2d Civil _____
Superior Court No. BC 055491

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

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

PETITION FOR WRIT OF MANDATE, PROHIBITION AND/OR OTHER EXTRAORDINARY RELIEF

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INTRODUCTION

There were at least two well-settled legal principles that required the trial court to grant summary judgment for Petitioners Robert and Josephine Lewis, as well as several additional first-impression questions that the trial court should have answered in the Lewises' favor. Ruling against the Lewises on everything, the trial court disregarded basic components of real property law that the real estate community relies on literally every day.

The broad question is whether one can be a fraudulent transferee in a fraudulent conveyance when he or she pays full value for property and has, *at most*, only constructive knowledge of claims against the seller. The trial court did not identify any triable factual issues; its ruling turned entirely on legal questions applied to undisputed facts. This case is therefore uniquely suited for review by writ.

Folksam Mutual General Insurance Company, the plaintiff and Real Party in Interest, claims that when the Lewises paid $2,300,000 to buy their Palos Verdes home, they were buying from a seller who acquired the home with misappropriated funds and that the sale to the Lewises was a fraudulent conveyance. In their summary judgment motion, the Lewises showed by undisputed evidence that they paid a fair price and that, in the trial court's words, they had "no actual knowledge of [the Seller's] misdeeds." [VI/43 at 1295.][1] The Lewises

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[1] All exhibits appear in the accompanying Appendix, which is sequentially paginated. They are accurate copies of documents filed with the trial court and are incorporated in this Petition by reference. Exhibits are usually cited by volume, exhibit number and sequential page and line numbers: "[VI/43 at 1295]" refers to Volume VI, Exhibit 43, page 1295.

For convenient reference, the basic pleadings — complaints, cross-complaint and relevant answers — are all contained in the first volume, and the papers on the original motion for summary judgment and motion to expunge lis pendens are grouped separately.

therefore established a complete defense to the fraudulent conveyance claim under Civil Code section 3439.08(a), which protects good-faith purchasers — meaning purchasers who, like the Lewises, had no fraudulent intent.

However, the trial court found that a lis pendens recorded after the Lewises signed their purchase contract and only a few days before their deed was recorded — even though it had not yet been indexed at the County Recorder's office, was not disclosed in the Lewises' preliminary report or title policy, was unknown to the Lewises, and has since been withdrawn — was enough to transform the Lewises into fraudulent transferees. It further ruled that they must post a $4,600,000 bond, which is double the amount of their title insurance policy, to free their property from Folksam's claims.

Some of the trial court's conclusions reflect misunderstandings that may well be shared in the legal and judicial communities generally, and they should be corrected. Other conclusions, although reached on first-impression questions of statutory interpretation, are contrary to the clear purpose of the statutes. This Petition addresses the following questions:

- ***Question of first impression:*** Whether constructive notice of a claim makes a buyer a fraudulent transferee, even though the Legislature has provided that the good-faith defense to a fraudulent conveyance claim is evaluated by a subjective standard, in that "'good faith' means that the transferee acted *without fraudulent intent* and that he or she *did not collude* with the debtor or otherwise *actively participate in the fraudulent scheme* of the debtor." Legislative Committee Comment, Assembly — 1987 Report, reprinted at Civ. Code § 3439.08 (West Supp. 1994) at 162 (emphasis added).

- ***Question of first impression:*** Whether the 1992 revisions to the lis pendens statute allowed the trial court to disregard settled, unequivocal authority in this and other Districts to the effect that a constructive trust claim — which is the only possible basis for the lis pendens in this case — does not support the recording of a lis pendens. *E.g.*, *Urez Corp. v. Superior Court* (1987) 190 Cal.App.3d 1141, 1149; *La Paglia v. Superior Court* (1989) 215 Cal.App.3d 1322, 1327.

- ***Question of first impression:*** Whether, despite the fact that the withdrawal of a lis pendens is supposed to provide for "the absolute and complete free transferability of real property" (Code Civ. Proc. § 405.61), a withdrawn lis pendens can support a fraudulent conveyance claim that arose before the withdrawal.

- Whether the trial court properly rejected the settled rule that a recorded document does not impart constructive notice until it is properly indexed. *E.g.*, *Hochstein v. Romero* (1990) 219 Cal.App.3d 447, 452.

- Whether the trial court properly rejected the settled rule that a title insurer is not its insured's agent and its knowledge is not imputed to the insured. *E.g.*, *Rice v. Taylor* (1934) 220 Cal. 629, 636; *Mayhew v. Melby* (1929) 206 Cal. 396, 400.

The trial court's resolution of these issues against the Lewises tears at the very fabric of California real property law, creating significant risks for innocent buyers as well as a potentially tragic loss for the Lewises personally. This Court should direct the trial court to vacate its order and to enter summary judgment for the Lewises.

PETITION

Petitioners Robert F. Lewis and Josephine N. Lewis ("Lewises") allege:

Timeliness of Petition

1. This Petition seeks review of an order denying summary judgment filed and served by the trial court on April 25, 1994. On May 16, 1994, pursuant to Code of Civil Procedure section 437c(l), the trial court extended by ten days the Lewises' time within which to seek review by this Court. [VI/49.] The Lewises' deadline for filing this Petition is therefore May 31, 1994, and this Petition is timely.

Parties

2. The Lewises are defendants in an action pending in the Los Angeles County Superior Court entitled *Folksam General Mutual Insurance Society, etc. v. Fontana Films of Sweden Aktiebolag, etc., et al. ("Folksam v. Fontana")*, Case No. BC055491. They were formerly cross-defendants in a cross-complaint filed by Fontana Films Sweden AB and others (collectively "Fontana"), but that cross-complaint was dismissed against the Lewises as part of a settlement that followed the summary judgment proceedings described below.

3. Robert F. Lewis is a lawyer and one of the founding members of Lewis, D'Amato, Brisbois & Bisgaard. He has lived in Palos Verdes, where the property described in this Petition is located, for over 20 years. [IV/34 at 744-745.] The Lewises became involved in this litigation through the purchase of their home at 2728 Via Elevado, Palos Verdes ("Property").

4. Respondent Los Angeles County Superior Court is the court exercising judicial functions with respect to *Folksam v. Fontana*.

5. Real Party in Interest Folksam General Mutual Insurance Society ("Folksam") is the plaintiff in *Folksam v. Fontana*.

General Background

6. On February 1, 1992, the Lewises entered into a contract to buy the Property. [IV/34 at 777-784.] They opened escrow on or about February 4 [II/12 at 282 ¶ 5], and acquired title on February 28 [II/12 at 283 ¶ 7, 300].

7. On February 21, 1992, Fontana filed an action against Randolph Shipley and others in the United States District Court for the Central District of California, Case No. 92-1139-AAH ("federal action"). [I/1.] On February 24, Fontana recorded a "Notice of Pendency of Action" describing the Property ("federal lis pendens"). [I/2.] The federal action was later stayed.

8. The federal action concerns an allegedly fraudulent enterprise involving Shipley and others that Fontana claims resulted in the theft of tens of millions of dollars that Fontana borrowed from various Swedish banks. Among other things, the complaint alleges that some of the funds were delivered to Yuk Lee Ltd., a Hong Kong corporation controlled by Shipley, and that Yuk Lee used those funds to acquire the Property. [I/1 at 29-33.] The Lewises were never named as defendants in this action.

9. On May 18, 1992, Folksam, a Swedish insurance company, filed its complaint in *Folksam v. Fontana*. [I/3.] In general, this pleading alleges the same scheme described in the federal action, but it names Fontana as a defendant and alleges that Folksam guaranteed the Swedish bank loans to Fontana. Folksam further alleges that Fontana defrauded it. On May 29, 1992, Folksam recorded a "Notice of Action Pending." [I/4.] The operative

pleadings in effect during the Lewises' involvement in the case are Folksam's Second Amended Complaint, filed September 16, 1993 [I/7] and its Third Amended Complaint, filed March 14, 1994 [I/9]. The Lewises were not named in any of these pleadings until the Third Amended Complaint.

10. In its Third Amended Complaint, Folksam admitted that its involvement in the alleged scheme came about through the fraudulent activities of one of its own officers, the head of its bond and credit department, who was convicted in December 1993 of taking bribes from a Fontana employee. [I/9 at 210:10-17.]

