status as a "flow-through" entity. But the conversion of MSC II, at that time a C-corporation as a result of the Revocation, into an LLC may itself have been a taxable event to the extent the conversion could have been treated as a corporate liquidation. *See* I.R.C. § 336. The Debtors were aware of the

Plan of Reorganization, MSC II ceased to be wholly owned by an S-corp, so that, even absent the LLC conversion, and independent of the Revocation, MSC II would no longer have qualified as a QSub. The Debtors' Plan of Reorganization was substantially consummated on December 1, 2011, and MSC II emerged from bankruptcy together with the other Debtors on that date.

B. *Procedural History*

On December 31, 2010, the Debtors filed an adversary complaint in the Bankruptcy Court, asserting that the Revocation caused an unlawful postpetition transfer of MSC II's estate property, in violation of §§ 362 and 549 of the Bankruptcy Code. The complaint sought recovery of that "property" under Code § 550, through an order "directing the IRS and [the] Indiana [Department of Revenue] to restore BDI's status as an S corporation and MSC II's status as a QSub retroactively effective January 1, 2010." (App. at 50.).

The IRS moved to dismiss the Debtors' adversary complaint on February 14, 2011, contending that the Bankruptcy Court lacked jurisdiction and that the Debtors failed to state a claim under Federal Rules of Civil Procedure 12(b)(1) and 12(b)(6) (incorporated by Federal Rule of Bankruptcy Procedure 7012(b)). More particularly, the IRS argued that the Bankruptcy Court lacked jurisdiction under Code § 505(a)(1) because the Debtors had not alleged that MSC II had actually paid any federal corporate income taxes or filed any federal income tax returns prior to initiating their

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possible taxable nature of the conversion to an LLC when it occurred.

adversary proceeding, so that their claims were not ripe. The IRS also argued that the Debtors had failed to state a claim because MSC II's status as a QSub was not "property" of the MSC II estate because MSC II "never had a right to claim, continue, or revoke" that status "either before or after it filed its bankruptcy petition" (App. at 81), and that no "transfer" of estate property occurred when BDI terminated its S-corp election and triggered the loss of MSC II's QSub status, (App. at 83-84).

Barden and BDI answered the Debtors' adversary complaint on February 28, 2011, and moved for judgment on the pleadings under Federal Rule of Civil Procedure 12(c). They contended that because a QSub has no separate tax existence, MSC II had no cognizable property interest in that status. They also argued that, because a subsidiary's QSub status depends entirely on elections made by its S-corp parent, even if MSC II's QSub status were a species of property, it was property that belonged to BDI and Barden.

The Debtors moved for summary judgment on March 16, 2011, and, on January 24, 2012, the Bankruptcy Court granted their motion and denied both the IRS's motion to dismiss and the Barden Appellants' motion for judgment on the pleadings. The Court held that MSC II's status as a QSub was the property of MSC II, and that, as such, it belonged to MSC II's bankruptcy estate. The Court therefore concluded that the revocation by non-debtor BDI of its status as an S-corp, and the resulting termination of MSC II's status as a QSub, were void and of no effect. Finally, the Court ordered the defendants, including the IRS, to take all actions necessary to restore the status of MSC II as a QSub of BDI.

That order, of course, has significant practical implications for the parties. As with many bankruptcy reorganizations, the Debtors' emergence from bankruptcy resulted in the cancellation of a substantial amount of indebtedness, which, in turn, generated "cancellation of debt" ("COD") income equal to the amount by which the debt was reduced in bankruptcy. At oral argument before us, the IRS said that the amount of that COD income was $170 million. COD income is generally subject to federal taxation. *See* I.R.C. § 61(a)(12) (including in the definition of "gross income" "income from the discharge of indebtedness"). If BDI is restored to S-corp status, then it, and ultimately Barden, is the taxpayer and would be liable for the taxes on the COD income. *See* Prop. Treas. Reg. § 1.108-9, 76 Fed. Reg. 20593-01 (Apr. 13, 2011) (providing that, when the debtor is a disregarded entity, such as an S-corp, then the owner of that entity is the taxpayer). Normally, under the so-called "Bankruptcy Exception," a taxpayer in bankruptcy does not recognize COD income on debt that is cancelled or written down as part of a plan of reorganization. I.R.C. § 108(a)(1)(A). However, in this case, neither Barden nor BDI was part of the Majestic bankruptcy, so they may not qualify for the Bankruptcy Exception and could be liable for the tax on the COD income. *See* Prop. Treas. Reg. § 1.108-9 (limiting the Bankruptcy Exception to entities under the jurisdiction of the Bankruptcy Court). Also, the Bankruptcy Court's order caused the IRS to lose the benefit of MSC II's tax liabilities being treated as an administrative expense of the bankruptcy estate, which would have allowed the government to be paid before most other creditors. *See* 11 U.S.C. § 503(b)(1)(B).

By contrast, the Debtors – or, more precisely, their former creditors who replaced BDI as the holders of MSC II's equity – benefit in at least two dramatic ways if the Revocation is deemed to have been void or is otherwise avoided. First, if MSC II remains a QSub even after having emerged from bankruptcy, then it (and its new equity holders) will continue to enjoy its tax-free status, while BDI retains liability for MSC II's income taxes, even though BDI no longer has access to MSC II's income and cash flow to fund the tax payments. Second, by shifting the tax liability for COD income to BDI, MSC II need not make use of the Bankruptcy Exception, which would ordinarily come with a substantial cost. Under the I.R.C., a debtor that makes use of the Bankruptcy Exception must reduce the value of other tax attributes dollar-for-dollar by the amount of COD income excluded from gross income. *See* I.R.C. § 108(b)(1). That means that the reorganized debtor loses the value of various deductions and credits that would have been available to reduce taxes in the future. *See id.* § 108(b)(2). As a consequence of the Bankruptcy Court's order, however, the Debtors avoid liability for COD income without the adverse impact on their tax attributes.

The Bankruptcy Court granted the IRS and the Barden Appellants leave to appeal on March 7, 2012, even though the Court's judgment and order had left open the calculation of the damages for which Barden and BDI were liable as a result of the Court's conclusion that they had violated the automatic stay. The United States District Court for the District of Delaware certified the appeals to us on May 23, 2012, and we authorized the appeals on July 9, 2012.

II. JURISDICTION AND STANDARDS OF REVIEW

The Bankruptcy Court had jurisdiction over the adversary proceeding pursuant to 28 U.S.C. §§ 157(b)(2), 1334(a)-(b). We have jurisdiction over this direct appeal under 28 U.S.C. § 158(d)(2)(A). We reject the Barden Appellants' argument, raised for the first time in this appeal, that the Bankruptcy Court, as an Article I court, lacked jurisdiction to order the IRS to reinstate BDI's status as an S-corp and MSC II's status as a QSub. Leaving aside that arguments not raised below are normally waived on appeal, *see In re American Biomaterials Corp.*, 954 F.2d 919, 927 (3d Cir. 1992), that argument is without merit. The Bankruptcy Code gives bankruptcy courts the power to "'issue any order, process, or judgment that is necessary or appropriate to carry out [its] provisions.'" *Official Comm. of Unsecured Creditors of Cybergenics Corp. ex rel. Cybergenics Corp. v. Chinery*, 330 F.3d 548, 567 (3d Cir. 2003) (quoting 11 U.S.C. § 105(a)). The IRS is subject to that power as an "entity" referred to in specific provisions of the Code, because that term expressly includes a "governmental unit." 11 U.S.C. § 101(15). The Court's ability to exercise jurisdiction over the IRS has been affirmed in a number of contexts. *See United States v. Energy Res. Co.*, 495 U.S. 545, 549 (1990) (holding that "a bankruptcy court has the authority to order the IRS to apply the payments [made by a debtor] to trust fund liabilities if the bankruptcy court determines that this designation is necessary to the success of a reorganization plan"); *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 209 (1983) (concluding that the Code authorizes a bankruptcy court to recover property seized to satisfy a lien prior to the filing of a petition for reorganization, and noting that "[w]e see no reason why a different result should obtain when the IRS is the creditor").

