2d Civil B084276
Superior Court No. BC 055491

IN THE COURT OF APPEAL
STATE OF CALIFORNIA
SECOND APPELLATE DISTRICT
DIVISION SEVEN

ROBERT F. LEWIS and JOSEPHINE N. LEWIS,

Petitioners,

v.

SUPERIOR COURT OF CALIFORNIA FOR THE COUNTY OF LOS ANGELES,

Respondent.

FOLKSAM GENERAL MUTUAL INSURANCE SOCIETY,

Real Party in Interest.

Petition from the Superior Court
of the County of Los Angeles
Honorable Richard C. Neal

REPLY IN SUPPORT OF PETITION FOR WRIT OF MANDATE

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I

INTRODUCTION

Folksam steadfastly refuses to acknowledge that the Legislature has spoken very clearly on the meaning of "good faith" in the fraudulent conveyance statute. *The Return does not even mention* the dispositive statement in the Legislative Committee Comment that "good faith" means acting without "fraudulent intent" or "active participation" in the debtor's fraudulent scheme. Instead, Folksam quotes isolated bits of text from a grab-bag of cases that either pre-date the fraudulent conveyance statute or come from other jurisdictions, some with entirely different statutory schemes. Even so, soon as one studies the facts and the courts' reasoning in those cases, it becomes clear that *they all support the Lewises' interpretation of the good faith defense*.

Equally absent from the Return is any recognition that a fraudulent conveyance action is not just about competing claims to title, but rather seeks to hold the transferee liable *for fraud*. It is not the traditional "no-fault" case where a lis pendens makes a purchaser's title subject to the resolution of a dispute between other parties, such as disputes involving easements or prior purchase agreements. Here, the claim of fraudulent conduct is directed *against the Lewises themselves*. To hold a person liable for such a charge on the basis of the fiction of constructive notice violates the most basic notions of justice and common sense.

Folksam devotes a lot of space to describing the underlying business relationship between itself and Shipley, even though for purposes of their motion the Lewises conceded Shipley's wrongful conduct and focused entirely on their affirmative defense. Folksam apparently hopes that it can tar the Lewises with the brush of Shipley's so-called "scam."

Return, p. 27. The Court should pay no attention to this stratagem. For one thing, if either side is chargeable with a scam, it is Folksam, whose bribed employee began the chain of events that has led Folksam to try to take away the Lewises' home. Equally important, however, is that the bulk of the evidence Folksam cites on this subject (most of which appears in its supplemental appendix) was not cited in Folksam's opposition to the Lewises' motions, is not properly before this court, and is irrelevant to the Lewises' defense.

Whatever wrongs Shipley may have committed, the Lewises had nothing to do with them. The law should be their protector, not their prosecutor.

Fortunately, it is.

II

GOOD FAITH CANNOT BE DEFEATED BY PURELY CONSTRUCTIVE NOTICE.

It is revealing that Folksam has chosen to address this question almost entirely with out-of-state decisions involving different statutory schemes, while *ignoring the express mandate of our own Legislature*. Regardless of what the law may be elsewhere, in California a transferee is in good faith if he or she acts "without fraudulent intent" and does not "collude with the debtor or otherwise actively participate in the fraudulent scheme of the debtor." Legislative Committee Comment, Assembly - 1987 Report. In fact, the Legislative Committee Comment makes it clear that even *actual knowledge* of the debtor's fraudulent intent will not necessarily create liability. Rather, that knowledge "*may*, in combination with other factors, be *relevant* on the issue of the transferee's good faith." *Id.* (emphasis added).

The facts of this case throw the Legislature's intent into sharp relief, because the *only* basis of the trial court's ruling is the purely constructive — that is, fictitious — notice derived from a lis pendens that the Lewises did not know about.

The importance of this point cannot be overstated. We do not quarrel with the general concept that a person who knows about certain facts may, in an appropriate case, be charged with notice of other facts. But we are aware of no decision, and Folksam has not cited one, in which a party has been found to be a fraudulent transferee without *actual, subjective* knowledge of some *specific facts* — we will call them "trigger" facts — that could have led him or her to discover the transferor's fraud.

A. Folksam's Authorities Strongly Support The Rule That A Fraudulent Transferee Must Have Actual Knowledge Of Some Trigger Facts.