11. On October 26, 1992, Fontana filed a cross-complaint in *Folksam v. Fontana*, naming the Lewises as cross-defendants. [I/5.] This pleading is substantially the same as Fontana's complaint in the federal action. Fontana did not serve the Lewises until nearly a year later. The Lewises filed their answer on November 8, 1993. [I/6.]

12. As of November 1993 the status of this litigation was as follows:

a. The federal action was still on file and the federal lis pendens was still of record, although the federal action had been stayed.

b. Folksam's Second Amended Complaint was the operative pleading in *Folksam v. Fontana*. It did not name the Lewises as defendants, and the Lewises were never served as Does. Folksam's lis pendens was still of record.

c. Fontana and the Lewises were at issue with respect to Fontana's cross-complaint in *Folksam v. Fontana*.

The Lewises' Motions

13. On November 12, 1993, the Lewises filed a motion for summary judgment as to Fontana's cross-complaint and a motion to expunge Folksam's lis pendens. [II/11.] The papers filed by the various parties with respect to the summary judgment motion appear in the Appendix as Exhibits II/11-23; the papers filed with respect to the motion to expunge lis pendens appear in the Appendix as Exhibits III/24-27.

14. In their summary judgment motion, the Lewises argued that they purchased the Property in good faith and that the recording of the federal lis pendens did not defeat their status as good-faith purchasers. In their motion to expunge Folksam's lis pendens, the Lewises argued that Folksam's complaint did not state a claim affecting title to real property, but rather only the kind of constructive trust claims that virtually every court has held do not support the recording of a lis pendens.

15. Among the subjects of debate in the parties' papers was whether Folksam's or Fontana's pleadings asserted fraudulent conveyance claims with respect to the Property. [*E.g.*, II/11 at 271-274, II/16 at 394-402, III/24 at 529-534, III/25 at 551-554.] The Lewises argued that despite their being named in Fontana's cross-complaint, there was no claim that the Property was fraudulently conveyed to them or anyone else. [II/19 at 468-69.] As to Folksam, the Lewises themselves were not named as defendants; Folksam's counsel acknowledged that Folksam would have to add the Lewises as parties in order to plead an appropriate fraudulent conveyance claim. [III/28 at 633:17-24.]

16. Following a lengthy hearing on December 16, 1993 [III/28], on December 20 the trial court issued an order deferring rulings on the motions pending further

discovery and briefing by the parties [III/29, 30]. The court recognized that Folksam and Fontana's fraudulent conveyance allegations "are insufficient as they stand" to support a lis pendens, but it invited amendments to the pleadings. [III/30 at 672.] Fontana never amended its cross-complaint. Folksam did not file its motion to amend until February 23, 1994 [I/8]; the Third Amended Complaint was not actually served until March 16 [I/9].

17. During January and February 1994, the parties undertook extensive discovery, deposing virtually every person involved in any way in the sale of the Property to the Lewises. They then filed supplemental memoranda and declarations. [III/32-33, IV/34].

18. At this juncture, although the Lewises' summary judgment motion was still nominally directed only at Fontana, it had become clear that identical issues would be raised when Folksam ultimately amended its complaint. Accordingly, the parties' memoranda all treated the motions as though both Folksam and Fontana had alleged that the sale of the Property to the Lewises was itself a fraudulent conveyance. [*E.g.*, III/33 at 694-695, 715-721 (Lewis); IV/35 at 981-992 (Folksam); V/37 at 1113-1121 (Fontana).]

19. In their supplemental papers, the Lewises detailed the results of the discovery the parties had undertaken. In substance, this discovery showed that neither the Lewises nor anyone else involved in the transaction knew anything about Shipley or his dispute with Folksam and Fontana. The Lewises further showed, through the testimony of Shipley's own broker as well as a real estate appraiser, that the $2,300,000 million they paid for the Property was a fair price.

20. There was some specific evidence regarding the federal lis pendens:

a. Although the lis pendens was recorded on February 24, 1992, it was not indexed in the County Recorder's office until February 29. [IV/34 at 944-948.]

b. Although the lis pendens was disclosed on a report obtained by the Lewises' title insurer from an unofficial source, it was misposted so that the title searcher did not recognize it. [V/36 at 1022, 1024, 1033; V/39 at 1223-1229.]

c. The existence of the lis pendens was not disclosed to the Lewises on either of the two title insurance policies they obtained in connection with their purchase of the Property. [IV/34 at 750 ¶¶ 17-18, 786-794, 804-821, 826-840.]

21. The court heard further argument on March 3, 1994 and took the matter under submission. [VI/40.]

The Lewis-Fontana Settlement

22. Following the hearing, at a settlement conference before another judge, the Lewises settled with Fontana. As part of the settlement, Fontana withdrew the federal lis pendens and dismissed its cross-complaint as against the Lewises. The Lewises filed a "Notice of Settlement of Claims," which contained copies of the Withdrawal of the Lis Pendens and the Request for Dismissal of the cross-complaint. [VI/41.]

The Trial Court's Ruling

23. On April 25, 1994, the trial court issued its order denying the Lewises' motions. [VI/42-43.] That order is the subject of this petition. In general, the order concluded that the federal lis pendens was proper — that is, that the federal action stated a claim that permitted the recording of a lis pendens — and that that lis pendens gave the Lewises constructive notice of the federal action and therefore supported a fraudulent

conveyance action. The court did not find any triable issues of fact; rather, it reached its conclusions as matters of law. Accordingly, there is no order describing triable issues under Code of Civil Procedure section 437c(g).

24. The trial court based its denial of summary judgment on legal conclusions that are contrary to law in the following respects, among others:

a. In holding that the Lewises' status as good-faith purchasers could be defeated by constructive or imputed knowledge, the court refused to follow the requirements of the fraudulent conveyance statute, under which "'good faith' means that the transferee acted without fraudulent intent and that he or she did not collude with the debtor or otherwise actively participate in the fraudulent scheme of the debtor." Legislative Committee Comment, Assembly — 1987 Report, *supra*. [VI/43 at 1302-1303.]

b. The federal action at most states only a claim for the imposition of a constructive trust based on the misappropriation of funds. Under *Urez Corp. v. Superior Court*, *supra*, 190 Cal.App.3d 1141 and *La Paglia v. Superior Court*, *supra*, 215 Cal.App.3d 1322, among other decisions, these claims do not support the recording of a lis pendens. The court refused to follow these controlling authorities. [VI/43 at 1297-1299.]

c. The court ruled that the federal lis pendens gave constructive notice as of the date it was recorded rather than as of the date on which it was indexed, directly contrary to *Hochstein v. Romero* (1990) 219 Cal.App.3d 447, 452 and other controlling authority. [VI/43 at 1303-1304.]

d. The court ruled that the Lewises were charged with knowledge of the lis pendens because of the supposed knowledge of their title insurer, which the trial court

said had been "retained as Lewises [sic] agent to search title." [VI/43 at 1304.] In so ruling, the trial court refused to follow dispositive Supreme Court authority that a title insurer is not the insured's agent and that the insurer's knowledge is not imputed to the insured. *Rice v. Taylor* (1934) 220 Cal. 629, 636; *Mayhew v. Melby* (1929) 206 Cal. 396, 400.

25. The trial court based this last ruling on a factual finding that the Lewises' title insurer was their agent. There was no evidence to support that finding. [VI/43 at 1304.]

26. If the trial court had ruled in the Lewises' favor on any of the matters described in the preceding paragraphs, as it was required to do, it would have reached the correct conclusion that the Lewises were good-faith purchasers and that their title was not affected in any way by the federal lis pendens.

27. Because of its decision that the Lewises were not good-faith purchasers, the trial court failed to reach the question of whether they paid reasonably equivalent value for the property. There was no triable issue of fact on this subject; all of the evidence confirmed that $2,300,000 was the property's reasonably equivalent value. The court acknowledged as much at the March 3 hearing. [VI/40 at 1269-1270.]

28. For the foregoing reasons, the court was under a mandatory duty to grant summary judgment in favor of the Lewises and to expunge Folksam's lis pendens, and it was an abuse of discretion for the court to deny the Lewises' motions.