Transactions to which the IRS is a party are also subject to the general rule that they are void if they violate the automatic stay. *See United States v. Galletti*, 541 U.S. 114, 124 n.5 (2004) (noting that the automatic stay barred the IRS from bringing suit against a debtor in bankruptcy); *In re Schwartz*, 954 F.2d 569, 571 (9th Cir. 1992) (holding that an IRS tax assessment that violated the automatic stay was void).

Although we reject the Barden Appellants' argument that the Bankruptcy Court lacked jurisdiction, we note that this case raises a jurisdictional question of standing that the parties did not raise and the Bankruptcy Court did not consider. We address that question in Parts III.A and III.B, *infra*, in the context of the merits.

When reviewing a bankruptcy court's grant of summary judgment, "we review the ... findings of fact for clear error and exercise plenary review over the ... legal determinations." *In re Kiwi Int'l Air Lines, Inc.*, 344 F.3d 311, 316 (3d Cir. 2003) (citing *In re Woskob*, 305 F.3d 177, 181 (3d Cir. 2002); *In re Cont'l Airlines*, 125 F.3d 120, 128 (3d Cir. 1992)). A grant of summary judgment is "proper only if it appears that there is no genuine issue as to any material fact and that [each of] the moving part[ies] is entitled to a judgment as a matter of law." *Id.* (alterations in original) (quoting Fed. R. Civ. P. 56(c)) (internal quotation marks omitted). In evaluating the evidence, we "view inferences to be drawn from the underlying facts in the light most favorable to the party opposing the motion." *Bartnicki v. Vopper,* 200 F.3d 109, 114 (3d Cir. 1999).

We exercise plenary review over rulings on motions to dismiss, *In re Avandia Mktg., Sales Practices & Prods. Liab.*

Litig., 685 F.3d 353, 357 (3d Cir. 2012), and over rulings on motions for judgments on the pleadings, *Rosenau v. Unifund Corp.*, 539 F.3d 218, 221 (3d Cir. 2008).

III. DISCUSSION

This appeal requires us to answer two related questions. As a threshold matter of justiciability, we must decide whether the Debtors have standing to challenge the revocation of MSC II's QSub status. That, however, requires us to address the merits of whether the MSC II bankruptcy estate had a property interest in MSC II's QSub status such that the Debtors had the right to challenge what they characterize as the postpetition transfer of that interest.

A. *Standing*

Front and center in this case is the question of whether a debtor subsidiary's entity tax status is "property" at all, and, if so, whether it is property belonging to that subsidiary or to its non-debtor corporate parent. That implicates standing, even though the issue was not addressed before this appeal. Inasmuch as the "[s]tanding doctrine embraces ... judicially self-imposed limits on the exercise of federal jurisdiction," *Allen v. Wright*, 468 U.S. 737, 751 (1984), we turn to it first.

The doctrine of standing "focuses on the party seeking to get his complaint before a federal court and not on the issues he wishes to have adjudicated." *Valley Forge Christian Coll. v. Ams. United for Separation of Church & State, Inc.*, 454 U.S. 464, 484 (1982) (quoting *Flast v. Cohen*, 392 U.S. 83, 99 (1968)) (internal quotation marks omitted). It "involves both constitutional limitations on federal-court

jurisdiction and prudential limitations on its exercise." *Warth v. Seldin*, 422 U.S. 490, 498 (1975). One of those prudential limits demands that "the plaintiff generally ... assert his own legal rights and interests, and []not rest his claim to relief on the legal rights or interests of third parties." *Id.* at 499.

The Debtors' effort to pursue claims under Code §§ 362, 549, and 550 is dependent upon Code § 541, which provides that a bankruptcy estate succeeds only to "legal or equitable interests of the debtor ... as of the commencement of the case." 11 U.S.C. § 541(a)(1). It is a given that "[t]he trustee [or debtor-in-possession] can assert no greater rights than the debtor himself had on the date the [bankruptcy] case was commenced." *Guinn v. Lines* (*In re Trans-Lines West, Inc.*), 203 B.R. 653, 660 (Bankr. E.D. Tenn. 1996) (quoting 4 Collier on Bankruptcy ¶ 541.06 (15th ed. 1996)) (internal quotation marks omitted).

As discussed in more detail in Part III.B.1, *infra*, "a corporation cannot alter its tax status through election, revocation or rescission, without some form of shareholder consent," so that "the corporation, standing alone, cannot challenge the validity of a prior Subchapter S revocation ... without the consent of at least those shareholders who consented to the revocation." *Trans-Lines West*, 203 B.R. at 660. As a result, "[a] trustee [or debtor-in-possession] who attempts to challenge the validity of a revocation without such consent is asserting the rights of a third party," i.e., the equity holder, and "does not have standing ... ." *Id.*; *cf. Simon v. E. Ky. Welfare Rights Org.*, 426 U.S. 26, 37 (1976) (declining to decide "whether a third party ever may challenge IRS treatment of another").

Following that reasoning, if we assume that a subsidiary's entity tax status, e.g., its existence as a pass-though entity, is "property" but hold that such status belongs not to the subsidiary itself but rather to its parent, then the right to challenge the revocation of QSub status belongs solely to the parent corporation, and the bankruptcy estate of a QSub does not succeed to that right under Code § 541. If that is the case, then a debtor subsidiary that challenges a revocation, as MSC II has done in this case, is endeavoring to assert the rights of a third party, namely its S-corp parent, which is contrary to general principles of standing.

The prohibition on third party standing, however, "is not invariable and our jurisprudence recognizes third-party standing under certain circumstances." *Pa. Psychiatric Soc'y v. Green Spring Health Servs. Inc.*, 280 F.3d 278, 288 (3d Cir. 2002). We have recognized that "the principles

animating ... prudential [standing] concerns are not subverted if the third party is hindered from asserting its own rights and shares an identity of interests with the plaintiff." *Id.* (citing *Craig v. Boren*, 429 U.S. 190, 193-94 (1976); *Singleton v. Wulff*, 428 U.S. 106, 114-15 (1976) (plurality opinion); *Eisenstadt v. Baird*, 405 U.S. 438, 443-46 (1972)). "More specifically, third-party standing requires the satisfaction of three preconditions: 1) the plaintiff must suffer injury; 2) the plaintiff and the third party must have a 'close relationship'; and 3) the third party must face some obstacles that prevent it from pursuing its own claims." *Id.* at 288-89 (citing *Campbell v. Louisiana,* 523 U.S. 392, 397 (1998); *Powers v. Ohio*, 499 U.S. 400, 411 (1991); *Pitt. News v. Fisher*, 215 F.3d 354, 362 (3d Cir. 2000)).

If the entity tax status of MSC II is "property" that belongs to BDI, then the present case does not satisfy the third condition for third-party standing. Nothing in the record suggests that BDI, as the former shareholder of MSC II and the "third party" with standing, is unable to protect its own interests. The term "third party" is actually something of a misnomer here because BDI, as well as its ultimate shareholder Barden, are both defendant parties in the present action and have vigorously fought to protect their interests. Sticking with that nomenclature, though, it is settled that "third parties themselves usually will be the best proponents of their own rights," *Singleton*, 428 U.S. at 114, and the fact that BDI chose not to backtrack and challenge the Revocation does not mean that MSC II or the Debtors have standing to do so.

We thus find ourselves in a circumstance where what is ordinarily the preliminary question of standing cannot be

answered without delving into whether the entity tax status of MSC II is "property" and, if so, whether it belongs to MSC II. In short, we must consider the merits.

B. *QSub Status Claimed as "Property" of the MSC II Bankruptcy Estate*

Referring to MSC II's QSub status, the Bankruptcy Court said that "because the debtor-corporation's subchapter 'S' status provided the debtor-corporation the ability to pass-through capital gains tax liabilities to its principals, the right to make or revoke its subchapter 'S' status had value to the debtor and constituted property or an interest of the debtor in property." *In re Majestic Star Casino, LLC*, 466 B.R. 666, 675 (Bankr. D. Del. 2012). The Barden Appellants argue that the Bankruptcy Court erred in that conclusion because the Court "applied a general overarching bankruptcy principle that anything that brings value into a bankruptcy estate must be a property right" (Barden Appellants' Opening Br. at 21), despite the fact that "the Bankruptcy Code by itself ... does not constitute a source of property rights" (*id.* at 18). Likewise, the IRS asserts that simply because an S-corp election "means that the corporation may 'use' and 'enjoy'" the benefits of a pass-through entity tax status, "it does not follow that the postpetition revocation of ... [that] election is a transfer of estate property." (IRS Opening Br. at 27.)