Instead of discussing the Legislative Committee Comment, Folksam has cited seven decisions that come mostly from other jurisdictions and trial-level courts. While the cases do contain the language Folksam quotes, they provide no support for Folksam's position. Quite the contrary, the cases show what the Lewises have been saying all along: good faith can only be defeated by evidence of *actual* knowledge. The cases have at least two important features in common:

- None of the cases involves even a claim, much less a holding, that fraudulent conveyance liability can be predicated entirely on the constructive notice provided by a recorded document. In this context, it must be remembered that the claim here is different from a claim that a lis pendens has made someone's property subject, on a no-fault basis, to the outcome of a fraudulent conveyance action against a prior transferee; the withdrawal of Fontana's lis pendens has eliminated that claim. The Lewises' affirmative defense and the trial court's ruling concern Folksam's claim that the Lewises *themselves* were fraudulent transferees.

- None of the cases indicates that a legislature had imparted to the governing statute the kind of express interpretation that exists in California. In fact, contrary to Folksam's statement that these cases interpret a "uniform statute" (Return, p. 42), only two of the seven cases — neither from California — were decided under the Uniform Fraudulent Transfer Act ("UFTA"), which was not promulgated until 1985 and has not been adopted in all states (California adopted it in 1986). 7A *Uniform Laws Annotated*, Uniform Fraudulent Transfer Act (Master ed. 1985, supp. 1994), p. 182 ("ULA").

The cases are so instructive in the support they give to the Lewises' position that we will discuss them in detail, in the order in which they appear in the Return.

***Boness v. Richardson Mineral Springs* (1956) 141 Cal.App.2d 251**

The Court of Appeal *rejected* a fraudulent conveyance claim despite the presence of these facts: (1) the transferor's attorney testified that he told the transferee of his clients' pressing financial obligations and that he attempted to get additional consideration from the transferee to pay these obligations; (2) the transferee admitted that the transferor had told him these things; (3) the transferor's attorney, who was aware of pending actions attempting to set aside the transfer, was present at meetings with the transferee where the transaction was consummated. *Id.* at 259. Even though this evidence showed a far greater likelihood of fraud than anything in the present case, the Court of Appeal refused to hold that the transferee had actual, inquiry or constructive notice of any fraud. *Id.* at 261.

Estate of Cook **(1976) 64 Cal.App.3d 852**

Contrary to Folksam's characterization of this case, it does not pronounce a "should have known" test. In fact, the court *rejected* a fraudulent conveyance claim very similar to the one Folksam makes here, specifically declining to hold that the transferee had a duty to conduct more of an investigation than it did.

Dr. Cook was in arrears in support and alimony. He assigned his interest in his father's estate to a bank as security for a loan, and his ex-wife sought to set aside the assignment as a fraudulent conveyance. The trial court rejected her claim.

On appeal, the ex-wife conceded that "not only must the assignor have fraudulent intent but *the assignee must also participate in or have knowledge of the fraud.*" *Id.* at 862 (emphasis added). Like Folksam here, Cook's ex-wife relied not on any actual knowledge the bank supposedly had, but rather on its claimed failure to investigate:

> "The allegedly suspicious circumstances surrounding the bank's participation in the loan include the fact that the bank makes a concerted effort to help the executive officers of the New York Life Insurance Company, a large bank customer. Dr. Cook is an assistant medical director of New York Life. The only evidence of any investigation by the bank into Dr. Cook's credit appeared to be a search of the Uniform Commercial Code filings in the New York county where he lived.

"Appellant argued that the failure of the bank to investigate more fully into Dr. Cook's financial affairs should result in its being charged with constructive notice of appellant's support judgment against Dr. Cook.

"The probate court rejected appellant's contentions, finding that appellant had failed to show the assignment was fraudulent on the part of either Dr. Cook or the bank or that the bank should have known of any fraud." *Id.* at 863.

The Court of Appeal affirmed, holding that the trial court's conclusion was supported by substantial evidence. *Id.* Aside from the factual differences between *Cook* and the present case, it is clear that in using the phrase "should have known," the *Cook* court had in mind some *actual* knowledge of a trigger fact, because it refused to hold that a transferee without knowledge of trigger facts has an affirmative obligation to investigate. The phrase "should have known" as used in *Cook* is therefore not the equivalent of the fictitious notice in the present case.

In re Agricultural Research & Technology Group, Inc. **(9th Cir. 1990) 916 F.2d 528**

Agretech cultivated and marketed tropical plants. It accepted seeds for cultivation from investors, who guaranteed a certain germination rate and made a cash advance to Agretech for cultivation costs. Agretech agreed to buy seedlings from the investors for a predetermined amount that guaranteed the investors a substantial return on their investment, but greatly exceeded the costs of production and had no apparent connection with the market value of the seedlings. *Id.* at 532. The district court concluded that this was a Ponzi scheme, in which the substantial returns were created with later investors' funds. *Id.* at 531.