The Reconsideration Motion

29. On May 9, 1994, the Lewises filed a motion for reconsideration, based among other things on the withdrawal of the federal lis pendens pursuant to their settlement

with Fontana. [VI/44.] Folksam opposed that motion, and the Lewises filed a reply. [VI/47-48, 50.] On May 20, 1994, the court denied reconsideration. [VI/52.]

30. The trial court had a duty to grant reconsideration and, on reconsideration, to grant summary judgment because, as a matter of law, the withdrawal of the lis pendens eliminated its effect for all purposes, including the constructive knowledge that was the sole basis of the court's denial of summary judgment. Code Civ. Proc. §§ 405.60, 405.61.

31. The Lewises face irreparable harm in that title to the Property remains clouded by Folksam's lis pendens and the trial court has required the Lewises to post a bond of $4,600,000 in order to clear title. [VI/43 at 1305.] That amount is double the face amount of the Lewises' title insurance policy. [IV/134 at 830.]

32. The Lewises face further irreparable harm in being forced to remain in this complex litigation, almost all of which concerns persons and transactions that have nothing to do with them. The trial court has scheduled the case for a 20-day jury trial on March 29, 1995. There are nearly 40 parties named in Folksam's Third Amended Complaint, and there are at least a dozen participating law firms or parties in pro per. Without relief from this Court, the Lewises will have to incur extraordinary litigation expenses, even though most of the case does not concern them and even though, in the end, they will be entitled to judgment as a matter of law.

PETITIONERS ACCORDINGLY PRAY:

1. That this Court issue a peremptory writ of mandate commanding the trial court to vacate its order denying the Lewises' motions for summary judgment and for expungement of lis pendens and to enter a new order granting those motions.

2. In the alternative, that this Court issue an alternative writ commanding the trial court to show cause why the relief described in Paragraph 1 should not be granted and, on return of the alternative writ, issue the peremptory writ requested in Paragraph 1.

3. For such other relief as may be proper.

DATED: May 26, 1994

Respectfully submitted,

LOEB AND LOEB
ROBIN MEADOW
MEGAN SCOTT-KAKURES

By _____
Robin Meadow
Attorneys for Petitioner
Robert F. Lewis and
Josephine N. Lewis

VERIFICATION

ROBIN MEADOW declares:

I am licensed to practice law in California. My professional corporation is a member of Loeb and Loeb, counsel for the Petitioners. I am the lawyer principally responsible for representing the Petitioners in this proceeding.

I am making this verification instead of the Petitioners because I am more familiar than they are with the facts described in the foregoing PETITION FOR WRIT OF MANDATE, PROHIBITION AND/OR OTHER EXTRAORDINARY RELIEF. The Petition concerns trial proceedings in which I have been personally involved. The statements in the Petition are true of my own knowledge.

I declare under penalty of perjury that the foregoing is true and correct and that this verification is executed on May 26, 1994, at Los Angeles, California.

ROBIN MEADOW

MEMORANDUM OF POINTS AND AUTHORITIES

INTRODUCTION

Josephine Lewis was happy and excited when she called her husband to tell him that an historic Palos Verdes home they had always liked was up for sale.

She couldn't have suspected that two years later, after they had spent $2,300,000 to buy the home and another $2,600,000 to renovate it, a judge would take it all away from them. She would never have dreamed that the judge would do so by finding that the Lewises were fraudulent transferees at the tail end of an international conspiracy involving dozens of people and companies the Lewises never knew anything about — and in which the Lewises' principal adversary, and the party that now seeks to take their property, was itself enmeshed through the bribe-taking activities of one of its employees. Certainly even in her worst nightmare Mrs. Lewis could not have imagined that the judge would reach this result by disregarding nearly 150 years of settled real property law, and that to top off his ruling he would require the Lewises to post a $4,600,000 bond in order to free their property from the cloud on title — double the face amount of their title insurance policy.

What the Lewises thought would be their dream home has become this nightmare for reasons they never suspected and could not control. None of those reasons is even remotely supported by the law or the facts. Nevertheless, the Lewises now face extended litigation and a multi-million-dollar claim against their house unless this Court intervenes.

If there is anything fortunate for the Lewises, it is that the facts have been fully developed and the trial court's ruling is based entirely on legal conclusions applied to undisputed facts. The ruling is therefore ideally positioned for review by this Court.

STATEMENT OF FACTS

Despite the complexity of the frauds that Randolph Shipley and Folksam's own employee allegedly perpetrated, the Lewises' summary judgment motion turned on a simple set of facts that concerned only their defense to Fontana and Folksam's claims. They assumed for purposes of their motion that before he sold the Property to the Lewises, (1) Shipley wrongfully obtained money from Folksam and/or Fontana; (2) he transferred the money to various bank accounts, trusts and business entities that he controlled and (3) through Yuk Lee, he purchased the Property with some of the money. [III/33 at 693:1-7.] The evidence before the trial court therefore concerned only the Shipley-Lewis transaction.

A. Background of the sale

Shipley bought the Property in November 1990 for $3,200,000. About a year later, he contacted a broker, Al Scafati, hoping to sell the Property for $2,950,000. [IV/34 at 893-894.] However, Scafati believed that the property would only bring somewhere around $2,500,000 to $2,700,000 [IV/34 at 894 ¶ 9], and after seeing the condition of the property, he lowered his estimate [IV/34 at 896 ¶ 11]. Scafati found a buyer at $2,500,000, and escrow

was opened at that price. However, Shipley and the buyer never reached agreement on financing. [IV/34 at 897¶ 18.]

B. The Lewises enter the picture

The Lewises had lived in Palos Verdes for many years. They were casual house-hunters — not particularly anxious to move, but willing to consider opportunities. [IV/34 at 745 ¶ 4.] Chris Adlam, like Scafati a RE/MAX realtor, called Mrs. Lewis in late January 1992 to tell her about the Property. Knowing that Mr. Lewis had always liked the Property, she told him about it and they decided to go see it. [IV/34 at 745 ¶ 5, 889 ¶ 2.]

Adlam told the Lewises about the $2,500,000 escrow and provided them with an appraisal Shipley had obtained only a month before that showed a $2,500,000 value. [IV/34 at 746 ¶ 6, 747 ¶ 10, 758-759.] Because the Lewises had the ability to pay cash without a financing contingency, Mr. Lewis believed that Shipley would accept less than the $2,500,000 asking price, and he offered $2,250,000. After an exchange of counterproposals, they agreed on $2,300,000 and opened escrow in early February. [IV/34 at 748-750, 783-784.]

Subsequent analyses confirmed that $2,300,000 was a reasonable price. For instance, shortly after the purchase, the Lewises' bank obtained its own appraisal, which concluded that the property was worth $2,300,000. [IV/34 at 756 ¶ 31, 843.] An additional valuation conducted for this litigation showed that the probable range of sales prices for the property in early 1992 would have been $2,200,000 to $2,600,000. [IV/34 at 929-942.]

C. Fontana records the federal lis pendens, but it is neither indexed by the County Recorder nor discovered by the title insurer.

After the Lewises opened escrow, and just a few days before they acquired title, Fontana recorded the federal lis pendens. However, the County Recorder's acceptance of a document is actually the beginning, rather than the end, of the recording process. As explained in the Declaration of Dennis McCraven (the County Recorder's Division Manager, Document Recording), central to the process is *indexing* the recorded documents — entering relevant information into an index that allows interested persons to locate them. *Until a document has been indexed, there is no way that anyone searching title can find it.* [IV/34 at 944-48.] Mr. McCraven determined that although the federal lis pendens was recorded on February 24, it was not indexed until February 29 — *the day after the Lewises acquired title.* [*Id.*]

During the same period, a title search was under way at Lincoln Title Company, which ultimately issued title insurance to the Lewises. The trial court based one of its key conclusions on its statement that Lincoln title was "retained as Lewises [sic] agent" [VI/43 at 1304], *but there was no evidence to that effect.* In fact, the *only* evidence concerning how Lincoln Title became involved was Mr. Lewis' statement that Adlam suggested using Lincoln Title because it had been used in the previous, failed escrow. [IV/34 at 750:10-14.] The Lewises' original offer to purchase the Property only provided that the buyer was to receive a title policy issued by Lincoln Title "at seller's expense." [IV/34 at 778 ¶ 6.]