In their adversary proceeding, the Debtors sought relief under §§ 549, 550, and 362 of the Code.[11] Section 549

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[11] Specifically, the Debtors sought "an order voiding the Avoidable Transfer under section 549 of the Bankruptcy Code, and[,] pursuant to section 550 of the ... Code," orders

provides that a debtor-in-possession or trustee "may avoid a transfer of property of the estate that occurs after the commencement of the case[] and that is not authorized ... by the court." 11 U.S.C. § 549(a). Section 550 permits the debtor-in-possession or trustee to "recover, for the benefit of the estate" property whose transfer has been avoided under § 549. *Id.* § 550(a). Finally, § 362 provides for an "automatic stay" such that the filing of a chapter 11 petition "operates as a stay, applicable to all entities," of, *inter alia*, "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." *Id.* § 362(a)(3). Section 362 also provides that "an individual injured by any willful violation of [the] stay ... shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover punitive damages." *Id.* § 362(k)(1).

Section 362 operates differently than §§ 549 and 550. Those latter sections authorize the bankruptcy court to "avoid" the violative transfer, but the debtor-in-possession or trustee must commence an adversary proceeding. *See* Fed. R. Bankr. P. 7001(1) (requiring that a "proceeding to recover money or property" be brought as an "adversary proceeding"); *In re Doll & Doll Motor Co*., 448 B.R. 107, 111 (Bankr. M.D. Ga. 2011) (denying bank's motion seeking

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directing all of the defendants to return any transferred property and directing the IRS and Indiana Department of Revenue to return any tax payments made by MSC II as a result of the Avoidable Transfer, an order invalidating the Revocation, and an order "voiding the Avoidable Transfer under section 362(a)(3) ... and section 362(k)(1) of the Bankruptcy Code ... ." (App. at 51.)

an order to recover property sold by a Chapter 11 debtor because the bank had not filed an adversary proceeding against the buyer). By contrast, a transfer that violates the automatic stay is generally considered to be void without any action on the part of the debtor. *In re Myers*, 491 F.3d 120, 127 (3d Cir. 2007) (citing *In re Siciliano*, 13 F.3d 748, 750 (3d Cir. 1994) ("[T]he general principle [is] that any creditor action taken in violation of an automatic stay is void *ab initio*.")).

Notwithstanding that difference, all three sections have three elements in common for purposes of the problem before us. For the Revocation to be void under § 362 or avoidable under §§ 549 and 550, QSub status must be (1) "property" (2) "of the bankruptcy estate" (3) that has been "transferred." Though a lack of any one of those elements is dispositive, we choose to consider – in the alternative – only the first two.

1. *QSub Status as "Property"*

Section 541(a) of the Bankruptcy Code defines "property of the estate" as "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). "[W]e have emphasized that Section 541(a) was intended to sweep broadly to include all kinds of property, including tangible or intangible property, [and] causes of action[.]" *In re Kane*, 628 F.3d 631, 637 (3d Cir. 2010) (second alteration in original) (quoting *Westmoreland Human Opportunities, Inc. v. Walsh*, 246 F.3d 233, 241 (3d Cir. 2001)) (internal quotation marks omitted). "[T]he term 'property' has been construed most generously and an interest is not outside its reach because it is novel or contingent or because enjoyment must be postponed." *In re Fruehauf Trailer Corp.*, 444 F.3d 203, 211 (3d Cir. 2006) (quoting *Segal v. Rochelle*, 382 U.S. 375, 379 (1966)) (internal quotation marks omitted). "It is also well established that the mere opportunity to receive an economic benefit in the future is property with value under the Bankruptcy Code." *Id.* (internal quotation marks omitted).

However, "[f]iling for bankruptcy does not create new property rights or value where there previously were none." *In re Messina*, 687 F.3d 74, 82 (3d Cir. 2012); *cf. Butner v. United States*, 440 U.S. 48, 56 (1979) (noting that the holder of a property interest "is afforded in federal bankruptcy court the same protection he would have had under state law if no bankruptcy had ensued"). Consequently, "[t]he estate is determined at the time of the initial filing of the bankruptcy petition ... ." *Kollar v. Miller*, 176 F.3d 175, 178 (3d Cir. 1999).

This appears to be a matter of deliberate Congressional choice. Although the constitutional authority of Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States," U.S. Const., art. I, § 8, cl. 4, could, in theory, encompass a statutory framework defining property interests for purposes of bankruptcy, "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law," *Butner*, 440 U.S. at 54; *see also In re Brannon*, 476 F.3d 170, 176 (3d Cir. 2007) ("[W]e generally turn to state law for the determination of property rights in the assets of a bankrupt's estate." (internal quotation marks omitted)). However, if "some federal interest requires a different result," *Butner*, 440 U.S. at 55, then property interests may be defined by federal law. *Cf. McKenzie v. Irving Trust Co.*, 323 U.S. 365, 370 (1945) (noting that, "[i]n the absence of any controlling federal statute," a creditor may acquire rights to property transferred by a debtor "only by virtue of state law").

Given the importance of federal tax revenues, one might assume that the Internal Revenue Code determines whether tax status constitutes a property interest of the taxpayer, but it does not do so explicitly and the case law is not entirely clear. *See Drye v. United States*, 528 U.S. 49, 57 (1999) (considering whether "state law is the proper guide to ... 'property' or 'rights to property'" under a provision of the I.R.C. and noting that the Court's "decisions in point have not been phrased so meticulously"). On one hand, the I.R.C. "creates no property rights but merely attaches consequences, federally defined, to rights created under state law." *United States v. Bess*, 357 U.S. 51, 55 (1958). Thus, "[i]n the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer

had in the property." *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 722 (1985) (quoting *Aquilino v. United States*, 363 U.S. 509, 513 (1960)) (internal quotation marks omitted). On the other hand, "[o]nce it has been determined that state law creates sufficient interests in the [taxpayer] to satisfy the requirements of [the federal revenue statute], state law is inoperative, and the tax consequences thenceforth are dictated by federal law." *Id.* (second alteration in original) (quoting *Bess*, 357 U.S. at 56-57) (internal quotation marks omitted). In *Drye v. United States*, the Supreme Court ultimately concluded that "the [I.R.C.] and interpretive case law place under federal, not state, control the ultimate issue whether a taxpayer has a beneficial interest in any property subject to levy for unpaid federal taxes." 528 U.S. at 57. Also, the I.R.C. does address the handling of tax attributes in the bankruptcy context, at least when "the debtor is an individual," *see* I.R.C. § 1398(a), and provides that the "[e]state succeeds to tax attributes of [the] debtor ... determined as of the first day of the debtor's taxable year in which the case commences ... ." I.R.C. § 1398(g); *see also United States v. Sims* (*In re Feiler*), 218 F.3d 948, 953 (9th Cir. 2000) ("I.R.C. § 1398 determines what tax attributes of the debtor rightfully belong to the bankruptcy estate ... ."). The Bankruptcy Code itself defers to the I.R.C. with respect to the creation and character of certain tax attributes of the bankruptcy estate. *See* 11 U.S.C. § 346(a) (providing that the I.R.C. governs whether the creation of a bankruptcy estate creates a tax entity separate from the debtor). Thus, we conclude that the I.R.C., rather than state law, governs the characterization of entity tax status as a property interest for purposes of the Bankruptcy Code.

With this background, we review the case law that the Debtors say supports their claim that MSC II's QSub status was "property."

i. S-Corp Status as "Property"

The Bankruptcy Court reasoned that QSub status is analogous to S-corp status and, based on a few cases holding that the latter is "property" for purposes of the Code, concluded that the former is "property" too. The principal case is *In re Trans-Lines West, Inc.*, 203 B.R. 653 (Bankr. E.D. Tenn. 1996), which concerned whether a corporation's revocation of its S-corp status prior to filing for bankruptcy was a prepetition transfer of property avoidable by the trustee pursuant to Code § 548.[12] The bankruptcy court in that case acknowledged that, "[i]n the absence of controlling federal law, the question of whether a debtor possesses an interest in property is governed by state law," but the court reasoned that, "[b]ecause the subject of the alleged transfer is the Debtor's status as a Subchapter S corporation, a status created under title 26 of the United States Code, ... federal law, and more specifically the Internal Revenue Code," determines whether a debtor holds a property interest in its S-corp status. 203 B.R. at 661.[13] The court observed that "'property' refers

[12] Section 548 provides, in relevant part, that "the trustee may avoid any transfer ... of an interest of the debtor in property, or any obligation ... incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition ... ." 11 U.S.C. § 548(a)(1).