Agretech's bankruptcy trustee sought to set aside a payment by Agretech to an investor limited partnership from which Agretech bought seeds, in a context where the payment, though arguably consistent with the parties' agreement, vastly exceeded the value Agretech received. The District Court found for the trustee, and the Ninth Circuit affirmed.

The Ninth Circuit considered and rejected the transferee's good faith defense under Hawaii's version of the UFTA. Although the court nominally refused to apply a purely subjective standard, the opinion's "should have known" test, considered in light of the facts of the case, clearly requires *actual* knowledge of trigger facts. The court's discussion of this issue has to be viewed in context, so we quote at length:

> "These pronouncements [in cases cited by the trustee] indicate that courts look to what the transferee objectively 'knew or should have known' in questions of good faith, rather than examining what the transferee actually knew from a subjective standpoint. Therefore, appellants' reference to the subjective assertions of good faith in the Grant affidavit [general partner of the transferee partnership] are of no moment.
>
> "At least one court has held that *if the circumstances would place a reasonable person on inquiry of a debtor's fraudulent purpose*, and a diligent inquiry would have discovered the fraudulent purpose, then the transfer is fraudulent. [Citation.] Courts have been candid in acknowledging that good faith 'is not

> susceptible of precise definition.' [Citation.] Notwithstanding the lack of a precise definition, the facts of this case reveal that Palm Seedlings-A [the transferee] has not met its burden of establishing good faith." *Id.* at 535-536 (emphasis added).

The facts the court was referring to created a very strong inference that Grant, the transferee's general partner, not only knew about Agretech's Ponzi scheme but was an active participant in it, particularly because in correspondence at the time of the payment, Grant had said that the payment would help it to fill up a new investment partnership:

> "The trustee asserts that Grant received the transfers in bad faith on two grounds: 1) the value received by Grant was grossly in excess of the value Grant exchanged for the transfer; and 2) in its demand for these transfers, Grant affirmatively stated the transfers would induce new investment. The first fact is highly probative of bad faith because *Agretech's willingness to accept virtually no value in exchange for its transfer of significant sums of money should have put Grant on notice of a fraudulent scheme*. A diligent inquiry, as required by such notice, certainly would have led one to conclude that a business venture cannot long remain solvent where the enterprise certainly could not sell ungerminated (worthless) seeds in order to finance the transfer payments.
>
> "Indeed, *Grant's statement regarding new investment, coupled with the disproportionate exchange of value, is a strong*

> *indication that Grant not only knew of the fraud, but was an active participant in it as well.* It is significant that Grant did not phrase its demand for payment in terms of contractual obligations, but rather in terms of new investment opportunities which would accrue to Grant should the transfer be made. One wonders why possible benefits to Grant would provide any incentive to Agretech to effect the transfers unless Agretech also had an interest in inducing new investments as part of the overall Ponzi scheme." *Id.* at 539 (emphasis added).

Regardless of how the Ninth Circuit described the good faith test, *on the facts* its conclusion was consistent with the California Legislature's directive that the transferee must be guilty of "active participation" in the fraud.

United States v. Shepherd (N.D. Tex. 1993) 834 F.Supp. 175, _rev'd on unrelated ground_, (5th Cir. 1994) 1994 WL 258881

This trial court decision does not reveal the factual basis for the court's conclusion that the transferees were not in good faith under the Texas UFTA. However, from the names of the parties it appears that one of the transferees (Dora Harvey) was related to the co-defendant debtor (Clifton Harvey), and the court found that the transfers were for "grossly inadequate consideration." 834 F.Supp. at 181.

Folksam's brief quotation from this case — that a purchaser is not protected if he or she "knows facts which would put a reasonably prudent person on inquiry and if diligence would lead to knowledge of the transferor's fraudulent intent" (*id.* at 181) — is the decision's entire discussion of the subject of good faith. Even if this statement were applied in the present case, it would not support the trial court's conclusion that fictitious notice from a lis pendens is enough to defeat good faith. *Shepherd* contemplates a transferee who "*knows* facts" that put him or her on notice, clearly indicating that there must be *actual* knowledge of trigger facts. Here, there was none.