The title officer, David Pelis, explained that title companies have access to private services that provide copies of recorded documents. [V/36 at 1002:8-1003:5.] In this

case, the service provided Lincoln Title with a computer report that contained an entry for the federal lis pendens. [IV/36 at 1020-21, 1033.] However, the service misposted the information, and as a result it did not appear to affect the Property. [V/39 at 1223-1228.] Mr. Pelis himself was never aware there was a lis pendens. [V/36 at 1024:1-6.]

D. The Lewises acquire title and receive two "clean" title policies and never learn about the federal action.

The purchase agreement provided that after all contingencies were removed, $350,000 could be released from escrow to Shipley in return for a note secured by a first trust deed on the property. [IV/34 at 750 ¶ 18, 796.] (Shipley used that money to buy other property [IV/34 at 749:3-8], which Folksam then froze in place by an injunction.) This transaction occurred on February 24 — the very day Fontana recorded its lis pendens — and the Lewises received a title insurance policy insuring their trust deed. Neither this policy nor the preliminary report that preceded it disclosed the federal lis pendens. [IV/34 at 750 ¶¶ 17-18, 786-794, 805-821.]

Although escrow was originally scheduled to close by April 1, Shipley asked for an earlier close and the Lewises agreed, with the result that the Lewises' grant deed was recorded on February 28. The Lewises received a second title insurance policy, this time insuring their title as owners. Like the earlier policy, this one did not reveal any claims against title. [IV/34 at 752 ¶ 21, 823-840.]

During this series of events, there was no substantive communication between the Lewises and Shipley; everything was handled through the realtors. [IV/34 at 753-754 ¶¶ 25-27.] Neither the Lewises nor the realtors heard anything about any litigation involving Shipley, Yuk Lee, or anyone connected with them. [IV/34 at 752 ¶ 21 (R. Lewis); 890 ¶ 5 (J. Lewis); 896 ¶ 12-14 (Scafati); 927 ¶ 12-13 (Adlam).]

E. The Lewises undertake multi-million-dollar improvements to the Property, still completely unaware of the Folksam-Fontana litigation.

This was an all-cash purchase for the Lewises, funded by liquidating securities holdings. [IV/34 at 748 ¶ 12, 752 ¶ 22.] They expected to spend an additional $1,050,000 in renovating the Property, but that estimate turned out to be far too low. By the March 3 hearing, they had spent approximately $2,600,000 on still-uncompleted construction, and they expected the total cost of the house to exceed $5,000,000. [IV/34 at 753 ¶ 24.]

Some 19 months after the Lewises closed escrow, the nightmare began. In the midst of their multi-million-dollar renovation of the Property, they received a copy of Fontana's cross-complaint in the mail. [II/12 at 283 ¶ 8.] This was the first they ever heard about Folksam or Fontana or about any of the claims alleged in this case.

The trial court proceedings are detailed in the foregoing Petition. In brief, the trial court ruled on the Lewises' motions after an unusually complete factual presentation by the parties. There was no serious claim of factual dispute and no credibility battles. The denial of summary judgment was based entirely on legal conclusions drawn from the undisputed facts.

ARGUMENT

I

THE NATURE OF THE CLAIMS AGAINST THE LEWISES

Because of the Lewises' settlement with Fontana, the issues are narrower than when the trial court ruled.

Both Folksam and Fontana's pleadings, including Fontana's federal complaint, originally focused on the conduct of Shipley and related parties, alleging in substance that Shipley bought the Property with misappropriated funds. There was no claim that the Lewises did anything wrong; indeed, they were not even named in either the federal action or Folksam's Second Amended Complaint. Any claim affecting the Property therefore necessarily depended entirely on the intervention of the federal lis pendens: if the lis pendens were valid — supported by a proper complaint, and properly recorded before the Lewises acquired title — in theory the Lewises' purchase could be set aside solely upon proof of Fontana's claims against Shipley, without regard to the Lewises' conduct.

The expungement of the federal lis pendens has eliminated this possibility. Code Civ. Proc. §§ 405.60, 405.61. What remains is Folksam's fraudulent conveyance claim against the Lewises. Since this claim is based on Shipley's transfer of the Property *to the Lewises* rather than his original acquisition of the property, it necessarily concerns the conduct

of the Lewises themselves. The Lewises contended that they had established a complete defense to this claim by virtue of Civil Code section 3439.08(a), which provides:

> "A transfer or an obligation is not voidable under subdivision (a) of Section 3439.04 [transfer made with intent to hinder, delay or defraud creditors], against *a person who took in good faith and for a reasonably equivalent value* . . . ." (Emphasis added.)[2]

The trial court recognized that the Lewises did not actually know about the claims against Shipley or about the lis pendens:

> "The evidence presently before the court indicates *the Lewises had no actual knowledge of Shipley's misdeeds, nor any relationship with Shipley* other than in connection with purchase [sic] of 2728 Elevado [R. Lewis Dec., par. 10]. The Lewises personally apparently had no knowledge of the federal lis pendens until September 1993 . . . ." [VI/43 at 1295-1296 (emphasis added).]

The court's analysis should have stopped right there. But instead, the court concluded that the federal lis pendens deprived the Lewises of their status as good-faith purchasers through *constructive notice*, imparted through a multi-link chain of imputation and other legal fictions. [VI/43 at 11-12.]

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[2] The trial court did not reach the question of whether the Lewises paid "reasonably equivalent value." However, as discussed above, the Lewises offered substantial evidence that they paid reasonably equivalent value, *and there was no contrary evidence*. The trial court remarked, "I am just almost 100 percent this was a [sic] reasonably equivalent value." [VI/40 at 1271:7-8.]

This conclusion is the linchpin of the trial court's denial of summary judgment and its refusal to expunge Folksam's lis pendens. Without this conclusion, summary judgment and expungement were mandatory.

The conclusion is dead wrong as a matter of law.

II

THE FRAUDULENT CONVEYANCE STATUTE REQUIRES ACTUAL, SUBJECTIVE KNOWLEDGE BY THE ALLEGED FRAUDULENT TRANSFEREE. THE FICTION OF CONSTRUCTIVE KNOWLEDGE IS NOT ENOUGH.

> The requirements of the fraudulent conveyance statute could not be more clear: "As used in this subdivision and in subdivision (d) [of Civ. Code § 3439.08], 'good faith' means that the transferee acted *without fraudulent intent* and that he or she *did not collude* with the debtor or otherwise *actively participate in the fraudulent scheme* of the debtor." Legislative Committee Comment, Assembly — 1987 Report, *supra* (emphasis added).

"Fraudulent intent," "collusion," "active participation," "fraudulent scheme" — this is the language of *deliberate wrongful conduct*. It belies any notion that one can become a fraudulent transferee by accident, or even negligently. It certainly belies the notion that guilty knowledge can be created by the fiction of constructive notice. *See Richardson v. White* (1861) 18 Cal.

102, 106 (recognizing that constructive notice is a "fiction"). But that is nevertheless what the trial court concluded, rejecting the Legislature's clear mandate in the name of "common sense":

> "[C]ommon sense suggests that the test cannot be a purely subjective one which allows the transferee to preserve good faith by hiding his head in the sand and making no reasonable inquiry. The extensive case authorities cited at pages 5-6 of Folksam's reply brief [sic; opposition (*see* IV/36 at 983-984)] confirm that 'good faith' includes doing the sort of reasonable inquiry that a reasonably prudent person would do under the circumstances." [VI/43 at 1303.]

The problem with this reasoning, aside from the fact that the cited authorities do not support it [*see* V/38 at 1142-1143 (Lewis Reply)], is that in the very next breath *the trial court concluded that the Lewises* ***did*** *make what* ***the court itself believed*** *was a "reasonable inquiry"!* The court said:

> ". . . reasonable inquiry includes getting a title report and title insurance. . . . The Lewises themselves by their conduct evidence this to be so: they *obtained* title reports and title insurance." [VI/43 at 1303 (emphasis in original).]

Unfortunately, the Lewises' reasonable inquiry still left them in blissful ignorance, because the federal lis pendens was not disclosed in the preliminary reports and title policies.

Since the Lewises had made precisely the inquiry that the trial court thought they should have made and still knew nothing about the claims against Shipley, the trial court should have recognized that they could not possibly have "colluded" or "actively participated" in the claimed fraudulent conveyance. Instead, the court stripped the Lewises of their good-faith status by imputing to them knowledge supposedly (but not actually) held by their title insurer concerning the federal lis pendens and the supposed (but not shown by any evidence) negligence of their title insurer in failing to find and disclose the lis pendens.