[13] Courts that have followed *Trans-Lines West* have reached the same conclusion. *See, e.g.*, *Parker v. Saunders* (*In re Bakersfield Westar, Inc.*), 226 B.R. 227, 233 (B.A.P. 9th

... to the right and interest or domination rightfully obtained over [an] object, with the unrestricted right to its use, enjoyment, and disposition." *Id.* (quoting 63A Am. Jur. 2d *Property* §1 (1984)) (internal quotation marks omitted). It then jumped to the conclusion that,

> once a corporation elects to be treated as an S corporation, I.R.C. § 1362(c) guarantees and protects the corporation's right to use and enjoy that status until it is terminated under I.R.C. § 1362(d). Moreover, § 1362(d)(1)(A) provides that "[a]n election under subsection (a) may be terminated by revocation." I.R.C. § 1362(d)(1)(A) ... . Thus, I.R.C. § 1362(d)(1)(A) guarantees and protects an S corporation's right to dispose of that status at will.

Id. (first alteration in original).

The court also noted that I.R.C. § 1362(c) provides that an S-corp election "shall be effective ... for all succeeding taxable years of the corporation, until such election is terminated," *id.* at 661-62 (internal quotation marks omitted), and it reasoned that the I.R.C. thus "affords a corporation which has elected the Subchapter S status a guaranteed, indefinite right to use, enjoy, and dispose of that status," *id.* at 661. From that, the court concluded that "the Debtor possessed a property interest (i.e., a guaranteed right to use, enjoy and dispose of that interest) in its Subchapter S status ...

Cir. 1998) ("[A] debtor's subchapter S status is a creation of I.R.C. § 1362, and federal law therefore determines whether a debtor holds a 'property' interest in its subchapter S status.").

." *Id.* at 662. Other courts that have considered the issue of S-corp status as a property right have all come to the same conclusion. *See Halverson v. Funaro* (*In re Funaro*), 263 B.R. 892, 898 (B.A.P. 8th Cir. 2001) ("[A] corporation's right to use, benefit from, or revoke its Subchapter S status falls within the broad definition of property [under the Code]."); *Parker v. Saunders* (*In re Bakersfield Westar, Inc.*), 226 B.R. 227, 234 (B.A.P. 9th Cir. 1998) (concluding that the holding in *Trans-Lines West* "is consistent with the Ninth Circuit's definition of property"); *Hanrahan v. Walterman* (*In re Walterman Implement Inc.*), Bankr. No. 05-07284, 2006 WL 1562401, at *4 (Bankr. N.D. Iowa May 22, 2006) ("[T]he right to revoke [a] Subchapter S election is property ... as defined in § 541[] ... [and] the revocation of Debtor's subchapter S status is also voidable under § 549 as a postpetition transfer.").

The *Trans-Lines West* decision and those that follow it base their conclusion that S-corp status is "property" on a series of precedents holding net operating losses ("NOLs") to be property.[14] In *Segal v. Rochelle*, the Supreme Court

[14] Net operating losses

> are created when the taxpayer's deductible business expenses for a given year exceed her net income for that year. [I.R.C.] § 172(c). Once NOLs are sustained, the taxpayer may carry the loss back three years and use it as a deduction in that year. NOLs that remain are applied to the next two years and deducted accordingly. *Id.* § 172(b)(1)(A), (b)(2). If any loss remains at the end of the three-year carryback period, it is carried forward and deducted from the

declared that the right to offset NOLs against past income (a "loss carryback") is property of an individual debtor, because it entitles the debtor to a refund of taxes already paid. 382 U.S. at 380-81. The Court decided that a debtor's NOLs, because they arise from prior losses, are "sufficiently rooted in [its] pre-bankruptcy past" that, when carried back to generate a tax refund, they "should be regarded as 'property' under [the Code]." *Id.* at 380.

Subsequent cases extended the holding in *Segal* to the right to use NOLs to offset future tax liability (a "loss carryforward"). For example, in *Official Committee of Unsecured Creditors v. PSS Steamship Co.* (*In re Prudential Lines, Inc.*), 928 F.2d 565, 567 (2d Cir. 1991),[15] a corporate

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> taxpayer's income over the next fifteen years (or until it is exhausted), beginning with the year after the loss was initially sustained. *Id.* § 172(b)(1)(B). Alternatively, the Tax Code permits the taxpayer to forego the carryback option and instead use the NOLs exclusively in future years. *Id.* § 172(b)(3)(C). Such an election, once made, is irrevocable for that tax year. *Id.*

Gibson v. United States (*In re Russell*), 927 F.2d 413, 415 (8th Cir. 1991). An NOL "carryback" against past earnings therefore generates a claim for a refund of taxes paid on those earnings, while an NOL "carryforward" represents the ability to shelter future income from taxation.

[15] Although *Prudential Lines* and cases that followed it extended *Segal*'s holding, the *Segal* Court expressly reserved judgment on whether future tax benefits, such as loss

subsidiary had $74 million of NOLs attributable to its past operations when an involuntary petition for reorganization under Chapter 11 was filed against it. Its corporate parent attempted to take a $39 million "worthless stock" deduction, based on the anticipated loss of its investment in the subsidiary, which would have eliminated the value of its NOL for future use, but creditors of the subsidiary sued the parent

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"carryforwards" (or "carryovers") would also constitute bankruptcy estate property. The Court observed that "a carryover into post-bankruptcy years can be distinguished both conceptually as well as practically" from a benefit available against past taxes because "the supposed loss-carryover would still need to be matched in some future year by earnings, earnings that might never eventuate at all." *Segal*, 382 U.S. at 381. Despite that *dictum*, the court in *Prudential Lines* concluded that "[t]he fact that the right to a[n] NOL carryforward is intangible and has not yet been reduced to a tax refund ... does not exclude it from the definition of property of the estate." 928 F.2d at 572. That conclusion relied on the *Segal* Court's reasoning that "postponed enjoyment does not disqualify an interest as 'property,'" and that "contingency in the abstract is no bar" to finding that an interest is property of a bankruptcy estate. 382 U.S. at 380. But that reasoning in *Segal* was addressed only to the argument that an NOL carryback was not property of the estate at the commencement of the proceeding because "no refund could be claimed from the Government until the end of the year" of filing, during which "earnings by the bankrupt ... might diminish or eliminate the loss-carryback refund claim ... ." *Id.* It does not support the broad proposition that any contingent tax attribute can necessarily be labeled as "property."

to enjoin it from doing so. The bankruptcy court held that the NOL carryforward was property of the subsidiary's bankruptcy estate and that the parent's planned tax deduction would violate the automatic stay. The court thus granted the injunction. *In re Prudential Lines Inc.*, 114 B.R. 27, 32 (Bankr. S.D.N.Y. 1989). The United States Court of Appeals for the Second Circuit affirmed, holding that the "right to carryforward [the] $74 million NOL to offset future income is property of the [subsidiary's] estate within the meaning of § 541." 928 F.2d at 571. *Accord In re Feiler*, 218 F.3d at 955-56 (holding that a prepetition election to carry forward NOLs, making them unavailable to the debtor to claim a refund of past taxes, constituted a preference payment avoidable under the Code); *Gibson v. United States* (*In re Russell*), 927 F.2d 413, 417-18 (8th Cir. 1991) (same). The Second Circuit also held that the non-debtor parent's proposed worthless stock deduction was barred by the automatic stay because, "where a non-debtor's action with respect to an interest that is intertwined with that of a bankrupt debtor would have the legal effect of diminishing or eliminating property of the bankrupt estate, such action is barred by the automatic stay." *Prudential Lines*, 928 F.2d at 574.[16]