***Federal Deposit Ins. Corp. v. United States* (N.D.Ga. 1986) 654 F.Supp. 794**

This case was decided under Georgia law, which does not include the UFTA. *See* ULA. The district court devotes several pages to detailed factual findings showing an elaborate creditor-avoidance scheme by a convicted felon, whose financial problems were widely known. The court concluded that the convict's conveyance to his wife as part of a divorce settlement, made on the eve of his escape from prison, was fraudulent. *Id.* at 799-806, 812. The court found ample reason to conclude that both the wife and the trustee of the transferee trust (the convict's cousin (*id.* at 812)) were well aware of the transaction's fraudulent nature.

According to the court, Georgia law requires a strong showing of the transferee's bad faith: the creditor must show the "assignee's *knowledge of debtor's intent*, or the assignee has *reasonable grounds to suspect* that such was his object." *Id.* at 807 (emphasis added). Indeed, a further transfer is subject to an even higher standard, because if the second grantee "has only reasonable grounds for suspicion, but is without notice of the fraud, such does not render the title of the second grantee void." *Id.* at 808.

In the present case, the fictitious notice provided by the lis pendens is not even remotely comparable to the kind of knowledge that the court found the transferee had in *FDIC* *v. U.S.*, and a lis pendens certainly cannot provide the kind of "notice or reasonable grounds for suspicion" contemplated by that decision. *Id.* at 808.

Sparkman and McLean Co. v. Derber **(Wash.App. 1971) 481 P.2d 585**

A creditor sought to set aside a mortgage given to secure the fees of a lawyer who was intimately familiar with the debtor's financial condition because, among other things, he had been hired to help resolve its serious debt problems. *Id.* at 587-588. The case turned on whether there was substantial evidence supporting the trial court's ruling that the lawyer was not in good faith. The Court of Appeals began by describing the general rule under Washington law as it then existed (Washington adopted the UFTA in 1987; *see* ULA):

> ". . . not only must the transferor (BIC) have had the necessary 'actual intent' to defraud creditors to denominate the transaction as fraudulent, but the transferee (appellant) must also have knowledge of such intention. His knowledge need not be actual knowledge, but *he may be charged with such knowledge where he is aware of facts or circumstances* which would put him on inquiry leading to a discovery of such fraudulent intent. *Mere suspicion is not sufficient to charge the transferee with inquiry and knowledge.* [Citation.]" *Id.* at 589 (emphasis added).

The court was confronted with uncertainty in Washington law as to whether lack of good faith was the same as intent to defraud, a relevant question because they were governed by different burdens of proof. *Id.* at 591. The court ultimately determined that they were different, adopting an earlier case's definition of good faith:

> "[In *Tacoma Association of Credit Men v. Lester* (1967) 72 Wash.2d 453, 433 P.2d 901, 904] the court attributes to the good faith concept:
>
> "(1) An honest belief in the propriety of the activities in question; (2) no intent to take unconscionable advantage of others; and (3) no intent to, or knowledge of the fact that the activities in question will, hinder, delay, or defraud others." *Id.* at 591.

Measured against these standards, the lawyer-transferee's claim easily failed. The court recited at length his knowledge of the debtor's financial problems, among other things making this understatement:

> "When Schwitalla himself [the transferee] testified that he knew, before the mortgage, that BIC was in dire straits and that he had been requested under unusual circumstances to draft instruments that were found to be part of a fraudulent scheme to loot the assets of BIC, we think that he failed to carry the burden of demonstrating good faith . . . ." *Id.* at 592.

That the Washington Court of Appeals felt compelled to recite the transferee's knowledge at length demonstrates the kind of evidence it felt would be required to overcome a claim of good faith. The fictitious notice imparted by the lis pendens in the present case would not even come close.

United States v. Orozco-Prada (S.D.N.Y. 1986) 636 F.Supp. 1537, *aff'd* (2d Cir. 1988) 847 F.2d 836

Orozco-Prada was about to receive a criminal sentence when he deeded his house to Ballestas for essentially no consideration. Orozco continued to live in the house. Ballestas obtained a loan that resulted in the recording of two trust deeds, which the United States sought to set aside. The beneficiaries claimed they acted in good faith, relying on title insurance policies that revealed no interest in Orozco or the United States. Following extensive evidentiary hearings (*id.* at 1540) and applying New York law (which does not include the UFTA; *see* ULA), the district court rejected this claim. The court noted the many clear signs that Orozco had an interest in the property — including his continued residence in the house, the existence of mechanics liens against the property in his name, and his extensive involvement in closing the loan. The court said:

> "[The beneficiaries'] steadfast reliance on the title report is misplaced, since they failed to inquire into any of the warning flags raised in either the title report [*i.e.*, the mechanics liens in Orozco's name] or the open possession of the property by Orozco and his family. Schultz and Cooper's ostrich-like behavior will not permit them to prevail in this action." *Id.* at 1545.