In the remainder of this Memorandum, we will demonstrate that even if the trial court were entitled to look beyond the Lewises' actual knowledge, its analysis was wrong at every turn because it ignored both undisputed facts and settled law.

III

THE FEDERAL LIS PENDENS WAS A NULLITY AND DID NOT IMPART NOTICE, BECAUSE THE CLAIMS IN THE FEDERAL ACTION DID NOT SUPPORT A LIS PENDENS.

The trial court's entire analysis depends on some form of constructive or imputed notice gained in some way or other from the federal lis pendens. Accordingly, while there are other flaws in the analysis as well, if the lis pendens was invalid then the entire analysis collapses.

In ruling that the lis pendens was proper, the trial court refused to follow decisional authority squarely holding that claims like those asserted in the federal action —

essentially, claims to impose a constructive trust — do not support a lis pendens. The trial court implicitly concluded that the 1992 revisions to the lis pendens statute (Code Civ. Proc. §§ 405 *et seq.*) overruled this authority. [VI/43 at 1297-1300.] There is no decisional support for this conclusion, and it is wrong as a matter of logic and policy.

A. Only a proper lis pendens can affect title.

Under Code of Civil Procedure sections 405.2 and 405.4(a), a lis pendens is only authorized in actions that affect "title to, or the right to possession of, specific real property."[3] Historically, the purpose of a lis pendens was to preserve the court's jurisdiction over property: if a party to litigation were able to transfer clear title during the litigation, the court would be unable to render an effective judgment. *See Richardson, supra*, 18 Cal. at 106. The lis pendens prevents "a defendant property owner from frustrating any judgment that might eventually be entered by transferring his or her interest in the property while the action was still pending." CEB, *California Lis Pendens Practice* (1983), § 1.2, p. 3.

Consistent with this limited purpose, the courts have repeatedly held that a lis pendens recorded in an action that does not involve title has no effect: "If there is a failure to comply with [the lis pendens statute] *there can be no constructive notice of the pendency of*

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[3] Although changes to the lis pendens statute have varied this formulation somewhat, the underlying principle has remained constant since the earliest lis pendens statute: a lis pendens is *only* authorized in an action affecting title or possession. *See Richardson, supra*, 18 Cal. 106. The current statute requires a "real property claim," which is defined in the language quoted in the text.

the action." *Bernhard v. Wall* (1921) 184 Cal. 612, 630 (emphasis added). As the court said in *Brownlee v. Vang* (1962) 206 Cal.App.2d 814, the complaint must

> "set forth some cause of action affecting the title or right of possession of the specific real property described in the *lis pendens*. When it does not do so the *lis pendens* becomes a nullity." *Id.* at 817.

See also MacDermot v. Hayes (1917) 175 Cal. 95, 110 (lis pendens in action to set aside sale of stock ineffective to give constructive notice); *Allied Eastern Financial v. Goheen Enterprises* (1968) 265 Cal.App.2d 131, 134 (lis pendens in action on loan "would have no legal effect").

B. The claims in the federal action all involve alleged fraud and conversion, not disputes over title.

Fontana's lengthy federal complaint boils down to this: Shipley and his co-conspirators defrauded Fontana and put the money they got in various assets that Fontana seeks to reach by the imposition of a constructive trust.

The first 27 pages of the pleading recite the details of Shipley's alleged fraudulent conduct, asserting claims for the illegal sale of securities (First Claim for Relief) and violations of RICO (Second Claim for Relief). In these two claims, the only allegations that relate to the Property appear in paragraph 12(c) (alleging the diversion of "the sums of $310,000 and $2,880,000 to defendant Yuk Lee Limited," this apparently being the money

ultimately used to buy the Property) and paragraph 20(k) (alleging the establishment of the escrow to purchase the Property). [I/1 at 13:16-19, 20:6-10.]

The claims that involve the Property are as follows:

Third Claim for Relief (Imposition of Trust): Fontana alleges that Shipley was acting as the plaintiffs' trustee, and further alleges:

> "32. As a proximate result of the foregoing, including specifically the transfer of any money and/or property to defendants and each of them, defendants and each of them hold such money and property, in trust, for the benefit of plaintiffs, with the interests of plaintiffs being superior to all other interests, in and to all such transferred property including without limitation, the following [describing the Property]." [I/1 at 31:18-24.]

Fourth Claim for Relief (Injunctive Relief): This claim incorporates most of the preceding allegations and simply alleges that the plaintiffs will suffer harm unless the defendants are enjoined from transferring "the money and property wrongfully taken from plaintiffs." [I/1 at 34:19-20.]

Fifth Claim for Relief (Possession): The only substantive allegations are those incorporated by reference. Beyond that, Fontana merely alleges that "plaintiffs were and are entitled to possession, control and beneficial use of Plaintiffs' property." [I/1 at 35:7-8.]

Sixth Claim for Relief (Quiet Title): Again, the substantive allegations appear by incorporation. Fontana adds the conclusionary allegation that the property described in the complaint "is property of and rightfully belonging [sic] to plaintiffs herein." [I/1 at 35:23-26.]

Seventh Claim for Relief (Fraudulent Conveyance): This claim does not incorporate the complaint's charging allegations. As it pertains to the Property, it alleges:

> "44. Within the four years last past [Shipley and other defendants] made the following conveyances: . . .
>
> "c) In October, 1990, transferred the sums of $310,000 and $2,880,000 to defendant YUK LEE LIMITED from the account of FONTANA HOLDINGS in the Cayman Islands with monies belonging to the plaintiffs." [I/1 at 36:17-20, 37:24-38:2.]

None of these claims describes any transfer *of real property*. None of them alleges that any of the plaintiffs had any kind of interest in the Property beyond the fact that Shipley used allegedly misappropriated funds to buy it. Even the fraudulent conveyance claim does not allege a conveyance *of the Property*, but rather the movement of money from one Shipley pocket to another followed by the *purchase* of the property.

C. A constructive trust claim does not support a lis pendens.

As the preceding recapitulation of Fontana's claims shows, the essence of the federal complaint is the effort to impose a constructive trust on the Property. It is well settled that such a claim does not permit the recording of a lis pendens.

The leading case in this District is *Urez Corp. v. Superior Court*, *supra*, 190 Cal.App.3d 1141. There the plaintiff held a second trust deed that was extinguished by the foreclosure of the first trust deed. The purchaser at the foreclosure was a corporation formed by the defaulting owner. *Id.* at 1143-44. The complaint alleged causes of action for fraud in the formation of the corporation, for a declaration that the plaintiff held a beneficial interest in the property, and for the imposition of a constructive trust. *Id.* at 1144.

This Court found that the action did not support a lis pendens, noting that the case was "essentially a fraud action seeking money damages with additional allegations urged to support the equitable remedies of a constructive trust or an equitable lien." *Id.* at 1149. The Court held that "allegations of equitable remedies, even if colorable, will not support a lis pendens if, ultimately, those allegations act only as a *collateral means to collect money damages*." *Id.* 1149 (emphasis added). The Court expressly rejected the contrary reasoning of *Coppinger v. Superior Court* (1982) 134 Cal.App.3d 883, as has "a chorus of other decisions." *Hunting World, Inc. v. Superior Court* (1994) 22 Cal.App.4th 67, 71.

1. The trial court's conclusion that Folksam "owned" the Property was incorrect and irrelevant.

The trial court tried several detours around the *Urez* rule. First, it sought to distinguish *Urez* by noting that in *Urez* the plaintiff had asserted "a remote and attenuated real property claim." [VI/43 at 1298.] In contrast, according to the trial court, here there was

an earlier summary judgment finding that Shipley had indeed misappropriated money from Folksam, and on this basis the court leaped to the conclusion that this fact

> "establish[es] that Folksam owned a 100% beneficial interest in Elevado [the Property] at the time Shipley (Yuk Lee) purported to deed the property to the Lewises. Thus Folksam was entitled to title and possession of the property, outright." [*Id.*]

This conclusion is irrelevant: the validity of the lis pendens depends on the nature of *Fontana's* claims, not Folksam's.