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[16] We have not yet addressed the question of whether NOL carrybacks or carryforwards constitute property. The closest we have come to deciding the question was an issue arising under the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. § 1001 *et seq.*, rather than the I.R.C. In *In re Fruehauf Trailer Corp.*, 444 F.3d 203 (3d Cir. 2006), a debtor made an irrevocable election to increase pension benefits that denied the bankruptcy estate the ability to recoup an accumulated surplus in plan assets. We held that

Trans-Lines West and the decisions that follow it extended *Prudential Lines*, saying that the ability to make an S-corp election, like the ability to elect whether to carry forward or carry back NOLs, is property. We think that extension untenable, though, for several reasons.[17] First, in

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"[t]his recoupment right is a transferable property interest" because,"[a]lthough the right to recover [the surplus from an ERISA-qualified retirement plan] is a future estate, the reversion itself is a present, vested estate. As a result, the employer's reversionary interest falls within the broad reach of section 541(a) of the Bankruptcy Code and is considered property ... ." *Id.* at 211 (second alteration in original) (internal quotation marks omitted); *see also id.* ("Property of the estate includes all interests, such as ... contingent interests and future interests, whether or not transferable by the debtor." (quoting *Prudential Lines*, 928 F.2d at 572) (internal quotation marks omitted)).

[17] We are not the only ones to find the *Trans-Lines West* line of cases wanting. *See* James S. Eustice & Joel D. Kuntz, Federal Income Taxation of S Corporations ¶ 5.08[1] (4th ed. 2001) ("These cases seem like little more than hard bankruptcy cases making bad tax law."); Camilla Berit Galesi, *Shareholders' Rights Regarding Termination of a Debtor Corporation's S Status in a Bankruptcy Setting*, 10 J. Bankr. L. & Prac. 157, 161-62 (2001) ("[D]ue to the [*Trans-Lines West*] court's misunderstanding of the rules governing S election and termination[] ... the court adopts an erroneous conception of the nature of a corporation's interest in its S status."); Richard A. Shaw, *Taxing Shareholders on the Income of an S Corporation in Bankruptcy*, 1 No. 6 Bus. Entities 40, 1999 WL 1419055, at *46 (1999) ("In its haste to provide cash for creditors, the Ninth Circuit BAP in

applying the NOL-as-property principle, which had been extended once already by *Prudential Lines*, *see supra* note 15, the decision in *Trans-Lines West* and the other S-corp-as-property cases fail to consider important differences between the two putative property interests.[18] In holding that tax status is property, the S-corp cases reason from the premise

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Bakersfield [*Westar*] and the Tennessee Bankruptcy Court in ... *Trans-Lines West* ... are simply creating a windfall for the bankruptcy estate at the expense of third parties who are not in the bankruptcy proceeding."); *id.* ("The NOL cases are somewhat easier to accept ... [but] [t]he case for disrespecting the revocation of an S election is, in many ways, much more troublesome.").

[18] The reasoning of the "NOL-as-property" cases is itself not without flaws. Those cases looked, in part, to Congressional intent that "property of the estate" be construed to "include[] all interests, such as ... contingent and future interests." *Prudential Lines*, 928 F.2d at 572 (quoting H.R. Rep. No. 95-595, at 176 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6136) (internal quotation marks omitted); *see also Feiler*, 218 F.3d at 956-57 (quoting same and suggesting that "Congress affirmatively adopted the *Segal* holding when it enacted the present Bankruptcy Code"). But Code § 541 contains no reference to "contingent" or "future" interests and refers only to "legal or equitable interests of the debtor in property *as of the commencement of the case*." 11 U.S.C. § 541(a)(1) (emphasis added). Moreover, "the crucial analytical key [is] not ... an abstract articulation of the statute's purpose, but ... an analysis of the nature of the asset involved in light of those principles." *Kokoszka v. Belford*, 417 U.S. 642, 646 (1974).

that the "prospective ... nature [of a right] does not place it outside the definition of 'property.'" *Bakersfield Westar*, 226 B.R. at 234. Even accepting that this will sometimes be the case, not all contingencies are of equal magnitude or consequence. NOLs when carried back are hardly contingent at all. In all events, a debtor in possession of NOLs has a defined amount of them at the time of the bankruptcy filing; they are a function of the debtor's operations prior to bankruptcy and are not subject either to revocation by the shareholders or termination by the IRS. *See Segal*, 382 U.S. at 381 (noting that "[t]he bankrupts in this case had both prior net income and a[n] [NOL] when their petitions were filed"); *Prudential Lines*, 928 F.2d at 571 (noting that the subsidiary had "a $74 million NOL attributable to its pre-bankruptcy operation" when it filed for Chapter 11 reorganization). By contrast, the shareholders of an S-corp can terminate its pass-through status at will, regardless of how long it has been an S-corp and whatever its pre-bankruptcy operating history has been. The tax status of the entity is entirely contingent on the will of the shareholders.

NOLs also have value in a way that S-corp status does not. The value of an NOL is readily determinable as a tax refund immediately available to the bankruptcy estate to the extent that it is applied to prior years' earnings, and it is still subject to relatively clear estimation if the debtor decides to carry it forward against future earnings. The value of the S-corp election, however, is dependent on its not being revoked, as well as the amount and timing of future earnings. Moreover, NOL carryforwards may be monetized in a manner that continuing S-corp status cannot. A corporation that does not expect to generate sufficient future earnings to use its NOLs may be purchased by another more profitable

corporation which may then use the NOLs to shelter its own income, a transaction expressly contemplated by the I.R.C. *See* I.R.C. § 382 (setting forth certain limitations on the use of NOL carryforwards after a change in the corporation's ownership). By contrast, the sale of an S-corp will generally result in the termination of its tax-free status. *See* I.R.C. § 1361(b)(1) (setting forth the requirements for "small business corporation" status and providing that the sale of an S-corp to most corporate purchasers would terminate its "S" status). Thus, the analogy of S-corp status to NOLs is of limited validity.

A further flaw in the S-corp-as-property cases is that they presume that "once a corporation elects to be treated as an S corporation, [the I.R.C.] guarantees and protects the corporation's right to use and enjoy that status ... [and] guarantees and protects an S corporation's right to dispose of that status at will."[19] *Trans-Lines West*, 203 B.R. at 662. That reflects an incomplete and inaccurate understanding of the law. The I.R.C. does not, and cannot, guarantee a corporation's right to S-corp status, because the corporation's shareholders may elect to revoke that status "at will." *See* I.R.C. § 1362(d)(1)(B) (providing for termination of S-corp status by revocation with the approval of shareholders holding more than one-half the corporation's shares). Even if the shareholders do not vote to revoke their corporation's S-corp status, any individual shareholder may at any time sell his interest – without hindrance by the Code or the I.R.C. – to another corporation, or to a nonresident alien, or to a number

[19] To speak of the revocation as a "disposition," as *Trans-Lines West* does, is to assume that the tax status is a property interest, which is exactly the issue in contention.

of new individuals sufficient to increase the total number of shareholders to more than 100.[20] Any of those sales would trigger the automatic revocation of the company's S status because the corporation would no longer qualify as a "small business corporation." *See* I.R.C. § 1361(a)(1), (b)(1). Thus, the *Trans-Line West* line of cases is incorrect in concluding that S-corp status is a "right" that is "guaranteed" under the I.R.C.[21]

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[20] There may, of course, be contractual agreements among the shareholders limiting the alienability of shares.

[21] Our holding in *Fruehauf Trailer*, *see supra* note 16, is not to the contrary. In that case, we held that a corporate debtor's right to recoup an accumulated surplus in its pension plan was property, even though the plan trustee had the right to make an irrevocable election under ERISA to increase pension benefits, denying the debtor the benefit of that surplus. *See* 444 F.3d at 211 (noting that property may be "contingent" and that "the mere opportunity to receive an economic benefit in the future is property with value under the Bankruptcy Code" (internal quotation marks omitted)). But in that case the debtor had a contractual right to recover the surplus, which we found to be a "future estate, [in which] the reversion itself is a present, vested estate," and one that was "transferable and alienable." *Id.* As a result, we held that the debtor's "reversionary interest falls within the broad reach of section 541(a) of the Bankruptcy Code and is considered property of the debtor's estate." *Id.* An S-corp has no such contractual or otherwise "reversionary" interest in its tax status, let alone one that is "transferable and alienable."