While this superficially sounds like the trial court's conclusion in the present case, there is a major difference: in the present case the trial court reached its conclusion entirely on the basis of a lis pendens that the Lewises *knew nothing about*. The court did not mention a single "warning flag" that would have triggered any duty of inquiry by the Lewises. In contrast, if anything the implication of *Orozco-Prada* is that the beneficiaries could have relied on their title policies if there had not been so many other "warning flags."[1]

B. There Is Additional Evidence Within The Statutory Scheme That There Must Be A Showing Of Fraudulent Intent To Defeat Good Faith.

Apart from the Legislature's explicit language on the subject, the architecture of the fraudulent conveyance statute makes it clear the Legislature felt that one cannot become a fraudulent transferee by accident, and that a fraudulent transferee must in some way mirror the culpability of the transferor.

A theme that runs through the statute is the focus on whether a transfer was made for less than reasonably equivalent value. The obvious reasons are that such a transfer in itself suggests an intent to defraud creditors and, in any event, usually harms the creditors.

Under Civil Code section 3439.08(a), a transferee has an absolute defense if he or she proves *both* good faith *and* the payment of reasonably equivalent value. Otherwise, under section 3439.07 the transfer can be set aside or avoided. However, setting aside or avoiding the transfer is not the same as rescission: if it were, the consideration paid by the transferee, regardless of its inadequacy, would automatically be returned. But under section 3439.08(d), *that only happens if the transferee acted in good faith*:

[1] Folksam claimed there were "warning flags" or "badges of fraud" here, too, but the trial court did not base its decision on them. In any event they were trivial compared to those in *Orozco*, and at most they would only indicate the existence of triable issues of fact.

"Notwithstanding voidability of a transfer or an obligation under this chapter, *a good faith transferee or obligee is entitled*, to the extent of value given the debtor for the transferor obligation, to the following:

"1. A lien on or right to retain any interest in the asset transfer.

"2. Enforcement of any obligation incurred.

"3. A reduction in the amount of the liability on the judgment." (Emphasis added.)

The potential consequences to a transferee are enormous. Even a transferee who has paid full value — as the Lewises did here, when they paid $2.3 million for the property — *loses both that payment and the transferred property if he or she cannot show good faith*. Creditors with claims exceeding the value of the property get a windfall if they can also recover from the debtor, since then in effect they get both the property and some or all of what the transferee paid for it. The transferee, however, loses everything. The only possible remedy would be a suit against the transferor, which would simply put the transferee in a race against other creditors who, like Folksam here, may already have a long head start.[2]

Such a draconian result can only be justified if the lack of good faith really means what the Legislature said it means — *knowing participation in a fraud*. Imposing this kind of punishment on a truly guilty wrongdoer is the Legislature's prerogative; it is consistent

[2] The Lewises contend that the creditor's judgment must be reduced by what the creditor can recover directly against the debtor from the proceeds of the conveyance, but Folksam disagrees with that position.

with the view that the law will not aid a wrongdoer. But it is inequitable and contrary to the most basic notions of fair play to visit such a result on someone who is innocent of any fraudulent intent.

Yet that is exactly the result here. Under a strict interpretation of section 3439.08, the Lewises — who paid $2.3 million for the property without having any idea that Folksam or Fontana even existed — may end up losing both the property *and their $2.3 million*. This result is just wrong. In fact, since the Lewises will lose their property without having had any legal notice of the claim against the property, the result is probably unconstitutional. *Cf. Mennonite Board of Missions v. Adams* (1983) 462 U.S. 791, 798-800, 77 L.Ed.2d 180, 103 S.Ct. 2706. The unfairness is crystallized by Folksam's cavalier comment that the Lewises' remedy was to make a motion to expunge the lis pendens before they acquired the property. Return, p. 40. How could they possibly be expected to seek a remedy for a problem they didn't know existed?

The way to avoid this untoward result is simple: interpret the statute as the Legislature required it to be interpreted, so that innocent conduct like the Lewises' — whose claimed liability rests entirely on a legal fiction — will not be penalized.

C. The Requirement Of Subjective Knowledge Is Consistent With The Definitions Of "Good Faith" And "Bad Faith" In Other Contexts.