More fundamentally, there is no apparent legal basis for the trial court's conclusion, and the court cited none. The fact that someone buys property with stolen money does not make the victim the *owner* of that property as a matter of real property law. It merely entitles the victim to pursue the thief and to recover a money judgment, perhaps seeking to attach the property along the way (something that no one in this case ever tried to do).

2. The trial court ignored other controlling authority.

Regardless of whether *Urez* is factually distinguishable, the trial court failed to recognize that *La Paglia v. Superior Court* (1989) 215 Cal.App.3d 1322 rejected the propriety of a lis pendens on facts virtually identical to those here. There the plaintiff claimed that the defendant was withholding royalties due plaintiff from the defendant's business operation. *Id.* at 1324. Alleging that the defendant used the wrongfully withheld money to buy some property, the plaintiff claimed that the defendant held title to that property in constructive trust, and it recorded a lis pendens. *Id.* The Fourth District held that the lis pendens was improper,

observing that the plaintiff claimed "an interest in the defendant's property only to the extent the monies it alleges were wrongfully obtained have been invested therein." *Id.* at 1327.

Exactly as in *La Paglia*, here the federal action seeks to impose a constructive trust on property purchased with money wrongfully obtained. As in *La Paglia*, Fontana claims an interest in the property "only to the extent the monies it alleges were wrongfully obtained have been invested therein." *Id.* *La Paglia* is therefore directly controlling, and the trial court was required to follow it.

3. The 1992 revisions in the lis pendens law did not overrule *Urez* and *La Paglia*.

The trial court further sought to distinguish the *Urez* line of cases by relying on the 1992 revisions to the lis pendens law (Stats. 1992, ch. 883). Noting that the new statute made it easier to expunge a lis pendens, the court observed that the "drastically revised procedure eliminates the concerns about abuse of lis pendens which led the court in *Urez* and related cases to take a narrow view of what constitutes a 'real property claim.'" [VI/43 at 1299.] Although the trial court cited *Hunting World*, *supra*, in support of this conclusion, the discussion in that case was dictum. *Hunting World* involved an entirely conventional fraudulent conveyance claim, and the question before the court was whether the *Urez* line of cases precluded the use of lis pendens in fraudulent conveyance case *in addition to* constructive trust cases — in other words, the defendants were trying to *narrow* the lis pendens remedy even further than cases like *Urez* had already narrowed it. The *Hunting World* court declined to take that step, saying that "[e]xtension of the *Urez/Wardley* line of decisions is not warranted." 22 Cal.App.4th at 73. The court did not even hint that it questioned *Urez*.

Neither logic nor policy supports the trial court's evident belief that the Court of Appeal should reverse field on this question. Allowing a lis pendens to be used in a constructive trust case like this transforms it into a money-collection remedy without any of the protections of the attachment statutes, a tactic for which the courts have consistently eschewed its use.

There is no reason to believe the Legislature intended to change the scope of the term "real property claim." The State Bar Report that supported the legislation disclaimed any definitional strictures: it stated that the term "neither includes nor excludes claims of constructive trust or equitable lien," and suggested leaving the area for further judicial development. *See Hunting World,* 22 Cal.App.4th at 72. In the face of this report and the *Urez* line of decisions, the fact that the Legislature made no definitional change in the statute creates a very strong presumption that it was satisfied with the restrictive interpretation given to the statute by the overwhelming majority of decisions. *E.g.*, *Buchwald v. Katz* (1972) 8 Cal.3d 493, 502.

There is no getting around the fact that all Shipley did was to take *money*, and all the federal action seeks is to get the money back. Nothing in the case suggests the kind of real property dispute that has classically been the basis for the use of a lis pendens.

D. The fraudulent conveyance claim does not support a lis pendens.

The trial court's order does not address Fontana's fraudulent conveyance claim at all, instead focusing its entire discussion on *Folksam's* claim — even though only *Fontana's*

claims in the *federal action*, not Folksam's claims in the present case, are relevant to the analysis of the federal lis pendens. To the extent it even mentioned Fontana's claims, the court actually seemed to reaffirm its earlier ruling that Fontana had not alleged a fraudulent conveyance: while the court said that it had changed its thinking as to the pleading of fraudulent conveyance claims since its December 20 order (where it ruled no such claim was pleaded [III/30 at 672]), it only said this about Folksam — and at that, the change in thinking seems to have been based on the erroneous belief that Folksam had named the Lewises in its Second Amended Complaint [*see* VI/43 at 1299-1300].

In any event, while in the abstract the trial court was correct in stating that a fraudulent conveyance claim can support a lis pendens, the application of this rule in a given case depends on the specific nature of the claim. The facts of the cases the trial court relied on show why the federal action's fraudulent conveyance claims are insufficient.

McKnight v. Superior Court (1985) 170 Cal.App.3d 291 [*see* VI/43 at 1300], presented an archetypal fraudulent conveyance. The defendant defaulted on a loan secured by real property. The plaintiff obtained a writ of attachment against the property and later obtained a judgment against the defendant. The defendant then quitclaimed his community interest in the property to his wife. The plaintiff filed a separate action to set aside this conveyance and recorded a lis pendens. *Id.* at 295-96. The Court of Appeal held that this second action affected title to the real property and that a lis pendens was therefore proper (although it affirmed expungement on unrelated grounds) *Id.* at 299, 303.

In *Hunting World*, *supra*, 22 Cal.App.4th 67, the plaintiff filed a federal trademark infringement action against one Bogar and obtained a temporary restraining order

and an order to seize any counterfeit property in Bogar's possession. Soon after that, Bogar quitclaimed his interest in his residence to his wife. The plaintiff then filed a fraudulent conveyance action and recorded a lis pendens. 22 Cal.App.4th at 69. As noted above, the Court of Appeal held that the lis pendens was proper.

The obvious and fundamental distinction between Fontana's federal action and cases like *McKnight* and *Hunting World* is that Fontana's complaint does not allege that there was *any* conveyance of *real property*, fraudulently or otherwise, to *anyone*, much less to the Lewises. It merely alleges that Shipley wrongfully took Fontana's money and used the money to *buy* — not *convey* — the Property.

That Fontana labelled its claim "fraudulent conveyance" is irrelevant, because the allegations make it clear that there is no claim of a fraudulent conveyance *of real property*. Without such a conveyance, there can be no claim that affects "title to, or the right to possession of, *specific real property*" as required by Code of Civil Procedure section 405.20 (emphasis added). At bottom, *Fontana merely re-alleged its constructive trust claim*, which the overwhelming weight of authority holds cannot support a lis pendens.

E. None of the remaining claims supports a lis pendens.

The Fourth, Fifth and Sixth Claims for Relief in the federal action are merely perfunctory incorporations of the securities and RICO allegations, coupled with conclusionary allegations of entitlement to certain relief. Since none of these claims alleges anything

concerning title to the Property beyond the claims discussed above, they provide no additional support for a lis pendens.

The quiet title claim superficially seems to support a lis pendens; the trial court certainly thought so. [VI/43 at 1301.] But despite the terminology, there is no quiet title claim, for three reasons. First, as noted above, the incorporated allegations describe only a *theft of money*, and the other allegations do not add anything concerning title. Second, Fontana has never had standing to bring a quiet title action, because whatever interest it might have is only equitable, and the holder of equitable title cannot maintain a quiet title action against the legal owner. *Stafford v. Ballinger* (1962) 199 Cal.App.2d 289, 294-95. Third, the complaint was not verified as required by the quiet title statute. Code Civ. Proc. § 761.020.

F. Summary

The trial court failed to recognize that there is no "real property claim" anywhere in the federal action. Without a sea change in the law — and particularly unless the courts decide to allow the new lis pendens statute become a standard enforcement tool for money claims — the federal constructive trust claims do not support a lis pendens.

The federal lis pendens was therefore a "nullity" (*Brownlee*, *supra*, 206 Cal.App.2d at 817) that could not impart any kind of notice to the Lewises and could not defeat their status as good-faith purchasers.

IV

EVEN IF THE FEDERAL LIS PENDENS WERE VALID, THE FACT THAT IT WAS INDEXED AFTER THE LEWISES TOOK TITLE PREVENTED IT FROM GIVING CONSTRUCTIVE NOTICE.