Perhaps recognizing those flaws, some courts holding that S-corp status is "property" have defaulted to the argument that such status must be property because it has value to the estate. *See Prudential Lines*, 928 F.2d at 573 ("[W]e must consider the purposes animating the Bankruptcy Code ... [and] Congress' intention to bring anything of value that the debtors have into the estate." (internal quotation marks omitted)); *Bakersfield Westar*, 226 B.R. at 234 ("The ability to not pay taxes has a value to the debtor-corporation in this case."). Indeed, the Bankruptcy Court in this case essentially defined the Debtors' property interest as "the right to prevent a shifting of tax liability from the shareholders to the QSub through a revocation of the 'S' corporation's status." *Majestic Star Casino*, 466 B.R. at 678. But § 541 defines property only in terms of "legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). It goes without saying that the "right" of a debtor to place its tax liabilities on a non-debtor may turn out to have some value, but that does not mean that such a right, if it exists, is property. Capacious as the definition of "property" may be in the bankruptcy context, we are convinced that it does not extend so far as to override rights statutorily granted to shareholders to control the tax status of the entity they own. "[T]he Code's property definition is not without limitations ... ." *Westmoreland*, 246 F.3d at 256. Even accepting that an interest that is "novel or contingent" may still represent property under the Code, *Segal*, 382 U.S. at 379, a tax classification over which the debtor has no control is not a "legal or equitable interest[] of the debtor in property" for purposes of § 541.

Finally, aside from their flawed reasoning, *Trans-Lines West* and its progeny (and the Bankruptcy Court's decision in

this case) also produce substantial inequities. Taxes are typically borne and paid by those who derive some benefit from the income. *Cf.* I.R.C. § 1 (imposing taxes on "the taxable income" of the parties listed in that section). As the IRS observes in its brief, "[i]n the typical case where an S corporation or Q-sub receives income, the shareholder has the ability to extract the income from the corporation in order to pay the taxes due on that income." (IRS Opening Br. at 29.) *See also supra* notes 2 and 4 (discussing the "flow-through" nature of S-corps). If a bankruptcy trustee is permitted to avoid the termination of a debtor's S-corp or QSub status, then any income generated during or as part of the reorganization process (such as from the sale of assets) is likely to remain in the corporation, and ultimately in the hands of creditors, but the resulting tax liability must be borne by the S-corp shareholders. The *Trans-Lines West* decision, despite its flaws, clearly recognized that unfairness:

> The Trustee's successful challenge of the Debtor's revocation of its Subchapter S status in the present case would have dire tax consequences to the non-consenting shareholder. Upon the Trustee's sale of the Debtor's real estate, the liability for any capital gain would be passed on to the shareholder. Conversely, in its present C corporation status, the Debtor's estate will be liable for the capital gains tax.

203 B.R. at 660 n.9. *Trans-Lines West* treated that inequitable outcome as indicating a problem with the bankruptcy trustee's standing to challenge the transfer of a supposed property interest in a debtor's S-corp status without

the consent of the company's shareholders. *Id.* at 660. That bit of *Trans-Lines West* is true enough. But the inequity also calls into question the soundness of the court's holding that an entity's tax status is property in the first place. "Under the scheme contemplated by the Bankruptcy Code, a debtor's creditors are typically compensated to the extent possible and in as equitable a fashion as possible ... after the trustee marshals the debtor's bankruptcy property ... ." *Westmoreland*, 246 F.3d 251. It would be impossible for a trustee (or a debtor-in-possession) to "marshal" a debtor's S-corp status and use it to compensate creditors, as that status is not controlled by the debtor and has no realizable value.

For all these reasons, we decline to follow the rationale of *Trans-Line West* and its progeny, and we conclude that S-corp status is not "property" within the meaning of the Code.

ii. MSC II's QSub Status as "Property"

QSub status is an *a fortiori* case. As with S-corp status, the I.R.C. does not (and cannot) guarantee a QSub "the unrestricted right to [the] use, enjoyment and disposition" of that status, *see Trans Lines West*, 203 B.R. at 661, because it depends on a variety of factors that are entirely outside the QSub's control. The QSub has an even weaker claim to the control of its status than does an S-corp. The use and enjoyment of its entity tax status is not only dependent on its S-corp parent's continuing to own 100 percent of its stock, *see* I.R.C. § 1361(b)(3)(B)(i), (b)(3)(C)(i), but also on the parent's decision to not revoke the QSub election, *see id.* § 1361(b)(3)(B)(ii), as well as the parent's continuing status as an S-corp, *see id.* § 1361(b)(3)(B)(i). That last

contingency, in turn, depends on the S-corp contingencies already discussed.[22] Therefore, a QSub's use and enjoyment of its tax status may be terminated by factors not only outside its control, but outside the control of its S-corp parent.

Nor can the QSub transfer or otherwise dispose of its QSub status. "As a practical matter," rights to which a debtor asserts a property interest "must be readily alienable and assignable," *Westmoreland*, 246 F.3d at 250, to fulfill the equitable purpose of bankruptcy, which is to generate funds to satisfy creditors. *See id.* at 251 (holding that a license for which few entities other than the debtor would qualify was not a property interest of a bankruptcy estate because it is "dubious, as a practical matter, that any potential buyers would actually bid for that right"). QSub status itself is neither alienable nor assignable, and an S-corp that wishes to sell its QSub and preserve its tax status can only sell it to another S-corp that is willing to purchase 100 percent of its shares and to make the QSub election. *See* I.R.C. § 1361(b)(3)(B) (setting forth the requirements for QSub status). The subsidiary would no longer qualify as a QSub after any other type of sale, and the I.R.C. expressly provides for the loss of QSub status as a result of a sale of the subsidiary's stock. *See id.* § 1361(b)(3)(C)(ii). Thus, a QSub can hardly be said to control the disposition of the alleged property interest in its entity status. Again, a tax classification over which a debtor has no control and that is not alienable or assignable is not a "legal or equitable interest[] of the debtor in property." 11 U.S.C. § 541(a)(1).

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[22] *See supra* note 2. The S-corp parent's contingencies include preservation of its own S-corp election which, as discussed above, is controlled by its shareholders.

We therefore hold that MSC II's QSub status was not "property" and that the Bankruptcy Court's contrary conclusion was error.

2. QSub Status as Property of the Estate

Even if QSub status were property, it would still have to be property "of the estate" for a transfer of that status to be void under Code § 362 or avoidable under § 549. The Code defines "property of the estate" as "all legal or equitable interests *of the debtor* in property as of the commencement of the case."[23] 11 U.S.C. § 541(a)(1) (emphasis added). Notwithstanding "Congress' intention to bring anything of value that the debtors have into the estate," *Prudential Lines*, 928 F.2d at 573 (internal quotation marks omitted), the legislative history of § 541 also demonstrates that it was "not intended to expand debtor's rights against others more than they exist at the commencement of the case." S. Rep. 95-989, at 82 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5868; *see also* 4 Collier on Bankruptcy ¶ 541.06 (15th ed. 1996)) ("Although [§ 541(a)(1)] includes choses in action and claims by the debtor against others, it is not intended to expand the debtor's rights against others beyond what rights existed at the commencement of the case. ... The trustee can assert no greater rights than the debtor himself had on the date the case was commenced.").