There is nothing exotic about the Lewises' argument that good faith must be judged by actual knowledge. That standard applies in other areas of the law as well.

The closest analog is the standard for determining whether someone is a holder in due course under the Commercial Code. There, it is clear that good faith can only be defeated by a showing of actual knowledge. The code itself defines "good faith" as "honesty *in fact* in the conduct or transaction concerned." Commercial Code § 1201(19) (emphasis added). Citing *Mann v. Leasko* (1960) 179 Cal.App.2d 692, the California Code Comment to section 3302 states that "the presence of suspicious circumstances sufficient to put a reasonably prudent person on inquiry *does not negative existence of good faith.*" California Code Comment, Commercial Code § 3302 (West 1964). This language is almost a direct quote from *Leasko*, in which the court also said:

> "It has been uniformly held that the requirement of 'good faith,' imposed by the Negotiable Instruments Law, generally means that the transaction was honestly conceived and consummated without collusion, fraud, knowledge of fraud or intent to assist in the perpetration of a fraud." 179 Cal.App.2d at 697.

In a similar vein, imputed knowledge is not enough to require a finding of bad faith in cases under Civil Code section 3306, which allows special damages for the bad-faith refusal to perform an agreement to convey property. For instance, in *Snook v. Netherby*

(1954) 124 Cal.App.2d 797, a frustrated buyer sought to charge an appellant with bad faith because of facts known to the appellant's agent. The court rejected this claim:

> "There is no showing of actual knowledge in appellant upon which to base a judgment sounding in bad faith.
>
> "While breach of contract may be based upon imputed knowledge, it would be a contradiction in terms to base breach in bad faith upon imputed knowledge.
>
> *"The term 'bad faith' necessarily requires actual rather than imputed knowledge."* *Id.* at 801-802 (emphasis added).

Citing a comment to section 275 of the Restatement of Agency (concerning an agent's duty to disclose information to a principal), the court further stated:

> "'In many situations, in order for one to be responsible, it is necessary that the act should be done with knowledge in a subjective sense and it is not sufficient that one has means of information'" This language appears to be controlling here. *Certainly bad faith requires subjective knowledge.* None is here shown." *Id.* at 802 (emphasis added).

See also Estate of Fiddyment (1946) 74 Cal.App.2d 72, 76-77 (intention can only be judged by actual knowledge, not constructive knowledge).

The Supreme Court stated a similar rule in yet another context in *Harte v. United Benefit Life Insurance Co.* (1967) 66 Cal.2d 148. Harte received a life insurance policy at a time when his wife knew, but he did not, that he was dying of cancer. The trial court granted a nonsuit in the wife's action to enforce the policy, ruling that her knowledge of her husband's condition was imputed to him and that his imputed knowledge violated the good-health requirement of the policy. The Supreme Court reversed, stating:

> "The fact that plaintiff was her husband's agent for the purpose of accepting the policy and that she knew he was suffering from cancer doest not alter this conclusion. The uncommunicated knowledge of an agent is not imputed to the principal for the purpose of determining whether he acted in good faith since *the principal's good faith must be determined on the basis of facts of which he had actual knowledge.*" *Id.* at 152-153 (emphasis added) (citing among other cases *Snook* and *Fiddyment*, both *supra*).

III

FOLKSAM HAS FAILED TO SHOW EITHER THAT LINCOLN TITLE WAS THE LEWISES' AGENT OR THAT ITS KNOWLEDGE WAS IMPUTED TO THE LEWISES.

Folksam cites no evidence or authority to support its argument that Lincoln Title was the Lewises' agent, because there is none. But even if there were some kind of agency relationship, it does not follow that there would be any imputation of knowledge of which Folksam could take advantage.

Imputation of an agent's knowledge has a limited reach: it protects persons who have dealt with the principal through the agent, not those who are strangers to a transaction.

As the Supreme Court observed in *Hale v. Depaoli* (1948) 33 Cal.2d 228, in which a personal injury plaintiff sought to charge a property owner with a duty to disclose a property defect because his partner knew about it:

> "The doctrine of imputed notice does not justify such compounding and extension of the rule [concerning duty of disclosure]. Imputation of knowledge is based upon the necessities of general commercial relationships, and where a principal acts through an agent, a third person dealing with such agent is entitled to rely upon his knowledge and notice and it binds the principal. . . . *But the rule has never been applied to protect one who has had no dealings with the principal through an agent or otherwise.*" *Id.* at 232 (emphasis added).