It is a common misperception, which the trial court evidently shared [*see* VI/43 at 1303-1304], that a recorded document imparts constructive notice from the moment it is recorded. That is not the law. The operative event is actually the *indexing* of the document, and that did not occur until *the day after the Lewises acquired title*. [IV/34 at 944-48.]

The most recent in a long line of authorities stating this principle is *Hochstein v. Romero*, *supra*, 219 Cal.App.3d 447:

> "[B]efore the constructive notice will be conclusively presumed, the document must be "recorded as prescribed by law." (Civ.Code, § 1213.) A document not indexed as required by statute (see Gov.Code, §§ 27230-27265), does not impart constructive notice because it has not been recorded 'as prescribed by law.'" *Id.* at 452.

The court explained the principle, citing such authorities as Witkin and Miller & Starr:

> "'The policy of the law [requiring recordation and indexing] is to afford facilities for intending purchasers . . . in examining the records for the purpose of ascertaining whether there are any

> claims against [the land], and for this purpose it has prescribed the mode in which the recorder shall keep the records of the several instruments, and an instrument must be recorded as herein directed in order that it may be recorded as prescribed by law. If [improperly indexed], it is to be regarded the same as if not recorded at all.' (*Cady v. Purser* (1901) 131 Cal. 552, 558, [63 P. 844].) Thus, it is not sufficient merely to record the document. 'California has an "index system of recording," and . . . *correct indexing is essential* to proper recordation. [Citations.]' (4 Witkin, Summary of Cal. Law (9th ed. 1987) Real Property, § 202, at p. 407; *see also* 3 Miller & Starr, Current Law of Cal. Real Estate (2d ed. 1989) Recording and Priorities, §§ 8:16-8:20, pp. 308-314.)" *Id.* (emphasis, bracketed language and ellipses in original).

The reason for this rule is obvious. The courts have long recognized that constructive notice is a "fiction" (*Richardson*, *supra*, 18 Cal. at 106), so if a recorded document is going to affect title there must at least be a way for interested parties to find it:

> "The California courts have consistently reasoned that the conclusive imputation of notice of recorded documents depends upon proper indexing because *a subsequent purchaser should be charged only with notice of those documents which are locatable*

by a search of the proper indexes." *Hochstein*, 219 Cal.App.3d at 452 (emphasis added).

The trial court refused to follow this settled authority. In part, the trial court simply disagreed with the decision, finding "puzzling" the Court of Appeal's perceived failure to "reconcile" its holding with the language of Civil Code section 1213 stating that a document "recorded as prescribed by law *from the time it is filed with the recorder* for record *is constructive notice.*" [VI/43 at 1303-1304 (emphasis by the trial court).]

Of course, a trial court does not have the luxury of refusing to follow decisions it disagrees with. *Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 455. But more important, the trial court's criticism was just wrong. *The language that the trial court believed Hochstein failed to "reconcile" had in fact been interpreted by the Supreme Court in Cady v. Purser (1901) 131 Cal. 552, which Hochstein cited on that very point.* The *Hochstein* court didn't disregard the effect of "filed with the recorder"; it knew that the question had been resolved in *Cady*. In fact, the principle was settled long before *Cady*, inasmuch as *Cady* relied in part on a case dating back almost to California's statehood. *Cady*, 131 Cal. at 555 (citing *Chamberlain v. Bell* (1857) 7 Cal 292, 294). Over the years, the courts have been absolutely consistent in following the indexing rule. *E.g. Dougery v. Bettencourt* (1931) 214 Cal. 455, 462-464; *Federal Construction Co. v. Curd* (1918) 179 Cal. 479, 487-88.

At the hearing on the Lewises' reconsideration motion, the trial court adopted Folksam's argument that attempted to distinguish *Hochstein* and similar decisions from the present case on the basis that those cases involved documents that were improperly indexed, while the present case involves a document that ultimately was indexed properly. [*See* VI/47

at 1375-1376, VI/51 at 1425:1-9.] This is no distinction at all. The reason an improperly indexed document does not give notice is that no one can find it. The complete absence of indexing, even though it may be temporary, means exactly the same thing — no one can find the document. That was the state of affairs on February 28, 1992, when the Lewises acquired title. The federal lis pendens therefore did not impart notice.

V

THE TRIAL COURT'S FINDING THAT THE LEWISES ACQUIRED IMPUTED KNOWLEDGE OF THE FEDERAL LIS PENDENS FROM LINCOLN TITLE IS BOTH FACTUALLY UNSUPPORTED AND DIRECTLY CONTRARY TO SETTLED LAW.

The trial court also attempted to distinguish *Hochstein* on the ground that "[i]n Hockstein [sic], there was no evidence that the purchasers or any agent of the purchasers had *actual* notice of the title defect at the time they bought." [VI/43 at 1304 (emphasis in original).] The entire predicate for this conclusion appears in just a few words in the order:

> ". . . Lincoln Title, the very person retained as Lewises['] agent to search title, in fact discovered the existence of the federal lis pendens on February 25, 1992, using, as it regularly does, a search system wholly independent of any indexing." [*Id.*]

Having concluded that Lincoln Title was the Lewises' agent, the trial court further concluded that the Lewises were charged with Lincoln Title's supposed knowledge of the lis pendens. There are at least three reasons why the conclusion is wrong, including direct Supreme Court authority that a title insurer's knowledge is not imputed to its insured.

A. There was no evidence that Lincoln Title "discovered the existence of the lis pendens."

As noted above, the sum total of the evidence on this subject was that Lincoln Title's outside title service had (or knew about) the lis pendens but misposted it, so that neither Lincoln Title's title searcher nor Mr. Pelis, the title officer on the Lewises' policies, knew it was there. [V/36 at 1024:1-6; 39 at 1223-1228.] The *most* that can be said about the evidence on this subject is that there might have been a triable issue as to the state of the title searcher's knowledge. The trial court nevertheless concluded, *as a matter of law* (it did not specify any triable issues), that Lincoln Title knew about the lis pendens. That erroneous conclusion was the indispensable starting point for the imputation of constructive knowledge to the Lewises.

B. There was no evidence of any agency relationship between the Lewises and Lincoln Title.

The trial court cited no evidence to support its conclusion that Lincoln Title was the Lewises' agent, and there was none. The only evidence on the subject was the Lewises'

original offer to purchase the Property, which provided that a title policy was to be issued by Lincoln Title "at seller's expense." [IV/34 at 778 ¶ 6.] There simply is no agency here.

> "The essential characteristics of an agency relationship as laid out in the Restatement are as follows: (1) An agent or apparent agent holds a power to alter the legal relations between the principal and third persons and between the principal and himself; (2) an agent is a fiduciary with respect to matters within the scope of the agency; and (3) a principal has the right to control the conduct of the agent with respect to matters entrusted to him. (Rest. 2d Agency, §§ 12, 13, 14, pp. 57-60.)" *Alvarez v. Felker Mfg. Co.* (1964) 230 Cal.App.2d 987, 999.

See also Civ. Code § 2295 ("An agent is one who represents another, called the principal, in dealings with third persons"). There was no evidence that Lincoln Title fit within even one of these requirements, much less all three. There was no evidence that it represented the Lewises vis-à-vis anyone else; that it could alter their relationships with anyone else; that anyone believed it was a fiduciary; or that the Lewises had any right to control its conduct.

C. Regardless of how one characterizes the relationship between the Lewises and Lincoln Title, as a matter of law a title insurer's knowledge is not imputed to an insured.

Another well-settled rule is that a title insurance company *is not* the agent of its insured, and the insurer's knowledge *is not* imputed to its insured. *Mayhew v. Melby*, *supra*, 206 Cal. 396, 400.

Rice v. Taylor, *supra*, 220 Cal. 629, is uncannily similar to this case. It involved two trust deeds executed by Taylor, the first one to Rice and the second one to a mortgage company. Rice's trust deed was improperly indexed and the mortgage company was unaware of it when it made its loan to Taylor, but the mortgage company's title insurance company did know about it. The trial court held that Rice's trust deed was superior to the mortgage company's.

The Supreme Court reversed. Its description of the issues could have been written for the present case:

> "Appellant makes three basic contentions: (1) That it had no actual notice of said instruments; (2) that it had no constructive notice thereof because of the improper indexing, and (3) that it had no imputed knowledge thereof because the title company, that discovered the documents, was not its agent respecting the condition of title to the property." *Id.* at 633.