As discussed above, whether a tax attribute is property of a corporate entity for purposes of Code § 541 is a function

[23] The terms "property of debtor" and "interests of the debtor in property" are co-extensive for purposes of § 541(a)(1). *Begier v. IRS*, 496 U.S. 53, 59 n.3 (1990).

of the I.R.C. and related regulations. Even if it were proper to think of S-corp status in terms of "ownership," the ownership question would rightly be decided by considering the S-corp's "flow-through" treatment for tax purposes. *See supra* note 4. For example, an NOL may belong to a debtor that is a "C" corporation, such as in *Prudential Lines*, or to an individual debtor, as in *Feiler* and *Russell*, because "when [a] C corporation and/or ... individuals file[] for bankruptcy, the estate created contain[s] all of their assets[,] [and] [i]ncluded therein [are] their tax attributes, including NOLs." *Official Comm. of Unsecured Creditors of Forman Enters., Inc. v. Forman* (*In re Forman Enters., Inc.*), 281 B.R. 600, 612 (Bankr. W.D. Pa. 2002). However, when an S-corp files for bankruptcy, its estate cannot contain any NOLs because "[u]nder the provisions of the [I.R.C.] ... , the NOL and the right to use it automatically passed through by operation of law to [the] ... S corporation shareholders." *Id.* "Any tax benefits resulting from the NOL and the right to use it inure solely to the benefit of ... shareholders and would not be available to satisfy claims of the corporation's creditors." *Id.*

The same can be said of an S-corp's entity tax status itself. The S-corp debtor is merely a "conduit" for tax benefits that flow through to shareholders. The corporation retains no real benefit from its tax-free status in that, while there is no entity-level tax, all of its pre-tax income is passed on to its shareholders. *See* I.R.C. § 1363(a) (providing that an S-corp is a disregarded entity for federal tax purposes and is not taxed on its income); *United States v. Tomko*, 562 F.3d 558, 576 n.14 (3d Cir. 2009) (en banc) (noting that the shareholders of an S-corp receive their individual shares of the corporation's income, deductions, losses, and tax credits).

For its part, a QSub does not even exist for federal tax purposes. If an S-corp makes a valid QSub election with respect to an existing subsidiary, the subsidiary is deemed to have liquidated into the parent under I.R.C. §§ 332 and 337. Treas. Reg. § 1.1361-4(a)(2).[24] As a result, a QSub is generally not treated as a corporation separate from its S-corp parent. *Id.* § 1.1361-4(a)(1).[25] If a subsidiary ceases to qualify as a QSub – because, for example, its corporate parent is no longer an S-corp – the subsidiary is treated as a new corporation acquiring all of its assets (and assuming all of its liabilities) from the parent S-corp immediately before termination, in exchange for stock of the new subsidiary corporation, under I.R.C. § 351. I.R.C. § 1361(b)(3)(C); Treas. Reg. § 1.1361-5(b). Lastly, a QSub that loses its QSub status cannot return to that status for five years, at which time a new QSub election by the parent S-corp is required. I.R.C. § 1361(b)(3)(D); Treas Reg. § 1.1361-5(c)(1). Pertinent

[24] That is what happened in this case; MSC II was incorporated in 2005, and BDI made the QSub election in 2006.

[25] The Debtors argue that a QSub's separate existence "is respected for a number of ... purposes, including various tax purposes as set forth in the U.S. Treasury regulations." (Debtors' Br. in Resp. to Barden Appellants' Opening Br. at 23.) However, the purposes they cite for which a QSub's separate existence is respected (for taxes due on pre-QSub income, employment and excise taxes, and the obligation to file information returns, *see* Treas. Reg. § 1.1361-4(a)(6)-(a)(9)) are the narrow exceptions to the general rule that a QSub has no independent status under the I.R.C., *see id.* § 1.1361-4(a)(1)(i).

regulations thus strongly suggest that a QSub's tax status is not "owned" by the QSub.

If QSub status were property at all, it would be property of the subsidiary's S-corp parent. Because "[t]he desirability of a Subchapter S election depends on the individual tax considerations of each shareholder[,] [t]he final determination of whether there is to be an election should be made by those who would suffer the tax consequences of it." *Kean v. Comm'r*, 469 F.2d 1183, 1187 (9th Cir. 1972). *Trans-Lines West* was correct in that regard. It acknowledged that "[a] corporation's election and revocation of the S corporation status under I.R.C. § 1362 is shareholder driven," and "[a]lthough the corporation is the sole entity that makes the election or revocation under I.R.C. § 1362, both acts are contingent upon various degrees of consent by the corporation's shareholders." 203 B.R. at 660 (citing I.R.C. § 1362(a)(2), (d)(1)(B)).

Moreover, allowing QSub status to be treated as the property of the debtor subsidiary rather than the non-debtor parent, as the Bankruptcy Court did in this case, places remarkable restrictions on the rights of the parent, restrictions that have no foundation in either the I.R.C. or the Code. First, the corporate parent loses not only the statutory right to terminate its subsidiary's QSub election, *see* I.R.C. § 1361(b)(3)(B), (D), but also its right to terminate its own S-corp election, *see id.* § 1361(d). Second, the corporate parent loses the ability to sell the subsidiary's shares to any purchaser other than an S-corp, and would then be required to sell 100 percent of the shares, because any other sale would trigger the loss of the subsidiary's QSub status. *See id.* § 1361(b)(3)(B). Third, the S-corp parent and its

shareholders lose the ability to sell the parent to a C-corporation, partnership, or other non-S-corp entity, to a non-resident alien, or to more than 100 shareholders, because any of those transactions would also trigger the loss of the subsidiary's QSub status. *See id.* § 1361(b)(1)(B), (C), (A). Filing a bankruptcy petition is not supposed to "expand or change a debtor's interest in an asset; it merely changes the party who holds that interest." *In re Saunders*, 969 F.2d 591, 593 (7th Cir. 1992). But under the Bankruptcy Court's holding in this case, a QSub in bankruptcy can stymie legitimate transactions of its parent as unauthorized transfers of property of the estate, even though the QSub would have had no right to interfere with any of those transactions prior to filing for bankruptcy.[26]

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[26] For similar reasons, we question whether the relief that the Bankruptcy Court granted was permissible or appropriate. Code § 550, which authorizes relief for transfers avoided pursuant to § 549, places several limitations on the scope of that relief. First, the trustee may only recover "the property transferred, or, if the court so orders, the value of such property." 11 U.S.C. § 550(a). Therefore, "only net amounts diverted from, that is damages consequently suffered by the creditor body of, a debtor may be recovered" pursuant to § 550. *In re Foxmeyer Corp.*, 296 B.R. 327, 342 (Bankr. D. Del. 2003) (considering a claim under Code § 548). Second, "[t]he trustee is entitled to only a single satisfaction" under § 550. 11 U.S.C. §550(d); *see also HBE Leasing Corp. v. Frank*, 48 F.3d 623, 640 (2d Cir. 1995) (prohibiting an "unjustified double recovery" in an avoidance action); *In re Skywalkers, Inc.*, 49 F.3d 546, 549 (9th Cir. 1995) (applying the "single satisfaction" rule to a debtor's recovery of both a liquor license and the payments made to procure that license).

Third, a debtor may avoid transfers and recover transferred property or its value only if the recovery is "for the benefit of the estate." *In re Messina*, 687 F.3d 74, 82-83 (3d Cir. 2012) (citing 11 U.S.C. §550(a)). A debtor is not entitled to benefit from any avoidance, *id.*, and "courts have limited a debtor's exercise of avoidance powers to circumstances in which such actions would in fact benefit the creditors, not the debtors themselves," *In re Cybergenics Corp.*, 226 F.3d 237, 244 (3d Cir. 2000). Because "the rule is that the estate is dissolved upon confirmation of the plan, ... there is no post-confirmation bankruptcy estate … to be benefitted," and property recovered as a result of an avoidance action after a plan has been confirmed may represent an impermissible benefit to the reorganized debtor. *Harstad v. First Am. Bank*, 39 F.3d 898, 904 (8th Cir. 1994) (citing Code § 1141). For that reason, some courts have required a specific mechanism whereby the prepetition creditors, rather than the reorganized debtor, receive the benefit of a post-confirmation avoidance and recovery of transferred property. *See In re Kroh Bros. Dev. Co.*, 100 B.R. 487, 498 (Bankr. W.D. Mo. 1989) (authorizing relief pursuant to which creditors would receive at least one half of preference recoveries); *In re Jet Fla. Sys., Inc.*, 73 B.R. 552, 556 (Bankr. S.D. Fla. 1987) (authorizing relief pursuant to which creditors would receive 80 percent of the proceeds of preference actions).