See also Lucas v. Pollock (1992) 7 Cal.App. 4th 668, 674-675 (in suit by plaintiff injured on defendant's land, broker's knowledge of dangerous conditions of which defendant was not aware was not imputed to defendant); *Redman v. Walters* (1979) 88 Cal.App.3d 448, 454 (knowledge of law partners that firm had dissolved not imputed to client).

Agency does not exist in the abstract or in a vacuum. As we pointed out in the Petition (pp. 41-42), an agent represents a principal in dealings with third parties. Lincoln Title did not deal with any third parties *on the Lewises' behalf*, and it did not deal with Fontana or Folksam at all. The connection between agent and third party that the Supreme Court required in *Depaoli* is simply absent here, so there is no basis for the imputation of whatever knowledge Lincoln Title may have had.

IV

FOLKSAM HAS FAILED TO ESTABLISH THAT FONTANA'S FEDERAL ACTION ASSERTED A "REAL PROPERTY CLAIM."

Folksam has not offered any new decisional law or analysis that detracts from the Petition's demonstration that Fontana's federal action did not support a lis pendens.

Folksam repeats its trial court argument that Fontana's complaint asserted a "real property claim" because it was based on the alleged diversion of trust funds. Return, p. 38. But Fontana never alleged that Shipley was supposed to buy property with the money he was handling, and it never asserted that it was interested in recovering the Via Elevado property because of anything unique to that property. Under the allegations of Fontana's complaint (and Folksam's, for that matter), all that happened was that Shipley stole money — a fungible commodity — and bought property with it. The fact that Shipley held the money in trust is a *non sequitur*: theft is theft. It is exactly what the plaintiff alleged in *La Paglia v. Superior Court* (1989) 215 Cal.App.3d 1322, where the court held that a lis pendens was improper.

The legislative change in the lis pendens statute carried with it no suggestion that parties are free to obtain the equivalent of an ex parte attachment without notice. But that is what a lis pendens is, even if the new statute makes it easier to get the lis pendens removed. A lis pendens should remain, as it historically has been, a remedy unique to disputes that are truly centered on real property issues — such as disputes over competing chains of title, the existence of easements, breaches of purchase agreements, and the like. That is not this case, and without such a claim the lis pendens was a nullity.

V

THE SUMMARY JUDGMENT MOTION IS NOT MOOT.

Folksam never before claimed that the Lewises' summary judgment motion was moot — not when it was notified of the Fontana-Lewis settlement shortly after the hearing on the summary judgment motion [VI/41], not in its opposition to the motion for reconsideration [VI/47], and not in its preliminary opposition to this Petition.

The Lewises made it clear in their supplemental memorandum that they were seeking an adjudication of all fraudulent conveyance claims that *had been or could be* asserted against them by *both Fontana and Folksam*, because it was abundantly clear that Folksam was going to assert those claims. [III/33 at 694-695, 715-721.] Far from objecting to this characterization, Folksam briefed the Lewises' affirmative defense in detail, exactly as though it had already asserted a fraudulent conveyance claim — as indeed it was about to do in the proposed Third Amended Complaint it filed with its motion to amend only a few days later. [I/8, 9; IV/35 at 981-992.][3]

The pendency of Folksam's current summary adjudication motion (rescheduled to July 1) is another *non sequitur*. Whether now or in a later appeal, the issues raised in the Petition will have to be decided, and that fact alone justifies the Court in hearing this matter.

[3] The statement in the Lewises' reply that the proposed Third Amended Complaint did not allege a fraudulent conveyance [V/38 at 1133 n. 1] was in error, occasioned by the fact that the Lewises had only a very brief opportunity to review the complex document — which among other things did not name them in the caption and gave them different "Doe" numbers for different causes of action. [*See* I/9.]

Marriage of Abernathy (1992) 5 Cal.App.4th 1193, 1197. The issues have been briefed as fully as they are ever likely to be briefed — indeed, this is already the third round of briefing on the Lewises' affirmative defense. The matter is ripe for decision, and a prompt decision will further the speedy resolution of the case regardless of what happens on Folksam's motion.

In any event, this Court has discretion to consider this matter even if it is technically moot. The Petition raises issues of substantial public importance that should be addressed regardless of the procedural posture of the case in the trial court. *See Motown Record Corp. v. Brockert* (1984) 160 Cal.App.3d 123, 128-129.

VI

FOLKSAM'S OTHER MISCELLANEOUS POINTS ARE ERRONEOUS OR IRRELEVANT.