The Supreme Court agreed with all of these contentions. As to the agency claim, it observed:

> "The insured and the insurer deal at arm's length. There is no room for the operation of a fiduciary relationship. The title company is in business for profit. It may be willing to assume risks that the insured might think imprudent." *Id.* at 636.

The trial court essentially misconceived Lincoln Title's role when it stated that "Lincoln's lack of reasonable diligence in acting upon the information it discovered, [sic] is imputed to the Lewises." [VI/43 at 1304.] As a matter of express statutory law, a title company issuing a preliminary report *does not owe a negligence duty to a prospective insured.* Ins. Code §§ 12340.10, 12340.11. *See generally Southland Title Corp. v. Superior Court* (1991) 231 Cal.App.3d 530, 536-38 (no negligence liability based on preliminary report).[4]

Lincoln Title was simply selling a product. Imputing its knowledge to the Lewises would be like imputing a car salesperson's knowledge of defective brakes to an unsuspecting buyer, and then using that imputed knowledge to subject the buyer to liability for reckless conduct for driving a car with actual knowledge that its brakes didn't work. Such a conclusion would be contrary to law, as well as to the most basic notions of fair play. It is no more appropriate here.

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[4] These principles also answer *Rice's* suggestion, in dictum, that a "searcher of titles" could be an agent. 220 Cal. at 635. It is clear the court was referring to an *abstractor*, which is not the role Lincoln Title was playing.

D. The absence of an agency relationship between the Lewises and Lincoln Title cannot, as the trial court held, preclude a finding of good faith.

A further component of the trial court's analysis, revealed during the hearing on the Lewises' reconsideration motion, is the notion that the Lewises are actually worse off if Lincoln Title was *not* their agent. According to the trial court's remarks from the bench, that conclusion would mean that the Lewises conducted no title search at all, so that, under the trial court's "duty of inquiry" standard, they would lack good faith because they failed to make a reasonable inquiry. [VI/51 at 1424:8-16.]

We are aware of no authority, and Folksam never cited any, holding that a residential homebuyer owes some sort of duty to the world at large to search title *at all*, much less for the purpose of avoiding fraudulent conveyance claims. More to the point, however, is that the trial court's own formulation of the supposed duty of inquiry — "getting a title report and title insurance" [VI/43 at 1303] — *exactly describes what the Lewises did.* This Court can take judicial notice of the fact (Ev. Code § 452(g)) that as far as title matters were concerned, the Lewises' purchase was absolutely conventional, like virtually every residential home purchase in California — to the point that the seller's obligation to furnish a title policy was embodied in a standard form California Association of Realtors purchase contract.

An additional feature of this case is that on the same day Fontana recorded its lis pendens — in other words, before even Lincoln Title's title service could possibly have known about it — the Lewises had already received a trust deed and a clean title policy. It is impossible to conceive of a rationale that would impose a *heightened* duty of care in connection

with obtaining a grant deed only several days later, but that is the effect of the trial court's ruling.

The Lewises' conduct cannot have been negligent if they did what homebuyers in California have been doing day in and day out for generations — homebuyers who, like the Lewises, had no legal relationship with their title companies beyond the purchase of a policy. It is impossible to understand how the *absence* of any relationship with Lincoln Title could transform the Lewises' absolutely conventional conduct into negligence.

E. Summary

There is no dispute that the Lewises knew nothing about the Folksam-Fontana-Shipley dispute and that no information about the dispute was available in the public records on the date the Lewises acquired title. The trial court nevertheless concluded that because an independent service apparently had a copy of the lis pendens, its knowledge was imputed to a title searcher at Lincoln Title (imputed, since the misposting prevented the title searcher from recognizing the document for what it was); that the title searcher's imputed knowledge was further imputed to the title officer (who never had any idea there was a lis pendens); and that the title officer's imputed knowledge was in turn imputed to the Lewises, who never spoke to anyone at Lincoln Title, and whose only information was preliminary reports and title policies *that did not disclose the lis pendens*. This claim of imputation takes constructive notice beyond fiction and into the realm of fantasy.

This Court should not lose sight of the fact that this case concerns *a claim of fraud.* The undeniable thrust of the Legislative Committee Comment is that in order to be liable, a fraudulent transferee *must somehow be a part of the fraud.* The trial court's chain of imputation carries no hint of the guilty knowledge that the Legislature clearly intended to require as an essential component of fraudulent conveyances.

VI

THE WITHDRAWAL OF THE LIS PENDENS TRANSFORMED THE LEWISES INTO GOOD-FAITH PURCHASERS, AND THEY ARE ACCORDINGLY ENTITLED TO SUMMARY JUDGMENT.

Although the federal lis pendens was the linchpin of the trial court's order, the court refused to recognize that the withdrawal of the lis pendens pursuant to the Lewises' settlement with Fontana eliminated any possible basis for Folksam's claims.

Sections 405.60 and 405.61 of the Code of Civil Procedure govern the effect of a lis pendens that has been withdrawn. Section 405.60 provides:

> "Upon the withdrawal of a notice of pendency of action . . . , *neither the notice nor any information derived from it, . . . shall constitute actual or constructive notice* of any of the matters contained, claimed, alleged, or contended therein, or of any of the matters related to the action, or create a duty of inquiry in

any person thereafter dealing with the affected property."

(Emphasis added.)

Section 405.61 provides that upon the withdrawal or expungement of a lis pendens, even a person with *actual* knowledge of a claim is not bound by it. The statute provides that no one who acquires an interest in the property

". . . shall be deemed to have actual knowledge of the action or any of the matters contained, claimed, or alleged therein, or of any of the matters related to the action, *irrespective of whether that person possessed actual knowledge of the action or matter and irrespective of when or how the knowledge was obtained.*"

(Emphasis added.)

The statute contains an unusually strong statement of Legislative intent that emphasizes the statute's broad reach:

"It is the intent of the Legislature that this section shall provide for the *absolute and complete free transferability of real property* after the expungement or withdrawal of a notice of pendency of action." *Id.* (emphasis added).

These statutory provisions make clear that once a lis pendens is withdrawn or expunged, title to the property must be treated as though the lis pendens had never been filed.

The few courts that have interpreted these statutes and their almost identical predecessors have all recognized this goal. *E.g., Knapp Development & Design v. Pal-Mal Properties, Ltd.* (1987) 195 Cal.App.3d 786, 790 (any notice "is entirely eliminated");

Ranchito Ownership Co. v. Superior Court (1982) 130 Cal.App.3d 764, 770 (record owner can "deal with his property as though no notice of lis pendens has been filed").

While it is true that the expungement statute speaks in terms of persons dealing with the property after the withdrawal of the lis pendens, here that description applies to *anyone who acquires title from the Lewises* — in other words, the Lewises may now transfer their property *as though the lis pendens never existed.* This result functionally makes the Lewises bona fide purchasers retroactively, since otherwise they could not transfer clear title.

The only fact that could possibly change this result is the pendency of *Folksam's* claims, and *Folksam's* lis pendens. But under the trial court's ruling, the only basis for Folksam's claims is the *federal* lis pendens, which supports Folksam's claims only because it gave the Lewises constructive or imputed notice. Since the Lewises' liability is based entirely on a fiction, when the fiction goes away so should the liability.

CONCLUSION

This is not a case where a unique set of facts cries out for some special rule of law to address a inequity that would result from applying settled principles. Quite the contrary, any balancing of equities weighs heavily on the Lewises' side.

No blame can attach to the Lewises for Folksam's problems with Fontana or Shipley, or for Folksam's inability to subject the Lewises' property to the payment of its claims against Shipley. The Lewises had nothing to do with the underlying disputes, and, as the trial court acknowledged, they did everything a prudent buyer would do.

In contrast, Folksam — a large enough insurance company to credibly guarantee tens of millions of dollars of loans to many different banks — was no model of innocence, prudence, or diligence. Its complaint affirmatively alleges that the source of this litigation was its own employee's conspiracy with the Fontana/Shipley defendants in a scheme that was patently risky and questionable. And unlike Fontana, Folksam didn't even file its lawsuit until well after the Lewises acquired title.

The trial court should be directed to apply the law as it has existed for well over a hundred years and to wake the Lewises from this litigation nightmare.

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Respectfully submitted,

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