The remedy fashioned here by the Bankruptcy Court runs afoul of such limitations. The Bankruptcy Court held that "[t]he revocation of Defendant [BDI's] status as a subchapter 'S' corporation and the termination of MSC II's status as a qualified subchapter 'S' subsidiary are void and of no effect" and ordered that "[t]he Defendants shall take all actions necessary to restore the status of Debtor [MSC II] as a

qualified subchapter 'S' subsidiary of Defendant [BDI]." *Majestic Star Casino*, 466 B.R. at 679-80. However, MSC II had already emerged from bankruptcy and was no longer a wholly-owned subsidiary of BDI. That meant that MSC II "recovered" not only its transferred "property" – its tax-free status that was subject to BDI's claim on 100 percent of its income – but also its ability to retain all of its pre-tax earnings. That represented a double recovery and then some. Likewise, because the relief ordered by the Bankruptcy Court was of indefinite duration, it would continue to benefit MSC II long after its creditors had been compensated and sold their interests, thus impermissibly benefitting MSC II itself as the former debtor.

Relief under § 362 admittedly is not subject to the limitations of § 550 because a transfer that violates the automatic stay is void *ab initio*. *Siciliano*, 13 F.3d at 749. Nevertheless, under § 362, in order to define the relief due as a result of a void transfer, it is still necessary to identify the postpetition transfer that violated the stay. *See* 11 U.S.C. § 362(a)(3). The Bankruptcy Court failed to do that, and simply treated the revocations at both BDI and MSC II as void. But those revocations were themselves irrevocable, *see* I.R.C. §§ 1361(b)(3)(D), 1362(g); Treas. Reg. § 1.1361-5(c)(1), and the Court's treatment of them as simply void raises a question of whether § 362 "could, under the tax laws of the United States, be utilized to undo previously executed acts." *Forman*, 281 B.R. at 612.

Finally, MSC II no longer qualified as a QSub after the Majestic Plan was confirmed both because it was owned by its former creditors rather than being wholly-owned by an S-corp, *see* I.R.C. § 1361(b)(3)(B)(i), and because those creditors had converted it to an LLC, *see id.* § 1361(b)(3)(B)

The Debtors argue that "the manner in which an S-corp or QSub obtains or maintains its status is not determinative" of who holds the property right. (Debtors' Br. in Resp. to Barden Appellants' Opening Br. at 26). They say that "the proper focus is on the fact that, under the Internal Revenue Code, the corporation possesses and enjoys the benefits that result from such status at the time of its chapter 11 petition." (*Id.*) In support of that contention, they cite *In re Atlantic Business & Community Corp.*, 901 F.2d 325 (3d Cir. 1990), for the proposition that "mere possession of property at the time of filing suffices to give an interest in property protected by section 362(a)(3)." (*Id.* at 26-27 (quoting *Atl. Bus. & Cmty. Corp.*, 901 F.2d at 328) (internal quotation marks omitted).)

There are two problems with that argument. First, the holding in *Atlantic Business & Community Corp.* was, by its own terms, limited to possessory interests in real property. *See* 901 F.2d at 328 (holding that "a possessory interest in real property is within the ambit of the estate in bankruptcy under Section 541"); *id.* ("[W]e hold that a debtor's possession of a tenancy at sufferance creates a property interest as defined under Section 541, and is protected by Section 362 ... ."). The case does not support the broad principle that any interest that "benefits" the debtor or that

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(requiring that a QSub be a "domestic corporation"). Therefore, treating the revocation of MSC II's QSub status as void pursuant to Code § 362 left that entity in violation of at least those two I.R.C. provisions. "Humpty Dumpty could not be restructured using this scenario." *Forman*, 281 B.R. at 612.

"the corporation possesses and enjoys" (Debtors' Br. at 26) is necessarily property of the estate rather than property of a non-debtor. *Cf.* 11 U.S.C. § 541(a)(1) (limiting property of the estate to "legal or equitable interests of the debtor"). Second, the QSub's S-corp parent – and the parent's ultimate shareholders – have at least as strong an argument that they possess and enjoy the benefits that result from the subsidiary's QSub status due to the pass-through of income, the pass-through of losses which may be used to shelter other income, and the elimination of entity-level tax at the QSub.

Based on the foregoing, we conclude that, even if MSC II's QSub status were "property," it is not properly seen as property of MSC II's bankruptcy estate, and the contrary conclusion of the Bankruptcy Court cannot stand.[27]

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[27] We also doubt that, even if MSC II's QSub status were property of its bankruptcy estate, the Revocation would constitute a transfer for purposes of Code §§ 549 and 550. The Code defines a "transfer" as, *inter alia*, "each mode, direct or indirect, absolute or unconditional, voluntary or involuntary, of disposing or parting with ... property[] or an interest in property." 11 U.S.C. 101(54)(D) (numbering omitted). "Congress intended this definition to be as broad as possible." *Russell*, 927 F.2d at 418. However, both §§ 549 and 550 presume that a "transfer" requires that there be a "transferee" that receives the property interest conveyed from the debtor. *See* 11 U.S.C. § 549(b) (providing that the trustee has avoidance powers "notwithstanding any notice or knowledge of the case that the transferee has"); *id.* § 550(a)(2) (providing for the recovery of value from "any immediate or mediate transferee of such initial transferee"). There are only two candidates for transferee in this case –

C. *Standing Revisited*

Having determined that a debtor's QSub status is not property of its bankruptcy estate, we return to the question of whether such a debtor has standing to challenge the revocation of that status by its corporate parent. As discussed in Part III.A, *supra*, an S-corp, "standing alone, cannot challenge the validity of a prior Subchapter S revocation without the consent of at least those shareholders who consented to the revocation." *Trans-Lines West*, 203 B.R. at 660. "A trustee [or debtor-in-possession] who attempts to challenge the validity of [such] a revocation without such consent is asserting the rights of a third party," i.e., its shareholders, and "does not have standing ... ." *Id.* By analogy, a debtor QSub that seeks to challenge the revocation of its tax status is asserting the rights of a third party, its S-corp shareholder, and can do so only if it can claim third-party standing. That, in turn, requires that the QSub plaintiff demonstrate both that its S-corp parent "is hindered from asserting its own rights and shares an identity

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Barden and BDI – and neither can be said to have been the "transferee" of MSC II's QSub status or of its "right" not to pay taxes on its income. The Revocation was itself triggered by BDI's revocation of its S-corp status, so that, far from enjoying a transfer of MSC II's tax-free status, BDI itself became a taxpayer. Likewise, Barden did not somehow become an S-corp or a QSub as a result of the revocations at BDI and MSC II. The transfer envisioned by the Bankruptcy Court thus seems very far removed from the definition set forth in 11 U.S.C. § 101(54) and suggested by the concept of a "transferee" as that term is used in §§ 549 and 550.

of interests with the plaintiff." *Pa. Psychiatric Soc'y*, 280 F.3d at 288.

Neither of those conditions exists in this case. Far from being "hindered," BDI and its ultimate shareholder Barden are both parties to this suit and have effectively defended BDI's right to revoke its own S-corp status and, by extension, the QSub status of MSC II. And far from having an "identity of interests," the interests of MSC II and the other Debtors are diametrically opposed to those of Barden and BDI, onto whom they would like to shift substantial on-going tax liabilities. "The extent of potential conflicts of interests between the plaintiff and the third party whose rights are asserted matters a good deal." *Amato v. Wilentz*, 952 F.2d 742, 750 (3d Cir. 1991). "While it may be that standing need not be denied because of a slight, essentially theoretical conflict of interest, ... genuine conflicts strongly counsel against third party standing." *Id.* We therefore hold that the Debtors lacked standing to initiate an adversary proceeding to seek avoidance of the alleged "transfer" of MSC II's QSub status.

IV. CONCLUSION

Sections 362, 549, and 550 of the Code set forth guidelines to determine whether a voidable transfer of estate property has occurred. The Bankruptcy Court's decision, like the S-corp-as-property cases on which it relied, was based in part on the conclusion that "a broad range of property [should] be included in the estate," due to the "Congressional goal of encouraging reorganizations and Congress' choice of methods to protect secured creditors." *Majestic Star Casino*, 466 B.R. at 673. But, as the Supreme Court recently

observed, "nothing in the generalized statutory purpose of protecting secured creditors can overcome the specific manner of that protection which the text [of the Code] contains." *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2073 (2012).

Given that principle, and for the reasons set forth in this opinion, we will vacate the Bankruptcy Court's January 24, 2012 order and remand this matter with directions to dismiss the complaint for lack of jurisdiction.