A. Folksam Continues To Ignore The Effect Of *Hochstein v. Romero*.

The impact of indexing on the effect of the lis pendens is fully briefed in the Petition, which also anticipates and refutes Folksam's argument that there is a difference between an un-indexed document and one that is improperly indexed.

Folksam's subsidiary argument is that even though a document is indexed some time after it is recorded, it still gives constructive notice from the date of recordation. Aside from the fact that this interpretation is directly contrary to *Hochstein*, it makes no sense. Since the rationale of *Hochstein* is that no one can get notice until a document is properly indexed, making the indexing retroactive to the date of recordation would create exactly the result that

Hochstein was trying to avoid: charging people with notice during a period in which it was not possible to get notice.

While it is true that the *Hochstein* line of cases could theoretically give rise to Folksam's multiple-deed hypothetical, that problem is easily avoided by recognizing that a deed and a lis pendens are completely different animals that do not have to be treated the same way. The purpose of a deed is to convey an interest in property to someone else. The conveyance is effective on delivery; no recording is necessary. Civ. Code § 1054; 4 Witkin, *Summary of California Law* (9th ed. 1987), Real Property §§ 140, 170, pp. 354, 379-80. The purpose of a lis pendens — its one and only purpose — is to give notice of a claim. It has no legal effect without recording. *Hochstein's* entire rationale compels the conclusion that one cannot be charged with notice of lis pendens until it has been indexed, because until then it cannot give the notice that is its *raison d'être*.

B. Folksam Has Not Acquired Whatever Claims Fontana May Have Had Against The Lewises.

Apparently recognizing the frailty of its reliance on a lis pendens that someone else recorded, Folksam seeks to put itself in Fontana's shoes by virtue of repaying the Swedish bank loans to Fontana that Folksam guaranteed. *See* Return, pp. 7, 17 and 34 n. 15. Even if Folksam had raised this claim in the trial court (it never did), the argument is dead wrong.

Civil Code section 2848 defines subrogation as follows:

> "A surety, upon satisfying the obligation of the principal, is entitled to enforce every remedy *which the creditor then has*

> *against the principal* to the extent of reimbursing what he has expended . . . ." (Emphasis added.)

In this case, the "creditors" are the Swedish banks, the "surety" is Folksam, and the "principal" is Fontana. If Folksam really is a subrogee, it has acquired the *banks'* rights against *Fontana*, not Fontana's rights against other parties. In other words, as far as this claim is concerned, Folksam has simply entered into an ordinary creditor-debtor relationship with Fontana. Like any other creditor, Folksam can acquire Fontana's assets only by attachment or by execution on a judgment. It has done neither (although it has twice sought and failed to obtain an attachment, both times after the settlement between Fontana and the Lewises).

C. Folksam's References To Title Insurance Are Wholly Improper.

In several places, Fontana mentions the fact that the Lewises have title insurance, apparently in an effort to suggest to the Court that the existence of insurance somehow makes a difference in the parties' rights. *See* Return, pp. 2, 15-16. If that is the purpose, the references are completely improper; indeed, making such a statement in front of a jury would invite an instant mistrial. *See* 1 Witkin, *California Evidence* (3d ed. 1986) § 417, p. 391. Significantly, Folksam has no trouble shifting gears when trying to reject one of the Lewises' arguments: it states that "[t]he exposure of the Lewises and the Property to Folksam's superior claims, just like the exposure of a driver to an accident claim, is the same whether there is insurance or not." Return, p. 41, n. 25.

The presence or absence of insurance is just as irrelevant in this case as it would be in any accident case. It is the Lewises' property that Folksam is trying to take, and, as

Folksam admits, the only way to save the property is for the Lewises to post a bond that is double the face amount of their title insurance policy — in other words, to place at risk yet another $2.3 million. Return, p. 21. But even if that were not the case, the fact that an insurance company is involved does not transform an unjust ruling into a just one.

VII

CONCLUSION

The sometimes technical arguments in this case should not distract the Court from the Lewises' predicament. They have devoted their fortune to their home, spending $2.3 million to buy it and even more to renovate it, all without any reason to believe that there was any competing claim to the property.

Although Folksam has apparently lost a lot of money, that happened because of the fraudulent activities of one of its own employees. Folksam and the Lewises are not at odds because of anything the Lewises did, but because of a fraud by Folksam's employee coupled with an alleged conversion by Shipley. For the Lewises to be penalized by the draconian remedies of the fraudulent conveyance statute would be an extraordinary injustice that this Court should not tolerate.

DATED: June 30, 1994

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